WIK projects Ltd.
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venturing towards a bright future

Submission to Treasury

Native title, indigenous economic development and tax

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About Wik Projects

Wik Projects Limited is a company limited by guarantee formed in 2007 for the benefit of Wik and Wik Waya people, whose traditional country is near Aurukun on the west Cape York Peninsula.

As an entity controlled by traditional owners, Wik Projects was established to negotiate, facilitate, design and implement appropriate business, social, economic, environmental, cultural development and infrastructure projects on Wik Waya traditional country, in the western Cape region and the wider world.

Wik Projects' vision is for Wik and Wik Waya people to be able to harness their natural abilities to live productive, imaginative lives where they can move between their own country, mainstream Australian life and the wider outside world. It is a vision of people who have cohesive, resilient families, strong cultural and personal identities, social justice, enhanced wealth and abundance and better work and life choices.

1. Introduction – the policy context

There is little dispute that indigenous Australians continue to experience significant disadvantage in terms of their social, economic, health, educational and cultural status compared to other Australians.

The Australian Government is committed to *closing the gap* between indigenous and other Australians – a commitment given after many decades of government intervention in indigenous communities which have yielded little in terms of the advancement of indigenous people. Many indigenous Australians – especially those in remote communities – still live a life that is defined by poor health, unemployment, substance abuse and violence, underscored by a history of decades-long, community-wide passive welfare dependency.

The challenge for government in the 21st century is to find new and more effective ways to secure better outcomes for present and future generations of indigenous Australians.

This will only be achieved by adopting a development philosophy under which indigenous Australians can:

- continue to build their capacity to make decisions for themselves about social, economic and environmental issues affecting them and their traditional country, balancing the objectives of incrementally improving their socio-economic status to a level similar to that of other Australians and looking after the land and sea so they will continue to provide for their present and future generations,
- set the direction of their future welfare and development for themselves, and not simply rely on government to do so, and
- use returns from economic development of their traditional country – including native title payments:
    - to support community development, cultural protection and land and sea management and the development of their own organisations, and
    - *most importantly*, if cycles of dependency are to be broken, to make investments in their own economically-viable enterprises that will create long-term employment and returns to present and future generations of traditional owners.

In this way, the process should be seen as one which is encouraging the transition of indigenous Australians from passive welfare dependency to fuller socio-economic participation and self-reliance, with the suitability and success of various government responses measured against that background and the extent to which they have facilitated that transition. It is against these objectives that proposals relating to the taxation treatment of native title payments need to be considered and evaluated.

The *Native Title, Indigenous Economic Development and Tax* Consultation Paper (**Consultation Paper**) begins by stating that, although the "Government has ... received a range of proposals to use the tax system to promote Indigenous economic

development ... [d]irect spending programs are ordinarily better suited to providing support for this important Government priority" (p. 1). The inflexibility of this position needs to be reconsidered in the context of the principles mentioned above. Certainly, direct spending programs will remain an important form of support for indigenous economic development in the foreseeable future. But over-reliance on such programs, as the process of transition to greater socio-economic participation progresses, may only reinforce dependency on an artificial 'grants economy' – characterised by the short-term nature of most grants funding, and a complex and constantly changing framework of funding programs. Is this the best way and only way for government to encourage the development of self-reliant, commercially-viable indigenous enterprises? It is submitted that concessional tax treatment should legitimately be part of the policy response to these challenges.

2. The nature of native title

It may be trite, since the High Court of Australia acknowledged it, to reiterate that native title predates European settlement of Australia, the assertion of British sovereignty and the creation of the colonial, state, territory and Commonwealth governments.

Less well understood in wider Australian society is the nature of native title, the rights and obligations it implies, and how it differs from other kinds of property recognised by the Australian legal system.

As the Consultation Paper acknowledges, native title rights and interests are *sui generis* (p. 15). Unlike other kinds of property, native title rights and interests are:

- collectively held, not individually-owned – with the collective interest held by past, present and future generations (in other words, by people who include individuals who are yet to be born),
- incapable of transfer, lease, licence or disposal – with the consequence that they cannot be attributed a monetary value in the same way as other property, and
- inextricably linked to a range of cultural obligations under traditional law (the 'cost' of which also cannot be attributed a monetary value in the same way as obligations relating to other property).

