THE HIDDEN POWER OF TAXATION: HOW THE HIGH COURT HAS ENABLED PUNITIVE LEGISLATION TO BYPASS THE SENATE

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Commonwealth fiscal legislation is constrained by s 53 of the Constitution*, which stipulates that a taxation Act cannot operate as a penalty. The purpose of this restriction is to limit the legislation which the House of Representatives can pass without Senate review. However, the courts have persistently given the term 'tax' such a broad definition that legislation which appears to operate punitively, both on its face and in practice, has been declared valid. This article provides an extensive review of the major High Court cases which discuss the distinction between a tax and a penalty. This analysis demonstrates that by declaring punitive legislation valid as taxing Acts, the House of Representatives is able to bypass review by the Senate.*

1. INTRODUCTION

This article is an examination of the paradox that lies hidden at the heart of the High Court's approach to the parliamentary power of taxation. Section 51(2) of the *Constitution* grants the Commonwealth Parliament the power to pass laws with respect to 'taxation; but so as not to discriminate between States or parts of States'. In interpreting this power, the courts have developed a set of positive and negative criteria that every taxation Act must satisfy. The positive criteria require that a tax be 'a compulsory exaction of money by a public authority for public purposes, enforceable by law'.[1] The negative criteria, imposed by s 53 of the *Constitution*, prescribe that 'a proposed law shall not be taken to appropriate revenue or moneys, or

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[1] *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263, 276 (Latham CJ).

to impose taxation, by reason only of its containing provisions for the *imposition or appropriation of fines or other pecuniary penalties*, or for the demand or payment or appropriation of fees for licences, or fees for services under the proposed law.'[2]

The requirement that an exaction not impose a penalty has been relied upon when taxation Acts are constitutionally challenged. Whilst these challenges have generated judicial discussion of the distinction between a tax and a penalty, legal scholars have largely limited themselves to analysing the positive criteria of a tax.[3] However, the decision in *Australian Tape Manufacturers Association Ltd v Commonwealth*[4] suggests not only that a tax is valid even if it is not paid to a public authority,[5] but also that the 'public purpose' element can be satisfied by the legislature identifying a public interest.[6] This has simplified the positive limb to the extent that a valid tax must only be a compulsory exaction under law.[7] Thus, cases following *Tape Manufacturers* are more likely to focus on the negative criteria and, in particular, the question of a penalty.

By tracing the fundamental cases which developed the notion of a penalty, it is clear that the High Court has persistently applied the principles of literalism when characterising taxing Acts, in a repeated refusal to acknowledge the underlying purpose of the legislature.

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[2] Emphasis added.

[3] The only article that appears to the author to analyse the penalty and tax distinction is V Morabito, 'Tax or Penalty?: The Latest Sequel' (1999) 2(6) *CCH Journal of Australian Taxation* 391. For discussion of the positive criteria see, eg, P Johnston, 'A Taxing Time: The High Court and the Tax Provisions of the Constitution' (1993) 23 *University of Western Australia Law Review* 362; G Brysland, 'What Is a Tax?' (1993) 5(3) *CCH Journal of Australian Taxation* 23; F Alpins, 'Why the Superannuation Guarantee Scheme Is Unconstitutional' (1999) 28 *Australian Tax Review* 13; V Morabito, 'Why the Superannuation Guarantee Scheme Is Constitutional' (1999) 28 *Australian Tax Review* 81.

[4] *Australian Tape Manufacturers Association Ltd v Commonwealth* (1993) 176 CLR 480 ('*Tape Manufacturers*').

[5] Ibid 503 (Mason CJ, Brennan, Deane and Gaudron JJ). See also Johnston, above n 3, 365; Brysland, above n 3, 24.

[6] *Tape Manufacturers* (1993) 176 CLR 480, 501. See also Brysland, above n 3, 24.

[7] Johnston, above n 3, 369.

Consequently, any Act which uses the language of taxation is most likely to be declared a valid exercise of the tax power if it is challenged before the courts. This focus on form over substance enables the House of Representatives to bypass Senate review by enacting ostensible taxing legislation.

This article assesses the major taxation cases which have dealt with the tax–penalty distinction within the historical context in which they were decided. Part 2 addresses the methodology that has been utilised and the approach that this article seeks to advocate. Part 3 outlines the constitutional foundations of the tax power and summarises its interpretation. The major cases where the tax–penalty distinction has been considered are analysed in Parts 4 to 7. Finally the implications for the future of the taxation power are assessed in Part 8. Through this, it will be shown that the courts' apparent refusal to acknowledge any possibility of a penal purpose in taxation legislation has the potential to render the restrictions in s 53 of the *Constitution* otiose.

2. METHODOLOGY AND ARGUMENT

2.1 Methodology

The judicial approach to taxation cases is highly dependent on the ideology of the High Court at the time that the particular case is decided. Underlying philosophies of interpretation such as the reserve powers doctrine and literalism are evident throughout the history of cases relating to the taxation power, resulting in a wealth of contradictory precedents.[8] In order to distinguish the judicial dicta in one case from the next, it is necessary to look at these ideologies and how they were applied or discarded.

Therefore, to understand the tax–penalty distinction, a law in context methodology will be adopted. This approach enables the

[8] On the reserve powers doctrine see, eg, *R v Barger; Commonwealth v McKay* (1908) 6 CLR 41 ('*Barger*'). For an example of the application of literalism, see *Federal Commissioner of Taxation v Commonwealth Aluminium Corporation Ltd* (1980) 143 CLR 646.

major tax–penalty cases to be analysed within their historical context. The history of the constitutional provisions and any evolution in the method of interpretation and characterisation adopted by the High Court will be considered. Any patterns evident within the Court's reasoning will be identified and critiqued. As a result of this analysis, the implications for future legislation and governments can also be assessed.

2.2 Against a Punitive Approach

Tax bills and money bills are the only categories of legislation that the Senate is not entitled to amend or reject. Similarly, such bills may originate only in the lower house, affording the House of Representatives the power to control taxation and money supply. However, it is clear that the framers of the *Constitution* wanted to ensure that this exclusive power could not be abused. This intention is evident through the restrictions contained in s 53, one of which is the requirement that a law that imposes taxation does not operate as a fine or other pecuniary penalty. That limitation was included so that bills which punish citizens for failing to follow a stipulated course of conduct require the consent of both houses of Parliament.

Interference with how citizens control their lives is not beyond the power of the government, and in fact most valid taxation Acts do interfere in the day to day functioning of every person. However, these Acts can be justified because they enable the government to fulfil its role by raising money. Punitive legislation cannot be defended on this basis. The purpose of a penalty or fine is to deter individuals from undertaking a particular course of action. Thus the overarching purpose of punitive legislation is deterrence. Although revenue raising may be achieved as a by product of punitive legislation, it is the prevention of a particular action or activity that is the primary goal.

The *Constitution* itself stipulates that the Senate is entitled to review, amend or reject legislation which operates in a punitive fashion. By persistently failing to acknowledge this entrenched

constitutional right, the High Court has effectively granted to the House of Representatives a much broader power than it was ever intended to possess. Through passing punitive taxing legislation, the House of Representatives can effectively regulate any aspect of an individual's life without Senate review. Thus, a hostile Senate will be robbed of its constitutional power. It is this ability to impose what is in effect a 'punitive tax' without any check or balance that is the hidden power of taxation.

3. THE POWER TO TAX

3.1 A Brief History of English Taxation

Taxation as we now know it came about during early medieval England. At this time, the Crown exacted aids, burdens and services from its tenants (the lords) and they, in turn, divided these charges amongst their occupants.[9] During this time, the Parliament (such as it was then) possessed very little control over finances. The King was expected to fund all elements of the government and, in order to accomplish this task, possessed considerable discretion over the generation of revenue.[10] However, the income from this did not meet the expenditure that was required to fund the many wars of that time. In fact, following the 1588 war with Spain, the Crown had to sell off 25 per cent of its land to cover its debts.[11]

By the 17th century, the Crown had adopted a number of questionable means in order to meet its debts. These included: the development of new forms of taxation; forcing institutions to loan money with little chance of being repaid; granting monopolies for a price; and seizing goods for below market prices.[12] This use of the

[9] John Quick and Robert Garran, *The Annotated Constitution of the Australian Commonwealth* (1995) 550.
[10] Douglass North and Barry Weingast, 'Constitutions and Commitment: The Evolution of Institutional Governing Public Choice in Seventeenth-Century England' (1989) 49 *Journal of Economic History* 803, 809.
[11] Ibid.
[12] Ibid.

royal prerogative angered the Parliament, whose goal of preserving private property rights was being repeatedly undermined.

