8th Annual Tax Lecture

Melbourne Law School University of Melbourne

29 August 2012

The Commonwealth's taxing power and its limits - Are we there yet?

Introduction

I am delighted and honoured to be asked to deliver the Annual Tax Lecture for 2012.

The subject – the Commonwealth's taxing power and its limits – is broad and is not what the purists might call "tax law". As many of you know, I have never regarded myself as a "tax lawyer". My exposure to tax law was as a result of others.

One of those responsible for that exposure was Brian Shaw QC, an alumnus of this Law School (where we was awarded the Supreme Court Prize) and of Oxford University (where he was the Vinerian Scholar in the Bachelor of Civil Law). The Prize in Corporate Tax in the Melbourne Law Masters is named in his honour. Shaw signed the roll of counsel in April 1959. His first appearance in the High Court was in October 1959. His last appearance was in June 2006. Over 45 years he appeared in more than 80 cases in the High Court which have been reported in the Commonwealth Law Reports. His appearances in other courts are far too numerous to count. On his last appearance in the High Court, the Court took the extraordinary but delightful step of referring not only to his length of practice but to "acknowledge … with gratitude the assistance [he] provided over that period". That assistance extended to the areas of tax, constitutional law, trusts, equity, superannuation, even criminal cases. The list is as diverse as it is long. It was Shaw's intellectual grasp of these seemingly disparate areas of the law that ensured that he was one of the leading intellectuals of this State and this nation. Shaw demonstrated that the areas in which he practised and appeared in fact were not distinct, or disparate, silos. It was his detailed understanding of, and reference to, other areas of the law and the wider world that marked his advice and advocacy. Advice and advocacy sought by government and by the corporate community. Advice and advocacy he provided to many groups and individuals, pro bono and without fanfare. Brian Shaw was and remains an intellectual, mentor and friend.

Brian's contribution to the tax jurisprudence of this country was, and remains, significant. And it is not possible for me to consider the Commonwealth's taxing powers and the implications of the exercise of that power without thinking of Brian Shaw. It is in his honour that I deliver tonight's lecture.

My choice of subject was, of course, deliberate. The Commonwealth's use of its taxing power affects not only Commonwealth, State and Territory governments, commerce and industry but Australia's future. Consideration of the constitutionality of the exercise of that power is therefore important; some would say essential. Consideration of what are the limits to the exercise of the power is not some political exercise. Such a review (and any subsequent challenge) does no more than reflect a proper functioning democracy where one arm of the democracy - the judicial arm - acts as a check or balance on the political arm.

In the second decade of the 21st century, that process of checking and balancing will, I suspect, become more common especially where, at times, the result of the exercise of the power has been, or at least has the potential to be, destabilising.

Given that there are limits on the exercise of the taxing power, such a review will often provoke the question – have the limits of the power been reached? Or as a young child on a dreadfully long car trip might ask – "are we there yet?" It is some of those issues I seek to raise this evening.

The taxing power and its limits

As we know, the *Constitution* confers, and limits the Commonwealth's powers to make laws with respect to taxation. It creates a scheme, all of the elements of which go to make up the "taxing power". One element is s 51(ii). It provides that:

> The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:
>
> …
>
> *taxation*; but so as not to discriminate between States or parts of States.

The question often posed is whether it is a valid law with respect to "taxation". The word "taxation" lies at its core. What exactly is the constitutional concept of "taxation"?

In 1908, Isaacs J said the word "taxation" was:

> a word so plain and comprehensive that it would be difficult to devise anything to surpass it in simplicity and amplitude.

He definitely did not contemplate the more than 10,000 pages that currently comprise our tax laws. Thirty years later, in *Mathews v Chicory Marketing Board*, Chief Justice Latham defined taxation as:

> a compulsory exaction of money by a public authority for public purposes, enforceable by law, and … not a payment for services rendered.

That has been the working definition for many years.