The Consultation Paper refers to complex issues that currently arise under Australian tax law about whether native title payments are appropriately treated as ordinary income of the recipient or as a payment in respect a capital asset, and in turn whether such a payment is in respect of a pre-CGT asset. Similarly, the Consultation Paper discusses some of the arrangements – like charitable trusts – currently used in an effort to ensure that native title payments receive appropriate tax treatment having regard to the collective nature of benefits flowing to traditional owners in return for the loss or suspension of their native title rights.

Ongoing efforts to define and fit native title payments into general taxation categories that have their origins in a non-indigenous legal, cultural and economic context is inappropriate and will continue to lead to outcomes which run contrary to the overarching policy imperatives referred to in section 1. The use of charitable trusts, for example, not only imposes complexity but in practice tends also to constrain severely the use of payments to facilitate indigenous economic development. By directing the benefits flowing to traditional owners from economic development on their country into a trust run on charitable principles, there is a real likelihood that one form of passive welfare dependency will just be substituted by another. This will not secure significant improvements in socio-economic participation and well-being for Aboriginal people in the medium or long term.

In summary, the unique nature of native title justifies treating native title payments differently from payments flowing from other kinds of property – especially when different treatment would support important policy objectives including greater socio-economic participation and self-reliance.

Response to consultation questions

In response to the specific consultation questions asked in section 2 of the Consultation Paper:

(a) potential income tax implications of an agreement are relevant in all stages of its negotiation and in preparations for that negotiation, since they drive the development of structures and impact on the range of purposes to which payments may be applied,

(b) advice obtained confirms the complexity and indicates uncertainty associated with the interaction between the income tax system and native title payments, which results in the use of structures which tend to replace one form of passive welfare dependency with another and imposes constraints on the use of funds for economic development, and

(c) government agencies *might* assist to provide greater clarity by issuing public rulings and other guidance material in appropriate areas – but it is submitted that this is unlikely to be enough without tax reform in this area.

3. Considering the alternatives

3.1 Income tax exemption for native title payments

Income tax exemption for native title payments is supported on social justice grounds, not only because of the economic disadvantage of traditional owners but also because their native title predates the legal system which would otherwise impose that tax. It is also supported on policy grounds, given the position of significant socio-economic disadvantage of many traditional owners.

We support the concept of payments under indigenous land use agreements registered under the *Native Title Act* automatically qualifying, since this provides simplicity and certainty. If this is not the approach ultimately favoured by government, then our clear preference would be for clear, unambiguous and broad criteria to be included in the legislation so that parties can ensure their agreements are drafted in a way that payments qualify. We do not support reference to an *independent person* as suggested in the Consultation Paper because of the need then to obtain a ruling before any agreement can be finalised (and we note that the Commissioner for Taxation can hardly be regarded as independent in this regard in any event).

The more difficult question relates to whether or not, and at what point, the proceeds of such payments (and income derived from investing them) should in effect lose their tax exempt status.

Tax exemption for native title payments will not be sufficient in supporting desired policy outcomes unless reforms are also introduced which recognise and give concessional tax treatment to indigenous entities and organisations which hold the proceeds of those payments (and income received from investing them) for the collective benefit of present and future generations of traditional owners.

Response to consultation questions

In response to the specific consultation questions asked in section 3.1 of the Consultation Paper:

(f) an upfront tax exemption for payments made in respect of a native title agreement would reduce the need to negotiate complex structures designed to ensure appropriate tax treatment for the proceeds of those payments,

(g) a native title agreement, for tax exemption purposes, should be defined by reference to the simple fact of registration under the *Native Title Act* or, if further criteria are imposed (which is not the preferred approach), by reference to clear, unambiguous and broad legislated criteria that do not require parties to obtain a ruling from an 'independent' person prior to finalising their negotiations, and

(h)	we submit there are policy reasons for *not* restricting the tax exemption of native title payments based on the uses for which the proceeds are applied.

