The Imposition of Income Taxation Upon State Authorities by State Governments A Clayton's Tax or the Real Thing?

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Introduction

In recent years there has been a trend towards the commercialisation, corporatisation or privatisation of government enterprises, both in Australia and overseas[1]. In both New South Wales and Tasmania the legislatures have introduced wide-ranging reforms compelling certain State Government Authorities to adopt commercially accepted bases for accounting. Furthermore, both State Governments have in many cases removed the exemption from Commonwealth taxes enjoyed by Government Authorities by compelling prescribed Authorities to make tax equivalence payments to the relevant State Government[2]. The cost of implementing the former aspect of this legislation is no doubt expected to be recouped by improved efficiency within the Authorities concerned. However, the introduction of a taxation equivalents system will generate considerable compliance and administration expenditure by State Treasuries and the Authorities concerned, and there is no reason to conclude that these costs will necessarily be recouped from improved efficiency. The purpose of the taxation equivalence regimes lie elsewhere, perhaps principally in the perceived need to establish the commercial viability of at least some portions of the state public sector. This article will focus upon the extent to which the perceived intention of the legislatures in creating tax equivalents regimes is achieved by the legislation. The Tasmanian legislation will be focussed upon for the purposes of this enquiry, although the differences to the New South Wales legislation will be noted.

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1 See, for example, the State *Owned Enterprises Act* 1986 (NZ). Note that in *Western Australia the Financial Management and Audit Act* 1985 requires government departments to adopt commercial accounting principles without imposing any liability to income tax equivalence payments. In Queensland the Government released a green paper in August 1990 canvassing the issues associated with commercialisation of government owned enterprises.

2 See *State Owned Corporations Act* 1989 (NSW); *State Authorities Financial Management Act* 1990 (Tas). In Tasmania , 33 State Authorities are subject to the general requirements of the Act while just 16 of those Authorities are required to make tax-equivalents payments (see Schedules 1 and 3 to the Act).

Objectives of the Legislation

The recitals to the State Authorities Financial Management Act 1990 (Tas) ("SAFMA") indicate that it is:

> "...to provide for the financial management of State Authorities in an economical, efficient and effective manner consistent with contemporary accounting standards and financial practices and to ensure adequate returns to the State from the assets and operation of State Authorities"

SAFMA embodies a multi-faceted approach to pursuing these objectives. With respect to improvements in efficiency, prescribed State Authorities are required to adopt a common business planning and accounting framework founded upon commercial principles[3].

The expectation that some State Authorities produce an adequate financial return to the State finds its expression in the requirement that prescribed Authorities pay dividends, guarantee fees and taxation equivalents to the State[4]. These requirements were also explained by the Treasurer in his second reading speech as introducing a level playing field for both the State Authorities and their private enterprise counterparts[5]. No longer would the State Authorities have such competitive advantages as having access to low cost financial accommodation and being exempt from significant portions of Commonwealth taxation[6]. However, one must wonder whether the changes wrought by the new legislation will be as significant as they at first appear.

Prior to the introduction of SAFMA, many of the State Authorities affected were required to pay an amount determined by the Treasurer as a dividend into the State Consolidated Fund[7]. In some cases, it would appear that such amounts far exceeded the total amount which might be payable under the new legislation[8]. Thus, the actual financial benefits to the State flowing directly from the introduction of the requirements under the new

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3 See Part 3 of SAFMA.

4 See Parts 4, 5 and 6 of SAFMA.

5 Tasmanian Parliamentary Debates (Hansard), 8 November 1990, at p.4660.

6 Section 23(d) of the *Income Tax Assessment Act* 1936 exempts from assessable income "the revenue of a ...public authority constituted under any Act or State Act...". Note that the *State Owned Corporations Act* differs from the Tasmanian legislation in that it seeks to introduce a level playing field in respect of all Commonwealth taxes (including wholesales sales tax) rather than just income tax.

7 See, for example, the former s.40 of the *Forestry Act* 1920 (Tas) which required the Forestry Commission to pay a dividend "...calculated on the public equity in the Commission at a rate, or being an amount, agreed between the Minister and the Treasurer." This requirement was repealed by the *State Authorities Financial Management* (Consequential Amendments) Act 1991 (Tas).

