— 542 exemption

S 42 exemption

***Constitutional issues with the RSPT***

6. You asked us to consider whether there are any constitutional problems with the proposal to introduce a tax credit/refund based on royalties paid to States, which can offset the RSPT liability.

7. In our view, there is a risk that this proposal, specifically the proposal to cap the amount of refund available based on the State in which the expenditure was incurred, constitutes discrimination between States for the purposes of s 51(ii) of the Constitution, and a preference between States for the purposes of s 99 of the Constitution. To avoid this risk, one possibility would be to impose a cap on the total refund/credit which is consistent across all States.

8. We note that it is not clear from the proposal whether it is contemplated that the refund/credit may only be used to offset taxation liabilities. If it is possible for the refund/credit to reduce a person's tax liability below zero (so that the Commissioner would be paying an amount to the person), we do not think this would be supported by the taxation power in s 51(ii) of the Constitution.

**BACKGROUND**

S42 exemption

10. In May 2008 the Government commissioned a panel chaired by the Treasury Secretary, Dr Ken Henry, to undertake a review (the Henry Review) of the entire tax and transfer system at both the Commonwealth and State level. The final report (the Report), containing recommendations to the Government on possible reforms to the tax and transfer system, was handed to the Government in December 2009. The Government is yet to publicly respond to the recommendations contained in the Report.

11. The Report recommends the introduction of a resource super profits tax (RSPT) that could apply to profits made by private producers from engaging in the exploitation of non-renewable resources.

S42 exemption

— S42 exemption

***Constitutional issues with the RSPT***

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**Issue 3: refunding State royalties to companies**

21. As part of the implementation of the RSPT, it is proposed that State and Territory royalty regimes would continue, at least for a transitional period. Entities would be

3 The Office of International Law (OIL) in the Attorney-General's Department has advised that they assume, when drafting the FTAs, that the FTAs will be interpreted consistently with international law, and that guidance can also be gained from Investor State Dispute settlement case law dealing with expropriation.

liable for both the RPST and the State taxes, but it is proposed that entities would receive a Commonwealth tax credit or refund for the royalties they pay under State regimes during this transitional period. This tax credit or refund will be used by entities to reduce their Commonwealth RSPT tax liability.

22. Royalty rates are different in each of the States and Territories and apply at different rates for different resources. You have provided us with a table outlining the royalty rates of each of the States and Territories at present. The amount of the tax credits would be capped to reflect the royalty rates applicable at the time of announcement; royalty rates as announced by State and Territory Governments at the time of announcement; or such rate as agreed to by the Commonwealth and the relevant State. That is, even if State royalty rates increase in the future, the amount of the refund available will be a maximum of the amount that would have been payable at the time of announcement.

23. As a result, the tax credit or refund provided to entities will vary, not only between entities, but also between States. That is, an entity will receive more of a tax credit or refund in relation to the royalties it has paid to one State over another State if the first States' royalty rates are higher for the resource the entity extracts.

24. You seek an opinion on whether refunding or crediting State royalties in this way raises any constitutional issues.

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## Issue 3: Refunding State royalties to companies

***Discrimination and preference***

50. As discussed in our advice of 9 December 2009 (our ref 09083409), the Commonwealth's power to enact laws relating to taxation is subject to an express limitation in s 51(ii); namely, that the Parliament cannot enact tax laws which discriminate between States or parts of States. A legislative tax scheme cannot treat one State (or part of a State) differently from another State (or part of a State). Section 99 of the Constitution also provides that the Commonwealth may not 'by any law or regulation of trade, commerce, or revenue' (including a taxation law[10]) give 'preference to one State or any part thereof over another State or any part thereof'. The proposed laws introducing the RSPT and associated tax credit/refund would be a law with respect to taxation, and may not, therefore, discriminate between States or parts of States for the purposes of s 51(ii). It would also be a law of 'revenue' for the purposes of s 99, and may not, therefore, give preference to one State or any part thereof, over any other State or any part thereof.

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9 The unitisation of such straddling deposits is required by Article 9 of the Timor Sea Treaty.

10 *Permanent Trustee Australia Limited v Commissioner of State Revenue (Victoria)* (2004) 220 CLR 388 at [83] - [84].

51. While ss 51(ii) and 99 refer to discrimination or preference between States or parts of States, there are *dicta* supporting the view that s 99 binds Territory legislatures (*Capital Duplicators v Australian Capital Territory (No. 1)*[11]). It appears to follow that s 99 also binds the Commonwealth in so far as it is legislating in relation to the Territories, either under s 51(i) or some other power, including the Territories power, if the law can be characterised as a law or regulation of trade or commerce. It also appears to follow that laws made under s 51(ii) (the taxation power) cannot discriminate between States and Territories or between parts of Territories.[12]

52. We concluded in our previous advice that there was no discrimination involved in the proposed RRT, given that the tax, as described, would apply equally at equal rates, wherever resources are located.

53. However, where it is proposed to offer a tax credit or refund to offset the RSPT, and the amount of this offset or refund will be based on State royalty regimes, and will vary between States, it is necessary to reconsider the discrimination/preference question. As noted in our previous advice, the threshold question is whether the law entails discrimination between States; if there is no discrimination, there is no preference for s 99 purposes.

