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Native Title Services Victoria Ltd

ABN 27 105 885 149
642 Queensberry Street (PO Box 431) North Melbourne VIC 3051
ph (03) 9321 5300 fax (03) 9326 4075 www.nts.com.au

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Committee Secretary
Standing Committee on Economics
PO Box 6021
Parliament House
CANBERRA ACT 2600
AUSTRALIA

email: economics.reps@aph.gov.au

Dear Committee Secretary

Submission on TAX LAWS AMENDMENT (2012 MEASURES NO. 6) BILL 2012

Native Title Services Victoria Ltd (NTSV) is the recognised Native Title Services Provider for the State of Victoria.

Attached is NTSV's submission to the Standing Committee on Economics with regard to the tax treatment of Native Title benefits.

Yours sincerely,



Matthew Storey

Chief Executive

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Native Title Services Victoria

Submission on

TAX LAWS AMENDMENT (2012 MEASURES NO. 6) BILL 2012

Tax Treatment of Native Title Benefits

1. INTRODUCTION

- 1.1. Native Title Services Victoria Ltd (NTSV) supports the principle that income derived from settlements be treated as non-assessable non-exempt (NANE).
- 1.2. NTSV submits that this treatment should be applied to the income derived from holding those funds on the basis that it should be able to hold its value over time.
- 1.3. Where income is earned from compensatory capital, and added to that capital, it should continue to be considered as part of the compensatory capital. This is based on the principles underlying:
 - 1.3.1. Tax neutrality
 - 1.3.2. Trusteeship
 - 1.3.3. Economic equity
- 1.4. It is submitted that this is best achieved by providing that:
 - 1.4.1. Investment returns be included as NANE¹
- 1.5. However, as second best alternatives:
 - 1.5.1. NANE to apply to returns to meet a growth index rate (to meet factors such as inflation and population growth)
or, at least
 - 1.5.2. NANE to apply to at least the amount that maintains the capital in line with inflation.
- 1.6. Further, NTSV draws the Committee's attention to our understanding that in relation to organisations such as Native Title Representative Bodies, Native Title Service Providers and the Victoria Traditional Owner Settlement Trust, money held for Traditional Owners or their bodies would be subject to the NANE regime, even if there is no formal trust in place. For the avoidance of doubt, it is submitted that this is made explicit.

¹ Similar to the concept of the Indigenous Community Development Corporation concepts that have been presented to the Government through the Minerals Council of Australia and National Native Title Council.

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2. COMMENT

Application of NANE to preserve the capital value

- 2.1. Income or capital earned from the original settlement capital should be NANE. In particular, the original capital should be able to grow to retain at least its original value.

Tax neutrality

- 2.2. The proposed regime skews the incentives for distributing bodies, holding entities and trustees away from risk managed investment and wealth creation across generations, and in instead:
- towards immediate distribution; and
 - towards adopting organisational forms that are charitable in structure and nature;
 - away from adopting organisational models that can help manage risks.
- 2.3. In Victoria (and in other States) settlements include one-off sums. This means that over time the funds lose value, unless they earn income to beat inflation. This income should equally be NANE in order to provide tax-neutral decisions and remove the perverse incentive of immediate distribution to the current beneficiaries of the settlement, rather than the intended long term outcomes.
- 2.4. Furthermore, holding and distributing entities and trusts will seek to off-set the tax position through using 'charitable' tax status. This has a number of consequences, including limiting the way in which money can be used (particularly for business investment), the ability to preserve the money over time (rather than spend it) and in relation to the 'public benefit' test.²
- 2.5. Moreover, tax neutrality should apply to any form of investment return, whether capital or income.
- 2.6. An example of this would include the investment in a 100% owned subsidiary – independent of the nature of that body (eg if it is a corporation under the Corporations Act 2001). If that subsidiary was liquidated, the capital would be returned to the holding or distributing entity. The increase in capital in the subsidiary should be able to be moved back into the parent organisation as if it were not any different.
- 2.7. This would preserve the tax neutrality, while providing Traditional Owner corporations with broader options for operational vehicles.³ It is noted that the capital gain from the transfer of a 'right to be provided with a native title benefit' is NANE, but the income derived is not.

² While NTSV supports the adoption of charitable structures where appropriate to fulfil the objects of the Aboriginal corporation, other vehicles are less likely to be considered if there are limited incentives favouring the long term approach or economic development objectives.

³ However, the operational income earned by the subsidiary would be considered as its own income, and not relevant to NANE.

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Trusteeship and investment

- 2.8. A fundamental principle within trusteeship, with both common law and statutory underpinnings, is preservation of the capital (unless there is a distribution). This requires trustees to invest money. A second fundamental principle for any trustee is to ensure the fairness of distribution, including for present and future beneficiaries.
- 2.9. Therefore, investment income that preserves the value of the funds for the members/beneficiaries, including through capital gains and investment income streams of the corporation should be treated as NANE. This is the purpose for which it was provided – to be NANE for the beneficiaries. But the current Bill only those who receive the money now will benefit from the agreed amount (future beneficiaries will receive an amount that is of a lower value, or will need to bear higher risk).

