ADVICE RE *PAPE V COMMISSIONER OF TAXATION* AND DIRECT FEDERAL FUNDING OF LOCAL GOVERNMENT

Opinion

1. I have been asked to advise on the implications for local government of the decision of the High Court on 7 July 2009 in the matter of *Pape v Commissioner of Taxation* (2009) 257 ALR 1. In particular, I have been asked to address:

    1. the main points in the decision;
    2. the implications for local government stemming from the decision, including in particular the implications for current Australian government programs which provide funding directly to local government through an allocation formula or on the basis of competitive grants and a direct funding agreement (for example, the Nation Building Roads to Recovery Program and the Community Infrastructure Program); and
    3. the measures that the Australian government may need to consider to ensure that the funding of local government under the relevant programs can continue.

2. A summary of my conclusions can be found at paragraphs 79-85.

A BACKGROUND

3. Section 81 of the Constitution enables the federal Parliament to appropriate money (that is, to authorise its expenditure) out of the Consolidated Revenue Fund 'for the purposes of the Commonwealth'.

4. Under section 83, no money may be drawn from the Treasury of the Commonwealth except by way of appropriation 'made by law' (that is, under a valid law passed by the federal Parliament).

5. What is not made clear by these sections are the purposes for which the federal Parliament may appropriate money under section 81. A key question is whether the federal Parliament may appropriate money for any purpose that it wishes, or whether it may do so only for a limited set of purposes that correspond to its powers as elsewhere set out in the Constitution?

6. Despite its fundamental importance, this question has come squarely before the High Court on only three occasions since federation in 1901. The Court failed to resolve the issue by way of a majority of four judges on the first two occasions.

7. The High Court's first attempt was in *Attorney-General (Vic); Ex rel Dale v Commonwealth* (*First Pharmaceutical Benefits Case*) (1945) 71 CLR 237. The *Pharmaceutical Benefits Act 1944* (Cth) had established a scheme of free medicine, obtainable from approved chemists upon prescription by a doctor using a federal form.

8. The Medical Society of Victoria sought a declaration that the Act was invalid, and an injunction against any expenditure under its provisions. The High Court upheld the challenge, holding that the Act was not authorised by the power of appropriation in section 81 of the Constitution.

9. On the meaning of 'the purposes of the Commonwealth' in section 81, the *First Pharmaceutical Benefits Case* yielded no clear view. Latham CJ and McTiernan J took a broad view that there is no limit to the power, and as a result that that the Commonwealth may fund whatever it wants. They found, in the words of McTiernan J (at 273), that '[t]he purposes of the Commonwealth are, I think, such purposes as the Parliament determines'. Dixon J, with whom Rich J agreed, did not reach any conclusion on what 'the purposes of the Commonwealth' might mean. Starke and Williams JJ held that the Act was invalid by construing 'purposes' narrowly and thus that the Commonwealth can only fund matters that fall within its other powers in the Constitution, most notably those areas listed in section 51 of the Constitution such as defence and taxation. As Williams J put it (at 28): 'These purposes must all be found within the four corners of the Constitution'.

10. The scope of section 81 next came before the High Court in *Victoria v Commonwealth and Hayden* (*AAP Case*) (1975) 134 CLR 338. It again remained unresolved.

11. The High Court had before it in the *AAP Case* a two-line item and schedule in the *Appropriations Act (No 1) 1974* (Cth) that authorised expenditure of $5,970,000 for the Australian Assistance Plan. The Plan envisaged the establishment of Regional Councils for Social Development throughout Australia that would spend this money on welfare activities such as family day care programs, counselling services for families and Community Health and Welfare Centres.

12. By 4:3 (McTiernan, Stephen, Jacobs and Murphy JJ, with Barwick CJ, Gibbs and Mason JJ dissenting), the High Court rejected the challenge. McTiernan, Mason and Murphy JJ affirmed a broad view of Commonwealth 'purposes'. Barwick CJ and Gibbs J took a narrow view, while Jacobs J assumed for purposes of argument that such a view was correct. The final judge, Stephen J, expressed no opinion. He held that the plaintiffs' challenge failed because they lacked the legal right to raise the issue.

