MELBOURNE LAW SCHOOL
Australia's first, Australia's global

Legal Studies Research Paper
No. 436

December 2009

Tax Law and Policy for Indigenous Economic Development

Miranda Stewart

Tax Law and Policy for Indigenous Economic Development

Miranda Stewart

Associate Professor, Melbourne Law School, University of Melbourne

m.stewart@unimelb.edu.au

The importance of taxation

This paper discusses tax law and policy for indigenous economic development, with a particular focus on business taxation. Indigenous communities, organisations and individuals are increasingly engaging in business or commercial activity in the mainstream Australian economy. Taxation has little relevance for individuals and communities with no economic engagement in the market, although the presence of government may be very significant in other ways in those communities. However, as business activity in indigenous communities and on indigenous land increases and levels of income rise in some of these communities, taxation law become significant.

There are a number of indicators of a desire for and increasing practice of indigenous business engagement. Cape York Institute has an official policy on Economic Viability, which is focussed on developing three key pillars – 'enhanced individual capabilities', individual 'mobility' and 'enabling engagement with the real economy' (Cape York Institute, 2009, 2005). Several native title agreements incorporate substantial income and asset transfers over time to traditional owners who need to ensure that they obtain full value from business activities on indigenous lands and from the investment of indigenous-owned capital assets. The previous Howard government instituted an Indigenous Economic Development Strategy (see for example Andrews 2005) adopted at the same time by the Northern Territory Government, among others, (NT Government 2005). The Rudd Labor government seeks to expand this Strategy to establish 'the foundations of sustainable economic development across Australia (Australian Government 2008, p 1; Macklin 2008). Capitalising and supporting indigenous businesses has been a primary goal of the federal agency Indigenous Business Australia (IBA).

To date, the main focus for indigenous economic development in Australia has been the recognition of native title and other property rights and appropriate compensation and profit sharing arrangements. However, taxation can contribute to sustainable indigenous economic and governance systems, as well as ensuring optimal business tax outcomes. Effective taxation is a necessary condition both for financial redistribution and for the development of genuinely accountable systems of governance and citizenship: taxation is 'the tie that binds the ruler and the ruled' (Brautigam 2002, p 10; and see Stewart 2006). It is argued that taxation by and for local communities, and active engagement of indigenous communities and individuals with all levels of government through tax, as well as welfare systems and compensation, will become increasingly important. For indigenous groups with access to significant resource revenues, an analogy may be drawn with developing countries like East Timor, where a key concern of tax policy is to avoid a 'resource curse' of continuing poverty and poor governance while being heavily dependent on oil and gas revenues (Langton & Mazel 2008; Drysdale 2008). For other communities, well designed tax laws can enhance incentives to engage in diverse economic activity while enabling redistribution. It must be emphasised that the increasing importance of taxation does not obviate the need for substantial federal and state government spending on infrastructure and services, funded by the Australian taxpayer population as a whole, to redress injustice and eliminate indigenous disadvantage and poverty.

The strong link between taxation and citizenship raises the issue of sovereign immunity from taxation for indigenous communities or lands, which does not currently apply in Australia. In contrast, a limited form of sovereign tax immunity applies for some First Nations lands in Canada (and also in the United States).[1] There is not scope in this paper to address the arguments for and against sovereign immunity. However, the Canadian experience suggests that tax immunity is not a panacea for the economic and governance issues facing indigenous communities. Some Canadian First Nations communities have recently moved towards *increasing* taxation on local peoples and businesses in association with increased self-governance, and have given up their tax immunity by agreement with Canada's federal and provincial governments. For example, under the Nisga'a Final Agreement with the Province of British Columbia and the Government of Canada of 2000, provincial and federal tax collections commenced in 2008. It must be noted however, that there remain good arguments that *compensation* for native title and land rights agreements should be exempt from taxation in Australia (Strelein 2008).

Taxation can affect incentives to work in the market, to become educated and to improve capabilities as well as on entrepreneurship. These issues are being reviewed by the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) in its review of indigenous employment programs (Australian Government 2008) and by the federal Treasury, which is examining the disincentive effects generated by high effective marginal tax rates in the tax-transfer system (the Henry Tax Review: see Australian Treasury 2008). However, the focus of this paper is specifically on entities for business activities and the possible establishment of tax incentives to encourage such activity.

Australia's tax system for indigenous business activities

Indigenous individuals and corporations are, in general, subject to the same tax rules as all other individuals or entities in Australia. The most important tax is income tax. Essentially, unless a specific exemption applies, all employment, business or investment income and capital gains are subject to tax under the *Income Tax Assessment Act* 1936 (Cth) (ITAA36) and the *Income Tax Assessment Act* 1997 (Cth) (ITAA97). Individuals are taxed at progressive marginal tax rates from a zero tax-free threshold to a top marginal rate of 45 percent plus the Medicare levy (commencing at taxable income of $180,000 per year). In addition, business enterprises must remit the Goods and Services Tax (GST) at a rate of 10 percent on most business supplies.

