Legal Definitions of Taxation Terms – Implications for the Design of Environmental Taxes and Charges

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Legal distinctions between taxes, excises and charges, and constitutional provisions, have important implications for the design and imposition of environmental taxes, charges and regulations. This paper examines the legal definitions of various types of taxes, including levies and excise duties, as well as other imposts like user charges and penalties. It highlights the constitutional constraints on state revenue raising through excise duties, and the constitutional requirement that Commonwealth Government taxes do not discriminate between states. Implications for the levying of environmental taxes and charges are identified.

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1. Overview and main points

This paper examines the legal definitions of various types of taxes, including levies and excise duties. It also considers other imposts that are not taxes, such as user charges and penalties. It highlights the constitutional constraints on state revenue raising through excise duties, and the constitutional requirement that Commonwealth Government taxes do not discriminate between states. Implications for the levying of environmental taxes and charges are identified.

The technical legal meaning of taxation terms may differ from their meaning in non-technical contexts. The definition of taxation terms has been the subject of some debate, particularly from a legal perspective. The Australian Constitution and case law require that different types of government impost have certain characteristics to meet the legal definitions of tax, levy, charge, excise or penalty. A government impost that fails to satisfy the relevant legal definition may be challenged and declared invalid. However, the design of valid taxes and other imposts may be complicated by the absence of a definitive legal statement of their characteristics, leading to uncertainty for governments in designing legally valid taxes and other imposts.

The legal distinctions between taxes, excises and charges, and the constitutional provisions, have important implications for environmental taxes, charges and regulations. Legal considerations may determine which level of government can impose a specific environmental impost, how a particular impost is designed and imposed, and who can be subject to an environmental tax, fee or charge. For example, Commonwealth Government environmental taxes must be designed to avoid discriminating between states or parts of states, and to ensure that any differentiation is clearly based on differences in environmental or other conditions. Environmental imposts based on the costs of environmental damage borne by the community (externalities) will usually be legally characterised as taxes and may be excises, which may not be legally imposed by state governments. State environmental licence fees may have to reflect the costs of the regulatory system, or the costs to government of environmental damage mitigation or conservation measures, or the value of benefits received by licensees, to ensure their legal validity. Commonwealth, state and local governments may legally impose user charges for the provision of environmental services, provided the revenue from the charge is directly related to either the costs of service provision or the value of benefits received.

2. Taxation terms — definitions

The technical legal meaning of taxation terms may differ from their meaning in non-technical contexts. For example, the same term may appear in a magazine article and in a report of a government inquiry, but have a different meaning in each instance. The relevant meaning of a term will depend on the context in which the term is used. While the focus of this paper is on technical or legal definitions, it may be useful to compare briefly the technical definitions (discussed below) with their definitions in common usage (see the appendix). While there are clear similarities between the technical and common definitions, the terms are defined less precisely in common usage and are used more broadly than they are in their technical usage. These differences may at times lead to confusion. A clear statement of the meaning of a term may be useful when there is potential for confusion.

International comparisons of tax burdens are complicated by different definitions of taxes and charges. Some imposts defined as charges in some countries may be defined as taxes in other countries, requiring adjustments to ensure comparability among different countries.

The definition of taxation terms has been the subject of some debate, particularly from a legal perspective. The Australian Constitution and case law require that different types of government impost have certain characteristics to meet the legal definitions of tax, levy, charge, excise or penalty. A government impost that fails to satisfy the relevant legal definition may be challenged and declared invalid. However, the

design of valid taxes and other imposts may be complicated by the absence of a definitive legal statement of their characteristics, requiring reference to the various factors the courts have applied in their decisions.

2.1 Tax

The precise characteristics of a tax are not set out in the Australian Constitution. The High Court has traditionally defined a tax as 'a compulsory exaction of money by a public authority for public purposes, enforceable at law, and … not a payment for services rendered.' (Latham CJ, *Matthews v Chicory Marketing Board (Victoria)* (1938) 60 CLR 263)

However, in its most recent discussion on this issue, the High Court has steered away from providing a definitive statement of the characteristics that identify a tax. Instead the Court has applied a number of factors in considering whether a particular impost should be regarded as a tax for constitutional or legal purposes.

- **Compulsion**: A tax is usually compulsory in that the taxpayer has no choice about whether to pay it. The compulsion may not necessarily be legal. A practical, or effective, compulsion may be sufficient to characterise an impost as a tax (*General Practitioners Society v Commonwealth* (1980) 145 CLR 532). A requirement to pay an impost (such as a licence fee) in order to receive a particular benefit or to participate in a particular industry may be judged to amount to taxation, even though the impost could be avoided by forgoing the benefit or by not participating in the industry. For example, a fee for a licence to operate a natural gas pipeline was held to be a tax (*Hematite Petroleum Pty Ltd v Victoria* (1983) 151 CLR 599). In other circumstances, imposts that are effectively compulsory may not be seen as taxes, depending on the other relevant factors. Compulsion is only one of the factors that are relevant.

- **Revenue raising**: The most significant, though not sufficient, factor that needs to be considered is whether the purpose of the impost is to raise revenue (*Luton v Lessels* (2002) CLR 333). The New South Wales tobacco licence fee, which amounted to 75 to 100 per cent of the value of tobacco sold during the licence period, was held to be 'manifestly a revenue-raising tax' because of the large amount of revenue raised (*Ha and Anor v State of New South Wales and ors* (1997) 145 ALR 355*; Walter Hammond and Associates v State of New South Wales and Ors* (1997) HCA 34). However, there may be exceptions. 'Not all taxation has as its primary purpose the raising of revenue; and some forms of taxation are notoriously inefficient means to that end. An objective of raising revenue is not, therefore, a universal determinant.' (Gleeson CJ and Kirby J, *Airservices Australia. v Polaris Holding Company* (1999) C24/1998)

- **Public purposes**: Taxes are generally imposed for 'public purposes', including the financing of government expenditures (*Airservices Australia v Polaris Holding Company* 1999). One indication of whether a tax is imposed for 'public purposes' is whether the amounts raised are paid into the Consolidated Revenue Fund (CRF), although the fact that an amount is paid into the CRF is not itself an indication that an impost is a tax (*Luton v Lessels* 2002). The Court has also stated that an impost may be a tax even if it is not paid into the CRF.