13. A decade later in *Davis v Commonwealth* (1988) 166 CLR 79 at 95, Mason CJ, Deane and Gaudron JJ noted the 'long-standing controversy about the meaning of 'purposes of the Commonwealth' in section 81'. They concluded that the *AAP Case* could best be summarised 'as an authority for the proposition that the validity of an appropriation act is not ordinarily susceptible to effective legal challenge'.

14. In the three and a half decades since the *AAP Case*, the Commonwealth has proceeded generally on the basis that the broad view of its power is correct, and thus that it may directly fund whatever it wishes. It has done so despite this view of the power not having been authoritatively upheld by a majority of the High Court.

B *PAPE V COMMISSIONER OF TAXATION*

15. The legal uncertainty arising from the contradictory judgments in the *First Pharmaceutical Benefits Case* and the *AAP Case* was resolved by the High Court in *Pape v Commissioner of Taxation* [2009] HCA 23 (7 July 2009).

16. The seven judges produced three different views of the appropriate result in the case over 238 pages of written judgments. They did, however, unanimously reject the

Commonwealth's broad view of its power. The Court held that an appropriation made under section 81 is not itself sufficient to confer validity on proposed expenditure. Instead, the expenditure must be supported by some other grant of power in the Constitution.

17. *Pape v Commissioner of Taxation* arose from the response of the Rudd Labor government to the global financial crisis that emerged in 2008. The *Tax Bonus for Working Australians Act (No 2) 2009* (Cth) provided for a 'fiscal stimulus package' in the form of a one-off bonus payment to 8.7 million taxpayers whose taxable income in 2007-2008 was less than $100,000. For incomes under $80,000 the amount payable was $900; for incomes between $80,000 and $90,000 it was $600; for incomes between $90,000 and $100,000 it was $250. Mr Bryan Pape, an academic at the University of New England and potential recipient of a $250 payment, challenged the validity of the legislation.

18. By a narrow 4:3 margin (French CJ, Gummow, Crennan and Bell JJ, with Hayne, Heydon and Kiefel JJ dissenting), it was held that the additional source of the power necessary to uphold the bonus payments could be found in the Commonwealth's executive power section 61 of the Constitution. That provision states:

> The executive power of the Commonwealth is vested in the Queen and is exercisable by the Governor-General as the Queen's representative, and extends to the execution and maintenance of this Constitution, and of the laws of the Commonwealth.

19. It was recognised that this power includes the responsibilities arising, as Mason J had put it in the *AAP Case* (at 397), 'from the existence and character of the Commonwealth as a national government'. The making of payments to taxpayers as part of a 'fiscal stimulus package', in an effort to minimise the effects in Australia of the global financial crisis, was held to fall within this aspect of the power.

20. The enactment of legislation to identify the recipients and amounts of the payments was further held by the majority to be incidental to the exercise of executive power, and thus valid under the express incidental power in section 51(xxxix) of the Constitution. That power enables the federal Parliament to pass laws with respect to:

> Matters incidental to the execution of any power vested by this Constitution in the Parliament or in either House thereof, or in the Government of the Commonwealth, or in the Federal Judicature, or in any department or officer of the Commonwealth.

21. Although the administration of the Tax Bonus Act was vested in the Commissioner of Taxation, thus bringing it within the definition of a 'taxation law', the whole Court held that the Act could not be supported in its full operation as a law with respect to taxation under section 51(ii) of the Constitution. However, Hayne and Kiefel JJ (in dissent) held that its operation could be read down so that a significant proportion of the intended payments could be supported by section 51(ii). This could be achieved by treating the 'bonus payments' as offsets against tax liability. In the case of taxpayers entitled to the payment of $900, for instance, those who had already paid tax of less than $900 would be entitled only to a refund of the total tax they had paid (and not to the remainder of the $900), while those who had paid a tax of more than $900 would be entitled to the whole $900 by way of a partial tax refund. This, however, was a minority view, rejected (at 65-7) by Gummow, Crennan and Bell J, and (at 119-20) by Heydon J.