The High Court recently revisited that issue in *Roy Morgan Research Pty Ltd v Commissioner of Taxation*. In *Roy Morgan*, the superannuation guarantee charge, a charge imposed on an employer who fails to provide a prescribed minimum level of superannuation, was challenged on the basis that it was not a tax because it was not imposed for public purposes. The challenge failed. "The exaction represented by the Charge … [was] not of a nature which [took] it outside the constitutional conception of 'taxation'".

In a joint judgment of six of the Justices, their Honours said:

> … It is settled that the imposition of a tax for the benefit of the Consolidated Revenue Fund is made for *public purposes*. That is not to say that the receipt of funds into the Consolidated Revenue Fund conclusively establishes their character as the proceeds of a tax. But it does establish … that the charge is imposed for "*public purposes*" and thus, if *other necessary criteria* are met … the Charge is a valid tax.
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> (Citations omitted and emphasis added.)

Before turning to the "other necessary criteria", aspects of the *Roy Morgan* decision are worth noting. First, the link between the charge and a benefit to employees did not mean the charge was *not* imposed for public purposes. Secondly, the phrase "public purposes" is narrower than "public interest". Thirdly, the charge did not cease to be a tax because it served some public purpose beyond the raising of revenue. This third point is not new. As Justice Kitto said in *Fairfax v Federal Commissioner of Taxation* by reference to the decision of Justice Clark in *United States v Sanchez*:

> It is beyond serious question that a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the activities taxed ... The principle applies even though the revenue obtained is obviously negligible ... or the revenue purpose of the tax may be secondary ... Nor does a tax statute necessarily fall because it touches on activities which Congress might not otherwise regulate.

A law may bear multiple characters.

Fourthly, the importance of a legislative objective to raise revenue is not without some controversy. Chief Justice Gleeson and Justice Kirby thought its presence or absence "will often be significant" while the majority in *Roy Morgan* later expressed the view that "a legislative objective to raise revenue is *not* necessarily a determinant that an exaction bears the character of taxation".

Roy Morgan demonstrates that limits to the taxing power (or at least some of them) are well defined. Most may be simply stated. Application of those limits in a particular circumstance may, however, be more problematic.

What then are the *other necessary criteria* to which the justices in *Roy Morgan* were referring? It is dangerous to simplify the list. As Justices Gaudron and Hayne said in *Luton v Lessels,* "[i]t is necessary, in every case, to consider all the features of the legislation which is said to impose a tax".

However, we know some other things. We know the charge cannot be a payment for services rendered. A fee for services, although imposed by law, is not a tax. On the other hand, just because something is labelled a "fee for services" does not necessarily remove it from being a tax. So, an imposition which must be paid, whether or not the relevant services are acquired and which has no discernible relationship to the value of the services, is unlikely to escape characterisation as a tax. See, for example, *Air Caledonie International v Commonwealth* concerning the immigration clearance fee imposed on overseas passengers entering Australia.

Next, the imposition cannot be outside the rule of law. An imposition will not be within the taxing power if it is arbitrary. The liability must be imposed by reference to some ascertainable criteria which have a sufficiently general application. I will return to these particular criteria later.

An imposition must not result from an administrative decision based on individual preferences not related to a test prescribed by law. A tax must be contestable. It must be amenable to judicial review when the circumstances of the taxpayer do not attract a legal liability to pay the tax.

Taxes are also to be distinguished from financial penalties. A penalty is a payment for "an unlawful act or omission, other than non-payment of or incidental to a tax". By way of contrast, a tax is a payment "demanded as a contribution to revenue irrespective of any legality or illegality … upon which the liability depends".

These additional limits or criteria are also well known and relatively simply stated. But are there other limits and questions which *may* arise when the Commonwealth exercises its taxing power? Before turning to suggest some of them, I want to place this exercise in some context.

Why is this important?

