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The *eJournal of Tax Research* is a refereed journal that publishes original, scholarly works on all aspects of taxation. It aims to promote timely dissemination of research and public discussion of tax-related issues, from both theoretical and practical perspectives. It provides a channel for academics, researchers, practitioners, administrators, judges and policy makers to enhance their understanding and knowledge of taxation. The journal emphasises the interdisciplinary nature of taxation.

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Editorial

20th Anniversary of GST in Australia

It is a privilege to provide this foreword to this special edition of the *eJTR*, commemorating 20 years of Goods and Services Tax (GST) in Australia. Debate about tax in Australia is not new, and certainly debate about the role and form of its indirect tax system is not new. At the time of the introduction of the GST in 2000, our reliance on income tax rather than indirect taxes had been discussed at some length. Compared to other nations we continue to rely comparatively heavily on income taxes rather than consumption taxes. The issues associated with the tax mix that we had, and it seems we still have, were formally raised in 1975 when the Asprey Committee recommended that our then Wholesale Sales Tax (WST) be replaced with a Value Added Tax. In 1985, the Labor government proposed that the WST be replaced with a 12.5% Retail Sales Tax, and in 1992 the Coalition advocated as part of *Fightback!* (its election platform at the time) the introduction of a 15% GST to replace the WST, payroll taxes, import tariffs, petroleum and other excises as well as the Training Guarantee Levy. Conspicuously the excises to be discontinued did not include those on alcohol and tobacco.

Ironically, it was pressure on the states arising from the illegality of the tobacco franchise levies (see *Ha v New South Wales* (1997) 189 CLR 465) that brought things to a head in 1998. From that point the pressure was on to find an adequate alternative funding model for the states whose tax base had been further eroded. The GST that was introduced on 1 July 2000, was the product of a thorough and lengthy consultation and was introduced after the Coalition government had been re-elected with this tax as part of its platform. The tax as introduced included a number of new concepts as it had attempted to take into account the experience of other countries which had introduced such taxes more recently than the original VAT of Europe. At the 2000 ATAX GST conference in Noosa I recall the colourful remarks of barrister Roderick Cordara QC in which he characterised the European VAT as a 1965, VW beetle with only one control on the car's dashboard. The Australian GST he characterised as equivalent to a Holden Statesman luxury car with a massive array of dials, switches, and controls on the dashboard, for half of which we would still have to work out their function. This novelty in aspects of design, new terminology, and the somewhat limited nature of the drafting process necessary in that political context has led to a tax which is rich in many ways including in its anomalies and unique growing jurisprudence.

The articles in this issue of the *eJTR* expand on all of these features and have been capably written by experts in the field. I commend them to the reader as an insight into our unique GST and as a guide on how it may develop and improve.

Michael Walpole
Guest Editor
December 2020

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Making the value added tax happen

Michael D'Ascenzo AO*

Abstract

Political will and a persuasive and well-marketed rationale are required to secure community acceptance of a value added tax (VAT), also termed a goods and services tax (GST). Allied to this political dimension, the capabilities of businesses and their agents are critical considerations in the introduction of a GST/VAT.

From the public's perspective, the merit of a government's decision to introduce a GST/VAT is measured by the net impact of the tax reform measures and their costs of compliance. These in turn are influenced by the design of the GST/VAT and the efficiency and effectiveness of its implementation by the public sector and its administration by the tax authority.

By examining how the GST was introduced in both New Zealand and Australia this article concludes that an ongoing focus on the interdependent trinity of: (1) politics, policy and legislative design; (2) taxpayer acceptance and readiness; and (3) administration, remains essential for making a GST/VAT happen and prosper.

Key words: Value added tax policy; Australian GST; New Zealand GST; legislative design; community acceptance; tax administration

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1. FOREWORD

In 2006 I had the privilege of speaking at a conference in New Zealand hosted by the Victoria University of Wellington to mark the 20th anniversary of the introduction of New Zealand's goods and services tax (GST). On the 20th anniversary of the introduction of Australia's GST, I am again privileged to share insights on how to make a value added tax (VAT) work in practice.

As a former tax administrator and Commissioner of Taxation, any observations I may have on the political and policy processes for the introduction of the GST in Australia are at best peripheral. These rest mainly in the domain of government. Even my insights on the administrative challenges associated with its implementation are limited in personal experience, given that my predecessor Commissioner, Michael Carmody, and others including Rick Matthews (administration) and Bruce Quigley (legislative design), played leading roles on these matters at the Australian Taxation Office (ATO).

Nevertheless, on one important aspect of the intersection of policy, community readiness, and administration I played a modest role – that is, in the development, through the ATO's Public Rulings Panel, of the foundation public rulings associated with the introduction of the GST in Australia. These public rulings provided certainty to the community on the ATO's position on a range of GST issues that had proven vexed in other countries. These public rulings were also the tax technical basis for the ATO's guidance endeavours and products.

In addition, as Commissioner, I had shared stewardship responsibilities with Treasury for the health of the GST, and accountability for the delivery of the ATO's commitments under the then GST Administration Performance Agreement between the Commissioner and the Council on Federal Financial Relations.[1]

More recently I have had the opportunity to advise other jurisdictions on making the VAT happen or on improving its operation.

2. INTRODUCTION

A value added tax is a consumption tax placed on a product or service whenever value is added at each stage of the supply chain to the point of supply. VAT is levied on transactions in the production process, but registered parties in the production chain other than the final consumer are entitled to input tax credits (and refunds where the

[1] In Australia the GST is a federal (Commonwealth) tax but the net revenue collected is currently distributed to the States and Territories under the Intergovernmental Agreement on Federal Financial Relations of July 2011 (IGA), available at:
http://www.federalfinancialrelations.gov.au/content/intergovernmental_agreements.aspx (accessed 28 June 2020). The IGA is the current successor to the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations made prior to the commencement of the GST on 1 July 2000, set out as Schedule 2 to the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (Cth), enacted on 10 September 1999. The Commonwealth Grants Commission distributes the GST revenue to the States and Territories with a view to achieving Horizontal Fiscal Equalisation amongst the States and Territories. The IGA (Schedule A) requires as an accountability mechanism a GST Administration Performance Agreement between the Commissioner of Taxation and the Council on Federal Financial Relations. Schedule A of the current GST Administration Performance Agreement of 2017 contains performance outcome measures and Schedule B outlines the GST Budget for specified administrative activities. The ATO reports twice yearly to the Council through the GST Policy and Administration Sub-Group and the GST Administration Sub-Committee of the Council.

input tax credits exceed the tax payable). In Australia the VAT is referred to as a goods and services tax, to better describe its coverage.

At the time the GST was proposed by the Howard Government in Australia there were 128 countries which operated a consumption tax known as the value added tax. This trend has continued.

In broad and simplified terms, making the VAT happen has three key interdependent and related dimensions. These are:

1. politics, policy and legislative design;
2. community acceptance and readiness; and
3. effective, efficient and fair administration.

The purpose of this article is to impart some wisdom, based on practical experience and the historical record, on how to make a GST/VAT happen. Hopefully the guidance provided will be of benefit to countries which are considering the introduction of a GST/VAT or seeking to refine their VAT policy or administration. This article seeks to achieve this purpose by:

- distilling the lessons learnt from the way the GST legislation was enacted in New Zealand and Australia, and from the way the GST was implemented in Australia; and
- highlighting from this historical perspective the interdependent and non-sequential nature of the processes associated with the introduction and administration of a GST/VAT.

3. POLITICS, TAX POLICY AND LEGISLATIVE DESIGN

> *'Things like GST do not just happen. People make them happen. And they do so because ideas, thoughts and knowledge accumulate to a point where choices narrow and the available paths forward become clearly delineated.'*[2]

3.1 The New Zealand experience in introducing the GST

> *'The success of the GST [in New Zealand] can be traced to five key process elements: political will, the right people, the way in which the proposal was packaged, an effective consultative process, and an effective communication process.'*[3]

The introduction of a major new tax such as a VAT plays out first in the realm of politics and tax policy. These are matters mainly in the domain of the government of the day.

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[2] Ian Dickson, 'The New Zealand GST Policy Choice: An Historical and Policy Perspective' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 45.

[3] Hon Sir Roger Douglas, 'The New Zealand GST Policy Choice and its Political Implications' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 3. See also Jeff Todd, 'Implementing GST – Information, Education, Co-ordination' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 40.

In the case of New Zealand there was a public perception that tax reform was well overdue.[4] Previous reports on and reviews of the tax system had highlighted the problems and limitations of the existing system. It was generally accepted that the existing system did not deliver enough revenue to fund the government's expenditure agenda; that the tax system was not neutral; and that its overwhelming reliance on personal income tax had resulted in high marginal tax rates.[5]

In political terms, it is perhaps more accurate to add to the claim that the decision to implement a VAT is a matter for government, that governments will in their decision-making have regard to the likely voter acceptance of a new, major tax. Governments therefore are inclined to, and indeed need to, focus upfront on community acceptance and readiness when considering the introduction of a VAT. This was recognised in the development of the policy parameters of the GST in New Zealand – a new tax that represented a significant change to New Zealand's tax mix. The nature of the work of the Advisory Panel and Consultative Committees that were established to support the introduction of the GST was all about promoting community acceptance and readiness for the tax. They engaged extensively with key business, industry, community and professional representative bodies and marketed the potential benefits of the reform package. The adoption of this approach was in a sense ground-breaking in that it placed considerable emphasis on participation by interested parties as to both the content and operation of the proposed changes.[6]

In the New Zealand context, the features that were vital to its passage through Parliament and for obtaining public support for the tax included the following:

- packaging of the tax reform measures provided the flexibility needed to demonstrate that the costs to consumers associated with the introduction of the GST would be offset by worthwhile gains through lower personal taxes and increased social welfare benefits.[7] This was especially important in obtaining the support of charities and religious organisations, as well as acceptance of the tax by the general public;

- the Advisory Panel and the Consultative Committees that were established helped to create a bond of understanding between business and government as well as advising the government on the policy and legislative design of the new tax. Perhaps the most significant advice provided by the Advisory Panel was

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[4] Todd, above n 3, 27. See also Dickson, above n 2, 47 who notes that the fiscal deficit had increased to 9 per cent of GDP by 1984.

[5] Robert Stephens, 'The Economic and Equity Effects of GST in New Zealand' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 66:

> A significant amount of preparatory work had been undertaken [P McCaw, *Report of the Task Force on Tax Reform* (Wellington: Government Printer, 1982); New Zealand Planning Council, *Agenda for Tax Reform* (Wellington: Government Printer, 1982)]. The electorate was reasonably well informed on the problems and limitations of the tax system, with acceptance that the tax system did not deliver sufficient revenue to finance government expenditure; that the tax system was not neutral in respect of production, consumption, work, and investment decisions; and that too much reliance had been placed on a single base – personal income tax.

[6] Richard Green, 'Consulting the Public in Developing a GST' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 16.

[7] See Dickson, above n 2, 62: '[t]hrough the GST campaign, the Treasury calculated the likely inflation effects of the switch at around 5-5.5%. Various academics made the estimates between 6% and 8%, which turned out to be closer to the mark'.

> the recommendation to adhere to a single rate of GST with minimal exemptions.[8] The rationale for this advice was a desire to reduce compliance and administrative costs. While this issue was outside the Panel's terms of reference, submissions to the Panel had almost unanimously advocated for such an approach. It was considered that multiple rates and exemptions would increase complexity, whereas a single-rate broad-based tax would minimise the costs of accounting for the tax and the cost of levying it;

- the GST Co-ordinating Office grew naturally out of the government's public relations strategy. The government recognised that the introduction of the GST needed a very extensive information, education and promotional effort from many people. For example, coordination was required to ensure consistent messaging from Government Ministers and the various relevant elements of the bureaucracy, including Treasury, Inland Revenue, Social Welfare and Customs.[9] In addition, and importantly, other key constituencies such as industry, charitable and tax professional bodies were drawn into the marketing and education campaigns;[10]

- the mandate of the GST Co-ordinating Office was to market the GST so as to promote community acceptance and readiness for the tax. It was considered that such an Office could independently market the concept of the tax separately from taxpayer education, which the Inland Revenue Department would do.[11] This perceived independence may have had two possible benefits. It might have made the marketing exercise more persuasive and trustworthy in the eyes of the public, without any negative connotation associated with Inland Revenue. Secondly, it catered for the relative independence of the tax authority from government which means that the former should not engage in marketing campaigns which are clearly political in nature, although the line is often difficult to draw;

- the GST Co-ordinating Office also played a crucial role in dealing with complaints, questions and problems associated with the GST;

- a feature of the way in which New Zealand introduced its GST was the extent to which it engaged with stakeholders through consultative processes. These processes sought to balance business compliance costs and simplicity with revenue and equity considerations. However, these consultations were mainly about improving the government's design rather than a wholesale change to the fundamental parameters of the proposed GST.[12] New Zealand was fortunate that there was general support for a single-rate broad-based GST.

Jeff Todd attributed the successful implementation of the GST in New Zealand to

> a bold government with a strong mandate, committed to sound tax reform principles; a fair, simple, 'clean' tax with minimal exemptions; a genuine commitment to public consultation; widespread dissatisfaction with the current

[8] Green, above n 6, 18.
[9] Todd, above n 3, 29, 31.
[10] Ibid 29.
[11] Dickson, above n 2, 62.
[12] Douglas, above n 3, 8.

> tax system and a public reasonably willing to contemplate radical change; and a small, committed, 'public-private' team with a strong mix of talent and plenty of energy and imagination.[13]

3.2 The Australian experience: a historical perspective

> *'The Senate inquiry* [associated with the Australian introduction of the GST] *had again highlighted the fact that the proposed GST has sharply divided the opinion of tax academics and professionals. There appears to be equally strong support for and opposition to the GST amongst leading tax experts…*
>
> *Nothing in recent times has divided the opinions of Australians as the GST.'* [14]

Often it can take a long time to make substantial changes to a tax system, and the Australian experience with the introduction of the GST demonstrates that it is not only a 'slow burn' but also a repeat game. In Australia, the GST saga was played out through numerous attempts over three decades. It was first proposed in the findings of the Asprey Committee with unsuccessful attempts to introduce such a tax in 1985 and in 1993.[15] It was only on 1 July 2000 that the government introduced a GST based on the value added tax model, as part of a broader package of taxation reform.

The Australian experience has been that successive initiatives to introduce a GST prior to 2000 failed on political terms.[16] Nevertheless, as was the case in New Zealand, in the period prior to the introduction of the GST there was a groundswell of support for tax reform, led by several business and community organisations.[17] In 1997, the Howard Coalition Government established both an Interdepartmental Committee, headed by Treasury, as a Taxation Task Force to prepare options for tax reform, and a Tax Reform Consultative Task Force as a mechanism for public input.

The existing tax system was viewed as complex and costly to administer. Many saw it as inequitable and economically inefficient, failing in terms of revenue adequacy and

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[13] Todd, above n 3, 40.

[14] Binh Tran-Nam, 'Assessing the Revenue and Simplification Impacts of the Government's Tax Reform' (1999) 2(5) *Journal of Australian Taxation* 329, 329, 343.

[15] Taxation Review Committee (Justice Kenneth Asprey, chair), *Full Report* (1975); Sam Reinhardt and Lee Steel, 'A Brief History of Australia's Tax System' (Paper presented at the 22nd APEC Finance Ministers' Technical Working Group Meeting, Vietnam, 15 June 2006).

[16] John Kehoe, 'GST: The Reform That Divided a Nation', *Australian Financial Review* (30 June 2010):

> Australian political history was littered with failed attempts to introduce a single tax on most goods and services levied at the point of purchase. As treasurer in the Fraser government, Howard was rebuffed in 1981 when he proposed a broad-based indirect tax. In 1985, Paul Keating was forced to back down on a 12.5 per cent retail sales tax. In 1993, John Hewson was infamously defeated by an unpopular Labor government after promising to introduce a 15 per cent GST… Hewson, on the cusp of dethroning prime minister Paul Keating at the 1993 election, infamously came unstuck when he struggled to explain how a GST would affect the price of a birthday cake.

[17] Neil Warren, *Tax: Facts Fiction and Reform* (Research Study No. 41, Australian Tax Research Foundation, 2004) 66. For a chronology of the GST debate up to September 1997, see John Harrison, 'The GST Debate – A Chronology' (Australian Parliamentary Library Background Paper 1, 1997-98, 22 September 1997), https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/Publications_Archive/Background_Papers/bp9798/98bp01#INTRO; Kathryn James, *The Rise of the Value-Added Tax* (Cambridge University Press, 2015) 247-259.

susceptible to tax avoidance.[18] A GST was considered by some as a necessary element of a new tax mix which could ameliorate some of these problems. Nevertheless, even though there was widespread dissatisfaction with the existing tax system, the introduction of a GST was still a divisive issue. As it turned out, the pros and cons of a GST were the subject of heated debate in the run up to its introduction.

Over the next 12 months Prime Minister Howard and Treasurer Costello orchestrated the development of the *Tax Reform: Not a New Tax, A New Tax System* (ANTS) package:

> The tax reform plan set out in this document constitutes generational change in the Australian taxation system. The changes proposed in personal income tax rates and thresholds, in business tax, in assistance for families, in Commonwealth-State financial relations, in simplifying and streamlining the indirect tax system, in reducing business costs (including reducing fuel costs), in making private health insurance more affordable, and in many other areas constitute historic breakthroughs.[19]

As a feature of the 1998 federal election, the proposed GST was made one of the major political battle lines. Despite a strong anti-GST campaign, the Coalition Government narrowly won the 1998 election.

The election battle was won, but not yet the war. The passage of the GST through Parliament was 'torturous'. Treasurer Costello introduced a comprehensive package of 14 Bills to Parliament on 2 December 1998. The measures in the Bills were intended to give effect to the Government's A New Tax System package and covered matters such as the Australian Business Number (ABN), Pay As You Go (PAYG),[20] GST (including Transition, Administration and Imposition Bills), personal tax cuts and increased family assistance.

The Bills included a Regulation Impact Statement for the GST.[21] However, some of the conclusions made in the Regulation Impact Statement were subject to debate.[22]

There was substantial Parliamentary scrutiny of the Bills, with four Senate committees examining the legislation, and a lengthy Senate session – the second longest in history. At the time, the government did not have control of the Senate (one of Australia's two houses of Parliament) and numerous amendments to the Bills were made to secure

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[18] Harrison, above n 17. See also Australian Treasury (circulated by Hon Peter Costello (Treasurer)), *Tax Reform: Not a New Tax, A New Tax System* (August 1998) 3, https://treasury.gov.au/publication/tax-reform-not-a-new-tax-a-new-tax-system, which refers to the then existing tax system as failing Australia: '[t]he existing taxation system is out of date, unfair, internationally uncompetitive, ineffective and unnecessarily complex. It is a system that is preventing the development of a more efficient, relevant and accountable framework for Commonwealth-State financial relations'.

[19] Australian Treasury, above n 18.

[20] The PAYG scheme replaced 11 existing payment and reporting schemes including provisional tax, company and superannuation fund instalments, pay-as-you-earn (PAYE), and the prescribed payments and reportable payment systems. PAYG has two distinct components – instalments and withholding. The instalment regime replaced provisional tax and company tax instalment. The withholding regime replaced PAYE.

[21] Regulation Impact Statement for the Introduction of a Goods and Services Tax (1998) 8.

[22] See Ross Guest, 'The GST Package: Has the Senate Resolved the Controversies?' (1999) 2(6) *Journal of Australian Taxation* 419.

passage of the legislation.[23] The most significant amendment was the removal of 'basic' food and beverages from the GST base.[24]

The legislation was passed on 28 June 1999 as *A New Tax System (Goods and Services Tax) Act 1999*. It gained Assent on 8 July 1999 and came into operation on 1 July 2000.

As a postscript to these events, during the 2001 federal election campaign, Labor made a 'GST rollback' a centrepiece of its election platform, but the narrow scope of its rollback proposals, which applied only to gas and electricity, failed to attract widespread public support. Labor lost the election and, while the September 11 attacks and the so-called Tampa affair, about 'children overboard' and the influx of illegal refugees to Australia, dominated the campaign, the electoral loss effectively ended all serious attempts to undo the GST.

While the GST became part of Australia's tax mix, there was nevertheless ongoing political sensitivity and scrutiny on the administration of tax reform, including the GST. A possible adverse impact may have been the government's general reluctance to amend the GST legislation for unintended consequences.[25] The government, chilled by criticism from the Opposition that the speed of the GST's introduction had resulted in an imperfect product, was reluctant to make changes to the GST law. The GST remained a political football for some time and impacted on the administration of the GST. The ATO could address some but not all of the unintended consequences or problems raised as a result of the operation of the GST in practice, through clarification of the law using its purposive approach to interpretation, or by adjusting its processes, forms and procedures. However, there were matters that were beyond the Commissioner's power to remedy.[26] These 'inconvenient' outcomes nevertheless reflected the proper interpretation of the GST Act,[27] and it would have been *ultra vires* for the Commissioner to have acted in a way that was inconsistent with the law.

Notwithstanding recent changes to the GST system,[28] a 'root and branch' review of the GST system in Australia remains largely off the political agenda.[29]

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[23] The Bills were originally drafted with one rate and a broad base like the New Zealand legislation.

[24] There were polarised opinions on the inclusion or exclusion of basic food and beverages from the GST net, with business groups generally arguing for no exemption and religious and welfare groups arguing for a narrower base. The view of the ATO was made public by the then Commissioner of Taxation, Michael Carmody, who said in a speech: 'any attempt to draw a line around food will lead to costly disputation and greatly increased costs for the community in administering the GST': Michael Carmody, 'Preparing for Tax Reform and the New Millennium: Don't Draw the GST Line Around Food' (1999) 2(4) *Tax Specialist* 170. See also Tran-Nam, above n 14, 343. However, others have argued that equity considerations outweigh any additional compliance costs: see Paul Kenny, 'The GST Food Exemption' (2000) 3(6) *Journal of Australian Taxation* 424.

[25] Justice D Graham Hill, 'To Interpret or Translate? The Judicial Role for GST Cases' (2005) 5(11) *Australian GST Journal* 225, 238.

[26] Bruce Quigley, 'Interpreting GST Law in Australia' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 113, 118-120.

[27] *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act).

[28] GST now applies to sales of low value imported goods, and to imported digital products and services. Tampons and other sanitary goods are now GST-free.

[29] For example, the Terms of Reference of the 2008-9 Australia's Future Tax System Review (Dr Ken Henry, chair) (Henry Review) excluded consideration of the GST.

3.3 The copybook

> *'With its unicameral legislature and majority government in the mid-1980s, unfettered by second houses of Parliament or state or provincial counterparts, New Zealand was able to adopt what many consider to be the world's purest value added tax.'*[30]

Australia had the benefit of New Zealand's experience when it introduced the GST. In fact, many of the features of New Zealand's successful implementation of its GST were replicated in Australia.

Following the New Zealand example, the introduction of the GST was part of a package of tax reform. The introduction of the GST was accompanied by significant changes to personal income taxes and social security payments. Adjustments were also made to excise taxes and some specific indirect taxes to adjust for the removal of the wholesale sales tax and the imposition of the GST.

As a point of departure from the New Zealand experience, the government made several compromises to achieve passage through Parliament. The most notable of these was the removal of 'basic' food and certain personal products from the GST base.

Consistent with the New Zealand experience, considerable effort was made by the government to bring key stakeholders within the advising and consultative tent. The ANTS documents highlighted the importance and benefit to be derived from a range of consultative processes.[31] The post-election consultation and implementation strategy for the GST included:

- the Prime Minister and Treasurer meeting with all Premiers, Chief Ministers and State Treasurers to discuss the proposed reform to Commonwealth-State financial relations. This process was assisted by a Working Group of Commonwealth and State officials under the chairmanship of the Commonwealth Treasury;

- the Taxation Task Force continued, supported by a group of working committees, to consult on outstanding areas of policy and associated legislation;

- a New Tax System Advisory Board was appointed to advise on all aspects of the implementation of the New Tax System. It was tasked to pay particular attention to ensuring that the new tax arrangements could be implemented effectively whilst minimising costs and transitional difficulties. The Board advised the government on what help business and the community sector would need in implementing the GST;[32]

- a GST Start-Up Assistance Office was established within Treasury to administer the AUD 500 million assistance set aside by the government to assist the readiness of small and medium enterprises, the community sector and

[30] Richard Krever and David White, 'Preface' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) viii.
[31] Australian Treasury, above n 18, 31.
[32] Hon Peter Costello (Treasurer), 'The New Tax System Advisory Board' (Media Release No. 042, 21 July 1999).

education institutions to deal with their obligations under the GST.[33] Its website contained guides, manuals, media and organisational information.

As can be seen from the above, the government was conscious of the importance of community readiness and of obtaining public acceptance of and support for the GST. These consultation processes were also designed to minimise compliance costs for businesses. Amendments to the Bills were made as a result of consultation with business, industry groups and other stakeholders. However, some of these amendments had the opposite effect of introducing complexity or narrowing the GST base. The amendment to the GST provisions relating to insurance, which had originally been modelled on the New Zealand approach, provides an example.

The ATO was also brought within the tent of policy advisers to advise government and Treasury on the practicalities and potential implications of various policy options, including their feasibility and compliance cost impacts. At the time the ATO was responsible for the development of drafting instructions to the drafters, the Office of Parliamentary Counsel (OPC). The ATO worked closely with Treasury and OPC in relation to the legislative design of the GST.

In terms of legislative design, the framework of the GST borrowed heavily from the New Zealand template.[34] But there were some uniquely Australian elements in the legislation. These included provisions dealing with time of supply and place of supply, as well as the introduction of the concept of reduced input tax credits.

In terms of drafting, the GST Act contains a broad overview of the legislation, defined terms, and boxed descriptions of the purpose and effect of the relevant Divisions. Chapter 2 of the Act provides the basic rules and Chapter 3 outlines exemptions from the GST base. The drafting style uses plain English – for example, 'you' is used throughout the Act, and a supply other than goods or real property is connected with Australia 'if the thing is done in Australia'. The language used in the drafting is also intended to be descriptive; for example a taxable supply at a rate of zero is termed GST-free. However, underlying these simple words are concepts that have potential application across the whole gamut of commerce and consumption. Their application (as is the case with all VAT systems) can give rise to difficult and complex issues of interpretation in some cases. Hence, the importance for taxpayer certainty of the protection afforded by the public and private ruling systems.

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[33] Hon Peter Costello (Treasurer), 'GST Start-up Assistance: Program, Office and Advisory Panels' (Media Release No. 047, 13 August 1999):

> The Office, working to the supervision of the New Tax System Advisory Board and including private sector advisory panels, will help small and medium enterprises, charities and education bodies prepare for the introduction of the GST. The GST Start-Up Office will administer the delivery of $500 million in Government assistance for small and medium enterprises, charities, education bodies through:
>
> - An education and information program on business skills for The New Tax System;
> - Assisting key industry and professional organisations to deliver information and assistance to their members;
> - A 'train the trainer' program to increase the number of people able to train others to provide advice on business skills and the GST; and
> - Direct assistance to individual enterprises to prepare for the GST.

[34] Hill, above n 25, 225: '[s]econd, there is the fact that much of the Australian GST legislation has been based upon the GST or VAT laws of other countries of which the major example is the NZ legislation, although there are signs of Canadian and European Union (EU) influence'.

In seeking to engage interested parties on the content and operation of the proposed changes, the ATO established industry partnerships as a channel for ATO/Treasury and industry to discuss and address GST issues impacting on each sector. The objective was to clarify areas of uncertainty and where necessary to co-design appropriate solutions, whether in the drafting or the administrative procedures that would give effect to the proposed new tax. In all, through these industry partnerships the ATO and Treasury worked through and clarified a plethora of issues, while providing feedback to government.

In a federation such as Australia, the federal government also needs to secure the support of the States and Territories where changes are proposed to State taxes and federal/State financial sharing arrangements. The upshot in Australia of the government's discussions with States and Territories was the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, which envisaged the elimination of specified inefficient State and Territory taxes that were considered to impede economic activity.[35]

Taken together, these multifarious, multi-party interactions supported the political process for the introduction of the GST in Australia, and highlighted matters necessary for community readiness and the administration of the new tax system. Nevertheless, the process seemed more torturous and less bipartisan than had been the case in New Zealand. The outcome in Australia was a less efficient GST, with the extra complexity adding to the compliance and administrative burden.

3.4 Lessons

As a matter of economic theory, a single-rate and broad-based design is seen as desirable to improve efficiency and to reduce the compliance costs of a VAT system. The New Zealand GST is often held up as an efficient system.[36]

The introduction of the GST in New Zealand and Australia provides several political and policy lessons:

- first, the importance of a persuasive rationale for the introduction of a VAT. The community should be provided with enough explanation of the changes to allow them to make sound judgements – 'never fall into the trap of selling the public short';[37]
- a clear majority in Parliament and/or community acceptance of the need for the tax reform package is desirable. The VAT is usually part of a revenue neutral tax reform package to garner community acceptance – such a package could

[35] Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, above n 1, Part 2 Reform Measures, 3 and Appendix A – Taxes Subject to Reform, 11.
[36] In measuring the efficiency of a VAT, a C Index (VAT Coverage Ratio) is used – VAT systems that are broad based with single rates are more efficient in policy terms. Hon Josh Frydenberg (Assistant Treasurer), 'An Efficient and Resilient GST' (speech to the *Future of Australia's GST: Good Design for the Real World* Conference, Tax and Transfer Policy Institute, Canberra, 16 September 2015): '[b]ased on 2012 data, Australia's GST has a coverage ratio of 47 per cent, the OECD average is 55 per cent, and New Zealand has one of the best ratios in the world at 96 per cent'.
[37] Douglas, above n 3, 10.

include income tax cuts, abolition of the wholesale sales tax and other taxes and increases in welfare benefits;[38]

- marketing and communication of the reform package should be done in partnership with key stakeholders such as business, industry, tax professional and community groups;

- wide consultation with the community and key stakeholders improves community acceptance of a new tax and has the potential to minimises taxpayer compliance costs. Hence the three 'C's of consultation, collaboration and co-design with key stakeholders are desirable attributes of any well-managed introduction of a VAT, or refinements to an existing VAT.[39] However, the consultation process should focus on the 'public interest'[40] – making the legislative design better rather than as a consensus building exercise;[41]

- maintain political will – 'don't blink' – because any lack of commitment or consistency on the part of the government will reduce public confidence in the proposed tax or may encourage lobbying for a narrower base;

- the policy and legislative design should be kept simple, and it should seek to resolve interpretational and practical problems that have arisen because of the form of the legislation in other countries.[42] Where in the operation of the GST unintended consequences arise because of the drafting of the law, these should be fixed promptly through amendments to the law;

- consideration needs to be given upfront to community readiness and the capacity of the tax administration to implement the VAT. Given the wide-ranging impacts on the community and the tax administration of a VAT, the time between the passage of the law and its date of effect should take into consideration the preparatory work that is necessary on the part of taxpayers and the tax agency.

The politics in Australia, including a strong anti-GST campaign which had its roots in the successful derailing of the *Fightback!* package incorporating the proposed GST associated with the 1993 federal election; a lack of control of the Senate by the

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[38] As a VAT is generally regarded as a regressive tax, its introduction is usually accompanied by a support package, including income tax cuts and increased welfare benefits. See also Alan A Tait, 'VAT Policy Issues: Structures, Regressivity, Inflation, and Exports' in Alan A Tait (ed), *Value Added Tax: Administrative and Policy Issues* (International Monetary Fund, 1991) 7:

> The question of VAT regressivity and inequity is not simple. It deserves a more thoughtful treatment than simplistic use of exemptions and zero rating. Basically, instead of trying to amend and distort the VAT, its strengths should be used to generate revenue that will enable the government to help the poor in more effective ways. This is probably a more positive way to tackle the issue of regressivity than throwing out the VAT or manipulating the new tax until its merits are eroded.

[39] Graham Holland, 'Planning for VAT' in Alan A Tait (ed), *Value Added Tax: Administrative and Policy Issues* (International Monetary Fund, 1991) 19.

[40] See generally Board of Taxation, *Post-Implementation Review of the Tax Design Review Panel Recommendations* (December 2011).

[41] Douglas, above n 3, 8.

[42] Hill, above n 25, 225: '[a] perusal of the GST Act shows that in many cases consideration was given to problems in the legislation of other countries and a solution to these problems legislated for'.

government;[43] lobbying on equity and sectoral grounds; and the reluctance of the States and Territories to eliminate the full range of specified inefficient taxes, meant that concessions were made on GST policy, and that federal and State taxes were not simplified as much as they could have been.

4. COMMUNITY ACCEPTANCE AND READINESS

> *'A comprehensive education and training program – getting things right first – minimises compliance costs.'*[44]

A focus on taxpayer readiness is essential politically for community buy-in in relation to the new tax. An efficient transition to the new tax also makes it more likely that it can be ensured that the VAT will achieve its revenue purpose while minimising the dead weight of compliance costs. Therefore, a major community change program is required to cope with the introduction of a VAT.[45] Such a program needs to address fundamental behavioural and attitudinal changes as well as business practices such as pricing, accounting and cash flow management. Different strategies are necessary when engaging with small business and large businesses, and in relation to different industries and economic sectors, because they each have different capacities for change. Moreover, the registration, lodgement, reporting and payment processes must cater for the different needs and practices of these sectors. For example, large businesses are usually better able to adopt on-line monthly reporting requirements than many small businesses.

Building community readiness is not solely the responsibility of government and the tax administration – it is best achieved in partnership with business and professional organisations. Ideally, in the delivery of major tax changes, the government and the bureaucracy, especially Treasury and the tax administration, should share responsibility with business, industry, tax professional and community bodies for marketing the changes and educating businesses, their agents and the broader community.

There is a strong interdependence between administration and taxpayer readiness, as there is with the policy design and vice versa. Even before the enactment of VAT legislation, the tax administration's tasks associated with community communication, education and consultation; targeted guidance to business, intermediaries and industries; outreach activities; walk-in, call centre and fieldwork assistance; fact sheets, booklets and guides; and website development, are all essential ingredients in promoting community readiness.

In large measure the success of a VAT is dependent on the ability of businesses to cope with the new tax obligations.[46] This is especially the case for small businesses and their

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[43] See generally James, above n 17, 255-259.

[44] Cedric Sandford, 'Minimising the Compliance Costs of the GST' in Chris Evans and Abe Greenbaum (eds), *Tax Administration – Facing the Challenges of the Future* (Prospect Media, 1998) 130.

[45] Commissioner of Taxation, *Annual Report 1999-2000* (2000) 1: '[t]here can be little doubt that the introduction of the new tax system from 1 July 2000 involved one of, if not the most, extensive community change programs ever tackled in Australia'.

[46] Countries typically include special VAT rules for small businesses. Certain small businesses may not be required to register and pay VAT, often achieved using a high VAT threshold; or may be entitled to use simplified procedures to calculate tax liability (for example cash-based accounting); or may have reduced record keeping and/or simplified invoices requirements; or have longer accounting periods (that is, a

agents, because they generally have the greatest difficulty in adapting to the new tax and suffer disproportionately higher start-up costs than large businesses relative to their turnover, even though they may not contribute the same level of VAT revenue. The existing level of sophistication in the use by businesses of digital accounting, invoice and payment systems will influence the ease with which they can transition to a VAT. The availability of technological tools and support for businesses and their agents such as accounting packages that facilitate record keeping and reporting helps to minimise compliance costs and to embed good compliance habits. Thus, the level of adoption of modern technology by business and their propensity and ability to do so has a significant influence on the success of a VAT system. In introducing a VAT, the opportunity exists for government to promote a more digitally savvy business community, even though the mandating of on-line processes is itself a decision with its own political risks.

In addition, the interface between businesses and their agents and the tax administration contributes to the ease of compliance with the VAT. It is therefore important for the tax authority to have seamless (and preferably digital) processes that allow businesses and their agents to register for the VAT; to file VAT returns within the relevant statutory periods; to pay VAT liabilities on time; and to claim and receive refunds where appropriate.

4.1 The Australian experience

> *'Australian business faces probably its most profound tax changes in several generations. Within this major reform, the new PAYG and GST systems are of critical importance. The effects are likely to vary from industry to industry and business to business. However, it is reasonable to assert that nearly all businesses will need revised and improved management accounting systems to deal with this change.* '[47]

The administration of the new tax system, including the task of promoting community readiness for the GST, started well before the enactment of the GST.[48] The responsibilities of the tax authority and the task of promoting community readiness are closely intertwined. Prior to the GST receiving Assent, the ATO understood the criticality of taxpayer readiness for the successful implementation of a VAT. As can be seen from the Commissioner's 2000 and 2001 Annual Reports, substantial activities were directed towards taxpayer education:

- the ATO distributed more than 12 million publications, fact sheets and booklets. These materials included registration kits, record keeping guides, booklets and checklists, as well as a GST curriculum for practitioners. An interim guide on GST was also mailed to tax agents;
- more than 50 key rulings covering general principles and complex areas of the operation of the New Tax System were developed. Drafts of these rulings were

reduced number of returns required each year). However, the effectiveness of these measures is difficult to quantify when measured against a neutral and non-distortive system.

[47] Jeff Pope, 'Tax Compliance Costs: The Value of Cash Flow Benefits to Business and the Effect of Pay As You Go and the GST' in Michael Walpole and Chris Evans (eds), *Tax Administration in the 21st Century* (Prospect Media, 2001) 303, 311.

[48] Commissioner of Taxation, *Annual Report 1999-2000*, above n 45, 1-2, 55, 60-68.

released for comment and consultation, with the final public rulings being issued after the enactment of the GST law;

- the ATO responded to more than 2.4 million telephone enquiries and about 39,000 written or email enquiries. 'Reply-in-5' was launched to expedite written requests (email, fax, letters) for advice on the GST. This facility responded to 36,500 pieces of correspondence. However, even though the problems that arose were largely at the margin, the program attracted strong criticism where the five-day turnaround target could not be met, as well as concerns about the consistency of replies;

- in the order of 1,000 seminars were run by the ATO and these were attended by more than 200,000 people;

- relevant educational material was added to the ATO's tax reform website which had more than 100 million hits. Treasury's tax reform website also provided information on the GST;

- an extensive program of field visits was directed primarily to assisting businesses and tax agents on site with any issues associated with the GST, Business Activity Statement, ABN and PAYG.

The ATO's focus on community readiness did not stop there. For example the ATO worked closely with peak industry organisations and appointed industry teams covering mining and energy, manufacturing, construction, tourism, accommodation, cafes and restaurants, cultural and recreational, sport and entertainment, transport and storage, communications, banking and finance, insurance and superannuation, property services, motor vehicles, personal, business and other services, primary production, government, charities, religious organisations and public benevolent institutions, health and education.[49] These teams worked through thousands of issues with these bodies, and developed industry specific publications, as well as providing feedback to government.

The ATO concentrated a great deal of effort on the business sector because the scope of the new tax system meant virtually every business transaction that occurred in Australia would have to be recorded and the record keeping practices of many small businesses were poor.[50] This meant that they faced the daunting challenge of introducing or upgrading their business systems to deal with the more rigorous and regular recording and reporting requirements of the GST. In order to assist these businesses, and to promote more efficient processes, the ATO assisted software developers on record keeping and accounting packages designed to ease the compliance burden associated with the GST, and to update their software products used by tax agents to include GST.[51] In the interim while these packages were being developed at reasonable costs to firms, and to reduce compliance costs for micro-businesses, the ATO distributed around one million copies of its free record-keeping software package called e-Record.[52]

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[49] Michael D'Ascenzo, 'Y2K Relationships – The ATO and You Post 2000' (Paper presented at the 38th Victorian State Convention, Taxation Institute of Australia, 1999) 132.
[50] Leigh Edmonds, *Working for All Australians: A Brief History of the Australian Taxation Office 1910-2010* (Australian Taxation Office, 2010) 226.
[51] D'Ascenzo, above n 49, 132.
[52] Edmonds, above n 50, 226.

While marketing the benefits of the GST rested mainly in the political realm, the ATO marketed the need, and developed processes, for GST registration. This was a high priority for the ATO, because businesses need an ABN to trade, and required GST registration if they were above the turnover threshold for voluntary or mandatory registration. The ATO used a variety of media channels to advise businesses of the new tax system's dependence on the ABNs, and about the registration requirements associated with the GST.[53]

In order to register businesses for the ABN and GST, the ATO had to build new infrastructure such as the Australian Business Register (ABR).[54] It then had the task of registering around 2.8 million taxpayer applications for an ABN, and about 2 million businesses were registered for the GST. While it was expected that many business would seek registration close to the date of commencement of the GST, it was still a challenge to respond to these applications in a timely way.[55] In anticipating this workload, the ATO encouraged the use electronic registration, with 62 per cent of registrations being lodged through the Business Entry Point (15 per cent) or the ATO's Electronic Lodgement Service (47 per cent).[56] More generally, the ATO sought to promote digital processes by issuing 137,000 digital signature certificates for lodging Business Activity Statements (BASs) on-line.

In the Australian context, the high dependence of businesses, especially small businesses, on tax agents (and BAS agents), put a sharp spotlight on their capabilities, and well as on the inadequacies of the ATO's interface with them. In introducing a VAT or in refining an existing system, consideration needs to be given to the capabilities of intermediaries, and targeted support needs to be provided to them so that they can effectively assist their clients.

The introduction of the GST was a particularly massive challenge for businesses and their agents who struggled to cope with the requirements of the new tax. It was also a challenge for the ATO.[57] The ATO felt the strain of implementing what was a politically charged tax package. The task of establishing a GST administrative capability was itself complex and difficult from an organisational perspective. Adding to this complexity was the level of political and public scrutiny of the ATO's performance in implementing the new tax system.[58] The political sensitivity of the GST put the ATO under intense

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[53] Commissioner of Taxation, *Annual Report 1999-2000*, above n 45, 65: '[t]o convey the importance of timely registration, we used conventional communication channels such as advertising, publications and public-relations, as well as other media such as websites, workshops, Sky Channel broadcasts, talk-back radio, educational videos, and advisory visits to businesses'.

[54] Ibid 63-68. The ABR was developed as a comprehensive database of Australian Business Number (ABN) registrations. An entity needs an ABN before it can register for GST. Under the New Tax System, the ABN became the new single identifier for business and a key element of the new tax system. The ATO was made responsible for implementing the ABN and the ABR because it 'had the foundations of an appropriate infrastructure, strong partnerships with tax agents and industry groups, and national registration and service centres that registered businesses for taxes': ibid. The ABN is searchable by the public via the online ABN Lookup facility. This facility allows buyers and sellers to know whether their counterparty is registered for GST.

[55] Edmonds, above n 50, 232.

[56] Commissioner of Taxation, *Annual Report 1999-2000*, above n 45, 65.

[57] The ATO had just completed work on Y2K and faced serious challenges and intensive public scrutiny of its handling of mass marketed tax avoidance schemes. It also had to implement the tax changes associated with the Review of Business Taxation (John Ralph, chair) (RBT).

[58] Tom Sherman, *Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Taxation Office* (Australian Taxation Office, 2000) 6:

public scrutiny – a reflection of the interplay of politics, community acceptance/readiness and administration.

Following the introduction of the new tax system (and other tax changes), the confidence of tax agents in the ATO reached a low ebb. A major new tax, together with issues associated with mass marketed tax avoidance schemes, reduced community confidence in the ATO. In response, in 2002 the ATO launched its *Listening to the Community* program.[59] This program influenced the ATO's decision in 2004 to turn a need for new information technology (IT) into an opportunity to transform the ATO into a more user-centric organisation.[60]

An early significant deliverable of the ATO's 'Change Program'[61] was the Tax Agent Portal which provided tax agents with a secure on-line interface with the ATO and revolutionised the relationship between tax agents and the ATO. Subsequently, the Business Portal allowed business to interact with the ATO online, reducing compliance costs.

4.2 Lessons

The effectiveness of implementation processes for a VAT is highly dependent on the readiness of the business community, especially small business and their agents. Special attention needs to be given to supporting their transition to a new tax regime.

It is important to get things right up front:

- there must be both widespread and targeted communication on the VAT. A focus on VAT registration requirements is a necessary prelude and prerequisite to the operation of a VAT system. The communication campaign should cover the basics of the VAT system such as thresholds for registration, requirements in relation to tax invoices, record keeping obligations, pricing issues (VAT inclusive or exclusive requirements), activity statement reporting (for example, usually monthly with electronic lodgement for large business, and quarterly for others), payment and refund arrangements, and transitional matters;
- the extent of taxpayer education is on a grand scale and multiple communication channels should be used;
- the communication should be tailored to the needs of different audiences – for example different industries, firms with different capabilities (usually a

'[a]n important added complexity [was] the increased political sensitivity of tax administration as the major political parties [drew] one of their major battle lines on tax reform and administration'.

[59] Edmonds, above n 50, 230.

[60] Greg Farr, former Second Commissioner of Taxation, speech to the *Government Technology World Conference* 2006, cited in Michael D'Ascenzo, 'Modernising the Australian Taxation Office: Vision, People, Systems and Values' (2015) 13(1) *eJournal of Tax Research* 361, 369:

> [To transform the ATO] from an organisation-centric body into a user-centric one – putting the needs of the community first, standing in their shoes, getting to know them better and working with taxpayers and their representatives – tax agents and the IT industry and others – to work together in developing better services and products to make one of life's certainties just that much easier.

[61] Ibid.

dichotomy between large and small business), and different market segments (for example government and charities);

- industry partnerships should be established to provide targeted education specifically tailored to the relevant industries. These industry partnerships facilitate consultation and co-design on GST processes to reduce compliance costs. They are also a channel for conveying to government specific VAT issues relating to these industries;

- the tax authority must provide easily accessible guidance or advice on the operation of the VAT and ensure that the guidance or advice provided clearly addresses the needs of the taxpayer or their agent. In other words, it should clarify matters and assist the taxpayer or their agent in a practical way – it should not just repeat the words contained in the law;

- it is important to listen to suggestions made by taxpayers and their representatives and respond to the concerns of the various stakeholders. The response could be by way of co-designing administrative processes to reducing compliance costs or by providing feedback to government on possible amendments to the law;

- it makes good sense to support key intermediaries such as tax agents and software developers so that they can assist their clients in managing the obligations under the VAT. By helping tax agents, the tax authority is able to multiply the beneficial impact of its education of tax agents, with tax agents using that knowledge to assist their clients. Tax agents also provide a channel for on-line reporting to the tax authority. By working with software firms, the tax agency can promote better record keeping and a more digital commercial environment. All this is important for a VAT system to prosper because, in the context of a VAT, the invoice and record keeping practices of businesses are core elements of a viable tax base, and online reporting and payment processes reduce compliance costs;

- in assisting businesses, especially small business, it is worthwhile to highlight the managerial benefits associated with the VAT and to encourage greater take up of digital and on-line processes.

5. ADMINISTRATION

> *'Some of the basic requirements for successful administration of a VAT are the following: an appropriate taxpayer identification system; a simple VAT return form which does not request information that cannot be processed in a timely fashion; an effective taxpayer assistance program; a reliable electronic data processing (EDP) system, which provides accurate and timely information; systems for cross-checking information in VAT returns with information from other sources to detect underreporting; an enforcement system that applies different strategies to different kinds of noncompliance; and, finally, a sound and effectively applied penalty system.'*[62]

[62] Milka Casanegra de Jantscher and Carlos Silvani, 'Guidelines for Administering a VAT' in Alan A Tait (ed), *Value Added Tax: Administrative and Policy Issues* (International Monetary Fund, 1991) 31.

Effective implementation of any major tax is critical to its successful operation. The public sector organisations who have responsibilities for implementing the VAT are likely to require additional funding to effectively deliver the desired outcomes. All the necessary implementation tasks require close attention and project management at senior levels. Moreover, it cannot be assumed that the capabilities required for a smooth and efficient introduction of a VAT, including key multidisciplinary skills, will be readily available in these organisations, at least in the short term.

Given the widespread impact of a VAT across the economy, the capabilities of the public sector are likely to be tested when they are required to introduce a major change to the existing tax system. This was certainly the case for the ATO, which had primary responsibility for the implementation of a raft of new tax measures under ANTS and the Review of Business Taxation, as well as challenging 'business as usual' responsibilities.

5.1 Other administrators

It is useful to note up front that in focusing on administration of a VAT the tax administration is not the only public sector agency involved. To varying degrees, responsibility for implementing a VAT also involves other areas of government administration. It is therefore essential to ensure that these other agencies are prepared and capable of meeting their respective responsibilities. It is also important that there are good lines of communication and effective collaboration amongst these different arms of government.

For example, a VAT may result in 'price gouging' by businesses. When the GST was introduced in Australia, a transitional price oversight regime was established under special legislation which gave the Australian Competition and Consumer Commission (ACCC) special powers to ensure that businesses did not engage in price exploitation or misleading and deceptive conduct in relation to the New Tax System changes. The ACCC's Annual Report for 2000-2001 noted that most businesses had acted properly, and that action had been taken in respect of inappropriate practices.[63]

Depending on a country's dependence on imports, the role of the Customs authority in the implementation and administration of a VAT can be critical.[64] For example, in some countries the customs authority collects a substantial proportion of VAT revenue. While

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[63] Australian Competition and Consumer Commission, *Annual Report 2000-01* (2001) 16:

> After one year of the GST the Commission found that most businesses have fully complied with its pricing guidelines. Businesses generally acted correctly in adjusting prices to take account of the tax changes. However, there were instances of inappropriate pricing and price representations. Commission staff investigated approximately 6000 matters and took five cases to court this year, resolving a further 31 matters with court enforceable undertakings.

[64] Casanegra de Jantscher and Silvani, above n 62, 36:

> The customs administration should be ready to collect the VAT on all goods cleared either at import or the exbonded warehouse from the date the VAT is supposed to begin. In most developing countries collections of VAT by customs represent 40-60 percent of VAT revenue. The relevant customs forms will need to be amended to provide boxes for the calculation of the VAT (where chargeable) and for the insertion of the importer's VAT registration number, if he is registered. Of course, the TIN for VAT should become the single identification number for all tax liabilities, including customs. The customs declaration form should relate to the VAT as well as to customs duties. The value for the VAT should be the customs value plus customs duties actually charged, if any (and any other amounts for fees, stamps, etc). Customs brokers and importers should be given timely notification of these requirements to allow them to calculate the VAT and fill out the new customs forms.

the share of GST revenue collected by the Australian Customs Service in the 2001 fiscal year was under 7 per cent of total GST revenue,[65] it was still a substantial amount, and the performance of Customs impacted on the efficiency of dealings at the border.

A design characteristic of VAT systems is the refundability of input tax credits that exceed the GST tax payable in a reporting period, although this requirement has been modified in some countries. In Australia special arrangements with the Reserve Bank of Australia were necessary to facilitate the prompt payment of refunds.

A major focus for the Treasury portfolio in 2001 fiscal year was the New Tax System reforms. The GST Start-up Assistance Office, the ATO and the Australian Competition and Consumer Commission (ACCC) all played major roles in the introduction of the New Tax System, with Treasury playing a central policy role in monitoring and advising on the implementation phase,[66] reflecting the coalescence of administration and policy.

5.2 The ATO experience

> *'Operational procedures must be designed to identify and register traders, process returns, record payments, issue refunds, identify noncompliers, and collect arrears. Appropriate forms must also be drafted. An audit system must be developed to identify and assess noncompliers.'*[67]

As outlined in section 4 above, there is a clear link between many of the activities undertaken by the ATO and the readiness of the community, especially businesses and their agents. The ATO sought to assist taxpayer readiness through extensive education, information and support programs for businesses (including visits by field officers, call centre assistance and web sites to provide information and assistance), and education programs for consumers, as well as targeted activities designed to educate Australia's multicultural communities on their obligations under the GST.[68] All this was done in relation to a highly emotive and politically sensitive matter – taxation.

In terms of legislative design, the drafting process for the new tax system was intensive. Highly skilled officers from the ATO, Treasury and the Office of Parliamentary Counsel were involved in translating policy to legislative design, with some 300 pages of legislation being written in very tight deadlines.

Work commenced early on interpretational issues with 50 public rulings being prepared through the Public Rulings Panel on the GST to help the tax industry understand how the ATO intended to interpret the new legislation.

Inside the ATO, its organisational structure had to be amended to include accountability for the various elements of the new tax system. New lines of responsibility and accountability had to be integrated within the existing organisational structure. For

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[65] Commissioner of Taxation, *Annual Report 2000-01* (2001) 21: in the 2001 fiscal year, Customs collected $1,702 million in GST revenue, with $23,788 million collected by the ATO.
[66] Australian Treasury, *Annual Report 2000-01* (2001). For example, Treasury made constant enquiries of the ATO as to whether the GST revenue was tracking in accordance with Budget estimates.
[67] Holland, above n 39, 22.
[68] Edmonds, above n 50, 230: '[t]ax officers also visited 232,000 people and businesses, conducted around 27,000 interviews, spoke to some 1,500 groups, and answered 4.1 million telephone calls and more than 68,000 written requests for tax technical advice'.

example, a new Goods and Services Tax Division was established, and separate arrangements were made for the Australian Business Register.

The ATO had to recruit and train thousands of new staff – 3,600 additional staff were recruited during 1999-2000.[69] Additional accommodation had to be procured. New or expanded call centres were established, with scrips covering frequently asked questions, to handle public and tax agent enquiries. New or adjusted processes, forms and procedures were developed to cater for the new tax system.

New information technology systems had to be built and tested, and modifications made to the ATO's legacy IT systems, to accommodate the GST, ABN and PAYG. As Edmonds has noted:

> In a normal year, amendments to legislation might result in about 500 program changes to ATO computer systems but over 4,000 program changes involving more than 17 million lines of computer code had to be made in preparation for the new tax system. At the same time a large body of tax officers went out into the community to educate and help anyone with problems in adjusting to the new tax system. And while all this was taking place the ATO still had to keep all its old systems running.[70]

Once the GST received Assent, the ATO was responsible for its administration. This is an ongoing commitment. However, it often takes some time for new systems, procedures and forms to be fine-tuned to meet the expected or unexpected demands of the community and of the tax office.[71] In the short term, this bedding-in period has implications for the community's post enactment acceptance of the VAT. This is so because the ease of compliance influences the community's attitudes about taxation and their willingness to comply with their statutory obligations. The ease of compliance under a GST system is partly a derivative of the policy parameters and legislative design of the law (for example, the level of registration threshold, the length of the GST reporting periods, the requirements in relation to invoices, whether electronic filing is mandatory, and of course the number of rates and the range of exclusions from the GST base). Ease of compliance is also partly a factor of the administrative processes that support the legislative design. Moreover, the ease with which taxpayers, particularly businesses, can interact with the tax system, has broader political implications. For example, during the implementation of the new tax system in Australia, the main concern of taxpayers was the costs imposed on businesses to comply with the system, especially the paperwork associated with completing the Business Activity Statement.[72] Serious community complaint arose as people began filling out their first Business Activity Statements.[73] In response to these vocal concerns the government introduced BAS simplification measures in February 2001. Small businesses were given the option to use simplified reporting and instalment arrangements, with an end of year settlement. By the end of 2001, 11 per cent of the eligible BAS population had opted for the simplified BAS arrangements.[74] While this represented a significant percentage of GST registrants, it was lower than might otherwise have been the case because of the heavy

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[69] Commissioner of Taxation, *Annual Report 1999-2000*, above n 45, 97.
[70] Edmonds, above n 50, 226.
[71] Ibid 232.
[72] Commissioner of Taxation, *Annual Report 2000-01*, above n 65, 1-2.
[73] Edmonds, above n 50, 226.
[74] Commissioner of Taxation, *Annual Report 2000-01*, above n 65, 1-2.

reliance by small business on tax agents (and the newly created BAS provider profession).

A feature of the bedding-in phase of the GST in Australia was the Commissioner's guarantee which promised the community that any education and assistance activities would have a help focus, with any other action generally off the agenda. In adopting this approach, the ATO took the opportunity to show a more supportive face to the community. Where inadvertent errors were made, the ATO's focus was on correction rather than penalising the business.[75] This was the approach adopted by a widely distributed field force which conducted 232,000 advisory visits and 27,000 one-on-one BAS assistance visits in 2000-2001.[76]

Similarly, the ATO adopted a flexible administrative approach during this transitional period on lodgement deadlines, payment arrangements and taxpayer mistakes as well as an ongoing openness to reducing compliance costs for businesses where possible.[77] A distinction was made between those businesses trying to do the right thing, and those that were not. The latter included business with a poor compliance history, such as serial non- or late lodgers (in the absence of special circumstances). These strategies helped to build the goodwill necessary to sustain community acceptance of the new tax, and community trust in the tax authority.

While the ATO's priority was to support taxpayers and their advisors, refund processes and associated integrity checks needed to be established for the proper operation of the GST system. Work also started, based on the insights gained from the industry partnership, of potential risk areas, on the development of a longer-term compliance strategy (covering both help and enforcement activities), and for the upskilling of staff to undertake those tasks in a sensitive and professional manner.

VAT refund management is an early risk following the introduction of a VAT. The prompt recovery of tax by VAT-registered persons on business inputs is designed to remove VAT as a business cost so that the input VAT does not enter the pricing structure for those sales. Thus, the timely payment of legitimate refund claims is an implicit feature of normative VAT regimes and may be critical to the cash flow of a business. A focus on BAS refunds is also necessary to protect against fraudulent revenue leakage. The ATO's management of refunds involved the development of criteria against which the claims could be considered, and the triaging and follow-up of high-risk refund claims. The vast bulk of refunds were issued within 14 days, with most refund checks done by telephone.[78]

As businesses became more familiar with the GST system, the ATO gradually shifted the focus of its field activities to verification programs rather than advisory visits, while continuing to give the benefit of any doubt to the taxpayer in respect of penalties.[79] There was also a shift of emphasis away from micro-businesses towards medium and large taxpayers. In the 2002 fiscal year these activities included about 50,000 field verification visits and a similar number of outbound telephone-based compliance

[75] Commissioner of Taxation, *Annual Report 1999-2000*, above n 45.
[76] Commissioner of Taxation, *Annual Report 2000-01*, above n 65, Table A1.8 Tax Reform.
[77] Ibid 2-3.
[78] D'Ascenzo, above n 49, 132.
[79] Ibid 2-3.

activities – all of which resulted in a net increase of AUD 363 million in GST and more than AUD 100 million in other taxes.[80]

5.3 Lessons

In delivering a new tax, the ATO built a reasonably reliable IT system, recruited and trained additional staff,[81] developed new forms, processes and procedures, settled complex issues of interpretation, developed guides and other educational material, and enhanced its call centre, outreach and marketing capabilities, amongst other essential activities. As it turned out the implementation workload for the ATO was greater than anticipated and additional funding was provided as a result.

The first point to make is that the implementation of a VAT is a major undertaking by the tax office and other relevant public sector organisations. The scale of change, especially within the tax administration, challenges the capabilities of the public sector, with any shortcomings likely to be highlighted in the public and political arena.

The relevant public sector organisations must be funded to carry out their functions effectively. Even with appropriate funding, substantial organisational changes, the acquisition of additional staff and different skills, and the training of staff takes time and requires the close attention of senior management.

The following infrastructure, activities and approaches should be built or undertaken by the tax authority in administering a VAT:

- a reliable IT system is necessary to cater for the registration, filing, and payment processes associated with a VAT;
- in the initial phases for the implementation of a VAT, the tax administration focus must be directed at supporting taxpayers and their agents;
- there should be ongoing consultation and co-design with stakeholders. In the reinvention of the ATO that followed the introduction of the GST, it became clear that greater buy-in from tax professional, business and industry representative bodies, and the community more generally, is a vital ingredient in the development of effective administrative strategies that achieve the policy intent and minimise compliance costs. A wide range of consultative forums were revamped or established for this purpose;
- refund management is important to ensure prompt refunds to legitimate registrants while protecting the revenue and the integrity of the VAT system;

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[80] Commissioner of Taxation, *Annual Report 2001-02* (2002) 78.

[81] Holland, above n 39, 21:

> Once the main decisions have been taken on the policy, legislation, and operating systems, the VAT staffing needs can be estimated with reasonable precision. Various administrative matters will then have to be tackled; these relate to staffing, including recruitment, job grading, and job descriptions, as well as securing accommodation and transferring staff…[Training] is a major task, and to appreciate its size it must be understood that virtually none of the existing training material in any government department will be relevant to VAT.

- in the bedding down period for a VAT, a 'softly-softly' approach to compliance acknowledges the newness of the tax and is apt to reduce taxpayer backlash against the tax;
- to minimise the gap between the tax reported by taxpayers and the statutory tax due, a compliance plan must be developed and implemented. This plan should include a risk-based audit coverage of taxpayers, supported by an increasingly sophisticated analytical and data mining and matching capability.

As the Commissioner of Taxation commented in his Annual Report 2000-20001, '[i]t is also the case that the implementation period is not over yet as we work to improve our systems and processes to make compliance easier for taxpayers and their advisers'.[82] In fact, once implemented, there is the ongoing responsibility of ensuring that the VAT system operates efficiently and effectively. This requires the tax administration to continually scope a new horizon which takes advantage of technological developments to modernise the administration of the VAT. This must be supported by a culture of assisting honest taxpayers while being vigilant (using sophisticated analytics) for abuses of the system.

6. CONCLUSION

The introduction of a major tax such as the VAT, or even its refinement, is an emotive issue. The politics and policy of a VAT are entwined and enmeshed around questions about the community's acceptance and readiness for the tax, and the ability of the public sector to implement the tax in an effective, fair and efficient way. Each of these dimensions influences the others.

Political will and careful navigation of the political, policy and legislative design processes associated with a VAT is a prerequisite for the successful enactment of a VAT. Obtaining voter acceptance to a VAT usually requires a package of tax measures, including specific compensation for sectors likely to be disadvantaged by the tax. In addition, the benefits of the tax reform package must be communicated broadly to the community, preferably in partnership with other stakeholders.

Interrelated with the political dimension of the VAT is the state of the community's readiness for major changes to the tax system. In introducing a VAT, the capabilities of businesses and their agents is a critical consideration. Considerable focus should be given to the ability of businesses, especially small businesses and their agents to meet the more stringent record keeping and reporting obligations under a VAT.

In implementing a VAT there is the opportunity for government and the public sector to mandate or encourage greater use of technology by businesses and their agents, although this may increase the start-up costs of the new tax.

The successful operation of a VAT is also dependent on the capabilities of the public sector, especially the tax authority. The tax agency has a subordinate but important role to play in the policy and legislative design of a VAT. In preparing for the introduction of a VAT the tax authority has an enormous responsibility. It must build the organisational and operational infrastructure necessary to support the new tax. A key external role for the tax authority during the implementation phase is to promote

[82] Commissioner of Taxation, *Annual Report 2000-01*, above n 65, 1.

community readiness by educating businesses and their agents about the VAT and assisting them in their transition to the new tax regime.

Once the legislation is enacted, the tax authority should seek to optimise voluntary compliance by building trust in the VAT system and in its administration. It does this by effectively, efficiently and fairly managing the administrative and compliance risks to the health of the VAT system.

As a final comment on the value added tax, there has been a worldwide trend towards significant reliance on consumption taxes notwithstanding the political, community and administrative challenges associated with the introduction of a VAT. In terms of the global proliferation of VAT systems, it has been said of the VAT that it '*may be thought of as the Mata Hari of the tax world – many are tempted, many succumb, some tremble on the brink, while others leave only to return, eventually the attraction appears irresistible*'.[83]

[83] Alan A Tait (*Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988) 3), cited in Warren, above n 17, 80.

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GST as a secure source of revenue for the States and Territories

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Abstract

Goods and services tax (GST) revenues collected by the Commonwealth Government in Australia are provided in full as untied revenue grants to the State and Territory governments. The hypothecation of GST revenues in this way provides a reasonably secure foundation for federal financial relations in Australia. However, Australia's federation has been marked by continuing change in the vertical sharing of government functions, costs and revenues, and State fiscal security is potentially vulnerable in these changing circumstances. The advantages and disadvantages of the GST revenue arrangements have themselves changed over time since the GST was introduced in 2000, with implications both for the GST as a tax and for the evolution of the Australian federation. This article discusses these developments and some possible future directions.

Key words: Federal Financial Relations, GST, fiscal equalisation, revenue sharing.

* Former Chairman, Commonwealth Grants Commission; the views expressed in this article are those of the author alone and do not necessarily represent the views of the Commonwealth Grants Commission or any other entity.

1. INTRODUCTION

The introduction of the goods and services tax (GST) in Australia on 1 July 2000 combined a substantial tax reform with a more modest reform of federal financial relations.

The main tax reform had the orthodox feature of greater 'tax neutrality' – through a broadening of the tax base and flattening of the tax rate.[1] The GST base is equivalent to a little over one-third of Gross Domestic Product (GDP), much broader than the tax bases it replaced (mainly the wholesale sales tax exclusively levied on goods and not services), and the relatively low flat tax rate of 10 per cent generates revenues of around 3.4 per cent of GDP.[2] At least for a time, the introduction of the GST also provided for some overall tax mix switch from income to indirect taxes, although indirect taxes in Australia have long experienced trend decline.

The reforms to federal financial relations were relatively modest. The Commonwealth has long provided untied financial assistance to the States and Territories (hereafter 'the States'), but there has equally long been controversy about the amount of that assistance. Under the new arrangements, the aggregate assistance was set to equate to the full revenue collections of the GST, net of collection costs.

The 1999 intergovernmental agreement for these arrangements included some other federal reforms as part of the overall policy package.[3] These included:

- a role for the States in deciding any future changes in the rate or base of the GST, with substantive changes notionally requiring their unanimous agreement;
- abolition or reduction of a number of State business and financial taxes;
- providing first home owner grants as an offset to the price effects of GST on dwellings; and
- applying the GST to State government bodies, notwithstanding constitutional constraints on the Commonwealth levying taxes on States.

This article addresses the question: is the GST a secure source of revenue for the States and Territories? While that question raises some legal issues, these are not of great interest because, under the Constitution, the Commonwealth is alone sovereign in

[1] These features of reform which are 'neutralising' the effect of taxes on behaviour, are widely supported for bringing three advantages – greater economic efficiency through a reduced impact of taxation on resource allocation, greater horizontal equity as tax burdens vary less with different personal circumstances or preferences, and more robust revenue collection as tax avoidance behavioural changes are rendered more difficult.

[2] Australian Bureau of Statistics, *Australian System of National Accounts, 2017-18*, Cat. 5204.0 (26 October 2018), https://www.abs.gov.au/ausstats/abs@.nsf/mf/5204.0. Tax revenue data is sourced from Commonwealth Government Budget Papers (various years).

[3] Council of Australian Governments (COAG), Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, https://www.coag.gov.au/sites/default/files/agreements/reform_of_comm-state_financial_relations_PDF.pdf (and Schedule 2 to the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (Cth)).

relation both to GST policy and Commonwealth payments to the States. In other words, the States receive grants based on GST revenues (or anything else) only for as long as the Commonwealth Parliament so decides. So the short answer as a matter of law is that the GST is a secure revenue source for the States for as long as, and no longer than, Commonwealth legislation so provides. For the States, the legal foundation is arguably quite flimsy.

But given that these arrangements have continued in place for nearly two decades, and look likely to continue for the foreseeable future at least in some form, the practical security of the GST revenues for the States may be more strongly established than the legal standing might imply. That suggests that whether the GST is a secure revenue source for the States owes more to political economy than legal considerations. In particular, what is perhaps more interesting is how the GST performs as a tax revenue source, and how it fits within the overall framework of federal financial relations. Accordingly, this article will focus much more on the political economy issues that arise in these areas.

2. AUSTRALIA AS A CONSTITUTIONAL FEDERATION

A federation is an arrangement whereby two levels of government, central and regional, have sovereign jurisdiction over the same populations or territorial areas, with their respective powers divided formally so that neither level is able unilaterally to alter or abrogate the powers of the other. This is distinguished from a unitary state (the more common form of jurisdiction), where only one level of government is sovereign. In unitary states, subnational governments such as regional or local government, if they exist at all and whether democratically elected or otherwise, are created merely by legislative act of the central government, which may alter, override, circumscribe or even abolish their powers.

The Australian federation was formed on 1 January 1901, with a formal division of powers set out in the Constitution, originally enacted in 1900 by the British Parliament. The Commonwealth of Australia was established as the central government, while the six States, each formerly a self-governing British colony, formed the second tier regional level. Late in the 20th century, two territories of the Commonwealth, which are not part of any State, were granted self-government by the Commonwealth (just as a unitary state might do, and the UK has done, for example, for Scotland) with substantially similar purposes and legislative powers as the constitutional States.

However, the formal constitution of a federation does not necessarily prescribe many of the important features of how it operates in practice. In particular, the functions of government in 1901 in Australia and elsewhere were much smaller and very different to what they were to become over the course of the 20th century, and the Constitution, even with some amendments, only indirectly addresses much of that change.

This article argues that the Australian federation today operates largely on the basis of evolving considerations of political economy, rather than solely in reliance on its constitutional foundations. As such, the Australian federation is a far more fluid arrangement than may have been originally intended, and remains open to considerable further potential change even without any change in formal powers. This is particularly so in relation to matters of finance, but through this route it is effectively so for a great deal more than finance.

Among the most important developments in the decades after federation, at least in the financial and economic spheres, can be encapsulated as a political transition, in common with other developed countries, which overlaid social democracy on liberal democracy. In essence, this involved a considerable expansion of the role of government, in particular (though by no means exclusively) in relation to education and social spending,[4] with a large-scale expansion of the tax system both to provide the required revenues and to directly contribute to income redistribution.

Generally speaking, these developments were not anticipated at Federation. However, in one of the few significant changes subsequently made to the Constitution, in 1946 a referendum provided a new power for the Commonwealth in the following terms:

> Section 51 (xxiiiA) the provision of maternity allowances, widows' pensions, child endowment, unemployment, pharmaceutical, sickness and hospital benefits, medical and dental services (but not so as to authorise any form of civil conscription), benefits to students and family allowances.

This very large addition to Commonwealth powers supplemented the original power in section 51(xxiii), invalid and old age pensions.[5] Together these powers underpin the predominant central government role in Australia in that substantively 20th century invention, the 'welfare state', which refers to functions often combined as health, education and welfare ('HEW'). It is perhaps a hangover of this history, however, that the States remain as large-scale service providers in at least some of the HEW functions. But while they have kept a role in these functions, the 20th century tax revenues to fund them went overwhelmingly to the Commonwealth.

It is into this setting and context that the State-funding role of the goods and services tax (GST) in Australia can be considered. The GST is a Commonwealth tax, but the Commonwealth has agreed with the States and Territories that each year an amount equivalent to cash GST receipts (net of collection costs) will be granted to the States and Territories on an untied basis (that is, available to them to use for any purpose of their own choosing). It is perhaps ironic that the GST revenues are given to the States, since they are precluded by section 90 of the Constitution[6] from levying a GST themselves, since a GST in part includes duties of customs or excise for which the Commonwealth from the outset had been given exclusive power.

3. FEDERAL FINANCIAL RELATIONS

The Australian Constitution constrains and influences, but does not fully determine, the financial relations between the Commonwealth and the States. To a large extent, therefore, federal financial relations in Australia have evolved through the practical

[4] Public social spending generally encompasses general government health spending and welfare spending such as pensions, allowances, welfare services and family assistance. Education is generally identified separately. In discussion of the role of government, as in this article, they are often combined as 'HEW' – health, education and welfare.
[5] Australian Constitution, s 51(xxiii).
[6] Ibid s 90.

playing out of political economy considerations,[7] rather than fully corresponding to any constitutional principles.

Federal financial relations are the joint outcome of three main sets of decisions. No one has ever set down a comprehensive, clear or generally-accepted statement of intent or theoretical framework for these decisions, and their ever-changing interaction means that few if any principles can readily be found to apply to them. To put it bluntly, in large measure these are just made up as all of the parties go along, responding to the exigencies of the day.

The three decision sets, not necessarily in any meaningful order, are discussed below.

3.1 Sharing of functions

First, the allocation of program responsibilities between central and regional government must be decided. This is perhaps where the Constitution has the most to say, in that it specifies Commonwealth roles in a range of areas, with the States retaining residual powers. It also prescribes a range of rules relating to the allocation of revenue powers. But nonetheless, a great deal of the detailed task of functional allocation, both on the revenue and spending sides, is left substantially unspecified. In the tax sphere, the incompleteness of the Constitution is best illustrated by noting that while the Constitution gives the exclusive excise power to the Commonwealth, the income tax is not mentioned. Yet since 1942 it has been exclusively a Commonwealth tax in practice.

In 2016-17, the States had a 41 per cent share of total general government recurrent and capital expenditures by all levels of government in Australia. Government Finance Statistics (GFS) operating expenses were about AUD 251 billion (of a total AUD 624 billion) while the States' net acquisitions of non-financial assets, mainly infrastructure investments, were AUD 16.6 billion in a total of such general government spending of AUD 26.3 billion.[8]

3.2 Sharing of costs

Second, whatever the allocation of program responsibilities, there may be a separate set of decisions on the sharing of program costs. In Australia, the Constitution provides that the Commonwealth may make payments to the States on such terms and conditions as Parliament thinks fit.[9] The Commonwealth and the States have entered into a range of agreements under which the costs of State programs (and more recently even Commonwealth-led programs such as the National Disability Insurance Scheme) are shared, particularly in the health, education and welfare areas, and also for new transport infrastructure. Commonwealth cost sharing contributions are generally referred to as payments for specific purposes (PSPs).

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[7] The term political economy in this article has its general meaning, which is to link legal and political structures and outcomes (such as federal financial relations) to underlying economic and social conditions or forces.

[8] Australian Bureau of Statistics, *Government Finance Statistics, Australia, 2016-17*, Cat. 5512.0 (26 April 2018), https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5512.02016-17?OpenDocument. At time of writing, the most recent comprehensive ABS data on government finances relates to 2016-17. Commonwealth payments data come from Commonwealth Budget Papers (various years).

[9] Australian Constitution, s 96.

In 2016-17, payments for specific purposes were made to the States amounting to AUD 55 billion. Cost sharing then, by the Commonwealth, funded about 20 per cent of State general government spending.[10]

3.3 Sharing of revenues

Thirdly, in Australia and some other federations, revenue collections are predominantly made by central governments with some of the revenues then shared with the States. The key feature of such revenue sharing is that the funds are not specified for use in any particular program of the States – they are 'untied' grants. This may, or may not, be formalised in tax sharing arrangements set out in federal constitutions. In Australia they are not. Much the same outcome occurs for any basis of general revenue payment, even if formula rather than tax revenue based, as it has often been in Australia. The GST revenue is now the main legislated basis for revenue sharing payments.

In 2016-17, GST-based grants, as the predominant general revenue payments to the States, amounted to about AUD 60 billion, or about 23 per cent of total State general government revenues (and expenditures).[11]

3.4 The interaction of three shares – functions, program cost and revenues

The States themselves then, overall, generate funding for about 57 per cent of their program spending, which means their revenues meet the costs of just 23 per cent of total general government spending (at all levels) in Australia.[12] They collect a narrow range of taxes, mainly on payrolls, land and property transfers, together with mining revenues mainly from royalties, and a considerable range of other non-tax revenues.

The changing operation of the three variables in federal financial relations – functional sharing, cost sharing and revenue sharing – are all prescribed or at least permitted by the Constitution[13] but their particular changing patterns in large part were not specified or anticipated. The fact that fiscal outcomes depend on the joint operation of these three decision variables means that it is very difficult to form clear judgements about any one of them in isolation of the others. Inevitably, this means that there is endless political tension between the Commonwealth and the States on arrangements for all three, and adjustments or even broader reforms to one do not necessarily address those tensions for very long.

Over time, there has been a tendency for functional shares to shift towards the Commonwealth. In the case of social transfers, as noted in section 2 above, this was reflected in constitutional changes. Another factor has been the difficulty experienced by the States in meeting increased demand for a range of services. Health spending has for many years increased everywhere, in part driven by ageing of populations but also as a result of changing (more costly) technologies. Education has expanded everywhere, with higher participation and retention, and also with extensions in the years of

[10] Australian Bureau of Statistics, *Government Finance Statistics, Australia, 2016-17*, above n 8.
[11] Ibid.
[12] Ibid.
[13] These outcomes arise from the broad Commonwealth powers conferred by the Constitution. The scope of Commonwealth legislative, including taxing, powers are specified in section 51 while section 96 provides that financial assistance can be provided to any State on such terms and conditions as the Parliament thinks fit.

education both pre- and post-school. Some other social programs such as aged care, child protection and disability care have seen exceptional growth in recent years.

The Commonwealth has often come under political pressure to take, or seen political opportunity in taking, functions from the States, given its stronger fiscal capacity to meet them and given the likelihood that in doing so, the response will be delivered in similar terms across Australia, rather than develop piecemeal State by State. Examples have been university funding, aged care, disability care, child care and early education, and some non-HEW fields such as corporate and financial regulation.

Cost sharing has had a more mixed history. Although the States only infrequently reject assistance, cost sharing is often resented by them for a range of reasons. The States sometimes see this assistance as coming with Commonwealth policy interference in what might otherwise be areas of State functional responsibility. At times there have been attempts to simplify cost sharing agreements and to reduce policy prescription within them. At other times, diverse cost sharing agreements have mushroomed. Frequently, cost-shared services have co-developed with other forms of service delivery (public and private hospitals, government and non-government schools, and so on) and this has often come with complicating philosophical and policy agendas. Politically, it would now be very difficult for most voters in Australia to comprehend the respective roles of the Commonwealth and the States in areas such as health, education and transport infrastructure, so comprehensively are funding responsibilities (and policy decision making) shared in these areas.

Revenue sharing has also had a mixed history. The States were compensated by the Commonwealth when in 1942, amidst fears of foreign invasion, the income tax became solely a Commonwealth tax, never to return to the States. After years of bickering over resources, the Commonwealth transferred the payroll tax to the States in 1971, but this proved too little to resolve very much. The Fraser government in 1976 introduced personal income tax sharing with the States, but tax sharing was abandoned again in 1985, with a return to grant growth formulae as the basis for determining the general revenue assistance pool of funds.

In the 1990s, the States built up a considerable new revenue source in business franchise license fees. While these were designed to appear otherwise, they effectively were heavy excises imposed on tobacco, alcohol and fuel sales. In 1997 the High Court, in the *Ha* case,[14] found them to be so, and hence in contravention of section 90 of the Constitution which gives the Commonwealth exclusive powers over customs and excise.

The Commonwealth introduced additional excises to replace the lost State revenues, but this was a temporary fix. The GST three years later provided the long term fix.

To say the least, this history reveals how messy federal financial relations have been. It also shows that it is not just the federal relations themselves that have created the tensions, but rather the underlying difficulties in finding fiscal means to meet expanding demands for government services, particularly in the HEW areas. The political economy of HEW is a core driver of the political economy of federal financial relations.

[14] *Ha v New South Wales* [1997] HCA 34; 189 CLR 465 (5 August 1997), High Court.

The central issue for this article is whether the GST is a secure source of revenue for the States. Given that revenue sharing is just one of the variables in federal financial relations, little can be meaningfully secure for States about the GST revenues if changes in those other variables have adverse or offsetting fiscal consequences for them. It is only in the combined outcome of all the elements that any concept of fiscal security, such as it ever can exist without constitutional prescription, may be delivered.

Somehow, the arrangements that have developed provide an outcome that persists, albeit with periodic change. To understand what might be driving that pattern it is perhaps necessary to look behind the three decision variables themselves and look more fundamentally at what States do. This provides an insight into the likely forces at work. The next section explores this question to see what it reveals about the political and economic forces that drive these outcomes.

4. WHAT STATES DO – THE DRIVERS OF FEDERAL FINANCIAL RELATIONS

Whatever intentions may have existed at the time of Federation, or whatever views may have developed since, to make sense of our federal financial relations it is probably better to simply start with the facts as they now are and to see if any underlying logic in political economy terms might apply to them. Earlier theories do not seem to have driven the evolving form of our federation, but some other forces undoubtedly have. We more likely would benefit from having a theory that fits and explains those forces rather than trying to fit events to the old theoretical models.

The federations in the world have long had two broadly different styles. The US model, developed in the 18th century and representative of one style at least for much of its history, is largely of competitive, autonomous, self-funding states, with substantial differences claimed to exist state-by-state in preferences for public services and taxes that justify a decentralised model of government. In contrast, the more modern German model, adopted post-World War 2 although built partly on 19th century Bismarckian traditions, is essentially one of a strong central or national perspective on government, with a cooperative structure allowing for only modest degrees of subsidiarity.[15] The main public services are established and funded as national programs but the advantages of decentralised service delivery are provided under negotiated, cooperative agreements with the Länder (states).

The US model is largely indifferent to substantial fiscal inequalities across regional jurisdictions. In contrast, the central dominance of the German model typically includes substantial horizontal equalisation (a challenge greatly increased in Germany's case when the unification of East and West Germany brought together Länder of very different levels of economic development).

While the Australian Constitution clearly began with much of the nomenclature and appearances of an American style model, there has been in the major spending areas a comprehensive shift over time towards features of the German model.[16] In Australia's case, however, the protections of the fiscal powers of the States that are provided for in

[15] Subsidiarity refers to the principle that decision-making on service delivery should be decentralised as far as is practicable.

[16] This is not to say that Australia has copied Germany or vice versa. Rather it is to observe that the style of federation evolving in each country is often similar, perhaps because the underlying forces driving change are also similar, despite their radically different specific courses of history.

the post-war German Constitution are missing (notably that the upper House in the German national legislature is appointed by each Länder government, giving them considerable influence over federal tax policies), but the functional directions are broadly similar.

Perhaps the key point to observe about the States is that a relatively few functional areas account for the great bulk of their spending. At the same time, however, those high-cost areas are by no means exclusively State functions, but rather are component parts of broader national public programs shared with the Commonwealth. In these areas, the Commonwealth in fact is often the greater spender than the States, particularly when account is taken of the fact that the Commonwealth shares in meeting the cost of State programs.

In political economy terms, it can be said that these areas have come to be seen in Australia more as national public goods than local public goods regardless of which level of government provides or funds them. That is to say, they are less the subject of a competitive model of federation, where what each state does would differ considerably from the others reflecting different local preferences, but rather reflect a shared national set of policy expectations with state service delivery favoured only as a means of achieving greater proximity and responsiveness to local characteristics at the point of service delivery.

The main areas of program sharing are of two types. The largest is the HEW (health, education and welfare) grouping which became the dominant field of government expenditure in developed countries in the 20th century.[17] The national public good element in these is perhaps largely one of a national set of expectations about income distribution (or 'fairness'), reinforced in some areas by the mobility of the population across States and, at least in the case of education, the links with the national economy and national labour market. The second is transport infrastructure, mainly roads and rail. One national element here is that much of the transport system, particularly freight movement, operates as part of a jurisdictionally seamless national economy.

In 2016-17, States spent AUD 158 billion on HEW. While this was 60 per cent of their total spending, the Commonwealth spent much more in these areas – AUD 265 billion (including AUD 43 billion in payments for specific purpose in these areas made to the States).[18]

In each of these areas, the Commonwealth role has been expanding. In health, the Commonwealth has major roles in the universal cover provided by Medicare and pharmaceutical benefits, support for private health insurance, and acceptance of a share of the costs of public hospitals provided by States. State spending on health, particularly concentrated on public hospitals, net of Commonwealth cost sharing, is now about 42 per cent of total public sector health spending.[19]

In education, the Commonwealth has played the major role both in the expansion of non-government provision and the extension of education participation. It has taken the main financial responsibility for both pre-school and post-school education, including

[17] For a comprehensive survey, see for example Peter H Lindert, *Growing Public: Social Spending and Economic Growth since the Eighteenth Century, Vol. 1* (Cambridge University Press, 2004).
[18] Australian Bureau of Statistics, *Government Finance Statistics, Australia, 2016-17*, above n 8.
[19] Ibid.

Australia's very large university sector. State spending on education, net of Commonwealth cost sharing, is around 45 per cent of total public education spending, and is concentrated mainly on public primary and secondary schools.[20]

In welfare the Commonwealth dominates in almost all fields, particularly income support and other cash transfers. From the States it has taken primary responsibility for aged care, and more recently for disability care. The States are left mainly with some role in disability care, child protection services and social housing and homelessness programs. However, their spending on social security, welfare, housing and community development is now only about 15 per cent of all public spending in these areas.[21]

The predominant, and apparently growing, national character of HEW in Australia creates a strong tension in the federation. The result has been that the Commonwealth and the States are fully entangled in the funding and delivery of HEW, so that much the same issues arise politically in the parliamentary electoral processes at each level. The Commonwealth and the States each have 'democratic voice' for these entangled fields of policy.

Jurisdictional entanglement then combines with the complex interplay of functional sharing, cost sharing and revenue sharing between the Commonwealth and States. It may seem logical that if HEW are largely national public goods, this entanglement and interplay could be cut through by shifting substantially or even fully financial responsibility for HEW to the Commonwealth, which already takes the larger share. That this has not happened is traditionally ascribed to subsidiarity arguments for certain types of service delivery. But it perhaps reflects also another underlying political preference that can arise and persist in federations – people may prefer to have two avenues for democratic expression on what governments do, rather than one, expressing themselves on similar issues both at federal and state level. That is, for many perhaps, the real reason they may prefer federation over unitary government – a type of 'balance of powers' argument in an environment generally of low trust in government.

Apart from HEW, entanglement is also well entrenched in Australia in the area of transport funding. State transport spending, both current and capital, in total amounted to about AUD 35 billion in 2016-17 which is about 13 per cent of total State general government spending. Commonwealth road and rail infrastructure grants to the States were about AUD 6.7 billion (excluding grants to local government) which accounted for more than half of net new additions to State transport assets.[22] Of course, the Commonwealth collects fuel excises from road users, amounting to about AUD 10 billion per year (after allowing for excise tax credits).[23] Since fuel excise is the most substantive road user charge in Australia, its exclusive collection by the Commonwealth directly entangles road funding and policy.

The revenue and funding arrangements for road and rail transport in Australia have long been ripe for reform – in common with most other countries – with most interest in using new technologies to replace fuel-related taxes with economic-cost based user charges and to more closely link investment to economic valuation. The jurisdictional

[20] Ibid.
[21] Ibid.
[22] Ibid.
[23] Refer Commonwealth Budget Paper No. 1, *Budget Strategy and Outlook* (various years). Petrol and diesel excise collections are reported in Statement 4 while fuel tax credit payments are reported in Statement 5.

entanglement of existing arrangements is likely one of the barriers to this reform, although there are many others, practical and political, as well.

Again, as for HEW, future reform could release States from relying on discretionary vertical fiscal transfers for transport infrastructure funding, but there appears little impetus for such reform.

What is left of what States do if HEW and transport are set to one side? Since HEW and transport in combination amount to almost three-quarters of what States spend, at an aggregate level (and leaving aside issues that might arise in relation to fiscal equalisation) the States could readily fund their other functions from existing own-account taxes and other revenues. Those other functions involved spending in total of only about AUD 64 billion in 2016-17.[24]

The largest of those other functions are the justice-related functions (police, courts and correctional services) where Commonwealth engagement has increased in recent times but remains relatively limited.[25] Others are regulatory and legislative services, including oversight of local government, industry promotion and assistance, government business enterprises, arts and culture, sports, all the central administrative functions, national parks and a wide variety of planning, land use and water resources programs, provision of community utilities or infrastructure, and environmental regulations and programs. The Commonwealth delves into many of these, seemingly at will, but perhaps most often to take opportunities for political credit for initiatives while avoiding if it can being caught with ongoing functional responsibility.

It is therefore possible to see the States in two parts. One is a largely self-contained and self-funded part where perhaps the original expectations of the US-style Constitution continue to prevail, and where competitive policy innovation may well be working effectively. HEW, and at least for now transport infrastructure, are a second, much larger, part mainly made up of deeply entangled programs with the hallmarks of a German-style cooperative federalism.

The fiscally larger entangled part of the federation is where it is particularly important to look to understand the role of the GST as a revenue source for the States in Australia. Gaining an understanding of it requires not just looking at its role as the main means of delivering general (untied) revenue sharing, but also the two other decision variables – function and cost sharing within the federation.

5. THE POLITICAL ECONOMY OF GST HYPOTHECATION

The revenues from the GST are hypothecated to, and form almost all of, the pool of untied grants for the States. Hypothecation is often opposed by finance ministries because it reduces budget flexibility. However, this objection had little weight in the case of the GST, because inflexibility was a political objective. The government was keen to create an impression that the rate of the GST, and as far as possible its base, would not easily be altered in years to come. Equally, there was no desire to vary the GST for macroeconomic, countercyclical purposes.

[24] Australian Bureau of Statistics, *Government Finance Statistics, Australia, 2016-17*, above n 8.
[25] Ibid.

On the other hand, hypothecation is often politically attractive as a means for offsetting the political unpalatability of any tax. A major factor against the GST is that it is a regressive tax, at least in the short run. This is because the household savings rate rises with income, and hence the proportion of income paid in any consumption tax commensurately falls.

Hypothecating the regressive GST to State budgets provided a very neat offset, because State expenditures are highly progressive given the predominance of outlays on health (mainly public hospitals), education (mainly public schools) and welfare (including social housing). While there may not have been full community trust in the compensation arrangements offered for the price effects of the GST, the link to State programs provided a second political bow.

Given that the GST did not really add much if anything to funding for State expenditures, this was something of a sleight of hand, but its political impact was sustained by a secondary consideration – that of engaging and recruiting to some degree support from State governments for the overall reform package.

What was done, or said to be done, for the benefit of the States thus had a political *quid pro quo* in also being of benefit for the political case for introducing the GST as a centrepiece of tax reform.

5.1 The advantages of the GST for the States

The States knew this of course. For them there were probably three main benefits.

First, they were able to share in some tax reform themselves, with revenues provided by the Commonwealth to fund the abolition of some inefficient State financial taxes.

Second, the States had recently lost, as a result of the High Court decision in the *Ha* case[26] in 1997, access to their own indirect tax base in the form of franchise license fees. These had been applied mainly to sales of tobacco, alcohol and fuels. While the Commonwealth had covered this loss with a quick and temporary fix of increased excises provided to the States as revenue replacement payments, the result did not look entirely stable and carried some obligations to provide politically incongruous offsetting subsidies. The GST reform was a potential opportunity to move beyond these problems.

Thirdly, a tax base linked fairly closely to consumption, and hence general economic growth, looks more secure than grants determined by governments of the day, and there had been several examples in history, including in the then recent past, where the revenue and cost sharing grants to the States were cut unilaterally by the Commonwealth. Even though the previous attempt, by the Fraser government in 1976, to link untied grants to tax collections had not survived long (being abandoned in 1985) the GST agreement had such comprehensive coverage and interactions with State commitments that it appeared more likely to prevail for a longer period of time.

The States may also have expected that the GST would prove a robust tax base – whether this is so is discussed in section 6.

[26] *Ha v New South Wales* [1997] HCA 34 (5 August 1997), High Court.

5.2 The disadvantages of the GST for the States

The GST is a Commonwealth tax and as such must be imposed on a uniform basis across the nation. Since it is imposed in part on goods, it is in part an excise and so also cannot (under section 90 of the Constitution[27]) be imposed by the States.

This means that the GST cannot play the same role as was envisaged for tax sharing, at least in principle, under Fraser federalism. Under that scheme, a second, never implemented, leg was to allow the States each to vary the rate of tax and hence the revenue yield within their own borders. This restriction to the GST is either an advantage or a disadvantage of the GST as a base for State revenue, depending on one's perspective about such flexibility.

For those who still believe in competitive federalism, perhaps as a potential source of fiscal discipline on governments, the lack of revenue flexibility for individual States is a disadvantage. Others see the new arrangements as another manifestation of the centralising dynamic of the Australian federation in practice.[28] However, if the major part of State expenditure relates to national public goods, as posited in this article, then the loss of flexibility is likely of relatively little importance. State by State differences in expenditure on these major areas (after equalisation of fiscal capacities) are likely to be small and any such differences that may emerge can be reflected in other parts of the State revenue or expenditure budgets.

A second potential disadvantage of hypothecating the GST to State grants is that it adds a constraint on future changes to the GST itself. There is little reason to imagine that the preferred future revenue yield of the GST, particularly relative to other taxes, would or should reflect the revenue needs of the States. Of course, it is not particularly difficult to break the 100 per cent link. Already, the Commonwealth has agreed to add additional amounts to the GST pool for payments to the States. It could readily strike any number of possible future variations to the arrangements – paying as grants a greater or lesser percentage of revenue collections than 100 per cent. This might, for example, be necessary if ever the role of the GST was to be increased in the context of a tax reform – it is quite likely that some of the revenues would need to be paid by the Commonwealth as compensation payments to low income earners, or otherwise applied to other purposes.

All this is to say, nonetheless, that hypothecation is not much of a constraint on policy simply because it can be wholly or partly undone, though of course that might present some form of political challenge in the process.

6. IS GST REVENUE ROBUST?

The tax arrangements that included the introduction of the GST were designed from the outset to provide approximately the same net fiscal position for the States as already existed. This required that the GST revenues would not only replace the previous financial assistance grants and revenue replacement payments, but also the abolished or reduced State taxes and the fiscal costs arising on the outlays side of the States' budgets.

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[27] Australian Constitution, s 90.
[28] David Hamill, *The Impact of the New Tax System on Australian Federalism* (Australian Tax Research Foundation, 2006).

Indeed, the arrangements were so closely matched that there was a risk of shortfalls for one or more States, and so a guarantee was provided that supplementary payments, termed budget balancing assistance, would be made where any State fell short of the pre-existing position. As it turned out, these additional payments were required for the first four years of the GST, and indeed were revived in 2008-09 when the GST revenues fell sharply after the global financial crisis (GFC).

It had been hoped that the GST would prove to be a robust base for the determination of untied financial assistance to the States. Once the initial budget balancing assistance years had passed, for a time this appeared likely. But things have not worked out quite as well as hoped.

The GST is notionally a tax on a large share of private consumption. However, it varies from that in two main respects. First, the tax base does not include some key items of consumption expenditure, either because they are fully exempt (GST-free) or input taxed. In general these items have had an increasing share of total consumption. Secondly, the final tax base includes one item of capital investment – investment in dwellings. The first consideration has created a trend decline in GST collections relative to GST, while the second is one source of volatility in collections.

6.1 Trend base decline

The trend increase in the spending share on fully exempt items, particularly health and education, and the often input taxed items (involving a lower effective rate of tax) on rent and financial services, has meant that over time the tax base has weakened relative to total consumption and to GDP.

Over the 15 years from 2002-03 to 2017-18, the share of household final consumption spending on health and education increased from 8.4 to 11.3 per cent. Rent and financial services increased from 25.2 to 28.5 per cent. In total therefore, the consumption share of fully exempt or more lightly taxed categories increased from 33.6 to 39.8 per cent. Since in the same time the increased savings rate resulted in a small fall in the private consumption share of GDP, the GST collections grew much more slowly than GDP.[29]

Apart from these trend movements in the base of the GST, it is also usual for tax avoidance opportunities to gradually erode any tax base. In the case of value added taxes, as for income taxes, the improvement in technologies that facilitate international transactions has probably provided the main tax avoidance opportunities. Actions have been taken to stem these losses, but it is likely that the revenue gains from these actions have merely offset the losses that had been occurring. The overall yield of the GST, expressed as a share of GDP, remains somewhat lower now than it was in the initial years. In broad terms the loss represents around 15 per cent of total revenues, with a fall from a peak in the early 2000s of about 4 per cent of GDP to about 3.4 per cent or less in recent years.[30]

[29] Australian Bureau of Statistics, *Australian System of National Accounts, 2017-18*, above n 2.
[30] See Commonwealth Budget Paper No. 1, *Budget Strategy and Outlook*, Statement 4 (various years).

6.2 Base volatility

The tax on dwelling investment has imparted an element of revenue volatility, since dwelling investment is often more cyclical than consumption spending.

At the same time, a consumption tax base will vary with the pattern of household savings. This has been markedly volatile in the first 20 years of the GST. Three periods can be distinguished. At the time of introduction of the GST, and until the Global Financial Crisis (GFC) in 2008, household savings rates were extremely low, and even negative in some years. This corresponded to high GST collections.

The GFC brought a sudden and very substantial increase in household savings rates, peaking at around 9 per cent and persisting above 7 per cent for several years. In these years, the GST yield fell appreciably. In broad terms, while the GST yield had peaked at nearly 4 per cent of GDP in 2003-04, it fell as low as 3.1 per cent in the high-savings years after the GFC.[31]

The third period, dating from around 2015, has been one of some recovery in GST collections to about 3.4 per cent of GDP, associated with a period of falling household savings rates together with growth (until 2018) in dwelling investment.[32] Whether these trends will continue in the period ahead is far less certain – indeed a considerable decline in dwelling investment has been underway and may bring a further weakening in GST collections.

However, the States did not experience great fiscal stress as a result of this somewhat disappointing GST yield. Perhaps the main reason for this has been the mining boom which occurred largely at the same time as the weakness in GST unfolded. The mining boom was heavily concentrated in one State, namely Western Australia, with one or two others participating to a lesser degree (mainly the coal States of Queensland and New South Wales), but the distribution arrangements for the GST meant that all States fiscally benefited from it. This is explained in the following section.

7. STATE REVENUE EFFECTS OF HORIZONTAL EQUALISATION

Following the first attempt at formal tax sharing, introduced by the Fraser government in 1976 by designating a fixed State share of personal income tax collections (the vertical distribution), it was understandably decided that the allocation of the shares of total grants among the states (the horizontal distribution) should also be placed on a more formal footing. Up to that point, the State shares had largely developed over time in a series of bilateral arrangements without ongoing independent formal assessment of relative fiscal needs.

The Commonwealth Grants Commission, which hitherto had the more limited role of assessing special grants for individual States facing fiscal hardship, was asked to determine a set of per capita relativities for the allocation of tax sharing grants among all States. The basis for these relativities was the longstanding principle of horizontal fiscal equalisation (HFE), which means the distributional objective is equalisation of

[31] For household savings rates see Australian Bureau of Statistics, *Australian System of National Accounts, 2017-18*, above n 2, Analysis of Results. For GST collections see n 29 above.
[32] Ibid.

the fiscal capacities of the States.[33] The new relativities were introduced in the early 1980s, albeit with some transitional concessions to some States in the earliest years, and the Northern Territory (1988) and Australian Capital Territory (1993) were brought into the scheme later when each was granted self-government.

The fiscal equalisation arrangements have been substantively maintained over the subsequent decades, and continued to be applied even when tax sharing gave way to formula based grant pools in 1985, and then again when the GST revenues became the basis for the grant pool in 2000-01.[34]

In recent years, a period of particularly low relativities for Western Australia arose because Western Australia became by far the fiscally strongest state in Australia. The mining boom, associated particularly with the emergence of China as the world's largest real economy, resulted in a more dramatic increase in mining revenues (mainly royalties) for Western Australia than for other States. Western Australia now has more than half of Australia's mining production including nearly all of the production of iron ore.

The low Western Australian relativities due to high mining revenues in Western Australia have resulted in higher GST grants for the other States, representing a transfer of about AUD 5 billion per year in recent years.[35]

Through this mechanism, the fiscal positions of all States have benefited similarly from the approximately six-fold increase in total State mining revenues (from a little over AUD 2 billion per year to over AUD 12 billion) since the GST was introduced. The surging mining revenues have provided no doubt welcome supplementation to State budgets in the face of some disappointment in the rates of growth of aggregate GST revenues and perhaps some State own-source revenues.

While the taxation of the frequently strongly growing property sector has also operated to boost State revenues, over time this has had more a cyclical than structural effect on GST shares, particularly since property tax bases are more evenly distributed among the States, at least relative to mining activity.

8. OBSERVATIONS ON POSSIBLE FUTURE DEVELOPMENTS

Will the GST be a secure source of revenue for the States in the future? The linking both by agreement and in legislation of most untied Commonwealth payments to the States to GST revenues will likely continue to provide a more certain untied revenue pool than the more discretionary alternative of annual grant determination. But any meaningful fiscal security for the States can only be understood in the full context of federal financial relations, where the sharing of functions, costs and revenues all combine in a

[33] The current interpretation of HFE allocates funds so that each State has the same fiscal capacity to provide services and their associated infrastructure at the same standard, if each makes the same effort to raise revenues from their own sources, operates at the same level of efficiency and maintains the same average per capita net financial worth (see CGC, https://www.cgc.gov.au/).

[34] For a history of the arrangements, see Commonwealth Grants Commission, *Equality in Diversity, History of the Commonwealth Grants Commission* (Australian Government Publishing Service, 1995) and Commonwealth Grants Commission, *The Last 25 Years* (CGC, 2008).

[35] Recently, through a combination of budget measures since 2018 and legislative changes to apply from 2021-22 until 2026-27, a part of the fiscal cost of these transfers has been, or will be, shifted from Western Australia to the Commonwealth.

complex interplay to determine fiscal outcomes for the States. These broader fields of decision making remain subject to considerable long term uncertainty, and so whether relative certainty for the untied grant pool translates into overall fiscal certainty when all aspects of financial relations are considered remains unclear.

The practice of Australian federal financial relations seems likely to continue to respond to continually changing underlying social, political and economic forces more than to any clear theory of federation or strong overarching intergovernmental agreement on arrangements. At this point, after 118 years of this practice, there is little sign that the Australian federation will be the subject of sustained broad-scale reform efforts, at least not of a kind that would greatly reduce the policy entanglement that has long prevailed. On the contrary, as suggested in this article, the federal entanglement of health, education and welfare and some other government functions may well have its own logic in terms of sustaining democratic voice in relation to complex and increasingly *national* public goods, and so any efforts at simplifying or rationalising arrangements could well stir considerable political resistance.

At the same time, there is little in Australia's history to suggest that existing arrangements will prove entirely stable, persisting indefinitely in their particular current form. The ongoing tensions arising in the three interrelated fields of function, cost and revenue sharing, in the face of relentless underlying pressures on expenditure in all of the main areas of public spending, are likely to continue to cause pressures for adjustment, which have been seen repeatedly over time. To this can now be added new tensions that have arisen from changes in the relative fiscal strengths of the States, associated particularly with the structural shift in the economy towards the mining sector which is concentrated in one or two States. Underlying this, of course, is that in Australia, unlike in unitary states and some other federations, mineral resource endowments are owned and largely taxed at the State level.

Whether tax reform, as it did in 2000, drives a change in federal arrangements through a change in the desired scale or role of the GST in the overall tax architecture, is another matter. The Australian GST is perhaps a relatively low rate tax, at least in comparison with Europe and many of Australia's major trading partners such as China, India and New Zealand. While there is little sign of change pressure on this at present, in the longer run the tax architecture is certain to be stressed by increasing fiscal demands from multiple sources (and not perhaps just those addressed in intergenerational reports[36]).

The faltering robustness of the GST base itself may prove a factor in this. While it is not possible to be certain that trends for decline to date will continue, equally they may. The question then is whether the link between GST revenues and grant arrangements for the States hinders or aids future tax policy adjustment.

If there are limited signs of change impetus coming directly from either federalism or immediate tax architecture perspectives, there remains a third possibility for driving reform, which could have implications for State revenue arrangements. Arguably among the main sources of future fiscal pressures will be the issues arising in each of

[36] The Commonwealth government releases an Intergenerational Report every five years 'that assesses the long-term sustainability of current Government policies and how changes to Australia's population size and age profile may impact on economic growth, workforce and public finances over the next 40 years': see Australian Treasury, 'Intergenerational Report', https://treasury.gov.au/intergenerational-report.

the major functional areas described in this article as 'what States do'. The big five – health, education, welfare, transport and justice – and perhaps also in future some now relatively less costly, traditionally State-dominated areas such as land use, housing, urban design and the environment, all potentially face rising demand pressures that could create significant future challenges for federal financial relations.

They also will, and already do, involve tensions and opportunities for reforms relating to the relative role of public and private provision and decision-making. So any significant federal financial relations reforms in these areas will need to come through holistic policy attention to the entire strategic public policy approach to them. Changes to the GST, and State payments, may well arise in that context at some time, but whether it brings comprehensive reform is at best uncertain given the pattern of for the most part piecemeal attention invested in these questions to date.

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GST: where to next?

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Abstract

1 July 2020 marked the 20th anniversary of implementation of GST in Australia. It is not surprising that this is seen as an occasion for a review and reform of the scope and operation of GST and consideration of what reforms might be necessary. This article reflects on the objects of GST as part of the A New Tax System reform package, measures the performance of GST since its inception and concludes that Australia's GST system is not the sustainable, robust and reliable source of revenue for the States and Territories that it was intended to be.

An examination of the design features of the GST system and scope concludes that the existing GST system is unlikely to provide a reliable revenue source necessary to be the dominant source of future revenue to satisfy the spending needs of the States and Territories. Further, the analysis of the revenue estimates indicates that the robust and growing revenue stream for the States and Territories is unlikely to be achieved by broadening the base and/or increasing the rate.

However, if a number of 'policy gaps' in the GST system are addressed the revenue from GST could be restored to its initial 4 per cent of GDP. But fraud, evasion and non-compliance are inherent weaknesses of a value added tax system. By reference to the findings of the Black Economy Task Force, the article considers changes to the GST system consistent with the Task Force recommendations and the design of VAT systems internationally to limit further erosion of GST revenue.

Lastly, the article addresses whether Australia would be better off staying with a value added tax system or if there are alternatives that might better achieve the reliability, stability and sustainability that governments require.

Key words: Reform of Australia's GST; VAT policy and compliance gaps; Tax Expenditure; C-Efficiency; Black Economy; A New Tax System; GST-free goods and services; GST policy and design; horizontal fiscal equalisation; sustainability of tax revenue; intertemporal consumption; savings ratio; fraud and evasion in GST; Willie Sutton Rule; supplementary financial tax; GST reverse charge; intermediaries and disaggregation in VAT; GST treatment of peer-to-peer and or gig economy and GST; GST-free business-to-business transactions.

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1. INTRODUCTION

> *'Would you tell me, please, which way I ought to go from here?*
> *That depends a good deal on where you want to get to, said the Cat.*
> *I don't much care where … said Alice.*
> *Then it doesn't matter which way you go, said the Cat.'*[1]

Clearly, providing some commentary on what the future holds for GST requires a decision to be made as to 'where we want to get to'.

In addressing the question of what the future might hold for GST, it must be borne in mind that:

- GST is a part of the broader scheme of State/federal financial relations, the challenges of vertical fiscal imbalance and horizontal fiscal equalisation; and
- in theory, changes to the GST rate can be used as tools to affect aggregate consumption and growth.

Other articles in this special issue address:

- GST as a secure source of revenue for the States and Territories;
- should the GST base and rate be reformed?;
- the case for selected exemptions; and
- the case for a broad base.

Accordingly, sections 2 and 3 of this article, while covering some of the ground that is traversed in other articles, seek to identify those things about the GST system that might no longer be 'fit for purpose' after 20 years.

Sections 4 to 6 of this article discuss changes to overcome limitations of the GST system.

In classical times, a haruspex would examine the livers of sacrificed sheep and chickens to discover the will of the gods.[2] In the divination of what the future holds for GST, it will be necessary for the entrails of the A New Tax System (ANTS) package to be revisited:

- what objectives were held in 1998 for GST – the centrepiece of the ANTS package?[3] What was the aim for the Commonwealth, States and Territories?;
- where are we now - were the objectives satisfied? If not, what went wrong?;
- which way … ought [we] go from here?;

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[1] Lewis Carroll, *Alice's Adventures in Wonderland* (Macmillan, 1865) 89.
[2] Wikipedia, 'Haruspex', https://en.wikipedia.org/wiki/Haruspex.
[3] Australian Treasury (circulated by Hon Peter Costello (Treasurer)), *Tax Reform: Not a New Tax, A New Tax System: The Howard Government's Plan for a New Tax System* (1998) (ANTS White Paper).

- should Australia's indirect consumption tax revenues be preserved for the State and Territories dominant source of revenue? Or should the Commonwealth revert to general purpose grants?;
- when viewing the revenue potential of the consumption tax system, is Australia better off staying with the value added tax design?;
- are there alternatives that might better achieve the reliability, stability and sustainability that governments require?

2. WHAT WAS THE AIM OF GST AS PART OF THE NEW TAX SYSTEM REFORM?

The examination in this article of Australia's indirect taxation of household consumption begins with the context of the tax system, its scope and the purpose at which its design features are directed.

2.1 The choice of a tax on consumption

Taxation systems can be divided into two types:

- *direct taxation*, which is assessed upon the property, person, business, income of those who pay them;
- *indirect taxation*, which is levied on commodities before they reach the consumer and are paid by those upon whom they are ultimately purchased as part of the market price of the commodity.[4]

Generally, consumption taxes are levied to raise revenue for government programs[5] whereas selective taxes are often justified on other grounds or viewed as serving a special purpose[6] – for example, to remedy or contribute to the community cost of the consumption of particular goods and services.

2.2 Neutrality and efficiency

The choice of household consumption expenditure (HFCE) as the tax base is said to promote economic efficiency and to minimise distortions that might arise from other forms of taxation.

The choice of household consumption expenditure as the preferred[7] tax base is because:

- the tax base is robust and reliable;
- with a tax base of HFCE, tax revenues grow in line with household expenditure, regardless of the type of the goods and services consumed;

[4] John Bouvier, *Bouvier's Law Dictionary* (The Boston Book Company, 1897).
[5] Sijbren Cnossen, *Theory and Practice of Excise Taxation* (Oxford University Press, 2005).
[6] For example, the use of taxes to restrain harmful greenhouse emissions, pollution or consumption of scarce resources. The taxation of tobacco and alcohol is often justified on the basis of the health costs for which the consumption of these products is responsible.
[7] Or so it was been thought at the time of the ANTS White Paper.

- while HFCE is linked to household and national incomes, the taxation of household consumption is less affected by variations in economic conditions than a direct tax on income.

The base is designed to allow revenue collection with *neutrality and efficiency* – the tax can be levied to maximise the production of goods and services with minimal economic costs to the economy.

With a uniform rate of tax applied to the broadest range consumption expenditure, a consumption tax will *not distort relative prices*. Because the tax does not alter relative prices, households and firms are indifferent, from a tax perspective, between:

- which goods and services to buy, produce or sell; and
- whether to consume (or produce) in the present or defer consumption (or production) for the future by means of saving – the so-called *intertemporal consumption* decision.

Furthermore, as the tax base is household final consumption expenditure, the base excludes Australian production that is consumed outside of Australia but includes foreign production that is consumed in Australia – the so-called *destination principle*.

Essentially, the preference for a tax on consumption is that it enables a secure and reliable revenue source without distorting the behaviour of firms and households. Under the destination principle, a GST is intended to be neutral in relation to decisions of consumers and producers about what goods and services they buy and produce and where – this follows from the design feature whereby GST does not alter *relative prices*.[8]

Significantly, the choice of HFCE as the tax base for GST is founded on the effect of the tax system on prices and the assumption of price elasticity of demand – *its efficiency and neutrality* is achieved because of the way *prices* affect decisions about *household expenditure and saving*.

In contrast, Treasury's *Architecture of Australia's Tax and Transfer System* paper[9] discussed the impact of personal taxation:

> All taxes and all transfers affect behaviour in some way. They change how much money people have and the incentives they face. For example, high levels of taxes on salary and wages reduce the disposable income of salary and wage earners … it can dampen the incentive to work more to earn more money.[10]

The Henry Review[11] considered the tax base and design features of consumption taxation and commented:

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[8] This theory assumes equal price elasticity. Again, in theory, higher taxes could be applied to products with lower price elasticity without any substitution effect and hence inefficiency and distortion from the tax system.

[9] Australian Treasury, *Architecture of Australia's Tax and Transfer System* (2008).

[10] Ibid 3.

[11] Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (2009) Pt 2, Vol 1, 273 (Henry Review).

> One of the most efficient and sustainable tax bases is consumption. A tax on consumption does not tax the normal return to capital, encouraging investment and saving. From a macroeconomic perspective, consumption is generally less volatile than income or wealth, and therefore provides a more stable revenue source. As the population ages, [a broad-based] consumption tax is likely to become increasingly important, since it taxes the capital of retirees as it is spent, which might otherwise largely be untaxed under an income tax.

Further, the Henry Review noted that a consumption tax can be levied directly or indirectly. In its direct tax form, it can be designed to tax:

- personal expenditure (that is, exempting income that is saved); or
- pre-paid consumption (which taxes only labour income and exempts earnings from savings).[12]

The Henry Review concluded:

> Nearly all countries pursue consumption taxation through taxes on goods and services. Personal expenditure taxes were implemented briefly in India and Sri Lanka in the 1960s and 1970s … but the worldwide trend since then has been to tax consumption through indirect taxes such as the value added tax … There would be few benefits and significant difficulties in implementing a direct consumption tax in Australia …[13]

While the discussion in the Henry Review supports an indirect tax on final household consumption expenditure, there has been an ongoing debate about the design of the system to levy such a tax – in particular, the relative advantages and disadvantages of a value added tax (VAT) or a retail sales tax (RST).[14]

2.3 The New Tax System's aim for GST

Australia's GST is an indirect tax on final private consumption in Australia.[15] It follows the design of the European Union's credit-invoice value added tax.[16] The measure of private consumption is found in the Australian Bureau of Statistics (ABS) data category 'Household Final Consumption Expenditure'.[17]

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[12] Ibid 273-274.
[13] Ibid 274 (references omitted).
[14] Alan A Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988) 18, 19; Australian Treasury, *Reform of the Australian Tax System: Draft White Paper* (1985) 131; Liam Ebrill, Michael Keen, Jean-Paul Bodin and Victoria Summers, *The Modern VAT* (International Monetary Fund, 2001) 23; George E Lent, Milka Casanegra and Michèle Guerard, 'The Value-Added Tax in Developing Countries' (1973) 20(2) *IMF Staff Papers* 318; George R Zodrow, 'The Sales Tax, the VAT and Taxes in Between – or, Is the Only Good NRST a "VAT in Drag"?'(1999) 52(3) *National Tax Journal* 429.
[15] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1999, 'GST in a nutshell', ch 1, 1.
[16] Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015) 15.
[17] ABS, *Australian National Accounts: National Income, Expenditure and Product*, Cat. 5206.0 (4 September 2019) Table 8: Household Final Consumption Expenditure.

GST's purpose is to raise revenue for government programs[18] in a way that is comprehensive, neutral and efficient.[19]

The ANTS White Paper emphasised the inefficiencies, distortions and flaws inherent in the disparate system of the narrowly-based State and federal indirect taxes.

The particular mischief identified in the ANTS White Paper was that the wholesale sales tax and the narrowly-based, distortionary State and Territory taxes were narrow, distorting the decisions of firms and consumers about what they produced and consumed. The selective taxes (such as tobacco, alcohol and petroleum excises) were designed to affect production and consumption decisions – at odds with the objective of a reliable and robust revenue source.[20]

The federal wholesale sales tax, for example, was limited to goods and imposed on their wholesale value. The tax base became a lower proportion of household consumption over time.

During the 23 years prior to ANTS, the Asprey Review, the RATS Statement[21] and *Fightback!*[22] sought to place more emphasis on the broad-based taxation of household consumption expenditure and decrease the reliance on personal income tax and narrowly-based excises and sales taxes. The process in mind was a 'tax mix switch' from the economically damaging high rates of personal tax to an efficient and economically neutral consumption tax.

Conversely, the ANTS package proposed a broadening of indirect tax to provide a sustainable, reliable and stable base to the States and Territories for the long term. The ANTS White Paper contrasted this approach with earlier reform proposals as follows:

> Earlier attempts at tax reform in Australia have had *a substantial 'tax mix switch'* motive - increasing indirect taxes substantially … to fund large cuts in personal income tax rates (particularly the higher marginal rates). That *is not the objective* of this reform. *A fundamental objective of this package is to halt the erosion of indirect tax revenue …*[23]

The ANTS White Paper, while providing a 'guaranteed minimum amount' to the States up until 2002-03, envisaged that GST revenues would continue to grow thereafter such that general purpose grants would no longer be required:

> ... [the] introduction of the GST stabilised the process for determining the size of the pool. It also locked in the role of the CGC in determining the distribution

[18] As will be shown, Australia's GST was enacted to raise revenue for the programs of the State and Territory Governments.
[19] Schenk et al, above n 16, 23.
[20] See, eg, Taxation Review Committee (Justice Kenneth Asprey, chair), *Full Report* (1975) [3.41] (Asprey Review).
[21] Australian Treasury, *Reform of the Australian Tax System: Draft White Paper*, above n 14.
[22] Liberal Party of Australia, *Fightback! It's Your Australia: The Way to Rebuild and Reward Australia* (November 1991) (Fightback!).
[23] ANTS White Paper, above n 3, 77 (emphasis added).