22. It was also argued that the Tax Bonus Act could be supported by reference to the trade and commerce power (s 51(i)) and the external affairs power (s 51(xxix)) in the Constitution. French CJ, Gummow, Crennan and Bell JJ had no need to consider these arguments, while Hayne, Heydon and Kiefel JJ rejected them.

23. The correct analysis, as adopted by all of the judgments in *Pape v Commissioner of Taxation*, is that although an appropriation under section 81 is a necessary precondition for expenditure, neither expenditure nor activities will be valid unless supported by some other source of power.

24. French CJ summed up the Court's conclusions by saying (at 7):

> The provisions of ss 81 and 83 do not confer a substantive 'spending power' upon the Commonwealth Parliament. They provide for parliamentary control of public moneys and their expenditure. The relevant power to expend public moneys, being limited by s 81 to expenditure for 'the purposes of the Commonwealth', must be found elsewhere in the Constitution or statutes made under it.

25. This means that it is also no longer important to determine the scope of the phrase 'the purposes of the Commonwealth' in section 81 of the Constitution. What is necessary is to determine in each and every case in which the Commonwealth spends money whether there is a sufficient, separate, basis in the Constitution to support that expenditure.

C IMPLICATIONS FOR LOCAL GOVERNMENT

26. *Pape v Commissioner of Taxation* was a clear rejection the Commonwealth's wide view of its own spending power. The Court found that the Commonwealth can spend money in areas that are listed in the Constitution as being a federal responsibility, but not in other areas in which the Commonwealth has no constitutional mandate.

27. There is no express or implied provision in the Constitution that grants the Commonwealth responsibility over local government. The consequence is that the Commonwealth has no general power to directly fund local government bodies or activities under section 81 of the Constitution. This reflects the fact that the Constitution was drafted and structured with a view to local government being the primary responsibility of the States and not the Commonwealth.

28. The Commonwealth may nonetheless still directly fund specific local government bodies and activities where this can be tied back to federal power. Such funding will now need to be assessed on each and every occasion against whether it falls under Commonwealth power, with the starting position being that such funding will not be constitutionally possible (and will thus be illegal) unless a source of power can be identified.

29. All past and future direct federal funding of local government must be assessed by undertaking a careful analysis of whether the funding lines up against an expressed or implied power of the Commonwealth. Possible powers include:

(i) Corporations Power

30. The first possibility is that local government bodies might be directly funded by the Commonwealth taking advantage of its power in section 51(xx) of the Constitution over

'Foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth' (collectively known as 'constitutional corporations'). Where local government bodies are trading corporations for the purposes of this power, this may provide a valid basis to fund their activities. The potentially enormous scope of such funding is demonstrated by the decision of the High Court in *New South Wales v Commonwealth* (*Work Choices Case*) (2006) 229 CLR 1. In that case it was held that the corporations power enables the enactment of a general regime of industrial relations for the types of corporations specified in section 51(xx).

31. The problem is that it is not clear that local government bodies are trading corporations for the purposes of this power. *R v Trade Practices Tribunal; Ex parte St George County Council* (1974) 130 CLR 533 concerned whether a local government body, St George County Council, was a 'trading corporation'. McTiernan, Menzies and Gibbs JJ, with Barwick CJ and Stephen J dissenting, held that it was not. The focus was upon whether this question was to be determined by reference to the *original purposes* for which the Council was incorporated, or by reference to its *current activities*.

