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Mr John Gallagher
The Treasury
Langdon Cres
PARKES ACT 2600

Australian Government Solicitor
50 Blackall Street Barton ACT 2600
Locked Bag 7246 Canberra Mail Centre ACT 2610
T 02 6253 7000 DX 5678 Canberra
www.ags.gov.au

Canberra
Sydney
Melbourne
Brisbane
Perth
Adelaide
Hobart
Darwin

Dear Mr Gallagher

_____ s 42 exemption

SUMMARY OF ADVICE

2. In our view, there are no significant issues raised by the proposal to implement an RRT which would make the proposal infeasible. In particular, we do not think the RRT would be a law with respect to taxation which discriminates between States for the purposes of s 51(ii) of the Constitution.

_____ s 42 exemption

— S 42 exemption

BACKGROUND

6. The background to this matter, as set out in your tasking statement, is as follows.
7. In May 2008 the Government commissioned a panel chaired by the Treasury Secretary, Dr Ken Henry, to undertake a review (the AFTS Review) of the entire tax and transfer system at both Commonwealth and State level. The panel will provide its final report to the Government at the end of this year. The Treasury has provided secretariat services for the review assisting the panel in its deliberations and in the drafting of various public consultation documents and the final report.

— S 42 exemption

9. The AFTS review secretariat has nominally identified one recommendation that appears to raise constitutional issues and you seek formal advice on this issue which is set out below.

— S 42 exemption

Possible recommendation on a uniform resource rent tax

10. Consideration is being given to a Commonwealth imposed RRT. The RRT would be similar in form to a profits based tax (such as the Commonwealth's income tax) but with the normal return on an investment effectively not subject to tax. This latter feature aligns the RRT with the Commonwealth's Petroleum Resource Rent Tax (PRRT), though the latter is a cash flow profits based tax. The proposed RRT model is commonly referred to as a cash flow equivalent profits based tax.

11. The RRT would replace the royalty regimes of the states and territories. Subject to a limited number of exceptions, most notably the Northern Territory's 10 per cent profit based royalty, these regimes are output based (*ad valorem* or volumetric).

12.

— S 42 exemption

13. The Review Panel's consultation paper contains a broad description of a cash flow equivalent tax at Appendix E. An allowance for corporate capital tax differs from an allowance for corporate equity tax in that the tax value of assets is substituted for the value of equity.

— S 42 exemption

REASONS FOR ADVICE

Resource rent tax

15. You asked us to consider whether the proposed RRT raises any constitutional issues.
16. A tax on profits from selling resources needs to be supported by a Commonwealth head of legislative power. There is no Commonwealth power to legislate generally in relation to resources of any kind, but there is a power to make laws with respect to 'taxation; but so as not to discriminate between States or parts of States' in s 51(ii).
17. It is well established that a law which operates directly on, or within, the subject of taxation has the character of a law 'with respect to' taxation. There is no doubt that a law setting out the circumstances in which a person is liable to pay a tax is a law with respect to taxation. A law which has such a direct connection with the subject matter of taxation is sometimes referred to as being made in reliance on the 'central' aspect of the taxation power.
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18. The proposed RRT would be a law which prescribed the circumstances in which a taxpayer was required to pay tax, by making tax payable and certain deductions available in relation to particular activities/transactions (selling of resources), and calculated by reference to profit. This appears to us to be clearly within the scope of the taxation power.

19. In relation to the full offset proposed to be provided, where a tax offset reduces the RRT payable by an entity on the relevant project or other future commonly owned resource projects, in our view it will clearly be supported by the taxation power. We note that it is immaterial for constitutional purposes that the amount of the reduction of a person's liability in respect of one tax is calculated by reference to that person's liability in respect of another tax.

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Limitations on the taxation power

Discrimination and preference

27. There is an express limitation in s 51(ii) on the Parliament's power to enact laws relating to taxation, and that is that the Parliament cannot enact tax laws which discriminate between States or parts of States. That is, a legislative tax scheme

⁵ French CJ at [9], Gummow, Crennan and Bell JJ at [226].

cannot treat one State (or part of a State) differently from another State (or part of a State).

28. There is also a related prohibition in s 99 of the Constitution, which provides that the Commonwealth may not 'by any law or regulation of trade, commerce, or revenue' give 'preference to one State or any part thereof over another State or any part thereof'. A law of revenue for the purposes of s 99 includes, but is not limited to, a taxation law.⁶ A 'preference' for the purposes of s 99 involves geographically based discrimination that also confers 'some tangible advantage obtained in the course of trading or commercial operations, or some material or sensible benefit of a commercial trading character'.⁷ However, while 'preference' in s 99 necessarily involves discrimination between the States, 'discrimination' does not necessarily involve preference.⁸ Therefore, if it can be concluded that a law does not discriminate, it is not necessary to go on and consider whether it gives preference.
29. In *Permanent Trustee Australia Limited v Commissioner of State Revenue (Victoria)*⁹, the High Court confirmed that in constitutional contexts, discrimination involves 'the unequal treatment of equals or the equal treatment of those who are not equals, where the differential treatment and unequal outcome is not the product of a distinction which is appropriate and adapted to the attainment of a proper objective'.
30. The High Court has tended to focus on form rather than substance in relation to the limitation in s 51(ii). In particular, where the rate of a tax is equal regardless of the State in which it applies, but the practical effect of the tax is that one State bears a greater burden than another because it has a greater occurrence of the taxable event, this is not discrimination for the purposes of s 51(ii).¹⁰
31. In the present context, the tax would apply equally at equal rates, wherever resources are located. We understand that, as a practical matter, the range of resources to which the tax would relate are located across the country in all States, even if some States are likely to be more resource heavy than others. Given that the tax would apply in all States and there would be no difference in the amount paid regardless of where the resources were located, it seems to us unlikely that there is any risk that the tax would discriminate between the States (or give preference to one State or another) for the purposes of s 51(ii) or s 99.
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