PHILIP MORRIS LTD V. COMMISSIONER OF BUSINESS FRANCHISES[1]

The judicial interpretation of s. 90[2] of the Constitution is of vital importance to the States, who are permanently dependent upon Commonwealth handouts under s. 96, owing to their limited capacity to raise revenue. In the past however, s. 90 has proved to be a logistic minefield surpassed only by s. 92. In the light of the decisions in *Cole v. Whitfield*[3] and *Bath v. Alston Holdings*[4] which postulated a new test and severely diminished the relevance of precedent on s. 92, it was hoped that the High Court would take the opportunity to rationalize and clarify the existing unsatisfactory position relating to s. 90 in a similar fashion.

THE FACTS

Philip Morris Ltd (PML) and its subsidiaries were well known cigarette manufacturers and pursuant to the relevant Victorian legislation (Business Franchise (Tobacco) Act 1974) had to pay licence fees in order to engage in the business of selling tobacco. Licences to sell were issued on a monthly basis and calculated according to a formula comprising a flat fee and a fixed percentage of past sales.[5] The legislation was identical in substance to that upheld in *Dennis Hotels v. Victoria*[6] and *Dickenson's Arcade v. Tasmania.*[7] PML contended that these cases should now be overruled. The High Court, in a 5-2 decision, upheld the franchise fees as not being duties of excise within s. 90 of the Constitution.

THE MAJORITY
MASON C. J AND DEANE J.

The theme of this judgment appears to be increased flexibility in determining what is or is not a duty of excise. Their Honours referred to a number of factors which will aid in determining whether a particular tax is an excise duty or not and more importantly, from the point of view of the States, *Dennis Hotels* and *Dickenson's Arcade* were followed but heavily qualified.

THE FACTORS
FACTOR #1 — HISTORY

In a similar manner to *Cole v. Whitfield*, their Honours examined the history of s. 90, and its interrelation with other provisions of Chapter IV of the Constitution, especially s. 92. These sections, it seems, were designed to give the Commonwealth exclusive power over commodity taxation, yet still ensure equality of treatment in trade and commerce amongst the states. The Commonwealth must not be hampered in its economic policies by the States, although the importance of this factor is unclear.

1 (1989) 63 A.L.J.R. 520. High Court, 7-10 March 1989, 24 August 1989, Mason C.J., Brennan, Deane, Dawson, Toohey, Gaudron, McHugh JJ.

2 On the imposition of uniform duties of customs the power of the Parliament to impose duties of customs and of excise, and to grant bounties on the production or export of goods, shall become exclusive.

On the imposition of uniform duties of customs all laws of the several States imposing duties of customs or of excise, or offering bounties on the production or export of goods, shall cease to have effect, but any grant of or agreement for any such bounty lawfully made by or under the authority of the Government of any State shall be taken to be good if made before the thirtieth day of June, one thousand eight hundred and ninety eight, and not otherwise.

3 (1988) 165 C.L.R. 360.

4 (1988) 165 C.L.R. 411.

5 The provisions mirror ss 19(1)(a) and 19(1)(b) of the Licensing Act 1958 (Vic.).

6 (1960) 104 C.L.R. 529.

7 (1974) 130 C.L.R. 177.

FACTOR #2 — IS THE IMPOST A TAX?

Their Honours, as part of the historical discussion of s. 90 referred to both Quick and Garran[8] and the first decision on excise, *Peterswald v. Bartley*[9] in which it was held that an excise duty is a special form of tax and so, logically, what is not a tax cannot be an excise duty. Thus initially, it must be established that an impost is 'a compulsory exaction of money by a public authority for public purposes enforceable by law and not a payment for services rendered'.[10]

This definition, taken from *Matthews v. Chicory Marketing Board*[11] has recently been held not to be exhaustive,[12] but again is only a guideline as to whether a particular impost is a tax as opposed to a fee for service or privilege. The labelling of the particular impost would appear to be irrelevant as to its true nature since if the impost has the 'attributes of a tax'[13] then it will always be a tax regardless of what it is called. Unfortunately, the judgment does not spell out what these particular characteristics are, although the method of calculation seems to be a decisive factor. Accordingly, the franchise fees were held to be taxes.

