IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No S228 of 2012

BETWEEN:

COMMISSIONER OF TAXATION
Appellant

and

CONSOLIDATED MEDIA HOLDINGS LTD (ACN 009 071 167)
Respondent

RESPONDENT'S SUBMISSIONS

Part I – Publication

1. The Respondent certifies that these submissions are in a form suitable for publication on the internet.

Part II – Issue on the Appeal

2. In the year ended 30 June 2002 the Respondent entered into a share buy-back agreement pursuant to which 840,336,000 shares it held in Crown Limited (**Crown**) were to be subject to an "off-market purchase" in consideration for $1,000,000,000. The purchase price was payable, and was paid, in the following (2003) year of income when the buy-back agreement was completed and the shares transferred by the Respondent to Crown.

3. The amount payable was debited in the 2002 year to Crown's Share Buy-Back Reserve, a new account established in Crown's general ledger in that year and which had no amount standing to its credit.

4. The issue in this appeal is whether, having regard to s 159GZZZP(1) and s 6D of the *Income Tax Assessment Act 1936* (the **1936 Act**), the consideration of $1,000,000,000 is capital proceeds of the 2002 year, as the Appellant contends or is deemed to have been a dividend and deemed to have been paid out of profits, as the Respondent contends.

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Part III – Section 78B of the Judiciary Act

5. The Respondent has considered whether any notice should be given in compliance with s 78B of the *Judiciary Act 1903* and respectfully submits that no such notice should be given.

Part IV – Factual matters

6. The facts were found by the trial judge at J[16]-[37]. In addition to those facts the Respondent relies on or emphasises the following.

7. Mr Long, the auditor of Crown, gave evidence that the buy-back was "reflected" in the $1 billion reduction in "contributed equity" in the Crown financial statements.[1]

8. Mr Long's evidence was that a share buy-back always involves a reduction in shareholders' equity, which is the total of the capital, reserves and retained profits of the company.[2] His evidence was that the Share Buy-Back Reserve could have been disclosed separately in the financial statements, but that in his view it would not have been more appropriate to do so, because the non-disclosure of the Share Buy-Back Reserve would not have adversely affected decisions by the users of the financial report.[3]

9. While the trial judge recorded the agreement between the accounting experts that a reserve account with a debit, or negative, balance was neither prohibited nor expressly permitted by the accounting standards (with the exception of one standard that did not apply),[4] there was no finding by the trial judge that the establishment of the Share Buy-Back Reserve or the debit entry to that account was in breach of the accounting standards or was in any other way impermissible. His Honour recorded the evidence that the financial statements could have been prepared differently.[5]

10. There was no finding by the trial judge, independently of s 6D, that "the SBBR account was part of the account kept by Crown of it share capital",[6] or that "the Shareholder's Equity account and the SBBR account together constituted the account kept by Crown of its share capital".[7]

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[1] Affidavit of Brian James Long sworn 15 December 2009, para 8, AB-xx.

[2] Affidavit of Brian James Long sworn 15 December 2009, para 11, AB-xx; J[52], AB-xx;, affidavit of Brian James Long sworn 4 March 2011, para 3, AB-xx. Cf *Sons of Gwalia v Margaretic* (2007) 231 CLR 160 at 250.6 [250] per Callinan J.

[3] Affidavit of Brian James Long sworn 15 December 2009, para 13, AB-xx; Affidavit of Brian James Long sworn 4 March 2011, para 6, AB-xx; Transcript 7 March 2011, P-28.38-P-29.22, AB-xx.

[4] J[37], AB-xx.

[5] J[53], AB-xx.

[6] Cf AS[22.6].

[7] Cf AS[22.7].

11. The accounting experts also agreed that reserve accounts are used to record elements of shareholders' equity other than contributed capital or retained profits.[8] An example is an asset revaluation reserve,[9] from which a dividend may be paid.[10]

12. The buy-back agreement was executed in the 2002 year of income (on 28 June 2002),[11] but was not completed until the following income year.[12] The consideration for the shares bought back was not paid until 6 August 2002.

