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The Constitution and Islam: Are Tax Reforms Possible To Facilitate Islamic Finance?

Abstract

Islamic banking and finance is emerging in global financial markets and governments seek to facilitate it. This article focuses on whether it is constitutionally possible for Australia to implement reforms to facilitate faith-based financial transactions.

There have been calls for Australia to become a financial hub – particularly in South East Asia. One aspect of this is the recognition of Islamic finance as an alternative in the marketplace. This would include ensuring that tax laws are synchronised with Islamic tenets on financial transactions and do not hinder such alternatives.

Being different to conventional finance, Islamic finance has attracted interest and scepticism, partially because of the lack of understanding and the paucity of academic research on the subject. While the idea of facilitating faith-based finance may seem economically rational, a fundamental question needs to be addressed: is it appropriate for Australia's tax laws to be amended to facilitate what may be construed to be the furtherance of any religion? This article considers the theoretical considerations of tax and religion and assesses the implications of Islamic finance in light of Australian constitutional law.

Keywords

Islamic banking, Islamic finance, religion and tax

THE CONSTITUTION AND ISLAM: ARE TAX REFORMS POSSIBLE TO FACILITATE ISLAMIC FINANCE?

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INTRODUCTION

Recent developments in financial markets underline how religious concerns may 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 trans-national banking cooperation, capital and

* Griffith University Brisbane, Queensland. The authors would like to acknowledge the support from CPA Australia they have received as grant recipients through the 2009 CPA Global Research Perspectives Program. The authors are grateful for the insightful remarks and recommendations by the referee.

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investment flows and tax revenues. Given its 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 the extent to which it recognises faith-based financing alternatives.

While the Australian Government is empowered to make laws for taxation under the Australian Constitution,¹ that document also says there will be no establishment of a religion by the state. More recently, much attention has been drawn to the ethical relationship between religion and taxation² and between religion and the state.³ 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 whether it is appropriate or legal to accommodate financial transactions structured in a certain manner to ensure religious compliance. 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 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 article will firstly consider calls for Australia to reform its tax laws to facilitate Islamic finance. This is followed by a brief discussion of the meaning and principles of Islamic finance. Then the historical relationship between religion and law will be considered, focusing on the Australian perspective. This will include highlighting the tax preferential treatment available to religions and consider what 'religion' is. Then the relationship between the three major Abrahamic faiths and tax is discussed.

¹ *Commonwealth of Australia Constitution Act* (Cth), s 51 (ii).

² M Amin, 'The Taxation of Islamic Finance in Major Western Countries' (2007) 1st Quarter *Arab Banking Review* 129-138; RW McGee (ed), *The Ethics of Tax Evasion* (1998 The Dumont Institute for Public Policy Research); RW McGee, *The Philosophy of Taxation and Public Finance* (2004 Kluwer Academic Publishers); RW McGee and G Cohn, *Jewish Perspectives on the Ethics of Tax Evasion* (2006 <http://ssrn.com/abstract=929027>); A Murtaza and SM Ghazanfar, 'Tax as a Form of Worship: Exploring the Nature of Zakat', in RW McGee (ed) *The Ethics of Tax Evasion* (1998 The Dumont Institute for Public Policy Research); ED Schansberg, 'The Ethics of Tax Evasion within Biblical Christianity: Are there Limits to "Rendering unto Caesar"?' (1998) 1(1) *Journal of Accounting, Ethics & Public Policy* 77.

³ I Ellis-Jones, *Beyond the Scientology Case* (2007 University of Technology Sydney).

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Thereafter, constitutional issues concerning this debate will be analysed, initially by considering s 116 which provides, among other things, that there will be no establishment of a religion by the state, and then s 51(ii) which provides the Commonwealth with the power to tax. Attention will then be 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 akin to models proposed by the UK Financial Services Authority.⁴ It is worth noting that the UK authorities have actively advanced this ambition ahead of other western governments by recently amending tax legislation.⁵ Such actions may be viewed as a tacit acceptance of financial market developments and innovations that Australia could also emulate.

Islamic finance is estimated to be worth more than AU\$1 trillion (US\$822 billion)⁶ – with growth estimated by the International Monetary Fund (IMF)⁷ at 10-15% annually and expanding.⁸ Globally, shariah-compliant assets are projected to reach US\$1 trillion in 2010 and US\$1.6 trillion by 2012.⁹ Currently, most Islamic financial services are facilitated through a combination of pure Islamic banks, conventional western banks with Islamic windows and hybrid institutions offering both

⁴ N Sherry (Assistant Treasurer), 'The Future of Islamic Finance in Australia' (Paper presented at *Islamic Finance Conference*, Melbourne 8 and 9 June 2010). C Bowen (Minister for Financial Services, Superannuation & Corporate Law, Minister for Human Services) 'Islamic Finance in Australia – A Minister's Perspective' (Paper presented at *Islamic Finance Conference*, Melbourne 8 and 9 June 2010); C Bowen (Minister for Competition Policy and Consumer Affairs and Assistant Treasurer) (Paper presented at *La Trobe University, National Australia Bank and Muslim Community Corporation of Australia Symposium on Islamic Banking and Finance*; Australian Financial Centre Forum, *Australia as a Financial Centre: Building on our Strengths*, (2009 Commonwealth of Australia); S Crean (Minister for Trade), *Landmark Islamic finance publication* (2010 Commonwealth of Australia); UK Financial Services Authority, *Islamic Finance in the UK: Regulation and Challenges* (2007) available at: <http://www.fsa.gov.uk/pubs/other/islamic_finance.pdf>.

⁵ HM Treasury, *Government moves to support UK Islamic finance industry*, (21 January 2010), available at: <http://www.hm-treasury.gov.uk/press_04_10.htm>.

⁶ The Banker, *Top 500 Islamic Financial Institutions*, (November 2009).

⁷ IMF, *Monetary and Capital Markets Department* (19 September 2007), available at <<http://www.imf.org/external/pubs/ft/survey/so/2007/RES0919A.htm>>.

⁸ Standard & Poor's, *Islamic Finance Outlook* (2009) 5.

⁹ O Wyman, *The Next Chapter in Islamic Finance: Higher Rewards But Higher Risks* (2009).

conventional and shariah-compliant banking and investments.¹⁰ 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 2008.¹¹ Under-utilised oil revenue, sovereign wealth institutions and private investment portfolios of high net-worth families and individuals drive much of this capital market activity.¹²

The current reach of Islamic finance in global capital and equity markets suggests there is potential for Australia, through multi-lateral trade and financial services, to facilitate Islamic finance expanding opportunities within and beyond its borders.¹³ 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 stock and *sukuk* issues; 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'.¹⁴ This petrodollar liquidity refers to oil rich nations' domestic economies being too small to absorb all capital inflows from oil revenues thereby providing them greater liquidity.¹⁵ Other 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.¹⁶ This is complemented by the high recognition of Australia's financial

¹⁰ Australian Financial Centre Forum, above n 4, 70; Malaysian Islamic Finance, *Malaysian Islamic Finance Report* (2006) 48-52.

¹¹ R Millikan, 'Choppy Waters for Islamic Debt Markets' (2009) *Islamic Finance News* 14, 14. See also the International Financial Services Research, *Islamic Finance* (2009 IFSL Research), 1.

¹² NJ Adam and A Thomas, *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk* (2005 Euromoney Books).

¹³ Through dedicated Islamic indexes such as the Dow Jones Islamic Market Index (DJIM), the FTSE Islamic Global Index and The FTSE Bursa Malaysia EMAS Shariah Index. For a more detailed discussion see MN Siddiqi, 'Muslim Economic Thinking: A Survey of Contemporary Literature' in K Ahmad (ed), *Studies in Islamic Economics* (1980 The Islamic Foundation) 46.

¹⁴ Crean, above n 4.

¹⁵ Australian Trade Commission, *Islamic Finance* (2010 Australian Trade Commission) 5.

¹⁶ 62% of world's Muslims (972.5 million) live in Asia Pacific: Pew Research Centre, *Mapping the Global Muslim Population – A Report on the Size and Distribution of the World's Muslim Population* (2009); Crean, above n 4.

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sector – with Australia’s financial system and capital market ranking second among 55 leading nations in 2009.¹⁷

Currently, the major centres for Islamic finance include the United Arab Emirates, Bahrain and Malaysia.¹⁸ However, there is significant activity occurring in the UK, other parts of Europe, Africa and Indonesia.

