HIGH COURT OF AUSTRALIA

GLEESON CJ
GUMMOW, KIRBY, HAYNE, AND HEYDON JJ

AVON PRODUCTS PTY LIMITED APPELLANT

AND

COMMISSIONER OF TAXATION RESPONDENT

Avon Products Pty Limited v Commissioner of Taxation [2006] HCA 29
14 June 2006
S541/2005

ORDER

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation

S J Gageler SC with M Richmond for the appellant (instructed by Ernst & Young)

B J Shaw QC with S B McGovern SC and A J O'Brien for the respondent (instructed by Australian Government Solicitor)

CATCHWORDS

Avon Products Pty Limited v Commissioner of Taxation

Taxation and Revenue − Sales tax − Credit for sales tax overpaid − Passing on − CR1 in Table 3 of Schedule 1 to the *Sales Tax Assessment Act* 1992 (Cth) − Taxpayer did not change its pricing policy when it learned a lower rate of tax applied − Burden of proof upon taxpayer to establish it has not passed on the overpayment − Whether taxpayer satisfied onus of proof − Whether an overpayment of sales tax is passed on only if the price is increased by the amount of the tax overpaid.

Words and phrases − "passing on".

Sales Tax Assessment Act 1992 (Cth), Pt 4, Sched 1, Table 3 CR1.
Taxation Administration Act 1953 (Cth), Pt IVC, s 14ZZO.

1 GLEESON CJ, GUMMOW, KIRBY, HAYNE AND HEYDON JJ. This appeal from the Full Court of the Federal Court of Australia (Ryan and Merkel JJ; Conti J dissenting)[1] concerns the entitlement of the appellant ("Avon") to a credit under Pt 4 of the *Sales Tax Assessment Act* 1992 (Cth) ("the Act") for sales tax overpaid. It is not in dispute that Avon remitted the sums in question to the respondent ("the Commissioner"), nor indeed that they constituted an overpayment. Part 4 of the Act is headed "Credits" and comprises ss 51-60. What is at issue is whether Avon passed on all or part of those amounts so as to entitle it to a credit pursuant to s 51(1) and credit ground CR1 in Table 3 of Sched 1 to the Act.

2 The Full Court dismissed an appeal by Avon against the decision of Hill J[2] which rejected Avon's claim that the disallowance of its claim to the credit be set aside.

The Act

3 The regime contained in Pt 4 of the Act for reimbursement for sales tax overpaid represents a statutory code which provides relief against overpaid sales tax to the exclusion of what otherwise could be common law claims for money paid under mistake[3]. This was the conclusion reached by the Full Court of the Federal Court in *Chippendale Printing Co Pty Ltd v Commissioner of Taxation*[4] following a comprehensive discussion of the statutory scheme and the applicable authorities. It should be accepted as correct, and indeed counsel for Avon expressly did as much.

4 Section 51(1) provides that "Tables 3 and 3A set out the situations in which a claimant is entitled to a credit". Those tables are contained in Sched 1 and set out respectively "Credit grounds" and "Transitional credit grounds". Credit ground CR1 in Table 3 applies in cases of "Tax overpaid", where the "[c]laimant has paid an amount as tax that was not legally payable". It further provides that the amount of the credit in such a case is "[t]he amount overpaid, to

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1 *Avon Products Pty Ltd v Commissioner of Taxation* (2005) 223 ALR 259.

2 *Avon Products Pty Ltd v Federal Commissioner of Taxation* (2004) 55 ATR 520.

3 See *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353.

4 (1996) 62 FCR 347.

the extent that the claimant has not passed it on". In this way, the Act evinces a stance against automatic recovery of sales tax merely upon proof that it has been overpaid. To the contrary, even where the taxpayer can establish the existence of a credit ground by proving overpayment of sales tax, entitlement to an amount in credit depends upon proof that the taxpayer has not passed on the overpayment.