The political branches in our Federation foreshadow, and decide, policy. At a Federal level, those policy choices are, to some extent, limited by the powers enumerated in the *Constitution*. It is therefore unsurprising that the announcement of a new or changed policy, the invocation of one or more of the powers in the *Constitution* to implement that policy and the resulting law, is subject to scrutiny, especially when the Commonwealth exercises its taxing power.

The resulting tax laws are central to our Federation and to the health of our national economy. Australia is dependent on direct foreign investment. The World Investment Report for 2012 for Australia, published by the United Nations, gives the relevant numbers. Put bluntly, Australia's economic growth is reliant on direct foreign investment.

And economic growth and political stability are interconnected. Political instability includes uncertainty about policy and property rights. Political instability has the potential to make economic decisions risky and therefore less attractive. What a number of fiscal studies have revealed is that complexity and uncertainty in tax laws deter direct foreign investment and have a significant negative impact on inward direct foreign investment. That uncertainty does not stem solely from the *enactment* of laws. Uncertainty may arise from the use of imprecise language, the making of inconsistent changes in taxation laws and from perceived difficulties in interpreting existing laws. Some have gone so far to suggest that uncertainty may arise merely from the discussion of potential tax changes which introduce some element of additional risk.

It is in that context that I turn to other considerations possibly relevant to a challenge to the exercise by the Commonwealth of its taxing powers. The considerations I mention are not exhaustive. And many are not new.

Either / or classification appropriate?

First, the question about the constitutional validity of the exercise of the taxing power is *not* answered by first erecting some either / or classification and trying to put the particular case into some artificially constructed taxonomy. Consideration of the constitutional validity of the exercise of the taxing power will in *each* case require consideration of some more fundamental principles. It is convenient to begin examination of the issues that can arise by looking outside Australia at the constitutional challenge made to what is colloquially known as "Obamacare" but more properly called the Federal Affordable Health Care Act of the United States.

In 2010, the United States Congress passed legislation designed to extend the operation of "Medicaid", the federally funded healthcare scheme. The general scheme of the Act is reasonably well known. One aspect, described as the "individual mandate", required most Americans to maintain a certain standard of private health cover.

For those who did not maintain that minimum standard, they would make a "shared responsibility payment", described as a "penalty", to the Internal Revenue Service as part of their taxes.

It is instructive to observe the way the minority opinion in the Supreme Court of the United States dealt with the issue of validity of the "individual mandate", by seeking to classify it as either "tax" or "penalty"; the former valid, the latter invalid. An exercise no doubt assisted by Congress describing the exaction for failing to comply with the "individual mandate" as a penalty.

It is useful to contrast that either / or analysis with the fact that the United States accept that penalty taxation, of the kind familiar to Australian lawyers, is (despite the language of penalty) to be treated as a species of tax. The recognition then that a label is *not* determinative of the more basic constitutional question begins to suggest that the classification, reflected by the label may, itself be suspect or, at least, may not be a useful tool for deciding validity.

The other contrast is with the High Court decision in 1965 in *Fairfax v Federal Commissioner of Taxation*. The issue in *Fairfax* was the validity of an amendment that denied certain exemptions from income tax to a superannuation fund unless the Commissioner was satisfied the fund had an identified level of investment in Commonwealth and other public securities. There could be little doubt the political motive for the amendment was to encourage investment in public debt securities. Indeed, the taxation consequences of the amendment came about only if the fund did *not* maintain the necessary level of investment in public debt securities.

The trustees of the fund contended no head of federal legislative power supported the amendment. They submitted it was a law with respect to the investment of the moneys of superannuation funds, a subject not one which the Commonwealth Parliament had any power to make laws.