Indigenous people who live, work and do business in urban areas have a similar level of engagement with the Australian tax system as non-indigenous Australians. Even so, where urban indigenous enterprises seek to carry out for-profit activities for the benefit of a collective group or community, they may run into difficult choices of entity form and uncertainties in taxation treatment. In the last few years, taxation has affected some indigenous groups and businesses for the first time, especially in remote communities. The application of income tax, GST and state taxes, such as duties and land tax, to a range of payments such as cultural heritage assessment and monitoring payments, mineral royalties or profit shares, lump sum compensation and land title grants, infrastructure construction and payments for native title negotiations, is complex and often uncertain. Native title representative bodies (NTRBs) have recently sought legal advice and training on such tax matters.

Tax-exempt organisations

The current, default Australian approach to solving most of these tax issues has been to seek to ensure that taxation does *not* apply at all. This may be argued on the basis that the income or assets comprise tax-exempt compensation; that an individual activity such as a heritage service is conducted in a private and non-commercial capacity; or that a tax exemption applies on the basis of charitable status for a native title corporation, trust or other community entity. Indigenous individuals or communities on land subject to specific land rights regimes (such as that applying in the Northern Territory) may also receive income free of tax, where it has already been subject to a low Aboriginal withholding tax that is remitted to the Australian Taxation Office (ATO), for example, by a mining company operating on the land (Div 11A of ITAA36).

Many indigenous communities seek to derive income or hold assets in a not-for-profit corporation or charitable trust which qualifies as tax-exempt under Division 30 or Division 50 of the ITAA97. Tax-exempt status of indigenous non-profit organisations is likely to continue to be important, but it may limit the options for indigenous business development. Adopting taxable structures for enterprises and individuals, combined with the potential for delivery of subsidies or other incentives for economic activity through the tax system, may enable more commercial freedom and encourage more active governance and engagement of communities in both local and broader economies.

Tax-exempt organisations must be endorsed as such by the ATO and may lose this status if they fail to comply with administrative and legal restrictions. Problems include uncertain limits on the ability of charitable trusts to accumulate income and assets for long term benefit; the relatively limited goals of poverty relief, education, aged care or similar activities that must be the core goals of a tax-exempt entity; potential breach of trust associated with payments to particular individuals; limits on political or law reform activity; the definition of the public or benefiting class of native title holders and the problem that many in a community may not benefit under the defined terms of a charitable trust; and the overlap between charitable and governmental service delivery, in particular in remote communities (see Strelein & Tran 2007; Strelein 2008; Martin 2007; and Martin, this volume).

A matter of growing concern is the ability of an indigenous tax-exempt entity to carry on a commercial business. The ATO has in the past emphasised that commercial activities must be merely incidental to charitable purposes or the tax exemption is at risk (Tax Rulings TR 2005/21 and TR 2005/22). However, in the recent decision of *Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55 (*Word*

Investments), the High Court concluded that a company carrying on business for profit still qualified as a tax-exempt endorsed charitable institution because the profits were distributed solely in accordance with and to carry out its religious objects as specified in its memorandum of association. Word Investments was a company limited by guarantee that carried on both a funeral and an investment business and distributed all its profits for its religious purposes.

Following *Word Investments*, tax-exempt native title corporations established for the benefit of traditional owners may be eligible to carry on active business activities in furtherance of their goals of relief of poverty and disadvantage of native title groups. However, uncertainty remains and the ATO, although it has accepted the decision, is likely to apply it conservatively (ATO 2009). It is also unclear how this decision will apply to charitable trusts which are not institutions. The government may also seek legislative reform to limit the effect of the decision. The Henry Tax Review has noted that the 'full implications' of *Word Investments* 'are not yet clear' (Australian Treasury 2008, p 164), while Assistant Treasurer Chris Bowen has indicated that the government is concerned about competitive neutrality of not-for-profit organisations (Bowen 2009).

The use of taxable entities

Given the uncertainties and limits of tax-exempt organisations, taxable entities would be a useful addition to the 'portfolio' of choices for indigenous communities. A taxable entity may be useful for the productive investment of some or all of a compensation payment in an ongoing business activity that generates income for individuals or the collective community. Businesses may range from micro or startup operations, such as 'Jim's mowing' or engineering businesses involving individual services, arts & crafts, tourism or culture businesses; to small or medium businesses such as an individual-owned bakery franchise or another 'high street' business, such as a pharmacy or car mechanic; to larger arts or tourism ventures, branches or subsidiaries of a large enterprise (a supermarket or hotel chain); or to large corporate businesses or joint ventures such as mining or pastoral operations.