5 The onus of proof in that regard lies upon the taxpayer by reason of the terms of the foregoing provision ("to the extent that the claimant has not passed it on") and the procedure by means of which claims for credits are determined. First, pursuant to s 51(4) of the Act, the taxpayer must submit a claim to the Commissioner in approved form and with such supporting evidence as the Commissioner requires. Secondly, following the Commissioner's decision, a dissatisfied taxpayer has a right pursuant to s 60(2) of the Act to object in accordance with Pt IVC of the *Taxation Administration Act* 1953 (Cth) ("the Administration Act"); this enacts a procedure for such objections to be dealt with in the first instance by the Commissioner (Div 3). Thirdly, s 14ZZ of the Administration Act provides that the taxpayer may challenge the Commissioner's "objection decision" either by review in the Administrative Appeals Tribunal (Div 4) or by "appeal" to the Federal Court (Div 5), depending upon the nature of the decision. A decision arising from a taxpayer's objection pursuant to s 60(2) of the Act constitutes an "appealable objection decision", and therefore must be dealt with under Div 5 of Pt IVC of the Administration Act. Section 14ZZO(b) deals with the burden of proof and relevantly provides that the "appellant has the burden of proving that ... the taxation decision should not have been made or should have been made differently". In this way, it is for the taxpayer to prove that it has not passed on the overpayment and is therefore entitled to a sales tax credit. Avon did not contest that it carried the burden of proof.

6 The Act does not provide a comprehensive definition of "passed on"[5]. Whether or not sales tax has been "passed on" by the taxpayer is for determination according to the ordinary meaning of that term. That question ought not to be approached in an abstract way divorced from the circumstances of a particular case. To speak of a test is to invite error by superimposing upon the words of the statute some alternative formulation which obscures rather than reveals the nature of the inquiry that must be undertaken in order to determine whether a taxpayer has established an entitlement to a credit.

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5 Section 5 of the Act merely states that "***passed on***, in relation to an amount of tax that has been borne by a person, does not include an amount that the person has passed on to another person, but has later refunded to that other person".

Sales tax and "passing on"

7 The nature of the legislative scheme for the imposition and collection of sales tax was explained in *Deputy Federal Commissioner of Taxation (SA) v Ellis & Clark Ltd*[6]. Dixon J there stated that the "whole plan" of the legislation was to impose tax prior to goods entering the retail market and (as nearly as possible) "either upon the antecedent sale by wholesale or upon the immediately antecedent wholesale value which they possessed"[7]. Because it is levied upon the value of goods, sales tax is generally regarded as a duty of excise within the meaning of ss 55, 86, 87, 90 and 93 of the Constitution[8]. A central feature informing this character of sales tax is that the economic burden of the impost is generally not intended to be borne by the person liable to remit it; it is to be passed on.

8 The judgment of the whole Court in *Deputy Commissioner of Taxation v State Bank (NSW)*, referring to the nature of sales tax as an excise, said[9]:

> "That view of sales tax has been based no doubt on a consideration of the central element in sales tax legislation − the imposition of the tax in respect of some dealing with goods by way of sale or distribution in the expectation, or with the intention, that the taxpayer will not bear the incidence of the tax but will indemnify himself or herself by passing it on to a purchaser or consumer. This characteristic of the tax enables one to say of it that its fundamental concern is with the goods rather than with the person from whom it is exacted."

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6 (1934) 52 CLR 85 at 89-92 per Dixon J. See also the joint judgment of Gibbs CJ, Mason, Wilson, Deane and Dawson JJ in *Brayson Motors Pty Ltd (In Liq) v Federal Commissioner of Taxation* (1985) 156 CLR 651 at 656-658.

7 (1934) 52 CLR 85 at 92.

8 See *Mutual Pools & Staff Pty Ltd v Federal Commissioner of Taxation* (1992) 173 CLR 450 at 453. See also *Deputy Commissioner of Taxation v State Bank (NSW)* (1992) 174 CLR 219 at 225, and the authorities there cited.

9 (1992) 174 CLR 219 at 225-226. See also *Mutual Pools & Staff Pty Ltd v The Commonwealth* (1994) 179 CLR 155 at 181.

Nothing for present purposes turns upon the circumstance that this statement was made in the context of determining whether or not sales tax levied upon goods manufactured by the State Bank for its own use offended s 114 of the Constitution. It is the "central element" referred to by the Court which is significant to the resolution of this case.

9 That sales tax is expected to be passed on depends upon the circumstance that sales of goods occur within an economy geared to making profit. It is the profit-making motive of business which, in the nature of things, generally results in sales tax being passed on. This is because, leaving aside rare cases where sales tax is separately identified and superadded to the invoice price after sale, sales tax can only be passed on indirectly through the price mechanism. In a profit-making structure, businesses will set prices so as to ensure at least that all foreseeable costs are recovered, anything above this being conceptualised as a margin of profit. Because sales tax is levied upon the vendor *prior* to the ultimate sale by retail in the manner explained by Dixon J in *Ellis & Clark*[10], it forms part of the cost structure of doing business. There is nothing extraordinary in the proposition that in the usual course of things sales tax will be passed on.