Justice Kitto disposed of the argument as to invalidity in the following terms:

> The argument for invalidity not unnaturally began with the proposition that the question to be decided is a question of substance and not of mere form; but the danger quickly became evident that the proposition may be misunderstood as inviting a speculative inquiry as to which of the topics touched by the legislation seems most likely to have been the *main* preoccupation of those who enacted it.
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> Such an inquiry has nothing to do with the question of constitutional validity under s 51 of the Constitution. *Under that section the question is always one of subject matter, to be determined ... **by reference to the nature of the rights, duties, powers and privileges which it changes, regulates or abolishes**; ...: **is it in its real substance a law upon, "with respect to", one or more of the enumerated subjects**, or is there no more in it in relation to any of those subjects than an* ***interference so incidental as not in truth to affect its character*****?**

In this, and later judgments of the High Court, there is a total rejection of arguments that depend upon assigning a single characterisation to a law.

What the decision in *Fairfax* shows is that there was, and remains, a need to distinguish between form and substance. In the exercise of one or more of the s 51 powers, the Parliament may seek to establish objectives which are beyond those expressly prescribed. But that does *not* mean the resulting legislation is unwell or dead. Because the task of characterising laws according to subject matter is a task which is much more principled. At the outset, a court is not bound by the name of the Act. You must consider the substance of the Act; "what it does, what it commands or prescribes".

There are two well known examples of the differing approaches that can be adopted; *The Child Labor Tax Case* in the United States and *Fairfax* in Australia. In each case, the argument proceeded from the premise that though the provisions in issue were couched in terms of taxation and prominently wore the badge of a tax law, each really operated to address some other subject matter with the result that, in substance, each was not a law upon taxation. As Justice Kitto put it in *Fairfax*:

> … the argument endeavours to lift the section out of its formal surroundings in an Income Tax Assessment Act, to treat the use it makes of the terminology and machinery of taxation legislation as a veil to be removed, and to exhibit it as in truth but an attempt to regulate, with sanctions, the investment of superannuation fund moneys.

This method of attack worked in *The Child Labor Tax Case*. It failed in *Fairfax*. In *The Child Labor Tax Case*, the legislation imposed a tax of ten per cent on the net profits from the sale of the products of any mine, quarry, mill or factory in which children were employed in certain conditions during any portion of the taxable year. The United States Supreme Court held that Congress, "in the name of a tax which on the face of the Act is a penalty" was seeking to regulate the hours of labour of children, a matter beyond its constitutional authority, and that the Act was void.

In *Fairfax*, Justice Kitto analysed some of the matters the US Supreme Court in *The Child Labor Tax Case* treated as decisive of the true character of the Act. That analysis repays careful reading. First, the Supreme Court expressly refrained from treating the heaviness of the burden as conclusive. But, the extent of the burden was not irrelevant. The Supreme Court referred to the fact the Act imposed a heavy exaction upon a departure from a specified course of conduct in business - one-tenth of the entire net income in a business for a full year.

Secondly, the terms of the imposition of the burden were considered. The amount imposed was not proportional to the extent or frequency of the departures from the specified course of conduct. The amount to be paid by the employer was the same whether five hundred children were employed for a year or only one child for a day. Next, an employer was liable to pay only where that employer knowingly departed from the prescribed course. As the Supreme Court said:

> … a court must be blind not to see that the so-called tax is imposed to stop the employment of children within the age limits prescribed. Its prohibitory and regulatory effect and purpose are palpable. All others can see and understand this. How can we properly shut our minds to it?

The approach in *Fairfax* was different. After analysing the provision in issue and, in particular, the role it played in the general scheme of the Act, Justice Kitto adopted the language of the US Supreme Court and said that "a court must be blind not to see that the 'tax' is imposed to stop trustees of superannuation funds from failing to invest sufficiently in Commonwealth and other public securities".

But Justice Kitto did not stop there. He then posed the question:

> But is this enough to justify the conclusion that *what* purports to be a set of provisions for imposing a tax upon the investment income of superannuation funds *is* in reality not a law with respect to taxation at all, but only a law with respect to the investment of such funds?

