IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No. S134 of 2016

BETWEEN:

BYWATER INVESTMENTS LTD
CHEMICAL TRUSTEE LTD
DERRIN BROTHERS PROPERTIES LTD
Appellants

and

COMMISSIONER OF TAXATION
Respondent

APPELLANTS' REPLY

Part I:

1. This submission is in a form suitable for publication on the internet.

Part II:

2. The focus of this reply is, *first*, the Respondent's contention that *Esquire Nominees*[1] stands for some limited, fact specific, proposition (contrary to both its plain meaning and its interpretation by appellate courts in the United Kingdom) or should otherwise be overturned and, *second*, the Respondent's submissions about the availably of treaty protection. The reply then addresses other matters raised by the Respondent.

Esquire Nominees is on point, and should not be overturned

3. The Respondent's primary submission is that the decision in *Esquire Nominees* should be applied. The Appellants agree. The Appellants rely on Gibbs J's reasons[2] for rejecting the Commissioner's contention that the facts in *Esquire Nominees* called for the same result as *Unit Construction*. The difference between the Appellants and the Respondent is the significance the Respondent seeks to attach to the relevant findings of fact of the Primary Judge. In the present matter the lawfully appointed organs of the companies were not by-passed. The effective decisions of the companies were made by the board or its directors albeit in many cases influenced by Mr Gould. The Appellants have not advanced any novel doctrine. Nor do the Appellants put the case as contended by the Respondent in the first sentence of RS [30]. The Appellants agree with the concluding sentence of RS [30]. The Appellants contend that the *Esquire Nominees* decision is an apt

1 *Esquire Nominees v F. C. of T.* (1973) 129 CLR 177.
2 *Esquire Nominees* at 129 CLR 190.2 to 191.4.

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illustration of a circumstance where those who had significant influence with the directors of a company, but who did not undertake the companies' transactions, did not constitute the relevant decision makers, and, as a consequence, did not constitute the companies' central management and control.

4. The Respondent, by notice of contention and three paragraphs of submission, seeks, as an alternative submission if its primary submission is not accepted, to overturn settled authority. The reasons in *John*[3] and *HCF*[4] set out the four general principles guiding whether and when this Court should overturn a prior decision. To these principles two further propositions ought to be added. A decision whether to reconsider an earlier decision must be made in light of the "*grave danger of a want of continuity in the interpretation of the law*", informed by "*a strongly conservative cautionary principle, adopted in the interests of continuity and consistency in the law*".[5] And when the Parliament has had repeated opportunities to amend the effect of a decision of this Court over 40 years, but has not done so, the Court should not depart from what was then held to be the proper construction of the relevant statute.[6] That observation applies with greater force in the present case where the Parliament has been active in making amendments to the income tax legislation. Rather than enact legislation to reverse the effect of *Esquire Nominees*, it has chosen to introduce the CFC rules, thereby entrenching the ruling in that case. The principles established in *John* provide no support for overturning *Esquire Nominees*. The four principles all weigh heavily in favour of maintenance of the status quo.

(a) First, *Esquire Nominees* rests on a principle carefully worked out in a significant line of cases. AS [31] to [44] identified the decisions that were considered by Gibbs J. In the appeal from Gibbs J's decision, none of the Justices expressed any reservations with his Honour's reasoning concerning central management and control. At RS [28] the Respondent accepts as much. Nor have any of the appellate decisions which have followed the *Esquire Nominees* decisions expressed any doubts about Gibbs J's reasons.

(b) Second, contrary to the submission advanced at RS [27], the passages from Gibbs J's judgment concerning central management and control were not *obiter*. Residence in Norfolk Island was the foundation for the claim to be exempt from tax on account of the alleged source of the income in

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3 *John v F.C of T* (1989) 166 CLR 417 at 438-439 (Mason CJ, Wilson, Dawson, Toohey and Gaudron JJ).

4 *The Commonwealth v Hospital Contribution Fund* (1982) 150 CLR 49 at 56-58 (Gibbs CJ, Stephen J *and* Aickin J agreeing).

5 *Attwells v Jackson Lalic Lawyers Pty Limited* (2016) 90 ALJR 572 at [28] (French CJ, Kiefel, Bell, Gageler and Keane JJ) and the authorities cited there.

6 *Plaintiff M76/2013 v Minister for Immigration, Multicultural Affairs and Citizenship* (2013) 251 CLR 322, 366 [125] Hayne J and 382 [194] Kiefel and Keane JJ.

question.[7] Central management and control was pivotal to the question of residence.[8]

(c) Third, *Esquire Nominees* has not led to any inconvenience. To the contrary, in a setting where three tests are provided to determine a company's place of residence, first the place of incorporation, second the place of central management and control and third the place of controlling shareholder voting power, *Esquire Nominees* is a convenient and clear application of the second test. It creates no mischief that the Commonwealth cannot (and has not) addressed with legislation.

(d) Fourth, the decision has been independently acted on in a manner which militates against reconsideration. RS [43] makes the submission that *Esquire Nominees* has formed part of the *'tax lore'* of this country. Notwithstanding the submission's pejorative tone, it is nevertheless implicit recognition that taxpayers and their advisers have relied upon the *Esquire Nominees* decision to organise their affairs. It has also been followed in the each of the appellate and first instance decisions analysed at AS [45] to [50].

The double taxation agreements protect the taxpayers

5. The Appellants accept that they must make out a case for treaty protection. The Respondent's submission on this point is that the Appellants have not made out their case on the factual findings of the Primary Judge.