32. On either basis, the character of the County Council was ambiguous. Under the *Local Government Act 1919* (NSW), it could have been given a wide range of local government functions. However, the only functions which it had been given related to the supply of electricity and electrical appliances. Barwick CJ and Stephen J preferred the 'activities' test. They therefore held that the County Council was a 'trading corporation' because of its substantial trading. Gibbs and Menzies JJ preferred the 'purposes' test. They consequently held (at 564) that the County Council was not a 'trading corporation' because it had been 'constituted for the purposes of local government to provide an essential service to the inhabitants'. McTiernan J agreed with the latter result, but for slightly different reasons.

33. The High Court has since held that a company is a trading corporation when it has 'substantial trading activities', that is, when its trading activities 'form a sufficiently significant proportion of its overall activities as to merit its description as a trading corporation' (*R v Federal Court of Australia; Ex parte WA National Football League* (*Adamson's Case*) (1979) 143 CLR 190 at 233). It has also been held that corporations

formed by government can be trading corporations (*Commonwealth v Tasmania* (*Tasmanian Dam Case*) (1983) 158 CLR 1).

34. However, it is still not clear that local government bodies are trading corporations for the purposes of s 51(xx). The 'substantial trading activities' test can be notoriously difficult to apply. Judges tend to form an instinctive judgement about whether the business of a corporation is sufficient to make it a constitutional corporation. The result is that it cannot be said with certainty whether individual local councils are encompassed by the power.

35. The picture is further complicated because the test must be applied to each individual local government body and not to the sector as a whole. This makes it likely that some large local authorities like Brisbane City Council are covered by section 51(xx), while other bodies are not.

36. Most recently, Spender J of Federal Court in *Australian Workers' Union of Employees, Queensland v Etheridge Shire Council* (2008) 250 ALR 485 found that Etheridge Shire Council in Queensland is not a constitutional corporation. In applying the 'substantial trading activities' test, the judge took account of a wide range of commercial activities undertaken by the Council. As this case shows, the test involves examining the extent of the buying and selling of goods and services by the body, whether such activities are undertaken to make a profit and whether they are a significant part of the work of the body or merely incidental to its primary functions. This could mean attention being paid to business activities such as the sale of land and water, the renting out of residential or commercial property, the provision of accommodation services, the running of a childcare facility and the provision of tourism and other services.

37. Based on this approach, a particular council might even be a constitutional corporation in a year that involves extensive trading, but not in the following year if its business undergoes significant change.

38. Local government bodies also may fall out of federal coverage by having their corporate status removed. This has been achieved for local government bodies in Queensland (with the exception of the Brisbane City Council) by the *Local Government and Industrial*

Relations Act 2008 (Qld)). If a body is not a corporation in the first place, it cannot be classed as one of the types of corporation listed in section 51(xx) of the Constitution.

39. The result is that the corporations power does not provide a safe and certain hook upon which to base direct federal funding of local government. A number of major councils might be funded directly by the Commonwealth using the corporations power, but others could not be. Moreover, the list of which bodies could and could not be so funded will change over time.

40. It is also important to note that the current approach to this power that recognises that some local government bodies are likely to be trading corporations may be revisited by the High Court. The High Court may over the coming years offset its wide reading in the *Work Choices Case* of what can be regulated under the corporations power with a more restrictive approach as to which bodies fall under the power. When the Constitution was drawn up in the 1890s there was no suggestion that a local council would be classed as a trading corporation. There were hints of a return to this approach in argument before the High Court in the *Work Choices Case*.

(ii) Nationhood and Incidental Powers

41. The High Court in *Pape v Commissioner of Taxation* found by a narrow majority that a combination of the Commonwealth's executive power in section 61, applied through its incidental power in section 51(xxxix), provided a basis for the making of the tax bonus payments. That finding was based largely upon the severity of the global financial crisis, and can be seen as a response to the exceptional nature of that economic threat.