The existing legal entities typically used for business and investment in Australia are trading corporations (Pty Ltd or Co Ltd); unit or discretionary trusts; and partnerships. They have limited liability to various degrees; are flexible; have specific governance rules for undertaking activities and sharing or distributing the benefits;

and they are well understood in the business and tax worlds generally. It is also common for businesses to combine legal entities, such as trusts and companies, or non-profit and taxable entities. This enables flexibility and suitability to purpose.

Partnerships are suitable for small services or family businesses. They are 'transparent', so that profits or losses are taxed on a flow through basis directly to the partners at their individual tax rates and there is flexibility in how profits are allocated (Div 5 of ITAA36). Liability of partners in a partnership is not limited.

A discretionary or unit trust must identify and benefit a specific class of beneficiaries (unlike a charitable trust). Profits in a trust are taxed on a flow through basis to beneficiaries at their individual tax rates, or to the trustee (at a higher rate) if no beneficiaries entitled to the income can be identified, under the rules in Division 6 of ITAA36. Trusts are widely used for small and medium size businesses and enable flexible distribution.

The most common business vehicle is a proprietary limited company. Profits of a company are subject to a 30 percent company tax rate. There is no requirement for distribution of profits, which can be retained in the company for reinvestment to build up the business, or can be loaned or contributed to capitalise another business. Thus, as long as the company does not distribute a dividend, 30 percent is the final tax. Where a company distributes a dividend of taxed profit – a franked dividend – the individual shareholder includes it in their assessable income, grossed up to reflect the pre-tax amount of company profit. The shareholder is then entitled to a credit (tax offset) for the full amount of company tax previously paid. If an individual shareholder has taxable income of less than $80,000 per year they are eligible for a tax refund, or at least pay no further tax, on the franked dividend. An individual with a marginal tax rate of 15 percent or lower would get a refund, so that, overall, the corporate profit is taxed at only 15 percent when distributed. An individual shareholder on a higher marginal tax rate – that is, with taxable income in excess of $80,000 per year – must pay 'top up' tax to reflect their higher marginal tax rate.

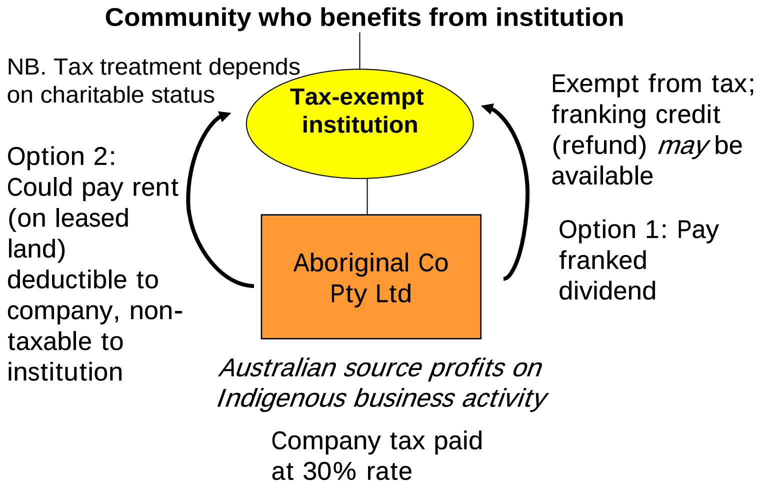
A possible solution for native title or other indigenous organisations is to combine a taxable corporation with a tax-exempt entity. It may be possible to rely on *Word Investments* to enable a tax-exempt indigenous organisation to receive profit distributions from a commercial company that it owns and generate a refund of franking credits under special rules in sub-division 207-E of the ITAA97. The franking credit refund applies even though the tax-exempt entity does not pay any tax

- thus the government writes a cheque to the entity. These rules were originally enacted to encourage endorsed charities to diversify their investment portfolios to include Australian listed companies which pay franked dividends. It seems unlikely that the Treasury intended them to allow charities to control and operate underlying commercial businesses. It is thus not clear whether the ATO would accept such a structure, or whether it would seek to terminate the tax-exempt status of the shareholder entity. The ATO may be concerned to prevent the mischief of ordinary business profits being channelled through a tax-exempt entity, attracting a tax refund from the government on the way.

An alternative to distributing profits to the tax-exempt indigenous entity is to arrange for it to derive passive investment income, such as rent. For example, the organisation could own property such as a retail shop and charge a commercial rent to a taxable corporation that it owns but that is prohibited from distributing profits to the tax-exempt entity under the corporation's memorandum and articles. In this way the tax-exempt entity would derive income for its broader community purposes. The rent is tax-deductible to the taxable corporation and so reduces its taxable profit. The taxable enterprise can also employ individuals from the community in the business and pay them tax-deductible salary, superannuation contributions and fringe benefits.