- **Payment for services**: An impost is <u>not</u> a tax when it is a 'payment for services rendered' or a 'fee for services', even though it may share many of the features of a tax. Whether an impost is a tax or a fee for service does not depend on the label given to it, but on its substance and operation. To be legally defined as a 'fee for services', the person required to pay the impost must either receive the services or have directed or requested their provision (*Air Caledonie International v The Commonwealth* (1988) 165 CLR 462). Generally, the overall fee structure for a 'fee for services', as distinct from a tax, is not designed with a general revenue raising purpose. For example, in *General Practitioners Society v The Commonwealth* 1980, it was stated that 'an exaction may be so large that it could not reasonably be regarded as a fee' for service and was therefore a tax. The relationship between the level of the fee and the cost of delivering the service is an important but not definitive consideration, especially where the provider of the services has a statutory monopoly on the provision of the services (*Airservices Australia v Canadian Airlines International Ltd* (1999) 167 ALR 392).

- **Arbitrariness**: For an impost to be a tax, it must not be imposed in an arbitrary manner. Liability for a tax must be imposed by reference to criteria that are general and clear in their application, and not as a result of an administrative decision based on individual preference, unrelated to any test laid down by the legislation (*Deputy Federal Commissioner of Taxation v Truhold Benefit Pty Ltd* (1985) 158 CLR 678).

As well as 'fees for services', there are other categories of compulsory payments that are not taxes. A charge for the acquisition or use of property, a fee for a privilege and a fine or penalty imposed for criminal conduct or breach of statutory obligation is not, generally speaking, a tax (Latham CJ, *Air Caledonie International v The Commonwealth* 1988). But, even where an impost does not fall within the recognised exceptions, it is possible that it may not be classified as a tax (Australian Government Solicitor, Canberra, pers. comm., 31 October 2005; see, for example, *Shahid Kamran Qureshi v Minister for Immigration and Indigenous Affairs* (2005) FCA 11).

Thus the High Court applies a variety of factors when considering what amounts to a tax. Determining whether a particular impost is a tax can be a matter of weighing up the various factors as they apply in the particular circumstances.

2.2 Excise duty

An excise duty is a particular type of tax, which has been defined in case law developed by the High Court as:

> duties of excise are taxes on the production, manufacture, sale or distribution of goods, whether of foreign or domestic origin. Duties of excise are inland taxes in contradistinction from duties of customs which are taxes on the importation of goods. (*Ha v State of New South Wales* 1997 368)

Excise duties are typically charged at a rate based on the quantity or value of the goods being taxed. Taxes that are not related to quantity or value, such as a flat charge unrelated to usage/purchase, may not be considered to be excise duties. However, in some cases, the High Court has found an impost to be an excise duty, despite there being no relationship between the amount of the tax and the quantity or value of the goods manufactured or produced. In *Hematite Petroleum v Victoria* 1983, the High Court invalidated a fixed fee imposed on a licence to operate specific pipelines carrying natural gas from Bass Strait. The absence of a relationship between the amount of the tax and the quantity or value of the goods manufactured or produced was judged to be:

> outweighed by the combination of a number of other factors, namely, the magnitude of the tax, its nature as an indirect tax, the fact that it is imposed at the stage of manufacture and production of goods and the fact that it must be paid before an essential step in the actual process of manufacture or production of those goods can be lawfully taken. (*Hematite Petroleum v Victoria* 1983 668*)*

A number of cases have sought to clarify the determination of whether a tax satisfies the legal requirement for an excise duty that it fall upon a step in the stage of production, manufacture, sale or distribution to final consumers. High Court decisions on the incidence of specific taxes are based on legal considerations, which may lead to significantly different conclusions from those based on an economic understanding of tax incidence. From an economic perspective, all taxes will be at least partly passed on to the final consumer, except under some special demand and supply elasticities. In contrast, legal analyses inquire into the operation and substance of the enabling legislation:

> … one must ask whether the real operation and effect of the Act by which the duty is imposed is to tax the goods directly, whatever be the means it employs. The question is a legal one. Economic consequences are irrelevant. (Wilson J, *Gosford Meats Pty Ltd v The State of New South Wales and Anor* (1985) 155 CLR 368)

Similarly, in another case the judge stated that 'in deciding whether in its operation a State statute does impose a duty of excise … [t]his does not involve any resort to economic theory: the question remains a legal question' (Barwick CJ, *Dickenson's Arcade Pty Ltd v Tasmania* 1974).

A tax on the consumption of goods may not be an excise, if it taxes only 'the act of consuming goods, completely divorced from the manner or time of their acquisition by purchase' (Barwick CJ, *Dickenson's Arcade Pty Ltd v Tasmania* (1974) 130 CLR 177). It may be difficult to formulate taxes that meet this condition. In more recent cases, the question of whether a consumption tax is a duty of excise has been deliberately left open by the High Court (*Capital Duplicators Pty Ltd v ACT* (No. 2) (1993) 178 CLR 561; *Ha v New South Wales* 1997). Accordingly, a state could not proceed to impose a tax on consumption in the certain knowledge that it would be upheld (Australian Government Solicitor, Canberra, pers. comm., 31 October 2005).

Despite the existence of a body of case law, legal uncertainty appears to remain about whether certain taxes are excises:

- There seems to be some uncertainty about which activities will be seen, on a legal perspective, to form part of the production process. For example, a tax on plant, equipment and tools used as inputs to the productive process but not intended, on a legal analysis, to be passed on to consumers would seem not to be an excise (*Logan Downs Pty Ltd v Queensland* (1977) 137 CLR 59).