13. AS[27] is incorrect:

(a) it is not common ground that "Crown could not have funded the buy-back out of profits". The net profit and retained profits/(losses) line items in Crown's Annual Report as at 30 June 2002 were each less than $1 billion, but neither of these is necessarily the same as "profits" for the purposes of the ITAA 1936.[13] The market value of Crown as at 30 June 2002 was more than $1 billion in excess of the balance of the Shareholders Equity account.[14]

(b) nor is it common ground that "the buy-back was in fact funded entirely out of share capital." The buy-back was completed in the next year of income by Crown assigning a debt to the Respondent.[15] As at 30 June 2002, the purchase price was accounted for by a debit to the Share Buy-Back Reserve account.

Part V – Legislation

14. In addition to the legislation identified by the Appellant, the Respondent relies on:

(a) s 44, s 45A, s 45B, 45C, 45D, s 46A, s 46C, s 46E, s 46G, s 46H, s 46K and s 47 of the 1936 Act as at 30 June 2002;

(b) s 6(1) definition of "dividend", "share premium account" in the 1936 Act as amended or enacted in 1967;

(c) s 6(1) definition of "dividend" in the 1936 Act as enacted;

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[8] Joint Report of Professors Boymal and Walker dated 30 September 2010, paras 11-12, AB-xx.

[9] J[36], AB-xx.

[10] *Commissioner of Taxation (Cth) v Sun Alliance Investments Pty Ltd (in liq)* (2005) 225 CLR 488 per Gleeson CJ, Gummow, Kirby, Callinan and Heydon JJ at 408.3 [53].

[11] J[19], AB-xx.

[12] J[23], AB-xx.

[13] *Re Spanish Prospecting Co Ltd* [1911] 1 Ch 92 per Fletcher Moulton LJ at 98-99; *Commissioner of Taxation (Cth) v Sun Alliance Investments Pty Ltd (in liq)* (2005) 225 CLR 488 per Gleeson CJ, Gummow, Kirby, Callinan and Heydon JJ at 511.5 [67].

[14] The off-market purchase of 840,336,000 Crown shares was for $1 billion (Exhibit BJL-2, page 23, AB-xx), which is $1.19 per share; the 2,938,587,410 shares on issue as at 30 June 2002 (Exhibit BJL-2, page 23, AB-xx) would on that basis be valued at $3,496,919,577. The balance in the Shareholders Equity account was $2,411,822,878.30 (AB-xx).

[15] J[23] AB-xx, FC[8] AB-xx.

(d) s 257H of the Corporations Act 2001.

Part VI – Argument

Appellant's primary argument

15. The Appellant succeeded at first instance because the trial judge found that the Share Buy-Back Reserve account was a share capital account within s 6D, and because it "*follow[ed] that the consideration for the buy-back was debited to Crown's share capital account*": J[72]. It was necessary for his Honour to rely on the deeming provision, s 6D, to reach that conclusion. The primary argument now put by the Appellant seeks to achieve that end without the aid of s 6D (or any similar deeming provision), presumably due to the difficulties exposed by the Full Court in his succeeding in an argument that relies on that provision.

16. At the core of the Appellant's primary argument are the propositions that:

(a) the financial statements of Crown "confirmed" that the amount was debited against amounts standing to the credit of the share capital account;[16]

(b) the share capital of Crown was reduced by $1,000,000,000.[17]

17. Neither of those propositions is, with respect, made out.

18. The language of s 159GZZZP(1), which directs attention to an "account", requires an analysis of the relevant ledger accounts, which in this case are the accounts labelled "Shareholders Equity"[18] and "Share Buy-Back Reserve".[19] Neither of those accounts[20] are line items in the financial statements, as the Appellant's summary in AS[16]-[18] demonstrates. By contrast, financial statements are a form of periodic reporting. They do not record transactions. They are not "accounts" within the meaning of and for the purposes of s 159GZZZP(1). They are not ledgers and do not contain debit and credit entries. The Appellant acknowledges that at AS[56].

