COMMENTARY ON IMPLICATIONS OF THE PIPELINES CASE FOR STATE RESOURCE REVENUE

By Cheryl Saunders*

> Mr Shaw: . . . One can take the stand that duties of excise are a heterogeneous collection of unrelated duties which happen to be described by a name, which is simply the name of the bag in which they are put, and that if you open the bag you look in and you find a marble and a piece of stone and a bottle of wine, or something; or one can take the view . . .
> Gibbs C.J.: But that is not the *ratio* of *Hematite*.
> Mr Shaw: No, no. Or one can take the view that duties of excise describes a genus of duties which can logically be described . . .[1]

The paper written by Mr. Parker provides a clear and comprehensive analysis of the judgments in *Hematite Petroleum Pty. Ltd. v. State of Victoria.*[2] He identifies with precision the differences between the reasoning of the six justices who, as he says 'appear to split into four identifiable categories'. He draws together such majority views as exist on important issues. His paper shows, for example, that a majority no longer adheres to the criterion of liability test, and that the absence of a quantitative relationship between a tax and goods is a relevant, but no longer a determining, factor in deciding whether the tax is a duty of excise, at any rate when it is imposed at the point of production. Similarly, he demonstrates majority support for the view that a duty of excise must be identified by reference to the substance or practical effect of an impost, although that same majority does not agree on what the essential characteristics of an excise duty are.

The paper also deals well with the difficult question of the significance of the *Hematite* decision for a range of other State taxes and charges. The discussion of whether the business franchise licences would survive challenge has, of course, been overtaken since by the decision of the High Court in *Evda Nominees v. State of Victoria*[3] not even to hear argument urging a departure from earlier cases where a licensing scheme is indistinguishable from the one upheld in *Dennis Hotels.*[4] The paper foreshadows both the challenge and the outcome, however. The challenge was almost inevitable in view of the comments about licence fees in *Hematite* by several of the justices, particularly Mason J.[5] Its rejection was likely, on the assumption that Murphy J., despite his characterization of the *Dennis Hotels* line of cases as 'a blot on our constitutional jurisprudence'[6] would not join a majority to invalidate a business franchise fee unless it were imposed at the stage of production or manufacture. Although the

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1 Exchange between counsel for the plaintiffs and the Bench during the hearing of *Evda Nominees Pty. Ltd. v. Victoria, Transcript of Proceedings*, 3 April 1984, p. 17.
2 (1983) 47 A.L.R. 641.
3 (1984) 58 A.L.J.R. 307.
4 *Dennis Hotels Pty. Ltd. v. Victoria* (1960) 104 C.L.R. 529.
5 (1983) 47 ALR 641, 659, 661.
6 (1983) 47 ALR 641, 666.
7 *Financial Review*, 4 April 1984.

Financial Review was guilty of considerable overstatement in describing the result of *Evda Nominees* as 'State tax open go' and 'High Court unanimously grants a blank cheque'[7] there is no doubt that the decision provided welcome confirmation of what had hitherto been speculation, that *Hematite* did not necessarily threaten the validity of business franchise fees.

Some general observations about the methodology and role of the High Court in excise duty cases, as exemplified by *Hematite*, are suggested by the discussion in the paper.

The first concerns the explicit reliance by individual justices on factors other than those traditionally used by courts; in particular, on assumptions about the historical purpose of section 90 and the economic effects of the tax. Mason J., for example, stated that the purpose of section 90 was to invest the Commonwealth with 'a real control over the taxation of commodities'.[8] Gibbs C.J., on the other hand, identified its purpose as to do no more than to give the Commonwealth 'a real control of its tariff policy'.[9] Deane J. described it as necessary 'for ensuring that the people of the Commonwealth were guaranteed equality as regards the customs and excise duties which they were required to bear'.[10] Each of these justices attached substantive consequences to their very different views about the historical purpose of section 90. There was virtually no argument on the history of section 90 during the hearing of the case. If it had been considered relevant to hear argument, it would have been possible for the Court to identify the framers' views of the purpose of the section more precisely and accurately. Some of the judgments give the impression, in fact, that the propositions advanced were intended to represent not so much the actual historical purpose of section 90 but the purpose which it ought to serve. The appropriate division of fiscal and economic power between the Commonwealth and the States is a matter on which debate is both necessary and desirable, but it is questionable whether it is an issue which ought to influence the outcome of a case before the High Court, particularly in the absence of extended argument.