While this brief discussion indicates some possibilities, the use of taxable entities by indigenous communities is not without its difficulties. First, it is necessary to identify who owns and benefits from the entity. Second, it is important to consider the governance of such an entity where it conducts private enterprise for the collective benefit of traditional owners. A combination of entities, as illustrated in Diagram 1, can add to complexity and compliance issues and it does requires resources for management on an ongoing basis.

Diagram 1: Tax-exempt Indigenous organisation or PBC owning a business



A tax-exempt indigenous foundation for Australia?

The identification of drawbacks of existing tax-exempt entities for indigenous communities has led to recommendations for legislative reform to establish a specific indigenous tax-exempt entity (see for example, FaHCSIA 2008, section 3d, p 15). More broadly, the Senate Standing Committee on Economics report on the not-for-profit sector proposed significant reforms for the not-for-profit sector, including a new model corporation for use by all or most not-for-profits (Senate Standing Committee 2008). Interestingly, the model corporation they proposed was the *Corporations (Aboriginal and Torres Strait Islander) Act* 2006 (Cth) (CATSI corporation) recently enacted as a standard model for native title and other indigenous corporations.

An indigenous foundation established as a registered corporate entity, either as a CATSI corporation or on the basis of standard model, could be specifically listed as exempt under the ITAA97. Such a foundation could have a constitution enabling ot to receive, accumulate and invest income and assets derived through native title negotiations or as a result of native title agreements. One possibility would be for such a foundation to be eligible to apply for endorsed tax-exempt status under s 50-105 of Division 50 of the ITAA97.

Some existing categories of endorsed tax-exempt organisation may be suitable. This kind of entity would be most similar to a 'community service' entity (s 50-10) or a municipal corporation, which is essentially a local government body (s 50-25, Item

5.1(a) or (b)). Indeed, there is a clear relationship between this proposal and the establishment of local government entities. In the context of the current debate about failed government, particularly in remote communities, this raises a number of important policy questions that cannot be addressed here. It is worth noting that in Canada, in spite of the sovereign immunity of tax for income derived on reserves, many First Nations communities also rely on tax exemption as a municipality. One reason for this is that sovereign immunity does not apply to Aboriginal-owned corporations, but these can be owned by municipalities without penalty. To avoid some of these issues, the best approach may be establish a separate statutory category for such an indigenous foundation. A charitable trust with the sole object of benefiting a native title group through such a foundation should also be eligible for exemption under s 50-20 of ITAA97.

The registered indigenous foundation should be entitled to the tax exemption although it has multiple purposes, as long as all have the object of enhancing welfare and relieving disadvantage and poverty of the particular native title group or indigenous community. It should be eligible both to accumulate benefits for the long term and to invest them in business activities for profit to benefit the native title group and should be empowered and permitted to own and control business ventures.

Tax incentives for indigenous business

Tax incentives are one tool for government support for particular economic activities. Direct subsidy and regulation are the other two main tools of government. Tax incentives to encourage indigenous economic development have been proposed by a range of interested parties. In August 2007, Gunya Australia proposed tax concessions for businesses operating on Aboriginal land to encourage more private sector activity (Gunya Australia 2007). The Gunya discussion paper proposed a 150 percent tax credit on initial capital costs, paid in the year they are incurred and a 150 percent tax credit for operating losses in the first five years of operating a business venture, paid in the year the losses were incurred. The Minerals Council of Australia (MCA 2007) and Levin of Jackson McDonald Lawyers (Levin 2007) have also proposed variants on existing venture capital investment incentives in the income tax law (for venture capital limited partnerships),[2] to encourage capital investment into indigenous communities and businesses.

As a tax incentive distorts market choices, the case for a tax incentive for investment in entrepreneurial activity is based on the argument that the activity faces unusually high business and financial risk or that there is market failure in respect of the activity. In a circumstance where private firms ‘tend to allocate less than socially optimal levels of investment of labour and capital’ to the relevant activity, an income tax incentive may be able to be designed that can help to offset the higher risk on the investment decision by offering an increased return by way of lower taxation (Rider et al 2006, p 1; Organisation for Economic Co-operation and Development (OECD), 2002).

Tax incentives tend to leave investment choices to the market with the ‘carrot’ that they will reward those who take up opportunities. In contrast, a system of cash grants requires the government to ‘pick winners’ – that is, the government selects the activity to be subsidised. Regulation is usually a ‘stick’ that may be a more effective mechanism if government seeks to prevent or limit an activity, rather than encourage it. A combination of tax incentives, direct grants or similar support (such as government-guaranteed loans) and regulation may be more likely to succeed than a simple tax incentive.