19. While the line item "Contributed Equity" in the financial statements of Crown for the year ended 30 June 2002 is a summary of what appears in two ledger accounts: the Shareholders Equity account and the Share Buy-Back Reserve account, the evidence was that the Share Buy-Back Reserve could have been shown as a separate line item in the financial statements.[21] The Contributed Equity line item would have presented the same balance as at 30 June 2002 as it would have as at 30 June 2001 and "Issued and Paid Up Capital" would have been likewise unchanged.

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[16] AS[53]-[56].

[17] AS[50]-[52].

[18] Affidavit of John Salomone sworn 18 December 2009, exhibit JS-7, AB-xx.

[19] Affidavit of John Salomone sworn 18 December 2009, exhibit JS-3, AB-xx.

[20] "Account" is defined in the Macquarie Dictionary, Fifth Edition as a "formal record of the debits and credits relating to the person named (or caption placed) ... caption placed ... at the head of the ledger account".

[21] See paragraph [8] above.

20. While the financial statements have the effect of summarising the year end balances of the various accounts kept by the company, they are not capable of effecting a set-off between the accounts themselves. The purchase price was debited to the Share Buy-Back Reserve account, not the Shareholders Equity account. There was no amount standing to the credit of the Share Buy-Back Reserve account when the debit was made. The financial statements cannot "confirm" or make happen an event which did not take place: cf AS[17], [56].

21. The financial reports were prepared not only after the end of the 2002 year of income (with which the Court is concerned) but also after completion of the buy-back.[22] The consideration was not in fact paid in the 2002 year of income. The ledger accounts record the transaction as at the end of that year of income;[23] they could and did reflect only the obligation to pay the buy-back consideration – the transaction had not been completed as at 30 June 2002. The shares had not been bought back at that time; capital would only be reduced once the shares were transferred to the company and cancelled, which occurred on 6 August 2002, in the following tax year.

22. In reality, as the Appellant himself points out, the question of whether the purchase price was debited against amounts standing to the credit of Crown's share capital account is one of fact: AS[54]. While expert accounting evidence was adduced before the trial judge, and the financial statements relied on were the subject of detailed submissions, his Honour expressed no preference for either expert; nor made any finding that the financial statements had the effect contended for by the Appellant.

23. The Full Court was also correct, with respect, in concluding that the debit entry in the Share Buy-Back Reserve account was not a debit "*against*" the credit balance in any account: FC[46], AB-xx. Not every debit that is somehow referrable to the purchase price for a share buy-back is the subject of s 159GZZZP(1)(b); if it were otherwise then s 159GZZZP(1) would never deem any amount to be a dividend, even a debit to the retained earnings account. The words of the subsection simply do not accommodate the Appellant's submission in AS[56].

24. Nor is the Appellant assisted by the distinction he seeks to draw between the phrase "*debited against*" (in s 159GZZZP(1) and paragraph (d) of the s 6(1) definition of dividend) and "*debited to*" (in subparagraph (e)(iii) of the s 6(1) definition of dividend): AS[55]. The phrase "*debited against*" is used in the former provisions because it is followed by the words "*an amount standing to the credit of*". The point is that the debit must not only be to a particular account, it must be made "*against*" a credit to that account which must result in the credit balance in that account being

[22] The financial statements were approved by the directors of Crown and lodged with ASIC on 27 September 2002: J[24], AB-xx; exhibit BJL-2 at p 8, AB-xx.

[23] *Commissioner of Taxation v H* (2010) 188 FCR 440 per Downes, Edmonds and Greenwood JJ at 448 [39]-[41].

reduced. The alternative formulation "*debited to*" appears in a provision that requires only that the debit be made in a particular account.

25. Second, and contrary to what is implied at AS[26], the Full Court did not agree that even the consequence of the buy-back was that $1,000,000,000 of share capital was returned to the Respondent.[24] What the Full Court actually said was that "[i]n a company law sense, it was correct for the primary judge to conclude... that the consequence of the share buy-back resulted in a return of capital to CMH and a related reduction in Crown's share capital": FC[42], AB-xx.