FACTOR #3 — DIRECTNESS OF THE TAX

A string of excise cases[14] had required that excise duties be taxes which 'directly affected commodities'[15] or 'bear a close relation to production or manufacture'[16] and that this requirement was the 'essential characteristic of a duty of excise'.[17] This requirement had led to conflicting opinion amongst members of the High Court in the 1970s and in this case their Honours were critical of the emphasis on form rather than substance in previous s. 90 decisions:

> But it must be said that the characterisation of a law by reference exclusively to its strict legal operation, without regard to its practical or substantial operation, is bound to yield, at least in some instances, highly artificial results.[18]

Interestingly, such a criticized result was the result in *Dennis Hotels*.

Their Honours then proceeded to state that the 'directness' (in the sense of taxing a transaction) or otherwise of a particular impost will not of necessity be indicative of the existence of an excise duty. Further, there is no rigid dichotomy between a licence fee and an excise duty. 'A particular impost or exaction may be accurately described as being both a licence fee and a tax which amounts to an excise'.[19]

On this reasoning, the licence fees imposed in this case could still be duties of excise.

FACTOR #4 — THE EFFECT OF THE IMPOST

The judgment of Mason C.J. and Deane J. recognizes the effects of a tax on production, manufacture, sale or distribution of goods in being passed on in the form of higher prices to the ultimate consumer and seems to suggest that on this basis, the decision in *Dennis Hotels* was wrong. It is implied that a licence fee calculated on past sales will still inevitably be incorporated into final prices since the fee forms part of total business overheads. If this need for the tax to be passed on is the dominant criterion for establishing a duty of excise then it is far too wide. Using this test, all taxes

8 Quick, J. and Garran, R.R., *The Annotated Constitution of the Australian Commonwealth* (1901).
9 (1904) 1 C.L.R. 497.
10 *Matthews v. Chicory Marketing Board (Victoria)* (1938) 60 C.L.R. 263, 276.
11 *Ibid.*
12 *Air Caledonie International v. Commonwealth* (1988) 165 C.L.R. 462.
13 *Philip Morris supra* 525.
14 For example, *Matthews supra*, *Bolton v. Madsen* (1963) 110 C.L.R. 264.
15 *Matthews supra* 303.
16 *Ibid.* 304.
17 *Bolton v. Madsen supra* 271.
18 *Philip Morris supra* 528.
19 *Ibid.*

and licence fees must be excises since they are, sooner or later, added to business costs and turn up in prices. This formulation would result in the virtual destruction of the States' revenue base.

The decision in *Dennis Hotels* was held to be standing for a result rather than a reasoned approach and qualified to the extent that there is no guarantee that a licence fee calculated on past sales is not an excise.

FACTOR #5 — POLICY

Having qualified *Dennis Hotels*, their Honours decided to follow it, *Dickenson's Arcade v. Tasmania* and *H C Sleigh v. South Australia*[20] to preserve the States' revenue base.

> Financial arrangements which are of great importance to the governments of the States and perhaps to the economy of the nation have been made for a long time past on the faith of these decisions.[21]

This would signal a movement towards a very wide definition of excise with special category exceptions such as *Dennis Hotels*. To overrule these decisions, it *was* argued, would entail considerable administrative cost and financial hardship for the States, who would be forced to raise existing taxes, cut services or find new taxes and risk challenge in the High Court. I do not accept this proposition. The fact that the states have arranged their affairs on the basis of these decisions is no excuse for not overruling them. If they choose to arrange their affairs in a particular way then they take the risk that the legal situation will change. If the High Court is so concerned with the financial difficulties of the States, then it could provide more money to them by restricting Commonwealth grants power under s. 96 or re-opening the decision in the *Surplus Revenue* case.[22] If the States were provided with funds under s. 94 then excise could be defined widely and the use of the current miscellany of highly regressive and inflationary taxes could be avoided. It goes without saying that neither of these occurrences are particularly probable in the future.

