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Native Title, Indigenous Economic Development and Tax

Consultation Paper

Submission by McCullough Robertson

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Native title, indigenous economic development and tax consultation paper

McCullough Robertson submission

1 Our involvement

1.1 This submission is in response to the Government's consultation paper 'Native title, indigenous economic development and tax' (**consultation paper**).

1.2 In preparing this submission McCullough Robertson draws on its experience:

(a) negotiating native title arrangements when acting for clients in the resources industry;

(b) advising on tax issues flowing from the negotiation of native title agreements; and

(c) providing legal and tax structuring and corporate governance advice to Indigenous organisations (nonprofits and native title groups).

1.3 In addition to responding to the consultation paper questions, our submission focuses on the following key issues raised by the Consultation Paper:

(a) the need for certainty around the treatment of payments made under native title agreements; and

(b) the appropriateness of establishing a new category of income tax exempt fund being the second option outlined in the consultation paper.

2 Tax treatment of benefits received for different reasons

Consultation question (a)

2.1 In our experience, negotiation of native title agreements are undertaken on the basis that payments made pursuant to native title agreements are not assessable income and therefore it is believed they reflect the amount to be received in 'the hands' of the recipient. This is often certain and therefore not controversial due to the use of the enclosed charitable trusts.

2.2 However the nature of the arrangements are starting to involve more community benefit non-charitable activities.

2.3 On this basis, in our view, it is essential to provide certainty around this issue in respect of payments.

Consultation question (b)

2.4 In responding to the consultation paper we are drawing on our experience as a private law firm being involved in the arrangements outlined in paragraph 1.2.

2.5 In our experience, the view of government agencies on the appropriate taxation treatment of payments made under native title agreements is not clear.

2.6 From an income tax perspective, there is no publicly available guidance available on the appropriate characterisation of payments made pursuant to native title agreements. Specifically the Australian Taxation Office (**ATO**) being the government agency charged with administering the Australian taxation regime has not provided any material guidance available in the public domain on the issues.

Consultation question (c)

2.7 Should this consultation not result in certainty being achieved – being the introduction of an appropriate legislative regime – then it is critical that clarity and more importantly certainty is provided by the ATO issuing a binding public ruling.

2.8 It is our view that it is essential that the ruling be prepared in consultation with Indigenous groups, the resources sector and other relevant stakeholders such as the state governments to ensure that the approach in the ruling appropriately addresses the range of circumstances and arrangements that arise.

2.9 We also consider that the date of effect of ruling needs to be carefully considered with any unfavourable position to taxpayers having prospective application only, with transitional rules for already negotiated arrangements being available.

3 Tax treatment of benefits used for different purposes

Consultation question (d)

3.1 In our experience, the establishment and use of charitable trusts for the management of compensation received by native title groups is common and suitable having regard to the nature of benefits received under native title agreements. Payments are not for the benefit of particular unchanging individuals, but for a group or community, the individual members of which change over time.

3.2 In our view, there are advantages to using a charitable trust structure to receive, manage and distribute payments under native title agreements. Clients we act for in the resources sector prefer the establishment of a charitable trust as it provides a level of assurance that native title payments are to be maintained and distributed in accordance with the purposes for which the trust is established and for which the payments are agreed. Provided appropriate trustee appointment and corporate governance arrangements are in place (including in appropriate cases the input of independent parties with relevant expertise), it is our view that charitable trusts are an appropriate legal structure subject to the restrictions discussed below.

3.3 We understand a key (often critical) benefit for Indigenous groups adopting the charitable trusts structure is the availability of the income tax exemption. A disadvantage for Indigenous groups establishing a charitable trust is the capacity to distribute funds for purposes that are not charitable, in the legal sense, but are beneficial to Indigenous communities, e.g. establishment, promotion or support of Indigenous business opportunities. This in our experience is an increasingly important purpose associated with receiving the funds.

3.4 In response to the comment in the consultation paper on the limitation imposed by the rule against perpetuity, we note the rule against perpetuity is concerned with ensuring the vesting of an interest or right in property cannot be postponed indefinitely. As a charitable trust will, ordinarily, vest in a charitable trustee contemporaneously with establishment of the trust, the rule against perpetuity is not a limitation.

