Tax and Religion: Never the twain shall meet?

Dr Brett Freudenberg
Senior Lecturer – Taxation, Griffith University

Dr Mahmood Nathie
Lecturer, Griffith University

proceedings from: 9th International Tax Administration Conference, Sydney, April 8-9, 2010
ABSTRACT

This paper focuses on the emergence of Islamic banking and finance in global financial markets and efforts by governments (through regulatory and tax initiatives) to facilitate it. Particularly, this paper focuses on the fundamental question as to whether it is constitutionally possible for Australia to implement such tax reforms to encourage and facilitate faith-based transactions.

Recently there have been calls for Australia to become a financial hub – particularly in south East Asia. One aspect of this is the recognition of faith-based financial alternatives in the marketplace. This consideration includes ensuring that tax laws are synchronised and do not unduly hinder or restrict the orderly development of such alternatives. The Islamic financial markets stand out as one example. In 2007 it was estimated that the market for Islamic finance products were worth in excess of US$700 billion associated primarily with the world’s Muslim population.

However, one core element to the structure of Islamic financial transactions is the necessity to ensure religious compliance with, for example, not involving the usage of riba (interest). Being different to conventional finance, Islamic finance has attracted both interest and scepticism, partially because of the paucity of academic research on the subject – with Australia being no exception (Amin, 2007). However, the structural nature of some of these faith-based financial models can sit awkwardly with Australia’s tax system. For example, housing finance using an Islamic product is, in certain circumstances, structured more like a pre-determined fixed sum hire purchase agreement compared to an outright conventional purchase with payment of interest on the amount borrowed.

The need for research in this area is critical as some countries like the United Kingdom, Malaysia and Singapore, have introduced reforms to their finance and tax laws to recognise the use of and facilitation of Islamic finance. There have been calls in Australia for similar reforms to be considered as part of Australia’s quest to become a regional financial services hub (Bowen, 2009).

Juxtaposed between competitive forces among nations, it is important to consider whether Australia’s tax system is impeding the development of an emerging Islamic finance market. Also, given Australia’s multi-culturalism it is important to consider whether Australia’s legal system (including tax) can be broaden to ensure greater fairness between its citizens regardless of their faith.

While the idea of facilitating more faith-based transactions may seem economically rational – a fundamental question needs to be addressed – is it appropriate for Australia’s tax laws to be amended to facilitate other religions. This paper will explore this fundamental question before considering how this idea may be facilitated. This paper addresses the theoretical considerations of tax and religion and critically assesses the implications of Islamic finance in light of Australian constitutional law, tax neutrality and economic efficiency.

This full paper can be downloaded at:


[The authors would like to acknowledge the support of CPA Australia they have received as grant recipients through the 2009 CPA Global Research Perspectives Program]
INTRODUCTION
Recent developments in financial markets underline how religious concerns and practices influence tax reform and the transformation of ethical and banking practices in global finance. Such changes call for a closer look at tax reforms in ways that may produce tangible benefits to Australia in terms of trans-national banking cooperation, capital and investment flows and tax revenues. Given Australia’s stringent and prudential banking regulations and its pre-eminent position in financial markets, Australia has the potential to become the financial hub of South East Asia. However, this aspiration may be conditional on recognising faith-based financing alternatives. Indeed regulatory and tax changes are already in place and foreshadowed in other Western countries.

While the Australian Government is empowered to make laws for taxation under the Australian Constitution, there is also provision for the non-establishment of a state religion. More recently, much attention has been drawn on the ethical relationship between religion and taxation (Amin, 2007; McGee, 1998, 2004; McGee & Cohn, 2006; Murtaza & Ghazanfar, 1998; Schansberg, 1998) and between religion and the state (Ellis-Jones, 2007). Much of these debates centre around tenuous issues concerning the right of the state to tax, the tax preferential treatment of religious institutions and, the issue of what legally constitutes a religion.

What has not been argued in terms of taxation reforms is it appropriate or indeed legal for there to be consideration of financial transactions structured in a certain manner to ensure religious compliance? Indeed, is it impractical for all religions to be considered? Furthermore, given the goal of tax equity and neutrality, what are the implications if the policies underlying tax provisions (including concessions) do not apply equally to transactions entered into due to religious beliefs? In broader economic terms, is the application of Australian tax laws inhibiting or raising the costs of transactions for certain religious groups? That is, is it worthwhile for Australia to be more proactive to ensure its legal framework, particularly tax laws, do not unduly hinder transactions structured in different ways due to religious beliefs? Being aware of these issues, Australia could ensure that it is has a more ‘globalised’ tax framework and attract increased levels of diverse investments, not only from its own citizens but also foreigners with diverse religious backgrounds.

This paper will firstly consider recent calls for Australia to reform its tax laws to facilitate Islamic finance. The paper will then consider the historical relationship between law and religion taking into account the Australian perspective of this relationship. Thereafter, constitutional issues concerning this debate will be canvassed, initially by considering section 116 which provides, among other things, that there will be no establishment of a religion by the state, and then section 51(ii) which provides the Commonwealth the power to tax. Attention will be then focused on the direct relationship between these two provisions to consider their application to reforms for facilitating Islamic finance. Finally, it will be argued that tax reforms to facilitate Islamic finance are possible.
CALLS TO ENCOURAGE ISLAMIC FINANCE

Recently, there have been a number of government announcements highlighting the potential for Australia to tap into the Islamic finance market (Bowen, 2009; Australian Financial Centre Forum, 2009; Crean, 2010) akin to a model proposed by the United Kingdom Financial Services Authority1. It is worthy to note that the United Kingdom authorities have actively advanced this ambition ahead of other western governments by recently amending tax legislation.2 Such actions may be viewed as a tacit acceptance of financial market developments and innovations that Australia could also implement.

Islamic finance is estimated to be worth more than A$1 trillion (US$822 billion)3 – with growth estimated by the International Monetary Fund (IMF)4 at 10-15 per cent annually and expanding.5 Globally shariah-compliant assets are projected to reach US$1 trillion in 2010 and US$1.6 trillion by 2012.6 Currently, most Islamic financial services are facilitated through a combination of pure Islamic banks, conventional western banks with Islamic windows and hybrid institutions offering shariah-compliant banking and investments.7 A large proportion of Islamic finance activity is comprised of issuances through the Islamic bond (sukuk) market, with global sukuk issuances totalling US$30.94 billion in 2007 and US$23.6 billion in 20088. Under-utilised oil revenue, sovereign wealth institutions and private investment portfolios of high net-worth families and individuals (Adam & Thomas, 2005; Wilson, 2009) drive much of this capital market activity.

The current reach of Islamic finance in global capital and equity9 markets suggests there is potential for Australia through multi-lateral trade and financial services to facilitate Islamic finance expanding opportunities within and beyond Australia’s boarders. Potential economic benefits include, but are not limited to, Islamic bank operations in Australia; capital raising in foreign markets; managing, lead underwriting and maintaining books of shariah compliant securities for new issue; exporting specialist financial services, as well as conventional banks providing shariah-compliant investment and financing products across the Asia Pacific and Gulf regions. Also, investment in Australian assets and business by overseas shariah investors may be facilitated particularly from ‘petrodollar liquidity’ (Crean, 2010). This ‘petrodollar liquidity’ refers to oil rich nations’ domestic economies being too small to absorb all capital inflows from oil export revenues10 thereby giving them greater liquidity.11 Other

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3 The Banker, Top 500 Islamic Financial Institutions, November 2009.
10 However, Iqbal (2004, p. 2) argued that in relation to Islamic investment funds, there was a “massive reallocation of wealth [is] taking place”. He argues further that, in relation to Saudi Arabian investors, there is a particular preference for ‘Commodity’ funds where the aim “is to produce income for the investors, not capital
opportunities relate to services provided to, and investments made by, shariah-compliant managed funds. Demographically, the potential for Australia is accentuated by the fact that there are over a billion Muslims living in the Asia-Pacific region (Crean, 2010).

