5 January 2024

Constitutional cases

‘Notional GST’ is not a tax

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The High Court has held unanimously that ‘notional GST’ paid by local government bodies in New South Wales is not a ‘tax’ for the purposes of s 114 of the Constitution.

The Court held that no Commonwealth law imposes a legal obligation on local government bodies to pay notional GST, and local government bodies are not practically compelled to pay notional GST such that it amounts to a tax.

Hornsby Shire Council v Commonwealth
High Court of Australia, 14 June 2023
[2023] HCA 19

Background

Section 114 of the Constitution relevantly provides that the Commonwealth shall not impose any tax on property of any kind belonging to a state. The parties agreed that Hornsby Shire Council was part of the State of New South Wales for the purposes of this proceeding. The key question therefore was whether notional GST, as reflected in laws passed by the parliaments of the Commonwealth and New South Wales, constitutes a 'tax' for the purposes of the Constitution.

Notional GST is a product of the 1999 Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations (1999 IGA). Under the 1999 IGA, the Commonwealth agreed to legislate to provide all of the revenue collected by way of GST to the states and territories, in exchange for the states, territories and local government operating 'as if' they were subject to the GST legislation by making voluntary or notional payments. The 1999 IGA was replaced in 2009 by the Intergovernmental Agreement on Federal Financial Relations (2009 IGA). The 2009 IGA is relevantly identical to the 1999 IGA.

Hornsby Shire Council initially challenged a number of Commonwealth laws passed or amended consistently with the 1999 IGA which it said, read in conjunction with the *Intergovernmental Agreement Implementation (GST) Act 2000* (NSW), amounted to a tax. The Council also argued that the relevant Commonwealth Acts infringed the rule in s 55 of the Constitution that laws imposing taxation shall deal only with the imposition of taxation.

The case narrowed by the time of the hearing. The plaintiff ultimately asked the Court to answer questions about the sale of one vehicle at auction and the inclusion of notional GST on that sale in the Council's Business Activity Statement. The s 55 argument was not pressed at the hearing, and the only law ultimately challenged was the *Local Government (Financial Assistance) Act 1995* (Cth) (Local Government Financial Assistance Act). The Council argued that it contravened s 114 of the Constitution in its application to payment of the notional GST on the sale of the vehicle.

The Council argued that these provisions constitute a 'tax' either because the Council was *legally* required to remit notional GST or because it was *practically compelled* to remit it.

The Attorneys-General of Western Australia, South Australia, Victoria and Queensland intervened under s 78A of the *Judiciary Act 1903* (Cth) in support of the Commonwealth and New South Wales.

The High Court's decision

The High Court held unanimously that notional GST is not a tax for the purposes of s 114 of the Constitution. The scheme is voluntary in nature and does not amount to legal or practical compulsion.

Issue 1: Is 'notional GST' a tax?

The Court started its analysis of whether notional GST is a 'tax' for the purposes of s 114 of the Constitution by endorsing Latham CJ's seminal formulation in *Matthews v Chicory Marketing Board (Vict)* (1938) 60 CLR 263 ([28]):

> [A tax] is a compulsory exaction of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered.

> The parties disagreed about whether notional GST was a 'compulsory exaction enforceable by law'.

The parties disagreed about whether notional GST was a 'compulsory exaction enforceable by law'. The joint judgment rejected the Council's argument that it was both legally and practically compelled to remit notional GST. The Court accepted the Commonwealth and New South Wales arguments that the payment of notional GST is an entirely 'voluntary' act ([29]).

Although the special case was only about the sale of one vehicle by the Council, the Court emphasised that its conclusion 'would apply to any local government body that also chose to include, in any BAS, notional GST' ([5]).

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Notional GST is not legally compelled

The Council argued that the combined effect of ss 15(aa) and (c) of the Local Government Financial Assistance Act was to require the Council to remit notional GST to the Commonwealth. Those provisions operate in the following way:

- Section 15(aa) relevantly makes a state's receipt of federal funding conditional upon the state's agreement to withhold payment of that funding to a local government if the local government fails to remit notional GST. To the extent that a local government 'should have, but [has not]' paid notional GST, the states are required remit that sum back to the Commonwealth.
- Section 15(c) imposes a further condition: if the federal Minister tells the Treasurer that a state has failed to comply with the condition in s 15(aa), the state must repay to the Commonwealth an amount determined by the Minister. The amount cannot be more than the Minister is satisfied that the state has failed to pay.

The Council placed emphasis on the statutory language 'voluntary GST payments that should have, but have not, been paid' as a textual indicator that the Local Government Financial Assistance Act *requires* notional GST to be paid.

The Court dismissed this submission as 'misconceived' ([31]). Their Honours construed that phrase as a reference to the 'voluntary' 'political' agreement in the 1999 IGA which 'did not by itself give rise to enforceable rights'. The Court focused on the word 'should', which, as opposed to the word 'must', does not denote an enforceable obligation ([31]). 'The Council "should" pay notional GST, but it may choose not to, in which case the obligation on the State to withhold funding becomes engaged.' Any obligation imposed on the state by s 15(aa) and (c) is one which the state has agreed to accept ([32]).