8 In the case of the Forestry Commission, the dividend was traditionally calculated upon the basis of the net income of the Commission, and in the 1988-1989 year of income amounted to approximately $33 million. By contrast, the total amount expected to be received in respect of taxation equivalents payments, dividends from State Authorities and guarantee fees from all relevant State Authorities for the 1991-1992 year of income is $28.3 million (1990-1991 Tasmanian Budget Overview).

legislation to make certain payments may be minimal. All that may happen is that the dividend amount which was formerly payable will be divided into a dividend amount, a taxation equivalent amount and a guarantee fee amount.

This is not to say that the objective of the new legislation is necessarily flawed.

Introducing the Bill into the Tasmanian Parliament for the second time, the Treasurer indicated that the focus of the legislation is upon applying the same constraints and obligations upon Tasmanian Government instrumentalities as are applicable to private enterprise[9]. One objective of this program is to enable the State Government to determine the commercial viability of the instrumentalities concerned, possibly with a view to the privatisation of at least some functions of those instrumentalities.

The Treasurer did not expressly say that the sale of government assets was contemplated, although there is some basis for this inference in his comments in Parliament:

> "At the other extreme there may be operations where the circumstances which led to government involvement have changed markedly. In each case the basis for continued government involvement should be reviewed."
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> "This bill places the onus on State authorities to adopt commercial principles and to demonstrate that they are capable of operating successfully under commercial disciplines. If an authority can do that, and if further reform is clearly in the interests of the State, at some future time such further reform as is appropriate may be considered by the Government...There is no sense whatsoever in moving to full corporatisation - with full commercial freedoms and full commercial disciplines - until an enterprise has demonstrated that it is capable of operating commercially...without drawing on the public purse;..."[10]

The preparation of some State Authorities for privatisation therefore underlies some of the provisions of SAFMA. A component of this programme is to generate financial records which mirror as closely as possible the records maintained by private enterprises. Those records will therefore take account of the cost of at least some Commonwealth taxation and the financing expense which would be encountered by the Authority if it were operating outside the Government umbrella. Further, the new financial information would also contain details as to the real rate of dividend return which could be expected by shareholders if the Authority were privately owned.

The Terms of the Tax Equivalents Legislation

Section 35(1) of SAFMA requires the Treasurer to determine the "estimated taxation equivalent" of each prescribed State Authority in respect of each "financial year"[11]. The instrumental provisions of the tax equivalents legislation are relatively short, and it is worthwhile quoting them in full:

> "(2) The estimated taxation equivalent is an amount which the Treasurer determines to be equal to the amount of income tax,

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9 Tasmanian Parliamentary Debates, op cit, 8 November 1990 at p.4660.

10 See Second Reading Speech on SAFMA, Tasmanian Parliamentary Debate, 8 November 1990 at pp.4659-4660.

other than capital gains tax, the [particular state authority] would have to pay under the laws of the Commonwealth if it were a company.

(3) In determining an estimated taxation-equivalent, the Treasurer may -

(a) consider the State Authority as if it were a single company; or

(b) consider a part of the State Authority and the State Authority and the State Authority less that part, as if they were separate companies; or

(c) consider that part and the State Authority less that part as if they were a group of companies."

Section 37 provides that the Treasurer is to determine, within 30 days of receiving a copy of the Auditor General's report (also prepared in accordance with the Act) with respect to a State Authority, the actual taxation equivalent. Section 3 sub-section (1) defines "actual taxation equivalent" as a taxation equivalent determined under s.37. The Treasurer's determination is, according to s.37(2), to be founded upon the final financial reports of the relevant Authority and also the opinion of the Auditor-General in relation to those financial statements." Importantly, there is no reference to the criteria to be applied by the Treasurer in determining the actual taxation equivalent, whereas criteria are specified in relation to the determination of the estimated taxation equivalent. This issue will be dealt with below[12].

Section 38 provides that where there is a difference between the estimated and actual taxation equivalent amounts, the State Authority is to pay the difference where the actual taxation equivalent exceeds the estimated taxation equivalent, or, where the actual taxation equivalent is less than the estimated taxation equivalent, the Authority is to receive an offset against the estimated taxation equivalent for the immediately subsequent year.[13]

The Meaning of "Tax"

A tax has been defined as a "...compulsory contribution, imposed by the sovereign authority on, and required from, the general body of subjects or citizens, as distinguished from isolated levies on individuals"[14]. Further, in *DFC of T v Brown*[15] Gibson CJ, Wilson, Deane and Dawson JJ held that:

"For an impost to satisfy the definition of a tax it must be possible to differentiate it from an arbitrary exaction and this can only be done by

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11 Note that financial year is defined in s.3 of the Act as "a period of 12 months ending on 30 June in any year; or ...any other period of 12 months in respect of which a State Authority is required by any other written law to maintain financial records".