10 As has been explained, it is for the taxpayer to establish a circumstance out of the ordinary, namely that the amount of the overpayment of sales tax has not been passed on. Where the whole or part of the economic burden of sales tax may have been passed on indirectly through prices, the inquiry in this regard is likely to be complex. The complexity arises because prices may be set with reference to a wide range of factors (including considerations of cost of production, competitive advantage, operational cash flow and customer goodwill). However the starting point must be the seller's pricing policy and practice.

11 In this way, the question is to be approached with reference to the actual conduct of the seller in setting prices based upon its actual knowledge at the relevant time. That knowledge includes the belief that the component of sales tax which later proves to have been an overpayment is a real cost of doing business. Accordingly, it is unsurprising that a seller's intention, whether subjective or objectively ascertained, will generally be to pass the burden of the impost on to the purchaser. Since the onus of proof lies upon the taxpayer, it will be for it to establish that a price which is set so as to ensure that it recovers its cost *does not include* the economic burden of the sales tax.

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10 (1934) 52 CLR 85 at 89-92.

12 Additionally, once it is appreciated that it is in the nature of sales tax to be passed on, there is nothing remarkable in the consequence that proof to the contrary will occur comparatively seldom. In his dissenting judgment in the Full Court, Conti J proceeded on the footing that what was required of the legislation was "a realistic prospect of sensible invocation at the instance of a taxpayer"[11]. But, given what has been said above, realism requires a recognition that in the ordinary course sales tax will have been passed on.

Avon's sales and pricing operations

13 In order to understand the application of the Act to Avon's case (and its treatment in the Federal Court), it is necessary to consider the characteristics of Avon's sales operations and the manner in which pricing occurred. These were considered in some detail by Hill J, drawing in this regard chiefly on the affidavit and oral evidence of Mr Christopher Stevens, who had been both Marketing Manager and later Vice President of Sales for the company.

14 Avon carried on business selling a variety of products by means of a network of sales representatives who acted as its agent in door to door sales. It sold two classes of product, designated as "CFT products" (an acronym for "Cosmetics, Fragrances and Toiletries") and "non-CFT products", which accounted respectively for 60 per cent and 40 per cent of sales. Prior to introducing a product, Avon's finance department undertook a cost analysis involving preparation of a cost sheet containing a full breakdown of the estimated maximum cost of the product, including sales tax. Avon would also assign each product a "regular price", which was benchmarked wherever possible against prices charged by competitors for comparable products, or at a price which the market would bear. Avon would consider introducing a product only if the regular price exceeded the maximum estimated cost by an acceptable profit margin. Avon did not change the regular price in any way in response to the various reductions in the applicable taxable values for its goods.

15 However, it is important to note that the regular price was not the price at which Avon generally retailed the products. This was because of the nature of Avon's marketing strategy which revolved around 18 standardised marketing "campaigns" each calendar year, each of approximately three weeks in duration. The sales campaigns were controlled by Avon's marketing department, and each

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11 (2005) 223 ALR 259 at 280.

campaign had a separate gross profit margin target. Integral to each campaign was the discounting of the regular price to a price or prices which were attractive to customers and also would enable Avon to meet the gross profit margin for each campaign and other campaign targets, while still covering costs (including sales tax). Discount prices were set in advance of each campaign. For each campaign, Avon produced an internal document listing all products on offer together with the regular price and any discounted "offer price" for that product, and then produced a campaign brochure based upon this information.

16 The evidence shows that approximately 85 per cent to 95 per cent of sales of CFT products were made at the discounted offer price instead of the regular price. Given that CFT products accounted for 60 per cent of the revenue of each campaign, it is clear that the actual price at which Avon sold was commonly the discounted price. Indeed, in the Full Court, the majority were prepared to draw the inference that only about 30 per cent of total sales of all Avon's CFT and non-CFT products occurred at their "'regular' prices"[12]. It is also clear that the discount price almost invariably covered Avon's costs (including sales tax). Hill J made a finding to this effect and, indeed, Avon accepted as much.