Table 1 lists the top ten countries in terms of value of shariah-compliant assets, demonstrating that Malaysia is third largest, with the UK eighth. In Malaysia prominent Islamic financial institutions include Bank Rakyat, Maybank Islamic Berhad, BIMB Holdings, CIMB Islamic Bank Berhad and Public Bank Islamic Berhad.¹⁹ Indeed Malaysia and Bahrain have been credited as the most active in developing dual systems where Islamic and non-Islamic financial institutions operate alongside each other.²⁰

Table 1: Top Ten Countries: shariah-compliant assets

Rank	Country	Shariah-compliant assets US\$bn
1	Iran	293.2
2	Saudi Arabia	127.9
3	Malaysia	86.5
4	United Arab Emirates	84.0
5	Kuwait	67.6
6	Bahrain	46.2
7	Qatar	27.5
8	UK	19.4
9	Turkey	17.8
10	Bangladesh	7.5

(Source: *The Banker, Top 500 Islamic Financial Institutions, (November 2009) 4*)

Within Australia there is also a growing Muslim community, with 365,000 Muslims, representing 1.7% of Australia’s population.²¹ Contextualised, there are

¹⁷ World Economic Forum, *The Financial Development Report* (2009).

¹⁸ Haron & Wan Azmi, *Islamic Finance and Banking System: Philosophies, Principles & Practices* (2009) 373-4.

¹⁹ Australian Trade Commission, above n 15, 17.

²⁰ Ibid 9.

²¹ Ibid 5, referring to Australian Bureau of Statistics 2006 Census.

approximately 1.57 billion Muslims world-wide representing approximately 23% of the world's population.²² It is estimated that Islamic finance represents only 1% of global finance.²³ It is because of this dichotomy that commentators consider there is the potential for growth.²⁴ 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.²⁵ This is complemented by the ethical character and financial stability of Islamic products.

Among western countries, the UK has been very active from an early stage in facilitating Islamic finance. In December 2008 the UK Treasury released a comprehensive study, aimed at raising awareness about Islamic finance.²⁶ At the same time, HM Treasury and the UK Financial Services Authority (FSA) released a proposed legislative framework for the regulatory treatment of Islamic sukus (bonds).²⁷ Consistent with its intention to promote London as the global hub for Islamic financial services, the UK authorities have foreshadowed other changes to be made in a manner that would ensure 'fairness', as opposed to preferential treatment, to Islamic finance over conventional finance.²⁸ Accordingly, a number of tax and legislative changes aimed at preventing multiple payment of stamp duty on Islamic mortgages. Furthermore, amendments were introduced to ensure 'alternative finance investment bonds' (which would include some Islamic finance products) were put on the same tax footing as conventional products.²⁹

While there has been some activity in Australia, this is still largely in the formative stages. Following the recommendations by the Australian Financial Centre Forum (the 'Johnson Report'),³⁰ the Australian Government on 26 April 2010 announced that

²² Pew Research Centre, above n 16.

²³ Australian Financial Centre Forum, above n 4, 14.

²⁴ Australian Trade Commission, above n 15.

²⁵ S Jaffer (ed), *Islamic Retail Banking and Finance* (2006 Euromoney Books) 3-4.

²⁶ HM Treasury, *The development of Islamic finance in the UK: the Government's perspective* (2008).

²⁷ HM Treasury, *Consultation on the legislative framework for the regulation of alternative finance investment bonds (sukuk)* (2008).

²⁸ M Amin, 'The Taxation of Islamic Finance in Major Western Countries' (2007) 1st Quarter *Arab Banking Review* 129.

²⁹ Ibid.

³⁰ Australian Financial Centre Forum, above n 4; 'The Forum recommends that the Treasurer refer to the Board of Taxation the question of whether any amendments to existing Commonwealth taxation provisions are necessary in order to ensure that Islamic finance products have parity of treatment with conventional products, having regard to their economic substance.' Subsequently, there has been the Austrade publication *Islamic Finance* in 2010 which sets out its wide ranging observations in relation to Islamic finance and how it is positioned with Australia: Australian Trade Commission, above n 15.

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the Board of Taxation would undertake a comprehensive review of Australia's tax law with the purpose that the laws do not inhibit the expansion of Islamic finance, banking and insurance products.³¹ More recently the Board of Taxation released a 'Discussion Paper' inviting submissions on its terms of reference in pursuance of that brief.³²

Notably, the Victorian government introduced provisions to limit the imposition of double stamp duty on Islamic financing arrangements for home purchases, thereby allowing equal tax treatment with conventional financing arrangements.³³ These Victorian stamp duty changes were in response to Islamic financial products being offered by the Muslim Community Co-operative (Australia) Limited ('MCCA') and submissions made by it.³⁴ MCCA has been providing various Islamic financial products since 1989 in Australia, and currently has some \$425 million finance written or managed by it.³⁵

However, there has been a conspicuous lack of enthusiasm by Australia's conventional banking sector to tack on to this emerging market. Some tangible support did emerge in June 2009, when the NAB announced its intention to offer Islamic loans.³⁶ Most recently, in February 2010 Westpac Banking Corp announced it would offer a commodity-trading facility aimed at overseas investors that operates in accordance with Islamic Law.³⁷ However, this move does not address the Islamic retail banking, fund management and capital markets.

Prior to discussing the relationship between religion and law, a brief overview of Islamic finance, its meaning and principles will be canvassed.

³¹ N Sherry (Assistant Treasurer), *Terms of reference for Board of Taxation Review into Islamic finance announced* (2010 Treasury).

³² Board of Taxation, *Review of the Taxation Treatment of Islamic Finance: Discussion Paper* (2010 Board of Taxation).

³³ *Duties Act 2000* (Vic), ss 57A, 57B and 57C. The potential for double stamp duty arises because, pursuant to the Islamic financing product, the Bank initially purchases the home, and then subsequently leases it to the eventual owner. It is only at a later date that the home is then transferred to the owner.

³⁴ MCCA Ltd, *Milestones*, available at www.mcca.com.au/Pages/Aboutus.html?tab=2 [Accessed 8 July 2010].

³⁵ MCCA Ltd, *MCCA Income Fund*, available at www.mcca.com.au/Pages/WealthManagement [accessed 8 July 2010].

³⁶ N Gardner and W Russell, *The Courier Mail*, June 14, 2009.

³⁷ E Johnston, 'Westpac dips into Islamic Finance' *Sydney Morning Herald*, 12 February 2010.

MEANING AND PRINCIPLES OF ISLAMIC FINANCE

Islamic finance is an economic system premised on ethical rules and norms that, when properly practised, are intended to satisfy a moral purpose. Consequently, contracts, obligations and transactions that subscribe to these rules are meant to ensure that: they are free of interest; they do not include prohibited acts and investments; there is risk sharing between parties; and the financing models are based on real assets. Where these conditions prevail, contracts are said to be shariah compliant.

The rationale of Islamic finance is compliance with the *shariah* (Islamic law).³⁸ The corpus of the shariah emanates from two canons, namely the Qur'an and the prophetic traditions (*hadith*). These sources are complemented by independent legal decision-making (*ijtihad*) in the form of analogical deductions, legal precedents, presumption of continuity and juristic consensus.³⁹ As such, the shariah sets parameters within which Islamic finance may endure such as: recognising the use of money and capital as a means of exchange and not a tradable commodity; prescribing acts that are lawful or prohibited;⁴⁰ defining the relationship between risk and profit;⁴¹ and setting out the social responsibilities of parties in financial dealings.⁴² Thus compliance with shariah may result, for instance, in transactions that may be intended to achieve 'compliance' outcomes that are nevertheless similar to loan agreements legally structured as lease or sale and purchase agreements.⁴³ While the shariah sets the boundaries, the legal applications are to be found in *fiqh* or Islamic jurisprudence. *Fiqh* is a juristic edifice that is essentially comprised of common law, customary practices and juristic precedents derived from analogical deductions.⁴⁴

³⁸ N Yaqubi, 'Shariah Requirements for Conventional Banks' (2005) 22 *Journal of Islamic Banking & Finance* 1.