Currently, the major centres for Islamic finance include the United Arab Emirates, Bahrain and Malaysia (Haron & Wan Azmi, 2009, pp. 373-374). However, there is significant activity occurring in the United Kingdom, other parts of Europe, Africa and Indonesia.

Within Australia there is also a growing Muslim community, with 365,00012 Muslims, representing 1.7 per cent of the Australia’s population.13 Contextualised, there are approximately 1.57 billion Muslims world-wide representing approximately 23 per cent of the world’s population.14 It is estimates that Islamic finance represents a mere 1 per cent of global financial.15 It is because of this dichotomy that commentators consider that there is the potential for growth.16 These arguments are based on the emergence of a strong middle class, rising oil revenue and strong economic growth of the Gulf, demand from Muslim and non-Muslim investors and low penetration levels (Jaffer, 2006, pp.3-4). This is complimented by the ethical character and financial stability of Islamic products.

Briefly, the cornerstone to Islamic finance is compliance with the shariah (Islamic law) (Yaquby, 2005). Islamic jurisprudence is essentially common law derived from analogical deductions and precedents (El-Gamal, 2009, p. 27). The corpus of the shariah emanates from the canons namely, the Qur’an, the traditions (hadith) and consensus (Doi, 1984; Kamali, 2004). It explains the ethical concepts in use of money and capital; it establishes the boundaries between the lawful and the prohibited (al-Qaradawi, 1984); it defines the relationship between risk and profit (El-Gamal, 2009) and it sets out the social responsibilities of financial institutions (Vogel & Hayes, 1998; Usmani, 1998; 2006). This compliance with Shariah can result in transactions that can ‘economically’ achieve outcomes that are similar loan agreements – but legally structured differently (Ayub, 2007).

The norms that characterise Islamic finance prevalent in Islamic economics may be classified into two categories – a moral and ethical dimension and, an economic dimension (Ahmad, 1980; Chapra, 2005). The first deals predominantly with socio-economic justice and equitable distribution through tax by way of zakat (obligatory alms) and, the prohibition of trading in forbidden objects and hoarding (Usmani, 1998). The economic dimension incorporates a number of distinct elements identified by Obaidullah (2006, pp. 10-12) namely:17

- Freedom to contract (Qur’an 2:275; 4:29);

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17 These have also been identified by the Australian Financial Centre Forum as essential elements in Islamic finance. See: Australian Financial Centre Forum. (2009). Australia as a Financial Centre: Building on our Strengths. Barton: Commonwealth of Australia, at p 70.
- Freedom from *riba* (interest) (Qur’an 30:39; 4:161; 3:130-2; 2:275); 18
- *Gharar* or excessive speculation and uncertainty;
- Freedom from *al-qimar* (gambling) and *al-maysir* (unearned income);
- Trading and investment in forbidden acts and objects (such as gambling, pornography and alcohol);
- Duality of risk (parties must share risk); and
- Asset-based financial transactions. These are based on the condition that identifiable and tangible underlying assets should underpin financial transactions.

Among the financial products frequently referred to in Islamic financial contracts are: 19 the *murabaha* or (cost-plus transactions); 20 the *ijara* contracts (leasing contracts); 21 *mudaraba* contracts (trustee partnership); 22 *musharaka* contracts (forms of limited partnership); 23 *sukuk* (Islamic bonds) 24 and, *takaful* (mutual insurance arrangement). 25

The practical manifestation of these products in the marketplace is accomplished with the assistance of both shariah scholars and conventional legal practitioners (DeLorenzo & McMillen, 2007) 26 for guiding Islamic institutions to ensure compliance with the shariah through their financial activities. 27 For this reason, Islamic banks are required in many jurisdictions to establish Shariah supervisory boards or committees to ensure compliance with the shariah (Securities Commission Malaysia, 2004; AAOIFI Accounting, Auditing and Governance Standards, 2009).

Turning to Australia, its location within Asia-Pacific with its large Muslim population 28 combined with its political stability and prudential banking record provides a competitive advantage in facilitating greater penetration of Islamic finance. This is complimented by the

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18 The prohibition of interest constitutes one of the key principles of Islamic finance. Instead, the prohibition is replaced by a raft of financial alternatives underpinned by risk-sharing through partnership
20 A form of asset financing where an Islamic Finance Institution (IFI) purchases an asset and then sells it to its client at a higher price with deferred payments. (the higher price represents the interest that would normally be payable). Australian Trade Commission. (2010). Islamic Finance: Australian Trade Commission at p 8: A residential house would be purchased through a Murabaha contract. And banks can offer profit-sharing investment accounts to their customers.
21 Similar to a hire-purchase, the bank purchases the assets and allows the customer to use it for an agreed period and for an agreed rent.
22 A form of limited partnership where an investor (the silent partner) gives money to an entrepreneur for investing in a commercial enterprise. The profits generated by the investment are shared between the partners in a pre-determined ration. The losses are borne only by the investor.
23 A form of limited partnership where both partners in Musharaka must contribute capital to the partnership. Both partners or one of them may manage the venture or alternatively both may appoint a third party manager to manage the investment. While profits may be shared in a pre-determined ration, losses are shared in proportion to the capital contributed.
24 Shariah-compliant financial certificates of investment that are similar to asset-backed bonds.
25 Similar to a mutual insurance arrangement, a group of individuals pay money into a Takaful fund, which is then used to cover payouts to members of the group when a claim is made.
26 These authors provide an extensive review of the manner in which legal practitioners from both sides have collaborated in producing hybrid specimens of modern Islamic financial contracts. In a related article McMillen (2001) provides a detailed discussion of how he was able to sit with Islamic scholars in drafting a complex agreement for a multi-million petro-chemical project in Saudi Arabia
high recognition of Australia’s financial sector – with Australia’s financial system and capital market ranking second among 55 leading nations in 2009.29

However, there has been a conspicuous lack of enthusiasm within conventional banking to tack onto this emerging market. However, some tangible support did emerge in June 2009 when the NAB announced its intention to offer Islamic loans.30 Most recently, in February 2010 Westpac Banking Corp announced it would offer a commodity-trading facility aimed at overseas investors that operate in accordance with Islamic Law.31 However, this move does not address the Islamic retail and capital market. Nevertheless, for the Australian aspirations to be fully realised one of the supportive government policies has been stated to be:

  A level taxation, legal and regulatory playing field for Islamic and non-Islamic finance. Taxation must be responsive and enabling but non-preferential.32

But this raises the fundamental question: is it appropriate for reforms to be introduced facilitate or favour faith based financial transactions?

**RELATIONSHIP BETWEEN LAW AND RELIGION**

In the *Adelaide Company of Jehovah’s Witnesses Inc v Commonwealth* (1943) 67 CLR Latham CJ noted that ‘in the early history of mankind it was almost impossible to distinguish between government and religion’ and that a clear distinction only emerges relatively late in human development.33 However, Latham CJ acknowledged even in more modern times that ‘religious beliefs and practice cannot be absolutely separated either from politics or from ethics’.34 This sentiment is supported by Gleeson CJ who has written that:

  the separation between religion, morality, and law, which most people now take for granted, is relatively recent – although the division is not as clear cut as many people assume.35

Historically, the earliest courts in England were not courts of common law but ecclesiastical courts,36 with the development of the common law itself seen as being intimately bound up with Christian theology.37 Berman states:

  basic institutions, concepts, and values of Western legal systems have their sources in religious rituals, liturgies, and doctrines of the eleventh and twelfth centuries, reflecting new attitudes toward death, sin, punishment, forgiveness, and salvation, as well as new assumptions concerning the relationship of the divine to the human and of faith to reason. Over the intervening centuries, these religious attitudes and assumptions have changed fundamentally, and today their theological sources seem to be in the process of drying up38

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33 *Adelaide Company of Jehovah’s Witnesses Inc v Commonwealth* (1943) 67 CLR Latham CJ at p 125
The relationship between law and religion has not always been pleasant. It has been observed that Christianity has been used and abused, by Western law to ‘produce profoundly negative outcomes for individuals and groups’.  