26. In fact, there was no evidence as to what was paid up on the particular shares bought back by Crown; all that is known is that $1,000,000,000 was paid in the 2003 income year for 840,336,000 shares.[25] A share buy-back will always "result in the return of capital" and will always lead to "a reduction in the share capital of the Company" no matter by how much the consideration paid exceeds the paid up value of the shares bought back, and no matter which account or accounts are debited with the purchase price. That is what the Full Court pointed out at FC[42], AB-xx.

27. There can be no dispute that completion of the buy back in this case resulted in an amount being applied to reduce capital.[26] In *Inland Revenue Commissioners v Universal Grinding Wheel Co Ltd* [1955] AC 807 at 819, Viscount Simonds said that:

> [I]n a reduction of capital it is competent for a company to pay off share capital by transferring to the shareholders assets of which the value may exceed the amount by which the share capital is reduced, and that the court should sanction the reduction provided that it is satisfied as to the safeguarding of the creditors, the shareholders and the public. From this it clearly emerges that there need be no precise correspondence between the amount by which the shareholder's capital is reduced and the value of that which is transferred to them, even though the latter exceeds the former. It need, therefore, cause no surprise if the 'sum applied in reducing capital' exceeds the amount by which the capital is nominally reduced.

28. As the Full Court observed at FC[41], AB-xx, *Universal Grinding Wheel* was applied by this Court in *Comptroller of Stamps (Victoria) v Ashwick (Vic) No 4 Pty Ltd*.[27] In the latter case, it was observed that a redemption of preference shares effected out of profits otherwise available for the payment of a dividend will constitute a reduction of share capital.[28] The fact that the transaction is sourced in, or

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[24] Even if this were the correct consequence, nothing was "returned" in the year of income.

[25] However, we do know, for instance, that the approximately $1 billion worth of Crown shares subscribed for by the Respondent in 1999 were paid up to 64 cents per share ($1,059,893,998 divided by 1,665,714,282 shares: Commissioner's appeal statement, 101[6]), AB-xx.

[26] Contrary to the impression attempted in AS[34], Kitto J in *Uther*, supra, did not doubt that proposition.

[27] (1987) 163 CLR 640.

[28] Ibid per Mason CJ, Wilson, Dawson, Toohey and Gaudron JJ at at 650.7.

funded by, profits does not affect the character of the transaction. A redemption of shares, like a buy-back, will always result in a reduction of share capital.

29. Nothing said by Gibbs CJ in *Slater Holdings*[29] changes that analysis. While Gibbs CJ would have preferred the analysis of Kitto J in *Uther*,[30] it was not necessary in that case to decide whether the decision of the majority in *Uther* was correct. His Honour said nothing at all about *Universal Grinding Wheel.*

30. The fundamental proposition put by the Respondent is that the character of the transaction from a company law perspective does not answer the question asked by s 159GZZZP(1). The history of the treatment by the income tax legislation of distributions as dividends for tax purposes, whatever their character for company law purposes, supports that proposition. An analysis of that history, including the position of s 159GZZZP(1) within it, follows.

Legislative history: deemed dividends

31. The 1936 Act as originally enacted included a wide definition of "*dividend*".[31] This definition has at all times been broader than the company law concept of dividend.[32] Section 44 includes in the assessable income of the shareholder, as dividends, part or all of a wide range of distributions by means of deeming provisions such as s 45B (demerger and capital distributions), s 47 (distributions on liquidation), s 109 and former s 108 (loans or payments to shareholders, associates or directors) and Division 7A (payments, loans and other benefits to shareholders).

32. Many of the deeming provisions were enacted (or amended) to deal with what were perceived to be specific shortcomings arising from the definition of "dividend" in s 6(1). An early example is s 47.

33. In its original form, s 47 dealt with the issue that arose in *Inland Revenue Commissioners v Burrell.*[33] In that case the Court of Appeal determined that while a distribution of a mass of assets on liquidation may, in a colloquial sense, represent or contain profits, the distribution will be a distribution of capital. Section 47 changed this for taxation purposes by deeming distributions made in the course of winding up to be dividends "*to the extent to which they represent income derived by the company*". It also takes the further step of deeming those dividends to have been paid by the company out of profits[34] derived by it, thereby ensuring assessability by engaging s 44(1).