³⁹ Abdur Rahman Doi, *Shariah: The Islamic Law* (1st ed, 1984 Ta-Ha Publishers Ltd); MH Kamali, *Principles of Islamic Jurisprudence* (2nd ed, 2004 Ilmiah Publishers).

⁴⁰ Y al-Qaradaw, *The Lawful and the Prohibited in Islam* (1st ed, 1984 The Holy Qur'an Publishing House).

⁴¹ El-Gamal, *Islamic Finance: Law, Economics and Practice* (2009 Cambridge University Press).

⁴² FE Vogel and SL Hayes, *Islamic Law and Finance: Religion, Risk and Return, Arab & Islamic Laws Series* (1998 Kluwer Law International).

⁴³ M Ayub, *Understanding Islamic Finance* (2007 John Wiley & Sons Ltd).

⁴⁴ El-Gamal, *Islamic Finance: Law, Economics and Practice* (2009 Cambridge University Press), 27.

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The norms that characterise Islamic finance may be classified into two dimensions – a moral and ethical dimension, and an economic dimension.⁴⁵ 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.⁴⁶ The economic dimension incorporates a number of distinct elements identified by Obaidullah, namely:⁴⁷

- Freedom to contract;⁴⁸
- Freedom from *riba* (interest);⁴⁹
- *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, based on the condition that identifiable and tangible underlying assets should underpin financial transactions.

The juristic principles underpinning these elements are vast and extant and transcend into very fine detail over which there is no unanimity among the four leading Islamic juristic schools. Thus, as a means of standardising these principles, the Malaysian Securities Commission, the Islamic Financial Services Board and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) have compiled detailed guidelines for financial practitioners to follow in the application of Islamic finance.⁵⁰

⁴⁵ K Ahmad, *Studies in Islamic Economics* (1st ed, 1980 The Islamic Foundation); MU Chapra, *Islamic Economics: What it is and how it developed* (2005 EH.Net Encyclopaedia) <http://eh.net/encyclopedia/article/chapra.islamic>.

⁴⁶ MT Usmani, *An Introduction to Islamic Finance* (1st ed, 1998 Idaratul Ma'arif).

⁴⁷ M Obaidullah, *Islamic Financial Services* (2006 King Abdul Aziz University) 10-12. These have also been identified by the Australian Financial Centre Forum as essential elements in Islamic finance. See: Australian Financial Centre Forum, above n 4, 70.

⁴⁸ Qur'an 2:275; 4:29.

⁴⁹ Qur'an 30:39; 4:161; 3:130-2; 2:275. The prohibition of interest constitutes one of the key principles of Islamic finance. Instead, interest is replaced by a raft of financial alternatives underpinned by risk-sharing through partnership.

⁵⁰ Securities Commission Malaysia, *Resolutions of the Securities Commission Shariah Advisory Council* (2nd ed, 2006 Kuala Lumpur); AAOIFI, *Shar'iah Standards* (2008 Manama, Bahrain: Accounting and Auditing Organisation for Islamic Financial Institutions).

Among the financial products frequently referred to in Islamic financial contracts are:⁵¹ *murabaha* or (cost-plus) financial transactions;⁵² *ijara* contracts (leasing contracts);⁵³ *mudarabah* contracts (trustee partnership);⁵⁴ *musharaka* contracts (forms of limited partnership);⁵⁵ *sukuks* (Islamic bonds);⁵⁶ and *takaful* (mutual insurance arrangement).⁵⁷

The practical manifestation of these products within Islamic banking institutions is accomplished with the assistance of both shariah scholars and conventional legal practitioners.⁵⁸ This additional regulatory layer is meant to guide financial institutions to ensure compliance with the shariah in their financial activities.⁵⁹ For this reason, Islamic banks are required in many jurisdictions to establish shariah supervisory boards or committees.⁶⁰

Given this brief exposition of Islamic finance, it is difficult to determine the extent to which this faith-based alternative may influence or persuade any secular Australian

⁵¹ Australian Trade Commission, above n 15, 8.

⁵² Ibid 8: 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).

⁵³ Similar to a hire-purchase, the bank purchases the asset and allows the customer to use it for an agreed period and for an agreed rent.

⁵⁴ 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 fashion. The losses are borne only by the investor.

⁵⁵ A form of limited partnership where both partners in *Musharaka* must contribute capital to the partnership. Both partners or any 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 fashion, losses are shared in proportion to the capital contributed.

⁵⁶ Shariah-compliant financial certificates of investment that are similar to asset-backed bonds.

⁵⁷ 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.

⁵⁸ YT DeLorenzo and MJT McMillen, 'Law and Islamic Finance: An Interactive Analysis' in S Archer and RA Abdel Karim (eds) *Islamic Finance: The Regulatory Challenge* (2007 John Wiley & Sons (Asia)). 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.

⁵⁹ Australian Trade Commission, above n 15, 7.

⁶⁰ Securities Commission Malaysia, *Resolutions of the Securities Commission Shariah Advisory Council* (2nd ed 2006 Kuala Lumpur).

government to enact laws to facilitate it in light of proscriptions in the constitution. Therefore it is important to consider the relationship between religion and law, and how this relationship has been dealt with by the courts. This will facilitate understanding, to determine whether it is appropriate for reforms to be introduced to facilitate or favour faith-based financial models.

RELATIONSHIP BETWEEN RELIGION AND LAW IN AUSTRALIA

To decide whether, in an Australian context, it is appropriate to consider financial transactions structured in ways that ensure religious compliance, calls for an understanding of the relationship between religion and law. It is questionable whether such a relationship is tenable. In common law at least, while courts may recognise faith as influential in peoples' behaviour through its diversity, the courts have always adjudicated in disputes on the basis of justice and equity. However, it remains to be seen what means the courts have resorted to in arriving at decisions on issues concerning religion and whether any settled law transcends to faith-based financial issues.

In the *Adelaide Company of Jehovah's Witnesses Inc v Commonwealth*, 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.⁶¹ However, Latham CJ acknowledged even in more modern times that 'religious beliefs and practice cannot be absolutely separated either from politics or from ethics'.⁶² This sentiment is supported by Gleeson CJ:

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.⁶³

Historically, the earliest courts in England were not courts of common law but ecclesiastical courts,⁶⁴ with the development of the common law itself seen as being intimately bound up with Christian theology.⁶⁵ 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

⁶¹ *Adelaide Company of Jehovah's Witnesses Inc v Commonwealth* (1943) 67 CLR 116, 125 (Latham CJ).

⁶² *Ibid* 125- 6 (Latham CJ).

⁶³ M Gleeson, 'The Relevance of Religion' (2001) 75 *Australian Law Journal* 93, 93.

⁶⁴ P Babie, 'Breaking the Silence: Law, Theology and Religion in Australia' (2007) 11 *Melbourne University Law Review* 1, 2.

⁶⁵ *Ibid*.

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 up.⁶⁶

The relationship between religion and law 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'.⁶⁷ Such abuse led to the Enlightenment against irrational passion, which tried to break the link between religion and law.⁶⁸ Whether this 'break' is fully achieved is questionable, as in a legal system that purports to be secular, this can lead to a complex and controversial relationship.⁶⁹ Part of the problem is that the division between religion, legal philosophy and political philosophy cannot be neatly maintained in the real world.⁷⁰ For example, blasphemy continues to be an offence in the UK and its Christianity focus has been upheld, as the offence does not apply to other religions.⁷¹ In Australia, blasphemy has been largely repealed from such things as film regulations.⁷²

More specifically for Australia, Gleeson CJ 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.⁷³ The public perception of the separation between law (state) and religion was exemplified early in Australia's federalism, as a petition was said to have been signed by 30,000 Australians protesting against Australia's first

⁶⁶ Ibid, quoting Harold J Berman, *Law and Revolution: The Formation of the Western Legal Tradition* (1983).

⁶⁷ Ibid 12.

⁶⁸ C Evans, 'The Double Edged Sword: Religious Influences on International Humanitarian Law' (2005) 6(1) *Melbourne Journal of International Law*, 2.

⁶⁹ Ibid.

⁷⁰ Ibid.

⁷¹ G Blake, 'Promoting religious tolerance in a multifait society: Religious vilification legislation in Australia and the UK' (2007) 81 *The Australian Law Journal* 386, 387-8: In the UK blasphemy and blasphemous libel are common-law offences triable on indictment and punishable 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, 439-47]. The offence of blasphemy is only applicable to Christianity. There have been unsuccessful attempts to repeal the offence in the UK.