The design of a tax incentive is important. The OECD describes a simple typology of tax concessions to support entrepreneurship or venture capital investment, which can also be utilised in analysing potential tax incentives for indigenous economic development (OECD, 2002 p 15; Stewart, 2005). A tax incentive may be a ‘front-end incentive’ that aims to reduce the upfront cost of the investment by providing a deduction or up-front credit for the investment. The federal government’s 50 percent small business investment tax credit for investment in business assets before December 2009 is a classic front-end incentive. It rewards or subsidises the investment in the asset even if the underlying business activity is not profitable. Such incentives generate an up-front cost to government and may lead to tax shelter activity. A front-end incentive for indigenous business investment may increase the number of investments but it does not test them on the basis of quality or success (as measured by business survival or profit generation).

In contrast, the exemption from tax of a profit generated by the investment is a ‘back-end incentive’. The investor only gets the subsidy if the investment actually generates a gain, thus this rewards only ‘winners’ who have successful investments. It is delivered later in time and it may be less costly to government but may motivate fewer investments overall. A generalised ‘back-end’ incentive is simply a reduction in the tax rate, such as the Australian discount Capital Gains Tax (CGT) rate (Div 115 of ITAA97). The Australian tax regime for venture capital limited partnerships provides exemptions from CGT to foreign investors and to some Australian investors and managers, providing an enhanced ‘back-end’ incentive to venture capital investment.

The OECD favours ‘back end’ subsidies which are considered more likely to increase successful entrepreneurship. However, this may not be sufficient incentive for the desired level or kind of new investment in indigenous communities. The Gunya proposal is a ‘front end’ subsidy, as it would provide tax credits for start up investment capital. An investment tax credit could be designed to be worth more, dollar for dollar, than the expenditure itself – for example, the proposed 150 percent tax deduction or credit for expenditure in indigenous businesses proposed by Gunya.

Experience has shown that a poorly designed tax incentive may not be effective. An example of such a failure is the first type of venture capital tax incentive enacted some years ago with the goal of encouraging foreign pension funds to invest in Australian businesses; no funds took up the incentive (Stewart 2005). The revenue cost was minimal, but so too was the outcome.

Alternatively, a tax incentive may affect economic behaviour but not in a productive way. A business already operating in an indigenous community may access a poorly designed subsidy to do what it is already doing (and thereby pay less tax). This subsidy does cost money for government, but would not achieve the policy goal of increased and more diverse investment in sustainable businesses. A new business may access the incentive when it would have invested anyway. Tax incentives also have a long history of being ‘gamed’ for tax minimisation. There are many examples of this in the operation of tax incentives seeking to encourage foreign direct investment in countries around the world. For example, taxpayers can set up a company in the region and channel money through it, taking advantage of a poorly designed subsidy, and then diverting the money out again (Holland & Vann, 1998 p 999 and p 1019). This degrades the revenue base and does not help develop real businesses in the relevant community.

A tax incentive directed at indigenous businesses

A tax incentive could be directed to indigenous corporations or individuals. For example, an incentive could provide a tax rate for indigenous corporations lower than the standard corporate rate of 30 percent. A ‘tax holiday’ could be provided for start up indigenous enterprises, for example, no tax payable for the first five years for a tourism enterprise. Credits could be provided for investment in capital equipment used in an indigenous corporation. A modified ‘entrepreneur’s tax offset’ (sub-div 61-J ITAA97) could provide a tax credit to reduce tax paid by an individual who is working in a job but also wants to start up a business.

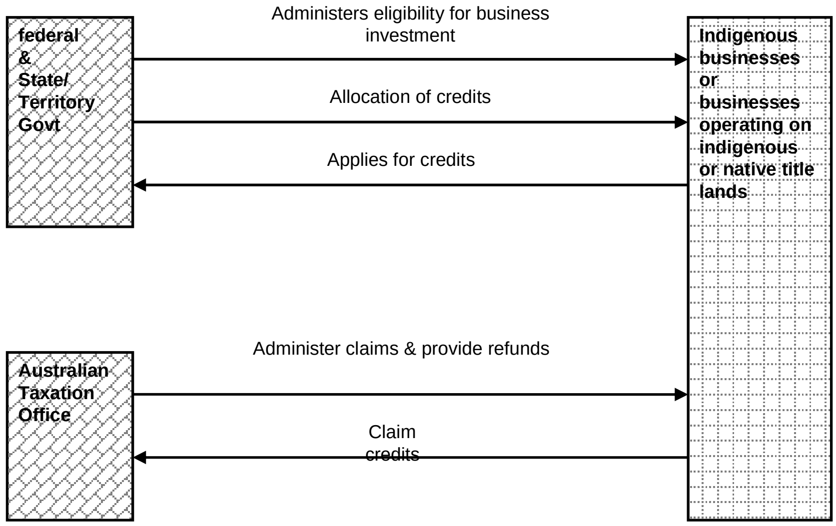
Such tax credits can be designed to be ‘refundable’, so that if the individual or business does not pay enough tax to absorb the full tax credit, they receive a refund which is equivalent to a grant. The Australian system does utilise refundable credits for a range of purposes but they are disliked by the Treasury because of the risk of writing refund cheques in circumstances which may be difficult to verify. As currently designed, the ‘entrepreneur’s tax offset’ is not refundable and it assumes that the entrepreneur has another source of taxable income besides the start-up business.