3.5 However we note for completeness that for non-charitable trusts the limitation is an issue that should be addressed. For example we understand that the rule has been abolished for trusts generally under South Australian law.

Consultation question (e)

3.6 We have some experience of legal structures used to manage payments received under native title and other forms of compensation agreements other than through charitable trusts. Examples include fixed and discretionary trusts (that are not charitable) as well as corporations and incorporated bodies which provide for member benefit and are not nonprofit. The variety of available options has in our experience contributed to instances where the statutory and legislative obligations of those bodies are not routinely understood and carried out when operationalised. Further, the variety of governance options that are available through these models have not been fully explored in the context of the particular community organisation that is represented, leading to internal disputes which often then reduces the capacity of the organisation to meet its objectives for the benefit of that community.

3.7 While not an option regularly explored in native title negotiations in Queensland, we have recently had cause to consider the legal structures of prescribed bodies corporate.

3.8 In our view, the requirement that prescribed bodies corporate are incorporated under the *Corporations (Aboriginal and Torres Strait Islanders) Act 2005* (**CATSI Act**) is a potential limitation. In our view:

(a) it is possible to prescribe participation by native title holders in an organisation's governance and management arrangements (e.g. a particular minimum proportion of the Board), as an alternative to requiring incorporation under the CATSI Act;

(b) the benefit of facilitating participation by Indigenous organisations in mainstream regulatory frameworks (i.e. ASIC as opposed to ORIC) should be considered.

4 Income tax exemption for native title agreements

Consultation question (f)

4.1 In our experience, negotiations of native title agreements are undertaken on the basis that payments made pursuant to native title agreements are not assessable income to the recipients.

4.2 Confirmation of tax exemption for payments made pursuant to native title agreements will provide certainty to parties in negotiations. In reality it will legislatively confirm the position being adopted (whether correct or not in every instance) that the payments are not taxable.

4.3 Our concern as discussed above is that, if a purpose of the payment is to undertake activities which, while beneficial to Indigenous communities are not charitable in the strict legal sense, this means that payments received will not be tax exempt by reference to the entity receiving the payment. In the absence of a tax exemption the ongoing uncertainty will, we expect, result in Indigenous groups seeking 'gross up' provisions for the potential tax liability. We expect there would be considerable objection from the resources sector on this issue.

Consultation question (g)

4.4 In our view, defining the concept of a native title agreement may be problematic given the range of legal arrangements reached in native title negotiations. We consider that further specific consultation to determine an appropriate definition or set of criteria once the taxation framework is resolved would be necessary.

Consultation question (h)

4.5 In our view, a limitation on the availability of the tax exemption should be linked to the flow of a benefit to Indigenous communities. We expect payments that are consistent with such a benefit would be exempt along with expenses that are ancillary or incidental to such payments.

4.6 From a compliance perspective, it may be appropriate to establish a process that enables exemption to be clawed back, i.e. subsequent liability to assessment. Our greatest concern with this option is the practical administration. This includes assessing how to determine whether a payment has been applied for prescribed purposes. That is, was it the original payment received or the income on that payment that was applied to the particular purpose. Further defining which purposes are prescribed will be important.

4.7 In our view, the appropriateness of exemption for expenses related to 'private consumption' is a matter of degree and circumstance. Distribution of funds for certain purposes to Indigenous communities will necessarily result in what would best be described as private consumption e.g. a community bus for transporting children to school. However, it does not necessarily flow that such purposes are not appropriately exempt.

4.8 Consideration of how restrictions around the availability of exemption may be managed requires consultation with Indigenous groups.

4.9 This is consistent with the existing regime for charitable funds. As long as it satisfies the criteria for being characterised as the fund and its activities are consistent with those criteria then the type of payments received should not be relevant.

5 Indigenous community fund

Consultation question (i)(i)

5.1 In our view it is not necessary to restrict the nature of payments capable of being received by the Indigenous community fund.

5.2 In our view, entitlement to the exemption will flow from the purposes for which the Indigenous community fund is established. Provided payments are applied consistently with the Indigenous community fund's purposes, we expect all payments would be exempt.

5.3 This approach is consistent with the existing regime for charitable funds which in our view is well understood. That is, as long as it satisfies the criteria for being characterised as an Indigenous community fund and its ongoing activities are consistent with those criteria then the type of payments received should not be relevant.