The Court also rejected an analogy the Council sought to draw between notional GST and the obligations on an employer to remit Pay As You Go tax on behalf of an employee to the Commonwealth. In *Deputy Commissioner of Taxation v Woodhams* (2000) 199 CLR 370, an employer's withholding and remittal obligations were held to be a tax. However, their Honours explained that the reasoning in that case depended on there being an underlying legal obligation on the employee to pay tax. Here, the obligation on the part of New South Wales to withhold notional GST 'is dependent upon both the choice of the local governing body and the voluntary receipt by New South Wales of federal funding' ([33]).

There is also no practical compulsion

The Council argued that it was practically compelled to pay notional GST, relying on *Attorney-General (NSW) v Homebush Flour Mills Ltd* (1937) 56 CLR 390 (Homebush Flour Mills). In that case, the High Court concluded that flour millers, who were obliged to sell flour to New South Wales at one price and could then repurchase it at a higher price, faced an 'illusory' choice and held that the larger sum was an excise contrary to s 90 of the Constitution ([34]).

On the Council's case, it also faced an 'illusory' choice because if it failed to pay notional GST it would suffer financial detriment or because the same amount would be taken away from it ([37]). The Council's submission was that, if it failed to pay notional GST, it would not receive the 'full grant to which it was otherwise entitled'. This would compromise its ability to fund local projects ([38]).

The High Court rejected this argument and distinguished *Homebush Flour Mills* ([39]). Even if (which the Court did not decide) practical compulsion is sufficient to characterise a payment as a tax ([34]), the High Court explained that the premise of the Council's argument is wrong. The Council could not argue that it suffered detriment by not receiving a grant to which it had no entitlement ([39]).

The facts agreed in the special case showed that grants under the Local Government Financial Assistance Act account for 2% of the Council's revenue ([40]) and (inferentially) that 'the failure to pay notional GST would either result in a revenue neutral outcome for the Council or leave it better off':

> That is because a failure to pay, say, $10 of notional GST could only result in a reduction in federal funding in the same amount. However, and again inferentially, because it was agreed that any reduction in funding would only take place well after the failure to pay notional GST, and because the Council could retain the sum of $10 in the meantime, due to the time value of money it would probably be better off in not paying notional GST. As such, the withholding of funds is, if anything, a poor inducement to pay notional GST.

The Court also rejected the Council's 'faint' contention that the combined operation of the Local Government Financial Assistance Act and the other laws impugned in the special case constituted a 'circuitous device' to avoid the prohibition in s 114 of the Constitution. The Court found that the Council had not identified any reason why, if the Local Government Financial Assistance Act does not impose a tax, the scheme as a whole does ([43]).

Issue 2: The scope of s 96 of the Constitution

Each of the impugned Commonwealth Acts is supported by s 96 of the Constitution ([13]). In the parties' submissions, various statements of principle were advanced about the intersection, or lack thereof, between ss 96 and 114 of the Constitution. The Commonwealth and New South Wales, together with the Attorneys-General of Western Australia, Victoria and Queensland, argued that the provisions cannot intersect: s 96 only authorises grants of financial assistance with conditions that may be voluntarily accepted by states. The Council argued that s 96 is subject to constitutional limitations, including s 114, in the same way that any head of power in s 51 of the Constitution is so constrained.

The Court did not resolve these questions of principle ([13]). However, their Honours reiterated 4 principles about the scope of the power in s 96 of the Constitution (also at [13]):

- the power to grant financial assistance to the states is 'susceptible of a very wide construction' and is non-coercive in nature
- grants may be made subject to the fulfilment of conditions by the state
- any conditions must be consistent with the Constitution, including express prohibitions contained in s 51(xxxi) or s 116 of the Constitution
- states are free not to accept any grant.

Their Honours noted, however, that this case does not address the question of whether conditions, or obligations, attached to a s 96 grant are themselves legally enforceable by the Commonwealth against a state ([32]).

Issue 3: Relief

In the event that the Council succeeded in its challenge to the validity of the notional GST scheme, it claimed restitution of the notional GST remitted on the sale of the vehicle. Its restitution case relied on the existing law of restitution but also urged the High Court to find that the Australian common law recognises a right to restitution implied from the Constitution itself (adopting the Supreme Court of Canada's approach in *Kingstreet Investments Ltd v New Brunswick* [2007] 1 SCR 3) or as of right when a tax is held to be invalid (adopting the House of Lord's reasoning in *Woolwich Equitable Building Society v Inland Revenue Commissioners* [1993] AC 70).

> The High Court did not need to decide the basis upon which the Council was entitled to restitution because the Council's validity challenge failed ([44]).

The High Court did not need to decide the basis upon which the Council was entitled to restitution because the Council's validity challenge failed ([44]).

The Commonwealth's legal team

AGS (Niamh Lenagh-Maguire, Liam Boyle and Nick Pokarier from the Constitutional Litigation Unit) acted for the Commonwealth. The Commonwealth Solicitor-General, Dr Stephen Donaghue KC, Graeme Hill SC, Anna Lord and Melinda Jackson appeared as counsel for the Commonwealth.

The text of the decision is available at: https://eresources.hcourt.gov.au/showCase/2023/HCA/19

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