- There may also be uncertainty about the legal interpretation of what is actually being taxed. For example, a tax on land planted with chicory was held to be a tax on the production of chicory, rather than on the land, and was therefore judged to be an excise (*Matthews v Chicory Marketing Board (Victoria)* 1938).

2.3 User charge

The term 'user charge' is not a technical legal term and does not have an established legal definition (Australian Government Solicitor, Canberra, pers. comm., 31 October 2005). It is an economic term encompassing fees for service and payments for goods. It 'may be defined as a payment for which the payer receives a benefit in direct proportion to the amount paid, and … serves to recover some or all of the costs incurred by the provider of the service or good.' (Hatfield Dodds 1999, p. 3) User charges are not generally taxes.

2.4 Licence fee

Licence fees may or may not be taxes. The High Court has investigated the nature, purpose and level of licence fees to determine whether licence fees have been imposed as fees for service or as a form of taxation. There have been cases where state licence fees have been deemed to be taxation and have been declared to be excise duties and hence invalid (see the examples in section 3.2 of this paper). There have been other cases where licence fees have been found not to be taxation (see Box 3.1).

It appears that licence fees may be considered as fees for service, rather than as taxes, where holding the licence confers clear benefits to licensees (including access to a limited resource) and where the licence fees bear a reasonably close relationship to either the costs of administering the licensing system and associated regulatory framework, or to the value of the benefits received by licensees (see section 3.2).

2.5 Levy

There appears to be no specific legal definition of a levy. The term is used broadly to encompass both taxes and charges. However, 'levy' appears to be commonly used to describe taxes where the revenue raised by the tax is identified as being for specific expenditures, for example, the Medicare levy, Research and Development Corporation levies for agricultural industries, cost recovery levies to fund regulatory activities in the telecommunications and postal industries, a proposed national salinity levy, and a proposed environment levy directed towards promoting the sustainable use of Australia's catchment systems (HRSCEH 2000). Whether a particular levy is a tax depends on whether it has the general features of a tax (set out in section 2.1 of this paper).

The Productivity Commission report *Cost Recovery by Government Agencies* (2001) considered the role of levies in cost recovery for government services. The use of levies was seen as 'a tool for improving economic efficiency and equity' by requiring firms and consumers to pay for the services they receive from government (Productivity Commission 2001, p. 11). Levies – rather than user charges – were appropriate in cases where:

- it is possible to identify a group of beneficiaries but difficult to identify individual users or the extent of their usage, such as an industry levy to fund marine navigation services;
- the users of services can be identified but usage is costly to monitor;
- the users of services can be identified but the determination and levying of user charges would be administratively complex, such as a flat passenger movement charge to recover the costs of customs, immigration and quarantine; and
- imposing fees on users directly may discourage the use of a particular service, such as therapeutic goods recall activities, the costs of which are recouped through an industry levy rather than charges on the particular company recalling a product.

While levies imposed for cost recovery purposes by government agencies are related to the costs of service provision, they are legally taxes, not user charges, because levy payments are not clearly related to the cost or value of benefits received by individual payers.

Hypothecated taxes differ from other levies imposed for specific purposes in that hypothecated tax revenues must be paid into a trust account established for the specific purpose for which the tax is imposed. Revenues must not be used for any other purpose. Levies that are not hypothecated are paid into consolidated revenue and excess revenue, above expenditure for the specified purpose, may be used for other purposes. Revenue from the Medicare levy is not hypothecated while the Research and Development Corporation levies are paid into trust accounts.

The imposition of levies for specified purposes is often seen as promoting public acceptance of those taxes — the 'view that there would be community support for tax levies directed at specific purposes.' (Allen Consulting Group 2001, p. 96)

The Australian Treasury generally opposes the use of earmarked tax revenues because it potentially reduces the 'efficiency and effectiveness of government through impeding budget review and flexibility' (Treasury 1996 cited in Hatfield Dodds 1999, p. 4). A reluctance to earmark tax revenues is shared by the OECD:

> Earmarking the revenue of environmental taxes should … be considered with great caution. There is a clear risk that such policies contribute to an inefficient allocation of resources; it may also cause governments' spending priorities to become 'locked in', thereby limiting their future options for policy changes. Earmarking could contribute to suboptimal spending on environmental priorities, to the detriment of other policy areas; and to increased overall government spending. (OECD 1997)

Levies imposed by governments are usually, but not always, compulsory. For example, high income earners can avoid paying the Medicare levy surcharge by taking out private health insurance. However, they must either pay private health insurance fees or incur the Medicare surcharge.

Levies may be imposed by authorities other than governments. Schools, for example, commonly charge book levies and 'voluntary' levies to parents. These levies are usually compulsory, although low income parents may not be required to pay. They may be seen as a user charge for specific educational goods and services provided to or for students. However, the common practice of averaging costs and charging a uniform levy for all students at the same school suggests that such levies may not be in direct proportion to the goods and services actually received, as commonly required for a user charge. Another example is body corporate levies for common services.

2.6 Other imposts

A royalty may take one of two forms: (a) payments made under licence to the holders of monopoly rights such as patents and copyrights; and (b) payments made in respect of the exercise of a right to take a substance, and calculated either in respect of the quantity taken or the value of the substance (*Stanton v Federal Commissioner of Taxation* (1955) 92 CLR 630). For income tax purposes, royalties include any amount paid or credited for:

- the use, or right to use, any copyright, patent, design, model, secret formula, trademark or like property right;
- the use, or right to use, industrial, commercial, or scientific equipment or the supply of such knowledge;
- the reception, or right to receive, visual images or sounds transmitted to the public by satellite, cable, or optic fibre;
- the use in connection with television or radio broadcasting of visual images or sounds transmitted by satellite, cable, or optic fibre;
- the use, or right to use, motion picture films, films, or video tapes in television, or tapes for radio broadcast; or
- a total or partial forbearance of any of these uses or rights to use (see s. 61(1) of the *Income Tax Assessment Act 1936*).