5.4 To the extent funds are applied for non-exempt purposes, these may be:

(a) accounted for separately and excluded from exemption; or

(b) paid to a separate, non exempt, fund.

Consultation question (i)(ii)

5.5 Determination of permitted uses of Indigenous community funds, or criteria for permitted application of funds, requires further consultation with Indigenous groups.

Consultation question (i)(iii)

5.6 In our view, a trust structure similar in form to the charitable trust is an appropriate legal structure. The legal nature of the trustee, presumably a corporate trustee, may require further consideration.

5.7 The perceived limitation of a charitable trust in the context of indigenous communities relates to the application of funds to projects aimed at economic development. While some such projects could still fall within the definition of charitable purpose, as recently outlined in the High Courts decision in *Word Investments*, there would be some activities that would not. Further, if there was any future legislative change to narrow the scope of commercial activities that a charitable organisation could undertake without loss of its charitable status, planned activities focused on furthering economic development within indigenous communities could be at risk of falling outside concessional tax arrangements for charities.

5.8 For this reason, the establishment of a tax exempt category that enabled indigenous community organisations and funds to support economic development activity is in our view an appropriate approach.

5.9 In this context use of a discretionary trust structure (that is not strictly charitable) may also be considered. However, in our view, consideration to the following points should be given:

(a) the need to ensure appropriateness of purposes for which funds can be applied (i.e. that benefit a wide section of the community and not just the promotion of personal interests);

(b) the length of time for which Indigenous community funds may operate, in light of the rule against perpetuity applying to the discretionary trust. Non charitable trusts would not be able to operate in perpetuity; and

(c) governance arrangements should also be required to reflect a 'public interest' consideration that is analogous to the requirement for charitable organisations. This will also guard against the concessional tax benefits being applied to private interests.

Consultation question (i)(iv)

5.10 In our view, it is not necessary to establish particular governance requirements for Indigenous community funds, other than to reflect the "public interest" considerations outlined above.

5.11 There are no particular governance requirements for other types of income tax exempt entities.

5.12 To the extent appropriate, we expect that:

(a) accounting and audit obligations will be imposed in connection with the operation of a tax exempt fund (similar to the current requirements of organisations with concessional tax endorsement);

(b) the fund (or trustee of the fund, as appropriate) will be required to adopt governance arrangements suitable to the exemption available, including, where appropriate, participation by the public in the fund.

5.13 It is important to retain as much flexibility as possible to enable indigenous communities to choose the most appropriate governance arrangements that best suit their community, having regard to:

(a) cultural considerations;

(b) experience and capacity of individuals within the community to undertake governance leadership roles; and

(c) the interpretation of good governance practice in the context of that community.

Consultation question (i)(v)

5.14 As outlined above, it is our experience that the resources sector is interested to ensure governance arrangements and legal and tax structures are in place in connection with the management of funds paid under native title agreements. To date, this has been facilitated by the establishment of charitable trusts.

5.15 Establishment of a new category of tax exempt vehicle should be focussed on providing certainty to parties negotiating native title agreements. We would recommend that transitional rules be introduced that would allow existing arrangements, both charitable and other, to move into the new regime without any tax consequences.

Consultation question (j)

5.16 Establishment of a new category of tax exempt vehicle will provide certainty for native title groups and Indigenous communities determining appropriate legal and tax structures to manage payments made under native title agreements, and funds received more broadly.

5.17 Establishment of a new category of tax exempt vehicle will enable funds received under native title agreements, and from other sources where appropriate, to be directed to the particular needs of native title groups and Indigenous communities without losing the benefit of concessional tax arrangements.

5.18 Further, unlike the 'option 1 tax exemption' it provides the following additional benefits:

(a) the ongoing use of the original payments and income earned is 'controlled' in terms of appropriate use of the funds by the obligation imposed on the fund;

(b) the income earned is tax exempt to the extent that the fund is operated consistently with the requirements of the regime.

6 Native title withholding tax

Consultation question (k)(i)

6.1 Consistent with our comments above, we expect that advisers to Indigenous groups would start with the amount expected in 'the hand' and then negotiate for a 'gross up' for the tax withholding amount. This will increase the total cost to the payers (resources companies, state governments, etc.).