Consequently, the Dutch Prince, William of Orange was invited to invade England and a deal was struck between the Parliament and the new King. In exchange for supporting the Dutch war against France, the Crown become subject to parliamentary oversight of taxation.[13] This agreement, embodied in the English *Bill of Rights*, secured parliamentary power of the purse.[14] This ability of the Parliament to curtail the Crown's ability to tax its subjects significantly contributed to the increase in parliamentary power.

3.2 Taxation within the *Constitution*

The drafting of the *Constitution* incorporated many of the conventions which had arisen in the English Parliament. In line with the English tradition, those present at the convention debates acknowledged that the Commonwealth Parliament must have the power to tax. Attempts to curtail the taxation power were quickly stifled by the argument that 'no commonwealth in the world has existed or can exist, without possessing unlimited power of taxation.'[15] Therefore, the ability to fulfil the responsibilities of government was identified as being inextricably linked with the power to impose taxation.[16] Accordingly, the power to tax was granted to the Commonwealth Parliament in s 51(2) of the *Constitution*.

However, the power to tax in England, as in Australia, is not absolute. Conventions arose in England whereby only the lower house (the House of Commons) could introduce money bills. Furthermore, the House of Lords was not entitled to amend any

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[13] Stephen Quinn, 'The Glorious Revolution's Effect on English Private Finance: A Microhistory, 1680–1705' (2001) 61 *Journal of Economic History* 593, 595.
[14] *An Act Declaring the Rights and Liberties of the Subject, and Settling the Succession of the Crown 1689*, 1 Wm & M, c 2, s 1. See also ibid 596.
[15] *Official Report of the National Australasian Convention Debates*, Sydney, 2 March – 9 April 1891, 672 (Thomas Playford).
[16] See, eg, ibid 674 (Bolton Bird), 675 (Alfred Deakin), 678 (John Donaldson).

taxation or money bill passed by the Commons.[17] These conventions ensured that the government, formed in the Commons, received the funds required to fulfil its role without any threat of sabotage by the Lords. However, over time the Commons sought to manipulate this convention by 'tacking' additional, completely unrelated provisions into taxation bills, in an attempt to bypass review by the Lords.[18] In response, a further convention arose requiring all provisions within a taxation law to deal only with taxation.[19] The resolution adopted by the English Houses was enacted into the *Constitution* through ss 53, 54 and 55.

Section 53 prevents the Senate from proposing or amending any taxation bills. Pursuant to the section, all that the Senate is entitled to do is 'return to the House of Representatives any proposed law which the Senate may not amend, requesting, by message, the omission or amendment of any items or provisions therein.' However, the House of Representatives is under no obligation to enact the suggested change(s).[20] This discrepancy between the powers of the two houses was justified upon the basis of English history. However, it was also acknowledged that this ability to prevent review by the upper house could potentially be abused by the members of the lower house, as it had been in England.[21] Thus, s 53 also states that a proposed law will not be considered a taxation bill if it contains fines or pecuniary penalties, fees for licences or fees for services. Section 54 requires that bills that purport to exact money for the services of government should only deal with such appropriation, and pursuant to s 55 provisions within taxation laws that deal with matters other than taxation will be of no effect. Together, ss 53, 54 and 55 operate to limit the wide scope of the taxation power as it exists in s 51(2).

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[17] William McKay (ed), *Erskine May's Treatise on the Law, Privileges, Proceedings and Usage of Parliament* (23rd ed, 2004) 918–19, 923–4.
[18] Ibid 924.
[19] Ibid.
[20] *Constitution* s 53.
[21] *Official Record of the Debates of the Australasian Federal Convention*, Sydney, 2 – 24 September 1897, 482–3 (John Forrest).

Another taxation convention which has been incorporated into the *Constitution* is the requirement that all revenue be consolidated into one account. In England, the convention was that the income from taxes be paid in their entirety into the 'Majesty's Exchequer' account in the Bank of England.[22] Similarly, s 81 of the *Constitution* requires that 'all revenue or moneys raised or received by the Executive Government of the Commonwealth shall form one Consolidated Revenue Fund'.[23] Therefore, the fiscal conventions of the English Parliament formed the foundations of the taxation power within the *Constitution*.

3.3 The Interpretation of the Taxation Power by the Courts

In considering what should be regarded as a tax, the courts have developed both positive and negative criteria. Both of these criteria must be satisfied for the exaction to bear a sufficient connection to the taxation power. The first attempt at a comprehensive definition was made by Latham CJ in *Matthews v Chicory Marketing Board (Vic)*.[24] His Honour stated that 'a tax … is a compulsory exaction of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered'.[25] It should be noted that ordinarily speaking, an exaction of money was automatically deemed to be for a public purpose when it was paid into the Consolidated Revenue Fund.

However, this definition is clearly not exhaustive as it does not include the limitations imposed by s 53 of the *Constitution*. Subsequent courts have recognised this, as the fee for services prohibition has been considered an example of an exaction which may satisfy the positive criteria but is nevertheless not considered to be a valid tax.[26] Over time, the negative criteria have been further

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[22] A V Dicey, *Laws of the Constitution* (10th ed, 2000) 316.
[23] *Constitution* s 81.
[24] (1938) 60 CLR 263.
[25] Ibid 276.
[26] *Air Caledonie International v Commonwealth* (1988) 165 CLR 462, 467 ('*Air Caledonie*').

developed to include an exaction that is a fee for services,[27] imposes a penalty,[28] is arbitrary[29] or which discriminates between States or parts of States.[30]

Since the adoption of the Latham definition, the positive requirements for a tax have been significantly altered. No longer is payment to a public authority necessary to establish that the exaction is for a public purpose.[31] Instead, the decision in *Tape Manufacturers*, in accepting that a monetary exaction which was not paid into Consolidated Revenue would still be a tax, suggested that the 'public purpose' limb of the positive criteria can be satisfied where Parliament has identified a public interest. Since it is the role of the Parliament, as elected representatives of the people, to determine what is in the public interest, the decision to change this criterion has rendered the public purpose limb virtually non-justiciable, while also undermining the purport of s 81 of the *Constitution*. Therefore, the positive limb of the taxation test has arguably been reduced to the requirements that the exaction is compulsory and enforceable by law.[32]

The extinction of the public purpose and public authority requirements means that the positive criteria are easier to satisfy. As a result, challenges to taxation Acts will probably proceed on the basis that the Act in question does not meet one or more of the negative criteria. Therefore, it is now essential that the distinction

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[27] Cf *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263, 276 (Latham CJ).
[28] *Luton v Lessels* (2002) 210 CLR 333, 342 (Gleeson CJ), 352–3 (Gaudron and Hayne JJ), 365 (Kirby J), 382 (Callinan J); *Air Caledonie* (1988) 165 CLR 462, 466; cf *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263, 276 (Latham CJ).
[29] *Deputy Federal Commissioner of Taxation v Truhold Benefit Pty Ltd* (1985) 158 CLR 678, 684 (Gibbs CJ, Mason, Wilson, Deane and Dawson JJ); *MacCormick v Federal Commissioner of Taxation* (1984) 158 CLR 622, 639–40 (Gibbs CJ, Wilson, Deane and Dawson JJ).
[30] Proscribed by *Constitution* s 51(2).
[31] *Tape Manufacturers* (1993) 176 CLR 480. See also Johnston, above n 3, 365; Brysland, above n 3, 23.
[32] See, eg, Johnston, above n 3, 365; Brysland, above n 3, 23.

between a tax and a penalty is comprehensibly analysed so that the outcome in these future cases can be hypothesised.

4. TAXING WORKING CONDITIONS: THE *HARVESTER* JUDGMENT AND *BARGER*

4.1 The First Goals of the Australian Parliament: The Introduction of Punitive Legislation

The federation of the Commonwealth and the creation of the *Constitution* immediately followed the Depression of 1890. This period of history was marked by industrial strikes over the conditions of labour and the inadequacy of remuneration.[33] Consequently, the majority of Australians expected the creation of the federation to result in a better way of life through a more comprehensive system of social justice. [34] The politicians of the time adopted these expectations amongst their policies in order to ensure public support.

