

# Court patrols the boundary: Tax laws and the Constitution



## CLARKE V COMMISSIONER OF TAXATION.

*Clarke v Commissioner of Taxation*<sup>1</sup> considers the constitutional validity of the imposition of the superannuation surcharge upon a member of a constitutionally protected superannuation fund. Although this case may be of only passing interest from a superannuation law perspective as the superannuation surcharge is now a thing of the past, *Clarke* is significant because of the High Court's exploration of constitutional issues. Namely, the question of whether the Commonwealth had so discriminated against the State of South Australia or so placed a particular disability or burden upon the operations of the State of South Australia as to be beyond the legislative power of the Commonwealth. On this basis the High Court found Commonwealth legislation to be invalid.

The High Court had previously considered a similar issue in *Austin and another v The Commonwealth of Australia*<sup>2</sup> where the validity of the surcharge legislation as it related to the superannuation entitlements of serving State Supreme Court judges was considered. In *Austin*, the High Court found the legislation invalid insofar as it applied to serving judges on the basis that the laws placed a particular disability or burden on the superannuation and activities of a State.

### BACKGROUND FACTS

Ralph Clarke (**Taxpayer**) was elected as a member of the House of Assembly of the South Australian Parliament in 1993. He was re-elected in 1997, and lost his seat in February 2002.

The Taxpayer had superannuation entitlements under three schemes:

- the contributory Parliament Superannuation Scheme;
- the Southern State Superannuation Scheme; and
- the State Superannuation Benefit Scheme (which was subsequently merged with the Southern State Superannuation Scheme).

Between 15 February 2000 and 15 February 2005 the Commissioner of Taxation (**Commissioner**) issued assessments of superannuation contribution surcharge in respect of the Taxpayer's entitlements under the three superannuation schemes, pursuant to the *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1987 (CPSF Assessment Act)* and the *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997 (CPSF Imposition Act)*. The amended assessments related to the financial years ending 30 June 1997 to 30 June 2001 inclusive.

Although the Taxpayer objected to the assessments, the Commissioner disallowed his objection. The Taxpayer then appealed against the disallowance to the Administrative Appeals Tribunal, where the matter was referred to the Full Court of the Federal Court based on the questions of law identified in the appeal. The Full Federal Court found for the Commissioner by distinguishing the present case from the case of *Austin*.<sup>3</sup> *Austin* differed from the present case in that in the present case there was both absence of judicial tenure, and an additional requirement for continued elected success.

The Taxpayer was granted special leave and appealed against the decision of the Full Federal Court to the High Court, which is the subject of this case note.

### RELEVANT LEGISLATION

The *Superannuation Contributions Tax (Assessment and Collection) Act 1997 (Cth) (Act)* legislation of general operation enacted a surcharge on contributions made by or for taxpayers above certain taxable incomes. The liability was imposed upon the providers of the superannuation benefits. Effectively, payment was made out of the superannuation fund. The surcharge did not apply to the Commonwealth<sup>4</sup> or property of any kind belonging to a State.<sup>5</sup>

The CPSF Assessment and Imposition Acts established a separate superannuation surcharge scheme for constitutionally protected funds, a term defined by regulations made under Part IX *Income Tax Assessment Act 1936 (Cth)*, which included the three funds which held the Taxpayer's superannuation entitlements.

The CPSF Acts worked differently from the Act: liability was imposed upon a fund member if the member's adjusted taxable income exceeds a defined threshold amount.<sup>6</sup>

Surchargeable contributions in respect of a defined benefit superannuation scheme were calculated by reference to the actual value of the benefits accrued to the member for a given financial year, plus the actuarial value of the administration expenses and risk benefits provided in respect of the member for that year.

The CPSF Assessment Act provided for deferral of liability to pay the surcharge. Where a member became liable, the Commissioner was required to give the member a notice of liability. The amount was to be paid within three months of the date on which the notice was issued. If the surcharge was not paid when due, the general interest charge was payable.

A consequence of the operations of the CPSF Acts was that upon retirement of a member of a constitutionally protected fund, the member would be liable to pay a tax debt equivalent to about one year's pension.

If the funds of which the Taxpayer was a member permitted commutation of part of his entitlement, he could have covered the surcharge liability, if he so commuted.

If fact, the South Australian Parliament in 1999, amended the legislation governing at least one of the superannuation schemes to which the Taxpayer belonged permitting a member to commute some of his entitlement to allow payment of the surcharge.

## DECISION OF THE HIGH COURT

The central question for determination by the High Court was whether the Commonwealth had so discriminated against the State of South Australia or so placed a particular disability or burden upon the operations of the State of South Australia as to be beyond the legislative power of the Commonwealth.