3.2 Indigenous community funds

Charitable trust structures are currently typically used to preserve the concessional tax treatment afforded to native title payments and income received from investing the proceeds of those payments. But the charitable trust framework promotes outcomes which are inappropriate from a policy point of view for several inter-related reasons:

- it encourages passive dependency rather than responsibility and self-reliance,
- conservative views about the common law principles surrounding charitable purposes can severely constrain the use of trust funds for a range of legitimate community development purposes, particularly as those principles are more relevant to the public charitable institutions that emerged in the context of 19th century industrial England than they are to indigenous communities in 21st century Australia, and
- the tax status of those trusts are often regarded as at risk if they invest in indigenous businesses even though, as one commentator has observed, the decision of the High Court in *Commissioner for Taxation v. Word Investments Limited* [2008] HCA 55 has "given the 'green light' to charitable institutions to undertake commercial operations with a view to making profits, provided those profits are applied to charitable purposes".*

Above all else, reforms to the taxation treatment of native title payments must be made to enable funds held for the collective benefit of traditional owners to be invested in indigenous economic development initiatives including, in particular, to make it clear that those funds can be invested in indigenous enterprises.

One essential aspect of that reform should be to eliminate the need to use charitable trust structures to obtain and preserve concessional treatment (see the comments in section 2 above). The other is to ensure that it is beyond any doubt that entities formed for the collective benefit of traditional owners are able to invest in indigenous enterprises (and obtain a return on that investment) without jeopardising the concessional tax treatment of the native title payments and income on investments (including investments in indigenous enterprises) which they receive.

We have already commented on the adverse effects associated with the current need to fit native title benefits into inappropriate structures, such as charitable trusts, and suggested that a much better approach would be to

* Will Marryat, *Word Investments: the changing landscape for the not-for-profit sector*, paper presented to the South Australian Division of the Taxation Institute of Australia conference, Adelaide, 18 March 2009.

acknowledge the unique nature of native title (and therefore associated payments) and treat them accordingly (see sections 2 and 3.1 above).

For this reason, we support the concept of creating a new category of entity for taxation purposes along the lines of an indigenous community fund discussed in the Consultation Paper.

We do *not* support a prescriptive approach to the definition of the purposes for which the fund can be operated, but accept that payments that are made out of the fund:

- to individuals, and
- to businesses which are not owned by the fund or carried on for the collective benefit of the traditional owner group,

may be taxable in the hands of those individuals or businesses *if they are in the nature of ordinary income which is not otherwise exempt*. In this way:

- the fund would be able to make payments of any kind to individuals and entities without prejudicing its own tax status, and
- those payments would not be liable to tax if (for example) they are in the nature of equity investments or loans, or if the recipient is otherwise entitled to claim an exemption (such as, for example, if the payment is a native title payment).

As research by the ANU's Centre for Aboriginal Economic Policy Research confirms, "governance capability is at the heart of sustainable Indigenous socioeconomic development".[**] Clearly, good financial management, accountability and transparency will be critical. But the development of effective, representative governance structures requires the active participation of indigenous people in designing those structures. Flexibility is required to ensure that the different needs of different traditional owner groups can adequately be reflected in the structure adopted. To quote from the same report:

... capacity development for governance ... should be a process that actively strengthens Indigenous decision-making and control over their core institutions, goals and identity, and that enhances cultural match and legitimacy.[***]

We agree with the view in the Consultation Paper (p.13) that a "governance model which encourages a high level of participation in decision making is also

[**] J Hunt & D E Smith, *Building Indigenous Community Governance in Australia: Preliminary research findings*, ANU Centre for Aboriginal Economic Policy Research Working Paper No. 31/2006, p.50.

[***] *Ibid*, p.55.

consistent with recognising the rights of these groups to exercise choice in how these payments are applied", but suggest that this same approach should be applied to enable traditional groups themselves to develop and implement their own governance models within the parameters required to ensure compliance with whatever requirements apply to the chosen structure under general law. Indigenous people themselves should also decide whether or not they regard governance arrangements as representative.

In summary, we do *not* support a prescriptive approach to the nature of the structure or its governance but *do* support requirements:

- that the entity (in whatever form) is formed for the collective benefit of traditional owners and its governance model be representative of their interests, and
- to comply with legal, equitable and regulatory requirements applicable generally to whatever structure is chosen (for example, the *Corporations Act*, the law relating to trusts and trustees and so on).