The early Liberals, of whom Alfred Deakin was the leader, promoted protectionism as the solution, whereby local industry would be favoured through the imposition of taxes.[35] Conversely, the Free Trade Party, led by George Reid, believed that free trade and low tariffs would be more likely to generate jobs and economic rewards.[36] It was not until Deakin developed the 'New Protection' policy that popular support was secured. New Protection provided tariff protection to employers in exchange for 'fair and reasonable' wages for employees.[37] This approach appeared to the majority of Australians to guarantee the life improvement which was anticipated at federation and won Deakin not only the support of the public but also an alliance with the Labor Party. This alliance secured a large

[33] F G Clarke, *Australia: A Concise Political and Social History* (2nd ed, 1992) 164–5.
[34] Paul Kelly, *100 Years: The Australian Story* (2001) 98–9.
[35] Ibid 100.
[36] Ibid 101.
[37] Clarke, above n 33, 188.

majority in the House of Representatives and defeated the notion of free trade.

4.2 Higgins and the *Harvester* Judgment

Henry Bourne Higgins was a pre-eminent lawyer who argued for Commonwealth dominance during the Convention debates. He was also a union leader and protectionist elected to the first Parliament, and a close friend of Alfred Deakin.[38] As a result of this friendship, Deakin offered Higgins a place on the High Court in 1906 at the time of its expansion from three to five judges, and later the presidency of the Court of Conciliation and Arbitration (he served on both Courts concurrently).[39] His first decision whilst on the Court of Conciliation and Arbitration was in *Ex parte McKay*,[40] a decision better known as the *Harvester Judgment*.

After securing the support of the Labor Party and the majority of the House of Representatives, Deakin sought to pass his New Protection legislation. However, at that time it was thought that the *Constitution* did not grant the Commonwealth Parliament any power over wages,[41] and that the industrial relations power[42] was limited to conciliating and arbitrating industrial disputes extending beyond the limits of one State.[43] Therefore, the government sought to regulate wages through the imposition of a tax.[44] The *Excise Tariff Act 1906* (Cth) imposed a £6 duty on all Australian harvesters. However, no amount was payable if the President of the Court of Conciliation and

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[38] See generally John Rickard, *H B Higgins: The Rebel As Judge* (1984).
[39] Ian Holloway, 'Higgins, Henry Bourne' in Tony Blackshield, Michael Coper and George Williams (eds), *The Oxford Companion to the High Court of Australia* (2001) 322.
[40] (1907) 2 CAR 1 ('*Harvester Judgment*').
[41] This conception has since been overturned in relation to constitutional corporations in *New South Wales v Commonwealth* (2006) 229 CLR 1 ('*Work Choices Case*').
[42] Referred to in s 51(35) of the *Constitution* as the conciliation and arbitration power.
[43] *Constitution* s 51(35).
[44] Leslie Horsphol, *The Story of Australia's Federation* (1985) 116.

Arbitration certified that the employees manufacturing the harvesters were being given 'fair and reasonable' remuneration.[45] By granting exemption from the tax where wages were reasonable, Deakin effectively secured control over wages despite the Commonwealth not possessing any specific power under the *Constitution* to do so.

Higgins J, as an outspoken protectionist and advocate for federal dominance, could only be expected to support this move. When McKay, a manufacturer of harvesters, lodged an application at the Court of Conciliation and Arbitration to obtain a declaration that the remuneration he was providing was fair and reasonable, Higgins J selected the case as his first as President.

Higgins J determined that the provision was intended to secure employees a benefit which could not otherwise be obtained through the current bargaining system.[46] Whilst the legislation provided no explanation as to what this intended benefit was, Higgins J asserted that:

> The standard of 'fair and reasonable' must, therefore, be something else; and I cannot think of any other standard appropriate than the normal needs of the average employee, regarded as a human being living in a civilised community.[47]

Thus, Higgins J had to ascertain what the cost of living for an average employee actually was. To do this, the wives of employees gave evidence identifying the amount that they spent on a weekly basis.[48] Higgins J found that the cost of living was at least seven shillings a day and, by paying his employees six shillings a day, McKay's conditions of remuneration were not fair and reasonable.[49]

Higgins J also went one step further by annexing to his decision the minimum remuneration which should be paid to all of the

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[45] *Harvester Judgment* (1907) 2 CAR 1. See also Rickard, above n 38, 171.
[46] *Harvester Judgment* (1907) 2 CAR 1, 3.
[47] Ibid.
[48] Ibid 5–6.
[49] Ibid 7.

different employees within manufacturing factories.[50] These stipulated amounts included an increased wage for skilled employees and the amount which women should be paid if they were to be employed in different capacities. Through the generation of this list, Higgins J had set the first minimum wage.

4.3 The Constitutional Challenge to the *Harvester Judgment*: Against Punitive Legislation

4.3.1 Facts

As a result of the *Harvester Judgment*, action was taken against William Barger and H V McKay (both manufacturers of agricultural implements) for failing to pay tax on their goods that had not been manufactured under conditions of fair and reasonable remuneration.[51] In response to these allegations, the defendants asserted that the *Excise Tariff Act 1906* (Cth) was not a constitutionally valid taxing Act because the object of the Act was to regulate the conditions of remuneration.[52] Their main contention was that regulation of wages was the realm of the States and, consequently, the Commonwealth should not be able to impose a tax to interfere.[53] Whilst the idea that this levy might actually operate as a penalty was raised, it was not addressed in any detail as counsel for the defendants persisted with the reserved powers argument.[54]

4.3.2 The Majority Judgment

The majority of Griffith CJ and Barton and O'Connor JJ declared that the Act was not constitutionally valid as it interfered with the powers reserved to the States. According to the majority, the purpose of the *Constitution* is to grant a limited number of powers to the Commonwealth Parliament and those not expressly conferred on

[50] Ibid 19–25.
[51] *Barger* (1908) 6 CLR 41, 44.
[52] Ibid 45.
[53] Ibid 46–51, 52–5.
[54] Ibid 47.

the Commonwealth should be reserved to the States.[55] Therefore, the taxation power must be limited by the remaining parts of the *Constitution*, including those powers left to the States. Failure to adopt this approach would mean that

> the power of taxation is an overriding power, which would enable the Parliament to invade any region of legislation … by the simple process of making liability to the taxation depend upon matters within those regions.[56]

Therefore, given this interpretation of the constitutional provision, the majority reviewed the Act itself and found that regard must be had to the substance of the Act, not to the literal form.[57] Whilst the motives of the legislature were deemed to be irrelevant,[58] it was found that the Commonwealth Parliament was attempting to do indirectly what it could not do directly.[59] That is, the Act was passed for the purpose of regulating wage conditions and because employee remuneration was considered to be the exclusive realm of the States the Commonwealth Parliament could not legislate so as to interfere with this control. Consequently, the *Excise Tariff Act 1906* (Cth) was declared invalid.

However, the majority also stated that if this Act was deemed to be a valid exercise of the taxation power, that would mean that

> the Commonwealth Parliament might assume and exercise complete control over every act of every person in the Commonwealth by the simple method of imposing a pecuniary liability on every one who did not conform to specified rules of action, and calling that obligation a tax, not a penalty.[60]

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[55] Ibid 67.
[56] Ibid 71.
[57] Ibid 75.
[58] Ibid.
[59] Ibid 80.
[60] Ibid 77.

Therefore, it appears from this discussion that the majority may well have been willing to declare the *Excise Tariff Act 1906* (Cth) invalid, on the basis that it imposed a penalty.

4.3.3 The Minority Judgments: Isaacs and Higgins JJ

Although Isaacs and Higgins JJ wrote different judgments, their Honours' arguments are largely the same and therefore will be addressed together. Given that Higgins J had decided the case being challenged, it was unsurprising that his Honour would not want to overrule his own landmark decision. In fact, both his Honour and Isaacs J strongly believed in the supremacy of the Commonwealth Parliament and by adopting an approach very similar to that of the majority in the *Work Choices Case*, their Honours rejected the reserve powers argument. Their Honours asserted that the taxation power of the Commonwealth Parliament was absolute and could not be limited by implied restriction. Thus a taxation Act will be valid unless it violates an express provision within the *Constitution*.[61] Since s 53 expressly states that a tax cannot operate as a penalty, it became necessary to determine whether the *Excise Tariff Act 1906* (Cth) was a tax or a penalty.