⁷² Ibid 389. Previously, there was references to the term 'blasphemous' in federal legislation (Australia) such as the *Customs (Cinematograph Films) Regulations 1956* (Cth) (repealed), Regulation 13, which prohibited the Censorship Board from registering imported films and advertising matter which were, inter alia, blasphemous. The offence was abolished in Queensland in 1899.

⁷³ Gleeson, above n 63.

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Prime Minister, Edmund Barton, paying a courtesy call on the Pope in Rome while returning from a visit to London.⁷⁴

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.⁷⁵ Australian Prime Ministers have acknowledged how their own religious beliefs have influenced their policy decisions.⁷⁶

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 United States’.⁷⁷ 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’.⁷⁸ 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.⁷⁹

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 that may be more of the soft than the hard variety.⁸⁰ Gleeson CJ uses the example of the unlawfulness of bigamy to provide a good example of the influence that religion has had, and continues to have, on the law. He argues that, ‘it is difficult to explain why bigamy is criminal,

⁷⁴ Ibid 94.

⁷⁵ Ibid.

⁷⁶ For example, former Prime Minister John Howard has publically acknowledged that his policies have been influenced by his Protestant beliefs: ‘Liberal Rule’ documentary broadcast on SBS: <http://www.sbs.com.au/documentary/program/liberal-rule/about/synopsis> [accessed 22 July 2010].

⁷⁷ GV Puig and S Tudor, ‘To the advancement of thy glory? A constitutional and policy critique of parliamentary prayers’ (2009) 20 *Public Law Review* 56, 70.

⁷⁸ Ibid, quoting Reid Mortensen, ‘Judicial (In)Activism in Australia’s Secular Commonwealth’ in Christine Parker and Gordon Preece (eds), ‘Theology and Law: Partners or Protagonists?’ (2005) 8(1) *Interface: A Forum for Theology in the World* 52.

⁷⁹ Ibid 54.

⁸⁰ Babie, above n 64, quoting Frank Brennan, ‘Church-State Concerns about Same Sex Marriage and the Failure to Accord Same Sex Couples Their Due’ in Christine Parker and Gordon Preece (eds), ‘Theology and Law: Partners or Protagonists?’ (2005) 8(1) *Interface: A Forum for Theology in the World* 83, 83.

even though no deception is involved, except by reference back to religious doctrine'.⁸¹

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'.⁸² 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 the wording of the preamble was intended to appeal to those voters of religious conviction for the formation of a Federation.⁸³ However, those opposed to the insertion of the religious overtones in the preamble then sought the introduction of s 116 to provide some religious safeguards.⁸⁴ This article will later analyse the extent to which s 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 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.⁸⁵ This practice of prayer commencing parliamentary sittings is not unique to Australia, as other common law jurisdictions such as New Zealand, Canada, the UK and the United States also do this.⁸⁶ The Lord's Prayer in Australia has been clearly identified as Anglican in terms of denomination affiliation.⁸⁷ Puig and Tudor have concluded that while the saying of the Parliamentary prayer is technically constitutional they question whether it is [morally] appropriate.⁸⁸

This is not to say that there is not an awareness of 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

⁸¹ Gleeson, above n 63, 94.

⁸² T Blackshield, 'Religion and Australian Constitutional Law' in P Radan, D Meyerson and RF Croucher (eds), *Law and Religion: God, the State and the Common Law* (2005 Routledge) 82.

⁸³ Puig and Tudor, above n 77, 61, referring to the Official Record of the Debates of the Australasian Federal Convention, Third Session, Melbourne, 20 January to 17 March 1898, Vol V, 1732.

⁸⁴ Ibid, referring to Henry Higgins of Victoria.

⁸⁵ Ibid; Standing Order 38 for the House of Representatives and Standing Order 50 for the Senate.

⁸⁶ Puig and Tudor, above n 77, 57.

⁸⁷ Ibid 58.

⁸⁸ Ibid.

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the Northern Territory, makes racial vilification unlawful and/or creates an offence of racial vilification.⁸⁹ There are similar definitions of 'race' or 'racial group' in this legislation, which refer to colour, nationality and/or national origin, descent or ancestry, and ethnicity or ethnic origin.⁹⁰ 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.⁹¹ Religious vilification is defined as:

A person must not, by a public act, incite hatred towards, serious contempt for, or serve ridicule of, a person or group of persons on various grounds including religion of the person or members of a group.⁹²

A defence for religious vilification include public acts done reasonably and in good faith for a purpose in the public interest.⁹³ However, it has been observed that there is very little in Australia's constitution that demands such separation between state and religion.⁹⁴

It is argued that it would be naïve to consider that Australia's dominant 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 a largely homogenous population – over the last century Australia has actively encouraged immigration resulting in a larger ethnic mix with different religious beliefs (greater heterogeneity). Consequently, it is argued that religion can, and does, influence Australia's laws.

⁸⁹ Blake, above n 71, 391: eg, *Anti-Discrimination Act 1991* (Qld), s 124A.

⁹⁰ For example *Anti-Discrimination Act 1991* (Qld), s 4.

⁹¹ Blake, above n 71, 393.

⁹² Since 7 June 2001 the *Anti-Discrimination Act 1991* (Qld) has included religious vilification provisions: *Anti-Discrimination Act 1991* (Qld), ss 124A and 131A.

⁹³ For example of the application of the good faith and public interest defence see: *Deen v Lamb* [2001] QADT 20, which was a case about a complaint by a Muslim relating to the pamphlet distributed by a candidate for the seat of Moreton in the Federal election held on 10 November 2001. The President found that the pamphlet incited hatred and serious contempt for Muslims as a whole, but not unlawful because it was within an exception.

⁹⁴ Puig and Tudor, above n 77, 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, s 50-5 *Income Tax Assessment Act 1997* (Cth) exempts from tax the income of charitable, religious, scientific or public educational institutions.

Some 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.⁹⁵ These sentiments are based on the premise that as Australia is a secular state, there is no need to advance any religion. Very recently, Carling in arguing for reform of Australia's tax law also questioned loss of fiscal revenue through generous exemptions.⁹⁶ This tension was recognised by Kirby J (dissenting) in *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.⁹⁷

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.⁹⁸

Further, non-religious groups argue that s 116 of the Constitution was intended to make Australia a secular state and that reality ought to be reflected in denying preference to religion in tax exemptions and other privileges.⁹⁹ They rely on the argument advanced by Murphy J that:

⁹⁵ J Perkins and F Gomez, 'Taxes and subsidies: the cost of advancing religion' (2009) 93 *Australian Humanist* 6, 6.

⁹⁶ R Carling, *The Unfinished Business of Australian Income Tax Reform* (2010 The Centre for Independent Studies).

⁹⁷ *Federal Commissioner of Taxation v Word Investments Ltd* [2006] FCA 1414, 250.

⁹⁸ *Ibid.*

⁹⁹ The Atheist Foundation of Australia, *Response to the Hon Wayne Swan's Press Release number 36 regarding Australia's future tax system* (June 24, 2008). However, many submissions have been made to the Henry Review on *Australia's Future Tax System* by other interest groups

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The crushing burden of taxation is heavier because of exemptions in favour of religious institutions, many of which have enormous and increasing wealth.¹⁰⁰

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’.¹⁰¹ 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 found to be complex and confusing¹⁰² and not easily accorded tax exempt status.¹⁰³

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 *Church of the New Faith v Commissioner of Pay-Roll Tax (Vic)* (the *Scientology* case). Chief Justice Mason 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.¹⁰⁴

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

who take a different view to that espoused by the Atheist Foundation. A more detailed discussion is to found at;

<<http://taxreview.treasury.gov.au/content/submission.aspx?round=1>>. For example, exemptions from stamp duty, pay-roll tax and municipal rates.

¹⁰⁰ *Church of the New Faith v Commissioner of Payroll Tax (Vic)* 14 ATR 794 (Murphy J). For instance, the commercial operations of *Sanitarium Food Company* controlled by The Seventh Day Adventist Church.

¹⁰¹ Fr Brian Lucas, *Modernising Charity Law Religion - Some Comments*, paper presented at the Queensland University of Technology conference on *Modernising Charity Law* (18 April 2009).