Justice Kitto's answer is instructive. In deciding whether a law is supported by the taxing power it is *irrelevant* to inquire into the ultimate indirect consequences of the operation of the law. The question to be asked and answered is whether the substantial purpose of the law is to raise revenue, or to regulate the conduct of persons by providing for a sanction in the form of a penalty for departing from a specified course.

The sources for the answer to that question are not straightforward. One source, of course, is what appears on the face of the law. However, it is not sufficient or correct to proceed from some unstated premise that "a law which purports to provide for a tax upon behaviour is in substance not a law with respect to taxation if it exhibits on its face a purpose of suppressing or discouraging the behaviour …". Why? Because as we know "a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the activities taxed". And that principle applies even where the revenue raised is negligible and the revenue purpose of the tax is secondary.

Is there a premise or principle from which consideration of the exercise of the Commonwealth's taxing powers might proceed? I suspect the premise rises no higher than that adopted by the minority in *Barger's Case*: subject only to the limitations expressed in the *Constitution* the power with respect to taxation is "plenary and absolute; unlimited as to amount, as to subjects, as to objects, as to conditions, as to machinery" so that "the Parliament has, prima facie, power to tax whom it chooses, power to exempt whom it chooses, power to impose such conditions as to liability or as to exemption as it chooses". Or, as Sir Owen Dixon stated in *Melbourne Corporation v The Commonwealth*:

> … once it appears that a federal law has an actual and immediate operation within a field assigned to the Commonwealth as a subject of legislative power, that is enough. It will be held to fall within the power *unless some further reason appears for excluding it*. ….

In other words, despite the breadth of the power, there are limits. In *Fairfax*, the provision in issue did not fall foul of those limits. There were, to adopt the language of Sir Owen Dixon, "no other reasons for excluding the law" from the taxing power.

The approach revealed in Fairfax stands in stark contrast with the approach of the minority in the Obamacare case. I mention Obamacare not just because it is current and politically interesting. I mention it because it exposes the difficulties of beginning any analysis having first adopted an either / or classification of a law. Something more is required.

Other limitations – express or implied?

What then are the other possible reasons for excluding a federal law from the reach of the taxing power? The context in which I seek to raise these limitations is retrospective taxation legislation.

Acquisition of property within the meaning of s 51(xxxi)?

First, s 51(xxxi) of the *Constitution*. It is generally accepted that a law with respect to taxation is not properly characterised as a law with respect to the acquisition of property within the meaning of s 51(xxxi). Often this proposition has been explained on the grounds that it would be incongruous to require the provision of just terms before there could be compulsory acquisition of money as a tax.

However the principle is properly identified, the retrospective alteration of taxation liabilities *may* (I do not say must) reach a point where some question of the acquisition of property arises. Here, I am not referring to the application of extant taxation laws to extant facts some years later. I am referring to the laws which, on enactment, apply retrospectively and, on one view, may apply differently to different taxpayers. Additional questions may be thought to arise from retrospective legislation of that kind – not least questions that may arise from what can be seen to be the potential destruction, or degradation, of long standing rights.

If issues of this kind arise at all, they are issues which require close attention to whether the law imposes taxation. That question may not be straightforward. It may direct attention to such matters as whether the law that is enacted (however it is expressed) is a law of general application or is better seen as a law directed at particular individuals (the class of which is closed), identified according to defined criteria which, if satisfied, lead to the liability of those persons to make certain payments, in respect of periods or transactions or events that, by the time the law is made, have passed and are complete. Not only in respect of transactions or events that by the time the law is made have passed and are complete but which, *at the time* of the relevant transactions or events, were entered into consistent with the legislation that was in force.

Section 51(xxxi) is an "important limitation on power"; an "implied guarantee". A guarantee of property rights. The guarantee has been described as a "constitutional guarantee of just terms" "to be given the liberal construction appropriate to such a constitutional provision".