According to Isaacs J:

> the true test as to whether an Act is a taxing Act … is this: Is the money demanded as a contribution to revenue irrespective of any legality or illegality in the circumstances upon which the liability depends, or is it claimed as solely a penalty for an unlawful act or omission, other than non-payment of or incidental to a tax?[62]

Similarly, Higgins J asserted that the Act could only be invalid if the legislature had first rendered illegal wages below the minimum that his Honour himself had set.[63] Applying this distinction, both justices concluded that because the Act did not render any course of action illegal, it could not possibly operate as a penalty.[64] Therefore,

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[61] Ibid 112–13 (Higgins J).
[62] Ibid 99 (Isaacs J).
[63] Ibid 112–13 (Higgins J).
[64] Ibid 100–1 (Isaacs J).

the object and effect of the Act was irrelevant as the Court should only assess what the Act actually said.[65]

4.3.4 Analysis

Looking at the history of the legislation and how it was applied in the *Harvester Judgment*, it is clear that the *Excise Tariff Act 1906* (Cth) had a dual purpose of protecting agriculture and regulating the employment conditions of the industry. These purposes would be achieved if all agricultural manufacturers met the minimum wage requirements set out in the *Harvester Judgment*. In fact, these purposes would be achieved without any money being raised under the Act because if all manufacturers provided fair and reasonable remuneration, no manufacturer would be required to pay the £6. Thus, it was equally possible for the defendants to contest the validity of the *Excise Tariff Act 1906* (Cth) on the basis that the Act actually operated as a penalty.

Since this case was the first in which the notion of a penalty was discussed, it is necessary to assess the tests established by the justices. There was a marked distinction in the definition applied by the majority and the minority. The majority asserted that an Act would be a penalty where a liability was imposed on the failure to abide by specified rules of action.[66] This definition is much easier to satisfy than the one proposed by the minority, which requires an amount to be levied on illegal conduct for a penalty to exist.[67] The difference in these approaches could be attributed to the majority's focus on the substance of the Act, as opposed to the minority's concentration on form.

The minority's refusal to assess the operation of the Act means that taxation Acts could be passed which do not raise any revenue. As explained above, the *Excise Tariff Act 1906* (Cth) could potentially have raised no revenue. Thus, the fundamental purpose of a taxation Act, which is to raise money in order to fulfil the

[65] Ibid 89 (Isaacs J).
[66] Ibid 77 (Isaacs J).
[67] Ibid 99 (Isaacs J), 112–13 (Higgins J).

obligations of government, is frustrated. Therefore, the literal approach of the minority means that any Act that uses the word 'tax' will automatically satisfy the revenue-raising element of the positive criteria, despite the reality that no money may be raised at all. If this method of characterisation prevails, any Act which uses the language of taxation would be deemed to satisfy the test and, as a result, could not possibly impose a penalty.

Divergently, the majority's approach requires an assessment of the practical effect of the legislation. A taxation Act which exempts those who comply with a stipulated method of conduct can be deemed to be regulating this behaviour through the imposition of a penalty. This finding can be made despite the use of the word 'tax', as the court will actually assess how the Act operates. This method ensures that Acts can only rely upon the taxation power where all of the criteria, both positive and negative, have been satisfied. Thus a taxation Act will need to generate income for the purposes of government rather than merely being a tool for the Commonwealth Parliament to legislate over areas in which it does not have direct powers. However, because the majority based their conclusion that the Act was invalid on the reserved powers doctrine, their Honours' comments on the notion of a penalty are obiter dicta and are therefore not binding.

4.4 After *Barger*: The Tax in *Osborne*

Three years after the *Barger* decision was handed down, a similar case was bought before the High Court. The case was *Osborne v Commonwealth*.[68] Frank Osborne alleged that the *Land Tax Act 1910* (Cth) and the *Land Tax Assessment Act 1910* (Cth) were both constitutionally invalid for a number of reasons. One of these reasons was that, by imposing a progressive tax on land, the Acts were a means of penalising land ownership.

The Acts imposed a levy on land owned by all individuals. The rate of taxation was progressive, so that as the value of land that was

[68] (1911) 12 CLR 321 ('*Osborne*').

owned increased, so did the amount of the tax that was payable.[69] There was no tax imposed on land valued under £5000 and landowners who did not live in Australia were taxed at higher rates than those who lived in Australia.[70] Whilst the argument focused on a possible violation of s 55, the idea that this tax might operate as a penalty was stated in the submissions.[71] The basis of this argument was that the Acts violated the taxation power because they were aimed at preventing people from owning significant quantities of land.[72]

All five justices found against the plaintiff and upheld the validity of the two Acts. In doing this, Griffith CJ and Barton, O'Connor and Isaacs JJ discussed the penalty contention. All four justices stated that although the imposition of a tax may have an indirect effect on the ability of individuals to accumulate large portions of land, the primary purpose of the legislation was to raise revenue.[73] This conclusion was reached because the legislation in no way directed who could and could not own land.[74] Thus the purpose of the Acts in both substance and form was the imposition of land tax.

This case can clearly be distinguished from the levy imposed in *Barger*. In *Barger*, there was a clear set of criteria (the amount of remuneration that should be paid) which had to be followed in order to receive the exemption. Furthermore, if every person followed the criteria then no tax would be collected. Conversely, in *Osborne*, the tax was levied on the land irrespective of any action by the taxpayer. There were no corresponding criteria which had to be followed in order to avoid the tax and since the levy was not significant enough to deter the ownership of land, it was clear that the Act would raise substantial revenue. Applying the penalty test handed down by the majority in *Barger*, the liability was not imposed on a failure to abide

[69] Ibid 344 (Barton J).
[70] Ibid 333–4 (Griffith CJ).
[71] Ibid 327–33.
[72] Ibid 325–6.
[73] Ibid 334–5 (Griffith CJ).
[74] Ibid 344–5 (Barton J).

by specified conduct. Instead, it was imposed uniformly on a possession.

5. THE INADEQUACY OF A FORMALISTIC INTERPRETATION: THE SUBSTANCE OF PUNITIVE LEGISLATION

5.1 The Dominance of Capitalism and the Problem of Tax Evasion

The period after World War II left Europe and Britain in desperate need of food and clothing.[75] Australia, not having been the site of any conflict, was equipped to meet those needs. The exorbitant profits that were consequently received strengthened the economy and ensured that all returning servicemen could be provided with employment. [76] However, the Commonwealth government also had debts which had accrued during the War to pay off, so it imposed income tax rates of up to 85 per cent.[77] This combination of a wealthy individualistic society and extremely high tax rates resulted in an increase in tax evasion.[78]

Tax evasion is a problem which has existed since the time when taxation was introduced. One of the most effective ways of deterring tax evasion is to increase the penalties that apply when the evader is caught.[79] Therefore, during this time, the government increased the penalties for evading tax. These increases resulted in challenges to taxation legislation being taken to the courts.

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[75] Clarke, above n 33, 266.
[76] Ibid.
[77] J Braithwaite, 'Through the Eyes of the Advisers: A Fresh Look at High Wealth Individuals' in V Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (2003) 260.
[78] T Bingham, *Tax Evasion: The Law and the Practice* (1980) 10.
[79] V Braithwaite, 'A New Approach to Tax Compliance' in V Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (2003) 4.

5.2 The Dixon Court and the Literalist Approach to Characterisation

Following *Barger* and *Osborne*, taxation legislation flourished. However, the tax–penalty argument was not raised again for 50 years. The main reason for the abandonment of this argument was the decision in *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd*,[80] where the High Court expressly rejected the reserve powers reasoning, thus giving paramount status to federal laws.[81] Due to concentration of the majority in *Barger* on the reserved powers argument, it was assumed by later courts that this doctrine was the only ground for denying constitutional validity to the legislation. However, this reasoning ignores the obiter dicta of the majority regarding the possibility that the Act in *Barger* might also be a penalty. Therefore, because the reserved powers doctrine was utilised in reaching the decision in *Barger*, the case has been repeatedly distinguished and implicitly overruled.

The next time that the tax and penalty argument was addressed, the dominant form of characterisation of statutes was legalism, albeit a literal form of legalism. The chief proponent of this approach, Sir Owen Dixon, had recently been appointed as Chief Justice. This approach was based on a belief that the terms that are used in a document can be solely relied upon when interpreting the meaning of the document.[82] The role of the court is to apply the literal meaning of the terms to the facts, ignoring any political or social consequences bought about by this application.[83] This approach was thought to ensure that decisions were not influenced by underlying

[80] (1920) 28 CLR 129.

[81] Sir Anthony Mason, 'The High Court of Australia: A Personal Impression of Its First 100 Years' (2003) 27 *Melbourne University Law Review* 864, 872.