¹⁰² K Keating, *The National Governance of the Non-Profit Sector* (2007 The Winston Churchill Memorial Trust of Australia) 32. See the Report of the Senate Standing Committee on Economics, *Disclosure regimes for charities and not-for-profit organisations*, December 2008 – especially Chapter 8, available from: http://www.aph.gov.au/senate/committee/economics_ctte/charities_08/report/report.pdf (accessed 20 December 2009)

¹⁰³ *Federal Commissioner of Taxation v Word Investments Ltd* [2006] FCA 1414.

¹⁰⁴ (1983) 14 ATR 769, 769.

taxpayer's religious pretensions were a sham'.¹⁰⁵ Those 'pretensions' 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 judgment, the second criteria of 'canons of conduct' suggests that, provided the canons are not 'offensive' as Mason and Brennan JJ observed, other faiths may adduce greater flexibility in their religious convictions to qualify for tax exemptions. It is 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 exist'.¹⁰⁶ Given Mason and Brennan JJ's judgment, there would be little doubt that Islam would be readily accepted as demonstrating the indicia of religion. If this is indeed so, how do religions view tax law?

Religion and 'tax' law

Given that it is proposed to amend tax laws to facilitate faith-based financial transactions – how does religion view 'tax'? This argument is crucial to consider as a means to fully appreciate whether governments should be proactive in implementing tax reforms.

In *Halliday v The Commonwealth of Australia* [2000] FCA 950 the nexus between tax law and Islamic religious practices was raised. The example given in the particulars of the case was that those of the Muslim faith are enjoined 'to not tax, tithe or charge interest'. 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.

This argument however, may be dismissed on the grounds of an incorrect understanding of taxation vis-a-vis religion. Furthermore, the three dominant Abrahamic faiths, although professing different views on tax, have not vitiated tax imposition both in its customary form and its present character. Their treatment of tax is explored to demonstrate how each religion's own tenets acknowledge the role of tax in society. There is merit in raising this issue since Australia's cosmopolitan societies follow a number of religious affiliations – the dominant being the Abrahamic faiths.¹⁰⁷

¹⁰⁵ (1983) 14 ATR 769, 769.

¹⁰⁶ (1943) 67 CLR 116.

¹⁰⁷ ABS Census of Population and Housing 2914.0.55.002. The dominant religions being: Christianity 63.9%; Non-Christian 5.6%; No-religion 18.7% and Others 11.8%.

The Judeo-Christian perspective

The early Judea-Christian practices of tithing¹⁰⁸ may be accepted as one form of taxation. Conceptually, tithing is found in the *Old Testament* and means giving a tenth of one's property for religious purposes as a moral obligation.¹⁰⁹ These (in-kind) payments were to be deposited in the Temple for distribution to the Levites.¹¹⁰ The scriptural verses supporting these practices established some form of taxation as obligatory on its adherents. However, some commentators suggest that the New Testament does not recommend nor command the paying of tithes.¹¹¹ Importantly, the Judeo-Christian faiths did recognise taxation on produce of the soil as a form of income, to be collected and brought to the 'storehouse'.¹¹² Further, when asked if people should pay taxes to Caesar, Jesus replied that, 'what belonged to Caesar must be given to him and so must things that are God's'.¹¹³

Over the centuries, the levying of tax through tithing has mutated through different stratagems adopted by different regimes prompted by various circumstances in which fiscal abuse was clearly visible. The important point, as McGee argues, is that even if some form of taxation were found to be mandatory, there always exist ways of minimising tax payment, even if that meant blatant evasion justified on scriptural grounds¹¹⁴ – a view shared by Crowe.¹¹⁵

There is also the view that, in terms of Jewish law, a person is duty bound to follow the laws of a country which includes the payment of taxes.¹¹⁶ Cohn and Tamari both hold that to do otherwise would be to bring shame to the religion and limit the ability to practice the Jewish faith. Christian views on taxation largely reflect those found in

¹⁰⁸ Abraham presenting a tenth of his property (Genesis 14:20).

¹⁰⁹ See RW McGee, 'The Ethics of Tax Evasion and Trade Protectionism from an Islamic Perspective' (1997) (1) *Commentaries on Law & Public Policy* 250, 250.

¹¹⁰ References to tithing may be found in Leviticus 27:30; Numbers 18:26; Deuteronomy 14:24 and Chronicles 31:5.

¹¹¹ For differences in opinions, see <http://www.gotquestions.org/tithing-Christian.html> and <http://www.thebiblepage.org/biblesays/tithing.shtml> where these issues are discussed at length.

¹¹² Malachi 3:10.

¹¹³ Matthew, 22:17, 21.

¹¹⁴ McGee, above n 2, 220.

¹¹⁵ RW McGee, *Three Views on the Ethics of Tax Evasion* (2005 <http://ssrn.com/abstract>) 1, citing Martin Crowe, *The Moral Obligation of Paying Just Taxes* (1944).

¹¹⁶ G Cohn, 'The Jewish View on Paying Taxes' (1998) 1(2) *Journal of Accounting, Ethics & Public Policy* 109; M Tamari, 'Ethical Issues in Tax Evasion: A Jewish Perspective' (1998) 1(2) *Journal of Accounting, Ethics & Public Policy* 121.

Jewish teachings with some variations among different denominations.¹¹⁷ The common view according to McGee and Cohn is that both faiths regard tax evasion as unethical however much some followers may differ ethically.¹¹⁸ The philosophical reason cited as justification for payment of taxes is that if each person were to pay their 'fair share' the burden to the rest of society would be fairer.¹¹⁹ This same utilitarian argument however, has been used by non-religious institutions insisting that tax exemptions effectively create tax imbalances.¹²⁰ McGee and Cohn however, produce empirical evidence showing that all major religions frown upon tax evasion.¹²¹

The Islamic perspective

The recognition of taxation in Islam generally follows the traditions in Judeo-Christian teachings, albeit with some differences.¹²² The equivalent of tithes in Islam is the *ushr*, or a tenth of gross agricultural output – a tax calculated taking into account for instance, whether the land is irrigated naturally or by man.¹²³ Etymologically *ushr* has the same meaning as 'ma'asher' (the tithe) in Hebrew.¹²⁴ But in Islam this tithe is only due when there is a produce, to the extent that when the produce is destroyed by acts of God, its payment lapses.¹²⁵ Thus *ushr* is a form of tax on income in the sense that it is the value of goods (produce) that become the basis of taxable income.¹²⁶ Ra'ana argues further that the caliph (the head of state today) 'has the right to levy on the people the amount needed if funds are not available in the public treasury'.¹²⁷ The *ushr* was a fixed levy, but the jurist Abu Yusuf¹²⁸ in his treatise

¹¹⁷ RW McGee, 'Is Tax Evasion Ethical?' (1994) 42(2) *University of Kansas Law Review*, 411; ED Schansberg, above n 3.

¹¹⁸ McGee and Cohn, above n 2.

¹¹⁹ RW McGee, *The Philosophy of Taxation and Public Finance* (2004 Kluwer Academic Publishers).

¹²⁰ J Perkins and F Gomez, 'Taxes and subsidies: the cost of 'advancing religion' (2009) 93 *Australian Humanist* 6.

¹²¹ McGee and Cohn, above n 2, 21.

¹²² BA Shemesh, *Taxation in Islam* (1965 Brill).

¹²³ MU Chapra, 'The Islamic Welfare State and its Role in the Economy' in K Ahmad (ed), *Studies in Islamic Economics*, (1980 The Islamic Foundation) 160, citing Qaradawi (I: 394-397).

¹²⁴ IM Ra'ana, *Economic System under Omar the Great* (1977 Muhammad Ashraf) 68.

¹²⁵ NP Aghinides, *Mohammedan Theories of Finance* (1961 Premier) 286.

¹²⁶ F Lokkegaard, *Islamic Taxation in the Classical Period with Special Reference to Circumstances in Iraq* (1950 Brenner & Korch).

¹²⁷ IM Ra'ana, *Economic System under Omar the Great* (1977 Muhammad Ashraf) 73.

¹²⁸ The Chief Justice and tax advisor to the caliph Harun al-Rashid.