12 See below, at p.11.

13 Under the New South Wales legislation provides in s.15(1) that "A State owned corporation must from time to time pay to the Treasurer for payment into the Consolidated Fund such amounts as the Tax Assessor determines to be equivalent to the amounts that would be payable by the corporation if it were liable to pay taxes under the law of the Commonwealth."

14 *Leake v Commissioner of Taxation* (State) (1934) 36 WALR 66 per Dwyer J at p.67.

15 (1958) 100 CLR 32 at p.40.

> reference to the criteria by which liability to pay the tax is imposed. Not only must it be possible to point to the criteria themselves, but it must be possible to show that the way in which they are applied does not involve the imposition of liability in an arbitrary or capricious manner."

In the context of the ITAA, the Commissioner of Taxation is required to make an assessment of the amount of taxable income of each taxpayer, based upon the information available to him/her.[16] The making of an assessment entails more than plucking a figure out of the air, it requires the Commissioner to make a calculation upon an intelligible basis, even if there is some element of approximation[17]. Thus, although there may be some uncertainty in the making of an assessment, particularly in the context of default assessments[18], the imposition of income tax under the ITAA is regulated by the requirement that an assessment be made in accordance with the criteria set down in the ITAA.

Determining the Effectiveness of the Tax Equivalents Regime

The premise underlying the taxation equivalents regime is that the imposition of a requirement to pay a taxation equivalent brings government owned enterprises closer to the private marketplace. Clearly therefore, the taxation equivalents regime is intended to duplicate the tax regime which would apply to the State Authorities concerned if they were being taxed under the ITAA.

Given that the tax equivalents regime is intended to introduce a parity between government and commercial enterprises in their taxation liabilities, the assessment of the tax equivalents legislation must focus upon the extent to which government enterprises under the legislation are treated identically to commercial enterprises under the ITAA. In particular, the extent to which the Treasurer is authorised under SAFMA to exercise a discretion as to the quantum of the taxation equivalent will be critical to determining whether there is truly an equivalence between private and state owned enterprises.

In short, does the taxation equivalents legislation create a tax or merely an arbitrary exaction?

The Exemption of State Authorities from Commonwealth Taxation

It should be noted that the State Authorities affected by the tax equivalence provisions of SAFMA are potentially liable for Commonwealth

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16 See s.166. Even in the context of default assessments (that is, where a person has made a default in failing to lodge a return or has lodged a return with which the Commissioner is not satisfied) the Commissioner must still make an assessment - see s.167.

17 See the joint judgment of Shephard and Gummow JJ in *Dalco v FCT* 88 ATC 4,649 at p.4,656; this view has also been adopted in *Briggs v DFCT and Ors; ex parte Briggs* 86 ATC 4,748 at p.4,755 and *Scallan v FCT* 89 ATC 4,129.

18 Under s.167 of the ITAA, the Commissioner of Taxation is authorised to issue a "default assessment" where a person who is obliged to lodge an income tax return has failed to lodge a satisfactory return.

income taxation[19]. The Authorities are only excluded from Commonwealth income taxation by virtue of s.23(d) of the ITAA, which provides, *inter alia*, that the revenue of a public authority constituted under the law of a State will be exempt from income tax.

In the context of State Authorities undergoing the process of commercialisation and the introduction of the "user pays" philosophy, it may be expected that the authorities will come under the scrutiny of the Commonwealth Commissioner of Taxation with a view to determining whether those Authorities retain their exempt status under s.23(d). This scrutiny will be closest where State Authorities conduct substantial commercial operations which are perhaps only ancillary to the public functions carried out by the Authorities concerned.

In *Renmark Hotel Incorporated v FCT*[20] it was held by Rich J that the indicia of a "public authority" are that it carry on some undertaking for the benefit of the community or of some section of it, that the authority may not make profits for the benefit of private corporators although profits may be made for the public benefit and that the powers of the relevant Authority must be conferred by statute[21]. However, in that case the Renmark Hotel Incorporated did not have a public function.