An effective tax incentive also requires significant regulatory architecture. A range of conditions would need to be designed and satisfied for an individual or business to be eligible for an indigenous tax incentive. Some important issues are summarised here:

- Does the business need to be indigenous-owned, or managed, or service an indigenous community? How should part-ownership or a joint venture be treated?
- Can the business carry on any type of profit-making activity? Should restrictions be placed on the economic activity to be supported, for example excluding a liquor store?
- Are incentives limited to particular regions or zones?
- Should there be a limit on the size of the business?
- Are there limits on the kinds of investor? Can not-for-profit entities participate and if so, how?
- Who determines eligibility? The ATO, FaHCSIA, the IBA, the local land council, or traditional owners (represented by what persons or agencies)? How much consultation or shared participation is required?
- What is the process for administering the tax incentive and who administers it? The claimant of a tax incentive usually has to file a tax return; apply for the incentive; satisfy conditions; retain paperwork and so on. Significant compliance and governmental coordination may be required.

Diagram 2 indicates how such a tax incentive might work:

Diagram 2: Delivery of tax credit to indigenous business



A tax incentive to encourage capital investment in indigenous communities

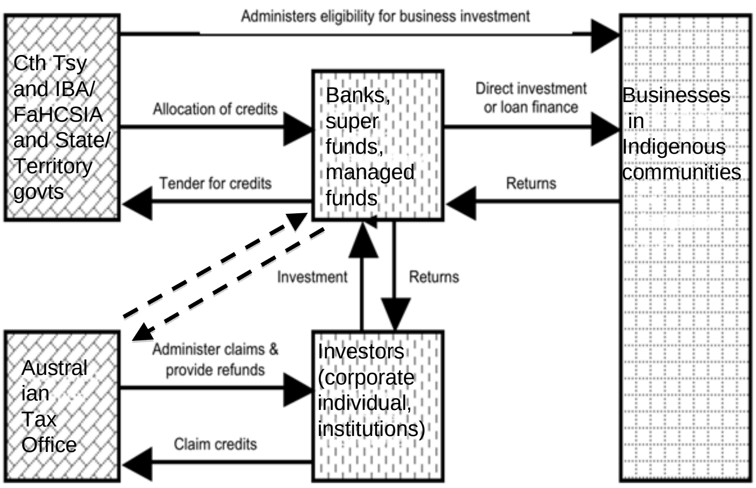
Alternatively, a tax incentive could be designed to attract capital investment *into* indigenous communities. The tax incentive would be delivered to the investors – individuals and entities that are paying tax in Australia - who have made a qualifying investment. There are some existing schemes that could provide models for such an incentive.

In Australia, the National Rental Affordability Scheme (NRAS) seeks to encourage investment in affordable rental housing (NRAS, 2008). The NRAS combines an income tax credit or grant from the federal government with a subsidy, such as relief from land tax, from a state or territory government, to deliver a tax benefit of a set value each year over time to investors in new construction of affordable housing. The NRAS has an estimated total dollar cap over five years of $3 billion.

A United States scheme called the New Markets Tax Credit (NMTC), established in 2000 (*Community Renewal Tax Relief Act of 2000* US), has the goal of ‘revitalisation of impoverished, low-income communities’ and ‘provides individuals, financial institutions and corporations with a tax credit for investing in communities that are economically distressed or consist of low-income populations’ (United States Government Accountability Office (GAO) 2007, p. 1). The NMTC is administered by a US Treasury community fund, which can allocate up to a US $19.5 billion in federal income tax credits over a period of five years under the NMTC program. Thus, this is a capped tax credit program. In each of 2006, 2007 and 2008, US $3.5 billion of tax credits was allocated to investment entities by tender. Funding for native American owned businesses has been obtained through this scheme.