Economic Equity

- 2.10. The Victorian Native Title (and Traditional Owner) settlement context includes among other issues, that the settlement bodies are strongly long term and intergenerational, with a membership/beneficiary pool that has significant growth in the population base and which is different from the usual 'shareholding' base of a company (where there is ability for shareholders to come and go according to the value derived).
- 2.11. In the context of settlements, it is understood that the settlement amount is intended to provide the basis for on-going capital. In order to retain its value to the beneficiaries (including future beneficiaries), it needs to grow not only at a rate relative to the cost of inflation, but also be cognisant of beneficiary population growth.⁴
- 2.12. In the context of the intergenerational perspective, handing assets on to a growing population base, the asset base needs to grow faster than its value depreciates.
- 2.13. Therefore, it is not appropriate to adopt a regime that mirrors the general approach to income tax from investment. A tax regime that seeks to treat such organisations on a similar footing to other organisations is inequitable and further erodes the value of the settlement and undermines approaches more apposite to long-term growth and development, or at least in preserving the value of the compensation.⁵

⁴ The Indigenous population of Australia is projected to grow by 2.2% per year between 2006 and 2021, compared with an annual growth rate of between 1.2% and 1.7% per year for the total Australian population. (ABS Media Release, September 2009). Victoria's Indigenous population is expected to grow by 2.4-2.5% as an average annual rate. (ABS Experimental Estimates and Projections, Aboriginal and Torres Strait Islander Australians, 1991 to 2021, September 2009).

⁵ In Victoria the Indigenous population has grown at approximately 5% per annum since 1996. It is estimated to grow at approximately 2.5% per annum over the period 2006-2021. It would be appropriate for the capital to be able to grow at that amount before tax is paid in addition to any allowance for inflationary effects. At that rate, in one generation the settlement would have halved in value.

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Uplift Indexing

- 2.14. In order to enable income earned from capital to preserve the value of the original settlement capital over time it is possible that an indexing system could be used. This could be based on:

Factor	Uplift rate of capital allowable as NANE
Inflation (CPI)	2.5 - 3.5% ⁶
Victoria: Indigenous population growth	2.4 - 2.5%
Total index figure	4.9 - 6.0%

- 2.15. In other words the 'income earned would be NANE up to 6% of growth on the capital'. For example, if a settlement was \$1,000,000, then in the first year it should be able to have an increase of \$60,000 as NANE. If the capital earned a return of \$100,000 the remaining \$40,000 would not be NANE. This would maintain the tax neutrality over time. If a distribution took place, this would be subtracted from the capital (and form the base amount for the following year).
- 2.16. There are numerous examples where indexation is used to maintain the real value of a compensation benefit received, and the tax treatment afforded to the compensation, including on-going payments.⁷

Application to money held under other authorities

- 2.17. It is NTSV's understanding that funds held by the Traditional Owner Settlement Trust, as established under section 78 of the *Traditional Owner Settlement Act 2010* (Vic) would be included within the NANE treatment proposed in the Bill, even though the trustees are appointed by, and report to, the Attorney-General.
- 2.18. Similarly, our understanding is that other organisations (including Native Title Service Providers and Representative Bodies or possibly established under the corporations legislation) that hold funds without formal trusts in place are included within the proposed NANE regime. For the avoidance of doubt it is recommended that this is made explicit within the proposed NANE regime.

3. CONCLUSION

- 3.1. NTSV fully supports the introduction of NANE income treatment for Native Title and Traditional Owner Settlement Act (Vic) compensatory payments.
- 3.2. However, it is submitted that the Bill be amended to give regard to the nature and context of the payments, the recipient bodies and their obligations and for balancing the incentives for providing benefit to current and future beneficiaries.
- 3.3. In this regard, it is submitted that the NANE treatment be provided for all income and capital gains earned from the original settlement capital. In the alternative, it would be possible to enable factors affecting the treatment to be

⁶ Reserve Bank of Australia, Monetary Policy Statement, February 2012 and November 2012.

⁷ Such indexing is used in various other contexts. The FBT regime, for example, sets thresholds based on a CPI index and the Minerals Resource Rent Tax uses an 'uplift factor' indexed according to the CPI. The tax treatment on personal injury compensation – either as lump sum or structured settlement periodic payments are tax exempt (since 2002), including the CPI or other indexation used to maintain its real value. In addition the CGT is disregarded.

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taken into account in setting an 'indexed allowable uplift', or at least take inflation into account when determining the income and capital earned that would be liable for tax.

- 3.4. Finally, NTSV draws your attention to our understanding that NANE treatment would apply to money received on behalf of Traditional Owners held by bodies such as the Victorian Traditional Owners Trust and Native Title Service Providers and Representative Bodies even where no formal trust is established, and recommends that for the avoidance of doubt this is explicitly included within the legislation.