Such abuse led to the Enlightenment against irrational passion leading to trying to break the extent of the link between law and religion. Whether this ‘break’ is fully achieved is questionable, as a legal system that purports to be secular can lead to a complex and controversial relationship. Part of the problem is that the division between religion, legal and political philosophy cannot be neatly maintained in the real world. For example, blasphemy continues to be an offence in the United Kingdom and its Christianity focus has been upheld as the offence does not apply to other religions. While in Australia blasphemy has been largely repealed from such things as film regulations, it is argued that there is still a religious influence in Australian law.

In Australia

Chief Justice Gleeson has observed that Australians would not expect [Australian] law to enforce religious doctrine, as Australia is seen as being a multicultural society, which necessarily involves a multiplicity of values, including religious and moral values. The public perception of the separation between law (state) and religion was exemplified earlier in Australia’s federalism as a petition was said to have been signed by 30,000 Australians protesting against Australia’s first Prime Minister, Edmund Barton, paying a courtesy call on the Pope in Rome while returning from a visit to London.

Nevertheless religious influence can exist, albeit indirect at times, on various aspects of civil and criminal law, and largely by way of religious influence on morality.

Puig and Tudor argue that ‘Australian constitutionalism does not have a strict separation of state and religion, particularly when compared with that found in other nations, such as the

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43 Blake, G. (2007). Promoting religious tolerance in a multifath society: Religious vilification legislation in Australia and the UK. The Australian Law Journal 81:386, at p 387-388: In the UK blasphemy and blasphemous libel are common-law offences triable on indictment and publishable by fine or imprisonment [it continues to exist today] [at p 388 per R v Chief Metropolitan Magistrate, ex parte Choudhury (the Satanic verses case) [1991] 1 QB 429 at pp. 439-447 offence of blasphemy is only applicable to Christianity. There have been unsuccessful attempts to repeal the offence in the UK.
44 Blake, G. (2007). Promoting religious tolerance in a multifath society: Religious vilification legislation in Australia and the UK. The Australian Law Journal 81:386, at p 389: previously there was references to the term ‘blasphemous’ in federal legislation (Australia) [such as the Customs (Cinematograph Films) Regulations 1956 (Cth) (repealed), reg 13 prohibited the Censorship Board from registering imported films and advertising matter which were, inter alia, blasphemous. Blake, G. (2007). Promoting religious tolerance in a multifath society: Religious vilification legislation in Australia and the UK. The Australian Law Journal 81:386, at p 390: The offence was abolished in Queensland in 1899.
United States’. Mortensen argues that notwithstanding appeals to the contrary, in the Australian polity, integration as opposed to separation of churches (religions) and state is the norm. Integration finds expression in ‘an anti-discrimination principle by which citizens have equal rights to bring their religious beliefs into the public square and government’s only role is to deal even-handedly between them’. This lack of a ‘wall of separation’ between religion and state is likely to continue given the courts’ interpretation of constitutional provisions dealing with religion.

These conclusions can be supported by legislative (in)action concerning same sex union and the meaning of ‘marriage’. Brennan concludes that same sex union in Australia confirms separation between state and religion may be more of the soft than the hard variety. Chief Justice Gleeson uses the example of the unlawfulness of bigamy to provide a good example of the influence of religion has had, and continues to have, on the law. He argues that ‘it is difficult to explain why bigamy is criminal, even though no deception is involved, except by reference back to religious doctrine’.

This influence of religion is illustrated by the existence at the beginning of the Australian Constitution of a preamble which has been described as a ‘constitutional obeisance to God’. The preamble reads:

WHEREAS the people of New South Wales, Victoria, South Australia, Queensland, and Tasmania, humbly relying on the blessing of Almighty God, have agreed to unite in one indissoluble Federal Commonwealth.

It appears that part for the reasoning of the wording of the preamble was to appeal to and gain support of those voters of religious conviction for the formation of a Federation. However, those opposed to the insertion of the religious overtones in the preamble then sought the introduction of section 116 to provide some religious safeguards. This paper will later analyse the extent to which section 116 has been effective in providing religious guarantee.

Another very clear connection between the Australian parliament and religion are the current standing orders for both the House of Representatives\(^{56}\) and the Senate which state that each sitting is to begin with two prayers – one a prayer for Parliament and the other the Lord’s Prayer.\(^{57}\) This practice of prayer commencing parliamentary sittings is not unique to Australia, as other common law jurisdictions such as New Zealand, Canada, the United Kingdom and the United States also do this.\(^{58}\) The Lord’s Prayer in Australia has been clearly identified as Anglican in terms of denomination affiliation.\(^{59}\) Puig and Tudor have concluded that while the saying of the Parliamentary prayer is technically constitutional they question whether it is [morally] appropriate.\(^{60}\)

This is not to say that there is not an awareness of or active steps taken to ensure greater inclusiveness of people with different backgrounds in Australia. For example, legislation in each of the Australian jurisdictions, apart from the Commonwealth and the Northern Territory, makes racial vilification unlawful and/or creates an offence of racial vilification.\(^{61}\) However, only the jurisdictions of Queensland, Tasmania and Victoria have enacted ‘religious’ vilification legislation, with similar legislation having been rejected in NSW, WA and SA.\(^{62}\) However, it has been observed that there is very little in Australia’s constitution that demands such separation between state and religion.\(^{63}\)

It is argued that it would be naïve to consider that Australia’s dominate religion has not permeated in part Australia’s legal system – including tax laws. For example, this religious influence can be indirect, such as the facilitation of legal relationships that are in accordance (or not in conflict) with it. It is not argued that there is an overt intent to discriminate on religious beliefs. Nevertheless, it is argued that Australia’s legal system (which is historically influenced by Christianity) can sit awkwardly with Australians of different religious, or no religious, beliefs. This religious influence is more acute now because, while previously there may have been greater congruency between Australia’s legal system and religious beliefs due to largely a homogenous population – over the last century Australia has actively encouraged immigration resulting in a larger ethnic mix with different religious beliefs (greater heterogeneity). Despite this ‘blurring’ practically it has been stated that generally, the expectation is that ‘religion will not play a central role in the affairs of the state and vice versa’.\(^{64}\)

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\(^{56}\) Standing Order 38 for the House of Representatives, and Standing Order 50 for the Senate.

\(^{57}\) Puig, GV, and S Tudor. (2009). To the advancement of thy glory?: A constitutional and policy critique of parliamentary prayers. PLR 20:56 - 78.


\(^{60}\) Puig, GV, and S Tudor. (2009). To the advancement of thy glory?: A constitutional and policy critique of parliamentary prayers. PLR 20:56 - 78.


\(^{63}\) Puig, GV, and S Tudor. (2009). To the advancement of thy glory?: A constitutional and policy critique of parliamentary prayers. PLR 20:56 – 78, at p 70.

\(^{64}\) Puig, GV, and S Tudor. (2009). To the advancement of thy glory?: A constitutional and policy critique of parliamentary prayers. PLR 20:56 – 78, at p 70.
**Special tax treatment of religious institutions**

A clear example of the influence of religion and the provision of preferential treatment are the tax concessions available to religious organisations. For example, section 50-5 *ITAA 1997* exempts from tax the income of charitable, religious, scientific or public educational institutions.