A more justifiable policy ground, in my view, is the creation of apparent special categories of goods, namely petrol, tobacco and liquor which have a history of regulation in the public interest. This public interest is not expounded in any detail, but has valid economic grounds. All three commodities have externalities (social costs or side effects) for which governments can expect some recompense. Liquor consumption results in costs to health services by virtue of road accidents, tobacco due to its carcinogenic properties and petrol consumption damages the environment. Although most goods have some social costs, it could be said that the costs resulting from these three are comparatively large.

In the present situation, the licence fees in question fell within a special category, were certainly taxes even though licence fees and being calculated with respect to past sales, this was sufficient for them not to be excises.

DAWSON J.

Dawson J. followed a similar line to the Chief Justice and Deane J. by emphasizing the need to read s. 90 with s. 92 and looking at the history of judicial interpretation of the section. He accepted the lack of a concrete definition of 'duty of excise' and was critical of the dismantling of the original narrow definition of excise in *Peterswald v. Bartley*. The problems created by this departure are numerous and in Dawson J.'s view include the blurring of the distinction between customs duties and excise duties, and the attempt to categorize particular taxes as excise duties by reference to their 'directness'. This 'attempt to observe the distinction between direct and indirect taxes in an Australian context has led to curious and illogical results'.[23]

In spite of this criticism, Dawson J. also decided to follow *Dennis Hotels* although he too appears to have confined it rigorously to its facts. He goes on to outline the primary characteristics of a duty of excise to date, being[24]

20 (1977) 136 C.L.R. 475.
21 *Philip Morris supra* 530.
22 *N.S.W. v. Commonwealth* (1908) 7 C.L.R. 179.
23 *Philip Morris supra* 544.
24 *Ibid.* 545.

(1) a consumption tax is not a duty of excise;
(2) a duty of excise is a tax on goods;
(3) a duty of excise can be a tax on manufacture, production distribution or sale;
(4) substance is now more important than form;
(5) a licence fee with a *Dennis Hotels* formulation will not be a duty of excise.

Accordingly, the licence fees, being of a *Dennis Hotels* form but, more importantly, being payable for the privilege of carrying on business were not duties of excise.

TOOHEY J. AND GAUDRON J.

In this judgment their Honours appear to try to apply a type of *Cole v. Whitfield* reasoning to the concept of a duty of excise. Thus to constitute a duty of excise, a tax must bear a close relation to production, manufacture or sale of goods and affect the goods in their character as goods produced or manufactured in Australia.[25] On this basis, it is suggested that the franchise cases [26] are explicable since a tax calculated by reference to past sales in these cases did not affect the goods as subjects of Australian manufacture. Using this test, the question is then asked whether the tobacco licence fee in this case is a duty of excise. In applying the test, Toohey J. and Gaudron J. point out that the scheme of licence fees is probably purely for revenue raising purposes which would tend towards the view that the fee is a duty of excise. However, since the tax under consideration affects locally produced and imported tobacco equally, they found that the tobacco products were not affected 'in their character as goods produced or manufactured in Australia'[27] but rather 'in their character as goods produced or manufactured in Victoria'.[28] Thus the licence fees were not duties of excise.

Unfortunately, this test is, as is the *Cole v. Whitfield* test for s. 92, a test which is difficult to apply. What does it mean to say that goods are affected by a tax in their character as goods manufactured in Australia? The question as to whether imported goods are subject to the tax cannot be the determinative factor since if it were, this would allow the States to impose taxes on a wide range of goods and rely on the argument that the tax would affect imported and locally produced goods equally. The reasoning in the judgment gives the impression that the test proposed has been tailored to explain past s. 90 decisions but cannot be applied in practice.

THE MINORITY
BRENNAN J.

His Honour surveyed the authorities on s. 90 since *Matthews v. Chicory Marketing Board* and enunciated the four propositions of principle which can be derived from them, being, that to be a duty of excise, an impost must be a tax on the production or distribution of goods, must be sufficiently 'connected' with the goods (here lies the distinction between a tax and a licence fee payable for the privilege of carrying on business), but that a number of factors will be relevant to deciding whether the impost is a duty of excise or not. He then went on to discuss the *Dennis Hotels* type licence fee, making it clear that he does not accept the proposition that such a fee can never be a duty of excise. A *Dennis Hotels* formulation will be relevant but by no means conclusive, and its relevance will be determined on a case by case basis.