6. Contrary to the submission at RS [49], Chemical and Derrin were found to be residents of the United Kingdom for the post-2004 income years. Although the reasons of the Primary Judge are admittedly unclear, PJ [427] contains a finding, rather than an assumption, that the taxpayers were resident in the United Kingdom. The basis for that finding is at PJ [423], where the Primary Judge relied on the legal presumption that the law of residence in the United Kingdom was the same as Australian law. Place of incorporation therefore determined residence under the treaty. As such, in respect of the treaty position for those income years, if Chemical and Derrin are not resident in Australia, then their profits are shielded by their residence in the UK.[9] They do not need to rely on the tie-breaker provisions.

7. For the United Kingdom treaty provisions for the income years up to and including 2004, the Appellants accept that the Primary Judge assumed that Chemical and Derrin were resident in the United Kingdom in PJ [431]. The lack of a finding was not raised by the Respondent below, and the Full Court correctly stated that it *'was*

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7 *Esquire Nominees* at 129 CLR 186.9 to 187.1, 188.8, 189.3 (Gibbs J).
8 *Esquire Nominees* at 129 CLR 189.8 (Gibbs J).
9 Article 7, *Convention Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Australia for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains*, signed 21 August 2003, [2003] ATS 22

common ground between the parties, [that it was] necessary to determine the place of central management and control of the appellants' in order to dispose of the treaty question. The Full Court found that the two UK treaties were the same in effect: FC [6]. Given the conduct of the matter on appeal, if they cannot rely on the UK treaty before 2005, Chemical and Derrin ought to have the opportunity to rely on the treaty with Switzerland. Leave is sought to file an Amended Notice of Appeal as annexed[10] to accommodate a determination of this point on appeal or on remitter to allow Chemical and Derrin that opportunity.

8. Chemical, Derrin and Bywater are residents of Switzerland if their *place of effective management* is in Switzerland. The Full Court did not consider the question of whether the Appellants were resident in Switzerland, which would have required an assessment of the facts against the test identified at PJ [439], being where *'day-to-day business decisions are made'*. If the Appellants satisfy that test, and are not resident in Australia, they are entitled to treaty protection without resort to the tie breaker provision.[11] If this Court accepts that a company makes its business decisions through its functioning board or directors, i.e. that its *place of effective management* is the same as its place of central management and control, it follows that the Appellants each have their place of effective management in Switzerland. Any doubt about the issue ought to be determined on remitter.

Other matters

9. At RS [7], the Respondent complains that the Appellants' have proposed a *question begging* statement of issues. The criticism proceeds from the false premise that the questions assume a matter in contest. The Appellants' case does not require an assumption that the lawful organs play an operative role in decision making. They contend that where the lawful organs are not by-passed, and are the means by which the company undertakes transactions, that is sufficient to constitute central management and control.

10. At RS [36], the Respondent appears to accept that the Appellants' interpretation of *Esquire Nominees* is supported by the appellate authorities from the United Kingdom, particularly *Wood v Holden*. The Respondent says that those decisions can be distinguished because of the factual finding that the decisions were made by the directors. In footnote 65 of his submissions, the Respondent accepts that in *Wood v Holden*, the factual finding was no more than a finding that the directors signed documents. For present purposes, an equivalent finding was made by the Primary Judge.

11. The Respondent also relies on the Canadian decisions in *Bedford*[12] and *Birmount*.[13] In both of those cases, the revenue unsuccessfully argued that central management

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10 Also annexed to the Affidavit of Eric Herman dated 14 July 2016.
11 Article 7, *Agreement between Australia and Switzerland for the Avoidance of Double Taxation with respect to Taxes on Income*, signed 28 February 1980.
12 *Bedford Overseas Freighters Ltd v MNR* [1970] CTC 69.
13 *Birmount Holdings Ltd v R* [1978] CTC 358.

and control was vested in a third party, who was involved (to varying degrees) in giving directions to the directors in respect of critical decisions of the taxpayers. Any additional independence or deliberation present in those cases was not a necessary factor of the taxpayers' success.

12. The Respondent also refers to the US Supreme Court decision in *Hertz Corp v Friend,*[14] a case involving the *'principal place of business'* test for the purpose of establishing diversity jurisdiction. That context and the language of the statute make the decision an awkward guide for this Court. However, if it were to be such a guide, the passages relied on by the Respondent misstate the effect of the decision of the Court. The Court found that the location of the corporate headquarters (or officers) was the relevant locus, where the company's affairs were directed, controlled and coordinated.[15]

13. At RS [46], the Respondent relies on the capacity for third parties to be deemed a 'director' in the context of the Corporations law. The Respondent accepts that those deeming provisions have no application in the context of taxation: RS [46]. There is good reason for that, rules for imposing liability for corporate misconduct have no obvious role to play in the context of tax policy. That may explain why the Respondent never advanced a case below that Mr Gould was a shadow director.

14. The Respondent says at RS [52] to [55] that ownership is a 'false issue', and that it never advanced a case that ownership was dispositive. The Commissioner's submissions to the Primary Judge and the primary judgment are to the contrary. That submission was ... *that whoever had a beneficial interest in [JA and MH Investments] and whoever had control over the shareholding and directorship of those entities, was in a position to control the voting, distribution of dividends, application of funds, and so on, ultimately of the three taxpayers.*[16] The Primary Judge observed that *[a]s the Commissioner submitted, Mr Gould's ownership makes it highly unlikely that Mr Borgas would have been making the decisions:* PJ [340]. The Respondent led the Primary Judge into error by advancing this case.

Dated: 14 July 2016

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14 559 U.S. 77 (2010).

15 559 U.S. 77 (2010) 93 and 97.

16 The Respondent's subm issions to the Primary Judge at T.55, l.40-44, provided to the Full Court in the Appellants' Reply Folder and appearing in the Joint Appeal Book at AB 1049 l.42-46.