A royalty 'is not a tax and, not being a tax, cannot be a duty of excise' (*Harper v Minister for Sea Fisheries and others* (1989) 168 CLR 314). The 'essence of a royalty [is] that the payments should be made in respect of the exercise of a right granted and should be calculated in respect of the quantity or value of things taken, produced or copied or the occasions upon which the right is exercised.' (*Australian Tape Manufacturers Association Ltd and Ors v The Commonwealth of Australia* (1993) HCA 10) Therefore a royalty is analogous to a fee for service or user charge.

Rates are generally 'a tax on property, imposed by a local authority, and used for the maintenance and supply of services, as garbage, sewerage etc' (Macquarie Dictionary 2001). Depending on the circumstances, rates can amount to a tax, or they can be characterised as a fee for service. For example, ordinary rates that are imposed under local government Acts generally constitute taxes. Special rates which a council may impose in order to meet all or part of the cost of any works, services, facilities or activities within the council's area may constitute fees for services (for example, an environmental planning charge or a domestic waste charge).

A penalty is ordinarily defined as an amount imposed for either the breach of a prohibition or the failure to discharge an obligation (see *MacCormick v Federal Commissioner of Taxation* (1982) 52 ALR 53 at 63; *R v Barger* (1908) 6 CLR 41 at 99). A penalty is not a tax. In *R v Barger* (1908) 6 CLR 41 at 99, Issacs J described the difference between a tax and a penalty as follows:

> The difference between a pecuniary penalty and a tax is that the former is a sum required in respect of an unlawful act, and the latter is a sum required in respect of a lawful act.

In *Re Dymond* (1950) 101 CLR 11, the High Court held that provisions imposing a penalty 'by way of additional tax' constituted a penalty, rather than a tax. The factors considered in reaching the decision were whether the charge was 'directly punitive, and only indirectly fiscal', and whether it was imposed 'as a sanction and not for the sake of revenue as such'.

Table 2.1 summarises the legal criteria for classifying taxes, excises, and other government charges.

Table 2.1 **Legal Criteria for Classifying Taxes, Excises, Charges and Levies**

<table>
<tr><td colspan="11">Payment for goods or services received?</td></tr>
<tr><td colspan="3">Yes</td><td colspan="8">No</td></tr>
<tr><td colspan="3">Identifiable benefits received by payer?</td><td colspan="8">Legally compulsory?</td></tr>
<tr><td colspan="2">Yes</td><td>No</td><td colspan="8">Yes</td><td>No[3]</td></tr>
<tr><td colspan="2">Payment based on value of benefits or cost of service provision?</td><td colspan="2">Legally compulsory?</td><td colspan="7">Purpose to raise revenue for general government expenditure?</td><td colspan="2">Payment for right to access resources?</td></tr>
<tr><td>Yes</td><td>No</td><td>Yes</td><td>No</td><td colspan="5">Yes</td><td colspan="2">No</td><td colspan="2">Yes</td><td>No</td></tr>
<tr><td>USER CHARGE
eg public transport fares</td><td>TAX
eg fee for licence to sell X-rated videos</td><td>TAX
eg pollution tax</td><td></td><td colspan="5">TAX</td><td colspan="2">Earmarked for specific purpose?</td><td colspan="2">Payment based on value of benefits received by payer?</td><td></td></tr>
<tr><td></td><td></td><td></td><td></td><td colspan="5">Tax on stage in production or distribution process?</td><td>Yes</td><td>No</td><td>Yes</td><td>No</td><td></td></tr>
<tr><td></td><td></td><td></td><td></td><td colspan="4">Yes</td><td>No</td><td>TAX
eg Medicare levy, Guns Buyback levy</td><td>PENALTY
eg fines imposed in respect of unlawful activities</td><td>ROYALTY
eg mineral royalties, copyright fees, Tasmanian abalone licence fee</td><td>TAX
eg oil pipeline licence fee, resource rent tax</td><td></td></tr>
<tr><td></td><td></td><td></td><td></td><td colspan="3">% rate on quantity or value of good?</td><td rowspan="3">TAX
eg income tax</td><td rowspan="3"></td><td rowspan="3"></td><td rowspan="3"></td><td rowspan="3"></td><td></td></tr>
<tr><td></td><td></td><td></td><td></td><td>Yes</td><td colspan="2">No</td></tr>
<tr><td></td><td></td><td></td><td></td><td>EXCISE
eg GST, fuel excise, sales tax</td><td colspan="2">TAX
eg NSW levy on Water Board</td></tr>
</table>

Notes: **1.** This table provides only a general overview and there are exceptions to the categories listed above. For example, there have been cases where an impost has been held to be an excise duty despite there being no relationship between the amount of the tax and the quantity or value of the goods manufactured or produced.
2. The answers to the questions in the table are based on legal considerations, which may not always coincide with answers based on economic principles.
3. While not legally compulsory, some of these imposts in this category may effectively be compulsory (see p. 2 of the paper).

3. Constitutional provisions for taxes

3.1 Commonwealth Government taxation powers

The Constitution grants the Commonwealth Government the power to impose 'taxation; but not so as to discriminate between States or parts of States' (s. 51 (ii)). A tax law that discriminates between states or parts of states will therefore be invalid. Taxes that have different impacts on different states or parts of states may not be considered discriminatory if their different impacts are clearly based on different factual circumstances, or where differential treatment is considered 'appropriate' to achieve a 'proper' government objective:

> The essence of the notion of discrimination is said to lie in the unequal treatment of equals or the equal treatment of those who are not equals, where the differential treatment and unequal outcome is not the product of a distinction which is appropriate and adapted to the attainment of a proper objective. (*Permanent Trustee Australia Ltd v Commissioner of State Revenue* (2004) 211 ALR 18)

However, this case contains little discussion of when a distinction is 'appropriate', how such distinctions should be 'adapted', and what objectives are 'proper'. Consequently there is legal uncertainty about when taxes with different impacts on different states or parts of states are discriminatory and when they are considered appropriate.

