Submission to Treasury in response to Consultation Paper 'Native Title, Indigenous Economic Development and Tax'

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In order to determine whether or not payments arising from agreements or actions under the *Native Title Act 1993* (Cth) (NTA) should be exempt or subject to a different tax system such as a native title withholding tax I submit that we should attempt to understand the current taxation situation for these payments.

This submission undertakes to clarify the current income tax situation for many activities that might arise in respect of native title as well as make some submissions regarding this tax situation. In order to do this I make the following points:

1. Differences between Native Title Payments and Statutory Mining Royalty Equivalents in the Northern Territory

The discussion paper focuses on its vision for native title that effectively came into operation in 1994 however there is no indication in the paper of the scope of definition of native title payments.

In order to understand these payments it is necessary to briefly consider the history of payments relating to traditional land in Australia and reference should be made to the submissions by Jon Altman to Treasury in respect of taxation of native title payments[1] and Attorney-General's Department on agreement making.[2] In summary until 1978, all statutory royalties raised on Aboriginal reserves were earmarked for Aboriginal use and were deemed

[1] Jon Altman 'Native Title and Taxation Reform' Topical Issue No 4/2010 CAEPR.
[2] Jon Altman Submission on the Discussion Paper 'Leading practice agreements: maximising outcomes from native title benefits'.

broadly compensatory. Subsequently with the enactment of the *Aboriginal Land Rights (Northern Territory) Act 1976* (Cth) (ALRA), a diversity of payments could be negotiated in the Northern Territory. This was due mainly to the fact that free prior informed consent rights (sometimes referred to as veto rights) constituted a de facto mineral right and so provided negotiation leverage for the traditional owners. This resulted in a complex benefit sharing regime because the Australian government guaranteed all or most statutory mining royalty equivalents (SMREs) to Aboriginal interests (with 30% reserved for the owners of areas affected). Land owners and others could also negotiate additional monetary and non-monetary benefits above this compensatory base and in addition land owners could receive any statutory and negotiated development lease payments.

The Northern Territory situation which is not mentioned in the discussion paper has created a precedent under which the Australian government has adopted a regulatory role in relation to agreement benefits. The statutory land rights scheme has provided considerable oversighting and controlling powers to the Federal Minister for Indigenous Affairs especially in relation to the financial activities and performance of the Aboriginals Benefit Account (ABA). The Australian government has always asserted that SMREs are public moneys and so it has an interest in ensuring appropriate outcomes from their use.

Native title agreements and the payments that arise are different to SMREs because in general agreements are struck with private sector interests and the amounts are not directly linked to statutory payments. Sometimes however agreements may include a mix of payments from private and public sources. An example is the Century Mine Agreement signed in 1997 that included a twenty-year benefits package made up of $60 million from Pasminco (subsequently Zinifex and then Oz Minerals) and $30 million from the Queensland State government.

Section 2 outlines 6 situations where payments are made from resource companies to native title claimant groups and highlights the complexity and variety of these agreements.

2. Analysis of Resource Agreements between Mining Companies and Native Title Groups

Ciaran O'Faircheallaigh has analysed a number of the agreements that relate to the mining-resource sector and has identified six different types of payments that are made to indigenous Australians and their communities.[3] Although many of the agreements will be as a result of native title negotiations his analysis is not limited to payments arising as a consequence of the NTA. The following is a summary of the types of agreements and payments.

Model 1: Single Up-front Payment

This is the simplest financial model and involves a single payment by a resource company to the Indigenous Community-entity at the start of a project. There are no further payments made between this time and the end of a project. An example given by O'Faircheallaigh is the Eastern Gas Pipeline Agreement. This agreement is between seven native title groups in Victoria and New South Wales and the developer of a 700km pipeline between Sale in Victoria and Sydney in New South Wales. A single payment was made before construction started and no further payments will be made during the rest of the project's life.[4]

Model 2: Fixed Annual Payments

A second approach involves the use of payments made on an annual basis. The amount of the payment for each year is set when the agreement is made. The amount may be identical for every year of the agreement, or a particular amount may be paid for some years (for

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[3] Ciaran O'Faircheallaigh 'Financial Models for Agreements Between Indigenous Peoples and Mining Companies' Aboriginal Politics and Public Sector Management Research Paper No 12 January 2003.