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on taxation in Islam proposed a model of proportional taxation and not a fixed levy.¹²⁹

A different variant of the *ushr* known as the *ushur* also exists – one introduced by the second caliph Umar – that resembled a type of sales tax.¹³⁰ It was charged to traders who entered the Islamic state to conduct trade.¹³¹

A third form of taxation in Islam is what is known as *kharaj* or land tax payable to the state – irrespective of who owns the land.¹³² The implications of these tax impositions is that the state's right to tax is legitimised – although this right is not to be assumed to be unfettered. Chapra has argued that:

[While] Islam does allow the levying of taxes to a reasonable extent to meet all necessary and desirable state expenditures, it does not permit an unjust tax structure which penalises honesty and creates an un-Islamic tendency of evading taxes.¹³³

Chapra argues that an Islamic state has the right to raise resources through tax collection:¹³⁴

This right is defended on the basis of the Prophetic saying that 'in your wealth there are also obligations beyond the *zakat*', and one of the fundamental principles of Islamic jurisprudence is that 'a small benefit may be sacrificed to attain a larger benefit and a smaller sacrifice may be imposed in order to avoid a larger sacrifice'. Most jurists have upheld the right of the state to tax. ... If the resources of the state are not sufficient, the state should collect funds from the people to serve the public interest because if the benefit accrues to the people it is their obligation to bear the cost.

While taxation has been accepted as an institutionalised function in the Abrahamic faiths, it remains to be seen how these functions converge in Australian law.

¹²⁹ AYusuf, *Kitab al Kharaj, Taxation in Islam* (B Shemesh, Trans 1969 Brill) 731-798.

¹³⁰ IM Ra'ana, *Economic System under Omar the Great* (1977 Muhammad Ashraf).

¹³¹ Officers (called *ashirs*) were posted at borders to collect the taxes. These were payable annually, based on records of trade volume: AYusuf, *Kitab al Kharaj, Taxation in Islam* (B Shemesh, Trans 1969 Brill) 406-8. On this basis it may be implied that all persons, foreigners and locals, were obliged to pay taxes imposed by the state.

¹³² MN Siddiqi, 'Muslim Economic Thinking: A Survey of Contemporary Literature' in K Ahmad (ed), *Studies in Islamic Economics* (1980 The Islamic Foundation) 191, 214. The *kharaj* generally meant tax revenue akin to rental or a levy based on land value: DC Dennett, *Conversion and the Poll Tax in early Islam* (1950 Cambridge University Press); IM Ra'ana, *Economic System under Omar the Great* (1977 Muhammad Ashraf). Farmers would therefore pay both the *ushr* and the *kharaj*: Chapra, above n 124, 161, citing Qaradawi, vol 1, 415.

¹³³ MU Chapra, *Towards a Just Monetary System* (1985 The Islamic Foundation) 89.

¹³⁴ Chapra, above n 123, 160.

INTERPRETATION OF SECTION 116 CONSTITUTION

Having established that there appears to be inherently a link between religion and law in Australia – to what extent does the Australian Constitution fetter or enable the Commonwealth parliament to enact tax laws to facilitate faith-based financial transactions?

Section 116 of the Australian Constitution is the pivotal section in setting out the relationship of state (being the Commonwealth of Australia) and religion:

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.

This section provides four guarantees in relation to religion – three of which are influenced by the First Amendment of the United States' Constitution.¹³⁵ However, only two of the four guarantees have been interpreted by the High Court: (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 s 116, which is dealt with separately below. It is argued that the fourth guarantee, religious test for public office, would not be infringed with the introduction of tax reforms to facilitate faith based transactions. The second guarantee, imposing religious observance, will be considered with the 'free exercise' guarantee.

(a) The Commonwealth shall not make any law for establishing any religion

On the first guarantee against the Commonwealth 'establishing' any religion, the High Court has said that the Commonwealth is prohibited from enacting laws to set up a religion as the official religion of the country.¹³⁶ This means that, even if the Commonwealth makes laws that favour one religion over another, this will not necessarily breach s 116.¹³⁷

¹³⁵ Puig and Tudor, above n 77, 61.

¹³⁶ Ibid 63.

¹³⁷ *Attorney-General (Vic); Ex re Black v Commonwealth* (1981) 146 CLR 559, 582 (Gibbs J), 608-9 (Barwick CJ, Stephen J), 616 (Mason J), 653 (Wilson J); while s 116 may prohibit the Commonwealth Parliament from constituting a 'particular religion or religious body as a state religion or state church', it does not stop the Commonwealth Parliament supporting religion generally.

Barwick CJ framed what the prohibition on 'establishment' means in *Attorney-General (Vic): Ex re Black v Commonwealth*:¹³⁸

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.¹³⁹

In the same decision, Stephen J explained:

[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.¹⁴⁰

In interpreting s 116, the use of the word 'for' has been critical, as observed by Sundberg J in *Halliday v the Commonwealth of Australia*:

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 p 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'.¹⁴¹

However, some see the use of the word 'for' as more of a grammatical necessity in the initial drafting of the provision, rather than as imposing a particular meaning.¹⁴²

(b) The Commonwealth shall not make any law for prohibiting the free exercise of any religion

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*:¹⁴³

¹³⁸ (1981) 146 CLR 559: referred to as the DOGS Case.

¹³⁹ *Attorney-General (Vic): Ex re Black v Commonwealth* (1981) 146 CLR 559, 582 (Barwick CJ).

¹⁴⁰ *Ibid* 606 (Stephen J).

¹⁴¹ *Halliday v the Commonwealth of Australia* [2000] FCA 950, 463 (Sundberg J).

¹⁴² Puig and Tudor, above n 77, 67.

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 s 116.¹⁴⁴

It was observed in *Adelaide Company of Jehovah's Witnesses Inc v Commonwealth* 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.¹⁴⁵

The courts in interpreting s 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, because some religious beliefs ... regard the existence of organized society as essentially evil ...¹⁴⁶

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.¹⁴⁷ An example used was that a Mormon could not use his religious beliefs of polygamy to excuse himself from the criminal law against such acts.¹⁴⁸

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'.¹⁴⁹ 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

¹⁴³ (1912) 15 CLR. This case concerned the provision of the *Defence Act 1903* (Cth) and held that imposing obligations on all male inhabitants of the Commonwealth in respect of military training does not prohibit the free exercise of religion.

¹⁴⁴ *Krygger v Williams* (1912) 15 CLR 369 (Griffith CJ).

¹⁴⁵ *Adelaide Company of Jehovah's Witnesses Inc v Commonwealth* (1943) 67 CLR 116, 123 (Latham CJ).

¹⁴⁶ *Ibid* 132 (Latham CJ).

¹⁴⁷ *Ibid* 131-2 (Latham CJ).

¹⁴⁸ *Reynolds v United States* (1878) 98 US 145.

¹⁴⁹ Puig and Tudor, above n 77, 61.

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infringe the right of free exercise.¹⁵⁰ That is, the court has balanced the competing public interests of freedom of religion and the regulation of an organised society.¹⁵¹ 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 interned 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.¹⁵²

For example it has been held (obiter) that a law overriding the confidentiality of religious confessions is not a law prohibiting the free exercise of religion.¹⁵³ In *Kruger v Commonwealth*, Brennan CJ stated that for a law to breach the right of freedom expressed in s 116, there had to be a clear intent. That is, 'To attract invalidity under s 116, a law must have the purpose of achieving an object which s 116 forbids'.¹⁵⁴ Consequently, a law which just 'incidentally affects that freedom' will be not be invalid due to s 116.¹⁵⁵

Also 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 to be a decision to prohibit the free exercise of religion – even though it was acknowledged there would be some 'disruption of worship'.¹⁵⁶ Indeed it appears that s 116 has been interpreted more as proclaiming tolerance for different religions, as well as the right for an absence of religious belief.¹⁵⁷

Hogan has observed that:

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,

¹⁵⁰ Ibid.

¹⁵¹ *Adelaide Co of Jehovah's Witnesses Inc v Commonwealth* (1943) 67 CLR 116, 132 (Latham CJ), and 155 (Starke J).

¹⁵² Ibid 159 (Williams J).

¹⁵³ *SDW v Church of Jesus Christ of Latter-Day Saints* [2008] NSWSC 1249 (Simpson J).

¹⁵⁴ *Kruger v Commonwealth* (1997) 190 CLR 1, 40 (Brennan CJ).

¹⁵⁵ Ibid 134-4 (Gaudron J).