Accordingly, the Taxpayer's primary contentions questioned the ability of the Commonwealth to interfere with the functioning of the States.

French CJ considered the starting point was that the Commonwealth Constitution assumed the continuing existence of the States, their co-existence as independent entities with the Commonwealth and the functioning of their governments.<sup>7</sup> This underpinned an implied limitation upon the Commonwealth to make a law for the States: the Commonwealth cannot make laws singling out the States by placing a special burden on them, nor could it make laws of general application which would destroy or curtail the continued existence of the States or their capacity to function as governments.<sup>8</sup>

French CJ reviewed and referred to many High Court authorities upon the issue. He found that the States have no general immunity from the taxation power of the Commonwealth. State employees or what might broadly be described as constitutional office holders do not enjoy such an immunity. The laws which impose income tax upon the salaries of members of State Parliament, State Ministers and judges are laws of general application which do not inhibit the capacity of the States to appoint and remunerate public officers.<sup>9</sup>

However, by his analysis of the authorities he found that the Commonwealth cannot, by the exercise of its legislature power, significantly impair, curtail or weaken the capacity of the States to exercise their constitutional powers and functions, or the actual exercise of those powers or functions.

French CJ drew a distinction between a general concept of intergovernmental immunity and recognising that there may be some types of Commonwealth law which would represent such an intrusion upon the functions or powers of the states as to be inconsistent with the constitutional assumption about their status as independent entities.<sup>10</sup> French CJ applied a multifactorial assessment in considering the application of the implied limitation.

1. Whether the law in question singles out one or more of the States and imposes a special burden or disability on them, which is not imposed on persons generally.
2. Whether the operation of a law of general application imposes a particular burden or disability upon the States.
3. The effect of the law upon the capacity of the States to exercise their constitutional powers.
4. The effect of the law upon the exercise of their functions by the States.
5. The nature of the capacity or functions affected.
6. The subject matter of the law affecting the State or States and in particular the extent to which the constitutional head of power under which the law is made authorises its discriminatory application.

The Chief Justice found the relevant factors in relation to the CPSF Assessment and Imposition Act are:

1. The State of South Australia is singled out by reference to benefits and funds established by State laws, which are specifically designated by Commonwealth laws.
2. The laws, insofar as they relate to one of the superannuation schemes, impose a tax specifically upon persons holding office as members of the Parliament of the State.
3. The laws collectively and specifically burden the pension and superannuation benefits able to be enjoyed by the members of the State Parliament.
4. Unlike income tax laws and other laws of general application, the impugned laws are specifically aimed at the remuneration arrangements between the State and members of the legislature.
5. The significance of the effects of the surcharge upon State legislators was reasonably evidenced by the amendment, which the State made to the commutation provisions<sup>11</sup> effecting pension and superannuation entitlements.

The Chief Justice found that the legislation significantly interfered with the remuneration arrangements made between the State and its legislators and, to that extent, significantly burdened the exercise by the state of its powers and functions in fixing the remuneration of its legislators.

The laws were invalid.

In a joint judgment, Gummow, Haydon, Keifel and Bell JJ found in essence that the State of South Australia<sup>12</sup> was left with no real choice but to provide retirement benefits by a method which enabled parliamentarians to meet the burden imposed by the surcharge legislation.

Their Honours found that it is in the interests of a state to attract competent persons to serve as legislators. The capacity to fix the amount and terms of remuneration of parliamentarians is a critical aspect of the conduct of the parliamentary form of government by the State.<sup>13</sup>

Adapting *Austin*, one tendency of the Federal laws in question here was to induce the States to vary their method of remuneration of members of the legislatures, and and:

“The liberty of action of the State in these matters, that being an element of the working of its governmental structure, thereby is impaired. No doubt there is no direct legal obligation imposed by the federal laws requiring such action by the State. But those laws are effectual to do so, as was the *Banking Act* [1945 (Cth)].”<sup>14</sup>

Their Honours, as in *Austin*, adopted the practical question passed by Starke J in the *Melbourne Corporation* case.<sup>15</sup>

“whether, looking to the substance and operation of the federal laws, there has been, in a significant manner, a curtailment or interference with the exercise of State constitutional power.”<sup>16</sup>

In respect of the *Parliamentary Superannuation Act 1974 (SA) (PSS)*, the Acts were invalid.