42. There is nothing particular about the direct funding of local government bodies that would likely enable it to fall into the same category, except where payments are made as part of an economic package in response to this or a like event. This is because the executive power is not a power to act generally in the national interest or in a way that is convenient. As Barwick CJ stated (at 362) in the *AAP case*: 'to say that a matter or situation is of national interest or concern does not, in my opinion, attract any power to the Commonwealth'. Instead, as Mason J stated (at 397) in that case, it must be a matter arising 'from the existence and character of the Commonwealth as a national

government'. There is nothing about local government that makes it a particular concern of the Commonwealth. Indeed, the long history of the regulation of this tier of government suggests that, if anything, it has been has been the particular concern of the States.

(iii)Other Powers

43. There are many other federal powers, especially in section 51 of the Constitution, that could support specific direct payments by the Commonwealth to local government bodies. For example, the Commonwealth's power over 'quarantine' in section 51(ix) would enable the Commonwealth to directly fund local government bodies to establish local quarantine infrastructure and the like. Similarly, the power over 'marriage' in section 51(xxi) could enable the local provision of counselling and other services related to marriage.

44. Section 122 of the Constitution gives the Commonwealth a broad power over the territories. This would enable it to directly fund all local government bodies and their activities in such jurisdictions.

45. However, as these examples make plain, direct funding could only be made in regard to matters that lie within these powers, or matters that can fairly be regarded as being incidental to them. They provide no basis for the general direct funding of local government bodies and their activities.

D SPECIFIC LOCAL GOVERNMENT PROGRAMS

46. The only local government programs affected by *Pape v Commissioner of Taxation* are those that involve direct funding to local government by the Commonwealth.

47. Funding provided to local government through Specific Purpose Payments made first to State governments and then distributed to individual local government bodies on the basis of an agreed allocation (for example, Financial Assistance Grants to Local Government,

Roads Safety Black Spots payments and grants under the Natural Disaster Mitigation Program) are unaffected.

48. I have been asked to advise in regard to the constitutionality of the following two current programs that involve direct federal funding of local government:

(i) Nation Building Roads to Recovery Program

49. Roads to Recovery Programs have been in operation since 2001. The current Nation Building Roads to Recovery Program is the third of its kind, commencing on 1 July 2009 for a five year period. $1.75 billion will be made available to local government authorities, and State and Territory governments responsible for unincorporated areas.

50. The legislative basis for the current Program is provided by the *Nation Building Program (National Land Transport) Act 2009* (Cth). Section 87 states that payments are to be made according to the Nation Building Program Roads to Recovery List:

> **87 Nation Building Program Roads to Recovery List**
> The Nation Building Program Roads to Recovery List must:
> (a) specify the amounts of Commonwealth funding that are to be provided under the Nation Building Program Roads to Recovery Program during the funding period; and
> (b) in relation to each of those amounts, either:
>
> > (i) specify the name of the person or body that is to receive the amount; or
> > (ii) state that the amount is specified on account of a particular State, or a particular area of a State, but the persons or bodies that are to receive the amount have not yet been decided.

51. Under section 4 of the Act, the '*Nation Building Program Roads to Recovery List* means the list in force, immediately before the commencement of this definition, under subsection 87(1) of this Act for the period starting on 1 July 2009 and ending on 30 June 2014.' (See also s 121(2) of the *Nation Building Program (National Land Transport) Amendment Act 2009* (Cth) and the full list of allocations at www.nationbuildingprogram.gov.au/publications/reports/pdf/RTR_funding_allocations_2009_14.pdf.)

52. The payments in the Nation Building Program Roads to Recovery List are made directly to recipients in accordance with section 89:

89 Payments to persons and bodies specified in Nation Building Program Roads to Recovery List

(1) Subject to this section and to section 92, each amount specified in a Nation Building Program Roads to Recovery List for a Nation Building Program Roads to Recovery funding period is payable to the person or body (if any) specified in the List for that amount.

(2) The amount is payable in one or more instalments. The amounts and timing of instalments are as determined by the Minister.

(3) The amount may only be paid during the funding period.

(4) Payments under this Part are to be made out of money appropriated by the Parliament.