¹⁵⁶ *Minister for Immigration and Ethnic Affairs v Lebanese Moslem Association* 17 FCR 373 (Fox, Burchett and Jackson JJ).

¹⁵⁷ Puig and Tudor, above n 77, 67.

and from the evolving pattern of Australian federalism and judicial interpretation.¹⁵⁸

It is argued that the guarantee against imposing 'religious observance' would be interpreted in a similar manner – that is, 'incidental' observance would be valid.

Because of the interpretation the High Court has accorded to s 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.¹⁵⁹ Even though the distinction may seem to be mere syntax, the result is profound, as noted by Stephen J in *Attorney-General (Vic); Ex re Black v Commonwealth*:

[that s 116 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.¹⁶⁰

However, Latham CJ in the *Jehovah's Witnesses* case did specify the importance of s 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.¹⁶¹

Kirby J (dissenting) in *Federal Commissioner of Tax v World Investments Ltd*, while acknowledging the narrow interpretation given to s 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 ...¹⁶²

Nevertheless the extent of the reach of s 116 is clearly articulated by Rich J in *Church of New Faith v Commissioner for Payroll Tax (Vic)*:

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.¹⁶³

¹⁵⁸ M Hogan, 'Separation of Church and State: Section 116 of the Australian Constitution' (1981) 53(2) *The Australian Quarterly* 214, 214.

¹⁵⁹ Puig and Tudor, above n 77, 64.

¹⁶⁰ *Attorney-General (Vic); Ex re Black v Commonwealth* (1981) 146 CLR 559, 609 (Stephen J).

¹⁶¹ *Adelaide Company of Jehovah's Witnesses Inc v Commonwealth* (1943) 67 CLR 116, 124 (Latham CJ). The learned judge further identified that s 116 protects not only opinion, but also acts done in pursuance of religious beliefs.

¹⁶² *Federal Commissioner of Tax v World Investments Ltd* (2008) 236 CLR 204, 249 (Kirby J) (dissenting).

¹⁶³ *Church of New Faith v Commissioner for Payroll Tax (Vic)* (1983) 154 CLR 120, 149-150 (Rich J).

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Having established that s 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, amongst other things, the need for tax reform. The primary power that the Commonwealth would rely on would be s 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.¹⁶⁴

The taxing power given to the Commonwealth has been described as being very broad. Indeed, Isaacs J (dissenting) in *R v Barger* 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.¹⁶⁵

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'.¹⁶⁶ 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.¹⁶⁷

The broad interpretation of the Commonwealth's power to tax 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 1942,¹⁶⁸ which confirmed that the Commonwealth could give itself priority for payment of tax over the states.¹⁶⁹

¹⁶⁴ *Commonwealth of Australia Constitution Act* (Cth), s 51(ii).

¹⁶⁵ *R v Barger* (1908) 6 CLR 41, 94-5 (Isaacs J) (dissenting).

¹⁶⁶ *Osborne v Commonwealth* (1911) 12 CLR 321, 345 (Barton J).

¹⁶⁷ *MacCormick v Federal Commissioner of Taxation* (1984) 158 CLR 622.

¹⁶⁸ S Guy, *Constitutional Law* (2010 Pearson Australia) 314, referring to *South Australia v Commonwealth (First Uniform Tax Case)* (1942) 65 CLR 373.

¹⁶⁹ *Ibid* 318: 'Similarly the court held [in the First Uniform Tax Case] that s 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)'.

The early High Court decision of *R v Barger* construed the power subject to the 'reserve powers' doctrine.¹⁷⁰ 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.¹⁷¹ For example, later the High Court upheld the validity of Commonwealth laws which used land tax to break up large concentrations of land.¹⁷²

In the *Fairfax* case,¹⁷³ Kitto J endorsed the opinion expressed in the United States Supreme Court in *US v Sanchez* (1950) US 42, 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.¹⁷⁴ 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 objectives – fiscal, social and economic – may be achieved through 'tax' legislation.¹⁷⁵ For example, the High Court has upheld the validity of a scheme designed to encourage higher levels of investment in Commonwealth securities.¹⁷⁶

In *MacCormick v FCT*, Brennan J held that the s 51(ii) power:

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.'¹⁷⁷

¹⁷⁰ Ibid 294.

¹⁷¹ Ibid.

¹⁷² RE Krever and G Kewley (eds), *Australian Taxation: principles and practice* (1987 Longman Cheshire) 38; *Osborne v Commonwealth* (1911) 12 CLR 321.

¹⁷³ *Fairfax v FCT* (1965) 114 CLR 1, 13 (Kitto J).

¹⁷⁴ Above n 15, 68 quoting *South Australia v The Commonwealth* (1942) 65 CLR 373, 424-5 (Latham CJ).

¹⁷⁵ Krever and Kewley, above n 172, 39.

¹⁷⁶ *Fairfax v FCT* (1965) 114 CLR 1.

¹⁷⁷ *MacCormick v FCT* (1984) 158 CLR 622, 655 (Brennan J).

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Indeed ‘politics’ has been stated as a greater practical restriction on tax legislation rather than legal, provided the constitutional boundaries are not infringed:¹⁷⁸

under s 51(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.¹⁷⁹

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 *Melbourne v Commonwealth*:¹⁸⁰

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.¹⁸¹

Or put another way:

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.¹⁸²

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’.¹⁸³ An earlier interpretation referred to tax as ‘the process of ‘raising money for the purposes of governments by means of contribution from individual persons.’¹⁸⁴

In *MacCormick v FCT*; *Camad Investments Pty Ltd v FCT*,¹⁸⁵ 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

¹⁷⁸ RH Woellner, S Barkoczy, S Murphy, C Evans, and D Pinto, *Australian Taxation Law* (20th ed 2010 CCH Australia Limited) 67-8.

¹⁷⁹ *Fairfax v FCT* (1965) 114 CLR 1, 16 (Taylor J), and 12-13 (Kitto J).

¹⁸⁰ (1947) 74 CLR 31. Guy, above n 168, 300.

¹⁸¹ *Melbourne v Commonwealth* (1947) 74 CLR 31, 79 (Dixon J). Known as the ‘State Banking Case’.

¹⁸² *Northern Suburbs General Cemetery Trust v Commonwealth* (1993) 176 CLR 555, 589 (Mason CJ, Deane, Toohey and Gaudron JJ).

¹⁸³ *Matthews v The Chicory Marketing Board (Vic)* (1938) 60 CLR 263; 276 (Latham CJ); applied by Gibbs J in *The State of Victoria v The Commonwealth* (1971) 122 CLR 353, 416.

¹⁸⁴ *R v Barger* (1908) 6 CLR 41, 68 (Griffith CJ, Barton and O’Connor JJ).

¹⁸⁵ (1983-1984) 158 CLR 622.

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 classifying whether a law involved a 'tax' – as opposed to a fee for service – was illustrated in *Air Caledonie International v Commonwealth*¹⁸⁶ 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;¹⁸⁷ the non-preference of states;¹⁸⁸ laws imposing tax should only deal with tax and not other matters;¹⁸⁹ the senate is not to introduce or amend tax legislation;¹⁹⁰ and the Commonwealth cannot impose tax on state property.¹⁹¹ Other provisions that are in part relevant are that the Commonwealth must acquire property on just terms,¹⁹² that

¹⁸⁶ (1988) 165 CLR 462.

¹⁸⁷ *Commonwealth of Australia Constitution Act* (Cth), s 51(ii). Woellner, Barkoczy, Murphy, Evans, and Pinto, above n 178, 60: s 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.

¹⁸⁸ *Commonwealth of Australia Constitution Act* (Cth), 99. Woellner, Barkoczy, Murphy, Evans, and Pinto, above n 178, 61: s 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.

¹⁸⁹ *Commonwealth of Australia Constitution Act* (Cth), s 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 provision seeks to protect the Senate because of its restricted powers in terms of taxation and s 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.

¹⁹⁰ *Commonwealth of Australia Constitution Act* (Cth), s 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.

¹⁹¹ *Commonwealth of Australia Constitution Act* (Cth), s 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.

¹⁹² *Commonwealth of Australia Constitution Act* (Cth), s 51(xxxi) Commonwealth power to acquire property 'on just terms from any State or person in respect of which the Parliament has power to make laws'.

