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High Court: Super Surcharge invalid for SA Parliamentarians

On 2 September 2009, the High Court handed down its judgment in *Clarke v Commissioner of Taxation (2009) 258 CLR 623*; [2009] HCA 33; BC200908000. The High Court ruled that the imposition of surcharge tax on members of the South Australian Parliament, based on their notional entitlements under defined benefit superannuation schemes, was constitutionally invalid.

This ruling was on the ground that the legislation imposing the surcharge on “constitutionally protected funds” placed a special disability or burden on the state concerning the way it remunerated members of Parliament, which was beyond the legislative power of the Commonwealth Government.

Member of three state schemes

Mr Clarke was a member of the South Australian Parliament from 1993 to 2002. During his term of office, he was a member of three state superannuation schemes, being the Parliamentary Superannuation Scheme, the Southern State Superannuation Scheme and the State Superannuation Benefit Scheme. All three operate under SA legislation, are exempt public sector superannuation schemes under the Superannuation Industry (Supervision) Act 1993 (Cth) and are “constitutionally protected funds”.

Between February 2000 and February 2005, the Commissioner of Taxation issued superannuation contribution surcharge assessments to Mr Clarke under the Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997 (Cth) and the Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997 (Cth) (Assessment and Collection Act). These two Acts are collectively referred to in this article as the surcharge legislation.

Mr Clarke’s objections to these assessments were disallowed and he sought review by the Administrative Appeals Tribunal (AAT) of that disallowance. The AAT referred questions of law to the Full Court of the Federal Court, including whether the surcharge legislation was invalid in its application to Mr Clarke, on the ground that it discriminated against the state of South Australia, or so placed a particular disability or burden on the operations and activities of that state, as to be beyond the legislative power of the Commonwealth.

Mr Clarke relied on the decision of *Austin v Commonwealth*,¹ in which the surcharge legislation was held invalid in its application to the statutory pension entitlements of a judge of the Supreme Court of New South Wales. The Full Court of the Federal Court distinguished *Austin* and answered the questions put to it by the AAT in the negative. Mr Clarke successfully sought special leave to appeal from the Full Court’s judgment to the High Court.

Legislative background

A surcharge tax on superannuation contributions was introduced in 1997 and imposed on contributions made by taxpayers who earned above a specified income threshold. The surcharge did not apply to the Commonwealth or property of any kind belonging to a state.

A separate arrangement was put in place under the surcharge legislation to deal with “constitutionally protected funds”. Constitutionally protected funds are generally those established by a state Act or specified provision of a state Act referred to in Sch 4 of the Income Tax Assessment Regulations 1997 (Cth).ⁱⁱ

Unlike arrangements for other tax payers, where liability for the surcharge is imposed on the provider of the superannuation fund, liability under the surcharge legislation was imposed on the member if his or her adjusted taxable income exceeded a prescribed threshold amount. The Assessment and Collection Act allowed deferral of liability for payment of the surcharge until the pension benefit became payable, which differed from arrangements for other taxpayers.

The surcharge legislation required members to pay surcharge based on notional contributions. These notional contributions do not necessarily bear any relation to the pension actually paid to the member. Potentially, the benefit received could be less than the amounts assumed in the calculation of the surcharge. In addition, the surcharge amount accrued, compounding at market interest rates until the benefit was paid. Potentially, the surcharge debt could equal pension payments for the first year of the benefit.

To overcome this problem and ensure parliamentarians had access to a lump sum to pay the surcharge debt, the SA Government passed legislation allowing commutation of part of the pension to allow members to pay their accumulated surcharge debt at the time the benefit became payable.

Austin v Commonwealth

In *Austin*, the surcharge legislation was held to be invalid in its application to statutory pension entitlements of judges of the Supreme Court of New South Wales. The court placed great emphasis on the reference in s 5 of the Assessment and Collection Act to “high-income members of constitutionally protected superannuation funds”, and the different taxation regime that applied to other superannuation funds, as an indication that the surcharge legislation did not comprise laws of general application which the states must comply with as part of the tax system applicable to the whole community. For example, the states are subject to payroll tax and fringe benefits tax.

Gleeson CJ in *Austin* made the comment:

That differential treatment is constitutionally impermissible, not because of any financial burden it imposes upon the States, but because of its interference with arrangements made by the States for the remuneration of their judges.ⁱⁱⁱ

The impairment on the state to exercise its right to select the manner and method for discharging its constitutional functions concerning the remuneration of judges of the courts of the state was seen as significant. The test applied was whether, looking at the substance and operation of the federal laws, there had been a significant curtailment or interference with the exercise of the state’s constitutional power.

The *Austin* case viewed the need for the state to vary state law to allow commutation of part of the pension to a lump sum to offset the impact of the accumulated surcharge debt as evidence that the working of the state governmental structure had been impaired.