In recent years much attention has been drawn on the relationship between religion and taxation (McGee, 1998, 2005; McGee & Cohn, 2008; Murtaza & Ghazanfar, 1998; Schansberg, 1998) and between religion and the state (Ellis-Jone, 2007; Fox, 2006; Fox & Sandler, 2005). These debates in the main, centre around tenuous issues on the rights of the state to tax; the tax preferential treatment of religious institutions and, what constitutes religion.

However, despite legal efforts, historically there has been no attempt to alter Australia’s legal systems to find tax structures that deliver clear outcomes for the state and religious institutions (Perkins & Gomez, 2009). The latter argue that the present tax dispensation is ‘archaic and inequitable’; that it does not reflect present-day realities in the marketplace; that religious tax exemptions impose cost imposts on the public generally and, the benefits are for the purpose of advancing religion and not the national interest (Perkins & Gomez, 2009, p. 6). These sentiments are based on the premise that Australia as a secular state, there is no need to advance any religion. Very recently, Carling (2010) in arguing for reform of Australia’s tax law also questioned loss of fiscal revenue through generous exemptions.

Further, non-religious groups argue that s116 of the Constitution was intended to make Australia a secular state and that that reality ought to be reflected in denying preference to religion in tax exemptions and other privileges. They rely on the argument advanced by Murphy J that:

> The crushing burden of taxation is heavier because of exemptions in favour of religious institutions, many of which have enormous and increasing wealth.

The rejoinder to the denial argument adopts a different line of reasoning preferring that Australia should be construed as a ‘pluralistic society rather than a secular one, if by ‘secular’ one means a society where there is no place for religion’. Further, religious institutions relying heavily on tax concessions, fill a raft of charitable obligations aimed at promoting human wellbeing – many of which fall outside the remit of state social services. But even here, tax laws for promoting non-religious activities by non-profit organisations have been

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65 The Atheist Foundation of Australia, June 24, 2008, *Response to the Hon Wayne Swan’s Press Release number 36 regarding Australia’s future tax system*. However, many submissions have been made to the Henry review on *Australia’s Future Tax System* by other interest groups that take a different view to that espoused by the Atheist Foundation. A more detailed discussion is to founded at: http://taxreview.treasury.gov.au/content/submission.aspx?round=1

66 For example exemptions from stamp duty, pay-roll tax and municipal rates

67 Murphy J, in *Church of the New Faith v Commissioner of Payroll Tax (Vic)* 14 ATR 794

68 For instance, the commercial operations of Sanitarium Food Company controlled by The Seventh Day Adventist Church

69 Fr Brian Lucas *Modernising Charity Law Religion - Some Comments*, paper presented at the Queensland University of Technology 18 April, 2009 conference on *Modernising Charity Law*. What is also significant in this debate is the role of the ‘third sector’ – a non-profit sector in relation to the Government and the Business sectors whose primary function is the promotion of activities that lead to important social and economic outcomes. In recognition of the importance of this sector, the UK government established the Office of Third Sector in 2006 – its Australian equivalent being the Ministry of Social Inclusion.
found to be complex and confusing (Keating, 2007, p. 32)\textsuperscript{70} and not easily accorded tax exempt status.\textsuperscript{71} This tension was recognised by Kirby J (dissenting) in \textit{FCT v World Investments}:

A taxation exemption for religious institutions, so far as it applies, inevitably affords effective economic support from the Consolidated Revenue Fund to particular religious beliefs and activities of some individuals. This is effectively paid for by others. … a cross-transference of economic support. The courts must recognise that this is deeply offensive to many non-believers, to people of different faiths and even to some people of different religious denominations who generally share the same faith.\textsuperscript{72}

Kirby J (supra) went on to emphasise the importance of equity between Australian taxpayers: charitable and religious institutions should share with other Australian taxpayers the liability to pay income tax upon their income. Exemption needs to be clearly demonstrated as conformable to law.\textsuperscript{73}

The ethical arguments on tax exemptions from both sides are, by and large, outside the remit of the law. Tax law simply is there to promote equity but may, in doing so, at times confer privileges to religious and non-profit institutions but only to the extent of ensuring that those institutions promote social harmony through public benevolence. In so doing, tax law is incapable of capturing every aspect of revenue loss through the tax net through strict application of tax concessions. The reason tax law accords privileged status to religion can be traced back historically and has for that reason been termed ‘archaic’ by Perkins and Gomez (2009). Consider for example, present tax codes on charitable donations. These, according to Keating (2007), are based on the \textit{Statute of Elizabeth of 1601} and recognise ‘four classes of charity: relief of the afflicted, advancement of religion, advancement of education and other purposes beneficial to the community’.\textsuperscript{74} While one may sympathise with the archaic reasoning, particularly the importance of charitable work, there is a compelling case for reform of tax law to stamp out exploitive opportunism (Keating, 2007, p. 32).

\begin{center}
\textbf{What is a religion?}
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An issue that arises within this discourse is: what is ‘religion’ and how it is defined. This issue featured very prominently in the well-known High Court case \textsuperscript{75} \textit{Church of the New Faith v Commissioner of Pay-Roll Tax (Vic)} (1983) 14 ATR 769 (the \textit{Scientology} case). Chief Justice Masson and Brennan J held:

For legal purposes the criteria of religion are twofold: first belief in a supernatural being, thing or principal; second, the acceptance of canons of conduct in order to give effect to that belief, though canons of conduct which offend against the ordinary laws are outside the area of any immunity, privilege or right conferred on the grounds of religion\textsuperscript{76}

The High Court decision was a reversal of an earlier decision by Crockett J in the Supreme Court of Victoria dismissing the plaintiffs’ appeal holding ‘that the taxpayer’s religious


\textsuperscript{71} \textit{Federal Commissioner of Taxation v Word Investments Ltd} [2006] FCA 1414

\textsuperscript{72} \textit{Federal Commissioner of Taxation v Word Investments Ltd} [2006] FCA 1414, at p 250.

\textsuperscript{73} \textit{Federal Commissioner of Taxation v Word Investments Ltd} [2006] FCA 1414, at p 250.

\textsuperscript{74} Report by the Asia-Pacific Centre for Philanthropy and Social Investment. “Encouraging Wealthy Australians to be More Philanthropic”. A report for the Petre Foundation 4 February 2005 p. 39

\textsuperscript{75} Commonly referred to as the ‘Scientology’ case Ellis-Jones (2007, p. xviii)

\textsuperscript{76} (1983) 14 ATR 769 at 769
pretentions were a sham’. Those ‘pretentions’ were precisely the grounds (or canons of conduct) relied upon by the Church of New Faith seeking exemptions from pay-roll tax. On a closer reading of the judgement, the second criteria of ‘canons of conduct’ suggests that, provided the canons are not ‘offensive’ as the learned judges Mason and Brennan observed, other faiths may adduce greater flexibility in their religious convictions to qualify for tax exemptions. It is therefore understandable that Latham CJ held very early in the Jehovah Witnesses case that ‘it would be difficult, if not impossible, to devise a definition of religion which would satisfy the adherents of all the many and various religions that exists’. In terms of the focus of this paper, there would be little doubt that Islam would be readily accepted as demonstrating the indicia of religion.

**INTERPRETATION OF SECTION 116 CONSTITUTION**

In terms of the Australian constitution, section 116 is the pivotal section in setting out the relationship of state (being the Commonwealth of Australia) and religion. Section 116 specifies:

> The Commonwealth shall not make any law for establishing any religion, or for imposing any religious observance, or for prohibiting the free exercise of any religion, and no religious test shall be required as a qualification for any office or public trust under the Commonwealth.