In this case, Brennan J. found the Victorian licence fees sufficiently distinguishable from the *Dennis Hotels* formulation to constitute duties of excise for a number of reasons. In particular, he emphasized the shortness of the licence period (one month), and the high rate of tax, these both pointing to a mere revenue raising device rather than a regulatory licensing scheme. This view is further supported by the fact that the only criterion for obtaining a licence was the payment of the fee. So it could not be said that the fee was one payable for the privilege of carrying on business.

His Honour also refuted the special category approach put forward by Mason C.J. and Deane J. on

25 *Ibid.* 550.
26 *Dennis Hotels supra*, *Dickenson's Arcade supra*, and *H.C. Sleigh supra*.
27 *Philip Morris supra* 549.
28 *Ibid.* 550-1.

three grounds, namely that there is no implication of such categories in the Constitution, that if tobacco and alcohol are special then why was *H. C. Sleigh v. South Australia* decided on a *Dennis Hotels* basis, and the fact that alcohol and tobacco are prime targets for duties of excise, regardless of their character.

On this analysis, it would be possible for the States to levy 'licence fees' on a wide variety of goods, providing the rates were low (whatever that means), the licence period reasonably long and the legislation imposing them were truly regulatory, that is, specifying additional criteria to be met in order to obtain a licence. These conditions would make the fee not sufficiently 'connected' with the goods and more likely to be held to be a fee for the privilege of carrying on business rather than a duty of excise. This approach is a common sense one which uses statutory interpretation and focuses on substance rather than form in determining what is a duty of excise.

McHUGH J.

McHugh J. followed a roughly similar view to that of Brennan J. focussing on the 'directness' of the tax in entering into the price of the commodity. He noted that the demand for tobacco is inelastic which would enable more of the tax to be passed on to the consumer. This view is not particularly useful since all taxes imposed on goods are sooner or later passed on to the consumer in the form of higher prices.

He too qualified the effect of the franchise cases, clearly rejecting any general principle that a licence fee calculated by reference to past sales could not be a duty of excise. Further, the cases themselves were doubted.

The fees were found by McHugh J. to be duties of excise on the basis of factors outlined by Brennan J. such as the size of the tax *etc*. For this reason, it was also clear that the licence fees could not be for the privilege of carrying on business, especially since the tobacco was taxed only once before reaching the consumer, and that monthly licences are fairly uncommon.

CONCLUSION

The waters of s. 90 remain as murky as ever. The High Court has failed to grasp the nettle and undertake a major review of s. 90 case law as was done with s. 92, and this decision suffers from the usual lack of across the board consistent reasoning which has plagued decisions in this area. There are however two broad principles which I think can be drawn from the case generally.

First, the nature of a duty of excise is flexible and a number of factors will influence a decision, no one of them being decisive. More prominent factors are history and policy, policy taking the form of the need to regulate activities which could be detrimental to the public interest, with the added dimension of preserving the States' narrow revenue base. There is a distinct possibility that such activities may constitute special categories of exemption from s. 90 (per Mason C.J. and Deane J., *contra* Brennan J.).

Secondly, the whole court rejects the proposition that as a general principle, *Dennis Hotels* licence fees cannot be duties of excise. This is consistent with the notion of a flexible interpretation of s. 90, and does not augur well for the States. This decision has heavily qualified the franchise cases, restricting their outcome to being merely a result rather than a general principle. There seems to be a feeling in the judgments that these cases should be overruled, but that the High Court is not quite prepared to take what would be in the States' view such a drastic step.

S. 90 is a direct cause of inefficient State tax administration, due to the width that has been given to the definition of a duty of excise. Not only do the States not have a clear idea of what taxes they can impose, but those that survive challenge are excessively inflationary and regressive. Given the limitations imposed on State taxation powers, the only true solution to the mess created by s. 90 is, in my opinion, for the Commonwealth to foot the bill and ensure a realistic degree of financial autonomy for the states.

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