It may be possible to design a federal Indigenous Investment Tax Credit (IITC) for business investment in indigenous communities or for indigenous-owned businesses. The IITC would provide a refundable income tax credit to an investor in a new business being established in an indigenous community, or that is indigenous-owned. See Diagram 3.

Diagram 3: Intermediary tax credit scheme design



The IITC could be allocated to registered investment entities on a competitive tender basis as in each of the NMTC and NRAS schemes. As for those schemes, the total dollar amount of an IITC would be subject to a cap over a period of years. The entities would tender for an allocation (for example, $1 million of tax credits) based on a proposal that would set out track record and plans for investment. Key elements for a successful tender could include community impact and business and management strategies. The credit would be available to companies (taxed at a 30 percent tax rate), superannuation funds (taxed at a 15 percent tax rate) and as a grant to not-for-profit organisations, and to individuals who invest in a managed fund. The complexity of this kind of credit and the need for registration and monitoring suggests that it would be more efficient to deliver the credit to intermediary investment funds, superannuation fund and companies such as banks.

The investment entity would seek contributed capital from investors to invest in eligible businesses. The credit would be delivered over a set period of time on condition that the investment is made in the relevant period. Given the need to encourage establishment of stable, long-term businesses, the credit could be delivered over 10 years at, say, 3 percent of the investment capital each year (a total value of 30 percent) or it could be tapered over time. Alternatively, as in the NRAS, the credit could be a set dollar amount per year. At the end of the period, the investment entity could sell the investment and would receive a taxable gain or loss. Investors may also receive returns over the period of the investment.

Rules would be needed to ensure registration and accountability of the investment entity which would tender for the credits. The United States NMTC model requires that the investment entity have the mission of serving or providing investment capital to low income communities. The capital invested could be equity (shared ownership) or more likely, a low interest or guaranteed loan.

The investment entity must also be accountable to state/territory governments and to residents of the indigenous communities that it serves. Federal and state or territory governments would need to coordinate an approvals process. There would need to be a mechanism established for participation in decision-making with the indigenous communities to ensure local 'ownership'. The program would also need to be coordinated with other federal programs, in particular IBA. Issues would no doubt arise as to appropriate representation and level of decision-making. Investment entities could also be required to provide financial or other training to the community and to investee businesses and could be allowed to take a proportion of the actual return from the business (this would encourage them to invest in viable businesses). The skills here are essentially small to medium enterprise lending or investment. The investment entity may play a role as both lender and perhaps, if another entity is lending, as guarantor.

Example: Bank Ltd successfully tenders to the government for the allocation of $300,000 of income tax credits (attached to $1 million of investment dollars) for economic development in a particular indigenous community. Bank Ltd is registered with the federal government for eligibility for the credit. Bank Ltd works with the state government to identify appropriate small to medium businesses in which to invest in *the relevant community, for example, a franchise of a business. Bank Ltd offers an interest-free or low-interest loan of $1 million to the business to set up in the relevant community, for the term of 10 years. Over the 10 year period, Bank Ltd utilises the tax credits for its investment in the business. At the end of the 10 year period, the business is obliged to repay the Loan to the bank, or it reverts to normal commercial terms as agreed between the Bank and the relevant business.*

A final issue is design of the conditions for a business to qualify for investment by the entity. US experience with the NMTC scheme suggests that these conditions can be some of the most difficult and complex rules to design, depending on the degree of targeting that is required, for example, based on location of a business; level of indigenous employment; and requirements for the provision of services and property within the targeted community. As always, there is a risk that conditions may be too rigid and discourage investment (this has been a concern with Australian venture capital tax incentives). If the conditions are breached, rules and resources are needed to correct problems and perhaps ultimately recapture the tax credit from investors in noncompliant activities.

Conclusion

This paper has considered a range of tax issues that are relevant to indigenous economic development. It has emphasised that a charitable tax-exempt entity may not be suitable for significant business activity by native title groups and other indigenous individuals and communities. The paper therefore discusses the potential use of a taxable entity, such as a proprietary company, perhaps in combination with a not-for-profit tax-exempt entity, for this purpose. It then considers proposes for design of a tax-exempt indigenous foundation with improved features that may be able to own or invest in businesses or a wider range of activities for the benefit of indigenous communities. Finally, this paper discusses recent proposals for a tax incentive to encourage capital investment in indigenous businesses or on indigenous land and surveys the policy and technical design issues raised by these proposals in light of some existing models for delivery of such a tax incentive.

REFERENCES

Andrews, Kevin 2005, *Fact Sheet: Indigenous Economic Development Strategy,* Budget 2005-2006.

Australian Government, Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) 2008, Discussion Paper on Optimising Benefits from Native Title Agreements.