Avon's claim for sales tax credit

17 The manner in which Avon operated described above rendered it liable to sales tax in respect of the class described in Table 1 of Sched 1 to the Act as "indirect marketing sale[s] as defined by section 20" of the Act. Its liability arose pursuant to s 16 and assessable dealings AD2d (Australian goods) and AD12d (imported goods) in Table 1. In both cases, the taxable value of the goods was "the notional wholesale selling price". That was defined by the Notes to Table 1 to be "the price (excluding sales tax) for which the taxpayer could reasonably have been expected to sell the goods by wholesale under an arm's length transaction".

18 In practice, for the purposes of remitting sales tax, the notional wholesale selling price appears to have been determined by the Commissioner's various sales tax rulings. Hill J explained that the overpayments occurred because, on 5 February 1999, Avon obtained a Sales Tax Private Binding Ruling which determined that the taxable value of its products should be the "store cost of the goods plus 11.63%". That taxable value was lower that those on which Avon had previously based its remittances acting in accordance with sales tax rulings

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12 (2005) 223 ALR 259 at 264.

issued by the Commissioner[13]. Accordingly, Avon submitted claims for credits in the aggregate sum of $3,610,261 for the period from 1 March 1993 to 31 August 1998. As earlier indicated, there is no dispute that this amount was overpaid.

19 The Commissioner disallowed Avon's claims in their entirety, and also Avon's objection to that decision, on the basis that Avon had passed on the overpaid sales tax to its customers at point of sale and had not subsequently refunded them so as to fulfil the criterion of credit ground CR1.

20 Avon then "appealed" to the Federal Court. Hill J correctly identified the question as to whether sales tax has been passed on as a question of fact. As previously mentioned, his Honour canvassed the evidence in great detail and relied heavily upon the finding referred to earlier that the goods were always priced at a figure which exceeded cost plus sales tax and ensured a profit to Avon. His Honour held that, although the regular prices were not calculated as a function of cost, the undeniable significance of discounting in Avon's operations (which was done so as to produce an overall margin over cost for each campaign) was such that Avon had failed to prove that its prices were not set with regard to cost. The ultimate decision of Hill J was based upon the failure by Avon to satisfy the burden of proof imposed by s 14ZZO of the Administration Act.

21 A majority of the Full Court (Ryan and Merkel JJ)[14] accepted those findings of the primary judge, including the critical findings on price-setting practice and onus of proof referred to above. The essence of the majority decision was correctly identified in this Court by the Commissioner as being that, where the facts disclose that the taxpayer has set prices at a level to ensure that they exceed cost (including sales tax), it will be difficult for the taxpayer to satisfy its onus under s 14ZZO of the Administration Act to show that it has borne the tax burden itself. This Avon had failed to do.

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13 Until 1 December 1995, Avon treated the taxable value as "cost plus 35%" in accordance with sales tax ruling ST 2424 effective from 1 June 1988. After 1 December 1995, Avon treated the taxable value as "cost plus 15%" in accordance with the "safe harbour" set out in sales tax ruling SST 6, issued on 5 June 1996.

14 (2005) 223 ALR 259.

22 In the light of the analysis of the Act and the nature of sales tax contained in these reasons, the approach and conclusion of the majority were correct. We now turn to consider in more detail why this is so.

Avon's "test"

23 Avon's contention in this Court was that a tax is only passed on if the price at which the goods are sold is increased by the amount of the tax. Its contention in the Full Court appears to have been expressed somewhat differently, namely that a tax will have been passed on if the seller made a profit less than (or sustained a loss greater than) had it not been overpaid[15]. Each proposition actually represents the inverse function of the other. Conti J, in his dissenting judgment, accepted both contentions and the consequence Avon said flowed from them[16].

24 Avon submits that, since its regular prices remained constant and were fixed by reference to market benchmarks without reference to cost and, further, since its discounting policy remained constant (so that no smaller discount would have been made had the true cost position been known), then the above "test" was satisfied. That is, since the buyer was no worse off when sales tax was overpaid than it would otherwise have been, and the seller was worse off, the tax was absorbed by Avon.

25 Avon's approach suffers from the fallacy that it converts the question posed by the words of credit ground CR1 in Table 3 of Sched 1 to the Act into a hypothetical question, expressed in the nature of a "test". Avon submitted that this test is necessary in order to inform the factual inquiry required to answer the question as to whether sales tax was passed on. This should not be accepted; the "tests" merely restate the question using words different from the statutory language, and thus distract attention from the real task of the court.