> of the pool among the States. At this point, the Commonwealth very clearly shed any responsibility for determining the distribution.[24]

As a revenue source, if GST was to grow in proportion to revenue needs of the States and Territories, a failure to contribute a reliable proportion of revenue for the States and Territories would mean:

- the return to Commonwealth untied grants to make up deficiencies; and/or
- a greater emphasis placed on other less efficient taxes, with consequential impacts on savings, workforce participation and efficiency.

2.3.1 The objectives of GST

The ANTS White Paper described the overall objectives for GST as:

- a broad-based value added tax to provide a secure stable and growing source of revenue for the States and Territories in the long term[25] to remove the reliance of the States on Commonwealth grants and distorting taxes; and[26]
- to reform the indirect tax base so that 'the erosion of indirect tax revenue is halted permanently'.[27]

Inherent in these twin objectives is the expectation that the GST, as designed, would provide an efficient, growth tax for the States and Territories.

The Commonwealth government maintains the position of GST as States' revenue (and not Commonwealth). Changes to the base must have the agreement of all States and the Commonwealth governments.[28] The Agreement on the Reform of Commonwealth-State Financial Relations 1999 ensures that, without uniform agreement, GST cannot be used to produce the type of tax mix switch envisaged in previous tax reform reports. That is, under the IGA, GST is 'locked in' to its present base and rate – and hence State and Territory revenue potential.

2.4 The benchmark

The discussion so far has referred to GST as an indirect tax on final private consumption in Australia.[29] The measure of private consumption is found in the Australian Bureau of

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[24] M Gray, *Accountability in the Australian Federation*, Background Paper for the Productivity Commission Inquiry into Horizontal Fiscal Equalisation (Analytic Outcomes, August 2017) 30, cited in Productivity Commission, *Horizontal Fiscal Equalisation*, Inquiry Report No. 88 (15 May 2018) 78 (HFE Report).

[25] ANTS White Paper, above n 3.

[26] Under the 1999 Intergovernmental Agreement, the GST revenue would be shared between the States and Territories on HFE principles. See Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, set out as Schedule 2 to the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (Cth), enacted on 10 September 1999 (IGA). The IGA provided for additional untied grants to be made until the 2002/03 financial year to maintain the States' budget in no worse position than would have been the case prior to the ANTS reforms. But it was estimated that payments would not be required from 2003/04.

[27] ANTS White Paper, above n 3, 78.

[28] IGA, above n 26.

[29] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1999 (Cth).

Statistics data category 'Household Final Consumption Expenditure'.[30] The ABS measures the final consumption expenditure of Australian households.

The 'GST Benchmark' is a statement of the ideal economic base at which GST is directed.[31]

The *Tax Benchmarks and Variations Statement 2018* describes the tax base for the GST benchmark as: [32]

> … the supply of all goods and services in Australia. The definition of 'goods and services' is broad and includes, for example, commercial property. Other features of the benchmark tax base include:
>
> - exports are exempt from GST;
> - non-commercial activities of governments are exempt from GST;
> - the supply of private residential accommodation is input-taxed (meaning rent is not subject to GST);
> - the sale of pre-existing residential premises is input-taxed;
> - the sale of new residential premises and the supply of alterations, additions and improvements to residential premises are subject to GST;
> - goods and services supplied to oneself are not subject to GST.

Departures from the ideal base arising from legislative policy are 'tax expenditures'. It is useful to examine both the ideal tax base and the expenditures to assess the extent to which, from a policy perspective, the GST's tax base is sustainable and stable as a source of State and Territory revenues.

In the *Tax Expenditures Statement 2015* (and in all previous Tax Expenditures Statements) the GST benchmark was described as 'the value of household final consumption expenditure plus the value of private dwelling investment where these are supplied in the course of an enterprise'.[33]

At this point it is worth examining the treatment of housing in the GST tax base because it has important implications for the GST's stability as a dominant revenue source for the States and Territories. The Australian treatment of housing is an adjustment to the benchmark of household consumption expenditure upon which the theory of the efficiency of value added tax is predicated.

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[30] ABS, *Australian National Accounts: National Income, Expenditure and Product*, above n 17.
[31] Australian Treasury, *Tax Benchmarks and Variations Statement 2018* (2019) 155 (TES 2018) states that, 'unlike the income tax benchmark, there is no starting point such as the Schanz-Haig-Simons definition of income for determining the benchmarks for indirect taxes. Each indirect tax therefore has its own benchmark that reflects the standard features of the tax to question. Identifying the standards of a tax unavoidably involves judgment'.
[32] Ibid 156 (footnote omitted).
[33] Australian Treasury, *Tax Expenditures Statement 2015* (2016) (TES 2015). The practice of describing the 'ideal' tax base in this way ceased thereafter and was replaced by the description in n 31, above.

2.4.1 Imputed rent and residential accommodation

The ABS calculation of HFCE includes actual and imputed housing rentals. Imputed and actual rent constituted 20 per cent of HFCE in 2017-18 but (as the *Tax Benchmarks and Variations Statement 2018* explains):

- actual housing rental expenditure and imputed rent from owner-occupied housing is not subject to GST;
- the sale of new residential premises and the value of alterations, additions and improvements to residential premises are subject to GST.

These structural adjustments to the HFCE benchmark mean that in any financial year:

- there is a part of HFCE upon which GST is not paid (at least entirely) – ie, actual and imputed rent; but
- there is an amount of private housing investment that is subject to GST but is not included in HFCE.

In doing so, GST collections might vary from year to year as a result of the extent of private dwelling investment.[34]

The December 2018 national accounts show a decrease in private dwelling investment of 3.4 per cent for the quarter.[35]

With housing investment representing a large proportion of the GST tax base, year on year variations and trends affect the reliability of GST as a dominant feature of State and Territory revenue. If the base were closer to the actual and imputed rent in the HFCE data, there would be a more stability in year on year revenue.

2.5 GST's policy gaps - under taxation of consumption expenditure

The *Tax Benchmarks and Variations Statement 2018* calculates the amount of GST revenue that, in Treasury's view, is *excluded* from the tax base through the 'policy gap'.

For the 2018-19 financial year, the *Statement* measures the 'policy gap' (in section H) as follows:

- GST-free food – $7,300 million;
- GST-free health services, insurance, care, drugs and appliances – $6,550 million;
- GST-free education – $4,750 million;
- input taxation of, and reduced input tax credit (RITC) for, financial services – $4,500 million;
- GST-free child care – $1,540 million;

[34] States and Territories have experienced similar fluctuations in stamp duty revenues from real property conveyancing.
[35] ABS, 'Economy Grew 0.4 per cent in March Quarter', *Media Release* (8 March 2019).

- GST-free water and sewerage – $1,009 million;
- GST-free arranging of overseas travel, accommodation and other services by travel agents – $250 million;
- GST-free religious services – $55 million;
- simplified accounting methodologies – $15 million;
- GST free status to diplomats, diplomatic missions and international organisations – $11 million.[36]

2.5.1 ANTS' tax base

Taking the above into account, it can be seen that the tax base at which GST was directed was:

HFCE

Less: actual and imputed rent

Plus: private dwelling investment

Less: consumption expenditure on the items of 'tax expenditures' referred to above.

2.6 GST today

The 2019-20 *Mid-Year Economic and Fiscal Outlook*[37] forecasts for 2019-20 are:

- total GST revenues – $65,558 million;
- GST revenue as a percentage of total Commonwealth tax revenue – 14.4 per cent;
- GST revenue as a percentage of GDP – 3.26 per cent.[38]

While Organisation for Economic Co-operation and Development (OECD) and European Union (EU) data is not often a valid comparison with Australia's, published data of the OECD indicates that, in the 2016-17 fiscal year:

- the proportion of total Commonwealth tax to GDP (22.2 per cent) was less than the OECD average (34.3 per cent);
- VAT as a proportion of GDP in Australia was 3.4 per cent as compared with an OECD average of 6.3 per cent;

[36] TES 2018, above n 31, 130-140.
[37] Australian Treasury, *Mid-Year Economic and Fiscal Outlook 2019-20* (December 2019) (MYEFO 2019).
[38] Calculated from MYEFO 2019, ibid, Tables 3.2 and 3.9.

- in the OECD, the average VAT revenue as a percentage of total tax, was 34.5 per cent. Australia was 16.3 per cent.[39]

3. HOW IS GST GOING AFTER 20 YEARS?

The indirect tax reforms undertaken in the ANTS package of 1998 were directed at providing:

- a neutral and efficient tax on consumption expenditure so that 'the erosion of indirect tax revenue would be halted permanently';
- a secure, stable and growing source of revenue for the States and Territories in lieu of general-purpose Commonwealth grants.

The objective was to remove the reliance of the States on Commonwealth grants *and narrowly based distorting taxes*.

How well has the GST performed?

3.1 A stable and sustainable source of revenue for the States and Territories

Ten years ago, the Henry Review commented on the stability of consumption taxes:

> Total household consumption as a percentage of GDP has been relatively stable for a long time …. This suggests that a tax on consumption would provide a relatively sustainable revenue base that grows in line with the broader economy. The GST is slightly less robust because it does not cover the full consumption base. The Productivity Commission … found that by 2044-45 GST revenues may decline slightly as a share of GDP because tax-exempt consumption such as health care is expected to grow.
>
> … Underlying changes in consumption of specific goods and services *can be influenced by tax, as well as changing consumer preferences, new technology or government policy*. Together, these factors can affect the production and consumption of different goods.[40]

But the truth of the caution expressed in the Henry Review has emerged sooner than the Review warned. Recent publications of the Parliamentary Budget Office[41] and Productivity Commission[42] have examined the stability and sustainability of our 20-year-old GST system.

Both reports have focused on the sustainability and adequacy of GST revenues for their intended purpose.

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[39] Organisation for Economic Co-operation and Development (OECD), *Revenue Statistics: 1965-2016* (OECD Publishing, 2017).
[40] Henry Review, above n 11, Pt 2, Vol 1, 274-275 (emphasis added).
[41] Parliamentary Budget Office, *Trends Affecting the Sustainability of Commonwealth Taxes*, Report No. 2/2018 (18 July 2018) (PBO Report).
[42] HFE Report, above n 24.

3.1.1 The HFE Report

The HFE Report reminds us that Horizontal Fiscal Equalisation (HFE) is a product of Vertical Fiscal Imbalance (VFI). VFI arose progressively from Federation in 1901 (through the ceding of colonial customs revenues to the Commonwealth) through to the Second World War (the Commonwealth assuming sole responsibility for income tax) and, more recently, the absorption of State business franchise fees into the Commonwealth excise regime.[43]

Under the IGA, the general revenue transfers from the Commonwealth to the States and Territories were to be satisfied by giving the States and Territories access to the total of the GST revenues.

The HFE Report comments that:

> The real average annual growth rate of GST revenue[44] over the period 2000-01 to 2016-17 was approximately 3.6 per cent, roughly the same growth rate as personal income tax, but ... [t]he GST pool has grown more slowly in recent years, and is arguably not the steady and growing source of revenue for the States that was first envisaged. …
>
> The size of the pool distributed to the States has grown considerably since 1981. In 1981-82, approximately $25.4 billion (in 2016-17 terms) was distributed to States on the basis of HFE. In 1985-86, the amount had grown to nearly $28 billion (in 2016-17 terms) compared with roughly $62.4 billion in 2017-18. Nevertheless, the growth rate of GST revenue (in real terms) approximately halved between 2000-08 and 2009-17, from 4.5 per cent to 2.1 per cent.[45]

Williams[46] observed:

> Tying general revenue payments to the GST was seen by the States and Commonwealth as providing a growth tax to the States. In practice, the exemptions from the GST have meant that the revenue from it is now growing at a slower rate than personal consumption expenditure.

3.1.2 The PBO Report

The PBO Report, from a GST perspective, foreshadows decreasing GST revenues (as a proportion of GDP) resulting from the limitations of the existing GST base. The Report identifies areas that have given rise to a decrease and concludes that the reduction is likely to continue:

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[43] Ibid.

[44] There is a difference between the total amount of GST revenue collected, and that which is distributed to States (the GST pool) due to the fact that some GST revenue accrued during a financial year is not remitted to the Australian Taxation Office (ATO) by 30 June that year, because it is not due to be paid until Business Activity Statements are lodged the following financial year (this also applies to some GST collected by Commonwealth agencies) and because penalties owed to the ATO (other than general interest charge penalties) are not included in the GST to be paid to the States.

[45] HFE Report, above n 24, 77-78.

[46] Ross Williams, 'History of Federal-State Fiscal Relations in Australia: A Review of the Methodologies Used' (2012) 45(2) *Australian Economic Review* 145.

> When the GST was introduced, GST receipts were 3.4 per cent of GDP. GST revenue peaked shortly after, in 2003-04, at 3.8 per cent of GDP, reflecting the maturing of the new tax. Since then, GST receipts have declined as a share of GDP to 3.4 per cent in 2016-17.[47]

The PBO Report concluded that:

> ... [T]here is a likelihood that taxes on consumption will continue to trend downwards ... If these risks to tax receipts eventuate, and in the absence of other taxation reforms, maintaining Commonwealth Government revenue at recent levels as a share of GDP will lead to an increasing reliance on taxes on labour income through the personal income tax system.[48]

3.2 What has been the response to date?

The Commonwealth government's response to the HFE Report is that the Commonwealth will increase the 'GST pool' by AUD 600 million in 2020-21 and a further AUD 250 million in 2024-25. The latter is to be 'indexed to grow in line with GST collections on a permanent basis'.[49]

After the HFE Report, and the Commonwealth undertaking to 'top up' the GST pool, the *Mid-Year Economic and Fiscal Outlook 2018-19* (MYEFO 2018) forecasts[50] of 2018-19 GST revenues were downgraded from AUD 66,789 million to AUD 65,783 – a decrease of AUD 1 billion. The Commonwealth in its 2019-20 Budget commented:

> Receipts from GST are forecast to grow by 4.0 per cent in 2018-19 (equivalent to $2.5 billion), and by 2.4 per cent (equivalent to $1.6 billion) in 2019-20. Compared with the 2018-19 MYEFO, receipts are expected to be around $1.0 billion lower in 2018-19, $1.8 billion lower in 2019-20 and $10.3 billion lower over the four years to 2022-23. The downward revisions reflect weaker-than-expected collections, and the downward revisions to forecasts for growth in consumption and dwelling investment.[51]

In their 2019-20 Budget Papers,[52] the States have highlighted the downward revision in GST revenues post-MYEFO as well as decreases in State transfer/conveyancing duties[53] resulting from the downturn in the property market.

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[47] PBO Report, above n 41, page 4.4. MYEFO 2019, above n 37, estimates 3.26 per cent of GDP for 2019-20.
[48] PBO Report, above n 41, vii.
[49] Hon Scott Morrison (Treasurer), 'All Better Off from Fairer Way to Share the GST', *Media Release* (5 July 2018).
[50] Australian Treasury, *Mid-Year Economic and Fiscal Outlook 2018-19* (December 2018).
[51] Australian Treasury, *Budget 2019-20: Budget Strategy and Outlook – Budget Paper No. 1 2019-20* (2 April 2019) 4.13.
[52] New South Wales Treasury, *Budget Statement 2019-20* (18 June 2019); Queensland Treasury, *Budget Strategy and Outlook 2019-20* (11 June 2019); South Australian Treasury, *Budget Statement 2019-20* (18 June 2019); Tasmanian Treasury, *The Budget* (23 May 2019); Victorian Treasury, *Victorian Budget 2019/20* (27 May 2019); Western Australian Treasury, *State Budget 2019-20* (9 May 2019).
[53] As indicated earlier, from a real property point of view, GST is not a consumption tax but rather a tax on new dwelling investment. It is therefore a double jeopardy to the States which experience volatility in real property conveyance and transfer duties as well as GST as a result of fluctuations in property investment.

The prospect of lower GST revenue has led to the States looking to their existing revenue base to 'plug the gap'. Measures that are to be found in many State Budgets propose to increase revenues from:

- land tax through aggregated holding and absentee landlord measures;
- waste disposal/environmental levies;
- the gambling point of consumption tax;
- increases in fines, penalties and fees and charges;
- new taxes on motor vehicles and luxury cars in particular.

In general, confronted with the lack of growth in GST revenues, States and Territories resort to selective taxes that fall within their constitutional base. These are, by their selective nature, unstable and inefficient. Resort to plugging perceived gaps from their existing base and discovering new sources of selective taxes is an illustration of the 'Willie Sutton Rule'[54] at work – that's where the money is!

Ironically, it was the narrowness of the State revenue base and the distortionary effects of these taxes that the ANTS package sought to address.

What is it about the GST system that leads to low growth revenue outcomes and drives the nation backwards to the type of taxes that are neither robust nor efficient?

3.3 What's the problem?

3.3.1 The tax base

The Henry Review identified that changes in consumption of goods and services can be influenced by changing consumer preferences, new technology or government policy. The Henry Review made this observation as a factor that favoured a broad over a narrowly defined consumption tax base.

The PBO and HFE Reports postulated that declining growth of GST has been due to:

1. the exemptions in the GST base such that GST revenues are not keeping pace with household consumption.[55] There are two elements that contribute to this effect:

   (a) The change in the proportion of household consumption on taxable items:

   [One] factor that has led to a decline in GST receipts as a share of GDP has been the change in the consumption mix over time. Since the GST was

[54] The '*Willie Sutton rule*' suggests that, in activity-based costing, the focus should be on the highest costs first because that is where the largest savings can be found: see Robert S Kaplan and Robin Cooper, *Cost and Effect: Using Integrated Cost Systems to Drive Profitability and Performance* (Harvard Business Press, 1998). It derives from the response of Willie Sutton, when asked why he robbed banks: 'Because that's where the money is'.

[55] Williams, above n 46.

introduced, households have spent progressively more of their income on goods and services that are exempt from the GST.[56]

(b) The change in the prices of taxable items vs untaxed items:

The decrease in the proportion of household consumption subject to GST has largely occurred as prices of goods and services exempt from the GST have grown faster than those goods and services subject to the GST. In fact, the volume of consumption subject to GST has remained relatively stable since the introduction of the GST …[57]

2. Changes in the savings ratio:

Although consumption expenditure tends to be relatively stable, around the time the GST was introduced the household savings ratio was at historically low levels and consumption as a share of GDP was correspondingly high. With the terms of trade boom during the 2000s, Australian real incomes rose and households largely opted to save rather than consume the gain, leading to a fall in consumption as a per cent of GDP. The global financial crisis then also led to higher saving as households rebuilt their balance sheets.

Since 2008-09, consumption as a per cent of GDP has increased as the household savings ratio has decreased from around 8 per cent to less than 3 per cent.[58]

3. The increase in participation in economy by individual or small operators and suppliers who may fall under the GST registration threshold.[59]

While the PBO Report identified possible diminishing GST revenues because small operators could choose not to register for GST, the Report observed that:

> There are many changes occurring in the Australian labour market, including the well-established increase in part time work and an anticipated shift towards a peer-to-peer economy whereby an increasing proportion of workers are likely to be at least partially self-employed …
>
> Increasing self-employment could reduce the proportion of people having personal income tax deducted from their wages and remitted to the ATO by their employer and increase the proportion of people that are required to assess and remit their full tax liability to the ATO themselves. The shift towards a peer-to-peer economy also has the potential to increase participation in the black economy. However, so far the proportion of individuals who identify as self-employed for their main job has not increased … Although the many disruptions taking place in the labour market will undoubtedly lead to

[56] PBO Report, above n 41, 5.
[57] Ibid.
[58] Ibid 4-5.
[59] Ibid 7.

> challenges, the current data does not reveal negative implications for the personal income tax base so far.[60]

With respect to the PBO's observation, anecdotally, employees that convert to self-employed, often disappear from the taxation system altogether.

3.3.2 Non-compliance

It can be observed that the PBO and HFE Reports referred to the weaknesses in Australia's GST base as the cause of the decline in GST revenue.

But the PBO Report highlights that, even with a broader base, GST revenues are affected by non-compliance. The ANTS proposals assumed 95 per cent compliance on a tax base which incorporates an Australian Taxation Office (ATO) estimate of some AUD 18 billion of cash economy activity.[61]

3.3.3 Legislative, interpretive and administrative deficiencies

While variations from the ideal and actual revenues can be explained by the weakness in the base and revenue losses through non-compliance, deficiencies in the legislative expression of the consumption tax base, its interpretation and administration can be of considerable significance to the reliability of revenue flows.

Examples of inaccuracies or inadequacies in drafting, interpretation and administration are not dealt with in this article. But some aspects of the design features that contribute to these deficiencies are given in sections 4 and 5.[62] Whatever the cause of flagging GST revenues, in determining the future of GST, all gaps between 'ideal' and 'actual' revenue receipts need to be considered and addressed.

3.3.4 Policy and Compliance gaps

VRR and HFCE measures of efficiency

In reaching the conclusion that, in 2005, Australia taxed only 57 per cent of consumption, the Henry Review adopted an OECD measure called the VAT revenue ratio (VRR).[63] The VRR calculates a ratio of VAT/GST revenue as a proportion of total consumption. In doing so, the VRR uses 'total consumption' as the 'ideal'. Total consumption, in this sense, includes government consumption.[64] The OECD include

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[60] Ibid 33.

[61] ANTS White Paper, above n 3, 31.

[62] Reference to some of the annoyances and anomalies can be found in an earlier paper of the author's presented for the Taxation Institute: see Michael Evans, 'El Condor Pasa: Is GST Change Inevitable?' (Conference Paper, TIA National GST Intensive Conference, 6 September 2012).

[63] VRR = (VAT or GST revenue)/([consumption (including government consumption) – VAT or GST revenue] x standard VAT or GST rate). As the Henry Review noted, an 'ideal' value added tax, which would apply at a 'single rate on all domestic consumption, would have a VAT revenue ratio of 1. A VAT revenue ratio above 1 can reflect investment in residential housing that is taxed on a prepaid basis (and rents are input taxed) but is not included in national accounts as consumption, or cascading effects of input taxation in the value chain': Henry Review, above n 11, Pt 2, Vol 1, 285, chart D2-1. The VRR is explained in more detail in OECD, *Consumption Tax Trends 2018: VAT/GST and Excise Rates, Trends and Policy Issues* (OECD Publishing, 2018) 54-59.

[64] See OECD, *Consumption Tax Trends 2018*, above n 63, 54, which explains that 'in the absence of a standard assessment of the potential VAT base for all OECD countries, the closest statistic for that base is final consumption expenditure as measured in the national accounts, VAT is indeed, ultimately a tax on

VRRs across a number of jurisdictions in the *Consumption Tax Trends* publication.[65] The 2016 Australian VRR published by OECD was 50 per cent, meaning that the GST revenue collections were 50 per cent of the 'ideal VAT tax base' (including government consumption).[66]

However, Australia's GST is intended to exclude government consumption from the base and is limited to household final consumption expenditure. The Australian HFCE measure (excluding government expenditure), in 2006-07 calculated that GST revenue collections was at its highest of 71.3 per cent of Australian household final consumption expenditure but had fallen to 64 per cent by 2017-18.

The VRR and HFCE 'efficiency measures' seek to quantity the effect of both 'policy' and 'compliance' gaps on GST revenues. Items of household consumption that are excluded, as a matter of policy, from the tax base are described as 'policy gaps'. GST revenues that are not collected because of non-compliance with the GST law are described as 'compliance gaps'.

It is useful to determine the extent to which the sustainability, reliability, stability and efficiency of the GST system is the result of policy, compliance or legislative design inefficiencies. Then an assessment can be made of what remedial action can be taken to address it, ie, 'which way … ought [we] go from here?'

First policy gaps in GST revenues are considered below.

3.4 Policy gaps in GST's revenues

The PBO Report noted variations in savings and consumption as factors that affected the GST's reliability as a significant revenue source for State and Territory governments. Clearly, variations in savings and consumption from one budgetary period to another are undesirable if GST revenue is a dominant part of the revenue side of the Budget.[67]

However, the PBO Report focused on changes in consumption patterns where 'undertaxed' items of consumption were concerned. The PBO and HFE Reports conclude that, if the proportion of HFCE that is spent on GST concessionally treated items continues, GST collections are unlikely to grow at the same rate as GDP or HFCE.

The PBO attributes the declining growth in GST revenues to this shift in consumption preferences.

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final consumption. Final consumption expenditure in national accounts is calculated according to a standard international norm, the System of National Accounts (SNA 2008 - except for Turkey, Chile and Japan that still use SNA 1993) under Item P3 Final consumption expenditure'. The OECD state shows the breakdown of P3 between HFCE and P3S13 (General government final consumption expenditure).

[65] Ibid Fig. 2.3.

[66] Ibid 55.

[67] In the case of the Commonwealth Budget, variations in one source of tax revenue might be offset by movements in other tax revenues – or the expenditure side of the budget. These might be described as stabilisers. The aim of the design of the tax and expenditure Budget is to seek to manage the system and its stabilisers to ensure that year by year variations can be managed.

3.4.1 The tax expenditures

As noted in section 2.5, the *Tax Benchmarks and Variations Statement 2018* estimates the total GST tax expenditures for the 2018-19 year as AUD 26.2 billion:

- GST-free food – $7,300 million;
- GST-free health services, insurance, care, drugs and appliances – $6,655 million;
- GST-free education – $4,750 million;
- input taxation of, and RITC for, financial services – $4,500 million;
- GST-free child care – $1,540 million;
- GST-free water and sewerage – $1,090 million;
- GST-free arranging of overseas travel, accommodation and other services by travel agents – $250 million;
- GST-free religious services – $55 million;
- boats for export – $19 million;
- simplified accounting methodologies – $15 million;
- GST-free status to diplomats, diplomatic missions and international organisations – $9 million.

At 2018-19 estimates, the expenditures represent GST revenues forgone of 41.4 per cent.[68]

3.4.2 Willie Sutton rule

The four items of concessionally taxed household expenditure that are *growing at higher rates* than household expenditure generally, are:

- water and sewerage;
- health;
- education; and
- insurance and financial services.

The PBO Report opines that the trend in these categories will continue – with the result that GST revenues as a proportion of GDP will decline into the future.

[68] Calculated from Table 5, Australian Treasury, *Budget 2019-20: Budget Strategy and Outlook – Budget Paper No. 1 2019-20*, above n 51, 4-15.

An application of the Willie Sutton rule tells us we should focus on water and sewerage, health, education, insurance and financial services to get the best bang for our buck. That is where the money is!

Happily, a broadening of the base would also produce a more neutral and efficient tax on household consumption.

But food is the largest single concession.

The reasons that these particular elements of household consumption are not fully taxed and options for reform are discussed in section 5.

3.4.3 The rate

Of the 37 OECD nations, only the United States does not have a value added tax. The standard rates vary from 7.7 per cent (in Switzerland) to 27 per cent in Hungary. The OECD average is 19.3 per cent.[69]

At 10 per cent, only Japan and Switzerland have a lower standard rate than Australia.

Section 5 discusses increasing the Australian GST rate.

4. COMPLIANCE GAPS IN GST'S REVENUES

While the design of a value added tax promotes its 'neutrality' credentials, it is also its main weakness – it is susceptible to fraud.

In relation to GST compliance risks, the Henry Review commented:

> There is an argument that tax invoices make the GST 'self-enforcing', as a business purchaser of a taxed good or service requires a valid tax invoice from their supplier in order to receive an input tax credit. While this imposes an additional compliance burden for taxpayers, it creates an additional audit trail for the ATO.
>
> However, the inherent compliance benefits of an invoice-credit method should not be overstated. While business consumers have an incentive to ask for a tax invoice, consumers have no need for a tax invoice, as they cannot claim a tax credit. As such, tax collected at the final retail stage is not self-enforcing. Moreover, the existence of a tax invoice may assist but does not in itself ensure compliance. A false tax invoice might be used to make a claim for a credit. A missing or absent tax invoice may be used to understate sales.[70]

The OECD recorded that:

> Losses of VAT revenue from non-compliance can result from a number of factors. In addition to 'traditional' VAT avoidance (ie, arrangements intended to reduce the tax liability that could be strictly legal but in contradiction with the intent of the law) and evasion (illegal arrangements where liability to tax is ignored or hidden) there has been a continuous, significant and worrying trend

[69] OECD, *Consumption Tax Trends 2018*, above n 63, 66-67, Annex Table 2.A.1. Colombia, which became a member of the OECD in 2020, also has a VAT.
[70] Henry Review, above n 11, Pt 2, Vol 1, 287.

> of increasing criminal attacks on the VAT system. This organised and criminal VAT fraud has been shown to have connections with other criminal activities such as terrorism and money laundering in a number of cases …
>
> The most common type of organised VAT fraud is the 'missing trader' or 'carousel' fraud. It arises when a business makes a purchase without paying VAT (typically a transaction for which tax self-assessment applies), then collects VAT on an onward supply and disappears without remitting the VAT collected …
>
> Reducing the revenue losses from VAT non-compliance remains a key challenge and a priority for countries around the world. An increasing number of tax administrations carry out research to estimate the VAT compliance gap, ie, the revenue loss due to avoidance, evasion and fraud. In the European Union, the VAT gap in the 28 member states for 2016 … is estimated at EUR 147.1 billion. In relative terms, the VAT Gap share of the VAT total tax liability (VTTL) dropped to 12.3 percent from 13.2 percent in 2015. The smallest gaps were observed in Sweden (1.24%), Luxembourg (3.80%) and Finland (6.92%), and the largest gaps were registered in Romania (37.89%), Lithuania (35.94%) and Malta (35.32%). The United Kingdom estimated its VAT gap at GBP 13.3 billion in 2017-18, i.e. 9.6% of the estimated net VTTL … A number of other OECD countries provide public estimates of their VAT gap. In Australia the GST gap is estimated at AUD 5.3 billion or 7.9% of VTTL … in Canada, the multi-year average GST/HST gap for 2000-2014 is estimated at 5.6% VTTL … and in Chile … where the VAT gap is estimated at 16.6% VTTL.[71]

From a 'compliance gap' perspective, the ATO has published a 'gap' analysis. In the overview to the analysis, the ATO states:

> The tax gap is an estimate of the difference between the amount the ATO collects and what we would have collected if every taxpayer was fully compliant with tax law. Tax gaps exist in all countries to some extent, and the drivers include:
>
> - cultural and human factors
> - global forces
> - complexity in business and legal systems
> - those who take aggressive tax positions
> - genuine errors.
>
> Estimating tax gaps is a challenging task for any jurisdiction. Tax gaps are, in effect, about measuring what is not visible – what people have *not* told us about their compliance. This might due to a misunderstanding, by choice, or by taking a tax position that differs from the ATO view of the law. As a result, all tax gap estimates are subject to a degree of error. They can change from year to year

[71] OECD, *Consumption Tax Trends 2018*, above n 63, 59.

> due to improvements in the methodologies used and revisions of underlying data.
>
> Tax gap estimates and their trends over time provide useful insights into the longer-term operation of the tax and superannuation systems. Along with other performance measures, they tell a story about the performance and integrity of the system, including levels of willing participation and significant shifts in compliance. They can guide us in determining priority risks and opportunities to better inform where we invest our resources.
>
> Rapid changes in the economy, society and technology mean the issues driving tax gaps continue to evolve. No tax system can eliminate tax gaps, as the cost of doing so would be excessive.[72]

In relation to GST, the analysis shows that the estimate of the 'compliance gap' grew from 4.9 per cent in 2009-10 to 7.3 per cent in 2017-18 (the last year for which estimates have been published to date).[73]

The ATO estimates the 'compliance gap' in 2017-18 for GST, wine equalisation tax, tobacco tax and petrol and diesel excise and duty to be AUD 5.9 billion.[74]

The Black Economy Taskforce Report estimated that the black economy in Australia *could have doubled* since 2012 to now represent up to AUD 50 billion in 2015-16 dollars.[75]

All of this suggests that the compliance gap for GST is increasing.

4.1 The cause?

In its response to the Black Economy Taskforce Report (Taskforce Report) the government explained that the term 'black economy' generally refers to activities which take place outside the tax and regulatory systems.[76] The practices referred to in the Taskforce Report diminish taxation collections that are of relevance in identifying the extent of GST compliance gaps. Examples given (for both direct and indirect taxation) included:

- illegal phoenixing – liquidating and re-forming a business to avoid obligations;
- sham contracting – presenting an employment relationship as a contracting arrangement;

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[72] ATO, 'Australian Tax Gaps – Overview', https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Australian-tax-gaps-overview/ (accessed 1 July 2020).
[73] ATO, 'Goods and Services Tax Gap', https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Goods-and-services-tax-gap/ (accessed 1 July 2020); ATO, *Measuring Tax Gaps in Australia for the GST and the LCT* (2012).
[74] ATO, 'Tax gap program summary findings' (2016-17 for tobacco tax), https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Australian-tax-gaps-overview/?anchor=Summaryfindings#Summaryfindings (accessed 2July 2020).
[75] Black Economy Taskforce (Michael Andrew, chair), *Final Report* (October 2017) 223 (Taskforce Report).
[76] Australian Treasury, *Tackling the Black Economy: Government Response to the Black Economy Taskforce Final Report* (May 2018).

- demanding or paying for work cash in hand to avoid obligations;
- not reporting or under-reporting income;
- ABN, GST, and duty fraud.[77]

Recent changes to the GST law in relation to the following matters are examples of initiatives taken to address the 'compliance gap':

1. *Missing trader/phoenixing:*
   - introduction of withholding tax on the purchase of new residential properties;[78]
   - a reverse charge on taxable supplies of valuable metals and limitations on relief for the second-hand acquisitions of these metals.[79]
2. *Employee vs Independent Contractor Disputes:*
   - extension of taxable payment reporting systems to include supplies made to couriers and cleaners and expansion of reporting foreshadowed in the 2018/19 Budget.[80]

4.1.1 Missing trader and refund fraud

The OECD *Consumption Tax Trends 2018* refers to the inherent risk of 'missing trader' fraud in a value added tax system.[81]

Similar concerns can be found in a 2008 report of the United States Government Accountability Office[82] and a 2008 New Zealand Discussion Paper.[83]

The Taskforce Report refers to missing trader fraud as 'phoenixing'. At its simplest, it involves carrying on activities or transactions giving rise to taxation liabilities where the 'taxpayer' liquidates or otherwise goes missing without remitting tax to the Commissioner.

Reforms to the corporations and tax laws announced in the 2018-19 Budget seek to deter and disrupt phoenix activity.[84] The Budget package included:

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[77] Ibid 3.
[78] *Taxation Administration Act 1953* (Cth) Sch 1, Sub-div 14-E (TAA).
[79] *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 86-5 (GST Act), as inserted by *Treasury Laws Amendment (GST Integrity) Act 2017* (Cth).
[80] By adding items to the table in section 396-55 of Schedule 1 of the TAA to cover payments to security providers and investigation services; road freight transport; and computer system design and related services.
[81] OECD, *Consumption Tax Trends 2018*, above n 63.
[82] United States Government Accountability Office, *Value-Added Taxes: Lessons Learned from Other Countries on Compliance Risks, Administrative Costs, Compliance Burden, and Transition*, GAO-08-566 (April 2008).
[83] Inland Revenue Department (NZ), 'Options for Strengthening GST Neutrality in Business-to-Business Transactions: An Officials' Issues Paper' (June 2008).
[84] Australian Treasury, *Budget 2018-19: Budget Measures – Budget Paper No. 2* (8 May 2018).

- introducing new phoenix offences to target those who conduct or facilitate illegal phoenixing;
- preventing directors improperly backdating resignations to avoid liability or prosecution;
- limiting the ability of directors to resign when this would leave the company with no directors;
- restricting the ability of related creditors to vote on the appointment, removal or replacement of an external administrator;
- extending the Director Penalty Regime to GST, luxury car tax and wine equalisation tax, making directors personally liable for the company's debts; and
- expanding the ATO's power to retain refunds where there are outstanding tax lodgements.

These arrangements, the author suggests, do not address, directly, the design feature of a VAT/GST system that gives rise to the revenue risks.

Domestic reverse charge

The residential premises withholding tax[85] is an example of missing trader fraud – non-compliance or evasion that is available because payment of the GST to the Commissioner is not due until (in the case of a quarterly lodger) 28 days after the end of the quarter in which the sale proceeds are received:

> … an ATO submission to the 2015 Senate Inquiry on 'Insolvency in the Australian construction industry' … reported that $1.8 billion in GST debt had been written off as a result of phoenix activity by property developers …[86]

It appears from the Taskforce Report that these particular practices with new residential premises are part of a broader malaise.[87]

The GST revenue loss of phoenixing for residential premises is the non-collection of 'output tax'.[88] The solution is to institute a collection mechanism from the 'recipient' – in the case of residential premises this will often be a consumer or other entity that is not entitled to input tax credits.

Of a similar effect to Subdivision 14-E of the *Taxation Administration Act*, amendments made to the GST law in 2017 impose a GST liability on the 'recipient' of the taxable

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[85] TAA, Sch 1, Subdiv 14-E.
[86] Robyn Thomas, 'Improving the Integrity of GST on Property Transactions' (2017) 17(3) *Australian GST Journal* 164.
[87] In the 1980s, the 'bottom of the harbour schemes' involved either: (a) stripping a company of its assets before tax became payable, or (b) using another company as the entity which became liable for tax but ensuring that it never had sufficient assets to pay the money owed. The government's response at the time was to enact the *Crimes (Taxation Offences) Act 1980* (Cth), under which aiding or abetting an arrangement to make a company or trustee incapable of paying its taxation debts was a criminal offence. Penalties for a breach of the Act are currently 10 years' imprisonment or an AUD 100,000 fine.
[88] In other jurisdictions, the term 'output tax' is defined to be GST payable on taxable supplies: see, eg, *Value Added Tax Act 1994* (UK) s 24(2).

supply of valuable metals.[89] It is apparent that the arrangements at issue are another instance of 'phoenixing' but involve business-to-business (B2B) transactions and, instead of a withholding regime, a so-called 'reverse charge' has been adopted.

The Explanatory Memorandum that accompanied the Bill into Parliament explained that:

> … This Bill introduces a mandatory reverse charge for taxable supplies between suppliers and purchasers of gold, silver and platinum. This removes the opportunity for fraudulent input tax credit claims by the purchaser and for the supplier to avoid paying goods and services tax (GST) to the Commissioner by liquidating …
>
> 1.5 The objective of the announced changes is to combat 'missing trader' … schemes in the gold industry, which if left unaddressed would continue to present an integrity risk to the GST system …[90]

The 'valuable metals' schemes exploit similar VAT/GST design features to the new residential premises withholding in Subdivision 14-E. In the case of the valuable metal schemes, refunds of input tax credits are claimed but no GST revenue is obtained. The revenue is not depleted by the non-payment of GST, but by the payment of 'refunds' out of government funds.

The design feature that gives rise to the revenue loss, in the case of this type of 'missing trader fraud', is that payments are made out of government funds for amounts that were never collected as GST revenue.

An example, similar to phoenixing, but without fraudulent intent, is where a business under financial pressure disposes of its assets, either in a fire sale to close up business or in circumstances where assets must be liquidated under pressure from financiers:

- the assets in question may be trading stock, plant and equipment or the whole of the business;
- in the present state of the law, the sale of assets will be a taxable supply (unless it qualifies for GST-free treatment at the election of both parties[91]). If the vendor is under financial stress, it may not have the funds to remit the GST on sale (after satisfying claims from creditors). In this situation, the purchaser will have an input tax credit but the vendor will not be able to remit the GST on sale.

To date, the government's response to these risks is to collect the GST from the recipient of the supply rather than the supplier, but only for supplies of residential premises and valuable metals.

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[89] GST Act, s 86-5 as inserted by *Treasury Laws Amendment (GST Integrity) Act 2017* (Cth).
[90] Explanatory Memorandum to the Treasury Laws Amendment (GST Integrity) Bill 2017 (Cth).
[91] To address the position where a financially distressed trader sells a business without remitting VAT from the proceeds, the UK VAT law – in section 5 of Statutory Instrument 1995 No 1268 – provides that the transfer of a business as a going concern is neither a supply of goods nor a supply of services. Unlike the Australian elective GST-free status, the UK treatment applies to any supply falling within the terms of section 5 of the SI, illustrating that it is an integrity measure rather than a concessional measure available on an election of the parties.

The New Zealand Discussion Paper of 2008 suggested that the domestic reverse charge apply to a wide range of transactions:

- going concerns;
- extremely high-value transactions – for example, supplies of goods and services when the value of the transaction exceeds, say, NZD 50 million (excluding GST); and
- improved or unimproved land irrespective of value.[92]

The EU has authorised its Member States to apply a reverse charge mechanism in relation to domestic B2B supplies of any kind in case of sudden and massive VAT fraud. Member States can also apply the mechanism on an optional and temporary basis.[93]

The OECD *Consumption Tax Trends 2018* includes a list of EU countries' use of domestic reverse charge under these new and expanding rules.[94]

4.1.2 Employee vs independent contractor

ABN vs employee

The holding of an ABN has become accepted as a legitimate differentiator between employment and independent contracting.

The Black Economy Task Force observed:

> Many people think the ABN creates a business, rather than it simply registering a business.
>
> There is a widespread belief in the construction industry that having an ABN automatically confers the status of 'independent contractor', regardless of what the working arrangement is. There is also a widespread belief that quoting an ABN, whether it belongs to a hardware store or petrol station, immunises the person doing so from tax consequences or means they cannot be tracked down …
>
> A national cleaning company even refers job applicants to an accountant to obtain a trust package for a flat fee when incorporation wasn't feasible. …We have observed misleading websites instructing visa holders to increase their chances of employment by applying for an ABN without consideration to the key requirement of carrying on a business.[95]

For the purposes of this article, the widespread use of ABNs to avoid detection and employee status reduces GST revenue – in some cases because it allows business to assert that they are below the registration threshold and not liable to pay GST on takings – as is evidenced by *Uber BV v Commissioner of Taxation*.[96]

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[92] Inland Revenue Department (NZ), above n 83.
[93] OECD, *Consumption Tax Trends 2018*, above n 63, 34.
[94] Ibid 112, Annex Table 2.A.12 – 'Application of domestic reverse charge and split payment mechanisms'.
[95] Taskforce Report, above n 75, 246.
[96] [2017] FCA 110; 104 ATR 901.

Given the strong authority of *ATS Pacific Pty Ltd v Commissioner of Taxation*[97] to look beyond the contractual structure, it is surprising that when the employee vs independent contractor issue comes before the Courts – eg, the cases of *Qian v Commissioner of Taxation*,[98] *Private Tutor v Commissioner of Taxation*[99] and *On Call Interpreters and Translators' Agency Pty Ltd v Commissioner of Taxation (No. 3)*[100] – the Commissioner's position from a GST perspective seems be mixed.

The necessity to look past the contractual terms was emphasised in the High Court in *Hollis v Vabu Pty Ltd*[101] where the Court emphasised that:

- the substance or reality of the relationship needed to be identified;
- the terms agreed between the parties are not of themselves determinative because parties cannot deem their relationship to be something it is not;
- the relationship is to be found not simply from the contractual terms agreed to but by the system operated thereunder and the work practices which establish the 'totality of the relationship';
- the application of a practical and realistic approach is to be adopted and viewed as 'a practical matter'.

The widespread move from 'employee' on Friday night to 'self-employed' on Monday morning would seem to be a significant weakness in the integrity of the taxation system overall.

Disaggregation/arranging

The PBO Report made specific reference the implications of the 'peer-to-peer' or 'gig' economy.

The design feature of a value added tax that gives rise to a revenue risk from these structures is that, where supplies to households are arranged by intermediaries, if the amount paid by the consumer can be shared between the intermediary and the supplier, GST may not be payable on the part of the price paid to the supplier and/or the intermediary.

Arrangements can be put in place to achieve 'disaggregation' of the arranging function from the underlying supply. When combined with the emergence of an 'independent contractor', the integrity of an employment relationship and its withholding regime is lost.

Platforms such as Amazon, Airtasker, eBay and the Uber structure provide an illustration of how modern technology can facilitate the historical disaggregation or 'peer-to-peer' arrangements and diminish the GST collections.

Examples of the pursuit of this advantage (not always successfully) include:

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[97] [2014] FCAFC 33; 98 ATR 116.
[98] [2019] AATA 14; 109 ATR 465.
[99] [2013] AATA 136; 92 ATR 686.
[100] [2011] FCA 366; 83 ATR 137.
[101] (2001) 207 CLR 21; 47 ATR 559.

- hairdressers;[102]
- tourism agents;[103]
- Uber;[104]
- owner drivers;[105]
- brothels;[106] and
- labour hire arrangements.[107]

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[102] A quick search online shows that in the UK (where the VAT rate is 20 per cent and the registration threshold is GBP 85,000) the practice of disaggregation is widespread – at least in the hairdressing sector. Hairdressers in a salon can be self-employed (rather than employed by the salon owner) and contract in their own right with customers; but to run their business, it is necessary for them to rent the chairs in the salon from the salon owner. Each hairdresser's turnover is likely to be beneath the turnover registration threshold and, depending on the number of chairs, the salon may also be beneath the threshold. It is merely a matter of dividing the gross takings between salon and hairdressers. The National Hairdressers' Federation has a standard 'Independent Contractor Chair Renting Licence Agreement': H&H Accountants, 'HMRC Guidelines To Rent A Chair For Hairdressers', https://www.handhaccountants.com/news-and-events/hmrc-guidelines-to-rent-a-chair-for-hairdressers/ (accessed 1 July 2020).

[103] *ATS Pacific Pty Ltd v Commissioner of Taxation* [2014] FCAFC 33. The Full Federal Court found that the purchase and on sale of rights to accommodation and related services by an Australian travel agent was not an 'arranging' service but an acquisition and resale of the rights. Edmonds J opined that '[i]n determining the character of a supply … a court is not to be "handcuffed" by the terms embodied in the four corners of the contract, … What the cases require is that the truth of the matter be sought with an eye focused on practical business affairs, rather than on nice distinctions of the law …'.

[104] *Uber BV v Commissioner of Taxation* [2017] FCA 110. The case proceeded on the basis that the driver contracts with the passenger and makes the supply of the services. Uber deducts an amount from the passenger's payment for the use of the Uber app, and pays the driver the excess. From a GST perspective the travel service is provided by the driver; Uber supplies a software package to link the passenger with the driver. Note that the London Employment Tribunal has ruled that Uber drivers are employees and entitled to be paid a minimum wage: see *Mr Y Aslam, Mr J Farrar and Others v Uber BV* [2018] EWCA Civ 2746; *Aslam, Farrar and Others v Uber BV and Others* [2016] Case 2202550/2015 (28 October 2016). An appeal by Uber was dismissed on 10 November 2017 by Her Honour Judge Eady QC: *Uber BV and Others v Mr Y Aslan and Others* [2017] UKEAT/0056/17/DA. See also *O'Connor et al v Uber Technologies, Inc., CA No. 13-03826-EMC (ND Cal.)* whether Uber drivers are employees for the purposes of the California Labor Code; *Independent Workers' Union of Great Britain (IWGB) and RooFoods Limited T/A Deliveroo* [2017] TUR1/985(2016) in which the drivers of motorbikes and riders of bicycles were held not to be 'workers' within the meaning of section 296 of the *Trade Union and Labour Relations (Consolidation) Act 1992* (UK).

[105] *Qian v Commissioner of Taxation* [2019] AATA 14. The applicant supplied his own motor vehicle to undertake 'subcontract' courier services to the courier company. Senior Member Taylor commented that there 'is a significant bias in the authorities in favour of the proposition that an arrangement where a contractor is responsible for the provision, operation and maintenance of a significant piece of equipment that is essential to the remunerated activity (as in the carriage of goods), is best characterised as one of independent contracting …'.

[106] *HKYB and Commissioner of Taxation* [2018] AATA 4770; 109 ATR 435. The applicant who operated a brothel contended that it was it was the sex worker who supplied the sexual service to the customer and the operator only supplied the venue. The AAT found (referring with approval to ATS) that 'the character of a supply made as a result of the performance of the terms of that contract'' was a single supply of a sexual service in a room, not two discrete supplies, sexual service and room, by the sex worker and the applicant respectively.

[107] *CCE v Reed Personnel Services* [1995] STC 588; *Reed Employment Ltd v HMRC* [2011] SFTD 720. The taxpayers provided nurses to hospital clients for work on a temporary basis. The Tribunals found that Reed's activities did not amount to a supply of staff because Reed did not exercise control over the temps

The arranger as supplier

The disaggregation of services between 'intermediaries' and 'service providers' involves broader policy and industrial issues than the GST impact. Nevertheless, in GST/VAT regimes there are circumstances where there are examples of the recharacterisation of the services of intermediaries (particularly ones effected by websites and platforms) so that the intermediary is treated as the supplier and the value-added by both service providers and arrangers are brought within the normal GST system.

For example:

- the recent Netflix and low value goods amendments, provide that a supply to an Australian consumer through an electronic distribution platform is made by the operator of the platform (and not the actual supplier) for consideration and in the course or furtherance of the operator's enterprise. This is the case notwithstanding that the actual supplier might not carry on an enterprise in its own right or might be below the turnover threshold;[108]

- Subdivision 153 allows principals and intermediaries to agree that:

  > *A taxable supply that the principal makes to a third party through the intermediary is a supply that is [made] by the intermediary to the third party, and not by the principal.*[109]

  Under the UK VAT rules supplies through agents for undisclosed principals are treated as supplies to and by the agent. That is, the arranger is made the supplier;

- section 12-60 of Schedule 1 of the *Taxation Administration Act* provides for an entity that carries on the business of arranging for persons to perform work or services directly for clients to be liable to withhold an amount from payments it makes to an individual in the course of the enterprise. For GST purposes, individuals in receipt of such payments are excluded from the meaning of enterprise. Arguably, the GST law should also provide that the payer be deemed to be the supplier of the services of the individuals to the client.

The recharacterisation of 'intermediary' services could be broadened for GST purposes so that supplies made through intermediaries are treated as supplies made to and by the intermediary, regardless of the GST status of the principal.

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at any stage, meaning that no control of the worker could pass from Reed to the client. Consequently, Reed made a more limited supply – an introductory service combined with a number of ancillary services (eg, evaluating the worker's skills, taking references and providing a payments service for the workers). Refer also to Chris Sievers' comments on these and other cases at https://chrissievers.com/case-analysis-adecco-uk-ltd-v-revenue-customs-2015-ukftt-600/ (accessed 1 July 2020).

[108] See GST Act, s.84-55.

[109] GST Act, s.153-155. However, s 188-24 allows the intermediary to treat only its 'commission' as contributing to its registration turnover.

4.2 Fraudulent/black economy activities

The Black Economy Taskforce identified a number of practices, in addition to those referred to above, that were the cause of revenue losses from non-compliance. For GST in particular, these included:

- fraudulent or erroneous non-reporting, under-reporting or non-payment GST liabilities
- fraudulent or erroneous over-claiming of input tax credit entitlements.

In their seminal work, Professors Vann and Cooper[110] observe that the revenue risk of a credit-invoice VAT can be twice as problematic as that under a wholesale sales tax (WST) or RST:

> A registered business will always prefer to purchase *at the same price inclusive of GST* from another registered business which charges output tax and provides an invoice rather than from a business which does not charge GST and does not provide an invoice. It is possible in this case that the supplier may not charge GST but provide a fictitious invoice for GST.[111]

In these cases, there is both a loss of GST revenue from the vendor and an underpayment by the purchaser in the tax period of acquisition. Evidence that this is the case can be seen from the Taskforce Report:

> Too many people have ABNs although they are not entitled, including tourist visa holders and apprentices, criminal groups hide behind them (when offering illegal labour hire services, for example) and too often they are misquoted … We have heard many instances of tradesmen who intentionally include the Bunnings' ABN when issuing invoices to customers for the work they complete.[112]

The PBO Report noted that:

> Increasing self-employment could reduce the proportion of people having personal income tax deducted from their wages and remitted to the ATO by their employer and increase the proportion of people that are required to assess and remit their full tax liability to the ATO themselves.[113]

But the government's 2018 Consultation Paper on reform of the Australian Business Number System states:

> In 2017, the Black Economy Taskforce …found that *the ABN system is being used by participants in the black economy to provide a false sense of legitimacy to their business*. … It is therefore timely to consider whether the ABN system remains fit to support the expanded range of purposes that an ABN is used for today. …

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[110] Graeme Cooper and Richard Vann, 'Implementing the Goods and Services Tax' (1999) 21(3) *Sydney Law Review* 337.
[111] Ibid 356 (emphasis in original).
[112] Taskforce Report, above n 75, 223.
[113] PBO Report, above n 41, 33.

> The holding of an ABN has become an accepted and legitimate differentiator between employment and independent contracting.[114]

4.2.1 Reporting and deduction – historically speaking

For over 35 years, evasion of taxation obligations in the black/shadow/cash economy has sought to be addressed by a system of withholding and reporting by payers of transactions of specified types.

In 1988, Senior Member P M Roach explained the problem with what he referred to as the cash economy and how the government had sought to address it:

> … [The problem of cash economy exists because] there are many in the community who are able to carry out their income-earning activities in such a way as to be able to easily conceal their earnings. … Because there are a large number of persons in the community who are willing to be dishonest in tax matters, various attempts have been made over a prolonged period to limit the opportunities of the dishonest to defraud the Commissioner to the detriment of the taxpaying community …[115]

The Senior Member went on to describe the government's 1983 response to this difficulty:

> In 1983 the Commonwealth amended the [1936 Act] [and] introduced what is known as the Prescribed Payments System [PPS]: a system providing for 'collection of tax in respect of certain payments for work''. … The Prescribed Payments System … was intended to ensure that something on account of tax would be deducted from all payments made other than to 'employees'' on 'salary or wages'' so as to ensure, to that extent, funds to the Revenue and to provide some degree of disclosure as to the identity of payees.[116]

But 20 years ago, the PPS and RPS systems were replaced by the ABN initiative in the ANTS package. A broader reporting mechanism was foreshadowed *but not triggered*. The ANTS White Paper stated that 'the new reporting capability will only be activated if the Government is convinced that it is necessary and then only for a specified period …'.[117]

Taxation Payments Reporting System (TPRS)

The 2011-12 Budget foreshadowed the specification of the building and construction industry for the purposes of reporting required under the *Taxation Administration Act*, an initiative that arose as a result of the ATO having identified significant levels of non-compliance by contractors in the building and construction industry.

The taxable payments reporting system (TPRS) commenced on 1 July 2012 for businesses in the building and construction industry which were required to report, to the ATO, all payments to suppliers/subcontractors who provide building services.

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[114] Australian Treasury, 'Tackling the Black Economy, Designing a Modern Australian Business Number System', Consultation Paper (20 July 2018) 2 (emphasis added).
[115] *Case V158,* 88 ATC 1030.
[116] Ibid.
[117] ANTS White Paper, above n 3, 146.

The Taskforce Report provides a quantification of the success when TPRS was introduced in 2012-13 - it raised an additional AUD 2.3 billion in tax liabilities in its first year:

- AUD 265 million from outstanding returns being lodged – 249,000 contractors were found to have outstanding returns;
- AUD 506 million GST – a 6.1 per cent increase in net GST from the industry in a single year;
- AUD 1.128 million PAYG withholding – demonstrates significant under-reporting of wages and concomitant underpayment of personal income tax;
- AUD 357 million pay as you go (PAYG) instalments — an additional 50,306 taxpayers were identified as payees …

  This will not be the total increase as at the time the ATO report these results there were 76,000 contractors who had not lodged returns for that year, 53,000 who had lodged but TPRS reports indicated they had underreported, and 84,000 contractors without an active GST registration that TPRS reports indicated had received payments likely subject to GST.

Amendments made to the *Taxation Administration Act* in 2018 extended the operation of the TPRS to contractors in the courier and cleaning industries.[118]

The 2018-19 Budget announced the further extension of the TPRS:

> The Government will further expand the taxable payments reporting system (TPRS) to the following industries:
>
> - security providers and investigation services;
> - road freight transport; and
> - computer system design and related services.
>
> The measure will have effect from 1 July 2019 and is estimated to have a net gain to the budget of $605.8 million in fiscal balance terms over the forward estimates period. In underlying cash balance terms, this measure has a net gain of $545.8 million over the forward estimates period.[119]

Despite these developments, from a GST perspective, the TPRS is limited in its application:

- it applies to payees in a limited range of services;

[118] TAA, Sch 1, s 396-55 as amended by *Treasury Laws Amendment (Black Economy Taskforce Measures No. 1) Act 2018* (Cth).
[119] On 8 March 2019, the Treasury released, for consultation, exposure draft legislation and an explanatory statement dealing with this measure: see Treasury Laws Amendment (Black Economy Taskforce Measures No. 2) Bill 2018; Explanatory Statement, Treasury Laws Amendment (Black Economy Taskforce Measures No. 2) Bill 2018.

- it applies to payers who derive above a minimum revenue from the same services;[120]
- it does not, generally, apply to supplies of services made to consumers;
- it does not require a deduction from the payment.

The TPRS system could be extended to apply to:

- payees in a broader range of services;
- all payers regardless of whether they supply similar services – and extend to payers as agents or arrangers;[121]
- payers that are 'households' in relation to building and construction work – similar to the original PPS.

In general, the TPRS concept could be extended to a full reporting of B2B transactions as part of a broad data matching system. E-invoicing and matching is required in limited circumstances in the EU, India and China.

The 2018-19 Budget announced a number of other initiatives coming out of the Taskforce Report:

- the introduction of an economy-wide cash payment limit of AUD 10,000;[122]
- AUD 318.5 million over four years to implement enhanced enforcement strategy, including mobile strike teams, an increased audit presence, a Black Economy Hotline, improved government data analytics, and educational activities;
- removing tax deductibility of non-compliant payments.[123]

In addition, valid tax invoices for purchases in selected industries ought to be made mandatory with penalties for both the consumer and supplier for non-issue and non-possession.

5. WHICH WAY TO GO FROM HERE?

The previous sections have examined:

- what objectives were held for GST in 1998?;
- where are we now – were the objectives satisfied?;
- if these objectives have not been satisfied, policy and compliance gaps should be examined.

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[120] Arguably, if UberEats is based on the Uber structure, the amendments will not apply because it is merely an arranger and not the entity supplying the service.
[121] See n 120, above.
[122] The Budget measure is included in the Currency (Restrictions on the Use of Cash) Bill 2019.
[123] The Budget measure was included in Treasury Laws Amendment (Black Economy Taskforce Measures No. 2) Bill 2018, Schedule 1.

This section addresses the 'where to from here?' question.

5.1 There is not enough GST revenue for its current purpose

The ANTS White Paper described the overall objectives for GST as being broad-based value added tax to replace wholesale sales tax and provide a *sustainable*, *reliable* and *stable* growth tax to the States and Territories for the long term: 'the objective was to remove the reliance of the States on Commonwealth grants and distorting taxes'.[124]

The PBO and HFE Reports suggest that the declining growth of GST has been due to:

- '[t]he change in the consumption mix over time. Since the GST was introduced, households have spent progressively more of their income on goods and services that are exempt from the GST';[125]
- '[p]rices of goods and services exempt from the GST have grown faster than those goods and services subject to the GST. In fact, the volume of consumption subject to GST has remained relatively stable since the introduction of the GST';[126]
- fluctuations in the savings ratio;[127]
- the increase in participation in the economy by individual or small operators and suppliers who may fall under the GST registration threshold.[128]

In addition to revenue losses from policy gaps and fluctuations in the savings ratio, section 4 identified losses in GST revenue, year on year, from 'compliance gaps' – fraud, evasion and deficient design features.

As noted in section 3.2, the government's response to the HFE Report is that the Commonwealth will increase the 'GST pool' by AUD 600 million in 2020-21 and by a further AUD 250 million in 2024-25. The latter is to be 'indexed to grow in line with GST collections on a permanent basis'.[129]

Essentially, the Commonwealth is reverting to the topping up of the 'pool' for distribution between the States and Territories under HFE principles. At the same time, States and Territories are revisiting their penchant for narrowly-based, distortionary and inefficient selective taxes, fees and charges.

At the present time, it is unlikely that the pool will grow to an extent that the Commonwealth's contributions to it will reduce or cease. And fluctuations in the savings ratio mean that the size of the pool will not be stable from one year to the next.

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[124] Under the IGA, above n 26, the GST revenue would be shared between the States and Territories on HFE principles. It provided for additional untied grants to be made up until the 2002-03 financial year to maintain the States' budget in no worse position than would have been the case prior to the ANTS reforms. But it was estimated that payments would not be required from 2003-04.
[125] PBO Report, above n 41, 5.
[126] Ibid 5.
[127] Ibid 4-5.
[128] Ibid 7.
[129] Morrison, above n 49.

Under the current settings, GST will not be sufficiently stable to sustain the lofty ambitions held for it in ANTS.

5.2 What options are available?

In considering how a future government might respond, there are two significant scenarios to ponder.

Inheriting the legacy of the Howard/Costello ANTS package, a future government must consider the extent and nature of GST's position in State/federal financial relations. Is it preferable to:

- *Scenario 1:* continue to reserve GST revenue for the benefit of the States and Territories?; or
- *Scenario 2:* abandon the reservation of GST 'for the States and Territories' and, instead, revert to funding general purpose grants from consolidated revenue or an income tax sharing arrangement?

From an adequacy of revenues perspective, both scenarios require a re-examination of the design of the GST to address policy and compliance gaps and other inefficiencies. But under scenario 1, the government can only increase the base and rate with the agreement of the States and Territories.

5.2.1 Scenario 1: revenue for the States and Territories

Scenario 1 assumes that the Commonwealth/State financial relations structure continues so that GST revenues are to be raised to satisfy State and Territory spending needs in lieu of general purpose grants and distortionary narrowly-based taxes.

The present position is that the Commonwealth has responded to shortfalls in the GST pool by committing to 'top up' payments – effectively general-purpose grants. But the size of the pool is determined by reference to GST revenues compared to what is necessary to achieve HFE guidelines.

This does not have the consequence, at least initially, that the Commonwealth must determine the amount of the distributions to the States and Territories – even the total amount to be distributed.

The political sensitive issue arises because the existing Commonwealth Grants Commission (GCC) process allows a comparison between the per capita proportion of GST revenue and the per capita amount of the GST pool distributed.[130]

Can the prospect of diminishing GST revenues compared to State and Territory requirements be addressed by 'broadening the base' or increasing the rate?

Scenario 1: the political dimension

The date of 8 July 2019 marked 20 years since the GST Act received Assent. While the Rudd Government commissioned a Board of Taxation review of the legal and

[130] See Australian Treasury, *Budget 2019-20: Federal Financial Relations 2019 – Budget Paper No. 3* (2 April 2019) 80, Table 3.6.

administrative framework of GST, the terms of reference contained the following stark limitation:

> In pursuing the reference, the Board should ensure that its consultations and recommendations focus on the legal framework for the administration of the GST as set out in the Tax Administration Act and GST Act. Whilst the Board may consider related issues to the above categories consistent with its terms of reference, its work should not extend to the rate of the GST or the scope and extent of what goods and services are subject to the GST.[131]

Under the IGA, changes to the base and rate must have agreement of all States and the Commonwealth Government.[132]

That is, GST is 'locked in' to its present base and rate – and hence, State and Territory revenue potential.

But from a practical point of view, an increase in base or rate is of benefit only to the States and Territories and, in general, any compensation package that offsets increases in prices of items of household consumption will have to come from the Commonwealth.

The Commonwealth wears the political pain and the States the gain.

The political influence that can be marshalled to oppose GST on 'sensitive' items is apparent from the removal of GST from sanitary products.[133]

Perhaps, the possibility of a tax rate and base increase can only be effected under Scenario 2.

5.2.2 Scenario 2: Commonwealth revenue

Addressing the policy gap

Section 3 showed that the top five items of GST tax expenditure in 2018-19 were:

- GST-free food – $7,300 million;
- GST-free health services, insurance, care, drugs and appliances – $6,655 million;
- GST-free education and child care – $6,290 million;
- input taxation of and RITC for financial services – $4,500 million;
- GST-free water and sewerage – $1,090 million.

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[131] Board of Taxation, *Review of the Legal and Administrative Framework of the Goods and Services Tax: A Report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs* (December 2008) 94.
[132] IGA, above n 26, cl 13.
[133] A New Tax System (Goods and Services Tax) (GST-free Health Goods) Determination 2018 on 26 November 2018 makes 'maternity pads, menstrual cups, menstrual pads and liners, menstrual underwear, tampons, and other similar products specifically designed to absorb or collect lochia, menses or vaginal discharge' GST–free as of 1 January 2019 under s 38-47 of the GST Act.

The total additional GST revenues are AUD 25,835 million, resulting in a proportion to GDP (on 2018-19 forecasts) of 4.5 per cent.

The ABS statistics show that the four items of household expenditure that are *growing at higher rates* than household expenditure are:

- health services, insurance, care, drugs and appliances;
- education and child care;
- financial services;
- water and sewerage.

But food is the single greatest concession.

As the taxation of any or all of these categories (other than financial services) is likely to be regarded as regressive, the reform package would require compensation – no doubt from Commonwealth outlays. In all likelihood this could only be achieved by an expenditure of an equivalent amount through income tax reductions and welfare increases.

But let us consider why these particular elements of household consumption are not fully taxed.

(i) Food

While the GST-free treatment of food is the largest GST tax expenditure, its growth as a proportion of household consumption is reasonably stable. On present trends, its inclusion in the tax base would not improve the growth of the GST to GDP proportion of household expenditure.[134]

Nevertheless, there is no technical limitation on its inclusion in the base. If the GST base is to be protected from future shifts in consumption, the GST-free treatment of food should cease.[135]

(ii) Items identified under the Willie Sutton rule

As noted above, the four items of *concessionally taxed* household expenditure that are *growing at higher rates* than household expenditure generally, are:

- water and sewerage;
- health;
- education;
- financial services.

[134] But taxing food at the standard rate would decrease the compliance and administrative risk arising from misclassification and miscalculation (whether in error or by design).
[135] Bob Deutsch, 'Time to Wean Off the (GST-free) Milk', *Tax Institute blog* (26 July 2018), https://insights.taxinstitute.com.au/2018/07/written-by-bob-deutsch-senior-tax.html (accessed 2 July 2020).

The PBO Report opines that the trend on these categories will continue – with the result that GST revenues as a proportion of GDP will decline into the future.

An application of the Willie Sutton rule tells us we should focus on water and sewerage, health, education, insurance and financial services to get the best bang for our buck.

What are the limitations on including these four items in the GST base?

(a) Government provided or subsidised services (water and sewerage, health and education)

The first three areas of expenditure identified above are either government provided or government subsidised. To tax the expenditure (or inputs as is the case in the EU) may result in the increase in State and Commonwealth government outlays (to cover GST on purchases) and an equal increase in GST revenues. This could involve unproductive churning and, in the Australian situation where the GST revenue is shared amongst the States and Territories, contributions to the revenue of some States by other governments depending only upon their relative level of public expenditure.

However, while the GST-free status of subsidised or government provided services can be justified on the grounds that increasing the price may lead to greater subsidies and churning, the accepted theory is that the efficiency of a tax on household expenditure is achieved if the GST system itself does not alter 'relative prices'.

The heavy government subsidisation of the services in question has the result that any efficiency in household consumption decisions being based on the 'pricing signal' has been abandoned.

The favoured model in many other VAT jurisdictions is for these services to be exempt from VAT with the result that VAT is collected on the inputs to the services but, while raising considerable revenue, it is significantly offset by increases in government outlays.

If the quest is for greater revenue, the consequential increase in outlays makes an exemption approach less attractive.

On this view, health and education should be subject to standard rate GST – even at the subsidised price. Taxation should *not* be avoided merely to achieve equal treatment between services for which a price is paid by households and those that are provided 'free' of explicit charges. The focus of a consumption tax is on the spending of households irrespective of the character of the item of consumption.

In Fightback! and the ANTS White Paper, the view taken was that, if services were provided to the public for free, then it was unfair to subject to GST the private sector provision of the same items of consumption. For health, for example, the ANTS White Paper opined:

> The health sector in Australia has significant government involvement through direct subsidy and regulation. Many health services are provided to patients free of any direct charge or by means of a co-payment that is a fraction of the total cost of providing the service.

> Applying taxes to health care would place the private health sector, with its heavier reliance on direct fees, at a competitive disadvantage with the public health system.[136]

Taxing health and education would not appear to be a politically attractive proposition – nor would it be favoured by the States and Territories.

(b) Water and sewerage: further considerations

In addition to the 'subsidised service' issue discussed above, the ANTS White Paper chose GST-free treatment applying generally to taxes and charges levied at all levels of government (including local government rates and water and sewerage rates and charges).[137]

(c) Financial services

The *Tax Benchmarks and Variations Statement 2018* estimates that the exemption of financial services is the fourth largest GST expenditure.

The argument for the input taxation of financial services is that it is technically difficult to include financial intermediation services in the invoice credit, transaction-based method employed by a value added tax.

The application of GST is difficult because a financial institution's service charge is often an implicit fee, margin or spread arising from financial transactions entered into by the institution over a period of time with a number of customers.

In 2015, the then Premier of South Australia proposed that a tax equivalent to GST be collected on the household consumption of financial services— a 'supplementary financial tax'.[138]

Confronted with the prospect of the consumption of financial services increasing as a proportion of HFCE, and GST's diminishing proportion of GDP, action to address the under taxation of financial services would be of benefit both economically and improve the security of the State and Territories' revenue stream.

The SFT Report discussed a number of approaches to impose a 'GST equivalent tax' on financial intermediation services.

Essentially, the SFT Report recommended:

- retaining the existing margin-based GST approaches to gambling and insurance;
- imposing a 'margin-based supplementary financial tax' on margin-based financial services including fees charged for margin-based products;

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[136] ANTS White Paper, above n 3, 93.
[137] Ibid.
[138] Taxsifu, 'GST Equivalent Taxation of Financial Services (Supplementary Financial Tax)', paper prepared for the South Australian Department of Premier and Cabinet [2015], http://taxsifu.com.au/wp-content/uploads/2015/09/SADPC15-GSTfinancialservices-0914final.pdf (SFT Report). See also Michael Evans, 'GST Equivalent Taxation of Financial Services (Supplementary Financial Tax)' (2017) 17(3) *Australian GST Journal* 121.

- the SFT payable under margin-based method be adjusted by either:

  (a) reducing the aggregate margin for a period to take account of the proportion of business done with other registered taxpayers or as exports; or

  (b) applying a reduced rate to the aggregate margin for a period to reflect the proportion of margin on B2B and exported supplies;

- the SFT charged using a margin base be accompanied by full relief under the normal GST system for input tax on purchases of goods and services. Under the present legislative structure, this might be achieved by either:

  (a) removing 'financial supplies' from the definition of 'input taxed supplies'; or

  (b) treating 'financial supplies' as non-supplies.

Further, as an illustration that there are alternative taxes that can be applied for 'difficult to tax' items of household expenditure, Chris Murphy has modelled an economic rent tax to raise approximately equivalent revenue to the SFT suggested in the SFT Report: '[t]he economic assessment finds that, per dollar of revenue raised, the economic rents tax does no economic harm, with moderate harm from full taxation under the GST…'.[139]

As one would expect, however, the lure of collecting tax on the value added by financial institutions has not been lost on all governments.

In July 2017 the Commonwealth introduced a financial services charge under the *Major Bank Levy Act 2017*. It applies to authorised deposit-taking institutions (ADIs) with total liabilities of greater than AUD 100 billion. The levy is imposed at an annual rate of 0.06 per cent on around 75 per cent by value of the liabilities of the ADIs.

The purpose of the major bank levy is as a means of raising revenue from the financial services sector. It is estimated that the major bank levy will contribute around AUD 1.5 billion to Commonwealth revenue on an annual basis.[140]

Nevertheless, even with the major bank levy attacking the profits of the banks, on the basis of the *Tax Benchmarks and Variations Statement 2018*, in 2018-19 there is still another AUD 3 billion in GST revenue available for the States and Territories if the input taxation of financial services was to be removed.

The rate

As noted in section 3.4.3, of the 37 OECD nations, only the United States does not have a value added tax. The standard rates vary from 7.7 per cent (in Switzerland) to 27 per cent in Hungary. The OECD average is 19.2 per cent.

At 10 per cent, only Japan and Switzerland have a lower standard rate than Australia.

But international comparisons are difficult and taxation systems vary in their taxation incidence and welfare arrangements.

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[139] Chris Murphy, 'GST and How to Tax Australian Banking' (2017) 17(2) *Australian GST Journal* 84, 84.
[140] Ibid 94.

New Zealand increased its 12.5 per cent rate to 15 per cent from 1 October 2010.

The Inland Revenue Department explained the change as follows:

> The rate of goods and services tax (GST) will increase from 12.5% to 15% from 1 October 2010, as part of a switch in the tax mix from income tax to consumption tax announced in Budget 2010. The GST rate was last increased in 1989.
>
> New Zealand relies heavily on income taxes in order to fund expenditure. Income taxes may, however, be harmful for efficiency and growth. Taxes on consumption, such as GST, tend to be less harmful to growth as, unlike income taxes, they do not apply to savings and, therefore, do not discourage this activity. A switch from income tax towards GST can, therefore, boost incentives to save and encourage economic growth.[141]

Under Scenario 1 above, because of Australia's State/Commonwealth financial relations it would seem unlikely that an increase in GST revenues could be based on a tax mix switch in the same way as in New Zealand. In any event, the lessons of 1993 illustrate that higher rates on narrow bases do not overcome the issue of shrinking revenues. The shortfall reappears later on.[142]

But under Scenario 2 above, a return to untied grants from consolidated revenue would open the option for an increased reliance on GST.

It seems that, if GST revenues are to be increased, the base must first become stable and then attention can be paid to the rate.

In addition, it is likely that, under Scenario 1, only a portion of the revenue would be reserved for the States and Territories.

5.3 Broadening the base from here (policy gaps)

The recommendations from the considerations discussed in section 5.2 are:

1. the GST-free treatment of food should cease – $7.3 billion;
2. taxing health, education and water and sewerage would not appear to be a politically acceptable proposition for the States and Territories;
3. the input taxation of financial services and the major bank levy should cease and be replaced by a supplementary financial tax – $4.5 bn.

These reforms would, on the basis of the *Tax Benchmarks and Variations Statement 2018* numbers, raise an additional AUD 11.8 billion in GST. Using the 2018-19 estimates as a base, these reforms would increase GST to approximately 4 per cent of GDP in 2018-19.[143]

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[141] Inland Revenue Department (NZ), 'Special Report: Guide to the Tax Changes Proposed in the Taxation (Budget Measures) Bill: GST Rate Increase' (May 2010), taxpolicy.ird.govt.nz/publications/2010-sr-budget2010-special-report/gst-rate-increase (accessed 2 July 2020).
[142] ANTS White Paper, above n 3, 77-78.
[143] Australian Treasury, *Budget 2019-20: Budget Strategy and Outlook – Budget Paper No. 1 2019-20*, above n 51, 4-5, 4-17.

5.4 Addressing the compliance gap

Section 4 identified a number of losses in GST revenues arising from fraudulent and avoidance activities and design inefficiencies. There is no quantification of the revenue that might arise from addressing these weaknesses in the GST system. Fraudulent or avoidance activities giving rise to losses in GST revenues include:

- missing trader fraud;
- independent contractor vs employee status, including sham contracting;
- disaggregation of single supplies, eg, separating arranging from the underlying supply;
- fraudulent or erroneous non-reporting, underreporting or non-payment GST liabilities;
- fraudulent or erroneous overclaiming of input tax credit entitlements

To address these issues, GST design changes are suggested as set out below

5.4.1 Missing trader fraud

The revenue risk from missing trader fraud should be addressed by a mandatory domestic reverse charge to include:

- going concerns;
- high value transactions (eg, > AUD 10,000,000);
- business assets as part of a cessation of a business;
- sales of land in general;
- industry sectors where there is evidence of non-compliance sufficient for TPRS reporting to be required. For example, in many EU Member States, a domestic reverse charge applies to 'the supply of construction work, including repair, cleaning, maintenance, alteration and demolition services in relation to immovable property'.[144]

5.4.2 Independent contractor vs employee

It appears that the Commissioner is prepared to be more forceful when the matter at issue is to benefit a meritorious 'employee' (as in *On Call Interpreters* where superannuation guarantee charge (SGC) was at issue) but resorts to simpler solutions when the matter is mere input tax relief.

The integrity risk requires reforms to the 'employee' definition to ensure that in substance 'contracts of service' are treated consistently for all taxation and regulatory purposes.

[144] OECD, *Consumption Tax Trends 2018*, above n 63, 112-113, Annex Table 2.A.12.

Options worthy of consideration are:

- extension of the 'employee' definition to the situations covered by the 'personal services income measures' in Division 85 of the *Income Tax Assessment Act 1997* (Cth);
- reforming the ABN rules;
- extending the TPRS to any payer with an ABN that acquires the relevant service, including an entity that pays an affected contractor as an agent for another.

5.4.3 Disaggregation of single supplies, eg, separating arranging from the underlying supply

The design feature of a value added tax that gives rise to a revenue risk from these structures, where supplies to households are arranged by intermediaries, were discussed in section 4.

While the disaggregation of services between 'intermediaries' and 'service providers' involves broader policy and industrial policy issues than the GST impact, in GST/VAT regimes there are circumstances where there are examples of the recharacterisation of the services of intermediaries (particularly ones effected by websites and platforms) so that the intermediary is treated as the supplier and the value added by both service providers and arrangers are brought within the normal GST system.

For example:

- the recent Netflix and low value goods amendments provide that a supply to an Australian consumer through an electronic distribution platform is made by the operator of the platform (and not the actual supplier) for consideration and in the course or furtherance of the operator's enterprise. This is the case notwithstanding that the actual supplier might not carry on an enterprise in its own right or might be beneath the turnover threshold.[145]
- Division 153 allows principals and intermediaries to agree that:

  '*A taxable supply that the principal makes to a third party through the intermediary is taken to be a supply that is a taxable supply [made] by the intermediary to the third party, and not by the principal*'.[146]

  Under the United Kingdom VAT rules supplies through agents for undisclosed principals are treated as supplies to and by the agent: that is, the arranger is made the supplier.
- section 12-60 of Schedule 1 of the *Taxation Administration Act* provides for an entity that carries on the business of arranging for persons to perform work or services directly for clients to be liable to withhold an amount from payments it makes to an individual in the course of the enterprise. For GST purposes, individuals in receipt of such payments are excluded from the meaning of

[145] See GST Act, Divs 84-85. See n 108, above.
[146] GST Act, s 153-55. Cf s 188-24, which allows the intermediary to treat only its 'commission' as contributing to its registration turnover.

enterprise. Arguably, the GST law should also provide the payer be deemed to be the supplier of the services of the individuals to the client.

The recharacterisation of 'intermediary' services could be broadened for GST purposes so that supplies made through intermediaries are treated as supplies made to and by the intermediary, regardless of the GST status of the principal.

5.4.4 Other evasion/avoidance practices

Reporting and deduction systems

Despite being extended on three occasions to cover seven industry sectors, the TPRS is limited in its application:

- it applies to payees in a limited range of services;
- it applies to payers who derive above a minimum revenue from the same services;
- it does not, generally, apply to supplies of services made to consumers;
- it does not require a deduction from the payment;
- a domestic reverse charge is not required.

The TPRS system should be extended to apply to:

- payees in a broader range of services;
- all payers regardless of whether they supply similar services – and extend to payers as agents or arrangers;
- payers that are 'households' in relation to building and construction work – similar to the original PPS.

In general, the TPRS concept could be extended to a full reporting of B2B transactions as part of a broad data matching system. E-invoicing and matching is required in limited circumstances in the EU, India and China.

And, if a sector's compliance is found to be poor enough to warrant reporting, consideration should be given to instituting a reverse charge.

As noted in section 4.2.1, the 2018-19 Budget announced a number of other initiatives coming out of the Taskforce Report:

- the introduction of an economy-wide cash payment limit of AUD 10,000;[147]
- AUD 318.5 million over four years to implement enhanced enforcement strategy, including mobile strike teams, an increased audit presence, a Black Economy Hotline, improved government data analytics, and educational activities;

[147] See n 122, above.

- removing tax deductibility of non-compliant payments.[148]

In addition, valid tax invoices for purchases in selected industries ought to be made mandatory with penalties for both the consumer and supplier for non-issue and non-possession.

6. ALTERNATIVES TO GST

The discussion in the previous sections has brought us to a question of whether a different form of consumption tax might:

- facilitate the inclusion of a more complete measure of household consumption to be subject to tax; and
- be less susceptible to fraud and evasion.

The Henry Review explains the choice of a tax on consumption as follows:

> For the tax system to support Australia in making the most of the opportunities and meeting the challenges of the 21st century, it needs to raise revenue from efficient and sustainable tax bases. One of the most efficient and sustainable tax bases is consumption. A tax on consumption does not tax the normal return to capital, encouraging investment and saving. From a macroeconomic perspective, consumption is generally less volatile than income or wealth, and therefore provides a more stable revenue source. As the population ages, an indirect broad-based consumption tax is likely to become increasingly important, since it taxes the capital income of retirees as it is spent, which might otherwise largely be untaxed under an income tax …
>
> *A broad-based consumption tax is one of the most efficient taxes available to governments* … For a small open economy, investment is likely to be more mobile than consumption, suggesting economic growth is likely to be higher by shifting away from taxes levied on investment. Further, a single-rate consumption tax does not distort the timing preferences of consumption for individuals. The same tax is paid regardless of whether a person consumes now or in the future, imparting no bias for or against saving.[149]

The consumption taxes that are discussed in this section are:

- a direct expenditure tax;
- a value added tax;
- a retail sales tax;
- a hybrid GST;
- a cash flow tax

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[148] See Treasury Laws Amendment (Black Economy Taskforce Measures No. 2) Bill 2018 (Cth), Schedule 1.

[149] Henry Review, above n 11, Pt 2, Vol 1, 273-274 (emphasis added).

6.1 Direct expenditure tax

The Henry Review discussed the direct expenditure tax and concluded that there would be few benefits and significant difficulties in implementing a direct consumption tax in Australia:

> While consumption taxes are usually levied indirectly on the sale of goods and services, a consumption tax can also be levied as a direct tax. This can be achieved by taxing personal expenditure (that is, exempting income that is saved) or through a pre-paid consumption tax (which taxes only labour income, and exempts earnings from savings).
>
> Nearly all countries pursue consumption taxation through taxes on goods and services. Personal expenditure taxes were implemented briefly in India and Sri Lanka in the 1960s and 1970s … but the worldwide trend since then has been to tax consumption through indirect taxes such as the value-added tax …[150]

6.2 Retail sales tax (RST) vs value added tax (VAT)

There is debate in the literature about the superiority of a VAT over an RST. Much of it focuses on compliance costs and advantages.

The reference to an RST in the discussion below relates to a tax on turnover (whether on a transaction-by-transaction basis or aggregated). The difference from a VAT is that:

- under an RST, a B2B sale is not taxed; but
- under a VAT it is taxed but the business purchaser is entitled to a credit for the VAT paid on the purchase.

A New Zealand paper on goods and services tax of March 1985 stated:

> The main options which deserve consideration as a means of reforming present indirect taxes are broadly:
>
> 1. *Retail sales tax,* which is used predominantly in North America ...
> 2. *Value-added tax,* which operates at each stage of production and distribution, using a *credit-invoice* system. GST is a tax of this type. The tax is comprehensive, well suited to taxing consumption expenditure without the economic disadvantages inherent in other tax systems.[151]

Compliance and administration costs and integrity

The discussion of the relative merits of an RST or VAT involves measures of integrity and compliance and administration costs.

In theory, the breadth of the base – and hence the policy gap – is not altered. The New Zealand, *Reform of the Australian Tax System* and ANTS discussion papers did not distinguish a value added tax from an RST from the perspective of the breadth of the

[150] Ibid 274.
[151] Office of the GST Launch Co-ordinator (NZ), *GST, the Key to Lower Income Tax* (March 1985).

base – although Ebrill et al expressed the view that 'in practice, it is hard to ensure that RST does not fall on business inputs'.[152]

In both an RST and VAT, a system of 'private use'[153] adjustments is necessary for purchases for which quotation has been given or credit has been claimed.

(i) VAT is collected along the way

The preference (in 1985) in the New Zealand GST was for a value added tax, predominantly because of the concern of the integrity of a single stage tax at the retail level. However, the identical nature of the tax base – being private final domestic consumption expenditure - is evident from comments made in the 2008 New Zealand Discussion Paper:

> 1.8 The ideal consumption tax system would ensure perfect neutrality for both businesses and the government in business-to-business transactions. Perfect neutrality would be achievable in practice if GST did not apply at every stage of production and distribution but applied only at the point of final consumption, as happens with retail sales taxes.[154] However, retail sales taxes are more likely to be exposed to evasion than is GST because of the opportunity for goods and services to be untaxed if acquired by consumers from wholesalers, importers or other providers who are not identified as 'retailers'.
>
> 1.9 The trade-off associated with the government preferring GST over a retail sales tax is the challenge of ensuring that business neutrality is achieved to the greatest extent possible …[155]

The conclusion in the New Zealand Discussion Paper is in keeping with the general view that *a value added tax is superior because, in a retail sales tax, all the revenue is lost if the retailer does not account for the tax on sale*. It is argued that, because tax on the value-added is collected at each step of the production and distribution chain, it is only tax on the retail margin that is lost.

(ii) But is it?

Both Tait[156] and the *Reform of the Australian Tax System* Draft White Paper counter that a retailer might claim credits on all purchases and not remit the tax on sale (as is the case with the phoenix arrangements).

The *Reform of the Australian Tax System* Draft White Paper preferred a broad-based consumption tax (BBCT) – a retail sales tax and not a value added tax – essentially covering the same base as the value added tax (GST) implemented 15 years later:

> The situation is more complicated than this. It is true that the net liability which the retailer faces under a VAT is significantly lower than his liability under an equal rate BBCT. However, the possible tax evaded at the retail stage could be the same under either tax. Under either a VAT or BBCT the evader is likely to

[152] Ebrill et al, above n 14, ch 3.
[153] Including input taxed use such as financial services and residential rent.
[154] GST and sales taxes are generally economically equivalent when they function perfectly.
[155] Inland Revenue Department (NZ), 'Options for Strengthening GST Neutrality', above n 83.
[156] Tait, above n 14, 19.

> obtain his purchases tax free (by refund under the former and quotation under the latter) and understate his sales …
>
> Under a VAT, business may be able to marginally overstate claims for credit for purchases and marginally understate tax liabilities without arousing suspicion; as this can be done at every link in the production and distribution chain, the overall effect could be significant. It is possible that the opportunities for tax evasion under a VAT are greater than under a BBCT simply because more taxpayers are involved.[157]

The authors of *The Modern VAT*[158] are moderate in their assertions about the strength of the value added tax credit-invoice system.

> The alleged 'self-enforcing' feature of the invoice-credit VAT – the notion that the purchasers will help enforce the VAT as a consequence of their interest in obtaining a proper invoice from their suppliers – is not as important in practice as sometimes has been argued: purchasers do not care, for instance, whether tax has been paid by their suppliers, only about the acceptability to the authorities of the invoices they hold. There is evidently a potential problem in the claiming on the basis of fraudulent invoices.[159]

Nevertheless, Ebrill et al, having canvassed both opinions, conclude in favour of a value added tax – at least at rates above 10 per cent:

> The collection of revenue at many points under the VAT rather than simply at the final stage under the RST renders the RST much more vulnerable to evasion – while the RST may work at low rates (5-10%) at higher rates it proves too vulnerable. … There are of course those who argue for the superiority of the RST over the invoice-credit VAT.[160]

The ANTS White Paper preferred a value added tax approach:

> In supporting an international preference for a value-added tax it is contended that the multi-stage, credit offset approach of the value-added tax creates an audit trail by attaching the tax liability to each transaction, 'making it legally and technically ... superior'.[161]

But the prevalence of missing trader fraud in value added tax systems and the increasing use of the reverse charge mechanism would indicate that the much-lauded advantage of VAT's audit trail and multiple collections is, in the modern economy, becoming its Achilles' heel.

At the commencement of GST, Professors Vann and Cooper made the following observations about the ability of a value added tax to deal with the black economy:

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[157] Australian Treasury, *Reform of the Australian Tax System: Draft White Paper*, above n 14, 131.
[158] Ebrill et al, above n 14, 23.
[159] See Lent et al, above n 14, which provides early recognition of the limits of self-enforcement.
[160] Zodrow, above n 14, 435, states that '… although … some of the advantages of the VAT have been exaggerated by its proponents, it seems difficult to argue that the VAT is not, on balance, superior to the standard RST'.
[161] Tait, above n 14, 18-19.

> … A moment's thought will make it clear that the GST is potentially more prone, not less, to evasion than a WST or RST. The latter taxes involve only one cash flow of tax, and this cash flow is deferred until a single transaction occurs. Thus the usual form of evasion under a RST or WST is that the seller of goods will charge the tax to the buyer … and not remit the tax … to the government. The GST on the other hand, involves two cash flows – the refund of input tax credits, as well as the charging of tax on sales. This makes GST vulnerable to a further kind of evasion – the claiming of input credits for tax on fictitious acquisitions. The analogy with the income tax is evident – income tax taxpayers, like GST taxpayers, but unlike WST or RST taxpayers, can cheat by overstating their deductions as well as under-reporting their sales income. And, again unlike the WST or RST, the GST puts this temptation in the face of every commercial firm and for every transaction they undertake (or do not undertake), not just a few.[162]

And, as for the refund of surplus input tax:

> Where the tax credits in a tax period exceed the GST on the taxable supply of goods and services in that period by a registered person, the excess tax credits give rise to a refund … This refund system is particularly important in the case of capital goods if the integrity of the tax as a consumption-type is to be maintained, but equally, it is one of the major weak points from an administrative viewpoint. It assists fraudulent claims that are only detected after the horse, in the form of the refund, has bolted. New Zealand is said to have suffered in this way at the hands of a number of UK criminals in the early days of its GST. What is clear is that whatever level of compliance with the GST is achieved, is brought about through the skill and diligence of the tax administration in conducting the usual processes of audit, document checking and so on, aided (or perhaps hindered) by a mountain of additional paper created by the tax.[163]

And the 'self-enforcing' argument:

> On the other hand, a claim is often made for the superiority of the GST over RST and WST, because each business will be looking over the shoulder of every other business to ensure that they pay their GST, so that a purchaser from the business can get GST credits on its inputs (often referred to as the 'self-enforcing nature' of the GST). Again these assertions depend very much on the assumptions about pricing, and parties to transactions that underlie them. A registered business will always prefer to purchase *at the same price inclusive of GST* from another registered business which charges output tax and provides an invoice rather than from a business which does not charge GST and does not provide an invoice. It is possible in this case that the supplier may not charge GST but provide a fictitious invoice for GST as just noticed. But such behaviour will be difficult to sustain over a long period for ordinary sales, if regular audits of on-going businesses are in place as is intended in Australia. This is why such fraud is likely to arise around large one-off transactions such as purchase of large capital items, since a single fraudulent invoice can generate a large tax

[162] Cooper and Vann, above n 110, 356 (footnote omitted).
[163] Ibid.

> refund, and in the early stage of implementation of the GST before audit coverage is fully in place. In this case it is more likely, however, that no actual transaction at all occurs, but a fraudulent invoice for a non-existent sale is used to claim a refund.
>
> If the GST evading supplier discounts the GST-inclusive market price by the amount of the GST, the registered business purchaser will generally be indifferent. So too the ATO may not be overly concerned as the tax lost on this purchase will be made up for on the next sale in the chain. If, however, the GST evader is supplying to a consumer and not to another registered business, the evaded tax is lost forever. If the evader uses few taxed inputs (as is common in the services sector), there is little incentive to register to recover input tax. Hence the GST is as prone to evasion in household services (cleaning, plumbing, electrical, repairs etc) as other taxes. It may also lead to evaders specialising in this area and not making supplies to registered businesses, or alternatively charging tax on supplies to registered businesses but not households and seeking to allocate all input tax to the supplies to businesses.[164]

The value added tax system design makes it susceptible to fraud but can the design rules be improved to address its weaknesses?

6.3 Hybrid GST

It is worth considering why a value added tax is designed as a tax paid by the merchant on the price paid to him/her by the consumer.

The explanation, no doubt, is that to require the consumer to remit tax on their own expenditure is not likely to be:

- politically acceptable; and
- practically workable.

But, as discussed in section 4, a value added tax is merely a collection mechanism for tax payable on household consumption expenditure. A lesser number of tax collectors is a good thing from a compliance and administration point of view.

It is, in effect, a withholding tax collected by the merchant for the tax burden intended to be suffered by his or her customer.

Can the GST system be modified to manage the risks described by the Professors Cooper and Vann consistent with the concept that GST is merely a tax collected by a payee on expenditure incurred by a payer?

6.3.1 Reverse charge

While GST was not within its terms of reference, the Henry Review found:

> An alternative proposal would be to allow businesses to agree to reverse charge a greater number of transactions … . Making greater use of reverse charging would have cash flow benefits for the purchasing business. However, the

[164] Ibid 356-357.

> reverse charge approach would not remove the compliance costs associated with identifying business-to-business transactions.
>
> Reverse charging would be similar in effect to a retail sales tax, as some transactions within the supply chain would be excluded from GST, provided that the recipient is registered for GST …
>
> This approach might reduce some compliance costs associated with the current GST system. It also reduces the risk to revenue of paying input tax credits where no GST has been paid. … This would be of particular benefit in relation to large, infrequent transactions.[165]

The Henry Review recommended:

> The government should consider making greater use of GST-free business-to-business transactions or reverse charging, provided the potential compliance cost savings outweigh the additional complexity costs and risks to revenue.[166]

The discussion in earlier sections illustrates that the increasing use of the reverse charge on B2B transactions is a less risky way of ensuring that GST liabilities and credits are offset in the reporting obligations of the one entity – the payer. This avoids the risk of unfunded refunds.

And the Subdivision 14-E residential premises withholding tax is a mechanism to put the GST obligation on the party on which it is intended that the tax burden lies.

As discussed above, a broadening of the reverse charge mechanism should be undertaken.

6.3.2 Employee/arranger provisions

The discussion of intermediaries in previous sections and the tendency to adopt Friday night and Monday morning contractor arrangements supports the view that the GST liability for supplies that are arranged (or subcontracted) should fall on the entity 'arranging' for the supply to be made to the customer and managing the payment from the customer.

In *Asociación Profesional Elite Taxi v Uber Systems Spain, SL* (Case C-434/15), the Advocate General recommended that:

> Uber's activity must be viewed as a whole encompassing both the service of connecting passengers and drivers with one another by means of the smartphone application and the supply of transport itself, which constitutes, from an economic perspective, the main component. This activity cannot therefore be split into two, for the purpose of classifying a part of the service as an information society service. Consequently, the service must be classified as a 'service in the field of transport'.[167]

In Australia's own *ATS case*, the Full Federal Court stated:

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[165] Henry Review, above n 11, Pt 2, Vol 1, 290.
[166] Ibid 291.
[167] Case C-434/15, Opinion of Advocate General Szpunar, ECLI:EU:C:2017:364 (11 May 2017).

> In determining the character of a supply – what was really supplied? – pursuant to performance of an executory contract, a court is not to be 'handcuffed' by the terms embodied in the four corners of the contract, the more so if those terms and conditions do not represent all the terms and conditions of the contract; or where the contract is but one link in a chain of contracts, the performance of each being related to, if not dependent on, performance of the immediately preceding contract; or where, by reference to the factual matrix of the entirety of the arrangements, the commercial or practical reality points to the conferral or provision of a supply which goes beyond the conclusion that might otherwise be drawn from a confined analysis of the terms and conditions of one contract in that chain …[168]

And referring to Burdett J in *Thorpe Nominees Pty Ltd v Federal Commissioner of Taxation*,[169] it was stated that:

> Practical reality is not a test so much as an attitude of mind in which the court should approach the task of judgment. Reality, like beauty, is often in the eye of the beholder …. What the cases require is that the truth of the matter be sought with an eye focused on practical business affairs, rather than on nice distinctions of the law. …. So the exactness which the lawyer is prone to seek must be consciously set aside; indeed, with respect to a choice between various contributing factors, it cannot be attained. The substance of the matter, metaphorically conveyed when we speak of the source of income, is a large view of the origin of the income – where it came from – as a businessman would perceive it.[170]

The legal distinction between subcontractor, employee and arranging/labour hire is a weakness in the indirect tax system which has as its central design feature the identification of the 'entity', 'enterprise' and 'supply' concepts.

In the consideration of the reforms to GST in section 5, broad amendments to treat an 'arranger' as a supplier have been suggested.

A 'hybrid' GST could involve reshaping these core concepts to strengthen the collection mechanisms.

6.3.3 Difficult to tax items

Residential property and financial intermediation are difficult to tax under the transaction-based invoice credit VAT scheme.

But as the discussion above in relation to financial services suggests, a supplementary tax can be applied to the same 'price' without the complexities of the value added tax regime.

A land tax, for example, could be applied to the improved value of owner-occupied housing to collect the equivalent of GST on imputed rent.

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[168] *ATS Pacific Pty Ltd v Commissioner of Taxation* [2014] FCAFC 33.
[169] (1988) 19 ATR 1834.
[170] Ibid 1846.

6.4 Cash flow tax – the direct subtraction method

The main complexity and risk with the VAT and RST are that they are transaction-based, with a mechanism to relieve tax cost of intermediate production on a transaction by transaction basis.

A cash flow tax (suggested in the Henry Review) 'focuses on taxing entities, rather than outputs'.[171]

The Henry Review suggested a direct subtraction tax:

- consumption is potentially an efficient and sustainable tax base;
- consumption taxes can be levied directly on individuals by taxing only wages or allowing deductions under income tax for savings, or indirectly by taxing sales of goods and services that individuals buy;
- while Australia's main consumption tax – the indirect invoice-credit GST – is an efficient tax relative to most other taxes levied in Australia, its design is complex;
- another means of taxing consumption would be to tax the difference between businesses' cash inflows and outflows (excluding wages from outflows; that is, the value-add of labour would be taxed).[172]

The Henry Review suggested that an alternative to the credit-invoice value added tax should be considered:

- under the 'direct subtraction' method … the tax applies to cash receipts after payments (excluding payments for the labour services of employees) are subtracted;
- the direct subtraction method is the simplest and likely to be the most consistent with the needs of a modern economy, as it can run off standard business cash flow management practices;
- unlike the transaction-based GST that taxes goods and services, the CFT is based on accounts. … Rather than adding up tax payable or refundable for each individual sale or acquisition (as necessary for an invoice-credit GST), a taxpayer would apply a single rate of tax to their net cash flow position. The broader the cash flows included in the base, the simpler the tax is for those in the system.[173]

Some adjustments would be made in calculating the 'net amount' for a period that is subject to tax. For example:

- removing cash flows associated with financial services;[174]

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[171] Henry Review, above n 11, Pt 2, Vol 1, 273.
[172] Ibid.
[173] Ibid 279.
[174] The consumption of financial services would be separately taxed under an additive method.

- removing cash receipts from exports.

The Henry Review suggested refunds would be paid where there was a negative cash flow in any period.

The inference is that a cash flow tax could be adopted on a broader base than the GST. Accordingly, business and government operating in 'sensitive areas' could be brought within the same 'cash flow tax' system without overtly placing a tax liability on the items produced.

Removing the transaction-by-transaction reporting would simplify compliance and administration because the focus would shift to aggregates in the accounts – much the same as income tax.

Limitations

While not covered in the Henry Review, it is possible that sales from offshore would not be brought within the cash flow tax system. The regime instituted in July 2017 and 2018 might not be able to be utilised for suppliers that are not established in Australia.

The 'cash flow' approach would not calculate the appropriate 'value added' for financial services and rents – two of the 'difficult to tax' areas in VAT or RST. But other ways of raising equivalent amounts of tax through alternative mechanisms can be adopted.

In addition, while the 'self-enforcing' character of a value added tax may be exaggerated, the cash flow method, of itself, is a self-assessment and declaration regime. As such it is susceptible to fraud in both overstatement of outlays and receipts.

A cash flow consumption tax has the potential to overcome the policy gap by focusing on 'entities' rather than goods and services; but under the cash flow system the common difficulties of consumption taxation persist:

- *government subsidised services*: it would appear that the cash flow tax would require both subsidies as well as explicit fees to be brought to account as revenue against which all costs can be claimed. Given the large value of grants and subsidies in the education and health sectors, there are considerable cash flow and churning inefficiencies in the 'full tax' approach. The alternative would be to exclude subsidies and grants from the calculation – giving rise to large and ongoing refunds, as is the case under the GST;

- *the proper taxpayer*: the stated advantage of the cash flow approach is that it focuses on entities rather than transactions. But the identification and opportunity to manipulate the correct entity under GST is mirrored in the cash flow approach. A discussion of this weakness in the GST system is beyond the scope of this article;

- *employee/independent contractor/arranging*: it is not clear whether the cash flow approach would address the inherent difficulty in ensuring that tax is collected on the value added by 'Friday night/Monday morning' arrangements and 'intermediaries' discussed in section 4;

- *phoenix and missing trader fraud*: the cash flow mechanism suggested in te Henry Review would result in a refund of the tax component of purchases if not accounted for by the supplier;

- *Demanding or paying for work cash in hand to avoid obligations*;
- *Not reporting or under-reporting income*.

Further, the cashflow system would seem to suffer from fluctuations in the savings ratio, making it (perhaps) unsuitable as a tax base for the States and Territories.

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The case for specific exemptions from the goods and services tax: what should we do about food, health and housing?

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Abstract

The Australian goods and services tax (GST) was introduced in 1999, somewhat later than other developed countries. This article examines the GST provisions in the context of three 'exemptions' from GST: the supply of basic food, healthcare and the supply of residential housing (both rented and sold). It examines the arguments for these exemptions on the basis of equity and also considers other arguments in their favour, including health considerations relating to unhealthy eating and the public perception that imposing tax on basic food, health and homes is unjust and unfair.

It commences with a background discussion of the main forms of taxation that combine to make up our tax system. It then moves on to a discussion of tax policy and the policy rationales for GST exemptions for food, healthcare and housing. It canvasses some arguments against the exemption and finishes with concluding thoughts on the exemptions.

Key words: GST, exemptions, zero-rating, food, healthcare, residential premises

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1. INTRODUCTION

'Of all the preposterous assumptions of humanity over humanity, nothing exceeds most of the criticisms made on the habits of the poor by the well housed, well warmed and well fed.'[1]

In 1975 the Taxation Review Committee argued, in what is generally referred to as the Asprey Report, that in a complex society where there is a high level of government spending, it is necessary to raise revenue through a variety of taxes as no one form of tax can hope to raise sufficient revenue in the most appropriate manner for all purposes.[2] This Report, along with other reports and researchers, also stated that the key criteria to evaluate a taxation system are equity, simplicity and efficiency.[3] The difficulty exists, as Justice Graham Hill argued, in that 'these criteria are often, and probably always, incompatible with each other'.[4]

This article examines the Australian goods and services tax (GST), introduced in 1999 and effective from 2000,[5] in the context of three 'exemptions' from GST: the supply of basic food, healthcare and the supply of residential housing (both rented and sold). It examines the arguments for these exemptions on the basis of equity and other arguments in their favour, including health considerations relating to unhealthy eating and the public perception that imposing tax on basic food, health and homes is unjust and unfair. The author also examines some of the arguments against exemptions, with a particular focus on tax simplicity and the conflict between equitable considerations and simplicity. However, the main aim of the article is to analyse whether or not these exemptions are equitable within the tax policy term.

The article commences with a background discussion of the main forms of taxation that combine to make up our tax system. It then moves on to a discussion of tax policy and the policy rationales for GST exemptions for food, healthcare and housing. It canvasses some arguments against the exemption and finishes with concluding thoughts on the exemptions.

2. AUSTRALIA'S TAX MIX

Before the author commences this discussion of the consumption tax it is necessary to briefly consider Australia's tax mix. Australia has a large number of taxes; however, only four are significant in terms of the amount of revenue collected: income tax

[1] Herman Melville, *Poor Man's Pudding and Rich Man's Crumbs* (1854), reproduced in *Billy Budd and Other Stories* (Wordsworth Editions, 1998) 39, 46.
[2] Taxation Review Committee (Justice Kenneth Asprey, chair), *Full Report* (January 1975) [3.3] (Asprey Report).
[3] Ibid [3.6]; Graham Hill, 'Tax Reform: A Tower of Babel; Distinguishing Tax Reform from Tax Change' (2005) 1(2) *Journal of the Australasian Tax Teachers Association* 1; Kathrin Bain, 'Exemptions and Concessions in the Australian Tax System: Equity at the Expense of Simplicity' (2010) 5(1) *Journal of Australasian Tax Teachers Association* 66.
[4] Hill, above n 3.
[5] *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act).

(including income tax on companies), the GST, excise duties, and pay-roll tax.[6] Personal income tax counts for nearly 40 per cent of revenue and the GST for 13 per cent.[7]

The Mid-Year Economic and Fiscal Outlook for 2018/19 forecasts that total GST revenues will be AUD 71,650 million, the GST revenue as a percentage of total Commonwealth tax revenue will be 15 per cent and that GST revenue as a percentage of gross domestic product (GDP) will be 3.5 per cent.[8] Furthermore, Organisation for Economic Co-operation and Development (OECD) data indicates that, in the 2016-17 income year, the proportion of total Commonwealth tax to GDP was 22.2 per cent compared to the OECD average of 34.3 per cent, Value Added Tax (VAT/GST) as a proportion of GDP in Australia was 3.4 per cent as compared with an OECD average of 6.3 per cent and the OECD average VAT/GST revenue as a percentage of total tax was 34.5 per cent compared to 16.3 per cent for Australia.[9]

In 2011-2012 most individual taxpayers had taxable incomes below AUD 80,000 per year. Table 1 demonstrates which taxable income brackets paid which amounts of income tax. This shows that our taxation system is essentially a progressive one.[10]

Table 1: Australia, proportion of individual taxpayers and total income tax by taxable income band, 2011-12

Taxable income band	Percentage of individual taxpayers	Percentage of Net Income Tax
$16,000 or less	18.3	0
$16,001-$37,000	27.3	3.7
$37,001-$80,000	37.6	32.8
$80,001-$180,000	14.5	37.4
$180,001 and more	2.3	26.1
Total	100.00	100.00

It is currently reported that individual taxpayers are paying more in income tax than they would have in the past. Eslake states that 'in 2017, Australian households in aggregate paid 19.5% of their taxable incomes in income and other direct taxes – the

[6] In 2014 the taxes that generated the most revenue were individual income tax at AUD 170 billion or 39.3 per cent of all revenue collected in Australia, income tax on enterprises at AUD 77 billion or 17.7 per cent of all revenue, GST at AUD 55.5 billion or 12.8 per cent of all revenue, and excise taxes at AUD 26.4 billion or 6.1 per cent of all revenue. Payroll tax generated AUD 21 billion or 4.9 per cent of all taxes. See John Freebairn and Helen Hodgson, 'FactCheck: How Much of Australia's Tax is Collected by States and Territories?', *The Conversation* (12 November 2015), https://theconversation.com/factcheck-how-much-of-australias-tax-is-collected-by-states-and-territories-50457 (accessed 13 July 2020);
Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System, Report to the Treasurer* (December 2009). (Henry Review).
[7] Freebairn and Hodgson, above n 6.
[8] Australian Treasury, *Mid-Year Economic and Fiscal Outlook 2018-19* (December 2019).
[9] OECD, *Revenue Statistics 1965-2016* (2017).
[10] Australian Treasury, *Re:think – Tax Discussion Paper* (2015) 41 (Re:think).

highest proportion since 2005, and continuing a steady rise since 2011'.[11] This is confirmed by representatives of the Reserve Bank of Australia,[12] with Ellis stating that 'the tax revenue collected from households has grown solidly in recent years'.[13]

As it comprises approximately 13 per cent of overall tax, GST accounts for the second largest amount of revenue.[14] GST-based revenues were expected to increase over time;[15] however, due to factors such as changes in consumer spending and GST exemptions, the amounts collected in GST have varied in the almost two decades since its inception. In 2000, when the tax was first introduced, GST receipts were 3.4 per cent of GDP. In 2003-04, this lifted nominally to 3.8 per cent of GDP, before dropping back to 3.4 per cent in 2016-17.[16]

3. PRINCIPLES OF TAX POLICY

It is widely acknowledged that there are five main policy principles that should underpin a good tax system. The review of the Australian tax system, *Australia's Future Tax System: Report to the Treasurer* (the Henry Review), stated that the design principles of a good tax system should consider equity, efficiency, simplicity, sustainability and policy consistency.[17] These policy perspectives are universally recognised as important aspects of a good tax system, but it is also recognised that they are often in conflict.[18]

In this article the author has chosen to analyse the exemptions from the GST of specific items on the basis of equity and simplicity. There are three reasons why these two canons of tax design were specifically chosen. First, they are both highly valued by reviewers and commentators in the area of tax policy.[19] 'Equity, or fairness, is a basic criterion for community acceptance of the tax system' and people generally expect that a tax system is fair.[20] In 1975, the Asprey Committee referred to 'simplicity' as being, after equity, 'perhaps the next most universally sought after of qualities in individual taxes and tax systems as a whole'.[21]

Second, equity and simplicity are often seen to be in competition. The Henry Review put it this way: equity encompasses the idea that the tax system should 'treat individuals

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[11] Saul Eslake, 'Budget Policy Check: Does Australia Need Personal Income Tax Cuts?' *The Conversation* (24 April 2018), https://theconversation.com/budget-policy-check-does-australia-need-personal-income-tax-cuts-94500 (accessed 13 July 2020).
[12] Luci Ellis, 'What's Up (and Down) With Households?' (Speech, Housing Industry Association March Industry Outlook Breakfast, 26 March 2019), https://www.rba.gov.au/speeches/2019/sp-ag-2019-03-26.html.
[13] Ibid 14.
[14] Freebairn and Hodgson, above n 6.
[15] Henry Review, above n 6, Pt 2, Vol 1, 274.
[16] Parliamentary Budget Office, *Trends Affecting the Sustainability of Commonwealth Taxes*, Report No. 2/2018 (18 July 2018) 4.
[17] Henry Review, above n 6, Pt 1, [2.1].
[18] Ibid; Ken Henry, 'How Much Inequity Should We Allow?' (Speech, Australian Council of Social Service National Conference, 3 April 2009).
[19] Henry Review, above n 6, Pt 1, [2.1]; Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (Methuen & Co, 1776), Chapter II; Graeme Cooper, 'Themes and Issues in Tax Simplification' (1993) 10(4) *Australian Tax Forum* 417; Richard Krever, 'Taming Complexity in Australian Income Tax' (2003) 25(4) *Sydney Law Review* 467.
[20] Review of Business Taxation (John Ralph, chair), *A Strong Foundation: Establishing Objectives, Principles and Processes, Discussion Paper* (1998) [39]; Henry Review, above n 6, Pt 1, 29.
[21] Asprey Report, above n 2, [3.19]-[3.20].

with similar economic capacity in the same way', but with an eye on complexity and associated costs and risks.[22]

Third, the GST is often argued to be preferable from a simplicity perspective. When introducing the GST, the Howard Coalition government stated that the existing tax system was 'out of date, unfair, internationally uncompetitive, ineffective and unnecessarily complex'.[23] It was argued that the GST would address this by providing economic security, consistency, simplicity and work incentives.[24]

There are two major approaches to equity in the literature; namely, ability to pay and benefit principles.[25] Over the years, most tax policy-makers and researchers have been inclined to accept ability to pay as the basic principle of equity.[26] Under the ability to pay principle, there are two commonly recognised dimensions to the quality of equity; horizontal and vertical equity. Horizontal equity means that people in the same position should be taxed equally. Vertical equity means that those who are in different tax positions should be treated differently, and where they are in a more favourable position they should be taxed more.[27] The Henry Review states the policy rationale behind equity as:

> The tax and transfer system should treat individuals with similar economic capacity in the same way, while those with greater capacity should bear a greater net burden, or benefit less in the case of net transfers. This burden should change more than in proportion to the change in capacity. That is, the overall system should be progressive. Considerations about the equity of the system also need to take into account exposure to complexity and the distribution of compliance costs and risk.[28]

Regarding simplicity, the Review put it in context like this:

> In forming its recommendations the Review has drawn on the latest developments in economic theory and rigorous evidence-based analysis of the impact of taxes and transfers … Translating this information into policy design has, of necessity, required the Review to make judgements about its relevance in the Australian context and about the trade-offs that arise between the goals of fairness, efficiency, simplicity, sustainability and policy consistency …
>
> Policy settings should be coherent and reflect a greater emphasis on simplicity and transparency than is presently evident.[29]

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[22] Henry Review, above n 6, Pt 1, [2.1].
[23] See Australian Treasury (circulated by Hon Peter Costello (Treasurer)), *Tax Reform: Not a New Tax, A New Tax System: The Howard Government's Plan for a New Tax System* (1998) 5 (ANTS Paper). See also Kathryn James, 'We of the "Never Ever": The History of the Introduction of a Goods and Services Tax in Australia' [2007] 3 *British Tax Review* 320.
[24] ANTS Paper, above n 23, 15.
[25] Asprey Report, above n 2, [3.7]; Henry Review, above n 6, Pt 1, Overview, 23; Binh Tran-Nam, 'Tax Reform, Tax Simplification: Some Conceptual Issues and a Preliminary Assessment' (1999) 21(3) *Sydney Law Review* 500.
[26] Henry Review, above n 6, Pt 1, Overview, 23; Asprey Report, above n 2, [3.7]; Tran-Nam, above n 25.
[27] Henry Review, above n 6, Pt 1, [2.1]; Asprey Report, above n 2, [3.7].
[28] Henry Review, above n 6, Pt 1, 17.
[29] Ibid, Pt 1, 15-16.

An easily understood tax-transfer system that makes it easier for people to understand their obligations and entitlements[30] also tends to encourage taxpayers' voluntary compliance. This may be regarded as a fundamental attribute of a successful modern tax system.

A potentially useful approach to analysing tax simplicity is to distinguish between legal simplicity and effective simplicity.[31] Legal simplicity includes both statutory and procedural (administrative) simplicities. Statutory simplicity refers to the ease by which a tax law can be read, understood, applied and resolved in cases of dispute. Procedural simplicity refers to the ease by which tax administrative requirements can be met by taxpayers and tax administrators. An example of procedural simplicity is the number of dealings that taxpayers must have with government departments in order to comply with their tax obligations. Legal simplicity is clearly of particular interest to tax lawyers and tax practitioners and also those who wish to argue against a specific interpretation of tax legislation.

An alternative way of looking at tax simplicity involves shifting from comprehensibility to applicability. This approach emphasises the ease with which the correct tax liability can be determined. Surrey and Brannon state that 'simplicity is the characteristic of a tax which makes the tax determinable for each taxpayer from a few readily ascertainable facts'.[32] Thus, effective or economic simplicity can be measured in terms of the value of resources expended by the society in raising some amount of tax revenue. In this sense, a tax is considered to be effectively simpler than another (revenue equivalent) tax if the operating costs, which are defined as the sum of administrative and compliance costs of the first tax, are lower than those incurred in raising the same amount of revenue by the second tax, all other things being equal.[33] In 1975, the Asprey Committee considered that a tax is simple relative to other taxes if the ratio of its operating costs to the tax revenue is small compared to other types of taxes.[34]

Budak, James and Sawyer reviewed the literature on tax simplification from 11 countries and concluded that there are a number of ways of conceptualising tax simplification. It can be viewed as simplification of tax systems. This includes reducing the number of taxes, tax bases, exemptions and structures of tax rates. The second approach is simplification of tax law. Simplifying legislation does lead to some improvement; however, this is of limited success. Reform of the legislation does not address broad ranges of complexities within tax systems. Examples include Australia (Tax Law Improvement Project) which engaged in rewriting the income tax legislation and created a parallel regime instead of unifying legislation, New Zealand (New Zealand Rewrite Project) which improved readability and understandability but not overall simplification and the United Kingdom (Tax Law Rewrite project) which aimed to rewrite major tax laws. This was an overly ambitious project that eventually lost political support. A third approach is simplification of taxpayer communications. Improving taxpayer communication to increase public understanding and engagement with the tax system can assist in simplification. A fourth approach is simplification of

[30] Ibid, Pt 1, [2.1].
[31] See, for example, Chris Evans and Binh Tran-Nam, 'Managing Tax System Complexity: Building Bridges through Pre-filled Tax Returns' (2010) 25(2) *Australian Tax Forum* 245, 251-252.
[32] Stanley S Surrey and Gerard N Brannon, 'Simplification and Equity as Goals of Tax Policy' (1968) 9(4) *William and Mary Law Review* 915, 915.
[33] Tran-Nam, above n 25, 500, [3B].
[34] Asprey Report, above n 2, [3.20].

tax administration. This includes electronic filing of tax returns and automatic deductions of taxation at source. The final idea discussed is longer term approaches to simplification which have been successful in New Zealand, but the authors point out that this is a smaller economy and therefore may be easier to overhaul.[35] This article considers the first approach to tax simplicity, in other words whether or not reducing GST exemptions would lead to greater simplicity. All OECD countries except the United States have adopted consumption taxes.[36] Consumption taxes are taxes on the supply of a broad range of goods and services that are consumed by everyday taxpayers.[37] While intended to be a tax on final consumption, in practice consumption taxes are levied on all goods and services supplied by businesses for consideration.[38] In its purest form, this tax also allows businesses to claim back any consumption taxes incurred in the making of these taxable supplies.[39] The consumption tax is therefore passed onto the consumer. The regressive nature of this tax is clear when we consider that a broad-based GST takes a higher proportion of the income of those on low incomes, compared to those on higher incomes. A broad-based consumption tax with no exceptions is regressive because it applies uniformly, and those on lower incomes spend a higher proportion of their income on essential goods and services than those on higher incomes.[40] This begs the question of what should be done to redress the regressive nature of consumption taxes, bearing in mind that these taxes are often part of the price of essential goods and services for everyday consumers.