Assumptions about the economic consequence of the tax played a less obvious, but nevertheless important, role in some of the judgments. Thus Mason J., having suggested that a test for determining whether a tax is upon goods and therefore an excise duty is to ascertain whether it enters into the cost of the goods, supported his conclusion that the pipeline fee was an excise duty on the ground that it was 'so large that it will eventually increase the price of the products in the course of distribution to the consumer'.[11] Deane J., appeared to take a similar view in describing the pipeline fee as an 'indirect tax'.[12] Yet no assertion to this effect appeared in the pleadings, and the conclusion which Mason J. reached may have been wrong. The fact that the fee in this instance would not enter into the ultimate price of the goods was reported to be one of its attractions for the

8 (1983) 47 ALR 641, 660-1.
9 (1983) 47 ALR 641, 648.
10 (1983) 47 ALR 641, 685.
11 (1983) 47 ALR 641, 663.
12 (1983) 47 ALR 641, 691.

Victorian government and one of its less desirable features from the standpoint of the companies.

The second general observation highlights the problem of judicial review in cases of this kind. The task of constitutional interpretation is inevitably a sensitive one, involving the possibility of the High Court, representing one arm of government, invalidating action taken by elected parliaments or governments of the Commonwealth or the States. The sensitivity of the issue is heightened, in both a theoretical and practical sense, when the Court is asked to decide the validity of taxation legislation. It is heightened theoretically by the importance of taxation to a government's ability to govern and its relationship to parliament: in other words, by the place which the power of taxation occupies in a system of responsible government. It is heightened practically by the length and complexity of the annual budget process and the interdependence of the various budget measures.

The *Hematite* case provides an illustration of how conflict can occur between the function of the court and the needs of government without producing any obvious benefit. It was argued in September 1982, one week before the Victorian budget 1982-83 was introduced. At issue was the validity of a tax which had yielded $30 million in the previous year, was about to be doubled in the forthcoming budget, and was estimated to yield $66.4 million in 1982-83. That amount was equal to approximately 2.7% of the revenue estimated to be raised by State taxation in Victoria during 1982-83. The decision of the High Court was handed down almost eleven months later, on 5 August 1983, six weeks before the Victorian budget for 1983-84 was introduced. On the face of it, it deprived the State, at that very late stage in its fiscal year, of $100 million, comprising pipeline fees to be repaid and pipeline fees foregone in the coming financial year. The impact on the State budget was, of course, considerable.

In addition and even more seriously, however, the case offered little clear guidance for the future. The constitutional definition of excise duty has always been notorious for lack of accepted principles, but such principles as had achieved a measure of acceptance were rejected in *Hematite*. The majority justices who held the tax invalid were divided in their reasoning. The new emphasis on substance, the abandonment of the need for a quantitative relationship between the tax and the goods, and various incidental statements in the judgments made new challenges to other State taxes likely and their outcome difficult to predict. Such a situation is inefficient, to say the least, in terms of fiscal management and planning.

To make these observations is not necessarily to criticize the High Court. No doubt some of the less desirable features of *Hematite* could have been avoided if the Court had handed down its decision more quickly or if there had been a greater degree of consensus between the justices. The problem, however, may be the more fundamental one of leaving such matters to be determined solely in the judicial arena in the first place. The concept of excise duties has not proved susceptible of satisfactory judicial definition. There do not appear to be convincing reasons why excise duties should be exclusive to the Commonwealth, thus attracting the problems of judicial review. Apart from customs duties, all other forms of taxation are available

to both the Commonwealth and the States. Their effective distribution between the various governments is determined by political and economic forces. The result has not been particularly satisfactory, but it is unlikely that it would have been any better if the Constitution had assigned specific taxes to one level of government or the other. This is one aspect of federal government in which flexibility is necessary, coupled with a genuine desire to make the system work. The attraction of dealing with the constitutional problem of excise duties by removing them from section 90 has become more obvious since *Hematite*. More compelling still, however, is the argument for a fiscal compact between the Commonwealth and the States to deal with matters of this kind, based on an enabling provision in the Constitution.[13]