On a closer reading, this section provides four guarantees in relation to religion – three of which are influenced by the First Amendment of the United States’ Constitution. However, only two of the four guarantees have been subjected to interpretation by the High Court, they being: (a) The Commonwealth shall not make any law for establishing any religion; and (b) The Commonwealth shall not make any law for prohibiting the free exercise of any religion. However, both of these interpretations have narrowed the potential operation of section 116 which is dealt with separately below.

*The Commonwealth shall not make any law for establishing any religion*

In terms of ‘establishing’ any religion, the High Court has interpreted this to mean that the Commonwealth is prohibited from enacting laws to set up a religion as the official religion of the country. This means that even if the Commonwealth makes laws that favour one religion over another, this will not necessarily breach section 116.

Barwick CJ framed what the prohibition on ‘establishment’ means in *Attorney-General (Vic): Ex re Black v Commonwealth* (1981) 146 CLR 559:

> Establishing a religion involves the entrenchment of a religion as a feature of and identified with the body politic … It involves the identification of the religion with the civil authority so as to involve the citizen in a duty to maintain it and the obligation of … the Commonwealth.

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77 (1983) 14 ATR 769 at 769
78 (1943) 67 CLR 116
82 Referred to at the DOGS Case.
83 *Attorney-General (Vic): Ex re Black v Commonwealth* (1981) 146 CLR 559, per Barwick CJ, at p 582.
In the same decision, Stephen J explained it in the following way:

[T]o speak of a religion being established by laws of a country may well be to include much more than the act of according material recognition and status to a set of beliefs, a system of moral philosophy or particular doctrines of faith; it would certainly include the recognition of a particular religion or sect, with its priestly hierarchy and tenets, as that of the nation.\(^{84}\)

It appears that in interpreting section 116 the use of the word ‘for’ has been seen as critical as observed by Sundberg J in *Halliday v the Commonwealth of Australia* [2000] FCA 950:

In *Attorney-General (Vic); Ex re Black v The Commonwealth* (1981) 146 CLR 559 several members of the court considered the import of the word ‘for’ in the expression ‘for establishing any religion’. Barwick CJ (at 583) thought that the word indicated that the law must be intended and designed to set up the religion as an institution of the Commonwealth. Gibbs J (at p 598) said the word ‘for’ looked to the purpose of the law rather than to its relationship with a particular subject matter…Mason J (at p 615-616) was of the view that ‘for’ connoted a connection by way of purpose or result with the subject matter which was not satisfied by the mere fact that the law touches or relates to the subject matter…..There is no reason to think that the meaning attributed to ‘for’ in the expression ‘for establishing any religion’ should not apply to the word in the expression ‘for prohibiting the free exercise of any religion’.\(^{85}\)

However, some see the use of the word ‘for’ more of grammatical necessity in the initial drafting of the provision rather than imposing a particular meaning.\(^{86}\)

*The Commonwealth shall not make any law for prohibiting the free exercise of any religion*

In terms of the second guarantee considered by the High Court, the ‘free exercise’ provision has also been interpreted narrowly. The provision was specifically considered by Griffith CJ in *Krygger v Williams* (1912) 15 CLR\(^{87}\):

To require a man to do a thing which has nothing to do with religion is not prohibiting him from a free exercise of religion. It may be that a law requiring a man to do an act which his religion forbids would be objectionable on moral grounds, but it does not come within the prohibition of s116\(^{88}\)

It was observed in *Adelaide Company of Jehovah’s Witnesses Inc v Commonwealth* (1943) 67 CLR that all religions are potentially covered by the provision:

Section 116 applies in express terms to “any religion”, any “religious observance”, the free exercise of “any religion” and any “religious test”. Thus the section applies to all religions.\(^{89}\)

The courts in interpreting section 116 have also tried to reconcile and balance religious freedom with ability of governments to govern and maintain an ordered society. This is clearly evident in the sentiment expressed by Latham CJ in the *Jehovah’s Witnesses* case:

Can any person, by describing (and honestly describing) his beliefs and practices as religious exempt himself from obedience to the law?...The complete protection of all religious beliefs might result in the disappearance of organized society, become some religious beliefs…regard the existence of organized society as essentially evil…\(^{90}\)

\(^{84}\) Attorney-General (Vic); Ex re Black v Commonwealth (1981) 146 CLR 559, per Stephen J at p 606.

\(^{85}\) *Halliday v the Commonwealth of Australia* [2000] FCA 950, per Sundberg J at p 463.


\(^{87}\) This case concerned the provision of the Defence Act 1903 Cth imposing obligations on all make inhabitants of the Commonwealth in respect of military training do not prohibit the free exercise of religion.

\(^{88}\) *Krygger v Williams* (1912) 15 CLR, per Griffith CJ at 369.

\(^{89}\) *Adelaide Company of Jehovah’s Witnesses Inc v Commonwealth* (1943) 67 CLR, per Latham C, at 123.

\(^{90}\) *Adelaide Company of Jehovah’s Witnesses Inc v Commonwealth* (1943) 67 CLR, per Latham CJ, at p 132.
Latham CJ referred to the jurisprudence that had already been established in the United States concerning the free exercise of religion which did not allow religious practices to excuse breaches of the criminal law. An example referred was that a Mormon could not use his religious beliefs of polygamy to excuse himself from the criminal law against such acts.

The approach of the High Court is that this right of ‘religions freedom’ is not absolute, the reasoning being ‘religion is so broad a political and ethical concept that it is liable to be misinterpreted to include objectionable, if not otherwise illegal, rituals and practices’. To this end the High Court may ‘take the general interest into account’, and that if a law has general application then that law is not likely to infringe the right of free exercise. That is, the court has balanced the competing public interests of freedom of religion and the regulation of an organised society. Justice Williams framed this balancing act as:

[T]he meaning and scope of the [the Constitution, s116] must be determined, not as an isolated enactment, but as one of a number of sections interrelated to provide in their inter-relation a practical instrument of government, within the framework of which laws can be passed for organising the citizens of the Commonwealth in national affairs into a civilised community, not only enjoying religious tolerance, but also possessing adequate laws relating to those subjects upon which the Constitution recognises that the Commonwealth Parliament should be empowered to legislate in order to regulate its internal and external affairs.

For example it has been held (in obiter) that a law overriding the confidentiality of religious confessions is not a law prohibiting the free exercise of religion. In *Kruger v Commonwealth* (1997) 190 CLR 1 Chief Justice Brennan stated that for a law to breach the right of freedom expressed in section 116 there had to be a clear intent. That is, ‘[t]o attract invalidity under s 116, a law must have the purpose of achieving an object which s 116 forbids’. Consequently, a law which just ‘incidentally affects that freedom’ will be not be invalid due to section 116.

For example, the refusal of permanent resident status to a person who had come to Australia to take up the position of the Imam of a mosque was held not be a decision to prohibit the free exercise of religion – even though it was acknowledged there would be some ‘disruption of worship’. Indeed it appears that section 116 has been interpreted more as proclaiming tolerance for different religions, as well as the right for an absence of religious belief.