53. Conditions upon the receipt of payments may be set under section 90:

90 Conditions that apply to payments

(1) The Minister must, in writing, determine the conditions that apply to payments under this Part.

(2) The conditions must include:

(a) a condition that requires the payment to be spent on the construction or maintenance of roads; and

(b) a condition that requires the expenditure to be properly accounted for; and

(c) for any payment that is made to a local government authority—a condition that requires the authority to maintain the level of its expenditure on roads, so far as that expenditure comes from sources other than Commonwealth, State or Territory funding; and

(d) a condition that requires signs to be displayed in relation to projects (other than maintenance programs) that are funded under this Part.

(3) The conditions may also include conditions requiring the funding recipient to repay amounts to the Commonwealth in the event of a breach of any of the conditions.

(4) Subsections (2) and (3) do not limit the matters that may be dealt with in the conditions.

(5) The Minister may, in writing, vary or revoke any of the conditions.

54. Section 91(1) further states that the Minister may 'exempt the person or body from a condition determined under section 90'; and 'if the Minister considers it appropriate to do so—specify a replacement condition to be complied with by the person or body.'

55. As is clear from this legislation, the Nation Building Roads to Recovery Program has been constructed in a way that reflects the Commonwealth's wide view of its appropriation power, as was rejected in *Pape v Commissioner of Taxation*. No attempt is made in the Act to limit payments to particular bodies that fall within Commonwealth power, nor to set conditions that would make the payments attributable to federal power.

56. Section 90(2)(a) provides that payments must be made with 'a condition that requires the payment to be spent on the construction or maintenance of roads'. There is no general power held by the Commonwealth to legislate for roads or the like. In any event, section 91(1) arguably enables even this condition to be dispensed with. This means that, theoretically, the Act could enable grants to be made to local government bodies on almost any basis.

57. It is difficult to see how the Nation Building Roads to Recovery Program could now be upheld as valid under the Constitution after the decision in *Pape v Commissioner of Taxation*. The Commonwealth lacks any general power over local government and roads. Of course, it is able to engage in aspects of such areas indirectly, such as through its power over trading corporations, but the Act is not structured to reflect this, nor has the Nation Building Program Roads to Recovery List been formulated on this basis.

58. As currently constituted, the Nation Building Roads to Recovery Program as set out in the *Nation Building Program (National Land Transport) Act 2009* (Cth) is likely to be invalid, and payments made under the Program illegal and thus liable to be repaid.

59. A number of powers could be useful for reconstructing at least part of this Program. Where roads run across interstate borders, or are part of a national highway network, they

might be the subject of direct funding under the Commonwealth's power over 'interstate trade and commerce' in section 51(i) of the Constitution. Where a local government body is a trading corporation under section 51(xx), that might be a sufficient basis to fund those bodies for this and other programs. Other powers might support aspects of the Program, but there is no power broad enough that is likely to cover all aspects.

(ii) Community Infrastructure Program

60. The Community Infrastructure Program was announced by Prime Minister Kevin Rudd at the Australian Council of Local Government inaugural meeting on 18 November 2008. The Program has since made more than $1 billion available to local government authorities to build and modernise community infrastructure as part of the government's Nation Building Economic Stimulus Plan.

61. Funding is provided directly to councils. The Program is not underpinned by legislation, with funds instead appropriated through the general budget process.

62. One-off funding of $250 million in 2008-09 was initially provided to local government authorities. Each local government body received a minimum payment of $100,000. A further $550 million Strategic Projects component of the Program was made available to local government authorities based upon applications submitted for funding. Government Guidelines show that eligible projects under the Strategic Projects component include (www.infrastructure.gov.au/local/files/Strategic_Projects_550M_Guidelines_13Feb2009.pdf):

- social and cultural infrastructure (e.g. art spaces, gardens);
- recreational facilities (e.g. swimming pools, sports stadiums);
- tourism infrastructure (e.g. walkways, tourism information centres);
- children, youth and seniors facilities (e.g. playgroup centres, senior citizens' centres);
- access facilities (e.g. boat ramps, footbridges); and
- environmental initiatives (e.g. drain and sewerage upgrades, recycling plants).