[82] G Craven, 'The Crisis of Constitutional Literalism in Australia' (1992) 30(2) *Alberta Law Review* 492, 493; M Burton, 'The Rhetoric of Taxation Interpretation and the Definition of "Taxpayer" for the Purposes of Part IVA' (2005) 15 *Revenue Law Journal* 4, 8.

[83] Craven, above n 82, 494; S Gaegler, 'Legalism' in Tony Blackshield, Michael Coper and George Williams (eds), *The Oxford Companion to the High Court of Australia* (2001) 429.

biases of the judge. To implement this style of characterisation, the High Court adopted formalist analysis similar to the approach of the minority in *Barger*. Therefore, with the rejection of the reserved powers doctrine and the adoption of a characterisation method similar to that utilised by Higgins and Isaacs JJ, it was evident that the minority judgment in *Barger* would probably be followed.

5.3 The First Penalty: *Re Dymond*

5.3.1 Facts

On 24 May 1957, Mr Dymond filed for bankruptcy. However, the only debt which was lodged against his estate was made by the New South Wales Deputy Commissioner of Taxation for £17,148, due under the *Sales Tax Assessment Act (No 2) 1930* (Cth). In response to this, Mr Dymond lodged a constitutional challenge to the validity of the Act.

The basis of his argument was that the Act imposed a tax and also contained provisions that dealt with matters other than the imposition of taxation, in breach of ss 54 and 55 of the *Constitution*. The challenged section of the Act required that a minimum of £1 be paid as additional tax where a failure to comply with the Act was established. The other sections in question dealt with the administration of the Act, including provisions for: registration of taxpayers; lodging returns; collecting the tax; and the penalty provisions.[84]

If it was found that the amount levied was a tax, then the Act would breach ss 54 and 55 of the *Constitution* as the Act contained administration provisions which dealt with matters other than the imposition of taxation. Thus, these administration provisions would have to be severed for the Act to comply with s 55. Therefore, whilst Mr Dymond would still owe an amount, there would be no mechanism to allow the tax authorities to collect it. On the other hand, if the challenged section was a penalty, then the Act would not

[84] *Re Dymond* (1958) 101 CLR 11, 28 (Taylor J).

infringe ss 54 or 55 of the *Constitution* because the whole Act would deal with matters other than the imposition of taxation.

In response to this, the Deputy Commissioner of Taxation declared that the Act did not impose a tax and only contained the mechanisms for assessment and collection. Therefore, it did not violate s 55.

5.3.2 The Decision

All of the justices found for the Deputy Commissioner, stating that the Act did not impose a tax and therefore did not infringe s 55 of the *Constitution*. In reaching this conclusion, two lead judgments were given. One judgment was written by Fullagar J (with whom Dixon CJ, Kitto, Taylor and Windeyer JJ agreed), and the other was given by Menzies J (with whom McTiernan J agreed).

Menzies J focused on interpreting s 55 of the *Constitution* and did not find it necessary to discuss whether the Act that was being challenged imposed a tax.[85] However, Fullagar J analysed the tax–penalty distinction and determined that the provision in question imposed a penalty.[86] The use of the terms 'additional tax' did not detract from the reality that the levy was imposed on a failure to pay tax already owing under the Act.[87] The fact remained that

> the liability is imposed by the Act not as a consequence of a sale of goods but as a consequence of an attempt to evade payment of a tax on a sale of goods. The exaction is directly punitive, and only indirectly fiscal.[88]

Therefore, despite the use of the term 'tax', the amount imposed was in practice a penalty.

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[85] Ibid 28–9.
[86] Ibid 21.
[87] Ibid 21–2.
[88] Ibid 22.

5.4 The Impact That *Re Dymond* Had on the Generation of a Definition of a Penalty

The decision in *Re Dymond* demonstrated that the court should not limit itself to a formalistic analysis of legislation. By looking past the use of the word 'tax' in the legislation and conducting a logical examination of both the purpose of the provision and when the amount became payable, Fullagar J looked at the substance of the impost. Therefore, this case illustrates the restrictions of a literalist characterisation of legislation and demonstrates that when determining whether an Act is punitive, it is necessary to look not only at the form and the terms used by the legislature but also to the substance and how the Act operates in practice. Hence, although the decision of the majority in *Barger* was not referred to in the judgment, their Honours' approach was actually utilised.

Fullagar J's judgment is also important because of its discussion of the essential features which distinguish a penalty from a tax. The excerpt from the judgment quoted above demonstrates two key features of a penalty. First, a penalty is imposed on a failure to follow a course of action. In this case, the course of action being penalised was Mr Dymond's refusal to pay sales tax and, in *Barger*, it was a failure to provide employees with 'fair and reasonable' remuneration. Secondly, a penal exaction is only indirectly fiscal. This is because the prime reason for passing the legislation is to deter people from taking the prohibited course of action. If all people abide by the legislation, no revenue will be raised. Therefore, the aim of punitive legislation is the opposite of taxation legislation, where the purpose of imposing the levy is to maximise the money raised so that the government can fulfil its obligations.

6. ALLOWING PUNITIVE LEGISLATION

6.1 The Vietnam War and the Decline in the Australian Economy

After World War II, the Australian government sought to form an alliance with the world's greatest superpower: the United States of America.[89] As a sign of loyalty, Australia sent troops to camp in the Middle East in case the Cold War erupted into combat.[90] This act secured the signing of the *ANZUS Treaty*.[91]

This treaty was called upon when America commenced the Vietnam War, forcing Australia into a conflict from which it would obtain very little benefit.[92] This war drained Australian resources, forcing Prime Minister Menzies to implement a limited form of conscription.[93] Furthermore, the anti-war sentiment of the public and the finances required to support the troops in Vietnam resulted in a loss of investor confidence in Australia. The weakened economy prompted the government to take macroeconomic steps to reverse the situation.

6.2 Conflict in the Barwick Court

During this period, Sir Garfield Barwick was Chief Justice and his Honour's Bench was often characterised by conflict.[94] Although Sir Garfield was the Chief Justice, his Honour and Menzies J were often in the minority when constitutional questions of freedom of

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[89] Kelly, above n 34, 230.
[90] Ibid.
[91] *Security Treaty between Australia, New Zealand, and the United States of America*, opened for signature 1 September 1951, [1952] ATS 2 (entered into force 29 April 1952). See ibid 235; Clarke, above n 33, 288.
[92] Kelly, above n 34, 235; Clarke, above n 33, 289.
[93] Clarke, above n 33, 290.
[94] Sir Anthony Mason, 'Barwick Court' in Tony Blackshield, Michael Coper and George Williams (eds), *The Oxford Companion to the High Court of Australia* (2001) 59; G Winterton, 'Barwick the Judge' (1998) 21 *University of New South Wales Law Journal* 109, 115–16.

trade and commerce under s 92 were addressed. This was because Barwick CJ and Menzies J advocated a commercial, economic and practical approach to trade and commerce laws.[95] This approach was inconsistent with that of Kitto, Windeyer and Taylor JJ, who supported a more literalist characterisation.[96] These differing styles of characterising trade and commerce legislation represented a conflict between substance and form.

However, when taxation legislation was before the Barwick Court, Barwick CJ and Menzies J adopted a literal characterisation.[97] Although their Honours were willing to consider the commercial, economic and practical consequences for laws in s 92 cases, Barwick CJ and Menzies J continually held that these factors could not be considered when characterising taxation legislation. The case of *Fairfax v Federal Commissioner of Taxation* [98] clearly demonstrates how this persistence with literalism ensured that punitive legislation remained valid.

6.3 The Focus on Form Permits Punitive Legislation: The *Fairfax* Decision

6.3.1 Facts

In order to address decreased investment in Australian securities caused by the war, Division 9B was inserted into the *Income Tax and Social Services Contribution Assessment Act 1936* (Cth).[99] This

[95] G Winterton, 'Barwick, Garfield Edward John' in Tony Blackshield, Michael Coper and George Williams (eds), *The Oxford Companion to the High Court of Australia* (2001) 58.
[96] Justice Michael Kirby, 'Kitto and the High Court of Australia' (1999) 27 *Federal Law Review* 131, 141; B Debelle, 'Windeyer, (William John) Victor' in Tony Blackshield, Michael Coper and George Williams (eds), *The Oxford Companion to the High Court of Australia* (2001) 718.
[97] Justice Graham Hill, 'Barwick CJ: "The Taxpayers Friend"?' (1997) 1 *Tax Specialist* 9, 10.
[98] (1965) 114 CLR 1 ('*Fairfax*').
[99] The Division was inserted by s 11 of the *Income Tax and Social Services Contribution Assessment Act 1961* (Cth).