The Commonwealth may, under s. 51 (ii), impose a tax on an activity even though it does not have the constitutional power to otherwise regulate that activity (*Northern Suburbs General Cemetery Reserve Trust v Commonwealth* (1993) 176 CLR 555). Section 99 of the Constitution prevents the Commonwealth Government from giving preference to a state or any part of a state through regulatory or revenue measures. Section 92 prohibits the imposition of restrictions on trade and commerce among the states that create protectionist barriers and reduce competition (*Cole v Whitfield* (1988) 165 CLR 360). These sections may have implications for the design of environmental taxes and regulations, such as the auction of tradeable pollution permits.

Section 114 of the Constitution provides that the Commonwealth can not impose 'any tax on property of any kind belonging to a State'. This provision may determine who may be subject to Commonwealth environmental taxes in certain circumstances.

3.2 Constitutional provisions for excise duties

The Australian Constitution gives the Commonwealth Parliament exclusive power to impose excise duties, and consequently prevents the states and territories from imposing excises. Section 90 of the Australian Constitution provides that:

> 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.

This provision was intended to permit the Commonwealth Government to implement a national tariff policy, and to prevent the states from imposing local tariffs (so that there would be a common Australian market). However, over time, successive High Court decisions have expanded significantly the scope of s. 90.

The current interpretation of s. 90 is that 'any tax in respect of goods at any step in their production or distribution before they reach the point of consumption is an excise.' (Gibbs 2003) Three High Court judges expressed the view in 1997 that 'the effect of the decision in *Parton v Milk Board (Victoria)* was to establish a conception of an excise duty which has the capacity to encompass all taxes on commodities.' (Dawson, Toohey and Gaudron JJ, *Ha v State of New South Wales* 1997*; Walter Hammond v State of New South Wales* 1997)

The High Court's interpretation of s. 90 has two main effects. First, the states are prevented by the Court's broad interpretation of s. 90 from imposing a general sales tax or consumption tax, such as a Goods and Services Tax (GST). Hence the Australian Government imposes a national GST and pays the revenue from the GST to the states and territories. The impact of s. 90 is seen by some commentators (see Gibbs 2003) as placing an excessive restriction on the states' taxing powers, with the consequence that the states are forced to rely for revenue on inefficient taxes, such as stamp duties and payroll tax, and on large transfers of revenue from the Australian Government (due to vertical fiscal imbalance).

Second, the states are, except in strictly defined circumstances, prohibited from levying a sales tax, purchase tax or tax on the production of specific goods when the rate of tax is related to the quantity or value of the goods, since such taxes have been declared to be excise duties. Some examples of state levies ruled invalid by the High Court are:

- a levy imposed on the owners of stock used for production, and intended to raise funds for animal husbandry (*Logan Downs v Queensland* 1977);

- a levy to finance the administrative costs of an industry marketing board (*Parton v Milk Board (Victoria)* 1949);

- a fish processing licence fee, the revenues from which were paid into a fund that financed the costs of regulation and development of the industry (*Kailis v Western Australia* 1974);

- a licence fee to operate abattoirs and slaughterhouses, the revenues from which financed the regulation and monitoring of meat processing standards (*Gosford Meats v New South Wales* 1985); and

- a fee for a licence to sell 'X' rated videos (Rainsong Holdings Pty Ltd v Australian Capital Territory and Anor (1993) HCA 68).

The High Court had allowed the states to charge licence or franchise fees from sellers of alcohol and tobacco under certain conditions. Until recently, fees calculated by reference to the quantity or value of goods sold or purchased during a period other than the licence period were held to be valid. Since there was no direct correlation between fees payable during the period and sales or purchases during that period, the fees were legally deemed not to be a tax on production or distribution of goods during the term of the licence, and consequently were held not to be excise duties.

However, in August 1997, the High Court overturned previous case law and ruled that the New South Wales tobacco licence fee was an excise duty (*Ha v New South Wales* 1997*; Walter Hammond v State of New South Wales* 1997). The decision effectively invalidated state and territory franchise and licence fees.

Hatfield Dodds (1999) suggests that fees reflecting the cost of administering a licence scheme imposed to meet certain regulatory objectives may be valid under the Constitution. In such cases, the licence fees may be interpreted as fees for services (or user charges). However, to be a fee for service, the licence holder must receive identifiable benefits (*Parton v Milk Board (Victoria)* 1949; *Kailis v Western Australia* 1974; *Logan Downs v Queensland* 1977; *Gosford Meats v News South Wales* 1985) and the licence fees must bear a reasonable relationship to either the cost of providing the service or to the value of the service received (*Airservices Australia. v Polaris Holding Company* 1999).

In an important case, the Court held that a fee for a licence to take abalone, calculated by reference to the amount which the licensee was entitled to take, was not an excise (*Harper v Minister for Sea Fisheries* 1989) (see Box 3.1). In this case, the fee was deemed to reflect the value of the benefit received from holding a licence and was a charge for exclusive access by licensees to publicly-owned property, that is, the right to fish for abalone. The objective of the licensing system — conservation of a finite natural resource — was a deciding factor in determining the nature of the licence fee.

This case has important implications for licensing schemes established to conserve limited natural resources, for the auction of rights to use certain resources, and for resource rent charges when they are imposed by a state or territory. An important caveat, however, is that the licence fees, auction prices, and

resource rents charged in these cases must relate to the value of the access rights to the resource. Fees and charges that are judged by the Court to be substantially greater than the value of the access rights may be deemed to constitute taxation (see Box 3.1) and may then be invalidated as being excise duties. It is important to note that the value of access rights determined from a legal perspective may not be the same as the value calculated on an economic basis. From an economic perspective, licensees would not be willing to pay licence fees that exceeded their private benefits from holding the licence.

Box 3.1 **Harper v Minister for Sea Fisheries 1989**

The Tasmanian abalone licensing system seeks to protect abalone stocks from over-fishing by granting quotas to licensees. The regulations allow the Minister to issue and sell commercial abalone licences, with the price prescribed in the regulations.