Response to consultation questions

In response to the specific consultation questions asked in section 3.2 of the Consultation Paper:

(i)(i) the fund should be able to receive returns on investments it makes,

(ii) we do *not* support an approach which prescribes the purposes for which the fund may be used; the fund should retain its tax status irrespective of the purpose of payments it makes, but those payments may be taxable in the hands of the recipient if they are otherwise in the nature of income and not otherwise exempt,

(iii) there should be flexibility for traditional owner groups to adopt a range of legal forms, depending on their needs, so long as the entity is formed for the collective benefit of traditional owners,

(iv) there should also be flexibility for traditional owner groups to adopt a governance model which meets their needs, so long as they determine the model is representative of the interests of traditional owners and so long as it meets the general legal and regulatory requirements applicable to the kind of entity selected,

(v) if the flexible approach advocated is adopted, structures in place under existing agreements are likely to qualify as indigenous community funds but there will be greater flexibility in how those structures are administered so that some of the adverse outcomes referred to at the beginning of this section are minimised, and

(vi) similarly, minimal transitional arrangements are likely to be required, and

(j) creating a new category of tax exemption for indigenous community funds would, if the approach advocated here is adopted, make a significant contribution to achieving the overarching policy objectives referred to in section 1 above.

3.3 Native title payment withholding tax

As stated in section 3.1 above, we support a tax exemption for native title payments. That reform, along with the creation of a new category of tax exemption for indigenous community funds would, if the suggestions made in 3.2 above are followed, deliver all of the benefits which might theoretically flow from the introduction of a withholding tax regime – and would do so without the potential adverse impacts (including reduction in the amount received by traditional owners), complexities and unintended consequences of the introduction of a withholding tax regime.

In addition, the introduction of a withholding tax regime would not obviate the need for indigenous community funds, since entities of that kind will require concessional tax treatment while they continue to hold, invest and apply funds received for the collective benefit of present and future generations of traditional owners.

We do not, therefore, support a withholding tax on native title payments.

Response to consultation questions

In response to the specific consultation questions asked in section 3.3 of the Consultation Paper, introducing a withholding tax regime:

(k)(i) would not greatly simplify the negotiation of native title agreements, since structures will still be required in which native title payments can be held for the collective benefit of present and future generations of traditional owners,

(ii) may result in traditional owners seeking non-monetary benefits under native title agreements, even though (in the absence of the withholding tax) they might otherwise seek greater flexibility for their present and future generations by seeking a monetary benefits, and

(iii) is unlikely to significantly affect the management of benefits under native title agreements, since an entity will still be required to hold them for the collective benefit of present and future generations of traditional owners and there will be a concern to ensure that that entity is entitled to concessional tax treatment on income it receives on investment of those benefits.

4. Conclusions

Proposals for reform of the taxation treatment of native title payments must have regard to the overarching policy objective of encouraging the transition of indigenous Australians from passive welfare dependency to fuller socio-economic participation and self-reliance.

It is essential that the tax system is used to promote indigenous economic development. While direct spending programs will remain an important form of support for indigenous economic development in the foreseeable future, over-reliance on those programs will only reinforce dependency.

We support tax exemption for native title payments. While worthwhile in itself, this will not however be sufficient to support desired policy outcomes unless reforms are also introduced which recognise and give concessional tax treatment to indigenous organisations which hold the proceeds of those payments (and income received from investment them) for the collective benefit of present and future generations of traditional owners.

We support the introduction of a new category of tax exempt entity – the indigenous community fund.

So long as they are formed for the collective benefit of traditional owners and adopt a governance model which is representative of their interests and otherwise complies with general legal and regulatory requirements, the tax legislation should not prescribe specific requirements as to the form or governance of these entities.

Most importantly, indigenous community funds should not lose their tax exempt status if they invest in the development of indigenous enterprises, since indigenous economic development should be a key objective of these entities.

The tax status of indigenous community funds should not be dependent on the purposes on which it spends its funds. Rather, the revenue is protected by imposing tax on the recipient of those funds if they are received as ordinary income (which is not otherwise exempt).