In *The Western Australian Turf Club v Federal Commissioner of Taxation*[22] an unincorporated association had certain powers conferred by the legislature[23] but otherwise conducted its affairs for the benefit of its members. The issue was whether the existence of its statutorily conferred powers meant that the Club was a "public authority" for the purposes of s.23(d), despite the fact that the Club was otherwise a private body. In the leading judgment of Stephen J (with whom Barwick CJ and Jacobs J agreed), his Honour considered that the appropriate test for the applicability of s.23(d) in this context is:

> "...the possession of some statutory duties or powers is not, I think, enough to attract the income of a body the exemption from tax which the paragraph confers unless, upon examination of all its characteristics, the body can be seen in general to conform to the common understanding of a public authority."[24]

Stephen J then carried on to note that this test was to be applied by examining the circumstances of the particular case with a view to identifying those features of the particular body which are "...clearly alien to the concept of what is a public authority and judging to what degree those features are pervasive and important."[25]

It is interesting to speculate as to how this test is to be applied where a State Parliament has enacted legislation which attempts to redefine the

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19 Provided that such taxation is not considered to be a tax upon the property of the State, as the property of the States is protected from Commonwealth taxation by s.114 of the Constitution.

20 (1949) 79 CLR 10.

21 This decision was upheld on appeal to the Full High Court, see 79 CLR 21.

22 78 ATC 4,133

23 By virtue of the *Racing Restriction Act* 1917 (WA.) the Club became the sole licensing body for horse racing in Western Australia.

24 Western Australian Turf Club, supra., at p.4,137.

25 Ibid, at p.4,137.

purpose and function of many public authorities by introducing commercial principles of cost recovery, and many programs formerly treated as of a governmental nature are being assessed not so much on criteria of public benefit but on the commercial criteria of return on capital invested. What may be the ordinary perception of the meaning of "public authority" may differ markedly from what Parliament is hoping government instrumentalities will become under such legislation as SAFMA. If this is the case, the interpretation of s.23(d) adopted by Stephen J may require reconsideration if commercialised State Authorities are not to be liable to Commonwealth income tax.

Ultimately the question of whether commercialised State Authorities will be subject to Commonwealth income tax may become a political question to be resolved between the Commonwealth and the States if the Commonwealth Commissioner of Taxation were to treat the income of such Authorities as assessable income under the ITAA.

The Exclusion of Capital Gains[26]

As one of the stated objectives of SAFMA was to "require authorities which undertake trading activities to operate under commercial disciplines and to move closer to competitive neutrality with the private sector", the specific exclusion of taxation with respect to capital gains appears inexplicable. By narrowing the taxation base in this manner, the legislature has created a window of opportunity for the avoidance of tax equivalence payments. This hardly places government authorities on a level playing field with their private enterprise competitors.

It should also be noted that there is no Commonwealth "capital gains tax" as such. Rather, the ITAA deems net capital gains to be assessable income[27], and so brings such gains within the sphere of income taxation. On a literal reading of s.35(2), it could therefore be argued that the attempt at excluding taxation upon capital gains is invalid on the basis that there is no capital gains tax. This would mean that the relevant State Authorities would be required to make tax equivalence payments of their entire notional liability under the ITAA, rather than just the income component of that liability.

However, such an interpretation ignores the attempted exclusion of taxation upon capital gains. The better view would therefore appear to entail having cognisance of the legislative attempt to exclude taxation upon capital gains. This would accord with the principles of statutory interpretation with respect to revenue legislation set down in Cooper Brookes (Wollongong) Pty Ltd v FCT[28]:

> "...when the judge labels the operation of the statute as "absurd", "extraordinary", "capricious", "irrational" or "obscure" he assigns a ground for concluding that the Legislature could not have intended such an operation and that an alternative interpretation must be preferred. But the propriety of departing from the literal interpretation

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26 Note that by virtue of the wide wording adopted in s.15(1), the New South Wales legislation does not exclude taxation with respect to capital gains or wholesale sales tax.

27 See s.160ZO(1)

28 1981 ATC 4,292 per Mason J (as he then was) and Wilson J at p.4,306.

> is not confined to situations described by these labels. It extends to any situation in which for good reason the operation of the statute on a literal reading does not conform to the legislative intent as ascertained from the provisions of the statute, including the policy which may be discerned from those provisions."

But even if the approach is adopted that the legislature intended to exclude capital gains from the tax equivalence calculation, the question remains whether all capital gains brought to account under the ITAA are to be excluded, or just those brought to account under Part IIIA of the ITAA?