When discussing the term exemption in the context of consumption taxes, it is first necessary to define what an exemption is. The term exemption in the GST context is usually said to refer to supplies that do not bear GST but which are also ineligible for the supplier to claim back the input GST that went into the supply. In other words, the supplier cannot claim the input tax credits.[41] In Australia the legislation refers to these supplies as input taxed.[42] However, other researchers also use the term exemption when discussing supplies that in Australia are referred to as GST-free.[43] This is because these supplies, although eligible for the claiming back of relevant GST from the revenue authorities, are charged at the rate of zero per cent. In many countries they are therefore

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[35] Tamer Budak, Simon James and Adrian Sawyer, 'International Experiences of Tax Simplification and Distinguishing between Necessary and Unnecessary Complexity' (2016) 14(2) *eJournal of Tax Research* 337.

[36] Dylan Gowans and Simon Richards, *Consumption Taxes in Canada: Revenue, Rates and Rationale*, Canadian Library of Parliament (23 March 2017), https://hillnotes.ca/2017/03/23/consumption-taxes-in-canada-revenue-rates-and-rationale/ (accessed 13 July 2020).

[37] Rita de la Feria and Herman van Kesteren, 'Introduction to this Special Issue – VAT Exemptions: Consequences and Design Alternatives' (2011) 22(5) *International VAT Monitor* 300.

[38] Ibid 300.

[39] Ibid.

[40] Patricia Apps and Ray Rees, 'Raise Top Tax Rates, Not the GST' (2013) 28(3) *Australian Tax Forum* 679.

[41] Rita de la Feria and Richard Krever, 'Ending VAT Exemptions: Towards a Post-Modern VAT' in Rita de la Feria (ed), *VAT Exemptions: Consequences and Design Alternatives* (Wolters Kluwer, 2013) 3, 11.

[42] GST Act, s 9-30(2).

[43] Re:think, above n 10, 136; PricewaterhouseCoopers (PwC), 'A Guide to VAT/GST/SUT in the Americas 2018: Indirect Tax Guidance of 21 Countries in the Americas' (2018), https://www.pwc.com/gx/en/tax/indirect-taxes/assets/guide-to-vat-gst-sut-in-the-americas-2018-indirect-tax-guidance-of-21-countries-in-the-americas.pdf (accessed 13 July 2020); Paul Kenny, 'The GST Food Exemption' (2000) 3(6) *Journal of Australian Taxation* 424; Fiona Martin, 'The Application of the Australian Goods and Services Tax to Real Property in Australia' (2015) 18 *Comparative Law Journal of the Pacific* 179, 180-181.

referred to as zero-rated.[44] In this article the term exemption will be used to refer to both scenarios.

4. CONSUMPTION TAXES, EXEMPTIONS AND FOOD

Australia is one of only five OECD member countries that applies a zero rate exemption to specific food items, the other countries being Canada, Mexico, Ireland and the United Kingdom. The majority of European countries do, however, apply reduced rates to various food items, or exempt them from GST (or value added tax (VAT) as it is called in many countries) as input taxed supplies.[45]

The equity issue of taxing food at a flat rate occurs because of the greater proportional cost of food to the income of low income earners as opposed to high income earners. Given the necessity of food expenditure, a GST without an exemption for food is considered highly regressive.[46]

There are different ways to address the regressive nature of a consumption tax. The most common method is to either exempt certain goods and services (generally those that are considered 'necessities') or tax them at a lower rate than other 'luxury' goods and services. Alternatively, a tax credit method could be used, whereby lower income taxpayers are reimbursed 'for the tax paid on a minimal or essential level of consumption'.[47] A further solution would be to provide low income families with a direct payment.[48] Carlson and Patrick argue that taxing certain items at a lower or zero rate is 'probably the most frequently used method of alleviating the regressivity of a consumption tax'.[49]

The interaction between low income earners and consumption taxes has been the subject of a large number of research reports and other publications. A 2007 study looked at the average European Union consumption shares for household groups divided into quintiles (quintiles are from the lowest income to the highest income numbered from 1 to 5). It showed that consumption patterns are rather similar for most sectors, except for food and utilities like electricity and heating. For those sectors, low-income consumption was on average almost twice (1.83 and 1.71) the corresponding high income consumption. The researchers therefore concluded that retaining reduced VAT rates on food would benefit high income households, but be comparatively beneficial for low income households because they spend a significantly larger share of their income on food.[50]

In Australia, food is a significant proportion of the cost of living for all households. Figure 1 below extracted from an Australian Bureau of Statistics survey for 2015-2016, shows that, after housing costs, people in the lowest net worth quintile spend the largest proportion of their household income on food and non-alcoholic beverages. People in

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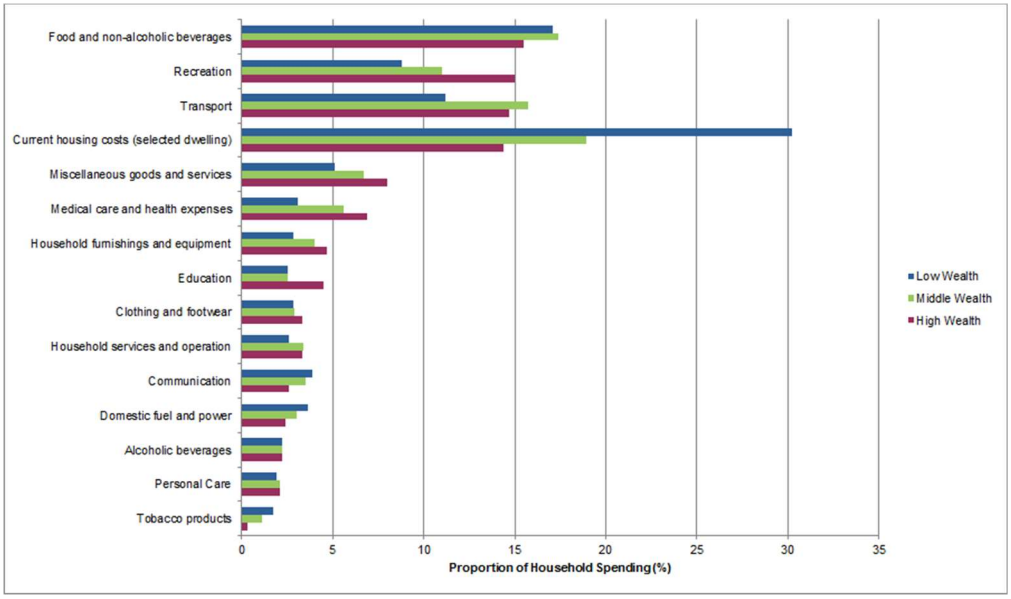
[44] Martin, above n 43, 180-181.
[45] Australian Treasury, *International Comparison of Australia's Taxes* (3 April 2006) 249.
[46] Bain, above n 3.
[47] George Carlson and Melanie Patrick, 'Addressing the Regressivity of a Value-Added Tax' (1989) 42(3) *National Tax Journal* 339, 345.
[48] Binh Tran-Nam, 'Assessing the Revenue and Simplification Impacts of the Government Tax Reform' (1999) 2(5) *Journal of Australian Taxation* 329, 343.
[49] Carlson and Patrick, above n 47, 344.
[50] Copenhagen Economics, *Study on Reduced VAT Applied to Goods and Services in the Member States of the European Union, Final Report*, Report 6503 DG TAXUD (21 June 2007) 30.

the highest quintile actually spend most on food, but this is only slightly more than they spend on recreation, with transport and housing costs their third and fourth highest areas of expenditure.[51]

Fig. 1: Proportion of Weekly Household Spending on Goods and Services, by Low, Middle and High Wealth, Australia 2015-16[52]



This is a shift from 1993-1994 when low income earners in Australia spent five times as much of their income on food as people in the highest income quintile.[53]

Like Australia, Canada applies a zero rate on basic food, and like most other OECD countries, general consumption taxes (federal and provincial) account for an increasingly large share of total tax revenue and social security contributions.[54] The Canadian Government has followed the view that general consumption taxes are regressive because they have a greater effect on individuals with low incomes. Zero-rating of basic foods is thus a way of mitigating this regressive effect of a GST.[55]

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[51] The terms quintile, decile and percentile are used. If a distribution, such as household income, is put in order from lowest to highest, and then divided into 100 equal groups, each group is a percentile. Ten percentiles make up a decile (ten equal groups) and 20 percentiles make up a quintile. Australian Bureau of Statistics, *Household Expenditure Survey, Australia: Summary of Results, 2015-16: Explanatory Notes*, Cat. 6530.0 (13 September 2017), http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6530.0Explanatory%20Notes12015-16?OpenDocument.

[52] Ibid.

[53] Kenny, above n 43, 425.

[54] Gowans and Richards, above n 36.

[55] Ibid.

Like Australia and Canada, Ireland gains a significant proportion of its revenue from its VAT.[56] The Irish standard VAT rate is 23.0 per cent, which is above the OECD average of 19.2 per cent.[57] In Ireland basic food and drink for human consumption is zero-rated.[58] This applies to items such as fruit, vegetables and milk, but not alcoholic beverages or confectionary.[59] Ireland also applies reduced VAT rates of 4.8per cent, 9 per cent and 13.5 per cent to a number of goods and services.[60]

A study using the 2004/2005 Household Budget Survey conducted by researchers at Trinity College Dublin found that Irish households in the lowest equivalised income decile expended about 16 per cent of their disposable income in VAT. The richest households on the other hand spent only about 6 per cent in VAT. As the worst off were those in the lowest income decile, the authors concluded that the then VAT system in Ireland was highly regressive.[61] The study also concluded that increasing the VAT would increase the regressive effect of the tax, particularly on those persons on the lowest income decile, rural households, single adult households with children and households with six or more people.[62] The Irish government ignored this research and increased the highest rate of VAT, although it maintained the zero rate for basic foods and beverages.[63]

The standard rate of GST in Mexico is 16 per cent.[64] Among the supplies that are zero-rated are the supply of non-industrialised animals and vegetables, as well as certain specific food products, patent medicines and fertilisers.[65] It appears that the original policy behind zero-rating basic food was similar to other countries in that the GST was considered to impact more harshly on low income households.[66] However, Cotis' research into the Mexican economy suggests that:

> zero-rating of basic staples, such as food and medicine, is a very inefficient way of using taxes for redistribution. People at higher income levels are actually compensated more in absolute terms than low-income people. They are being heavily subsidised by the non-taxation of food in particular.[67]

Dalsgaard agrees with this.[68] However, a contrary argument exists in that there are many micro businesses in Mexico that may operate outside the tax system and, as many low

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[56] OECD, *Consumption Tax Trends 2016 – Ireland* (2016), https://www.oecd.org/tax/consumption/consumption-tax-trends-ireland.pdf.
[57] Ibid.
[58] Irish Tax and Customs, 'Zero Rate of VAT' (2 August 2018), https://www.revenue.ie/en/vat/vat-rates/what-are-vat-rates/zero-rate-of-value-added-aax-vat.aspx.
[59] *Value-Added Tax Consolidation Act 2010* (Ireland) sch 2, part 2.
[60] OECD, *Consumption Tax Trends 2016 - Ireland*, above n 56.
[61] Eimear Leahy, Sean Lyons and Richard S J Tol, 'The Distributional Effects of Value Added Tax in Ireland' (2011) 42(2) *The Economic and Social Review* 213, 219-220.
[62] Ibid.
[63] OECD, *Consumption Tax Trends 2016 - Ireland*, above n 56.
[64] PwC, above n 43, 115.
[65] Ibid; José A Tijerina-Guajardo and José A Pagán, 'Valued-Added Tax Revenues in Mexico: An Empirical Analysis' (2000) 28(6) *Public Finance Review* 561.
[66] Thomas Dalsgaard, 'The Tax System in Mexico: A Need for Strengthening the Revenue-Raising Capacity' (Working Papers No. 223, OECD Economics Department, 2000) 19-20, https://www.oecd-ilibrary.org/economics/the-tax-system-in-mexico_713001800850.
[67] Jean Philippe Cotis, 'What are the OECD's Views about the Mexican Tax Reforms' (14-15 October 2003) 4, https://www.oecd.org/mexico/22425199.pdf (accessed 13 July 2020).
[68] Dalsgaard, above n 66.

income consumers purchase food from these suppliers, they would not pay GST on food, even if it was taxable.[69]

The top rate of VAT in the United Kingdom is 20 per cent; however most food and children's clothes are zero-rated.[70] This policy is based in history as the United Kingdom had a VAT prior to joining the European Union and was allowed to continue with zero-rating anything that was zero-rated at that time.[71] As Rita de la Feria states, '[t]he decisions were based on evidence available in 1972 … In order to keep the zero rates, the United Kingdom basically had to stop in time'.[72] Accordingly, the United Kingdom continues to zero-rate anything considered healthy (such as basic food and beverages) but not luxury goods such as biscuits, achieving the policy of protecting lower income households.[73]

A 2018 OECD report found that reduced VAT rates for basic food 'provide in general greater support to the poor than the rich as a proportion of household income or expenditure'.[74] However, despite this progressive effect, the report argues that reduced VAT rates are a very poor distributive tool. Indeed, better-off households tend to benefit more in absolute terms from reduced VAT rates, as their consumption of the tax-favoured goods and services is generally greater than that of poorer households, as they tend to consume comparatively more expensive products and in greater quantities.[75]

Some believe that the impact of a consumption tax should be assessed over the lifetime of an individual and not on an annual basis.[76] In theory, annual income is low when an individual is young, because that individual is still in school or is just starting employment. It should peak in middle age and then start decreasing in old age because of a loss of efficiency or retirement. Analysing the impact of VAT on the basis of annual income thus presents a more regressive result for the young and old, whereas the same analysis carried out over a lifetime's income might lead to a different conclusion.[77] This analysis assumes, however, that all individuals have the same life expectancy and earn on average the same income. The salary of a lower qualified person may not reach a peak at middle life.[78] Furthermore, it does not take into account the fact that women continue to be disadvantaged by a gender pay gap despite years of working.[79]

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[69] Ibid 7; OECD, 'Mexico Policy Brief' (OECD Better Policies Series, January 2017), https://www.oecd.org/mexico/mexico-raising-productivity-in-small-traditional-enterprises.pdf.
[70] United Kingdom, 'VAT Rates', *Gov.uk* (2019), https://www.gov.uk/vat-rates.
[71] European Union, Sixth Council Directive 77/388/EEC of 17 May 1977 on the Harmonization of the Laws of the Member States relating to Turnover Taxes - Common System of Value Added Tax: Uniform Basis of Assessment [1977] OJ L 145/1.
[72] Camila Ruz and Maisie Smith-Walters, 'The Mysterious World of Zero-Rates of VAT', *BBC News Online* (28 October 2015), https://www.bbc.com/news/magazine-34649495 (accessed 13 July 2020).
[73] Ibid.
[74] OECD, *Consumption Tax Trends 2018: VAT/GST and Excise Rates Trends and Policy Issues* (OECD Publishing, 2018) 47.
[75] Ibid.
[76] Neil Warren, 'A Review of Studies on the Distributional Impact of Consumption Taxes in OECD Countries' (Working Paper No. 64, OECD Social, Employment, and Migration, 24 June 2008) 24.
[77] Ibid.
[78] Alain Charlet and Jeffrey Owens, 'An International Perspective on VAT' (2010) 59(12) *Tax Notes International* 943, 950.
[79] Workplace Gender Equality Agency, 'The Gender Pay Gap' (2018), https://www.wgea.gov.au/topics/the-gender-pay-gap (accessed 13 July 2020): 'The full-time total remuneration* gender pay gap based on the 2018-19 WGEA data is 20.8%, meaning men working full-

4.1 The exemption for food and low income households in developing nations

Research over the last decade has examined the impact of VAT/GST exemptions on low income households within the context of developing nations. Peru has a VAT/GST equivalent, although basic food is zero-rated.[80] A 2013 study found that indirect taxes such as VAT/GST have a significant effect on incomes across the wealth distribution. However, their effects are higher among those with higher incomes. This is likely to be a result of high informality levels, as richer households usually buy from formal establishments, while poorer households are more likely to buy products in informal conditions, such as from street vendors or in informal markets, thus not paying any VAT/GST.[81]

An earlier study by Younger and others[82] in Madagascar suggests that most taxes in that country are progressive. Younger and Sahn[83] reached the same qualitative conclusion for Côte d'Ivoire, Guinea, and Tanzania. These studies indicate that the consumption taxes in these countries impact more on the wealthier households. However, this result cannot be assumed for all developing countries. A study in Bangladesh found that while zero-rating food would greatly mitigate the adverse impact of replacing the pre-existing indirect tax regime by a VAT/GST, it would not eliminate it.[84] A South African study found that poor South African households spend around 61 per cent of their income on food as opposed to high-income households which spend 15 per cent.[85] In this context, Charlet and Owens argue that 'the poor would suffer more from a VAT on food'.[86]

4.2 Health and zero-rating of food

There is some limited research about the implications of a rise in the price of fruits and vegetables for the Australian diet and consequently health. Estimates of the price elasticity of demand for fruits and vegetables in the United States conclude that the removal of zero-rating in Australia would mean that fruit consumption would decline by 4.9 per cent and vegetable consumption by 4.8 per cent.[87] Veerman and Cobiac argue that reduction in fruit and vegetable consumption is associated with an increase in the incidence of ischaemic heart disease (IHD), ischaemic stroke, and cancer of the lung, oesophagus, stomach and colon, leading to increased prevalence of disease and mortality in later years. They calculate that adding GST to fruits and vegetables could

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time earn $25,679 on average a year more than women working full-time. The full-time base salary gender pay gap for 2018-19 is 15.5%, which means that men working full-time earned $15,176 on average more than women. … *Total remuneration includes full-time base salary plus any additional benefits – bonus payments, performance pay, superannuation, discretionary pay, overtime, other allowances and benefits, for example share allocations'. The gender pay gap is consistent across industries in Australia.

[80] Miguel Jaramillo Baanante, 'The Incidence of Social Spending and Taxes in Peru' (Working Paper No 9, Commitment to Equity, Tulane University, October 2013) 1.

[81] Ibid 13.

[82] Stephen D Younger, David Sahn, Steven Haggblade, and Paul A Dorosh, 'Tax Incidence in Madagascar: An Analysis Using Household Data' (1999) 13(2) *World Bank Economic Review* 303.

[83] Stephen D Younger and David E Sahn, 'Fiscal Incidence in Africa: Microeconomic Evidence' (Working Paper No. 91, Cornell Food and Nutrition Policy Program, 1998).

[84] Liam Ebrill, Michael Keen, Jean-Paul Bodin and Victoria Summers, *The Modern VAT* (International Monetary Fund, 2001) 109-110.

[85] Delfin S Go, Marna Kearney, Sherman Robinson, and Karen Thierfelder, 'An Analysis of South Africa's Value Added Tax' (Working Paper No. 3671, World Bank Policy Research, August 2005) 19.

[86] Charlet and Owens, above n 78, 950.

[87] J Lennert Veerman and Linda J Cobiac, 'Removing the GST Exemption for Fresh Fruits and Vegetables Could Cost Lives' (2013) 199(8) *Medical Journal of Australia* 534, 535.

cost about 100,000 healthy life-years over the lifetime of the 2003 Australian adult population, due to an additional 90,000 cases of IHD, stroke and cancer. This extra disease burden could add AUD 1 billion in health care costs over the same period.[88]

This research suggests that abolishing the GST exemption for fruits and vegetables could have a large detrimental impact on health and health care budgets. It is also noted, however, that the removal of all zero-rating would result in complex shifts in diet that have not been rigorously studied.

4.3 Reducing VAT on food and increasing employment

In 1999 the European Union allowed Member States to set a reduced VAT rate for no more than three years on a limited number of items that are labour-intensive services. These were home renovations, small repair services such as shoe repairs, home cleaning, domestic care services and hairdressing.[89] The policy rationale was that this would stimulate employment in these areas, and would also reintegrate small businesses which had largely drifted out of the tax system back into it.[90] However, a subsequent review of the impact of the VAT reduction demonstrated that the reduced rate had very little, if any, impact on prices or job creation. The review concluded that a reduction in VAT rates 'would therefore seem to be a waste of budget resources which could be deployed more usefully elsewhere'.[91]

A 2007 study by Copenhagen Economics raises some theoretical elements in favour of reduced consumption tax rates impacting positively on employment rates provided that specific circumstances are met. The report argues that reduced VAT rates applied in carefully targeted sectors may increase employment of low-skilled local workers. Where there are many low-skilled workers and high levels of unemployment, for example in food retail, hospitality and food production, reducing the VAT on food can lead to an increase in demand for this labour force.[92] However, the report concluded that this increase was very slight.[93]

4.4 Self-supply and underground activities

Services that are often provided by microbusinesses and which can be alternatively provided by consumers (eg, house cleaning, haircuts) may be sensitive to the imposition of a consumption tax. Piggott and Whalley argue that taxation at the full tax rate may actually encourage self-supply of these services, thereby reducing employment and not raising the expected revenue.[94] This argument could also apply to the production of basic foods, a proportion of which could be grown at home.

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[88] Ibid.
[89] Tina Weber, 'Reduction of VAT on Labour-Intensive Services Agreed' *Eurofound* (27 September 1999), https://www.eurofound.europa.eu/publications/article/1999/reduction-of-vat-on-labour-intensive-services-agreed (accessed 13 July 2020); Ebrill et al, above n 84, 77.
[90] Weber, above n 89.
[91] European Commission, 'Preparation of Eurogroup and Informal Council of Economics and Finance Ministers' (Memo 03/173, European Commission, 12-13th September 2003) 3, https://ec.europa.eu/commission/presscorner/detail/en/MEMO_03_173 (accessed 13 July 2020).
[92] Copenhagen Economics, above n 50, 69.
[93] Ibid.
[94] John Piggott and John Whalley, 'VAT Base Broadening, Self-Supply and the Informal Sector' (Working Paper No. 6349, National Bureau of Economic Research, 1998).

If some supplies which are difficult to tax when provided by small scale suppliers, such as small scale construction, are added to the consumption tax base, Piggott and Whalley argue that one effect may be to stimulate underground or outside market activities which avoid tax.[95] Again, this argument is also applicable to purchasing fruit and vegetables from local markets as these businesses are usually family-owned/operated and difficult to fully capture in the tax base.

4.5 The political importance of zero-rating food

Apart from the reasons discussed above, it is also likely that food is zero-rated in Australia, Canada, Ireland, Mexico and the United Kingdom because the potential political cost of increasing the consumption tax on food would be too high.[96] In Australia, food was considered one of the most essential GST-free categories in terms of equity by some groups, with the Australian Democrats refusing to support the GST legislation until the Liberal-National Coalition agreed to its GST-free or zero-rated status.[97] Several years before Australia introduced a GST, the Australian Council of Social Service (ACOSS), business groups and other peak bodies met to discuss tax reform.[98] They agreed in principle to the introduction of a broad-based consumption tax that would replace the existing wholesale sales tax and many of the existing State taxes, such as Financial Institutions Duty, Debits Tax, Payroll Tax and Franchise Taxes. Throughout the conference 'emphasis was placed on the need to protect those on social security and those on low wages from any adverse changes'.[99]

Australia was one of the last of the OECD nations to introduce a GST. Although, as mentioned earlier, the Asprey Report recognised the need for a broad-based consumption tax back in 1975, it was not introduced until 2000. The idea of a GST was first mooted by John Howard (then Federal Treasurer) in 1980.[100] The GST was so politically unpalatable to the Australian public that it took the Liberal/National Coalition close to two decades to actually introduce it. As noted above, the eventual GST system was only able to be passed by the Australian Senate (upper House) on the basis that food was GST-free. The political situation was so sensitive that it was also agreed that any change to the GST rate or base would require the unanimous support of the State and Territory governments, the endorsement of the Australian Government and the passage of relevant legislation by both Houses of the Australian Parliament.[101]

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[95] Ibid.
[96] Leahy, Lyons and Tol, above n 61, 231 n 13.
[97] Josh Gordon, 'Costello "Impeded GST Deal"' *The Age* (20 June 2005), https://www.theage.com.au/national/costello-impeded-gst-deal-20050620-ge0di7.html (accessed 13 July 2020); see also John Harrison, 'The GST Debate – A Chronology' (Background Paper 1 1997-98, Australian Parliamentary Library, 22 September 1997), https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/Publications_Archive/Background_Papers/bp9798/98bp01; Peter Hill, 'Taxation of Goods and Services: Past, Present and Future' in Chris Evans and Richard Krever (eds), *Australian Business Tax Reform in Retrospect and Prospect* (Thomson Reuters, 2009) 547, 549-550; Julie Smith, *Taxing Popularity: The Story of Taxation in Australia* (Australian Tax Research Foundation, 2004).
[98] Harrison, above n 97.
[99] Ibid.
[100] Ibid.
[101] Council on Federal Financial Relations, *Intergovernmental Agreement on Federal Financial Relations* (2011), http://www.federalfinancialrelations.gov.au/content/intergovernmental_agreements.aspx, and the *A New Tax System (Managing the GST Rate and Base) Act 1999* (Cth).

5. GST AND HEALTHCARE

Traditionally, the concept of healthcare as a public or merit good has afforded it special treatment in terms of consumption tax. Healthcare is classified as a merit good because consuming it is beneficial not just to the consumer but to other members of society. For example, inoculation against a contagious disease ensures protection and a benefit to the individual but also means that inoculated individuals do not pass on the disease to those who are not vaccinated.[102]

Public health, which is the health of the collective, represents a classic example of shared gain from a shared good. As David Woodward and Richard Smith argue, even though a person (or group of people) is the primary beneficiary of his/her health, public health, as illustrated by the example of herd immunity, represents a collective benefit from which no one is excluded. No one can be excluded from the benefit of infectious disease reduction, and one person benefiting certainly does not prevent others from benefiting as well.[103]

Furthermore, as the world rapidly globalises, the interdependence of our health on the health of those in other countries suggests that the provision of public health is dependent on global public goods that may require universal solutions.[104] The Ebola and SARS epidemics made this abundantly clear. For example, no country can be excluded from benefiting from a reduction in carbon dioxide emissions which will slow global warming.[105]

Another aspect of this concept is that of health equity: the opportunity for all to live in conditions that promote health, and which minimise inter-group health differences. Health equity leads to a community where individuals live and work in a 'level playing field'.[106] The merit or public good of health care is the basis for exempting (input taxing) basic medical services from VAT in the European Union.[107]

Specific services by healthcare professionals such as doctors, dentists, optometrists and others, as well as hospital services, are GST-free in Australia.[108] When the GST was proposed by the Howard-led Liberal-National Party Coalition, specific health care services were always intended to be excluded from GST. In the policy document *Not a New Tax: A New Tax System* (ANTS Paper) it was envisaged that these services would be those attracting a Medicare benefit.[109] The ANTS proposal did not rely on merit as its argument for GST-free status of health care services. Instead, the rationale for the GST-free status of healthcare was competitive neutrality of the public and private

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[102] Economics Online, 'Healthcare as a Merit Good', https://www.economicsonline.co.uk/Market_failures/Healthcare.html (accessed 13 July 2020).
[103] David Woodward and Richard D Smith, 'Global Public Goods and Health: Concepts and Issues; Is Health a GPG?' *World Health Organization* (2019), https://www.who.int/trade/distance_learning/gpgh/gpgh1/en/index6.html.
[104] Sandro Galea, 'Public Health as a Public Good' (Dean's Note, School of Public Health, Boston University, 10 January 2016), https://www.bu.edu/sph/2016/01/10/public-health-as-a-public-good/ (accessed 13 July 2020).
[105] Ibid.
[106] Ibid.
[107] European Union, Sixth Council Directive 77/388/EEC, above n 71) art 13A; Catherine Whitby, 'First Do No Harm: GST and Health Care Services' (2000) 10(1) *Revenue Law Journal* 119.
[108] GST Act, Subdiv 38B.
[109] ANTS Paper, above n 23, 93.

sectors.[110] The proposal argued that in view of the fact that many public healthcare services were provided free or at small cost, 'applying taxes to healthcare would place the private health sector with its heavier reliance on direct fees at a competitive disadvantage with the public health system'.[111] This policy proposal was originally raised in 1991, when a previous conservative Coalition, then in opposition, noted that it was not possible to apply GST to the public health system as no direct charge was made for its services.[112] It pointed out that although private services could be included in the tax base, 'to do so would be highly arbitrary and discriminatory'.[113]

Before being legislated in 1999, the proposal for a GST in Australia had been examined by the Tax Consultative Committee (the Vos Committee).[114] The Committee's terms of reference required it to limit discrimination between private and public provision of goods and services in the GST-free areas.[115] This Committee confirmed that the policy underpinning the recommendation that healthcare services were GST-free was maintenance of competitive neutrality.[116] Similar arguments have been used in respect of European countries exempting health from consumption tax.[117]

The author's final argument in favour of exempting healthcare from VAT/GST is the possibility of what is termed 'churning' of VAT/GST. This is particularly relevant for Australia where health care is heavily subsidised by the Commonwealth government but actually provided by the States and Territories.[118] As Evans points out, taxing this expenditure may result in the increase in State and Commonwealth Government outlays necessary to cover the VAT/GST on purchases and an equal increase in VAT/GST revenues. This could involve unproductive churning as revenue would be collected and then returned to the states and territories.[119] In addition, where the VAT/GST revenue is shared amongst the States and Territories, as occurs in Australia, contributions to the revenue of some States by other governments may occur.[120]

Evans concludes that 'taxing health and education would not appear to be a politically attractive proposition – nor would it be favoured by the States and Territories'.[121]

6. GST AND RESIDENTIAL HOUSING

Australia's average net wealth per household is AUD 936,000, of which 39 per cent is held in the main home, 20 per cent in superannuation, 19 per cent in shares and other financial assets, 12 per cent in investment real estate, and 10 per cent in other non-

[110] Ibid.
[111] Australian Liberal Party, *Fightback! Taxation and Expenditure Reform for Jobs and Growth* (21 November 1991) 75.
[112] Ibid.
[113] Ibid.
[114] Tax Consultative Committee (David Vos, chair), *Report of the Tax Consultative Committee* (13 November 1998) 2.
[115] Ibid.
[116] Ibid 26.
[117] Ebrill et al, above n 84, 94.
[118] See generally Greg Smith, 'GST as a Secure Source of Revenue for the States and Territories', this issue.
[119] Michael Evans, 'GST: Where to Next?', this issue.
[120] Ibid.
[121] Ibid section 5.2.2.

financial assets such as cars.[122] The family home is therefore a significant asset for the majority of Australians.

As was shown in Figure 1, which sets out the proportion of weekly household spending on goods and services, by low, middle and high wealth households, it can be seen that the lowest income households spend 30 per cent of their income on housing, compared to high income households who spend 13-14 per cent. Housing is the fourth highest area on which high income households spend their money. Those on low incomes, who are more likely to be renting, are also subject to housing insecurity given that the private rental market provides little long-term tenure. In fact, a 2018 report to the Commonwealth Government indicates that older women are the most vulnerable in Australian society to homelessness. The report states:

> Australian women aged over 50 are at greater risk of financial and housing insecurity than older men. This has been linked to a number of compounding and systemic factors. Women in this older age group today did not benefit from compulsory superannuation at the beginning of their working lives, they were more likely to have been paid at a lower rate than their male counterparts and were likely to have taken time out of the paid workforce to have children and fulfil caring roles.[123]

6.1 Residential premises

Technically, real property is a 'good' within the VAT/GST regime that is consumed by customers through purchase, licence or rental. The GST Act defines real property as including: any interest in or right over land; a personal right to call for or be granted any interest in or right over land; or a licence to occupy land or any other contractual right exercisable over or in relation to land.[124] Therefore if GST on residential premises is considered from a legal perspective, the supply of real property should be taxed and characterised as a taxable supply with creditable acquisitions (for both business and private use), and there should be some form of consumption tax on the rental value. If the consumption of residential premises were taxed in the normal way then this would result in a large compliance burden. Every homeowner and tenant would (subject to turnover thresholds) need to register and GST would be imposed each year on the value of annual consumption of the owner-provided assets.

Australia, like many other countries, does not do this.[125] Instead the supply of residential premises (either sale or lease) in Australia will generally be input taxed (exempt) unless it is a newly constructed property or commercial residential premises.[126]

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[122] Australian Council of Social Service (ACOSS), *Inequality in Australia 2018* (Australian Council of Social Service and University of New South Wales, 2018), https://www.acoss.org.au/inequality-in-australia-2018-html/ (accessed 13 July 2020).
[123] National Older Women's Housing and Homelessness Working Group, *Retiring into Poverty, A National Plan for Change: Increasing Housing Security for Older Women* (2018) 4, https://www.mercyfoundation.com.au/wp-content/uploads/2018/08/Retiring-into-Poverty-National-Plan-for-Change-Increasing-Housing-Security-for-Older-Women-23-August-2018.pdf.
[124] GST Act, s 195-1.
[125] Ebrill et al, above n 84, 98.
[126] GST Act, s 40-65.

The policy rationale is to tax the value of housing consumption in a manner that equates the treatment of those who rent their dwellings with the treatment of owner-occupiers.[127] Owner-occupiers would not be subject to the GST when selling their residences as they would not be selling their house in the course of carrying on an enterprise, but actually selling their home.[128] The effect from a tax perspective is that they are making an input taxed supply – no GST is charged on the sale and no input tax credits can be claimed. To realise this policy objective, residential premises are input taxed only to the extent that they are actually used to provide accommodation outside the course of business, and then only to the point that accommodation is comparable with home ownership. To the extent that business-related activity is associated with either the use or supply of premises, housing supplies are taxable to enable both the commercial supplier and user of premises to claim a tax credit in respect of supply-related acquisitions, and hence ensure their immunity to the tax.[129]

As Ebrill et al state:

> Owner-occupied housing is problematic, however, because this involves final consumption on which one would like the tax to 'stick'. While attempts have been made in the past to impute value to services enjoyed from owner-occupation for the purposes of income tax, the experience has not been a success and is now rarely made. Thus services enjoyed from owner occupation are – with no exception that we know of – exempt from VAT. To avoid distorting the choice between house ownership and renting, the commercial leasing of residential property is commonly also exempt.[130]

Housing services are also widely exempt from consumption tax on the basis of regressivity.[131] This is particularly relevant when comparing owner occupation and renting as those on lower incomes are more likely to rent, and therefore be disadvantaged by increases in the cost of renting through the imposition of an indirect tax.[132]

The OECD points out that:

> Access to good-quality affordable housing is a fundamental need and key to achieving a number of social policy objectives, including reducing poverty and enhancing equality of opportunity, social inclusion and mobility. Housing needs are frequently unmet, and today a significant number of people across

[127] Explanatory Memorandum, A New Tax System (Goods and Services Tax) Bill 1998 (Cth) 5-164.
[128] The GST Act, s 9-5(b), states that a taxable supply must be made in the course of carrying on an enterprise; see Wei Cui, 'Learning to Keep the Consumption Tax Base Broad: Australian and Chinese VAT Design for the Housing Sector' in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011) 367, 370; Michael Evans 'The Value Added Tax Treatment of Real Property – An Antipodean Context' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 243, 255-257.
[129] Martin, above n 43, 181-182.
[130] Ebrill et al, above n 84, 98.
[131] Ibid 99.
[132] See generally Judy A Kraatz, Johanna Mitchell, Annie Matan and Peter Newman, *Rethinking Social Housing: Efficient, Effective and Equitable, Progress (Report 1* (Sustainable Built Environment National Research Centre, 2015).

> the OECD are homeless and too many households live in low-quality dwellings or face housing costs they can ill afford.[133]

The OECD found that in 2013, housing-related expenditure constituted the single highest household expenditure item in OECD countries, at 22.9 per cent of final household consumption expenditure.[134] Furthermore, the likelihood of a household owning the dwelling (with and without outstanding mortgages) increases with income.[135]

The OECD reports that in 2016, 16 countries identified ensuring access to affordable housing as one of their key objectives. Australia was one of these countries, specifically referring to low income households and Indigenous Australian peoples as targeted groups.[136]

A final argument for exempting residential premises from a consumption tax is that home ownership is viewed in many jurisdictions as an important policy objective which is actually encouraged through various taxation incentives.[137] Australia has enacted a suite of tax concessions over the years that encourage home ownership. These include the First Home Owners Grant, First Home Saver Accounts Scheme,[138] and negative gearing, which is the ability to deduct expenses relating to renting residential premises from a taxpayer's other income, effectively encouraging investment in second and third properties.[139] Other significant tax concessions are the capital gains and land tax exemptions on owner-occupied housing, and the 50 per cent capital gains tax discount available to individuals who sell residential property that is not their home if it has been held for 12 months or more.[140] However, it can be noted that some of these concessions are actually counter to equity arguments; for example, low income earners are not a primary group who are able to take advantage of negative gearing.[141]

7. ARGUMENTS AGAINST EXEMPTING FOOD, HEALTHCARE AND HOUSING FROM THE GST

Although the objective of this article is to justify specific exemptions from the GST, like all arguments, there are always counter-arguments. Exemptions from the tax base significantly reduce the amount of revenue that can be collected by the government and then used to provide public goods and services.[142] In fact, a review of the Australian

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[133] OECD, 'Affordable Housing Database' (2019), https://www.oecd.org/social/affordable-housing-database.htm.
[134] OECD, 'Affordable Housing Database, HC1.1 Housing Related Expenditure of Households', (2019), https://www.oecd.org/social/affordable-housing-database.htm.
[135] OECD, 'Affordable Housing Database, HM1.3 Housing Tenures' (2019), https://www.oecd.org/social/affordable-housing-database.htm.
[136] OECD, 'Affordable Housing Database, PH1.2 Housing Policy Objectives and Obstacles' (2019), https://www.oecd.org/social/affordable-housing-database.htm.
[137] Satya Poddar, 'Taxation of Housing Under a VAT' (2010) 63(2) *Tax Law Review* 443, 444.
[138] Australian Parliament, Senate Select Committee on Housing Affordability in Australia, *A Good House is Hard to Find: Housing Affordability in Australia* (Report, June 2008) 4.
[139] Ibid 2.
[140] Ibid.
[141] Cameron Murray, 'Game of Homes: How the Vested Interests Lie About Negative Gearing' *The Conversation* (11 March 2019), https://theconversation.com/the-game-of-homes-how-the-vested-interests-lie-about-negative-gearing-112222 (accessed 13 July 2020). Murray comments that the occupations most likely to negatively gear are surgeons and anaesthetists.
[142] Asprey Report, above n 2, [27.20].

2017 Tax Expenditures Statement reveals that of all the GST-free categories, food has the largest monetary impact. It was estimated in 2013-14 that making food GST-free cost AUD 6,200 million, expected to increase to AUD 7,900 million in 2020-21.[143] Significantly, there are other developed nations that apply their VAT/GST to all foods including Singapore[144] and New Zealand.[145]

The Singapore Government successfully argued that its VAT/GST should be comprehensive and this does not appear to have impacted adversely on those households on low incomes. The introduction of GST in Singapore was accompanied by other measures including personal income tax cuts and an increase in existing public assistance payments for low income families and individuals.[146] Significant researchers in the area have commented that distributive concerns arising from a GST are best addressed by directly compensating low income families outside the GST system where the country is a developed country such as Singapore.[147] Another important aspect of the Singapore system is that the government is transparent about reinvesting the tax collected into services such as education and aged care.[148] But it should also be remembered that most people in Singapore pay little income tax and that the VAT/GST is very low by OECD standards,[149] and lower than Australia.[150] Furthermore, the turnover registration threshold for the GST is comparatively high[151] which means that a significant proportion of supplies such as sales of food are potentially outside the input tax credit system. Compliance costs for small businesses are also minimised in this way.[152]

New Zealand introduced a GST in October 1986.[153] It was originally 10 per cent and has had several rate increases so that it is now 15 per cent.[154] It is a very broadly based consumption tax with very few exemptions, and food has always been included in the tax base.[155] It is considered by some researchers in the area that the New Zealand GST is the preferable approach.[156] David White and Richard Krever comment that:

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[143] Australian Treasury, *Tax Expenditures Statement 2017* (January 2018) 133.
[144] Ministry of Finance (Singapore), 'Goods and Services Tax' (2019), https://www.mof.gov.sg/Policies/Tax-Policies/Goods-and-Services-Tax.
[145] *Goods and Services Tax Act 1985* (NZ).
[146] Andrew Maples and Adrian Sawyer, 'The New Zealand GST and Its Global Impact: 30 Years On' (2017) 23(1) *New Zealand Journal of Taxation Law and Policy* 9, 34 referring to Jeff Pope and Eng‑Hin Poh, 'Compensating for the Goods and Services Tax: The Contrasting Policy Approaches of Singapore and Australia' (2001) 20(4) *Economic Papers* 1.
[147] Pope and Poh, above n 146, 5.
[148] Prime Minister's Office, Singapore 'The Straits Times Interview with DPM Tharman Shanmugaratnam: Social Policies, Spending and Taxes' (11 January 2018), https://www.pmo.gov.sg/Newsroom/straits-times-interview-dpm-tharman-shanmugaratnam (accessed 13 July 2020).
[149] The mean VAT rate for OECD countries in 2018 was 19.3 per cent: see OECD, *Consumption Tax Trends 2018*, above n 74.
[150] Prime Minister's Office, Singapore, above n 148. The current rate is 7 per cent although this is expected to increase to 9 per cent.
[151] Pope and Poh, above n 146, 4.
[152] Ibid.
[153] Statistics New Zealand, *How GST Affected Retail Sales in the 1980s* (July 2010), http://archive.stats.govt.nz/browse_for_stats/industry_sectors/RetailTrade/historical-impact-gst-introduction-and-increase-on-retail-sales.aspx.
[154] Ibid.
[155] Christopher Ball, John Creedy and Michael Ryan, 'Food Expenditure and GST in New Zealand' (2016) 50(2) *New Zealand Economic Papers* 115.
[156] Maples and Sawyer, above n 146.

> New Zealand was able to adopt what many consider to be the world's purest value added tax. The contrast with the European examples could not have been starker and the New Zealand model became the starting point for many of the world's modern value added taxes.[157]

This is certainly true from a tax simplicity perspective as the New Zealand GST legislation has few exemptions. This makes it easier to understand and to apply. It is also considered that this approach is consistent with the aims of a GST; a 2018 report of the New Zealand Inland Revenue Department and New Zealand Treasury states that GST exemptions are 'poorly targeted instruments for achieving distributional aims'.[158] It refers to research on food expenditure and the New Zealand GST which concluded that 'the absolute and relative gains and losses from a revenue neutral policy of zero-rating food in a GST are small relative to total expenditure, despite the fact that the policy can achieve some progressivity'[159] and 'a policy of raising transfer payments – even where these are received by everyone – is capable of producing more progressivity'.[160]

Any exemption provision, no matter how well drafted, can also lead to ambiguity at the margins, increasing complexity and consequently implementation costs.[161] Operational complexity can arise due to legal uncertainty. This operational complexity occurs 'when taxpayers do not fully understand what their true tax liabilities are – how certain transactions should be treated for tax purposes – and/or, if they do not understand the basis on which the tax authority comes to a different view how they should be treated if the authority challenges the tax return'.[162] A lack of consistency with definitions can reduce taxpayers' ability to understand their rights and obligations. This results in the need to engage a tax professional which also adds to their compliance costs, or alternatively results in their choosing not to comply.[163]

An example of the complexity of the legislation when referring to zero-rated supplies is the exceptions and exclusions that surround the supply of food. In Australia the supply of basic foods and beverages such as fruit, vegetables, milk and water are GST-free or zero-rated[164] which at first glance seems an easy object to achieve. However, the difficulties around foodstuffs, how they are delivered to the consumer and whether or not they are heated prior to sale has become so complex that the Australian Taxation Office (ATO) has created a comprehensive list of different types of foods and beverages

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[157] David White and Richard Krever, 'Preface' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) vii, viii.
[158] Inland Revenue Department and New Zealand Treasury, 'GST: Background Paper for Session 2 of the Tax Working Group' (Background Paper, February 2018) 14, https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-gst.pdf.
[159] Ball, Creedy and Ryan, above n 155, 121.
[160] Ibid. Also see Alida van Klink and Chye-Ching Huang, 'How to Zero-Rate the GST on Food: Best and Worst Practice from the United Kingdom, Canada, and Australia' (29 April 2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2048014.
[161] Binh Tran-Nam, 'The Implementation Costs of the GST in Australia: Concepts, Preliminary Estimates and Implications' (2000) 3(5) *Journal of Australian Taxation* 331, 335. See also Bain, above n 3.
[162] David Ulph, *Measuring Tax Complexity* (January 2013) 8, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/193497/ots_david_ulph_measuring_tax_complexity.pdf.
[163] Tracy Oliver and Scott Bartley, 'Tax System Complexity and Compliance Costs: Some Theoretical Considerations', *Economic Roundup* (Winter 2005), https://treasury.gov.au/publication/economic-roundup-winter-2005/tax-system-complexity-and-compliance-costs-some-theoretical-considerations.
[164] GST Act, ss 9-30, 38-2.

and whether or not they are taxable or GST-free.[165] An example of the complex and unusual operation of the GST is the supply of wine grapes that are used to make wine. Are grapes fruit and therefore GST-free or one of the ingredients of an alcoholic beverage which is a taxable supply? This issue so concerned the wine industry that its representations to the ATO have successfully resulted in the categorisation of wine grapes as GST-free.[166] As Peter Hill commented in relation to exemptions, 'one of the results is that Australia is experiencing, once again, costly arguments over the indirect taxation status of things such as dietary supplements and frozen yoghurt'.[167]

However, to counter this, the ATO has issued a number of interpretative decisions[168] and the searchable list of foods referred to above to assist taxpayers. There are also five simplified accounting measures designed for food retailers who buy and sell a mixture of products where some are taxable and some not, so that these businesses can estimate their GST liability.[169] Van Klink and Huang argue that the combination of ATO guidance and the simplified accounting measures has resulted in lower compliance and administrative costs to businesses in Australia than have occurred in the United Kingdom and Canada.[170]

Turning to the GST and real property, there are a number of exceptions and provisos that relate to the GST exemption for residential premises. For example, in Australia the supply of new residential premises is a taxable supply.[171] These exemptions have led to complexity in the GST system which has meant that it is difficult to administer.[172] The complexities created by exempt treatment suggest that officials and politicians should aim for a simple GST system if they wish to reduce compliance costs both from a revenue perspective and a business perspective. Peacock argues that this is particularly necessary in developing countries where embryo tax administrations may struggle to administer a more complex system.[173]

Furthermore, the exemptions for residential premises and all the exceptions and carve-outs in this area, such as the imposition of GST on 'new residential premises' and the making of residential premises in retirement villages provided by charities GST-free,[174] are far more complex than would appear on a first reading of the legislation. As Evans[175]

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[165] Australian Taxation Office, 'Detailed Food List: Details of the GST Status of Major Food and Beverage Product Lines', Goods and Services Tax Industry Issue (17 January 2018), https://www.ato.gov.au/law/view/document?DocID=GII/GSTIIFL1/NAT/ATO/00001.
[166] See Paul Kenny, 'The Grapes of Wrath: GST and Food' (2002) 5(1) *Journal of Australian Taxation* 136, 136; Australian Taxation Office, 'No Slug on Grapes', *Media Release* (Nat 01/66 Tax Office, 10 August 2001); Australian Taxation Office, *Detailed Food List*, above n 165, 42.
[167] Hill, 'Taxation of Goods and Services', above n 97, 549-550.
[168] Australian Taxation Office, 'GST, Food Classification', Interpretive Decision ID 2008/132, https://www.ato.gov.au/law/view/document?docid=AID/AID2008132/00001.
[169] Australian Taxation Office, 'GST for Food Retailers – Simplified Accounting Methods' (23 October 2019), https://www.ato.gov.au/Business/GST/In-detail/Your-industry/Food/GST-for-food-retailers---simplified-accounting-methods/.
[170] Van Klink and Huang, above n 160.
[171] GST Act, s 40-65(2)(b).
[172] Christine Peacock, 'Why Simple GST Treatment of Real Property is Important' (2010) 13(4) *Tax Specialist* 216, 222.
[173] Ibid.
[174] GST Act, s 38-260.
[175] Evans, above n 128.

and Wolfers[176] have separately argued, a significant problem occurs because the legislation on GST and real property vacillates between a legal or juristic concept of real property and the physical characteristics of property. Issues around statutory interpretation in this area have been at the core of several court cases.[177]

Exemptions allow inroads into the legislation that tempt advisors to push the boundaries and make the exemptions wider. Exemptions can also lead to increased litigation costs, which arguably add to the administrative costs of businesses and the revenue, at least in the short term. This is demonstrated by the significant number of cases that have been referred by national courts in European countries to the European Court of Justice regarding interpretation of exemptions.[178] In Australia, issues regarding the GST on real property and residential premises have been the subject of the largest number of court and contractual disputes, ATO rulings, legislative changes and tax avoidance behaviours,[179] although this could also be because large sums of money are usually at stake. Furthermore, exemptions are often the subject of aggressive tax planning[180] which some might argue is also a cost to the revenue and which is not productive.[181] However it should be noted that litigation around areas that are genuinely in dispute, including ambiguous definitions in the legislation, is not necessarily a cost to society. As Tran-Nam and Walpole argue:

> Finally it is worthwhile to note that tax disputes are not socially wasteful from a pure economic point of view. This is because the outcomes of the disputes may help to clarify the tax law, especially in test cases sponsored by the ATO. In this case, while tax disputes will increase the current operating costs of the tax system, it may reduce the future tax operating costs. On the negative side, however, tax disputes may indeed sometimes increase future tax operating costs, for example, if unclear/testable outcomes generate more cases.[182]

As has been discussed earlier in this article (section 6.1), one of the reasons that residential premises, both leased and sold, are exempt from VAT/GST is that it is administratively cumbersome to register and collect tax from all owner-occupiers of residential premises and all lessors of residential premises. In order to overcome this issue, some VAT/GST literature suggests that the correct approach for a pure VAT/GST system is to include imputed rent of a house or apartment in the indirect tax base.[183] Researchers argue that imposing VAT/GST on immovable property is in keeping with

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[176] Lachlan Wolfers, 'GST and Real Property in Australia' in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011) 213, 214.
[177] See, eg, *Marana Holdings Pty Ltd v Federal Commissioner of Taxation* [2004] FCAFC 307, 57 ATR 521; *South Steyne Hotel Pty Ltd v Federal Commissioner of Taxation* [2009] FCAFC 155, 74 ATR 41; *Federal Commissioner of Taxation v Gloxinia Investments Ltd* [2010] FCAFC 46, 75 ATR 806; *Sterling Guardian Pty Ltd v Federal Commissioner of Taxation* (2005) 220 ALR 550, 60 ATR 502; *Sterling Guardian Pty Ltd v Federal Commissioner of Taxation* [2006] FCAFC 12, 62 ATR 119; *Brady King Pty Ltd v Federal Commissioner of Taxation* [2008] FCAFC 118, 168 FCR 558, 69 ATR 670.
[178] De la Feria and Krever, above n 41, 22.
[179] Ken Fehily, 'Residential Premises' in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011) 201, 202.
[180] De la Feria and Krever, above n 41, 24.
[181] Ibid; Ebrill et al, above n 84.
[182] Binh Tran-Nam and Michael Walpole, 'Tax Disputes, Litigation Costs and Access to Tax Justice' (2016) 14(2) *eJournal of Tax Research* 319, 326.
[183] De la Feria and Krever, above n 41, 22.

the economic objective of an indirect tax,[184] and that the exemption should be removed. The way that this would work is that imputed rent would be included within the VAT/GST base. Imputed rent has been defined as the value of the benefit the owner would have received had their house or apartment been rented to another person.[185] This imputed rent would not be imposed at the time that the transactions between parties take place as this would not capture the full value of the benefit to the owner. Instead a valuation of the imputed rent would be made for a particular period, and this value, and therefore the VAT/GST, would be updated as the immovable property appreciates.[186]

As mentioned above, in Australia the supply of new residential premises is a taxable supply and therefore subject to the GST.[187] Peacock points out that the Australian system assumes that the value of new residential premises at the time of purchase is equal to the use and enjoyment (consumption) of the residential premises over its lifetime. But this is problematic where the value of residential premises appreciates over time (as the land usually increases in value). Clearly, the initial GST on new residential premises is insufficient to tax the flow of consumption.[188] She therefore argues in favour of a GST on all sales of residential premises; however, she does admit that this could lead to housing affordability concerns as the price for used houses would be likely to increase as a result of the GST.[189]

Bourassa and Grigsby argue that there are equity reasons against this as the VAT/GST has little relationship with capacity to pay and imposing this tax on homes will thus weigh more heavily on lower income taxpayers and elderly homeowners.[190]

8. CONCLUSION

This article has demonstrated that there are strong arguments on the basis of equity for lower consumption taxes on basic food and beverages, housing and health. Although such lower rates may also benefit the wealthier households, it is clear that low income households suffer when there is tax on food, due to the necessity to consume this item. Healthcare and housing exemptions similarly assist low income earners and it is arguable that, as they are already disadvantaged, increasing consumption tax on essential and merit goods would impact on these households to a disproportionate degree. Imposing a VAT/GST on residential housing, either sale or lease, has not been attempted in any developed nation, for both political reasons and the accepted high compliance costs this would bring.[191]

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[184] Ibid. Christine Peacock, 'Is There a Viable Way to Tax the Consumption of Immovable Property that is More Consistent with the Economic Objective of the VAT?' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336.
[185] Peacock, above n 184, 342.
[186] Ibid.
[187] GST Act, s 40-65(2)(b).
[188] Christine Peacock, 'How Could Sales of Residential Premises Between Otherwise Unregistered Homeowners Be Brought Into the VAT Base?' (2019) 14(1) *Journal of the Australasian Tax Teachers Association* 151, 152.
[189] Ibid 165.
[190] Steven C Bourassa and William G Grigsby, 'Income Tax Concessions for Owner-Occupied Housing' (2000) 11(3) *Housing Policy Debate* 521, 528.
[191] Ebrill et al, above n 84, 98; Peacock, 'How Could Sales of Residential Premises Between Otherwise Unregistered Homeowners Be Brought Into the VAT Base?', above n 188, 152-155.

There are examples from overseas where minimising exemptions has been combined with greater income and other subsidies to low income persons and this has been successful. This has occurred in both Singapore and New Zealand. However, although at the time of the introduction of the GST in Australia the government lifted pensions and other payments by 4 per cent in order to compensate low income earners,[192] it did not apply across the board subsidies, but rather addressed issues of equity through the exemption of fresh foods.

Countering the arguments in favour of equity is the complexity of exemptions which leads to high compliance costs and the possibility of exploitation of loopholes and additional litigation. However, at least in Australia, it appears that these exemptions are now reasonably settled and that a combination of ATO rulings, guidelines, advice and publications from tax specialists means that the boundaries of these exemptions are now well defined. Furthermore, the political difficulty that occurred merely in introducing a GST in Australia, as described earlier in this article, indicates that any changes to the GST that impact negatively on consumers would be extremely difficult to introduce. This is particularly so given the need to seek approval by the States and Territories.

In conclusion, it seems unlikely that the voting public would consider favourably the removal of the exemptions for food, healthcare and residential housing as these items are considered essential to maintaining a reasonable standard of living in Australia. It therefore seems that the current GST exemptions relating to basic food, healthcare and residential premises will remain and this article has pointed out some strong arguments in favour of the status quo.

[192] Peter Martin, 'Cabinet Papers 1998-99: How the GST Became Unstoppable' *The Conversation* (1 January 2020), https://theconversation.com/cabinet-papers-1998-99-how-the-gst-became-unstoppable-128844 (accessed 13 July 2020).

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GST administration – a practitioner's perspective

Kevin O'Rourke*

Abstract

In this article, the author examines the administration of GST from a practitioner's perspective, and discusses audits, refunds, rulings and disputes. The author concludes that Australia has a world-class GST administration: efforts to ensure compliance are succeeding; refunds and private rulings are mostly processed with efficiency; and the resolution of disputes through early engagement is working. However, it is also contended that the administration has become increasingly assertive over the last 20 years, and that the biggest threat to the administration of GST over the next 20 years is overreach.

Key words: GST; GST administration; GST audits; GST rulings; GST refunds; GST objections; GST appeals; GST disputes

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1. OVERVIEW

A GST practitioner may not be the best person to speak about GST administration, at least at the 'whole of system' level. GST practitioners are rarely concerned about the wider system when immersed in the day-to-day realities of practice. Senior practitioners in particular typically get involved in the most difficult of client issues in which disputes with the Commissioner are either on foot or are in reasonable contemplation. From this limited perspective the system for the most part seems difficult and confrontational; a far cry from the halcyon days following the implementation of GST when the Commissioner really was here to help.

Without wanting to diminish the role of GST practitioners, it is a sobering fact that most of what happens in the administration of GST happens without us. Looking at the ATO's *GST Administration Annual Performance Report for 2017-18*,[1] one can see that 10.3 million original Activity Statements were processed for 2.75 million active GST registrants, and AUD 51.7 billion in GST refunds paid to taxpayers. This resulted in a net AUD 63.1 billion of GST cash being received. Of those 10.3 million Business Activity Statements (BASs) lodged, this author prepared only four, and they were for my own firm. So, the GST world really does turn without me, and without GST practitioners more generally.

These are impressive statistics but the ATO is more than a mere processing centre. It was the first administration globally to implement a model for the collection of GST on low value imported goods, and has implemented measures to tax digital imports. The ATO has also implemented measures to combat GST fraud in both the property and precious metals industries. These have all been successful measures; the term 'successful' is used here because, while practitioners can point to teething issues with each and every measure, in practice they have all broadly worked as intended. There is of course much more to the GST administration story than this but these are significant achievements.

It is safe to say that Australia has a world-class GST administration.

Beyond that description, this article has little to say about the 'whole of system' administration of GST. The article will look instead at the limited world of compliance, refunds, rulings and disputes, for this is where 'policy meets reality' for the practitioner.

2. COMPLIANCE

To a GST practitioner, the ATO's compliance activities usually result in a world of pain for both clients and practitioners, though the practitioner is at least remunerated for the pain. Just how much financial pain is extracted from clients is shown in Table 1.

[1] Australian Taxation Office (ATO), *GST Administration Annual Performance Report 2017-18* (18 March 2019), https://www.ato.gov.au/about-ato/commitments-and-reporting/in-detail/gst-administration/gst-administration-annual-performance-report-2017-18/.

Table 1: GST Compliance Liabilities[2]

Year	GST compliance liabilities
2013 - 2014	$3.4b
2014 - 2015	$2.6b
2015 - 2016	$3.3b
2016 - 2017	$2.9b
2017 - 2018	$3.0b

These liabilities are primary GST liabilities arising from non-compliance and do not include any penalties or interest. This information yields at least two conclusions. First, the liabilities increase or decrease significantly year on year, reflecting the large revenue 'outliers' which might arise in any given year. Second, the GST liabilities remain substantial in each year reflecting a level of non-compliance which is unacceptable and which needs to be constantly monitored and addressed.

It is perhaps for this reason that the government recently announced that it would extend the current GST compliance program for a further four years. It will provide AUD 467 million to the ATO over four years from 2019-20, and is expected to deliver an additional AUD 2.3 billion in revenue to the States and Territories over the forward estimates period.[3]

The author's own practice mainly advises large corporate clients. There have been significant changes in this market segment over the last decade that have had an impact on GST compliance.

First, the global financial crisis saw a major focus on cost-cutting which often led to a dramatic reduction in the size of tax teams. The size of the tax team continues to be historically low and this has an obvious impact on the time that can be invested in managing GST compliance. It is usually a struggle just to respond to day-to-day compliance responsibilities, let alone stepping back and reviewing the broader GST function.

Second, and as part of the cost-cutting, many corporates sent a range of 'back of house' functions, such as information technology (IT) and accounting, to offshore centres. This has at times made it difficult for those responsible for tax in Australia to meaningfully review what happens in another country.

Third, and also as part of the cost-cutting, many corporates outsourced these 'back of house' functions as well as offshoring them. This has at times compounded the difficulties.

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[2] Australian Taxation Office, *GST Administration Annual Performance Report 2013-14* (2015); Australian Taxation Office, *GST Administration Annual Performance Report 2014-15* 2016); Australian Taxation Office, *GST Administration Annual Performance Report 2015-16* (2017); Australian Taxation Office, *GST Administration Annual Performance Report 2016-17* (2018); Australian Taxation Office, *GST Administration Annual Performance Report 2017-18*, above n 1 (GST Performance Reports).

[3] Australian Treasury, *Mid-Year Economic and Fiscal Outlook 2018-19* (17 December 2018) 122, https://archive.budget.gov.au/2018-19/myefo/myefo_2018-19.pdf.

Fourth, there is an increase in the automation of repetitive processes. On paper this is a good thing, but it can be a double-edged sword. In the author's experience, the complexity of the implementation process itself has tended to magnify error rather than eliminate it. With vigilance, that should diminish over time, but there is often a false sense of security with automation which weighs against this.

Many larger corporates now have fewer people in tax teams (and related accounting and compliance teams), dealing with offshore and outsourced functions, in an increasingly automated environment. It might have been possible to get away with this if a taxpayer was dealing with a GST compliance audit ten years ago but times have changed.

The GST audit of ten years ago was a happily superficial experience for many corporates. It was mainly characterised by lengthy PowerPoint presentations. These showed the corporate structure, the BAS preparation process, the policies and procedures in place and the overall history of good governance. One or two difficult questions were handled out of session and many good cups of coffee were consumed. Interrogation of systems was rudimentary. The superficial nature of the audit acted to breed complacency among some corporates.

The GST review of today can be a vastly different experience. The ATO is now more willing to take a deep dive into the systems and accounts of a large corporate in conducting a review, and it is anything but superficial. From a 'whole of system' perspective this is a welcome development. For the individual corporate it is a painful process. Beverages stronger than coffee are increasingly consumed. But the time for complacency is over and tax teams need to be better resourced and equipped for today's tax compliance environment.

It should also be noted that the taxpayer experience for GST reviews varies dramatically. The main variable in this seems to be which compliance officer or team is assigned to the matter. While in one sense all GST reviews are unhappy experiences, the better the compliance officer the better the experience. The challenge for the Commissioner is to achieve a consistent experience across all reviews. There is a wide spectrum covering technical ability, commercial knowledge, and the ability to gather relevant evidence efficiently. The better compliance officers tend to sit at the one end of the spectrum on each measure.

Twenty years into the GST, the ATO's compliance program is in good shape. Yet this author is convinced that the Commissioner could achieve greater revenue with the same number of compliance officers, and with less pain for taxpayers, if there was an increase in investment in the training given. At the very least, it would improve the consistency of the taxpayer experience.

3. REFUNDS

There is little that makes the heart beat faster for a GST practitioner than to secure a GST refund for a client. Perhaps a compliance officer has the same feeling on raising an assessment but refunds always excite the imagination of practitioners. Clients like them too, even more than income tax refunds. This is because GST refunds are 'above the line' in an accounting sense and are therefore reflected in the year's profit.

It is therefore unsurprising that since the implementation of GST there have been a number of cases dealing with GST refunds and, as a consequence, numerous law

changes.[4] Of course, GST refunds can arise from either under-claimed input tax credits or overpaid 'output' GST. But there is a significant difference in policy between the two. In broad terms, an under-claimed input tax credit usually involves a loss suffered by the relevant enterprise, while overpaid 'output' GST may either be suffered by the enterprise or have been shifted forward in price and so suffered by the enterprise's customer. In the latter case, the refund rules are often written to prevent the enterprise receiving a 'windfall gain' at the expense of the customer.

Overlaid on these rules are limitation periods which generally prevent a refund being claimed beyond a four-year period, subject to rights of objection and appeal being exercised within the limitation period.

3.1 Refunds of GST output tax

In the early days of GST, the provision every party fought over was section 105-65(2) of Schedule 1 to the *Taxation Administration Act 1953* (Cth).[5] This provision was directed to restricting the payment of refunds of output GST. Where the Commissioner was not satisfied that the relevant conditions in the provision were met, then he 'need not give you the refund'. This was interpreted as 'need not, but may' give the refund, a so-called residual discretion. The law and practice governing this provision and the exercise of the residual discretion was complex.

The boundaries of section 105-65 were judicially tested for the first time in *KAP Motors*.[6] It was a matter conducted on the basis of agreed facts which included that the taxpayer had overpaid GST under the mistaken belief that it had made taxable supplies. KAP Motors neither reimbursed nor undertook to reimburse its customers.[7]

The Commissioner contended that section 105-65(1) should be construed as though the word 'supply' included a purported or putative supply, such that it referred to any transaction that was incorrectly treated as a taxable supply.[8] He attached significance to the proposition that a refund of overpaid GST would ordinarily result in a windfall gain to the supplier. In response to that proposition, Emmett J stated:

> Section 105-65 should not be given an expansive construction. While its object may be commendable, in seeking to avoid windfall gains for taxpayers, it is, in a sense, a paternalistic interference with the rights of taxpayers. It proceeds on the basis that GST that should not have been paid has been paid by a taxpayer. Its operation is to ensure that the Commissioner receives a windfall rather than a taxpayer.[9]

His Honour held that section 105-65 had no application in circumstances where there was no supply. Following that decision, the law was amended to extend the restriction

[4] See generally Kevin O'Rourke, 'GST Refunds' (Paper presented at the Taxation Institute National GST Intensive, Melbourne, September 2011).
[5] *Taxation Administration Act 1953* (Cth), Sch 1, s 105-65(2)(b) (Administration Act).
[6] *KAP Motors Pty Ltd v Commissioner of Taxation* [2008] FCA 159; 68 ATR 927.
[7] Ibid.
[8] Ibid para 29.
[9] Ibid para 33 per Emmett J.

on refunds to situations in which tax was overpaid where there was no underlying supply.[10]

Further issues arose about the application of section 105-65 to supplies made using the margin scheme,[11] and to gambling supplies.[12] In broad terms, section 105-65 only applied if a supply was treated as a taxable supply 'to any extent' and the supply is not a taxable supply 'to that extent'.

And then a jurisdictional issue arose. The Administrative Appeals Tribunal in *Naidoo* held that a decision made by the Commissioner under section 105-65 was not part of the assessment process and as such did not qualify for merits review under Part IVC of the Administration Act.[13]

These issues were finally resolved with the repeal of section 105-65 and the insertion of a new Division 142 into the GST Act with effect from June 2014. Merits reviews were reinstated, the 'residual discretion' discarded in favour of a self-assessing provision, and the concept of 'excess GST' solved problems involving margin calculations.

3.2 Time limitations on refunds

Also complex were the time limitation provisions. In relation to input tax credits, the attribution or timing rules operated in a manner that effectively permitted previously unclaimed input tax credits to be claimed in any subsequent tax period. In other words, indefinitely.[14] This was an intended outcome; an input tax credit was to be treated like cash and an enterprise was still entitled to its money if a tax invoice turned up after ten years.

In relation to output GST, the time limitation periods were unfathomable. In general, there was a four-year time limitation on claiming refunds of output GST. However, there was effectively no time limit on claiming a refund if there was a positive net amount for the tax period in which the overpayment occurred. In a paper delivered in 2006 the author concluded as follows:

> There are sound public policy reasons for limitation periods which go to the finality of disputes or potential disputes, and to certainty of financial position. In the case of the Commonwealth, it is entirely reasonable that the books be ruled off after four years in the certain knowledge that no further refunds will be due. This policy intent, clear in the Explanatory Memorandum, has miscarried in the drafting of section 105-55 of the [Administration Act]. It is also inequitable that some taxpayers are limited to a four year refund period while others enjoy an unlimited refund period based around arbitrary criteria, such as whether they happened to have a positive net amount in the relevant

[10] Administration Act, Sch 1, s105-65(2)(b).
[11] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), Div 75 (GST Act).
[12] Ibid, Div 126; see also *International All Sports v Commissioner of Taxation* [2011] FCA 824; 81 ATR 607.
[13] *Naidoo v Commissioner of Taxation* [2013] AATA 443; 93 ATR 437.
[14] GST Act, s 29-10(4).

> tax period. Section 105-55 should be amended to provide a four year time limit on claiming refunds in all circumstances.[15]

Five years later, in 2011, another paper of the author's dealing with GST refunds at a similar conference opened with the following observation:

> Five years ago at this conference I made a number of comments about GST refunds. Life seemed much simpler then; the Commissioner regularly paid refunds in respect of overpaid GST. That happy situation has changed dramatically. Why?[16]

In relation to the anomaly in the four-year limitation period, the author observed that 'the authorities were painfully slow to act'.

In relation to limitation periods affecting output tax, the Treasurer announced changes only in May 2008. The commencement date was expressed to be 1 July 2008, thereby giving taxpayers several weeks to notify the Commissioner of any refunds which would extend back beyond four years.[17] Many refund claims were made in the weeks before 1 July 2008 with significant revenue implications.

In relation to limitation periods affecting input tax, a new Division 93 was inserted into the GST Act with effect from May 2009, and which now provides an effective four-year limitation on claims for previously unclaimed and unattributed input tax credits.[18] Some may say it is too effective; a fresh battleground has now emerged in the shape of draft ruling MT 2018/D1: time limits for claiming an input tax or fuel tax credit ('the draft ruling'), released for comment late in November 2018.[19]

The Commissioner's preliminary view is that the four-year time limit for claiming an input tax credit represents an absolute time limit even in circumstances where a taxpayer has lodged an objection or appeal against an assessment in relation to that credit within the four-year period. If the Commissioner's view is correct it highlights a deficiency in the interaction of the self-assessment provisions and the refund limitation provisions. The poor interaction between the various pieces of legislation dealing with GST administration is a recurring theme.

Chartered Accountants Australia and New Zealand, a body which this author represents on indirect tax issues, has lodged a detailed submission with the Commissioner stating:

> CAANZ strongly disagrees with the Commissioner's preliminary view, which represents a radical departure from a straightforward policy in place for over 100 years – that limitation periods in federal tax statutes give way to an

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[15] Kevin O'Rourke, 'GST Administration Issues' (Paper presented at the Taxation Institute National GST Intensive, Melbourne, November 2006) 3.4.
[16] O'Rourke, 'GST Refunds', above n 4.
[17] *Tax Laws Amendment (2008 Measures No. 3) Act 2008* (Cth), Sch 2, sub-item 16(2).
[18] GST Act, Div 93.
[19] Australian Taxation Office, 'Time Limits for Claiming an Input Tax or Fuel Tax Credit', Draft Miscellaneous Taxation Ruling MT 2018/D1. While this draft ruling was withdrawn on 4 December 2019, the Commissioner has indicated that a further draft ruling will be issued in 2020: Australian Taxation Office, 'Advice under Development', available on the ATO website.

> objection provided the objection is itself lodged within the relevant limitation period. The inability to have an independent review is inherently unfair.[20]

Despite the Commissioner's view being 'preliminary' while he seeks comment, he has already raised the issue against taxpayers in current litigation.[21]

So, the notion that authorities might be 'painfully slow to act' when revenue is at risk is no longer a feature of the current administration of GST. Some might go so far as to say that the authorities can now be painfully quick to act, and perhaps painfully quick to over-react. This is increasingly so when revenue is merely 'at stake' rather than 'at risk'.

3.3 Administration of GST refunds

Much of the Commissioner's efforts on compliance discussed above relate to the verification of refunds made by taxpayers. The ATO's ability to retain GST refunds for verification was considered by the Federal Court in the *Multiflex* litigation.[22] The Commissioner had retained Multiflex's GST refunds while conducting a review into refunds that were suspected to be part of a fraudulent scheme. The Court decided that the 'reasonable time' referred to in section 35-5 of the GST Act is the period that the Commissioner takes to facilitate the payment of a GST refund and does not include the time taken to conduct an investigation into the accuracy of the claims. The Commissioner was ordered to pay the GST refunds before the audit was finalised. The law was quickly changed by introducing section 8AAZLGA of the Administration Act, which gives the Commissioner power to withhold refunds pending a verification check.

The Inspector-General of Taxation recently conducted a review of the ATO's administration of GST Refunds and concluded as follows:

> Overall, the IGT has found that the ATO's administration of GST refunds operated efficiently with the vast majority of refunds released without being stopped for verification. Moreover, where refunds are stopped, the majority were processed and released within 14 or 28 days.[23]

The Inspector-General noted that, of the 2.4 million BASs lodged claiming GST refunds annually, the ATO's case selection process stopped less than 1 per cent for verification, which represented less than 6 per cent of GST refund amounts claimed.[24] He also noted that the ATO's automated risk assessment tools had been achieving a strike rate of only 26.7 per cent, which the ATO acknowledged to be no better than random selection for at least part of the risk assessment systems.[25]

The author's own experience in assisting clients whose refunds have been withheld has been generally positive. Some matters have been escalated and, in my opinion, dealt with appropriately. As much as the withholding of refunds is an annoyance to

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[20] Ibid.
[21] The Commissioner's view was rejected by Jagot J sitting as a Deputy President of the Administrative Appeals Tribunal in *Linfox v Commissioner of Taxation* [2019] AATA 222; 109 ATR 707 (22 February 2019); note that the author was involved in this matter for the applicant.
[22] See *Multiflex Pty Ltd v Commissioner of Taxation* (2011) 81 ATR 347 (Federal Court) and, on appeal, *Commissioner of Taxation v Multiflex Pty Ltd* (2011) 197 FCR 580 (Full Federal Court).
[23] Inspector-General of Taxation, *GST Refunds* (March 2018) vii, https://cdn.tspace.gov.au/uploads/sites/16/2018/08/IGT-GST-Refunds-Final-Report_Redacted.pdf.
[24] Ibid 3.4.
[25] Ibid 3.57.

practitioners and their clients, this is an area of continuous improvement by the administration, which needs to balance timely refunds against fraudulent claims.

3.4 Interest on GST refunds

The availability of interest on GST refunds is currently contested. Perhaps more accurately, the time from which interest runs is contested. The Federal Court has recently held in *Travelex* that delayed refund interest was available to Travelex 14 days after its running account balance surplus arose (which was shortly after its original BAS was lodged in respect of the tax period to which the refund related).[26] Travelex established its entitlement to GST refunds in earlier proceedings that finished in the High Court.[27]

In simple terms, interest on a disputed GST refund is broadly available back to the original BAS rather than many years later when, on the Commissioner's view, a relevant notification relating to the refund was lodged. The provisions are complex and the matter is on appeal.[28] It highlights again the poor interaction between different pieces of legislation governing GST administration.

Twenty years into the GST, the law and administration relating to refunds remains far too complex. That is especially undesirable given the importance of refunds in an invoice-credit multi-stage GST.

4. RULINGS

Not long after the introduction of GST the author was asked to deliver a paper on the topic: 'The GST Rulings System – Is it Failing?'.[29] To pose the question two years rather than 20 years into the GST may have been a touch premature but the paper concluded then that the system was not failing. A number of suggestions for improvement were also made which were favourably received by the Commissioner.[30] The definition of a public ruling, for example, was drawn so widely that it might have extended to material on an ATO PowerPoint slide used at a conference presentation.

For the first decade of GST administration, the GST rulings regime was embodied in section 105-60 of Schedule 1 to the Administration Act (and its predecessor), which drew heavily from the earlier sales tax rulings system, rather than from the income tax rulings system.[31] This changed with effect from 1 July 2010 when the GST rulings regime was integrated into the general tax ruling regime, with some special rules applicable only to GST rulings. Further changes were made from 1 July 2012 to accommodate the incoming self-assessment regime for indirect taxes which replaced the so-called 'self-actuating' regime.

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[26] *Travelex Ltd v Commissioner of Taxation* [2018] FCA 1051, 108 ATR 278; note that the author has been acting for the applicant in the proceedings.
[27] *Travelex Ltd v Federal Commissioner of Taxation* [2010] HCA 33; 241 CLR 510.
[28] The Commissioner's appeal to the Full Court of the Federal Court was unsuccessful: *Commissioner of Taxation v Travelex Ltd* [2020] FCAFC 10; though the High Court has now granted him special leave to appeal: [2020] HCATrans 089.
[29] Kevin O'Rourke, 'The GST Rulings System – Is It Failing?' (2002) 12(1) *Revenue Law Journal* 79.
[30] The recommendations were adopted by the Law Council of Australia and discussed at the National Tax Liaison Group meeting of 5 December 2002.
[31] Administration Act, Sch 1, s 105-60.

There are now common rules for public and private rulings in Division 357 of Schedule 1 to the Administration Act, while there are special rules for both public and private rulings in Divisions 358 and 359 respectively.[32]

In the case of private rulings, there are formal review rights for taxpayers to challenge an adverse ruling, though these are now for the most part redundant in a self-assessment environment. Paragraph 359-60(3)(a) of Schedule 1 to the Administration Act provides that a taxpayer cannot object against a private ruling if there is an assessment 'for the income year or other accounting period to which the ruling relates'.[33] This has implications for tax periods from 1 July 2012 as there will ordinarily be deemed assessments for each BAS lodged under the self-assessment regime. In such a case a taxpayer can only object against any assessments for the tax periods to which the private ruling relates.

There will still be occasions, however, where an objection against a private ruling can be made on the basis that it does not relate to an assessment. This will include private ruling applications on proposed future transactions and, perhaps curiously, private ruling applications lodged by taxpayers with outstanding BASs.

On the subject of curiosities, mention should be made of subsection 357-60(3) of Schedule 1 to the Administration Act.[34] This is a special rule which applies only to GST private rulings. It is essentially a deeming provision which provides that the GST payable on a supply is 'the amount worked out in accordance with a ruling' (if any) that relates to the GST payable on the supply and binds the Commissioner in relation to the supplier. In other words, the decision in a GST private ruling will override the substantive law. Pity the recipient of the supply who is thus bound, not by the substantive law, but by a ruling obtained by the supplier in which he or she played no part, and of which he or she may have no knowledge.

4.1 Administration of private GST rulings

It is often the case in the early days of a GST implementation that there are numerous requests by taxpayers and their advisors for clarification of how the new law might apply to their circumstances. In Australia's case in the calendar year 2000, the Commissioner issued 89,779 private rulings across all taxes, of which 84,287 were GST private rulings. This was a staggering number and at the time the author wrote as follows:

> While I have seen much criticism of ATO rulings, and of the introduction of GST generally, too little praise has been directed towards the Commissioner and his officers for an outstanding effort in even coping with the magnitude of the transition. Perhaps it is now time to do so.[35]

As might be expected, the number of GST private rulings has dropped dramatically, as Table 2 illustrates.

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[32] Ibid, Divs 357-359.
[33] Ibid, Sch 1, s 359-60(3)(a).
[34] Ibid, Sch 1, s 357(60)(3).
[35] O'Rourke, 'The GST Rulings System – Is It Failing?', above n 29, 88.

Table 2: GST Private Rulings Finalised[36]

Year	Private rulings finalised
2000	84,287
2013 - 2014	1,163
2014 - 2015	927
2015 - 2016	730
2016 - 2017	748
2017 - 2018	840

The figures between 2000 and later years may not be strictly comparable as the Commissioner now also issues 'guidance requests' which, for example, numbered 5,492 in 2017-2018.[37] The Commissioner consistently finalises over 95 per cent of ruling requests within 28 calendar days of receiving all of the necessary information. Even though some practitioners may quibble over the necessity and timeliness of some requests for information, there is little doubt that the private rulings system is working reasonably efficiently.

There are of course benefits in applying for a private ruling which include: certainty of position (including for proposed transactions on assumed facts); mitigating the risk of underpaid tax, penalties and interest; and transparency with the Commissioner. However, there has been a tendency in recent times for the Commissioner to issue a 'negative' private ruling in favour of the revenue if there is even a slight doubt about the interpretation of a statutory provision. This has led advisers to recommend that clients not seek a private ruling unless it is considered essential to do so, such as with a major transaction. The author is not convinced that this is the best outcome for the GST system as a whole. Both the Commissioner and taxpayers would be better off with a higher level of engagement and, for the Commissioner at least, there is much to be gleaned from private ruling requests.

4.2 The changing nature of public GST rulings

In the case of public rulings, the Commissioner issued a number of very lengthy GST rulings on a comprehensive range of matters in the first few years of GST. It is an impressive and substantial body of work which has obviated the need for many taxpayers and their advisors to seek private rulings. Those early public rulings have succeeded in being helpful and informative to taxpayers and advisers. It was inevitable that such rulings could not continue to be published at the same rate, though there is a strong case to be made for maintaining them, as well as integrating them into a coherent body of work.

In more recent times, however, a different trend has emerged. In the last three years, GST public rulings (and draft rulings) have fallen into two categories, both few in number. First, there are those public rulings associated with new measures, essentially updating the 'cross-border' rulings for a modern era:[38]

[36] GST Performance Reports, above n 2.
[37] Australian Taxation Office, *GST Administration Annual Performance Report 2017-18*, above n 1.
[38] There also exist Law Companion Guidelines (LCGs) giving guidance on new legislative measures.

- GSTR 2017/1 – Goods and services tax: making cross-border supplies to Australian consumers;
- GSTR 2018/1 – Goods and services tax: supplies of real property connected with the indirect tax zone (Australia);
- GSTR 2018/2 – Goods and services tax: supplies of goods connected with the indirect tax zone (Australia).

The second and emerging category of public ruling is those which add further weapons to the armoury of the ATO:

- MT 2018/D1 – Time limits for claiming an input tax or fuel tax credit;
- GSTD 2018/D1 – Goods and services tax: determining the creditable purpose of acquisitions in a credit card issuing business.

The first of these draft rulings was discussed earlier, being the Commissioner's preliminary view that the four-year time limit for claiming an input tax credit represents an absolute time limit even in circumstances where a taxpayer has lodged an objection or appeal against an assessment in relation to that credit within the four-year period. The second of these draft rulings has emerged as a response to detailed audits of the credit card issuing businesses of major financial institutions.

Of course, there is nothing inherently wrong in the Commissioner publishing his views on a range of matters, and he should be encouraged to do so. However, there needs to be some balance and taxpayers should not feel as though public rulings are now just a means by which their rights and entitlements are diminished. The Commissioner would be well advised to consult on further suitable topics for GST rulings. Suggestions in the past have often been met with the response that the topic applies only to a narrow class of taxpayer. However, the credit card issuing businesses of major financial institutions is a fairly narrow class and this has not been a barrier to the issue of the draft ruling in this case.

Twenty years in to the GST, the rulings system continues to operate well, though improvements can and should be made.

5. DISPUTES

The provisions governing taxation objections and appeals are well known to practitioners and are contained in Part IVC of the Administration Act.[39] These provisions, or variations of them, have been in place in the federal tax system for over one hundred years.

Tax disputes are inevitable so the real debate is how the administration handles them. There has been a perception for some time that the ATO officers dealing with the objection or appeal were not sufficiently independent of the ATO officers originally dealing with the matter. In May 2015, in response to recommendations from the inquiry by the House of Representatives Standing Committee on Tax and Revenue into tax disputes, the ATO created a new business line, Review and Dispute Resolution (RDR). It is a kind of 'half-way' house of semi-independence and there are arguments both for

[39] Administration Act, Pt IVC.

and against full independence. So, what does the evidence indicate about how the GST disputes system is working? Something of the system can be gleaned by looking at relevant figures for objections, litigation and settlements.

5.1 Objections

A taxation objection against an assessment or other appealable indirect tax decision is the formal document which initiates the dispute resolution process. Of course, that process may be engaged informally at any time but it is the taxation objection which crystallises a claim in a legal sense. The number of GST objections received and finalised over the last few years is set out in Table 3 below.

Table 3: GST Objections[40]

Year	Objections received	Objections finalised
2013 - 2014	1353	1388
2014 - 2015	1214	1381
2015 - 2016	1150	1355
2016 - 2017	859	934
2018 - 2019	842	767

It is clear from Table 3 that the number of objections is falling at a welcome rate. The most likely explanation for this is early engagement by the ATO in resolving the matter under objection.

5.2 Appeals to courts and tribunals

An objection which is not resolved to the satisfaction of the parties may well proceed by way of appeal to either the Administrative Appeals Tribunal or to the Federal Court of Australia. The number of GST appeals received and finalised over the last few years is set out in Table 4 below.

Table 4: GST Appeals[41]

Year	Appeals received	Appeals finalised
2013 - 2014	143	163
2014 - 2015	106	143
2015 - 2016	67	84
2016 - 2017	53	61

[40] GST Performance Reports, above n 2.
[41] Ibid.

There are two matters of note. First, a cursory comparison of the numbers of objections and appeals reveals that most objections are resolved without proceeding to appeal. Second, the number of appeals has fallen dramatically. Again, the most likely explanation for this is engagement by the ATO in resolving the matter.

It can also be gleaned from the ATO's annual GST Administration Performance Reports that a significant proportion of cases (up to 50 per cent) deal with largely non-technical issues where taxable supplies are understated or input tax credits over-claimed. Another large proportion of cases (typically 15 to 20 per cent) deal with property matters. Outside of these categories, the remaining areas of dispute are relatively small. Another feature of the appeals is that most of the cases are from the micro and small to medium enterprises business market segments, rather than from the large business or government segments.

5.3 Settlements

The ATO may choose to settle a dispute where it considers settlement to be consistent with the good management of the tax system. In doing this, the ATO has to balance its responsibility to collect taxes with relevant factors such as the relative strength of the positions of both parties, the cost versus the benefits of continuing the dispute and the impact on future compliance for the particular taxpayer and the broader community. The number of GST cases settled over the last few years is set out in Table 5 below.

Table 5: GST Settlements[42]

Year	Cases settled	Original $ liability	Settled $ liability
2013 - 2014	32	N/A	N/A
2014 - 2015	77		
2015 - 2016	49	$179m	$155m
2016 - 2017	75	$193m	$152m

Although it is difficult to fully reconcile the figures, there are again two matters of note. First, it is unsurprising that, as the number of objections and appeals are falling, the number of cases which settle are increasing. Second, a comparison of the original liability with the settled liability suggests that the Commissioner is not 'giving away the furniture' in settling matters.

5.4 Two classes of GST dispute

There may now be two classes of GST dispute.

The first class of dispute arises when the ATO takes the view that the matter is suitable for resolution. The impressive figures set out above clearly involve matters within this class. Some have suggested that this is simply the 'low hanging fruit' or the easy cases

[42] Ibid.

involving no real technical issues. That would be churlish. The figures should simply be welcomed and the Commissioner congratulated.

The second class of dispute arises when the ATO takes the view that the matter is not suitable for resolution. For these disputes there is a perception among practitioners that the ATO has become unnecessarily confrontational in recent times and that it marks a low point in relations with the ATO. Of course, litigation and disputes more generally are by their nature adversarial. However, practitioners who have litigated over many years see a real change and a return to the 'win at all costs' mentality, with the Commissioner taking every point, many of which are procedural, rather than focus on the issue in dispute. That is unfortunate as many genuine disputes in this class remain capable of resolution without the need to be in a courtroom.

If it were possible for the author to offer some advice to the ATO it would be to take a much broader view of which matters might be suitable for a form of alternative dispute resolution. Absent fraud or evasion, it is the author's experience that almost every matter would benefit from intervention. One of the benefits of taking a broader view is that, even if a matter does not settle, it is often possible to narrow the points in dispute, whether technical points, procedural points or evidentiary matters. That benefits all parties. Further, the mere presence of an experienced facilitator with a mindset of resolving a dispute often tends, of itself, to bring about that result. All of this would go a long way to allaying the current concerns of practitioners.

6. CONCLUSION

Australia has a world-class GST administration both for the 'nuts and bolts' of processing BASs and for the 'bells and whistles' of world-first legislation. The efforts to ensure compliance are succeeding; refunds and private rulings are for the most part processed with efficiency; and the resolution of disputes through early engagement is working. Over the last 20 years, the ATO has become more confident and assertive.

However, the administration is increasingly muscular, and the biggest threat to the administration over the next 20 years is overreach. The recent tendency towards unfairly restricting refund claims; issuing 'negative' private rulings; issuing public rulings mainly for compliance; and a return to the 'win at all costs' mentality in litigation, all work against fostering a willing participation in the tax system.

Underpinning all of this is a legislative framework for GST administration which now resembles a patchwork quilt loosely knitted together by administrative fiat and litigation. That may well be a function of the way the provisions developed: limitations on claiming credits in 2008; a new rulings regime in 2010; a new self-assessment regime in 2012; and a new refunds regime in 2014. These provisions are overlaid on existing complex provisions in the GST Act and the Administration Act. It is an unsatisfactory state of affairs and when the provisions do not work well together the Commissioner now routinely resolves any difference against the taxpayer. These provisions are begging to be reformed into a coherent framework for GST.

Viewed from the perspective of a GST practitioner, these are the challenges in GST administration for the Commissioner and practitioners alike to resolve moving into the third decade of the GST.

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GST administration – commentary

Dr Peter Hill*

Abstract

This article provides comments on two articles presented on the 20th anniversary of GST administration in Australia. In relation to the administration of GST rulings over that period, the author disagrees with some of the assessments made of the ATO's performance, and seeks to highlight ongoing issues with (a) the ongoing use of 'foundation' GST public rulings; (b) the lack of any stated period for any GST private ruling and the consequent issues of ongoing reliance by taxpayers; and the problems associated with a particular provision discussed in one of the articles – subsection 357-60(3). The author explores the ATO's performance in reducing the large GST gap mentioned in one of the articles and agrees that the process of GST refunds is still overly complex.

Key words: Goods and services tax, GST gap, GST refunds, GST public rulings, GST private rulings

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1. INTRODUCTION

I was honoured to be asked to participate in this event and the session on goods and services (GST) administration as a Panel Speaker. Not only do I vividly recall the administrative arrangements for the commencement of the GST system in Australia and spoke about them at the time and afterwards, I also spoke on the topic at the event organised by Atax to mark the 10th anniversary of GST.

In my view, it was in some part a reflection of the maturing state of Australia's GST system that Karl-Heinz Haydl, Chair of the *Business at OECD*'s VAT/GST Committee and Co-chair of the OECD's VAT/GST Technical Advisory Group, presented one of the session's papers, looking at the role of business in VAT implementation and administration. Other OECD representatives delivered papers in other sessions. This simply did not happen ten years ago.

Whilst there is no doubt the OECD is now closely interested in the frameworks being established by Australia and other countries to tackle GST in the global context, particularly in the on-line market space, I will confine my comments to the matters covered by the other two speakers in the session on GST administration – Tim Dyce, (then) Deputy Commissioner of Indirect Tax, Australian Taxation Office (ATO), and Kevin O'Rourke, Director of O'Rourke Consulting.[1]

My first comment though is on the title of the conference – *Where policy meets reality*. This brought a small smile to my face, because as far as the ATO's administration of GST has been concerned, policy first met reality *before* the commencement of the GST system on 1 July 2000, and has been doing so ever since.

If tax administration can ever be described as exciting, then the period between the eventual passage of the package of GST legislation on 28 June 1999 and its commencement was an exciting time. In short order, in the lead-up to the commencement of GST in Australia, the ATO's initial policy of manually processing every GST registration application was dispensed with. It had quickly become obvious to the ATO that the reality was that it had neither the time nor the resources to persist with manually checking every application, and instead the policy became one of deeming any applicant to be registered unless and until a post-1 July 2000 examination of the applicant determined otherwise, retrospectively. This is just one example of the early stages of GST administration where pragmatism often displaced policy. In this instance, it was necessitated by the ATO's gross underestimation of the number of original GST applications it would receive.

2. GST RULINGS AND GUIDANCE

2.1 GST private rulings

In his paper and presentation, Kevin referred to the 'staggering' number of GST private rulings made by the ATO in that hectic time, specifically 84,287 in calendar year 2000. This compares with the more recent numbers of less than 1,000 GST private rulings each year.

[1] See Kevin O'Rourke, 'GST administration – a practitioner's perspective', this issue.

The reality was, however, somewhat different as I recall. Rather than create a category of binding private rulings for GST alongside or within the existing income tax binding rulings system, the drafters of our original GST legislation decided to adopt section 77 of the *Sales Tax Assessment Act*[2] – a sales tax recovery provision – as the model for GST rulings. This was despite the then Treasurer, Peter Costello, lauding the GST legislative package as sweeping away sales tax as 'an outdated, inefficient tax system that does not serve the needs of the modern nation'.[3]

This meant that *any* written advice to a taxpayer concerning GST was administratively treated as a private ruling, regardless of whether or not the advice met the technical requirements then applying to income tax private rulings. In most cases, they did not. Thus, an ATO response to simplistic, if not merely procedural, questions such as '*I am selling my house. Do I need to charge GST?*' were classified as private rulings. Thus, I feel it is dangerous to now draw any conclusions as to the performance of the ATO's early administration of GST by pointing to that 'staggering' number.

A final comment about GST private rulings: the ongoing administration of the private rulings register. To put it bluntly, the on-line depository of all GST private rulings is a mess. The ATO seems to have either forgotten or no longer cares about the reason for giving the public access to edited versions of these rulings – transparency – courtesy of the Sherman Report following the Petroulias scandal.[4] No longer a unique database, the depository is now embedded in the ATO's Legal Database and categorised as 'Edited Private Advice'. Browsing it is impossible as:

(a) access is via folders created for each date any edited rulings are uploaded, not by tax or topic;

(b) headings adopted for each GST private ruling are haphazard and cursory, eg, 'GST', 'GST and sushi'; and

(c) the actual content of many GST private rulings has been eviscerated to such an extent as to render the outcome either meaningless or without context.

Now, almost 20 years after the introduction of GST and the contemporaneous Sherman Report, the private rulings register is an oddity, and I suspect no rioting will occur were it to be removed and discontinued. It is a pointless exercise of administrative time and effort.

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[2] *Sales Tax Assessment Act 1992* (Cth) s 77. This provision stated in part:

> (1) This section applies to a taxpayer if:
> (a) the Commissioner alters a previous ruling that applied to the taxpayer; and
> (b) in reliance on the previous ruling, the taxpayer has underpaid tax on a dealing that happened before the alteration.
> (2) The Commissioner must remit the underpaid tax unless the Commissioner is satisfied that the taxpayer contributed to the giving, or continuing in force, of the earlier ruling by a mis-statement or suppression of a material fact.

[3] Commonwealth Parliamentary Debates, House of Representatives, Wednesday 2 December 1998, 1087.

[4] Tom Sherman, 'Report of an internal review of the systems and procedures relating to Private Binding Rulings and Advance Opinions in the Australian Taxation Office' (2000).

2.2 Subsection 357-60(3)[5]

Described by Kevin as a 'curiosity', subsection 357-60(3) stipulates that if there is a ruling binding the Commissioner in relation to a supplier and the amount of GST payable on a supply, the amount of GST payable (and thus the corresponding input tax credit) is the amount stated in the ruling.

To my mind, subsection 357-60(3) remains a perverse antithesis of the long-dead proposal to allow third-party reliance on GST private rulings – a proposal which today is just as valid as it was when it was first mooted, considered, hijacked, and rejected.

At the time it was introduced, I was vociferous in my calls for subsection 357-60(3) to be repealed,[6] not least because the provision represents an unnecessary and confusing obstacle to certainty and purports to do away with legal rights held by recipients to challenge the amount of 'GST payable' at the heart of input tax credit entitlements. It was and remains my view that subsection 357-60(3) can be repealed without any loss of functionality of the remainder of the GST administrative provisions.

For its part, the Tax Institute chimed in with a formal submission to the then Assistant Treasurer in March 2011 pointing out the ATO had confirmed that subsection 357-60(3) effectively denies recipients any right to object and, accordingly, labelled the provision as unconstitutional.[7]

Subsection 357-60(3) remains law. Does the ATO apply it? I have been told by one senior GST practitioner that he has seen it applied once, 'benevolently'. That is, a particular GST private ruling had the effect of a lower amount of GST payable than was required by law, and the ATO applied the ruling to the recipient's benefit.

My concern is that the true effect of subsection 357-60(3) will one day be revealed by a solitary decision of the ATO to apply it malevolently, similar to *Patcorp Investments* when a company suddenly found its right to a dividend rebate under section 46 of the *Income Tax Assessment Act 1936* did not actually exist as it was not the legal owner of the relevant shares and despite the practice, if not policy, of the ATO until then of ignoring nominee company ownership for the purposes of the rebate.[8]

2.3 GST public rulings

Kevin discussed the ongoing benefits of the 'foundation' GST public rulings. I disagree with the current utility of many of these early rulings. Whilst a number of them have been amended over time to take account of relevant court decisions (or to dismiss irrelevant court decisions), many of them were broad brush strokes when they were made, and they continue to be representations of interpretative views of the ATO that are subjectively narrow in focus and which have never been tested.

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[5] *Taxation Administration Act 1953* (Cth), Schedule 1, s 357-60(3).
[6] See, for example, Peter Hill, 'Editorial: Repeal the Rogue Rule' (2010) 10(10) *Australian GST Journal* 93; and Peter Hill, 'The New GST Rulings System – Emerging Issues' (Paper presented at the UNSW Atax 23rd Annual GST Conference – *GST in a Brave New World*, Noosa, 2011).
[7] Letter to the Assistant Treasurer from Robert Jeremenko, Senior Tax Counsel, Tax Institute, 25 March 2011. See also the Minutes of the Meeting of the National Tax Liaison Group's GST Subcommittee on 30 November 2010, 46.
[8] *Federal Commissioner of Taxation v Patcorp Investments Ltd* [1976] HCA 67; 140 CLR 247.

Fairly recently I experienced an example of this issue in a matter involving many millions of dollars in GST. There was only one 'authority' on the GST consequences – one of these foundation rulings – and perhaps unsurprisingly, one party relied on one part of the ruling to argue that GST was payable and another party relied on another part *of the same ruling* to argue that GST was not payable.

As a consequence, when Kevin states in his article that '[t]hose early public rulings have succeeded in being helpful and informative to taxpayers and advisors',[9] I would agree only in relation to their immediate effect on issue, and only to a limited extent. Kevin also feels 'there is a strong case for maintaining them, as well as integrating them into a coherent body of work'.[10] This I have to disagree with.

In my view, all the 'foundation' GST public rulings should be withdrawn *en masse*, reviewed and then, if necessary, re-issued. The longer these original rulings remain 'live', the less their utility. I have two main reasons for suggesting this. The first has to do with developments occurring since such a ruling was originally issued. In any such event, the policy is to graft the development into the framework of the existing ruling. Over time, the exceptions and differences overwhelm the principles, rather than prompting an overall re-think.

The second reason is more obvious, and can be demonstrated by GSTR 2006/9.[11] This public ruling covers a fundamental issue of GST – the meaning of 'supply' for the purposes of GST. If there is no supply, there cannot be a taxable supply and therefore no liability or input tax credit.

GSTR 2006/9 enunciated 16 'propositions' about the concepts of 'supply' (verb) and 'a supply' (noun). For example, Proposition 5 is that 'an entity will make a supply if it provides something to another entity'.[12] As a slight corollary to Proposition 5, Proposition 6 is that 'a supply usually, but not necessarily, requires something to be passed from one entity to another'.[13]

Albeit six years in the making, GSTR 2006/9 purports to explain 'the Commissioner's view of the law as it applied from 1 July 2000'.[14] This is an example of ATO policy struggling to match reality. Notwithstanding that statement, GSTR 2006/9 has been amended on *eight* separate occasions. I have to question the utility of the current consolidated version.

For example, I challenge any tax professional to make sense of the notes in paragraph 8 of GSTR 2006/9 as to its *current* date of effect. This is but a small sample of those notes:

> The Addendum to this Ruling that issued on 6 December 2006 explains the Commissioner's view of the law as it applied from 1 July 2000. You can rely on that Addendum from its date of issue (6 December 2006) for the purposes of former section 105-60 or section 357-60 of Schedule 1 to the Taxation Administration Act 1953 (as applicable). The Addendum to this Ruling that

[9] O'Rourke, above n 1.
[10] Ibid.
[11] Australian Taxation Office, 'Goods and Services Tax: Supplies', Goods and Services Tax Ruling GSTR 2006/9.
[12] Ibid, proposition 5.
[13] Ibid, proposition 6.
[14] Ibid.

> issued on 1 July 2009 explains the Commissioner's view of the law as it applied before and after its date of issue. You can rely on that Addendum from its date of issue (1 July 2009) for the purposes of former section 105-60 or section 357-60 of Schedule 1 to the Taxation Administration Act 1953 (as applicable).[15]

Hopefully, you get the picture.

Since GST rulings were *finally* migrated to the existing binding rulings system with effect from 1 July 2010,[16] the ATO has issued a mere 18 GST public rulings. Half of that total were issued before 2013. Subsequently, the ATO has issued no more than two GST public rulings in the GSTR series each year. As for GST Determinations – also categorised as binding public rulings – the ATO has not issued any GSTDs for over two years, and no more than two per year since 2013.[17]

The only positive thing I can say about GST public rulings is that they no longer purport to retrospectively explain the Commissioner's view of the law as it applied on the commencement of GST on 1 July 2000. It would be simply ridiculous if they did.

2.4 No sunset clause, ongoing use/reliance

An income tax private ruling will, as a matter of policy, specify the income tax years to which the ruling relates. This is to overcome the effect of subsection 359-25(4), which would otherwise deem the ruling to stop having any effect at the end of one tax year.[18] Excluded from the operation of this provision are GST and other indirect tax private rulings. The result is that, as a matter of administrative policy, the ATO does not generally specify any period of time of applicability of any GST private ruling it issues. This means that a GST private ruling issued in, say, 2011, is still *prima facie* valid in 2019 if it has not previously been withdrawn.

That fact alone is not an issue, but the ATO does not actively track and monitor any GST private ruling. Perhaps it should, or begin specifying time periods in such rulings, to at least prompt a timely review of the ruling given. In my experience, recipients of favourable GST private rulings can and do rely on them for many years, even private rulings made before they were binding on the Commissioner, and I have had more than one argument over whether or not a ruling recipient can legitimately continue to rely on their old and dusty GST ruling.

In short, I consider there to be grounds for the ATO to implement either a policy of every GST private having a sunset clause (negotiated or not) or at least a default system of unilateral withdrawal after a specified period – something that would force a recipient to actively re-engage with the ATO on their GST position to maintain their favourable treatment and thus, consequently, force a fresh examination of the view of the law adopted by the ATO in its original ruling.

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[15] Ibid, para 8.
[16] By virtue of Schedule 2 of *Tax Laws Amendment (2010 GST Administration Measures No. 2) Act 2010*.
[17] As of 24 July 2019, the most recent GST Determination is GSTD 2017/1 – 'Goods and Services Tax: When is the Supply of a Credit Card Facility GST-free under paragraph (a) of Item 4 in subsection 38-190(1) of the A New Tax System (Goods and Services Tax) Act 1999 (Cth) (GST Act)?'.
[18] *Taxation Administration Act 1953* (Cth), Schedule 1, s 357-25(4).

3. GST GAP

Tim pointed out in his presentation that since the introduction of the tax, approximately AUD 785 billion had been collected for GST, via approximately AUD 7.9 trillion in GST throughput, and he mentioned the ATO's activities to reduce the net GST gap.

For 2016/17 – the most recent year examined at the time of Tim's presentation – the ATO originally estimated that gap to be AUD 5.3 billion, representing a difference of 7.9 per cent between the GST that the ATO believed should have been paid and the amount that was paid.[19] Notwithstanding the ATO only attached a reliability rating of 'medium' to this estimate – in other words, there was a medium chance the actual GST gap was more or less than $5.3 billion – it is a staggering amount and was nearly 300 per cent more than the then most recent ATO estimate of the income tax gap in the large corporate sector, being AUD 1.8 billion for the 2015/16 income year.[20]

Apart from the streamlining of compliance and more education activities, Tim was a bit light on what the ATO is doing to combat the GST tax gap, but it appears that whatever it is doing, it is not working. I can say this because the gap in dollar terms has increased from $4 billion since 2012/13 to just under $5 billion in 2017/18, and in percentage terms has never moved out of the range of 7.1 per cent to 8.2 per cent over the period since 2012/13.[21]

Is it a question of ATO resources allocated to administering compliance with GST law, or something else?

4. ADMINISTRATION OF REFUNDS

Kevin's article solidly recounts the history of the administration of GST refunds, and I concur with his assessment that '20 years into the GST, the law and administration relating to refunds remains far too complex'.[22]

One thing that struck me, however, was the substantial changes that have been made in the ATO's administration of the verification of GST refunds before they are released.

In that regard, Kevin noted the outcome of a 2018 review by the Inspector-General of Taxation – that 'of the 2.4 million BASs lodged claiming GST refunds annually, the ATO's case selection process stopped less than 1 per cent for verification, which represented less than 6 per cent of GST refund amounts claimed'.[23]

It has always been my view that it is not the number of refund claims held back that is relevant, it is the total dollar amount of those claims. That 6 per cent equates to approximately AUD 3 billion of a total of AUD 56.7 billion. This is a significant

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[19] Australian Taxation Office, 'Goods and Services Tax Gap' (26 October 2018), https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Goods-and-services-tax-gap/.

[20] Australian Taxation Office, 'Large Corporate Groups Income Tax Gap' (13 December 2018), https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Large-corporate-groups-income-tax-gap/.

[21] See Australian Taxation Office, 'Tax Gap – Methodology', https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Goods-and-services-tax-gap/?page=6.

[22] O'Rourke, above n 1.

[23] Ibid, citing Inspector-General of Taxation, *GST Refunds* (March 2018) vii, https://cdn.tspace.gov.au/uploads/sites/16/2018/08/IGT-GST-Refunds-Final-Report_Redacted.pdf.

difference from the outcome of a similar review of the Inspector-General concluded in early 2005:

> The Tax Office has information which shows that, during 2003-04, 4.3 per cent of all BAS refunds were stopped for manual checking. These stopped refunds amounted to approximately $20 billion in dollar value and represent about *90 per cent of the total value of BAS refunds claimed*….. In all, some $275 million (approximately) has been recovered from pre-issue reviews of $20 billion of GST refunds. The additional tax recovered as a result of the practice of stopping and checking refunds was 1 per cent of all stopped refunds.[24]

Clearly, improvements have been made to the ATO's automated programs for the selection of GST refunds to be held back for manual verification.

5. THE FUTURE

Will there be a 25th Anniversary of GST event? Or even a 30th? This is hard to say. Akin to fringe benefits tax (FBT), GST is at risk of becoming a forgotten tax as advances in automation continue to be made. If anything, however, the annual billion dollar-plus GST gap – assuming the ATO has its calculations reasonably correct – is something that needs serious attention.

[24] Inspector-General of Taxation, *Review of Tax Office Administration of GST Refunds Resulting From The Lodgment of Credit BASs – A Report to the Minister for Revenue and Assistant Treasurer* (2005) paras 2.7 and 2.13 (emphasis added).

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Financial supplies after 20 years

Amrit MacIntyre*

Abstract

This article will review the workings of GST in Australia in relation to financial supplies over the past 20 years, focusing in particular on the issues that have arisen before the courts. In this context the article first considers the workings of the rules denying input credits to makers of financial supplies, where it is noted that the legislative provisions have been interpreted expansively so as to determine creditability based on direct or indirect attribution to taxable or input taxed supplies. The article then considers the rules for apportioning inputs between creditable and non-creditable purposes and notes a debate as to the extent to which particular expenses need to be directly related to taxable or input taxed activities in order to be included in a general apportionment formula. The article also considers the proper approach to how supplies should be characterised for GST purposes and the extent to which this relies on a view that the GST is 'a practical business tax'. The article concludes with observations on some of the challenges posed by technological change, and in particular advances in artificial intelligence, to the workings of GST in the financial sector and the current understanding of the concepts in the definition of financial supplies.

Key words: Goods and services tax, financial supply, input taxed supply, attribution to taxable supply, apportionment of input tax; interpretation of GST law, technological change, artificial intelligence

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1. INTRODUCTION

The introduction of goods and services tax (GST) in 2000 represented a major turning point in the development of Australia's tax system. Coming into operation as part of a package of reforms, which saw the abolition of wholesale sales tax, the reform package included a timeframe for the abolition of a range of other taxes. The intergovernmental agreement that set out the timetable for the abolition of those taxes, having been revised several times, is now embodied in the *Intergovernmental Agreement on Federal Financial Relations* between the Commonwealth and the States and Territories of Australia dated July 2011.[1]

The scheme of GST provides for the 'input taxation' of financial supplies (referred to as 'exemption' in most other jurisdictions with a value added tax (VAT) or GST). The input taxation of the finance sector follows the general model for value added taxation applying in other parts of the world, such as the European Union, Singapore and New Zealand.[2] This article will review the workings of GST in Australia in relation to financial supplies over the past 20 years, focusing in particular on the issues that have arisen before the courts. The matters deliberated on by the courts include the workings of the rules denying input credits to makers of financial supplies (discussed in section 3 below), the rules for apportioning inputs between creditable and non-creditable purposes (section 4) and the proper approach to how supplies should be characterised for GST purposes (section 5).

The last of these matters involves basic questions of how the legislation and the transactions it applies to should be construed, with a clear preference on the part of the courts towards a legal technical approach rather than one which looks more to economic substance. The difference in the two approaches to interpretation continues to remain relevant, with different tax outcomes capable of being produced depending on which approach prevails. The article will conclude with observations on some of the challenges posed by technological change to the workings of GST in the financial sector (section 6).

However, the legislative context in which these matters have arisen first requires brief consideration, and in particular some of the unique aspects of the Australian GST system that unsurprisingly have given rise to some of the questions that the courts have had to consider.

2. OVERVIEW OF GST ON FINANCIAL SUPPLIES

The foundational concept underlying GST is that of taxing the 'value added' by a business, that is, taxing the value added along a supply chain until the good, service or other thing moving down the supply chain reaches the end consumer. The effect is that the end consumer bears the full cost of the GST when they pay for the thing they acquire.

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[1] Council on Federal Financial Relations, *Intergovernmental Agreement on Federal Financial Relations* (2011) Schedule B, http://www.federalfinancialrelations.gov.au/content/inter_agreement_and_schedules/current/Schedule_B.pdf.

[2] European Union, Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax [2006] OJ L 347, art 135 (VAT Directive); *Goods and Services Tax Act*, 2015 Ed (Singapore) ss 19, 20; *Goods and Services Tax Act 1985* (NZ) s 20(3A).

How GST works to achieve this outcome was described in the following terms by Hill J in *HP Mercantile Pty Limited v Commissioner of Taxation*:

> The genius of a system of value added taxation, of which the GST is an example, is that while tax is generally payable at each stage of commercial dealings (supplies) with goods, services or other 'things', there is allowed to an entity which acquires those goods, services or other things as a result of a taxable supply made to it, a credit for the tax borne by that entity by reference to the output tax payable as a result of the taxable supply. That credit, known as an input tax credit, will be available, generally speaking, so long as the acquirer and the supply to it (assuming it was a 'taxable supply') satisfied certain conditions, the most important of which, for present purposes, is that the acquirer make the acquisition in the course of carrying on an enterprise and thus, not as a consumer. The system of input tax credits thus ensures that while GST is a multi-stage tax, there will ordinarily be no cascading of tax. It ensures also that the tax will be payable, by each supplier in a chain, only upon the value added by that supplier.[3]

By way of exception to the scheme described above, certain kinds of supplies including financial supplies are 'input taxed'. This means that the maker of financial supplies is effectively treated as the end consumer in that it is not taxed on the financial supplies it makes but unlike other businesses, must bear the costs of the GST charged to it by its own suppliers. This is achieved by the statutory rule that prevents claims of input tax credits where a thing acquired 'relates to making supplies that would be input taxed', relevantly including financial supplies.[4] The rationale for this treatment of makers of financial supplies was set out as follows by Hill J in *HP Mercantile*:

> In terms of GST theory, it is generally accepted that there are certain kinds of activities where the basic system of output tax on supplies and input tax credits on acquisitions will not lead to taxation on the value added by each supplier in the chain. The most important example is said to be financial transactions of financial institutions such as, but not confined to, banks, because they constantly borrow and lend and turn over money in a way that amounts, such as interest charged, will not represent the real value added by the financial institutions. Indeed, as the explanatory memorandum distributed with the bill which, as amended, later became the GST Act says in Chapter 1 [5.140]: '...there is no readily agreed identifiable value for supplies consumed by customers of financial services'. In such a case, it is the margin or imputed margin that is the real economic subject of the supply. There are other examples where this may be the case, one of which is the leasing of, or other dealings with, residential property (not being new residential property).
>
> By way of what may be seen as a compromise for the difficulties of applying the normal system of value added taxation to financial supplies and other difficult cases, value added taxation design has created a form of supply which is referred to in Australia as an input taxed supply but which, in international value added tax parlance, is referred to as an 'exempt supply'. An input taxed or exempt supply (and financial supplies made by financial institutions will

[3] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126; 60 ATR 106, para 13.
[4] *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 11-15 (GST Act).

> be the main example) will not, generally speaking, attract output tax, but the entity which makes financial supplies will, likewise, not obtain an input tax credit for the tax payable on acquisitions it makes in the course of its enterprise of making input taxed supplies.[5]

Similarly, in *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* Lindgren J observed:

> Financial supplies have been treated as input taxed because it has been found to be administratively difficult to subject them to a valued added tax, such as GST, because of the difficulty in identifying and measuring any value added.[6]

De la Feria and Walpole elaborate on the difficulties in identifying the 'value add' component of financial supplies in the following terms:

> where financial supplies are concerned there is a difficulty in 'identifying that charge separately from the other elements that are included when determining levels of payments of interest or fees'. Disentangling the several components of typical financial transactions is generally seen as administratively complex and costly; however, complexity levels are often even higher, as financial transactions are frequently more sophisticated, incorporating several types of financial flows. As a result, most jurisdictions simply exempt financial supplies from VAT, not as a matter of principle, but rather as a necessity.[7]

Section 40-5 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act) provides for input taxation of financial supplies.[8] What supplies are input taxed as financial supplies are set out in detail in Division 40 of the GST Regulations.[9] They include a range of transactions such as relevant loans, mortgages, credit arrangements and dealings in currency.

While the broad workings of input taxation adopted by the Australian GST as set out in the GST Act and GST Regulations system are similar to those of the typical model of value added taxes as applied to financial supplies, some aspects of the Australian GST system, from its inception, differed from comparable systems found in other countries.

First, the ability to claim input tax credits does not depend on attribution of specific acquisitions to taxable supplies (or GST-free supplies) as is the case with the more usual model. Under the European model, for example, deductions are allowed where the acquired 'goods and services are used for the purposes of the taxed transactions of a taxable person'.[10] A similar approach is adopted by Singapore and New Zealand.[11] What follows under the model commonly found overseas is that deductions are allowed for

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[5] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126, paras 16-17.
[6] *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* [2008] FCA 1834; 71 ATR 1.
[7] Rita de la Feria and Michael Walpole, 'Options for Taxing Financial Supplies in Value Added Tax: EU VAT and Australian GST Models Compared' (2009) 58(4) *International and Comparative Law Quarterly* 897, 897-898, citing D Williams, 'Value Added Tax' in Victor Thuronyi (ed), *Tax Law Design and Drafting: Vol 1* (International Monetary Fund, 1996) 41 (other footnote omitted).
[8] GST Act, s 40-5.
[9] *A New Tax System (Goods and Services Tax) Regulations 1999* (Cth) Div 40 (GST Regulations).
[10] VAT Directive, art 135.
[11] *Goods and Services Tax Act*, 2015 Ed (Singapore) ss 19-20; *Goods and Services Tax Act 1985* (NZ) s 20(3A).

inputs used for supplies that are taxable, with the consequence that no deductions are allowed for inputs relating to other supplies, such as financial supplies.