In a unanimous decision, the High Court decided that the licence fee is not a tax and that the abalone licensing system 'is not a mere device for tax collecting'. The licensing system effectively grants private property rights to fish for abalone to licensees. The licensing system converts a public right to fish in tidal waters into a

> privilege confined to those who hold commercial licences. … it is an entitlement … created as part of a system for preserving a limited public natural resource … In that context, the commercial licence fee is properly seen as the price exacted by the public, through its laws, for the appropriation of a limited natural resource to the commercial exploitation of those who, by their own choice, acquire or retain commercial licences (Mason CJ, Deane and Gaudron JJ).

The licence fee is payment for the property rights granted by the licence and attached quota — 'it is a charge for the acquisition of a right akin to property.'

> As the amounts payable to obtain an abalone fishing licence are of the same character as a charge for the acquisition of property, they do not bear the character of taxes. They are not duties of excise.

Three judges in the case cautioned that a charge for access to a resource, even though it is imposed to conserve the resource, may constitute a tax if the charge exceeds the value of the private benefits (to the licensees) obtained from access to the resource.

Source: Harper v Minister for Sea Fisheries and others (1989) 168 CLR 314 F. C. 89/044.

3.3 Constitutional provisions for user charges

Section 53 of the Constitution distinguishes between taxation, and fees charged for licences (however, some licence fees can be taxes, as discussed in section 3.2) and fees for service. It provides that:

> … a proposed law shall not be taken to appropriate revenue or moneys, or 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.

For an impost to be a user charge or fee for service rather than a tax, the High Court requires that 'particular identified services [must be] provided or rendered individually to, or at the request or direction of, the particular person required to make the payment', and 'it is not sufficient that the charge be levied to defray the expenses of an authority charged with the performance of functions which benefit the class of persons from whom it is exacted' (Gaudron J, *Airservices Australia. v Polaris Holding Company* 1999). For example, a levy on stock to finance animal husbandry and health measures was held to be a tax, rather than a user charge, because it was not possible to identify specific benefits received by individual payers:

> The Stock Fund [into which revenues from the levy were paid] is no doubt applied for purposes which are beneficial to farmers and graziers generally, but no particular service or benefit need be rendered

> to any owner of stock who is required to pay an assessment, and if, by coincidence, the person liable to pay an assessment has been rendered some service under the Act, the assessment is not payable because that service has been performed and bears no necessary relation to the expenditure incurred in providing that service. (Gibbs J, *Logan Downs Pty Ltd v Queensland* 1977)

A charge by a marketing board to meet administrative expenses was also held to be a tax and not a user charge (*Parton v Milk Board (Victoria)* 1949).

Fees for licences to operate in an industry, the revenues from which were directed to the maintenance of industry standards, have been held to be taxes:

> In the present case the licensing system was not mere machinery for the collection of a fee. It had an important purpose of maintaining proper standards in the industry of processing fish. That, however, is in my opinion immaterial. … it is impossible to regard [the licence fees] as fees for services. (*M. G. Kailis (1962) Pty Ltd v Western Australia* (1974) 130 CLR 245)

> The fact that the licensing system is no mere device to collect the [meat processing licence fee], but has been introduced in order to maintain proper standards in the meat industry, does not necessarily mean that the fee for the licence is not an excise … (Gibbs CJ, *Gosford Meats v The State of New South Wales and Anor* 1985)

In the same case, another judge stated that: 'The licensing scheme … is a detailed and comprehensive scheme for ensuring the efficient and hygenic operation of the meat industry in New South Wales. An abattoir licence is a valuable right attaching to particular premises which allows the licensee to participate in that industry.' (Wilson J, *Gosford Meats v The State of New South Wales* 1985) However the fee was still held to be a tax, although not an excise.

Moreover, even when identifiable benefits are provided to payers, the charges must be clearly related to the cost or value of the benefits received by individual payers:

> … if an instrumentality of government provides services or facilities on a user-pays basis, but does not seek to relate its charges to the value of the services, or the cost of providing them, to particular users, then although its total revenues from that activity do not exceed its total expenses, (or total expenses plus a reasonable rate of return on capital), what is involved is taxation. (Gleeson CJ and Kirby J, *Airservices Australia. v Polaris Holding Company* 1999).

In *Airservices Australia v Polaris Holding Company* 1999, the High Court eventually decided, on appeal, that Ramsey pricing was an acceptable method of allocating costs between users of the services provided. The Court rejected the argument that the user charges determined under a Ramsey pricing system did not clearly relate the charges to the costs of service provision and that some users were subsidising other users, implying that the charges constituted taxation.

These decisions may have implications for charges imposed for use of environmental services, where specific environmental benefits are not identifiable as being received by individual payees or where charges are not clearly related to costs or the value of benefits received (see below).

4. Implications for environmental taxes and charges

The legal distinctions between taxes, excises and charges, and the constitutional provisions, have important implications for environmental taxes, charges and regulations. Legal considerations may place limits on:

- which level of government, whether the Commonwealth or state/territory, can impose a specific environmental tax, fee or charge;
- the design of the particular impost to ensure it falls within a particular legal category;

- how the environmental tax, fee or charge is imposed (there are special formal requirements as to the content of Commonwealth tax legislation); and

- who the environmental tax, fee or charge can be imposed on.