[4] Ciaran O'Faircheallaigh 'Financial Models for Agreements Between Indigenous Peoples and Mining Companies' Aboriginal Politics and Public Sector Management Research Paper No 12 January 2003.

instance the first five years) and a different amount for the remaining years. This approach is the financial model used in the agreement for the Century Mine in the Gulf of Carpentaria.[5]

Model 3: Royalties Based on Output

This style of agreement involves the use of royalties based on the application of a flat charge for each unit of mineral produced. The payment is usually calculated on the basis of x cents per pound or x dollars per tonne. This arrangement is referred to as ‘unit royalties’, and under this approach payments to Indigenous communities will increase or decrease as the volume of minerals produced moves up and down. For example, if the royalty is $1 per tonne and 200,000 tonnes are produced in a year, the payment for that year will be $200,000. If production rises in the next year to 400,000 tonnes, the payment will be $400,000. If it falls in the following year to 100,000 tonnes, the payment will be $100,000.

Model 4: Royalties Based on the Value of Mineral Output

A fourth approach involves the application of a fixed, percentage royalty referrable to the value of minerals extracted. This if often referred to as *ad valorem* royalty. In this case revenue is determined by a number of factors. These are the royalty rate (which is calculated by a percentage), the volume or quantity of output and the price received by the company for each unit of output. An increase in either the royalty rate, the amount produced or the unit price will mean higher payments and a decrease in one or more of these will result in lower payments.

[5] Ciaran O’Faircheallaigh ‘Financial Models for Agreements Between Indigenous Peoples and Mining Companies’ Aboriginal Politics and Public Sector Management Research Paper No 12 January 2003.

Model 5: Profit Based Royalties

Profit based royalties are charged on the amount of money a company has left from its revenue after it has met its costs of production, including the cost of borrowing money from banks, and the cost of replacing capital invested in a project. Profit is affected by changes in the volume of output, in the price of minerals and in production costs. Profit is usually described as 'before tax' or 'after tax', depending on whether or not tax payments to government have been deducted.

An example of this type of agreement is found in the original mining leases held by Cape Flattery Silica Mines Pty Ltd (Cape Flattery Mines).[6] Cape Flattery Mines held four mining leases for mineral sands on land at Cape Flattery. When those mining leases were first granted they contained special conditions. One of the special conditions which applied to each of the leases was a requirement that 3 per cent of its annual net profit in each year be paid to the Department of Aboriginal and Islander Affairs (subsequently called the Department of Community Services). This amount was for the benefit of the aboriginal inhabitants of the Hope Vale Reserve who were represented by the Hope Vale Aboriginal Council. The areas the subject of each of the mining leases were at the date of the grant of those mining leases within the area of the Hope Vale Aboriginal Reserve.[7] The amount payable for the mining leases was subsequently changed to a percentage of gross sales which brings it within a Model 4 approach.

[6] *Cape Flattery Silica Mines Pty Ltd v Federal Commissioner of Taxation* 97 ATC 4552.
[7] *Cape Flattery Silica Mines Pty Ltd v Federal Commissioner of Taxation* 97 ATC 4552, 4554.

Model 6: Equity Participation or Shareholding

This sixth approach involves Indigenous groups taking shares in a company that operates a project on their land. The groups own a part of the company involved and so own a share of the project that is established on their land. To be regarded as a ‘financial model’ constituting part of an agreement between Indigenous people and a mining company, equity must either be provided by the company free of charge or on a concessional basis. If this is not the case what is involved is a commercial transaction no different to any other on the share market.