Limitation on Commonwealth powers

The Constitution recognises the states as independent entities co-existing with the Commonwealth Government. This independence gives rise to an implied limitation in the Commonwealth Government’s power to make laws affecting states which have been dealt with extensively by the courts.

Case law distinguishes between the enactment of a general law intended to apply to all and laws that discriminate against states or place a particular disability or burden upon an operation or activity of a state and especially on the execution of its constitutional powers.^{iv}

This general principle has two elements, being the prohibition against discrimination that places special burdens or disabilities on the states and the prohibition against laws of general application which operate to destroy the continued existence of the states or their capacity to function as governments.^v

Clarke v Commissioner of Taxation

Independence of the states

Clarke followed *Austin*, but held that the significance of a Commonwealth law affecting the functions of the state should not be determined simply by reference to the practical effect on those functions. The test that should be applied is whether the Commonwealth laws represent such an intrusion on the functions or powers of the state as to be inconsistent with the constitutional assumption that the states are independent entities. Whether the effect on the capacities or functions of the state is significant is judged qualitatively and also by reference to its practical effects.

Factors to be considered

Clarke sets out the following factors as relevant to the application of the implied limitation on the Commonwealth Government.

- Does the law in question single out one or more of the states and impose a special burden or disability on them which is not imposed on persons generally?
- Does the operation of the law of general application impose a particular burden or disability on the states?
- What is the effect of the law on the capacity of the states to exercise their constitutional powers?
- What is the effect of the law on the exercise of the states' functions?
- What is the nature of the capacity of functions affected?
- What is the subject matter of the law affecting the state or states and, in particular, the extent to which the constitutional head of power under which the law is made authorises its discriminatory application?

Amendment of state legislation

In relation to the changes made to the state legislation to accommodate payment of the surcharge debt, the Full Court of the Federal Court was of the view that the state had not been compelled by the surcharge legislation to make those amendments. The High Court disagreed and saw the amendments as indicative of the curtailment or restriction of legislative choice for South Australia to provide remuneration to senior officeholders.

The High Court regarded the amendments made to the state legislation as "responsive to and indicative of that curtailment". That is, the state had no real choice but to provide a method by which parliamentarians would be able to meet this burden imposed by the surcharge legislation.

Status of persons affected

The High Court held that members of state legislatures come within that class of person operating at the "higher levels of Government". It saw as critical that the states retain the ability to fix the terms and conditions under which those persons serve when elected to parliament of the state to ensure the state is able to function appropriately.

In general, it is not the size of the financial burden that will be crucial, but its effect on the state's right to function as a separate body politic from the Commonwealth Government as the Constitution requires. This means the Commonwealth Government and the state governments must each be in a position to control their own money.

Commonwealth Government's response

The Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, has confirmed that he has received preliminary advice on the *Clarke* case and that it is of concern to the Commonwealth Government. The Minister also confirmed that the government is working through the implications of the case and considering the different legal views that are emerging as to the extent of the implications of the decision.

This includes how many states the case may apply to and the potential financial impact it may have on the government. The minister indicated that the implications depended on the finer constitutional details of how the various superannuation funds providing benefits to state parliamentarians are established. He indicated that one legal interpretation was that the case would only impact on South Australia and Western Australia, but there are other views to suggest that it will apply more broadly. The government is awaiting further advice from constitutional scholars and its legal advisers.^{vi}

Even greater disparity

It appears inevitable that the *Clarke* case will be relied on by others to challenge the surcharge. They will need to be people:

- within a class of persons "at the higher levels of Government";
- who are so critical to the state's capacity to function as a government that the state must retain the ability to fix the terms and conditions under which they serve the state; and
- who have similar superannuation arrangements to those of Mr Clarke.

This potentially leaves state governments in a situation where their judiciary and parliamentarians may be relieved of the burden of the surcharge while other taxpayers are not. The generosity of public sector superannuation arrangements has been the subject of much debate, in particular the arrangements for parliamentarians. The *Clarke* case is likely to result in further debate on this disparity with the superannuation arrangements for the rest of the public sector and the community in general.

As with any case involving the constitutional powers of the Commonwealth and state governments, many of the issues discussed in *Clarke* are complex. No doubt the Commonwealth Government will indicate its interpretation of *Clarke* after it has received the views of its constitutional law experts.

ⁱ (2003) 215 CLR 185; [2003] HCA 3.

ⁱⁱ Regulation 995.1.04 of the Income Tax Assessment Regulations 1997 (Cth).

ⁱⁱⁱ (2003) 215 CLR 185 at 219.

^{iv} *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129; [1920] HCA 54.

^v *Melbourne Corporation v Commonwealth* (1947) 74 CLR 31.

^{vi} Transcript of interview with David Speers, Sky News, Monday, 7 September 2009, available at www.treasurer.gov.au.