It is beyond the scope of this lecture to examine how and why a law which, on enactment, applies retrospectively and, on one view, applies differently to different taxpayers may fall foul of s 51(xxxi). It is enough to note that statutory rights may be property, or as having proprietary characteristics to be regarded as "property", for the purposes of s 51(xxxi). As the High Court in its unanimous decision in 2008 in *Telstra Corporation Limited v The Commonwealth* said:

> … references to statutory rights as being "inherently susceptible of change" must not be permitted to mask the fact that "[i]t is too broad a proposition ... that the contingency of subsequent legislative modification or extinguishment removes all statutory rights and interests from the scope of s 51(xxxi)". Instead, analysis of the constitutional issues must begin from an understanding of the practical and legal operation of the legislative provisions that are in issue.

What is self evident is that not only are statutory rights capable of being regarded as "property" for the purposes of s 51(xxxi), but there may be an acquisition of that property where there is an extinguishment or even *impairment* of those rights.

How may those issues arise in the context of retrospective tax legislation? Where, on enactment, laws apply retrospectively and, on one view, apply differently to different taxpayers, it may be open to a taxpayer to contend not only that the retrospective legislation adversely affects or terminates a pre-existing right but that the Commonwealth has acquired an interest in that property. The pre-existing right the taxpayer enjoyed may arguably be constituted by the taxpayer entering into transactions and events based on, and consistent with, the legislation in force at the time of those transactions and events, not least by paying tax as *then* assessed. The interest the Commonwealth acquires in that property is arguably constituted or represented by the amount later assessed as a result of the application of the retrospective laws to those same transactions and events. Or, put in terms that tax practitioners well understand, the difference in result caused by the application of retrospective legislation to the same or sometimes different "taxable facts". The only reason for the different result and, possibly different taxable facts, is the existence and terms of the retrospective legislation.

One should not forget what Chief Justice Gleeson said in *Theophanous v The Commonwealth*. Statutory modification or extinguishment of a statutory right could effect an acquisition or property. Whether or not s 51(xxxi) had potential application to that modification or extinguishment may depend on the legislative context in which the modification or extinguishment occurred. If Parliament's purpose for the modification or extinguishment was to save money, or at a policy level because it thought the rights were too generous, then the case may fall within s 51(xxxi). On any view, those categories are not closed.

Retrospectivity – length and purpose??

Section 51(xxxi) may not be the only problem or the only other way in which to look at the issues.

Retrospective legislation which removes substantive rights has long been recognised as "moving the goal posts after the kick was taken". Courts have traditionally been reluctant to construe legislation to have retrospective operation without the clearest parliamentary direction.

The validity of retrospective legislation was revisited by the High Court in 2011 in *Haskins v Commonwealth*. The Plaintiff argued that, by enactment of retrospective legislation, the Commonwealth had, contrary to s 51(xxxi) of the Constitution, acquired property - his right of action for false imprisonment against the Commonwealth - otherwise than on just terms. Mr Haskins failed. He was found to have had no action for false imprisonment. Accordingly, there was no "property" that the "retroactive operation" of the Act could be said to have acquired and s 51(xxxi) was not engaged. What is significant for tax practitioners is that the application of s 51(xxxi) to retrospective legislation was considered possible; it failed on the facts.

There is another possible approach to retrospective tax legislation; that adopted by the United States. In contrast to s 51(xxxi), the Fifth Amendment to the American Constitution relevantly reads: "no person shall be held to answer for ... nor be deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation." While the Fifth Amendment differs materially from s 51(xxxi) in the sense that the former *limits* plenary power, whereas the latter *confers* power, the last words of the Fifth Amendment – "without just compensation" – are similar to the constitutional guarantee in s 51(xxxi).

In *Brushaber v Union Pacific Railroad Company*, Chief Justice White in the Supreme Court described the taxing power of the United States as "embrac[ing] every conceivable power of taxation", and declined to accept that the Fifth Amendment placed any limitation upon the taxing power conferred upon Congress by the Constitution. However, his Honour did not foreclose the possibility of a purported exercise of the taxing power being so arbitrary as to amount to a confiscation of property within the Fifth Amendment, and not taxation.