3. Income Tax consequences of these Agreements

Models 1 and 2

The Model 1 arrangement identified by O’Faircheallaigh is arguably a payment for compensation for the giving up of an asset being the native title or the exclusive possession of the land. In this case, applying the principles determined from *Glenboig’s Case*[8] the amount is capital and not assessable as income (although CGT may still apply). This principle from taxation law is that if an amount is in substitution of a capital asset then the amount itself is capital and not income. This is the result even though the amount is calculated in a way that is related to profits.

Applying the Income/Capital substitution principle from *Glenboig* to Model 2 arrangements is more complex and unclear. If the payments are for the forgoing of native title or exclusive possession for a considerable length of time or some permanent damage to the land or some other significant and therefore ‘capital’ asset[9] then the amount is capital and not income. If the payments are not so referrable then it is likely that they are income. Where the payments

[8] *Glenboig Union Fireclay Co Ltd v Inland Revenue Commissioner* (1922) 12 TC 427.
[9] *Barrett v Federal Commissioner of Taxation* (1968) 118 CLR 666; *Nullaga Pastoral Co Pty Ltd v Federal Commissioner of Taxation* 78 ATC 4329.

are for both and cannot be dissected then they are capital. There are no tax cases that discuss this issue in the context of native title however there are some analogous cases that look at types of transactions where annual payments are made that involve some form of capital asset, including land over which mining is taking place. The cases also support the view that payments made on an annual basis are more likely than a one-off payment to be considered income as they are regular and periodic which is a characteristic of income.[10] This has been held in one case (not however dealing with native title) where the Court also stated that if the same amount had been paid as a lump sum for the sale of land (rather than a 50 year lease) it would have been considered capital rather than income.[11]

The decision that is nearest factually to Model 2 agreements is that *Nullaga Pastoral Co Pty Ltd v Federal Commissioner of Taxation*.[12] In this case Nullaga owned a property which it had farmed for several years. Two other companies (the joint venturers) approached Nullaga to enter into an agreement to explore the property for bauxite. The joint venturers were entitled to do this under various provisions of the *Mining Act 1978* (WA).[13] Nullaga and the joint venturers entered into an agreement under which Nullaga was to be paid $10,000 a year for a period of five years. This was expressed to be for compensation for deprivation of possession of the land and for interference in its farming activities. During this period there were limits on the nature of the exploration and the joint venturers could at any time give notice that they intended to commence mining. If they did this the annual instalments were to cease. If the joint venture ceased altogether then the full $50,000 remained payable. If mining operations commenced the joint venturers agreed that they would pay Nullaga 5 cents per ton of ore removed but the first 1 million tons were not brought to account resulting in the

[10] *Just v Federal Commissioner of Taxation* (1949) 8 ATD 419, 422.
[11] *Just v Federal Commissioner of Taxation* (1949) 8 ATD 419, 422.
[12] 78 ATC 4329.
[13] It should be noted that under s 3 of the *Mining Act 1978* (WA) minerals belong to the Crown.

first $50,000 being accounted in the total amount payable. The total payable under the agreement was not to exceed $400,000. At the time of the case only two instalments ($20,000) had been received by the taxpayer. The Commissioner of Taxation did not argue that the payments were assessable as royalties but that the periodic nature of the payments was enough to cause them to be analogous to payments for a lease or licence and therefore income as rent.[14] The case came before Wickham J of the Supreme Court of Western Australia. His Honour carefully considered the terms of the agreement in reaching his decision. He noted that the agreement had very little in common with a lease and was more a kind of licence. He held that the money was paid and received as consideration for the deprivation of part of a capital asset and in order to replace that capital asset. He stated that 'I think that these payments were patently paid and received as compensation to the taxpayer for interference with and damage to the land and diminution in its value resulting from operations carried on or proposed to be carried on'.[15] The payments were therefore capital and not income.