Part IIIA was introduced into the ITAA in 1985 and contains what is generally recognised to be the "capital gains tax provisions", but the ITAA contains a number of provisions outside Part IIIA which also bring capital gains to account[29]. Thus in s.26BB gains made upon the disposal of "traditional securities" are brought to account as income, and s.160ZB(6) specifically excludes such gains from assessment under the capital gains provisions. A further example of the inclusion of capital amounts under income provisions is found in Division 3B of the ITAA, which deals with foreign currency exchange gains and losses "only to the extent to which they are of a capital nature"[30]. The so called "income provisions" therefore also operate with respect to capital items[31]. There is considerable doubt as to the location of the border between income and capital items[32].

Academics and practitioners alike may be spared detailed consideration of this issue as the current Tasmanian Government has indicated that the capital gains tax exclusion is to be repealed, thereby ensuring that there is to be true tax equivalence, at least in respect of income taxation. In the expectation that the legislature will amend the legislation in the manner anticipated, this article will not dwell upon the issue further.

The Application of the Capital Gains Provisions

With respect to the proposal that the capital gains provisions of the ITAA also apply to the State Authorities, it can be expected that the amendment would repeal the express exclusion from capital gains currently in s.35(2), whilst a further provision would deem the assets of the relevant

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29 To the extent that there is an overlap between the income and capital gains provisions, s.160ZA(4) provides that the income provisions prevail.

30 Section 82U(1)

31 Note that recent developments may indicate that the capital gains tax is constitutionally invalid on the basis that the ITAA imposes taxation upon more than one subject of taxation, in contravention of s.55 of the Australian Constitution. This argument is beyond the scope of this article, but reference should be made to State of *South Australia v Commonwealth of Australia* (1992) 23 ATR 10 and *Mutual Pools and Staff Pty Ltd v FCT* (1992) 22 ATR 856.

32 In the constitutional context, this issue is important in ensuring that the *Income Tax Rating Act* 1986 only imposes taxation with respect to one subject of taxation, as required by s.55 of the Australian Constitution. In *Resch v Federal Commissioner of Taxation* (1941) 66 CLR 198 Dixon J indicated that there were many capital items which could legitimately be taxed under the *Income Tax Rating Act* without infringing s.55 of the Constitution. The Mutual Pools and Superannuation Fund of South Australia cases (ibid) indicate a contrary view.

State Authorities to have been acquired by those Authorities at their market values as at the date of commencement of the amendments.

This solution is perhaps the more expedient means of introducing the Authorities to the capital gains regime, given that they are most unlikely to have the requisite information for determining the loss or gain upon disposal of their assets. The only realistic alternative to this course of action would be to require the Authorities to undertake the costly exercise of constructing the information on the basis of their accounting records.

Although the first alternative of deeming the Authorities to have acquired their assets at a particular time and for market value means that the Authorities would lose the benefit of capital gains exemption in respect of their assets acquired pre 20 September 1985[33], they would nevertheless be spared the considerable expense of creating records to comply with the capital gains regime. There is some precedent for this approach at the Commonwealth level, where Division 10 of Part IX was passed in 1988 with the effect that superannuation funds which had previously been exempt from taxation with respect to capital gains were deemed to have acquired all capital assets on 30 June 1988 for the market value of the assets at that time.

The effect of deeming assets to have been acquired after the implementation of the capital gains provisions will have the effect of disadvantaging the State Authorities by comparison to their commercial counterparts, as many privately owned businesses continue to dispose of capital assets without incurring any taxation liability under the ITAA[34]. Whilst this comparative disadvantage will fade with time as so-called "pre-assets" are disposed of and so potentially fall within the capital gains net, it will nevertheless distort the comparison between State Authorities and commercial enterprises.

However, if the tax equivalents regime is viewed as enabling an assessment of the commercial viability of government-owned enterprises if those enterprises were privatised, the deeming of all of the assets of the Authorities to be potentially subject to capital gains accurately reflects the position if those government entities were privatised, as in that case the assets would be disposed of to the new privatised entity, and so the disposal of those assets by the new entity could attract a capital gains liability.

The Exclusion from Sales Tax

The Tasmanian tax equivalents legislation also does not take account of the exemption from Commonwealth sales tax[35] whereas it is clear that the New South Wales legislation takes account of all Commonwealth taxes.