Hogan has observed that:

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92 Reynolds v United States (1878) 98 US 145.
96 Adelaide Co of Jehovah’s Witnesses Inc v Commonwealth (1943) 67 CLR 116, per Williams J, at p 159.
97 SDW v Church of Jesus Christ of Latter-Day Saints [2008] NSWSC 1249: Simpson J.
98 Kruger v Commonwealth (1997) 190 CLR 1, per CJ Brennan, at p 40.
99 Kruger v Commonwealth (1997) 190 CLR 1, per Gaudron J at p 133-134.
100 Minister for Immigration and Ethnic Affairs v Lebanese Moslem Association 17 FCR 373, Fox, Burchett and Jackson JJ.
The constitutional standing of the relationship between church and state in Australia is a unique mixture of elements derived from a British Constitution and tradition of law, from a superimposed American principle of separation, and from the evolving pattern of Australian federalism and judicial interpretation.102

Due to the interpretation the High Court has accorded to section 116 it may be concluded that it is not a guarantee of an individual civil right, instead it should be seen as a regulator of Commonwealth power.103 Even though the distinction may seem to be a mere syntax, the result is profound, as noted by Stephen J in Attorney-General (Vic); Ex re Black v Commonwealth (1981) 146 CLR 559, per Stephen J held (at p 609):

\[\text{that s116 did not comprise} \] some broad statement of principle concerning the separation of church and state, from which may be distilled the consequences of such separation.104

However, Latham CJ in the Jehovah’s Witnesses case did specify the importance of section 116 for minority religions – as ‘the majority …can look after itself’:

Section 116 is required to protect the religion (or absence of religion) of minorities, and, in particular, of unpopular minorities.105

Kirby J (dissenting) in Federal Commissioner of Tax v World Investments Ltd (2008) 236 CLR 204 while acknowledging the narrow interpretation given to section 116 stated:

… for clear historical reasons, the secular character of the Commonwealth and its laws and the separation of the governmental and religious domains constitute settled features of constitutionalism in this country ...106

Nevertheless the extent of the reach of section 116 is clearly articulated by Rich J in Church of New Faith v Commissioner for Payroll Tax (Vic) (1983) 154 CLR 120:

Freedom of religion is not absolute. It is subject to powers and restrictions of government essential to the preservation of the community. Freedom of religion may not be invoked to cloak and dissemble subversive opinions dangerous to the Commonwealth.107

Given that it has been established that section 116 has been interpreted narrowly in terms of separating state and religion – for tax reforms to occur to facilitate Islamic finance would the Commonwealth’s power to tax be sufficient?

**POWER TO ‘TAX’ UNDER SECTION 51**

A key issue to facilitate Islamic finance in Australia is the need for tax reform. The primary power that the Commonwealth would rely on would be section 51(ii) which specifies that:

The [Commonwealth] Parliament shall ... have power to make laws with respect to ... (ii) Taxation; but not so as to discriminate between States or parts of States”.108

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103 Puig, GV, and S Tudor. (2009). To the advancement of thy glory?: A constitutional and policy critique of parliamentary prayers. PLR 20:56 - 78, at p 64.
104 Attorney-General (Vic); Ex re Black v Commonwealth (1981) 146 CLR 559, per Stephen J, at p 609.
105 Adelaide Company of Jehovah’s Witnesses Inc v Commonwealth (1943) 67 CLR Latham CJ at p 124. The learned judge further identified that s116 protects not only opinion, but also acts done in pursuance of religious beliefs.
107 Church of New Faith v Commissioner for Payroll Tax (Vic) (1983) 154 CLR 120, per Rich J, at p 149-150.
108 Commonwealth of Australia Constitution Act (Cth), section 51(ii).
The taxing power given to the Commonwealth has been described as being very broad. Indeed, Isaacs J (dissenting) in *R v Barger (1908)* 6 CLR 41 described it in the following way:

The unlimited nature of the taxing power is … incontestable. Its exercise upon all persons, things and circumstances in Australia is, in my opinion, unchallengeable by the Courts, unless … a judicial tribunal finds it repugnant to some express limitation or restriction.\(^{109}\)

Barton J identified that it was possible for such a taxing power ‘when exercised to the full it may destroy the interest or the industry taxed’.\(^{110}\) Due to its width, the Commonwealth can select any criteria it chooses to impose tax. Indeed cases have indicated that the purpose or motive of the legislature or even the economic consequences of tax legislation have no relevance.\(^{111}\)

The broad interpretation of the Commonwealth’s tax power has been stated as part of the reason for the Commonwealth’s dominance over finance, including the federal government’s assumption of control over income taxation in 1942,\(^{112}\) which confirmed that the Commonwealth could give itself priority for payment of tax over the states.\(^{113}\)

The early High Court decision of *R v Barger (1908)* 6 CLR 41 construed the power subject to the ‘reserve powers’ doctrine.\(^{114}\) This meant that an Act imposing a tax on the products of a manufacturer unless the manufacturer offered its employees fair conditions of employment could be constitutionally invalid. However this reserve power doctrine has been subsequently repudiated by later High Court decisions.\(^{115}\) For example, later the High Court upheld the validity of Commonwealth laws which used land tax to break up large concentrations of land.\(^{116}\)

In the *Fairfax* case,\(^{117}\) Kitto J endorsed the opinion expressed in the United States Supreme Court in *US v Sanchez (1950)* US 42 at p 44:

> that a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the activities taxed...Nor does a statute necessarily fall because it touches on activities which Congress might not otherwise regulate.

This is because the High Court traditionally focuses upon a law’s direct legal effect, rather than its indirect or economic consequences in characterising laws for constitutional purposes.\(^{118}\) The decision in *Fairfax* has been stated as recognising that the taxation power is not limited to the raising of revenue for government purposes. Indeed a wide range of

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\(^{109}\) *R v Barger (1908)* 6 CLR 41, per Isaacs J (dissenting), at pp 94-95.

\(^{110}\) *Osborne v Commonwealth (1911)* 12 CLR 321, per Barton J, at p 345.


\(^{113}\) Guy, S. (2010). *Constitutional Law*. Frenchs Forest: Pearson Australia, at p 318: Similarly the court held [in the First Uniform Tax Case] that section 221 of the Income Tax Assessment Act 1936 (giving priority to the Commonwealth in the payment of income tax) was also a law with respect to taxation and therefore supported by s 51(ii)\(^{11}\).


\(^{117}\) *Fairfax v FCT (1965)* 114 CLR 1, per Kitto J, at p 13.

objectives – fiscal, social and economic may be achieved through ‘tax’ legislation.\textsuperscript{119} For example, the High Court has upheld the validity of a scheme designed to encourage higher levels of investment in Commonwealth securities.\textsuperscript{120}

In \textit{MacCormick v FCT (1984)} 158 CLR 622, Brennan J held that the section 51(ii) power:

\begin{quote}
extends to any form of tax which ingenuity may devise’ [and] ‘the Parliament may select such criteria as it chooses, subject to any express or implied limitations prescribed by the Constitution, irrespective of any connection between them.\textsuperscript{121}
\end{quote}

Indeed ‘politics’ has been stated as a greater practical restriction on tax legislation rather than legal, provided the constitutional boundaries are not infringed:\textsuperscript{122}

\begin{quote}
under s51(ii) the Parliament has, prima facie, power to tax whom it chooses ... exempt whom it chooses ... [and] impose such conditions as to liability or as to exemptions as it chooses.\textsuperscript{123}
\end{quote}

Guy argues that an expansive approach in the exploitation of its limited legislative powers is illustrated by Kitto J invoking the seminal proposition of Dixon J in \textit{Melbourne v Commonwealth (1947)} 74 CLR 31:\textsuperscript{124}

\begin{quote}
Speaking generally, once it appears that a federal law has an actual and immediate operation within a field assigned to the Commonwealth as a subject of legislative power, that is enough. It will be held to fall within the power unless some further reason appears for excluding it. that it discloses another purpose and that the purpose lies outside the area of federal power are considerations which will not in such a case suffice to invalidate the law.\textsuperscript{125}
\end{quote}