Justice Wickham applied the earlier decision of Owen J of the High Court in *Barrett v Federal Commissioner of Taxation*.[16] In this case Barrett was the owner of property which contained mineral deposits. Barrett entered into an agreement with a company to reserve mineral rights in the property to the company and received amounts from the company for mineral deposits removed from this property. The High Court held that the payments were not for royalties as the deposits removed belonged to the company and not Barrett. Nor were the payments income in return for the grant of a licence to use the land for mining purpose, they were in effect for damage to the land. The amounts were therefore capital and not income.

[14] 78 ATC 4329, 4331.
[15] 78 ATC 4329, 4331.
[16] (1968) 118 CLR 666.

Models 3, 4 and 5

These payments are clearly linked to production of income and therefore take on an income characteristic.[17] This tax perspective does not take into account that the mining will have a long term physical impact on the land to the detriment of the native title to that land.[18]Some proportion of the payments is in effect for damage to a pre-CGT asset (pre 1985) or compensation for loss of homes and quality of life even though it is not calculated by reference to this. An income result is misleading and inappropriate from a tax policy perspective as there is inevitably long term damage to the underlying land and native title rights of the native title claimant group and possibly the wider Indigenous community. Also there will be cultural and community damage due to the imposition of mining on a remote community.[19]

Model 6

As what is now taking place is the ownership of shares in a company the shareholders (either the Prescribed Body Corporate under the NTA or individual traditional owners) will have a tax liability for any dividends that they receive.[20]

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[17] 15 CTBR *Case 5*.

[18] Ciaran O'Faircheallaigh 'Financial Models for Agreements Between Indigenous Peoples and Mining Companies' Aboriginal Politics and Public Sector Management Research Paper No 12 January 2003, 11.

[19] Jessica Weir, 'Native Title and Governance: The Emerging Corporate Sector Prescribed for Native Title Holders' (2007) 3(9) *Land, Rights, Laws: Issues of Native Title* 1.

[20] *Income Tax Assessment Act 1936* (Cth) (*ITAA36*) s 44(1) provides that dividends received by Australian shareholders are part of assessable income. There will also be capital gains tax consequences if the shares are sold as this is the disposal of an asset and therefore a CGT event A1 under *Income Tax A*ssessment *Act 1997* (Cth) (*ITAA97*).

4. Native Title Payments and Capital Gains Tax

With the introduction of CGT in 1985 the distinction between income and capital became less significant from a tax perspective.[21] CGT arises where what is termed in the legislation a CGT event takes place.[22]

The crux of the CGT regime is that a CGT liability will happen only where a defined event occurs. The most common CGT event occurs where there is the change of beneficial ownership from one person to another of an asset (CGT event A1)[23] however there are many other situations where a CGT event occurs.[24] If an amount is assessable as income then it is not included as a capital gain.[25] This is the reason I discussed the application of the concept of income to payments under the 6 Model agreements first.

There are several papers written on this issue and I refer the readers to the following:

- Fiona Martin 'Native Title Payments and their Tax Consequences: Is the Federal Government's Recommendation of a Withholding Tax the Best Approach?' (2010) 33(3) *University of New South Wales Law Journal*
- Rob O'Connor and JJ Hockley 'Native Title Payments: Tax Implications Part 2 - Assessability' (1997) 24 (11) *Brief* 14.
- Tom Middleton, 'Native Title and Taxation Issues' (2000) 28 *Australian Business Law Review* 86.
- Warren Black, 'Transferring Native Title to a Body Corporate under the *Native Title Act 1993* (Cth) - Can CGT Arise? (2000) *Journal of Australian Taxation* 155.

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[21] The current CGT provisions are found in pts 3-1 and 3-3 *ITAA97*.
[22] *ITAA97* Division 104 lists all the CGT events.
[23] *ITAA97* s104-10.
[24] Gordon Cooper and Chris Evans, *Cooper & Evans on CGT* (Thomson Reuters Australia, 2009) 30, [2 030].
[25] *ITAA97* s 118-20.