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33 The capital gains provisions of the ITAA took effect with respect to all assets acquired on or after 20 September 1985: s.160L(1)(b).

34 Note that the taxpayer must first establish that the receipt does not fall within the income provisions of the ITAA, and that since *FCT v Myer Emporium Ltd* (1987) 18 ATR 693 the debate has raged as to whether all business receipts constitute income. For a more recent consideration of this issue see the decisions of *Cooling v FCT* (1990) 21 ATR 13 and *Westfield Ltd v FCT* 21 ATR 1398.

35 See Item 74, Division XI of the First Schedule to the *Sales Tax (Exemptions and Classifications) Act* 1935.

Once again, if the purpose of the tax equivalents legislation is to give a true reflex of the taxation expense of the State Authorities treated as if they were privately owned, it could be expected that the tax equivalents legislation also impose an obligation with respect to sales tax from which the State Authorities are exempt.

The Treasurer's Discretion

Determining Estimated Taxation Equivalents[36]

As already apparent from the extract above, s.35(2) states that the estimated taxation equivalent is the amount which the Treasurer determines to be equal to the amount which the relevant entity would pay under the Commonwealth income tax laws.

The nature of the power conferred upon the Treasurer is clearly fundamental to the extent of the liability of the State Authorities to income tax equivalence payments. In turn, this will condition the extent to which the State Authorities are under identical taxation obligations as their commercial competitors. In particular, the required process for determining an estimated taxation equivalent must be considered, and it is also important to establish the extent to which the Treasurer's determination of the amount of tax which would be payable under Commonwealth taxation laws is subject to judicial review. The two issues are related.

Section 35(2) provides that, in determining an estimated taxation equivalent, the Treasurer is to determine the amount of income tax which would have been payable had the relevant State Authority been a taxable company. This is significantly different to an estimated taxation equivalent being defined as the amount which would have been payable had the State Authority been a taxable company. As s.35(2) is expressed, it indicates that the Treasurer's determination of the estimated taxation equivalent is conclusive. The quantum of the estimated taxation equivalent is therefore dependant upon the exercise of the Treasurer's judgment in this regard. This is not to say that s.35(2) grants an unfettered discretion to the Treasurer to determine the quantum of estimated taxation equivalents. Clearly, upon a construction of s.35(2), the Treasurer is required to have regard to the amount of income tax which the Authority would be paying if it were a taxable company. Thus, if the Treasurer made a determination which was untenable under Commonwealth income taxation law, such a determination would be subject to judicial review as an action ultra vires the powers vested in the Treasurer.

Given that s.35(2) does not grant the Treasurer an unfettered discretion in determining estimated taxation equivalents, the extent of the Treasurer's discretion under s.35(2) must be determined. This will be particularly relevant in establishing whether the Treasurer is entitled to adopt the interpretation of the Commonwealth taxation laws which is most favourable to Treasury, or whether the assessment of an estimated taxation

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36 Note that in the New South Wales legislation there is only one stage in the determination of the taxation equivalent to be paid by an Authority, rather than the two stage system applicable in Tasmania. Nevertheless, the language of s.15(1) of the New South Wales legislation is in similar terms to s.37 of the Tasmanian legislation.

equivalent must be founded upon the likely outcome had the Commonwealth Commissioner of Taxation been applying the ITAA to the relevant government entity. If the former is the case, the Treasurer need only base the determination of an estimated taxation equivalent upon a reasonably arguable interpretation of the Commonwealth interpretation. This view would deny State Authorities the ability to challenge such determinations on the basis of an alternative interpretation, as their only recourse to the courts would then be if the Treasurer was acting ultra vires. If the latter is the case, the Treasurer must correctly ascertain the law of the Commonwealth, and faces the prospect of being challenged in court on the basis that the relevant determination was incorrect.

The answer to this question appears to lie in the fact that the Treasurer is authorised by s.35(2) to determine the amount of income tax which would have been payable had the State Authority been a taxable entity. The test of what is an estimated taxation equivalent is therefore not what the position actually is under the income tax law, but what the Treasurer determines the notional liability to be. Of course, where there is no doubt about the interpretation of the ITAA, the Treasurer would have to adopt the settled interpretation. However, where there is uncertainty as to the proper interpretation of the ITAA, the Treasurer is entitled to adopt the view most favourable to the Treasury, without fear of such a determination being challenged in the courts with any real prospect of success[37].