All put another way:

\begin{quote}
If a law, on its face, is one with respect to taxation, the law does not cease to have that character simply because Parliament seeks to achieve, by its enactment, a purpose not within Commonwealth legislative power.\textsuperscript{126}
\end{quote}

Nevertheless, to fall within this broad head of power the legislation must be enacting a ‘tax’. Tax has been stated to be ‘a compulsory exaction of money by a public authority for public purposes enforceable by law’.\textsuperscript{127} An earlier interpretation referred to tax as ‘the process of ‘raising money for the purposes of governments by means of contribution from individual persons.’\textsuperscript{128}

In \textit{MacCormick v FCT; Camad Investments Pty Ltd v FC of T (1983-1984)} 158 CLR 622, Gibbs CJ, Wilson, Deane and Dawson JJ in the High Court identified the following six characteristics of a ‘tax’. Firstly, it is a compulsory payment and secondly, the moneys are raised for government purposes. Thirdly, the moneys do not constitute fees for services rendered and next the payments are not penalties. Fifthly, the exactions are not arbitrary or capricious; and finally, the exaction should not be incontestable. The importance of

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\textsuperscript{120} \textit{Fairfax v FC of T (1965)} 114 CLR 1.
\textsuperscript{121} \textit{MacCormick v FCT (1984)} 158 CLR 622, per Brennan J, at p 655.
\textsuperscript{122} \textit{Woellner, RH, S Barkoczky, S Murphy, C Evans, and D Pinto. (2010). \textit{Australian Taxation Law}. 20 ed. Sydney: CCH Australia Limited, at p 67-68.}
\textsuperscript{123} \textit{Fairfax v FC of T (1965)} 114 CLR 1, at p 16 Taylor J, and Kitto J at p 12-13.
\textsuperscript{125} \textit{Melbourne v Commonwealth (1947)} 74 CLR 31, per Dixon J, at p 79. Known as the ‘State Banking Case’.
\textsuperscript{126} \textit{Northern Suburbs General Cemetery Trust v Commonwealth (1993)} 176 CLR 555 at p 589 per Mason CJ, Deane, Toohey and Gaudron JJ.
\textsuperscript{127} \textit{Matthews v The Chicory Marketing Board (Vic) (1938)} 60 CLR 263; at p 276 Latham CJ; applied by Gibbs J in \textit{The State of Victoria v The Commonwealth (1971)} 122 CLR 353, at p 416.
\textsuperscript{128} \textit{R v Barger (1908)} 6 CLR 41, at p 68 per Griffith CJ, Barton and O’Connor JJ.
\end{flushright}
classifying whether a law involved a ‘tax’ – as opposed to a fee for service – was illustrated in *Air Caledonie International v Commonwealth* (1988) 165 CLR 462 which concluded that immigration fees for arriving passengers in Australia was a tax and not a fee for service.

However there are some direct constitutional restrictions on the Commonwealth’s taxation power, and they relate to the non-discrimination of states;\(^\text{129}\) the non-preference of states;\(^\text{130}\) laws imposing tax should only deal with tax and not other matters;\(^\text{131}\) the senate is not to introduce or amend tax legislation;\(^\text{132}\) and, the Commonwealth cannot impose tax on state property.\(^\text{133}\)

Other provisions that are in part relevant is that the Commonwealth must acquire property on just terms,\(^\text{134}\) that the Commonwealth has exclusive power in property acquired by it,\(^\text{135}\) and that states are prohibited imposing duties of excise, customs and bounties.\(^\text{136}\)

**WHAT IS THE RELATIONSHIP BETWEEN S 116 AND S 51?**

Even though section 116 has been interpreted narrowly, there is judicial commentary to indicate that section 116 is an ‘overriding provision applicable to all instruments of laws’.\(^\text{137}\) As Latham CJ in the *Jehovah’s Witnesses* case phased it:

> It [section 116] prevails over and limits all provisions which give power to make laws. Accordingly, no law can escape the application of s 116 simply because it is a law which can be justified under s51 or s52 …\(^\text{138}\)

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\(^{129}\) Woellner, RH, S Barkocy, S Murphy, C Evans, and D Pinto. (2010). *Australian Taxation Law*. 20 ed. Sydney: CCH Australia Limited, at p 60: section 51(ii) has been interpreted as prohibiting direct legal discrimination, not indirect/consequential discrimination in the law’s operation: it does not matter that is practical operation will disadvantage some taxpayers in particular locations. *WR Moran Pty Ltd* (1940) 63 CLR 338.

\(^{130}\) Woellner, RH, S Barkocy, S Murphy, C Evans, and D Pinto. (2010). *Australian Taxation Law*. 20 ed. Sydney: CCH Australia Limited, at p 61: section 99 of the *Commonwealth of Australia Constitution Act* (Cth) complements s 51(ii) by prohibiting the giving of a tax preference, and there is unlikely to be a significant difference in practical operation between discrimination and preference: *James v Commonwealth* (1928) 41 CLR 442.

\(^{131}\) *Commonwealth of Australia Constitution Act* (Cth), section 55: “Laws imposing taxation shall deal only with the imposition of taxation, and any provision therein dealing with any other matter shall be of no effect” This provisions seeks to protect the Senate due to its restricted powers in terms of taxation and section 55 is designed to ensuring that ‘tacking’ does not occur. Laws relating to the assessment and collection of tax, such as the ITAA, are not ‘laws imposing taxation’ in the sense that is used in s 55: *Osbourne v Commonwealth* (1911) 12 CLR 321 and confirmed in *FCT v Munro* (1926) 38 CLR 153.

\(^{132}\) *Commonwealth of Australia Constitution Act* (Cth), section 53 provides that laws imposing taxation may not be introduced or amended by the Senate – although the Senate may return such laws to the House of Representatives with a request of amendments or omissions.

\(^{133}\) *Commonwealth of Australia Constitution Act* (Cth), section 114: the states are prohibited from imposing tax on property of any kind belonging to the Commonwealth without the Commonwealth’s prior consent, and the Commonwealth is not to impose any tax on property of any kind belonging to a state.

\(^{134}\) *Commonwealth of Australia Constitution Act* (Cth), section 51(xxxi): Commonwealth power to acquire property ‘on just terms from any State or person in respect of which the Parliament has power to makes laws’.

\(^{135}\) *Commonwealth of Australia Constitution Act* (Cth), section 52(i): gives the Commonwealth Parliament exclusive power to make laws with respect to the seat of government and all places acquired by the Commonwealth for public purposes.

\(^{136}\) *Commonwealth of Australia Constitution Act* (Cth), section 90: prohibits the states (and territories) from imposing duties of excise, customs and bounties on the production or export of goods.


\(^{138}\) *Adelaide Company of Jehovah’s Witnesses Inc v Commonwealth* (1943) 67 CLR, per Latham CJ, at p 123.
Consequently the Commonwealth’s power to tax under section 51(ii) would be subject to section 116. However, to what extent section 116 will invalidate tax law is questionable given how the courts have interpreted it. There are a number of cases that have considered the interplay between section 116 and 51(ii).

In *Halliday v The Commonwealth of Australia* [2000] FCA 950 the applicants sought declarations to set aside the validity of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (‘NTS’)

139 insofar as it related to the imposition of tax collection by persons to forward it to the Commonwealth. One of the taxpayer’s assertions was that the Acts used to establish the NTS contravened section 116 of the Constitution, in that they ‘force certain citizens to impose on others measures and demands contrary to their religion’. 140 The example given in the Particulars is that those of the Muslim faith are enjoined ‘to not tax, tithe or charge interest’. In the course of its argument it became apparent that the Muslim religious objection is not to the payment of tax but to the collection of tax payable by another for transmission to the Commonwealth.