- Warren Black, 'Tax Implications to Native Title Holders of Compensation Payments' (1999) *Journal of Australian Taxation* 344.

In summary, because the native title (being an asset for CGT purposes) has been in existence since at least the time of European settlement of 1788 it is a pre-CGT asset and any dealings in respect of this asset should not be subject to CGT. This approach is confirmed in an analogous situation by the Australian Taxation Office in 'Income Tax: Capital Gains: Treatment of Compensation Receipts' TR 95/35, 29 November 2006, [69]. My argument is that all payments arising in respect of native title including annual payments and 'royalties' are in substance compensation for long term damage to the native title and should be considered compensation for loss of a pre-CGT asset and therefore not taxable.

5. Native Title as Analogous to the Family Home

Any loss or gain from the disposal of the family home is not subject to CGT.[26] There are public policy reasons why any gain made on the disposal of the family home is not subject to CGT. Home ownership should be encouraged and in Australia there is a strong sense that home ownership is a very important goal. In addition, taxing the sale of the home would impose problems for the mobility of the workforce and as any gain made on the sale usually goes back into the purchase of a new home such gain is purely notional.

Home ownership amongst indigenous Australians is very low compared to non-Indigenous Australians. Between 2002 and 2008, the home ownership rate for Indigenous Australians fell from 10 per cent in 2002 to 8 per cent in 2008.[27] In 2008, Indigenous people aged 15 years and over were much less likely to live in a dwelling that was owned with a mortgage or

[26] The main residence exemption is found in Division 118-B *ITAA97*.
[27] Australian Bureau of Statistics, 'National Aboriginal and Torres Strait Islander Social Survey, 2008' (Report No 4714.0, 2009).

owned outright than non-Indigenous people (29 per cent and 72 per cent respectively). Indigenous people were correspondingly more likely to be living in rented dwellings (69 per cent compared to 26 per cent).[28]

Indigenous Australians have a strong spiritual and cultural connection to the land which has been expressed in a significant array of literature; this is akin to native title being their family home. Furthermore in many remote places Indigenous Australians did not live in a 'house' but in many 'houses' and shelters scattered about the country and adjoining countries due to their lifestyle as hunter-gatherers. It is suggested that many of these Indigenous Australians are still living in a variety of homes even though they may work in the mainstream labour market. Taking into account their low rates of home ownership and their strong connection to native title as their home I argue that native title should be considered analogous to the family home and therefore fall outside the CGT regime.

Conclusion

Although some payments in respect of agreements with native title claimant groups appear to be income in that they are expressed in terms of production of minerals or made in a series of payments the substance and effect of the agreements is to compensate the native title claimant group for damage to the underlying asset which is the native title. Such compensation is not income and not taxable as such. Furthermore, native title is clearly an asset that has existed since before the introduction of CGT and therefore falls outside this tax regime. Alternatively, native title is akin to indigenous Australians' 'family home' and should be exempt from CGT on this basis. If any or all of these arguments is accepted there is a very

[28] Australian Bureau of Statistics, 'National Aboriginal and Torres Strait Islander Social Survey, 2008' (Report No 4714.0, 2009).

strong case that the payments (no matter what form they take) should be exempt from income tax.

Finally, it is clear from the analysis of the 6 types of agreements that payments for native title are inherently different from SMREs and that a withholding tax is not appropriate due to the complexity of defining the fund out of which the tax should be withheld.

I conclude with the submission that a logical analysis of taxation law leads to a conclusion that native title payments fall outside the income tax system. They are capital amounts relating to destruction or long term damage to an asset (the native title) which has been in existence since before the introduction of CGT. Alternatively they are related to Indigenous Australians family homes and from a tax equity perspective should be exempt in order that Indigenous Australians are treated in a similar manner to non-Indigenous Australians.