The Australian system takes the opposite approach where denial of input tax credits is mandated for acquisitions that relate to input taxed supplies with the result that acquisitions relating to taxable (or GST-free) supplies are potentially creditable.[12] This difference in approach has resulted in the courts specifically having to consider the question of what relationship is required between acquisitions and input taxed supplies to produce the result of a denial of input tax credits as opposed to the question as framed in most other jurisdictions, of what relationship is required between acquisitions and taxable supplies to allow deductions.

Secondly, the Australian system does not contemplate a total denial of input tax credits for makers of financial supplies. A unique system of 'reduced input tax credits' was instituted to allow makers of financial supplies to claim credits to the permitted extent for the acquisitions of certain defined categories of things relating to making financial supplies. Perhaps this was an innovation that owes its existence to the time when GST came into effect when businesses were beginning to 'outsource' a range of 'back office' functions to third party contractors.[13] Had these functions been carried out in-house, the salary costs of providing these functions would not attract a GST cost but when outsourced, the delivery to the financial supply provider of these services would have given rise to an unrecoverable GST cost through the denial of input tax credits for the GST amount charged by the outsourced supplier. Hill J described the reduced input tax credits design feature of the GST as

> a unique Australian invention that certain kinds of activities, being, generally speaking, those which might be outsourced by entities making financial supplies and are in aid of making such supplies will, albeit that those activities might be defined as financial supplies, attract a reduced input tax credit of 75 per cent of the credit otherwise available. An example relevant to the present facts is debt collection activities: see reg 70-5.02 (Item 17) of the A New Tax System (Goods and Services Tax) Regulations 1999 (Cth).[14]

A third point of differentiation from overseas systems of value added tax, especially that of the European Union, is found in the approach of the courts to the interpretation of legislation. The general European approach, as set out in Case C-41/04, *Levob Verzekeringen BV, OV Bank NV v Staatssecretaris van Financiën*,[15] requires consideration of what a supply is 'from an economic point of view' and in accordance with 'the economic purpose of a transaction'. In this case, a supply of software and its customisation were to be treated as single supply and not two, in that they formed 'part of a single economic transaction'. Put another way, what is required is determination of the 'substance and reality' of a transaction for the purposes of VAT characterisation.[16]

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[12] GST Act, s 11-15(2).
[13] See, eg, Australian Taxation Office, 'Goods and Services Tax: Reduced Credit Acquisitions', GST Ruling GSTR 2004/1, paras 89ff.
[14] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126, para 17.
[15] Case C 41/04, *Levob Verzekeringen BV, OV Bank NV v Staatssecretaris van Financiën*, Opinion of Advocate General Kokott, ECLI:EU:C:2005:292 (12 May 2005).
[16] *Durham River Trips Limited* MAN/99/876, [2001] BVC 4169; discussed in HMRC Internal Manual, *VAT Supply and Consideration; Supply: Single and Multiple Supplies: Multiple Supply Indicators: The Terms*

However, this broad principle has some qualifications, notably that in the case of VAT exemptions, a strict interpretation is favoured as regards identifying the services that may be exempt.[17]

The trend of the Australian cases, by contrast, places greater emphasis on the legal effect of the statute and the transactions it taxes. While the overriding principle remains that 'the Court will prefer an interpretation of a statute which would give effect to the legislative purpose, as opposed to one that would not',[18] the courts in characterising a transaction for GST purposes appear to be more persuaded by legal form and effect of a transaction rather than the 'substance' of the transaction.[19]

During the preceding 20 or so years, it is striking to note that the number of cases that have been decided in connection with financial supplies has been relatively low in number, with perhaps half a dozen or so cases of importance having been decided. This may in part be a result of the detailed drafting of the rules set out in both the GST Act and in the accompanying GST Regulations. In addition, a number of detailed public rulings address many of the main issues, making the Australian GST system what is arguably one of the best explained in the world.[20] It is however not surprising that some of the cases that have been decided have arisen out of some of the unique features of the Australian system described above, such as the pathway for claiming input tax credits (discussed further in section 3 below) and the consequences for apportionment of acquisitions between different categories of supplies (section 4). The case law also considers the proper approach to construction of the legislation and transactions it taxes, with important consequences for GST (section 5).

3. CLAIMING INPUT TAX CREDITS

The reach of the provisions of the GST Act allowing for the claiming of input tax credits fell for consideration by the courts at an early stage, differing as they did from the more usual scheme for value added taxation. That is, under the usual model such as that in the European Union, the rules required relevant connections to be found between taxable supplies and acquisitions to *allow* creditability. Under the Australian system, the requisite relationship between input taxed supplies and acquisitions resulted in a *denial* of input tax credits.

The particular question was, therefore, what relationship was required between inputs and input taxed supplies to produce a denial of input tax credits. That is, when did an 'acquisition… [relate]… to making supplies that would be input taxed' under section

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of the Contract And 'Economic Reality' (10 April 2016; updated 17 January 2019), https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc11124.

[17] Case C-76/99, *Commission v France*, ECLI:EU:C:2001:12 (11 January 2001).

[18] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126; *CIC Insurance Limited v Bankstown Football Club Limited* (1997) 187 CLR 384.

[19] *Commissioner of Taxation v Gloxinia Investments (Trustee)* [2010] FCAFC 46; 75 ATR 806; *Australian Style Investments Pty Ltd as Trustee for the Australian Style Investments Unit Trust and Commissioner of Taxation* [2013] AATA 847; 94 ATR 984.

[20] See Australian Taxation Office, 'Goods and Services Tax: GST Treatment of Financial Supplies and Related Supplies and Acquisitions', Goods and Services Tax Ruling GSTR 2002/2; 'Goods and Services Tax: Determining the Extent of Creditable Purpose for Claiming Input Tax Credits and for Making Adjustments for Changes in Extent of Creditable Purpose', GSTR 2006/4; 'Goods and Services Tax: Reduced Credit Acquisitions', GSTR 2004/1.

11-15 of the GST Act?[21] The use of the subjunctive 'would be', referring as it does to conditions under which hypothetical input taxed supplies would be made, leaves open questions as to what those hypotheticals were. In particular, did they refer to the time when the actual input taxed supplies were required to be made? Or going further, were actual supplies that were input taxed (occurring at whatever time) required to be identified for creditability to be denied?

These questions fell for determination in *HP Mercantile*.[22] The taxpayer in question operated a debt collection business, acquiring certain debts for future collection, comprising input taxed supplies. Before the acquisition of the debts, certain expenses were incurred relating to the future collection of these debts. After acquisition, other expenses were incurred. The taxpayer claimed full input tax credits for GST costs included in these expenses. The question was whether expenses incurred both before and after the acquisitions of debts gave rise to creditability. This raised a broader question of whether a specific tracing of a thing acquired with a thing supplied was required for the purposes of determining creditability.

The Full Federal Court (Hill J delivering the leading judgment) held that there was no reason in principle or policy why the grant of input tax credits should depend upon the sequence in which an acquisition and supply occurs, noting that:

> It can hardly be thought that the legislative policy would refuse the input tax credit where the loan followed the advice, but allow it where the advice followed the loan. Just as in the income tax context, a loss or outgoing may have been incurred in gaining or producing assessable income of a previous taxation year (cf *Placer Pacific Management Pty Ltd v Federal Commissioner of Taxation* (1995) 95 ATC 4459), so too, an acquisition may have been made in relation to the making of input taxed supplies in a past GST period, just as it may be made in relation to the making of input taxed supplies in the current or future GST period. All that is required is a relationship between the acquisition and the making of supplies that, if any are made, would be input taxed.[23]

Hill J also held that there was no tracing requirement:

> The language of s 11-15 would suggest that it was not intended that there be a tracing between the subject matter of an acquisition and an actual supply. Such a tracing would be necessary were the language of s 11-15(2)(a) to operate to disallow a credit where there was a relationship between the acquisition and an actual supply which was input taxed.[24]

However, the relationship which negated the input tax credit was expressed as being between the acquisition and the making of input taxed supplies, rather than between the acquisition and actual input taxed supplies.

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[21] GST Act, s 11-15.
[22] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126.
[23] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126, para 52.
[24] Ibid para 46.

In *HP Mercantile*,[25] the Federal Court held that both acquisitions before and after an input taxed supply could be denied creditability. While not a matter that arose in the case, it would also appear that the ambit of section 11-15(2) should, it is submitted, also extend to continuing supplies (whether or not the subject of Division 156 relating to 'supplies and acquisitions made on a progressive or periodic basis') such as an ongoing service acquired by the maker of financial supplies, that straddles that point in time of making of an input taxed supply.

Hill J further held that it did not follow that 'an entity which has embarked upon an enterprise which consists of the making of input taxed supplies, but in fact makes no supplies, will be entitled to obtain input tax credits. Whether it will or not will depend upon whether the acquisitions are related to supplies which if made would be input taxed. If the acquisitions do not, then a credit will be available'.[26]

Where acquisitions did not directly relate to making specific input taxed supplies but could only relate indirectly to financial supplies (such as general business overheads that could not be attributed to any particular supply), the additional question arose in *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* as to whether the test in section 11-15 had a wide enough reach to deny the acquisition creditability.[27] The expenses in question were general management expenses incurred in the context of certain investments in unit trusts. The Federal Court (per Lindgren J) noted that some of the expenses were identifiable as relating directly to: (1) input taxed supplies; (2) taxable supplies; (3) GST-free supplies; and (4) supplies outside the scope of GST. An example of directly attributable expenses was commissions paid to independent sales agents in connection with the promotion and sale of products. Lindgren J noted that '[i]deally the evidence would specify the nature and use made of the things acquired in some detail, the attempts made to relate them directly to supplies, and the reason why the particular methodology and proxies proposed were most likely to approximate the relatedness between acquisition of the things and the use made of them'.[28] Lindgren J went on to hold that the extent to which the taxpayer acquired general management services for a creditable purpose was 'answered by looking to the extent to which those things were acquired in the carrying on of [the taxpayer's] enterprise, and then to the extent that the acquisitions *related, directly or indirectly, to the making of any input taxed supplies by [the taxpayer]*'.[29]

The wide language of section 11-15 has allowed the courts to read the provision expansively and not restrictively so that a range of expenses may be denied creditability regardless of whether they can be attributed to an actual input taxed supply or not, and regardless of whether the relationship between the acquisition and input taxed supply is direct or indirect.

The Commissioner, at least, has indicated a preference for 'direct' attribution as a means for determining the creditability of acquisitions so that a direct attribution of acquisitions to input taxed supplies would, on this approach, deny creditability under section 11 and similarly direct attribution to taxable supplies (or GST-free supplies)

[25] Ibid.
[26] Ibid.
[27] *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* [2008] FCA 1834.
[28] Ibid para 75.
[29] Ibid para 127 (emphasis in original).

should conversely allow creditability.[30] Undoubtedly, the preferred method of attribution will allow for a more accurate way of attribution. However, the structure of section 11 (and in particular the absence of a requirement to specifically attribute acquisitions to actual supplies whether taxable, input taxed or GST-free) allows flexibility in the treatment of acquisitions that cannot be directly related to supplies of a particular kind as held in the *AXA* case,[31] especially where there is an indirect relationship with different kinds of supplies, raising further questions of how apportionment should apply. This was also a matter that the courts have been required to consider.

4. APPORTIONMENT

Judicial consideration of the GST scheme as it applies to financial supplies has extended to the question of how taxpayers should apportion inputs between creditable and non-creditable purposes where the inputs in question relate both to input taxed supplies on the one hand and to other supplies on the other. The task of apportionment of inputs between creditable and non-creditable purposes is, of course, not unique to Australia and is a task that makers of financial supplies are commonly required to carry out in most jurisdictions that levy value added tax. De la Feria and Walpole observe:

> Fully exempt financial entities are probably relatively rare. More common will be the situation where one particular body has a mixed VAT nature, engaging in activities which are at the same time exempt, and taxable. This means in practice that most will be able to deduct at least part of their input VAT…[32]

In the Australian context, the task of apportionment arises in the context of the specific statutory rule denying creditability for an acquisition 'to the extent that' the acquisition relates to input taxed supplies and the judicial consideration of the relationship required between inputs and input taxed supplies (as discussed in section 3 above). In the absence of any further guidance in section 11 as to how this task should be undertaken, case law provides some guidance. In *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited*,[33] the Full Federal Court, in describing the task required for apportionment, was prepared to allow a broad formula- based approach without requiring analysis of the use of each acquisition individually. In this case, a formula based on the proportion of the taxpayer's revenue from non-input taxed supplies compared with revenue from all supplies was accepted as a basis for determining the creditable proportion of acquisitions generally. The question arose in a situation where revenue was earned by the taxpayer from making input taxed supplies and what were claimed by the taxpayer to be taxable supplies. The Court (per Kenny and Middleton JJ in their majority judgment) described the relevant methodology used as follows:

> As can be seen, determining the extent of creditable purpose under the GST Act requires an analysis of an acquisition's relationship to the making of particular supplies, and consideration of whether those supplies would be

[30] Australian Taxation Office, 'Goods and Services Tax: Determining the Extent of Creditable Purpose for Claiming Input Tax Credits and for Making Adjustments for Changes in Extent of Creditable Purpose', GSTR 2006/4, para 35.
[31] *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* [2008] FCA 1834.
[32] De la Feria and Walpole, above n 7, 908.
[33] *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited* [2010] FCAFC 122; 77 ATR 12.

> 'input taxed'. Rather than undertake this analysis individually for each of the acquisitions in question, the respondents used the formula based on revenue figures as a proxy for the relationship between their acquisitions (in the aggregate) and the making of particular supplies.
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> …
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> [T]he formula assumes that it is fair and reasonable to expect a roughly proportional relationship between: (a) the amount of revenue [the taxpayer] earns from making financial supplies relative to its total revenue; and (b) the extent to which [the taxpayer's] acquisitions relate to making financial supplies, relative to the acquisitions' relationship to its supplies overall.[34]

The Federal Court majority allowed apportionment to occur based on a comparison of *revenue* from input taxed supplies being compared with all revenues, without requiring that task to be carried out on the basis of the 'consideration' for each kind of supply, which would require a more technical analysis of what constituted consideration for each type of supply under the statutory rules defining consideration under section 9-15 of the GST Act.[35]

The Commissioner of Taxation in ruling GSTR 2006/4 accepts that generally the taxpayer has a degree of flexibility as to how apportionment should be carried out within certain limits described in the following terms:

> 32. You may choose your own apportionment method, but the method you choose needs to be fair and reasonable in the circumstances of your enterprise. It needs to appropriately reflect the intended or actual use of your acquisitions or importations.
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> 33. The 'fair and reasonable' principle was used by the High Court in *Ronpibon Tin v FC of T*, in the context of the apportionment of expenditure serving more than one object 'indifferently'. The High Court did not, in that case, apply this principle in relation to the allocation of specific acquisitions wholly to specific ends, or to apportioning items of expenditure 'distinct and severable parts of which' can be identified as being devoted to such specific ends. The Commissioner's view is that the 'fair and reasonable' principle applies equally to the choice of method for allocating or apportioning acquisitions in all circumstances.[36]

While the Commissioner expresses the view that apportionment should reflect the 'planned use of that acquisition', he accepts both 'direct or indirect methods' of apportionment.[37] A direct method would 'best reflect the intended or actual use of an acquisition'.[38] However, where the direct method though preferred is not appropriate, the indirect methods described by the Commissioner to determine the creditable proportion of an acquisition include 'output' methods (for example, based on the gross

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[34] Ibid paras 108, 127.
[35] GST Act, s 9-15.
[36] Australian Taxation Office, 'Goods and Services Tax: Determining the Extent of Creditable Purpose for Claiming Input Tax Credits and for Making Adjustments for Changes in Extent of Creditable Purpose', GSTR 2006/4.
[37] Ibid paras 34-35.
[38] Ibid para 35.

value of supplies that are not input taxed as a percentage of total supplies). Also accepted are 'input' methods based on the already established use of some inputs (directly allocated inputs) to estimate the use of other inputs not able to be allocated in this way.

The absence of hard and fast prescriptive rules in the legislation as to how the task of apportionment should be carried out has allowed the courts (and the Commissioner) to accept a degree of flexibility in methods of apportionment that taxpayer may use. However, because the legislation is not prescriptive, the fact that the taxpayer may be called upon to use one among a range of apportionment methodologies means that a risk of potential non-compliance arises due to choice of a particular methodology where a more accurate method was available. John de Wijn QC, in this regard, warns of 'the danger of using a formula that is not reflective of the statutory test', asking specifically 'whether a revenue-based formula is really appropriate to determine the extent to which acquisitions are made in respect of making input taxed supplies'.[39] He adds:

> [A]pportionment formulas need to be much more focussed on the particular relationship. General overheads that concern the corporation generally and are simply not necessary for the making of the input taxed supply will usually not relate to making the supplies. For example, one would have thought that the cost of recovering a debt would relate to the making of the loan or whatever financial supply was made, but a computer system used to prepare a tax return may be of a more remote connection and would, therefore, not require apportionment.[40]

The above focus on particular relationships clearly has the advantage of greater certainty. However, hard and fast rules in determining when such relationships arise and on how apportionment should be carried out, will be difficult to formulate. A stricter approach that depends on finding particular relationships between acquisitions and supplies raises particular difficulties in applying the attribution and apportionment rules to overhead type expenses. However, the mere fact of overheads not being *directly* related to particular financial supplies should not, it is respectfully submitted, prevent the operation of the statutory rule denying input tax credits for overheads either wholly or in part. This at least is consistent with the decision in the *AXA* case[41] above, which acknowledged that in the case of the relevant overhead costs, the relationship between acquisitions and input taxed supplies could be both direct and indirect.

The approach of allowing a range of apportionment methodologies extending also to overheads, instead of an alternative approach of prescribing hard and fast rules, though coming at the cost of certainty, appears now well settled. If the legislation is to operate in a way that gives effect to the statutory purpose of input taxation in accordance with the accepted model of value added taxation, such an approach appears to accord with that purpose better than one that through strict prescription allows overhead type expenses to escape input taxation. The Australian approach is broadly consistent with

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[39] John de Wijn QC, 'Input Tax Relief and Financial Supplies: Nexus and Relevance for Apportionment' (2012) 12(3) *Australian GST Journal* 125, 129-130.
[40] Ibid 130.
[41] *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* [2008] FCA 1834. See also Australian Taxation Office, 'Goods and Services Tax: Determining the Extent of Creditable Purpose for Claiming Input Tax Credits and for Making Adjustments for Changes in Extent of Creditable Purpose', GSTR 2006/4, para 142.

that taken in the United Kingdom where, like Australia, methods of apportionment are not prescribed by legislation.[42]

5. APPROACHES TO CHARACTERISATION

As a general matter, it is now well settled that the preferred approach to the interpretation of tax legislation is a 'purposive' approach in accordance with the general statutory rule set out in section 15AA of the *Acts Interpretation Act 1901* (Cth)[43] as taken in the *HP Mercantile* case,[44] in contrast to the traditional rule, that taxing laws must be construed strictly 'within the letter of the law'.[45] However, in the context of GST, the courts have generally preferred an approach to statutory interpretation that stays closer to the legal technical meaning of the statute. To some extent, the structure of the legislation as regards 'financial supplies' may require such an approach. The provisions defining what is a 'financial supply' embody a number of legal technical concepts that have a long history of evolution through case law, discussion of which this section turns to now.

First of all, whether something is the subject of a 'financial supply' or not depends on whether it is an 'interest', which in turn is defined to mean 'anything that is recognised *in law or in equity as property* in any form'.[46] Once something has been identified as an 'interest' within this meaning, that interest must then fall within one of the categories set out in Regulation 40-5-09(3) in order to become the subject matter of a financial supply. The list of subject matters of a 'financial supply' includes things such as relevant 'debts',[47] 'charges', 'mortgages',[48] 'securities'[49] and 'currency'.[50] All of these are concepts that have a long legal history through a significant body of case law that may be brought to bear in determining whether something falls within the relevant category of financial supply or not.[51] Other matters that come into play in determining whether a 'financial supply' has occurred include whether there was been an 'assignment',[52] 'transfer',[53] 'allotment'[54] or 'issue'.[55] These too are well understood concepts at law with a legal technical meaning.[56]

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[42] See *Value Added Tax Act 1994* (UK) s 26.
[43] *Acts Interpretation Act 1901* (Cth) s 15AA.
[44] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126.
[45] *Partington v Attorney-General* (1869) LR 4 HL 100.
[46] GST Regulations, reg 40-5 (emphasis added).
[47] Ibid reg 40-5.09(3), Item 2.
[48] Ibid reg 40-5.09(3), Item 3.
[49] Ibid reg 40-5.09(3), Item 10.
[50] Ibid reg 40-5.0 (3), Item 9.
[51] The common law concept of what is a debt is well understood: *Ogden's Ltd v Weinberg* (1906) 95 LT 567*; Webb v Stenton* (1883) 11 QBD 518; *Bakewell v Deputy Federal Commissioner of Taxation* (1937) 58 CLR 743; as is that of 'mortgage' and 'charge': *Santley v Wilde* [1899] 2 Ch 474, 474; *Tooth & Co v Parkes* (1990) 17 WN (NSW) 17 and *Broken Hill Proprietary Company Limited v Commissioner of Stamp Duties (Qld)* [1998] 1 Qd R 452; 36 ATR 120. For the concept of 'security', see CCH Australia, *Australian GST Guide* (online), para 30-900. The concept of 'currency' was discussed in some detail in the *Travelex* case: *Travelex Ltd v Commissioner of Taxation* [2010] HCA 33; 241 CLR 510, discussed further below.
[52] GST Regulations, reg 40-5.04.
[53] Ibid.
[54] Ibid reg 40-5.03.
[55] Ibid.
[56] The case law on what is a 'transfer' is discussed in *Coles Myer Ltd v Commissioner of State Revenue (Vic)* (1997) 35 ATR 1: on appeal [1998] 4 VR 728; 39 ATR 163. On 'assignments', see *Norman v Federal*

It is not surprising therefore that the courts have had to look carefully at the legal technical meaning of the concepts employed in defining what is a 'financial supply'. This context perhaps explains the general preference of the courts for a legal technical approach in their overall approach to interpretation of the legislation and also to the related but separate question of how transactions should be analysed to see if they fall within a defined category under the GST Regulations.

The question of what was an 'interest' fell for consideration in *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited* (discussed previously in section 4 above).[57] The Court (by majority), in finding that the supply of rights to use a charge card or credit card was the supply of an 'interest' in or under a credit arrangement (and not the supply of a payment system), referred to 'the breadth of the definition of "interest", and the expansive notion of "property" apparent in the GST Act and the Regulations'.[58] Kenny and Middleton JJ held that:

> [The taxpayer] supplies cardholders with an 'interest' within the meaning of regulation 40-5.02 when cardholders agree to the cards' terms and conditions. Cardholders agreeing to the terms gain a bundle of rights in relation to the card, the most important of which is the right to present the card as payment and incur a corresponding obligation to pay [the taxpayer] at a later date. This is sufficient to constitute an interest under the broad definition of 'interest' in the Regulations.[59]

Dowsett J (dissenting) held that the charge card and credit card facilities provided to cardholders were 'payment systems' for the purposes of the GST Regulations.[60] This characterisation was, in his Honour's view, sufficient to dispose of the matter without needing to consider the technical questions going to whether there was a financial supply. The facilities in question were in his Honour's view 'funds transfer systems, involving [the taxpayer], the suppliers (or merchants) and the cardholders'.[61]

The different conclusions of the majority and minority decisions stand as an example of the different outcomes capable of being produced by a more legal technical approach to statutory interpretation, on the one hand, and the approach of Dowsett J that turned more on identifying the factual workings of thing supplied, on the other.

Navigation of the 'interest' concept was also required to characterise for GST purposes the nature of a deed appointing proxies at a meeting of unitholders in *Australian Style Investments Pty Ltd as Trustee for the Australian Style Investments Unit Trust and Commissioner of Taxation*.[62] The question in issue was whether a deed providing for proxies at unitholder's meeting gave rise to a 'financial supply'. The Administrative Appeals Tribunal first considered whether the deed created an 'interest' as defined in the GST Regulations. In finding that it did, the Tribunal held that 'the "interest"

Commissioner of Taxation (1963) 109 CLR 9, 26 per Windeyer J; and 'allotment', CCH Australia, *Australian GST Guide* (online), para 30-052.

[57] *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited* [2010] FCAFC 122.

[58] Ibid para 148.

[59] Ibid.

[60] Ibid paras 54-66, 74.

[61] Ibid 65.

[62] *Australian Style Investments Pty Ltd as Trustee for the Australian Style Investments Unit Trust and Commissioner of Taxation* [2013] AATA 847.

provided was a chose in action which comprised the rights of action arising under the Deed in respect of each of those promises, including the promise to deliver the irrevocable proxies'.[63] What was also required was that the 'interest' be 'in or under' one of the subject matters of Regulation 40-05.09(3).[64] While those subject matters included the capital of trusts or benefits produced by a trust, the deed did not create rights 'in or under' the capital of the relevant trusts. The Tribunal rejected an argument that all that was required to come within the relevant definition of 'interest' was that the deed 'relate' in some way to the securities in question.[65] It accepted the Commissioner's argument that:

> Having regard to the ordinary meaning of the prepositions 'in' and 'under' and upon considering the expression 'in or under' read in the context of the provision in which it appears and its wider statutory context, in my view it requires a nexus between the 'interest' and the 'matter' mentioned in the items in the table in reg 40-5.09(3) more proximate than that for which the taxpayer contends.[66]

Further, the Tribunal in coming to its determination of the matter found that the 'interest' provided by the taxpayer for the purposes of Regulation 40-5.09 upon execution of the relevant deed was to be characterised according to the *legal effect* of the relevant deed.

Close analysis of the legal effect of the transaction under consideration also underpins the decision of the High Court in *Travelex Ltd v Commissioner of Taxation*[67] in which the Court was called upon to determine the nature of a purchase of foreign exchange. The question was whether the purchase of foreign exchange by a traveller at an Australian airport was GST-free as supply 'in relation to rights' for use outside Australia. The High Court held that a supply of foreign exchange comprised a supply 'in relation to the rights' attaching to the currency because the sale gave the acquirer property in the currency, rejecting the argument that the rights in question were incidental to the supply of bank notes. The Full Federal Court had held that the rights in question were not the subject of the supply made on sale of the foreign currency but were consequences of becoming the holder of the currency.[68] The High Court (per French CJ and Hayne J), in overturning the decision of the Federal Court, held that

> recognising that a sale of foreign currency transfers to the purchaser the rights that attach to the notes does no more than recognise the evident purpose of the transaction. Further classification or identification of the rights that pass, whether as rights against an issuing central bank, or as rights akin to those of the holder of a promissory note, is not necessary. What the Act requires is that there be a supply 'in relation to' rights; the operation of the Act does not call for attention to be given to the particular content of the rights.[69]

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[63] Ibid para 71.
[64] GST Regulations, reg 40-05.09(3).
[65] *Australian Style Investments Pty Ltd as Trustee for the Australian Style Investments Unit Trust and Commissioner of Taxation* [2013] AATA 847, paras 96-98.
[66] Ibid, para 98.
[67] *Travelex Ltd v Commissioner of Taxation* [2010] HCA 33.
[68] *Travelex Ltd v Commissioner of Taxation* [2009] FCAFC 133; 73 ATR 463.
[69] *Travelex Ltd v Commissioner of Taxation* [2010] HCA 33, para 32.

Heydon J (agreeing) held:

> The legal substance of the transaction was the supply of rights. The rights supplied were the rights enjoyed by the holder of the currency as created by the statute law of Fiji. The handing over of the pieces of paper constituted, evidenced, and was not capable of disaggregation from, the supply of rights. Apart from those rights, the pieces of paper had little value.[70]

The legal technical character of the transaction in question, namely a supply of rights of a particular kind, allowed the High Court to reach the conclusions that it did.

The consequences of too strict an interpretation of the legislation have been described by one commentator in the following terms:

> The plain meaning of the words of the current legislative provisions invite an interpretation that is so precise that it results in the taxing of the underlying transaction itself rather than the services that facilitate that transaction. In some scenarios, this interpretation will still achieve the desired result. However, in other circumstances … the result is completely contrary to policy intention…
>
> Clearly, in a financial supply context, proprietary interests in financial assets are transferred. Accordingly, it is not wholly inappropriate for the definition to embrace the transfer (by the provision, acquisition or disposal) of such interests. However, where a literal interpretation of the wording is adopted, the current focus on this transfer is at the expense of the underlying purpose of a GST, namely to tax consumption expenditure: what is consumed in a financial services context is not the interests themselves but rather the services that facilitate their exchange.[71]

The courts to a limited extent have ameliorated the consequences of strict interpretation, applying the interpretive principle that GST is 'a practical business tax'. The question in *Waverley Council and Commissioner of Taxation*[72] was whether a credit card administration fee payable in addition to council fees should be treated on a stand alone basis (as taxable) or treated in the same way as the council fees (GST-free). The Tribunal, in finding that the two amounts should not be disaggregated and should be treated in the same way, said:

> We think that the fee is correctly characterised as part of the fee for the underlying supply. The person procuring the supply is buying, for example, a parking permit. There is one payment. In a practical sense there is one supply. This is the 'practical' … application of the tax. This is the interpretation which is not 'unduly technical or overly meticulous and literal' (see *Saga Holidays Limited v Commissioner of Taxation* [2006] FCAFC 191; (2006) 156 FCR 256 at [70]; and *Re AGR Joint Venture and Commissioner of Taxation* [2007]

[70] Ibid para 47.
[71] Kavita Benedict, 'The Australian GST Regime and Financial Services: How Did We Get Here and Where Are We Going?' (2011) 9(2) *eJournal of Tax Research* 174, 181, referring also to John Prebble and Sybrand van Schalkwyk, 'Value Added Tax and Financial Services', *Asia-Pacific Tax Bulletin*, September/October 2004, 363, 364.
[72] *Waverley Council and Commissioner of Taxation* [2009] AATA 442; 73 ATR 243.

> AATA 1870 at [32]). The approach adopted by the Commissioner is therefore correct.[73]

While the concept of GST as 'a practical business tax' is now accepted to some extent as one of the tools for interpretation of the GST legislation,[74] the Federal Court in *Saga Holidays Limited v Commissioner of Taxation*[75] indicated that there were limits on how far a court can go in applying the principle:

> The Court has tended to adopt a purposive approach to the interpretation of the GST Act, rejecting strict grammatical analyses in favour of a consideration not only of the syntax but also of 'the policy and the surrounding legislative context' of the relevant provision: *HP Mercantile Pty Ltd v Commissioner of Taxation* [2005] FCAFC 126; (2005) 143 FCR 553 at [66]. Consideration of these aspects of the GST Act has lead to the tax being described as 'a practical business tax': *Sterling Guardian Pty Ltd v Commissioner of Taxation* [2005] FCA 1166; (2005) 220 ALR 550 at [39].
>
> The description is appropriate because it draws attention to two related aspects of the tax. The fact that liability to pay the tax is imposed at various stages of the supply chain means that it is a tax on business but, importantly, one that is designed, where practicable, to quarantine business from the ultimate burden of the tax. This and other aspects of the tax legitimately form part of the context in which the language of the Act is interpreted and explains, at least in part, why the description 'a practical business tax' seems to be appropriate. This does not mean, however, that there is some special canon of construction that should be applied when interpreting the GST Act. The purposive approach to interpretation, of its nature, takes account of the context of the Act and the phrase, 'a practical business tax' is a reference to that context.[76]

The concept of GST as 'a practical business tax' may allow for a departure from too strict an interpretation where the purpose of the particular provisions allows the court to do so. However, the dominant approach of the Australian courts still remains quite some distance away from the European approach of looking to the economic substance that may better achieve the legislative purpose of input taxation.

A final observation on questions of characterisation of transactions relates to the closed list of 'reduced credit acquisitions' set out in Regulation 70 of the GST Regulations.[77] Much turns on whether something falls within that list or not, in that a reduced credit acquisition could reduce the input GST cost of the acquisition by up to 75 per cent, failing which the entire amount of input GST becomes a cost to the business in question. However, little disputation has arisen in the courts on questions of characterisation of reduced credit acquisitions. This may in part be due to the detailed drafting in the GST Regulations as well as the public ruling on the matter[78] which, in accordance with the usual processes of the Australian Taxation Office, was issued after consultation with

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[73] Ibid para 42.
[74] Robert Olding, '"GST is a Practical Business Tax" – "Spin and Rhetoric" or an Inconvenient Truth?' (2009) 9(1) *Australian GST Journal* 1, 8-10.
[75] *Saga Holidays Limited v Commissioner of Taxation* [2006] FCAFC 191; 64 ATR 602.
[76] Ibid paras 29-30.
[77] GST Regulations, reg 70.
[78] See Australian Taxation Office, 'Goods and Services Tax: Reduced Credit Acquisitions', GSTR 2004/1.

taxpayers. The increasing use of technology to deliver some of the services within the categories of 'reduced credit acquisitions' however may create new challenges. Discussed in the final part of this article, these are challenges that may widely impact on aspects of the GST scheme including the question of attribution, apportionment and characterisation discussed above.

6. PROSPECTS AND CHALLENGES

When GST commenced in 2000, many of the issues that arose were perhaps predictable, having regard to the experiences of other countries imposing value added taxes. These issues included how attribution would work under the credit mechanism, rules for apportionment of inputs between creditable and non-creditable purposes and questions going to statutory interpretation and characterisation of supplies. Making guesses as to future trends, unsafe in the best of circumstances, will be more difficult, particularly in the context of a system of GST that has existed for some time now with many of the issues having been more or less settled. However, one matter that is already coming into focus is the challenge technological changes pose, especially the increasing deployment of artificial intelligence ('AI').

AI has been known since the 1940s, but what is new is its widespread application at an accelerating pace. Much has been written on the impact of AI on the economy as a whole, as well as expected trends in the future,[79] even if there is relatively less on the subject in the context of taxation including tax administration. As a preliminary matter, it would be useful to consider generally what one means by 'artificial intelligence'. AI has been described, at its widest, as functions that 'employ such capabilities – previously possessed only by humans – as knowledge, insight, and perception to solve narrowly defined (within the current state of technology) tasks'.[80]

Perhaps the simplest definition is that supplied by the American commentator and writer Jay Tuck, in which he defines AI simply as 'software that writes itself'.[81] Such a definition appears to capture the essential nature of AI, namely a capability to gather large amounts of information, analyse that information, make decisions based on that analysis, continually alter the parameters for decision-making by autonomous rewriting of the applicable software, and doing all of this without human intervention. These capabilities have now been widely deployed to carry out functions such as pricing for businesses (involving complex calculations with little or no human intervention).[82] The banking industry already speaks of 'the ability of machines to replicate, and often exceed, what humans are able to do in banking'.[83]

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[79] See Productivity Commission, *Digital Disruption: What Do Governments Need To Do?*, Productivity Commission Research Paper (June 2016), https://www.pc.gov.au/research/completed/digital-disruption/digital-disruption-research-paper.pdf.

[80] Thomas H Davenport, *The AI Advantage: How to Put the Artificial Intelligence Revolution to Work* (MIT Press, 2018) 9.

[81] Jay Tuck, 'Artificial Intelligence: It Will Kill Us', Youtube presentation, TEDxHamburgSalon (31 January 2017), https://www.youtube.com/watch?v=BrNs0M77Pd4 (accessed 11 July 2020).

[82] Ibid.

[83] John Manning, 'How AI is Disrupting the Banking Industry', *International Banker* (4 July 2018), https://internationalbanker.com/banking/how-ai-is-disrupting-the-banking-industry (accessed 11 July 2020).

Such technologies appear to be already deployed in taxation including GST.[84] Once the relevant AI starts operating and begins to 'self-learn' (ie, self-writing the applicable software program), a point may be reached where it becomes difficult for anyone to explain precisely what AI does and what methodologies are being applied. The general problem has been described as follows by the G20's Financial Stability Board:

> The lack of interpretability or 'auditability' of AI and machine learning methods has the potential to contribute to macro-level risk if not appropriately supervised by microprudential supervisors.[85]

Manning similarly observes:

> With complex algorithms likely to be employed by AI, banking shareholders, regulators and other parties with vested interests are unlikely to be assured if there is no one around to explain the workings and methodologies of the machines.[86]

The implications of deploying AI in the taxation sphere are troubling in these circumstances, for example when an apportionment methodology operates under a 'self-written' program with no one capable of explaining how it works. This could raise challenges both for taxpayers and also for revenue authorities when auditing the apportionment methodology, both of whom need to understand how the apportionment methodology works. In future years, it may be necessary for both taxpayers and revenue authorities to learn to operate in an environment such as this, although there may be no easy solutions.

A second area of difficulty, and perhaps more fundamental matter, arises in characterisation of services in order to see where those services fall within the scheme of GST. This becomes particularly relevant when a determination is required as to whether something is a reduced credit acquisition or not for the purposes of section 70 of the GST Act.[87] The closed categories of reduced credit acquisitions are set out in Regulation 70.[88] They include various forms of 'arrangement',[89] 'mortgage broking',[90] 'brokerage'[91] and 'management'.[92] The scope of each of these relevant services at the time the GST legislation was enacted was generally well understood. Typically, all of these services involved significant human input and skill and, as a matter of the cost structure, a significant part of the cost structure of such services could be expected to be wage and salary costs.

To the extent that the courts have considered the meaning of the term 'management', it appears that the factor of human agency is expressed or implied in what goes to make

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[84] Zhuowen Huang, 'Discussion on the Development of Artificial Intelligence in Taxation' (2018) 8(8) *American Journal of Industrial and Business Management* 1817.
[85] Financial Stability Board, *Artificial Intelligence and Machine Learning in Financial Services: Market Developments and Financial Stability Implications* (1 November 2017), http://www.fsb.org/wp-content/uploads/P011117.pdf (accessed 11 July 2020). See also Davenport, above n 80,70.
[86] Manning, above n 83.
[87] GST Act, s 70.
[88] GST Regulations, reg 70.
[89] Ibid, Item 9.
[90] Ibid, Item 11.
[91] Ibid, Item 25.
[92] Ibid, Item 23.

up 'management'. A manager of a company has been described as a 'person who has the management of the whole affairs the company'.[93] In the context of a business, 'management' is generally regarded as involving 'something in the nature of the exercise of a *discretionary power* of control and direction of the business',[94] such exercise of power presumably requiring a human actor in the traditional sense of what 'management' is.

'Brokerage' (including the work of a stockbroker within the 'arranging' concept in Item 9)[95] traditionally also involves a human actor. It has been held that to 'make a man a broker, he must intermediate, and be the agent through whom the contract is made'.[96] How that traditional role is changing has been described as follows:

> Stockbrokerage might be viewed by investors as a traditionally human-based service allowing them to buy and sell equities. When looking at the shift in how stock brokerage is different today compared to the early 2000s, the largest change seems to be in software-based automation. Put simply, a lot of what was being done by humans (such as executing trades, giving advice to investors, discretionary trading) can now be done through software.[97]

With the rapid evolution of AI to increasingly perform an ever greater range of functions that humans previously performed, the substitution of human agency with AI in performance of services such as brokerage and management appears to be already occurring,[98] the Financial Stability Board in 2017 noting the trend to 'use machine learning to devise trading and investment strategies'.[99]

If the factor of human agency forms an inherent part of the definition of the relevant services as the case law might suggest, it is conceivable that the performance of the relevant services by AI, substantially or alone, raises basic definitional questions as to whether the service in question remains within the relevant category of 'management' or 'brokerage' within Regulation 70, where there is a fundamental change in the way that the service is delivered through the exclusion of human actors.[100] That the meaning of words used in legislation is not static and can evolve to capture things not within the original meaning is accepted in that a court will have regard to 'the sense in which words are currently used'.[101] This may allow some scope to extend the understood meaning of terms such as 'management' and 'brokerage'. However, if the services in question evolve into something else, so that they form part of some overarching 'processing' service that falls outside an existing reduced credit acquisition category, obvious

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[93] *Gibson v Barton* (1875) LR 10 QB 329.
[94] *Barac v Farnell* (1994) 53 FCR 193, 197 (emphasis added).
[95] See Australian Taxation Office, 'Goods and Services Tax: Reduced Credit Acquisitions', GSTR 2004/1, paras 285 to 301.
[96] *Milford v Hughes* (1846) 16 M & W 174.
[97] Raghav Bharadwaj, 'Stock Brokerage Firms and Artificial Intelligence – Current Applications', *Emerj.com* (16 February 2019), https://emerj.com/ai-sector-overviews/stock-brokerage-firms-and-artificial-intelligence-current-applications/ (accessed 11 July 2020).
[98] Raghav Bharadwaj, 'Machine Learning in Investment Management and Asset Management – Current Applications', *Emerj.com* (3 April 2020), https://emerj.com/ai-sector-overviews/machine-learning-in-investment-management-and-asset-management/ (accessed 11 July 2020).
[99] Financial Stability Board, above n 85.
[100] GST Regulations, reg 70.
[101] *New South Wales Associated Blue-Metal Quarries Ltd v Federal Commissioner of Taxation* (1956) 94 CLR 509, 514.

consequences arise. These are not questions that are merely speculative but are current, as a result of changes in the way services can now and are being delivered in financial markets. No clear answers however can safely be proffered on how these changes impact GST until the matters in question are resolved either by legislative action or by the courts.

As a concluding observation, policy-makers may also need to consider the broader impact of technological change associated with AI on the common model of value added tax as it applies to financial supplies. The classic explanation for that model of input taxation is that, though not economically ideal, it is a necessary consequence of the inability to ascertain the 'value add' component of financial supplies, so that the currently accepted position of the Organisation for Economic Co-operation and Development (OECD) remains that 'transactions made by business are exempt because the tax base of the outputs is difficult to assess' (eg. many financial services).[102] The problems created by input taxation of financial supplies in this context has been described as follows by the OECD:

> Although it is a significant departure from the basic concept for VAT, all OECD countries apply a number of exemptions. A wide variety of motivations exist for the application of that exemption. These include the difficulties of determining the tax base (eg. financial and insurance services) …
>
> VAT exemptions introduce a cascading effect when applied in a B2B context. The business making an exempt supply can be expected to pass on the uncreditable input tax by including it in the price of the supply. This 'hidden tax' will subsequently not be deductible/recoverable by the recipient business. If the outputs of this recipient business are not also exempt, this hidden VAT will presumably be part of the price for the supplies on which it will charge output VAT. The result is a hidden tax at a variable rate depending on the number of production stages that are subject to the tax …
>
> Exemptions generally lead to the under-taxation of supplies to consumers … and an over-taxation of businesses who are unable to deduct the 'hidden' tax embedded in their inputs.[103]

If developments in AI allow for greater ease in making complex calculations of the cost elements making up the supply chains and of value generated by a business,[104] it may be the case that, at a future point in time, the very rationale of input taxation may need to be revisited. With the increasing ability of AI to analyse, process and collect vast amounts of data well beyond human capabilities to do so, the consequence may be that determining the amount of 'value add' for financial supplies may become less problematic at a future date. Such an eventuality would mean a radical change to the

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[102] OECD, *International VAT/GST Guidelines* (2017) para 2.4.

[103] OECD, *Consumption Tax Trends: VAT/GST and Excise Rates, Trends and Policy Issues* (OECD Publishing, 2018) 48-49.

[104] It is suggested that the point in time when AI can sharpen supply chains is not far off. See Joe McKendrick, 'Artificial intelligence may compensate for the opaqueness of supply chains', *ZDNet* (9 January 2019), https://www.zdnet.com/article/adding-intelligence-to-the-supply-chain/ (accessed 11 July 2020).

basic assumptions underlying the value added tax model for the taxation of financial services, namely the problems in finding the 'value add' component.

The change AI is already bringing to bear is real enough even if the full impact of those changes may not occur overnight. To remember what is known as 'Amara's law' in this regard may not go amiss, namely that 'we tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run'.[105] Although making too many predictions in a volatile and rapidly evolving area will not be prudent, in the medium to longer term, the application of AI in relation to taxation of the finance sector cannot be ignored.

[105] See Susan Ratcliffe (ed), *Oxford Essential Quotations* (Oxford University Press, 4th ed, 2016), 'Roy Amara 1925–2007, American futurologist'.

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Twenty years later: Australia's GST design, digitisation and disruption – old and new challenges

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Abstract

This article considers the impact of digitisation and disruption on Australia's goods and services tax (GST) and also sets out some areas of the GST policy and law that can be improved, including the rules relating to capital raisings and business expansion, financial services, changes in creditable use and vouchers. The article notes in conclusion that the government must ensure its laws, particularly revenue laws, are designed and managed in such a way that they can react and adjust to economic changes in a neutral manner, maintain coherence (ie, remain clear and simple), and keep compliance costs low.

Key words: Australian goods and services tax, digitisation, value added tax principles, principles based drafting, GST policy.

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1. INTRODUCTION

This year marks another milestone moment in the evolution of Australia's tax system. 9 July 2019 will mark the 20th anniversary of Australia's goods and services tax (GST) becoming law.

Milestone anniversaries are a time to celebrate, reflect, reassess and, if in a position to do so, resolve to improve. As we should with the GST system as it moves out of its teenage years.

The original theme proposed for this article was 'digitisation and disruption'. While these are important topics in the context of the GST system, for an article marking the 20th anniversary of the GST system becoming law, it seemed appropriate that we should also reflect on the design of Australia's GST law, particularly:

- the background to its introduction;
- the overarching principles that governed its design;
- key policy decisions that are features of the GST law;
- how the law has been amended to address various challenges, including the commercial impact of digitisation in a global marketplace; and
- whether it is still 'up to the job' as technology develops and the global marketplace evolves.

While digitisation is the latest economic and social 'disrupter', it is obviously not the first and it will certainly not be the last. The challenge for Treasury and the Australian Taxation Office (ATO) is to maintain the integrity of the GST law, ensuring it develops and grows with the economy and within a framework that keeps faith with the original design principles of a value added tax (VAT) or GST system.

The design principles of a GST or VAT system have been under pressure since the late 1970s. Recent changes to the Australian GST law, particularly relating to cross-border trade through electronic platforms, applying a reverse charge to domestic transactions involving gold, and the sale of residential property withholding provisions further challenge the design structure of a traditional VAT or GST system. This will inevitably lead to questions as to whether it is fit for purpose, or whether a different approach needs to be adopted.

Before this article considers some of these issues, it is appropriate to set out briefly how the GST was conceived, born and developed to where it is today.

2. BACKGROUND

In 1972, the then Treasurer, Sir Billy Mackie Sneddon established a Taxation Review Committee, chaired by Justice Kenneth Asprey, to review Australia's taxation system and make recommendations for future changes. The Asprey Committee released its report in January 1975.[1] This report became the base for many of the significant changes

[1] Taxation Review Committee (Justice Kenneth Asprey, chair), *Full Report* (1975).

to the Australian tax system during the following 25 years, including the adoption of capital gains tax (CGT), fringe benefits tax (FBT) and finally, the GST.

In 1985, Australia had its first attempt to significantly reform its indirect tax system. The Hawke government conducted a taxation summit at which several options to reform the Australian tax system were canvassed.[2] The government's preferred option ('Option C') included a broadening of the income tax base, a reduction in marginal income tax rates and a broad-based retail sales tax that would apply to most goods and services. Details on how the retail sales tax would apply were in short supply. Debate was heated, and the Tax Summit failed to reach consensus on Option C.

Following the summit, the government proceeded to implement an alternative option ('Option A') and reformed the income tax base, reduced personal income tax rates, and introduced CGT, FBT and dividend imputation. While many economists and practitioners in the indirect taxes area were disappointed at the time, the changes implemented following the 1985 Tax Summit were significant and were a direct consequence of the Asprey Report.

From an indirect tax perspective, the 1985 Tax Summit was important as a broad-based consumption tax was now in the public arena and would be (and still is) an important part of any future debate on the reform of Australia's tax system. The 1985 Taxation Summit marked the real beginning of Australia's path to a GST.

In 1985, the time for considering a broad-based consumption tax was right. The Australian economy was changing rapidly. In 1984, the Hawke government deregulated the financial markets, floated the Australian dollar, commenced a process to drastically reduce tariffs, commenced the privatisation of government-owned businesses including Qantas and the Commonwealth Bank, and significantly changed the industrial relations landscape (eventually including the wage accord). At the same time, consumer spending was starting to significantly shift from goods to services and intangibles. This was economic disruption that fundamentally changed the Australian economy and forms the base for much of the prosperity we enjoy today.

While Option C was consigned to history, and a retail sales tax was not seriously considered thereafter, personal computers, mobile phones, software products for private consumers and digitisation were not far away. If I recall, Ry Cooder recorded 'Bop Till You Drop' in late 1979 or early 1980. This was the first major label album recorded on a digital 32 track recording system. Music was digitised and the days of the record player were numbered. It took a bit of time for the technology to 'go retail' but it was always going to happen, and its impact would be profound for that industry (and our lives).

1993 was the year of 'Fightback!'.[3] The Fightback tax reform package included a broad-based 15 per cent GST, and was central to the Coalition parties' election manifesto that year. Prior to the release of Fightback, the Coalition parties established a 'GST Planning and Coordination Office', also known as the Cole Committee (named after its

[2] See Australian Treasury, *Reform of the Australian Taxation System, Draft White Paper* (19 September 1985) (RATS Paper); Australian Treasury (circulated by Hon Peter Costello (Treasurer)), *Tax Reform: Not a New Tax, A New Tax System: The Howard Government's Plan for a New Tax System* (1998) 5, n167 (ANTS White Paper).

[3] Liberal Party of Australia, *Fightback! Taxation and Expenditure Reform for Jobs and Growth: The Liberal and National Parties' Plan to Rebuild and Reward Australia* (November 1991) (Fightback!).

Chairman, Sir Robert William Cole). The Cole Committee delivered a report to the Coalition parties that would significantly shape the GST system we have today. However, the Coalition parties lost the 'unlosable' 1993 election.

During the 1996 election campaign, the then leader of the Liberal Party, John Howard, pledged never to introduce a GST if he became Prime Minister. Within 18 months of that pledge the Coalition government commenced work on a comprehensive reform of the Australian taxation system, including the introduction of a broad-based GST. The Howard government took this package of reforms to the 1998 election, was successfully elected in September 1998 and immediately set about implementing a GST, to commence on 1 July 2000.

The passage of the A New Tax System (Goods and Services) Bill 1999 (Cth) through Parliament was far from smooth. The GST-free treatment of food was the price the government paid to have the legislation passed, with the support of the Australian Democrats. The Australian Democrats would pay a far greater price.

Key policy decisions made during 1998 and 1999 were either forced upon the government (such as the GST-free treatment of food), made after careful consideration of overseas experience (such as the 'place of supply' / 'connected with Australia' rules, and the treatment of land, government and charity, GST grouping, going concern and international transactions), or were uniquely Australian (such as the reduced input tax credit regime for financial services and aspects of the GST treatment of general insurance).

When it came to designing the Australian GST law, there were two other matters that are rarely discussed in public; the impact of the tax law improvement project (TLIP) and the Organisation for Economic Co-operation and Development (OECD) principles for designing a modern efficient tax system.

3. GST LAW DESIGN

3.1 The tax law improvement project

In 1993, the ATO and the Office of Parliamentary Counsel (OPC) commenced a project to simplify the drafting of Australia's income tax law. Changing income tax policy was not part of the brief. Rather, the aim of the project was to make the drafting of the Australian income tax law simpler, easier to understand and, as a consequence, improve compliance and reduce compliance and administration costs.

The TLIP model was adopted and modified for Australia's GST. It was not the only legislative model considered. The streamlined sales tax model (which is the design model for the Wine Equalisation Tax) was initially considered but did not suit the structural complexities of a GST.

The TLIP model is uniquely Australian, yet often taken for granted by administrators and practitioners. It has the following features:

- it is based on a pyramid approach where core concepts (or basic rules) form the apex of the pyramid. Below the core concepts resides a chapter for exemptions. Below the exemptions chapter resides a chapter for qualifications or variations to the basic rules. Underpinning these chapters is a dictionary that, where

possible, seeks to apply common definitions across a variety of Commonwealth taxes;

- it should use clear and simple language. Consequently, the GST law is drafted in the second person for readability;
- Divisions and Sub-divisions of chapters are based around principles or conceptual building blocks;
- Guides are provided that summarise the purpose or object of a Division, Sub-division or section;
- signposts are provided that direct a reader to other provisions;
- white space is used around text and diagrams, for readability;
- a numbering system is used that is simple, predictable, flexible and sufficiently robust to stand the test of time (and amendments).

It is easy to overlook and underestimate how these features shape the key provisions of Australia's GST law. In particular the desire to use clear and plain language and reduce compliance costs for taxpayers resulted in the GST law incorporating accounting concepts, where possible. This is the reason there is no 'time of supply' rule, it is why bad debt and voucher provisions so clearly link to accounting events, and why, until recently, provisions were in place to relieve non-residents of having a GST liability.

It is notable that the purity of the TLIP model was quickly tarnished when the Australian Treasury decided to move the financial supply provisions from the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act) to the *A New Tax System (Goods and Services Tax) Regulations 1999* (Cth) (GST Regulations) (which OPC was not responsible for drafting). For whatever reason, a financial supply became linked to the supply of a property interest, rather than a particular activity (as it is in most countries). This soon resulted in an acquisition of a financial interest being made a 'supply' for GST purposes, an outcome that could not be more at odds with the TLIP design.

In my opinion, the recent changes to the GST law, particularly in relation to the cross-border provisions, could have been drafted a simpler and equally effective manner. This issue is discussed further in sections 4.1 and 4.2 below.

The TLIP drafting principles were complemented by a series of policy principles. Most notably:

- the GST itself should not be a factor in businesses making a commercial decision;
- the supplier should not have to determine the status of the recipient when determining whether GST applies to a particular transaction;
- the cascading of GST should be avoided, where possible;
- GST rules should complement business and accounting practice; and
- the GST would be based on the "destination principle" with a credit invoice system.

3.2 OECD principles for designing a tax system

In 1998 the OECD released the Ottawa Framework conditions for electronic commerce.[4] These framework conditions were consistent with the TLIP principles and were central to the design of Australian GST policy, legislation and the operations of the ATO in the years during and following its introduction. These conditions are as follows:

1. *Neutrality* – taxation should be neutral and equitable between forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.
2. *Efficiency* – compliance costs for taxpayers and administration costs for tax authorities should be minimised, as far as possible.
3. *Certainty and simplicity* – the tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction.
4. *Effective and fair* – the taxation system should produce the right amount of tax, at the right time. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to the risks involved.
5. *Flexibility* – the systems for taxation should be flexible and dynamic to ensure they keep pace with technology and commercial developments.

3.3 The evolution of VAT systems

The VAT/GST model has evolved significantly since its French origin.

All modern GST or VAT laws had their origins in the European Union VAT system. It is one of the key touchpoints for any country developing a GST or VAT system. However, the EU VAT system and, as a consequence, the Australian GST system in the year 2000 was very far from the model outlined in the European Union's (EU) Second VAT Directive of 11 April 1967 (Second Directive)[5] which sought to harmonise various turnover taxes in place in EU Member States, at the time.

There were essentially two place of supply rules outlined in the Second Directive, one for goods (where the goods are dispatched, or if not dispatched the location at the time of supply) and one for services (where the services are performed). There was no reverse charge, nor many of the provisions which would now be described as special rules. It was a simple tax for a simpler economic time.

[4] Committee on Fiscal Affairs, 'Electronic Commence: Taxation Framework Conditions' (Report, OECD Ministerial Conference, 8 October 1998).
[5] European Union, Second Council Directive of 11 April 1967 on the Harmonisation of Legislation of Member States Concerning Turnover Taxes, Structures and Procedures for the Application of a Common System of Value Added Tax 67/228/EEC.

It was the Sixth Directive in 1977 that introduced special place of supply rules for particular services and a reverse charge for those services covered by article 9(2)(e).[6] The EU VAT was changing to reflect the economic times. That said, the changes made in 1977, and later in 1997 regarding telecommunications supplies,[7] were largely consistent with a tax on final private consumption expenditure in a particular tax jurisdiction, collected and paid by GST registered businesses.

It is this model that was adopted and adapted by New Zealand, Canada, Singapore and Australia. Each jurisdiction shaped the EU model to suit their economy, geography, political, constitutional and legislative circumstances. As a consumption tax model, it has been remarkably robust. The latest challenge confronting it is whether it can appropriately address digitisation, more sophisticated global markets, new technology and payment systems such as 'blockchain' and cryptocurrencies, and organised fraud.

4. DIGITISATION, DISRUPTION AND THE GST LAW

In 2016 and 2018, the Australian GST law was significantly changed to bring within its scope 'inbound intangible consumer supplies' and 'offshore supplies of low value goods'.[8] The government also introduced a new withholding regime relating to the sale of new residential premises in order to counteract fraud that was occurring in the property development and construction industry.

4.1 Imported supplies of digital products and services

One of the fundamental requirements for a taxable supply is that the supply is connected with the Australian indirect tax zone. This provision secures the territoriality of the tax. That is, it sets the boundaries to ensure the GST taxes, to the extent possible, final private consumption expenditure in Australia.

The phrase 'to the extent possible' in the previous sentence is important. It has long been accepted by governments, academics and tax professionals that a GST seeking to tax final private consumption by imposing the relevant liability on a supplier will never achieve 100 per cent of its purpose. There will always be some leakage.

The design of a GST or VAT system has effectively traded the potential for 100 per cent coverage (eg, if it made the consumer liable to pay tax on the value of that consumer's domestic consumption) for marginally less coverage but an administratively simpler and politically palatable solution (ie, requiring most businesses to register and pay the GST on the value of private consumption undertaken by its unregistered domestic customers).

Even when the GST was introduced, tax authorities throughout the developed world, including Australia, were aware of the potential impact electronic commerce (and the

[6] European Union, Sixth Council Directive 77/388/EEC of 17 May 1977 on the Harmonization of the Laws of the Member States Relating to Turnover Taxes - Common System of Value Added Tax: Uniform Basis of Assessment.
[7] European Commission, 'Proposal for a Council Directive amending Directive 77/388/EEC as regards the Value Added Tax Arrangements Applicable to Telecommunications Services', COM (97) 4 final, 29 January 1997.
[8] *Treasury Laws Amendment (GST Low Value Goods) Act 2017* (Cth).

Internet specifically) may have on GST and VAT collections.[9] In July 2000, the government's view was to monitor the impact of electronic commerce on consumer spending and act when necessary. Clearly, the government has decided that the time is right to apply GST to the inbound, cross-border trade in services, intangibles and low value goods.

The 2016 and 2018 GST law changes relating to the inbound, cross-border trade in services, intangibles and low value goods, demonstrate the difficulty GST and VAT systems have in effecting compliance, protecting domestic suppliers from unfair competition and maintaining 'simplicity' in the tax system.

4.1.1 The 2016 amendments

The 2016 amendments were extensive and profound.

When GST commenced, the 'connected with Australia'[10] rules were generally fairly straightforward. Prior to the 2016 series of amendments affecting these rules, a supply was connected with Australia in the following circumstances:

- the supply of goods – if the goods are supplied wholly in Australia, brought to Australia or taken from Australia;[11]
- the supply of real property – if the property is located in Australia;[12]
- the supply of anything else (such as services and intangibles) – the 'thing' supplied had to be:
    - done in Australia;[13] or
    - supplied through an enterprise carried on in Australia.[14] Section 9-25(6) of the GST Act provided (it has since changed) that an enterprise is carried on in Australia where it is conducted through a permanent establishment. For this purpose, the definition of permanent establishment in section 6(1) of the *Income Tax Assessment Act 1936* was modified (but only for GST purposes) to broaden it; or
    - the supply:
        - is neither done in Australia or made through a permanent establishment in Australia; and
        - is the right to acquire something else; and

[9] In February 1999 the OECD's Working Party 9 on consumption taxes established a sub-group to consider the challenges electronic commerce presents to consumption tax systems.
[10] The phrase 'connected with Australia' is now referred to in the GST law as 'connected with the indirect tax zone'. For the purposes of this article, and for the ease of comprehension, the original description has continued to be used here – 'connected with Australia'.
[11] GST Act, ss 9-25(1), (2), (3).
[12] Ibid s 9-25(4).
[13] Ibid s 9-25(5)(a).
[14] Ibid s 9-25(5)(b).

- on redemption of the relevant right would be connected with Australia.[15]

The 2016 amendments contained the following changes to the GST law. These changes go to the heart of the most fundamental provision in the law, the issue of the territoriality of the tax. The changes to the GST Act include the following:

- a new subsection 9-25(5)(d) and a related definition of 'Australian consumer' at subsection 9-25(7);
- a new subsection 9-25(6) dealing with goods imported into Australia and installed or assembled in Australia;
- a new section 9-26 to remove from the scope of the GST certain transactions involving non-residents;
- a new section 9-27 to change the definition of when an enterprise is carried on in the Australian indirect tax zone. This has resulted in a shift from a 'permanent establishment' rule to a 'fixed establishment' rule;
- what is effectively a complete redraft of Division 84, which prior to the 2016 amendments consisted of a few sections (ss 84-5 to 84-25) relating to the reverse charge of services and intangibles supplied from offshore, to GST registered recipients not making the acquisition wholly for a creditable purpose;
- Division 84 now contains three sub-divisions and pages of mind-boggling complexity. Division 84 is now a reverse charge provision and taxable supply provisions for entities (including electronic platform operators) supplying 'inbound intangible consumer supplies' and 'offshore supplies of low value goods'; and
- a new Division 146 dealing with a limited registration regime for non-resident suppliers of 'Inbound intangible consumer supplies' and low value goods.

Not all of these changes relate to digitisation. Some of these provisions, particularly sections 9-26 and 9-27, directly relate to recommendations of the Board of Taxation following its 2010 report to the Assistant Treasurer on the application of GST to cross-border transactions.[16] This article will not address the changes to sections 9-25(6), 9-26 or 9-27. Rather, it will focus on the changes affecting 'inbound intangible consumer supplies' and 'offshore supplies of low value goods'.

With effect from 1 July 2016 supplies of services or intangibles delivered electronically by overseas enterprises to Australian consumers came within the scope of Australia's GST regime. Legislation to affect this change was contained in the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016* (Cth) (2016 Measures No. 1 Act). These changes were expected to raise AUD 150 million in the 2016 financial year and AUD 200 million in the next.[17]

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[15] Ibid s 9-25(5)(c).
[16] Board of Taxation, *Review of the Application of GST to Cross-Border Transactions: A Report to the Assistant Treasurer* (2010).
[17] Australian Treasury, *Budget 2015-16: Budget Measures – Budget Paper No. 2* (May 2015).

The 2016 Measures No. 1 Act included an additional paragraph 9-25(5)(d) such that a supply of anything other than goods or real property is connected with the Australian indirect tax zone if 'the recipient is an Australian consumer'.

An Australian consumer is defined to be an Australian resident who is either:

- not registered for GST purposes;[18] or
- if so registered, does not make the acquisition solely or partly for the purposes of an enterprise it carries on.[19]

Consequently, any resident or non-resident supplier of services or intangibles is making a supply that is connected with the Australian indirect tax zone if the recipient is an Australian consumer. Such supplies will be subject to Australian GST if the other conditions for making taxable supplies are present. However, a non-resident supplier may escape the requirement to register and account for GST if it makes a supply through an electronic distribution platform.

The 2016 Measures No. 1 Act includes a new Subdivision 84-B of the GST Act which provides that an electronic distribution platform operator (and not the non-resident supplier) is liable for GST on an 'inbound intangible consumer supply' made through the relevant platform. An 'inbound intangible consumer' supply is defined as a supply of anything other than goods or real property if the recipient is an Australian consumer, unless:

- the supply is done in the Australian indirect tax zone;[20] or
- the supplier makes the supply through an enterprise the supplier carries on in the Australian indirect tax zone.[21]

A service is defined as an electronic distribution platform if:

- the service allows entities to make supplies available to end users;[22] and
- the service is delivered by means of electronic communication;[23] and
- the supplies are made by electronic means.[24]

'Tie breaker' rules operate where a supplier supplies 'inbound intangible consumer supplies' through two or more platform operators.

Subdivision 84-C applies to offshore supplies of low value goods. Subdivision 84-D sets out the circumstances in which entities are not Australian consumers. Division 146 provides a limited registration regime for non-resident suppliers and platform operators.

[18] GST Act, s 9-25(7)(b)(i).
[19] Ibid s 9-25(7)(b)(ii).
[20] Ibid s 84-65(1)(a).
[21] Ibid s 84-65(1)(b).
[22] Ibid s 84-70(1)(a).
[23] Ibid s 84-70(1)(b).
[24] Ibid s 84-70(1)(c).

This is quite a bit for non-resident suppliers and platform operators to understand, and make appropriate systems and business process changes for to effect compliance. What is critical is that Australia's rules mirror those adopted by other tax jurisdictions.

4.1.2 Observations

The consequence of this amendment is that the reach of Australian GST has been extended to entities which may have no physical presence in Australia. With this change, the Australian GST became extraterritorial. The success of these provisions will essentially rely on taxpayers without a physical presence in Australia voluntarily complying with their obligations, knowing the Commissioner of Taxation's ability to effectively enforce the provisions is limited.

However, given that many of the suppliers caught by these provisions operate on a global stage with a desire to maintain a reputation as a good corporate citizen, it is likely that compliance from large suppliers and electronic platform operators will be high. On the other hand, undoubtedly there will be many others who may be ignorant of, or not enthusiastic about complying with, the taxation laws of a foreign country. It has been tacitly recognised that a level of revenue leakage must be accepted because it is either not possible, or not economic, to collect it.

These amendments are complex and far-reaching. In fact, the provisions are so far-reaching the Commissioner will never know who should be within the scope of the provisions once the large online retailers and platform operators have been identified and registered. Many non-resident online suppliers of services and intangibles may have a potential Australian GST liability without ever being aware of it.

Furthermore, determining whether a recipient is an Australian consumer can be difficult. The comments below in relation to the offshore supply of low value goods[25] are equally relevant to 'inbound intangible consumer supplies'.

What is still not clear is how the Commissioner proposes to administer these provisions. Does he:

- continue to seek to identify non-residents with an obligation to register, and ensure those taxpayers comply with that obligation?
- continue to attempt to educate non-residents of the peculiarities of the Australian GST law?
- invest ATO resources elsewhere once he has registered large suppliers and platform operators?
- accept that he cannot ensure compliance with these provisions on an ongoing basis?
- engage foreign tax authorities to conduct Australian GST audits of taxpayers residing in their jurisdiction?

[25] See paragraph 4.2.3.

- seek retrospective adjustments where he finds an entity that was required to register did not?

Education and ensuring compliance are significant issues here. Does the Commissioner intend to invest significant ATO resources in administering these provisions? If not, it might be preferable to raise the GST registration turnover threshold for non-resident suppliers of services and intangibles to Australian consumers from the present AUD 75,000.

4.1.3 How do these provisions rate under the TLIP and OECD model standard?

While these provisions are designed to achieve neutrality, the means through which this has been achieved is unnecessarily complex, particularly if the expected revenue gain is a relatively modest AUD 200 million per year.

Notwithstanding the simplified registration process for non-residents, the compliance costs and risks relating to identifying the status of the Australian recipient are very high. Furthermore, if the ATO is to administer these provisions in any serious manner, administration costs will also be very high.

In this author's view, these rules are far from clear, the drafting is unnecessarily complex and the risk of evasion or avoidance is high.

4.2 Imported low value goods

Since GST was introduced most goods that had a value of AUD 1,000 or less were not subject to GST when imported. This threshold was set at a time when there were comparatively few private importations of goods and it was thought that collecting GST on values at or below this level would be uneconomic. At the time, and it is probably still the case, most low value importations are less than AUD 250. Taxing these transactions results in less than AUD 25 per transaction/import.

That said, low value importations are now made in vast numbers as electronic commerce (and electronic platforms, in particular) are more commonly used by consumers.

4.2.1 Consumer importations and the 'Connected with Australia' rules

From 1 July 2018, goods with a value of AUD 1,000 or less ('low value goods') that are supplied to an Australian consumer by a supplier who imports the goods, or procures, facilitates or arranges the importation of the goods, will be taxed in the hands of the supplier, an electronic distribution platform (discussed above) or a re-deliverer.[26]

A consumer is defined to be an entity that is not registered or, if registered, does not acquire the goods imported solely or partly for the purposes of the enterprise it carries on in Australia.

If a GST registered entity imports low value goods not solely for a creditable purpose, it will be required to reverse charge pursuant to Division 84.[27]

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[26] *Treasury Laws Amendment (GST Low Value Goods) Act 2017* (Cth) ss 84-73 to 84-105.
[27] GST Act, s 84-5(1) Item 4.

4.2.2 Who makes the supply?

Where a supply is made through an electronic distribution platform, the operator of the distribution platform is treated as the supplier for GST purposes and the actual supplier is treated as not being the supplier.[28]

If an arrangement with the recipient of the supply involves the goods being delivered to an entity that is outside the Australian indirect tax zone and that entity (the re-deliverer) delivers (or procures, arranges or facilitates delivery of) the goods into the indirect tax zone (to the recipient), the re-deliverer is liable for the GST on the goods.[29] This is subject to the proviso that the re-deliverer:

- does this in the course of an enterprise;[30] and
- either provides an address outside Australia to which the goods are delivered, purchases the goods, or facilitates the purchase of the goods.[31]

4.2.3 Observations

As with the regime to tax 'inbound intangible consumer supplies', the regime to tax imported low value goods will impose a GST liability on entities that have no physical connection with Australia, and expect them to comply with laws that they have little or no exposure to. The scheme to tax electronic distribution platform operators and offshore re-deliverers may restrict the number of potential non-resident registrants, but it comes with considerable complexity and a lack of clarity in its application.

For example, in many instances it will be difficult for non-resident suppliers, electronic platform operators and re-deliverers to determine whether the recipient of a particular supply is an Australian consumer. The legislation effectively recognises this and addresses the matter in Sub-division 84-D. This Sub-division essentially requires non-resident suppliers, electronic platform operators and offshore re-deliverers to undertake reasonable steps to obtain information about the recipient and, after taking those steps, they must reasonably believe the recipient was not an Australian resident consumer.

Making subjective assessments of the status of a recipient is incompatible with the operation of an electronic platform. Determining how to address this matter is further complicated when non-resident suppliers, platform operators and re-deliverers are contemplating GST registration.

If a non-resident supplier, electronic platform operator or re-deliverer registers for GST purposes under the 'limited registration model', it will not be entitled to receive an Australian Business Number. As a result it cannot issue tax invoices. A GST-registered recipient who acquires offshore low value goods or 'inbound intangible consumer supplies' from an entity that is registered under this model, and is treated as an 'Australian consumer', will not be entitled to an input tax credit for the GST so charged.

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[28] Ibid s 84-81(3).
[29] Ibid s 84-81(4).
[30] Ibid s 84-77(3).
[31] Ibid s 84-77(4).

This potentially makes the limited registration model unattractive for some and is an added layer of unnecessary complication for taxpayers with limited understanding of Australia's taxation laws, and access to ATO information.

4.2.4 How do these provisions rate under the TLIP and OECD model standard?

The comments made in section 4.1.3 above in relation to 'inbound intangible consumer supplies' apply equally to the provisions relating to low value goods. That is, in the author's view, these rules are far from clear, the drafting is unnecessarily complex and the risk of evasion or avoidance is high.

4.3 Digital platforms – ride share and accommodation

The now ubiquitous uptake in the use of electronic platforms such as Uber and AirBNB continues to challenge GST policy and fair competition.

Division 84 should not apply to Uber, AirBNB and similar platforms where the service acquired is performed in Australia, or the property acquired under licence or lease is situated in Australia.

The question to be considered is whether the basic GST rules and exemptions provide the appropriate outcome for services supplied through Uber, AirBNB and other similar platform operators?

In the case of Uber's ride share arrangements with passengers, the Federal Court of Australia has effectively settled drivers' GST registration obligations – that is, Uber driver services are to be treated, for GST purposes, in the same manner as traditional taxi services.[32] Consequently, Uber drivers who transport passengers for a fare are required to register for GST purposes. The provisions of Division 144 of the GST Act apply equally to them and taxi drivers.

One assumes that drivers who do not transport passengers but only food, via Uber Eats, are in a different position and can remain outside the GST system if their GST turnover does not exceed the GST registration threshold.

In the case of AirBNB, the outcome is more debatable.

AirBNB accommodation may be provided in a number of ways; as a bed only, room only, room and breakfast, house or apartment rental, or a variety of these. Periods of residence may vary from a day to weeks. Some are available all year round, others for specific periods of time. Some operators have a 'stable' of properties, others just the family home, available for lease for limited time.

People providing accommodation through AirBNB are invariably carrying on an enterprise. The issue for many accommodation providers under the GST law is whether the supply of accommodation is an input taxed supply of residential premises or a taxable supply of commercial residential premises. If it is the former (as it is generally accepted to be), the policy issue governments need to contemplate is whether this outcome is appropriate where the accommodation provided through AirBNB is

[32] *Uber BV v Commissioner of Taxation* [2017] FCA 110; 104 ATR 901.

effectively competing with operators of premises that clearly qualify as commercial residential accommodation, such as hotels.

Currently, few providers of accommodation through AirBNB are registered for GST purposes. It is also likely hotels have accepted the new market 'options' available for sourcing accommodation and have adapted their business models accordingly, focusing on consumers looking for a 'hotel' experience.

Regardless, there is little doubt many providers of accommodation through AirBNB are carrying out activities in a business-like manner, are receiving income that would, in many cases, exceed the GST registration threshold and are a serious competitor to hotels, motels, hostels and boarding houses. There seems little reason why a government looking for revenue would not look at this 'market' as a ready-made source of GST revenue. It would also be hard for operators to contend that such an outcome was unfair. In fact, it sounds very fair.

5. A TAX ON CONSUMERS – WITHHOLDING RULES FOR SALE OF NEW RESIDENTIAL PREMISES

While not related to digitisation, I have included some comments in this paper on the withholding rules relating to the sale of new residential property, primarily because the Government has sought to provide an element of disruption into the property market in order to counteract GST fraud by a few.

Treasury Laws Amendment (2018 Measures No.1) Act 2018 (Cth) (2018 Measures No. 1 Act) amended the *Taxation Administration Act 1953* (TAA) by inserting new Sub-division 14-E into Schedule 1 of that Act. These provisions take effect from 1 July 2018.

In the second reading speech relating to the bill, the Minister for Revenue and Financial Services, Ms Kelly O'Dwyer said 'that the bill tackles tax evasion by companies that phoenix'.[33]

In its simplest form, 'phoenixing' in a tax context typically involves:

- a company disposing of certain assets or providing certain services to third parties and incurs a tax related debt;
- the company enters into liquidation holding no assets, but maintains an unpaid tax liability on its books;
- the individual(s) who effectively derived the economic benefits from the insolvent company, emerge 'from the ashes' to start anew through a direct or indirect involvement with a separate company, with no existing debts with the ATO (yet); and
- this new company will follow the path of its predecessor (or associate), and so it goes on.

It is clear the Commissioner believed he either required further powers to act on such individuals, or the relevant tax legislation (in this case the TAA and GST Act) required

[33] Hon Kelly O'Dwyer (Minister for Revenue and Financial Services), 'Legislation to Combat Illegal Phoenix Activity Released for Consultation', *Media Release* (16 August 2018).

changes to remove the ability for so minded individuals to enter into phoenix company arrangements. The 2018 Measures No. 1 Act sets out the changes for the latter of these two options.

5.1 Business structures and property

It is common for property developers to segregate properties under development in separate legal entities. This may be done for many reasons, including asset protection. Sometimes these entities may be unable to meet their financial obligations including taxation obligations and insolvency occurs. It is important to note that this is very much the exception rather than the rule.

It is difficult to overlook the fact that this withholding regime is effectively a 'back door' means of giving the Commissioner priority for property-related GST debts over all creditors (ie, including secured creditors) where a company becomes insolvent. Currently, the Commissioner ranks above secured creditors only in relation to certain Pay-As-You-Go (PAYG) withholding and superannuation debts.

5.2 The amendments

The broad effect of these amendments is to make the purchaser responsible for withholding the GST that is payable by a developer on:

- the sale of new residential premises (as defined in the GST Act), other than premises created through substantial renovation or commercial residential premises; or
- the sale of 'potential residential land' where:
  - the property is included in a property sub-division plan;
  - the property does not contain any building that is in use for commercial purposes; and
  - the purchaser is not registered for GST or does not purchase the property for a creditable purpose.[34]

The new provisions will apply to sales or long-term leases under contracts entered into on or after 1 July 2018. For the purposes of this article, a reference to a purchaser includes a reference to a long-term (greater than 50 years) lessee of property. The provisions have the following features:

- for contracts that are entered into before 1 July 2018, the withholding rules will not apply if any of the consideration is paid prior to 1 July 2020.[35] For contracts entered into before 1 July 2018 and settled on or after 1 July 2020, the withholding regime will apply despite the fact that the contract may have been signed before the start date of the withholding regime;[36]

[34] TAA, Sch 1, ss 14-250(1) and (2).
[35] See *Treasury Laws Amendment (2018 Measures No. 1) Act 2018* (Cth) ss 26-28.
[36] Ibid s 27.

- the amount of GST to be withheld is to be paid to the Commissioner on or before the payment of any of the consideration to the supplier;[37]
- the payment of a deposit does not constitute part payment of the consideration payable for the supply of the property, and as such does not trigger an obligation on the purchaser to withhold at the time the deposit is paid.[38] Furthermore, there is no withholding obligation where a deposit is forgone;
- however, where a purchaser acquires a property and the consideration is payable by instalments, the purchaser is required to pay to the Commissioner GST on the full purchase price of the property at or before the time the first instalment payment is made;[39]
- pursuant to section 14-250(6) of Schedule 1 of the TAA, the amount to be withheld is 1/11 of the contract price, unless the margin scheme applies. If the margin scheme applies, the amount to be withheld is 7 per cent of the contract price;
- if the contract specifies a price that is subject to adjustments, the amount to be withheld is determined on the above basis, without the need to take into account any adjustments. If the consideration is not specified in this way then the amount to be withheld is calculated by reference to the total amount payable under the contract;[40]
- where there are multiple recipients of a supply, the amendments treat each of them as receiving a separate supply and independently responsible for the withholding obligation in respect of their share of the original supply;[41]
- joint tenants are treated as if they were a single recipient. This means that joint tenants would be jointly liable for the withholding obligation, but tenants-in-common would have a separate obligation to withhold;[42]
- suppliers of property are required to notify the purchaser of the following:
    - whether the supply will be subject to the withholding regime and, if so, that GST is to be withheld;
    - the Australian Business Number (ABN) of the supplier;
    - the amount to be withheld; and
    - when it is expected that it will need to be paid by the recipient of the supply;[43]
- failure to do so exposes the supplier to court or administrative penalties of 100 penalty units (AUD 210,000). However, the failure of the supplier to notify the

[37] TAA, Sch 1, s 14-250.
[38] Ibid, Sch 1, s 14-250(4).
[39] Ibid, Sch 1, s 14-255(1)(a)(ii).
[40] Ibid, Sch 1, s 14-250(7).
[41] Ibid, Sch 1, s 14-250(11).
[42] Ibid.
[43] Ibid, Sch 1, s 14-255(1).

recipient does not impact on the obligation of the recipient to withhold GST if otherwise required to do so;[44]

- the supplier is entitled to a credit for the amount that has been withheld and paid over to the Commissioner by the recipient;
- in cases where the margin scheme applied to the supply, this could mean that the supplier is credited with a greater or a smaller amount than the actual amount of GST payable under the margin scheme;
- the recipient of a supply who fails to withhold GST on the acquisition of a relevant property is liable for a penalty equal to the amount that the entity fails to withhold and pay the Commissioner.[45]

5.3 Observations

5.3.1 A question of property

As mentioned above these provisions effectively give the Commissioner a priority over all other creditors of a property developer. This includes secured creditors. This is inconsistent with the general priority given to tax debts and will add further financial stress to small business suppliers to insolvent developers.

5.3.2 Cash flow

One of the consequences of this regime is the impact on cash flow for developers. Many businesses, including developers, rely on their payment terms with the Commissioner as a source of cash flow. These new measures will deprive all property developers of a cash flow advantage that is available to taxpayers in other industries.

Managing cash flow is a difficult exercise for property developers with a number of projects at various stages of completion. The time gap between incurring a development expense and realising the consideration for the finished 'product' is invariably large and requires careful financial management. It is common for developers to 'stretch' their terms of trade to pay suppliers in order to manage their cash flow. It will almost be inevitable that small business suppliers to property developers will have to wait longer to receive payment as a consequence of these measures.

5.3.3 Lack of precision

The distinction between premises that are residential premises and those that are not has not always been clear. There have been a number of cases that have considered whether a particular property is residential premises or not.[46] If the property consists of new residential premises and is not either created through substantial renovation or commercial residential premises, it will be subject to the withholding regime. If it is new but not residential premises, it will not be subject to it.

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[44] Ibid, Sch 1, s 14-255(3).
[45] Ibid, Sch 1, s 16-30.
[46] See, eg, *Sunchen Pty Ltd v Commissioner of Taxation* [2010] FCAFC 138, 78 ATR 197; *Vidler v Commissioner of Taxation* [2009] FCA 1426, 74 ATR 520.

Residential premises can remain new for five years or more after they are constructed. For GST purposes, residential premises are not 'new residential premises' if the premises have only been used to make input taxed supplies for a period of at least five years. The Commissioner's view is that the relevant five-year period must be continuous. If the premises have been used for any purpose other than making input taxed supplies, the five-year period starts again. Perversely, a property may be considerably more than 15 years old and still be considered new residential premises because it has not been used to make input taxed supplies for a continuous five-year period. How is a purchaser (who is generally unregistered) to know, with certainty, whether a property is new?

Where land is sold that comprises new residential premises and/or potential residential land and commercial premises, farming land or residential premises that is not regarded as 'new', an apportionment exercise will need to be undertaken. Who is responsible for this exercise, and how exposed a purchaser is in these circumstances, will give many purchasers cause for concern.

5.3.4 Fraud prevention v keeping compliance costs low

The withholding provisions are designed to counteract individuals entering into phoenix arrangements. Such arrangements are fraudulent, yet the provisions enacted are not aimed at punishing fraud and the perpetrators. Rather, the new provisions apply to all property developers and their unregistered customers. In other words, the vast majority of honest developers, their customers and legal advisers must pay for the sins of the fraudulent few.

To make matters worse, the application of GST to real property is arguably the most complex area of the GST law. These GST provisions must be navigated by the largest taxpayers in the country and the smallest.

To impose a complex withholding regime over an already complex set of rules, to be interpreted by small businesses and unregistered individuals who often do not have access to expert advice, and to potentially expose those entities to a tax administration that is presumably frustrated with tax leakage in the property sector, is a recipe for mistrust, fear, suspicion and dispute.

These provisions must be administered sensitively by the Commissioner, with a liberal application of common sense. It remains to be seen what happens. That said, I cannot help but think there must be a better way.

5.3.5 The design of a GST

A GST is a tax on final private consumption expenditure. It is imposed on the price charged by GST-registered suppliers of taxable goods, services (including intangibles) and real property and is complemented by a credit invoice system for GST-registered recipients. Where a recipient is unregistered, no credit applies, and GST is effectively imposed on the value of the relevant supply consumed. By design, GST collections are not imposed on unregistered consumers.

While the legislators may argue that the withholding amendments do not 'impose' the tax on unregistered consumers, but rather apply an obligation on those individuals to collect and remit, it is a moot point.

If the Commissioner cannot administer the GST system so that it appropriately applies to GST-registered entities only, perhaps it is time to consider whether a GST system is appropriate for Australia as we move towards the third decade of the new millennium. Then again, perhaps the government has overreacted to tax evasion by a few.

6. REVISITING THE PAST

This article does not seek to imply that the recent amendments have started some sort of erosion of the initial TLIP design. As mentioned earlier, that erosion started before 1 July 2000 when the financial services provisions were moved to the GST Regulations and were exacerbated when some other changes were made over the ensuing 20 years.

In the spirit of reviewing this 20-year journey, it is worth pointing out some areas of the GST policy and law that can be improved.

6.1 Capital raising and business expansion through the acquisition of shares

Where an entity raises capital through the issue of shares to Australian residents, the entity is potentially denied full input tax credits for the GST component of costs incurred to make the share issue. However, if the shares are sold to a non-resident of Australia, the supply would be GST-free as an 'exported' service and any GST incurred on business inputs should be fully recovered as input tax credits. Alternatively, if the same entity raised capital through borrowings and those borrowings are used to make taxable or GST-free supplies (which is what most entities supply), no denial of input tax credits ensues. This is hardly a neutral outcome and the reason for differing treatment is not evident.

Furthermore, if an entity making fully taxable supplies acquires shares in another entity making fully taxable supplies, both entities are potentially denied input tax credits for the GST incurred on transaction costs. However, no 'GST cost' would ensue if the assets of the business were sold in fully taxable circumstances (the GST-registered recipient would get a full input tax credit) or the business was sold as a GST-free going concern. Once again, an outcome that is not neutral.

One of the underlying strengths of a well-designed GST system is the neutrality of its application. A well-designed GST system should tax final private consumption expenditure and should not be a tax on business inputs (with a few notable exceptions). Denying an entity making fully taxable supplies input tax credits results in GST forming part of its cost base. One would expect that business to seek to recover its costs (including unrecovered GST) in the selling price of its taxable or GST-free goods and services.

In the author's view, in the 20th year of the Australian GST, the Australian Treasury should review the GST treatment of capital raising and merger and acquisition activity with a view to amending the GST law to provide a neutral outcome that avoids a cascading of GST.

6.2 Financial services

Australia's GST financial supply provisions are unique. Some may say, uniquely complicated. The Australian approach to applying GST to financial services has been studied by many countries implementing a GST or VAT system and adopted by none. On the occasion of the 20th anniversary of Australia's GST becoming law, it seems

appropriate to question whether Australia's approach to input taxing financial services is the right approach.

Input taxing financial services is the common GST/VAT international treatment. However, such a system is inherently flawed insofar as the GST cost incurred by the financial institution is embedded (in a non-recoverable form) in the price of its services. Where those services are acquired by an entity making fully taxable supplies, GST will be embedded in the price of those services and will cascade through the commercial chain. This was recognised by the New Zealand government. Since 1 January 2005, the New Zealand GST law has zero-rated financial supplies made to GST-registered businesses.

The drafting of the financial supply provisions in the Australian GST law is inelegant, repetitive, complex, and the antithesis of principles based drafting.

Most GST and VAT systems deny input tax credits for GST incurred on business inputs acquired to make certain financial services. Financial services are generally defined as a reference to certain activities, such as the borrowing and lending of money, the sale and purchase of shares, etc. In Australia, it was decided to define a financial supply as being a property interest in a particular thing, such as an interest in an account, an interest in a credit arrangement, etc. An unwelcome consequence of this approach was to treat an acquisition of an interest in a financial supply as a 'supply' for GST purposes.

It is unclear why those drafting the financial supply provisions did this but it is notable that this drafting was the basis of Travelex's argument in the High Court that the supply of an interest in Fijian currency was a right for use outside Australia and was GST-free.[47]

Supplies by financial intermediaries are not included in the definition of financial supplies and are taxable. To mitigate the financial impact of this decision on financial institutions, the government developed the reduced credit acquisition (or reduced input tax credit) regime. The financial supply provisions contain lengthy lists of what is and is not a financial supply and reduced credit acquisition, with few interpretive principles to assist. In the author's experience both administering and advising on the application of tax (primarily indirect tax), the longer the legislative list, the greater the scope for dispute, unless both sides (the ATO and financial institutions in this case) work together to agree an appropriate outcome.

That was the case for the first 15 or 16 years of the GST. The relationship between the ATO and financial institutions during the last three to four years is noticeably strained.

In the author's view, the time has come for the government to re-evaluate how GST applies to financial supplies. The Commissioner has announced he is considering issuing a legislative determination, compelling financial institutions to apply a mandated apportionment methodology (effectively mandating a GST recovery rate) for acquisitions relating to the credit card issuing business of financial institutions.[48]

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[47] *Travelex Limited v Commissioner of Taxation* [2010] HCA 33; 241 CLR 510.

[48] See Australian Taxation Office, 'Goods and Services Tax: Determining the Creditable Purpose of Acquisitions in a Credit Card Issuing Business', GSTD 2008/D1.

If the Commissioner is openly contemplating by-passing sections 11-5 and 11-15 of the GST Act for credit card issuing businesses, in my opinion, the time has come for the government to completely reconsider these provisions. To the author, as a tax professional of 40 years, it is astounding that the Commissioner would consider the use of a legislative instrument for this purpose as an appropriate use of his powers.

Perhaps it is the canary in the coal mine and the Commissioner and his team of advisors believe sections 11-5 and 11-15 are unworkable in relation to financial supplies and they have taken the matter into their own hands. If this is the path the Commissioner is heading down, it is not possible for the government to ignore this issue any longer.

In the author's view, the time has come for the government to openly embrace making margin based financial supplies GST-free. All other financial supplies should be taxable or GST-free. This will dispense with apportionment issues, the reduced credit regime and ensure GST does not become a cost for GST-registered Australian businesses and non-resident businesses. At least from an indirect tax perspective, it will assist in making Australia more attractive as a financial services centre for the region. The amount of revenue forgone may be a small price to pay for greater economic output, and for certainty in the GST system.

6.3 Changes in creditable use

The adjustment provisions designed to reflect changes in the extent of creditable purpose (over time) are unacceptably complicated, particularly when compared to similar provisions in other GST or VAT laws. The fact is, the Division 129 adjustment rules are 'more honor'd in the breach than the observance'.[49]

Division 129 of the GST Act requires an entity to make an adjustment of the GST claimed as an input tax credit where:

- the entity has acquired (or imported) goods and services that are not wholly used for a creditable purpose; and
- the acquisition (or importation) relates to the entity:
    - making financial supplies and the value of the acquisition (or importation) is greater than AUD 10,000 (excluding GST); or
    - not making financial supplies and the value of the acquisition (or importation) is greater than AUD 1,000 (excluding GST); and
- the use of the relevant acquisition or importation has changed during the adjustment period.

The adjustment period will be one period, five periods or ten periods, depending upon the value of the acquisition or importation.

It seems remarkable that a country which, through GST design, restricts the number of entities making input taxed supplies (when compared to most other countries with a GST or VAT system) requires affected businesses to make adjustments where the value of an acquisition is as small as AUD 1,000. It is little wonder many businesses ignore

[49] William Shakespeare, *Hamlet* (Simon and Schuster, 2012) Act 1, Scene IV.

their responsibilities in this area. It is cheaper to do so and manage the consequences (if any) later. This does not go well for the integrity of the tax and the original intent to complement business practice and reduce compliance costs, to the extent possible.

In the author's view, it is time to redesign Division 129 and take a practical approach. First, the thresholds should be increased substantially. Secondly, a *de minimis* threshold should be considered such that if the change of use is less than 10 per cent of the original estimate, no adjustment is required.

6.4 Vouchers

The voucher rules in the Australian GST law, and the Commissioner's interpretation of these rules, is a minefield of complexity.

Vouchers come in many forms and, in some circumstances, can be redeemed for taxable and GST-free supplies. Vouchers are often sold through a distribution chain (including at the retail level) at a discount to their face value. It is also common for vouchers to be sold by a retailer and redeemed from the originator who is also a wholesale distributor.

Division 100 of the GST Act provides that certain vouchers are not subject to GST when they are sold, but are treated as consideration for goods and services acquired upon redemption. GST is payable on the face value of the voucher when redeemed, in these circumstances. If a voucher covered by Division 100 is not redeemed, GST will be payable on the face value of the voucher when it is taken up as income in the originator's accounts.

The GST treatment of vouchers exposes a number of issues, including the following:

- the GST treatment is not neutral as different forms of voucher have different GST treatments that affect not just the timing of the payment of GST, but also quantum;
- upon redemption, GST is often applied to an amount (the face value) which is greater than the amount of money any person in the supply chain has received. In other words, GST is payable on an effective tax rate in excess of 10 per cent;
- businesses that acquire vouchers for use in their business (such as those who operate loyalty programs) do not get a credit for the GST embedded in the voucher; and
- the legislative provisions are complex and, in many instances, need to be read with the Commissioner's view set out in his GST ruling GSTR 2003/5.[50] It is not an exaggeration to suggest that, in part, this ruling is almost incomprehensible.

In the author's view, it is time for the government to consider amending the GST law to provide:

1. an option to tax vouchers (many are only ever redeemed for taxable supplies);

[50] ATO, 'Goods and Services Tax: Vouchers', GSTR 2003/5.

2. a decreasing adjustment for GST-registered businesses that acquire vouchers covered by Division 100 for use in their business; and

3. a simplified approach similar to those adopted by other tax jurisdictions.

7. CONCLUSION

Technology and digitisation are the great disrupters of the 21st century. They are the latest in a long line of disrupters that extends from the time humans first walked out of the Rift Valley. However, it is the pace and impact of change since the start of the Industrial Revolution that has been phenomenal. In one sense, digitisation is just another in a long line of post-Industrial Revolution disrupters that include the steam engine and the related automation across manufacturing industries, the Bessemer steel process, the internal combustion engine, the jet engine, personal computers, mobile phones and many other forms of technology. What is unique about digitisation is that the speed of change is increasing, not slowing.

People and economies have an amazing ability to adapt to new technology and it is incumbent upon governments to react appropriately. While digitisation is a direct consequence of the inventions and 'disrupters' that proceeded it, globalisation is a consequence of technology (including digitisation), economic policy and the political will to embrace it.

It is incumbent upon the government to ensure its laws, particularly revenue laws, are designed and managed in such a way as to ensure they can react and adjust to economic changes in a neutral manner, maintain coherence (ie, remain clear and simple), and seek to have a light touch on taxpayer businesses (ie, keep compliance costs low).

Once tax law becomes complex and impenetrable, it quickly becomes antiquated. Redesigning an outdated law is difficult. Developing and gaining support for a new tax is very difficult, as the road to Australia's GST clearly illustrates.

In the author's view, reducing complexity and compliance costs for taxpayers when developing and drafting law changes is key to maintaining control and integrity over the tax system. Complexity in tax law is too often a result of:

- not properly thinking through solutions that lead to legislative change; or
- poorly thinking through interpretations of existing provisions that eventually leads to a change in the law, often adding more complexity, rather than less.

Both of these have occurred with the GST law over the past 20 years.

As technology develops, new and more efficient forms of indirect tax may emerge. However, it is worth remembering that the road to a GST took Australia 25 years and it was a torturous journey. While some economists may dream of a broad-based, flat-rate, no-exemptions indirect tax model, that model has been found to be elusive – destroyed at the ballot box.

Some of the alternative indirect taxes proposed (such as cash flow taxes) appear to rely on few or no exemptions. It is difficult to see community support for a no-exemption indirect tax.

There is much to be learnt from the past, and things we should repair. However, we must also look to the future and plan for change. What is certain is that technology will continue to develop, challenges will continue to arise and we should expect the GST, with careful management, to continue to roll on for many years to come.

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Fiscal neutrality:
Foreign ghost in our GST machine?[1]

Gordon Brysland[2]

Abstract

This note argues for the orthodox view that EU neutrality is not part of the GST law. It is no foreign ghost in our GST machine, to use the metaphor selected for this note. The reasons for a negative answer on the issue are diverse, over-lapping, consistent, and ultimately mundane. They also go beyond any mere analysis of the respective legislation and cases in each jurisdiction. The stark differences between the two legal systems and, more importantly, their interpretation protocols are vital to explaining why the orthodox view on EU neutrality is not just the better one, but effectively the only viable one.

After a review of the VAT neutrality concept generally, attention turns in this note to the landmark judgment of Hill J in *HP Mercantile,* his later comments on 'underlying philosophy', and the way they have been received by the courts and commentators. This leads to a review of the principles which apply in our system of statutory interpretation, and discussion of the handful of Australian cases which directly consider EU neutrality. That neutrality, like our own, however, is properly to be understood only within its particular legal, economic and political milieu. A review of EU interpretation principles, the impact of EU law in Britain and selected EU neutrality cases then follows.

Observations made on these matters flow into a discussion of *Rio Tinto*, consumption, practical business tax and tie-breaker issues. The central conclusion reached by this note is that our interpretation protocols, and the real differences between the respective legal systems, only serve to confirm that EU neutrality is not part of the GST law. This is a less than surprising outcome. The Div 11 neutrality we do have, however, works to acceptable modern VAT standards of purity and integrity. Final comments are made about the 'life of our GST statute' so far and its future prospects.

Key words: goods and services tax, underlying philosophy and Hill J, *HP Mercantile* decision, VAT concept of fiscal neutrality, input tax credit access, statutory interpretation in Australia, judicial approaches to the GST law, Australian neutrality cases, statutory interpretation in Europe, teleological principles, EU system of law, European law in Britain, EU neutrality cases, *Rompelman* decision, key aspects of EU neutrality, adoption of EU neutrality in Australia rejected, *Rio Tinto Services* decision, impact of foreign cases, policy preconception, relevance of consumption, practical business tax, application of tie-breaker rules.

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[1] This note revisits themes considered in a paper given at the *Law Council Tax Committee Workshop* on 18 October 2008, and later comments on the issue in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 40-42).

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1. INTRODUCTION

1.1 A New Tax System

Twenty years ago, a package of bold tax reforms was implemented in Australia. They included replacing the old sales tax regime with a new GST law[3] substantially modelled on VAT-type legislation in force elsewhere. Political, economic and legal arguments supported passage of the package as a whole.[4] One legal reason was that the High Court had held that State franchising fees were constitutionally invalid.[5]

The *Tax Reform* paper with the draft legislation said the existing system was 'out of date, unfair, internationally uncompetitive, ineffective and unnecessarily complex'.[6] Hill J said that *Tax Reform* (the paper) 'was a political document and did not purport to be otherwise.[7] The *Australian Financial Review* on 3 August 1998 ran an article headed *– MPs see 'monster' tax reform as a winner*. The decision effectively to hand the GST revenue over to the States and Territories was described as a 'game-changer'.[8]

The *A New Tax System* Bills for the original blueprint were introduced into parliament on 2 December 1998. A nineteen month gestation period involving a range of complications followed – 'long and turbulent', as one commentator described it.[9] The new laws finally took effect on 1 July 2000. In the prophetic words of Alfred Deakin, the States were 'financially bound to the chariot wheels of the central Government'.[10]

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[3] The *A New Tax System (Goods and Services Tax) Act 1999* and the *A New Tax System (Goods and Services Tax) Regulations 1999*.
[4] Stewart *Reforming Tax for Social Justice* (1998) 23 *Alternative Law Journal* 157.
[5] *Ha v New South Wales* (1997) 189 CLR 465, cf Williams *'Come in Spinner': Section 90 of the Constitution and the Future of State Government Finances* (1999) 21 *Sydney Law Review* 627.
[6] Treasury *Tax Reform: not a new tax, a new tax system* (at 5).
[7] Hill J *Tax Reform: A Tower of Babel; Distinguishing Tax Reform from Tax Change* (2005) 1/2 *Journal of the Australasian Tax Teachers Association* 1 (at 17).
[8] Alley, Bentley & James *Politics and tax reform: A comparative analysis of the implementation of a broad-based consumption tax in New Zealand, Australia and the United Kingdom* (2014) 24/1 *Revenue Law Journal* 1 (at 13).
[9] McCarthy *The Australian GST – Why is it the Way it is and Where to from Here?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 61 (at 61).
[10] Deakin *Federated Australia: selections from letters to the Morning Post 1900-1910* (at 97).

It had been fully a quarter of a century since the *Asprey Report* recommended a broad-based consumption tax. Essentially, we picked and chose and innovated on GST from laws elsewhere.[11] The full history of this is traced by Kathryn James in a *British Tax Review* article – *We of the 'never ever'*,[12] and by former Tax Commissioner Michael D'Ascenzo in his paper for this conference – *Making the Value Added Tax Happen*.[13]

We generally liked the new drafting style of the GST law,[14] though the terminology jarred for a few. One federal judge said the statute was 'horribly named',[15] while another called it 'spin'.[16] It looked more to principles in some areas, though it descended into familiar rule-based tactics in others. We looked twice at the volume of exemptions, seen as 'anathema' generally to value added taxes,[17] but which temper their regressive tendencies. Overall, we were impressed by the vision of the project.

Downes J said our GST was 'based on a simple idea'.[18] That idea, commented Blow J, was that the 'very nature of the GST, as a species of value added tax, is that burden of all GST payable by the members of a chain of suppliers is passed on to the ultimate consumer'.[19] A tax based on a simple idea is not the same thing as a simple tax, of course, particularly when the simple idea is high-level economic in nature On whether GST is a simple tax, Richard Vann said – 'To put it mildly, simplicity was oversold'.[20]

We came to find that the GST law not as simple as we had hoped for, and that we had in fact not escaped classification cases.[21] Making certain public goods GST-free as a way of addressing inherent regressivity would only add to the complexities of administration and provide fertile ground for costly disputes.[22] And, many of us wondered what influence foreign VAT principles may have in Australia.

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[11] Acquisition supplies, the RITC regime, our financial supply regulations, and subjection of government to the tax, for example – Brysland *GST and Government in 2010* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 3.

[12] James *We of the "never ever": The History of the Introduction of a Goods and Services Tax in Australia* [2007] *British Tax Review* 320, cf Alvey & Roan *A Public Policy Case Study of the Introduction of the Goods and Services Tax: tax reform can be successfully achieved* (2015) 10 *Journal of the Australasian Tax Teachers Association* 67.

[13] D'Ascenzo *Making the Value Added Tax Happen* [2019] *ATAX Where Policy Meets Reality Conference paper*.

[14] Richardson & Smith *The Readability of Australia's Goods and Services Tax Legislation: An Empirical Investigation* (2002) 30 *Federal Law Review* 475 (at 485).

[15] Lindgren J *The Curious Case of GST* [2009] *TIA National GST Intensive Conference paper* (at 3).

[16] Logan J *Where are we with GST – black letter or the practical business tax?* [2008] *TIA National GST Intensive Conference paper* (at [2]).

[17] Crawford, Keen & Smith *Value Added Tax and Excises* in Adam (ed) *Dimensions of Tax Design: The Mirrlees Review* 275 (at 305), Ebrill *The Modern VAT* (at 100), James *The Rise of the Value-Added Tax* (at 50-52).

[18] Downes J *Eleven years of the 'practical business tax'* (February 2012) 70 *Law Institute Journal* 70 (at 70).

[19] *Pebruk Nominees Pty Ltd v Woolworths (Victoria) Pty Ltd* [2003] TASSC 94 (at [40]).

[20] Foreword to Chiert GST: Insurance and Financial Services (at v).

[21] *Lansell House Pty Ltd v FCT* [2010] FCA 329 (crackers), *JMB Beverages Pty Ltd v FCT* [2010] FCAFC 68 (de-alcoholised wine).

[22] cf Carmody *Commentary – Preparing For Tax Reform and the New Millennium: Don't Draw a GST Line Around Food* (1999) 2/4 *The Tax Specialist* (at 171).

1.2 Underlying philosophy

Justice Graham Hill of the Federal Court was particularly interested in how the EU concept of fiscal neutrality might influence credit access in Australia. No-one disagrees that strong and robust neutrality is a pre-condition for delivery on the economic policy objectives of the tax. In one influential article, Hill J described this as part of the 'underlying philosophy' of the VAT system.[23] The question I have posed is whether EU neutrality has become some foreign ghost in our GST machine, as the judge hinted at.[24]

My answer to this question is 'no'. The reasons for this are ultimately mundane. To the extent that any principle akin to 'fiscal neutrality' in either of its EU senses is part of Australian law (either substantively or as some rule of construction), it is to be found first and exclusively within our own GST provisions by reference to orthodox principles of interpretation. The fact that the EU trader, in principle and in practice, is to be relieved entirely of input tax borne is an observation about the operation of foreign law in other jurisdictions. This is the case whether we are talking about neutrality as part of the EU treaty principle of equal treatment, or neutrality as a rule of construction derived from the language and experience of VAT directives. My question, however, only opens the door to another (better) question – that being, if EU neutrality is no part of our GST law, do we have a native neutrality of our own and if so what does it look like?

1.3 Our native neutrality

Of course we do, whether or not the GST law or extrinsic materials use that precise term. This is what Div 11 is all about, subject to Div 129. EU statutes and cases decided under them do not impact, control or extend our own neutrality. EU neutrality is not some foreign ghost in our GST machine. Certainly, as Justice Hill hinted, there remains a wider international and historical perspective to our GST law.

That alone, however, provides no obviously coherence basis for reception into our law of EU neutrality. No formal linkage mechanism is present. No multilateral treaty was involved to which Australia is party. We passed no legislation like the *European Communities Act 1972*. No other rule makes good the connection – the language, context and cultures are too different. High-level economic policy (domestic or foreign) or its preconception cannot leverage the GST law. Appeals to broader philosophical notions tend to fall on deaf ears. More fundamentally, the text of Div 11 was enacted in its own terms, chosen with care and presumed deliberation.

These conclusions should come as no surprise.[25] The idea that EU 'fiscal neutrality' produces some presumptive bias in favour of the Australian taxpayer where interpretation is contested is problematic on its face. Rather like the 'private domestic consumption' yardstick of the economic policy analysts, EU neutrality is a distraction from the normal legal task of determining what parliament meant by the words it used in our GST law.[26] Australia did not acquire an EU-style neutrality by some process of

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[23] Hill J *GST Anti-Avoidance – Division 165* [1999] *Journal of Australian Taxation* 295 (at 306).
[24] cf Evans *Neutrality, like truth, is rarely pure and never simple* (2017) 17 AGSTJ 3, Evans *VAT Principles* [2018] taxsifu materials, Evans *Capital Raising costs – the wrong side of the mirror?* (2007) 10/3 *The Tax Specialist* 120, Evans *The Value Added Tax treatment of real Property – An Antipodean Context* in White & Krever (eds) *GST in Retrospect and Prospect* (at 243-249).
[25] cf Olding *An ATO perspective on the creditable purpose test* (2012) 12 AGSTJ 131.
[26] cf *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591 (at 613), *Harrison v Melham* [2008] NSWCA 67 (at [160]) for example.

international osmosis. The routine task of resolving constructional choice issues is performed by the 'unqualified statutory instruction' in s 15AA of the *Acts Interpretation Act 1901*. My conclusion is also supported by comments in three decided cases: one directly, the other two by necessary inference. Block DP was right in 2009 to hold that the 'principle of fiscal neutrality is not part of Australian law'.[27]

1.4 Policy and reality

The theme for this conference – *Where Policy Meets Reality* – may suggest an atmosphere of some regret. Has the bright idealism of the GST architects and the economic policy people been forced back to the grim reality of mere legal rules? Perhaps for some, the wake started in 2008 when the High Court decided *Reliance Carpet*.

Certainly, that case said important things which only go to underline that EU neutrality is no foreign ghost in our GST machine. The real reality, however, is that we do have a robust neutrality deriving from the GST law itself. It functions rather like its EU counterpart, and it is reckoned by many to work more efficiently. It may not be the same as the EU one and it may not be pure, but neutrality in the EU is far from pure either. The EU counterpart is acknowledged to be reduced by inconsistencies and is unpredictable in its outworkings. It is subject to judicial whim and manipulation; it is opaque in its evolutions; it is said to create uneven outcomes, and it is constantly besieged by member states acting in their own self-interest.[28]

When it comes to our neutrality, economic policy may have hit the reality of the law 20 years on. This can happen in a 'rule of law' system. The EU system by contrast is said by many to be governed by the 'rule of economics'.[29] John Davison and Roderick Cordara in their capital raising paper say that that the 'economic analysis of transactions which is often made by the European courts is potentially of universal significance'.[30]

In the opinion of some EU commentators – 'If we depart from the economic rules … there will be no coherent system at all and the best thing to do with the Directives is to burn them'.[31] Even if our domestic neutrality is different to the EU, are we really at the point where we should scrap our neutrality and start again? Even those critical of our system concede that the GST law is 'by and large, an efficient tax'.[32] Our neutrality outcome is no great policy failure on any objective measure.[33]

As *Rio Tinto* confirms, the credit access system works to modern standards with acceptable purity and integrity.[34] It also calibrates well to the Vatopian model proposed by law professors Schenk and Oldman.[35] The objective experience supported by

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[27] *Electrical Goods Importer v FCT* [2009] AATA 854 (at [52]).
[28] cf Cordara *The Sixth VAT Directive and Key Legal Issues under VAT in Europe* (at 4), James & Stacey *The limits of supply* (2002) 2 AGSTJ 41 (at 44).
[29] Watson & Garcia *EU VAT and the Rule of Economics* [2009] *International VAT Monitor* 190.
[30] Davison & Cordara *The raising of capital – a European perspective* (2004) 4 AGSTJ 1 (at 9).
[31] Watson & Garcia *Babylonian Confusion Following ECJ's Decision on Loyalty Rewards* [2011] *International VAT Monitor* 12 (at 12).
[32] Evans *Taxation of goods and services in Australia – commentary* (2009) 9 AGSTJ 30 (at 35) for example.
[33] cf Stitt *GST – History, Experience & Future* [2007] *Federal Court Judges' Taxation Workshop paper* (at 2).
[34] *Rio Tinto Services Ltd v FCT* [2015] FCA 94, *Rio Tinto Services Ltd v FCT* [2015] FCAFC 117.
[35] Schenk & Oldman Value Added Tax – A Comparative Approach (at 463), cf James The Rise of the Value-Added Tax (at 41), McCarthy *The Australian GST – Why is it the Way it is and Where to from Here?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 61 (at 66).

external feedback reveals a system which is tolerably coherent and largely functional. Denis McCarthy, for example, said that our GST law 'stacks up well in its design and application'.[36] Kevin O'Rourke wrote that Australia 'has a world-class GST administration both for the nuts and bolts of processing BASs and for the bells and whistles of world-first legislation'.[37] Apparently the Europeans envy it.

In terms of economic performance against wider federal financial goals and benchmarks,[38] however, there are a range of difficult strategic challenges ahead to confront,[39] particularly in the post-COVID-19 world. As a matter of plain fact, the GST system is performing progressively poorly against those goals and benchmarks as time goes by. As a matter of economic notoriety, both the rate and base cry out for re-examination and upgrading. Ten percent is unsustainable into the future. Even if the exemption categories are 'reasonably settled' in their application,[40] calls for rationalisation and expansion of the base are increasingly heard. Part of the problem is that any changes require a political consensus of the jurisdictions. Without irony, Peter Costello recently spoke about the 'lock mechanism' which had underwritten the success of the GST reforms and guaranteed that the system had remained 'remarkably stable'.[41]

2. VAT AND NEUTRALITY

2.1 Emergence and uptake

Indirect consumption taxes have been around since ancient times – it is 'historically the oldest form of taxation'.[42] Jonathan Barrett sets out the political economy VAT background of Thomas Hobbes and John Locke in a 2010 article – *Equity and GST Policy*.[43] He traces emergence of the concept of a consumption tax from a Wilhelm von Siemens essay on the *Veredelte Umsatzsteuer* a century ago, through the primitive French TVA of 1948 (*la taxe de valeur ajoutée*) presided over by Maurice Lauré (refined in 1954), and the Michigan *Business Activity Tax* of 1953.[44] Professor Terra

[36] McCarthy *The Australian GST – Why is it the Way it is and Where to from Here?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 61 (at 74).
[37] O'Rourke *GST Administration – a practitioner's perspective* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 15).
[38] Evans *GST: Where to next?* [2019] *Where Policy Meets Reality Conference paper* (at 14), Smith *GST as a secure source of revenue for the States and Territories* [2019] *Where Policy Meets Reality Conference paper* (at 12-13).
[39] Smith *GST as a secure source of revenue for the States and Territories* [2019] *Where Policy Meets Reality Conference paper*, Evans *GST: Where to next?* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 5).
[40] cf Martin *The Case for Specific Exemptions from the Goods and Services Tax: What should we do about Food, Health and Housing?* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 25).
[41] Alcorn *Cabinet papers 1998-99: Coalition's campaign to unleash the GST laid bare* (1 January 2020) *The Guardian*.
[42] Lang *The Case for Taxing Consumption* (1990) 1 *Revenue Law Journal* 186 (at 187), cf James *The Rise of the Value-Added Tax* (at 1-3), Schenk & Oldman *Value Added Tax – A Comparative Approach* (at 2).
[43] Barrett *Equity and GST Policy* [2010] *Journal of Applied Law and Policy* 15.
[44] cf Schenk & Oldman *Value Added Tax – A Comparative Approach* (at 395-400).

provides more detail on this issue,[45] and on early American theory and writings.[46] Regarding the French TVA, Carl Shoup observed[47] –

> The latest innovation is the value-added tax. Its emergence in France illustrates the process by which a sort of continuing ferment of improvisation now and then gives rise to an invention of the first order.

Other commentators have pointed out that VAT 'should be considered the most important event in the evolution of tax structure in the last half of the twentieth century',[48] and that it has become 'one of the most dominant revenue instruments across the world'.[49] Logan J said that our new GST 'is just an Australian exemplar of a value added type of regressive, indirect tax that was known to and described by public finance economists well before the Second World War'.[50] At any rate, rapid international and some intra-national[51] uptake of this model followed its adoption by the *European Economic Community* in 1967. The United States remains the only developed country not to legislate nationally or federally for a value-added tax.

Back in Europe, VAT Directives became subject to progressive evolution and refinement, culminating in Directive 2006/112/EC. The detail of the history in this respect is traced in *SAE Education*.[52] New Zealand is recognised as having the purest VAT system in terms of neutrality.[53] When our GST was introduced, Graeme Cooper and Richard Vann in their *Sydney Law Review* article concluded that our purity 'is midway between the EU and New Zealand versions'.[54] As Michael Evans gently reminds us – *Neutrality, like truth, is rarely pure and never simple*.

Tax laws 'work best when they interfere least with production and consumption decisions in a properly functioning market'.[55] The central idea is that those decisions 'should be made based on their economic merits and not for tax reasons'.[56] As Schenk and Oldman state, VAT 'is intended to tax personal consumption comprehensively, neutrally, and efficiently'.[57] VAT also 'has been the biggest EU success story do far',[58]

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[45] Terra *Creditable Input Tax and Shares in EU VAT – Attribution, Apportionment and Allocation* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 179-180), cf Brooks *An Overview of the Role of the VAT, Fundamental Tax Reform, and a defence of the Income Tax* in White & Krever (eds) *GST in Retrospect and Prospect* (at 603-609).
[46] Adams *Fundamental Problems of Federal Income Taxation* (1921) 35 *Quarterly Journal of Economics* 553.
[47] Shoup *Taxation in France* (1955) 8 *National Tax Journal* 328.
[48] Cnossen Global Trends and Issues in Value Added Taxation (1998) 5 *International Tax and Public Finances* 399 (at 399).
[49] James *The Rise of the Value-Added Tax* (at 1).
[50] Logan J *Where are we with GST – black letter or the practical business tax?* [2008] *TIA National GST Intensive Conference paper* (at [3]).
[51] *First Nations Goods and Services Tax Act 2003* in Canada, for example.
[52] *SAE Education Ltd v RCC* [2019] UKSC 14 (at [11-20]).
[53] Preface to White & Krever (eds) *GST in Retrospect and Prospect* (at vii-viii), cf *Value-Added Tax Act 1991* (South Africa).
[54] Cooper & Vann *Implementing the Goods and Services Tax* (1999) 21 *Sydney Law Review* 337 (at 344).
[55] James *The Rise of the Value-Added Tax* (at 26).
[56] van Brederode *Systems of General Sales Taxation: Theory, Policy and Practice* (at 45).
[57] Schenk & Oldman *Value Added Tax – A Comparative Approach* (at 33).
[58] Vanistendael *Can Member States Survive EU Taxation? Can the European Union Survive National Taxation?* in Baker & Bobbett (eds) *Tax Polymath* (at 369).

and neutrality 'is the leading principle of VAT'.[59] The House of Lords has described neutrality as a fundamental principle or 'golden rule' of value added tax.[60] Marco Greggi says effective neutrality 'is the European VAT's Holy Grail: a path rather than an achievement'.[61] Michael Ridsdale observes that the ECJ 'has consistently synonymised the purpose of the VAT directives with the principle of fiscal neutrality'.[62]

Neutrality in the EU is used in two distinct senses, as explained by Dr Friederike Grube in her 2017 article.[63] First, it reflects the constitutional principle of 'equal treatment' insofar as equal transactions are to be treated the same way, and taxable persons carrying on the same activities are to be treated the same way for VAT purposes. The VAT position in this regard reflects the wider European principle of equal treatment.[64] Second, neutrality is an interpretive principle derived from successive VAT directives.[65] While this over-simplifies the EU picture,[66] for present purposes it provides a working model.