26 Apart from the fundamental incongruity in approaching a question as to whether sales tax was in fact passed on by reference to a hypothetical question of this kind, Avon's "test" is unsatisfactory at a more basic level. It assumes that, if a cost is being passed on, removing it from the entire system will have an immediate correlative effect upon price and profit. That assumption is in conflict

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15 (2005) 223 ALR 259 at 263 per Ryan and Merkel JJ, 271 per Conti J.

16 (2005) 223 ALR 259 at 271.

with the more complex reality of price determination referred to earlier in these reasons. Indeed, the complexity of Avon's own pricing mechanisms belies that assumption. The Act requires proof of "the extent that the claimant has not passed [the overpayment] on". This question is not to be answered merely by pointing to price as the sole indicator of passing on.

27 The proposition for which Avon contends is also unsupported by relevant authority. The sole Australian authority relied upon by Avon in support of this contention was a passage from the judgment of Mason CJ in *Commissioner of State Revenue (Vict) v Royal Insurance Australia Ltd*[17]. That case concerned quite different legislation, and the passage from the judgment of Mason CJ provides no assistance[18].

28 The international authorities relied upon by Avon must be treated with considerable caution. They deal with different statutory regimes. In particular, Pt 4 of the Act provides a code of the applicable law relating to credits of sales tax in Australia. The international authorities tend to muddy the waters rather than to illuminate them. The United Kingdom authorities[19] may be put to one side because the statutory regime in force is quite different from the scheme of the Act[20].

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17 (1994) 182 CLR 51 at 71.

18 *Royal Insurance* concerned overpayment of stamp duties by the respondent insurer in circumstances where the Court found that the discretion vested in the Commissioner as to whether to refund overpayments must be exercised in accordance with common law principles. Mason CJ was considering the doctrine of passing on in that context. See further in that regard *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516 at 528-529 [22]-[24], 542 [69]; cf at 568-570 [139]-[143].

19 *Marks and Spencer plc v Customs and Excise Commissioners* [2000] STC 16; *Customs and Excise Commissioners v National Westminster Bank plc* [2003] STC 1072; *Baines & Ernst Ltd v Customs and Excise Commissioners* [2006] STC 653.

20 Section 80 of the *Value Added Tax Act* 1994 (UK) provided that the revenue authorities bear the onus of establishing that overpaid value added tax (VAT) *should not be* repaid. In that regard, s 80(3) created a defence to a claim by the taxpayer if "repayment of an amount would unjustly enrich the claimant".

29 The United States authority upon which Avon particularly relied was *Worthington Pump & Machinery Corp v United States*[21]. There, the United States Court of Claims considered a statute which Avon urged was to similar effect to the Act in question here[22]. The Court in *Worthington Pump* said[23]:

> "[T]he fact that a firm is making a profit or loss does not in itself determine whether or not it has passed on the tax. The only test is whether the seller has made a profit less than or sustained a loss greater than had the tax not been imposed on him."

This "test" was identical to that for which Avon contends. However, even if Avon is correct that the statutory provision was relevantly analogous (which is doubtful), the situation in *Worthington Pump* is clearly distinguishable, as Ryan and Merkel JJ pointed out in the Full Court[24]. This is because the taxpayer in *Worthington Pump* made a loss in the year for which the refund was claimed and the Court of Claims inferred an intention not to pass on the overpaid taxes. That is to say, the Court of Claims, contrary to the "test" urged by Avon, looked at factors outside price and profit margin.

Conclusion

30 Avon has failed to demonstrate any error in the approach of the majority of the Full Court in rejecting the utility of its purported test and in affirming the decision of Hill J that Avon had failed to establish that it had not passed on the overpaid sales tax. Ryan and Merkel JJ had due regard to Avon's evidence that its regular prices and its discounting policy remained unaltered whatever the

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21 122 F Supp 843 (1954).

22 Section 3443(d) of the *Revenue Act* 1942, 56 Stat 978, 26 USC 29 provided that no credit of overpaid tax could be made unless the taxpayer established:

> "(1) that he has not included the tax in the price of the article with respect to which it was imposed, or collected the amount of tax from the vendee, or (2) that he has repaid the amount of the tax to the ultimate purchaser of the article".

23 122 F Supp 843 at 847 (1954).

24 (2005) 223 ALR 259 at 262.

sales tax position. However, their Honours were unpersuaded that this was determinative. No error has been shown in that conclusion.

31 The appeal should be dismissed with costs.