At the Australian Council of Local Government meeting on 25 June 2009, the federal government announced additional funding of $220 million for the Program.

63. The Community Infrastructure Program has been explicitly cast as being part of the government's Nation Building Economic Stimulus Plan (see, for example, www.economicstimulusplan.gov.au/community_infrastructure/pages/default.aspx). That Plan is a response to the global financial crisis that emerged in 2008.

64. At least for the term of the global economic crisis, the Community Infrastructure Program is likely to be upheld on the same basis as the tax bonus payments in *Pape v Commissioner of Taxation* (that is, as an exercise of Commonwealth executive power in section 61, applied through its incidental power in section 51(xxxix)). However, this will only underpin such funding while the global financial crisis is seen as severe threat to the health of the nation's economy.

65. As the global economic crisis lessens, a point will be reached where any further funding under this Program will need to be justified as falling under other areas of federal power. Like the Nation Building Roads to Recovery Program, the broad nature of the funding available under the Community Infrastructure Program means that it is not in a form that will then be likely to survive challenge. The Program could be recast, but only in a way that limits which local government bodies and activities receive direct funding according to the powers of the Commonwealth as set out in the Constitution.

E REMEDIAL AND OTHER MEASURES

(i) Past Payments

66. *Pape v Commissioner of Taxation* affects both future and past direct federal funding to local government and other bodies. High Court decisions operate for all time, and not only prospectively (*Ha v New South Wales* (1997) 189 CLR 465). This means that prior payments made directly by the Commonwealth to local government bodies should be assessed for validity in light of the recent High Court decision.

67. Where payments cannot be upheld as being supported by a source of Commonwealth power, those payments will be illegal on the basis that they breach the Australian Constitution.

68. Strictly speaking, where such payments have been made and cannot be now seen as valid under the Constitution, the possibility of repayment arises. This will obviously not be desirable, and ideally the issue should be put to rest by the enactment of joint Commonwealth/State legislation to validate the payments retrospectively (perhaps by way of a retrospective use of the indirect State funding mechanism in section 96 of the Constitution). This would avoid the possibility of such payments being subject to attack. The likelihood of attack on past payments would seem very small, but then again so did the likelihood of a person like Mr Pape ever bringing his case to the High Court.

(ii) Current Programs

69. The Nation Building Roads to Recovery Program is now likely to be invalid, while the Community Infrastructure Program will become so in respect of any future payments that cannot be attributed to the government's response to the global economic crisis. This is not to say that attacks on these Programs are likely. Cases brought on the basis that expenditure breaches the Constitution are rare. It can also be difficult for an individual to possess the legal right to bring the case. Mr Pape was able to do so only because he was a recipient of one of the tax bonus payments. Then again, another possible source of attack would be a State government that wishes to further assert its financial and other rights.

70. Although constitutional attack may be unlikely, it is possible, and remedial action ought to be taken to safeguard these future programs. The Commonwealth should immediately look to restructure the legislative underpinning and administrative practices that support existing direct funding programs to local government to ensure that they comply with the new understanding of the Constitution in *Pape v Commissioner of Taxation*.

71. In a remodeled form, some councils and local activities may no longer be able to receive funding under the Programs. In order to gain a secure constitutional foothold, money may need to be allocated in a way that bypasses some local government bodies. This is because the Programs will need to be designed in light of the limits of federal

constitutional power rather than just considerations such as fairness and the desired policy outcome.

(iii)Future Programs

72. Future direct funding programs to local government will need to approached differently in light of the High Court's decision. There is no doubt that the Commonwealth can fund local government. However, in many areas it may now only be able to do so using a different mechanism. The likely mechanism is for the Commonwealth to make Specific Purpose Payments relying upon section 96 of the Constitution. That provision states that the federal Parliament 'may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit'.