Determining Actual Taxation Equivalents

In determining the actual taxation equivalent for a State Authority under s.37, the criteria which are to be applied by the Treasurer in determining the estimated taxation equivalent (under s.35(2)), are not specified. This leads to the inference that the Treasurer's power to determine the actual taxation equivalent are not fettered by the same restrictions applicable under s.35(2).

The problem with the Act as it presently stands is that it assumes that the "meaning of "taxation equivalent" is known. Perhaps the parliamentary draughts person should have defined "taxation equivalent" in terms of an amount which would be payable under the Commonwealth laws with respect to income taxation by the relevant State Authority if it were not exempt from such taxation. As it stands, the reader of the Act is possibly expected to apply the restrictions applicable to the determination of estimated taxation equivalents to the determination of actual taxation equivalents. Sadly, the legislation gives no such authority for such an interpretation. Indeed, the fact that s.35 specifies criteria to be applied by the Treasurer and s.37 does not is strong evidence in support of the inference that the Treasurer was not to be so confined in reaching a determination under s.37. In the course of debating SAFMA after giving the Second Reading Speech, the Treasurer appeared to indicate that s.37(2) requires the Treasurer to adopt the opinion

37 Although there is no specific appeal mechanism established under SAFMA, a State Authority may always seek judicial review of a purported exercise of legislatively conferred powers on the basis, for example, that the action of a public officer was ultra vires.

of the Auditor-General with respect to the appropriate taxation equivalent[38]. This view is not supported by the legislation.

Altering the Incidence of Taxation Equivalents Payments

Under s.35(3) of SAFMA the Treasurer also has the discretion to deal with each Authority as one entity, to isolate any part of the operations of a State Authority and treat that segment as an entirely separate entity or to treat the segment as a company belonging to the corporate group of the Authority concerned[39].

Under the ITAA, there are provisions for the transfer of losses between group companies and also for the carry forward of losses[40]. The exercise of the Treasurer's discretion under s.35(3) will clearly have an impact upon the ability of the particular Authority to notionally transfer losses under ss.80G or 160ZP.

Where an Authority conducts some operations which are not capable of being profitable and other operations which are generally profitable, the Authority's position under the ITAA would generally be that the losses could be netted off against the gains. This result would normally follow if the Treasurer accepts that the Authority should be treated as one entity. A similar effect would also obtain where the profitable company was a "group company" for the purposes of s.80G.

However, although the Treasurer is authorised to treat a segment of an Authority and the remainder of the same Authority as if they were group companies, the SAFMA does not specify whether the definition of "group company" is to be that adopted in s.80G(1) of the ITAA. Section 80G(1) provides that a company shall only be taken to be a group company in relation to another company where one of the companies was a subsidiary of another company or where each of the companies was a subsidiary of another company. Section 80G(2) defines "subsidiary" in terms of being 100% owned either directly or indirectly by a company. Thus, a group company for the purposes of the ITAA is markedly different to the ordinary understanding of a group company, where there need not be 100% common ownership. Should the Treasurer treat a segment of an Authority as one of a group of companies, such a determination would need to state that the ownership of notional entity was identical to that of the remainder of the relevant Authority if the transfer of loss provisions were to apply. Once again, the relevant provisions of SAFMA are inadequate in this regard, as they do not clearly set out the content of the Treasurer's powers.

It is also interesting to note that the Treasurer is only authorised to consider "parts" of the relevant State owned Authority as if they were one entity or separate entities as the case may be. But in many cases the

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38 "Clause 37(2) clearly states that the Treasurer 'shall', not 'may'. The more interesting question would have been what happens when the Auditor-General qualifies the statement prepared by the authority and suggests a lower or higher level of tax-equivalent obligation. The Treasurer will take the Auditor-General's number in either case." Tasmanian Parliamentary Debates, 14 November 1990 at p.4815.

39 Note that under the New South Wales legislation there is no similar provision to that of s.35(3).

40 See ss.80A, 80E, 80G and 160ZP.

expenses associated with the business of the Authority may be spread across several departments within the Authority. For example, a profitable plant nursery may at first blush be considered to be a "part" of the relevant Authority which the Commissioner may determine ought be treated as a separate entity. Importantly, s.35(3) does not authorise the Treasurer to consider the nursery and all of the activities carried out with respect to that nursery throughout the Authority as a separate entity. This means that, unless appropriate action is taken, the expenses associated with the operation of the nursery (such as administrative expenses) may not be taken into account in determining the taxation equivalent. The only means to overcome this difficulty would be for the Authority to attempt to predict where the Treasurer might invoke s.35(3) and establish an entirely separate set of accounts under which management and administrative expenses (for instance) would be separately billed. Obviously, such preventive measures could prove expensive and achieve little in terms of improved productivity of the Authorities concerned.

