

**BOOK REVIEW:**  
**GIANLUIGI BIZIOLI AND CLAUDIO  
SACCHETTO, *TAX ASPECTS OF  
FISCAL FEDERALISM*, IBFD, 2011**

Richard Krever\*

Constitutional specialists and political economy scholars commonly believe (wrongly) that federalism is a matter of constitutional divisions of powers and responsibilities and the political and legal processes of reconciling overlaps and lacunae arising from those divisions. Political realists know it's all about the money – specifically which level of government gets to tax what. The constitution may give lower tier governments responsibilities for constructing highways, establishing universities, building hospitals, regulating superannuation systems and funding schools and disability programs. The true power, however, lies with the government that has the cash.

No jurisdiction better illustrates the supremacy of the power to tax over the constitutional division of responsibilities than Australia. On paper, the colonies gave up relatively little to the central government upon federation – the transfer of customs duties with the abolition of inter-colony tariffs and the power to levy the reasonably modest excise taxes. Income taxes, the revenue growth engine of rapidly industrialising and developing countries, were levied only at the State level. Fast forward 112 years and the States are in many respects mere vassals of the central government. Which roads are built depends largely on Canberra's agenda. Canberra runs the universities incorporated and owned by the States. Canberra funds the hospitals, establishes disability programs, and mandates the amount

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\* Department of Business Law and Taxation, Monash University.

employers must contribute to superannuation funds. Nothing relevant in the constitution has changed, but taxes and access to taxing powers has.

This comparative volume looking at 15 countries and the EU provides Australian scholars with valuable insights into possibilities and probabilities. The survey includes jurisdictions in which colonies have joined together to form a federation (Canada, the US and Australia) or separate political entities that have done so (Germany and Switzerland), unitary states that have devolved and sometimes recaptured central powers (UK and France) and a host of hybrids and variations that fall into a multitude of further camps. Federalism may be the result of parts coming together to realise the benefits of aggregation, central authorities devolving powers to mitigate risks of succession or separatism, or simply as a reflection of an historical fragmentation inherited by a modern state.

Great diversity is to be expected in accounts from 16 jurisdictions. But despite the tremendous range in legal, constitutional and fiscal structures surveyed, there is a striking consistency across the narratives in respect of some themes. One instance is the central role of the judiciary in many countries in allocating tax powers through interpretation of constitutional allocations of taxing rights. In most jurisdictions, it seems, including those with separate constitutional courts and those with a single final appeals court of appeal for constitutional and substantive law appeals, courts have interpreted rules on the allocation of taxing powers with an eye on the corresponding allocation of responsibilities for spending programs. Logic suggests that if the framers of a constitution intended subordinate parts to take on primary responsibility for funding expensive programs such as health, education and social welfare, they would have intended the words allocating taxing rights to be interpreted in a way that provided the fiscal resources necessary to run these programs. Australia stands as something as an outlier in this regard.

## FISCAL FEDERALISM

The divergence of the Australian judicial approaches is well illustrated by comparing Australian and Canadian constitutional interpretations. Canadian provinces have social and economic responsibilities that in many ways overlap with those of Australian states. Under the Canadian constitution, the federal government, like the Australian federal government, has recourse to all tax bases. Provinces are restricted to a single type of tax in Canada, direct taxes. In economic terms, a direct tax is understood to mean an income tax or wealth tax where the tax directly appropriates some income derived by or some wealth received by or held by the taxpayer. It is contrasted with an indirect tax, levied on sales transactions.

Provinces in Canada, like their Australian counterparts, have the power to levy income taxes and like Australian States once did, the provinces levy these taxes within this constitutional authority. A provincial income tax alone would not raise sufficient revenues to fund all the responsibilities allocated to provincial governments and not surprisingly, they sought access to other tax bases, namely sales taxes, originally in the form of retail sales taxes and later in the form of a GST in most cases. Given the constitutional constraint limiting provinces to direct taxes, this could be done only if the courts were willing to construe sales taxes as direct taxes, contrary to ordinary economic and legal parlance elsewhere. With a view to the allocation of taxing powers appropriate for the allocation of social and economic responsibilities, the Canadian courts did just that, saying a retail sales tax and a GST are direct taxes so long as they are added on to the pre-tax price explicitly so they can be paid 'directly' by the customer.

Australian courts have shown similar flexibility when interpreting terms in the Australian constitution needed to protect the central government's constitutional taxing powers. The High Court has determined that the subjects of a tax on

capital gains, an undistributed profits tax imposed on retained earnings of private companies, and a tax on imputed benefits enjoyed by taxpayers who own their principal residences may all fall outside the judicial definition of income for tax purposes but can fit squarely within the meaning of income tax for constitutional law purposes.

But in contrast to their counterparts in Canada and other jurisdictions, Australian courts have not interpreted constitutional measures affecting the taxing powers of States in a way that enabled the Australian States to raise the revenues needed to cover their responsibilities. The judicial characterisation of an 'excise' tax illustrates well the contrary approach taken by the Australian judiciary. The reservation to the federal government of the power to levy an excise tax is a sound constitutional rule. To be effective, an excise tax correcting the price of commodities such as cigarettes to reflect the negative externalities they generate must be levied at the central government level. But to read the term 'excise' to include all sales, consumption and transaction taxes, well outside its ordinary or commercial meaning, as the Australian courts have done, has the effect of denying States access to revenue bases corresponding to their fiscal responsibilities, undermining the division of powers and responsibilities envisaged by the drafters of the constitution. Stripped of taxing powers, States are reliant on transfer payments to pay for, and subject to consequent federal government oversight of, areas that were intended to be State responsibilities.

A debate may be had as to whether the outcome is appropriate in the 21<sup>st</sup> century. Some believe Commonwealth usurpation of State responsibilities is in the national interest if that is defined to mean equalisation of entitlements and access to services. It has to be conceded, however, that the shift of responsibilities is inconsistent with constitutional principles to the extent it has been dictated by the courts rather than chosen by the citizens.

## **FISCAL FEDERALISM**

Australia's fiscal federalism division of taxing rights are unlikely to change dramatically in the near future. The courts are not about to revisit the doctrines that removed the powers of States to levy indirect taxes. For political reasons, the States are unlikely to consider seriously reinstating State income taxes or find new alternative tax bases. This does not, however, mean that comparative studies in fiscal federalism are of limited value to Australian scholars, only showing what could have been possible with a different constitution or with a High Court more attuned to purposive constitutional fiscal interpretation on the revenue side to complement fiscal responsibilities on the spending side. While the federal government will remain the nation's funder for the foreseeable future, there is plenty of room for modification of the revenue distribution formula and much to be learned about the allocation of resources in federal systems from experience abroad. So far, the practice of shifting resources to powerful disaffected sub-jurisdictions has been relatively low key in Australia compared to, say, the special deals cut to Quebec in Canada or the blind eye turned by the central government in China to a range of initiatives by provincial governments in that country. Current Australian debates over the allocation of GST revenues and mining revenues raise the question whether fiscal equalisation will remain the paramount guiding principle for fiscal federalism in Australia. In this context, a comparative volume setting out experience with alternatives may prove to be a very useful resource.

From a more parochial perspective, the volume is an invaluable resource for scholars interested in the story of tax and fiscal federalism in Australia. The Australia chapter, contributed by Professor Miranda Stewart, provides a clearly drafted and comprehensive survey of the history of fiscal federalism in Australia. It is an ideal resource for Australian lawyers, economics and political scientists and the book deserves a place on bookshelves for this chapter alone.