As discussed above, taxes are generally imposts for which no goods or services are provided (at the direction or request of the taxpayer), while charges are directly related to the provision of specified benefits. An environmental impost may therefore be considered a user charge where the impost is based on the costs to government of providing a service, which may include the costs of a regulatory regime imposed to ensure the conservation of a natural resource, or the impost corresponds to the value of benefits obtained as a result of environmental regulation (such as the abalone licence fee mentioned above). However, where an environmental impost is based on the costs of environmental damage borne by the community, it may be considered a tax because the impost is not calculated by reference to costs incurred by government. For example,

> … an impost based on measured emissions of pollution would be a tax if no costs were incurred by government in maintaining environmental quality, despite the fact that the implied permission to pollute provides a direct and proportional benefit to the taxpayer. Yet the same impost would be considered a charge, for example, if the government ran a desalinisation plant and imposed a fee on saline emissions into the river catchment to recoup the costs of providing this service. (Hatfield Dodds 1999, p. 3)

This definitional distinction is based on the principle that the main benefits from taxation do not accrue primarily to the taxpayer or in proportion to the amount of tax paid (Hatfield Dodds 1999, p. 3). This principle implies that environmental charges that are designed to internalise an externality by requiring users to pay for discharge rights may be considered to be taxes. Taxes imposed on the production or sale of environmentally damaging goods, that are based on production or sales volumes or values, would be deemed to be excise duties. This may have implications for the capacity of the states and territories to impose environmental taxes.

4.1 State environmental taxes

The states and territories can impose environmental user charges (as discussed above) and environmental taxes provided they do not constitute excise duties. For example, in New South Wales an environment levy was imposed on Water Board customers, earmarked for a program of environmental measures, from 1989–90 for 5 years (OECD 1995, p. 41). Since the levy was a flat fee — imposed at the rate of $80 for water and sewage facilities and $25 for water facilities only — it was not an excise. However there have been cases where an impost has been found to be an excise although it was not levied on the value of quantity of a product (eg. *Hematite Petroleum v Victoria* 1983).

The Victorian Government announced that, from 1 October 2004, it will require water utilities to:

> … contribute funding towards water related initiatives that seek to promote the sustainable management of water and to address adverse impacts to the environment associated with its use.
>
> It is proposed that each authority will be required to pay an annual environmental contribution based on a percentage of its existing revenues. Once this amount has been determined, this will become a fixed amount that the authority will be required to pay annually over four years. …
>
> This is likely to increase prices by an average of five per cent for urban water customers and two per cent for rural customers. (Victorian Government 2004, p. 129)

Important questions may be raised about the legal nature of the Victorian impost – is the charge a tax and, if so, is it an excise? These questions, and any questions about the constitutional validity of the impost, cannot be answered without close consideration of all aspects of the legislative scheme (Australian Government Solicitor, Canberra, pers. comm., 31 October 2005).

However, from an economic perspective and with reference to the characteristics of a tax (set out in section 2.1) and those of an excise (set out in section 2.2), the charge on water utilities appears to have

many features of an excise duty. It falls on a stage in the production and distribution process; the amount of the charge is initially based on the value of goods (the past revenues of the individual utilities); payment is compulsory; there is no discernible relationship between the amount of the charge and either the value of the water or the cost of providing it; and water utilities are expected to pass the charge onto water users. The main feature of the arrangement that may distinguish it from an excise duty is that, after the initial amount of the charge has been determined, it becomes a fixed annual charge. However, the 1997 High Court decision invalidating state government licence and franchise fees calculated in reference to past quantities or values of goods (*Ha v State of New South Wales; Walter Hammond v State of New South Wales* 1997) suggests that calculating a charge in reference to past quantities or values may not be sufficient to differentiate a specific charge from an excise. Application of the same charge for four consecutive years may be a factor in any determination about whether the charge is a flat fee or an excise duty. The method used to determine the amount of the charge at each four-yearly review may be another relevant factor. The legal nature of the charge is therefore uncertain.

4.2 Licence fees

The constitutional prohibition on state imposition of excise duties suggests that the states may encounter legal difficulties in designing state environmental charges related to the production or sale of goods with significant environmental externalities. The states may be able to use differentiated licence fees to address production-based environmental impacts as part of a wider environmental policy or regulatory regime. However, the licence fees must be clearly related to the costs to government of environmental damage mitigation, or to either the costs of environmental management or resource conservation regulations or the value to licensees of these regulations (so that they are judged to be user charges and in the nature of a legal 'fee for services'). State and local governments have increasingly introduced user charges for government-provided environmental services, such as waste disposal.

Alternatively, in the event of a legal challenge, it could be argued that the primary objective of the fees was environmental protection, and not revenue raising, and that the impost was not therefore a tax. For this to occur, it seems that 'the link between the fee and the environmental impact of the licensed behaviour [must be] direct and transparent.' (Hatfield Dodds 1999, p. 36) However, this argument may not in itself be enough to prevent the fees from being held to be a tax. Revenue raising is a significant but not essential determinant of whether an impost will be seen to be a tax. If the fees display the other important features of a tax (set out in section 2.1), then it is likely that a court may hold that the fees are a tax.

4.3 Resource rent charges

The legal position of state resource rent charges is not clear since there appears to be no established case law in this area. Output-based or ad valorem resource rent charges would be excises if they were deemed to constitute taxation. However, since producers receive direct benefits from access to the resource, it may be argued in the event of legal challenge that resource rent charges are payments for access to publicly-owned property and are not therefore taxation (provided the charges reflect the value of resource access to the producers, as in the abalone licence fee case). Charges for access to resources attached to the land may legally be royalties rather than taxes (for example, the Commonwealth Government's petroleum resource rent taxes, and up-front cash payments for coal leases in New South Wales).

Resource rent charges that are not calculated on the basis of the level of production or sales (for example, up-front cash payments for resource access bid at auction) may not be deemed to be excises, and may not even be judged to be taxes if they are seen as payments for access to property (provided the payment reflects the value of the property obtained). However, it should be noted that the legal position of state resource rent charges is not clear because the legal definition of resource rent charges has yet to be tested fully in the High Court (see Calzada 2000).

4.4 Excise duties

Environmental excise duties can be imposed by the Commonwealth Government. However, such duties may require careful design and definition:

> for the Commonwealth to levy a tax according to the quantity or type of emissions released, the quantity of these emissions would need to be established in a legally robust way, which may present practical difficulties. (Hatfield Dodds 1999, p. 32)

In addition, such duties must be carefully designed to ensure that they comply with s. 51 of the Constitution, which requires that the tax applies equally to all states and to parts of states. Any differentiation of environmental product or sales taxes would have to be clearly based on differences in environmental conditions that result in different environmental impacts from the taxed activity. For example, different (nationally uniform) excise rates apply to leaded and unleaded petrol.