Parker makes one point in his paper with which I should like to take issue. It is that the decision in *Hematite* was not surprising and has no necessary implications for other State taxes, because of the 'extraordinary statutory and factual setting of the case'. This is a view which I have heard expressed by a number of people since the decision was handed down, although before the event very few of them thought that the pipeline licence fee would be held to be an excise duty. The proposition therefore needs further examination.

Each member of the majority identified the characteristics of this tax which suggested that it was, in substance, an excise duty. Those on which most emphasis was placed were that these particular pipelines, which carried all the Bass Strait hydrocarbons, were singled out by reference to their licence numbers as subject to the tax; the dual licence and permit system established by the legislation; the size of the tax; and the fact that it was payable before an essential step in production could take place. While the legislative scheme admittedly was both unusual and cumbersome, which gave rise to the suspicion that it was a device to avoid section 90, that it is not a sufficient ground alone on which to invalidate a tax. Other grounds must lie in the characteristics identified, singly, or in combination.

One should be dismissed at once. Although the dual licence and permit system presented an odd appearance, it was the result of an historical accident in the development of mining administration in Victoria, rather than of anything more devious. The fact that the tax was imposed before the production stage was completed, on the other hand, was clearly crucial. It enabled Murphy J. to conclude that the tax discriminated against production in the State and thus automatically was a duty of excise. For the other members of the majority it reduced the significance of the absence of a quantitative relationship between the tax and the goods and in that sense made it easier for the tax to be identified as an excise duty. Many State taxes, however, are imposed at the point of production. Land tax, payroll tax and stamp duties are examples. They are not necessarily payable before production or an essential step in production can take place, but that feature of the pipeline licence fee was not integral to the scheme. It was included, presumably, to ensure that the tax was paid promptly. Although it is a relevant characteristic, therefore, the fact that the tax was held to be payable at the point of production cannot stand alone.

13 See Mathews R., in *A Fractured Federation? Australia in the 1980s* (1982).

The only other characteristics on which emphasis was placed were the singling out of these three pipelines and the size of the tax. The potential significance of the former is evident from Parker's paper: it is a factor that inevitably will influence the incidence of State taxes in the future. Yet it is a peculiarly subjective test, in this context. In order to 'single out' or 'discriminate against' a commodity it is necessary first to determine the genus of which the commodity constitutes a part. The genus adopted by the majority in *Hematite* was pipelines. Trunk pipelines are, however, a category of pipelines known and understood in the trade. If trunk pipelines were identified as the genus, the argument based on singling out or discrimination would disappear, because all the trunk pipelines in Victoria were subjected to the new rate of tax. They were made so subject by reference to their licence numbers rather than to their identification as trunk pipelines: a difference surely that is one of form, rather than substance. Ironically, the legislation was framed in that way to make it less, rather than more, likely that the pipeline licence fee was an excise duty.

The only remaining characteristic is the size of the pipeline fee. Certainly, it was abnormally large. This clearly influenced the decision, not only that the fee was a tax, but that the tax was an excise, if only by enabling an assumption to be made that there must be a connection between the tax and the goods. This must be considered an unsatisfactory ground on which to reach such a conclusion. The size of a tax is a classic example of a decision for the legislature and the executive, not for the courts. The remedy against such a decision, as we have been told in other contexts, lies in the ballot box, not in the judicial process. If the size of a tax is taken as an indication—virtually the sole indication—of a link between the tax and the goods, what is the cut-off point? Ten million dollars obviously is too high. Forty dollars per kilometre, by inference, is acceptable, although whether at that point the impost is a fee for service or a tax is not clear. What is the point between those two extremes where the licence fee on trunk pipelines turns into an excise duty?