6.2 The one clear attraction of the final withholding tax model (as described in 3.3.2) is that it is simplest of the options in terms of ongoing compliance in relation to monitoring the use of the funds. However as commented below this benefit may not actually be manifested given that in our experience the resource companies are not willing to negotiate 'pay and forget' arrangements.

Consultation question (k)(ii)

6.3 There would be a clear incentive for the resources company should the position in 6.1 become apparent to negotiate the provision of non-monetary benefits. In our experience this would

potentially be resisted by the Indigenous groups as it would impact on their ability to self determine over a period of time what would benefit their specific community.

Consultation question (k)(iii)

6.4 We are unsure as to what issue this question is directed.

6.5 Our comments are based on the comments in 3.3.2 that there is an assumption that once the withholding tax is remitted then no further restrictions on the use of the payment would be applied.

6.6 It is our experience that resource companies in negotiating the payment see benefits in assisting the Indigenous communities establishing structures that inherently have appropriate governance and restrictions on use of the funds. This means that practically the restrictions contemplated by options 1 and 2 may be negotiated anyway with the Indigenous group and incorporated in some part into the structures that are implemented.

6.7 Finally, there is a problematic differential outcome resulting from the difference in treatment between extinguishment and suspension. Anecdotally it appears that this is driven in part by the region in which arrangements are negotiated. For example in Western Australia extinguishment appears to be the common approach whereas in Queensland the suspension appears to be the approach.

6.8 Clearly a withholding on suspension arrangements only could be seen as an inequitable outcome.

7 Implications for business and non-government stakeholders

Consultation question (l)

7.1 As outlined above, it is our experience that the majority of arrangements are negotiated (whether always correct or not) on the basis that that Indigenous group receives the money without any tax liability.

7.2 However, as outlined in Chart 2 of the consultation paper, unless the amount is received by an income tax exempt entity then it is considered uncertain as to the correct tax treatment of payments for the suspension of native title. This uncertainty is not appropriate going forward.

7.3 Ultimately, the key outcome that is required is certainty about the treatment of the payments. From the perspective of the resources sector, an appropriate and targeted tax exemption for the payments would also ensure that there is not a material increase in their costs associated with addressing and managing their native title obligations.

7.4 In terms of negotiated arrangements that are not 'pay and forget' we are of the view that option 2 – Indigenous community fund would be a beneficial structure to have available.

Consultation question (m)

7.5 In our experience we do think that option 1 or option 2 would materially impact on the nature of the payments provided.

7.6 As outlined above in relation to options 3 our concerns are:

(a) the potential for 'grossing up' the payments for withholding tax liability;

(b) the different treatment depending upon whether the payment is for extinguishment or suspension; and

(c) the lack of any regulation on the subsequent application of the payments.

8 Deductible gift recipients

Consultation question (n)

8.1 In our view, establishment of a new category of deductible gift recipient (**DGR**) that will enable Indigenous organisations to maintain endorsement as a DGR while carrying out activities across more than one DGR category will have a number of advantages.

8.2 It is important to identify the motivation for establishing DGR entities in the context of communities who have the benefit of negotiating native title and compensation payments. Generally, the priority will not be the capacity to issue a tax deductible receipt as the paying entities will have the capacity to claim a deduction for the payment as a business expense against ordinary business income. The main advantage in seeking DGR endorsement is more likely to be due to the higher level of FBT exemption that is available for employees of the entity.

8.3 A new category of DGR will simplify the legal and tax structures currently maintained by organisations endorsed in more than one DGR category. Currently, an organisation endorsed to undertake more than one category of DGR activity is required to:

(a) operate separate funds or trading entities; and

(b) maintain separate accounting records and incur duplicated audit expenses.

8.4 Particularly, organisations that have elected not to undertake more than one category of DGR activity may be able to:

(a) pursue a broader range of purposes in their communities; and

(b) avoid duplicated compliance, audit and reporting obligations.

8.5 In relation to 8.4(a), we note that, currently, a number of DGR categories require particular purposes to be 'principal purposes' of an organisation to be endorsed as a DGR and, consequently each organisation is restricted to a single 'principal purpose'.

Please contact Heather Watson on 3233 8820 or David Marschke on 07 3233 8883 to discuss any of the issues outlined in our submission.

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Dated: 2 July 2010