Division stipulated that superannuation funds would be denied an exemption from income tax unless they invested a specified proportion of their income into 'Commonwealth securities' (as defined).[100] However, if the Federal Commissioner of Taxation was satisfied that the fund manager had made a bona fide attempt to ensure that the right amount of money was invested, the Commissioner could waive the tax that was otherwise due.[101] Furthermore, if the fund manager could satisfy the Commissioner that the inclusion of Commonwealth securities would jeopardise the financial stability of the fund, then the fund could obtain an exemption for a limited time.[102]

When the Sydney Morning Herald Centenary Fund was charged income tax for failing to invest the specified amount in Commonwealth securities, the trustees appealed to the High Court.[103] In argument, their representatives contended that the Act did not impose a tax but rather a penalty. It was asserted that the Act had no revenue-raising purpose because if all superannuation funds abided by the investment conditions, no money would be obtained.[104] Therefore, this Act was clearly an attempt by the government to regulate the investment of superannuation funds by using the guise of a taxation Act.[105]

In reply, the Federal Commissioner of Taxation stated that it was necessary to focus on the form of the legislation and inquiries into the indirect consequences of the law were not permitted.[106] The Act was merely encouraging trustees to invest in the stipulated way and it was stressed that encouragement does not amount to a command or prohibition.[107] Therefore, the Commissioner argued that the

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[100] *Fairfax* (1965) 114 CLR 1, 5.
[101] Ibid 6.
[102] Ibid.
[103] Ibid 1.
[104] Ibid 2.
[105] Ibid.
[106] Ibid 3.
[107] Ibid.

legislation did not regulate a course of conduct and was not prohibitive. As such, it was a validly enacted tax.[108]

Whilst all the justices agreed that this was a tax and not a penalty, there were two judgments delivered on this question, one by Kitto J (with whom Windeyer and Taylor JJ agreed) and one by Menzies J (with whom Barwick CJ agreed).

6.3.2 The Literalist Approach to the Legislation: Kitto J

Kitto J found that the law was a valid exercise of the taxation power by focusing on the form of the Act. Whilst his Honour's conclusion rested on his literalist foundations, his Honour first approached the question on a substantive level. The reason for this change was a review of the American precedents. The American courts found it imperative to ensure that an Act purporting to impose a tax was not merely a veiled attempt to regulate a course of conduct beyond legislative control.[109] Applying this analysis to the Act in question, Kitto J concluded 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.'[110] Despite this admission, Kitto J determined that the underlying justification for the American test was an amendment to the *United States Constitution* which specifically reserved powers to the states.[111] In making this logical leap, Kitto J was then able to reject any focus on substance and return to a formalistic analysis of the legislation.

In rejecting the American test and the approach of the majority in *Barger*, Kitto J adopted the strict minority approach in *Barger* of Isaacs and Higgins JJ.[112] His Honour also considered obiter dicta by

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[108] Ibid.
[109] Ibid 10. For the American test, see generally *Bailey v Drexel Furniture Co*, 259 US 20 (1922); *Hill v Wallace*, 259 US 44 (1922); *United States v Constantine*, 296 US 287 (1935); *Carter v Carter Coal Co*, 298 US 238 (1936).
[110] *Fairfax* (1965) 114 CLR 1, 9.
[111] Ibid 10.
[112] Ibid 12–13.

Dixon J in *Melbourne Corporation v Commonwealth*, where it was stated that wherever an Act appears to be within a field assigned to the Commonwealth, it will be within power.[113] This broad approach would appear in its application to catch anything which says within the text of the Act that it imposes a 'tax'. In utilising this as the test for validity, Kitto J was ensuring that any Act which uses the language of taxation will be a valid exercise of power. Therefore, despite acknowledging that the Act was an attempt to regulate investments by superannuation trustees, Kitto J found that the Act used the language of taxation and thus the only obligation imposed was to pay tax.[114] As such, formalistic analysis once again led to the Act being characterised as a tax.

6.3.3 The Limits of Taxation Legislation: Menzies J

Although Menzies J reached the same conclusion as Kitto J, his Honour's judgment is unique for one reason: the examples that his Honour employed. Despite saying that a taxation law cannot be assessed in terms of its economic consequences, Menzies J stated that a prohibitive tax upon income from the sale of heroin would not be a tax but a penalty designed to suppress trade in the drug.[115] His honour concluded that if such a law was passed, it would be invalidated not because of the economic consequences or the motive of the legislature, but simply because 'its true character is not a law with respect to taxation.'[116] However, Menzies J fails to explain how to determine the true character of an Act when an analysis of the economic consequences and the motive of the legislature are ignored. Furthermore, given that the sale of heroin is illegal it would appear that if such a tax was imposed it would fall foul of the test stipulated by the minority in *Barger*. Consequently, this example has been rejected by subsequent courts.[117]

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[113] (1947) 74 CLR 31, 79.
[114] *Fairfax* (1965) 114 CLR 1, 13.
[115] Ibid 17.
[116] Ibid 18.
[117] See, eg, *State Chamber of Commerce and Industry v Commonwealth* (1987) 163 CLR 329.

When analysing the Act in question, Menzies J concluded that the only reasons for finding the Act invalid would be the parliamentary motive and the economic consequences. Since these were not permitted considerations, the law was a valid exercise of the taxation power.

6.4 The Problem with the *Fairfax* Decision

The decisions of Menzies and Kitto JJ reject the reasoning of the majority in *Barger* and the American test because they are supposedly based on a reserved powers doctrine. However, usually when the federal legislature attempts to utilise the taxation power in a punitive way, it is because the legislature does not possess the direct power to control the area that it is seeking to regulate. Thus, questions of federal balance will inevitably arise. This does not mean that a reserved powers doctrine and the penalty argument are inextricably linked. A penalty is not limited to an Act which infringes upon state power; it is far broader than this. It is any Act which imposes an exaction on the failure to follow a specified course of conduct. If what is being regulated is an area of state power, then the two arguments overlap. However, if the Commonwealth Parliament is using the taxation power to regulate something within its control, this does not render the penalty argument any less relevant. Whilst it is clear that the reserve powers doctrine has been abandoned and the Commonwealth Parliament is entitled to legislate free from any such implication that restricts its power, the fact remains that s 53 of the *Constitution* expressly prevents the Commonwealth Parliament from imposing a penalty in the guise of a tax. Therefore, a penalty argument should be considered on its own merits by looking at how the Act operates instead of being dismissed because of its overlap with questions of federal balance.

7. THE PROBLEM OF PRECEDENT PERMITTING PUNITIVE LEGISLATION

7.1 The Move Away from Legalism: Progressivism in the Mason Court

After Sir Garfield retired, the conflict between literalism and a practical analysis of legislation which had beset the High Court was largely resolved in favour of a purposive approach. The new Chief Justice, Sir Harry Gibbs, encouraged this transition as his Honour believed that development and change were essential elements of judicial decision making.[118] However, Gibbs CJ did not opine that the role of the judges was to achieve substantial legal change. Thus, Gibbs CJ's approach represented a compromise between the literalism as employed by the Barwick and Dixon Courts, and the liberal progressive Court that was to follow him.

Succeeding Sir Harry as Chief Justice was Anthony Mason, whose career was characterised by a progression from conservatism to liberalism. [119] This trend towards judicial activism was immediately evident upon his Honour's appointment to the High Court in the landmark cases of *Cole v Whitfield*[120] (which established a new interpretation of s 92); *Mabo v Queensland (No 2)*[121] (where the common law doctrine of native title was developed); and *Australian Capital Television Pty Ltd v Commonwealth (No 2)*[122] (which found a constitutional implied freedom of political communication). These decisions set a clear pattern for all later

[118] D Jackson and J Priest, 'Gibbs, Harry Talbot' in Tony Blackshield, Michael Coper and George Williams (eds), *The Oxford Companion to the High Court of Australia* (2001) 302.
[119] K Walker, 'Mason, Anthony Frank' in Tony Blackshield, Michael Coper and George Williams (eds), *The Oxford Companion to the High Court of Australia* (2001) 459.
[120](1988) 165 CLR 360.
[121](1992) 175 CLR 1.
[122] (1992) 177 CLR 106.

judgments, marking the Mason Court as the most activist High Court in Australian history.