4.5 Tax rebates and subsidies

In some cases, tax rebates are paid to differentiate a uniform tax rate. For example, after the High Court ruled in 1997 that the states did not have the legal power to charge excise duties on fuel, the Commonwealth Government agreed to increase by a uniform amount its excise duties on fuel and pass on to the states the revenue from the additional excise duty. In Queensland, where no state excise had been applied to fuel, the Queensland Government paid to wholesalers and distributors subsidies equal to the amount of additional excise collected to leave consumer prices unchanged. In South Australia, where state fuel excise rates varied between urban and regional areas, differential subsidies were introduced for regional areas to partly offset the impact of the increase in the Australian Government excise duty (AAA 2000). The legal status of these subsidies is not certain.

The Commonwealth Government's zone rebates provide income tax concessions to taxpayers resident in prescribed zones 'in recognition of the disadvantages that taxpayers are subject to because of the uncongenial climatic conditions, isolation and high costs of living in comparison to other areas of Australia' (Hicks 2001). These rebates effectively alter the uniform rates of income tax applied to states and different parts of states. The constitutional status of these rebates, and the potential for the use of tax rebates for environmental purposes, may require further research.

It may be possible to differentiate a uniform tax rate through 'geographically targeted outlays that have the same economic characteristics as a tax rebate, but are constitutionally robust because of their different legal character' (Hatfield Dodds 1999, p. 27). A subsidy may be paid to offset the impact of particular excise duties to promote the use of products with environmental benefits. For example, the Energy Grants (Credit) Scheme provides grants for production or import of diesel and premium unleaded petrol with no more than 50 ppm sulphur content. The Scheme also refunds the fuel excise paid by eligible business for off-road use.

4.6 Penalties

Penalties are not taxes. They can be imposed by the Commonwealth Government and by state and territory governments. Penalties may have a role to play in discouraging behaviour that damages the environment. Examples of provisions that impose penalties for environmental damage include:

- the *Antarctic Treaty (Environment Protection) Act 1980 (Cth)* makes it an offence punishable by a penalty or imprisonment to engage in specified activities that would endanger the Antarctic environment, except in specified circumstances (such as action done in an emergency to save a person from death or serious injury) (s. 19);

- the *Great Barrier Reef Marine Park Act 1975 (Cth)* makes it an offence punishable by a penalty to undertake drilling or mining activities in the marine park, to use or enter certain areas without permission, or to discharge waste in the marine park without a permit (ss. 38, 38A and 38J);

- the *Motor Vehicle Standards Act 1989 (Cth)* enables the Commonwealth to establish and apply nationally uniform standards for motor vehicle environmental quality, and imposes a penalty on the supply, use or import of vehicles that do not comply with the standards (ss. 14, 15 and 18); and

- the *Protection of the Sea (Prevention of Pollution from Ships) Act 1983 (Cth)* makes it an offence punishable by a penalty to discharge oil or other specified pollutants from ships, except in certain specified circumstances (such as to secure the safety of a ship or to save life at sea) (ss. 9 and 10).

5. Summary

- The main purpose of a tax is revenue-raising to finance government expenditures. In contrast, a user charge is a payment for specific, identifiable goods or services, and the revenue from the charge is directly related to either the costs of service provision or the value of the benefits received.

- An excise is a type of tax, where the tax is levied on the production, manufacture, sale or distribution of goods. The states and territories cannot legally impose excise duties. Some uncertainty exists about when a tax or levy is an excise.

- There are no legal impediments to the imposition by the Commonwealth, state and local governments of user charges for the provision of environmental services, provided the revenue from the charge is directly related to either the costs of service provision or the value of the benefits received.

- Environmental imposts based on the costs of environmental damage borne by the community (externalities) will usually be legally characterised as taxes and may be excises where they are based on production or sales volumes or values.

- State environmental licence fees may be valid where the fees reflect the costs of the regulatory system, or the costs to government of environmental damage mitigation or conservation measures, or the value of benefits received by licensees.

- The legal position regarding resource rent charges has not been clearly determined in case law. Cash payments for access to natural resources, that are not directly related to production or consumption volumes or values, may be deemed not to be taxes or excise duties. Output-based or ad valorum rentals may either be excises, or charges for access to resources or property.

- Commonwealth Government environmental taxes must be designed to avoid discriminating between states or parts of states, and to ensure that any differentiation is clearly based on differences in environmental or other conditions.

Appendix

The Macquarie Dictionary (2001) gives similar definitions for ‘tax’ and ‘levy’. A tax is a compulsory monetary contribution demanded by government. A levy relates to the raising or collection of money by authority or force, or the imposition of a tax. The main distinction between the terms in common usage appears to be that a tax is typically imposed by government while a levy may be imposed by other authorities as well as by governments.

A charge is defined broadly as placing ‘a load or burden on’ some person or thing. A charge can therefore include a tax, a levy, or an excise duty, as well as other types of charges, such as ‘user pays’ charges. In a finance context, a ‘charge’ is a security given by a borrower on demand to a lender, which gives the lender the right to be repaid by sale of a particular item of property or various assets if the borrower does not repay the loan in accordance with the conditions set out in the loan contract.

In contrast, ‘excise’ has a more precise meaning. An excise is an indirect tax imposed on the (domestic) production, sale or consumption of a particular good. (A tariff is a tax imposed on the international sale of

goods.) An excise may also refer to a tax levied for a licence to carry on certain employment or undertake certain activities. Typically, excise duties are imposed on particular commodities, such as alcoholic beverages, tobacco, or oil, which are widely consumed and have relatively inelastic demands. (Newman 1998; Pass, Lowes and Davies 2000)

Another tax term is 'rates', which refers to a tax on property, imposed by local government and used for the maintenance and supply of services.

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