The classic statement of neutrality, quoted and applied numerous times with something approaching devotional fervour, comes from the 1985 decision in *Rompelman*[67] -

> … the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of the valued added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way.

Neutrality expresses the notion that traders in a VAT system are entitled, as a matter of primary right and systemic imperative, to recoup all the tax they bear on inputs. They are to be, to the greatest extent, fiscally neutral insofar as business inputs are concerned. Fiscal neutrality is the mechanism which prevents cascading – that is, the 'tax-on-a-tax' effect so noxious to proper functioning of any VAT system. One commentator refers to this under the general heading – 'Detestability of double taxation'.[68]

From an economic policy perspective, GST is to be wholly eliminated as a cost component in the price of taxable outputs.[69] Best-practice VAT design requires that

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[59] Kogels *Making VAT as Neutral as Possible* (2012) 21 *EC Tax Review* 230, Amand *VAT neutrality: a principle of EU law or a principle of the VAT system?* [2013] *World Journal of VAT/GST Law* 163 (at 163).
[60] *CEC v Liverpool Institute for Performing Arts* [2001] 1 WLR 187 (at 1190).
[61] Greggi *Neutrality and Proportionality in VAT: Making Sense of an (Apparent) Conflict* (2020) 48 *INTERTAX* 122 (at 123).
[62] Ridsdale *Abuse of rights, fiscal neutrality and VAT* [2005/2] *EC Tax Review* 82 (at 93).
[63] Grube *Neutrality and input tax deductibility* (2017) 17 AGSTJ 8.
[64] *LuP GmbH v Finanzamt Bochum-Mitte* [2006] ECR I-5123 (at [48]), CRC v Rank Group plc [2011] Joined Cases C259/10 and C-260/10 (at [61]), *Sub One Limited v CRC* [2012] UKUT 34 (at [11]).
[65] cf Evans *VAT Principles* [2018] taxsifu (at 6-11), Terra & Kajus *A guide to the European VAT Directive* (at 79).
[66] cf Amand *VAT neutrality: a principle of EU law or a principle of the VAT system?* [2013] *World Journal of VAT/GST Law* 163.
[67] *Rompelman v Minister van Financiën* [1985] ECR 655 (at 664), most recently – *Mitteldeutsche Hartstein-Industrie AG v Finanzamt Y* [2020] EUECJ C-528/19 (at [24]).
[68] Parisi *Interpreting the A New Tax System (Goods and Services) Tax Act 1999* [2006] unpublished paper (at 15-17).
[69] *HP Mercantile Pty Ltd v FCT* (2005) 60 ATR 106 (at 116 [45]), cf GSTR 2008/1 (at [43]).

taxable persons receive 'a full and immediate deduction (tax credit) of the VAT on inputs (including capital goods) from the VAT on output'.[70]

2.2 Economic angles

Fiscal neutrality is an economic and fiscal purity mechanism of critical importance. No true VAT system can function without a robust, substantial and predictable neutrality. This is fundamental to the point of having the status of Holy Writ. From an economic point of view, however, it is understood that complete neutrality 'would require supply to be perfectly elastic and demand to be perfectly inelastic' – conditions which rarely if ever collide in the real world.[71] In practice, the ultimate tax burden will often fall on those who are least able to shift it onto someone else.[72]

Consumption taxes, however, are said to promote economic growth better than other taxes.[73] Ben Terra and Julie Kajus state that VAT is 'believed to be superior to an income tax in fostering capital formation (and economic growth)'.[74] However, the 'relative burden of the VAT falls most heavily on those with least, thus making [even] the good VAT a regressive tax'.[75] As Edmonds J pointed out, GST is 'an inherently regressive tax by nature and as a stand-alone tax will never qualify on grounds of vertical equity'.[76] And it would be even more regressive in its impacts, but for the food, health and housing exemptions which apply widely.[77]

2.3 Division 11 rules

Our basic rules on fiscal neutrality, even if not called that, are found in Div 11 of the GST law. You are 'entitled to the input tax credit for any *creditable acquisition that you make' - s 11-20. The main condition for there being a creditable acquisition is that 'you acquire anything solely or partly for a creditable purpose' – s 11-5(a). Something is acquired for a creditable purpose 'to the extent that you acquire it in *carrying on your *enterprise' – s 11-15(1). As observed by Ross Stitt, the first limb of s 11-15 has not proved to be particularly controversial.[78] Neutrality, therefore, is legislated directly

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[70] Cnossen *Global Trends and Issues in Value Added Taxation* (1998) 5 *International Tax and Public Finances* 399 (at 400).
[71] van Brederode *Systems of General Sales Taxation: Theory, Policy and Practice* (at 32).
[72] Cooper *The Discrete Charm of the VAT* [2007] *University of Sydney Law School Legal Studies Research Paper No 07/65* (at 30), cf Cooper *A Few Myths About the GST* (2000) 23 *UNSW Law Journal* 252 (at 252-255).
[73] International Monetary Fund *Fiscal Exit: From strategy to Implementation* [11/2010] *Fiscal Monitor* 80, for example.
[74] Terra & Kajus *A Guide to the European VAT Directives* (at [7.6.1.3]), James *The Rise of the Value-Added Tax* (at 30-31).
[75] James *The Rise of the Value-Added Tax* (at 33), Krever *Designing and Drafting VAT Laws in Africa* in Krever (ed) *VAT in Africa* 9 (at 18).
[76] Edmonds *Judicial Assessment of the Performance of the Goods and Services Tax as an Instrument of Tax Reform* [2011] *TIA National GST Intensive Conference paper* (at [20]).
[77] Martin *The Case for Specific Exemptions from the Goods and Services Tax: What should we do about Food, Health and Housing?* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 6), cf Ghafari *GST design and structure* (2004) 4 AGSTJ 100.
[78] Stitt *Uncertainties Surrounding Input Tax Credit Entitlement in Australia* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 119), Olding *An ATO perspective on the creditable purpose test* (2012) 12 AGSTJ 131 (132).

into our law in tolerably clear terms, and it is comprehensive in its operation. Michael Evans has referred to s 11-15(1) as the 'elegant provision'.[79]

The counterpoint to this open statement of domestic credit access is its legal denial 'to the extent that … the acquisition relates to making supplies that would be *input taxed' – s 11-15(2)(a). This paragraph was described by Lindgren J in *AXA Asia Pacific* as the 'blocking provision', and so it has come to be known.[80]

Edmonds J of the Federal Court made three important points about s 11-15(2)(a) – (A) it is in different terms to normal VAT rules in this regard, (B) it gives rise to the 'greatest difficulties of construction', and (C) it is defectively drafted.[81] The categories of input taxed supplies most corrosive of neutrality in our system, of course, are financial supplies and residential premises. We also have a unique regime of 'reduced credit acquisitions' at the rate of 75% for financial supply providers. This enhances underlying neutrality by reducing competitive disadvantage suffered through outsourcing.[82] Our GST law engineers its own neutrality in the precise and concise terms selected with studied deliberation by the federal parliament.

2.4 Theatres of advantage

In a GST system where input tax credits operate much like virtual cash in the general economy,[83] an ongoing battle is naturally fought by taxpayers against the ATO to extend credit access and neutrality wherever possible. Where the line is to be drawn between utopian neutrality and s 11-15(2)(a) has a profound and enduring impact across the economy. Fiscal neutrality is of greatest importance to financial institutions, life insurers and others making financial supplies as a core business element. They are the ones with potentially the greatest stake in a pure or purer neutrality taking hold in our GST system. In their book, Peter McMahon and Amrit MacIntyre said that where the line is to be drawn on s 11-15(2)(a) issues 'is difficult to say, and early guidance from Australian courts on this issue will be of critical importance'.[84]

The only rational economic position for those entities (indeed, any entities) is to push neutrality as far as the courts or the Commissioner will allow. Sometimes the attempt is to force it into areas of prior controversy – capital raising by share issue for example[85] – at other times, into new and emerging theatres of perceived advantage – minesite housing comes to mind. Of prime concern, therefore, is the relevance of fiscal neutrality in the *Rompelman* sense to Australian law. Does EU neutrality inform the reach of our own provisions (as some foreign ghost in our GST machine perhaps), or could it impose

[79] Evans *Capital Raising costs – the wrong side of the mirror?* (2007) 10/3 *The Tax Specialist* 120 (at 121).
[80] *AXA Asia Pacific Holdings Ltd v FCT* [2008] FCA 1834 (at [38]), cf de Wijn *Input tax relief and financial supplies: Nexus and relevance for apportionment* (2012) 12 AGSTJ 125 (at 125-126).
[81] Edmonds *Interpretation of s 11-15: Significance of the text, context and history* (2012) 12 AGSTJ 79 (at 84-85).
[82] Explanatory Memorandum (at [5.1]), Treasury *Consultation Document* 1999 (at 12), Explanatory Statement to the GST Regulations [Attachment E (at 2-3)], Edmundson *Financial Supplies and Reduced Input Tax Credits* (2003) 6/3 *The Tax Specialist* 113 (at 114), Parisi *Investment management concept eludes principled delineation* (2008) 8 AGSTJ 221 (at 225), GSTR 2004/1 (at [89-101]).
[83] Illustrated indirectly by *Multiflex Pty Ltd v FCT* [2011] FCA 1112, *FCT v Multiflex Pty Ltd* [2011] FCAFC 142.
[84] McMahon & MacIntyre *GST and the financial markets* (at 31).
[85] *Kretztechnik AG v Finanzamt Linz* [2005] 1 WLR 3755.

an insistent and presumptive bias in favour of credit recovery where interpretation of the GST law yields contrary indications of roughly comparable merit?

3. *HP MERCANTILE*

3.1 At the hearing

The appeal from the AAT decision in *Recoveries Trust*[86] was heard by a Full Federal Court bench comprising Hill, Stone and Allsop JJ on 4 May 2005. A range of GST cases had already worked their way to various courts and tribunals - most notably on validity,[87] transitional relief,[88] damages,[89] valuation,[90] residential premises,[91] going concerns,[92] contract law issues,[93] legal costs,[94] gambling,[95] stamp duty,[96] and body corporates.[97] However, this was to be the first appellate level stress-testing of crucial credit denial provisions in Div 11 of the GST law. It was also before a presiding judge widely acknowledged as the preeminent master of the entire tax field – Justice Graham Hill. To say there was an air of anticipation is an understatement. Stephen Gageler SC, now a judge on the High Court, appeared for the taxpayer, with Roderick Cordara SC for the Commissioner. As many may recall, there was standing room only.

3.2 Landmark decision

On 8 July 2005, the Full Federal Court handed its landmark decision in *HP Mercantile Pty Ltd* in favour of the Commissioner.[98] Hill J gave the main judgment of the court (as was expected), the other two judges (Stone & Allsop JJ) each agreeing, but adding comments of their own. Hill J made no mention of 'neutrality' by name in his reasons. However, he drew particular attention to the cascading problem and the 'genius of a

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[86] *Recoveries Trust v FCT* [2004] AATA 1075, cf Stitt *Creditable Purpose: The Recoveries Trust Case* [2005] *ATAX 17th Annual GST & Indirect Tax Weekend Workshop paper*, Penning *Recovering input tax under the GST Act* (2005) 39 *Taxation in Australia* 380, Wolfers & Evans *Critical Comment: The recoveries Trust – the test case with no credi[ta]ble purpose* (2004) 4 AGSTJ 287.
[87] *McKinnon v Commonwealth* [2000] FCA 936, *Halliday v Commonwealth* [2000] FCA 950, *O'Meara v FCT* [2003] FCA 217, cf *Reference re Goods and Services Tax* [1992] 2 WWR 673 (Canada), Cominos & Dwyer *Constitutional Problems in the Goods & Services Tax* (1999) 28 *Australian Tax Review* 69.
[88] *ACP Publishing Pty Ltd v FCT* [2005] FCAFC 57, *DB Rreef Funds Management Ltd v FCT* [2005] FCA 509, *Coles Supermarkets Pty Ltd v Westley Nominees Pty Ltd* [2005] FCA 839.
[89] *Interchase Corporation Ltd v ACN 010 087 573 Pty Ltd* [2000] QSC 013, *Shaw v Director of Housing (No 2)* [2001] TASSC 2.
[90] *Orti-Tullo v Sadek* [2001] NSWSC 855, *Kurc v Eyecare Pty Ltd* [2004] VCAT 1139, *Stephens v Gerandu Pty Ltd* [2004] VCAT 1350, *CSR Ltd v Hornsby Shire Council* [2004] NSWSC 946, *Derring Lane Pty Ltd v Fitzgibbon* [2005] VCAT 552.
[91] *Marana Holdings Pty Ltd v FCT* [2004] FCAFC 307, *Karmel & Co Pty Ltd v FCT* [2003] AATA 481.
[92] *Midford v FCT* [2005] AATA 623.
[93] *ETO Pty Ltd v Idameneo (No 123) Pty Ltd* [2004] NSWCA 368, *Empire Securities Pty Ltd v Miocevich* [2004] WASC 118, *Eroc Pty Ltd v Amalg Resources NL* [2003] QSC 074, *Cermak v Ruth Consolidated Industries Pty Ltd* [2004] NSWSC 882, *Igloo Homes Pty Ltd v Sammut Constructions Pty Ltd* [2004] NSWSC 1213.
[94] *Treneski v Comcare* [2004] AATA 98, *Fiduciary Ltd v Morningstar Research Pty Ltd* [2004] NSWSC 381, *Thornton v Apollo Nominees Pty Ltd* [2005] TASSC 38.
[95] *TAB Limited v FCT* [2005] NSWSC 552.
[96] *CSR v Royal & Sun Alliance Insurance Australia Ltd* [2003] VSCA 177, *Gould Management Pty Ltd v CCSR* [2004] NSWADT 66.
[97] *Re Banyandah Towers* [2001] QBCCMC 33, *Villa Edgewater v FCT* [2004] AATA 425.
[98] *HP Mercantile Pty Ltd v FCT* [2005] FCAFC 126 (at [45]).

system of value added taxation' – that being, the mechanism of credits.[99] The judge had expressed similar views in his foreword to the book, *GST and the financial markets*.[100]

Robert Olding noted it was not surprising that Hill J made comments about cascading.[101] One commentator, however, thought the facts of the case were inadequate to fully explore this issue.[102] The judge repeated earlier views about the main characteristics of our GST, noted some of its unique features, and pointed to deliberate choices made to depart from foreign models. He also railed against any concentration on 'linguistic analysis' as a proper tool for resolving what s 11-15(2)(a) means,[103] instead applying the standard purposive approach required by the High Court (as he was bound to).[104]

3.3 Legislative scheme

Justice Hill said this approach requires the court to prefer a construction which gives effect to legislative purpose, to be identified 'both by reference to the language of the statute itself and also any extrinsic material which the court is authorised to take into account'. The judge then observed (at [45]) –

> The language of the GST Act, as seen in the context of value added taxation generally, makes it clear that the legislative scheme is that a taxpayer will be entitled to an input tax credit where it is necessary that a credit be given to ensure that output tax payable by the taxpayer is not imposed upon an amount which already includes tax payable at some early stage in the commercial cycle. Where possible, GST is not to be found embedded in the price or consideration on which output tax is calculated when taxable supplies are made.[105]

Several points may be made. The first is that, even if not formally named that way, the statement from *HP Mercantile* describes the core components of the neutrality principle. Second, it is the language of the GST law, seen against the wider context of VAT more generally, which makes it clear what the scheme of the legislation is in this regard. Third, the statement of Hill J is framed by reference to a 'where it is necessary' test regarding credit access. This phraseology may be taken to indicate a systemic bias for credit access generally, or the presence of an exceptional class or classes of situations where access is properly to be denied. Fourth, and importantly, the principle is to apply where it is otherwise available. Hill J concluded (at [66]) that the interpretation of the Commissioner 'is supported by the syntax, the policy and the surrounding legislative context'. Accordingly, the judge dismissed the taxpayer's appeal.

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[99] *HP Mercantile Pty Ltd v FCT* [2005] FCAFC 126 (at [13]).
[100] McMahon & MacIntyre *GST and the financial markets* (at vii), cf James & Stacey *The limits of supply* (2002) 2 AGSTJ 41 (at 42-43).
[101] Olding *Trends in the Interpretation of GST law* [2007] *ATAX 19th Annual GST and Indirect Tax Weekend Workshop paper* (at [9]).
[102] Penning *Creditable purpose, intention and timing* [2005] *ATAX 20th Annual GST & Indirect Tax weekend Workshop paper* (at 11).
[103] cf *SZTAL v Minister for Immigration and Border Protection* [2017] HCA 34 (at [34]).
[104] *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, s 15AA of the *Acts Interpretation Act 1901,* referred to.
[105] cf *ACP Publishing Pty Ltd v FCT* [2005] FCAFC 57 (at [2-3]), *Sterling Guardian Pty Ltd v FCT* [2006] FCAFC 12 (at [14-15]).

3.4 Stone and Allsop JJ

The other judges both agreed with the reasons given by Hill J, but added comments of their own. Stone J explained why the relationship required by s 11-15(2)(a) raised a question of law.[106] This was necessary given AAT parties may only appeal to the Federal Court on a question of law, rather than a question of fact.[107]

Allsop J (at [88-90]), with disarming frankness it must be said, stated that, were it not for the explanation given by Hill J of the scheme, purpose and context of the GST provisions, he would have inclined to a different outcome from a purely textual (perhaps literal) point of view. Ross Stitt noted that, although the judgment of Allsop J is less than half a page in length, '[y]et it tells us a great deal about the interpretation of GST and the potential pitfalls'.[108] Edmonds J commented that Allsop J's comments 'highlight the importance of the consequences which flow from matters concerning the statutory scheme and the purpose and context of the legislation'. In short, Edmonds J continued, 'they can lead to a totally opposite result'.[109]

4. HILL J'S FINAL COMMUNIQUÉ

4.1 Interpret or translate?

A month after *HP Mercantile* was handed down, and just a few weeks before his death,[110] Justice Hill delivered what was to be his final communiqué on things GST in a paper to the *Taxation Law & Research Policy Institute* at Monash University[111] – *To interpret or translate? The judicial role for GST cases*. The judge began by pointing out that, as Acts of the Commonwealth parliament, our GST law is subject to the ordinary principles of statutory interpretation. It could hardly be otherwise.[112] Hill J described these as being mainly 'rules of common-sense'.[113] This echoed judges in *Cooper Brookes* quoting Professor Dennis Pearce on the point.[114]

One American judge has said statutory interpretation 'ought to be realistic, pragmatic, free of contrary-to-real-world presumptions and fundamentally consistent with common sense'.[115] Appeals to 'common sense' are often no more a rhetorical device under which the speaker assumes the power of fundamental truth to which a univocal community agrees. So stated, it is a notoriously plastic standard. Basten JA said the days have passed

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[106] cf *FCT v Eskandari* (2004) 54 ATR 695 (at 701-702).
[107] s 44(1) of the *Administrative Appeals Tribunal Act 1975*.
[108] Stitt *GST – History, Experience & Future* [2007] *Federal Court Judges' Taxation Workshop paper* (at 21).
[109] Edmonds J *Five Years of GST* [2005] *TIA National GST Intensive Conference paper* (at [38]).
[110] His last judgment (dissenting in a Falun Gong matter) was handed down on his behalf a few days after the judge died – *NAJT v Minister* [2005] FCAFC 134. A further case on which he sat was decided by the two remaining judges – *SXBB v Minister* [2005] FCAFC 186 (at [1]).
[111] Hill J *To interpret or translate? The judicial role for GST cases* (2005) 5 AGSTJ 225.
[112] *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 (at [57]), cf Pearce & Geddes *Statutory Interpretation in Australia* (at [9.41]).
[113] cf Middleton *Statutory Interpretation: Mostly Common Sense* (2016) 40(2) *Melbourne University Law Review* 626, for example.
[114] *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297 (at 320), Gageler J *Legislative Intention* (2015) 41/1 *Monash University Law Review* 1 (at 4), *Department of Family and Community Services v Abraham* [2016] FamCA 847 (at [204-205]).
[115] Keeton *Statutory Analogies in Legal Reasoning* (1993) 52 *Maryland Law Review* 1192 (at 1204).

since interpretation was seen as an 'exercise in common sense'.[116] Common sense is viewed with suspicion, he added, as it is seen as evasive and may conceal political choices.[117] In the context in which Hill J uses the expression, however, in large part it merely expresses a contrast with intensive analysis.[118]

Hill J went on to observe that various parts of the GST legislation draw on income tax principles and experience.[119] Next, the judge said that, given that our law is based to some extent on foreign analogs and concepts, questions inevitably arise as to how much regard should be had to foreign cases in the interpretation of provisions modelled to some degree on other VAT regimes. This was only natural given there was little else to go on in the early days. In a paper two years earlier, Hill J had said that, in many cases, it will only be possible to understand our legislation by reference to case law on problems in the legislation of New Zealand and elsewhere'.[120]

The principle he framed around this observation (at 18) was that courts 'will always have regard to the case law of other jurisdictions in order to determine what the mischief was …' The maturing of our GST jurisprudence, however, and directions set by the High Court have dimmed the light foreign cases might otherwise shine on what our GST law may mean.[121] Lindgren J added his own caution, saying it was important 'to look very closely' at the legislative text under which a foreign case is decided. He went on to say 'it is not only the text that counts: concepts and assumptions underlying the foreign legislation may also have to be taken into account'.[122] By 2004, Paul Stacey as technical editor of the *Australian GST Journal* had detected a divergence in Australian practice away from the 'old world of European VAT', a trend he said was 'set to continue'.[123] Articles with titles like 'VAT lessons from Europe' soon became rare.

4.2 Underlying philosophy

Roderick Cordara was also interested 'to see how far the Australian judiciary feel the need or the ability to take a similar line [to EU fiscal neutrality cases]'.[124] The problem suggested by Hill J (at 225) …

> … will be that, while the Australian GST may not be modelled, in a particular respect, upon the law of any other GST or VAT country, the underlying

[116] Basten *Legislative Intention* (2019) 93 *Australian Law Journal* 367 (at 367).
[117] cf Burton *The Rhetoric Of Tax Interpretation - Where Talking The Talk Is Not Walking The Walk* (2005) 1 *Journal of The Australasian Tax Teachers Association* 1.
[118] *Comptroller-General of Customs v Pharm-a-Care Laboratories Pty Ltd* [2018] FCAFC 237 (at [24]) for example.
[119] cf Evans *Creditable purpose – can the relationship be to past activities?* (2004) 4 AGSTJ 131, Brad Miller *Another GST win for the Commissioner!* (2005) 40/3 *Taxation in Australia* 147 (at 153), Walpole *Keeping to the straight and narrow: interpreting the GST and income tax* (2005) 5 AGSTJ 193, de Wijn *Input tax relief and financial supplies: Nexus and relevance for apportionment* (2012) 12 AGSTJ 125 (at 125).
[120] Hill J *Some Thoughts on the Principles Applicable to the Interpretation of the GST* (2003) 6 *Journal of Australian Taxation* 1 (at 14), cf Edmundson *GST and Financial Supplies: A Comparative Analysis of Legislative Structure* (2001) 30 *Australian Tax Review* 132 (at 138).
[121] cf *AXA Asia Pacific Holdings Ltd v FCT* [2008] FCA 1834 (at [96]), Lindgren J *The relevance of overseas case law to Australia's GST* (2009) 13/2 *The Tax Specialist* 58, Edmonds *Recourse to foreign authority in deciding Australian tax cases* (2007) 36 *Australian Tax Review* 5.
[122] Lindgren J *The Curious Case of GST* [2009] *TIA National GST Intensive Conference paper* (at 19-20), cf *Food Supplier v FCT* [2007] AATA 1550 (at [17]).
[123] Stacey *GST as one-eyed ogre or a multi-headed beast?* (2004) 4 AGSTJ 3 (at 20).
[124] Cordara *The Sixth VAT Directive and Key Legal Issues under VAT in Europe* (at 27).

> philosophy to be found in the interpretation of VAT laws in other countries (particularly the European Union) may influence the interpretation of the Australian GST. This, in turn, leads to a consideration of the place which the European Union Directives on harmonisation of the VAT have had, both in that philosophy and in interpretative rules which have been adopted from them.

What exactly did Justice Hill mean by these remarks? There is no denying that VAT generally has a deep and enduring political and economic philosophy which underpins its practical expression. In an earlier paper, the same judge had set out his more general views on the issue – *How is tax to be understood by the courts?*[125] There he said (at 234) that 'judicial decision making should not proceed by reference to judicial conscience or political philosophy but principled decision'. This view is nothing but mainstream.

Later in his paper (at 238), Hill J returned to the putative role of EU neutrality saying that the EU Directives might be used for interpretational purposes insofar as they 'represent the way value added tax is supposed to work in the continent which invented VAT'. This suggests something like the 'vibe' comments that became popular in early discourse about our new tax.[126] Hill J added that the Directives themselves may also be a 'useful source of principle' in interpretation or a 'useful source of law or premise for legal reasoning'. This goes further than mere 'vibe' or economic nuance. To illustrate, the judge quoted *Rompelman* for the idea that system is meant to relieve the trader 'entirely' of the VAT burden on all economic activities. The three ingredients in this regard are purpose, extent and coverage.

4.3 Problems with policy

Hill J also commented on the basic difficulty of ascertaining policy for a new law 'necessarily written in language of great generality'. Characterising policy at the correct level is a real problem in all statutory settings,[127] as is the danger of reader preconception[128] and the arguably greater sin described as some judges treating policy as an empty vessel into which they may 'unrestrainedly pour their own wishes'.[129] On this score more widely, an international trend towards the 'judicialization of public policy' is being actively tracked and evaluated.[130]

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[125] Hill J *How is Tax to be Understood by Courts?* (2001) 4/5 *The Tax Specialist* 226 (at 226), cf Tretola *The Interpretation of Taxation Legislation by the Courts – A reflection on the Views of Justice Graham Hill* (2006) 16 *Revenue Law Journal* 73 (at 86).

[126] Cooper *Why GST is Not a Consumption Tax … and Why it Matters* [2003] *TIA GST Intensive Conference paper* (at 1), Howe & Penning *Creditable purpose and cancelled financial supplies – It's all in the timing* [2005] *ATAX 17th Annual GST & Indirect Tax Weekend Workshop paper* (at 1) quoting Denis Denuto in *The Castle* – 'It's Mabo, it's justice, it's law, it's the vibe and – No, that's it. It's the vibe!', cf Lazanas & Thomas *GST and the changing role of policy, purpose and the "vibe" in statutory interpretation* (2011) 12 AGSTJ 30.

[127] *Carr v Western Australia* [2007] HCA 47 (at [5-7]), *Construction Forestry Mining & Energy Union v Mammoet Australia Pty Ltd* [2013] HCA 36 (at [40-41]).

[128] *Australian Education Union v Department of Education & Children's Services* [2012] HCA 3 (at [28]), Certain Lloyd's Underwriters v Cross [2012] HCA 56 (at [26]), *Williams v Wreck Bay Aboriginal Community Council* [2019] HCA 4 (at [79]).

[129] *Momcilovic v The Queen* [2011] HCA 34 (at [450]).

[130] South *Are Legislative Intentions Real?* (2014) 40 *Monash University Law Review* 853, Ekins *The Nature of Legislative Intent* (at 887).

Neither is policy a reflection of or to be derived from subjective sources, Hill J pointed out. It is an objective exercise undertaken by reference to objective indicators. Also, there is the notorious fact that extrinsic materials are often of little use in identifying policy or purpose (let alone fixing meaning). Justice Hill recognised in his *To interpret or translate?* article that purposivism has its constitutional and practical limits, and that 'courts cannot act as legislators' to cure defects and fill in gaps where problems are revealed.[131] The Full Federal Court in the *Multiflex* appeal years later referred to this observation as one of 'enduring wisdom'.[132]

4.4 Special leave refused

On 16 June 2006, ten months after Hill J died, a High Court panel comprising Gummow ACJ and Kirby J refused special leave sought by the taxpayer.[133] Following spirited argument, Gummow ACJ summed-up by saying that a 'purely textual analysis' may give some support for the taxpayer position. Despite this, he and Kirby J 'reached a conclusion similar to that of Justice Allsop'. Gummow ACJ continued –

> However, as Justice Hill showed in what was the leading judgment delivered in the Full Court, the statutory scheme and legislative context and purpose carry the day for the respondent Commissioner.

Refusal of special leave is not generally taken to affirm the correctness of the decision below 'unless, of course, the court goes out of its way to say that it does agree with what was said in the court below'.[134] Arguably *HP Mercantile* falls into this category.

Bruce Quigley, in his contribution to the book *GST in Retrospect and Prospect,* described it in terms of the High Court giving its 'tacit approval' to the approach of Hill J in *HP Mercantile*.[135] Whether or not the decision derives some stronger precedential force by reason of the manner in which special leave was refused, however, does not much matter. The case was referred to by the High Court in *Travelex*;[136] it has been approved by the NSW court of appeal;[137] and it is taken as read by the Full Federal Court in almost every GST case it hears.[138] Apart from all that, the reasons of Hill J in *HP Mercantile* have a legal gravity and authority which compel our attention into the future.

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[131] *Taylor v Owners – Strata Plan No 11564* [2014] HCA 9 (at [65]), cf *CCA19 v Secretary, Department of Home Affairs* [2019] FCA 946 (at [90-91]), *Fremantle Lawyers Pty Ltd v Sarich* [2019] WASCA 48 (at [4]), *Ian Street Developer Pty Ltd v Arrow International Pty Ltd* [2018] VSCA 294 (at [60]).
[132] *FCT v Multiflex Pty Ltd* [2011] FCAFC 142 (at [1]).
[133] *HP Mercantile Pty Ltd v FCT* [2006] HCATrans 320, Brysland *GST and Government in 2010* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 3 (at 45-47).
[134] *Mihaljevic v Longyear (Australia) Pty Ltd* (1985) 3 NSWLR 1 (at 25), cf *Algama v Minister* (2001) 194 ALR 37 (at [62]), *North Ganalanga Aboriginal Corp v Queensland* (1996) 185 CLR 595 (at 643), *Ex parte Zietsch* (1944) 44 SR (NSW) 360 (at 368), Mason *Where Now?* (1975) 49 *Australian Law Journal* 570 (at 575), Mason *The Use and Abuse of Precedent* (1988) 4 *Australian Bar Review* 93 (at 97), Brysland *Tax cases and the High Court* (1991) 57 *Weekly Tax Bulletin* [982].
[135] Quigley *Interpreting GST Law in Australia* in White & Krever (eds) *GST in Retrospect and Prospect* (at 116).
[136] *Travelex limited v FCT* [2008] HCA 33 (at [25, 68]).
[137] *Shinwani v Anjoul* [2017] NSWCA 74 (at [88]) illustrates.
[138] *FCT v Secretary to the Department of Transport* [2010] FCAFC 84 (at [38]), *FCT v American Express Wholesale Currency Services Pty Ltd* [2010] FCAFC 122 (at [98, 103-105]), *Rio Tinto Services Pty Ltd v FCT* [2015] FCAFC 117 (at [3, 4, 8]) illustrates.

4.5 Interim reflections

Justice Hill leaves a formidable legacy, not just in tax circles, but more widely in the law as well.[139] The Chief Justice of the Federal Court, Michael Black, referred to Hill J's dedication to the rule of law and to the 'richness and diversity of his work and his service to the community: as a lawyer, a scholar, a teacher, a mentor and a member of our court'.[140] Professor Vann rightly called him a 'tax titan'.[141]

We now have the *Justice Graham Hill Memorial Speech* delivered each year in his Honour's honour. In the 2007 speech, Kirby J said that *HP Mercantile* was one of the judge's 'greatest legacies'.[142] Gzell J described the judgment as a 'powerful piece of jurisprudence'.[143] Edmonds J called it a 'template for the future'.[144] Logan J characterised it 'in terms of its masterly exposition of the statutory scheme of taxation'.[145] In the special leave application for *American Express*, Slater QC referred to *HP Mercantile* said[146] – 'Justice Hill knew perhaps more about GST and VAT than anyone in Australia, with due deference to your Honours'. Professor Millar noted that his passing 'left a void in the Australian judicial understanding of GST'.[147]

Justice Hill never got to see how his musings on the interplay between neutrality and interpretation might resolve in the 15 years since he posed his 'interpret or translate' question. It would take a further four years for the first GST case to reach the High Court – *Reliance Carpet*.[148] In matters of statutory interpretation, two things may be said about the way in which Hill J saw the world of legislation. First of all, he was solidly orthodox in his dedication to modern principle,[149] something which is a consensus assessment.

One commentator said he had 'quite strong views' on this, and about the right way and the wrong way to do things.[150] This understates the position, as anyone reading what Hill J wrote or who otherwise knew him will appreciate. The second is that, in a tangible way, his systemic coherence, constructional choice and anti-linguistic positions anticipated later articulation of those elements in the Federal Court and above.[151] His 'scheme of legislation' approach in *HP Mercantile* echoed the *Ellis & Clark* sales tax

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[139] Edmonds J *The Contributions of Justice Hill to the Development of Tax Law in Australia* (2006) 2 *Journal of the Australasian Tax Teachers Association* 1, Kirby J *Justice Graham Hill Memorial Speech* (2007) 42/4 *Taxation in Australia* 202, for example.
[140] Black CJ *The Hon Justice Graham Hill (1938-2005)* (2005 Summer) *Bar News: Journal of the NSW Bar Association* 91.
[141] Buffini *Tax Titan was no heir but had all the graces,* 26 August 2005 *Australian Financial Review* 29.
[142] Kirby J *Justice Graham Hill Memorial Speech* (2007) 42/4 *Taxation in Australia* 202 (at 204).
[143] Gzell *The Legacy of Justice Graham Hill* [2006] *TIA Annual Convention South Australian Division paper* (at 2).
[144] Edmonds *Tribute to the late Justice Graham Hill* [2005] *Law Council Tax Workshop paper* (at 5).
[145] Logan J *Where are we with GST – black letter or the practical business tax?* [2008] *TIA National GST Intensive Conference paper* (at [20]).
[146] *American Express Wholesale Currency Services Pty Ltd v FCT* [2011] HCATrans 114 (at 57).
[147] Millar *The Destination Principle: Past Developments and Future Challenges* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 313 (at 313).
[148] *FCT v Reliance Carpet Co Pty Ltd* [2008] HCA 22.
[149] cf Olding *Trends in the Interpretation of GST law* [2007] *ATAX 19th Annual GST and Indirect Tax Weekend Workshop paper* (at [19]), McElwain *How the courts have interpreted GST in Australia* (2007) 41/9 *Taxation in Australia* 539.
[150] Phair *The GST jurisprudence of the late Justice Graham Hill* [2013] UNSW 25th GST Conference paper (at 6).
[151] Edmonds *Interpretation of s 11-15: Significance of the text, context and history* (2012) 12 AGSTJ 79 (at 88) agrees.

decision 60 years earlier.[152] He also said courts should not be expected 'to make up for drafting deficiencies which revel in obscurity'.[153]

As I read again Justice Hill's *To interpret or translate?* article, the judge is essentially posing questions and suggesting possibilities. He draws no conclusions; he makes no findings; and he embeds no doctrines. This assessment aligns with the end-point reached by Robert Olding in 2010 – that there is nothing in the judgment 'that explicitly supports the conclusion some have suggested, that is, that there must be input tax relief in every case to the extent that the cost of the input is embedded in a taxed output'.[154]

Instead, Hill J raises whether underlying VAT philosophy and EU Directives 'may influence' interpretation in Australia or 'might be taken' as a source of interpretational principle or a 'useful source of law or premise for legal reasoning'. Roderick Cordara thought that, 'though not cited', the trend of EU cases had 'played their silent role in the proceedings'.[155] Hill J sounded a 'cautionary note' in this respect, adding the important qualifier that there is 'no legislative impediment' to the possibilities he suggested.

5. VIEWS OF COMMENTATORS

5.1 Ode to Neutrality

Michael Evans has been the central activist in neutrality debates for more than two decades. He has been an untiring influencer for a 'strict and complete' neutrality within our GST system. Nothing he writes, he says, is not about neutrality. In his view, EU neutrality is already an aspect of the GST law, as least as a rule of interpretation inferred from the context and purpose of the legislation when passed.[156] That would make it a 'foreign ghost fully resident in our GST machine' (my words). Who will forget Michael's *Ode to Neutrality* written on the ten year anniversary of the original ANTS Bills being introduced into federal parliament? – that is, about 12 months after the High Court gave judgment in *Reliance Carpet*.

It may come as no surprise that I disagree with both the basic thesis and detail of the *Ode*. My unease with the idea that we have somehow absorbed EU neutrality as an 'underlying philosophy' of legislation the GST law involves a standard application of interpretation principles required by the High Court. Mr Rompelman is no foreign ghost in our GST machine. I have drunk from no 'bitter cup of literal interpretation' (words from the *Ode*), nor have I sacrificed high transnational principle on the 'crucifix of

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[152] *DCT v Ellis & Clark Ltd* (1934) 52 CLR 85 (at 89), cf *Avon Products Pty Ltd v FCT* [2006] HCA 29 (at [7]), *CCSR v Hayson Group of Companies* [2006] NSWCA 233 (at [36]), *FCT v Multiflex Pty Ltd* [2011] FCAFC 142 (at [15]), Hill J *How is Tax to be Understood by Courts?* (2001) 4/5 *The Tax Specialist* 226 (at 227-228), Phair *The GST jurisprudence of the late Justice Graham Hill* [2013] UNSW 25th GST Conference paper (at 2), Gzell J *The Legacy of Justice Graham Hill* [2006] *TIA Annual Convention South Australian Division paper*.

[153] *Consolidated Press Holdings Ltd v FCT* [1998] FCA 1277.

[154] Olding *Interpretation of the GST Act – Towards a Principled Basis?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 91).

[155] Cordara *Developments in UK and European Case Law* [2005] *TIA National GST Intensive Conference paper* (at 2).

[156] cf Heydon Miller *Input Taxed: What's in a name – A look at input tax credit entitlements* [2007] *ATAX GST Conference paper*.

mindless textualism' (again from the *Ode*). This language may echo a description of tax officers by Lord Esher MR long ago as 'unpleasant tyrannical monsters'.[157]

However, the idea that merely legislating for a VAT-type model would bring with it an 'underlying philosophy' to which our GST law would bend is perhaps a romantic idea.

Evans also once advocated for a new objects clause to be inserted after the event into the GST law to enshrine EU neutrality and guarantee it application[158] –

> GST is a general tax on consumption exactly proportional to the price paid by the consumer, however many transactions take place in the production and distribution process before the stage at which consumption takes place. The credit for input tax is meant to relieve the entity entirely of the burden of the input tax payable or paid in the course of all its enterprise, provided that the input tax is not a cost component of an input taxed activity.

These themes are revisited by Evans in *Horton's lesson: Australia's struggle with 'truth in drafting'*.[159] Attention is drawn to structural differences between our system and others, including in the design of input tax relief provisions where different terminology is used, and used deliberately. It is observed (at 39) that, in choosing words 'significantly different to the NZ terminology, there is little in the GST Act to support the contention that the legislature meant the Australian law to follow the NZ model'.

The 'difficult question' is posed (at 42) as to whether, in these circumstances, the 'legislature intended that the test be different from the legislative approach in other jurisdictions'.[160] Following the UK approach may well have produced a different outcome in Australia. However, it does not follow that the 'cost component language' of the VAT Directives can somehow now leverage our GST law to that direction.[161]

The ordinary expectation is that legislating for a different mechanism in different words, in each case deliberately, will lead to a different legal outcome. Evans goes on to describe the High Court majority approach in *Travelex* as 'simple and brutal' regarding their reading of item 4 of the s 38-190(1) table. In his view, (A) we don't know if the legislature meant what it said, (B) we do know that it did not say what it meant, (C) the legislature didn't know what it meant, and (D) whatever the legislature meant, the outcome is what the courts say the words mean. Perhaps the best response to these various points is the fundamental one given by the courts – 'We are seeking the meaning of the words which Parliament used. We are seeking not what Parliament meant, but the true meaning of what they said'.[162]

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[157] *Grainger and Son v Gough* (1894) 3 TC 311 (at 318).
[158] Evans *Taxation of goods and services in Australia – commentary* (2009) 9 AGSTJ 30 (at 35).
[159] Evans *Horton's lesson: Australia's struggle with 'truth in drafting'* [2012] 1/1 *World Journal of VAT/GST Law* 21 (at 22, 28).
[160] cf *HP Mercantile Pty Ltd v FCT* [2005] FCAFC 126 (at [23]).
[161] cf *HP Mercantile Pty Ltd v FCT* [2005] FCAFC 126 (at [45]).
[162] *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591 (at 613), *Harrison v Melham* [2008] NSWCA 67 (at [160]) for example.

5.2 Only time will tell

Early in our GST journey, Professor Millar asked whether Australia needed to or would develop its own version of neutrality – 'only time will tell', she said.[163] Fast-forward 13 years, and the answer now given by her is the simple one that we have our own neutrality derived from Div 11 provisions. This is a conclusion to be drawn from her 2017 paper – *The principle of neutrality in Australian GST*.[164] If I understand all this correctly, there is no reason really to ask if EU neutrality somehow applies in our system.

As Professor Millar points out, no special rules apply to interpretation of the GST law. And nothing in the extrinsic materials provides any likely foundation for the reception of EU neutrality either. She says (at 33, 34) -

> In Australia, the broader principle established in *Rompelman* … is quite conveniently spelled out for us in the text of the law [primarily s 11-15(1)] … Thus, rather than merely being a principle of interpretation, under Australian GST the principle of neutrality is found in a specific legal rule.

Professor Millar looks at a range of Australian cases through the lens of our native neutrality, including three which consider the s 11-15(2)(a) limitation to our neutrality rule.[165] Millar then tests how our neutrality rule would play out on the facts of recent EU cases.[166] The important point, however, is that our native neutrality is a concept which emerges from the text of the GST law and not from foreign sources. As Pier Parisi says, *HP Mercantile* is a 'classic case of the application of the concept of fiscal neutrality … embedded in the statutory framework of the Australian GST'.[167]

5.3 Change the legislation

As editor of the *Australian GST Journal*, after *Reliance Carpet*, Peter Hill wrote[168] –

> Until such time as the Tax Office is told otherwise, by statute, it will abide by the High Court's decision.[169] If fiscal neutrality is to become a cornerstone of the Australian GST system, many things – including much of the legislation and not just the fundamental compliance approach of the Tax Office – will need to substantially change.

The writer notes that the 'alien concept of fiscal neutrality' had been simmering away on the interpretative front; that some are critical of 'any Tax Office interpretation that ignores fiscal neutrality';[170] and that others say fiscal neutrality 'should play no role in

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[163] Millar *Time is of the Essence: Supplies, Grouping Schemes & Cancelled Transactions* (2004) 7/2 *Journal of Australian Taxation* 132 (at 169).
[164] Millar *The principle of neutrality in Australian GST* (2017) 17 AGSTJ 26.
[165] *AXA Asia Pacific Holdings Ltd v FCT* [2008] FCA 1834, *Rio Tinto Services Ltd v FCT* [2015] FCA 94, *FCT v American Express Wholesale Currency Services Pty Ltd* [2010] FCAFC 122.
[166] *Sveda UAB v Valstybin mokesi inspektcija prie Lietuvos Respublikos Finans ministerijos* [2014] Case C-126/14 (Baltic Mythological Walkway), *Kopalnia Odkrywkowa Polski Trawertyn v Dyrektor* [2012] Case C-280/10 (stone quarry partnership).
[167] Parisi *The Goods and Services Tax as a Tax on Acquisitions* [2007] unpublished paper (at 25).
[168] Hill *Taxation of goods and services in Australia – past, present, and future* (2009) 9 AGSTJ 21 (at 29).
[169] The ATO of course has no discretion in this regard – *FCT v Indooroopilly Children Services (Qld) Pty Ltd* [2007] FCAFC 16 (at [6]).
[170] James & Stacey *The limits of supply – Part 3* (2002) 2 AGSTJ 81 quoted.

interpreting Australia's GST'.[171] Peter Hill then reviews the High Court position that consumption as a matter of economic policy should not drive interpretation.

This is taken to signal that no neutrality principle applies (or is being applied) in our system, either by reference to EU neutrality or via domestic provisions. In other words, change is needed to bring neutrality into the system. Others accept, however, that neutrality is secured by the concept of 'creditable acquisition'.[172]

5.4 Criteria of liability

In a 2012 article,[173] Robert Olding set out what he called – *An ATO perspective on the creditable purpose test*. The article is comprehensive and reaches the same general conclusions as this note. It is framed against the hypothetical 'mineco example' under which look-through credit access on minesite accommodation insurance is tested in a coal export situation. Olding accepted (at 133) that a 'high-level feature' of VAT regimes is to relieve business of the burden and to prevent cascading.[174] Then he said –

> … policy considerations are seldom single-dimensional: an application that may seem to be clearly consistent with perceived policy in one context may seem less so, or offend a different policy consideration, in another … Accordingly, the approach adopted is not to start with a notion of how an ideal GST would operate and see if the Australian GST can be construed to give life to that perspective. Rather the approach is to endeavour to determine how the provision should be properly construed in light of the judicial guidance available from the GST cases handed down to date …

Although it had been accepted in *HP Mercantile* 'where possible' that GST was not be found embedded in the output price, Olding points out (at 137-138) that nowhere in that case or in *AXA Asia Pacific* is the *legal* test stated in these terms. The relationship required is one of objective fact and no 'look-through' approach is endorsed.[175] Attention is then drawn to the dangers of using high-level policy to inform the meaning of provisions and to the related problem of policy preconception in interpretation.[176] In this regard (at 142), Olding concluded, rather uncontroversially it should be noted, that 'we must guard against assuming that whatever construction furthers the high level objects taxing value added or preventing cascading must be the law'.

Olding also drew attention to the fact that 'what lies behind the enactment of a taxing provision as a matter of public policy or economic theory is not the same thing as the elements or criteria of tax liability which Parliament has laid down'.[177] A further point made by him is that parliament rarely pursues a singular general policy.[178] Statutory

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[171] Cooper *Why GST is Not a Consumption Tax … and Why it Matters* [2003] *TIA GST Intensive Conference paper* cited.
[172] Howe & Penning *Creditable purpose and cancelled financial supplies – It's all in the timing* [2005] *ATAX 17th Annual GST & Indirect Tax Weekend Workshop paper* (at 2) for example.
[173] Olding *An ATO perspective on the creditable purpose test* (2012) 12 AGSTJ 131.
[174] cf Explanatory Memorandum (at [3.24]).
[175] cf Bird & Miller *GST and property apportionment: "The Wisdom of Solomon"* (2012) 12 AGSTJ 39 (at 48-49).
[176] *National Rugby League Investments Pty Ltd v Singtel Optus Pty Ltd* [2012] FCAFC 59 (at [94-99]) quoted.
[177] *WR Carpenter Holdings Pty Ltd v FCT* [2007] FCAFC (at [29]) quoted.
[178] *Carr v Western Australia* [2007] HCA 47 (at [5]) quoted.

provisions more usually involve a compromise of competing policy objectives. That general policy cannot be read as the law must now be regarded as beyond argument.

On the future impact of *HP Mercantile* itself, Olding elsewhere suggests that cascade avoidance as a key feature of the tax 'will continue to inform judicial decision-making', but that *HP Mercantile* 'is unlikely to be accepted as authority for that principle becoming a proxy for the relationship required by s 11-15(2)(a)'.[179]

6. INTERPRETATION IN AUSTRALIA

6.1 Legalism and literalism

Dennis Pearce, the once again sole author of *Statutory Interpretation in Australia*, in his preface to the First Edition quoted Lord Mansfield for the following – 'Most of the disputes in the world arise from words'.[180] This is an axiomatic truth in the land of statutes. 'Nothing is so easy as to pull them to pieces, nothing is so difficult as to construct them properly'.[181] The uncertainty of statutory words, said Lord Wilberforce, was what made statutory interpretation 'so exciting'.[182] Excitement or otherwise, one thing which is more than clear is that the principles applied by courts to interpretation apply equally to the Tax Commissioner and his officers.[183]

As French CJ has noted, the interpretation of statutes 'can be characterised as a small "c" constitutional function'.[184] For most of the twentieth century, Australia endured a generally literalist approach to statutory interpretation.[185] This approach was dominated by a myopic and morbid fixation on the words, driven by dictionary definitions, strict grammar analyses, mechanical rules and a refusal to look beyond the four corners of the statute. Often referred to as 'black letter' interpretation, inflexibility was front and centre[186] but cynicism (it seemed at times) was not far from the surface.[187] What Mason J called the 'dead weight of precedent' also played a role in its maintenance.[188] The general approach was typified, if not perpetuated and encouraged, by the way the Barwick Court decided a suite of tax cases.[189]

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[179] Olding *Trends in the Interpretation of GST law* [2007] *ATAX 19th Annual GST and Indirect Tax Weekend Workshop paper* (at [74]).
[180] *Morgan v Jones* (1773) Lofft 160 (at 176).
[181] *O'Flaherty v M'Dowell* (1857) 6 HLC 142 (at 179).
[182] *Symposium on Statutory Interpretation* (5 January 1983) Canberra (at 7).
[183] Logan *Statutory Construction* [2016] FedJSchol 5 (at 5) for example, cf Reid *Interpreting the GST law; tax law based on coherent principles* (2005) 5 AGSTJ 239 (at 243).
[184] French CJ *Common Law Constitutionalism* [2014] *Robin Cooke Lecture* (at 3).
[185] *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129 (at 161-162) exemplifies.
[186] cf *Ausdoc Information Management Pty Ltd v Central Document Storage Pty Ltd* [2003] NSWSC 1013 (at [18]), *Lakes Action Group Association Inc v Shire of Northam* (2004) 37 SR (WA) 7 (at 9).
[187] cf *Commonwealth Bank v Spira* (2002) 174 FLR 274 (at 301), *Porter v GIO Australia Limited* [2003] NSWSC 668 (at [1021]), *Overlook v Foxtel* [2002] NSWSC 17 (at [67]), *ACD Tridon Inc v Tridon Australia Pty Ltd* [2003] NSWSC 1014 (at [105]).
[188] Mason *Taxation Policy and the Courts* (1990) 2/4 *CCH Journal of Australian Taxation* 40 (at 42).
[189] Krever *Taming Complexity in Australian Income Tax* (2003) 25 *Sydney Law Review* 467 (at 476-480), Stone *The GST – A Practical Business Tax?* [2006] *TIA National GST Conference paper* (at 4-5), Slater *Tax in Australian society: An 80 year perspective* (2007) 81 Australian Law Journal 681 (at 696), cf Barwick *A Radical Tory* (at 229), *FCT v Westraders Pty Ltd* (1980) 144 CLR 55 (at 59-60).

Kirby J spoke out about the 'misfiring of texts that was the main legacy of the era of literalism'.[190] What came to be called the 'new literalism'[191] led to what was described as a 'notorious era of interpretation of legislation in Australia'.[192] Hill J had accepted this as only generally being correct, and he regarded the issue as being more complex.[193] So did Sir Anthony Mason, as he later explained in his *Fullagar Memorial Lecture*.[194]

Literalism on some occasions was tempered by the 'golden rule' in *Grey v Pearson* in cases of linguistic absurdity or inconsistency.[195] This 'safety net' facility rarely proved an effective foil to literalism in practice, however, given the way it was understood and applied by courts.[196] Hill J was later to point out some of the limitations of the golden rule in his paper – *To interpret or translate?* Essentially, the rule is one of inward focus on the statute itself and one which denies 'an excursus into legislative policy'.[197]

There developed a degree of concern if not embarrassment about our narrow literalism, and a sense that Australia had fallen behind the times. Professor Pearce in the *Oxford Companion to the High Court* spoke of government 'exasperation'.[198] Murphy J in *Westraders* was particularly scathing about our 'predicament'.[199] He said the prevailing trend was 'now so absolutely literalistic that it has become a disquieting phenomenon'. Interviewed in the book *Judging the World*, Murphy J intimated that this involved 'a departure from, virtually a repudiation of, the role of the judiciary'.[200]

Stone J later said there had been 'naïve confidence' that the literal approach in Australia would produce correct results'.[201] The *National Times* aptly described the approach of the High Court as *Backwards into the Future*.[202] The UK had been moving towards a more purposive approach, partly via the influence of EU protocols following passage of the *European Communities Act* of 1972. The history of what is rightly called the 'disorderly rise of the purposive rule' in the UK is traced by Jeffrey Barnes.[203]

One thing literalism did contribute to was a very granular, rule-based style of legislative drafting. Closed language aimed at eliminating all possible permutations and combinations of circumstance became the cultural norm. The unsurprising result was

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[190] *Palgo Holdings Pty Ltd v Gowans* [2005] HCA 28 (at [112]).
[191] Krever *Murphy on Taxation* in Scutt (ed) *Lionel Murphy: A Radical Judge* (at 130).
[192] Barnes *Statutory Interpretation, Law Reform & Sampford's Theory of the Disorder of Law* (1994) 22 *Federal Law Review* 116 (at 154).
[193] Hill J *How is tax to be understood by courts* (2001) 4/5 *The Tax Specialist* 226 (at 229-230), cf Hill J *Barwick CJ: 'The taxpayer's friend'?* (1997) 1/1 *The Tax Specialist* 9 (at 12).
[194] Mason *Future Directions in Australian Law* (1987) 13/3 *Monash University Law Review* 149 (at 161).
[195] *Grey v Pearson* (1857) 10 ER 1216 (at 1234).
[196] cf *Footscray City College v Ruzicka* [2007] VSCA 136 (at [16]), *JJ Richards & Sons Pty Ltd v Fair Work Australia* [2012] FCAFC 53 (at [50]).
[197] Hill J *To interpret or translate? The judicial role for GST cases* (2005) 5 AGSTJ 225 (at 226).
[198] Blackshield *Oxford Companion to the High Court of Australia* (at 642).
[199] *FCT v Westraders Pty Ltd* (1980) 144 CLR 55 (at 80), cf *The 'Purposive' Versus the 'Literal' Construction of Statutes* (1981) 55 *Australian Law Journal* 175.
[200] Sturgess & Chubb *Judging the World; Law and Politics in the World's Leading Courts* (at 361).
[201] Stone *The GST – A Practical Business Tax* [2006] *TIA National GST Conference paper* (at 4).
[202] McGregor *The High Court: Backwards into the Future* (17 February 1980) *National Times* 14.
[203] Barnes *Statutory Interpretation, Law Reform and Sampford's Theory of the Disorder of Law – Part One* (1994) 22 *Federal Law Review* 116 (at 149-154).

legislation 'not sufficiently general or experiential to allow a conception to live within it'.[204] In *Courts as (Living) Institutions and Workplaces*, Allsop CJ said[205] –

> Deconstruction and particularism and the mania for completeness and certainty plague our statutes, especially Commonwealth drafting … The elemental particularism of modern day legislation – its deconstructionist form, sometimes arranged more like a computer program than a narrative in language to be read from beginning to end – reflects this modern cast of mind intent on particularity, definition and taxonomical structure that is scientific only in a mechanical Newtonian sense.

There was desire for change and a more contemporary approach to interpretation, one which took more account of purpose, context and the modern world of legislation. A central agitator in this regard was Patrick Brazil at the Attorney-General's Department in Canberra with whom I had the pleasure of working.

One way the reform agenda was to be progressed was by a series of conferences, to which influential judges and others were invited from Australia and overseas.[206] Lord Scarman from the UK was one of the international visitors. In a lecture at *Monash University* in 1980, he had said – 'In London no-one would dare to choose the literal rather than a purposive construction of a statute: and 'legalism' is currently a term of abuse'.[207] Lord Diplock had observed in the UK a slow movement towards purposivism starting just after WW2.[208] It was possible to say by 1978 that purposive interpretation had already become 'fashionable'.[209] In the same year, David W Williams, writing in the *Modern Law Review,* put it in these terms[210] –

> The judicial orchestra rarely interprets the score to consistent effect, but broadly it is currently more ready to adopt a flexible and sympathetic approach than tradition suggests.

6.2 Parallel revolution

Sir Garfield Barwick retired as Chief Justice of the High Court at the age of 77 years on 11 February 1981. Before he departed, a bench of five other justices heard the prior year losses case, *Cooper Brookes*. Four months after Barwick left the stage, the decision was handed down.[211] It delivered what has come to be regarded as the comprehensive refutation of literalism that many had hoped for, and one that continues to resonate to this day in the courts.[212] In the recent sperm donor case, six members of the High Court

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[204] cf Allsop CJ *The Foundations of Administrative Law* [2019] FedJSchol 5 (at 9).
[205] Allsop *Courts as (Living) Institutions and Workplaces* [2019] *Joint Federal & Supreme Court Conference Hobart* paper (at 14-15).
[206] Geddes *Purpose and Context in Statutory Interpretation* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 127 (at 129-135) discusses.
[207] Lord Scarman *Ninth Wilfred Fullagar Memorial Lecture* (1980) 7 *Monash University Law Review* 1 (at 6), cf (9 March 1981) 418 House of Lords Official Report Col 65, Hayne & Gordon *Statutes in the 21st Century* (at 6).
[208] *Carter v Bradbeer* [1975] 1 WLR 1204 (at 1206-1207), cf *The Interpretation of Statutes* Law Commissions Report No 21 (1969), *Stenhouse Holdings Ltd v IRC* [1972] AC 661 (at 682).
[209] *Stock v Frank Jones (Tipton) Ltd* [1978] 1 All ER 948 (at 951).
[210] Williams *Taxing Statutes are Taxing Statutes: The Interpretation of Revenue Legislation* (1978) 41 *Modern Law Review* 404 (at 417).
[211] *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297.
[212] *HFM043 v Republic of Nauru* [2018] HCA 37 (at [24]) illustrates.

explained that, unless the 'text, structure or purpose of the legislation' provides a basis to suppose that some other meaning was intended, the word 'parent' would take its 'natural and ordinary meaning'.[213]

Not everyone saw *Cooper Brookes* in this same light at the time. Barnes, for example, saw the case as resting on 'fictional foundations', and with no majority support for a change to purposivism.[214] Two decades later, however, Hill J described that case as a 'step backwards from literalism'.[215] Mason J said that *Cooper Brookes* was a case where 'the courts accepted that a purposive construction should, in appropriate cases, be applied to revenue laws'.[216] Others saw it as merely applying existing principles.[217] *Cooper Brooks* does not use all the later language of purposivism. It clearly points in that direction, however, something which is borne out by intervening history.

Cooper Brookes was followed the next week by enactment of legislation to entrench purposive interpretation as the prevailing norm in Australia – s 15AA of the *Acts Interpretation Act 1901*. This new provision (amended in 2011) required a 'construction that would promote the purpose or object … shall be preferred to a construction that would not'. A parallel revolution of sorts had taken place,[218] one for which there was bipartisan support. Similar proposals had earlier failed in the UK. Mason J said of the idea that the approach in *Cooper Brookes* was prompted by awareness of the s 15AA proposal was 'something of an exaggeration'.[219]

Events leading to s 15AA are summarised in a note in the *Australian Law Journal*.[220] The note says variously that s 15AA was not 'radical or innovative', and that it merely made 'mandatory that which was previously facultative'. Dawson J saw it this way early on,[221] as did Supreme Court of Victoria,[222] and Hill J too in *Boral Windows*.[223] Harry Geddes said s 15AA 'gives the interpreter no choice as to whether to apply it'.[224] A visiting American academic, Philip Frickey, colourfully put the proposition that s 15AA

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[213] *Masson v Parsons* [2019] HCA 21 (at [26]) citing *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297 (at 305, 310, 321, 335) among other cases.
[214] Barnes *Statutory Interpretation, Law Reform and Sampford's Theory of the Disorder of Law – Part One* (1994) 22 *Federal Law Review* 116 (at 168).
[215] Hill J *How is Tax to be Understood by Courts?* (2001) 4/5 *The Tax Specialist* 226 (at 230).
[216] Mason *Taxation Policy and the Courts* (1990) 2/4 *CCH Journal of Australian Taxation* 40 (at 42).
[217] Allerdice *The swinging pendulum: Judicial trends in the interpretation of revenue statutes* (1996) 19 UNSWLJ 162 (at 174), cf Street *Judicial Law-Making – Some reflections* (1982) 9 *Sydney Law Review* 535 (at 539).
[218] cf Nettle *Applications for Special Leave in Tax Matters* [2015] *Tax Bar Association Annual Dinner paper* (at 9-12).
[219] Mason *Taxation Policy and the Courts* (1990) 2/4 *CCH Journal of Australian Taxation* 40 (at 42), *FCT v Lutovi Investments Pty Ltd* (1978) 140 CLR 434 (at 445), *FCT v Students World (Australia) Pty Ltd* (1978) 138 CLR 251 (at 265) cited.
[220] Starke *Statutory guidelines for interpreting Commonwealth statutes* (1981) 55 *Australian Law Journal* 711, cf Barnes *Statutory Interpretation, Law Reform and Sampford's Theory of the Disorder of Law – Part One* (1994) 22 *Federal Law Review* 116 (at 156-157).
[221] *Mills v Meeking* (1990) 91 ALR 16 (at 29).
[222] *R v Boucher* (1994) 70 A Crim R 577 (at 590).
[223] *Boral Windows v Indistrial Research and Development Board* (1998) 83 FCR 215 (at 220).
[224] Geddes *Purpose and Context in Statutory Interpretation* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 127 (at 133).

'arguably mandates purposivism *uber alles*'.[225] Stone J also observed that a purposive approach is 'mandated' by s 15AA.[226]

Subjection of 15AA to its own processes should perhaps have been enough to confirm this outcome.[227] The provision also applies to particular provisions and parts of a statute just as much as to an Act as a whole.[228] Professor Julius Stone wrote in the *Sydney Morning Herald* that intelligent lay people would feel no outrage at s 15AA, and Geoff Pryor penned a memorable cartoon depicting literalist and purposive judges (surely a first).[229] One commentator saw s 15AA as merely giving 'legislative respectability' to common law approaches.[230] Another perceived in the new purposive direction a 'greater threat … to basic human rights', with the literal approach would enable taxpayers 'to protect what is rightfully theirs'.[231]

6.3 Modern approach

The idea that purposive methods are some 'modern approach' to statutory interpretation is a popular myth fondly recalled. The historical antecedents of purposivism are generally regarded as 'equity of the statute' principles[232] and the 'mischief rule'.[233] More recent research suggests,[234] however, that the roots in this regard go all the way back to Aristotle[235] and continental Roman law. It might be noted that New Zealand from colonial times has had provisions on the statute book mandating a purposive approach, even if judges studiously ignored them and continued to favour literal approaches until the late 20th century.[236] The experience in Canada was much the same on very similar provisions.[237] That old legal habits die hard is a truism.

The modern march of purposivism into the common law world seems to date from 1958 with publication of the teaching materials of two *Harvard Law School* professors, Henry Hart and Oliver Sacks.[238] For them, 'every statute must be conclusively presumed to be

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[225] Frickey *Structuring purposive statutory interpretation: An American perspective* (2006) 80 *Australian Law Journal* 849 (at 856).
[226] Stone *The GST – A Practical Business Tax* [2006] *TIA National GST Conference paper* (at 5).
[227] cf Barker *First You See It, The You Don't – Harry Houdini and the Art of Interpreting Statutes* [2012] *JCA Colloquium paper* (at [16]).
[228] *Anglican Care v NSW Nurses and Midwives' Association* [2015] FCAFC 81 (at [49]).
[229] Reproduced in Morris , Cook, Creyke, Geddes & Seymour *Laying Down the Law* (at 151).
[230] Penfold *Legislative Drafting and Statutory Interpretation* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 81 (at 88).
[231] Lonnquist *The Trend Towards Purposive Statutory Interpretation: Human Rights at Stake* [2003] *Revenue Law Journal* 18 (at 27).
[232] *Eyston v Studd* (1574) 75 ER 688 (at 695), Plucknett *Statutes & their Interpretation in the First Half of the Fourteenth Century* (1986).
[233] *Heydon's Case* (1584) 76 ER 637 (at 638), Black *Development of principles of statutory interpretation* [2013] *Francis Forbes Society paper*.
[234] Corcoran *Theories of Statutory Interpretation* in Corcoran & Bottomley (eds) *Interpreting Statutes* (at 11-14).
[235] Aristotle *Ethics* Book 5, Chapter 10 (at 113-114).
[236] White *Appellate interpretation of NZ's GST legislation: an initial survey: 1986-2005* (2005) 5 AGSTJ 205, Ward *A Criticism of the Interpretation of Statutes in the New Zealand Courts* [1963] *New Zealand Law Journal* 293 (at 294-295), cf s 5(j) of the *Acts Interpretation Act 1924* (NZ), s 5(1) of the *Interpretation Act 1999* (NZ).
[237] *Sullivan on the Construction of Statutes* (at §15.20).
[238] Hart & Sacks *The Legal Process: Basic Problems in the Making and Application of Law*.

a purposive act'.[239] In carrying purpose into effect, they said a court should not give words a 'meaning they will not bear',[240] a basic condition which endures to this day. Their basic ideas were quickly embraced, first in academic circles, then more widely.[241]

In an America, stuck in unending dispute over even the basics of interpretation,[242] however, purposivism never became the prevailing norm before the courts. It remains a methodology of explanation, which has marginal influence in US courts compared to the 'new textualism' of Antonin Scalia.[243] Even by 1996, the purposivism of Hart and Sacks was being described as 'largely discredited' in the United States.[244]

The early years of purposivism are analysed in tense detail by Jeffrey Barnes in two *Federal Law Review* articles written in the mid-1990s.[245] His primary thesis is that the 'novel experiment' in legislating s 15AA only produced greater legal disorder and disarray – it made legal outcomes less certain. He said s 15AA and purposivism only added conflict, decanonised the common law, and gave rise to a more pluralistic practice.

Whether these charges now hold or are all pejorative, or Barnes himself would continue to adhere to them 20 years on, a strong chorus of High Court decisions over nearly four decades should be enough to confirm that formalistic black letter approaches are behind us.[246] There is the odd discordant note, of course, something which is only to be expected in a pluralistic judiciary.[247] A degree of anomalous discord, however, does not disturb the essential continuity of purposivism, something which has become more and more evident since the landmark cases of *Project Blue Sky* in 1997 and *CIC Insurance*. The latter case, with its clear direction to consider context at the beginning and in the 'widest sense', remains centrally important.

6.4 Importance of context

HP Mercantile itself illustrates the refined appreciation Hill J had for 'context' as a key driver in contemporary interpretation. 'Context' is a simple, indeed, obvious, concept, as Beazley P has recently observed.[248] In the words of Edelman J – 'No meaningful words, whether in a contract, a statute, a will, a trust or a conversation are ever

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[239] Frickey *Structuring purposive statutory interpretation: An American perspective* (2006) 80 *Australian Law Journal* 849 (at 859), cf *Ex parte Northern Land Council* (1981) 151 CLR 170 (at 204).
[240] Hart & Sacks *The Legal Process: Basic Problems in the Making and Application of Law* (at 1374).
[241] Frickey *Structuring purposive statutory interpretation: An American perspective* (2006) 80 *Australian Law Journal* 849 (at 849-855), Brooks *The responsibility of judges in interpreting tax legislation* in Cooper (ed) *Tax Avoidance and the Rule of Law* (at 111).
[242] Scalia & Garner *Reading Law* (at xxvii).
[243] For example - Scalia *A Matter of Interpretation: Federal Courts and the Law* (Tanner Lectures), Scalia & Garner *Reading Law* (at 15-28), *Johnson v Transportation Agency, Santa Clara County* 480 US 616 (at 657-677) (1987) Scalia J dissenting, Eskridge *The New Textualism* (1990) 37 *UCLA Law Review* 621, Eskridge, Frickey & Garrett *Legislation And Statutory Interpretation* (at 235-245).
[244] Livingston *Practical Reason, "Purposivism", and the Interpretation of Tax Statutes* (1996) 51 *Tax Law Review* 677 (at 681)
[245] Barnes *Statutory Interpretation, Law Reform and Sampford's Theory of the Disorder of Law – Part One* (1994) 22 *Federal Law Review* 116, Barnes *Statutory Interpretation, Law Reform and Sampford's Theory of the Disorder of Law – Part Two* (1995) 22 *Federal Law Review* 77.
[246] *The Queen v A2* [2019] HCA 35 (at [32]), cf Corcoran *Theories of Statutory Interpretation* in Corcoran & Bottomly (eds) *Interpreting Statutes* (at 29).
[247] Middleton J *Statutory Interpretation: Mostly Common Sense* (2016) 40 *Melbourne University Law Review* 626 (at 639).
[248] Beazley P *Language: The Law's Essential Tool* (2017) 12 *The Newcastle Law Review* 1 (at [15]).

acontextual'.[249] No person ever makes an acontextual statement; there is always some context no matter how meagre.[250] Words 'do not exist in limbo',[251] nor are they 'susceptible to interpretation standing by themselves'.[252] 'It is a matter of constant experience that people can convey their meaning unambiguously although they have used the wrong words', observed Lord Hoffman.[253]

To say that context is a 'major aspect' of interpretation in Australia is an understatement.[254] Accordingly, we are to have regard to context in the 'widest sense' at the beginning of the process, and not merely if difficulty later arises,[255] as Hill J himself noted many times. The judicial precursors to this approach are found in Mason J's judgment in *K & S Lake*[256] and, further back, a 1957 English case.[257]

The American judge, Felix Frankfurter, said that 'nothing that is logically relevant should be excluded'.[258] Perram J once characterised our 'widest sense' language as a 'high watermark',[259] but it remains confirmed as the legal standard. The passage from *CIC Insurance* has 'been cited too many times to be doubted'.[260] Context in its widest sense includes things both internal and external the statute. Francis Bennion in his UK textbook refers to the use of context as 'informed interpretation'.[261] The underlying idea is that better-informed decisions 'are likely to be more correct decisions'.[262]

Jeffrey Barnes has written recently that contextualism is 'the modern approach to statutory construction', and says it has far greater claims in this regard than either textualism or purposivism.[263] The resolution of contextual factors, to the extent that they may legitimately assist in the process, however, is through the 'unqualified statutory instruction' to prefer the meaning that 'would best achieve the purpose or object' of the provisions. That is one reason Suna Rizalar and I described constructional choice as being 'at the epicentre of statutory interpretation'.[264] French CJ wrote that the 'reality is that statutory interpretation is all about choice of available meanings'.[265] Contextualism, without doubt, performs a vital role in this process. As Jacinta Dharmananda observes,

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[249] *Rinehart v Rinehart* [2019] HCA 13 (at [83]), *Wollongong Coal Pty Ltd v Gujarat NRE India Pty Ltd* [2019] NSWCA 135 (at [50]), .
[250] *Kirin-Amgen Inc v Hoechst Marion Roussel Ltd* [2005] 1 All ER 667 (at [64]).
[251] Spigelman *Principle of legality and the clear statement of principle* (2005) 79 *Australian Law Journal* 769 (at 772) citing *Morris v Beardmore* [1981] AC 446 (at 459).
[252] Sunstein *Principles, Not Fictions* (1990) 57 *University of Chicago Law Review* 1247 (at 1247).
[253] *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 (at 774).
[254] Fishman *Statutory Misinterpretations: Rash Holding in Brash Holdings* (2017) 45 *Federal Law Review* 199 (at 206).
[255] *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 (at 408), cf *Attorney-General v Prince Ernest Augustus of Hanover* [1957] AC 436 (at 461), *K & S Lake City Freighters Pty Ltd v Gordon & Gotch Limited* (1985) 157 CLR 309 (at 315).
[256] *K & S Lake City freighters Pty Ltd v Gordon & Gotch Ltd* (1985) 157 CLR 309 (at 315).
[257] *Attorney-General v Prince Ernest Augustus of Hanover* [1957] AC 436 (at 461).
[258] Frankfurter *Some Reflections on the Reading of Statutes* (1947) 47 *Columbia Law Review* 527 (at 541).
[259] Perram *The perils of complexity: Why more law is bad law* (2010) 39 *Australian Taxation Review* 179 (at 183).
[260] *FCT v Jayasinghe* [2016] FCAFC 79 (at [7]), *SZTAL v Minister for Immigration & Border Protection* [2017] HCA 34 (at [37]), *CPB Contractors Pty Ltd v CFMMEU* [2019] FCAFC 70 (at [59]), *Australian Finance Direct Ltd v Director of Consumer Affairs* [2007] HCA 57 (at [40]).
[261] *Bennion on Statutory Interpretation* (at Part XIII).
[262] Burrows *The Changing Approach to the Interpretation of Statutes* (2002) 33 VUWLR 981 (at 986).
[263] Barnes *Contextualism: 'The Modern Approach to Statutory Interpretation* (2018) 41 UNSWLR 1083.
[264] Brysland & Rizalar *Constructional choice* (2018) 92 *Australian Law Journal* 81 (at 84).
[265] French *The Principle of Legality and Legislative Intention* (2019) 40 *Statute Law Review* 40 (at 44).

parliamentary materials 'inform but do not decide'.[266] In a real sense, while it is context which selects the candidates, it is purpose which picks the winner.

The High Court confirmed this in *Thiess* when it said that objective discernment of statutory purpose is 'integral to contextual construction', and that s 15AA involves the 'statutory reflection of a general systemic principle'.[267] *CIC Insurance* confirmed the potential reach of context from within which the constructional choice is to be made. In a way, the requirement to consult context in the widest sense is a necessary but not sufficient condition in determining what parliament meant by the words it used. Relevant context maps the outer reaches of the enquiry from within which meaning is potentially to be ascertained. Statutory purpose, however, is what legally and practically guides the resolution of statutory meaning.

There may be difficulties in identifying purpose, and often this is the case. Gleeson CJ illustrated this pesky reality in *Carr* by reference to income tax statutes, where provisions strike a balance between competing interests. Sometimes the legislature may abstain from stating any clear purpose at all. In rarer cases, the legislative purpose may be 'to express an inarticulate (or at least not publicly disclosed) compromise'.[268] Also, there is 'nothing to suggest that taxing Acts have higher standards of logical and normative consistency than any other class of statute'.[269]

Chief Justice French, with characteristic flair, reminds us that 'law's realm has its policy deserts, devoid of purpose, its badlands where conflicting purposes are tumbled up against each other in an incoherent jumble and the undulating country of policies in tension'.[270] However, once it is accepted that all legislation is purposive by nature, and that modern regulatory legislation inevitably pursues diverse, overlapping or obscure purposes, the s 15AA obligation is met by probing to what extent the respective interests are advanced. Political compromise does not relieve the s 15AA obligation, even if it makes its delineation more difficult. Legislative purpose 'is required to inform all interpretation', as French CJ points out.[271]

6.5 Disciplined and systematic

The exploration of context for interpretation purposes is now mandatory under the 'modern approach.[272] An early NSW chief justice said that '[e]verything depends upon

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[266] Dharmananda *Outside the Text: Inside the Use of Extrinsic materials in Statutory Interpretation* (2014) 42 *Federal Law Review* 333 (at 354).

[267] *Thiess v Collector of Customs* [2015] HCA 12 (at [23]), *Calidad Pty Ltd v Seiko Epson Corporation* [2020] HCA 41 (at [91]), *SZTAL v Minister for Immigration and Border Protection* [2017] HCA 34 (at [39]), *FCT v Sharpcan Pty Ltd* [2018] FCAFC 163 (at [208-212]), *Comptroller-General v Pharm-A-Care Laboratories Pty Ltd* [2018] FCAFC 237 (at [26]), *CCA19 v Secretary, Department of Home Affairs* [2019] FCA 946 (at [39]), cf *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 (at 381), *FCT v Unit Trend Services Pty Ltd* [2013] HCA 16 (at [47]).

[268] *Stevens v Kabushika Kaisha Sony Computer Entertainment* [2005] HCA 58 (at [34]), *Collins v Northern Territory* [2007] FCAFC 152 (at [59-60]), cf *Country Carbon Pty Ltd v Clean Energy Regulator* [2018] FCA 1636 (at [118-119])

[269] *Woodside Energy Ltd v FCT (No 2)* [2007] FCA 1961 (at [204]).

[270] French CJ *Dolores Umbridge and Policy as Legal Magic* (2008) 82 *Australian Law Journal* 322 (at 326).

[271] French CJ *Dolores Umbridge and Policy as Legal Magic* (2008) 82 *Australian Law Journal* 322 (at 331).

[272] *Independent Commission Against Corruption v Cunneen* [2015] HCA 14 (at [57]), cf *Kingston v Keprose Pty Ltd* (1987) 11 NSWLR 404 (at 423), *Bropho v Western Australia* (1990) 171 CLR 1 (at 20).

the subject matter and the context'.[273] When we refer to context in the 'widest sense', it is to context both within and outside the statute. Rather obviously, statutes are 'limited in the amount of context that they can contain'.[274] References to 'context' are often to matters external to the statute. Edelman J in the High Court, for example, notes that '*con*text is, literally, those matters to be considered (simultaneously) with the text'.[275] Similarly, context is always to be considered in close tandem with the text,[276] and before application of law to the facts.[277]

Kirby J asked rhetorically in *Lavender* – 'If context is important for statutory construction, why is it not always important?'[278] Some years later, the High Court in *Probuild* answered this in the affirmative.[279] The point to make is that context is 'always important',[280] but it can never be 'an end in itself'.[281] Context is 'often messy',[282] different in every case, and subject to change.[283] In some cases, the search for relevant context may prove laborious; in others, more straightforward.[284] However, even if context is random and taken as it is found to be, it must always be approached in a disciplined, systematic and logical way.[285]

Context may have influence at different levels. It usually includes the existing state of the law and the mischief the provisions were enacted to address.[286] It also, naturally, extends to the pre-enactment and enactment history of the provisions.[287] Extrinsic materials are part of the context, but 'statements of meaning' or intended meaning within those materials are usually accorded little weight.[288] Lord Steyn described this as being no more than 'what the government would like the law to be'.[289] The naïve

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[273] *Hall v Jones* (1942) 42 SR (NSW) 203 (at 208).
[274] Tanner *Confronting the Process of Statute-Making* in Bigwood (ed) *The Statute – Making and Meaning* (at 72).
[275] *SAS Trustee Corporation v Miles* [2018] HCA 55 (at [64]).
[276] *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 (at [47]).
[277] *Multiflex Pty Ltd v FCT* [2011] FCA 1112 (at [18]), *FCT v Multiflex Pty Ltd* [2011] FCAFC 142 (at [13]), *Virgin Blue Airlines Pty Ltd v FCT* [2010] FCAFC 137 (at [31]), cf Walshaw *Recent Developments in Statutory and Constitutional Interpretation* (2019) 40 *Statute Law Review* 1 (at 4).
[278] *R v Lavender* [2005] HCA 37 (at [109]).
[279] *Probuild Constructions (Aust) Pty Ltd v Shade Systems Pty Ltd* [2018] HCA 4 (at [34]).
[280] Spigelman *Principle of legality and the clear statement of principle* (2005) 79 *Australian Law Journal* 769 (at 772).
[281] *FCT v Consolidated Media Holdings Ltd* [2012] HCA 55 (at [39]), *CPB Contractors Pty Ltd v CFMMEU* [2019] FCAFC 70 (at [57-58]), *SZTAL v Minister for Immigration and Border Protection* [2017] HCA 34 (at [14]), *Alphapharm Pty Ltd v H Lundbeck A-S* [2014] HCA 42 (at [121]).
[282] Barnes *Contextualism: 'The Modern Approach to Statutory Interpretation* (2018) 41 UNSWLR 1083 (at 1088).
[283] Gleeson CJ *Justice Hill Memorial Lecture – statutory interpretation* (2009) 44 *Taxation in Australia* 25 (at 30).
[284] Middleton J *Statutory Interpretation: Mostly Common Sense* (2016) 40 *Melbourne University Law Review* 626 (at 632).
[285] *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 illustrates.
[286] *K & S Lake City Freighters Pty Ltd v Gordon & Gotch Limited* (1985) 157 CLR 309
[287] Allsop *Statute: context, meaning and pre-enactment history* [2005] *Bar News (Winter)* 19.
[288] *Berenguel v Minister for Immigration & Citizenship* [2010] HCA 8 (at [21]) illustrates, cf *NSW Aboriginal Land Council v Minister Administering the Crown Lands Act* [2016] HCA 50 (at [33]), *Ex parte Beane* (1987) 162 CLR 514 (at 518), *Saeed v Minister for Immigration and Citizenship* [2010] HCA 23 (at [31]), *Nominal Defendant v GLG Australia Pty Ltd* [2006] HCA 11 (at [22]), *Hunter Resources Limited v Melville* (1988) 164 CLR 234 (at 241).
[289] Steyn *The Intractable Problem of The Interpretation of Legal Texts* (2003) 25/5 *Sydney Law Review* 5 (at 14).

practice of 'planting' statements of intention in extrinsic materials does not go judicially unnoticed either.[290]

As has also been observed, the worst one to construe provisions is the person responsible for drafting them.[291] The basic reason for this is that determination of statutory meaning 'is an exercise of the judicial power, not of the legislative power'.[292] Context 'comes in many forms',[293] but 'no text can dictate its own interpretation'.[294] Context, of course, in its 'widest sense' may go further than these things, but it is never limitless or unconstrained.[295] Gleeson CJ has suggested the line be drawn at whatever 'could rationally assist understanding of meaning'.[296] Nor is context uniform in extent, value or impact. McHugh J said[297] –

> The true meaning of a legal text almost always depends on a background of concepts, principles, practices, facts, rights and duties which the authors of the texts took for granted or understood without conscious advertence by reason of the common language or culture.

6.6 Impact of context

The same language in different contexts may produce radically different outcomes. This is the whole thing about context - its potential to leverage diverse meanings and results.[298] The impact of context on the meaning of words is one reason why consultation of dictionaries is no substitute for interpretation. Words, after all, 'are only pictures of ideas on paper', as Wilmott CJ reflected in a case decided in 1767.[299]

Context is also to be expanded to include 'the way the statutory text is applied in the courts *after* the text is enacted'.[300] Rares J applied this theme directly in the recent case of *Berkeley Challenge*.[301] Statutory context, therefore, can be an evolving and dynamic thing. The weight and cogency of contextual factors is to be judged by the ordinary rules

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[290] Keith Mason *The intent of legislators: How judges discern it and what they do if they find it* (2006) 27 *Australian Bar Review* 253 (at 259-261) illustrates.
[291] *Hilder v Dexter* [1902] AC 474 (at 477), *Rambaldi v Weeden* [2008] FCA 1597 (at [47]), cf Middleton J *Statutory Interpretation: Mostly Common Sense* (2016) 40 *Melbourne University Law Review* 626 (at 630).
[292] *Harrison v Melhem* [2008] NSWCA 67 (at [15]), *R v Aubrey* [2012] NSWCCA 254 (at [37]).
[293] Basten *Choosing Principles of Interpretation* (2017) 91 *Australian Law Journal* 881 (at 884).
[294] Campbell & Campbell *Why statutory interpretation is done as it is done* (2014) 39 *Australian Bar Review* 1 (at 16, 35), *Harrison v Melham* [2008] NSWCA 67 (at [12]), *Amaca Pty Ltd v Novek* [2009] NSWCA 50 (at [74-78]).
[295] cf *Woodside Energy Ltd v FCT (No 2)* [2007] FCA 1961 (at [201-203]).
[296] Gleeson CJ *The meaning of legislation: Context, purpose and respect for fundamental rights* (2009) 20 *Public Law Review* 26 (at 29).
[297] *Theophanus v Herald & Weekly Times Ltd* (1994) 182 CLR 104 (at 196), cf *Singh v Commonwealth* [2004] HCA 43 (at [54]), *Momcilovic v The Queen* [2011] HCA 34 (at [19]), *Minister for Home Affairs v Zentai* [2012] HCA 28 (at [31]).
[298] *FCT v Multiflex Pty Ltd* [2011] FCAFC 142 (at [29-33]) for example.
[299] *Dodson v Grew* (1767) 96 ER 106 (at 108), cf *Fell v Fell* (1922) 31 CLR 268 (at 276), *House of Peace Pty Ltd v Bankstown City Council* [2000] NSWCA 44 (at [26]).
[300] Gageler *Common Law Statutes and Judicial Legislation: Statutory Interpretation as a Common Law Process* (2011) 37(2) *Monash Law Review* 1 (at 1), Mason *The interaction of statute law and common law* (2016) 90 *Australian Law Journal* 324 (at 328), *Westpac Banking Corporation v Lenthall* [2019] FCAFC 34 (at [88]), cf *Weiss v R* [2005] HCA 91 (at [9]), *Baiada Poultry Pty Ltd v R* [2012] HCA 14 (at [21]).
[301] *Berkeley Challenge Pty Ltd v United Choice* [2020] FCAFC 113 (at [190-191]).

of interpretation.[302] And, the more remote something is from the act and time of legislating, the higher will be its level of generality or abstraction. This means it will naturally have less (often no) influence on any constructional choice to be made.

A recurring problem is that there is no bright line in the land of context telling us when we have passed from potential legal relevance into alien non-justiciable territory – be it economics, science, philosophy or some other discipline. Although it has been said there is no 'explicit starting point' on the issue,[303] the most intuitive zones to begin exploration of internal context are immediately proximate sections and any cross-referenced or incorporated provisions. Once outside the statute, the natural inclination is first to look at the explanatory memorandum. Beyond that, and consistent with the 'widest sense' language ever-repeated by the courts, the field is relatively open.

What is clearer is that context only has utility 'if, and in so far as, it assists in fixing the meaning of the statutory text'.[304] Nor can it displace that meaning. A further indicator of the potential scope of 'context' in any particular case may be found by reference to the extrinsic materials listed in s 15AB(2) of the *Acts Interpretation Act 1901*.

That list is open-ended, but the utility of any particular document, whatever its source, is conditioned by the gateway requirement that the material in question is 'capable of assisting in the ascertainment of the meaning of the provision'.[305] This imposes an important practical restraint on what extrinsic material may properly be utilised by a court for interpretation purposes. It also provides a rough guide to the kinds of contextual things that might (emphasise 'might') be of value to an interpreter.

6.7 Unqualified statutory instruction

All legislation provokes questions about its practical application, but where does the record stand on s 15AA after 38 years? First of all, not everyone appreciated or agreed that the provision has mandatory effect. In some ways, this mirrored the experience in New Zealand where courts high and low all but ignored similar provisions.[306]

To the extent it is necessary to set the record straight on this point in Australia, the position was put beyond doubt in 2017 with confirmation that s 15AA involves an 'unqualified statutory instruction'.[307] Another view, expressed two decades after its enactment, was that s 15AA 'had virtually no effect on judicial doctrines'.[308] Whatever this means, it is certainly not a correct statement of the position today. Section 15AA has a tangible and enduring impact on how contested interpretation is settled.

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[302] Kenny J Current Issues in the Interpretation of Federal Legislation [2013] FedJSchol 41 (at 9).
[303] Geddes *Purpose and Context in Statutory Interpretation* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 127 (at 155).
[304] *FCT v Consolidated Media Holdings Ltd* [2012] HCA 55 (at [39]), Gleeson CJ *Justice Hill Memorial Lecture – statutory interpretation* (2009) 44 *Taxation in Australia* 25 (at 29).
[305] *Harrison v Melhem* [2008] NSWCA 67 (at [12]), *Amaca Pty Ltd v Novek* [2009] NSWCA 50 (at [77]), *Allan v R (No 2)* [2011] NSWCCA 27 (at [15]), cf *FCT v Anstis* [2010] HCA 40 (at [40]).
[306] Ward *A Criticism of the Interpretation of Statutes in the New Zealand Courts* [1963] *New Zealand Law Journal* 293 (at 295).
[307] *SZTAL v Minister for Immigration and Border Protection* [2017] HCA 34 (at [39]), cf *Ellis v Central Land Council* [2019] FCAFC 1 (at [116]), *Australian Mines and Metals Association Inc v Construction, Forestry, Maritime, Mining, and Energy Union* [2018] FCAFC 223 (at [77]), *FCT v Sharpcan Pty Ltd* [2018] FCAFC 163 (at [207-208]).
[308] Krever *Taming Complexity on Australian Income Tax* (2003) 25 *Sydney Law Review* 467 (at 480, n 43).

The record shows that a slow start and possibly disordering tendencies early on have been overtaken by a resiliently purposive ethos and practice. This was much driven by French CJ before and while he sat on the High Court. Having regard to purpose, that same judge reminds us, is not to engage 'in some creative usurpation of the legislative function' as the court is simply 'doing what the legislature itself has commanded'.[309] Purposivism is no longer to be stigmatised as judicial activism, much less some 'false judicial heroism'.[310] Nor is it necessary now to justify taking a purposive approach.[311] This is not to say that derivation of 'purpose' at the correct level (unaffected by subjective elements) may not be problematic, where the legislation is a product of political compromise, or parliament had a number of purposes.[312]

A modern statute 'will rarely be a seamless robe' in the sense that it identifies purpose with precision.[313] This practical fact, however, signals no systemic failure of purposivism or s 15AA, much less that courts are (or we should) retreat back into literalism. That approach is now truly to be regarded as an artefact of the past. Gleeson CJ said that the 'modern insistence on purposive construction is important in that it denies literalism as a sufficient method of expounding the meaning of a statutory text'.[314] The AAT put it correctly, therefore, when it said – 'It is clear that the High Court has determined that the current approach to statutory interpretation must be the purposive approach and not a literal approach'.[315]

6.8 Methodology and outcomes

The reign of purposivism of course does not mean the literal answer may not be the one forced by s 15AA requirements. To suggest otherwise tends to confuse methodology with outcomes. Experience shows that a purposive approach to interpretation rather often produces literal answers.[316] This is only to be expected in practice.

As McHugh J said in *Saraswati* – 'In many cases, the grammatical or literal meaning of a statutory provision will give effect to the purpose of the legislation'.[317] In these circumstances, the construction adopted is both literal and purposive.[318] To this extent, the perceived distinction between the literal and the purposive may involve a false polemic. The key point is that, while we may end up with a literal answer from the process, you cannot pre-confine the interpretive search to looking for one.

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[309] French CJ *Dolores Umbridge and Policy as Legal Magic* (2008) 82 *Australian Law Journal* 322 (at 332).
[310] cf Gava *The Rise of the Hero Judge* (2001) 24 *University of NSW Law Journal* 747.
[311] Gleeson CJ *The meaning of legislation: Context, purpose and respect for fundamental rights* (2009) 20 *Public Law Review* 26 (at 31).
[312] *Stevens v Kabushika Kaisha Sony Computer Entertainment* [2005] HCA 58 (at [126]), *Esso Australia Resources Pty Ltd v FCT* [2011] FCA 360 (at [124]).
[313] cf Gleeson CJ *Justice Hill Memorial Lecture – statutory interpretation* (2009) 44 *Taxation in Australia* 25 (at 28).
[314] Gleeson CJ *Justice Hill Memorial Lecture – statutory interpretation* (2009) 44 *Taxation in Australia* 25 (at 29).
[315] *Reid v Secretary of Education, Science and Training* [2006] AATA 1051 (at [35]).
[316] *Commissioner of Stamp Duties v Commonwealth Funds Management Ltd* (1995) 38 NSWLR 173 for example, cf Pagone *Tax Uncertainty* [2009] *Melbourne Law School Annual Tax Lecture* (at 16), Pagone *Deciding Tax Cases* [2017] *New Zealand Law Society Tax Conference paper* (at 13).
[317] *Saraswati v The Queen* (1991) 172 CLR 1 (at 21).
[318] *DPP v Leys* [2012] VSCA 304 (at [45]).

What s 15AA does not do is permit a literal *approach* to be taken to interpretation, whatever the context and whatever the answer. To the extent earlier judicial comments may suggest there is an ongoing choice between different *approaches* to interpretation,[319] they are either mistaken or overtaken by later events.[320] It is also inaccurate now to say that purposivism is the 'preferred' or 'dominant' approach; that there is a 'statutory imprimatur' for its invocation;[321] or that the literal approach 'may no longer be in vogue'. Relativism in this regard is a murmur from the past.

Nor is there valid scope for applying some hybrid of *approaches* dependent on personal inclination or the facts. The choices to be made in contested interpretation situations are overwhelmingly constructional, rather than methodological.[322] These choices – Julius Stone called them 'leeways for choice'[323] – are invariably about the application of known and understood principles, not their content. This remains true, not only for first instance judges and intermediate appeal courts, but also in the High Court itself. In making constructional choices, parliament and the High Court in lockstep tell us directly to take a purposive approach.[324]

In 1999, Spigelman CJ published a paper about *Identifying the Linguistic Register* in which he surveyed the 'modern approach'.[325] Referring to *Cooper Brookes* and s 15AA, he said our approach was the same as described by the celebrated American judge, Learned Hand J.[326] The Chief Justice said that a good shorthand description of this approach is 'literal in total context'.[327] That phrase, as he acknowledged, came from a textbook by the Canadian academic, Elmer Driedger QC.[328]

Some observations – first, Driedger based the description 'literal in total context' on pre-1975 English cases. Second, those cases do not fully reflect our 'modern approach'. Third, the phrase 'literal in total context' has always sounded vaguely odd, partly because we had moved decisively away from literalism nearly two decades before.

Despite these factors, 'literal in total context' became a part of the discourse on interpretation.[329] Of interest, however, is that that description did not survive into later

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[319] *Stevens v Kabushika Kaisha Sony Computer Entertainment* [2005] HCA 58 (at [30]), cf *Valuer-General v Fivex Pty Ltd* [2015] NSWCA 53 (at [26]), *Olefines Pty Ltd v Valuer-General* [2018] NSWCA 265 (at [11]).

[320] cf Quigley *Interpreting GST Law in Australia* in White & Krever (eds) *GST in Retrospect and Prospect* (at 116-119), Stone *The GST – A Practical Business Tax* [2006] *TIA National GST Conference paper*.

[321] cf Fisher *Judicial dissent in taxation cases: The incidence of dissent and factors contributing to dissent* (2015) 13 *eJournal of Tax Research* 470 (at 487).

[322] Hill J *How is Tax to be Understood by Courts?* (2001) 4/5 *The Tax Specialist* 226 (at 233).

[323] Stone *Legal System and Lawyers' Reasonings* (at 304).

[324] cf MacIntyre *Financial Supplies after 20 years* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 12), Sridaran *Reliance Carpet Co Pty Ltd: Was the Full Federal Court right?* (2008) 3 *Journal of the Australasian Tax Teachers Association* 269 (at 278).

[325] Spigelman CJ *Statutory Interpretation: Identifying the Linguistic Register* (1999) 4/1 *Newcastle Law Review* 1.

[326] *Cabell v Markham* (1945) 148 F 2d 737 (at 739), cf *Re Energex Ltd (No 4)* [2011] ACompT 4 (at [10]).

[327] cf Spigelman CJ *The poet's rich resource: Issues in statutory interpretation* (2001) 21 *Australian Bar Review* 224 (at 230).

[328] Driedger *Construction of Statutes* (at 2).

[329] *R v Young* (1999) NSWCA 166 (at [13-18]), *NSW Crime Commission v Murchie* [2000] NSWSC 591 (at [30]), *Lange v Lange* [2006] NTSC 74 (at [35]), *Taylor v Centennial Newstan Pty Ltd* [2009] NSWCA 276 (at [50]), *Griffiths v Trustees of Parliamentary Superannuation Fund* [2011] NSWSC 983 (at [13]), *Haureliuk v Furler* [2012] ACTCA 11 (at [26]) for example.

editions of the Driedger text.[330] Ruth Sullivan in the sixth edition emphasises the entire or total context requirement of 'Driedger's Modern Principle', but gone are references to it being the 'literal' meaning we are looking for in that setting.[331]

Gageler J, before he became a judge, discussed the concept of 'literal in total context' in a manner that gave a certain acceptance to the phrase as an accurate descriptor of what it stood for.[332] Some years later, in the inaugural *Spigelman Public Law Oration*, he said it was Spigelman CJ 'who first clearly articulated the now dominant text-in-context approach to statutory interpretation'.[333] Since *Taylor*, however, the phrase 'literal in total context' has been little heard, while the cases continue to emphasise the width of context together with the strengthening reign of purposivism. If we are to adopt a description like that from Driedger, in my view, it should be 'purposive in total context'. The phrase 'literal in total context' was never quite right, never achieved widespread approval, and was never actively embraced in the High Court.

6.9 Reversion and stability

Some commentators saw some reversion to textualism (aka literalism) by the High Court following *Alcan* in 2009 due to perceived inconsistency with *CIC Insurance*.[334] They described this as the 'new modern', but history is against a thesis in these terms. *Alcan* merely reminds us to start with the text of the law, surely a constitutional constant in our system.[335] In his *Orgy of Statutes* paper, Lord Steyn said primacy of the text 'is the first principle of interpretation'.[336] Wigney SC has regarded this as 'not a particularly startling or radical proposition'.[337] It is a baseline position involving no back-tracking from purposivism. In their teaching materials at *Melbourne University*, Kenneth Hayne and Michelle Gordon say – 'always, always, always one begins with the words that have been used and ends with the words that have been used'.[338]

This requirement is merely another way of reflecting earlier phraseology used in the High Court, like 'primacy of enacted law'[339] and 'text-based activity'.[340] In Canada, they

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[330] Spigelman CJ *The poet's rich resource: Issues in statutory interpretation* (2001) 21 *Australian Bar Review* 224 (at 230).
[331] *Sullivan on the Construction of Statutes* (at §2.1), *ATCO Gas & Pipelines Ltd v Alberta (Energy & Utilities Board)* [2006] 1 SCR 140 (at [48]), Beaulac & Côté *Driedger's 'Modern Principle' at the Supreme Court of Canada: Interpretation, Justification, Legitimation* (2006) 40 Thémis 131.
[332] Gageler *Common Law Statutes and Judicial Legislation: Statutory Interpretation as a Common Law Process* (2011) 37(2) *Monash Law Review* 1.
[333] Gageler J *Deference* in Williams (ed) *Key Issues in Public Law* 1 (at 1).
[334] Williams, Burnett & Palaniappan *Statutory Construction: A Method* in Williams (ed) *Key Issues in Public Law* 79 (at 92), cf Pearce & Geddes *Statutory Interpretation in Australia* (at [3.8-3.9]), cf *FCT v BHP Billiton Limited* [2011] HCA 17 (at [47]).
[335] *Dossett v TKJ Nominees Pty Ltd* [2003] HCA 69 (at [57]) explains, cf *Leichhardt Municipal Council v Montgomery* [2007] HCA 6 (at [54]).
[336] Steyn *Dynamic Interpretation Amidst an Orgy of Statutes* (2004) 35 *Ottawa Law Review* 163 (at 165).
[337] Wigney *Text, context and the interpretation of a 'practical business tax'* (2011) 40 *Australian Tax Review* 94 (at 95).
[338] Hayne & Gordon *Statutes in the 21st Century* (at 1), *Mondelez Australia Pty Ltd v AMWU* [2020] HCA 29 (at [14]),
[339] *Nominal Defendant v GLG Australia Pty Ltd* [2006] HCA 11 (at [82]), *Harrison v Melhem* [2008] NSWCA 67 (at [170]), cf Gleeson CJ The Meaning of Legislation: Context, Purpose and respect for Fundamental Rights [2008] *Victorian Law Foundation paper* (at 6), Steyn *Dynamic Interpretation Amidst an Orgy of Statutes* (2003) 35 *Ottawa Law Review* 163 (at 165).
[340] *Network Ten Pty Ltd v TCN Channel Nine Pty Ltd* [2004] HCA 14 (at [87]) for example.

express the latter idea by describing legislation as a 'literary genre'.[341] The instruction to start with the text is merely adjectival and carries no hidden stigma. As Kirby J noted about the 'text, context, purpose' mantra, the 'greatest of these is text'.[342] Courts observe that *CIC Insurance* has 'been cited too many times to be doubted'.[343]

If anything, purposivism is an increasingly secure norm and value in our system, something *Alcan* did nothing to undermine. It is easy to make that judgment a decade on with the benefit of hindsight of course. The record does tend to show, however, a degree of jumping at legal shadows in the aftermath to that case. Some commentators returned to notions of statutory interpretation in Australia being a 'fashion industry'[344] or representing a swinging pendulum.[345] These metaphors are largely overworked, however, insofar as they suggest a position now hostage to judicial whim or subject to inevitable and imminent reversal.

Our interpretational history shows long periods of relative stability, something undoubtedly now made all the more enduring by enactment of s 15AA and what Dan Meagher calls the 'twin pillars' of our modern approach – *CIC Insurance* and *Project Blue Sky*.[346] The ongoing coherence and rule of purposivism is not to be derailed by occasional judicial hiccups,[347] failure to appreciate what the new regime requires, or the odd outlier decision uncorrected by appeal processes.[348] Like any revolution, it has taken time for the complete outworkings of what took place in 1981 to be fully realised in any kind of consensus practice, let alone in legal theory.

The year after *Alcan* was decided, there was further concern that comments in *Saeed*[349] heralded regression to more literalistic methods.[350] This turned out not to be so, as some

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[341] *Sullivan on the Construction of Statutes* (at §8.1).
[342] Kirby J *Statutory Interpretation: The Meaning of Meaning* (2011) 35 *Melbourne University Law Review* 113 (at 134), cf *Commissioner of the AFP v Courtenay Investments Ltd (No 2)* [2014] WASCA 55 (at [14]).
[343] *FCT v Jayasinghe* [2016] FCAFC 79 (at [7]), cf *SZTAL v Minister for Immigration & Border Protection* [2017] HCA 34 (at [37]), *CPB Contractors Pty Ltd v CFMMEU* [2019] FCAFC 70 (at [59]).
[344] cf Brooks *The responsibility of judges in interpreting tax legislation* in Cooper (ed) *Tax Avoidance and the Rule of Law* (at 172).
[345] Allerdice *The swinging pendulum: Judicial trends in the interpretation of revenue statutes* (1996) 19 UNSWLJ 162, cf Olding *Interpretation of the GST Act – Towards a Principled Basis?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 79), Hill J *How is Tax to be Understood by Courts?* (2001) 4/5 *The Tax Specialist* 226 (at 227, 234), Livingston *Practical Reason, "Purposivism", and the Interpretation of Tax Statutes* (1996) 51 *Tax Law Review* 677 (at 680).
[346] Meagher *The Modern Approach to Statutory Interpretation and the Principle of Legality: An Issue of Coherence* (2018) 46 *Federal Law Review* 397 (at 402).
[347] *Northern Territory v Collins* [2008] HCA 49 (at [99]) for example.
[348] cf Slater *The Income Tax Assessment Acts: Statutes in Senescence?* [2015] *TIA 30th National Tax Convention paper* (at 11).
[349] *Saeed v Minister of Immigration and Citizenship* (2010) 241 CLR 252 (at 264).
[350] *Wentworth District Capital Ltd v FCT* [2010] FCA 862 (at [35]), Perram *The perils of complexity: Why more law is bad law* (2010) 39 *Australian Taxation Review* 179 (at 183), Downes J *Eleven years of the 'practical business tax'* (February 2012) 70 *Law Institute Journal* 70 (at 73), Wheelahan *Contemporary Issues in Construing Statutes: When will the Courts Rewrite or Modify the Words of a Tax Act?* [2016] *TIA Barossa Convention paper* (at 3), cf Kirby J *The Never-Ending Challenge of Drafting and Interpreting Statutes* (2012) 36 *Melbourne University Law Review* 140 (at 173).

predicted[351] and later decisions confirmed.[352] One judge took a pessimistic view only to later adjust his position.[353] The idea that the emphasis 'shifted somewhat'[354] is a verdict against the evidence. Wigney SC rightly said it would be wrong to read too much into cases like *Saeed* and *Travelex*.[355] In my view, *Saeed* is no more than a judicial caution to be careful with extrinsic materials, something which cases in the interim bear out.[356]

The fact is that the High Court has not returned 'to the dark days of literalism'. Any even survey of the court's work over the past two decades should allay any anxiety (if not the nostalgia of some[357]) that we are merely awaiting some return to interpretational styles which ruled the 1960s. To the extent it was strictly necessary, the High Court confirmed this is 2019 when it said that a literal approach to construction 'has long been eschewed by this Court', and that none of the intervening cases (including *Saeed*) 'suggest a return to a literal approach to construction'.[358] It needs always to be kept in mind that cases reaching the High Court 'rarely involve a choice between clearly right and wrong meanings'.[359] Special leave ensures that those cases are often concerned with nuances at the edge of words. It is only natural that application of the same purposive principles by different judges may legitimately yield different answers.[360]

6.10 Revolution and evolution

The stability of our new protocols, however, is not something to be frozen in time.[361] There was a parallel revolution in 1981 as to the approach to be adopted. In the meantime, that approach, hand-in-hand with common law principles of interpretation, continues to evolve in line with 'structural principles or systemic values'.[362] Flexibility, coherence and 'rejection of the adoption of rigid rules' is at the heart of the modern approach.[363] This is crucial to understanding purposivism. Common law 'rules of

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[351] Spigelman CJ *The intolerable wrestle: Developments in statutory interpretation* (2010) 84 ALJ 822 (at 831), *Re Energex Ltd (No 4)* [2011] ACompT 4 (at [18-21]), cf Brysland *GST and Government in 2010* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 3 (at 42-43).

[352] *Mondelez Australia Pty Ltd v AMWU* [2020] HCA 29 (at [66]), *CPB Contractors Pty Ltd v CFMMEU* [2019] FCAFC 70 (at [54-57]), cf *CFMMEU v BHP Billiton Nickel West Pty Ltd* [2018] FCAFC 107 (at [25-26]).

[353] *Skyy Spirits LLC v Lodestar Anstalt* [2015] FCA 509 (at [45-47]).

[354] *S M v The Queen* [2013] VSCA 342 (at [55]), cf *Reardon v Magistrates' Court of Victoria* [2018] VSCA 76 (at [82]).

[355] Wigney *Text, context and the interpretation of a 'practical business tax'* (2011) 40 *Australian Tax Review* 94 (at 97).

[356] *The Queen v A2* [2019] HCA 35 (at [35-37]), cf Dharmananda *Outside the Text: Inside the Use of Extrinsic materials in Statutory Interpretation* (2014) 42 *Federal Law Review* 333 (at 335, 346).

[357] *Australian Finance Direct Ltd v Director of Consumer Affairs* [2007] HCA 57 (at [40]) citing *Batagol v FCT* (1963) 109 CLR 243 (at 251).

[358] *The Queen v A2* [2019] HCA 35 (at [32, 37]), *Coeur de Lion Investments Pty Ltd v Lewis* [2020] QCA 111 (at [13]).

[359] *Pfeiffer v Stevens* [2001] HCA 71 (at [88]), *Ellavale Engineering Pty Ltd v Pilgrim* [2005] NSWCA 272 (at [53]), French CJ *The courts and the Parliament* (2013) 87 *Australian Law Journal* 820 (at 824).

[360] Hill J *How is Tax to be Understood by Courts?* (2001) 4/5 *The Tax Specialist* 226 (at 232), *FCT v Sharpcan Pty Ltd* [2018] FCAFC 163 for example, cf *Heather v PE Consulting Group Ltd* [1973] Ch 189 (at 216).

[361] Cf Blaker *The High Court's Minimalism in Statutory Interpretation* (2019) 40 *Adelaide Law Review* 539.

[362] *Probuild Constructions (Aust) Pty Ltd v Shade Systems Pty Ltd* [2018] HCA 4 (at [58]), cf *Corporate Affairs Commission v Yuill* (1991) 172 CLR 319 (at 322).

[363] *Taylor v Owners – Strata Plan No 11564* [2014] HCA 9 (at [37]), *Collector of Customs v Agfa-Gevaert Ltd* (1996) 186 CLR 389 (at 401), *BMK18 v Minister for Home Affairs* [2019] FCA 189 (at [22]), *Department of Health and Aging v Li* [2018] SASCFC 52 (at [96]).

interpretation' (canons and maxims) are only 'rules' in softly facultative way.[364] They are driven by force of circumstance and perception, rather than force of law. Lord Reid characterised them as 'our servants, not our masters'.[365] French CJ said they were 'but frail guidelines to which recourse is had as a last rather than as a first resort'.[366] Like proverbs, they are 'appropriate only in some circumstances and not in all'.[367]

What judges say about interpretation is also not to be read as having statutory effect.[368] Statutory interpretation involves the application of legal method, not scientific method.[369] Nor is it susceptible to empirical analysis using tools like 'corpus linguistics'.[370] Despite a degree of overlap between legal and scientific techniques (including syllogistic reasoning and induction techniques), interpretational problems 'are not solved as one can solve a simple linear equation which has only one solution'.[371]

Self-evidently, 'prediction of the likely results of a purposive construction is not a precise science'.[372] In this regard, commentators have spoken of 'chaos' in the field and creation of a 'judicial jungle'.[373] 'Being a pragmatic business', said John Burrows, statutory interpretation 'is not susceptible of a coherent philosophy'.[374]

Lord Steyn has said famously that interpretation is an art rather than a science, and 'too elusive to be encapsulated in a theory'.[375] This is correct but it may tend to over-mystify the position. Judgments are not works of art, of course, nor is the judge some kind of artist. As Hill J himself pointed out, 'an item created without the intention of making an artistic statement would not be a work of art no matter how artistic it might appear to

[364] Basten *Choosing Principles of Interpretation* (2017) 91 *Australian Law Journal* 881 (at 881), cf *Baker v Campbell* (1983) 153 CLR 52 (at 104), Raymond *Saving the Literal* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 177 (at 195).
[365] *Maunsell v Olins* [1975] AC 373 (at 382), cf *Corporate Affairs Commission v Yuill* (1991) 172 CLR 319 (at 347), *CB Cold Storage Pty Ltd v IMCC Group (Australia) Pty Ltd* [2017] VSC 23 (at [60]), Spigelman CJ *Statutory Interpretation: Identifying the Linguistic Register* (1999) 4/1 *Newcastle Law Review* 1 (at 14).
[366] French CJ *Statutory Interpretation in Australia: Launch of the 8th Edition* [2014] *University House ANU address* (at 4).
[367] Barwick CJ *Foreword* to Pearce *Statutory Interpretation in Australia* (First Edition).
[368] *Comcare v PVYW* [2013] HCA 41 (at [15-16]), *Stewart v Atco Controls Pty Ltd* [2014] HCA 15 (at [32]).
[369] Gordon J *The Interaction between Science and Law – Legal Science or a Science of Law* [2016] *UWA French CJ Colloquium paper*.
[370] Slocum *Ordinary Meaning and Empiricism* (2019) 40 *Statute Law Review* 13, cf De Mulder, van Noortwijk & Combrink-Kuiters *Jurimetrics Please!* (2010) 1 *European Journal of Law and Technology* (at [3.1]).
[371] French CJ *Science and Judicial Proceedings – Seventy-six years on* (2009) 17 *Journal of Law and Medicine* 206 (at 211), cf French CJ *Judging Science* [2011] *13th Greek/Australian International Legal and Medical Conference paper*, French CJ *The Principle of Legality and Legislative Intention* (2019) 40 *Statute Law Review* 40 (at 44).
[372] *Craies on Legislation* (at 304) quoted by Gummow *Statutes* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 1 (at 3).
[373] Ward *A Criticism of the Interpretation of Statutes in the New Zealand Courts* [1963] *New Zealand Law Journal* 293 (at 296).
[374] Burrows *The Changing Approach to the Interpretation of Statutes* (2002) 33 VUWLR 981 (at 981).
[375] Steyn *The Intractable Problem of The Interpretation of Legal Texts* (2003) 25/5 *Sydney Law Review* 5 (at 6, 8), cf Kirby J *Statutory Interpretation: The Meaning of Meaning* (2011) 35 Melbourne University Law Review 113 (at 133).

be'.[376] Statutory interpretation might be an 'art' in the sense that it requires a special skill, but that skill is always to be applied by reference to standards external to the judge.

As an AAT senior member put it, interpretation 'must involve the conscientious application of methodology'.[377] Creative elements no doubt are present to a limited degree, as Hill J himself freely acknowledged, but they are carefully confined by the judicial function and should not be overstated. French CJ said that interpretation involves law-making to the extent it involves constructional choice.[378] We might agree then that interpretation is a tightly disciplined craft within which correct methods are to be applied. Section 15AA and constructional choice principles play a central role in the practice of this technical craft.[379]

6.11 Purpose, policy and compromise

The discussion of text, context and purpose leads naturally to the vexed place of policy in statutory analysis. Purpose and policy are related concepts often used interchangeably or without deliberation. As Jacinta Dharmananda observes, their use 'in one breath' by the High Court illustrates the judicial vernacular in this respect.[380] Purpose is arguably narrower than policy, but for present purposes the precise boundary is not crucial. Purpose is conceived as the intended practical operation of the law or what it is designed to achieve.[381] The influence of legislative policy and its practical outworking may be subtle and sometimes complicated, but it is never irrelevant.

The following key principles, however, guide the way in most situations –

- *statutes always have some objective purpose to accomplish – parliament is never purposeless*[382]
- *modern statutes are often the product of political compromise and rarely pursue a singular purpose*[383]
- *framing the relevant purpose or policy at too high a level is likely to lead to interpretive error*[384]

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[376] *FCT v Murray* 90 ATC 4182 (at 4197), citing *Cuisenaire v Reed* [1963] VLR 719 (at 730), *George Hensher Ltd v Restawhile Upholstery (Lancs) Ltd* [1976] AC 64 (at 95),cf *Burge v Swarbrick* [2007] HCA 17 (at [54-62]).
[377] O'Donovan SM *oral remarks* [2019] *Cotter – Uriarra Conference*.
[378] French *The Principle of Legality and Legislative Intention* (2019) 40 *Statute Law Review* 40 (at 45).
[379] cf Williams, Burnett & Palaniappan *Statutory Construction: A Method* in Williams (ed) *Key Issues in Public Law* 79 (at 96).
[380] Dharmananda *Outside the Text: Inside the Use of Extrinsic materials in Statutory Interpretation* (2014) 42 *Federal Law Review* 333 (at 350), citing *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 (at [24-26]).
[381] *Work Health Authority v Outback Ballooning Pty Ltd* [2019] HCA 2 (at [72]) citing *APLA Ltd v Legal Services Commissioner* [2005] HCA 44 (at [178]), *McCloy v New South Wales* [2015] HCA 34 (at [132]).
[382] *Work Health Authority v Outback Ballooning Pty Ltd* [2019] HCA 2 (at [76]) citing *Residual Assco Group Ltd v Spalvins* [2000] HCA 33 (at [27]), *Thiess v Collector of Customs* [2014] HCA 12 (at [23]) for example.
[383] *McGlade v Native Title Registrar* [2017] FCAFC 10 (at [351]) describes the problem.
[384] *Carr v Western Australia* [2007] HCA 47 (at [5-7]), *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 (at [51]), *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011] FCAFC 58 (at [95]), *MyEnvironment Inc v VicForests* [2013] VSCA 356 (at [148-150]).