However, this Court also decided the *Tape Manufacturers* case. There a tax was imposed on people who purchased blank cassette tapes and then used them to copy copyrighted materials.[123] The amount was payable to a privately operated collecting society which was to use the money for the benefit of the individuals whose copyright had been breached. The Mason Court held that it was not necessary that the levy be paid to a public authority even though this is a stipulated requirement of the positive criteria.[124] It was also irrelevant that the amount was paid direct to the private body without going to the Consolidated Revenue Fund.[125] Instead, the Court found that if the levy served a purpose in the public interest and was enforceable by law it would meet the criteria of a tax, a decision which has radically altered the positive criteria.[126] Whilst the Court's changes were conducted in an activist fashion, the Mason Court was continuing in the trend of the previous High Courts by giving the Commonwealth Parliament a broader power of taxation.

7.2 Another Attempt to Control Working Conditions

Throughout the 10 years leading up to 1990, there was international recognition of a need for increased training of employees. The Australian government believed that increasing the skills of the labour force was inextricably linked with increases in economic growth and the ability of Australia to compete on an international level.[127] Thus, the federal government sought to pass legislation which would ensure that employees were given a

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[123] *Tape Manufacturers* (1993) 176 CLR 480, 497 (Mason CJ, Brennan, Deane and Gaudron JJ).
[124] Ibid 501 (Mason CJ, Brennan, Deane and Gaudron JJ).
[125] Ibid 503 (Mason CJ, Brennan, Deane and Gaudron JJ).
[126] Ibid 501 (Mason CJ, Brennan, Deane and Gaudron JJ). See also Johnston, above n 3, 369.
[127] Australian Bureau of Statistics, *Australian Social Trends 1995*, Cat No 4102.0, June 1995.

sufficient level of training. However, as with *Barger*, such legislation would involve regulation of working conditions, an area thought at that time to be beyond power. Therefore, in order to pass the desired legislation, the government adopted the same approach as it did back in 1906 and passed a taxation Act.

In the second reading speech of the Training Guarantee (Administration) Bill 1990 (Cth), the Minister for Employment, Education and Training declared that the government aimed to 'collect nothing' from the bill.[128] The purpose was merely to ensure that employers provided the appropriate amount of training themselves by imposing a 'charge on the failure to train'.[129] These ideals were supported by the House of Representatives and, since a taxation Act cannot be amended by the Senate, both the *Training Guarantee Act 1990* (Cth) and the *Training Guarantee (Administration) Act 1900* (Cth) were passed.

7.3 The Ultimate Punitive Legislation: The Case of *Northern Suburbs*

7.3.1 Facts

The *Training Guarantee Act 1990* (Cth) and the *Training Guarantee (Administration) Act 1990* (Cth) imposed a levy on employers' 'training guarantee shortfall' for the year.[130] If an employer spent over one per cent of their annual payroll on employee training, they were exempt from paying the fee.[131] Those who did not spend the appropriate sum were liable to pay the difference between the amount owed and spent as a 'tax'.[132]

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[128] Commonwealth, *Parliamentary Debates*, House of Representatives, 10 May 1990, 293 (John Dawkins, Minister for Employment, Education and Training).
[129] Ibid.
[130] *Northern Suburbs General Cemetery Reserve Trust v Commonwealth* (1992) 176 CLR 555, 564 ('*Northern Suburbs*').
[131] *Training Guarantee (Administration) Act 1990* (Cth) s 15.
[132] *Training Guarantee Act 1990* (Cth) ss 5, 6.

However, these Acts were unique because nowhere was it stated that the exaction was for the purpose of raising revenue. In fact, the objects clause in s 3 of the *Training Guarantee (Administration) Act 1990* (Cth) contained five objectives which all related to increasing the amount and quality of employee training. Another difference with the exaction was that the money collected did not go to the Consolidated Revenue Fund but was deposited in the 'Training Guarantee Fund'[133] to be used for payments to eligible training programs.[134]

This legislation was challenged when the Northern Suburbs Cemetery Reserve Trust incurred a liability under the Acts.[135] Counsel for the Trust submitted that the legislation: imposed a fee for services;[136] infringed s 81 of the *Constitution*;[137] infringed s 55 of the *Constitution*;[138] imposed an arbitrary exaction;[139] and, most important, the legislation did not impose a tax but was instead a penalty.[140] In response, the Commonwealth claimed that the legal operation of the law demonstrated that it was an Act with respect to taxation.[141]

7.3.2 The Judgment

Mason CJ and Deane, Toohey and Gaudron JJ delivered a joint judgment. Brennan J in a separate judgment agreed with their Honours in relation to the penalty argument. Dawson J (with whom McHugh J agreed) also delivered a separate judgment. Each of these judgments will be dealt with together as their response to the penalty argument is very similar.

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[133] *Training Guarantee (Administration) Act 1990* (Cth) s 32.
[134] *Training Guarantee (Administration) Act 1990* (Cth) s 34(1).
[135] *Northern Suburbs* (1992) 176 CLR 555, 566.
[136] Ibid 558.
[137] Ibid 557–9.
[138] Ibid 559.
[139] Ibid 558.
[140] Ibid 560.
[141] Ibid 561–2.

Their Honours acknowledged that it was entirely possible that no revenue would be raised through the scheme.[142] However, despite this reality, the Acts themselves stated that they imposed a charge on those who did not pay the minimum training amount.[143] Their Honours relied on the decisions in *Osborne* and *Fairfax* as authority for the proposition that the absence of a revenue-raising purpose does not render a taxation law invalid.[144]

Furthermore, neither Act proscribed or mandated conduct of any kind. Once again, the test of illegality espoused by Isaacs J in *Barger* was relied upon as their Honours asserted that the Acts had not made the failure to pay the required minimum illegal.[145] Thus, it was asserted that the 'charge is not a penalty because the liability to pay does not arise from any failure to discharge antecedent obligations on the part of the person on whom the exaction falls'.[146] This test is judicial acknowledgment that the approach of Isaacs J from *Barger* should be preferred.

7.3.3 Analysis

Given that the Mason Court was so progressive and open to change, it was possible that the literal characterisation which has dominated punitive legislation may have been overturned. The legislation in this case had no revenue-raising purpose, a fact acknowledged by the relevant Minister when the second reading speech was made. Furthermore, the Acts established a clear course of conduct which had to be followed in order for the levy to be avoided, that is employers had to spend one per cent of their annual payroll on employee training. It was the failure to spend this minimum amount that triggered the exaction. Using the test espoused by their Honours, it was the failure to comply with the antecedent obligation (the payment of the minimum amount on training) that triggered the levy.

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[142] Ibid 568 (Mason CJ, Deane, Toohey and Gaudron JJ), 589 (Dawson J).
[143] Ibid 589 (Dawson J).
[144] Ibid 569–70 (Mason CJ, Deane, Toohey and Gaudron JJ).
[145] Ibid 571 (Mason CJ, Deane, Toohey and Gaudron JJ).
[146] Ibid.

Therefore, it would appear that in substance and in form, the Acts actually operated as a penalty.

However, the Court avoided this conclusion by requiring that the conduct *be declared illegal* before an amount imposed upon the conduct could be considered a penalty. This literalist approach ignores not only the purpose of the legislature but also the practical reality of the Act in operation. This case shows how extreme this approach has become, as the Parliament openly stated that it was using the tax power to regulate something that it had no direct control over by penalising those who did not fulfil the required conditions. Furthermore, the legislation itself was expressly punitive as it first set out the minimum that had to be expended and then imposed a charge on those who failed to meet the minimum. However, it appears from the judgments that it will only be when an Act makes a course of conduct illegal that a levy imposed on that conduct will constitute a penalty. This overly narrow approach is a clear continuance of the formalistic analysis evident in the cases up until this time.

8. THE IMPLICATIONS OF THE APPROACH TAKEN TO THE TAX–PENALTY DISTINCTION

8.1 Factors Which Have Influenced the Development of the Tax–Penalty Distinction

The decision in *Northern Suburbs* demonstrates that the court has gone a full circle. The legislation in *Northern Suburbs* was very similar to that before the court in *Barger*, as both tried to regulate working conditions. However, now the complete opposite result has been reached. This turnaround in reasoning with respect to tax can be attributed to both the explosion of the reserve powers doctrine and the adoption of a literalist style of characterisation.

8.1.1 Reserve Powers

The reliance of the plaintiff in *Barger* on a reserve powers argument was a consequence of the time that the case was decided.