Membership of the other funds was not limited to members of parliament. Membership extended to a wider class of employees and employers which included employees of the State of South Australia and its agencies. The amount of the Taxpayer’s surcharge in respect of the two funds was much smaller than in respect of the PSS. Both of these other funds were classified as constitutionally protected superannuation funds. In relation to one of those funds, the State of South Australia amended legislation to permit a fund member liable for deferred superannuation contributions surcharge to commute fully the pension or to receive part of it in the form of a commutable pension.

Again, the Commonwealth Act was found to be invalid.

Hayne J, the final member of the court, adopted the reasoning of the joint judgment. However, he made some additional comments. He found that the fact that others apart from parliamentarians and others at the highest levels of government could join two of schemes was not relevant. “The principle that is engaged directs attention to whether the laws in issue interfere with, or impair, the governmental capacities of the States (in this case, a State’s capacity to decide the terms and conditions under which members of the State Parliament serve).”<sup>17</sup> He explained

that the laws here were directed only to those who were to receive benefits from constitutionally protected funds. They were not laws of general application. They did not impose taxes upon the States but they did single out those of the higher levels of government.<sup>18</sup>

The laws in issue in this matter imposed on those persons a special and legally different taxation regime from that which generally applied to those who were to receive pensions or superannuation benefits.

He then analysed the operation of the CPSF Assessment Act and the CPSF Imposition Act and concluded that they worked differently, in that rather than the superannuation providers paying the surcharge, the member paid<sup>19</sup> the surcharge and because of the use of actuarial calculations to determine benefits accruing to a member, this did not always reflect the position of a member.<sup>20</sup>

Hayne, J stated the position:

“What is important is that the laws now in issue, by their effect on how States may choose to remunerate their parliamentarians, place a special disability or burden upon the exercise of powers and the fulfilment of functions of the States. It is for a State to decide how and in what amount its parliamentarians are to be remunerated. Is it to be by salary, with or without funded or unfunded retirement benefits, or other forms of benefit? Are some or all of those benefits to be provided with or without contribution by the beneficiary? Are any or all of the benefits to be defined or are they to be an accumulation of whatever is contributed with interest? Are benefits to be paid by pension or in lump sum? The legislation imposing the surcharge in issue in this matter impairs the capacity of a State to choose between these various forms of remuneration of its parliamentarians in one particular but important respect: **the State has no real choice but to adopt a method of providing retirement benefits that will enable parliamentarians to meet the tax liability specially imposed on them.**”

He also found the laws invalid.

## CONCLUSION AND COMMENT

The High Court in *Austin* found that the Commonwealth had, by its interference with the remuneration of currently serving State judges curtailed or interfered with the exercise of State constitutional powers. Judges, of course, represent quite a narrow group with specific and important

constitutional positions. The legislature was therefore invalid.

In *Clarke*, the High Court was prepared to make a similar finding in relation to a former member of the South Australian parliament and in respect of funds which had as members a wider group of persons not only employees of the State of South Australia, but also persons who were employees of its agencies. Accordingly, the High Court provides a timely reminder that although the law making ability of the Commonwealth and State Parliaments are set out in the *Constitution* and inextricably linked, this does not mean that there are no boundaries on the laws that the Commonwealth can impose on the States. In the case of *Clarke* the High Court definitively determined that the Act was such a piece of legislation that did not comply with these boundaries, and is therefore an unconstitutional exercise of the Commonwealth’s power.

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### Reference notes

- <sup>1</sup> [2009] HCA 33 (Clarke).
- <sup>2</sup> [2003] 215 CLR (Austin).
- <sup>3</sup> *Clarke v Federal Commissioner of Taxation* (2008) 170 FCR 473.
- <sup>4</sup> *Superannuation Contributions Tax (Assessment and Collection) Act 1997 (Cth)* s 33.
- <sup>5</sup> *Ibid*, at s 9.
- <sup>6</sup> *CPSF Assessment Act* at s 8, s 9, s 10.
- <sup>7</sup> *Above n 1*, at [15].
- <sup>8</sup> *Above n 1*, at [1].
- <sup>9</sup> *Above n 1*, at [19].
- <sup>10</sup> *Above n 1*, at [32].
- <sup>11</sup> *Above n 1*, at [35].
- <sup>12</sup> *Above n 1*, at [72].
- <sup>13</sup> *Above n 1*, at [74].
- <sup>14</sup> (2003) 215 CLR 185 at 265.
- <sup>15</sup> (1947) 74 CLR 35.
- <sup>16</sup> *Ibid*, at 76.
- <sup>17</sup> *Above n 1*, at [42].
- <sup>18</sup> *Above n 1*, at [97].
- <sup>19</sup> *Above n 1*, at [101].
- <sup>20</sup> *Above n 1*, at [99].