In subsequent cases, the validity of a retrospective tax provision has been held to depend upon whether the "retroactive application is so *harsh and oppressive* as to transgress the constitutional limitation".

In 1994 in *United States v Carlton* in respect of an amendment to the Internal Revenue Code with retrospective application to 1986, the Supreme Court held that the "harsh and oppressive" formulation did not "differ from the prohibition against arbitrary and irrational legislation". The Court stated, provided that the retrospective application "is supported by a legitimate legislative purpose furthered by *rational means*", the provision will be valid. Where is the line drawn? What is "harsh and oppressive" or "arbitrary and irrational legislation"? So, for example, can a government rationally exercise such a power and pass legislation when the effect is retrospective for 20 or 25 years? And does a different result follow if the retrospective legislation destroys or degrades long standing rights?

In *Carlton,* the amendment withdrew a tax benefit and cost the taxpayer more than $2 million in deductions and several hundred thousand dollars in transaction costs. The period of retroactivity was only about a year. Despite the cost to the taxpayer, the Court held the taxpayer's reasonable reliance did not foreclose Congress' ability to make a *prompt* retroactive adjustment to the law. But there was a kicker. Justice O'Connor, in a concurring opinion, expressed a concern that retroactivity periods much longer than a year would raise "serious constitutional questions".

Where the line might be drawn has been considered since *Carlton* by two State courts. In 2006, the Court of Appeals of Kentucky upheld an amendment which did not *withdraw* a provision upon which taxpayers relied, but sought to *clarify* a provision in the wake of a Supreme Court decision.

In 2010 the Supreme Court of Washington considered a legislative amendment with retrospective application of 24 years. The applicant argued the amendment violated "due process" under the Fifth Amendment. The tax authority contended the amendment it did not because the amendment enacted to "clarify" a 1985 statute made no change to the meaning of the former provision. The Court agreed with the taxpayer; the 24 year retroactivity clause violated due process. The Court stated that "the legislature may not apply a 'clarification' retrospectively for 24 years when it is in direct conflict with the reasonable expectations of qualifying taxpayers".]

The Fifth Amendment jurisprudence has been rejected in Australia. One reason given by Chief Justice Dixon was our inherited concept of the Diceyan supremacy of Parliament. That is, the overall sovereignty of Parliament permits retrospective legislation. That concept has never been a feature of United States constitutional norms. There are many who now take the view that the concept has ceased to exist - both here and in the United Kingdom - where both Parliaments are subject to a superior law. In Australia, that superior law is the *Constitution*.

The question for us is, I think, can, or should, the United States approach be adopted in Australia in relation to retrospective legislation purportedly passed in the exercise of the Commonwealth's taxing power? Perhaps the line may be drawn between legislative amendments which *withdraw* taxation benefits and provisions which simply seek to *clarify* an existing position; or between *long* and *short* periods of retrospectivity. Indeed, it may be the period of retrospectivity is more significant than the nature or purpose of the provision. There is arguably scope for such an approach. As Justice O'Connor said in *Carlton*:

> … the Court has never intimated that Congress possesses unlimited power to readjust rights and burdens ... and upset otherwise settled expectations. The governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in finality and repose.

Arbitrariness?

Finally, may I then turn to another limit on the exercise of the taxing power which may be a potential, if not real, issue when the Commonwealth enacts retrospective tax legislation and to which I said I would return; arbitrariness.

The Commonwealth's taxing power does not permit the Commonwealth to impose "arbitrary exactions". I am not dealing with contestable and incontestable taxes. Rather, the requirement that to be treated as a tax rather than an arbitrary exaction, not only must it be possible to point to the criteria by which the Parliament imposes the liability to pay tax, but also that the exaction must have "a sufficiently general application".