In effect what the applicants argued was that the onward transmission of taxes constituted a violation of the ‘free exercise of any religion’. In the taxpayer’s view, tax collection was sitting at odds with Muslim religious convictions. Regardless of the interpretation of Islamic ethics by the taxpayer 141 Sundberg J dismissed the validity of this plea on grounds of an erroneous interpretation of s116. Sundberg J held that collecting GST does ‘not prohibit the doing of any act in the practice of religion.’ 142 Furthermore the Justice held that the relevant part of s116 which precludes the Commonwealth from making a law prohibiting the free exercise of any religion did not constitute a valid ground for not collecting taxes [by Muslims] for payment to the tax authorities.

Sundberg J in the *Halliday* held further that:

The GST laws (including the withholding provisions) do not prohibit the doing of acts in the practice of religion any more than did the military service law in *Krygger v Williams*. At most they may require a person to do an act that his religion forbids. But that is not within s 116. If the matter be approached by asking whether the law is a law “for prohibiting the free exercise of any religion”; in the sense that it is designed to prohibit or has the purpose of prohibiting that free exercise, the answer must be in the negative. It is plainly a law of general application with respect to taxation. There is no hint of a legislative purpose to interfere with the free exercise of a Muslim’s or anyone else’s religion. 143

The decision in *Halliday* is consistent with the earlier case of *Re Burrowes* where Heerey J rejected arguments of taxpayer in that the taxpayer should be excused from any liability to

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139 The plaintiff raised six grounds in its pleadings challenging the inoperability of the New Tax System (then foreshadowed by the Howard government) citing breaches of a number of Acts as well as the Australian Constitution.


141 It is interesting that the plaintiff chose to raise ethical concerns of a minority religious group (Muslims) in its pleadings for, in doing so, it is respectfully argued that this misinterpreted the role of taxation in Islamic law as well as conferring preference on Muslim beliefs, contrary to what the Constitution had intended under s116. The more serious aspect of that case is the impression that somehow Islam encourages tax evasion quoting a dubious dictum ‘to not tax, tithe’ attributed to Muslims in its pleading. If Sundberg’s dismissal was based solely on the operative aspect of s116, it is argued that the dismissal is justified even under Islamic law. Refer to the prior historical analysis of Islam and tax.

142 (2000) 45 ATR 458 at 465

pay tax because they held a conscientious objection to paying taxes which might be used for military expenditure.\textsuperscript{144}

Finally, Sundberg J quoted \textit{United States v Lee} 455 US 252 (1982), a case which involved a Amish person who did not withhold social security taxes because they believed that the payment of the taxes and receipt of benefits would violate the Amish faith:

The difficulty in attempting to accommodate religious beliefs in the area of taxation is that “we are cosmopolitan nation made up of people of almost every conceivable religious preference” [\textit{Braunfield v Brown} 366 US 599 at p 606]. The Court has long recognised that balance must be struck between the value of the comprehensive social security system, which rests on a complex of actuarial factors, and the consequences of allowing religiously based exemptions. To maintain an organized society that guarantees religious freedom to a great variety of faiths requires that some religious practices yield to the common good. Religious beliefs can be accommodated ..., but there is a point at which accommodation would ‘radically restrict the operating latitude of the legislature’..... Because the broad public interest in maintaining a sound tax system is of such a high order, religious belief in conflict with the payment of taxes affords no basis for resisting the tax.\textsuperscript{145}

Accordingly, it is argued that even though section 51(ii) is subjected to section 116, this would not prevent the Commonwealth introducing tax reforms to provide greater faith based transactions, particularly Islamic finance. This is because such tax reforms are not likely to ‘prohibit the doing of any act in the practice of religion.’\textsuperscript{146} Furthermore, the Commonwealth’s power to tax would appear to be broad enough to enable the reforms to facilitate greater Islamic finance. It should be recalled that in the \textit{Fairfax} decision the taxation power was not limited to the raising of revenue for government purposes – but a wide range of objectives – including fiscal, social and economic may be achieved through ‘tax’ legislation.\textsuperscript{147} As it has been stated that the Commonwealth can favour one religion over another without necessarily breaching section 116.\textsuperscript{148} Indeed, ‘imagination’ may be the only effective limit given Brennan J’s statement that section 51(ii) power:

\begin{quote}
extends to any form of tax which ingenuity may devise’ [and] ‘the Parliament may select such criteria as it chooses, subject to any express or implied limitations prescribed by the Constitution, irrespective of any connection between them.\textsuperscript{149}
\end{quote}

Accordingly, the Commonwealth’s desire to see Australia emerge as a financial hub in South East Asia through, amongst other things, facilitating greater Islamic financial transactions appears to be constitutionally possible.

An interesting parallel to the introduction of Islamic finance emerges in the evolution of faith-based equity funds\textsuperscript{150} in the United Kingdom. Sparkes (2005) recalls it was the pioneering role of the Quakers, the Methodists and people such as John Wesley that introduced faith-based ethics in investments. He argues that faith-based principles were already in vogue in Wesley’s 1760 ethical investment model. Put simply, those principles

\begin{itemize}
\item \textsuperscript{144} Woellner, RH, S Barkoczy, S Murphy, C Evans, and D Pinto. (2010). \textit{Australian Taxation Law}. 20 ed. Sydney: CCH Australia Limited, at p 57: \textit{Re Burrowes; Ex parte DFC of T} 91 ATC 5021.
\item \textsuperscript{145} Halliday v The Commonwealth of Australia [2000] FCA 950, (2000) 45 ATR 458, per Sundberg J, at p 464
\item \textsuperscript{149} MacCormick v FCT (1984) 158 CLR 622, per Brennan J, at p 655.
\item \textsuperscript{150} That later morphed into Socially Responsible Investments (SRI’s).
\end{itemize}
were reflective of the church’s desire to employ its capital to earn profit according to its religious tenets. That transformation later led to divergent ethical positions adopted by other concerned groups such as the South African Apartheid sanctions experience (Sparkes, 2002, pp. 52–58). But here’s the important observation: changes in the market effectively re-characterised faith-based investments since the ethical stance was strictly no longer representative of any religious doctrinaire. On this basis it seems that while accepting the religious underpinning of Islamic finance, the position adopted by the both the United Kingdom Financial Services Authority and HM Treasury in their desire to promote London as the international financial hub for Islamic finance is one based on ‘access to good financial services’.

CONCLUSION

This paper has sought to explore the relationship between religion and the law – particularly tax law. It was argued that this relationship is deserving of greater attention given the calls to amend Australia’s tax laws to facilitate greater Islamic finance.

The paper initially considered the potential benefits to Australia in becoming hub of Islamic finance in the South East Asian region, particularly given the low penetration levels to date. The historical relationship between law and religion was then considered, with a particular emphasis on Australia. This included consideration of the special tax treatment afforded to different religious groups.

Next the constitutional provisions dealing with religion where analysed, with reflection as to whether they amounted to a ‘freedom of religion’ in Australia. The Commonwealth’s power to tax was then analysed, as well as its interaction with the religious guarantees in Australia.

It was argued that it is constitutionally possible for the Commonwealth to introduce tax reforms to facilitate faith based transactions, such as Islamic finance. The questions that now rise from this, is whether reforms should be implemented, and if so, how best they be implemented. It is these questions that will be addressed in future research by the authors.

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151 See the comments by Ian Pearson MP, Economic Secretary to the Treasury: “The Government wants to ensure no one in the UK is denied access to good financial services on account of their religious beliefs. We value the contribution Islamic finance makes to London’s position as an international financial centre and we want to see this sector continue to grow and prosper in this country.” [http://www.hm-treasury.gov.uk/press_136_08.htm](http://www.hm-treasury.gov.uk/press_136_08.htm).
REFERENCE LIST