73. High Court authority on the scope of section 96 is clear in enabling the Commonwealth to set whatever terms and conditions it thinks fit if a State is to receive funding (*South Australia v Commonwealth* (*First Uniform Tax Case*) (1942) 65 CLR 373; *Victoria v Commonwealth* (*Second Uniform Tax Case*) (1957) 99 CLR 575). This means that the Commonwealth can direct States in very specific terms as to how money is to be expended on behalf of or to local government.

74. However, each State must consent to receive the money on the nominated terms and conditions. No State can be forced to receive money on behalf of local government.

75. To set too prescriptive and detailed a set of conditions could run counter to the significant rationalisation of Specific Purpose Payments achieved in the Intergovernmental Agreement on Federal Financial Relations that came into effect on 1 January 2009. That Agreement is intended to reduce the prescriptive conditions formerly imposed on such payments, and thus to allow the States increased flexibility in their delivery of services.

(iv)Constitutional Reform

76. The problems brought about by *Pape v Commissioner of Taxation* could be remedied by changing the Constitution by way of a referendum. There is a precedent for responding to such a situation in this way. The outcome in the *First Pharmaceutical Benefits Case* (see

above paragraphs 7-9) was overcome by a constitutional amendment achieved by the Chifley Labor government in 1946.

77. That proposal inserted a new power, section 51(xxiiiA), in the Constitution that allows the federal Parliament to legislate with respect to 'The provision of maternity allowances, widows' pensions, child endowment, unemployment, pharmaceutical, sickness and hospital benefits, medical and dental services (but not so as to authorize any form of civil conscription), benefits to students and family allowances'. The referendum that brought about this was held on 28 September 1946 and was carried nationally and in all six States.

78. A like response might either amend section 96 by adding the words 'and local government', or by drafting a new section 96A to provide: 'The Parliament may grant financial assistance to any local government body on such terms and conditions as the Parliament thinks fit'.

F CONCLUSIONS

79. *Pape v Commissioner of Taxation* has resolved decades of dispute over the scope of Commonwealth power to directly fund areas like local government. The clear result of the decision is that the Commonwealth does not possess the power to fund whatever bodies and activities it desires. It may only directly expend federal money in areas where the Commonwealth can demonstrate that it has a specific power under the Australian Constitution to do so.

80. The Commonwealth does not have any general power under the Constitution to regulate or fund local government. This means that past and future direct Commonwealth funding of local government must now be assessed against whether it can be supported by other specific Commonwealth powers, such as its power over constitutional corporations in section 51(xx) of the Constitution.

81. Applying this approach, it is difficult to see that the Nation Building Roads to Recovery Program is anything but constitutionally invalid. On the other hand the Community Infrastructure Program might be upheld, if only for the short term, on the same basis as

the tax bonus payments in *Pape v Commissioner of Taxation* as being a part of the government's response to the global economic crisis.

82. The decision of the High Court casts into doubt the possibility of there being an effective direct funding relationship between the Commonwealth and local government. Such a relationship will now only be possible in specific areas, and even then after a careful and exhaustive reconciliation of each aspect of funding against Commonwealth power. The absence of clear Commonwealth responsibility over local government means that many funding possibilities will not now be feasible.

83. The Commonwealth should respond to *Pape v Commissioner of Taxation* by seeking to validate past direct payments to local government through legislative cooperation with the States. It should also look to restructure existing direct federal funding programs for local government to ensure their validity.

84. Many future Commonwealth payments to local government may need to be made as Specific Purpose Payments via the States under section 96 of the Constitution.

85. The only long term means of ensuring general direct funding of local government by the Commonwealth is to bring about change to the Constitution by way of a referendum. This could be achieved either by amending section 96 of the Constitution by adding the words 'and local government', or by drafting a new section 96A to provide: 'The Parliament may grant financial assistance to any local government body on such terms and conditions as the Parliament thinks fit'.

Professor George Williams 12 August 2009

Barrister