- *the relevant question is usually how far the legislation goes in pursuit of identified purpose or policy*[385]
- *purpose and policy are surer guides to meaning than the logic with which provisions are constructed*[386]
- *do not construct your own idea of desirable policy then characterise that as the statutory purpose*[387]
- *purpose resides in the text and structure of the Act, even when derived from external sources*.[388]

A full treatment of these factors is beyond the scope of this note. Comment might be made about 'political compromise', however, given the complications it may produce in practice. The story starts with *Rodriguez*, an American case, stating that a modern statute rarely pursues some singular purpose at all costs. Deciding what competing values will be promoted or sacrificed is the 'very essence of legislative choice'.[389]

As Gleeson CJ explained by example in *Carr v Western Australia*, assuming that whatever advances the primary object stated in the statute 'is unlikely to solve the problem' and may involve 'a purported exercise of judicial power for a legislative purpose'.[390] Sometimes parliament may deliberately refrain 'from forming or expressing a purpose', as indeed this may be the very thing which enables passage of the law.[391] Edmonds J once spoke about 'political infection' of the tax law in this regard.[392] Eugene Wheelahan SC makes the sound point that often it is 'necessary to examine very closely what function the particular provisions play in the logic and structure of the enactment' in order to ascertain the purpose.[393]

6.12 Legislative intention

In the old case of *Saloman v Saloman*, legislative intention is described as a 'very slippery phrase'.[394] Traditionally, Australian judges have used 'legislative intention' in

[385] *Rodriguez v United States* (1987) 480 US 522 (at 525-526), *CFMEU v Mammoet* [2013] HCA 36 (at [40-41]), *Carr v Western Australia* [2007] HCA 47 (at [6]), *Attorney-General v Marquet* [2003] HCA 67 (at [145]), *NSW Aboriginal Land Council v Minister Administering the Crown Lands Act* [2016] HCA 50 (at [93]), *Tjungarrayi v Western Australia* [2019] HCA 12 (at [46]).
[386] *Commissioner for Railways v Agalianos* (1955) 92 CLR 390 (at 397), *FCT v Unit Trend Services Pty Ltd* [2013] HCA 16 (at [47]), *AB v Western Australia* [2011] HCA 42 (at [10]), *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 (at [24-26]).
[387] *Williams v Wreck Bay Aboriginal Community Council* [2019] HCA 4 (at [79]) most recently for example,
[388] *Lacey v Attorney-General* [2011] HCA 10 (at [44]), *Momcilovic v The Queen* [2011] HCA 34 (at [111]), *Lee v NSW Crime Commission* [2013] HCA 39 (at [45]), *Cole v Minister for Immigration & Border Protection* [2018] FCAFC 66 (at [42]), *FCT v Sharpcan Pty Ltd* [2018] FCAFC 163 (at [213]).
[389] *Rodriguez v United States* 480 US 522 (1987) (at 525-526), *Woodside Energy Ltd v FCT* [2009] FCAFC 12 (at [51]) for example.
[390] *Carr v Western Australia* [2007] HCA 47 (at [5]).
[391] Gleeson CJ *The meaning of legislation: Context, purpose and respect for fundamental rights* (2009) 20 *Public Law Review* 26 (at 33).
[392] Edmonds J *Structural Tax Reform: What Should be Brought to the Table?* (2015) 30 *Australian Tax Forum* 393 (at 398).
[393] Wheelahan *Contemporary Issues in Construing Statutes: When will the Courts Rewrite or Modify the Words of a Tax Act?* [2016] *TIA Barossa Convention paper* (at 11).
[394] *Saloman v Saloman & Co* [1897] AC 22 (at 38).

vague and non-deliberative ways[395] despite what has been referred to as an 'inherited understanding' of the concept.[396] Rules of construction are framed around the absence of contrary intention, a position which is mirrored in interpretation legislation generally[397] or to be implied.[398] Section 2(2) of the *Acts Interpretation Act 1901*, for example, says that the 'application of this Act or a provision of this Act to an Act or provision of an Act is subject to a contrary intention'. It is also pointed out that intention and purpose are 'not logically congruent' (although they may coincide),[399] and that it is possible to determine purpose without exploring intention.[400]

In Australia, legislative intention is now seen as the objective output of the interpretation process, rather than an input into the determination of what the text means.[401] Intention is what parliament is *taken* to mean by the words it used. Political motivations and exigencies are wholly neutral factors.[402] Parliament manifests its constructive intention through the medium of the language it adopts. Hayne J said that intention is a 'conclusion reached about the proper construction of the law in question and nothing more'.[403] It is a fiction or a metaphor,[404] and a 'constitutional courtesy' for us.[405]

Kirby J said he never uses the expression anymore,[406] French CJ called it a 'phantom',[407] and one writer went even further to describe it as an 'oxymoron'.[408] Legislatures do not have intents, 'only outcomes', an American judge noted.[409] Gleeson CJ emphasised the need to avoid the temptation to engage in 'psychoanalysis of individuals'.[410] A Canadian academic said intent was at most 'a harmless, if bombastic, way of referring to the social policy behind the Act'.[411]

The High Court in *Cross* makes it clear that intention is a 'product' of interpretation processes.[412] One textbook said this was a 'rather radical development'[413] and in some

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[395] Blaker *Is Intentionalist Theory Indispensable to Statutory Interpretation?* (2017) 43 *Monash University Law Review* 238 (at 247).
[396] Gageler J *Legislative Intention* (2015) 41/1 *Monash University Law Review* 1 (at 2-7).
[397] Pearce *Interpretation Acts in Australia* (at 7-11).
[398] *Buresti v Beveridge* (1998) 88 FCR 399 (at 401).
[399] *Lee v NSW Crime Commission* [2013] HCA 39 (at [45]).
[400] French CJ *The courts and the Parliament* (2013) 87 *Australian Law Journal* 820 (at 826).
[401] Mason *The interaction of statute law and common law* (2016) 90 *Australian Law Journal* 324 (at 328) for example.
[402] *Australian Rice Holdings Pty Ltd v CSR* [2004] VSCA 17 (at [16]).
[403] *Momcilovic v The Queen* [2011] HCA 34 (at [341]), cf *ASIC v Rent 2 Own Cars Australia Pty Ltd* [2020] FCA 1312 (at [60-61]).
[404] *Fothergill v Monarch Airlines Ltd* [1981] AC 251 (at 279), cf *Sloane v Minister for Immigration, Local Government and Ethnic Affairs* (1992) 37 FCR 429 (at 443).
[405] *Zheng v Cai* [2009] HCA 52 (at [28]), *NAAV v Minister for Immigration and Multicultural and Indigenous Affairs* [2002] FCAFC 228 (at [430]), *Dickson v The Queen* [2010] HCA 30 (at [32]), Spigelman *Principle of legality and the clear statement of principle* (2005) 79 *Australian Law Journal* 769 (at 769).
[406] Kirby J *Towards a Grand Theory of Interpretation: The Case of Statutes and Contracts* [2002] *Cambridge University Clarity and Statute Law Society Joint Conference paper* (at 2).
[407] *Sloane v Minister for Immigration, Local Government and Ethnic Affairs* (1992) 37 FCR 429 (at 443).
[408] Shepsle *Congress as a 'They', not an 'It': Legislative Intent as an Oxymoron* (1992) 12 *International Review of Law and Economics* 239.
[409] Easterbrook *Statutes' Domain* (1983) 50 *University of Chicago Law Review* 533 (at 547).
[410] *Singh v Commonwealth* [2004] HCA 43 (at [19]).
[411] Willis *Statute Interpretation in a Nutshell* (1938) 16 *Canadian Bar Review* 1 (at 3).
[412] *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 (at [25]).
[413] Crawford, Boughey, Castan & O'Sullivan *Public Law and Statutory Interpretation* (at 225).

quarters it is. Despite academic debate,[414] a 'growing band of defenders',[415] nuanced views elsewhere,[416] and a degree of judicial provocateurism,[417] however, the High Court has been concerned to stress that intention in this context has nothing to do with the legislative motivations of parliamentarians considered individually or as a collective.[418] Some of the criticism levelled at the court over its stance also has a fretting tone.

In his *Dolores Umbridge* paper, French CJ suggested that what others took as real intention was never more than attributed.[419] In 2019, he wrote – 'Although it has long been integral to the rhetoric of statutory construction, it does not denote a state of anybody's mind', and that 'once meaning is determined the legislative intention can be announced'.[420] Although the threads of this stretch back to early days of the High Court,[421] it was Dawson J in 1990 who first stated directly for us that intention is a 'fiction'.[422] Only a few years before, Mason J had said in *Babaniaris* that the 'fundamental responsibility of a court when it interprets a statute is to give effect to the legislative intention as it is expressed in the statute'.[423]

Not long afterwards, in *Project Blue Sky*, 'intention as imputation' was confirmed for the modern era in Australia.[424] In contract law, the equivalent position had been settled by the mid-19th century.[425] What was called the 'redefinition of legislative intent' in Australia has an impact insofar as imputed intention is arrived at by reference to rules of construction and their underlying assumptions.[426] Sir Anthony Mason made similar points concerning the 'moderation of statutory intention'.[427] Campbell and Campbell

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[414] Ekins & Goldsworthy *The Reality and Indispensability of Legislative Intentions* (2014) 36 *Sydney Law Review* 39, Feldman *Statutory Interpretation and Constitutional Legislation* (2014) 130 *Law Quarterly Review* 473, Blaker *Is Intentionalist Theory Indispensable to Statutory Interpretation?* (2017) 43 *Monash University Law Review* 238, South *Are Legislative Intentions Real?* (2014) 40 *Monash University Law Review* 853, Ekins *The Nature of Legislative Intent*, Goldsworthy *Is Legislative Supremacy Threatened?* (20 December 2016) *Quadrant online*, Hayne *Statutes, Intentions and the Courts: What Place does the Notion of Intention (Legislative or Parliamentary) have in Statutory Construction?* (2013) 13 *Oxford University Commonwealth Law Journal* 271, Smith *Is the High Court Mistaken about the Aim of Statutory Interpretation?* (2016) 44 *Federal Law Review* 227, for example.

[415] Goldsworthy *Legislative Intention Vindicated?* (2013) 33 *Oxford Journal of Legal Studies* 821 (at 842).

[416] Duxbury *Elements of Legislation* (at 92-119) illustrates, cf Radin *Statutory Interpretation* (1930) 43 *Harvard Law Review* 863 (at 881), *Bennion on Statutory Interpretation* (at 472-474), Sales *Legislative Intention, Interpretation, and the Principle of Legality* (2019) 40 *Statute Law Review* 53 (at 58-61).

[417] Gageler *Legislative Intention* (2015) 41/1 *Monash University Law Review* 1, Basten *Legislative Intention* (2019) 93 *Australian Law Journal* 367 (at 367) for example.

[418] *Byrnes v Kendle* [2011] HCA 26 (at [97]), cf *Work Health Authority v Outback Ballooning Pty Ltd* [2019] HCA 2 (at [74-77]), Gageler Legislative Intention (2015) 41 *Monash University Law Review* 1.

[419] French CJ *Dolores Umbridge and Policy as Legal Magic* (2008) 82 *Australian Law Journal* 322 (at 331-332).

[420] French CJ *The Principle of Legality and Legislative Intention* (2019) 40 *Statute Law Review* 40 (at 40, 50), cf French CJ *Interpreting the Constitution – Words, History and Change* (2014) 40 *Monash University Law Review* 29 (at 35-37), *Momcilovic v The Queen* [2011] HCA 34 (at [327]).

[421] *Tasmania v Commonwealth* (1904) 1 CLR 329 (at 358-359) for example, cf *Sovar v Henry Lane Pty Ltd* (1967) 116 CLR 397 (at 405).

[422] *Mills v Meeking* (1990) 91 ALR 16 (at 29).

[423] *Babaniaris v Lutony Fashions Pty Ltd* (1987) 163 CLR 1 (at 13).

[424] *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 (at 384).

[425] *Monypenny v Monypenny* (1861) 11 ER 671 (at 684), cf *Life Insurance Co of Australia v Phillips* (1925) 36 CLR 60 (at 76).

[426] Kenny J *Current Issues in the Interpretation of Federal Legislation* [2013] FedJSchol 41.

[427] Mason *The Interaction of statute law and common law* (2016) 90 *Australian Law Journal* 324 (at 328).

characterised this development as a 'radical revision',[428] and another writer called it a 'sea-change'.[429] In *Lacey*, the High Court said[430] –

> The legislative intention there referred to is not an objective collective mental state. Such a state is a fiction which serves no useful purpose. Ascertainment of legislative intention is asserted as a statement of compliance with the rules of construction, common law and statutory, which have been applied to reach the preferred results and which are known to parliamentary drafters and the courts.

While recognising the fact of ongoing academic debate on the issue, Campbell and Campbell point to the unlikelihood the High Court will change its mind on this in the foreseeable future. They suggest that the High Court 'is right as a matter of principle, not merely as a matter of authority'.[431] With this I agree, but a measure of balkanisation on the issue remains. Even among those who accept the current position, there are some who maintain that intention may sometimes be real and may sometimes be important.

Denial of the reality of intention, says Jim South, is dangerous and 'has serious implications for the functioning of democracy and the rule of law'.[432] Later comments by Gageler J in *Outback Ballooning* may suggest similar concern.[433] What is to be observed, however, is ongoing indiscriminate reference to 'legislative intention' in courts high and low without regard to the 'radical revision' mentioned. Perhaps the intellectual influence of French CJ on the issue generally is waning within the judiciary.

Two final comments may be made. The first is that, even if it now 'settled' that intention is an attributed output of the interpretation process, more guidance is desirable on the precise relationship between three of the core concepts – intention, purpose and policy.[434] The second is that, if the High Court was to U-turn from its 'output' characterisation of intention, the change would likely have more to do with symbolism and the habits of language than any radical re-engineering of our 'modern approach'.

6.13 Flexibility and harmony

As noted, flexibility is at the heart of the modern approach to interpretation in Australia. In *Taylor*, three judges spoke about 'rejection of the adoption of rigid rules of statutory construction'[435] citing unanimous comments in *Agfa-Gevaert*. That case in turn said

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[428] Campbell & Campbell *Why statutory interpretation is done as it is done* (2014) 39 *Australian Bar Review* 1 (at 20).
[429] Walshaw *Concurrent Legal Interpretation versus Moderate Intentionalism* (2014) 35 *Statute Law Review* 244 (at 253).
[430] *Lacey v Attorney-General* [2011] HCA 10 (at [43]), *Akiba v Commonwealth* [2013] HCA 33 (at [30]), *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 (at [25]), *Momcilovic v The Queen* [2011] HCA 34 (at [111]), *Queensland v Congoo* [2015] HCA 17 (at [36]).
[431] Campbell & Campbell *Why statutory interpretation is done as it is done* (2014) 39 *Australian Bar Review* 1 (at 24, n 59).
[432] South *Are Legislative Intentions Real?* (2014) 40 *Monash University Law Review* 853 (at 889).
[433] *Work Health Authority v Outback Ballooning Pty Ltd* [2019] HCA 2 (at [77]), cf *Mondelez Australia Pty Ltd v AMWU* [2020] HCA 29 (at [95]), *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520 (at 566), *Corliss v R* [2020] NSWCCA 65 (at [84]).
[434] cf *Lee v NSW Crime Commission* [2013] HCA 39 (at [45]).
[435] *Taylor v Owners – Strata Plan No 11564* [2014] HCA 9 (at [37]), *Collector of Customs v Agfa-Gevaert Ltd* (1996) 186 CLR 389 (at 401), *BMK18 v Minister for Home Affairs* [2019] FCA 189 (at [22]), *Department of Health and Aging v Li* [2018] SASCFC 52 (at [96]).

that, in the 'area of statutory interpretation and construction, courts must be wary of propounding rigid rules. Even the use of general rules carries dangers in this area because of the tendency for such rules to be given an inflexible application'.[436]

The flexibility of purposivism, it was said in *Taylor* (at [37]), may sometimes allow a provision to be read 'as if it contained additional words (or omitted words)'. Strict conditions derived from English cases regulate this sensitive facility.[437] Courts in our system are cautioned against filling gaps in legislation, or making an insertion which is 'too big' or 'too far-reaching' as may violate the separation of powers.

A key point is that the ability to add words (or omit them) arises only on 'rare occasions' in practice, usually for simple drafting errors. Where this is permitted, what results is an explanation of the text rather than its repair.[438] There is an important difference between a gap and a mistake even if the dividing line between the two may be less than clear. Two commentators put the prospect of adding words as 'only if it is plain beyond doubt that Homer, in the person of the parliamentary drafter, has nodded'.[439]

By insisting on the preservation of flexibility, however, the High Court is not sanctioning some kind of 'anything goes' idea in the sense that courts are free to pick and choose which basic approach or methodology they might apply. A purposive approach is mandatory but, within that framework, the soft common law 'rules' as they evolve to meet contemporary conditions are to be applied with flexibility. Rejection of rigid rules as an interpretational baseline requires the careful application of principle.

The 1998 decision of the High Court in *Project Blue Sky* is one of the monuments of statutory interpretation in this country. Legislation is to be construed on the basis that it is intended to give effect to 'harmonious goals' or an 'overall harmonious interpretation'.[440] Perram J called this the 'music of the spheres' theory of interpretation.[441] Conflict is to be resolved by 'adjusting the meaning of competing provisions' to best give effect to the purpose and language while maintaining an overall unity. This may (and often will) involve determining the hierarchy of provisions under which one 'must give way to the other'.

In the recent sperm donor case, for example, the High Court again pointed to the need to adjust competing provisions.[442] The comments from *Project Blue Sky*, like those in *CIC Insurance*, have also been endorsed too many times now to be doubted.[443] *Channel Pastoral* is a tax example of how they are applied in practice by courts.[444]

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[436] *Collector of Customs v Agfa-Gevaert Ltd* (1996) 186 CLR 389 (at 401), citing *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297 (at 320).
[437] *Inco Europe Limited v First Choice Distribution* [2000] 1 WLR 586 (at 592), *Wentworth Securities Limited v Jones* [1980] AC 74 (at 105-106).
[438] *CCA19 v Secretary, Department of Home Affairs* [2019] FCA 946 (at [90-91]).
[439] Lumb & Christensen *Reading words into statutes: When Homer nods* (2014) 88 *Australian Law Journal* 661 (at 677).
[440] *Independent Commission Against Corruption v Cunneen* [2015] HCA 14 (at [31]), *ASIC v Westpac Securities Administration Ltd* [2018] FCA 2078 (at [80]).
[441] Perram *The perils of complexity: Why more law is bad law* (2010) 39 *Australian Taxation Review* 179 (at 182).
[442] *Masson v Parsons* [2019] HCA 21 (at [42]).
[443] cf *FCT v Jayasinghe* [2016] FCAFC 79 (at [7]), *SZTAL v Minister for Immigration & Border Protection* [2017] HCA 34 (at [37]).
[444] *Channel Pastoral Holdings Pty Ltd v FCT* [2015] FCAFC 57 (at [4-5]).

6.14 Emphasis on coherence

The modern emphasis on 'coherence' in statutory interpretation mirrors its impact in other legal areas and is a natural progression from themes in *Project Blue Sky*.[445] A recently published book of essays traces the learning in this regard – *The Coherence of Statutory Interpretation*, edited by Jeffrey Barnes.[446] This book is one of the most important contributions to scholarship on statutory interpretation since *Project Blue Sky*. It was the systemic coherence themes of Hill J in *HP Mercantile*, which persuaded first Allsop J, then the special leave panel, that his approach in that case was to be preferred both as to outcome and in principle.

Sir Anthony Mason said that 'coherence has its place as a relevant consideration in statutory interpretation, in some cases where it is necessary to choose between competing interpretations'.[447] Gageler J has pointed out that, while legislation is sometimes harsh, it is 'rarely incoherent' and 'should not be reduced to incoherence by judicial construction'.[448] In *SAS Trustee*, a plurality of the High Court said[449] -

> Where the text read in context permits of more than one potential meaning, the choice between those meanings may ultimately turn on an evaluation of the relative coherence of each within the scheme of the statute and its identified objects or policies.

These comments come from Gageler and Keane JJ dissenting in *Taylor*,[450] repeated in *SZTAL* by Gageler J (again dissenting).[451] Later in the year *Taylor* was decided, a unanimous bench stated more generally that statutory construction 'should favour coherence in the law'.[452] In a similar vein, a bench of six said that the material provisions of the statute 'must be understood, if possible, as parts of a coherent whole'.[453]

Taken together, these comments echo older, more open, remarks about 'coherence' being an important legal value in our system,[454] indeed a 'meta-principle'.[455] As constructional choice theory evolves, the appearance of some sort of 'coherence'

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[445] *Andrews v Thomson* [2018] ACTCA 53 (at [38-39]) illustrates.
[446] It is beyond the scope of this note to digest and comment on the themes presented this book.
[447] Mason *The Interaction of statute law and common law* (2016) 90 *Australian Law Journal* 324 (at 338).
[448] *R v Independent Broad-Based Anti-Corruption Commissioner* [2016] HCA 8 (at [76]).
[449] *SAS Trustee Corporation v Miles* [2018] HCA 55 (at [20]), applied since - *Stamford Property Services Pty Ltd v Mulpha Australia Ltd* [2019] NSWCA 141 (at [120]), *Port Macquarie-Hastings Council v Mansfield* [2019] NSWCCA 7 (at [77]), *R v Green (No 3)* [2019] ACTSC 96 (at [12, 47]), *Wheatley v New South Wales* [2018] NSWCA 315 (at [86]).
[450] *Taylor v Owners – Strata Plan No 11564* [2014] HCA 9 (at [66]).
[451] *SZTAL v Minister for Immigration and Border Protection* [2017] HCA 34 (at [38]), reviewed McIntyre *Adrift: The High Court of Australian decides SZTAL v Minister for Immigration and Border Protection* (2018) 19 *Melbourne Journal of International Law* 389.
[452] *Plaintiff S4-2014 v Minister for Immigration and Border Protection* [2014] HCA 34 (at [42]), cf *CPFC v Minister for Immigration and Border Protection* [2015] HCA 1 (at [41, 214]), *Commissioner of the AFP v Halac* [2015] NSWSC 520 (at [9]).
[453] *ALDI Foods Pty Ltd v Shop, Distributive & Allied Employees Association* [2017] HCA 53 (at [16]), citing *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 (at 381-382).
[454] *Sullivan v Moody* (2001) 207 CLR 562 (at 576 [55]), cf *Miller v Miller* [2011] HCA 6 (at [15-16]), Fell *The Concept of Coherence in Australian Private Law* (2018) 41 *Melbourne University Law Review* 1160.
[455] Grantham & Jensen *Coherence in the Age of Statutes* (2016) 42/2 *Monash University Law Review* 360 (at 361), cf Perram *Constitutional Principles and Coherence in Statutory Interpretation* [2016] *La Trobe Law School Symposium on the Coherence of Statutory Interpretation paper*, Bant *Statute and Common Law: Interaction and Influence in Light of the Principle of Coherence* (2015) 38 *UNSW Law Journal* 367.

principle was never far from the surface. It is also consistent with earlier learning, and hardly controversial. *SAS Trustee* is the first time, however, a High Court majority has formally endorsed them. *Onody* illustrates the practical impact of coherence.[456]

As others have noted, legal coherence 'has been a topic of sustained and deep thought',[457] though never well-articulated by the High Court.[458] As a general concept, it carries with it a sense of consistency and the corresponding absence of contradiction. Dictionaries talk about cohesion, sticking together, congruity, logical connection and integrity. It is self-evidently a protean concept, and one having no immunity from subjective impression. Coherence is resistant both to strict definition and empirical demonstration. Under the heading, 'interpretation and coherence in legal reasoning', the *Stanford Encyclopaedia of Philosophy* talks about the 'frequent influence of the general philosophical climate upon the intellectual weather systems of jurisprudential theorising'. Legal coherence, as a 'special virtue', is seen as 'something more' than logical consistency, but there is much debate about what that 'something more' is.

Within a statute, coherence involves the systemic working together of provisions in a way greater than mere consistency or neutral non-interference. The 'something more' element suggested by the concept of 'coherence' is a kind of synergistic effect or a 'greater than the sum of its parts' characteristic. In any case, that is the theory.

The same idea is also reflected by other well-known metaphors – 'single eye of the law',[459] and parliament having 'one voice', a 'single imperious voice',[460] and speaking with no 'forked tongue'.[461] No matter now 'starry-eyed or astigmatic' the policy makers may be (words of Keith Mason),[462] courts are expected to strive for statutory coherence.[463] Basten JA in *Universal Property* called this the 'search for harmonious operation'.[464] In Canada, where the presumption of coherence is 'virtually irrebuttable',[465] it is explained in the following way[466] –

> It is presumed that the provisions of legislation are meant to work together, both logically and teleologically, as parts of a functioning whole. The parts are presumed to fit together logically to form a rational, internally consistent framework: and because the framework has a purpose, the parts are also

[456] *Onody v Return to Work Corporation* [2019] SASCFC 56 (at [73]).
[457] Grantham & Jensen *Coherence in the Age of Statutes* (2016) 42/2 *Monash University Law Review* 361 (at 363), Fell *The Concept of Coherence in Australian Private Law* (2018) 41 *Melbourne University Law Review* 1160 (at 1161).
[458] French CJ *Harold Ford Memorial Lecture: Trusts and Statutes* [2015] *Centre for Corporate Law and Securities Regulation paper* (at 2).
[459] *R v MJR* [2002] NSWCCA 129 (at [45]) for example.
[460] Keith Mason *The intent of legislators: How judges discern it and what they do if they find it* (2006) 27 *Australian Bar Review* 253 (at 256).
[461] *Waugh v Kippen* (1986) 160 CLR 156 (at 164), *Slivak v Lurgi (Australia) Pty Ltd* [2001] HCA 6 (at [96]), *Attorney-General v World Best Holdings Ltd* [2005] NSWCA 261 (at [171]).
[462] Keith Mason *The intent of legislators: How judges discern it and what they do if they find it* (2006) 27 *Australian Bar Review* 253 (at 254), quoting *R v Firns* [2001] NSWCCA 191 (at [53]), cf *Kizon v R* [2012] HCATrans 331.
[463] cf Ohlendorf *Against Coherence in Statutory Interpretation* (2014) 90 *Notre Dame Law Review* 735 (at 781-782).
[464] *Universal Property Group Pty Ltd v Blacktown City Council* [2020] NSWCA 106 (at [12]).
[465] *Sullivan on the Construction of Statutes* (at §11.4),
[466] *R v LTH* [2008] 2 SCR 739 (at [47]).

> presumed to work together dynamically, each contributing something toward accomplishing the intended goal.

At the bottom of it all, as Pat Lanigan told the *Australian Legal Convention* in 1975, is perhaps the most basic of observations – 'The law needs to be made to work',[467] a task to which a 'constructive loyalty' should be brought.[468] We also need to recognise that 'coherence' in the world of statutes is inevitably a utopian concept. Sometimes, the law cannot be made to work, as the degree of remediation sought to be imposed crosses into legislative territory. In other situations, *DPP v Walters* for example, the statute is simply, persistently and irremediably incoherent.[469]

As a New Zealand jurist put it – 'It is obviously fallacious to assume that revenue legislation has a totally coherent scheme, that it follows a completely consistent pattern, and that all its objectives are readily discernible'.[470] In spite of this reminder, a previous Tax Commissioner, Michael D'Ascenzo, always looked for systemic coherence in statutory interpretation 'to make the law work in a constructive and positively directed fashion, tempered by a thoughtful awareness of its intrinsic limits'.[471] Bruce Quigley made similar comments as follows – 'To achieve a coherent fabric of law it is critical to take an approach that strikes a balance between the syntax, the legislative policy and context in interpreting the law'.[472]

6.15 Process mapping interpretation

The cases and practice make it clear that text and context are considered at the same time with the whole process starting and finishing with the text of the law.[473] Reduced to basics, the approach is 'text > context > text', a protocol Professor Pearce has described as the 'best that one can make of the varying dicta and … in any case, good sense'.[474] Context in this setting – context in the 'widest sense' – refers to everything else appropriate to be considered in the particular case. The phrase 'text, context, purpose' is another way of expressing the same basic idea.

What these approaches reflect is an essentially symbiotic relationship between each of their core elements.[475] They are also part of and consistent with the ordinary two-step syllogistic approach traditionally applied by courts in resolution of disputes. The law as it is determined to be (major premise) is applied to the facts as found (minor premise) to produce the legal answer.[476] Determining what the statutory law requires is a 'multi-

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[467] Hill J *How is tax to be understood by courts?* (2001) 4 *The Tax Specialist* 226 (at 229).
[468] Cooke *The Crimes Bill 1989: A Judge's Response* [1989] *New Zealand Law Journal* 235.
[469] *DPP v Walters* [2015] VSCA 303.
[470] *Challenger Corporation Ltd v CIR* [1986] 2 NZLR 513 (at 549).
[471] D'Ascenzo *Along the Road to Damascus: A framework for interpreting the tax law* [2000] *Journal of Australian Taxation* 384 (at 235).
[472] Quigley *Interpreting GST Law in Australia* in White & Krever (eds) *GST in Retrospect and Prospect* (at 118).
[473] *FCS17 v Minister for Home Affairs* [2020] FCAFC 68 (at [57]) for example.
[474] Episode 7 of *interpretation NOW!*
[475] Duffy & O'Brien *When Interpretation Acts Require Interpretation: Purposive Statutory Interpretation and Criminal Liability in Queensland* (2017) 40 *UNSW Law Journal* 952 (at 975).
[476] cf *Ex parte Tasmanian Breweries Pty Ltd* (1970) 123 CLR 361 (at 374-375), Brennan J *Limits on the Use of Judges* (1978) 9 *Federal Law Review* 1 (at 3), *South Australia v Totani* [2010] HCA 39 (at [227]), *Re Nolan* (1991) 172 CLR 460 (at 496), *Fardon v Attorney-General* [2004] HCA 46 (at [92]), Hill J *The Judiciary and its Role in the Tax Reform Process* (1999) 2 *Journal of Australian Taxation* 66 (at 70-71), Hill J *How is Tax to be Understood by Courts?* (2001) 4 *The Tax Specialist* 226 (at 229).

factorial and contextual' exercise.[477] This does not mean, however, that key elements in the wider discipline are irreducible to practical steps in a logical process which obeys legal requirements.[478]

Not everyone sees these approaches are providing much real guidance in practice. One commentator views the 'text, context, purpose' mantra as lacking explanatory force.[479] Although interpretation may never be reduced to the mechanics of an equation, however, the cases do show the practical guidance which 'text, context, purpose' brings to the exercise. Hinting at a more systematic approach, others describe 'reiterative circular processes' for understanding statutory texts, in turn called 'hermeneutic circles'.[480] This involves more than simply taking a variety of factors into account. It imposes a more structured discipline, requiring repeated reconsideration of the text in light of what wider context reveals. Think of this loosely as an ongoing feedback loop.

The best analysis of modelling attempts so far comes from Jeffrey Barnes in Chapter 8 of the book *The Coherence of Statutory Interpretation – Is there an Overall Method to Interpreting Legislation?*[481] One approach he favours, originally proposed by Glazebrook J in New Zealand,[482] involves spiralling outwards from the provision in question into the statute as a whole and then beyond into the 'wider legal context'.

Justice Kirby gives a worked example of how 'text, context, purpose' works in practice in a post-judicial analysis of his dissenting judgment in *Carr v Western Australia*.[483] A variant of this approach – called 'concurrent interpretation' – involves considering facts as part of the process for determining what the text means. The rationale is that 'meaning is realised in application to a real-life situation'.[484] What results is that the ordinary two-step syllogistic approach becomes 'one composite process'.[485]

Under the heading '*Construction – method*', the High Court in *The Queen v A2* elaborates generally on the 'text, purpose, text' formulation.[486] Designation of this formulation as a 'method' or process to be followed constitutes what must be the core module for any process mapping of the field. Any number of cases show how this

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[477] Barnes *How statutory interpretation sustains administrative law* (2015) 22 *Australian Journal of Administrative Law* 163 (at 176).
[478] The ATO is looking at ways to process map interpretation protocols as part of the *interpretation NOW!* initiative.
[479] Gardner *What Probuild Says about Statutory Interpretation* (2018) 25 *Australian Journal of Administrative Law* 234 (at 252), cf Basten *Choosing Principles of Interpretation* (2017) 91 *Australian Law Journal* 881 (at 881).
[480] Campbell & Campbell *Why statutory interpretation is done as it is done* (2014) 39 *Australian Bar Review* 1 (at 42-45), *Thomas v NSW* [2008] NSWCA 316 (at [22]), *Waugh Hotel Management Pty Ltd v Marrickville Council* [2009] NSWCA 390 (at [33]), *AVS Group of Companies Pty Ltd v Commissioner of Police* [2010] NSWCA 81 (at [133]), *Nau v Kemp & Associates* [2010] NSWCA 164 (at [33]).
[481] Barnes in Barnes (ed) *The Coherence of Statutory Interpretation* (at 78-94).
[482] Glazebrook *Filling the Gaps* in Bigwood (ed) *The Statute: Making and Meaning* (at 169-176).
[483] Kirby *Statutory Interpretation: The Meaning of Meaning* (2011) 35 *Melbourne University Law Review* 113.
[484] Walshaw *Concurrent Legal Interpretation versus Moderate Intentionalism* (2014) 35 *Statute Law Review* 244 (at 259), Walshaw *Where are we with statutory interpretation?* [2014] *New Zealand Law Journal* 254, Walshaw *Interpretation is Understanding and Application: The Case for Concurrent Legal interpretation* (2012) 34 *Statute Law Review* 101.
[485] Burrows *Some Reflections on Cozens v Brutus* (1975) 4 *Anglo-American Law Review* 366 (at 366).
[486] *The Queen v A2* [2019] HCA 35 (at [31-37])

module is to be applied in practice.[487] They naturally traverse, however, only that part of the field relevant to the particular provisions being investigated.

My first attempt at illustrating the core module in a diagram – called the Circle of Meaning – appears in Episode 66 of interpretation NOW! It follows the familiar path directed by the High Court – text > context > purpose > text. After considering the relationships between 'text and context' and 'context and purpose' respectively, it emphasises two key principles – objectivity and coherence.

An important point then made is that, in every situation, interpretation requires anchoring your answer, finally and decisively, in the text of the statute. We do this at least to ensure the meaning chosen is open on the words, for broad constitutional reasons, and as a legal reality check. This follows from unambiguous statements in the High Court – first in *Consolidated Media Holdings* then in *Thiess* – that we are to start and finish with the text of the law.

What is desirable is a more comprehensive mapping of the entire field which may be applied to all circumstances – perhaps a three-dimensional matrix incorporating algorithm-driven suggestions. The expectation is not that hard answers will emerge in some mechanical way, or that this model would supplant the human evaluative element. The rather more modest aim would be that, by its orderly navigation of the field consistent with prevailing authorities, the model would direct the reader to factors relevant to determining what their provision means.

6.16 Judges and the GST law

In the GST sphere, Professor Millar has noted what she sees as the struggle of courts to come to grips with the new GST law. Referring to the High Court decisions in *Reliance Carpet* and *Travelex*, she said[488] –

> The default response to that struggle seems to involve, at least in the High Court, a reversion to the approaches of times past, in which strict, literal interpretation of tax law were the norm. Quite apart from this apparent retreat from the modern, purposive approach to statutory interpretation, the judgments also highlight flaws in the drafting of Australia's GST law.

Michael Evans made similar points in his *Horton's lesson* article, referring to the 'frustration of the courts' and the confusion 'at least in the minds of some administrators and members of the judiciary'.[489] Others have made like comments. Reflecting on *International All Sports*,[490] Gina Lazanas and Robyn Thomas referred to a 'shift' in approach where 'courts refused to deviate beyond the ordinary meaning of the relevant statute in order to achieve the Commissioner's desired outcome, even in circumstances

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[487] *ASIC v King* [2020] HCA 4, *Bluescope Steel (AIS) Pty Ltd v Australian Workers' Union* [2019] FCAFC 84 (at [33-45]) for example.
[488] Millar *The Destination Principle: Past Developments and Future Challenges* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 313 (at 314), Pelly *Taxman hit hard as focus narrows* (8 October 2010) *The Australian*, cf Millar *The principle of neutrality in Australian GST* (2017) 17 AGSTJ 26 (at 40).
[489] Evans *Horton's lesson: Australia's struggle with 'truth in drafting'* [2012] 1/1 *World Journal of VAT/GST Law* 21 (at 22, 28).
[490] *International All Sports Ltd v FCT* [2011] FCA 824.

where policy objectives and extrinsic materials may have supported that outcome'.[491] *Saeed* was cited and Logan J quoted for it being 'the duty of the courts to construe enactments, not to make them'.[492]

Justice Kirby once observed a certain tendency of judges to treat complexity as an excuse for taking a 'purely textual approach' to revenue statutes.[493] Tony Slater QC spoke of their 'lack of enthusiasm for an expansive construction'.[494] Richard Krever said it was 'possible to excuse many, if not all, exercises in strict literalism as a rational reaction to legislative ambiguity or choice'.[495] The anomalistic nature of tax legislation was once called the 'last refuge of judicial hesitation'.[496]

Whether these observations remain true today is an open question. Several counter-points can be made. First, the temptation to demonise variance is often a strong one, especially (it appears) among non-judicial experts in the field. Two, the idea that judges are raising the white flag of complexity obscures the analysis and introduces a certain tone of condescension. Three, the so-called 'literal' answer may be the only one available on the terms of the law. As has been noted, literal and purposive answers often coincide, precisely as parliament expects or hopes.

The proposition that judges in GST cases, consciously or otherwise, are ducking responsibility by taking refuge in some strict literalism is most unlikely.[497] So is the idea that they are confused or frustrated actors in a play beyond their understanding. The idea that a federal judge like Edmonds J, for example, was intimidated by the complexity of the GST law is laughable. It is also difficult to accept Professor Millar's comments even if you disagree with the two High Court decisions themselves.[498]

It is not as if both decisions were uniformly condemned. Pier Parisi thought the High Court in *Travelex* had restored 'reality',[499] while Richard Krever and Jonathan Teoh regarded *Reliance Carpet* (along with *Qantas* and *MBI Properties*) as situations where the High Court had acted to protect the integrity of the GST law.[500] Wigney SC said in relation to *Travelex* – 'it does not seem to me that it is correct to characterise the decision as a return to literalism and a rejection of matters of context and policy when it comes to statutory construction'.[501] An important point is that our system, including its constitutional architecture, provides only limited scope for judicial fixing of legislative flaws, something Hill J stressed and *Multiflex* underlines.

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[491] Lazanas & Thomas *GST and the changing role of policy, purpose and the "vibe" in statutory interpretation* (2011) 12 AGSTJ 30 (at 33).
[492] *FCT v PM Developments Pty Ltd* [2008] FCA 1886 (at [47]).
[493] *FCT v Chant* (1991) 24 NSWLR 352 (at 356),
[494] Slater *The Income Tax Assessment Acts: Statutes in Senescence?* [2015] *TIA 30th National Tax Convention paper* (at 10).
[495] Krever *Taming Complexity on Australian Income Tax* (2003) 25 *Sydney Law Review* 467 (at 480).
[496] Williams *Taxing Statutes are Taxing Statutes: The Interpretation of Revenue Legislation* (1978) 41 *Modern Law Review* 404 (at 415) citing *Ayrshire Employers Mutual Insurance v IRC* (1944) 27 TC 331 (at 344).
[497] cf Krever *Taming Complexity on Australian Income Tax* (2003) 25 *Sydney Law Review* 467 (at 470).
[498] cf Datt *The conflict between deposits and security deposits* (2005) 5 AGSTJ 89.
[499] Parisi *Supply Characterisation Brought Back to Reality* (2010) 10 AGSTJ 73.
[500] Krever & Teoh *Justice Edmonds and interpretation of Australia's GST legislation* (2016) 45 *Australian Tax Review* 121 (at 122, 130).
[501] Wigney *Text, context and the interpretation of a 'practical business tax'* (2011) 40 *Australian Tax Review* 94 (at 105).

It ought to be clear that simply requiring that we start with the text signals no regression to past literalism.[502] As stated in *Taylor* – 'The constructional task remains throughout to expound the meaning of the statutory text, not to divine unexpressed legislative intention or to remedy perceived legislative inattention. Construction is not speculation, and it is not repair'.[503] Neither does an 'ordinary meaning' answer automatically show regression. Wigney SC in an *Australian Tax Review* article playfully drew to attention the 'immense disappointment' that some practitioners must feel when judges[504] –

> …appear to sweep aside all this background and context and arrive at an interpretation of a particular provision of the GST Act by focusing on – dare I say it – the text of the Act. That is, the words actually used in the legislation! Don't they know anything about the VAT experience and that the GST is, after all, a value-added tax?

Driven by separation of powers, the requirement to start with the text merely states the constitutional obvious.[505] It is neither something new nor a litmus test for some 'new textualism', much less the 'mindless textualism' the Tax Commissioner is accused of in the *Ode to Neutrality*. An answer merely to be characterised as 'literal' is also a false positive for determining whether or not a literalistic *approach* has been adopted.[506] This is a common misunderstanding, as is the idea that every failure to provide the policy answer to a legal problem must evidence judicial recidivism or timidness.

Criticising Jessup J in *International All Sports* for refusing to read words into gambling provisions,[507] for example, appears to betray a misunderstanding of basic interpretation principles.[508] It may also suggest a (misplaced) attraction to ancient 'equity of the statute' notions (long discredited),[509] and EU-style teleological methods under which judges are expected or required to fill legal gaps with policy content.[510]

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[502] cf Olding *Interpretation of the GST Act – Towards a Principled Basis?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 80-81).
[503] *Taylor v Owners – Strata Plan No 11564* [2014] HCA 9 (at [65]), cf *CCA19 v Secretary, Department of Home Affairs* [2019] FCA 946 (at [90-91]), *Fremantle Lawyers Pty Ltd v Sarich* [2019] WASCA 48 (at [4]), *Ian Street Developer Pty Ltd v Arrow International Pty Ltd* [2018] VSCA 294 (at [60]), *Hall v The Queen* [2020] SASCFC 84 (at [24-31]).
[504] Wigney *Text, context and the interpretation of a 'practical business tax'* (2011) 40 *Australian Tax Review* 94 (at 94).
[505] *Treasurer of Victoria v Tabcorp Holdings Ltd* [2014] VSCA 143 (at [101]) illustrates.
[506] cf *Travelex Limited v FCT* [2018] FCA 1051 (at [93-94, 105]).
[507] *International All Sports Ltd v FCT* [2011] FCA 824 (at [49]) quoting *IRC v Wolfson* [1949] 1 All ER 865 (at 870).
[508] cf *National Rugby League Pty Ltd v Singtel Optus Pty Ltd* [2012] FCAFC 59 (at [97]), *Woodside Energy Ltd v FCT* [2009] FCAFC 12 (at [51]).
[509] *Nelson v Nelson* (1995) 184 CLR 538 (at 552-554), *Burragubba v Queensland* [2015] FCA 1163 (at [17]), *Pipikos v Trayans* [2018] HCA 39 (at [155]), cf *Comcare v Thompson* [2000] FCA 790 (at [43]), *Esso Australia Resources Ltd v FCT* (1998) 159 ALR 664 (at 693).
[510] *Bennion on Statutory Interpretation* (at 465), cf *Sanum Investments Ltd v ST Group Co Ltd (No 2)* [2019] FCA 1047 (at [86]).

7. AUSTRALIAN NEUTRALITY CASES

7.1 *TAB Limited* - 2005

7.1.1 Disunity and neutrality

Several GST cases have directly probed in one way or another if EU-style neutrality applies in Australia. The first gambling supply case is one of them - *TAB Limited*.[511] One focus was the meaning of 'liable' within the 'global GST amount' formula contained in s 126-10(1). Consistent with analogous authority, ordinary understanding of the word, structural aspects of the GST law, symmetry within the formula and extrinsic materials, the taxpayer argued for a legal obligation accruals meaning of 'liable'. This was accepted and declaratory relief granted.

The effect was to maximise 'total monetary prizes' within the formula, and therefore to reduce the overall GST exposure of the taxpayer. Dealing with the Commissioner's argument that the word 'liable' in s 126-10(1) was instead limited to race dividends actually paid, Gzell J said (at [83]) –

> It would be an odd result if total amounts wagered were to be determined on an accruals basis, while total monetary prizes were to be determined on a cash basis. That would create a disunity or, would offend what has been called the principle of neutrality in jurisdictions that have a developed value added tax jurisprudence[512]

The passage in *Elida Gibbs* to which Gzell J referred mentions neutrality 'in the sense that within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain'. While neutrality is referred to in the reasons given by the judge, it is by no means certain that Gzell J was making any authoritative finding about the status of EU neutrality in our law. Two things can be said. The first is that the neutrality remarks of Gzell J are in the nature of an afterthought to a conclusion reached on other grounds. Second, despite the disunity and asymmetry of mixing cash and accruals concepts within the s 126-10(1) formula that the contrary view would produce, it is not clear what offence this gives to the wide 'same tax burden' comments in *Elida Gibbs* to which the judge referred.

Pier Parisi has argued that the 'formulation of elements in the statutory scheme, such as the words "in the form of" in the enterprise concept, suggest that the Act recognises, implicitly, an idea corresponding to the "neutrality' principle in European VAT law'.[513] He then refers to the 'disunity' comments in *TAB Limited* and points out that neutrality 'lies at the heart of VAT law'. We may easily agree with the latter observation, but the argument for an implication so large from indicators so small seems more an exercise in hope than analysis. Cordara and Parisi otherwise question the correctness of *TAB Limited* more generally and query the basic characterisation of gambling activities for

[511] *TAB Limited v FCT* [2005] NSWSC 552, noted Brysland *Igloo Homes to Atkinson – The GST cases just keep coming!* (2005) 5 AGSTJ 137 (at 151).
[512] *Elida Gibbs Ltd v CEC* [1997] QB 499 (at 560 [20]) cited.
[513] Parisi *Interpreting the A New Tax System (Goods and Services Tax) Act 1999* (at 15).

GST purposes.[514] In their view, the European position that the principal objective of gambling is entertainment (and not financial gain) is the better view.[515]

7.2 *TSC 2000 Pty Ltd* - 2007

7.2.1 Economic equivalence

In *TSC 2000*, the taxpayer (a gambling syndicate organiser) argued for an application of the GST law by reference to the concept of 'fiscal neutrality'.[516] The argument made was essentially one of economic equivalence. In other words, that the GST effectively to be borne by all members of one syndicate should be the same, whether they placed their lotto bets directly or via the taxpayer acting as their agent. The taxpayer relied on a passage from a VAT car trade-in case, *Lex Services*[517] –

> Its central core meaning [of fiscal neutrality, that is] … is that whether goods purchased by the final consumer have been through the hands of a dozen different traders at successive stages of their manufacture, distribution and marketing or are the product of a single manufacturer who is also a retailer the VAT system should (through its mechanisms of input tax and output tax) produce the same end result …

Hack DP dealt with this under the heading – *The approach to construction*. The first issue was whether the assessment 'offends the principle of fiscal neutrality'. Responding to the *Lex Services* statement, Hack DP drew attention to the comments by Hill J in *HP Mercantile* regarding credit access 'where possible'.

The deputy president observed (at [54]) that the idea of neutrality had 'limited application' to the case before him. He said, however, that neutrality 'is an aid to construction where it is necessary to determine which of competing constructions is to be preferred', that it cannot operate to modify the plain operation of the statute, and that, if there is a supply from a practical and business point of view, 'then recourse to the principle of fiscal neutrality is unnecessary and unwarranted'. Echoing earlier judicial comments, Hack DP said that what lies behind the enactment of a taxing provision as a matter of public policy or economic theory is not the same thing as the elements or criteria of tax liability parliament has laid down.[518]

Later, the deputy president returned to fiscal neutrality and the argument that the ATO position was 'very odd … a good clue to its being wrong'. Any oddity, said Hack DP, 'arises as a consequence of the particular statutory provisions that apply to this case'. In his view, s 126-30 'operates to prevent the principle of fiscal neutrality operating'.

The approach of Hack DP in this case very much reflects suggestions made by Hill J in two respects. One, EU neutrality might function as an aid to construction but, two, it

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[514] Cordara & Parisi *Australian Goods and Services Tax Cases – Decisions and Commentary* (at [13.5.2]), cf *Crown Melbourne Ltd v FCT* [2020] FCA 1295.
[515] *RAL (Channel Islands) Ltd v CEC* [2005] EUECJ C-452/03 (at [31]) quoted.
[516] *TSC 2000 Pty Ltd v FCT* [2007] AATA 1629 (at [50-51]), noted Brysland *GST cases to the end of 2007 – Part 2* (2008) 7 AGSTJ 129 (at 141).
[517] *Lex Services plc v CEC* [2004] 1 All ER 434 (at 443 [26]).
[518] *WR Carpenter Holdings Pty Ltd v FCT* [2007] FCAFC 103 (at [29]), cf *WR Carpenter Holdings Pty Ltd v FCT* [2007] HCA 33, *Sterling Guardian Pty Ltd v FCT* [2006] FCAFC 12 (at [15]), *Westley Nominees Pty Ltd v Coles Supermarkets Australia Pty Ltd* [2006] FCAFC 115 (at [59]), *Reliance Carpet Co Pty Ltd v FCT* [2008] HCA 22 (at [3]).

may equally be excluded by particular provisions – in this case, the special rules of Div 126. So far as the first is concerned, the comments of Hack DP are incidental and without analysis or reflection. Nothing in Div 11 suggests any default rule in favour of credit access, and choices between interpretational alternatives are to be resolved as generally directed by s 15AA of the *Acts Interpretation Act 1901*.

The result in *TSC 2000* also stands against consumption being the measure of the tax. It rejects economic equivalence in the GST sphere, just as that concept is rejected for income tax purposes.[519] Roderick Cordara and Pier Parisi commented on *TSC 2000* that Div 126 is nothing other than a provision aimed at securing the gambling outcome established by the CJEU – the fundamental point being that 'the taxable amount is the consideration actually received'.[520] My point, however, is that Hack DP was stretching things too far to accept that fiscal neutrality, either in its EU guise or as legislated for in Div 11, has any legitimate tie-breaker role to play.

7.3 *AXA Asia Pacific* - 2008

7.3.1 Foreign decisions

The taxpayer in this matter argued for credits before Lindgren J in a life insurance group situation by reference to fiscal neutrality – *AXA Asia Pacific*.[521] The case raised (A) whether independent consideration from a financial supplier is necessary to support an acquisition supply by the acquirer,[522] (B) whether trust grouping extends to unit trustees not GST registered in that capacity,[523] and (C) the correct basis on which to apportion credits.[524] Cordara SC, who appeared for the taxpayer, had said that input taxation –

> … is an exception to the overarching concept underlying GST [that is, fiscal neutrality], which is that no 'sticking' tax will stay in the chain of suppliers: instead they should all be able to recover the input tax that they have had to incur (built into the price of their acquisitions) to make supplies that are either taxable or GST-free, with the burden only being borne by the final private consumer.

Counsel explained it is of the essence in a VAT-based system that entities get all their input tax back so they remain neutral in a fiscal sense. Cordara SC was merely reflecting the orthodox European position that neutrality is 'inherent in the common system of

[519] *IRC v Europa Oil (NZ) Ltd* [1971] AC 760, *Europa Oil (NZ) Ltd v CIR* [1976] 1 WLR 464, *Otto Australia Pty Ltd v FCT* 90 ATC 4604 (at 4609), *City Link Melbourne Ltd v FCT* [2004] FCAFC 272 (at [43]), *St George Bank Ltd v FCT* [2008] FCA 453 (at [63]), Walpole & Sommer *A sub-equatorial love affair – flirting with economic equivalence* [2007] *ATAX 19th GST and Indirect Tax Conference paper*.
[520] Cordara & Parisi *Australian Goods and Services Tax Cases – Decisions and Commentary* (at [13.10.2]), *HJ Glawe Spiel-und Unterhaltungsgerate v Finanzamt Hamburg-Barmbek-Uhlenhorst* [1994] Case C38/93 (at [8]) quoted.
[521] *AXA Asia Pacific Holdings Ltd v FCT* [2008] FCA 1834.
[522] cf GSTR 2002/2 (at [35]), *Finanzamt Groß-Gerau v MKG-Kraftfahrzeuge-Factory GmbH* [2003] EUECJ C-305/01, *Hagemeyer Ireland Ltd plc v Revenue Commissioners* [2007] IEHC 49.
[523] ss 48-10(1)(c) and 184-1, cf *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* [2006] NSWSC 83 (at [66]), *Di Lorenzo Ceramics Pty Ltd v FCT* [2007] FCA 1006 (at [87]).
[524] GSTR 2006/4 (at [32-35]), *Ronpibon Tin NL v FCT* (1949) 78 CLR 47 (at 55-56), *HP Mercantile Pty Ltd v FCT* [2005] FCAFC 126 (at [37]).

VAT'.[525] Lindgren J (at [62]) quoted the 'legislative scheme' comments in *HP Mercantile*, but he did not mention neutrality by name. He did say (at [96]), however, that he saw 'no reason to import as authorities on the construction of the GST Act approaches that were taken in cases concerning different statutory texts and contexts'.

This became an ever-stronger theme in the development of our GST jurisprudence. It also provides a cogent basis almost on its own for rejecting EU-style neutrality in Australia. In the year following *AXA Asia Pacific*, Lindgren J expanded on the 'different legislation, different context' theme in an article published in *The Tax Specialist*.[526] In *AXA Asia Pacific* itself, the judge also held (at [122]) that a 'look through' approach to Div 11 was inconsistent with the GST law.[527] This position was also to prove important in later cases also. While *AXA Asia Pacific* raises neutrality, Lindgren J did not buy into the issue and stuck to the provisions.

7.4 *Electrical Goods Importer* - 2009

7.4.1 Economic policy and consumption

This tribunal case, decided shortly after *Reliance Carpet* was handed down in the High Court, is the most targeted analysis of the status of EU-style neutrality in Australia to date.[528] Fiscal neutrality was argued by the taxpayer to reduce consideration by reference to cash-back amounts paid directly by the importer to consumers purchasing from interposed retailers. Block DP (at [41]) first drew attention to the fact that neutrality was an implication drawn from the description of VAT as a 'general tax on consumption'. Next, he observed (at [43]) that the passing reference in *TAB Limited* could not be taken as a pronouncement 'that the principle is part of Australian law'. After noting remarks of Hill J in *HP Mercantile*, the deputy president returned to consider the CJEU case referred to in *TAB Limited* by Gzell J – *Elida Gibbs*.

Elida Gibbs had involved a similar discount scheme under which the manufacturer redeemed consumer coupons direct. It was held in that case that the 'nominal value of redeemed coupons must be deducted from the original purchase price'. Block DP (at [47]) observed that there was no equivalent of the EU directive in the GST law. He referred to *TSC 2000* for the principle that what lies behind a taxing provision 'as a matter of public policy or economic theory' is not the same thing as the criteria of liability which parliament has laid down.[529] He quoted a commentator (me) on the point,[530] then referred to remarks in *Reliance Carpet* (at [3-5]) which contrast the respective systems operating in Europe and Australia.

In *Reliance Carpet*, the High Court stressed (A) that, as a matter of legal analysis, what generates the tax liability is 'not consumption, but a particular form of transaction,

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[525] *Finanzamt Oschatz v Zweckerband zur Trinkwasserversorgung und Abwasserbeseitigung Torgau-Westelbien* [2008] EUECJ C-442/05 (at [42]), *Canterbury Hockey Club v CRC* [2008] EUECJ C-253/07 (at [30]), *Commission v Italian Republic* [2008] EUECJ C-132/06 (at [39]).
[526] Lindgren J *The relevance of overseas case law to Australia's GST* (2009) 13/2 *The Tax Specialist* 58.
[527] cf Cordara & Parisi *Australian Goods and Services Tax Cases – Decisions and Commentary* (at [7.10.3]), Macintyre *AXA case: principles for claiming ITCs* (2008) 12 GST News ¶92.
[528] *Electrical Goods Importer v FCT* [2009] AATA 854.
[529] *WR Carpenter Holdings Pty Ltd v FCT* [2007] FCAFC 103 (at [29]).
[530] Brysland *GST cases to the end of 2007 – Part 2* (2007) 7 AGSTJ 129 (at 134), cf Brysland *GST and Government in 2010* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 40-42).

namely supply …',[531] (B) that, by contrast to the Australian system, VAT is a 'general tax on the consumption of goods and services',[532] and (C) that the composite expression 'taxable supply' is of critical importance for the imposition of liability.

Block DP concluded (at [51-52]) that there were no 'competing interpretation' in this case, that neutrality 'cannot modify the plain operation of the statute, and that the 'principle of fiscal neutrality is not part of Australian law'. These findings are expressed in categorical and direct terms. The last finding is consistent with a conclusion expressed in a later *Australian Tax Review* article – 'fiscal neutrality [in the European sense] has no function in the interpretation of the Australian GST'.[533]

As Roderick Cordara and Pier Parisi point out, Block DP did not discuss *Elida Gibbs* in detail, nor did he 'attempt to articulate precisely the principle of fiscal neutrality'.[534] The authors say there was broad reference to the principle 'without acknowledging that while it has specific aspects … which can assist in understanding the basics of a VAT, such as the GST, it is essentially, a core principle of European law'.[535]

Cordara and Parisi quote from EU treaty provisions on equal treatment, observing that these goals 'obviously do not form part of the objectives of the GST Act'. They suggest that, had *Electrical Goods Importer* been better argued for the taxpayer, there may have been scope to appeal more tactfully to underlying policy. Although the authors suggest that reliance on foreign cases for general principles may produce more success, as the years pass, that prediction has not been borne out in practice.

8. INTERPRETATION IN EUROPE

In his article – *Methods of interpretation in European VAT* –Professor Ben Terra said that European VAT 'requires that a tax specialist – whether judge, lawyer or practitioner – be an expert in European law, a polyglot and a bit of an historian'.[536] It goes without saying that I am none of the above. In attempting to trace out the main themes of EU interpretation, therefore, I will rely to some degree on the observations and experience of others mainly from within the European systems of law and taxation.

8.1 Purposive approach

To understand EU neutrality, some appreciation of the legal system including interpretation protocols which produced it is desirable. It is a universal truth that legal texts (like other texts) are only to be understood from their proper context. This is important when looking at legal principles from a different legal system.

A judge once said that the difference between civil law and common law judges was that, when faced with a new case, the former ask – 'what should we do this time?' – while the latter enquire – 'what did we do last time?'[537] Another commentator had put it in terms of the CJEU stating the principle then working down to the facts of the case,

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[531] *Sterling Guardian Pty Ltd v FCT* [2006] FCA FCAFC 12 (at [15]) quoted.
[532] Article 2(1) of the First Directive referred to.
[533] Spadijer *Is the GST unconstitutional? Some s 55 problems revisited* (2014) 43 *Australian Tax Review* 204 (at 225).
[534] Cordara & Parisi *Australian Goods and Services Tax Cases – Decisions and Commentary* (at [2.10.2]).
[535] *NCC Construction Danmark A/S v Skatteministeriet* [2009] Case C-174/08 (at [41]) quoted.
[536] Terra *Methods of interpretation in European VAT* (2005) 5 AGSTJ 170.
[537] Cooper *The Common and the Civil Law – a Scots View* [1950] *Harvard Law Review* 468 (at 471).

while UK courts do precisely the reverse.[538] In *Merck v Haupzollant Hamburg-Jonas*, the CJEU summarised its general approach to interpretation[539] –

> … in interpreting a provision of the … law it is necessary to consider not only its wording, but also the context in which it occurs and the objects of the rules of which it is part.

This statement conceals more than it reveals about the CJEU. If I read it correctly, the *Merck* statement is largely an understatement. In a 1963 case, the court said that 'it is necessary to consider the spirit, the general scheme and the wording' of provisions.[540] This theme traces back to the very earliest CJEU caselaw.[541]

Gunnar Beck states that the work of the CJEU (in treaty interpretation at least) 'must be placed at the extreme *activist* end of the judicial spectrum'. Another commentator put in terms of the CJEU being 'potentially a dangerous court – the danger being that inherent in uncontrollable judicial power'.[542] There is an enormous and growing literature in this area, however, including a range of textbooks,[543] numerous journal articles (many of which are in English), and personal debates (some rather hard-edged).

Beck's conclusion in the *Epilogue* to his book – 'Law, for the CJEU, is essentially the continuation of politics by other means'.[544] Not everyone agrees with this extreme view. Michal Bobek challenges it on the evidence in the book as a whole, and describes what Beck said as 'bitter and condemning'.[545] Beck doubled-down on his earlier views in a later article – *Law as the Continuation of Politics by Other Means*.[546] His conclusion in that regard is that the judgment in *Pringle* is 'not a model for legal reasoning, but an illustration of the sad, brute fact that the rule of law is, in the end, no more than a fair-weather phenomenon'. These are strong words indeed.

Defending his 'politics by other means' conclusion in a *University of Queensland* article, Beck spoke about 'Political Realpolitik' and that the CJEU would 'break the law to save the euro'[547] – a dramatic accusation. However, it is not as if CJEU judges themselves wholly deny a political dimension in their work. Koopmans J described this as the court in some cases having 'the courage to step into the vacuum'.[548] The point to make, however, is that, while the EU approach may be self-described as 'purposive', it

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[538] Tiley *The law of taxation in a European environment* (1992) 51 *Cambridge Law Journal* 451 (at 469).
[539] *Merck v Hauptzollant Hamburg-Jonas* [1983] Case C-292/82 (at [12]), *Alfred Lamb International Ltd v CRC* [2009] UKFTT 220 (at [29-30]), cf *Bosphorus v Minister for Transport* [1983] ECR I-3781 (at [12]).
[540] *van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1 (at 12).
[541] Fennelly *Legal Interpretation at the European Court of Justice* (1997) 20 *Fordham International Law Journal* 656 (at 660).
[542] Neill *The European Court of Justice - Case Study in Judicial Activism* (at 58).
[543] Rasmussen *On Law and Policy in the European Court of Justice*, Bengoetxea *The Legal Reasoning of the European Court of Justice,* Sankari *European Court of Justice Legal Reasoning in Context*, for example.
[544] Beck *Judicial Activism in the Court of Justice of the EU* (2017) 36 *University of Queensland Law Journal* 333 (at 353).
[545] Bobek *The Legal Reasoning of the Court of Justice in the EU* (2014) 39 *European Law Review* 418.
[546] Beck *The Court of Justice, Legal Reasoning, and the Pringle Case - Law as the Continuation of Politics by Other Means* (2014) 39 *European Law Review* 234.
[547] Beck *The Legal Reasoning of the Court of Justice: Response to Michal Bobek* (2014) 39 *European Law Review* 579 (at 581), *Pringle v Government of Ireland* [2013] 2 CMLR 2, cf *Thesing and Bloomberg Finance LP v European Central Bank* [2013] 2 CMLR 8, *B VerfG 2 BvR* [2012] Case I-1390.
[548] Sturgess & Chubb *Judging the World; Law and Politics in the World's Leading Courts* (at 497).

is not purposive in the sense we know it. EU purposivism roams far beyond even what we would regard as 'exorbitantly purposive'.[549]

All courts are criticised at one time or another for their judicial activism or perceived political motivations. A retired Hawaiian judge recently wrote to John Roberts, Chief Justice of the US Supreme Court, complaining about 'radical legal activism' and how the court had 'become little more than a result-orientated extension of the right wing of the Republican Party'. The ex-judge said that 'even routine rules of statutory construction get subverted or ignored to achieve transparent political goals'.[550]

Leaving aside any merit in these charges, there are differences between the two situations. The constitutional and judicial norms between Europe and America are starkly divergent. There is an expectation the CJEU will bridge gaps between law on the one hand and Realpolitik on the other where necessary. With expectation comes some legitimacy in its wake. We may recoil at EU judicial practices, but they are also a product of their peculiar environment.

8.2 Teleological interpretation

The predominating style of European interpretation tends to be 'teleological' in nature.[551] One text writer describes this as 'emblematic' of the approach of the CJEU. An Advocate General observes that there is 'an increased focus on systematic and teleological reasoning – more contextual and normatively thick'.[552] This methodology resonates with the French teleological approach of Francois Gény in his *Methode d'Interpretation et Sources en Droit Prive Postif* of 1919. Central to this was the need to adapt the law to changing social and economic conditions, liberally, humanely and to the demands of modern life.[553]

The first Advocate General, Maurice Lagrange (a Frenchman) was instrumental in promoting teleological methods to the CJEU.[554] Advocate General Maduro explains that EU statutes are interpreted 'in the light of the broader context provided by the EU legal order and its constitutional *telos*'.[555] Treaties are 'living' documents and read as such.[556] Beck also mentions that 'political fashion' is a factor in interpretation at the treaty level.[557] Professor Leslie Zines at the *Australian National University* described the CJEU in 1973 as being impatient with the treaty provisions 'and determined not to let

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[549] *Commissioner of Rating and Valuation v CLP Power Hong Kong Ltd* [2017] HKCFA 18 (at [34]), citing *China Field Ltd v Appeal Tribunal (Buildings) No 2* [2009] HKCFA 95 (at [36]), cf *Shanning International Ltd v Lloyds TSB* [2001] 1 WLR 1462 (at [24]).

[550] Lithwick *Former Judge Resigns From the Supreme Court Bar in a Letter to John Roberts* (18 March 2020) *slate.com*.

[551] *Henn and Darby v DPP* [1981] AC 850 (at 905), *Coloroll Pension Trustees Ltd v Russell* [1995] All ER (EC) 23 (at 42), *CCE v Federation of Technology Industries* [2004] EWCA Civ 1020 (at [67]), *Proctor & Gamble Company v Svenska Cellulosa Aktiebolaget SCA* [2012] EWHC 1257 (at [40-42]), *Healthspan Limited v CRC* [2018] UKFTT 241 (at [257]).

[552] Sankari *European Court of Justice Legal Reasoning in Context* (at 67, 69).

[553] Carney *Comparative Approaches to Statutory Interpretation in Civil Law and Common Law Jurisdictions* (2015) 36 *Statute Law Review* 46 (at 52), quoting Troper, Grzegorczyk & Gardies *Statutory Interpretation in France* in MacCormick & Summers (eds) *Interpreting Statutes: A Comparative Study* 171 (at 180).

[554] Burrows & Greaves *The Advocate General and EC Law* (at 59-88).

[555] Maduro *Interpreting European Law* (2007) 1/2 *European Journal of Legal Studies* 1 (at 2).

[556] *Cilfit v Ministry of Health* [1982] ECR I-3415 (at [20]).

[557] Beck *The Legal Reasoning of the Court of Justice of the EU* (at 390-404).

them stand in the way of the fulfilment of what the judges consider to be desirable political or economic ends'.[558] Beck explains further[559] –

> This ultra-flexible interpretative approach minimises methodological constraint and affords the CJEU almost complete freedom of interpretation. This methodological flexibility leaves the CJEU free to give the greatest weight to whatever arguments, usually teleological criteria, support its preferred conclusion.

Scalia and Garner give their understanding of 'teleological interpretation'[560] –

> An interpretation arrived at through imaginative reconstruction, whereby the judge attempts to read the text as he believes the drafter would have wished to phrase it in order to achieve the drafter's desired end.

The concept of 'imaginative reconstruction' is explained as being where the judge 'seeks to resolve a *casus omissus* (an omitted case) by putting himself in the place of the enacting legislature and trying to divine what the collective body would have wanted done'. Scalia and Garner discuss this further under the 'false notion' that, where a statute does not quite cover something, the court 'should reconstruct what the legislature would have done had it confronted the issue'.[561] Central to this view of teleological interpretation is that judicial predictions in this regard 'are bound to be little more than wild guesses'.[562] In Australia also, the term 'teleological' is sometimes used in a pejorative way, though usually with less venom or animus.[563]

It should not be thought, though, that there is any universal distaste for teleological interpretation in the common law world. As Lord Steyn once stated with approval – '*Cross* points out that of the four methods of interpretation – literal, historical, schematic and teleological – the first is the least important and the last the most important'.[564] This accords with how Lord Slynn saw things in his *They Call It 'Teleological'* article.[565]

8.3 The European way

The teleological approach transcends literal, historical and contextual approaches 'because it is not restricted by the wording, background or context of the provisions in issue'.[566] It is purposeful, but in the sense of being dynamic in its drive to give effect to the spirit and scheme of legislation (as the judges see it). It is also seen as unavoidable.[567]

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[558] Zines *The European Court* (1973) 5 *Federal Law Review* 171 (at 199).
[559] Beck *Judicial Activism in the Court of Justice of the EU* (2017) 36 *University of Queensland Law Journal* 333 (at 353).
[560] Scalia & Garner *Reading Law* (at 430-431).
[561] cf *Argentina v Weltover Inc* 504 US 607 (at 618) (1992), Millett *Construing Statutes* (1999) 20 *Statute Law Review* 107 (at 110).
[562] Scalia & Garner *Reading Law* (at 350), Easterbrook *Statutes' Domains* (1983) 50 *University of Chicago Law Review* 533 (at 547-548).
[563] *Taylor v Attorney-General* [2019] HCA 30 (at [148]), *LM Investment Management Ltd v Drake* [2019] QSC 281 (at [146]) for example.
[564] *Shanning International Ltd v Lloyds TSB* [2001] 1 WLR 1462 (at [24]) referring to Cross *Statutory Interpretation* (at 105-112), cf *Certain Underwriters at Lloyds London v Treasury* [2020] EWHC 2189 (at [33]).
[565] Slynn *They Call It Teleological* (1992) 7 *Denning Law Journal* 225 (at 226, 230).
[566] Moens & Tzovaras *Judicial Law-making in Europe* (1992) 17 *University of Queensland Law Journal* 76 (at 79), *Secretary of State for Work and Pensions v Lassal* [2010] ECR 1-09217 (at [49]).
[567] Sankari *European Court of Justice Legal Reasoning in Context* (at 19).

Judges take a 'panoramic view' and see solutions from a perspective of raw pragmatism. The result is not unlike 'web of beliefs', 'all things considered' and 'funnel of abstraction' ideas of legal pragmatists elsewhere.[568] Continental judges are expected to 'fill in the gaps' by reference to background values, often opaquely expressed.[569]

'It is the European way', Lord Denning once wrote.[570] This was not some veiled criticism. Denning defended the 'schematic and teleological method' of the Europeans saying it was 'really not so alarming as it sounds'.[571] The same law lord in another case observed that the CJEU interprets legislation 'so as to produce the desired effect' – 'This means that they fill in the gaps, quite unashamedly, without hesitation'.[572] The more principles-based style of legislative drafting in the EU presupposes and supports this. There is no formal doctrine of *stare decisis* in the EU, nor any coherent theory of *ratio decidendi*.[573] The CJEU is not bound by its own decisions, but will treat them in a kind of 'precedential' way when that is seen to be desirable.

In a system where 'all authority is persuasive, relative weight becomes crucial'.[574] Gunnar Beck says that the appeal to precedent 'lends later decisions only an *aura* of legal objectivity', an 'impression of continuity and consistency'.[575] Ruth Bader Ginsburg once described judges on the continent as having a civil service character.[576] This appears to be even more so when it comes to CJEU judges.

More creativity and judicial policy-making is ceded to (and demanded from) the EU judge.[577] Bingham J described this as 'supplying flesh to a spare and loosely constructed skeleton'.[578] European legislation 'must be understood in connexion with the economic and social situation in which it is to take effect'.[579] Much weight is placed on the practical consequences of each construction.[580] Reverse-engineering is an open fact of EU judicial life – that is, selecting an agreeable answer then finding whatever reasons

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[568] Blackshield *Pragmatism and Valid Law* [1965] *Sydney Law Review* 492, Eskridge, Frickey & Garrett *Legislation and Statutory Interpretation* (at 241), Estridge & Frickey *Statutory Interpretation as Practical Reasoning* (1990) 42 *Stanford Law Review* 321, *Flavell v Deputy Minister of National Revenue* (1996) 137 DLR (4th) 45 (at 56), Brooks *The responsibility of judges in interpreting tax legislation* in Cooper (ed) *Tax Avoidance and the Rule of Law,* Dworkin *Law's Empire* (at 159-163) variously provide background.

[569] Filling gaps by judges is usually referred to by its French name *effet utile* – the doctrine of effectiveness.

[570] *Bulmer Ltd v Bollinger SA* [1974] Ch 401 (at 425), cf *Nothman v London Borough of Barnet* [1978] 1 All ER 1243 (at 1246), Sturgess & Chubb *The Incoming Tide* in *Judging the World; Law and Politics in the World's Leading Courts* (at 80-121).

[571] *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK) Ltd* [1977] 2 WLR 107 (at 112).

[572] *Saarland v Minister for Industry* [1988] ECR 5013 (at [19]).

[573] Beck *The Legal Reasoning of the Court of Justice of the EU* (at 290).

[574] Dashwood *The Advocate General in the Court of Justice of the European Communities* (1982) 2 *Fiscal Studies* 202 (at 214).

[575] Beck *Judicial Activism in the Court of Justice of the EU* (2017) 36 *University of Queensland Law Journal* 333 (at 340, 353).

[576] Ruth Bader Ginsburg *Remarks on Writing Separately* (1990) 65 *Washington Law Review* 133 (at 136).

[577] Neill *The European Court of Justice: a case study in judicial activism*.

[578] *CEC v ApS Samex* [1983] 1 All ER 1042 (at 1056), *R v Food Standards Agency* [2013] EWHC 1966 (at [66]), *Lahyani v Minister for Justice* [2013] IEHC 176 (at [27-28]), *Re Civil Aviation (Investigation of Air Accidents and Incidents) Regulations* 1996 [2015] ScotCS 80 (at [4]).

[579] *Shanning International Ltd v Lloyds TSB Bank plc* [2001] UKHL 31 (at [24]), Cross *Statutory Interpretation* (at 107).

[580] *Enderby v Frenchay Health Authority* [1994] 1 All ER 495 (at 513).

may support it.[581] Legal realism prevails and ends justify means.[582] This is in stark contrast to the traditional 'bottom-up' methods which dominate judicial decision-making in common law countries.

Bennion colourfully summed up the position by saying that the 'continental version of purposive construction enables the legislative animal to be skinned alive'.[583] In similar vein, it has been said that the CJEU 'deliberately and systematically ignores fundamental principles of the western interpretation of law'.[584] Another commentator calls broadly for interpretative restraint by the CJEU, which (in his view) should be based on principles of democracy, rule of law, and the separation of powers.[585]

8.4 Legislative drafting

Interpretation protocols in Europe partly reflect the style of legislative drafting. This is no more than a cultural and systemic observation of general application. The open style of EU drafting facilitates and encourages, if not demands, that judges fill in the spaces between the lines and between the words. We call this interstitial law-making[586] and, in Europe, it happens without apparent anxiety. By contrast, UK legislation is far more complex. John Avery Jones described it as a 'plague of tax rule madness'.[587]

Cordara describes VAT legislation as 'tersely drafted'.[588] The VAT Directives, he says, 'represent a series of political deals interspersed among broad applications of principle'. The general style derives from Continental law systems, which rely on techniques 'not highly dependent on the precise use of language'. Beck explains this is terms of EU law being drafted 'in the less exhaustive and more abstract style of the civil law tradition'.

It is written very differently to the national legislation of member states, for example. As would be expected, the less precise and more open the EU law is, the more amenable it is to the intrusion of 'extra-legal' factors.[589] In many ways, the drafting style of EU law is more strategic, more optimistic, less tactical, less granular and far less absolutist that what we are used to in Australia.

EU legislation is drafted in all 23 official languages, none of which is privileged as original and all of them authentic. Maintaining this corpus – sometimes referred to as the 'Babel of Europe' – is a daunting and resource-intensive task with many obvious risks including legal and reputational ones. As has been observed in another context –

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[581] cf Hill J *A Judicial Perspective of Tax Law Reform* (1998) 72 *Australian Law Journal* 685 (at 686).
[582] cf Schulyok *The ECJ's Interpretation of VAT Exemptions* (2010) 07/08 *International VAT Monitor* (at 268).
[583] *Bennion on Statutory Interpretation* (at 966).
[584] Herzog & Gerken quoted in Sankari *European Court of Justice Legal Reasoning in Context* (at 61).
[585] Conway *The Limits of Legal Reasoning and the European Court of Justice*, cf Bobek *The Legal Reasoning of the Court of Justice in the EU* (2014) 39 *European Law Review* 418 (at 427).
[586] cf French *Competition law – covering a multitude of sins* [2004] Fed J Schol 5 (at [27]), French *Bending Words: The Fine Art of Interpretation* [2014] *University of Western Australia paper* (at 9), Blaker *Is Intentionalist Theory Indispensible to Statutory Interpretation?* (2017) 43 *Monash University Law Review* 238 (at 269).
[587] John Avery Jones *Tax Law: Rules or Principles?* (1996) 17 *Fiscal Studies* 63 (at 89).
[588] Cordara *The Sixth VAT Directive and Key Legal Issues under VAT in Europe* (at 5).
[589] Beck *The Legal Reasoning of the Court of Justice of the EU* (at 314, 345).

'Different languages are different worlds'.[590] Professor Terra has written that the multilingual nature of EU legislation 'can make any tax practitioner desperate'.[591]

The problem may be little different in principle from that arising in the reading of international treaties written in various language versions.[592] The European situation, however, generates more intensity in a smaller microcosm.

Lawrence Solan argues that multilinguality assists rather than frustrates the processes of interpretation.[593] It is the 'comparison of different language versions'[594] as an additional step which adds value to linguistic analysis, he says.[595] This appears also to be borne out at the practical level. One example is the opinion of Advocate General Slynn in *Rompelman* where no less than six language versions are consulted.[596]

Solan calls this the *Augustinian Approach* to interpretation, given it replicates closely the methodology applied by Augustine in *On Christian Doctrine* to resolve the meaning of scriptural texts in different languages. Capturing the essence of various versions by triangulation techniques assists the interpreter.[597]

In his view, 'Babel is not a punishment, it is a gift'. Solan's conclusion is that 'Augustine had it right when he observed that the careful study of different translations of the same text is likely to lead to a deeper understanding of the text's essential meaning'. The CJEU agrees saying interpretation of Community law 'thus involves a comparison of the different language versions'.[598] As the caselaw shows, however, multilinguistic analysis in this regard has become a dark art of sorts.[599] Having its own terminology, EU legal concepts do not necessarily match-up with those of member states.[600] Terra says this problem 'often results in mental gymnastics' in certain VAT situations.[601]

8.5 CJEU judgments

It is often difficult to identify a path of reasoning leading to the answer provided by the CJEU in its judgments. Three interrelated factors produce this state of affairs – (A)

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[590] Dixon, Hogan & Wierzbicka *Interpreters: Some basic problems* (1980) 5 *Legal Service Bulletin* 162 (at 163) quoted in French CJ *One Justice – Many Voices* [2015] *Language and the Law Conference paper* (at 3).

[591] Terra *Methods of interpretation in European VAT* (2005) 5 AGSTJ 170.

[592] cf *Comptroller-General of Customs v Pharm-a-Care Laboratories Pty Ltd* [2020] HCA 2 (at [36]), *Eiser Infrastructure Ltd v Kingdom of Spain* [2020] FCA 157 (at [137]).

[593] Solan *The Interpretation of Multilingual Statutes by the European Court of Justice* (2009) 34 *Brooklyn Journal of International Law* 277.

[594] *Simutenkov v Ministerio de Educatión y Cultura* [2005] ECR I-2579 (at [14]), *CILFIT v Ministry of Health* [1982] ECR 3415 (at [18-20]).

[595] *Commission of the European Communities v United Kingdom* [2006] ECR I-7471, *Irmtraud Junk v Kuhnel* [2005] ECR I-885 (at [33]) for example.

[596] Opinion of Advocate General Sir Gordon Slynn dated 15 November 1984 in Case 268/83, cf Slynn *They Call It Teleological* (1992) 7 *Denning Law Journal* 225 (at 228), *Orange România SA v Autoritatea Naţională de Supraveghere* [2020] EUECJ C-61/19 (at [42]).

[597] Van Calster *The EU's Tower of Babel – The Interpretation by the European Court of Justice of Equally Authentic Texts drafted in More Than One Official Language* (1998) 17 *Year Book of European Law* 363 cited.

[598] *Srl CILFIT v Ministry of Health* [1982] ECR 03415 (at [18]), *Alfred Lamb International Ltd v CRC* [2009] UKFTT 220 (at [28]).

[599] *Ex parte EMU Tabac SARL* [1998] ECR I-01605 (at [28-36]) illustrates.

[600] *Verbond van Nederlandse Ondernemingen v Inspecteur der Invoerrechten en Accijnzen* [1977] ECR 00113 (at [9-11]), *Apple & Pear Development Council v CCE* [1988] ECR 01443 (at [8, 17]) illustrate.

[601] Terra *Methods of interpretation in European VAT* (2005) 5 AGSTJ 170.

multilingualism of judgments, (B) protocols of interpretation, and (C) manner and style of judgments. Regarding (A), French being the common language of deliberation, all other judgment versions (including in English) are translations produced by a cadre of 'lawyer linguists'. One judge notes generally that court French is a 'rigorous and terse language which puts a penalty on the florid and the twisted'.[602]

It is observed that, for decades, CJEU judgments 'looked like a carbon copy of the judgments of the great French courts'.[603] The function of courts in France is to authoritatively communicate a decision, rather than explain why it has been reached. The French linguistic domination also 'spills over into intellectual domination'.[604] The potential for unwitting and subtle changes in meaning is high, especially when what has been called the 'minefield of Eurish' is added as a wildcard.[605] And, while all language versions of legislation have equal authority, judgments and their interpretation centre on the language of the case.[606]

In this respect, the court will have regard to different language versions 'as a smorgasbord of sources, to be consulted as need and convenience dictate'.[607] Reform moves have been made to change the working language of the court to English,[608] given the latter has become 'the *de facto lingua franca* of the EU legislative bodies'.[609] If this happens, it will be an ironic and Pyrrhic outcome in the wake of Brexit.

Regarding (B) and (C), comments from Matyas Bencze summarise the issue.[610] The CJEU 'engages in meta-teleology by assertion, rather than by justification through argumentation'.[611] While a teleological approach reflects the *telos* of provisions, a meta-teleological one approaches the interpretive task by reference to the *telos* of the wider context.[612] The CJEU also 'often adopts a magisterial or declaratory style of judgment' where a 'lack of substantive or dialogical or dialectical reasoning is apparent'. A key feature, says Bencze, is a 'tendency to under-articulate its methods of reasoning'.

It is this approach which 'helps conceal discretion and real choice, and it means justification is under-developed'.[613] Judgments involve a 'typically continental

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[602] Mancini *Crosscurrents and the Tide at the European Court of Justice* (1995) 4 *Irish Journal of European Law* 120 (at 121).
[603] Mancini & Keeling *Language, Culture and Politics in the Life of the European Court of Justice* (1995) 1 *Columbia Journal of European Law* 397 (at 399).
[604] Bobek *Epilogue* in Bobek (ed) *Selecting Europe's Judges: A Critical Review of the Appointment Procedures to the European Courts* (at 309).
[605] cf Potter *The use of 'Eurish' in Brussels confuses many* (28 May 2004) www.graydon.co.uk/blog/use-eurish-brussels-confuses-many
[606] In *Rompelman*, for example, the language of the case was Dutch.
[607] Derlén *Multilingual Interpretation of CJEU Case Law: Rule and Reality* (2014) 39 *European Law Review* 295 (at 315), cf Sankari *European Court of Justice Legal Reasoning in Context* (at 57).
[608] Arnull *The Working Language of the CJEU: Time for a Change?* (2018) 43 *European Law Review* 904 (at 911-914).
[609] Baaij *Legal Integration and Language Diversity* (at 65-66).
[610] Bencze *How to Measure the Quality of Judicial Reasoning* (at 231-232, 247).
[611] cf *CEC v Thorn Materials Supply Ltd* [1998] 3 All ER 342 (at 355).
[612] Sankari *European Court of Justice Legal Reasoning in Context* (at 62, 67).
[613] *Plaumann v Commission* [1964] CMLR 29 exemplifies.

preference for vague allusions'.[614] It is considered all but indecent to overrule an earlier decision,[615] and proper analysis of caselaw is avoided.

Other factors may contribute to this, including rotating chambers, lack of expertise and the growing complexity of references.[616] The overall result is often heuristically murky reasons. The fact that CJEU judgments traditionally involve short conclusory statements that go unlinked by reasons or analysis, also leads to the building of a certain existentialist atmosphere around what the court does and how it does it.

In the early days, the 'style was so gnomic that judgments could be impenetrable when read alone'.[617] Lewison J thought that 'discerning shifts in emphasis in successive decisions of the ECJ sometimes resembles the finer points of Kremlinology at the height of the Cold War'.[618] Mattias Derlén collects the various descriptions of others – 'famously opaque', 'superficial', 'cryptic', 'succinct', 'sibylline', 'laconic' 'magisterial', 'impersonal', 'stilted and awkward', 'Cartesian style'.[619]

Suvi Sankari observes that reading CJEU judgments 'is an act of interpretation in itself'.[620] The law is expressed as an inexorable declaration by anonymised judges. Neither dissent[621] nor appeal is permitted – the CJEU is a court of first and last resort.

A subtle and complex jurisprudence derived from treaty provisions regulates access to the CJEU.[622] To entertain the idea that a decision might be overturned, 'would look like a defect in the judicial process'.[623] Caselaw is read as if it was the text of the law itself. All this is in line with longer continental traditions. J Gillis Wetter said of the German style – 'Standing always unopposed by differing opinions of equal rank, a German judgment is a solid, conclusive and solemn *Staatsakt*'.[624] Judgments of Australian judges, by contrast, involve the opposite of almost all the above observations. Sir Anthony Mason, for example, has referred to the 'dense, grinding judicial style which is characteristic of typical High Court judgments'.[625]

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[614] Mancini & Keeling *Language, Culture and Politics in the Life of the European Court of Justice* (1995) 1 *Columbia Journal of European Law* 397 (at 402).
[615] *CNL Sucal v HAG GF* [1990] 3 CMLR 571 was the first occasion albeit obliquely.
[616] Sankari *European Court of Justice Legal Reasoning in Context* (at 31).
[617] Wright *The Language of the Law in Multilingual contexts – Unpicking the English of the EU Courts' Judgments* (2016) 37 *Statute Law Review* 156 (at 158).
[618] *CRC v Livewire Telecom Ltd* [2009] EWHC 15 (at [40]).
[619] Derlén *Multilingual Interpretation of CJEU Case Law: Rule and Reality* (2014) 39 *European Law Review* 295 (at 297-298).
[620] Sankari *European Court of Justice Legal Reasoning in Context* (at 33).
[621] Ruth Bader Ginsburg *Remarks on Writing Separately* (1990) 65 *Washington Law Review* 133 (at 146), Heydon *Threats to Judicial Independence: the Enemy Within* (2013) 129 *Law Quarterly Review* 205 (at 206).
[622] Terra *Methods of interpretation in European VAT* (2005) 5 AGSTJ 170 discusses, cf *Srl CILFIT v Ministry of Health* [1982] ECR 03415.
[623] Dashwood *The Advocate General in the Court of Justice of the European Communities* (1982) 2 *Fiscal Studies* 202 (at 213).
[624] Wetter *The Styles of Appellate Judicial Opinions* (at 26).
[625] Mason *Justice of the High Court* in McCormick & Saunders (eds) *Sir Ninian Stephen: A Tribute* 3 (at 5).

8.6 Role of Advocate General

Advocates General play an integral part in the work of the CJEU, and have done so since its inception as the Court of the European Coal and Steel Community.[626] Sometimes called the 'other voice in Luxembourg',[627] Advocates General are full members of the court,[628] but they are completely independent of and impartial to the judges. An Advocate General 'speaks for no one but himself'.[629]

Their task is threefold – to propose a solution to the case in question, to relate that solution to the general pattern of existing caselaw, and (where possible) to outline possible future development of that caselaw.[630] The office resembles the *commissaire du gouvernement* of the French courts in important respects, but their role is truly unique. Though their opinions may resemble a first instance decision which is subject to compulsory appeal,[631] the office of Advocate General 'cannot be compared to any judicial or legal being in the common law world'.[632]

The Advocate General is said to act as a 'legal representative of the public interest',[633] or as spokesman for the law and justice.[634] One writer referred to a dialectic between judgment and opinion, and between collegiality and individualism.[635] Another said there was an 'organic and functional link' between Advocates General and the CJEU.[636]

As law generalists, they were originally involved in all cases coming before the court. Now they sit in around 47% of CJEU cases, with their views being 'followed' about 70% of the time. Their opinions are not negotiated in any way and are published with the CJEU judgment in the case. These opinions form an integral part of the *acquis jurisprudentiel* and have authority in their own right.[637]

Appointed in 1953, Maurice Lagrange and Karl Roemer were the first two Advocates General, the former being regarded as the founder of the office. In his very first opinion, Lagrange pressed for a teleological approach to interpretation of EU law, a move which has proved enduring.[638] When later Advocates General Jacobs and Warner took a stricter approach to regulations, for example, the CJEU disagreed and applied the teleology of

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[626] Coincidentally, this was around the same time that France imposed its upgraded TVA – 1954.
[627] Derlén *Multilingual Interpretation of CJEU Case Law: Rule and Reality* (2014) 39 *European Law Review* 295 (at 305).
[628] *Vermeulen v Belgium* (2001) 32 EHRR 15 (at [31]), Craig & De Búrca *EU Law: Text, Cases, and Materials* (at 62).
[629] Dashwood *The Advocate General in the Court of Justice of the European Communities* (1982) 2 *Fiscal Studies* 202 (at 207).
[630] Lasok & Bridge *An Introduction to the Law and Institutions of the European Communities* (at 159).
[631] Borgsmidt *The Advocate General at the European Court of Justice: A Comparative Study* (1988) 13 *European Law Review* 106 (at 107).
[632] Burrows & Greaves *The Advocate General and EC Law* (at 3), citing Fennelly *Reflections of an Irish Advocate General* [1996] *Irish Journal of European Law* 5.
[633] Chalmers, Hadjiemmanuil, Monti & Tomkins *European Union Law* (at 123).
[634] Lasok & Bridge *An Introduction to the Law and Institutions of the European Communities* (at 159).
[635] Dashwood *The Advocate General in the Court of Justice of the European Communities* (1982) 2 *Fiscal Studies* 202 (at 216).
[636] Ryland *The Advocate General; Adversarial Procedure; Accession to the ECHR* [2016] *European Human Rights Law Review* 169 (at 174)
[637] Tridimas *The Role of the AG in the Development of Community Law: Some Reflections* [1997] *Common Market Law Review* 1349 (at 1385).
[638] *France v High Authority* [1954-1956] ECR 1 (at [26]).

Legrange.[639] His solutions to problems were invariably systemic, coherent and principles-based.[640] This is illustrated by Legrange's framing the pivotal rule that community law must prevail over national law,[641] with its requirement that a 'unity of interpretation' should be applied within each system.

In their 2007 book – *The Advocate General and EC Law* – Professors Burrows and Greaves trace the origins of the office, consider the careers and influence of selected Advocates General, and look at the role they have played in important areas of EU law. There is a substantial literature aimed at testing in various ways (including by econometric analysis) just how effective Advocates General have been in meeting their treaty obligation to assist the CJEU.[642] One study concludes that Advocates General are not 'cause lawyers', display no 'crusader zeal', and have no wider agenda. Activism is said to be 'not endemic' among them.[643]

8.7 Activism and coherence

Some views mentioned above may reflect a particularly Anglo-centric conception of EU judicial method, and it would be misleading not to acknowledge that other views are held. David Edward, himself a former CJEU judge, says that the court's role 'cannot be confined to that of providing a technocratic literal interpretation of texts produced by others', and that the judge must proceed 'to make the legal system consistent, coherent, workable and effective'.[644] Sturgis and Chubb in *Judging the World* describe this as the court 'having to take up the social slack and making the law march with the times'.[645]

The legal pluralism of the European Union, for one thing, appears to push things in this direction. Judge Edward vigorously defends the CJEU against charges of activism and wondered if he was 'on the same planet as some of the commentators'. By contrast, Edward J sees 'only a group of judges from different countries seeking to find acceptable legal solutions to practical legal problems'.[646] Having 'recently returned from a spell in Luxembourg' as Advocate General, Sir Gordon Slynn made similar points in his *They Call It 'Teleological'* article.[647] For him, teleological methods presented no alien threat, and the creativity of the Europeans was 'exaggerated'.

Leonor Soriano, writing in the journal *Ratio Regis*, defends European judicial method on the basis of coherence theory.[648] The CJEU, in her view, 'rightly refers to authority reasons and substantive reasons; values and principles'. Indeed, she says (at 298) that

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[639] *Davidoff & Cie SA v Gofkid Ltd* [2003] ECR I-389 (at [24]), *Camera Care Ltd v Commission* [1980] ECR 119.
[640] Burrows & Greaves *The Advocate General and EC Law* (at 59-88).
[641] *Costa v ENEL* [1964] ECR 585.
[642] Arrebola, Mauricio & Portilla *An Economic Analysis of the Influence of the Advocate General on the Court of Justice of the European Union* (2016) 5 *Cambridge Journal of International & Comparative Law* 82 illustrates.
[643] Solanke *'Stop the ECJ'?: An Empirical Analysis of Activism at the Court* (2011) 17 *European Law Journal* 764 (at 783).
[644] Edward *Judicial Activism; Myth or Reality?* in Campbell & Voyatzi (eds) *Legal Reasoning and Judicial Interpretation in European Law* (at 66).
[645] Sturgess & Chubb *Judging the World; Law and Politics in the World's Leading Courts* (at 112).
[646] Quoted in Sankari *European Court of Justice Legal Reasoning in Context* (at 54).
[647] Slynn *They Call It Teleological* (1992) 7 *Denning Law Journal* 225 (at 231), cf Brittain *Justifying the Teleological Methodology of the European Court of Justice: A Rebuttal* (2016) 55 *The Irish Jurist* 134.
[648] Soriano *A Modest Notion of Coherence in Legal Reasoning – A Model for the European Court of Justice* (2003) 16 *Ratio Juris* 296.

'many of the accusations of judicial activism addressed to the court are founded on a poor understanding of the content of legal reasoning and, in particular, of the role of coherence in the legal system and legal reasoning'.

It is the coherence between different kinds of reasons within a judgment which are important for Soriano, rather than the objective content of the reasons themselves. Internal coherence of judgments, therefore, is valued above external consistency. We might call this the 'good story' approach to the evaluation of judicial outputs. A similar viewpoint is that the CJEU is not really activist in its behaviour, but rather the court acts in an 'entrepreneurial' manner.[649]

A further appraisal of EU interpretation comes from Giulio Itzcovich in the *German Law Journal*.[650] The author categorises the criteria applied as linguistic, systemic and dynamic. So far as the first is concerned, ordinary meaning is seldom conclusive, never binding and often overridden. Plain meaning may also be something of an illusion when EU legislation is drafted in several languages,[651] especially where the different versions are to be treated as 'equally authentic'.[652] Literalism in a sense gets lost in translation.

One reason advanced for a teleological approach is elimination any misunderstandings that may arise between different EU languages.[653] This was one rationale given for the decision - *Skatteverket v Hedqvist* - that bitcoin is 'currency' for VAT purposes.[654] Where there are linguistic differences, it is explained, the answer cannot be determined on a basis that is 'exclusively textual'. Regard must always be had, says Itzcovich, to the aims and scheme of VAT.[655]

8.8 Technical regulation and VAT

There are mixed observations about whether the extreme kind of teleological approach described above is applied with full vigour in VAT situations. Some suggest that this is indeed what happens in practice.[656] Roderick Cordara, for example, has commented that 'European judges have made great use of the scope for creativity afforded to them by the open texture of the Directives'.[657] The imposition of *de facto* sanctions in *Halifax* is seen by Bobek as an example of 'sweeping purposive reasoning', for example.[658]

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[649] Solanke *'Stop the ECJ'?: An Empirical Analysis of Activism at the Court* (2011) 17 *European Law Journal* 764 (at 784).
[650] Itzcovich *The Interpretation of Community Law by the European Court of Justice* (2009) 10 *German Law Journal* 537.
[651] *CILFIT Srl v Ministero della Sanita* [1983] 1 CMLR 472 (at [18-19]), Duxbury *Elements of Legislation* (at 208).
[652] *National Smokeless Fuels Limited v IRC* [1986] STC 300 (at 308), cf Davis *Notes of Cases* [1986] *British Tax Review* 228 (at 232).
[653] Harasic *More About Teleological Argumentation in Law* (2015) 31 *Pravni Vjesnik* 23 (at 43).
[654] *Skatteverket v Hedqvist* [2014] Case C-264/14 (at [45]), cf Koulu *Blockchains & Online Dispute Resolution* (2016) 13 scripted 40 (at 51), Isakov *Australia's tumultuous road towards taxation of digital currencies* (2017) 17 AGSTJ 145.
[655] *Velvet & Steel Immobilien v Finanzamt Hamburg-Eimshuttel* [2007] Case C-455/05 (at [20]), *Commission v Spain* [2013] Case C-189/11 (at [56]).
[656] Farmer & Lyal *EC Tax Law* (at 89), James *VAT/GST: the UK Experience Revisited* (2000) 10 *Revenue Law Journal* 72 (at 84).
[657] Cordara *The Sixth VAT Directive and Key Legal Issues under VAT in Europe* (at 27).
[658] Bobek *The Legal Reasoning of the Court of Justice in the EU* (2014) 39 *European Law Review* 418 (at 425) citing *Halifax plc v CEC* [2006] ECR I-1609 (at [86]).

This was 'embraced with a passion', it might be added, Advocate General Bobek recently saying that it constitutes a notable exception to the rule that tax authorities 'do not fall in love easily'.[659] From early times, however, the CJEU has sanctioned a widely contextual approach to VAT law, applying the 'general system of value added tax as laid down in the Directive' to the meaning of particular provisions.[660] Professor Terra has pointed out that the 'teleological interpretation method is applied by the CJEU in many cases, often referring to the preamble of the Sixth VAT Directive'.[661] Other factors considered by the judges in this respect include the 'state of evolution of EU law' and the degree of VAT harmonisation.

Gunnar Beck, however, says it is rare in VAT situations for the CJEU to reach a conclusion 'based solely or primarily on teleological criteria at odds with a literal reading'.[662] VAT exemptions, certainly, are expected to be construed in a strict manner[663] though not always.[664] Neither are they to be approached acontextually or without reference to 'systematic and teleological criteria'. The rationale for strictness in this regard is that exemptions are exceptions to the fundamental principle that VAT is to be levied 'on all services supplied for consideration by a taxable person'.[665]

As Advocate General Jacobs explained in *Abbey National*, exemptions form a 'potentially serious departure from the principle on which VAT is levied in that a chain of supplies may be broken in this matter at more than one point, with a concomitant repetition of cumulative taxation'[666] (also called 'cascading'). Some of the CJEU neutrality cases discussed below certainly do suggest application of a broad teleological approach, though not always. The point to make is that, while teleological methods dominate treaty interpretation, they also intrude into regulatory areas like VAT.

8.9 Economics over law

In their 2009 article – *EU VAT and the Rule of Economics* – John Watson & Kate Garcia stake out their view that the 'jurisprudence relating to the VAT system contrasts starkly with the traditions of British tax law'.[667] In their estimation, the CJEU follows a more economic approach even ignoring the legal provisions while UK courts 'closely follow the provisions of the VAT Act'. EU methods extend well beyond the kind of purposivism available in Britain. As the authors explain, the economic principles on which the VAT system are based 'take precedence over the legal provisions', the Sixth Directive being 'merely the mechanism through which the economic structure of VAT

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[659] *Cussens, Jennings, Kingston v Brosnan* [2017] Case C-251/16 (at [1]).
[660] *Staatssecretaris van Financiën v Hong-Kong Trade Development Council* [1982] ECR 01277 (at [6-7]).
[661] Terra *Methods of interpretation in European VAT* (2005) 5 AGSTJ 170.
[662] Beck *Judicial Activism in the Court of Justice of the EU* (2017) 36 *University of Queensland Law Journal* 333 (at 341, 352)
[663] *Bakati Plus v Nemzeti Adó-és Vámhivatal Fellebbviteli Igazgatósága* [2020] EUECJ C-656/19 (at [23]), *SAE Education Ltd v RCC* [2019] UKSC 14 (at [42]), *Bulthuis-Griffioen v Inspecteur der Omzetbelasting* [1995] EUECJ C-453/93 (at [19]), *Blasi v Finanzamt München* [1998] EUECJ C-346/95 (at [18]), *Försäkringsaktiebolaget Skandia* [2001] EUECJ C-240/99 (at [32]), cf Tervoort *Interpretation methods of the CJEU and the meaning of the principle of fiscal neutrality* [2015] *World Journal of VAT/GST Law* 110.
[664] *Canterbury Hockey Club v CRC* [2008] EUECJ C-253/07 (at [41]) illustrates, cf *Wiener* [1997] ECR I-6495 (at [65]), *United Biscuits (Pensions Trustees) Ltd v CRC* [2020] EUECJ C-235/19 (at [36-38]).
[665] *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën* [1989] EUECJ C-348/87 (at [13]).
[666] *Abbey National plc v CEC* [2001] 1 WLR 769 (at [32]).
[667] Watson & Garcia *EU VAT and the Rule of Economics* [2009] *International VAT Monitor* 190 (at 190).

is delivered'. Directives are not some 'sacred text', and neutrality examples are given where economics is seen most clearly to rule over the law.[668] One Advocate General appears to have accepted that the CJEU had become a 'one-sided economic court'.[669]

The CJEU, Watson & Garcia go on, 'clearly recognises that the legal provisions of the VAT Directives are subservient to the conceptual structure of the tax'. Referring to *Elida Gibbs*, they say that the CJEU 'rode roughshod over the arguments that the detailed provisions of the Sixth Directive could not deliver them'. Further (at 191), Watson & Garcia say – 'Where the detailed provisions of the directives do not deliver the economics or do not follow the principles of the First Directive, they are ruthlessly corrected by the [CJEU]'.[670] In their later article – *Babylonian Confusion* – the same authors say that 'it would be nothing new for the ECJ to override the exact wording of the Directive in order to achieve a rational result'.[671]

These comments continue a steady theme about interpretation of euro-law by the CJEU. In a sense, that court 'translates' background economic values into legal outcomes, and is expected to. Perhaps this was the idea Hill J was getting at all along in his final communiqué on GST matters – *To interpret or translate?*

9. EUROPEAN LAW IN BRITAIN

9.1 EU law prevails

Britain legislated for a value-added tax in 1973 after repeal of the *Purchase Tax* and the ill-fated *Selective Employment Tax*. Professor Neil Warren, in an early *Revenue Law Journal* article, sets out the historical background to these developments.[672] UK courts in their application of European law, including VAT law, came 'under a duty to follow the practice of the European Court'.[673] This is a direct outcome of the *European Communities Act 1972*, a statute which is to be repealed when Brexit happens.[674]

In his *Lord Fletcher Lecture* given in 1979, Lord Denning said that the 'flowing tide of Community law is coming in fast', adding that it 'has submerged the surrounding land, so much so that we have to learn to be amphibious if we wish to keep our heads above water'.[675] Later, Denning re-expressed this notion in more judicial terms[676] –

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[668] *Intercommunale voor Zeewaterontzilting v Belgische Staat* [1996] Case C-110/94, *Securenta Göttinger Immobilienanlagen* [2008] EUECJ C-437/06.
[669] Bobek *The Legal Reasoning of the Court of Justice in the EU* (2014) 39 *European Law Review* 418 (at 427).
[670] cf Craig & Búrca *EU Law Text, Cases, and Materials* (at 74).
[671] Watson & Garcia *Babylonian Confusion Following ECJ's Decision on Loyalty Rewards* [2011] *International VAT Monitor* 12 (at 15).
[672] Warren *The UK Experience with VAT* (1993) 3 *Revenue Law Journal* 75 (at 76), cf Reddaway *Effects of the Selective Employment Tax*.
[673] *Lister v Forth Dry Dock & Engineering Co Ltd* [1990] 1 AC 546 (at 558).
[674] *R (Miller) v Secretary of State for Exiting the European Union* [2017] UKSC 5, Jones *Brexit and the Future of British Law* (2018) 49 *Victoria University of Wellington Law Review* 1, Basten *Statute, the Common Law and 'Brexit'* (2017) 91 *Australian Law Journal* 414.
[675] Quoted in Slynn *They Call It Teleological* (1992) 7 *Denning Law Journal* 225 (at 243), cf Lord Wilberforce interviewed in Sturgess & Chubb *Judging the World; Law and Politics in the World's Leading Courts* (at 276).
[676] *Macarthys Ltd v Smith* [1981] QB 180 (at 200), cf *Pham v Secretary of State for the Home Department* [2015] 1 WLR 1591 (at [80]).

> Community law is now part of our law; and whenever there is any inconsistency, Community law has priority. It is not supplanting English law. It is part of our law which overrides any other part which is inconsistent with it …

The law on VAT in the UK is now found in the *Value Added Tax Act 1994* which is 'intended to reflect the provisions of certain EC Directives'.[677] As *Halsbury's Laws of England* explains, 'there is a need to have constant reference to the Sixth Directive and to the various decisions of the ECJ in relation to VAT and allied topics in order properly to interpret and apply the domestic legislation'.[678] If EU law applies directly, national legislation in conflict must give way and be 'disapplied' under supremacy principles.[679] As a result, lower courts must defy domestic precedent 'where this is necessary to apply European law correctly'.[680] They must overlook their own 'black letter law' and give effect to the policy outcomes of EU Directives.[681]

'No longer do the hallowed principles of UK construction apply', as one writer put it.[682] Courts are also 'not to be bound by any strict or literal interpretation' it was said.[683] One difficult issue which also arises is whether, on disapplying inconsistent domestic UK law, a national court can or must act to fill a 'gap in the legislation'[684] in circumstances wider than otherwise permitted under the common law principles.[685] UK courts 'are obliged to take judicial notice not only of decisions of the ECJ or any court attached to it, but also any expression of opinion by such a court on any question of the meaning or effect of any Community instrument'.[686]

9.2 Europeanization

In the early case of *Haydon-Baillie*, the VAT Tribunal took the view that, where the wording of the UK statute 'echoes the intent of the Sixth Directive', there is no further room for reliance on the directive because the 'statute supersedes it'.[687] The tribunal quoted Nolan J in *Yoga for Health* as follows[688] –

> I accept that I must do my best to adopt a European as distinct from a traditionally English approach to the question of construction, but by that I

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[677] *Airtours Holidays Transport Limited v CRC* [2016] UKSC 21 (at [11]).
[678] *Halsbury's Laws of England* 49(1) Fourth Edition Reissue (at [2-3]), cf Duxbury *Elements of Legislation* (at 231-232).
[679] *Ex parte Factortame Ltd (No 2)* [1991] 1 AC 603 (at 659), *Ex parte Equal Opportunities Commission* [1995] 1 AC 1 (at 27).
[680] *Sub One Limited v CRC* [2012] UKUT 34 (at [16]), citing *Åklagaren v Åkerberg Fransson* [2012] Case C-617/10 (at [112]).
[681] James, Jeffrey & Miller *Apportionment Principles – Part I* (2004) 4 AGSTJ 10 (at 12).
[682] *R v V* [2011] EWCA Crim 2342 (at [19]), *R (Highbury Poultry Farm Produce Ltd) v Crown Prosecution Service* [2020] UKSC 39 (at [25-27]), Davis *Notes of Cases* [1986] *British Tax Review* 228 (at 230), cf *Garland v British Rail Engineering Limited* [1983] 2 AC 751 (at 771).
[683] *Institute of Chartered Accountants in England and Wales v CEC* [1998] 4 All ER 115 (at 123), cf *Healthspan Ltd v CRC* [2018] UKFTT 241 (at [257]), *R v Henn* [1980] 2 All ER 166 (at 196).
[684] *Fleming v RCC* [2008] 1 All ER 1061 illustrates.
[685] *Inco Europe Limited v First Choice Distribution* [2000] 1 WLR 586 (at 592), *Wentworth Securities Limited v Jones* [1980] AC 74 (at 105-106).
[686] cf *Marleasing SA v La Comercial Internacional de Alimentación SA* [1993] BCC 421 (at [8]).
[687] *Haydon-Baillie v CCE* [1986] CMLR 74 (at 79), cf *Pfeiffer v Deutsches Rotes Kreuz Kreiverband Waldshut eV* [2004] ECR I-8835 (at [16]).
[688] *Yoga for Health Foundation v CEC* [1984] STC 630 (at 634).

> think little more is meant than that I should adopt what is often called a purposive or sometimes a teleological method of construction …

Yoga for Health is also quoted for the proposition that, whatever was the EU norm, the filling of 'a gap in an exempting provision of a fiscal measure' was a matter for the legislature and not judges.[689] In other words, UK courts are to continue to apply basic domestic principle in this regard. Another case puts it in terms of applying directives 'if that can be done without distorting the meaning of the domestic legislation.[690] John Tiley wrote that 'we have two sharply different traditions of interpretation operating side by side in one tax system'.[691]

The ground was shifting, however, towards greater acceptance of Euro-style methods. In 1993, it was said in *Pepper v Hart* that courts 'now adopt a purposive approach' to interpretation.[692] Speaking on interactions between legislative style and interpretation techniques, Malcolm Gammie QC perceptively said[693] –

> This chicken-and-egg situation may yet be resolved by the European cuckoo: as the influence of the European Union on our legislation grows, the different traditions of European law may force us to change our ways, to accept a greater use of statements of principle and to adopt a different interpretative approach.

By and large, this appears to have happened in practice. By 1999, there was 'clear evidence' that UK courts were applying a different approach.[694] Lord Bingham spoke about the obligation to give effect to the purpose of parliament and to avoid 'undue concentration on the minutiae'.[695] In the *Assange* case, Lord Mance said domestic courts had gone far beyond their conventional rules of interpretation.[696] In this regard, he later remarked that 'UK courts may have been more catholic than the Pope'.[697]

Martin Brenncke explains that national courts in practice apply a 'hybrid methodology' to EU legislation resulting in 'Europeanization from the inside'.[698] EU techniques converge with and modify domestic principles, something which often results in a 'spill over' of interpretive tools into the domestic system.[699] The outcome is what Brenncke calls 'interlegality' – the blending of elements from different legal orders. Describing the same idea, John Tiley spoke of an 'approximation of methods'.[700]

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[689] *Expert Witness Institute v CEC* [2001] 1 WLR 1658 (at 1662).
[690] *Webb v EMO Air Cargo (UK) Ltd* [1992] 4 All ER 929 (at 939).
[691] Tiley *The Law of Taxation in a European Environment* (1992) 51/3 *Cambridge Law Journal* 451.
[692] *Pepper v Hart* [1993] AC 593 (at 617).
[693] Gammie *Legislation for business: is it fit for public consumption?* (1994) 3 *Fiscal Studies* 129 (at 138).
[694] Lee *A Purposive Approach to the Interpretation of Tax Statutes?* (1999) 20 *Statute Law Review* 124 (at 132).
[695] *R (Quintaville) v Secretary of State for Health* [2003] UKHL 13 (at [8]).
[696] *Assange v Swedish Prosecution Authority* [2012] UKSC 22 (at [203]).
[697] Mance *The interface between national and European law* (2013) 38 *European Law Review* 437 (at 450).
[698] Brenncke *Hybrid Methodology for the EU Principle of Consistent Interpretation* (2018) 39 *Statute Law Review* 134.
[699] Jacobs *Judicial Dialogue and the Cross-Fertilization of Legal Systems: The European Court of Justice* (2003) 38 *Texas International Law Journal* 547 (at 549-550).
[700] Tiley *The Law of Taxation in a European Environment* (1992) 51 *Cambridge Law Journal* 451 (at 466).

9.3 Fiscal theme park

The English judge Sedley LJ once commented (colourfully) that, 'beyond the everyday world', lies the world of VAT, a 'kind of fiscal theme park in which factual and legal realities are suspended or inverted'.[701] This description, made nearly two decades ago, is still being repeated in the First Tier Tribunal.[702] Sedley LJ (at [58]) described going through a 'hermeneutic turnstile' into 'this complex parallel universe' where 'relatively uncomplicated solutions are a snare and a delusion'. Another judge referred to the 'mystic twilight of VAT legislation'.[703] Lord Hope in *Svenska* called-out the 'make-believe world of VAT' where the statutory scheme does not always follow the real world and the guiding principle is neutrality'.[704]

As Roderick Cordara has explained, these various comments are no accident. They express, he says, genuine difficulties 'in coming to terms with a tax that is based on an unfamiliar system of economic policies and has its genesis in civil law thinking and analysis'.[705] In his view, VAT 'is a more political tax than most' and a 'mechanism with an avowedly economic and political agenda'.[706] National courts and the CJEU have been described as being in an 'unenviable position' in this regard.[707]

While technical laws like VAT may not attract the same degree of teleology as do treaty matters, the comments above do suggest the kind of alien legal landscape that teleological interpretation is apt to create. Others may see things in a different light. John Avery Jones, for example, provides a somewhat more sympathetic assessment.[708]

9.4 Brexit and the law

It is not in dispute that the influence of the EU on legal thinking within the UK, and development of the law there, has been profound by any measure. The interaction and exposure to new ways (including teleological interpretation) 'has resulted in a mutual exchange of ideas which has been described as a kind of osmosis between legal systems or the downloading and uploading of legal principles'.[709]

Subjugation of UK law to the European teleos, however, has been an important driver from the start in the Brexit debate under the populist catchcry 'take back control'. The Lord Chancellor even called the CJEU a 'rogue court' in a Brexit rally at Stratford-on-Avon in 2016.[710] Courts in Europe and Britain agree, however, that UK sovereignty has

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[701] *Royal & Sun Alliance Insurance Group plc v CEC* [2001] STC 1476 (at [54]), cf *ACN 154 520 199 Pty Ltd v FCT* [2019] AATA 5981 (at [1]) 'fiscal alchemy'.
[702] *Virgin Media Ltd v CRC* [2018] UKFTT 556 (at [113]) for example.
[703] *Card Protection Plan v CEC* [1994] STC 199 (at 209), cf *Talacre Beach Caravan Sales Ltd v CCE* [2004] EWHC 165 (at [11]), *Byrom, Kane & Kane v CRC* [2006] EWHC 111 (at [22]), *McCarthy & Stones (Developments) Ltd v CRC* [2013] UKFTT 727 (at [38]).
[704] *CCE v Svenska International plc* [1999] STC 406 (at 416).
[705] Cordara *GST – History, Experience and Future* [2007] *Federal Court Judges Workshop* paper (at [5-7]).
[706] Cordara *The Sixth VAT Directive and Key Legal Issues under VAT in Europe* (at 3).
[707] Joseph *The Vexed Question of Deductibility* [2006] *International VAT Monitor* 191 (at 191).
[708] John Avery Jones *Tax Law: Rules or Principles?* (1996) 17 *Fiscal Studies* 63 (at 81-88).
[709] Jones *Brexit and the Future of British Law* (2018) 49 *Victoria University of Wellington Law Review* 1 (at 20).
[710] Arnull *The Working Language of the CJEU: Time for a Change?* (2018) 43 *European Law Review* 904 (at 909).

been compromised by EU membership.[711] A 'sovereignty clause' was once suggested 'to put the matter beyond speculation'.[712] It is the Brexit case – the so-called 'constitutional case of the century' – however, which settles these issues and explains the true legal impact of EU laws in Britain.

The majority in the Brexit case said (at [65]) that, although the *European Communities Act 1972* gives effect to EU law, it is not the source of that law. It is the 'conduit pipe' by which EU law is introduced into UK domestic law, and 'its effect is to constitute EU law an independent and overriding source of domestic law'. Crucially, the Supreme Court then held (at [67]) that, while EU prevails over inconsistent UK law, the constitutional status of EU law can be changed by the UK parliament.[713] One commentator called this a 'flat contradiction' of the CJEU position that national courts cannot disapply or invalidate EU law.[714] In other words, held the Supreme Court, the UK must disapply domestic law inconsistent with EU law, but it may nevertheless legislate to remove the enhanced constitutional status that EU law now enjoys in Britain.

Under the *European Union (Withdrawal) Act 2018*, the *acquis* of EU legislation applying in the UK (including VAT Directives), called 'retained EU law', will form part of domestic UK law on 'exit day'.[715] This vast legislative corpus will then be subject to progressive rationalisation via formal amendment and repeal.[716]

As was pointed out in the Brexit case (at [80]) '… those legal rules derived from EU law and transposed into UK law by domestic legislation … will no longer be paramount, but will be open to domestic repeal or amendment in ways that may be inconsistent with EU law'. Lord Lloyd-Jones read the original Bill as preserving the authority of EU interpretation principles in relation to the domestic *acquis*.[717]

This appears now to be made secure by s 6 of the withdrawal legislation. This means Brexit itself may not make much difference to the VAT regime now operating in the UK – deal or no deal. EU neutrality, together with the EU cases and the way it is to be understood, is extended indefinitely. So much for 'take back control'. The Supreme Court later struck down the prorogation of parliament by Boris Johnson in a somewhat surprising decision which may yet come back to haunt the UK judiciary.[718]

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[711] *NV Algemene Transport v Nederlandse Tarief Commissie* [1963] ECR 1 (at 11), *Re a Draft Treaty on a European Economic Area* [1991] ECR I-6079 (at [21]), *Costa v ENEL* [1964] ECR 585, *Trent-on-Stoke City Council v B & Q plc* [1991] Ch 48 (at 56).

[712] Glancey *A 'sovereignty' clause for the UK – essential Act, empty words or hidden agenda?* [2011] 1 *Web Journal of Current Legal Issues* 1, cf *Jackson v Attorney-General* [2005] UKHL 56 (at [104]).

[713] Discussed – Gummow *The 2017 Winterton Lecture: Sir Owen Dixon Today* (2018) 43 *University of Western Australia Law Review* 30 (at 37).