Because of that argument, the majority reached its decision in favour of the plaintiff and the States. However, it is clear from the explanation above that this was not the only basis on which the majority's decision was based. Their Honours also assessed the substance of the Act and suggested it could also be a penalty because it levied a charge on those who did not follow a specified course of conduct. In contrast, the minority restricted themselves to saying that a penalty would exist only if the amount was levied on an illegal activity. Despite both definitions being enunciated in the same case, the dicta of the majority on 'penalty' has been continually ignored due to the reliance on the reserve powers doctrine.

In doing this, later courts have relied on the conclusion of the minority judgment as their guiding principle. If the plaintiff in *Barger* had only argued that the exaction was a penalty, later courts would have had to address the conflict between the majority and minority definitions and it would be possible that the approach of the majority would have been followed. However, because the plaintiff used alternative arguments, any attempt in later cases to argue that the court should look at the substance of the Act and how it operates in practice have been quickly rebuffed as attempting to engage the court in an analysis of reserved powers. Thus all courts, including the activist progressive Mason Court, have restricted their analysis of punitive legislation to the form of the Act.

8.1.2 Literalist Style of Characterisation

By adopting the minority approach in *Barger* and rejecting the substantive interpretation of the majority, subsequent courts have confined themselves to applying restrictive principles of characterisation. A literalist approach which focuses on the form of taxation legislation will undoubtedly be guided by what the exaction has been called. Although all judges have paid lip service to the notion that an Act cannot declare itself to be within power through the use of particular terminology, the reality is that a focus on form ignores one of the central tenets of taxation legislation: a revenue-raising purpose. There have been multiple examples of legislation which state that they will collect money for the government but,

when the Act is actually in operation, no revenue is collected at all. This was particularly so for the legislation that was at issue in *Northern Suburbs*, as its sole stated purpose was to force employers to spend their own money on training and the exaction of the training shortfall was merely there to penalise those who relevantly failed to do so. Yet because the Act said it would collect the shortfall as a 'tax', the Act was regarded as a tax Act.

8.2 Where to from Here?

The cases above have raised many questions regarding what a tax actually is. The oft quoted statement that 'a tax … is a compulsory exaction of money by a public authority for public purposes, enforceable by law'[147] no longer suffices. The positive criteria for a tax have been decimated by the literalist characterisation style, as it has now been repeatedly emphasised that a taxation Act does not have to raise any money. As long as the Act states that it exacts an identifiable amount, it is irrelevant if in practice this does not actually occur. However, this is not the only alteration to the positive criteria. The public purpose requirement has been reduced to the public interest, and an amount can be collected by a private body.[148] So what is a tax? It is a theoretical exaction of money enforceable by law which, if collected, would go toward a matter in the public interest.

Despite these overwhelming changes to the positive criteria, the negative criteria remain as they are, etched in s 53 of the *Constitution*. However, they too have been manipulated. A traditional definition of a penalty would be that it is an amount imposed to deter or prevent people from acting in a particular way. A penalty is imposed to discourage individuals from speeding. This does not mean that you cannot speed (in fact, most of us do at least once in our lives), but it means that if we do we will be liable to pay an amount to the

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[147] *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263, 276 (Latham CJ).

[148] *Tape Manufacturers* (1993) 176 CLR 480, 501. See also Johnston, above n 3, 365; Brysland, above n 3, 24.

government. The prime focus of such a measure is deterrence, as any revenue raised is merely incidental to the penalty aspect. If nobody ever speeds, this purpose would be achieved and no money would be generated. Thus, to determine if a statute is a tax or a penalty, it appears necessary to look at the substance of the Act, what it is trying to achieve and whether revenue will be raised. However, given the literalist interpretation which has dominated this approach, it is unlikely that any of these factors would be considered by a court.

Given that the court is likely to persist in this approach, it is necessary to determine what, if any, forced exaction will meet the criteria of a penalty. In *Northern Suburbs*, the test was said to be whether the exaction was imposed on a failure to comply with an antecedent obligation. Although the term antecedent does not relevantly appear to have been judicially considered, the *Oxford English Dictionary Online* states that it is simply a 'thing or circumstance which goes before or precedes in time or order'.[149] However, in *Fairfax* the tax was payable because the trustee had not invested a sufficient amount in Commonwealth securities and in *Northern Suburbs* the exaction resulted from the failure to spend a specified amount on training for employees. Whilst these examples appear to be failures to meet antecedent obligations which result in a monetary impost, the court has continually held that the legislation which imposed these exactions were valid as tax legislation. In essence, the court has enforced the test of the minority in *Barger* because for a penalty to exist, failure to comply with an antecedent obligation must involve stipulated illegality. Thus, as long as a taxation Act is carefully drafted, it does not appear that any taxation Act will ever impose a penalty.

8.3 Implications of This Approach

8.3.1 Implications for Section 53 of the Constitution

The main problem with the approach that the court has taken to the tax–penalty distinction is the effect that persistent punitive

[149] Oxford English Dictionary, *Antecedent, n* <http://www.oed.com> at 9 May 2007.

legislation will have on the power of the Senate. The framers of the *Constitution* deliberately stated that fines and pecuniary penalties could not be passed as taxation laws. By refusing to acknowledge that the relevant Acts discussed above operated as penalties, the courts have denied any significant meaning to the words of limitation in s 53. As a result, the power of the House of Representatives has broadened far beyond what was originally intended.

Although this development might not seem to be important when the government possesses a majority in both houses of Parliament, this issue is extremely important where different parties control each house. The House of Representatives and the Senate are intended to operate as a check and balance upon each other. If the House of Representatives is able to bypass the Senate even in relation to the passage of essentially punitive pecuniary legislation, it is possible that the party that is in control of the lower house could effectively govern in some respects without the upper house possessing any significant form of recourse. This is an untenable situation for the system of representative government as established by the *Constitution* and as understood by the citizens of Australia.

Although the literalist characterisation style has become the accepted rubric for taxation legislation, its repeated use has resulted in a constitutional conundrum. To continue to restrict the meaning of 'penalty' is to undermine the power of the Senate and potentially render s 53 redundant. Having reached this dilemma through literalism, it is clear that the only way out is by an alteration in characterisation style. It has now become essential to examine how a taxation Act operates in practice. By addressing whether the Act in question will raise revenue for government purposes or if it is imposed to deter individuals from a stipulated course of conduct, the term penalty in s 53 will be given its rightful meaning and the power of the Senate will be restored.

8.3.2 Effects on Section 51

By apparently eliminating many a chance of a penalty being imposed, the court is granting the Commonwealth Parliament

legislative power that appears to go well beyond the intended scope of the taxation power. Acts can now be enacted to effectively control areas that are otherwise outside the scope of s 51 through the simple passage of a taxing Act. Taxation Acts will now be allowed which enable the government to influence the wages of all employees, the training of employees and the investment of superannuation funds, all areas which are outside the direct legislative power of the Commonwealth Parliament.

Furthermore, in drafting the controversial Work Choices legislation, the Parliament could have used the taxation power if the corporations power had not been available.[150] If this approach had been adopted, the Work Choices legislation could have had a much broader scope, potentially extending to all employees (including the employees of non-corporate entities, and certain State employees who are currently not covered by the legislation). Therefore, by giving the definition of a tax such a broad application and almost extinguishing the notion of a penalty, the courts have given the Commonwealth Parliament an extremely broad power to legislate. This power virtually eliminates the restriction in s 53, allowing a government that is in control of the House of Representatives to regulate without effective review by the Senate. Whilst the implications of this for both federalism and the *Constitution* as a whole are beyond the scope of this article, it is clear that this ability to legislate in relation to areas that would otherwise be outside the scope of s 51 has the potential to be abused by the House of Representatives, without oversight by the Senate.

9. CONCLUSION

The Court's persistent finding that punitive legislation is valid as a taxing Act has eroded the power of the Senate. Although taxing Acts were originally developed to raise money for the government, the decisions reached by the High Court reveal that such Acts no longer require a revenue-raising purpose. Furthermore, it is irrelevant

[150] Commonwealth, *The Constitution and Industrial Relations: Is a Unitary System Achievable?*, Research Brief No 8 (2005) 43–5.

if the purpose of the Act is to deter a particular course of action or if the Parliament is manipulating the tax power to control an area of power which is not expressly granted to it through the *Constitution*. Therefore, the power to tax has become so broad and the concept of a penalty so narrow, that it is almost impossible for a taxation Act to be deemed invalid on this basis. Thus, the House of Representatives can now initiate legislation in relation to many matters without the possibility of interference in the form of amendments by the Senate, giving the government the unprecedented ability to rule from the lower house. It is this ability to enact punitive legislation without effective Senate review that is the hidden power of taxation.