Australian Government 2008, 'Increasing Indigenous Economic Opportunity: A Discussion Paper on the future of the CDEP and Indigenous Employment Programs (May 2008).

Australian Taxation Office 2009, *Decision Impact Statement: Commissioner of Taxation v Word Investments Ltd* (26 May 2009), available from http://law.ato.gov.au

Australian Treasury 2008, *Australia's Future Tax System: Review, Consultation Paper* (December 2008).

Bowen, Chris 2009, *Government's Interim Response to High Court Decision in Word Investments Case* (Press Release No 043, 12 May 2009).

Brautigam, Deborah 2009 'Building Leviathan: Revenue, State Capacity and Governance' *Institute of Development Studies Bulletin* vol 33(3) 1-17

Cape York Institute 2005 'Can Cape York communities be economically viable?' (Viewpoint, Cape York Institute for Policy and Leadership, November 2005)

Cape York Institute Website, 'Economic Viability' http://www.cyi.org.au/economicviability.aspx, viewed 1 July 2009

Drysdale, Jennifer 2008, 'Five Principles for the Management of Natural Resource Revenue: The Case of Timor-Leste's Petroleum Revenue', *Journal of Energy and Natural Resources Law* 26(1) 150.

Gunya Australia 2007, Discussion paper, '*Indigenous Economic Development Scheme: A solution to create employment opportunities within Indigenous communities'*

Holland, David & Vann, Richard J 1998, 'Income Tax Incentives for Investment' in Victor Thuronyi (ed), *Tax Law Design and Drafting*, Vol 2 (IMF) p 986.

Langton, Marcia & Mazel, Odette 2008, 'Poverty in the Midst of Plenty' *Journal of Energy and Natural Resources Law,* 26 (1) 31.

Levin, Adam 2007 *Improvements to the tax and legal environment for Aboriginal community organisations and trusts* (Jackson McDonald Lawyers), Discussion Paper presented at ATNS Workshop *Indigenous Communities, Economic Development and Tax Policy* (21 September 2007, Broome)

Macklin, J 2008, 'Closing the Gap – Building an Indigenous Future', National Press Club, Canberra, 27 February 2008.

Maclagan, Bill 2000 'Section 87 of the Indian Act: Recent Developments in the Taxation of Investment Income' *Canadian Tax Journal* vol 48 (5) 1503

Martin, Fiona 2007, 'Prescribed Bodies Corporate under the Native Title Act 1993 (Cth): Can They Be Exempt from Income Tax as Charitable Trusts?',*UNSW Law Journal*, 30(3), 713.

Minerals Council of Australia 2007 *Discussion Paper: Taxation and other arrangements for sustainable Indigenous communities* presented at ATNS Workshop, *Indigenous Communities, Economic Development and Tax Policy* (21 September 2007, Broome)

Northern Territory Government. 2005 *Indigenous Economic Development Strategy* (May 2005)

Organisation for Economic Co-operation and Development (OECD) 2002, *Entrepreneurship and Growth: Tax Issues*

Rider, Cameron, Lillian Hong, Ann O'Connell, Miranda Stewart, Michelle Herring 2006, *Taxation Problems in the Commercialisation of Intellectual Property*, IPRIA Report No 01/2006 (Intellectual Property Research Institute of Australia, University of Melbourne).
Senate Standing Committee on Economics. 2008, . *Disclosure regimes for charities and not-for-profit organisations.*
Strelein, Lisa 2008, *Taxation of Native Title Agreements,* Research Monograph 1/2008 AIATSIS, Canberra.
Stewart, Miranda 2006, 'Introduction: New Research in Tax Law and Political Institutions' in Stewart (ed) *Tax Law and Political Institutions* (Federation Press, Sydney).
Stewart, Miranda 2005, 'Venture Capital Taxation in Australia and New Zealand' 11 *New Zealand Journal of Taxation Law and Policy* 216

United States Government Accountability Office 2006, *Report to Congressional Committees*: *TAX POLICY: New Market Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance* (January 2007), Report GAO-07-296.

CASES AND LEGISLATION
Commissioner of Taxation v Word Investments Ltd [2008] HCA 55
Corporations (Aboriginal and Torres Strait Islander) Act 2006 (Cth)
Income Tax Assessment Act 1936 (Cth) (ITAA36)
Income Tax Assessment Act 1997 (Cth) (ITAA97).
Venture Capital Tax Act 2002 (Cth)

[1] See Maclagen 2000, and the other articles in special issue of the *Canadian Tax Journal*, Vol 46 (2000) for a discussion of the tax exemption for reserves and the range of fiscal issues associated with agreements for self-governance with particular Canadian First Nations groups.
[2] Sub-division 118-F, *Income Tax Assessment Act* 1997; Venture Capital Act 2002 (Cth).