54. In *Permanent Trustee Australia Limited v Commissioner of State Revenue (Victoria)*[13], the High Court confirmed that the concept of 'discrimination', as used in constitutional contexts including ss 51(ii) and 99, requires a Commonwealth law to 'discriminate against' a State or States. Discrimination might involve 'the unequal treatment of equals or the equal treatment of those who are unequals, where the differential treatment and unequal outcome is not the product of a distinction that is appropriate and adapted to the attainment of a proper objective'[14].

55. The High Court has not elaborated on the concept of a 'proper objective' in this context, or the degree of fit required for a particular distinction to be regarded as 'appropriate and adapted' to the attainment of such an objective. The present Solicitor-General has recently advised that it is reasonable to work on the hypothesis that a 'proper objective' must be one that is competitively neutral as between States and parts of States and that the differential treatment is reasonably necessary to attain the objective. Thus, a proper objective may be the accommodation of particular circumstances existing in particular States or parts of States, including State-based legislative regimes.

56. We note that in early caselaw on s 51(ii) and s 99, it had been held that there will be no discrimination in the relevant sense if the Commonwealth law applies generally

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11 (1992) 177 CLR 248, 276-277.

12 For simplicity, for the remainder of this advice, we have referred only to discrimination between States, but this should be read as including discrimination between Territories or between a State and a Territory.

13 (2004) 220 CLR 388 at [89].

14 At [88] - [90].

throughout Australia but, by reason of the circumstances in one or more States, it does not operate uniformly in all places. As Starkè J explains in *Cameron v Deputy Commissioner of Taxation*[15]:

> A law ... applicable to all States and parts of States alike does not infringe the Constitution merely because it operates unequally in the different States - not from anything done by the law-making authority, but on account of the inequality of conditions obtaining in the respective States.[16]

57. Under this view, a Commonwealth law to which s 99 or s 51(ii) applies might not, in its terms, discriminate between States, but the underlying facts in the States nevertheless may have the effect of discriminating between States[17].

58. However, it appears that, in *Permanent Trustee*, the High Court has moved away from the approach taken in the earlier cases and now favours an approach to interpreting s 99 (and, by extension, s 51(ii)) that focuses more closely on the *effect* of the Commonwealth law in question, rather than merely on the way in which it is expressed to operate. This approach is consistent with the Court's recent tendency to interpret constitutional guarantees less formalistically than in the past, so as to ensure that those guarantees are not 'circumvented by mere drafting devices' (see, for example, *Ha v New South Wales*[18]).

59. In the present circumstances, although the RSPT would be imposed consistently across States, the associated tax credit or refund would be available to persons who have paid royalties to a State or Territory, and would vary according to State-specific determined levels. On its face, this appears to be discriminatory, because a person mining a resource in one State could receive a different tax refund/credit than a person mining the same resource in another State.

60. If the refund/credit available were not capped by reference to State, but merely related to the total amount of royalties paid (to any State), we think there would be a reasonable argument that there is no discrimination for constitutional purposes. The actual operation of the taxation law would be consistent across States, irrespective of a taxpayer's residence or the place it did its business, and the level of the refund available would be based on particular identified expenditure that it incurred; i.e. actual amounts of royalties paid by the taxpayer to a particular State under a royalty regime. The amount of the refund received would be directly and solely tied to expenses incurred by a taxpayer, and not to the location of the taxpayer or the taxpayer's operations. While, in practice, the actual expenditure incurred will have varied by reference to the location of the mining operations, the amount of the

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15 (1923) 32 CLR 68 at 79.

16 For other examples of this view, see *WR Moran Pty Ltd v Deputy Commissioner of Taxation* (1940) 63 CLR 338 at 347-348, and *Conroy v Carter* (1968) 118 CLR 90 at 101.

17 For a recent endorsement of this interpretation of 'discrimination', see *Austin v Commonwealth* (2003) 185 at [117].

18 (1997) 189 CLR 465.

refund would still be tied to the expenses incurred and not to the State in which they were incurred.

61. However, the legislation will also establish a cap on the claim of these expenses which will apply irrespective of the actual amount of expenditure incurred, and which is based on the State rates at the time of announcement. This can have the result of discriminating against persons on the basis of the State in which they conduct their mining operations. For example, NSW and QLD currently have the same royalty rate for granite/sandstone ($0.50/tonne). If these rates remain constant after the introduction of the RSPT, two taxpayers who extract granite in NSW and QLD respectively will incur royalties in the relevant State, and will receive a refund on the full amounts paid which can be applied against the RSPT. There will be no apparent discrimination in those circumstances, because the amount of the refund is directly tied to expenditure incurred by the taxpayer and is an equal amount in any case. However, if NSW increased its rates to $0.75/tonne six months after the introduction of the RSPT, then the taxpayer operating in NSW will have incurred a greater expense than the taxpayer in QLD, but will receive the same rate of credit/refund, merely by reference to the legislative caps which are State based.