Impact of the Treasurer's Discretion

On this interpretation of ss.35(2) and 37, the prescribed State Authorities may operate at a serious competitive disadvantage with respect to their private sector competitors, in that the Treasurer may adopt a more aggressive interpretation of the ITAA than the Commissioner of Taxation would seek to apply. Alternatively, claims to prospective purchasers that a particular government entity had returned notional after-tax profits might be considered of less weight owing to the substantial opportunity for the Treasurer to adopt a less aggressive stance than that which might be taken by the Commissioner in respect of a particular entity. In either case, the claim that the taxation equivalents regime introduces a means for comparing the income taxation costs of private and public entities must be open to serious doubt.

The fundamental objection to s.35(3) is the hindrance to corporate planning which it establishes. The ability of the Treasurer to effectively vary the incidence of income tax equivalence under the broad discretion created under s.35(3) is unheard of under the ITAA. Under this regime, the State Authorities face the prospect that the Treasurer may isolate the profitable parts of the Authority and determine the estimated taxation equivalent upon the notional taxable income of the profitable part. From the State Authorities' viewpoint, this discretion is unpalatable as the circumstances under which it may be exercised are entirely beyond their control, apart from lobbying the Treasurer.

This discretion in the Treasurer impedes effective planning by the State Authorities of their affairs as the tax outcome for a given year is uncertain. By contrast, private enterprises may calculate tax exposures with a higher degree of certainty. Once again, SAFMA places Government owned enterprises at a competitive disadvantage by comparison to the private sector, where taxpayers can at least make business decisions in an environment where the response of the Commissioner of Taxation is considerably more predictable.

The Perceived Need for Flexibility

In his second reading speech, the Tasmanian Treasurer indicated that SAFMA was intended to be sufficiently flexible to enable the gradual implementation of the commercialisation program embodied in the legislation[41]. Indeed, the Treasurer indicated that the objective of the legislation was not to create complete competitive neutrality between the private and State public sectors, but rather merely to commence the process by which State Authorities are compelled to operate along commercial lines.

The reasons for this gradualist approach to the introduction of the commercialisation agenda are not expressly dealt with by the Treasurer. However, there is some reference in the Parliamentary Debate concerning the then Bill that the State Authorities affected were alarmed at the implications of the legislation, particularly in relation to the payment of dividends, taxation equivalents and guarantee fees[42]. Given the tenuous hold on political power of the Government of the day, the decision to adopt a gradualist approach may therefore have been for political reasons rather than any perception that such an approach was of greater merit.

Conclusion - an Alternative Approach to Achieving the Desired Flexibility

Once the objectives of the tax equivalents legislation are accepted, the question of how to implement those objectives must be considered. As the implementation of the taxation equivalents regime can only be expected to incidentally affect government revenue through perhaps the more profitable sale of government assets, there seems little point in the State Government expending considerable amounts of its precious financial resources upon resolving complex taxation issues arising from this implementation. Allowing some flexibility to the Treasurer during the early stages of the implementation of the taxation regime was therefore understandable, as the Treasurer may resolve an issue with the stroke of a pen which would otherwise entail the expenditure of considerable sums on seeking taxation advice.

The problem is that the existence of the Treasurer's ability to resolve difficulties with the stroke of a pen subverts the very purpose of the tax equivalents legislation in the first place, which is to show what the relevant State Authorities' taxation position would be under the Commonwealth taxation system. The Tasmanian Treasurer appears to have contemplated that this Catch-22 would need to be resolved by amending legislation at some specified time in the future. One alternative solution might have been to embark upon detailed consultation with the relevant Authorities before the implementation of a taxation equivalents regime which introduced complete taxation equivalence with absolutely no discretion in the Treasurer. A further option might have been to have legislated for the final taxation equivalence position sought, subject to a discretion in the Treasurer which was limited by a "sunset clause".

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41 See Tasmanian Parliamentary Debates, supra, at pp.4660-4661.

42 Tasmanian Parliamentary Debates, op cit, at pp. 4,819ff.