[714] Phillipson *EU Law as an Agent of National Constitutional Change: Miller v Secretary of State for Exiting the European Union* (2017) 36 *Yearbook of European Law* 46 (at 75), Phillipson *Brexit, Prerogative and the Courts: Why did Political Constitutionalists support the Government side in Miller?* (2017) 36 *University of Queensland Law Journal* 31 (at 328), cf *Costa v ENEL* [1964] ECR 585 (at 593).

[715] s 3(1) of the *European Union (Withdrawal) Act 2018*.

[716] It has been estimated that around 186 statutes and 7900 statutory instruments currently implement EU law in England alone.

[717] Jones *Brexit and the Future of British Law* (2018) 49 *Victoria University of Wellington Law Review* 1 (at 19).

[718] *R (Miller) v Prime Minister* [2019] UKSC 41, cf Lindsay *The Exercise of Prerogative Powers and their Political Outcome* (2019) 4 *Perth International Law Journal* 63 (at 78-79).

Finally, in a VAT case decided early in 2020, it was common ground of the parties before the Supreme Court that, at that stage in the UK's withdrawal from the EU, cases involving unclear issues of European law must be referred to the CJEU for resolution.[719] That referral was duly made by the Supreme Court.[720]

10. EU NEUTRALITY CASES

There is a seemingly endless matrix of cases about EU neutrality in the *Rompelman* sense and its derivatives. Any attempt at a comprehensive survey of the field can only end in a book. For present purposes, it is enough to understand where the principle comes from, to get some appreciation about its evolution, the manner in which it is interpreted, the role it plays within the EU legal structure, and how it is applied in practice by the CJEU within the EU. Some feeling for these matters is desirable when seeking to evaluate whether EU neutrality might have already become a 'foreign ghost in our GST machine'. With this in mind, ten EU neutrality cases are reviewed, some of which are also dealt with by Dr Grube in her 2017 paper.[721] They may not always be the most important decisions, but they draw out many of the major themes.

10.1 *Rompelman* - 1985

Key VAT principle

The classic statement of neutrality, applied verbatim too many times to mention and the one which this note adopts as authoritative, comes from the ECJ judgment in a preparatory activities case, *Rompelman v Minister van Financiën*.[722] The Rompelmans bought two units in premises under construction in Amsterdam. They were marked as 'showrooms' on the plan, and the intention was to later lease them to traders.

In a short opinion, Advocate General Slynn did not mention 'neutrality' by name, nor did he derive any concept of that kind in order to resolve the issues.[723] For him the question was simply whether the Rompelmans were taxable persons in circumstances where they were seeking to deduct input tax on a *future* taxable transaction.

Slynn reasoned that acquisition of the means of carrying out an economic activity is the first act in performing that activity, and that this made the Rompelmans taxable persons. He accepted, however, that there must be evidence to establish the intended use asserted. The Advocate General referred to no decided cases, nor is there any wider analysis for his conclusion. In this regard, he is obedient to prevailing style.

The CJEU comprising three judges saw the key issues as being timing and credit access. Before addressing the technical questions, the court recalled the 'elements and characteristics of the VAT system'. The earlier case of *Schul v Inspecteur* was cited (at [16]) for a basic proposition that there is to be charging of tax 'only after the deduction of the amount of the VAT borne directly by the cost of the various components of the price of the goods and services and that the deduction procedure is so designed that only taxable persons may deduct the VAT already charged on the goods and services from

[719] *Overseas Decisions Bulletin* [2002] 17:2.
[720] *Zipvit Ltd v CRC* [2020] UKSC 15 (at [42]).
[721] Grube *Neutrality and input tax deductibility* (2017) 17 AGSTJ 8.
[722] *Rompelman v Minister van Financiën* [1985] ECR 655.
[723] Opinion of Advocate General Sir Gordon Slynn dated 15 November 1984 in Case 268/83.

the VAT for which they are liable'.[724] Article 17(1) of the *Sixth Directive* said that the 'right to deduct shall arise at the time when the deductible tax becomes chargeable'. From these sources, the CJEU (at [19]) stated as follows –

> … the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of the valued added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way.

A number of features emerge from this short statement. First, it is a positive purpose of the provisions involved to produce the effect it describes. Second, it is the trader as the taxable person who is the focus of the measure. Third, it is that person who is to be relieved of a tax burden that would otherwise apply. Fourth, the burden in question is to be relieved entirely – not partly and not provisionally, but 'entirely'. Fifth, the relief is to apply universally across all economic activities, provided only that the purpose or results of those activities are themselves subject to the tax. Later cases have added myriad nuances of emphasis to these elements, but the original *Rompelman* formulation still captures the essence and impact of the neutrality principle.

Failure to honour *Rompelman* would burden the trader with the cost of VAT in the course of the economic activity carried on, and would create an 'arbitrary distinction' between preparatory and later costs.[725] This principle is well-illustrated by *Ryanair Ltd*, where input tax deduction was allowed on preparatory acts of a company forming part of a proposed acquisition of shares with the intention of pursuing an economic activity consisting in management of the second company by providing services to that company.[726] Where the purpose of an acquisition changes from non-taxable to taxable, neutrality demands deduction.[727]

What can be said about the style of interpretation applied in *Rompelman* by the court? The first thing is that it reflects the teleological approach of the CJEU generally, and of Maurice Lagrange in particular. The second is that the manner and substance of its derivation of the answer very much illustrates the economic aspects of its influence. That said, the classic statement from *Rompelman* itself is not to be characterised as the brute domination of economics over law. It might rather be seen more as a pragmatic partnership of economics and law.

However, in its later wider application and in its diverse leverage over the VAT system, *Rompelman* neutrality at times exhibits both high teleology and apparent rule of economics over law. Although the CJEU says that neutrality is a principle of interpretation and 'not a rule of primary law', and that it cannot 'be extended in the face of an unambiguous provision of the Sixth Directive',[728] the practical and historical record of its application suggests at times a rather different and more qualified story.

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[724] *Schull v Inspecteur der Invoerrechten en Accijnzen* [1982] ECR 1409.
[725] *Intercommunale voor Zeewaterontzilting v Belgische Staat* [1996] Case C-110/94.
[726] *Ryanair Ltd v Revenue Commissioners* [2018] EUECJ C-249/17.
[727] *Szef Krajowej Administracji Skarbowey v Gmina Ryjewo* [2018] EUECJ C-140/17 illustrates, cf *Sonaecom SGPS SA v Autoridade Tributária e Aduaneira* [2020] EUECJ C-42/19.
[728] *Finanzamt Saarlouis v Malburg* [2014] Case C-204/13 (at [43]) for example, cf Grube *Neutrality and input tax deductibility* (2017) 17 AGSTJ 8 (at 20).

10.2 *Elida Gibbs Ltd* - 1997

Dominance of neutrality

In this 'money-off coupon' case, *Elida Gibbs*, the CJEU explained that the 'basic principle of the VAT system is that it is intended to tax only the final consumer', so that the VAT collected 'cannot exceed the consideration actually paid by the final consumer'.[729] The outcome of the case has been controversial, has led to various problems, and is criticised.[730] On the issue of neutrality, the CJEU said –

> … that it was apparent from the First Council Directive … of 11 April 1967 on the harmonisation of the legislation of the member states concerning turnover tax that one of the principles on which the VAT system was based was neutrality, in the sense that within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain.

These are the comments to which Gzell J cross-referred in *TAB Limited*. The CJEU went on to say that, '[i]n order to guarantee complete neutrality of the machinery as far as taxable persons are concerned, the Sixth Directive provides, in Title XI, for a system of deductions designed to ensure that the taxable person is not improperly charged VAT'.[731] These comments emphasise elements derived in *Rompelman,* but that is not the end of the story. Watson and Garcia sum up *Elida Gibbs* by saying[732] –

> The lesson from *Elida Gibbs* is not that retailers can be left aside but that the ECJ will do everything it can to ensure neutrality at the cost of considerable violence to the mechanisms of the VAT Directive.

What these comments point to is precisely the kind of teleology and disregard of provisions that others assert. Whether or not they are accurate or it matters, as Cordara and Parisi point out, *Elida Gibbs* 'has withstood subsequent and sustained attacks, and was confirmed repeatedly in later cases under the Sixth Directive'.[733]

In *Zipvit Limited*, for example, *Elida Gibbs* was relied on for the proposition that 'it is only the final consumer at the end of a chain of supply who bears the burden of the tax, which is designed to operate with complete neutrality at each intermediate stage in the chain'.[734] This is no disagreement that this statement properly expresses in general terms what the neutrality principle requires in theory.

The point of contention, however, is with wider application of the principle in a situation where the detail of VAT provisions is all but disregarded. This is a common theme from various European commentators. What *Elida Gibbs* and its aftermath decisions tend to illustrate is the point made over and over again, both as criticism and as passive

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[729] *Elida Gibbs Ltd v CEC* [1997] QB 499 (at 560-561 [18-24]).
[730] Watson & Garcia *EU VAT and the Rule of Economics* [2009] *International VAT Monitor* 190 for example.
[731] *Gaston Schul Douane Expediteur BV v Inspecteur der Invoerrechten en Accijnzen* [1982] ECR 1409 (at 1426 [10]).
[732] Watson & Garcia *EU VAT and the Rule of Economics* [2009] *International VAT Monitor* 190 (at 193).
[733] Cordara & Parisi *Australian Goods and Services Tax Cases – Decisions and Commentary* (at [2.10.2]), *European Commission v Germany* [2002] Case C-427/98 (at [30]) quoted.
[734] *Zipvit Limited v CRC* [2018] EWCA Civ 1515 (at [46]), cf *Marcandi Limited v CRC* [2018] Case C-544/16 (at [93]).

statements of fact, that fiscal neutrality in practice confirms the rule of economic policy over the terms of the legislated law. That this continues is illustrated by the recent affirmation of *Elida Gibbs* by the CJEU in 2017 in the case of *Boehringer Ingelheim*.[735] In all these circumstances, the uncritical and unexplained quotation from *Elida Gibbs* by Gzell J in *TAB Limited* raises a series of questions.

10.3 *Kretztechnik AG* - 2005

Not to be limited

In this case, the CJEU held that credit access was available on certain capital raising costs of an Austrian manufacturer of medical equipment – *Kretztechnik AG v Finanzamt Linz*.[736] Issuing new shares was held by the court not to be an 'economic activity',[737] and hence there was no supply for consideration under applicable VAT provisions. However, share issue costs, because they were incurred for the benefit of the company's general economic activity, were to be considered as part of company overheads. Capital raising costs accordingly were held to be creditable by the CJEU to the extent that the company made taxable supplies.[738]

The CJEU in *Kretztechnik* stressed (at 3771) that the right of deduction 'is an integral part of the VAT scheme and in principle may not be limited'.[739] It must be exercised immediately in respect of all the taxes charged on transactions relating to inputs'.[740]

The court emphasised the theme from *Rompelman* about relieving the trader in question 'entirely' of the VAT burden. It made a further point of saying that the 'common system of VAT consequently ensures complete neutrality of taxation overall economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT'. A later case goes even further and says that the VAT system 'rests above all on the principle of fiscal neutrality'.[741]

Kretztechnik itself reversed earlier member state positions on the issue of capital raising, including *Mirror Group* in the UK.[742] In the latter case, it is ironic that a reference to the CJEU had been refused, 'the point being too obvious to trouble the [CJEU] with'.[743] In Australia, the ATO took the view that credits on capital raising costs are blocked.[744] Peter McMahon and Amrit MacIntyre said that it 'seems reasonably clear' that credits

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[735] *Finanzamt Bingen-Alzey v Boehringer Ingelheim Pharma GmbH & Co KG* [2017] Case C-317/94.
[736] *Kretztechnik AG v Finanzamt Linz* [2005] 1 WLR 3755.
[737] *Harnas & Helm CV v Staatssecretaris van Financiïn* [1997] ECR I-745 (at [15]), *KapHag Renditefonds 35 Spreecenter Berlin-Hellersdorf 3 Tranche GbR v Finanzamt Charlottenburg* [2003] ECR I-6851 (at [38, 40]), *Welcome Trust Ltd v CEC* [1996] ECR I-3013 (at 3041 [33]).
[738] *BLP Group plc v CEC* [1996] 1 WLR 174 (at 199 [25]), *Midland Bank plc v CEC* [2000] 1 WLR 2080 (at 2099-2100 [30]), *Abbey National plc v CEC* [2001] 1 WLR 769 (at 787 [35-36]), *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* [2001] ECR I-6663 (at 6692-6693 [31]), cf Cordara [2005] TIA National GST Intensive Conference paper (at 16-18).
[739] *Ecotrade SpA v Agenzia delle Entrate Ufficio di Genova 3* [2008] EUECJ C-95/07 (at [39]).
[740] *BP Supergas Anonimos Etairia Estatal Emporiki-Viomichaniki kai Antiprossopeion v Greek State* [1995] ECR I-1883 (at 1914 [18]), *Gabalfrisa SL v Agencia Estatal de Administración Tributaria* [2000] ECR I-1577 (at [43]).
[741] *CRC v Isle of Wight Council* [2008] EUECJ C-288/07 (at [16]).
[742] *Mirror Group Newspaper Ltd v CEC* [2000] STC 156, Esajas *The Issue of Shares* (1999) 10 *VAT Monitor* 159 (at 161-163).
[743] Cordara *Developments in UK and European Case Law* [2005] *TIA National GST Intensive Conference paper* (at 16).
[744] GSTR 2008/1 (at [184-187]).

would be denied.[745] Andrew Sommer and Jeffrey Lum concluded it was unlikely the precise outcome in *Kretztechnik* would be replicated in Australia.[746] This was because the costs in question were so clearly related to something which was an input taxed supply. So much appeared to follow from the words of Div 11.

Michael Evans, however, argued that the ATO was wrong in this regard and that a properly contextual approach to Div 11 confirms the correctness of *Kretztechnik* in Australia.[747] This case and others in the same area are discussed by Professor Terra in Chapter 8 of the *GST in Australia* book.[748] As the professor notes, it was the *Rompelman* principle which drove the ECJ decision. As the share issue costs were 'component parts of the price of its products', there was an entitlement to deduct. No part of the wider *Kretztechnik* history, however, permits the issue to be re-opened under the present terms of Div 11, in my view, at least. *Kretztechnik* and *Rompelman* were applied recently by the UK Supreme Court in *Frank A Smart*, a case about input tax deduction incurred in purchasing entitlements to an EU farm subsidy.[749] The court said (at [65]) –

> As VAT is a tax on the value added by the taxable person, the VAT system relieves the taxable person of the burden of VAT payable or paid in the course of that person's economic activity and thus avoids double taxation. This is the principle of deduction set out in article 1(2) and operated in article 168 of the Principal VAT Directive.

10.4 *Empowerment Enterprises* - 2006

Not always the answer

That fiscal neutrality has its limits, even in the EU, is illustrated by a 2006 Court of Session decision – *CRC v Empowerment Enterprises Ltd*.[750] The issue was whether tuition to students by the taxpayer was exempt as 'tuition given privately by teachers and covering school or university education'.[751] The court accepted that in VAT, being a turnover tax, the focus was on the nature of the transaction, rather than necessarily the identity of the supplier.[752] However, neutrality 'cannot provide the answer to every question of interpretation … [and] … it is not always the deciding factor'.[753]

Lord Macfadyen then said (at [27]) –

> The relevance of the principle of fiscal neutrality in construing an exemption comes therefore to be that if the language used admits of two constructions, one which treats the identity of the supplier as relevant and one which does not, the latter is to be preferred. The principle of fiscal neutrality cannot,

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[745] McMahon & MacIntyre *GST and the financial markets* (at 29).
[746] Sommer & Lum *Case Update* (2005) 5 AGSTJ 132.
[747] Evans *Capital Raising costs – the wrong side of the mirror?* (2007) 10/3 *The Tax Specialist* 120, cf Davison & Cordara *The raising of capital – a European perspective* (2004) 4 AGSTJ 1.
[748] Terra *Creditable Input Tax and Shares in EU VAT – Attribution, Apportionment and Allocation* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 186-187).
[749] *CRC v Frank A Smart & Son Ltd* [2019] UKSC 39 (at [37, 65, 67]).
[750] *CRC v Empowerment Enterprises Ltd* [2006] ScotCS CSIH 46.
[751] Article 13A.1(j) of the Sixth Directive.
[752] *Gregg v CCE* [1999] STC 934 (at [20]), *Ambulanter Pflegedienst Kügler GmbH v Finanzamt für Körperschaften I in Berlin* [2002] ECR I-6833 (at [30]).
[753] *Hoffmann v CRC* [2004] STC 740 (at [60]).

> however, constitute the basis for a construction which is contrary to the clear language of the provision in question.

These comments resonate with the tie-breaker comments of Hack DP in *TSC 2000*. Importantly, EU neutrality may function as a default mechanism where conflicting positions are properly available. In another case, it had been said that neutrality 'can in no circumstances constitute the basis for an interpretation *contra legem* of the provisions in question'.[754] In *Empowerment Enterprises*, however, it was held that this was not a case of competing interpretations. Neutrality simply had no impact on the exemption item in question. Neutrality may be powerful but it is not all-powerful.

In a different context involving third party consideration, Lord Neuberger in *Airtours* had said that 'fiscal neutrality cannot be invoked to invent a supply where there was none'.[755] *Empowerment Enterprises* functions as a reminder that EU neutrality, in the context of clear domestic provisions, may have no impact (as Hill J suggested and *Electrical Goods Importer* confirms in our system).

Associated British Ports is a UK decision also illustrating some boundaries applicable to EU neutrality.[756] The taxpayer, assessed to import VAT on timber unlawfully removed from a warehouse, argued access to an 'equal and opposite right of deduction'. Cordara QC, on the back of *Rompelman*, characterised this as a simple case of principle regarding 'first investment expenditure'. Berner J (at [24]) said –

> The Eighth Directive is founded on a balance between tax collection and prevention of evasion on the one hand and the principle of fiscal neutrality which provides the right of taxable persons to deduct input tax on the other. The principle of proportionality ensures that the balance is not tipped too far in one direction.

The judge traced the wide scope and influence of neutrality. Cordara QC drew attention to the problem of 'cascading', and argued (at [33]) that 'a way must be found to get the VAT lawfully borne by a fully taxable business, including on its overheads, back into the hands of the paying party, so that it is VAT neutral'.[757]

Berner J (at [35]) held, however, that 'none of this case law, whether of the Court of Justice or domestic, provides support for Mr Cordara's argument'. It was 'not applying an over-literal approach', continued the judge, to have regard to the clear requirement of the Directive that the goods 'must be used for the purpose of the relevant economic activity and it is that which provides the necessary direct and immediate link between the input and output transactions'. The taxpayer could establish no such link.

The judge said the 'link which Mr Cordara seeks to establish has no basis in EU law', and that 'a deduction is available only in so far as goods and services are used for the purpose of an applicable economic activity and not simply to the extent any import VAT is incurred absent the use of the related goods'. There is 'no absolute right' to deduct

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[754] *Gregg v CCE* [1999] STC 934 (at [29]).
[755] *Airtours Holidays Transport Ltd v HMRC* [2016] UKSC 21 (at [53]), noted McGowan *Airtours Holidays Transport Ltd v HMRC: to whom has a supply been made for VAT purposes?* [2016] 4 *British Tax Review* 449.
[756] *Associated British Ports v CRC* [2016] UKFTT 491.
[757] *St Helen's School Northwood Ltd v RCC* [2007] STC 633, *CEC v Redrow Group plc* [1999] STC 161, *RCC v Loyalty Management UK Ltd* [2013] STC 784 relied on.

import VAT simply because the liability arises from the economic activity carried on. Berner J said the position was clear and refused to refer the matter to the CJEU.

10.5 *Marks & Spencer plc* - 2007

Economic analysis & equal treatment

The opinion of Advocate General Kokott in the celebrated 'teacake case', *Marks & Spencer plc*,[758] sets out further basic propositions deriving from the principle of neutrality. Similar goods within each country must bear the same tax burden whatever the length of the production or distribution chain. This is guaranteed by the right to deduct input tax, under which 'all intermediate stages are relieved entirely of the VAT burden'. Similar and competing goods, therefore, must be treated in the same way, and economic operators carrying out the same transactions may not be treated differently for those transactions.[759] As a result, neutrality aims to eliminate distortion in competition as a result of differing VAT treatment.[760]

The taxpayer in *Marks & Spencer* argued for a right under general EU principles (including fiscal neutrality) to recover VAT overpaid on teacake sales, which were subject to concessional treatment.[761] The commissioners said that recovery was always subject to denial under UK law for unjust enrichment reasons.[762] The CJEU agreed that community law does not prevent limitations of the unjust enrichment type,[763] provided they are administered on an 'equal treatment' basis.[764] Discrimination could not be allowed, therefore, between VAT debtors [subject to the unjust enrichment rule] and VAT creditors [not subject to that rule at the relevant time], unless it could be 'objectively justified'.[765] This outcome applied even though the economic traders concerned may not be in direct competition with one another.

However, it was for the national court to determine if in fact there was discrimination of the type described. If discrimination was absent, the national court would have to find unjust enrichment would occur if overpaid VAT was refunded to the taxpayer. This was to be determined 'following an economic analysis' of all the relevant circumstances.[766] The CJEU emphasised again that fiscal neutrality 'is a fundamental principle of the

[758] *Marks & Spencer plc v CCE* [2007] EUECJ C-309/06 (at [56-63]).
[759] *Finanzamt Oschatz v Zweckverband zur Trinkwasserversorgung und Abwasserbeseitigung Torgau-Westelbein* [2008] EUECJ C-442/05 (at [42]), *Ampliscientifica Srl v Ministerop dell'Economica e delle Finanze* [2008] EUECJ C-162/07 (at [25]).
[760] cf Parisi [2006] unpublished paper (at 15-17), Parisi [2007] unpublished paper (at 3, 16-18).
[761] Article 28(2) of the Sixth Directive.
[762] s 80(3) of the *Value Added Tax Act 1994*, cf *Midland Co-Operative Society Ltd v CRC* [2008] EWCA Civ 305.
[763] *Marks & Spencer plc v CCE* [2008] EUECJ C-309/06 (at [47]), *EC Commission v Italy* [1988] ECR 1799 (at [6]), *Dilexport Srl v Amministrazione delle Finanze dello Stato* [1999] ECR I-579 (at [47]).
[764] cf *LA Leisure Ltd v CRC* [2008] UKVAT V20648.
[765] *Klensch v Secrétaire d'État à l'Agriculture* [1986] ECR 3477 (at [9]), *Idéal Tourisme SA v Belgium* [2001] STC 1386 (at [35]).
[766] *Weber's Wine World Handels-GmbH v Abgabenberufungskommission Wien* [2003] ECR I-11365 (at [94-100]).

common system of VAT'[767] which 'precludes treating similar goods, which are thus in competition with each other, differently for VAT purposes'.[768]

The Guardian commented that the decision brought to an end 'an epic dispute after 12 years and two trips to the ECJ'.[769] That said, what drove the legal outcome was high-level economic analysis built on inconvenient facts and a degree of unreality. Cordara & Parisi reflected on complications which the food exemption in *Marks & Spencer* had visited on the VAT system.[770] Referring to *Lansell House*, they hoped Australian judges might take a simpler approach.[771] This sentiment is shared by many.

10.6 *Polski Trawertyn* – 2012

Subvention of national law

This preparatory activities decision[772] is also considered by Dr Grube in her article.[773] Two individuals acquired a quarry then formed a partnership and claimed input tax on acquisition and notary costs. The tax authority rejected both claims, the first because it was the individuals not the partnership who bought the quarry, and the second because the notary work predated formal registration of the partnership.

Despite the textual impediments of Polish law, the CJEU on a very loud application of *Rompelman* had little difficulty in allowing the first claim. After observing that preparatory acts were economic activities, input tax on 'first investment expenditure' had to be recoupable. The court said (at [29]), that 'any other interpretation' would burden the trader and create an arbitrary distinction between expenditure made before and after exploitation. It followed that anyone who carries on investment activities 'closely connected with and necessary for the future exploitation of immovable property' must be regarded as a taxable person. It did not matter that transfer of the quarry to the partnership was VAT exempt.[774]

Although Advocate General Cruz Villalón had drawn attention to Polish law complications in this regard,[775] the CJEU held (at [35]) that the partnership 'must in order to ensure the neutrality of taxation, be entitled to take account of those investment transactions when deducting VAT'. In a line later to echo eerily in our own *Multiflex* proceedings,[776] the CJEU said that, if there was fraud or abuse by the taxpayer on deducting input tax, local authorities could seek recover the amounts over-claimed 'with retrospective effect'. Given the national court found that those who paid the tax and comprised the partnership 'are one and the same legal entity', the CJEU said (at [45])

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[767] *Schmeink & Cofreth AG & Co KG v Finanzamt Borken* [2000] ECR I-6973 (at [59]).
[768] *Fischer v Finanzamt Donauexchingen* [1998] STC 708 (at [21, 27]), *EC Commission v France* [2001] ECR I-3369 (at [22]), *J P Morgan Fleming Claverhouse Investment Trust plc v CRC* [2007] EUECJ C-363/05 (at [46]), *Banks v CRC* [2008] UKVAT V20695 (at [47-48]), cf *MyTravel plc v CEC* [2005] STC 1617 (at [32-33]), *Advocate General v K E Entertainments Ltd* [2020] UKSC 28 (at [33]).
[769] www.guardian.co.uk/business/2008/apr/10/marksandspencer.teacake (10 April 2008).
[770] Cordara & Parisi *Australian Goods and Services Tax Cases – Decisions and Commentary* (at [8.15.3]),
[771] *Lansell House Pty Ltd v FCT* [2010] FCA 329.
[772] *Kopalnia Odkrywkowa Polski Tavertyn v Direktor w Poznaniu* [2012] Case C-280/10.
[773] Grube *Neutrality and input tax deductibility* (2017) 17 AGSTJ 8 (at 13-17).
[774] *Finanzamt Offenbach v Faxworld Vorgrűndungsgesellschaft* [2004] Case C-137/02 (at [41-42]) cited.
[775] *Kopalnia Odkrywkowa Polski Tavertyn v Direktor w Poznaniu* [2011] Case C-280/10 (at [46-49]) (French text).
[776] *Multiflex Pty Ltd v FCT* [2011] FCA 1112, *FCT v Multiflex Pty Ltd* [2011] FCAFC 142.

that any inability to deduct resulted from a 'purely formal obligation'. Compliance with such an obligation cannot be required where it would make deduction rights ineffective.

Regarding notary costs, the court stated that the right to deduct was an 'integral part of the VAT scheme and in principle may not be limited'. Although Article 273 of the Directive enabled member states to impose obligations necessary to ensure correct collection and prevent evasion, that did not mean they could impose invoicing requirements additional to those in Article 178 and which burdened the ability to deduct input tax. VAT neutrality requires an ability to deduct if substantive requirements are satisfied (at [43]) 'even if the taxable person has failed to comply with some of the formal requirements'. Importantly, if the taxing authority has information sufficient to show that the person is the recipient of supplies subject to VAT, it cannot impose additional conditions which may operate to make the right to deduct ineffective.[777]

Dr Grube makes no comment on *Polski Trawertyn* beyond quoting what the CJEU says in its judgment. To similar effect is the note about the case prepared by Ben Terra and Julie Kajus.[778] If anything, *Polski Trawertyn* confirms in rather emphatic terms that EU-style neutrality is an economic steamroller in the administration of VAT laws. It does this by supporting the right to deduct in the face of otherwise reasonable national safeguards aimed at securing proper VAT compliance and preventing abusive practices.

Professor Millar notes that that the arguments for the partnership being able to deduct on the quarry acquisition were 'somewhat tortured', then deals with how this issue might play out in Australia.[779] Millar also draws attention to the 'agility' with which the CJEU dealt with the partnership question. This appears to be code for precisely the kind of teleological jump to be expected from the CJEU in its judgments.

What is surer, however, is the substantive impact which *Polski Trawertyn* has had in practice. As the First Tier Tribunal recently put it, that decision is clear authority that invoicing requirements like those in Article 226(6) and (7) 'must be dispensed with if the tax authorities are supplied with the information necessary to establish that the substantive requirements of the right to deduct are satisfied'.[780] Measures for the prevention of fraud and evasion must go no further than is necessary and must not undermine neutrality. This is consistent with the conclusion that the VAT aspects of economic activities 'must be dependent on the actual economic situation and the rationality of their result, rather than their formal characteristics'.[781]

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[777] *Nidera Handelscompagnie BV v Valstybin mokesi inspekcija* [2010] Case C-385/09 (at [42]) cited.
[778] Terra & Kajus *Kopalnia Odkrywkowa Polski* https://research.ibfd.org
[779] Millar *The principle of neutrality in Australian GST* (2017) 17 AGSTJ 26 (at 40).
[780] *Tower Bridge GP Ltd v CRC* [2019] UKFTT 176 (at [126]), cf *Barlis 06 – Investimentos Imobiliários e Turísticos SA v Autoridade Tributária e Aduaneira* [2016] Case C-516/14 (at [42-43]).
[781] Swinkels *Halifax Day: Abuse of Law in European VAT* [2006] *International VAT Monitor* 173 (at 181), cf Walpole *Tackling VAT Fraud* [2014] *International VAT Monitor* 258, Gunacker-Slawitsch *The Knowing Participation in VAT Fraud: Reflections on the Content and the Limits of a Reasonable Duty of Due Diligence* [2017] *British Tax Review* 649, cf *Butt v CRC* [2019] EWCA Civ 554.

10.7 *Macikowski* - 2015

Compulsory sales

This case raised if and how the principle of neutrality should affect compulsory sale situations.[782] Marian Macikowski was a court enforcement officer who, at the request of a creditor, seized immovable property belonging to a taxable person – *Royal sp z o.o*. The officer subsequently auctioned the property to Mr and Mrs Babinski who paid the price in full into court. The last of three questions before the CJEU involved the ability of national law to deny Macikowski the ability to offset input tax deductions otherwise available to the taxable person, where the enforcement officer (as paying agent) was made liable for VAT by Polish law. Did the principle of neutrality operate to transfer or re-vest the right to deduct in officer Macikowski?

The CJEU answered this question 'no'. The court said the right to deduct is an 'integral part' of the system which in principle may not be limited, and that the right is exercisable 'immediately' for all input tax.[783] It was the owner (not the paying agent) as the taxable person who was liable to submit a VAT return and who had the right to deduct input tax. Articles 193 and 199(1)(g) read together allowed 'another person' to be made liable for the tax under national laws where the person liable is the taxable person to whom 'the supply of immovable property sold by a judgment debtor in a compulsory sale procedure'. A national law requiring the enforcement officer to pay the tax was also justified as an 'interim payment' for Article 206 purposes.

The CJEU held that the neutrality principle did not preclude making Macikowski liable, despite the fact that he had no practical ability to deduct input tax. This case appears to create an asymmetrical and counter-intuitive outcome, insofar as the debtor retains deduction rights but the court enforcement officer must pay the tax.

Gunnar Beck has made the point that, generally, in VAT situations the CJEU 'pays very close regard to, and bases its decision on, the wording of the provision in question'.[784] Others disagree with this position as a matter of evidence, sometimes strongly. *Macikowski* is a case supporting the dissenters. The judgment of the CJEU involves a series of short conclusory statements casually unlinked by reasons or analysis, much less any step-by-step progression of logic or argument. The language of the articles in question is difficult from any angle, and we are left to guess about how they inform the conclusion reached. Teleological factors appear have driven the outcome, but we may only conjecture about this also. A patchwork neutrality is achieved it seems, but the steps involved are heuristically murky. In *Macikowski,* the CJEU again forces economic neutrality on provisions, rather than building that outcome on due regard for the words.

10.8 *Volkswagen AG* - 2018

Disregard of formalities

The way in which neutrality may apply when national laws place time limits on input tax recovery was the focus of this case.[785] Hella companies in Slovakia supplied VW in

[782] *Macikowski v Dyrektor w Gdańsku* [2015] Case C-400/13.
[783] *Gabalfrisa SL v Agencia Estatal de Administración Tributaria* [2000] ECR I-1577 (at [43]), *Gran Via Moineşti SRL v Agenţia Naţională de Administrare Fiscală* [2012] EUECJ C-257/11 (at [21]) cited.
[784] Beck *The Legal Reasoning of the Court of Justice of the EU* (at 296).
[785] *Volkswagen AG v Finančné riaditel'stvo Slovenskej republiky* [2018] Case C-533/16.

Germany with moulds for the manufacture of lights. Over a long period no VAT was charged until Hella detected the mistake. After Hella paid the back-tax, VW sought to deduct input tax on the supplies, but that right had expired under national laws in force.

The CJEU (at [38-39]) made familiar remarks about neutrality and its operative effect,[786] but noted that the right to deduct is 'subject to compliance with both substantive and formal requirements or conditions'.[787] The court had already held also that national laws may validly take away the right to deduct where time limits were exceeded and the taxable person 'had not been sufficiently diligent'.[788]

There was no hint or risk of evasion here, however, and it was objectively impossible for VW to exercise the right of deduction before Hella made the adjustment. There was no lack of diligence by VW, nor was there any abuse or 'fraudulent collusion' with the Hella companies. Subsequently, said the court (at [51]), fiscal neutrality precluded a member state from depriving VW of their right to deduct. The court had little difficulty distinguished its earlier decision on forfeiture of deduction rights. The underlying drivers for the decision are the big principles which govern the EU – equal treatment, proportionality and certainty. The case illustrates the more minor role played by precedent in the CJEU.[789] *Volkswagen* is another neutrality decision where it is difficult to properly evaluate the path of reasoning leading to the answer provided.[790]

10.9 *Vadan* - 2018

System jeopardy

My final case on EU neutrality continues a theme discussed by Dr Grube in her paper, that being the right to deduct even where formal documentary requirements are not satisfied by the taxable person.[791] In this case, Advocate General Tanchev held (at [85]) that 'neutrality cannot be legitimately invoked by a taxable person who purports to jeopardise the operation of the common system of VAT through failure to keep the records required under the VAT Directive for a sustained period of time'.

Earlier cases had dealt with the impact of various invoicing defects on the ability to deduct.[792] This one involved a Romanian property developer with a bad compliance history who kept no invoices or other records for several years, and who sought to rely merely on whatever a court appointed expert might glean from wider circumstances.

It was common ground that neutrality derived from Article 168 in the *Rompelman* form was not to be abridged simply by failure to comply with formal invoicing requirements. The CJEU re-stated that the right of deduction is a fundamental principle of the VAT

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[786] *Senatex GmbH v Finanzamt Hannover-Nord* [2016] EUECJ C-518/14 (at [27]), *SMS group GmbH v Direcţia Generală Regională a Finanţelor Publice Bucureşti* [2017] EUECJ C-441/16 (at [40]) cited.
[787] *SC Paper Consult SRL v Direcţia Regională a Finanţelor Publice Cluj-Napoca* [2017] EUECJ C-101/16 (at [38]) cited.
[788] *Criminal proceedings against Giuseppe Astone* [2016] EUECJ C-332/15 (at [34-35])
[789] Beck *The Legal Reasoning of the Court of Justice of the EU* (at 274-277).
[790] cf de Boer *Commentary on Case C-533/16* [2018] IBFD Bulletin.
[791] *Vadan v Agenţia Naţionala de Administrare Fiscala* [2018] EUECJ C-664/16, cf *Kardi Vehicles Ltd v CRC* [2020] UKFTT 254 (at [80]).
[792] *Uszodaépítő kft v APEH Központi Hivatal Hatósági Főosztály* [2010] EUECJ C-392/09, *Kopalnia Odkrywkowa Polski Trawertyn v Dyrektor Izby Skarbowej w Poznaniu* [2012] EUECJ C-280/10, *Idexx Laboratories Italia Srl v Agenzia delle Entrate* [2014] EUECJ C-590/13, *Senatex GmbH v Finanzamt Hannover-Nord* [2016] EUECJ C-518/14.

system and exercisable immediately to remove the burden of tax on all inputs.[793] Although invoices are a 'ticket of admission' for deduction purposes,[794] toleration of minor errors is required to ensure that neutrality is not undermined.

Luc Vadan went a step too far this time. His infringement was 'so great that it makes it impossible or overly difficult to ascertain whether the substantive conditions for entitlement to a deduction had been met'. The transactions being over 10 years old meant that Vadan's non-compliance was itself a barrier to the production of conclusive evidence supporting any right to deduct.[795] This case stands as a further illustration that EU neutrality is not unlimited. The more recent trend in many 'invoicing formality' cases, however, is for the court to side with the taxpayer and against the national taxing authority.[796] *Rompelman* routinely prevails over member state laws,[797] the bitcoin case being another example of this in practice.[798]

11. COMMENTS ON NEUTRALITY

11.1 Derived from legislation

It is important to notice the precise source of EU neutrality in its second sense. Dr Grube says that it is 'directly connected with the right of taxable persons to deduct input VAT', with that right now finding expression in Article 168 of the VAT Directive.[799] The judge further explains this, saying that the right to deduct input tax 'is essential to relieve taxable persons from the burden of the VAT payable or paid in the course of all their economic activities'.

This phraseology is very much like how the CJEU in *Rompelman* expressed the basic concept, and how it is habitually described in the decisions and the literature. It is not spelt out in so many words by Article 168, of course, but the inference and derivation are clear enough. Does EU neutrality have a statutory source then? I certainly thought so when I first looked at the issue back in 2008.[800]

In *TSC 2000 Pty Ltd*, Hack DP (at [51]) referred to neutrality in slightly different terms to Dr Grube, quoting Lord Walker in *Lex Services plc*.[801] The quotation, however, omits some key words. The full text of what the Law Lord said begins as follows – 'Its central core meaning (spelled out in art 2 of the First directive) …' The part in brackets also

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[793] *PPUH Stehcemp v Dyrektor Izby Skarbowej w Łodzi* [2015] EUECJ C-277/14 (at [26]), *Biosafe–Industria de Reciclagens SA v Flexipiso-Pavimentos SA* [2018] Case C-8/17 (at [27-29]) cited.
[794] *Jeunehomme and EGI v Belgian State* [1998] EUECJ C-123/87 (at 4534).
[795] cf *Criminal proceedings against Giuseppe Astone* [2016] EUECJ C-332/15 (at [46]), *Marius v Ministerul Finanţelor Publice* [2018] EUECJ C-159/17 (at [35]).
[796] Mikula *Consistency of ECJ Case Law: Formal Requirements in VAT Matters* (2019) 47 INTERTAX 121.
[797] *Siemens Gamesa Renewable Energy Rumânia v Agenţia Naţională de Administrare Fiscală* [2018] Case C-69/17, *TGE Gas Engineering GmbH v Autoridade Tributária e Aduaneira* [2018] Case C-16/17, *UAB 'Enteco Baltic' v Muitinės departamentas prie Lietuvos respublikos* [2018] Case C-108/17.
[798] *Skatteverket v Hedqvist* [2014] EUECJ C-264/14, cf *Don Bosco Onroerend Goed BV v Staatssecretaris van Financiën* [2009] EUECJ C-461/08 (at [25]), *DTZ Zadelhoff vof v Staatssecretaris van Financiën* [2012] EUECJ C-259/11 (at [21]), *JJ Komen en Zonen Beheer Heerhugowaard BV v Staatssecretaris van Financiën* [2012] EUECJ C-326/11 (at [20]).
[799] Grube *Neutrality and input tax deductibility* (2017) 17 AGSTJ 8 (at 9).
[800] Brysland *Fiscal neutrality – foreign aid to GST construction?* [2008] *Law Council Tax Committee Workshop paper* (at 8), cf Cordara *The Sixth VAT Directive and Key Legal Issues under VAT in Europe* (at 24).
[801] *Lex Services plc v CEC* [2004] I All ER 434 (at [26]).

suggests an understanding that EU neutrality has a statutory source. In *Kraft Foods Polska*, the CJEU observed that 'VAT neutrality … is a fundamental principle of the common system of VAT established by the relevant European Union legislation'.[802]

Christian Amand took this as a clear indication that *Rompelman* neutrality is a principle sourced, not in the treaties as primary law and not as a mere general principle of secondary law, but rather as a concept sourced in EU legislation itself.[803] So much seems uncontroversial, and it is the conclusion Dr Grube expresses without qualification.[804]

11.2 Fundamental right

Writing in INTERTAX, Marton Varju points to three key features of EO neutrality.[805] First, the right to deduct input tax is a fundamental,[806] imperative, immediate,[807] comprehensive,[808] objective[809] and binding[810] entitlement of all economic operators in comparable situations,[811] to be given without significant limitations,[812] without regard to 'purpose or results' of taxable transactions, independent of VAT payment[813] and even where some formalities are ignored.[814] These aspects of neutrality largely reflect and amplify the classic formulation in *Rompelman*. Despite the superlatives, however, neutrality has a series of legal and practical limitations. For example, it 'cannot be invoked to invent a supply where there is none'.[815] Nor is it immune from legislative adjustment where action of that kind is considered necessary.

The 2007 proposal to limit deduction rights on immovable property, in combination with two CJEU cases,[816] was met with the response that neutrality 'seems to be sacrificed on the altar of fiscal interests'.[817] Sometimes, but only sometimes, neutrality will bow to clear words in the Directives, though almost never to the terms of national laws. Second, Varju says that deduction rights are interfered with only on objective evidence of bad behaviour, like abuse of law or carousel fraud.[818]

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[802] *Minister Finansów v Kraft Food Polska* [2012] EUECJ C-588/10 (at [28]).
[803] Amand *VAT neutrality: a principle of EU law or a principle of the VAT system?* [2013] *World Journal of VAT/GST Law* 163 (at 168]), Varju *The Right to VAT Deduction and the ECJ: Towards Neutral and Efficient Taxation in the Single Market* (2019) 47 INTERTAX 324 (at 327).
[804] Grube *Neutrality and input tax deductibility* (2017) 17 AGSTJ 8 (at 24).
[805] Varju *The Right to VAT Deduction and the ECJ: Towards Neutral and Efficient Taxation in the Single Market* (2019) 47 INTERTAX 324.
[806] *Rusedespred 00D v Direktor na Direktsia* [2015] Case C-138/12 (at [29]) cited.
[807] *Royal and Sun Alliance Insurance Group plc v CEC* [2003] 2 All ER 1073 (at 1084) for example.
[808] *Kittel v Belgian State* [2006] Case C-C-439/04 (at [48]) cited.
[809] *BLP Group v CEC* [1995] Case C-4/94 (at [26]) cited.
[810] *Halifax plc v CCE* [2006] Case C-255/02 (at [57]), *Vámos v Nemzeti Adó* [2018] Case C-566/16 cited.
[811] *Vámos v Nemzeti Adó* [2018] Case C-566/16 (at [58]), *FinanČné riaditel'stvo v BB construct sro* [2017] Case C-534/16 (at [29]) cited.
[812] *Belgische Staat v Ghent Coal Terminal NV* [1998] Case C-37/95 (at [17]), *Intercommunale voor Zeewaterontzilting v Belgische Staat* [1996] Case C-110/94 (at [20-21]) cited.
[813] *Kittel v Belgian State* [2006] Case C-C-439/04 (at [49]) cited.
[814] *Salomie and Oltean* [2015] Case C-183/14 (at [58-61]), *Polski Tavertyn v Direktor w Poznaniu* [2012] Case C-280/10 (at [44-49]) cited.
[815] *Airtours Holidays Transport Limited v CRC* [2016] UKSC 21 (at [53]).
[816] *Investrand BV v Staatssecretaris van Financiën* [2005] EUECJ C-435/05, *Securenta Göttinger Immobilienanlagen v Finanzamt Göttingen* [2008] EUECJ C-437/06.
[817] Henkow *Neutrality of VAT for taxable persons: a new approach in European VAT?* [2008] *EC Tax Review* 233 (at 233).
[818] cf Amand & Boucquez *A New Defence for Victims of EU Missing-Trader Fraud* [2011] *International VAT Monitor* 234, Terra *The European Court of Justice and the Principle of Prohibiting Abusive Practices*

This controversial though cautious CJEU response has been subject to ongoing criticism which Varju sees as 'overly harsh'. Professor Terra summed up by saying that community law 'cannot be relied on for fraudulent ends'.[819] It may also be recalled that *Rompelman* itself explicitly recognises an exception to neutrality for fraudulent conduct.[820]

Third, although the caselaw has been 'overall balanced', it has produced an 'often highly factual jurisprudence'. Varju says the CJEU treads a fine line between giving full force to deduction rights and addressing the collection concerns of member states. Formality, though, is often sacrificed to neutrality.

Christian Amand provides deeper thoughts in this regard.[821] He emphasises that neutrality is 'only a principle of interpretation'.[822] His concern is how it inter-relates with equal treatment, and what precise status neutrality has as a 'principle of the VAT system' – 'the principle' or 'a fundamental principle'? Various inconsistences are identified in the way the CJEU has dealt with these issues.

Amand refers to cases echoing the *Rompelman* 'right to deduct' statement and tries to reconcile them with 'only a principle of interpretation' comments. He traces neutrality back to the *Treaty of Rome* in 1957, concluding that it reflects the principle of equal treatment. This only complicates any clear understanding of the precise role that neutrality plays. His conclusion is to suggest that the CJEU approach 'creates major confusion in the daily expectations of businesses operating in Europe and seriously damages the European economy'.

12. FOREIGN GHOST REVISITED

12.1 Mr Rompelman

It is one thing to think grandly about the 'underlying philosophy' to which Hill J referred and how the foreign ghost of EU neutrality might guide the resolution of GST disputes in Australia. It is quite another to think through how the logistics of this might play out. The classic statement in *Rompelman* was derived in 1985 from language and principles set out in the First Directive. By the time we legislated for GST, the EU framework had changed and a formidable corpus of neutrality jurisprudence was already building.

Even if it was 'highly factual', that jurisprudence added to and explained the underlying philosophy. When we legislated, did we take on the *Rompelman* principle as a stand-alone thing shorn of all interim learning,[823] or did our foreign ghost, Mr Rompelman, arrive here in 1999 with all his new clothes and possessions intact?

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in VAT in White & Krever (eds) *GST in Retrospect and Prospect* (at 495), Wolf *Mecsek-Gabona: The Final Step of the ECJ's Doctrine on Reliance on EU Law for Abusive or Fraudulent Ends in the Context of Intra-Community Transactions* [2013] *International VAT Monitor* 280, *Kittel v Belgium* [2008] STC 1537 (at [54-61]), *Peterborough Plant Sales Limited v CRC* [2020] UKFTT 338 (at [21]), *Crow Metals Ltd v CRC* [2020] UKFTT 423 (at [21]).

[819] Terra *VAT lessons from Europe – Part 2* (2007) 7 AGSTJ 73 (at 79).

[820] *Butt v CRC* [2019] EWCA Civ 554 discusses.

[821] Amand *VAT neutrality: a principle of EU law or a principle of the VAT system?* [2013] *World Journal of VAT/GST Law* 163

[822] *Finanzamt Frankfurt am Main V-Höchst v Deutsche Bank AG* [2012] EUECJ C-44/11 (at [45]), *Finanzamt Steglitz v Zimmermann* [2012] EUECJ C-174/11 (at [49-50]) cited.

[823] cf *Vallance v The Queen* (1961) 108 CLR 56 (at 76).

If it is the former, we should apply the principle as read through our eyes exclusively, and ignore everything which has happened in the EU neutrality space since 1985. If the latter, do we take Mr Rompelman as we found him in the arrivals hall at Mascot in 1999 with all his new clothes and possessions intact? Or do we treat him as an 'always speaking' Mr Rompelman in the sense that all the EU neutrality jurisprudence laid down from 1999 informs the principle as we are to apply it year-on-year?

There is no precedent for this and no ready analogy for untangling the practical issues. If we go with static Mr Rompelman, we should ignore all EU cases decided since, including ones like *Kretztechnik* and others discussed in this note. If it is dynamic Mr Rompelman we have welcomed, however, each time his uncles at the CJEU decide a neutrality case, there is a potential impact on how our GST law might operate in comparable situations. None of these speculations is attractive.

12.2 Law and economics

The drivers for EU neutrality being part of our GST law are seen to stem from a standard application of purposive principles. In this regard, the 'context in the widest sense' phraseology of *CIC Insurance* is taken as some open licence to read the words of Div 11 as if they contained concepts derived from foreign legislation different terms and in a different manner. The mandate for preferring an outcome consistent with EU neutrality, however, is suggested to be the 'unqualified statutory instruction' in s 15AA of the *Acts Interpretation Act 1901.* Seeming support for this approach is to be found in the judgment of Hill J in *HP Mercantile*, and comments from the same judge in his later article - *To interpret or translate?* The CJEU decision in *Kretztechnik* is seen as emblematic of how things should work out neutrality-wise in Australia. The arguments for this are best put by Michael Evans in his 2007 paper – *wrong side of the mirror?*[824]

Justice Pagone took up a similar theme in a paper about the 'problems in legislating for economic concepts'.[825] The judge said (at 46) that purposive construction requires judges 'to give effect to underlying objectives which the legislation seeks to achieve', and that 'legislation drafted to give effect to economic concepts is no exception'.

The problem, as Pagone J saw it, it was not lack of legislative direction, 'but that judges do not have the training, background or resources to implement legislation as an economist, accountant, or person of commerce would require'. The judge went on to say, however, that the idea that a judge should apply 'some personally held view of economics, accounting or commerce may be inconsistent with the judge's role as independent (non-partisan) interpreter of legal text'.

This last statement is no doubt correct, as the cases on policy preconception confirm. The deeper problem lies in giving effect to economic policy objectives where the legislative text is *not* open to a construction as would facilitate them. We may lament that judges in this country do not have the same freedom enjoyed by EU judges to openly calibrate their decisions to economic objectives with less regard (sometimes disregard) for the text of the law itself. Reduced to basics, this seems more a plea for different

[824] Evans *Capital Raising costs – the wrong side of the mirror?* (2007) 10/3 *The Tax Specialist* 120.
[825] Pagone *Some problems in legislating for economics concepts – a judicial perspective* [2010] *Treasury Revenue Group paper* 39, cf Pagone *Brambles, hedgehogs and foxes* [2018] FedJSchol 1 (at 3-5), Benedict *The Australian GST regime and financial services: How did we get here and where are we going?* (2011) 9 *eJournal of Tax Research* 174 (at 184-185).

interpretation protocols, a different judicial method and a different legal system. Economic training may assist our judges, but submissions can address economic issues, and expert evidence may be given where appropriate.[826]

Mason J gave his views on the general issue some time ago when he said – 'Understanding rational and sensible tax policy and its associated detail does not call for a sacred band of intellectual colossi'.[827] Gordon J also wrote about the 'myopic culture and specialisation that exists in the tax profession'.[828] Wigney SC made comments in a similar vein in an *Australian Tax Review* article on interpretation.[829]

The more inconvenient truth is that, for better or worse, we have a system which focuses on enacted text – first, and last, as the High Court says. Economic context may compel a different answer only where that answer is otherwise available on the terms of the law and the requirements of s 15AA can be made out.

12.3 Dimensions of difference

The key question posed, though, is whether it is enough that, simply because our system is a VAT system deliberately created with a weather eye to other VAT systems, EU neutrality has embedded itself fully formed into our system. Although neutrality is often described as being 'inherent' in the EU system, the case for any implied absorption into our domestic law is immediately more unlikely once it is seen that the principle derives from a supranational statute requiring fiscal harmony in Europe. Case after case in the EU links neutrality to express provisions within the VAT directive. Neutrality in the *Rompelman* sense has a legislative basis within the European Union, a conclusion confirmed by Dr Grube and others.[830]

To pose the question - how can a foreign statutory concept, unlegislated for in our system, and derived under different protocols, operate as a proxy for the words chosen by our federal parliament? Statutes as 'closed categories' are rarely sources of legal principle[831] – all the more so with foreign statutes. The fact is that our GST law does not contain any *Rompelman*-type formulation or words suggesting it. Our s 11-15(2)(a) language could have legislated for the EU concept (or might be amended to achieve that), but to date it has not done so or shown any inclination.

In the absence of a formal reception device – perhaps a multilateral treaty or a statute like the *European Communities Act 1972* – how can a principle derived from a foreign statute become part of an Australian law framed differently? It is the different terms of Div 11 which define our native neutrality, not what a foreign statute says, much less notions of 'underlying philosophy'. EU neutrality with all of its nuances is derived from

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[826] *BHP Billiton Iron Ore Pty Ltd v National Competition Council* [2006] FCA 1764 (at [172]), Middleton J *Expert economic evidence* [2007] FedJSchol 17 generally.
[827] Mason *Taxation Policy and the Courts* (1990) 2/4 *CCH Journal of Australian Taxation* 40 (at 40), cf Livingston *Practical Reason, "Purposivism", and the Interpretation of Tax Statutes* (1996) 51 *Tax Law Review* 677 (at 683).
[828] Gordon J *The interrelationship between tax law and other areas of law, and the consequences on teaching, drafting and interpreting tax laws* [2011] FedJSchol 1 (at 2).
[829] Wigney *Text, context and the interpretation of a 'practical business tax'* (2011) 40 *Australian Tax Review* 94 (at 95).
[830] Amand *VAT neutrality: a principle of EU law or a principle of the VAT system?* [2013] *World Journal of VAT/GST Law* 163 (at 168).
[831] Farrar *Reasoning by Analogy in the Law* (1997) 9 *Bond Law Review* 149 (at 158, n 37).

VAT Directives in different terms and in a manner alien to the principles of interpretation we apply. Others take the view that these differences do not matter.

John Davison and Roderick Cordara observed[832] -

> The differing legislation, legal tradition and structures, all mean the cases, circumstances and decisions need to be carefully considered to see if they are applicable, but as the base of all VAT and GST systems is the same, the analogies are too strong to ignore. However, overall, there are more similarities than differences in the 2 systems.

12.4 Context and its limits

Justice Hill was right to point to our 'modern approach' to interpretation as requiring consultation of context in the 'widest sense' up-front in the process. Context has a wide meaning and a narrower meaning, but it is the wide one which applies here.[833] Context, however, is never unlimited, and the further you get from the textual centre the more remote is the possibility that what you might find can have any proper influence on the meaning of the provisions being examined.[834] There comes a time, and rather quickly in many cases, when the boundaries of both relevance and utility are passed.

Foreign statutes, principles derived from them, and 'underlying philosophy' are invariably on the other side of the line. *Reliance Carpet* stands as the obvious and cardinal illustration of this. *CIC Insurance* is no open-ended invitation simply to apply whatever may be in the VAT policy background as if it were hard-wired into the GST law. Sometimes, as Edmonds J noted, the identified policy 'is incapable of manifestation through the text of the statute'.[835]

As the discussion of European interpretation shows, courts in the EU give far more prominence to economic policy as an interpretation tool than is permitted in Australia. This is one of the major themes which emerges from a text in the area – *The Legal Reasoning of the Court of Justice of the EU* – by Gunnar Beck. In Australia, the courts have set barricades against economic policy having any automatic influence over the law. We operate in a purposive system, perhaps an increasingly purposive one.

It is not 'teleological' in the EU sense or practice, however. We are no longer free to take literalistic approaches, yet statutory interpretation in Australia remains a 'text-based activity' under which we are to start and finish with what the provisions say. The EU in many ways is a dramatic reverse of this position.

Bruce Quigley, in a speech about general powers of administration, put it more directly in saying that the Commissioner's role 'is to apply the law not the policy'.[836] This language later found its way into an ATO practice statement. In another paper, Quigley said that, while it is erroneous to focus on syntax to the exclusion of policy and context,

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[832] Davison & Cordara *The raising of capital – a European perspective* (2004) 4 AGSTJ 1 (at 9).
[833] cf *Chaudhri v FCT* [2001] FCA 554 (at [6]), *Sterling Guardian Pty Ltd v FCT* [2005] FCA 1166 (at [33]).
[834] Williams, Burnett & Palaniappan *Statutory Construction: A Method* in Williams (ed) *Key Issues in Public Law* 79 (at 87) illustrates.
[835] *Hastie Group Ltd v FCT* [2008] FCA 444 (at [30]).
[836] Quigley *The Commissioner's powers of general administration: How far can he go?* [2009] *TIA National Convention paper* (at 5).

'it is equally erroneous for perceived policy to drive the interpretation without due regard for the words chosen by Parliament and their context within the Act'.[837]

In his article about the *Indirect Taxes Rulings Panel*, he said that the ATO and the panel 'attempts to the extent possible to take a purposive interpretation having regard to the policy behind the provision'.[838] Practitioners from time to time acknowledge that the Commissioner can and must apply purposive principles as the law demands.[839] He is criticised, however, by some for being too bound to the literal words, and by others for going too far and applying what is called a 'political approach' to interpretation.[840]

It is true that 'constructional choice' theory has opened the interpretive lens in Australia over the last decade, and that greater attention is now given to things like systemic coherence and anti-lingualism. The manner in which these notions play out in practice, however, remains governed by principle and a strong tradition of restraint. A recent example is the dissenting judgment of Gageler J in *SZTAL*.[841]

While the CJEU is expected to make legal decisions based on non-legal factors, in our system, matters of deeper economic policy and philosophy only rarely intrude into the interpretation process and but intangibly. However much we want GST to operate in some particular economic way or think it should operate, it is the words of the legislation which have the final say. This is not a case of reverting to some hard literalism of the past. Nor is it a situation to be solved by providing training in economics to judges. It is simply the way that purposive principles of interpretation operate in Australia – in other words, our system of law.

12.5 *Reliance Carpet*

The case which makes this point most loudly in the GST context is *Reliance Carpet*, decided by the High Court in 2008.[842] It was held that a deposit forfeited in a land sale context was consideration for a taxable supply – that supply being the obligations assumed by the vendor on exchange of contracts. Concerned to distance our GST law from the influence of Article 2 of the First Directive, the High Court referred to an 'important point respecting the nature of GST' made earlier in *Sterling Guardian*[843] –

> In economic terms it may be correct to call the GST a consumption tax, because the effective burden falls on the ultimate consumer. But as a matter of legal analysis what is taxed, that is to say what generates the tax liability (and the obligations of recording and reporting), is not consumption but a particular form of transaction, namely supply …

[837] Quigley *Interpreting GST Law in Australia* in White & Krever (eds) *GST in Retrospect and Prospect* (at 118).
[838] Quigley & Tredoux *Inside the Indirect Taxes Rulings Panel* (2004) 4 AGSTJ 89 (at [6.13]).
[839] Timmers *Division 135 – legislative defects: practical problems* (2004) 4 AGSTJ 213 for example.
[840] Robertson *The dangers of the ATO's 'policy intent' approach to the construction of Tax Acts* (2014) 43 *Australian Tax Review* 22, citing *Intoll Management Pty Ltd v FCT* [2012] FCAFC 179 (at [42]), *International All Sports Pty Ltd v FCT* [2011] FCA 824 (at [49]).
[841] *SZTAL v Minister for Immigration and Border Protection* [2017] HCA 34.
[842] *FCT v Reliance Carpet Co Pty Ltd* [2008] HCA 22.
[843] *Sterling Guardian Pty Ltd v FCT* [2006] FCAFC 12 (at [15]), cf GSTR 2006/9 (at [10]).

At the end of this passage, the Full Federal Court directed attention to what Hill J said in paragraphs [10-15] in *HP Mercantile*.[844] These passages describe the statutory scheme, point out the cascading problem, explain the 'genius' of the system, and quote earlier Hill J remarks from *ACP Publishing*. They do not, however, make reference to the divide between economic policy and legal analysis.

The point made in *Sterling Guardian,* repeated in the High Court, is neither isolated nor new. The same bench of the Full Federal Court had said in *WR Carpenter* that 'what lies behind the enactment of a taxing provision as a matter of public policy or economic theory is not the same thing as the elements or criteria of tax liability which Parliament has laid down'.[845] In *Universal Music*, the Full Federal Court made a similar point[846] –

> The primary task of the Court, however, is to apply the words of the Act to the facts found on the evidence before it. These words involve some economic concepts and the application of the Act to the facts of a particular case may be informed by economic evidence or argument. But it is the language of the Act which defines the task that the legislature has set for the Court. To the extent that the statutory language conflicts with economic theory, the Court is bound to apply the Act.

French J has also cautioned that an assumption that legislation using economic concepts therefore implements in full the theory or model from which the concepts arise 'requires close scrutiny'.[847] Speaking about *Reliance Carpet*, Logan J said that 'rhetoric is no substitute for regard to the language of a taxing statute',[848] and that the legal question is not answered by policy unless it is reflected in the law.[849] French CJ explained this further in his *Dolores Umbridge* paper, summing up by saying that policy 'divorced from law has no voice in the courts'.[850] The Full Federal Court recently also drew attention to the dangers of decontextualising policy.[851]

These various comments are nothing if not orthodox in our system. In the EU, as explained, the position is rather different for a variety of reasons. Despite the fact that GST is a value added tax, it was the difference between the respective legal systems which *Reliance Carpet* is concerned to stress. After quoting *Sterling Guardian*, the High Court (at [3]) made the following observations –

> By way of contrast to the Australian system, counsel for the Commissioner referred to Art 2(1) of the first Council directive … on the harmonisation of legislation of member states of the European Community concerning turnover

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[844] cf *Reliance Carpet Co Pty Ltd v FCT* [2007] FCAFC 99 (at [32]), *Westley Nominees Pty Ltd v Coles Supermarkets Australia Pty Ltd* [2006] FCAFC 115 (at [59]).
[845] *WR Carpenter Holdings Pty Ltd v FCT* [2007] FCAFC (at [29]), cf *SNF (Australia) Pty Ltd v FCT* [2010] FCA 635 (at [118]), *FCT v PM Developments Pty Ltd* [2008] FCA 1886 (at [33]), *FCT v Gloxinia Investments Ltd* [2010] FCAFC 46 (at [28]).
[846] *Universal Music Australia Pty Ltd v FCT* [2003] FCAFC 193 (at [163]).
[847] *Woodside Energy Ltd v FCT (No 2)* [2007] FCA 1961 (at [203]), *Esso Australia Resources Pty Ltd v FCT* [2011] FCA 360 (at [125]).
[848] Logan J *Where are we with GST – black letter or the practical business tax?* [2008] *TIA National GST Intensive Conference paper* (at [14]).
[849] *FCT v Ryan* [2000] HCA 4 (at [19]) quoted.
[850] French CJ *Dolores Umbridge and Policy as Legal Magic* (2008) 82 *Australian Law Journal* 322 (at 323).
[851] *Klemweb Nominees Pty Ltd v BHP Group Limited* [2019] FCAFC 107 (at [138]).

taxes; this indicates that VAT is a general tax on the consumption of goods and services.

13. *RIO TINTO SERVICES*

13.1 No enquiry into purpose

In *Rio Tinto*, Davies J held that credit access on a range of acquisitions into remote area housing was blocked by s 11-15(2)(a) despite the fact that the mining group used the housing for the broader purpose of making taxable and GST-free supplies of iron-ore.[852] Apart from explaining important things about Div 11 and wider policy considerations, this case is interesting for the observation by Dr Grube that the *Bundesfinanzhof* in Germany 'probably would have decided the case the same way'.[853]

The taxpayer argued that, for s 11-15(2)(a) to be engaged, the making of s 40-35 residential rent supplies had to be the 'moving cause' or purpose of the refurbishment and other acquisitions. Providing the accommodation was 'merely an intermediate step' in this respect. The 'moving cause', according to the taxpayer, was the carrying on of the enterprise of mining and selling iron-ore.[854] Davies J said both s 11-15 tests involved matters of objective fact and that there was no requirement to look into ultimate purpose.

The judge rejected Rio's contention that the statements of general policy found in *HP Mercantile* could be relied on as an aid to construing s 11-15(2)(a). Rio had argued that there would be 'double taxation on taxable supplies and unrecoverable GST would be embedded in the GST-free supplies because Hamersley's leasing activities operate at a loss'. The judge said (at [30]) that interpretation 'does not seek to identify or assume the underlying policy of a provision and then to construe that policy'.[855]

Observations by Hill J in *HP Mercantile* on general policy could be accepted, said Davies J, 'but those observations do not provide the answer to the proper construction of s 11-15'. The judge concluded (at [33]) that all acquisitions had a 'direct and immediate connection' to residential rent and that input tax credits were not available.

13.2 Appeal dismissed

In a short judgment delivered promptly, the Full Federal Court comprising Middleton, Logan & Pagone JJ dismissed the taxpayer appeal unanimously and jointly.[856] The judges pointed out (at [6]) that the s 11-15(2)(a) enquiry was not whether something had been acquired in carrying on an enterprise but, and irrespective of that, to what extent the acquisition related to making supplies that would be input taxed.

The relationship which needs to be focused on is 'between the antecedent acquisitions for which credit is claimed and the subsequent supply for which the credit is, in effect, lost'. This, said the Full Federal Court, is a factual enquiry. It does not depend on the 'broader commercial objective of the supplier'. As the court went on to explain (at [8]), the enquiry in question called for by s 11-15(2)(a) –

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[852] *Rio Tinto Services Ltd v FCT* [2015] FCA 94.
[853] Grube *Neutrality and input tax deductibility* (2017) 17 AGSTJ 8 (at 25).
[854] *CIR v BNZ Investment Advisory Services Ltd* [1994] BCL 466 referred to.
[855] *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 (at [24]) quoted.
[856] *Rio Tinto Services Ltd v FCT* [2015] FCAFC 117.

> … is not into the relationship between the acquisition and the enterprise more broadly … The terms of s 11-15(2)(a) do not depend upon the reason or purpose of the enterprise making the supply or making the anterior acquisition. The provision does not turn upon a characterisation of the purpose, or the occasion of the purpose, of the supplier but upon a characterisation of the extent to which the acquisition relates to the subsequent supply.

Before dismissing the appeal, the Full Federal Court noted (at [8]) that the extent of the relationship between the acquisitions and the residential rent in this case 'is not to be reduced by the fact that the acquisitions may also have related to another purpose where the other purpose is only related to the acquisition wholly by and through the otherwise input taxed supply'. The message from the court is unambiguously to address the words of the statute rather than remotely sourced ideas of policy.

13.3 Views of commentators

Much of the public comment following *Rio Tinto Services* has been directed at the ability to look through input taxed supplies to taxable ones as a means to establishing credit access. That door has been closed in this regard in Australia where the factual enquiry exposes sufficient nexus with an input taxed supply. In an early article, Peter McMahon and Amrit MacIntyre had reviewed a similar 'underlying purpose' argument in a VAT borrowing context.[857] Their conclusion was that the 'same outcome would not necessarily result under the Australian GST legislation because of the different concepts and language employed'.

Professor Millar[858] compares *Rio Tinto Services* with *UAB Sveda*, a CJEU case decided about the same time.[859] Both cases look at the right to deduct on the basis of some ultimate or underlying non-blocked commercial purpose. In *UAB Sveda*, however, the intermediate supply was 'for no consideration' – a key difference – and deduction of input tax was allowed.[860] In the EU, a primary use/secondary use analysis is applied, something which has no resonance in our GST law. Professor Millar concludes (at 47) by saying that, in both jurisdictions, 'once you establish an objective, relevant connection between an acquisition and an exempt/input taxed supply, the right to deduct/credit the input tax is blocked'.

In relation to the first instance decision in *Rio Tinto Services*, Gina Lazanas & Robyn Thomas note that it is an objective relationship between an acquisition and supplies which is required, 'not the moving cause or principal purpose behind the acquisition'.[861] The authors go on to say (at 46) that 'how the GST is intended to apply at a high level and mechanisms to avoid the cascading of tax, will not prevent s 11-15 from being construed on its terms'.

Although the case 'preserves the status quo', it is said (at 47) that the decision may give rise to 'unexpected outcomes' where s 11-15(2)(a) is 'more uncertain and complex in

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[857] McMahon & MacIntyre *GST and Financial Supplies* (2000) 3 *Journal of Australian Taxation* 167 (at 178-179) citing *Edgemont Group Ltd* [1995] BVC 627 (at 629).
[858] Millar *Limitations on the right to credit input tax* (2016) 5/1 *World Journal of VAT/GST Law* 42.
[859] *UAB 'Sveda' v Valstybin mokesi inspektcija* [2015] Case C-126/14.
[860] cf *BLP Group plc v CCE* [1995] ECR 1-983.
[861] Lazanas & Thomas *Rio Tinto Services Limited: No input tax credit relief* (2015) 15 AGSTJ 40.

its operation'.[862] Examples given include acquisitions into mergers and acquisitions, and acquisitions serving a dual purpose. Jeremy Geale said the decision 'creates significant uncertainty going forward' and that[863] –

> Such an outcome is entirely inconsistent with the primary objects of the Act, which seeks to avoid double taxation and cascading of tax, even in the context of an enterprise which primarily makes taxable or GST-free supplies.

Geale then drew attention (at 1) to a view that the language of Div 11 'may be illusory' insofar as the term 'creditable purpose' has been found to mean 'something other than purpose'. He also said (at 12) that some public rulings were not fully consistent with a submission that the 'creditable purpose' definition 'does not necessarily mandate an inquiry into the purpose of expenditure, notwithstanding its label'.

The ordinary position in Australia is that neither the label for a statutory definition nor the ordinary meaning of terms appearing in that label may be used as an interpretive aid when determining what the definition means.[864] To do otherwise would introduce circuity, as courts have consistently ruled.[865] Other views have been expressed from time-to-time on this issue,[866] but they are yet to be accepted in the High Court. GST commentators have raised that actual 'purpose' continues or should continue to play a role in the s 11-15(2)(a) context.[867] Michael Evans also argues that the focus of credit access 'should be the identification of the extent to which the acquisition relates to the consideration received for the input taxed supply'.[868]

Dr Grube and Professor Millar agree that *Rio Tinto* would be decided in the same way in Europe as it was in Australia. There is no reason to doubt that this is correct, but we ask what significance does this outcome have? My answer is 'probably not very much'. That different legislation in different jurisdictions interpreted differently may produce the same outcome on the same facts may give comfort on wider economic policy or neutrality grounds may be interesting.

However, this tells us little about the legal efficacy of the decisions themselves, whether *Rio Tinto* is good law or not, and much less whether either case confirms the legal correctness of the other. If we test the respective outcomes against some 'strict and complete' neutrality in an economic sense, both are undoubtedly sub-optimal. That neutrality would not deliver credit access in Europe on *Rio Tinto* facts is economically interesting but without wider legal significance.

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[862] cf Strauch *Sticking to the facts: creditable purpose after Rio Tinto* (2015) 50 *Taxation in Australia* 259.
[863] Geale *The assessment of creditable purpose in light of the decision in Rio Tinto* [2015] *unpublished paper* (at 15).
[864] *SZTVU v Minister of Home Affairs* [2019] FCAFC 30 (at [71]) illustrates.
[865] *Wacal Developments Pty Ltd v Realty Developments Pty Ltd* (1978) 140 CLR 503 (at 507), *Owners of Shin Kobe Maru v Empire Shipping Co Ltd* (1994) 181 CLR 404 (at 419), *ASIC v King* [2020] HCA 4 (at [18]).
[866] *Singh bhnf Kanwar v Lynch* [2020] NSWCA 152 (at [98-131]), *SZTVU v Minister of Home Affairs* [2019] FCAFC 30 (at [71]), *Minister for Immigration and Multicultural Affairs v Hu* (1997) 79 FCR 309 (at 324), *Manly Council v Malouf* (2004) 61 NSWLR 394 (at [8-9]), cf *MacDonald v Dextra Accessories Ltd* [2005] 4 All ER 107 (at [18]), *Birmingham City Council v Walker* [2007] 2 AC 262 (at [11]).
[867] Lavery & Patane *Financial transactions: Some Current Issues Arising from Recent Cases and Interpretations* [2017] *TIA National GST Intensive Conference paper* (at 4-8]).
[868] Evans *GST: Where to next?* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 80).

Perhaps it is simply validation of the prediction made by Cordara that there 'is likely to be a convergence of experience on the input tax front given the basically universal problems which input tax generates'.[869] That may be so, but it is not the international experience which is driving the Australian outcomes. It is the form of our legislation.

13.4 Policy preconception

One important point made by Davies J was that interpretation 'does not seek to identify or assume the underlying policy of a provision and then to construe that policy'.[870] This is a practice which the High Court has been concerned to call out more and more often in recent years. It is also precisely what the taxpayer sought to do in *Rio Tinto*.[871] Edmonds J, in his paper *Five Years of GST,* put the issue this way[872] –

> Accepting that the search for legislative policy involves inference, there is a danger that the judge may, in making that inference, apply, perhaps unconsciously, subjective views as to that policy. There may, indeed, be a potential danger that the judge will be mistaken in drawing that inference. Minds may differ as to precisely what the policy is, even if, as Mason CJ once remarked extra-judicially, taxation policy is not 'rocket science'.

The same judge was quoted the following year in the *Australian Financial Review* for saying – 'Perhaps all that may be said is that one person's policy will be the antithesis of another's'.[873] As John Burrows remarked, the art of interpretation 'lies in abandoning one's own prejudices and preconceptions and fully appreciating the direction of the legislature's thinking'.[874] Another writer described the basic problem in more fatalistic terms, saying that 'judges will, under the guise or even the delusion of pursuing unexpressed legislative intents, pursue their own objectives and desires'.[875]

There is perhaps also the human nature comment that 'each of us is very tempted to see his own first interpretation as much more strongly and clearly what the words say than any other view'.[876] As these remarks illustrate, policy preconception is a danger for interpreters generally. It is also a barrier to reception of EU neutrality ideas in particular. Scalia and Garner refer to it in the context of suppression of personal preferences.[877]

Most recently, the High Court warned against 'a judicially constructed policy at the expense of the requisite consideration of the statutory text and its relatively clear purpose'.[878] What we might describe as 'simplistic conception', however, is just as much a problem as preconception. Seeking to apply a policy derived by whatever means which is in terms too general or too abstract may equally lead to error. Modern

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[869] Cordara *The Sixth VAT Directive and Key Legal Issues under VAT in Europe* (at 33).
[870] *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 (at [24]) quoted.
[871] cf Evans *The Value Added Tax treatment of Real Property – An Antipodean Context* in White & Krever (eds) *GST in Retrospect and Prospect* (at 244).
[872] Edmonds J *Five Years of GST* [2005] *TIA National GST Intensive Conference paper* (at [42]).
[873] Kazi *Judge lays down law to government* (20 October 2006) *Australian Financial Review*.
[874] Burrows *The Changing Approach to the Interpretation of Statutes* (2002) 33 VUWLR 981 (at 985).
[875] Lonnquist *The Trend Towards Purposive Statutory Interpretation: Human Rights at Stake* [2003] *Revenue Law Journal* 18 (at 25).
[876] Bryson *Statutory Interpretation: An Australian Judicial Perspective* (1992) 13 *Statute Law Review* 187 (at 194-195).
[877] Scalia & Garner *Reading Law* (at 31).
[878] *Williams v Wreck Bay Aboriginal Community Council* [2019] HCA 4 (at [79]), cf *Commissioner of Police v Ferguson* [2019] WASCA 14 (at [72]).

legislation and particular provisions are more usually the product of political compromise. The correct enquiry here is not into the policy itself, but how far the provisions go in its implementation.

Mention might be made of a certain hubris which sometimes emerges in this regard. What is being referred to is the confidence of specialists (wherever they are to be found) that they just know what the law was intended to achieve and therefore what it means. Perhaps they were there at the time. In any event, they invariably seem to know from the start and without analysis what the 'right answer' is or should be.

This kind of policy preconception is at the more serious end of the practice courts are increasingly concerned to call out. As Kirby J has directed attention to, and others have repeated, it is sometimes necessary to 'haul experts back to the text of the statute'.[879]

Others describe the isolationist tendencies of 'tax cognoscenti'[880] and the 'myth of tax essentialism'.[881] Gummow J has written on similar themes with special mention for tax officers.[882] Edmonds J, in an article about interpretation of s 11-15, put it best when he said that high level tax policy considerations, 'while they may be relevant to context, are of limited assistance in the task of statutory construction because they do not inform that context in the sense of addressing the elements or criteria of tax liability by which the statute implements that policy.[883]

14. CONSUMPTION ISSUES

14.1 One subject of taxation

For constitutional validity purposes, the subject matter of GST as a tax on consumption is an important consideration. The requirement that the GST law deal with one subject of taxation only, however, is concerned with political relations rather than analytical or logical classifications. It is also for the legislature to choose its own subjects of taxation 'unfettered by existing nomenclature or by categories adopted for other purposes'.

The test is whether, looking at the subject of taxation selected by parliament, 'it can fairly be regarded as a unit rather than a collection of matters necessarily distinct and separate'.[884] Against this constitutional backdrop, it had been held by Hely J in *O'Meara v FCT* that[885] –

> … Parliament has according to 'common understanding and general conceptions' imposed a tax on a single subject of taxation, namely on final

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[879] Kirby J *Hubris contained: why a separate Australian tax court should be rejected* [2007] *Challis Taxation Discussion Group paper* (at 16).
[880] Livingston *Practical Reason, "Purposivism", and the Interpretation of Tax Statutes* (1996) 51 *Tax Law Review* 677 (at 709).
[881] Caron *Tax Myopia, Or Mamas Don't Let Your Babies Grow Up To Be Tax Lawyers* (1994) 13 *Virginia Tax Review* 517 (at 518).
[882] Gummow *The Law of Contracts, Trusts and Corporations as Criteria of Tax Liability* (2014) 37 *Melbourne University Law Review* 834 (at 835).
[883] Edmonds *Interpretation of s 11-15: Significance of the text, context and history* (2012) 12 AGSTJ 79 (at 81).
[884] *Austin v Commonwealth* [2003] HCA 3 (at [190]).
[885] *O'Meara v FCT* [2003] FCA 217 (at [24]), cf Brysland *Interchase to Kurc – the Australian GST cases so far* (2004) 4 AGSTJ 149 (at 151-152), Stone *The GST – A Practical Business Tax* [2006] *TIA National GST Conference paper* (at 6).

private consumption in Australia. That is one subject of taxation for the purposes of s 55 of the *Constitution*.

Steven Spadijer, in an *Australian Tax Review* article, argues the decision of Hely J in *O'Meara* is wrong with the result that the GST law is unconstitutional.[886] In his view, the GST is not a tax on consumption at all, nor can 'supplies' be a singular subject of taxation for s 55 purposes. He says (at 224) that the 'imposition of GST operates completely independently from the act of private consumption, or from private consumption expenditure'. Consumption 'is not even a necessary precondition needed to generate a GST tax liability' – *Reliance Carpet*.

The author's view is that GST involves an 'agglomeration of indirect taxes imposed across a range of heterogeneous and disparate subject matters' – an 'omnibus supertax' he calls it. Steven Spadijer concludes that the GST is in 'violent conflict' with the manifest tenor of s 55'. The article ends with the following statement – 'Political inconvenience is simply not a sufficient reason to continue to allow the *Constitution* to be held hostage to the demands of tax collectors'.

14.2 Economics and law

As Michael Evans pointed out, the 'preference for a tax on consumption is that it enables a secure and reliable source without distorting the behaviour of firms and households'.[887] What the High Court is saying in *Reliance Carpet* is that, although in economic terms GST may be a 'consumption tax',[888] that is not the legal yardstick by which its fiscal reach is to be measured. That GST is a tax on consumption is a truism for most of us,[889] though the kind of 'consumption' involved and the elements which define it may provide scope for analysis and debate.[890]

The High Court was at pains to emphasise this when it said that the 'composite expression "a taxable supply" is of critical importance to the creation of liability to GST'. Matthew Bambrick has observed that, 'while consumption is an economic driver *for* our GST, it is not a legal principle *of* our GST'.[891] The reason 'consumption' is important in the EU is that the Directives incorporate that concept into the statutory infrastructure for taxing purposes.[892] In Australia, parliament took a different approach.

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[886] Spadijer *Is the GST unconstitutional? Some s 55 problems revisited* (2014) 43 *Australian Tax Review* 204, cf Brysland *GST and Government in 2010* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 3 (at 6-10).
[887] Evans *GST: Where to next?* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 5).
[888] GSTR 2000/11 (at [27-29]), cf *Westley Nominees Pty Ltd v Coles Supermarkets Australia Pty Ltd* (2006) 62 ATR 682 (at 696 [59]), *DB Rreef Funds Management Ltd v FCT* (2005) 59 ATR 388 (at 389 [2]), *Reliance Carpet Co Pty Ltd v FCT* (2007) 66 ATR 117 (at 132 [31-32]), *O'Meara v FCT* 2003 ATC 4406 (at 4410 [22-24]), *TSC 2000 Pty Ltd v FCT* (2007) 66 ATR 945 (at 957 [55]).
[889] Millar *Time is of the Essence: Supplies, Grouping Schemes & Cancelled Transactions* (2004) 7/2 *Journal of Australian Taxation* 132 (at 137), Parisi *The Goods and Services Tax as a Tax on Acquisitions* [2007] unpublished paper (at 14-16) illustrate.
[890] Cnossen *VAT Treatment of Immovable Property* in Thurongi (ed) *Tax Law Design and Drafting* 231 (at 232-234).
[891] Discussion with Matthew Bambrick of the ATO on 20 March 2019, cf England *When contracts go astray – GST implications* [2009] *ATAX GST & Indirect Tax Weekend Workshop paper* (at 11).
[892] Lazanas *Current Hot Topics in GST* [2006] *TIA 22nd National Convention paper* (at 13-15).

Various passages in *Redrow Group* illustrate the legal focus on the concept of consumption in the EU which is absent in Australia.[893] One commentator said of neutrality that the 'root of the principle is that VAT is a tax on consumption'.[894] Advocate General Kokott has pointed out that neutrality represents a fundamental principle of VAT 'inherent in its nature as a tax on consumption'.[895]

It is the VAT Directive consumption context which makes cases like *Mohr*[896] of ongoing significance in the EU.[897] In that case (at [27]), it was stated that the scope of VAT is 'limited by its character as a tax on consumption'. Roderick Cordara and Pier Parisi observe, however, that the underlying consumption notion in Europe has done little to limit the supply concept.[898] They point to comments that there is 'no jurisprudence on the meaning of consumption',[899] and that the consumption tax principle 'needs clarification on a Community-wide basis, as the present situation is unsatisfactory'.[900]

One reason for this may be that expenditure on consumption is used as a proxy for consumption. Terra and Kajus say that this 'generally avoids the difficulties of defining consumption'.[901] The consumption at which the tax is directed, therefore, is not co-extensive with the economic concept.[902] Professor Millar agrees, and has noted that consumption discussions 'rarely give more than lip service to economists' concepts'.[903]

14.3 Not a consumption tax

A consumption analysis is legally unnecessary in Australia, due to the absence of comparable EU statutory language, and the firm rejection of economic policy more generally as some proxy for the text contained in the legislation. Graeme Cooper dealt with this in a 2003 paper[904] – *Why GST is not a consumption tax ... and why it matters*. In his view, the idea that GST is a consumption tax in economic terms 'should play no role' in GST interpretation. Three points can be made. The first is that Cooper was correct, in my view. The second is that the opposing position is no longer legally tenable.

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[893] *CEC v Redrow Group plc* [1999] 1 WLR 408 (at 415).
[894] Henkow *Neutrality of VAT for taxable persons: a new approach in European VAT?* [2008] *EC Tax Review* 233 (at 234).
[895] *Biosafe – Indústria de Reciclagens SA v Flexipiso – Pavimentos SA* [2017] Case C-8/17 (at [42]).
[896] *Mohr v Finanzamt Bad Segeberg* [1996] STC 328, *Landboden-Agrardienste GmbH v Finanzamt* [1998] STC 171, cf *CRC v Frank A Smart & Son Ltd* [2019] UKSC 39 (at [25]).
[897] *Trinity Mirror plc v CCE* [2001] STC 192 (at [17-18], *Stewart & Hammond v CCE* [2002] STC 255 (at [32-40]), *South Liverpool Housing Ltd v CCE* [2004] UKVAT V18750 (at [47-48]), *Parker Hale Ltd v CCE* [2000] STC 388, cf *NZ Refining Co Ltd v CIR* (1995) 17 NZTC 12307.
[898] Cordara & Parisi *Australian Goods and Services Tax Cases – Decisions and Commentary* (at [1.15.2]), cf Parisi *Attention diverted from need to focus on consumption* (2010) 10 AGSTJ 103.
[899] *Royal & Sun Alliance Insurance Group plc v CEC* [2001] EWCA Civ 1476 (at [48]).
[900] Butler *VAT as a Tax on Consumption* (2000) 5 *British Tax Review* 545 (at 552).
[901] Terra & Kajus *A Guide to the European VAT Directives* (at [7.2.2]), James *The Rise of the Value-Added Tax* (at 41).
[902] cf Millar *Time is of the Essence: Supplies, Grouping Schemes & Cancelled Transactions* (2004) 7/2 *Journal of Australian Taxation* 132 (at 137-138) quoting Cnossen *VAT Treatment of Immovable Property* in Thuronyi (ed) *Tax Law Design and Drafting* (at 232).
[903] Millar *GST issues for international services transactions* (2004) 4 AGSTJ 285.
[904] Cooper *Why GST is Not a Consumption Tax ... and Why it Matters* [2003] *TIA GST Intensive Conference paper*, cf Ture in McLure (ed) *The Value Added Tax: Key to Deficit Reduction* (at 79-80), Williams in Thuronyi (ed) *Tax Law Design and Drafting* (at 169), Cooper & Vann (1999) 21 *Sydney Law Review* 337 (at 357-359).

The third is that, just as consumption plays no role in determining liability, so it necessarily plays no role in Div 11 credit access questions either.

In his *Journal of Australian Taxation* article, Hill J also surveyed the possible impact of 'consumption' theory on GST interpretation.[905] The judge observed that there was no doubt that parliament had intended that GST 'would operate as a tax on consumption', given comments in the *explanatory memorandum*. Hill J pointed to the wide definition of 'supply', and to the fact that any obligation on a farmer to cease production (as was the case in *Mohr*) would involve a 'supply' for our purposes. He said (at 27) –

> … it is obvious that it will be unsafe to assume the same result will follow in Australia. And it will always be unsafe to assume the same result in Australia as is reached in overseas decisions where the legislation is different. Any attempt to interpret the Australian legislation by adopting a policy driven consumption tax analogy must yield to the terms of the legislation if contradictory to the approach. Conversely, however, if the relevant statutory provision is Australia is substantially similar to the overseas provision, overseas cases will clearly be treated with respect.

Hill J's point about it being 'unsafe' to assume our GST will produce the same results where the overseas legislation is different is an understatement. Of course, our results will yield to our legislation. If *Reliance Carpet* shows anything, it is the flaw of arguing by reference to offshore consumption theories. Commenting on the 'big picture' perspective that our GST is a consumption tax, Michael Walpole said 'it would appear that the purposive approach to interpretation required in our law a different outcome'.[906]

After an early trend towards engagement with foreign caselaw on GST questions, partly driven by Hill J himself,[907] the track record as well as messages from other judges suggests that foreign cases are not of much utility when interpreting our GST law.[908] Three reasons may be advanced for this. The first is that our statutory provisions are different. Second, the interpretation protocols which apply in the EU (including the UK in VAT matters) diverge, and radically so, from those in Australia. Third, there is now an extensive and maturing jurisprudence on the tax at various levels (including five High Court cases) even if there are less cases these days that in the past.[909]

In *Avon Products*, the High Court in a sales tax context said that foreign cases dealing with different statutory regimes need to be treated with 'considerable caution'.[910] This is a long-rehearsed theme of the Australian judiciary. It was said in *Avon Products* that international authorities cited 'tend to muddy the waters rather than to illuminate them'. The Full Federal Court in *Saga Holidays* said this warning 'is particularly apt in the

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[905] cf Hill J [2002] TIA Australian GST Symposium paper (at 26-27).
[906] Walpole *Keeping to the straight and narrow: interpreting the GST and income tax* (2005) 5 AGSTJ 193.
[907] *ACP Publishing Pty Ltd v FCT* [2005] FCAFC 57 (at [2-3]) quoting *Dansk Denkavit ApS v Skatteministeriet* [1994] 2 CMLR 377 (at 394-395) for example.
[908] cf Edmonds *Recourse to foreign authority in deciding Australian tax cases* (2007) 36 *Australian Tax Review* 5, Lindgren *The Courts' role in statutory interpretation: the relevance of overseas case law to Australia's GST* [2009] *National GST Intensive Conference paper*.
[909] cf Cordara *Value Added Tax/Goods and Services Tax* [2004] *TIA World Tax Conference paper* (at 2), Frost *The developing jurisprudence of the GST* [2013] *UNSW 25th GST Conference paper*.
[910] *Avon Products Pty Ltd v FCT* [2006] HCA 29 (at [28]).

present circumstances since the details of the GST Act are significantly different from those of the equivalent legislation in the UK and other countries'.[911]

Edmonds J made similar points.[912] It was also the absence of comparable statutory provisions which led the High Court in *Reliance Carpet* (at [30]) to reject the relevance of a VAT case – *Société Thermale*.[913] Others pointed out that to argue by reference to CJEU decisions in the future was 'now fraught with danger'.[914] Robert Olding predicted that 'reference to overseas cases and legislation will decline'.[915] So it has proved to be, not only in the courts and the AAT, but also in the journals and commentary.

A swathe of diverse provisions across the GST law, however, adopt some idea of consumption for one purpose or another. In addition to customs law[916] and food senses,[917] the GST law uses 'consumption' and cognate expressions as part of the legal gateway in a variety of situations. These include health exemptions,[918] exported goods,[919] exported services,[920] joint ventures,[921] margin scheme,[922] creditable purpose,[923] deceased estates,[924] and some definitions.[925] The most enigmatic of these is s 38-190(1), where the words 'consumption outside Australia' appear in the heading though not in the provision itself.

Mansfield J, dissenting in *Travelex Limited*, had regard to 'consumption',[926] but none of the majority judges in the High Court factored this into their reasons.[927] Amendments in 2016 introduced the notion of an 'Australian consumer' into s 9-25(5) for when certain supplies are connected with the 'indirect tax zone'. The definition of 'Australian consumer' in 9-25(7) involves a statutory construct, however, rather than an economic one. Choice of the word 'consumer' within the construct plays no role in its meaning.[928]

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[911] *Saga Holidays Ltd v FCT* [2006] FCAFC 191 (at [43]).
[912] Edmonds *Recourse to foreign authority in deciding Australian tax cases* (2007) 36 *Australian Tax Review* 5 (at 16), cf *Avon Products Pty Ltd v FCT* 2006 ATC 4296 (at 4301-4302 [28]), *Saga Holidays Ltd v FCT* [2006] FCAFC 191 [at 43]).
[913] *Société Thermale d'Eugénie-les-Bains v Ministère* [2007] 3 CMLR 1003.
[914] Batrouney & Geale *The decision of the High Court in Reliance Carpet and what it means for GST* [2008] *Victorian Bar Association Conference paper* (at 10).
[915] Olding *Interpretation of the GST Act – Towards a Principled Basis?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 92).
[916] ss 13-5(1)(b), 13-99 (item 3), 15-99 (item 2AA), 33-99 (item 4A), 37-1 (item 17), 108(1), 108(5)(1)(b), 114(1), 114-5 (various items), 114-10(a), 114-20(1)(a), 114-25(1), 141-5(1)(c), 141-10(1)(b) of the GST law.
[917] ss 38-3(1)(a), 38-4(1), cf *Cascade Brewery Co Pty Ltd v FCT* [2006] FCA 821, *P&N Beverages Australia Pty Ltd v FCT* [2007] NSWSC 338.
[918] ss 38-10(4)(b), 38-50(2), 38-50(7)(a).
[919] heading to Div 38-E, item 5 in the s 38-185(1) table.
[920] heading to s 38-190.
[921] s 51-30(2)(a).
[922] ss 75-11(2A)(b), 75-1(2B)(b).
[923] s 129-55 definition of 'apply'.
[924] s 139-1.
[925] s 195-1 definitions – 'course materials', 'retailer'.
[926] *Travelex Ltd v FCT* [2009] FCAFC 133 (at [23]).
[927] *Travelex Ltd v FCT* [2010] HCA 33.
[928] *SZTVU v Minister for Home Affairs* [2019] FCAFC 30 (at [66-71]), *Wacal Developments Pty Ltd v Realty Developments Pty Ltd* (1978) 140 CLR 503 (at 507), cf *MacDonald v Dextra Accessories Ltd* [2005] UKHL 47 (at [18]), *Manly Council v Malouf* [2004] NSWCA 299 (at [8-9]).

15. PRACTICAL BUSINESS TAX

15.1 A contextual thing

GST has been described in various cases as a 'practical business tax'.[929] As a result, there has been much debate about what impact this might have on interpretation of the GST law.[930] At its highest, there was a half-suggestion that this fact it constituted a special rule of construction for GST purposes.[931] Peter Green, speaking to his 2008 ATAX Noosa paper rejected this idea, calling it 'the refuge of the desperate man'.[932] Michael Wigney was also against any 'special rule' suggestion,[933] a position with which Downes J readily agreed.[934] When *Travelex* reached the Full Federal Court, Stone J called PBT a cliché because like most clichés 'it has achieved that status because it encapsulates a truth so well accepted that it hardly requires articulation'.[935]

In the High Court, no judges referred to the concept, but equally none rejected it either.[936] It is now settled that description of GST as a 'practical business tax' is merely part of the wider context.[937] It would follow then that regard should be had to PBT up-front when applying the 'modern approach'.

The forensic impact of this factor in any particular case, however, even after 20 years of the tax, remains conjectural and illusive.[938] Could it, for present purposes, strengthen the case for EU neutrality being absorbed into our law perhaps?

As Logan J has observed, a value added tax, through the elimination of cascading, is in this economic sense, a 'practical business tax'.[939] The same judge went on to suggest that reference to GST as a practical business tax may be more likely to mask than illuminate the task of interpretation. Many would agree, something which has been borne out to a large extent in practice. Focus on the PBT-status of the tax has worked mainly as a distraction from the words of the legislation.

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[929] *Sterling Guardian Pty Ltd v FCT* [2005] FCA 1166 (at [39]), *Saga Holidays Ltd v FCT* [2005] FCA 1892 (at [62]), *Saga Holidays Ltd v FCT* [2006] FCAFC 191 (at [29]), *TSC 2000 Pty Ltd v FCT* [2007] AATA 1629 (at [54]), *AGR Joint Venture v FCT* [2007] AATA 1870 (at [32]), *Reliance Carpet Co Pty Ltd v FCT* [2007] FCAFC 99 (at [13]), *Brady King Pty Ltd v FCT* [2008] FCA 81 (at [38, 48]), *Brady King Pty Ltd v FCT* [2008] FCAFC 118 (at [25]).

[930] cf Green [2008] *ATAX Noosa Conference paper* (at 14-20), Stone J [2006] *TIA National GST Conference paper*, Logan J *Where are we with GST – black letter or the practical business tax?* [2008] *TIA National GST Intensive Conference paper*, Olding [2008] *Law Council Tax Committee Workshop paper*, Hmelnitsky *The Truth about Supply – Lessons from Reliance, Qantas and MBI* [2015] *TIA GST Intensive Conference paper* (at [7-13]), Stitt *GST – History, Experience & Future* [2007] *Federal Court Judges' Taxation Workshop paper* (at 24-26).

[931] cf *Saga Holidays Ltd v FCT* [2005] FCA 1892 (at [29, 62]).

[932] Green [2008] ATAX Noosa paper (at 14-20).

[933] Wigney *Text, context and the interpretation of a 'practical business tax'* (2011) 40 *Australian Tax Review* 94 (at 95).

[934] Downes J *Eleven years of the 'practical business tax'* (February 2012) 70 *Law Institute Journal* 70 (at 72).

[935] *Travelex Limited v FCT* [2009] FCAFC 133 (at [46]).

[936] *FCT v Multiflex Pty Ltd* [2011] FCAFC 142 (at [37]).

[937] *Saga Holidays Ltd v FCT* [2006] FCAFC 191 (at [29-30]).

[938] Olding [2008] Law Council Tax Committee Workshop paper.

[939] Logan J *Where are we with GST – black letter or the practical business tax?* [2008] *TIA National GST Intensive Conference paper* (at 1-2 [3]).

This is something which *Reliance Carpet* appears to emphasise by omission. PBT cannot sanction the disregard of legal analysis, something already pointed out in the income tax sphere.[940] PBT just begs the question. Despite some high-powered analytical investment in the concept by commentators and litigation teams, there is not much to show for GST being a 'practical business tax'. Certainly, there is no case I am aware of in which the concept has been decisive in the final result. In one AAT decision, for example, the result reached on common law grounds was simply seen as being consistent with GST being a practical business tax.[941]

Wigney SC has said that characterisation 'is really what the practical business tax concept is all about'. In his expectation, the 'range of cases where significant weight is given to this consideration will be fairly narrow, and the cases where it will be the decisive consideration will be few and far between'.[942] After considering two Full Federal Court decisions – *Brady King* and *South Steyne* – Robert Olding said[943] –

> If practical business tax considerations are considered to be relevant in a particular case, it is important to understand which particular aspect of that context is considered relevant in the circumstances and why. If practical business tax aspects are not relevant, it is important to understand why that contextual consideration should be dismissed or given little weight in the particular case.

15.2 Character of the concept

In *Uber BV*, Griffiths J took a practical, common-sense and always-speaking approach to the meaning of 'taxi' in the GST law.[944] Although the judge referred to the 'practical business tax' context generally, his approach when analysed further merely applied the anti-linguistic orthodoxy within the 'modern approach'.[945] This is reflected in the much-quoted passage from *Agalianos* to the effect that the 'context, the general purpose and policy of a provision and its consistency are surer guides to its meaning than the logic with which it is constructed'.

In a special leave application, Ellicott QC described this as 'one of the most telling statements of principle in relation to the interpretation of statutes'.[946] This is not so far from what Hill J had himself proposed in his *Journal of Australian Taxation* article when he suggested a rule which 'requires GST legislation to be interpreted in a practical

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[940] *City Link Melbourne Ltd v FCT* [2004] FCAFC 272 (at [42]).
[941] *Trustee for the Whitby Trust v FCT* [2017] AATA 343 (at [69]).
[942] Wigney *Text, context and the interpretation of a 'practical business tax'* (2011) 40 *Australian Tax Review* 94 (at 101, 107).
[943] Olding *Interpretation of the GST Act – Towards a Principled Basis?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 86).
[944] *Uber BV v FCT* [2017] FCA 110 (at [127-130]), Ng *GST and Uber: an application of the duck test?* [2015] *Australian Tax Law Bulletin* 178.
[945] *Commissioner for Railways v Agalianos* (1955) 92 CLR 390 (at 397), *FCT v Unit Trend Services Pty Ltd* [2013] HCA 16 (at [47]), *AB v Western Australia* [2011] HCA 42 (at [10]), *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 (at [24-26]), *Lansell House Pty Ltd v FCT* [2010] FCA 329 (at [57]), *Comptroller-General v Pharm-A-Care Laboratories Pty Ltd* [2018] FCAFC 237 (at [24]) for example.
[946] *Macoun v FCT* [2015] HCATrans 257.

or business-oriented way … that is not overly technical'.[947] As the years go by, however, the shiny lustre and early promise of 'practical business tax' has dulled somewhat.

This has been the indirect result of directions taken by the High Court in the five GST cases so far to have come before it. Practical business tax is also an inherently impressionistic and plastic concept, and one which is too often worn as a cloak for self-interest. Similar to the 'businesslike interpretation' principle which applies in contract law,[948] PBT is an idea very much in the eye of the beholder. PBT may be a core article of GST faith, but everyone has their own version of what it means. Both sides may rely on 'practical business tax' in litigation contexts, but they invariably seek to leverage it for starkly different outcomes.[949]

Justice Downes has stated that PBT should not have 'more than a peripheral effect on the interpretation of the GST Act', but goes on to say that a construction which advances the role of GST as a PBT 'will generally be preferred to one that does not'.[950] We may agree generally with the first comment. However, the idea that PBT might act as an informal default rule in contested situations is an unlikely position.

Professor Millar also includes an 'aside' on practical business tax, starting from an earlier flippant comment that 'it should be considered dead'.[951] After considering how the concept has played out before the courts, Millar walked this back a little to say that it now 'remains alive'. In the context of her paper, however, the professor said that PBT is a side issue to our search for the principle of neutrality. I agree, but would characterise the first more as a quietly sleeping kind of aliveness.

Professor Millar makes another point which is potentially interesting. This is that a possible reason for PBT remaining relevant 'is because it is a GST-specific reflection' of the 'modern approach' to interpretation. This may flow from PBT being simply part of the background context. That does not mean PBT may ever be decisive in a forensic situation. Its remoteness from the words of the text tells against that.

Other aspects of the 'modern approach', however, may push things in the same general direction – like dissuasion of intense linguistic analysis – as *Uber BV* shows.[952] This is generally consistent with the rejection of expert evidence about the meaning of words.[953] In a *Melbourne University Law Review* article, Middleton J said that 'we should not be blinded by too many rules or over-analysis, or mechanical or scientific analysis'.[954]

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[947] Hill J *Some Thoughts on the Principles Applicable to the Interpretation of the GST* (2003) 6 *Journal of Australian Taxation* 1 (at 18).
[948] *Electricity Generation Corp v Woodside Energy Ltd* [2014] HCA 7 (at [35]), *Simic v NSW Land & Housing Corporation* [2016] HCA 47 (at [78]), *Daswan Australia Pty Ltd v Linacre Developments Pty Ltd* [2018] VSCA 350 (at [50]).
[949] *Travelex Limited v FCT* [2009] FCAFC 133 (at [47]) for example.
[950] Downes J *Eleven years of the 'practical business tax'* (February 2012) 70 *Law Institute Journal* 70 (at 73).
[951] Millar *The principle of neutrality in Australian GST* (2017) 17 AGSTJ 26 (at 29-31).
[952] *SZTAL v Minister for Immigration & Border Protection* [2017] HCA 34 (at [34]), cf Brysland & Rizalar *Constructional choice* (2018) 92 *Australian Law Journal* 81 (at 84).
[953] *Dyson v Pharmacy Board of NSW* [2000] NSWSC 981 (at [23-28]), for example.
[954] Middleton J *Statutory Interpretation: Mostly Common Sense* (2016) 40 *Melbourne University Law Review* 626 (at 632).

It was once suggested that 'practical business tax' might open the door to 'economic equivalence' arguments in GST analysis.[955] *Reliance Carpet*, however, appears firmly to slam the door against that idea. As Andrew Sommer concluded at the ten year point, the 'concept of taxation by economic equivalence has been too long rejected by the Australian Courts for it to be revived now in the context of GST'.[956]

16. TIE-BREAKER IDEAS

16.1 Common law and statute

It was suggested both in *TSC 2000* and by Hill J himself that EU neutrality might act as some sort of resolving principle where arguments of roughly even weight point for and against credit access. The idea of having unlegislated tie-breaker rules for tax statutes, however, is already behind us. Two judicial protagonists, Kirby and Hill JJ, fought a semi-private battle of sorts over many years about whether tax legislation is still subject to two well-known canons of construction. The first one is that tax laws are to be read strictly or literally. The second one is that ambiguity is to be resolved against the revenue.[957] '[L]et 'not individuals suffer … the benefit of the doubt should be given to the subject' was the ethos.[958] The competing views of Kirby J and Hill J are set out by the former in his *Justice Graham Hill Memorial Speech*.[959]

Both canons, with all their pomp and subtlety, are discussed in an article by Douglas Brown.[960] Very much, they reflected a judicial philosophy that was 'highly suspicious of taxation'.[961] Professor Walpole described their operation as the 'venerable *contra fiscum* rule'.[962] Kirby J regarded them as obsolete by reference to purposive principles[963] and 'a much less hostile judicial attitude' these days. A tax statute is 'just another statute', he famously observed.[964] The change in attitude reflected wider recognition that revenue collection is no longer the sole object of modern tax laws, as Gleeson CJ illustrated in *Carr*. Lord Halsbury had said in 1891 that 'in a taxing Act it is impossible, I believe, to assume any intention, in governing purpose in the Act, to do more than take such tax as the statute imposes'.[965] Things have changed in this regard.

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[955] Walpole & Sommer *A sub-equatorial love affair – flirting with economic equivalence* [2007] *ATAX 19th GST and Indirect Tax Conference paper* (at 14-15), cf GSTR 2006/9 (at [112-113]).
[956] Sommer *The Application of the GST Law to Complex Transactions* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* 97 (at 112).
[957] *Scott v Cawsey* (1907) 5 CLR 132 (at 154-155), *Anderson v Commissioner for Taxes* (1937) 57 CLR 233 (at 243), Pearce & Geddes *Statutory Interpretation in Australia* (at [9.35-9.36]), cf *Royal Bank of Canada v Saskatchewan Power Corp* [1990] 73 DLR (4th) 257 (at [18]).
[958] *R v Winstanley* (1833) 148 ER 1492 (at 1496).
[959] Kirby J *Justice Graham Hill Memorial Speech* (2007) 42/4 *Taxation in Australia* 202 (at 205-206).
[960] Brown *The Canons of Construction of Taxation and Revenue Legislation* [1976] *Australian Tax Review* 81.
[961] Gleeson CJ *Justice Hill Memorial Lecture – statutory interpretation* (2009) 44 *Taxation in Australia* 25 (at 26) quoting Devlin *Judges and Lawmakers* (1976) 39 *Modern Law Review* 1 (at 13-14).
[962] Walpole *GST Interpretation – The New Age of Uncertainty* (2011) *23rd Annual GST Conference paper*.
[963] *Austin v Commonwealth* [2003] HCA 3 (at [251]), *CSD v Commonwealth Funds Management Ltd* 95 ATC 4756 (at 4759), *CCSD v Buckle* 96 ATC 4098 (at 4101).
[964] *FCT v Chant* (1991) 103 ALR 387 (at 391), cf Livingston *Practical Reason, "Purposivism", and the Interpretation of Tax Statutes* (1996) 51 *Tax Law Review* 677 (at 683).
[965] *Tennant v Smith* [1892] AC 150 (at 154), cf *Hood Barrs v IRC* (1946) 27 TC 385 (at 400), cf *Campbell v The King* (1916) 22 *Argus Law Reports* 428 (at 430), *Trustees of the Wheat Pool of Western Australia v FCT* (1931) 34 WALR 53 (at 58).

Hill J, perhaps a little out of character, took the view that to abandon the rule 'is an encouragement to sloppy drafting'.[966] This comment, offensive to the professionalism of parliamentary counsel everywhere, has a deep and tangled history. The anomalies of tax legislation as a species have been called 'virtually endemic, and, like the spots of the leopard "of the nature of the brute"'.[967]

Charles Dickens in *Bleak House* likened all legal language to 'street mud which is made of nobody knows what'. Lord Reid once pointed to the 'prolixity and obscurity' of taxing provisions, saying that they 'strongly indicate hasty preparation and inadequate revisal'.[968] Anomaly, however, need not always be the result of any drafter negligence.

We should accept that legislative drafting is an inherently difficult exercise, and get over the idea that imperfection, any imperfection, must result from careless or casual drafting. As Hilary Penfold points out, 'Australian statutes are the deliberate and conscious products of fairly well functioning intelligences'.[969] French CJ, for one, has called for a 'degree of empathy in the hardest heart' for the plight of drafters.[970]

In his *Along the Road to Damascus* paper, Michael D'Ascenzo agreed with Kirby J on the issue, adding 'that it is unlikely that Parliament intended "free riders" in relation to taxable activities "to the detriment of the general body of taxpayers"'.[971] Years later, the High Court appeared to put the matter to rest in *Alcan* when it said that 'tax statutes do not form a class of their own'.[972] As in other jurisdictions, however, this has not deterred a lingering nostalgia and fondness for the old canons. In Australia, it is more often in the State sphere that the remnants of literalism in this regard are to be found.[973] When parliament legislated for s 15AA, ordinary wisdom would seem to dictate a shut-down of the old canons to the extent of inconsistency.[974]

In practice, s 15AA has not generally been seen as displacing older non-statutory rules of interpretation. Instead, an unanalysed co-existence of sorts has formed, under which the learning on each category has continued to evolve.[975] It is probably correct to

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[966] Hill J *A Judicial Perspective of Tax Law Reform* (1998) 72 *Australian Law Journal* 685 (at 689), cf Hill J *How is Tax to be Understood by Courts?* (2001) 4/5 *The Tax Specialist* 226 (at 228-229), Hill J *Some Thoughts on the Principles Applicable to the Interpretation of the GST* (2003) 6 *Journal of Australian Taxation* 1 (at 7-9), *WA Trustee Executor & Agency Co Ltd v FCT* 80 ATC 4565 (at 4571).
[967] *Macpherson v Hall* (1972) 48 TC 382 (at 390).
[968] *Stenhouse Holdings v IRC* [1972] AC 661 (at 682).
[969] Penfold *Legislative Drafting and Statutory Interpretation* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 81 (at 97).
[970] French CJ *Statutory Interpretation in Australia: Launch of the 8th Edition* [2014] *University House ANU address* (at 1).
[971] D'Ascenzo *Along the Road to Damascus: A framework for interpreting the tax law* [2000] *Journal of Australian Taxation* 384 (at 386-387), cf *IRC v McGuckian* [1997] 3 All ER 817 (at 824).
[972] *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 (at [57]), cf Vinelott *Interpretation of Fiscal Statutes* [1982] *Statute Law Review* 78, *Stubart Investments Ltd v Canada* (1984) 84 DTC 6305 (at 6323), *R v Golden* [1986] 1 SCR 209 (at 494).
[973] *BSH Holdings Pty Ltd v CSR* [2000] VSC 320 (at [19]), cf *Charles Lloyd Property Group Pty Ltd v CSR* (2011) 84 ATR 775 (at 781), *Intercorp Pty Ltd v CSR* [2018] WASAT 90 (at [53]), *Eames v CSR* [2018] WASAT 14 (at [66]).
[974] *Plaintiff S10 v Minister for Immigration and Citizenship* [2012] HCA 31 (at [97]), cf *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 (at [41]), Pearce & Geddes *Statutory Interpretation in Australia* (at [2.23]).
[975] Geddes *Purpose and Context in Statutory Interpretation* in Gotsis (ed) *Statutory Interpretation: Principles and Pragmatism for a New Age* 127 (at 135-139).

describe the relationship as symbiotic, insofar as each side may inform development of the other in situations where either may prevail.[976]

When it comes to those 'special rules for tax laws', however, two things are reasonably clear. The first is that, by reason of caselaw at least, no special status rule now applies to tax laws in Australia and no systemic presumption favours revenue or taxpayer. Second, despite this, the taxation character of the legislation in question will form part of context in the 'widest sense' to be considered. Kirby J has been vindicated in saying that tax legislation is to be construed 'like any other federal statute'.[977] Tax law 'is still law; it's just that there's so much more of it', so the old joke goes.

16.2 Unqualified statutory instruction

As already discussed, the tie-breaker rule which applies to all federal statutes, including the GST law, is s 15AA of the *Acts Interpretation Act 1901*. Where a constructional choice is available on the words of a provision, this 'unqualified statutory instruction'[978] now requires that choice to be made by reference to the interpretation 'which would best achieve the purpose or object' of the provision derived by legitimate means. It is true parliament could legislate for a Div 11 tie-breaker rule, but it is yet to do so. No-one has sought to promote such a course, and it is an issue for which policy support may well be difficult to secure in practice.

It was Hack DP in *TSC 2000* who said fiscal neutrality 'is an aid to construction where it is necessary to determine which of competing constructions is to be preferred'.[979] A position of this kind creates a presumptive bias in favour of credit access. This is immediately inconsistent with the GST law being construed just 'like any other federal statute'. It is also excluded by the terms of s 15AA which leave no room for its operation.

While fiscal neutrality is a principle of interpretation in Europe – as confirmed by commentators and cases - that outcome is complicated by derivation and status issues. With respect, it was not legally open to the deputy president in *TSC 2000* to adopt EU neutrality as a new tie-breaker rule for GST. There is no presumption in Australia in favour of credit access where arguments are otherwise balanced.

17. SOME CONCLUSIONS

This note has argued for the orthodox view that EU neutrality is <u>not</u> part of the GST law. It is no foreign ghost in our GST machine, to pursue the metaphor, something which may disappoint ghostbusters and ghost-chasers alike. What drives the negative answer suggested is a range of diverse and over-lapping, but ultimately mundane, reasons.

What does seem important, however, is the consistency of the indicators against EU neutrality being part of our GST law, perhaps all the more remarkable in light of Hill

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[976] cf French CJ *Harold Ford Memorial Lecture: Trusts and Statutes* [2015] *Centre for Corporate Law and Securities Regulation paper* (at 2), *Brodie v Singleton Shire Council* (2001) 206 CLR 512 (at 532).
[977] *FCT v Ryan* [2000] HCA 4 (at [84]) dissenting, cf *Transport for London Ltd v Spirerose Ltd* [2009] UKHL 44 (at [25]), *Commissioner of Rating and Valuation v CLP Power Hong Kong Ltd* [2017] HKCFA 18 (at [35]).
[978] *SZTAL v Minister for Immigration & Border Protection* [2017] HCA 34 (at [39]), cf Brysland & Rizalar *Constructional choice* (2018) 92 *Australian Law Journal* 81.
[979] *TSC 2000 Pty Ltd v FCT* [2007] AATA 1629 (at [54]).

J's comments on 'underlying philosophy'. Key differences between the respective legal systems, their legislation and the interpretation protocols point against EU neutrality being absorbed into the GST law.

To coin a phrase used recently in the High Court, the European position is of 'marginal analogical assistance'[980] in determining the quality and extent of our domestic neutrality. What nails the case shut, however, is basic legal principle. Fundamentally, it is the character of legislated law in Australia and its domination over unlegislated economic policy (from wherever it comes) which locks out Mr Rompelman. Misconceptions about our statutes, their interpretation, and 'what judges do' have only added to the problem. In the end, the question posed is not a difficult one, as *Reliance Carpet* tends to show.

From the perspective of two decades, it is timely to comment on what may be described as the 'life of the statute' – the life of the GST law. It has been observed that context, for interpretational purposes, expands dynamically to include judicial decisions about the GST law as they are made.[981] As Stephen Frost has said, the progress of GST litigation 'has not been a linear journey but a multi-directional, multi-faceted one'.[982]

By year 2020, however, we have the beginnings of a mature GST jurisprudence in this country. A range of foundational issues have been settled by the superior courts, and there is measurably less litigation these days than a decade ago. Australian judges have interpreted our law in our way and in our context, as they are bound to do. In performing this role, they have progressively forsaken foreign decisions and foreign policies, one of which is the EU concept of neutrality derived in *Rompelman*.

To the extent there is lament about the native neutrality achieved, the argument is more with our system and with parliament. What Roderick Cordara referred to as the 'leisurely caravan' of the law,[983] however, has delivered a degree of GST certainty that compares favourably with prevailing European conditions.

Not everyone sees it this way. Edmonds J, for example, was most concerned about complexity of the GST law and the difficulties this produces in 'resolving disputations'.[984] Another commentator described GST interpretation as being 'shrouded in a swirling mist of doubt.[985] The *Australia's Future Tax System* report to government noted that the 'design is complex'.[986] Certainly the legislation is no exercise in perfection, and opportunities for improvement have been lost.

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[980] cf *Comcare v Banerji* [2019] HCA 23 (at [99]).
[981] Gageler *Common Law Statutes and Judicial Legislation: Statutory Interpretation as a Common Law Process* (2011) 37(2) *Monash Law Review* 1 (at 1), cf Kirby J *The Never-Ending Challenge of Drafting and Interpreting Statutes* (2012) 36 *Melbourne University Law Review* 140 (at 160), Leeming *Theories and Principles Underlying the Development of the Common Law – The Statutory Elephant in the Room* (2013) 36 *UNSW Law Journal* 1002 (at 1024), *Westpac Banking Corporation v Lenthall* [2019] FCAFC 34 (at [88]), Brysland & Rizalar *Constructional choice* (2018) 92 *Australian Law Journal* 81 (at 82).
[982] Frost *The developing jurisprudence of the GST* [2013] *UNSW 25th GST Conference paper* (at 1).
[983] Cordara *Value Added Tax/Goods and Services Tax* [2004] *TIA World Tax Conference paper* (at 2).
[984] Edmonds *Judicial Assessment of the Performance of the Goods and Services Tax as an Instrument of Tax Reform* [2011] *TIA National GST Intensive Conference paper* (at [36]).
[985] Peter Hill *Taxation of goods and services in Australia – past, present, and future* (2009) 9 AGSTJ 21 (at 26), cf Richardson & Smith *The Readability of Australia's Goods and Services Tax Legislation: An Empirical Investigation* (2002) 30 *Federal Law Review* 475.
[986] *Australia's Future Tax System* Report (at 273).

But is our GST law really much different from any other modern regulatory statute, like the *Migration Act 1958* for example? Again the argument here is with the system and the style of our legislative drafting, rather than with how judges have approached it.