62. Accordingly, under the more substance-based view that we consider the High Court is more likely to follow, we think there is potential discrimination between States in the operation of the proposed law for s 51(ii) and s 99 purposes.

63. Given this, it then needs to be ascertained whether the unequal outcomes are 'the product of a distinction which is appropriate and adapted to the attainment of a proper objective' within the meaning of *Permanent Trustee.* The Solicitor-General's opinion is that the differential treatment must be reasonably necessary to attain the objective (as opposed to requiring that pursuing the objective itself is reasonably necessary).

64. In a broad sense, the different treatment between States, in the sense of providing different refunds based on royalty rates, is a necessary discrimination in order to achieve competitive neutrality. That is, to the extent that the amount of refund available differs between States, it is directed to ensuring that the effect of the different tax rates is neutralised to the extent possible. The legislation is intended to provide these credits/refunds in order to neutralise the effect of the double taxation and to ensure that any taxpayer mining anywhere in the country finishes in the same tax position, regardless of the State in which they conduct their operations. The law, while providing for different benefits for mining operators in different States, would be 'competitively neutral' in the sense that it was designed to ensure equal outcomes, in terms of total tax paid in relation to the extraction of minerals, for all Australian taxpayers. In our view, this purpose is likely to be a proper objective, since it relates to the accommodation of different State-based legislative regimes.

65. However, the law sets a different cap on the refund amount available in relation to each State which is fixed at a particular point in time. This aspect of the proposal is

not directed at the objective of accommodating different State legislative schemes and providing consistency for taxpayers across the country. Rather, this is presumably included for administrative simplicity, and to ensure a degree of certainty about the total cost of refunds to the Commonwealth. If no cap at all were provided, States could continue to raise their royalty rates up to the amount of the RSPT to increase their proportional share of the total tax payable by a particular taxpayer, or even above the rate of the RSPT, so that the Commonwealth could potentially be left in a negative net position. It might therefore be possible to argue that the cap is merely incidental to the broader goal, and is a reasonably necessary feature to administer the law. We think that a *general* cap on the amount of refund available would fall into this category (that is, a cap which is consistent across all States; see the discussion below).

66. However, in our view, there is a risk that a court would find that a cap which is based on State locality is not only not reasonably necessary to achieve a proper objective, but actively works against that objective in the sense of allowing the overall national consistency to be lost over time. For this reason, we consider there is a risk that a court would find that the law discriminated between States for the purposes of s 51(ii), and was therefore outside the scope of the taxation power. It follows that it would also be possible to argue that, to the extent that the law in effect permitted a mining operator to receive a more favourable tax treatment in one State over another, it constitutes a preference for s 99 purposes.

67. While the State royalty rates remain at the same level as at the date of announcement, the practical risk of challenge on the grounds of discrimination is probably low, since taxpayers will all effectively be in the same position regardless of the location of their mining operations. However, this risk will become greater if State rates increase and taxpayers are effectively required to pay that difference. We note that some taxpayers may well extract minerals in multiple States and will therefore be conscious of the differences. As noted above, in the event of a challenge, we think there is a risk that a court would find that the law constitutes a discrimination between States that is not reasonably necessary in order to achieve the objective of consistency across States.

***Suggested changes to the proposal***

68. It would be possible to revise the proposal to avoid the risk that the law could be held to be invalid on s 51(ii) or s 99 grounds. Specifically, as noted above, we do not consider that there would be a risk that the law would be invalid if it did not include a cap on the refund/credit which discriminated between States.

69. For example, the law could provide that the amount of the refund/credit is the lower of the royalty amount paid to a State and an amount determined by reference to a formula in the legislation. That formula might be based on a percentage of the RSPT liability itself, or some other amount determined by reference to the profits earned from the mineral. You may wish to determine a formula which is based on the highest royalty rate payable under any of the State regimes as at the time of

announcement. In our view, provided that the same cap applies to refunds/credits regardless of the State to which the royalty was paid, this will not raise any discrimination issues.

***Pape considerations***

70. In our previous advice we discussed the issues arising from the decision in *Pape v Commissioner of Taxation*[19], in which the High Court found that the taxation power in s 51(ii) would not support a law which required the payment of an amount in excess of tax liability.[20]

71. It is not clear from the description of the refund/credit in the instructions whether or not it is contemplated that a taxpayer could be paid an amount by the Commissioner if it was in a position of tax loss, or whether the amount of the refund/credit can only be applied against tax liabilities (including or limited to the RSPT). To the extent that the refund/credit can only be applied against tax liabilities, we think it is clear that the law establishing it will be a law with respect to taxation, because it will be a law reducing liability to pay tax.

72. However, our comments regarding refundable tax offsets in the previous advice (see paras 20-21 of that advice) would equally apply to this proposal if it is contemplated that the amount could reduce the income tax of a person to 'below zero', and result in the Commonwealth, through the Commissioner, paying a 'refund' to the taxpayer. Accordingly, to the extent that the law permitted such an amount to be paid to a taxpayer, it would have to be made in reliance on another constitutional power. We are happy to advise further on this issue, if you would like.

— S42 exemption

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— S 22 exemption