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the Commonwealth has exclusive power in property acquired by it,¹⁹³ and that states are prohibited imposing duties of excise, customs and bounties.¹⁹⁴

WHAT IS THE RELATIONSHIP BETWEEN S 116 AND S 51?

Accordingly, for tax reforms to facilitate Islamic finance to be constitutionally valid it is critical to determine the relationship between the religious freedom of s 116 and the Commonwealth's power to tax in s 51. Even though s 116 has been interpreted narrowly, there is judicial commentary to indicate that s 116 is an 'overriding provision applicable to all instruments of laws'.¹⁹⁵ As Latham CJ in the *Jehovah's Witnesses* case phrased 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 s 51 or s 52 ...¹⁹⁶

Consequently, the Commonwealth's power to tax pursuant to s 51(ii) would be subject to s 116. However, to what extent s 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 s 116 and 51(ii).

In *Halliday v The Commonwealth of Australia* the applicants sought declarations to set aside the validity of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ('GST')¹⁹⁷ 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 GST contravened s 116 of the Constitution, in that they 'force certain citizens to impose on others measures and demands contrary to their religion'.¹⁹⁸

Regardless of the interpretation of Islamic ethics by the taxpayer, Sundberg J dismissed the validity of this plea on grounds of an erroneous interpretation of s

¹⁹³ *Commonwealth of Australia Constitution Act* (Cth), s 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.

¹⁹⁴ *Commonwealth of Australia Constitution Act* (Cth), s 90 prohibits the states (and territories) from imposing duties of excise, customs and bounties on the production or export of goods.

¹⁹⁵ Puig and Tudor, above n 77, 67.

¹⁹⁶ *Adelaide Company of Jehovah's Witnesses Inc v Commonwealth* (1943) 67 CLR 116, 123 (Latham CJ).

¹⁹⁷ [2000] FCA 950. 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.

¹⁹⁸ (2000) 45 ATR 458, 460.

116.¹⁹⁹ Sundberg J held that collecting GST does 'not prohibit the doing of any act in the practice of religion.'²⁰⁰ Furthermore the Justice held that the relevant part of s 116 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 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.²⁰¹

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 pay tax because they held a conscientious objection to paying taxes which might be used for military expenditure.²⁰²

Consequently, it appears that while the power to tax would be subject to an overriding prohibition of religious freedom, provided that the tax law is of general application then s 116 will not invalidate it.

¹⁹⁹ 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 s 116. 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 s 116, it is argued that the dismissal is justified even under Islamic law. Refer to the prior historical analysis of Islam and tax.

²⁰⁰ (2000) 45 ATR 458, 465.

²⁰¹ *Halliday v The Commonwealth of Australia* [2000] FCA 950, (2000) 45 ATR 458, 464 (Sundberg J).

²⁰² Woellner, Barkoczy, Murphy, Evans, and Pinto, above n 178, 57; *Re Burrowes*; *Ex parte DFC of T* 91 ATC 5021.

RELIGION AND REFORM

Having established that it would be possible for tax reforms to be introduced to facilitate faith-based transactions, the observations of Sundberg J in *Halliday* are insightful in determining the extent to which tax reform should take account of religion. Sundberg J quoted *United States v Lee*, a case which involved an 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' [*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.²⁰³

The essence of Sundberg's judgment goes to the heart of the question posited in the introduction, namely that tax reforms may be appropriate to consider financial transactions structured in a manner to ensure religious compliance. However, the law cannot structure acts to accommodate what a person's religion forbids – such as, for instance, the avoidance of interest in contracts – as that is a matter for people to exercise personally to which the law is not averse. Thus some religious practices must yield to the common good as a way to enable the broad public interest to be maintained.

Halliday is very instructive to lawmakers seeking legal reforms to facilitate Islamic finance in that it clarifies constitutional tolerance parameters, namely avoiding the furtherance of religious convictions. This position (though strictly not dealing with legal reform) is supported by two English common law cases that established to what extent English courts will tolerate religious convictions due to the non operability of Islamic tenets in contractual disputation. In *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd* (No 1),²⁰⁴ the defendant failed in its principal defence of upholding shariah law relating to the defendant's default in payments, as

²⁰³ *Halliday v The Commonwealth of Australia* [2000] FCA 950, (2000) 45 ATR 458, 464 (Sundberg J).

²⁰⁴ [2004] EWCA Civ 19; [2004] 1 WLR 1784.

enforceability could only be determined under English common law and not shariah law. The court of appeal simply set aside the defendants' religious convictions in deciding the merits of the case. The second case, *The Investment Dar Company KSCC v Blom Developments Bank Sal*,²⁰⁵ demonstrated that the plaintiff was not absolved from its obligations to make payments that closely resembled interest payments despite raising the *riba* (interest) prohibition under shariah law.

Furthermore, the necessity for tax and regulatory reform to be binding and comprehensive in relation to Islamic finance was demonstrated in the South African High Court case *Registrar of Banks v Islamic Bank of South Africa Ltd* (in liquidation) (Case No 25286/97) in October 1997.²⁰⁶ The regulator approved the granting of a banking licence to the respondent based on shariah principles in the absence of appropriate banking and tax law. Further, the court-appointed Inspector's Report in this case revealed serious misunderstanding and lack of consistency over the tax treatment of so-called 'shariah compliant' financing contracts. Thus, following the bank's collapse, the liquidator simply set aside the shariah construction of depositors' claims as well as clients' debt obligations to the bank and applied conventional banking law in the liquidation proceedings. This demonstrates the necessity for a comprehensive set of laws for regulatory authorities to apply in their governance duties and that religions tenets will not override the law.

Thus it is argued that even though s 51(ii) is subjected to s 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'.²⁰⁷ 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 *Fairfax* 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.²⁰⁸ As has been stated, the Commonwealth can favour one religion over another without necessarily breaching s 116.²⁰⁹ Indeed, 'imagination' may be the only effective limit given Brennan J's statement that s 51(ii) power:

²⁰⁵ [2009] EWHC 3545 (Ch).

²⁰⁶ M Nathie, *Islamic Bank Failure: A Case Study* (2010).

²⁰⁷ *Halliday v The Commonwealth of Australia* [2000] FCA 950, (2000) 45 ATR 458, 465 (Sundberg J).

²⁰⁸ Krever and Kewley, above n 172, 39.

²⁰⁹ *Attorney-General (Vic) Ex re Black v Commonwealth* (1981) 146 CLR 559, 597 (Gibbs J), 582 (Barwick CJ), 608-9 (Stephen J), 616 (Mason J), 653 (Wilson J): while s 116 may prohibit the Commonwealth Parliament from constituting a 'particular religion or religious body as a

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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.²¹⁰

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. To this extent it has been stated that Australian reforms for Islamic finance should be 'responsive and enabling' but not 'preferential'.²¹¹

An interesting parallel to the introduction of Islamic finance emerges in the evolution of faith-based equity funds²¹² in the UK. Sparkes recalls it was the pioneering role of the Quakers, the Methodists and people such as John Wesley who introduced faith-based ethics in investments.²¹³ He argues that faith-based principles were already in vogue in Wesley's 1760 ethical investment model. Put simply, those principles 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.²¹⁴ But the important observation is that changes in the market effectively re-characterised faith-based investments since the ethical stance was strictly no longer representative of any religious doctrine. On this basis, it seems that while accepting the religious underpinning of Islamic finance, the position adopted by the both the UK 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'.²¹⁵

state religion or state church', it does NOT stop the Commonwealth Parliament supporting religion generally.

²¹⁰ *MacCormick v FCT* (1984) 158 CLR 622, 655 (Brennan J).

²¹¹ Above n 15, 6.

²¹² That later morphed into Socially Responsible Investments (SRIs).

²¹³ R Sparkes, *A Historical Perspective on the Growth of Socially Responsible Investment* (2005 Greenleaf Publishing).

²¹⁴ *Ibid* 52–8.

²¹⁵ 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

CONCLUSION

This article 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 for greater facilitation of Islamic finance.

The article 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 religion and law was then considered, with a particular emphasis on Australia. This included consideration of the special tax treatment afforded to different religious groups, as well as the Abrahamic faiths' views towards taxation.

Next, the constitutional provisions dealing with religion were 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 question that now rises is whether reforms should be implemented, and if so, how best can they be implemented. These questions will be addressed in future research by the authors.