What emerges in 2019 is a picture, in mosaic form, of the overall practical operation of the GST statute set against the backdrop of the general law. Kevin O'Rourke describes a 'legislative framework for GST administration which now resembles a patchwork quilt loosely knitted together by administrative fiat and litigation'.[987] Some 'immutable principles' of the kind flagged at the ten year mark are forming.[988]

As the years pass, the wider mosaic should come into better focus with the 'accumulation of experience' provided by decided cases, administration and academic testing. This will be driven by protocols of interpretation which are purposive and dynamic,[989] though not in the same way as in the EU, and not in a way as would invite Mr Rompelman to our shores. We and he are past that now.

While the idea of a fully harmonised international regime in this respect may be a 'theoretically desirable objective', there is little or no likelihood that Australia would now legislate to adopt EU-style neutrality, whether by substantive amendment or an after-the-event objects clause. To do so would also be misinformed.

Much of this note is about statutory interpretation, and the respective protocols which apply here and in the European Union. Given the question posed at the beginning, and the central importance of statutory interpretation as a driver of legal outcomes, this is less than surprising. It is those protocols, as products of different systems and different legal mosaics which suggest the answer about Mr Rompelman.

It is also those protocols in our legal system which suggest the one sustainable answer to the question posed by Justice Hill in his final communiqué on GST issues – *To interpret or translate?* While the European judge must translate and interpolate in line with community expectations, the Australian counterpart may only interpret.

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[987] O'Rourke *GST Administration – a practitioner's perspective* [2019] *ATAX Where Policy Meets Reality Conference paper* (at 16).
[988] cf Olding *Interpretation of the GST Act – Towards a Principled Basis?* in Peacock (ed) *GST in Australia: Looking Forward from the First Decade* (at 78).
[989] cf *Brown v Tasmania* [2017] HCA 43 (at [506]).

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The Australian GST cross-border rules in a global context

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Abstract

This article builds on previous research by the author examining the goods and services tax (GST) rules applying to cross-border supplies in a number of countries and highlights the immensely changed technological environment in which the GST operates in this context in Australia since the GST was introduced in 2000. The recent rules introduced in Australia are evaluated in light of global practice and it is concluded in particular that Australia was at the forefront of efforts to apply the tax to internet platform suppliers. The point is also noted that the breakthrough with platforms lends itself to allow taxing of the 'sharing economy' in a similar manner should the decision be made to do so.

Key words: Goods and services tax, digital economy, cross-border supplies, Australia, New Zealand, Canada, South Africa

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1. INTRODUCTION

This article on the 20th anniversary of the Australian goods and services tax is in one sense an update on a previous publication that undertook a comparative analysis of the cross-border supply rules for the supply of intangibles. That research examined the approach to this practically difficult challenge to the administration of the goods and services tax/value added tax (GST/VAT) in four jurisdictions – but with a significant focus on Australia. The other countries examined were New Zealand; Canada; and South Africa.[1] The article is also a recognition of the immensely different global economy that has developed since the introduction of the GST which economy has seen an increase in global connections through changes to the digital face of business and a shift to what many now call 'the digital economy'.

This article, as well as updating, endeavours to understand to what extent the approach in Australia may have been influential in the development of approaches to dealing with the phenomenon of cross-border supplies around the globe, or may itself have been influenced by other approaches. It also constitutes a record of how far the Australian GST has had to come, having been introduced when the internet was still a fledgling compared to the capacity to make cross-border orders and deliveries now in the digital age.

2. THE EARLY EMERGING THEMES

In the earlier work referred to above, the author and a researcher at University of Pretoria identified some themes in the manner in which revenue authorities have responded to the challenge of taxing cross-border supplies of intangibles. It appeared that the two principal methods of applying the destination principle to inbound digital supplies are either a reverse charging method or an extra-jurisdictional compulsion to register, imposed on the foreign supplier.

That study found that the VAT/GST rules governing inbound digital supplies varied across the sample jurisdictions (see Table 1 for a summary). Canada relied on the long-established rules applicable to traditional supplies. New Zealand has established detailed and tightly focused rules that seem to ensure that foreign suppliers do not incur irrecoverable GST although they require registration of foreign suppliers of inbound digital supplies.

The four sample countries all have a reverse charge mechanism. In Canada's case and also in the case of South Africa the reverse charge was required for inbound digital supplies to final consumers, whether they are businesses or not. The South African rules limited this reverse charge to circumstances where the foreign digital service provider is not required to register for VAT in South Africa (and that is determined by means of a number of tests related to the residence, address, bank account location and place of payment of the recipient of the supply; and to the turnover of the supplier). Whereas the South African approach seemed to be blind to whether the recipient is consuming for private consumption or for business purposes, the Australian and New Zealand approach applies the reverse charge mechanism to the receipt of partially creditable

[1] See Michael Walpole and Madeleine Stiglingh, 'Untangling the Worldwide VAT Web on Digital Supplies' (2017) 32(2) *Australian Tax Forum* 429.

supplies by GST-registered businesses. In those two jurisdictions domestic consumers do not reverse charge, and this seems very sensible.

In the group of countries whose rules the study examined South Africa was the first to require foreign suppliers to register if making foreign inbound digital supplies. The requirement was imposed in 2014. The requirement came in, in New Zealand, in October 2016 and in Australia in 2017. The idea, it appears, came from Norway which reported success in foreign supplier registration in around 2013.[2] The European Union had already begun to show signs of adopting this method for suppliers to consumers within EU Member States. The sample countries in the study differed in how broad the definitions were of supplies that trigger a requirement to register. The Australian definition seems the broadest including supplies (through the definition of 'inbound intangible consumer supplies'[3]) of everything other than goods or real property although recognising a limitation of the tax to supplies to final consumers, ie, wholly non-business supplies. The New Zealand definition is wide too using, as it does, a 'remote service' supply concept.[4]

The previous study contrasted these with the South African approach which the study noted had a finite list of supplies falling under the five headings of: (1) educational services; (2) games and games of chance; (3) internet-based auction services; (4) miscellaneous services (including e-books, audio-visual content, still images and music), and (5) subscription services. The study queried whether this list therefore included advertising services or the supply of software although the study also noted that there was some debate on this point. The study concluded that the exclusions from the list were probably made so as to exclude business supplies that would simply lead to the circularity of a reverse charge arising and then being credited under normal VAT principles. There is always a problem with lists as they can go out of date – and in the digital economy can do so very rapidly. They thus need constant attention and leave the revenue authorities open to the risk of suppliers and consumers finding a work-around that deprives the treasury of its consumption tax.

The study noted that, quite sensibly, the jurisdictions requiring the registration of foreign suppliers of inbound digital supplies limited this to the context of supplies to residents of the jurisdiction of consumption. (See, for example, the carve-out from the Australian rules of supplies of 'things' not being goods or real property to non-resident recipients who acquired them for the purposes of their conduct of an enterprise outside the (Australian) indirect tax zone.)

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[2] See, eg, Naoki Oka, 'Inland Revenue Authority of Singapore (IRAS)-OECD Regional GST/VAT Conference (May 2013), Taxing Cross-Border Supply of Services and Intangibles, Case Studies, Technical Summary of Discussions', 7, http://www.oecd.org/ctp/consumption/iras-oecd-vat-conference-technical-summary-of-examples.pdf (noting that '[a]ccording to the presentation made by the Norwegian participant, the revenue [from the 2011 reform to apply VAT to purchases of electronic services from abroad] was above initial projections and the number of simplified regulations was satisfactory').

[3] *A New Tax System (Goods and Services Tax Act) 1999* (Cth) s 84-65 (GST Act).

[4] 'A "remote" service is defined as a service where, at the time of the performance of the service, there is no necessary connection between the physical location of the recipient and the place of physical performance. The definition includes digital services, such as e-books, music, videos and software downloads, as well as non-digital services, such as general insurance, consulting, accounting and legal services': Inland Revenue Department (New Zealand), 'GST on Cross-Border Supplies of Remote Services: A Special Report from Policy and Strategy, Inland Revenue' (May 2016) 1, https://taxpolicy.ird.govt.nz/sites/default/files/2016-sr-gst-cross-border-supplies.pdf.

Thus, the long-established income tax concept of residence of the supplier (in income tax the party deriving the income) gives way in this aspect of VAT law to the primacy of the residence of the consumer. The study saw that New Zealand and South Africa used an objective test. South Africa had what the study called a 'two out of three' test. This was based on the fact that digital service supplies fell within the definition of an 'enterprise' for purposes of South African VAT if supplied from outside South Africa and two of three criteria were met, namely:

(a) the recipient of the supply is a resident[5] of South Africa;

(b) the payment for the service is made from a South African bank account;

(c) the recipient has a business address, residential address or postal address in South Africa.[6]

In New Zealand the test is a 'two out of six' test. The non-resident supplier is to regard the recipient of their supplies as a New Zealand resident where they have 'non-contradictory information' regarding any two of six items, namely:[7]

(a) the recipient's billing address;

(b) the internet protocol (IP) address of the device used by the recipient, or '…another geolocation method';

(c) the bank details of the recipient 'including the account the person uses for payment or the billing address held by the bank';

(d) the country code of the mobile device's subscriber identity module card (SIM card) that was used by the recipient;

(e) the location of the recipient's fixed land line used to supply the service to them; or

(f) 'other commercially relevant information'.

The study approved of the fact that the New Zealand law includes rules to assist in determining the place of residence where, for example, there are two non-contradictory indications of residence somewhere other than New Zealand. In such cases the more reliable information must be used. There is also a 'fail safe' rule such that the Inland Revenue can prescribe the use of another way to determine the residence of the recipient, in certain circumstances, and can also agree on another method, with the supplier, where the list approach has failed.

The Australian rule on determination of residence of the consumer of affected supplies is based on a 'reasonable belief' based on the supplier's 'usual business systems and

[5] A 'resident of the Republic' means 'a resident as defined in section 1 of the Income Tax Act: Provided that any other person or any other company shall be deemed to be a resident of the Republic to the extent that such person or company carries on in the Republic any enterprise or other activity and has a fixed or permanent place in the Republic relating to such enterprise or other activity': *Value-Added Tax Act 89 of 1991* (SA) s 1(1).
[6] Paragraph (b)(vi) of the definition of an 'enterprise' in section 1 of the *Value-Added Tax Act 89 of 1991* (SA).
[7] *Goods and Services Tax Act 1985* (NZ) s 8B(2).

processes'.[8] In the Australian rules it is only non-businesses (or businesses not registered) that are 'consumers' so the reasonableness of the supplier's belief that the recipient is not a resident consumer is restricted by the legislation to the extent that if it is based on the consumer being registered for GST it must have disclosed to the supplier its Australian Business Number (ABN) and a declaration that it is registered, or other information to the effect that it is registered. As the mere registration of a business for tax by means of an ABN is not evidence of GST registration it seems to this author that this aspect of the Australian rules is more than a little complex and prone to misunderstanding by foreign suppliers.

At least the Australian and New Zealand rules narrow the application of the GST to supplies from business to consumers (B2C); South Africa did not appear to do that and the study noted at the time of the survey of countries that the South African rules did not distinguish between business to business (B2B) supplies and B2C supplies requiring both types of supplier to register for VAT.

The registration threshold is another interesting feature to compare between jurisdictions. Australia and New Zealand have matched their registration thresholds for non-resident suppliers to that of domestic suppliers, so they are the same for both. The GST threshold in New Zealand is based on a 12-month actual or projected turnover of NZD 60,000,[9] and that in Australia is AUD 75,000. At the time of the survey the South African registration threshold for foreign suppliers was a 12-month actual or projected turnover of ZAR 50,000. It has since been increased so as to match the domestic registration threshold of ZAR 1 million.[10] Given that the former threshold was the equivalent of about USD 3,500 the net was very widely cast with such a low threshold and the adjusted threshold would no doubt be welcome to some small suppliers.

Table 1 below summarises the findings at the time.

Table 1: Summary of (2017) VAT Rules Governing Inbound Digital Supplies

Inbound digital supply rules	**Canada**	**South Africa**	**Australia**	**New Zealand**
Specific rules	No	Yes	Yes	Yes
Effective date	N/A	2014	1 July 2017	1 October 2016
Specific definitions	Yes	Yes	Yes	Yes
Type of definition	'intangible personal property'	'Electronic service' Finite list not including all intangibles.	'Australian consumer' and 'Inbound intangible consumer supplies'	'Remote service' that distinguishes between digital and non-digital services.

[8] GST Act, s 84-100.
[9] *Goods and Services Tax Act 1985* (NZ) s 51.
[10] *Value-Added Tax Act 89 of 1991* (SA) s 23(1A) effective 1 April 2019, as announced in 2018 National Budget Speech released on 21 February 2018. The change was to take effect from 1 October 2018 but was deferred to 1 April 2019.

Place of taxation proxy	Place it may be used (not actual use)	Residence Objective 'two of three item' test	Australian consumer Reasonable-belief test	Residence. Objective 'two of six item' test, or as prescribed.
Non-resident registration*	Not required for non-resident not carrying on business in Canada.	Yes Also provides for 'Intermediary'	Yes But only in relation to B2C supplies to non-registered recipients. Also 'electronic distribution service'	Yes Also provides for 'electronic marketplace'
Threshold? c/f domestic	Yes - same	Yes – same, ZAR 1 million (prev. ZAR 50,000)	Yes – same	Yes - same
Types of taxable inbound supplies	Registration of foreign supplier without Canadian presence not required.	B2B and B2C	Only B2C	Only B2C B2B are zero-rated
Reverse charging	Yes – B2C	Yes – B2C (unless non-resident is registered)	Yes – only GST registered business	Yes – only GST registered business

* Without permanent establishment and complying with carrying on of business requirement in the country.

3. THE CURRENT AUSTRALIAN STATUS QUO

The Australian rules on digital supplies across its borders into Australia have not been long in place and it is thus not all that simple to assess how they are going. Those interested in GST will know that the Australian model was adventurous in that it relied on registration by offshore suppliers and it was one of the first – but this approach has now become common.

Recent announcements have revealed that the Australian approach has generated more revenue than expected. In his speech to the *OECD Global Forum on VAT 2019* in Melbourne in March 2019 the Assistant Treasurer revealed that:

> Recent registration numbers reveal that over 1500 offshore businesses have registered under both [digital supplies and low value goods off shore supplier registration] measures, covering all major platforms and businesses from all jurisdictions.
>
> I can also report that both measures are collecting more revenue than estimated.

> In terms of revenue, the GST on digital products and services measure raised around $269 million Australian dollars in 2017-18 compared with an estimate of $150 million.[11]

This is an impressive achievement in light of the difficulties the GST system faced. The challenge that the Australian law faced was that cross-border supplies of intangibles were beyond the reach of the GST net because the section of the GST Act that created the legal connection (for GST purposes) between the supply and the indirect tax zone (ie, Australia) was too narrow. Section 9-25 was a textbook example (should anyone ever want to write a textbook on such subject matter) of pre-internet GST law. The relevant part said for intangibles:

> (5) A supply of anything other than goods or *real property is *connected with the indirect tax zone* if:
>
> (a) the thing is done in the indirect tax zone; or
>
> (b) the supplier makes the supply through an *enterprise that the supplier *carries on in the indirect tax zone; or
>
> (c) all of the following apply:
>
> (i) neither paragraph (a) nor (b) applies in respect of the thing;
>
> (ii) the thing is a right or option to acquire another thing;
>
> (iii) the supply of the other thing would be connected with the indirect tax zone.
>
> Example: A holiday package for a trip to Queensland that is supplied by a travel operator in Japan will be connected with the indirect tax zone under paragraph (5)(c).

The question of when it could be said that enterprises were carried on in the indirect tax zone was covered by the following provision that has now been replaced (with a new s9-27):[12]

> (6) An *enterprise is *carried on in the indirect tax zone* if the enterprise is carried on through:
>
> (a) a permanent establishment (as defined in subsection 6(1) of the *Income Tax Assessment Act 1936*) in the indirect tax zone; or
>
> (b) a place that would be such a permanent establishment if paragraph (e), (f) or (g) of that definition did not apply.

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[11] See Hon Stuart Robert (Assistant Treasurer), 'Address to the 5th OECD Global Forum on Value Added Tax, Melbourne Convention Centre' (20 March 2019), https://ministers.treasury.gov.au/ministers/stuart-robert-2018/speeches/address-5th-oecd-global-forum-value-added-tax-melbourne (accessed 21 March 2019).

[12] These changes resulting in the insertion of section 9-27 were part of those made to cure the problems with the operation of the B2B provisions, essentially the problem that under the old rules a non-resident may have a GST liability in Australia despite having no real presence. Note that the asterisk beside a term indicates that the term has a statutory definition in the GST Act.

It will be evident from this that the supply of intangibles to Australian residents made by a non-resident without a permanent establishment thus lacked the necessary connection with Australia. Downloaded intangibles from overseas like software, music videos and games were thus not within the GST net.

This was addressed by changing the place of supply rules so as to include supplies to 'an Australian consumer'. Section 9-25 was amended, and a relevant extract is shown below.

> Meaning of Australian consumer
>
> (7) An entity is an Australian consumer of a supply made to the entity if:
>
> (a) the entity is an *Australian resident …; and
>
> (b) the entity:
>
> (i) is not *registered; or
>
> (ii) if the entity is registered – the entity does not acquire the thing supplied solely or partly for the purpose of an *enterprise that the entity *carries on.
>
> Note: Suppliers must take reasonable steps to ascertain whether recipients are Australian consumers: see s 84-100.

The definition both cured the problem of lack of connection and narrows the impact of the change by ensuring that it applies to the private consumption of the supplies in question.

One observes in this approach the operation of a principle in Australian GST law of defining broadly so as to cast the net wide and then narrowing the application of certain rules to moderate them and thus target the rule. Australia has a (perhaps notoriously) broad definition of 'supply' for GST purposes and this is an example of confining such breadth to 'business to consumer' (B2C) supplies of intangibles across Australia's border. There is further narrowing of application evident in a new section 9-26 which introduced a further concept in the form of 'an inbound intangible consumer supply'. In summary, these supplies cover:

- 'inbound intangible supplies' (being supplies of things other than goods or real property) which are deemed not to be connected with the indirect tax zone when the recipient is an 'Australian-based business recipient' (another defined term);
- intangible supplies between non-residents where the recipient is a non-resident which acquires the supply solely for the purpose of carrying on its business enterprise outside Australia;
- a supply between non-residents of leased goods; and
- continued lease of goods covered by the previous item.

The exclusion of these items is revenue neutral because taxing the supply would lead to a credit being claimed by the recipient and consequential circularity and wasted compliance costs; they also preserve the GST-free status of exports. The provisions

seem to be fine-tuned to impose GST on supply of intangibles across the border to local domestic consumers.

There are other intricate elements of fine-tuning that ensure that the widened category of taxable supplies continues to be covered by the usual rules associated with 'GST-free' (zero-rated in European parlance) and 'input taxed' status.

Section 38-610[13] deals with the GST-free category and section 40-180 deals with input taxed supplies. Section 38-610 demonstrates the principle:

> 38-610 Inbound intangible consumer supplies
>
> (1) An *inbound intangible consumer supply is *GST-free* if:
>
> (a) it is made by a *non-resident; and
>
> (b) it is covered by a determination under subsection (2).
>
> (2) The Minister may, by legislative instrument, determine that a specified class of *inbound intangible consumer supplies are GST-free.
>
> (3) However, the Minister must not make the determination unless:
>
> (a) the *Foreign Minister has advised the Minister in writing that the treatment of the class of supplies under the *GST law would, apart from the determination, be inconsistent with Australia's international obligations; and
>
> (b) the Minister is satisfied that similar supplies made by *Australian residents would be GST-free.

Section 40-180 applies similar machinery to supplies that are determined by the Minister to be input taxed.[14] Thus certain supplies might be treated under this new cross-border regime in the same manner that they were treated before the new rules. Supplies might be regarded as GST-free health or education supplies; and others as input taxed financial supplies, but these determinations themselves require a further written determination by the Foreign Minister as to Australia's international trade obligations. It is interesting that the opinion of two Ministers on different matters is required in order to give effect to the GST-free or input taxed status. One might ask (flippantly and cynically), 'what could possibly go wrong?'.

The need for sundry additions and refinements in the statute that have been inserted in order to deal with the new special category of inbound intangible supply has been extensive.[15]

The remaining step is to tax supplies of inbound intangibles that are made to Australian businesses registered for GST, acquired as part of their enterprise but not solely for GST-creditable purposes. The relevant portion of the consideration for these supplies is

[13] GST Act, s 38-610.
[14] GST Act, s 40-180.
[15] A schedule of these new sections can be found in *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016* (Cth), Sch 1.

subject to reverse charging obligations requiring the recipient to pay GST on that portion.

The Australian rules as they apply to non-resident businesses

Having, as explained above, excluded from the application of the rules as many supplies as possible and appropriate, the obligation remains on non-resident suppliers to collect GST on the supplies they make in the form of 'inbound intangible consumer suppl[ies]'. The rules operate by way of default and an expectation is imposed on the supplier to collect GST (and remit it) *unless* they have taken reasonable steps to identify the recipient as one other than an Australian (domestic) consumer, and unless they have by this means formed a reasonable belief that the recipient is not such a consumer. As has been mentioned above, the supplier may rely on their 'usual business systems and processes' in order to form the reasonable belief as to the status of the recipient. The Australian GST registration of the recipient may be used to form an opinion, if the recipient has an Australian Business Number (ABN) and the recipient has made a declaration to the effect that they are registered for GST.

Other rules unique to this situation apply such as that the foreign supplier may either become fully registered for GST in Australia or may limit their exposure to Australian GST administration rules and become a limited registration entity. These rules are set out in Sub-division 84-D of the GST Act and a summary of their obligations can be seen in the Appendix to this article.

Such entities have been statutorily drawn into the Australian GST system by reason of the fact that intangible supplies by such non-residents have become connected with the indirect tax zone. So if their taxable supplies to Australia (of such intangibles) meet or exceed the normal annual turnover registration threshold of AUD 75,000 they are required to register for GST in Australia.[16] Anticipating, no doubt, that this might be deeply unattractive to foreign businesses, aside from the probably limited enforcement options, it is possible for such suppliers to opt for a 'GST-lite' registration under which they might register only as 'limited registration' entities.[17] The threshold is the same but the compliance obligations are fewer.

Some key aspects of the rules applicable are that limited registration entities are not entitled to input tax credits in Australia (– presumably they would be unlikely to have many credits given that they may have customers here, but no other presence). They are required to submit returns quarterly and cannot opt for less frequent returns, nor be subject to more frequent returns.[18]

Platforms

One of the more advanced aspects of these Australian rules is the manner of treatment of the internet phenomenon of businesses making supplies to consumers through multiple supplier websites. The concept is illustrated most easily by referring the reader to enterprises such as *Amazon*, *eBay* etc. Such enterprises may take many forms and

[16] GST Act, s 23-5.
[17] GST Act, s 84-135.
[18] GST Act, ss 84-140 and 84-155.

they may not be a supplier but may be an agent or facilitator between the actual supplier and the consumer. These types of platform are often described as intermediaries.

The Australian approach is to treat these types of supplier as 'electronic distribution platforms'. The approach is very much one of substance over form as it ignores the different legal forms and relationships that might underlie internet sites, suppliers and such intermediaries. Section 84-70 has inserted into our law a unique GST meaning of electronic distribution platform (EDP).

A service is an EDP if:

(a) it allows entities to make supplies available to end users; and

(b) is delivered by means of *electronic communication; and

(c) any of the supplies that are *inbound intangible consumer supplies are to be made by means of electronic communication.

The definition also excludes carriage services, payment, and payment processing systems.

The EDP definition was confined to electronically delivered sound and picture files, software applications, games, videos and the like. The extension of the GST to low value goods[19] meant a change to the definition of EDP.

There are other important exclusions from this definition of forms of supply dealt with elsewhere in the Act. Thus, a service is not an EDP solely because it is:[20]

> (a) a carriage service (within the meaning of the *Telecommunications Act 1997*); or
>
> (b) a service consisting of one or more of:
>
> (i) providing access to a payment system;
>
> (ii) processing payments;
>
> (iii) providing *vouchers the supply of which are not *taxable supplies because of section 100-5.

Each of these is subject to their own rules under other provisions. Payment systems and processing of payments are dealt with under the financial supply rules. Likewise, vouchers, as a voucher for supplies up to a stated monetary value is not subject to GST. GST may arise on the supply for which the voucher is redeemed but not the voucher itself.

As has been indicated, the problem of such platforms and how to tax them is theoretically large and significant because the variety of platforms and the permutations of ways in which they might operate are many. Australia was not the first but was nevertheless at the forefront in this attempt to cut through the legal and practical

[19] *Treasury Laws Amendment (GST Low Value Goods) Act 2017* (Cth), enacted on 26 June 2017.
[20] GST Act, s 84-70(2).

difficulties so as to establish a workable statutory framework for dealing with the phenomenon of internet platforms.

4. GLOBAL PRACTICES

The changes that are being made to taxation of the supply of intangibles around the world reveal certain trends. No doubt several of these have arisen through different jurisdictions simply reaching the same conclusion on ways to deal with a common problem. Others are a recognition in one jurisdiction that a practice developed in another can be adopted and adapted for use. It is unclear which.

One of the trends that is readily apparent is the use of residence of the consumer as a proxy for place of supply in B2C situations.

4.1 Residence of the recipient

As has been mentioned in section 2, in New Zealand the place of taxation of 'remote services' is determined by the residence of the recipient and this is a proxy for place of consumption. The New Zealand rule is to use non-contradictory information as to two of six items of information.[21]

In Australia the supplier the foreign supplier has to form a 'reasonable belief' as to the residence (and nature) of the Australian recipient of their supply. At least 'business processes' can be used to form an opinion about the recipient.

The South African solution of using the residence of the consumer seems to override the facts and through the legislation could lead to a supply to a South African resident being subject to VAT even when made (and consumed) in another country. (The South Africa rules stipulated that the recipient should be South African resident – as defined for Income Tax[22] – something a supplier might find hard to determine; that the payment of the service be made from a South African bank account; and that the recipient have a business address, residential address or postal address in South Africa.[23]) This is at least an objective two out of three test but not all that manageable for suppliers. Perhaps this is not something to be concerned about as it affects 'outliers'.

The Canadian rules seem to tax the supply based on the place it may be used – not its place of actual use. This is probably not all that different to the South African rules.

4.2 Registration threshold

An area where there is, and always has been, some diversity in approach to VAT/GST liability is that of the registration threshold.

In the group covered by the earlier study on which this article draws, there was less diversity at least in relation to differences between foreign and domestic businesses. That study found that Australia, Canada and New Zealand all applied the same threshold to foreign suppliers that applied to domestic suppliers. South Africa applied a different threshold in that foreign suppliers faced a threshold of ZAR 50,000 whereas domestic suppliers have a registration threshold of ZAR 1 million. This has now changed to a

[21] *Goods and Services Tax Act 1985* (NZ) s 8B(2).
[22] On the definition of 'resident of the Republic', see n 5, above.
[23] See n 6, above.

common ZAR 1 million threshold for both domestic suppliers and foreign suppliers of electronic services.

The question of what threshold to set for VAT/GST registration is not insignificant. The fact that a supplier is not registered means that it bears the tax on its inputs and it cannot get a credit for that tax. This can cause a cascading of taxes with adverse economic consequences. On the other hand, a threshold that is too low can result in the requirement that suppliers register when they are too small and too poorly equipped in terms of scale to manage their compliance obligations. As compliance costs are highly regressive this is harmful to the smaller players in a market.

It would seem that the suppliers across border of intangibles-like services would probably be better organised through their systems than many small businesses and so the compliance burden can be addressed to some extent by good systems built into their operating model. The risk of compliance costs being damaging is lower in this case than in the case of other small businesses, provided the registration threshold is not too low. But some countries, like Australia, do have rather low thresholds and this is a risk. The levelling of competition achieved by matching domestic resident and non-resident suppliers seems sensible. It certainly should address the complaints of unfair competition often made by domestic suppliers that have to compete with foreign suppliers. This equality of treatment is, of course, reliant on adequate enforcement of registration and collection.

4.3 Dealing with platforms

The development of international practices associated with dealing with electronic platforms that aggregate supplies by multiple suppliers in whatever legal manner and through whatever commercial arrangements is another strong theme that has emerged in the collection of VAT/GST on cross-border supplies of services and other intangibles.

It is probably correct that Australia, once again, took a bold step in attempting to get these suppliers under control. The definition of 'electronic distribution platform'[24] is novel and effective. In New Zealand the 'electronic marketplace' is similar. These solutions may seem complex because of their definitions but they are more useful and targeted than broader, looser, concepts like the term 'intermediary'. What suppliers require is certainty.

The platform approach is also in itself a platform for expansion of VAT/GST collection generally. This is because once platforms have been incorporated into the tax system and are understood conceptually, they provide an opportunity to tax such activities as the supplies inherent in 'the sharing economy' or 'gig economy'. These two terms attempt to describe the modern phenomenon of small suppliers aggregating their product (whether it be short term accommodation (AirBnB), or spare capacity in their motor car (Uber and other 'ride sharing' arrangements)). The individual suppliers participating in such activities would often be very small businesses not usually reached by or readily able to comply with the consumption tax system. Many such suppliers would ordinarily fall well below the registration threshold in their jurisdiction. If the platform can be required to register this may provide an opportunity for a concept developed for cross-border supplies to be adapted and applied in all situations including

[24] GST Act, s 84-60.

domestic and cross-border supplies. The decision to do so should be taken after some reflection. What the approach to platforms has done is to provide a tool developed for cross-border supplies of low value goods and some intangibles that can now be applied to 'the sharing economy' and to subject to consumption tax supplies by small and even micro businesses that would otherwise not have been within the reach of the VAT/GST.

Policy considerations, it is submitted, in deciding whether to apply platform rules to the 'sharing economy' should include: the size of this economy and the desirability of taxing it; the fact that the platform will have some input tax credits but would probably not be able to claim those in respect of its suppliers/members; the fact that the suppliers/members would remain input taxed and a consideration of whether this is a distortion; and whether the extension of the VAT/GST to this modern phenomenon will create transparency as to the income tax implications of these activities and result in revenue related to that.

4.4 The International Guidelines

Recognising the quiet revolution that has been taking place in relation to VAT/GST and the so-called 'digital economy' the OECD has been proactive in aligning the policies and activities of its members and others. It has recently adopted a set of *International Guidelines on VAT* (2017). It has also now issued a *Report on the Role of Digital Platforms in the Collection of VAT/GST on Online Sales* (March 2019). It is likely to be an interesting exercise to review these and identify the extent to which Australia has influenced and follows these. That will be an exercise for an updated version of this article. And it will be necessary to update it long before another 20 years has passed.

APPENDIX

Summary of Schedule 1 of *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016* Australia[25]

Provision	Intended effect of measure
Sub-division 84-B	Inserts new rules specifically for Inbound intangible consumer supplies as follow
Section 84-45	Tax invoices and adjustment notes not required for offshore supplies to Australian consumers. Operators of electronic distribution platforms are regarded as having themselves made electronic supplies that are made through the platform: (a) from offshore to Australian consumers; or (b) in some cases, under an agreement with the supplier. The operator of the platform counts the supplies towards its GST turnover, and it pays GST on the supplies.

[25] This is a summary of Schedule 1 of the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016* (Cth) with the author's gloss on those measures. Some description is drawn from the Act verbatim. Emphasis is added. An asterisk beside a term indicates (as used in the legislation itself) that the term has a statutory definition in the GST Act. The summary does not include any subsequent amendment to the provisions since enactment under the 2016 Measures No. 1 Act.

Section 84-50	There is to be no requirement for tax invoices or adjustment notes in respect of inbound intangible consumer supplies. Existing sections 29-70 and 29-75 (which deal with tax invoices and adjustment notes in the normal course) are to be ignored.
Section 84-55	As intimated in s 84-45 – the operator of an electronic distribution platform is to be treated as supplier who made the supply (84-55(1)(a)) for the *consideration that was made for the supply (84-55(1)(b)) as part of the *enterprise carried on by that operator. Thus, GST on the supply is payable by the operator of the electronic distribution platform. S 84-55(2) clarifies that where the *inbound intangible consumer supply is made through more than one *electronic distribution platform then 84-55(1) applies only to the operator of any of those platforms identified by a hierarchy of alternative rules which restricts the application to: (a) a party to a written agreement, between the operator and at least one of the other operators of the platforms, under which the operator is to be treated as the supplier; or (b) if no such agreement has been made—the operator determined in accordance with an instrument made by the Commissioner under subsection (3); or (c) failing such agreement or instrument made under subsection (3): (i) the first of the operators of those platforms to receive, or to authorise the charging of, any *consideration for the supply; or failing this (ii) the first of the operators of those platforms to authorise the delivery of the supply. S84-55(3) authorises the Commissioner of Taxation, by legislative instrument, to specify how an operator is to be determined for the purposes of paragraph (2)(b). S84-55(4) despite subsections (1) and (2), removes from the operation of the section operators of an *electronic distribution platform in relation to an *inbound intangible consumer supply made through the platform if: (a) a document, relating to the supply, issued to the *recipient of the supply identifies: (i) the supply; and (ii) the supplier as the supplier of the supply; and (b) the supplier and the operator of the electronic distribution platform (EDP) have agreed in writing that the supplier is the entity responsible for paying GST for the supply or a class of supplies that includes the supply; and the operator the EDP does not authorise the charge to the recipient for the supply nor authorise the delivery of the supply; and does not set the terms and conditions under which the supply is made. This specific set of circumstances seems to have been inserted after consultation in response to industry concerns on behalf of parties with specific arrangements in place between EDP operators and suppliers using their platform.
Section 84-60	Extends s 84-55 to certain other supplies through an EDP. Section 84-55 (above) applies to a supply as if it were an *inbound intangible consumer supply if (a) the supply is made through an EDP; and (b) that supply is covered by a written agreement between the supplier and the operator of the platform entered into before the supply is made; and (c) the EDP the operator is registered; and (d) the agreement treats the supply as if it were an inbound

	intangible consumer supply made through the EDP. In these circumstances s 84-60(3) treats the supply as having been made in the course/furtherance of the enterprise through which the EDP operates the platform. S 84-60(2) removes from this extension supplies in circumstances where (a) the supply is GST-free or input taxed; or (b) the operator would not be treated under section 84-55 as being the supplier of, and as making, the supply if it were an *inbound intangible consumer supply.
Section 84-65	Inserts a definition of *inbound intangible consumer supply* as discussed above. In summary supplies of things other than goods or real property qualify if the *recipient is an *Australian consumer. But they fall outside the definition if: (a) the thing that is the supply is done wholly in the indirect tax zone [which notionally removes it from the scope of "inbound"?]; or (b) (Ignoring s 84-55 about EDPs) the supplier makes the supply wholly through an *enterprise that the supplier *carries on in the indirect tax zone [which establishes a connection to the indirect tax zone (ITZ – ie, Australia) through other provisions?]. The specific explanations of why some supplies fall outside the definition seem to be out of an abundance of caution and for clarity and to ensure that B2B type supplies are dealt with under the normal but amended rules and the supplies to Australian (final) consumers are dealt with under the so-called 'Netflix' rules.
Section 84-70	Inserts a meaning of *electronic distribution platform.* A service is an EDP if: (a) it allows entities to make supplies available to end-users; and (b) is delivered by means of *electronic communication; and (c) the supplies are to be made by means of electronic communication. This would seem to exclude websites that facilitate online shopping for goods like clothing etc. It is more focussed on electronically delivered sound and picture files, games, videos and the like. There are important exclusions from this definition of certain supplies dealt with elsewhere in the Act. Thus, a service is <u>not</u> an EDP solely because it is: (s84-70(2)) (a) a carriage service (within the meaning of the *Telecommunications Act 1997*); or (b) a service consisting of one or more of: (i) providing access to a payment system; (ii) processing payments; (iii) providing *vouchers the supply of which are not *taxable supplies because of section 100-5. [Each of these is subject to their own rules under other provisions. Payment systems and processing of payments are dealt with under the financial supply rules. Likewise, vouchers - a voucher for supplies up to a stated monetary value is not subject to GST. GST may arise on the supply for which the voucher is redeemed but nor the voucher itself].
Sub-division 84-C	Inserts rules applicable to the identification of and the categorisation of supplies to *Australian consumers* and excludes certain supplies from these. These rules seem intended to reduce the compliance burden.
Section 84-95	Explains that one of the tests in s 9-25(5) as to whether a supply is connected with the ITZ is whether the recipient of a supply of an intangible is an Australian consumer. There are grounds for restricting this and treating a

	supplier in some situations as making a supply to an entity that is not an Australian consumer.
Section 84-100	Establishes when entities are treated as not being Australian consumers and states that the GST rules apply to you as if another entity was not an *Australian consumer of a supply if: (a) you take reasonable steps to obtain information about whether or not the other entity is an Australian consumer of the supply; and (b) after taking those steps, you reasonably believe that the other entity is not an Australian consumer of the supply. S 84-100(2) goes on to the effect that the *GST law applies in relation to you as if another entity was not an *Australian consumer of a supply if: (a) your usual business systems and processes provide you with a reasonable basis for forming a reasonable belief about whether the other entity is an Australian consumer of the supply; and (b) you reasonably believe that the other entity is not an Australian consumer of the supply. The argument that you have a reasonable belief that the recipient is not an Australian consumer because it is registered for GST does not provide a full escape from the compliance burden associated with making an Australian consumer supply. This is because s 84-100(3) specifies that any belief on your part that the other recipient is not an *Australian consumer of the supply on the relevant grounds 'is reasonable only if: (a) the other entity's *ABN, or the other identifying information prescribed under subsection (4) relating to the other entity, has been disclosed to you; and (b) the other entity has provided to you a declaration or information that indicates that the other entity is registered'. S 84-100(4) adds that the Commissioner may prescribe identifying information for the purposes of paragraph (3)(a) under a legislative instrument.
Sub-division 84-D	Inserts rules for 'limited registration entities' that have to comply with a subset of the GST rules. [Because intangible supplies by non-residents have been included in the definition of supply by means of the expanded meaning of 'connected with the ITZ' non-residents whose taxable supplies in the ITZ meet or exceed the AUD 75,000 annual turnover threshold are required to register for GST under the normal operation of s 23-5.]
Section 84-135	Explains that non-residents may elect to be limited registration entities. Limited registration entities are not entitled to input tax credits for acquisitions and must have quarterly tax periods. [These limited registration rules are seemingly intended to minimise the contact that non-resident suppliers must have with the Australian tax authorities and reduce their compliance burden. The cost of this is that they are not entitled to any input tax credits, but this cost may be illusory as if they are non-resident and their supplies are not otherwise connected with Australia, they are unlikely to have creditable costs in the jurisdiction.]
Section 84-140	Allows non-residents to elect to be limited registration entities. Such entities are not entitled to input tax credits for acquisitions and must have quarterly tax periods. The section notes that 'The Commissioner may approve simpler approved forms for limited registration entities: see subsection 388-50(3) in Schedule 1 to the *Taxation Administration Act 1953*.' [It is submitted that the section may

	be unnecessary as these separate registration arrangements can be established administratively.]
Section 84-145	Limited registration entities cannot make creditable acquisitions and an acquisition made by a *limited registration entity is not a *creditable acquisition if an election under s 84-140(2) is in effect. But elections are revocable and subsection (1) does not apply, and is taken never to have applied, to the acquisition if the election is revoked under subsection 84-140(5) during: (a) the *financial year in which the acquisition is made; or (b) the next financial year. [The section includes an explicit override of s 11-5 (which is about what is a creditable acquisitions).]
Section 84-150	Entries in the Australian Business Register The section provides key aspects of the administrative and compliance mechanics associated with the operation of the Australian Business Register and limited registration entities. Essentially limited registration entities do not have to have to be entered on the Australian Business Register. The section deals with the implications of changes in limited registration status.
Section 84-155	Establishes the rule that limited registration entities have only quarterly tax periods and have no other option (which would otherwise be available under s 27-10 (an election) or ss 27-15 or 27-37 (a determination by the Commissioner) and relate to one-month tax periods).

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The rapidly evolving universe of US state taxation of cross-border online sales after *South Dakota v Wayfair, Inc.*, and its implications for Australian businesses

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Abstract

The US Supreme Court's 2018 decision in *South Dakota v. Wayfair, Inc*. dramatically expanded the subnational states' power to require remote suppliers to collect taxes on in-bound sales to local consumers by repudiating the pre-existing, judicially created constitutional rule limiting the states' authority to enforce such collection obligations to those suppliers with an in-state physical presence and replacing it with a 'nexus' rule based on 'economic and virtual contacts'. The state legislatures reacted quickly and almost unanimously to the *Wayfair* decision by adopting rules imposing sales tax collection obligations on remote suppliers whose sales exceeded specified dollar or transaction thresholds. The states have imposed similar obligations on marketplace platforms that increasingly facilitate online cross-border sales. In principle, these post-*Wayfair* tax collection obligations imposed on remote suppliers apply equally to interstate and international cross-border sales and to domestic and foreign suppliers. As a practical matter, however, the states confront greater challenges in enforcing these obligations in the international context. Under the US Constitution's 'Full Faith and Credit Clause', judgments against domestic suppliers that fail to comply with a state's tax collection obligations may be enforced against such suppliers in other states where the suppliers are located. By contrast, under the so-called 'revenue rule' that is widely respected in the international context, judgments against foreign suppliers generally may not be enforced in the foreign suppliers' home jurisdiction. Despite differences in the legal and practical mechanisms available to state tax authorities in enforcing tax obligations upon foreign as distinguished from domestic suppliers, states nevertheless have a variety of tools at their disposal to enforce or encourage tax collection by foreign suppliers, and there are other reasons why foreign suppliers may choose to comply with state collection requirements with respect to online sales.

Key words: Enforcement jurisdiction, Marketplace platforms, Nexus, Retail sales tax (RST), Revenue rule, Thresholds, US Customs, Use tax

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1. INTRODUCTION

Any discussion of subnational state[1] taxation of cross-border online sales[2] in the United States must begin with a recognition of the significance of the US Supreme Court's 2018 decision in *South Dakota v Wayfair, Inc*.[3] In *Wayfair*, the Court dramatically expanded the states' power to require remote suppliers to collect taxes on in-bound sales to local consumers by repudiating the pre-existing, judicially created constitutional rule limiting the states' authority to enforce such collection obligations to those suppliers with an in-state physical presence. By replacing a constitutional 'nexus' rule based entirely on physical presence with one based on 'economic and virtual contacts',[4] the Court not only consigned much of the earlier US experience with the collection of tax on online sales to the dustbin of history,[5] at least for those with no physical presence in a state, but it also ushered in a new era of state law and practice explicitly embracing the states' expanded powers to tax online sales.

This article reflects the divide between the pre-*Wayfair* and the post-*Wayfair* world. The first portion of the article describes the US law governing the collection of tax on online sales prior to the Court's decision in *Wayfair*.[6] The second (and more extended) portion of the article examines the *Wayfair* decision, its implications for collection of tax on online sales, and the states' response to the decision.[7] Before turning to the principal focus of the inquiry, however, the article provides a brief overview of the US retail sales tax (RST), particularly in its application to cross-border sales, to avoid 'lost in translation' problems in any comparative analysis of the US retail sales taxes and the Australian goods and services tax (GST).[8]

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[1] Unless otherwise specified, all subsequent references to 'state' or 'states' in this article are to US subnational states, as distinguished from national states.

[2] The first sentence of this article refers to '*cross-border* online sales' rather than simply to 'online sales' because if all relevant participants in a taxable sale (eg, seller, purchaser, platform, or other intermediary) are located in the same jurisdiction, and if all of the elements of the sale (eg, purchase, payment, delivery) occur in the same jurisdiction, it does not raise most of the challenging issues associated with online sales, namely, how to implement and enforce a consumption tax when one or more of the key participants or elements of the sale are not located in the jurisdiction with the taxing rights. However, to avoid the repetition of the phrase 'cross-border' every time the article refers to 'on-line sales', the ensuing discussion generally refers simply to issues associated with 'collection of tax on online sales' with the understanding that the principal focus of the discussion is on the collection of tax on online sales in the cross-border context.

[3] *South Dakota v Wayfair, Inc*., 138 S. Ct. 2080 (2018).

[4] Ibid 2099.

[5] In particular, it rendered much of the pre-existing law and practice focused on 'workarounds' to the physical-presence rule obsolete – or, perhaps more accurately, unduly complicated or beside the point – because physical presence, while still a sufficient condition for constitutionally recognised power to require remote sellers to comply with online tax obligations, is no longer a necessary condition. These 'workaround' are discussed briefly in section 3.3 and in detail in Jerome R Hellerstein, Walter Hellerstein and John A Swain, *State Taxation* (Thomson Reuters, 3rd ed, 2019 rev) para. 19.03.

[6] See section 3.

[7] See sections 4 and 5.

[8] This article draws freely from the author's previous work in this area, most notably, Hellerstein et al, above n 5.

2. OVERVIEW OF US RETAIL SALES TAX (RST)

Although there is no broad-based federal[9] consumption tax in the United States,[10] 45 of the 50 states and the District of Columbia, as well as thousands of local jurisdictions,[11] impose general RSTs. The general sales tax is one of the two primary sources of state tax revenue along with the state personal income tax. During the 12-month period ending in March 2019, sales taxes yielded USD 331 billion or 31.7 per cent of state tax revenues.[12]

In principle, an RST is a single-stage levy on consumer expenditures; ie, it applies to final sales of goods and services for personal use and consumption. Accordingly, a theoretically ideal retail sales tax would apply to all consumer purchases of goods and services, and it would exclude business inputs from the tax base. The RST in force in most of the American states, however, deviates from this theoretical norm in two fundamental respects. First, the state RST is confined largely to sales of tangible personal property (goods) and applies only selectively (and unevenly) to the sale of services.[13] Second, the state RST includes substantial business purchases within the tax base.[14]

2.1 Application of US RST tax to cross-border transactions

The taxable event under most state RSTs is the transfer of title or possession of tangible personal property for a consideration. Virtually all states treat this transfer as occurring at the point of delivery, which is a practical proxy for a destination-basis tax. To reinforce the destination-basis character of the sales tax, most states exempt from tax all sales for delivery outside the state.[15]

Although most state RSTs do not apply generally to services, when the states do tax services the rules for the place of taxation for such services are not as consistent or as well established as they are with regard to the place of taxation for sales of goods. Following the same destination principle that they employ in connection with the place of taxation for sales of goods, some states take the position that services should be taxed in the state in which they are delivered or enjoyed, and they exempt services 'if the beneficial use of the service occurs entirely outside the state'.[16] Other states, however, take the position that a sale of services takes place in – and is taxable by – the state in which the services are performed, even though the services are in effect 'delivered' and consumed outside the state.[17] Finally, states sometimes take the position that a sale of

[9] Throughout this discussion, the term 'federal' refers to the national level of government in the United States as distinguished from the 'state' or subnational level of government.
[10] There are, however, a number of selective excise taxes imposed at the national level on specified types of consumption, such as fuel, telecommunications, and air transportation.
[11] With some notable exceptions, most RSTs imposed at the local level are administratively integrated with the RST at the state level and amount, in substance, simply to a local rate increase in the state sales tax.
[12] US Census Bureau, *National Totals of State Government Revenue by Type of Tax* (2019), https://www.census.gov/data/tables/2019/econ/qtax/historical.html. During the same period, the state personal income tax yielded USD 382 billion or 38.4 per cent of such collections. Ibid.
[13] Hellerstein et al, above n 5, 12.04[1].
[14] Ibid 12.06[1].
[15] Ibid 18.02[1]. This is analogous to zero-rating exports under a value added tax/goods and services tax (VAT/GST).
[16] *In re State and Municipal Sales and Use Tax Liability of K.O. Lee Co*., 489 NW2d 606, 610 (SD 1992) (quoting the statute).
[17] Hellerstein et al, above n 5, 18.05.

services may be apportioned among the states in which they are used depending on the extent of use.[18]

2.2 The states' constitutional incompetence to tax cross-border sales and the development of complementary use taxes

Under the US Supreme Court's interpretation of the Commerce Clause of the federal Constitution,[19] the states lack the constitutional power to impose a sales tax on goods or services purchased in other states or in interstate commerce because 'to impose a tax on such a such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction'.[20] The constitutional prohibition on the states' taxation of sales consummated outside their borders or in interstate commerce created a troublesome gap in their consumption tax structures. The gap created two concerns. First, states feared the loss of business that local merchants would suffer when prospective customers made out-of-state or interstate purchases to avoid in-state sales tax liability. Second, states feared the loss of revenue they would incur as a result of the diversion of sales tax to non-tax states. To deal with this potential loss of business and revenue, states enacted 'complementary' or 'compensating' use taxes on goods (and, as appropriate, on services[21]) purchased outside the state and brought into the state for use.

Compensating use taxes are functionally equivalent to sales taxes. They typically are levied upon the use, storage, or other consumption in the state of goods (and, as appropriate, to services[22]) that have not been subjected to a sales tax. The use tax imposes an exaction equal in amount to the sales tax that would have been imposed on the sale of the goods or services in question if the sale had occurred within the state's taxing jurisdiction. The state overcomes the constitutional hurdle of taxing an out-of-state or interstate sale by imposing the tax on a subject within its taxing power – the use, storage, or consumption of goods or services within the state.[23] In principle, then, the in-state purchaser stands to gain nothing by making an out-of-state or interstate purchase free of sales tax because it will ultimately be saddled with an identical use tax when the

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[18] In this connection, it may be worth observing that, with rare and isolated exceptions (see, eg, the *Mobile Telecommunications Sourcing Act*, 114 Stat. 626 (28 July 2000), codified at 4 USC section 116 et seq. (Westlaw 2019), limiting states' power to tax charges for mobile telecommunications services to the state of the customer's usual residence), Congress has not exercised its unquestioned power to require uniform place-of-taxation rules for state RSTs.

[19] The Commerce Clause by its terms is simply an affirmative grant of power to Congress to 'regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes': US Constitution, article I, section 8, clause 3. Nevertheless, the US Supreme Court has long construed the clause as imposing implicit restraints on state authority, even when Congress has not acted. Under this so-called 'negative' or 'dormant' Commerce Clause doctrine, the Court has consistently struck down taxes that, in the Court's judgment, discriminate against or otherwise burden interstate commerce. See generally Hellerstein et al, above n 5, ch 4.

[20] *McLeod v J.E. Dilworth Co*., 322 US 327, 328 (1944). Some of the Court's earlier pronouncements no longer reflect contemporary Commerce Clause doctrine. Specifically, the Court has held that states may impose taxes on interstate commerce 'against a Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State': *Complete Auto Transit, Inc. v Brady*, 430 US 274, 279 (1977); see generally Hellerstein et al, above n 5, 4.11[2], 4.12. Nevertheless, the Court's earlier doctrine informed and continues to inform the current structure of state RSTs.

[21] As already noted, state RSTs generally are applied only selectively to services, and state use taxes are correspondingly applied only to those services that are taxable by the state.

[22] See generally Hellerstein et al, above n 5, 16.12 (explaining application of use tax to services).

[23] See *Henneford v Silas Mason Co*., 300 US 577 (1937) (sustaining constitutionality of state use tax scheme).

goods or services are used in the taxing state. Taken together, the sales and use tax provide a uniform scheme of taxation on goods or services purchased within the state and goods or services[24] purchased outside the state for 'storage, use, or consumption' within the state. Every one of the 45 states (and the District of Columbia) that imposes a sales tax also imposes a compensating use tax.

In order to avoid double taxation of multistate transactions, every state imposing a use tax allows a credit against its use taxes for sales or use tax paid to other states. It is clear that such a credit is now required by federal constitutional law, at least if a state provides a credit against (or exemption from) the state's use tax for goods or services purchased within the state and taxed under the state's sales tax (as all states do). Otherwise there would be discrimination against out-of-state purchases.[25]

3. US EXPERIENCE IN THE COLLECTION OF TAX ON ONLINE SALES PRIOR TO *WAYFAIR*

3.1 Constitutional restraints on the states' power to require out-of-state vendors to collect use taxes on interstate sales: the online sales problem

State sales taxes generally are collected by the vendor from the purchaser, and all states have some system for registering vendors as collection agents. Once a vendor registers with the state, it is authorised to make sales at retail, and it is required to collect and remit taxes on taxable sales. Accordingly, when a registered vendor within the state delivers taxable goods or services to a purchaser within the state, it must collect the sales tax due, unless the purchaser presents it with a certificate establishing that the sale is exempt (eg, a resale certificate) or that the purchaser has a 'direct pay' permit allowing it to self-assess the tax and pay it directly to the taxing authority. A vendor is ordinarily liable (either primarily or secondarily) for tax on any taxable transaction, whether or not it collects it from the purchaser. There are no constitutional difficulties in requiring the registered vendor to collect the sales tax.

When interstate sales of taxable goods or services are involved, the use tax rather than the sales tax is applicable.[26] As explained above, it is beyond dispute that the purchaser is legally liable for the tax on the use of the taxable goods or services within the taxing state.[27] It is also settled law, as the US Supreme Court declared in one of the seminal

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[24] States clearly possess the same constitutional authority to levy use taxes on services that they possess to levy use taxes on goods. Nevertheless, because states levy taxes on services only selectively, they have not exercised such authority over taxable services purchased from out-of-state service providers to the same extent that they have exercised such authority over goods purchased from out-of-state sellers. Hellerstein et al, above n 5, 16.12[2].

[25] See *Oklahoma Tax Commission v Jefferson Lines, Inc*., 514 US 175 (1995); Walter Hellerstein, Michael McIntyre and Richard Pomp, 'Commerce Clause Restraints on State Taxation after *Jefferson Lines*' (1995) 51(1) *Tax Law Review* 47, 66-67.

[26] See section 2.2.

[27] In the United States, even though the registered vendor ordinarily must collect the sales and use tax, the purchaser is often the legal 'taxpayer' under the sales tax and is *always* the legal 'taxpayer' under the use tax. The registered vendor has secondary liability if it fails to collect the sales or use taxes due from the 'taxpayer'. Thus, consumers are regarded as 'taxpayers' and, in principle, could be required to file sales or use tax returns on items they purchase from non-compliant or non-registered vendors. While it is generally impractical to attempt to collect retail sales and use taxes directly from individual consumers, a number of states have a line on their individual income tax returns requiring individual consumers to pay use taxes on any goods they have acquired on which they have not paid sales taxes. Nina Manzi, 'Use Tax Collection on Income Tax Returns in Other States', Minnesota House of Representatives Policy Brief (2015),

cases establishing the constitutionality of the use tax and the vendor's obligation to collect the tax, that making 'the distributor the tax collector for the State is a familiar and sanctioned device'.[28] In the use tax context, however, the implementation of this 'familiar and sanctioned device' of making the vendor the collection agent for the state can give rise to constitutional difficulties that do not arise in the sales tax context.

Because the use tax generally applies to transactions involving interstate sales, and the vendor often has little or no presence in the state, it raises the constitutional question whether the state has the jurisdictional power to require the vendor to register and collect the tax. The US Supreme Court has declared that it is a 'fundamental requirement of both the Due Process and Commerce Clauses that there be "some definite link, some minimum connection between a state and the person, property, or transaction it seeks to tax"'.[29] This so-called 'nexus' requirement derives from the virtually axiomatic proposition that the exercise of a state's tax power over a taxpayer or its activities is justified by the 'protection, opportunities and benefits'[30] the state confers upon the taxpayer or its activities. If the state lacks the "definite link" or 'minimum connection' with the taxpayer or its activities, it has not 'given anything for which it can ask return'.[31] In the context of use taxes, the essential question becomes whether there is a sufficient connection with (and hence jurisdiction over) the out-of-state vendor to justify the state's enlisting the vendor to collect tax on its sales to in-state purchasers.[32]

3.2 The physical-presence nexus standard for requiring out-of-state vendors to collect use tax on interstate sales: 1967-2018

In 1967, in *National Bellas Hess, Inc. v Department of Revenue*,[33] the US Supreme Court first considered the question whether a state could require an out-of-state vendor with no physical presence in the state to collect a use tax on goods sold to in-state purchasers. In that case, Illinois sought to compel a Missouri mail-order seller to collect a use tax on goods sold to Illinois purchasers. National Bellas Hess challenged the tax under both the Due Process and Commerce Clauses of the US Constitution.[34] After reiterating that there must be 'some definite link, some minimum connection between a state and the person, property or transaction its seeks to tax',[35] and that such a 'link' or 'connection' between the out-of-state vendor and the state was a prerequisite to imposing a use tax collection duty on the vendor, the Court concluded that Illinois had exceeded the limits established by its precedents. The Court stated it 'has never held

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https://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf. Such levies are often colloquially referred to as 'taxes on honesty'.

[28] *General Trading Co. v State Tax Commission*, 322 US 335, 338 (1944).

[29] *Allied-Signal, Inc. v Director, Division of Taxation*, 504 US 768, 777 (1992) (quoting *Miller Bros. v Maryland*, 347 US 340, 344-345 (1954)).

[30] *Wisconsin v J.C. Penney Co.*, 311 US 435, 444 (1940).

[31] Ibid.

[32] When a vendor (or other party) collects and remits the tax on behalf of the purchaser (as in the typical retail sales or use tax transaction), the first part of the nexus inquiry focuses on the connection between the state and the tax collector rather than the taxpayer, at least when the tax collector is not the legal 'taxpayer'. See above n 27. In such cases, there ordinarily is no question about the state's nexus with the 'taxpayer', who is usually an in-state purchaser.

[33] *National Bellas Hess, Inc. v Department of Revenue*, 386 US 753 (1967).

[34] While the Court has construed the Commerce Clause as a restraint on the states' power to burden interstate commerce, it has construed the Due Process Clause as a restraint on the states' power to assert jurisdiction over out-of-state persons and to engage in extraterritorial taxation: *Moorman Manufacturing Co. v Bair*, 437 US 267, 273 (1978).

[35] *Miller Bros. v Maryland*, 347 US 340, 344-345 (1954).

that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail'.[36] The Court focused specifically on the lack of harmonisation in the states' RST regimes, which created intolerable burdens on distance sellers if they could be required to collect use taxes in all states and localities into which they shipped the goods they sold:

> The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose 'a fair share of the cost of the local government'. [37]

Declaring that the 'very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements',[38] the Court held the assessment unconstitutional.

In 1992, when the digital economy was still in its infancy, the Supreme Court revisited the question it had addressed 25 years earlier in *Bellas Hess* in *Quill Corp. v North Dakota*.[39] In *Quill*, the Court reaffirmed the rule that the Commerce Clause bars a state from imposing a use tax collection duty on an out-of-state seller with no physical presence in the state. In so holding, however, the Court made it clear that the Due Process Clause was no bar to the imposition of a use tax collection obligation on such sellers as long as the out-of-state seller was purposefully directing its efforts towards residents of the taxing state. Instead, the Court in *Quill* rested the physical-presence requirement entirely on the Commerce Clause.

The significance of the precise constitutional basis for the physical-presence requirement for nexus with an out-of-state vendor may seem like a lawyer's debating point, but it was important with respect to Congress's power to legislate on this question in the future and to provide a broad solution to the tax collection problems associated with distance selling and digital commerce. Congress is clearly free to change the rules that the Court articulates under the Commerce Clause, whereas there is serious question whether Congress can change the rules the Court articulates under the Due Process Clause.[40] Consequently, by resting the physical-presence requirement of nexus entirely on its interpretation of the Commerce Clause, the Court made it clear that Congress had the power to change this rule should it see fit to do so, perhaps in conjunction with a requirement that the states harmonise their sales tax regimes to remove the burden that the existing patchwork of state and local sales tax laws imposes on remote sellers.

3.3 States' responses to the physical-presence nexus standard for requiring out-of-state vendors to collect use tax on interstate sales

During the half-century that states were constitutionally prohibited from requiring vendors without physical presence in the state from collecting use taxes on interstate

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[36] *National Bellas Hess, Inc. v Department of Revenue*, 386 US 753, 758 (1967).
[37] Ibid 759-760 (footnotes omitted).
[38] Ibid 760.
[39] *Quill Corp. v North Dakota* 504 US 298 (1992).
[40] See generally Walter Hellerstein, 'Federal Constitutional Limitations on Congressional Power to Legislate Regarding State Taxation of Electronic Commerce' (2000) 53(4) *National Tax Journal* 1307.

sales, states adopted various administrative and legislative strategies to address the tax enforcement problem that the physical-presence rule created. These strategies broadly shared the same objective: to identify an actor or activity with an in-state physical presence that could be attributed to the out-of-state vendor thereby establishing the constitutionally required physical presence for the imposition of a tax collection obligation upon the out-of-state vendor. Among the strategies pursued by the states, which often spawned litigation over their constitutionality with varying results depending on the precise facts at issue, were the following:

- relying on the out-of-state vendor's own in-state activities, including
  - delivery of merchandise in the out-of-state vendor's own trucks;
  - temporary or occasional presence of out-of-state vendor's employees in the state;
  - attendance at trade shows by out-of-state vendor's employees;
  - passage of title to or temporary ownership of out-of-state vendor's goods sold to in-state customers;
  - licensing of out-of-state vendor's software (characterised as tangible personal property) to in-state customers;[41]
- attributing to the out-of-state vendor the in-state activities of third parties, including:
  - activities of independent contractors acting as the out-of-state vendor's in-state sales representatives;
  - activities of the independent in-state sales representatives of multi-level marketing organisations;
  - warranty, repair, or installation services performed within the state by independent service providers on behalf of out-of-state vendors;
  - printing services performed within the state for out-of-state vendors;
  - fulfilment services performed within the state for out-of-state vendors;
  - activities of teachers associated with children's book clubs;
  - common carrier activities exceeding standard services (eg, personalised delivery services);
  - activities of in-state suppliers or fabricators operating on behalf of an out-of-state vendor;[42]
- relying on in-state activities of retail stores operated by corporate affiliates of mail-order or online vendor to establish nexus over out-of-state vendor, including affiliates':

[41] See generally Hellerstein et al, above n 5, 19.03[2] (describing underlying case law in detail).
[42] See generally ibid 19.03[3] (describing underlying case law in detail).

- acceptance of 'returns' of purchases from out-of-state vendors at local stores;
- distribution at local stores of discount coupons on behalf of out-of-state online vendor.[43]

3.3.1 Click-through nexus

As mail order and other remote sales gradually evolved into online sales with the advent of the Internet and the digital economy, states adjusted, or, perhaps more precisely, supplemented their strategies to address the RST collection challenges associated with the digital economy. One such strategy involved the adoption of so-called 'click through nexus' statutes that established a presumption of nexus with out-of-state online retailers who paid commissions to in-state residents to post links to the online retailers' web sites.[44]

3.3.2 Information reporting and notice requirements

Prior to *Wayfair*, some states adopted legislation that required non-physically present vendors to comply with various information reporting and notice requirements with respect to sales made into the state unless they voluntarily agreed to collect tax on those sales.[45] The rationale for such statutes, which may best be explained by Justice Oliver Wendell Holmes's wise observation that '[a] page of history is worth a volume of logic',[46] was that the courts had drawn a constitutional distinction between states' constitutional power to impose *tax collection* obligations, for which physical presence was required, and their constitutional power to impose *tax reporting* obligations, for which physical presence was not required.[47] Although one can understand, as a matter of principle, why states would have an interest in acquiring information about inbound sales made by vendors over whom they had no authority to require compliance with tax collection obligations, a more realistic assessment of such provisions is that they were designed to induce sellers 'voluntarily' to choose to collect a tax that they could not be constitutionally compelled to collect by imposing on them a more burdensome alternative of complying with detailed reporting obligations that the state was empowered to impose.

3.3.3 Marketplace platforms

In the year preceding the US Supreme Court's decision in *Wayfair*, a number of state legislatures enacted legislation explicitly targeting marketplace platforms[48] in connection with state sales and use tax administration.[49] It was no secret why states had

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[43] See generally ibid 19.03[4] (describing underlying case law in detail).
[44] See generally ibid 19.04[2] (discussing statutory provisions and related case law in detail).
[45] See generally Eric S Smith, 'Due Process Implications Related to State Notice and Economic Nexus Laws' (2017) 70(4) *Tax Lawyer* 833, 855-866 (analysing the Colorado, Louisiana, Oklahoma and Vermont statutes).
[46] *New York Trust Co. v Eisner*, 256 US 345, 349 (1921).
[47] *Direct Marketing Ass'n v Brohl*, 814 F3d 1129 (10th Cir. 2015), *cert. denied*, 137 S. Ct. 591 (2016).
[48] The term 'marketplace platform' is employed broadly to describe entities that facilitate the sale of tangible personal property or services. Most states use the term 'marketplace facilitator'; other states use the term 'marketplace provider'. See section 5.2 (discussing platform legislation and these terms in more detail).
[49] See generally Walter Hellerstein, John A Swain and Jonathan E Maddison, 'Platforms: The Sequel' (2019) 91 *State Tax Notes* 7; Hellerstein et al, above n 5, 19.08[7].

begun to focus their attention on marketplace platforms in the sales and use tax context. They were concerned with and frustrated by then-existing judicially articulated physical-presence nexus restraint on states' power to require vendors to collect taxes on interstate sales to customers in the state. Indeed, three of the first four states that enacted platform legislation – Minnesota, Rhode Island, and Washington – made their motivations clear in their statements of legislative intent. Thus, in what is generally heralded as 'the nation's first marketplace nexus provision',[50] Minnesota enacted legislation on 30 May 2017, with one of the more unusual 'effective date' provisions in the annals of state tax law, which declared that its provisions were effective the earlier of

(1) a decision by the United States Supreme Court modifying its decision in *Quill Corp. v North Dakota*, 504 US 298 (1992) so that a state may require retailers without a physical presence in the state to collect or remit sales tax; or

(2) 1 July 2019.[51]

Similarly, Washington's platform-related legislation declared that '[t]he legislature intends by this act to address the significant harm and unfairness brought about by the physical presence nexus rule'.[52] Rhode Island, perhaps trying to place itself on firmer constitutional ground, declared that 'it is no longer an *undue burden* for non-collecting retailers to accurately compute, collect, and remit and/or report with respect to their sales and use tax obligations to Rhode Island'.[53]

To avoid repetition, and to incorporate the significant post-*Wayfair* modifications of the pre-*Wayfair* legislation into the discussion, state platform legislation is treated in more detail in the post-*Wayfair* portion of this article.[54]

4. *WAYFAIR* AND THE REPUDIATION OF THE PHYSICAL-PRESENCE NEXUS STANDARD FOR REQUIRING OUT-OF-STATE VENDORS TO COLLECT TAX ON INTERSTATE SALES

As the preceding discussion suggests,[55] the quarter-century following the US Supreme Court's 1992 decision in *Quill* witnessed two parallel developments in the universe of online sales. The first was the explosive growth of the digital economy, which was just emerging when *Quill* was decided but had become a central and increasingly important feature of global economic activity by 2018. The second was the states' persistent and increasingly innovative efforts to address the enforcement issues associated with *Quill*'s physical-presence rule, which one observer described as 'a guerilla war with remote

[50] Maria Koklanaris, 'Minnesota Enacts Nation's First Marketplace Nexus Provision' (2017) 84 *State Tax Notes* 1012.
[51] H.F. 1, s 44(a), https://www.revisor.mn.gov/bills/text.php?number=HF1&version=1&session=ls90&session_year=2017&session_number=1&format=pdf.
[52] Engrossed House Bill 2163, Section 201(3), Chapter 28, Laws of 2017, 65th Legislature, 2017 3rd Special Session, approved 7 July 2017, http://lawfilesext.leg.wa.gov/biennium/2017-18/Pdf/Bills/House%20Passed%20Legislature/2163.PL.pdf.
[53] RI Gen. Laws section 44-18.2-1(2) (Westlaw 2019) (emphasis supplied).
[54] See section 5.2.
[55] See section 3.3.

sellers, developing expanded nexus and reporting laws designed to skirt the restrictions of *Quill*, and push online sellers to collect tax'.[56]

Wholly apart from the 'guerilla war', several states adopted legislation or promulgated regulations in a frontal assault on the *Quill* decision. These statutes and regulations imposed sales and use tax collection obligations on sellers without physical presence in the state as long as their sales into the state exceeded a specified monetary or transactional threshold, thereby arguably establishing 'economic nexus'[57] with the state.[58] Online retailers challenged the constitutionality of these provisions, including the South Dakota statute, which requires out-of-state sellers to collect tax '*as if* the seller had a physical presence in the state',[59] provided that the seller, on an annual basis, delivers more than USD 100,000 of goods or services into the state or engages in 200 or more separate transactions for the delivery of goods into the state.[60] The statute foreclosed retroactive application of those provisions until the constitutionality of the law was clearly established.[61] The online retailers who challenged the South Dakota statute were among the largest online retailers in the United States and indisputably satisfied the statute's requirements.[62]

The South Dakota Supreme Court ruled that the statute was unconstitutional, observing that '[h]owever persuasive the State's arguments on the merits of revisiting the issue,

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[56] Billy Hamilton, 'The Problems of an Analog Tax in a Digital World' (2018) 90 *State Tax Notes* 119. The observer further noted that '[c]onsiderable progress was made, particularly when Amazon.com, the world's largest online retailer, began collecting tax in all states with a sales tax in 2017': ibid. What the observer fails to note, however, is that Amazon began collecting tax *only* on Amazon's own sales, not on sales made over Amazon's online platform by the 800,000 FBA (fulfilled by Amazon sellers). For further discussion of that issue, see section 5.2 (discussing state tax collection obligations of marketplace platforms).

[57] In US subnational state tax parlance, 'economic nexus' signifies economic presence without regard to physical presence, which is analogous to 'significant economic presence' or 'significant digital presence' in the international tax context: Organisation for Economic Co-operation and Development (OECD), *Tax Challenges Arising from Digitalisation – Interim Report 2018, Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2018) ch 4.3; European Commission, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, COM (2018) 147 final. See generally Hellerstein et al, above n 5, 6.11 ('Economic Nexus: Exploitation of the State's Market as a Basis for Asserting Jurisdiction Over Corporations with No Physical Presence in the State for Purposes of Income, Franchise, and Other Taxes on Business Activity').

[58] See, eg, Ind. Code section 6-2.5-2-1(c) (Westlaw 2019) (gross revenue in excess of USD 100,000 or more than 200 separate sales transactions); RI Gen. Laws sections 44-18.2-1–44-18.2-10 (Westlaw 2019) (same); SD Codified Laws section 10-64-2 (Westlaw 2019) (same); Ala. Admin. Code r. 810-6-2-.90.03 (Westlaw 2019) (sales in excess of USD 250,000); Miss. Admin. Code 35-IV-03.09 sections 101-103 (Westlaw 2019) (same). See generally Matthew Szudajski, 'The Rising Trend of Sales Tax Nexus Expansion' (2017) 70(4) *Tax Lawyer* 907 (containing a detailed and comprehensive description of recent sales tax nexus developments).

[59] SD Codified Laws section 10-64-2 (Westlaw 2019) (emphasis supplied).

[60] Ibid.

[61] Ibid s 10-64-6.

[62] As the US Supreme Court observed, the retailers, Wayfair, Inc., Overstock.com, Inc., and Newegg, Inc., are merchants with no employees or real estate in South Dakota. Wayfair, Inc., is a leading online retailer of home goods and furniture and had net revenues of over $4.7 billion last year. Overstock.com, Inc., is one of the top online retailers in the United States, selling a wide variety of products from home goods and furniture to clothing and jewelry; and it had net revenues of over $1.7 billion last year. Newegg, Inc., is a major online retailer of consumer electronics in the United States. Each of these three companies ships its goods directly to purchasers throughout the United States, including South Dakota. Each easily meets the minimum sales or transactions requirement of the Act, but none collects South Dakota sales tax.
South Dakota v Wayfair, Inc., 138 S. Ct. 2080, 2089 (2018).

Quill has not been overruled', and '[w]e are mindful of the Supreme Court's directive to follow its precedent when it "has direct application in a case" and to leave to the Court "the prerogative of overruling its own decisions"'.[63] In *South Dakota v Wayfair, Inc*.,[64] the US Supreme Court accepted the South Dakota Supreme Court's invitation, overruled *Quill* and *Bellas Hess* as 'unsound and incorrect',[65] and remanded the case for consideration of any Commerce Clause claims that may remain in the absence of *Quill* and *Bellas Hess*.[66]

4.1 The US Supreme Court's opinion in *Wayfair*

The Court's criticism of the physical-presence test was three-pronged. First, the Court's earlier embrace of the test was 'flawed on its own terms',[67] because the physical-presence test is not a 'necessary interpretation'[68] of the substantial nexus requirement, creates rather than resolves market distortions, and disregards the more '"sensitive, case-by-case analysis"'[69] of the Court's modern Commerce Clause jurisprudence. Second, the physical-presence test is inconsistent with modern e-commerce and other '"dramatic technological and social changes"'[70] that allow sellers to penetrate state markets without establishing a physical presence. Third, the physical-presence test is 'an extraordinary imposition by the Judiciary on States' authority to collect taxes and perform critical public functions'.[71]

In finding that the *Quill* decision was 'flawed on its own terms',[72] the Court emphasised that the Due Process Clause and Commerce Clause nexus requirements are 'closely related',[73] and that although they 'may not be identical or coterminous, … there are significant parallels'.[74] It found that the reasons given in *Quill* for rejecting the physical-presence rule for due process purposes 'apply as well to the question whether physical presence is a requisite for an out-of-state seller's liability to remit sales taxes'.[75] Addressing the argument that the physical-presence rule protects retailers from the burden of complying with tax collection obligations in thousands of different jurisdictions, the *Wayfair* Court noted that the 'administrative costs of compliance … are largely unrelated to whether a company has a physical presence in a State'.[76] Thus, the '[t]he physical presence rule is a poor proxy for the compliance cost faced by companies doing business in multiple states'.[77]

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[63] *South Dakota v Wayfair, Inc.*, 901 NW2d 754, 761 (SD 2017) (quoting *Rodriguez de Quijas v Shearson/American Exp., Inc.*, 490 US 477, 484 (1989)), *reversed*, 138 S. Ct. 2080 (2018).
[64] 138 S. Ct. 2080 (2018).
[65] Ibid 2099.
[66] Ibid 2100.
[67] Ibid 2092.
[68] Ibid.
[69] Ibid 2094 (citation omitted).
[70] Ibid 2095 (citation omitted).
[71] Ibid.
[72] Ibid 2092.
[73] Ibid 2093.
[74] Ibid.
[75] Ibid. By contrast, the *Quill* Court had seized upon the theoretical differences between the two standards as grounds for its determination that a taxpayer's connections with a state could satisfy the Due Process Clause nexus requirement but not the Commerce Clause nexus requirement. See section 3.2.
[76] *South Dakota v Wayfair, Inc.*, 138 S. Ct. 2080, 2093 (2018).
[77] Ibid 2093.

The Court further observed 'that the Commerce Clause was designed to prevent States from engaging in economic discrimination … '.[78] Moreover, 'it is certainly not the purpose of the Commerce Clause to permit the Judiciary to create market distortions'.[79] The physical-presence rule, however, 'puts both local businesses and many interstate businesses with physical presence at a competitive disadvantage relative to remote sellers. Remote sellers can avoid the regulatory burden of tax collection and can offer *de facto* lower prices caused by the widespread failure of consumers to pay the tax on their own'.[80] The physical-presence rule also 'produces an incentive to avoid physical presence in multiple States',[81] thereby distorting business decisions regarding the allocation of resources and giving rise to economic inefficiencies. Thus, '[r]ejecting the physical presence rule is necessary to ensure that artificial competitive advantages are not created by this Court's precedents'.[82]

The Court also contrasted the formalism of *Quill* with the 'sensitive, case-by-case analysis of purposes and effects'[83] embodied in modern Commerce Clause jurisprudence. *Quill*, it noted, 'treats economically identical actors differently, and for arbitrary reasons'.[84] The Court demonstrated this point by comparing the compliance obligations of a small, yet physically present, online retailer with those of a large, remote online retailer making sales nationwide. Under *Quill*, the small retailer is required to remit tax while the large retailer is not. 'This distinction simply makes no sense', and 'courts should not rely on anachronistic formalisms' to prevent a state from enforcing its tax laws so long as they 'avoid[ ] "any effect forbidden by the Commerce Clause"'.[85]

Turning to an examination of the physical-presence rule as applied to modern e-commerce and noting that the *Quill* Court had characterised the rule as 'artificial at its edges',[86] the Court declared that it is now 'all the more evident that the physical presence rule is artificial in its entirety'.[87] The Court observed:

> Between targeted advertising and instant access to most consumers via any internet-enabled device, 'a business may be present in a State in a meaningful way without' that presence 'being physical in the traditional sense of the term'. A virtual showroom can show far more inventory, in far more detail, and with greater opportunities for consumer and seller interaction than might be possible for local stores. Yet the continuous and pervasive virtual presence of retailers today is, under *Quill*, simply irrelevant. This Court should not maintain a rule that ignores these substantial virtual connections to the State.[88]

The Court also found that the physical-presence rule 'is an extraordinary imposition by the Judiciary on the States' authority to collect taxes and perform critical public functions'.[89] It described the rule as not only unfair to business competitors, but also to

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[78] Ibid 2093-2094.
[79] Ibid 2094.
[80] Ibid.
[81] Ibid.
[82] Ibid.
[83] Ibid (citation omitted).
[84] Ibid.
[85] Ibid 2094-2095 (citation omitted).
[86] *Quill Corp. v North Dakota*, 504 US 298, 315 (2018).
[87] *South Dakota v Wayfair, Inc.*, 138 S. Ct. 2080, 2095 (2018).
[88] Ibid (citation omitted).
[89] Ibid.

states seeking fair enforcement of their tax laws. Retaining the rule would allow many purchasers 'to escape payment of … taxes that are essential to create and secure for remote sellers the market they supply with goods and services'.[90] Moreover, '[i]t is essential to public confidence in the tax system that the Court avoid creating inequitable exceptions'.[91] While the Court recognised the 'legitimate concerns … for small businesses that make a small volume of sales to customers in many states',[92] it did not find these concerns to be sufficient justification for retaining an 'artificial, anachronistic rule that deprives States of vast revenues from major businesses'.[93] Rather, it pointed to other potential avenues of relief, such as developments in tax compliance software and the possibility of congressional legislation.

Finally, the Court pointed to the advent of the digital economy as a crucial factor in its conclusion that *Quill*'s physical-presence rule '*must* give way'[94] to a contemporary nexus standard.[95] After acknowledging that '*Quill* was wrong on its own terms when it was decided in 1992', the Court continued that 'since then the Internet revolution has made its earlier error all the more egregious and harmful'.[96] The Court elaborated on this point at some length, and it is worth quoting the Court's observations because they reflect the US judicial perspective on the impact of the digital economy on tax collection obligations:

> The *Quill* Court did not have before it the present realities of the interstate marketplace. In 1992, less than 2 percent of Americans had Internet access. When it decided *Quill,* the Court could not have envisioned a world in which the world's largest retailer would be a remote seller.
>
> The Internet's prevalence and power have changed the dynamics of the national economy. In 1992, mail-order sales in the United States totaled $180 billion. Last year, e-commerce retail sales alone were estimated at $453.5 billion. Combined with traditional remote sellers, the total exceeds half a trillion dollars. Since the Department of Commerce first began tracking e-commerce sales, those sales have increased tenfold from 0.8 percent to 8.9 percent of total retail sales in the United States. And it is likely that this percentage will increase. Last year, e-commerce grew at four times the rate of traditional retail, and it shows no sign of any slower pace.
>
> This expansion has also increased the revenue shortfall faced by States seeking to collect their sales and use taxes. In 1992, it was estimated that the States were losing between $694 million and $3 billion per year in sales tax revenues as a result of the physical presence rule. Now estimates range from $8 to $33 billion. The South Dakota Legislature has declared an emergency, which again demonstrates urgency of overturning the physical presence rule.

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[90] Ibid 2096.
[91] Ibid.
[92] Ibid 2098.
[93] Ibid 2099.
[94] Ibid 2097 (emphasis supplied).
[95] In this connection, the author cannot resist the temptation of quoting the Court's observation that '"while nexus rules are clearly necessary," the Court "should focus on rules that are appropriate to the twenty-first century, not the nineteenth"': ibid 2092 (quoting Walter Hellerstein, 'Deconstructing the Debate Over State Taxation of Electronic Commerce' (2000) 13(3) *Harvard Journal of Law and Technology* 549, 553).
[96] *South Dakota v Wayfair, Inc.*, 138 S. Ct. 2080, 2097 (2018).

> The argument, moreover, that the physical presence rule is clear and easy to apply is unsound. Attempts to apply the physical presence rule to online retail sales are proving unworkable. States are already confronting the complexities of defining physical presence in the Cyber Age. For example, Massachusetts proposed a regulation that would have defined physical presence to include making apps available to be downloaded by in-state residents and placing cookies on in-state residents' web browsers. Ohio recently adopted a similar standard. Some States have enacted so-called 'click through' nexus statutes, which define nexus to include out-of-state sellers that contract with in-state residents who refer customers for compensation. Others still, like Colorado, have imposed notice and reporting requirements on out-of-state retailers that fall just short of actually collecting and remitting the tax. Statutes of this sort are likely to embroil courts in technical and arbitrary disputes about what counts as physical presence.[97]

Once the Court had overruled the physical-presence rule, the Court's only remaining task was to apply the Commerce Clause nexus test – which 'simply asks whether the tax applies to an activity with a substantial nexus with the state'[98] – to the South Dakota statute. Quoting an earlier decision, the Court found that '"such a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction"'.[99] The decision followed easily:

> Here, the nexus is clearly sufficient based on both the economic and virtual contacts respondents have with the State. The Act applies only to sellers that deliver more than $100,000 of goods or services into South Dakota or engage in 200 or more separate transactions for the delivery of goods and services into the State on an annual basis. This quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota. And respondents are large, national companies that undoubtedly maintain an extensive virtual presence. Thus, the substantial nexus requirement … is satisfied in this case.[100]

4.2 Constitutional nexus after *Wayfair*

The constitutional nexus standard for requiring remote vendors to comply with states' sales and use tax collection obligations after *Wayfair* is whether the vendor has purposefully 'availed itself' of the 'privilege' or 'benefit' of carrying on business in the state's economic market. In *Wayfair*, the Court articulated the Commerce Clause nexus standard for imposing tax collection obligations on remote vendors as whether the taxpayer or tax collector 'avails itself of the substantial privilege of carrying on business' in the state.[101] This was substantially the same as the Due Process Clause nexus standard the Court had earlier articulated in *Quill* (and reaffirmed in *Wayfair*), namely, whether the 'foreign corporation purposefully avails itself of the benefits of an economic market in the … State'.[102] As the Court indicated in *Wayfair*, these questions

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[97] Ibid 2097-2098 (citations omitted).
[98] Ibid 2099.
[99] Ibid (citation omitted, brackets in original).
[100] Ibid.
[101] See text accompanying n 100, above.
[102] *Quill Corp. v North Dakota*, 504 US 298, 307 (1992).

may be answered by reference to the taxpayer's or tax collector's 'economic and virtual contacts'[103] with the state.

One does not have to be a tax professional to recognise that the foregoing standards provide little concrete guidance to state tax administrators and state tax advisors as to the nature and level of 'economic and virtual' contacts that will satisfy constitutional nexus norms for remote sellers. The only thing we know for sure about these norms as of mid-2019 is that sellers that deliver 'more than $100,000 of goods or services' into a state or 'engage in 200 or more separate transactions' in a state on an annual basis have 'economic and virtual contacts' with the state that are 'clearly sufficient' to satisfy constitutional standards.

Having said that, one must also underscore several other things we also know for certain at this juncture that will be critical in shaping the framework governing remote vendors' tax collection obligations in the wake of *Wayfair*. First, vendors' tax collection obligations will depend critically on the specific criteria set forth in state sales and use tax statutes (such as those embodied in the South Dakota statute at issue in *Wayfair*) and not merely on the vague constitutional criterion of purposeful 'availment' of a state's economic market that circumscribes state tax enforcement authority. Indeed, there is already strong evidence that states will embrace thresholds similar to those in the South Dakota statute as a safe harbour from post-*Wayfair* constitutional challenges.[104] Second, the Court's decision in *Wayfair* may well spur congressional action to impose nationwide standards governing states' power to require remote vendors to collect sales and use taxes on interstate trade. Third, the inevitable litigation over the application of the *Wayfair* nexus standards is likely to add some flesh to the bare bones of the criteria set forth in the Court's opinion.

In connection with the third point, it is worth noting that the Court, after holding that 'the substantial nexus requirement … is satisfied in this case',[105] went on to observe that '[t]he question remains whether some other principle in the Court's Commerce Clause doctrine might invalidate the Act'.[106] Because the pre-existing physical-presence rule had been an 'obvious barrier'[107] to enforcement of the South Dakota statute, the Court observed that these other aspects of the Court's Commerce Clause doctrine (apart from the substantial nexus requirement) that prevent discrimination against or undue burdens upon interstate commerce, had not been litigated or briefed. The Court accordingly remanded the case for consideration of such claims.[108]

In so doing, however, the Court strongly implied that such claims would not be persuasive on the facts presented and, more importantly, effectively provided guidance to other states as to how to design tax regimes that will survive Commerce Clause scrutiny in a post-*Wayfair* world. Specifically, the Court identified several features of

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[103] See text accompanying n 100, above.
[104] See section 5.
[105] *South Dakota v Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018).
[106] Ibid.
[107] Ibid.
[108] For further exploration of some of these issues, see Hellerstein et al, above n 5, 19.02[2][c][ii]; Walter Hellerstein and Andrew Appleby, 'Substantive and Enforcement Jurisdiction in a Post-*Wayfair* World' (2018) 90 *State Tax Notes* 283.

South Dakota's tax system 'that appear designed to prevent discrimination against or undue burdens upon interstate commerce'.[109]

First, the nexus statute provided a safe harbour for those who transact only limited business in the state. Second, the statute did not apply retroactively. Third, South Dakota was one of more than 20 states that have adopted the Streamlined Sales and Use Tax Agreement, which 'standardizes taxes to reduce administrative and compliance costs'.[110] As the Court elaborated:

> It requires a single, state level tax administration, uniform definitions of products and services, simplified tax rate structures, and other uniform rules. It also provides sellers access to sales tax administration software paid for by the State. Sellers who choose to use such software are immune from audit liability.[111]

Finally, it is important to keep in mind that the Court's embrace in *Wayfair* of a nexus rule based on 'economic and virtual contacts'[112] with a state did not render physical presence irrelevant to the nexus inquiry. To be sure, the introduction to this article observed that the Court's replacement of a nexus rule based entirely on physical presence with one based on 'economic and virtual contacts' consigned much of the earlier 'US experience' in the collection of tax on online sales 'to the dustbin of history'.[113] It was careful qualify this observation, however, with the caveat '*at least for those with no physical presence in a state*'.[114] Physical presence is surely an 'economic contact', and it remains relevant to – albeit not controlling of – the nexus inquiry, although the precise significance of physical presence in the post-*Wayfair* world, and its relationship to virtual presence in establishing nexus, will undoubtedly be a focus of further analysis and controversy.

5. THE STATES' RESPONSE TO *WAYFAIR*

It may seem premature to be examining the states' response to *Wayfair* a little more than a year after the Court's decision inasmuch as state legislators and tax administrators do not ordinarily respond rapidly to external developments. But *Wayfair* is the exception that proves the rule. The ink was barely dry on the Court's opinion in *Wayfair* before state legislatures and state tax administrators began to respond to the implications of the decision for their authority to collect taxes from online and other remote sellers. The balance of this article examines these responses, with the full knowledge that they continue every day (often to modify or fine-tune a previous response). For that reason, readers interested in the current 'state of play' in this domain are advised to consult one of the sources cited in the notes offering up-to-date summaries of states' statutory and administrative responses to *Wayfair*.[115]

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[109] *South Dakota v Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018).
[110] Ibid 2100.
[111] Ibid.
[112] Ibid 2099.
[113] See text accompanying n 5, above.
[114] See section 1 (emphasis supplied).
[115] See, eg, S Horn and R Newton-Clarke, *One by One, States Respond to South Dakota v Wayfair (state-by-state chart updated regularly)*, https://tax.thomsonreuters.com/checkpoint/catalyst; Joseph Bishop-Henchman, Hannah Walker and Denise Garbe, 'Post-Wayfair Options for States', Tax Foundation (29 August 2018), https://taxfoundation.org/post-wayfair-options-for-states. The Multistate Tax Commission

5.1 State legislative and administrative responses to *Wayfair* directed at remote sellers

As suggested above,[116] the Court in *Wayfair* effectively provided the states with three guiding principles for designing legislation or administrative guidance that would carry with it a strong presumption of constitutionality in a post-*Wayfair* world:

- first, adopt a threshold of selling more than USD 100,000 of goods or services into the state or engage in 200 or more separate transactions for delivery of goods or services into the state on an annual basis, because this quantity of business could not occur unless the seller avails itself of the substantial privilege of carrying on business in the state;
- second, do not apply the standard retroactively;
- third, adopt the Streamlined Sales and Use Tax Agreement (SSUTA) (if the state has not already done so) or equivalent measures that standardise taxes to reduce administrative and compliance costs and provide sellers with access to sales tax administration software paid for by the state and immunising sellers who use such software from audit liability.

Based on the states' responses to *Wayfair* thus far, the states have taken these guiding principles to heart, as reflected in Table 1, which reflects state legislative and administrative guidance as of July 2019.[117]

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has organised a '*Wayfair* Implementation and Marketplace Facilitator Work Group' which '**i**s intended to discuss and develop concepts or ideas for consideration by states desiring to require marketplace facilitators to collect and remit sales/use tax on marketplace sales, in order to maximize compliance while minimizing the burden on marketplace facilitators and marketplace sellers': see http://www.mtc.gov/getdoc/d3f9e214-6006-4f76-bca2-7287be89dd06/Wayfair-Implementation-Informational-Project.aspx. The group has scheduled weekly teleconferences and the web site is an invaluable source of information for the current state of 'post-*Wayfair*' play regarding remote sellers and marketplace facilitators (platforms). See also below n 117.

[116] See section 4.2.

[117] The guidance is based on sources cited above, n 115, as well as other sources of information, including: Bloomberg BNA, *Daily Tax Report: State*, https://www.bna.com/tax; CCH, *State Tax Day*, http://intelliconnect.cch.com; Tax Notes, *Tax Notes State* (formerly *State Tax Notes*), https://www.taxnotes.com/state-tax-today, and, in particular, Tax Notes, *Nexus Tracker*, https://www.taxnotes.com/nexus-tracker; Thomson Reuters, *Daily Updates, State and Local Tax*, https://www.checkpoint.thomsonreuters.com. Needless to say, readers should view the ensuing description as the current 'snapshot' of the state of play as of July 2019, and should assume that the picture may – and, in some cases clearly will – have changed by the time they read this article. In this connection, readers are advised to consult the sources cited in n 115, above, and Hellerstein et al, above n 5, Table 19-1 and Table 19-2.

Table 1: Post-*Wayfair* Nexus Rules for Remote Sellers (as of July 2019)

State	Annual Sales Threshold (USD)	Annual Transaction Threshold	Original Effective Date*	SSUTA Member
Alabama	$250,000 (goods only)	Not applicable	Oct. 1, 2018	No
Arizona	$200,000 for 2019 $150,000 for 2020 $100,00 for 2021	Not applicable		No
Arkansas	$100,000	200	July 1, 2019	Yes
California	$500,000	200	Apr. 1, 2019	No
Colorado	$100,000	Not applicable	Dec. 1, 2018	No
Connecticut	$250,000	200	Dec. 1, 2018	No
District of Columbia	$100,000	200	Jan. 1, 2019	No
Georgia	$200,000 (goods only)	200 (goods only)	Jan. 1, 2019	Yes
Hawaii	$100,000	200	July 1, 2018	No
Idaho	$100,000	Not applicable	June 1, 2019	No
Illinois	$100,000	200	Oct. 1, 2018	No
Indiana	$100,000	200	Oct. 1, 2018	Yes
Iowa	$100,000	Not applicable	Jan. 1, 2019	Yes
Kentucky	$100,000	200	Oct. 1, 2018	Yes
Louisiana	$100,000	200	Jan. 1, 2019	No
Maine	$100,000	200	July 1, 2018	No
Maryland	$100,000	200	Oct. 1, 2018	No
Massachusetts	$500,000 *and*	100	Oct. 1, 2017	No
Michigan	$100,000	200	Oct. 1, 2018	Yes
Minnesota	$100,000	200	Oct. 1, 2018	Yes
Mississippi	$250,000	Not applicable	Sept. 1, 2018	No
Nebraska	$100,000	200	Jan. 1, 2019	Yes
Nevada	$100,000	200	Nov. 1, 2018	Yes
New Jersey	$100,000	200	Nov. 1, 2018	Yes
North Carolina	$100,000	200	Nov. 1, 2018	Yes
North Dakota	$100,000	200	Oct. 1, 2018	Yes
Ohio	$100,000	200	Aug. 1, 2019	Yes
Oklahoma	$100,000	Not applicable	July 1, 2018	Yes
Pennsylvania	$100,000	Not applicable	Mar. 1, 2018	No
Rhode Island	$100,000	200	Aug. 17, 2017	Yes
South Carolina	$100,000	Not applicable	Nov. 1, 2018	No
South Dakota	$100,000	200	Nov. 1, 2018	Yes
Tennessee	$500,000	Not applicable	July 1, 2019	Associate Member
Utah	$100,000	200	Jan. 1, 2019	Yes
Vermont	$100,000	200	July 1, 2018	Yes
Washington	$100,000	Not applicable	Oct. 1, 2018	Yes

West Virginia	$100,000	200	Jan. 1, 2019	Yes
Wisconsin	$100,000	200	Oct. 1, 2018	Yes
Wyoming	$100,000	200	Feb. 1, 2019	Yes

*Some states have modified their "effective date" rules since the original adoption of their remote seller nexus rules, and one should consult current state statutes and administrative guidance to determine if the original effective date has been modified.

5.2 State marketplace platform legislation

As noted above,[118] during the year before *Wayfair* was decided, states had begun to enact legislation imposing tax collection and reporting obligations on marketplace platforms in connection with online sales. As originally conceived, the legislation was designed in large part to deal with the then existing physical-presence nexus restraint on requiring remote vendors to collect tax on interstate sales. The platforms' tax collection obligations were accordingly based, at least in part, on the platforms' physical presence in the state or, alternatively, on their election to comply with notice and reporting obligations, which could be imposed in the absence of physical presence, or to collect the tax due.[119]

Despite the continuing (and, indeed, increasing) significance of platforms in connection with enforcement of tax on online sales, the Court's decision in *Wayfair* fundamentally changed the constitutional premises underlying the original design of state platform legislation. These changes have had a substantial impact on the structure of pre-existing legislation and of the platform legislation that has been adopted by a large number of states since *Wayfair* was decided. The ensuing discussion examines state legislation directed at marketplace platforms.[120]

5.2.1 Overview

The precise details and operation of state platform regimes vary from state to state.[121] It may be therefore helpful at the outset to provide an overview of the general features of state platform legislation.

Viewed in most general terms, state platform legislation is directed at three categories of actors: (1) the platforms themselves, ie, the entities that operate the marketplaces (often called 'marketplace facilitators' or 'marketplace providers'); (2) referrers, those who bring buyers and sellers together to consummate a sale over a platform but do not collect receipts from the buyer; and (3) remote sellers, including those who sell over platforms, sometimes called 'marketplace sellers'. These categories of actors are not airtight. While platforms typically are online marketplaces that list third parties' products for sale on their websites, in many circumstances platforms not only facilitate sales of third parties' products but also sell products of their own. Referrers may operate

[118] See section 3.3.3.
[119] See section 3.3.2.
[120] The following discussion draws freely from Hellerstein et al, above n 5, 19.08[7] and Hellerstein et al, 'Platforms: The Sequel', above n 49. For the most recent version of this article, which contains an up-to-date description of state marketplace platform legislation as of December 2019, see Walter Hellerstein, John A Swain and Jonathan E Maddison, 'Platforms: The Finale' (2020) *Tax Notes State* 11 (6 January).
[121] See section 5.2.2.

as marketplace platforms or as sellers in their own right with respect to some of the transactions in which they engage, potentially triggering different reporting or collection obligations for specified classes of transactions. Remote sellers, as just noted, may or may not sell over platforms, and that distinction can be critical in determining their exposure to tax collection or reporting obligations. Platform legislation raises the following basic questions regarding the platform-related obligations imposed on platforms, referrers, and marketplace sellers.[122]

1. Does the law impose a collection and/or reporting obligation on the actor in question? Does the actor have a choice between the two?

As a matter of logic, one might have assumed that platform legislation would simply impose a tax collection obligation on platform-related actors under appropriate circumstances. But, as noted in the preceding discussion,[123] the 'page of history' that outweighed the suggested logic was the constitutional distinction courts had drawn, prior to the Court's decision in *Wayfair*, between states' constitutional power to impose *tax collection* obligations, which required the tax collector's physical presence in the state, and states' constitutional power to impose *tax reporting* obligations, which did not. State platform legislation adopted prior to the *Wayfair* decision often reflects that distinction, which contributes to its complexity.

Going forward, however, one would think that the days of information reporting and notice regimes will be numbered for platform-related actors that exceed the economic nexus thresholds endorsed by *Wayfair*, because they can now constitutionally be compelled to collect the tax, and there is no need for states to adopt reporting and notice regimes as a mechanism for inducing collection. Notice and information report statutes will still have relevance, however, to the extent they apply to persons who are not required to collect and report tax as a matter of state law, for example, persons falling beneath the state's quantitative nexus thresholds and 'referrers', as defined by state 'platform' statutes, who are sometimes required to provide customer notice and information reports even though they are not treated as taxpayers or tax collectors.

2. Does the law extend to all taxable transactions or only to sales of tangible personal property?

Although state sales and use taxes have historically been confined largely to sales of tangible personal property, marketplace platforms facilitate sales not only of tangible personal property but also of an increasing volume of services and 'digital products',[124] many of which are subject to tax. The platform legislation enacted in some states applies broadly to all taxable transactions, whereas other states' platform legislation is confined to tangible personal property. From a practical perspective, requiring platforms to collect tax on sales of taxable services and digital products may create burdens for

[122] Because platform-related obligations constitute the focus of this discussion, it does not consider the imposition of obligations imposed on remote sellers by platform-related legislation except insofar as such obligations arise by virtue of remote sellers' relationship to marketplace platforms (including referrers). State legislation directed at remote sellers wholly apart from their relationship to marketplace platforms is considered in section 5.1.

[123] See section 3.3.2.

[124] See Hellerstein et al, above n 5, 19A.04[2][c][ii] (discussing Streamlined Sales and Use Tax Agreement (SSUTA) definition of 'digital products').

platforms in determining what services and digital products are subject to tax in each state as well as determining the state in which such services or digital products are sold.

3. Is there a sales, transaction, or similar threshold for determining the point at which a platform-related actor acquires a tax collection or reporting obligation?

Virtually all platform legislation to date includes a threshold or thresholds that trigger tax collection or reporting obligations, and this trend will almost certainly continue in light of the Supreme Court's explicit reference to the existence of thresholds as one of the reasons for sustaining the constitutionality of the remote seller collection statute at issue in *Wayfair*.

5.2.2 State marketplace platform legislation

Since May 2017, 34 states and the District of Columbia have enacted marketplace platform legislation. Moreover, legislation is pending or is likely to be introduced in the diminishing number of states that have not yet enacted such legislation.[125] Table 2 summarises state marketplace platform legislation in effect as of July 2019.

Table 2: State Marketplace Platform Legislation (as of July 2019)

State (original effective date*)	Marketplace Facilitators		Referrers	
	Obligations	**Thresholds**	**Obligations**	**Thresholds**
Alabama (Dec. 1, 2019)	Collect and remit	$250,00 aggregate platform sales	Not applicable	Not applicable
Arizona (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales	Not applicable	Not applicable
Arkansas (July 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
California (Oct. 1, 2019)	Collect and remit	$500,000 aggregate platform sales	Not applicable	Not applicable
Colorado (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales	Not applicable	Not applicable

[125] See above nn 115 and 117. Indeed, between July 2019, when this article was drafted, and December 2019 when this article was finalised, an additional four states adopted platform legislation. Accordingly, as of this moment 38 states and the District of Columbia have enacted marketplace platform legislation. See above, n 120.

Connecticut (Dec. 1, 2018)	Collect and remit	$250,000 aggregate platform sales	Collect and remit tax or comply with notice/information reporting requirements (delayed effective dates)	receives commissions or other consideration in excess of $125,000
District of Columbia (Apr. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Hawaii (Jan. 1, 2020)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Idaho (June 1, 2019)	Collect and remit	$100,000 aggregate platform sales	Not applicable	Not applicable
Illinois (Jan. 1, 2020)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Indiana (July 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Iowa (Jan. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Collect or remit tax or comply with notice/information reporting requirements, but only if taxing authority issues pertinent implementation rules	$100,000 of referred sales
Kentucky (July 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Maine (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable

Minnesota (Oct. 1, 2018)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Nebraska (Apr. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Nevada (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Taxing authority authorized to promulgate collect and remit and notice/information reporting regulations	$100,000 in referred sales or 200 completed referred transactions
New Jersey (Nov. 1, 2018)	Collect and remit	none	Not applicable	Not applicable
New Mexico (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales	Not applicable	Not applicable
New York (June 1, 2019)	Collect and remit	$500,000 aggregate platform sales or 100 transactions	Not applicable	Not applicable
North Dakota (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales	Not applicable	Not applicable
Ohio (August 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Oklahoma (July 1, 2018)	Collect and remit tax or comply with notice/information reporting requirements	$10,000 aggregate platform sales	Collect and remit tax or comply with notice/information reporting requirements	$10,000 of aggregate referred and own sales
Pennsylvania (Mar. 1, 2018)	Collect and remit	$100,000 aggregate platform sales	Not applicable	Not applicable
Rhode Island (July 1, 2019)	Collect and remit	$100,000 aggregate platform sales	Collect and remit	$100,000 aggregate platform sales or 200 transactions

		or 200 transactions		
South Carolina (Apr. 1, 2019)	Collect and remit	none	Not applicable	Not applicable
South Dakota (Mar. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Texas (Oct. 1, 2019)	Collect and remit	$500,000 aggregate platform sales	Not applicable	Not applicable
Utah (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Vermont (June 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Virginia (July 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Washington (Jan. 1, 2018)	Collect and remit	$100,000 aggregate platform sales	Not applicable	Not applicable
West Virginia (July 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Collect and remit	$100,000 aggregate platform sales or 200 transactions
Wisconsin (Oct. 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable
Wyoming (July 1, 2019)	Collect and remit	$100,000 aggregate platform sales or 200 transactions	Not applicable	Not applicable

* Some states have modified their "effective date" rules since the original adoption of their remote seller nexus rules, and one should consult current state statutes and administrative guidance to determine if the original effective date has been modified.

6. *WAYFAIR* AND FOREIGN SUPPLIERS

6.1 The principle of equal treatment of international and interstate trade and foreign and domestic suppliers

Under US constitutional principles, international cross-border trade and non-US suppliers must be treated no worse (and, arguably, no better) than interstate cross-border trade and US suppliers.[126] Accordingly, the preceding discussion regarding the states' power to require remote sellers and marketplaces to collect tax on online sales in the context of cross-border trade applies equally to interstate and international cross-border trade and to US and non-US suppliers, at least as a matter of principle.

6.2 Practical differences in the states' ability to enforce tax collection obligations upon remote interstate sellers as compared to remote international sellers

Despite the theoretical parity between interstate and international cross-border trade and US and non-US suppliers, there may be significant practical differences in the states' ability to enforce remote suppliers' legal obligations to collect taxes on online sales in the context of international as compared to interstate trade. A simple hypothetical reveals the fundamental difference in 'enforcement jurisdiction'[127] in the interstate and international contexts. Assume that two suppliers, Supplier C-A from Country A and Supplier S-A from State A, make online sales into State B in excess of State B's $100,000 'distance selling' threshold for incurring an obligation to collect tax on sales into State B, a threshold the US Supreme Court has effectively approved as constitutionally justified in *Wayfair*. Assume further that neither Supplier C-A nor Supplier S-A has any physical presence or assets in State B. Finally, assume that both Supplier C-A and Supplier S-A ignore their tax collection obligations under State B law and do not respond to collection or audit notices.

In the context of the interstate sales made by Supplier S-A into State B, assuming that State B tax authorities have prima facie evidence of Supplier S-A's sales exceeding the State B threshold, the State B tax authorities could proceed to file suit in State B courts seeking a judgment for the amount of taxes that Supplier S-A failed to collect on its State B sales. Assuming that Supplier S-A representatives did not appear in court to contest the claim, the State B courts would presumably issue a default judgment in favour of State B tax authorities. Armed with that judgment, the State B tax authorities could file suit against Supplier S-A in State A courts seeking to enforce the State B judgment against Supplier S-A. Under the US Constitution's 'Full Faith and Credit

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[126] See Hellerstein et al, above n 5, 4.21-4.24.

[127] In earlier work, the author has drawn a distinction between '*substantive jurisdiction*' and '*enforcement jurisdiction*': see Walter Hellerstein, 'Jurisdiction to Tax in the Digital Economy: Permanent and Other Establishments' (2014) 68(6/7) *Bulletin for International Taxation* 346; Walter Hellerstein, 'Jurisdiction to Impose and Enforce Income and Consumption Taxes: Towards a Unified Conception of Tax Nexus?' in Michael Lang, Peter Melz and Eleonor Kristoffersson (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD Publications, 2009) 545; Walter Hellerstein, 'Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective' (2003) 38(1) *Georgia Law Review* 1. '*Substantive jurisdiction*' to tax relates to the power of a country to impose tax on the subject matter of the exaction, such as a country's power to impose a VAT on goods or services purchased from a supplier established outside the country but delivered or consumed within the country. '*Enforcement jurisdiction*' relates to the power of a country to compel collection of the tax over which it has 'substantive' tax jurisdiction. Enforcement jurisdiction includes such questions as whether a country has power to enforce the collection of a tax on goods or services purchased by a local customer from a remote supplier.

Clause', which provides that 'Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State',[128] State A courts would be required to honour the State B court's judgment in the absence of evidence that the judgment was obtained improperly.[129] State B tax authorities would then be able to satisfy their judgment by obtaining a lien on Supplier S-A's property in State A or, more likely, entering into a settlement agreement under which Supplier S-A paid the amounts due and agreed to comply with State B's tax collection laws in the future.

But now consider the international cross-border sales made by Supplier C-A into State B. Although the State B tax authorities would be able to obtain a default judgment against Supplier C-A in State B courts in the same manner that they would be able to obtain such a judgment against Supplier S-A, if Supplier C-A has no property in other US states, the default judgment would be of little value to the State B tax authorities. That is because of the so-called 'revenue rule', under which 'no country ever takes notice of the revenue law of another'.[130] Accordingly, unless the United States and Country A have entered into an agreement that overrides the revenue rule and recognises the countries' respective tax judgments on a reciprocal basis, Country A courts will not recognise the State B court judgment against Supplier C-A.

The United States is a signatory to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,[131] under which countries generally agree to override the revenue rule and assist other countries with the recovery of their tax claims 'as if they were its own tax claims'.[132] However, in ratifying the Convention, the United States issued a 'Reservation' declining to comply with the mutual tax recovery provisions.[133] Furthermore, although some US bilateral tax treaties agree to reciprocal enforcement of tax judgments,[134] these provisions (like most provisions of US bilateral tax treaties, with the exception of the non-discrimination provision) apply only to national-level income taxes.[135] Finally, insofar as states have adopted uniform legislation providing for recognition of foreign country judgments in their courts with the hope that this will 'make it more likely that money judgments rendered in that state would be recognized in foreign countries',[136] the legislation provides an exception for 'a judgment for taxes' (reflecting the revenue rule),[137] although some states provide that

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[128] US Constitution, article IV, section 1.
[129] *Milwaukee County v M.E. White Co.*, 296 US 268, 279 (1935) ('a judgment is not to be denied full faith and credit in state and federal courts merely because it is for taxes').
[130] *Holman v Johnson*, 98 Eng. Rep. 1120, 1121 (1775). As the US Supreme Court observed in *Pasquantino v United States*, 544 US 349, 360-361 (2005), '[s]ince the late 19th and early 20th century, courts have treated the common-law revenue rule as a corollary of the rule that, … "[t]he Courts of no country execute the penal laws of another"' (citation omitted).
[131] OECD and Council of Europe, *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol* (2011).
[132] Ibid art 11.
[133] Reservations and Declarations for Treaty No. 127 -- Convention on Mutual Administrative Assistance in Tax Matters (as of 06/02/2019) (United States of America) ('The United States will not provide assistance in the recovery of any tax claim … pursuant to Article 11 … of the Convention'), https://www.coe.int/en/web/conventions/full-list/-/conventions/treaty/127/declarations?desktop=true.
[134] Brian Kirkell and Mo Bell-Jacobs, 'E-Flight Risk? *Wayfair* and the Revenue Rule' (2018) 89 *State Tax Notes* 551, 552.
[135] Hellerstein et al, above n 5, 20.10[7][b].
[136] *Uniform Foreign-Country Money Judgments Recognition Act*, Prefatory Note, 1, https://www.uniformlaws.org.
[137] Ibid s 3(b)(1).

recognition of foreign tax judgments is permissible but not required.[138] Consequently, 'US courts are unlikely to enforce tax judgments of foreign courts, and foreign courts are highly likely to respond in kind'.[139] In short, it is highly unlikely that State B tax authorities will be able to enforce a default judgment obtained in State B courts against Supplier C-A in Country A courts.

However, this is not the end of the 'enforcement jurisdiction' story for foreign suppliers.

Despite the significant differences in the legal and practical mechanisms available to state tax authorities in enforcing tax obligations upon foreign as distinguished from domestic suppliers, states nevertheless have a variety of tools at their disposal to enforce or encourage tax collection by foreign suppliers, and there are other reasons why foreign suppliers may choose to comply with state collection requirements with respect to online sales.

First, although the above hypothetical scenario assumed (and still assumes) that Supplier C-A has no presence or assets in State B, if Supplier C-A has assets in any of the other US states, then State B tax authorities would ordinarily be in a position to enforce their claim against Supplier C-A. As in the case of Supplier S-A, the State B tax authorities would file the default judgment obtained in State B courts against Supplier C-A in a court in a state in which Supplier C-A *does have property*, obtain a judgment under the Full Faith and Credit Clause (as implemented by the Uniform Enforcement of Foreign Judgments Act, which has been adopted by 49 states and the District of Columbia),[140] and obtain a lien on Supplier C-A's property in that state.

In this connection, it is important to recognise that Supplier C-A, though organised and operating primarily outside the United States, may well have property in various US states. For example, it might have inventory on its way to customers in US distribution centres and US bank accounts or other financial assets in the hands of credit card companies, payment processors, and other financial intermediaries.[141] Assuming that Supplier C-A made sales into Ohio in excess of the *Wayfair* threshold, failed to comply with its Ohio tax collection obligations, and had funds in a New York bank, 'Ohio can collect tax from a foreign vendor by enforcing its judgment against the funds it holds in a New York bank'.[142] Indeed, in this connection it has been noted that the US Internal Revenue Service (IRS) requires payment processors to file a form 'informing the IRS of payments made to vendors when the amount exceeds $20,000 and the vendor has engaged in more than 200 transactions';[143] the IRS routinely shares this information with the states; and once the state tax authorities obtain access to such information, they are in a position 'to assess tax on amounts due to the vendor from the payment processor'.[144]

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[138] Kirkell and Bell-Jacobs, above n 134, 552-553.
[139] Ibid 553.
[140] *Uniform Enforcement of Foreign Judgments Act*, https://www.uniformlaws.org.
[141] See Glenn Newman, 'Offshore Retailers Can't Hide From Sales Tax Collection' (2018) 92 *Tax Notes International* 1309.
[142] Adam Thimmesch, Darien Shanske and David Gamage, '*Wayfair*: Marketplaces and Foreign Vendors' (2018) 90 *State Tax Notes* 18, 20.
[143] See Newman, above n 141, 1310.
[144] Ibid.

Second, with the dominant role that a small number of marketplace platforms play in facilitating international cross-border online sales,[145] most online sales by foreign suppliers are likely to involve such marketplaces. Moreover, there has been a strong and continuing trend in state legislation imposing tax collection obligations upon sales facilitated by marketplace platforms[146] – obligations with which the large marketplaces are already complying[147] and will almost certainly continue to in the future, especially if the states' marketplace tax collection regimes are designed to be as simple and efficient as possible.[148] In short, there is good reason to be sanguine about the prospects for enforcement of tax collection obligations with respect to foreign suppliers' marketplace-facilitated sales.

Third, wholly apart from the foreign suppliers' marketplace-facilitated sales, there may be reason to be hopeful about the prospects for foreign suppliers' compliance with their obligations to collect tax on their direct sales into states where they exceed the states' thresholds. As several observers have noted:

> This is not just a matter of altruism, but good sense for the business and the individual managers. A large state tax liability will show up on financial statements and will hover over any future plans to operate in the United States. It seems improbable that large vendors are likely to ignore the laws of states in which they make substantial sales.[149]

Finally, it may be worth addressing, at least in passing, the possibility that border controls (US Customs and Border Protection) might be able to assist the states in enforcing the foreign sellers' state tax obligations with respect to sales of imported goods, just as such customs authorities have traditionally assisted in the collection of VAT/GST with respect to imported goods.[150] The short answer, which no doubt reflects the strong 'federal' tradition in the US and the respect for the 'independence' of the national and subnational governments' respective tax regimes, is that the federal

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[145] According to the International Post Corporation, 'Cross-Border E-Commerce Shopper Survey 2018' (January 2019), https://www.ipc.be/services/markets-and-regulations/cross-border-shopper-survey, four marketplace platforms (Amazon, Alibaba/AliExpress, Ebay, and Wish) accounted for 64 per cent of cross-border e-commerce in the 41 markets surveyed.

[146] See section 5.2.

[147] For example, Amazon's website declares:

> Marketplace Facilitator is defined as a marketplace that contracts with third party sellers to promote their sale of physical property, digital goods, and services through the marketplace. As a result, Amazon is deemed to be a marketplace facilitator for third-party sales facilitated through www.amazon.com.
>
> Marketplace Facilitator legislation is a set of laws that shifts the sales tax collection and remittance obligations from a third party seller to the marketplace facilitator. As the marketplace facilitator, Amazon will now be responsible to calculate, collect, and remit tax on sales sold by third party sellers for transactions destined to states where Marketplace Facilitator and/or Marketplace collection legislation is enacted.

'Marketplace Tax Collection',
https://www.amazon.com/gp/help/customer/display.html?nodeId=202211260 (listing states in which Marketplace Facilitator legislation is in effect).

[148] See Walter Hellerstein, Stephane Buydens and Dimitra Koulouri, 'Simplified Registration and Collection Mechanisms for Taxpayers That Are Not Located in the Jurisdiction of Taxation: A Review and Assessment' (OECD Taxation Working Papers No. 39, 2018), https://www.oecd-ilibrary.org/taxation/simplified-registration-and-collection-mechanisms-for-taxpayers-that-are-not-located-in-the-jurisdiction-of-taxation_64bcf5de-en.

[149] Thimmesch et al., above n 142, 21.

[150] OECD, *International VAT/GST Guidelines* (2017) para. 1.13

government provides minimal assistance to the states with respect to collection of state sales tax on imported goods. The US Customs and Border Protection's website provides the following information:

> Customs and Border Protection (CBP) does not collect state sales tax on goods imported into the US. However, CBP will make entries and CBP declarations available to state tax representatives if requested. Some states occasionally review these documents and send letters to importers and travelers notifying them that they owe state taxes.[151]

7. CONCLUSION

Perhaps the most fitting observation that one can make at the end of this odyssey through the US experience and recent developments in the collection of tax on online sales, and its implications for Australian businesses, is that by the time anyone reads these words the discussion will need to be updated in light of the continuing evolution of the states' responses to *Wayfair* and the ever-expanding digital economy. But that is an observation that one could presumably make about virtually any discussion of developments in the digital economy. Accordingly, there is no reason either to be surprised or – at least for those whose knowledge of these ongoing developments puts food on their plates – dismayed. Rather it constitutes compelling counsel to stay tuned, because there is more to come.

[151] Customs and Border Patrol Information Center, 'Does Customs and Border Protection (CBP) Collect State Sales Tax On Imported Goods?', https://help.cbp.gov/app/answers/detail/a_id/295/~/taxes-on-imported-goods.