Or as the majority said in *MacCormick v Federal Commissioner of Taxation*:

> … Not only must it be possible to point to the criteria themselves, *but it must be possible to show that the way in which they are applied does not involve the imposition of liability in an arbitrary or capricious manner*.

The last limb, that the law must not involve the imposition of liability in an arbitrary or capricious manner, is not surprising. There are, I think, two related but distinct concepts. First, *regularity* as opposed to arbitrariness is central to the rule of law: "laws as rules of general application, capable of being known in advance by citizens who may exercise choice, and order their affairs, accordingly". On one view, a retrospective law may offend that central concept and be held to apply irregularly. A taxpayer entering into a transaction does not know how it will be taxed; the criteria are incapable of being known in advance by a citizen who can then exercise a choice and order its affairs accordingly. Why? Because the rules – the retrospective legislation – come *after* the taxpayer has legitimately ordered its affairs. At the time of ordering its affairs the taxpayer does not know and cannot know that the rules will change and, if so, when and how.

If the Commonwealth's position is taxpayers should order their affairs subject to the Commonwealth's overriding right to subsequently enact retrospective legislation at a time and of a kind of its choosing, then it will face scrutiny. And if that is not its stated position, but the practical outcome of it passing retrospective legislation, the result will be the same. The consequences (legal, economic and otherwise) are simply too important to the future of this country for them not to be scrutinised. And those consequences, in my view, are not avoided, but possibly exacerbated, by that "new" category of retrospective legislation – commencement from the date of the media release without indication of its terms or how it will operate.

The Asprey Committee identified three 'dominant' tests for a tax system; equity, simplicity and efficiency. I leave to one side simplicity and efficiency - they are I suspect a lost cause. "Equity" however extends, at the very least, to include two propositions - taxpayers in the same position should be treated equally and taxpayers in materially different positions should be treated differently. In *Bellinz Pty Ltd v Commissioner of Taxation*, the Court accepted without qualification that inequality of treatment of taxpayers is an aspect of unreasonableness of decision making. Why then is a law, a retrospective law, which by its express terms, treats taxpayers unequally, a law with respect to taxation?

"Imposition of liability in an arbitrary or capricious manner" has not been the subject of extensive consideration by the courts. That position may have changed. Retrospective laws that treat taxpayers differently depending on the way in which they legitimately ordered their affairs in the past may directly raise an element of arbitrariness. Taxpayers in the same position – namely, taxpayers who ordered their affairs legitimately in accordance with the existing laws at the time of the relevant events – are now treated differently *solely* because of the change in the applicable criteria as a result of the retrospective legislation. The question is whether that is legitimate?

Finally, I think it must be understood that the risk that retrospective laws treat taxpayers unequally, arbitrarily or irregularly, is not a risk simpliciter; it is a risk that substantially increases (and must substantially increase) the greater the period of retrospectivity.

Application in Australia?

I have not referred to, or commented on, any legislation passed by the Commonwealth Parliament or even foreshadowed by Government. That is deliberate. Any contrary position would be inappropriate.

Instead, what I have sought to do is to provoke thought and debate. Thought and debate about the way legislation purportedly enacted using the taxing power might be scrutinised. As I have said, scrutiny that is essential given the effects of the exercise by the Commonwealth of its taxing power are wide reaching and long term.

Retrospective legislation in the purported exercise of the Commonwealth's taxing power may well satisfy the "traditional" aspects of the "other necessary criteria" that I suspect the 6 justices in *Roy Morgan* may have had in mind. The question is whether it also satisfies other criteria. Whether *some further reason appears for excluding it*. Does it infringe the central elements of the rule of law, does it infringe the constitutional guarantee of s 51(xxxi), is it arbitrary, irregular and unequal? That list is not exhaustive.

In assessing whether the limits of the Commonwealth's taxing power have been reached, I suspect, like a mother responding to a child on a long car trip, my answer would be "what do you think is around the next corner?" When what I would really like to say to the driver is "where are we going again and why?"

Thank you.