I still think, therefore, that the result in *Hematite* was unexpected and could not easily have been predicted. Its implications for other State taxes are considerable, partly because of this very unpredictability. Leaving aside the problems caused by the absence of majority agreement on the principles to be applied in excise duty cases, an additional element of uncertainty has now been injected into the matter by the need to decide whether the conjunction of these disparate characteristics in a taxing scheme is such as to render the tax, in substance, an excise duty.

Two final observations should be made, both of which relate to the future development of principles of constitutional interpretation in Australia.

The first reverts to the concept of discrimination. It is used in three distinct ways in *Hematite* itself. One has already been mentioned: the fact that on one view the pipeline fee discriminated against these three pipelines influenced some members of the majority in their decision that the fee was an excise duty. Secondly, the term is used by Murphy J. to identify a tax as an excise duty where it discriminates against production or manufacture in the taxing State, a result that will always occur where the tax is imposed at

the point of manufacture or production but may occur in other circumstances as well. Thirdly, the significance of discrimination, or the lack of it, is evoked in the judgment of Deane J., where he identifies the purpose of section 90 as to ensure that the people of one State would not be 'disadvantaged . . . by the burden of higher customs or excise duties', or 'that the people of the Commonwealth were guaranteed equality as regards the customs and excise duties which they were required to bear'.[14] Thus whereas Murphy J. views discrimination from the perspective of the producer or manufacturer, Deane J. views it from the perspective of the people of the State who bear the tax. The difference is potentially important.

The Constitution itself makes reference to discrimination. The Commonwealth's taxation power, section 51(ii), is qualified by a prohibition against discrimination between States or parts of States. The theme is picked up again in section 99 which forbids the Commonwealth to give preference to one State or any part thereof over another State or any part thereof 'by any law or regulation of trade, commerce or revenue'. Until now, these requirements have been interpreted restrictively by the High Court. They have not been applied to a case where the inequality is the result of a section 96 grant. The existence of a preference is tested by reference to the provisions of the legislation rather than to their practical effect. The new emphasis on discrimination that has emerged in recent decisions of the High Court, however, suggests that these provisions may be revitalized. In particular if the approach of Deane J. were accepted, logic would appear to demand lack of discrimination in grants legislation, particularly where the distribution of tax sharing grants is concerned.

The second line of thought about possible future developments is related to the first. It concerns the importance attached to the 'substance' of the tax in *Hematite.* The dichotomy between form and substance has been familiar in Australian constitutional law since the early years of federation, but the search for substance usually has involved analysis of the legal effect of the legislation rather than its indirect practical consequences. The way in which the concept of substance is used in *Hematite* probably has a parallel only in the section 92 cases.

The difficulty of extracting clear guidance for the future from the majority judgments is primarily attributable to the emphasis placed on substance. It is a difficulty which Stephen J. expressly sought to avoid in *H.C. Sleigh v. South Australia.*[15] Commenting on the argument that the *Dennis Hotels* doctrine was 'merely artificial and destructive of clear constitutional intent' he said:

> So to submit is to assume that the exclusive nature of the federal Parliament's power to impose duties of excise can readily and with accuracy be explained by reference to constitutional purpose or historical reasons, that purpose or those reasons providing a reliable guide to the identification of the precise field of revenue-raising from which the States are to be excluded. Yet experience in the past suggests that neither source offers certain guidance and that it is, instead, to the meaning of "duties of excise" that attention must be directed if the extent of the area immune from State exaction is to be discovered . . . since s.90 denies to the States only these imposts of a particular character, it is to be expected that imposts especially designed so as to lack that

14 (1983) 47 ALR 641, 684, 685.
15 (1977) 136 CLR 475, 497.

> character will be resorted to: this is no more than the consequence of delimiting legislative capacity by reference to a particular class of impost identifiable by particular characteristics.

This eminently practical view having been rejected, it is now clear that the question whether a tax is an excise duty must be determined according to its substance. To what other areas of constitutional interpretation will the new test be extended? The question whether a law gives a preference to a State contrary to section 99 is an obvious candidate, but the potential for extension is much greater. Even the uniform tax scheme might not have withstood judicial scrutiny if the Court had been concerned with questions of substance.