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[29] Supra.

[30] *Slater Holdings*, supra, at 457.2, 459.6.

[31] Section 6(1) of the 1936 Act, as enacted in 1936.

[32] *Gibb v Commissioner of Taxation* (1966) 118 CLR 628 per Barwick CJ, McTiernan and Taylor JJ at 635.5, 636.7.

[33] [1924] 2 KB 52.

[34] Profits may be of a capital or income nature: *Resch v Federal Commissioner of Taxation* (1942) 66 CLR 198 at 225.1 per Dixon J.

34. In *Inland Revenue Commissioners v Blott*,[35] the Court of Appeal had held that bonus shares issued by a company to its shareholders were not income of the latter. Accordingly, the definition of "dividend" in s 6(1) of the 1936 Act included "*the paid up value of shares distributed by a company to its shareholders to the extent to which the paid-up value represents a capitalization of profits*".

35. Problems continued, however, where bonus shares were issued. In *Federal Commissioner of Taxation v WE Fuller Pty Ltd*,[36] a majority of this Court held that, for s 47 purposes, such a distribution when received by a company represented "income" of that company. That decision was not followed in *Gibb v Federal Commissioner of Taxation*,[37] the dissenting judgment of Dixon CJ in *Fuller* being preferred. The view of the Court in *Gibb* was given on the basis that the "*definition of 'dividend'* [did not operate] *to invest the allotment of bonus shares ... with the character of income for the purposes of the Act*".[38]

36. Prior to 1967, the definition of "dividend" in s 6(1) excluded a "*return of paid-up capital*". In *Commissioner of Taxation v Uther*,[39] the Commissioner had assessed the taxpayer on the amount by which a company distribution exceeded the aggregate of the amounts paid-up on cancelled shares. The majority concluded that the distribution was not an assessable dividend, Menzies J because in the shareholder's hands such a distribution was of a capital nature,[40] whether or not it was wholly or partly paid, or was deemed to have been paid, out of profits.

37. Kitto J (dissenting) was of the view that the character of the distribution from the perspective of the recipient shareholder was no longer the relevant legislative criterion; when one focussed on the statute, the definition "look[ed] only at the nature of the source from which the company has made the distribution".[41] However, it was not necessary, in his Honour's view, that the distribution be sourced from a particular fund of profits.[42]

38. Where provisions such as s 47 applied to deem a payment to be a dividend, and to have been paid out of profits, it was, of course, unnecessary to identify any actual profit source at all.

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[35] (1920) 2 KB 657.

[36] (1959) 101 CLR 403.

[37] (1966) 118 CLR 628 per Barwick CJ, McTiernan and Taylor JJ at 632.7, 635-636, Windeyer J at 640.1-641.1.

[38] at 635.1 per Barwick CJ, McTiernan and Taylor JJ. What is now ss 47(1A), inserted by the *Taxation Laws Amendment (Company Distributions) Act 1987*, reverses this result.

[39] (1965) 112 CLR 630. See Explanatory Memorandum for the *Income Tax Assessment Act (No. 4) 1967*.

[40] Ibid at 643.5-644.5.

[41] *Uther* at 640.5; and see *Federal Commissioner of Taxation v Slater Holdings Pty Limited* (1984) 156 CLR 447 at 459 per Gibbs CJ, with whom the other members of the Court agreed.

[42] *Uther* at 636.9-637.2

39. Following *Uther*, in 1967 the exclusion of "a return of paid-up share capital" in the s 6(1) definition of "dividend" was replaced by the following exclusions:[43]

(d) "*moneys ... debited against an amount standing to the credit of a share premium account of the company*";

(e) "*... moneys paid ... by way of repayment ... of moneys paid up on a share*".

40. A new definition of "share premium account" was also inserted.[44] It was defined as "*an account, whether called a share premium account or not, to which the company has, in respect of premiums received by the company on shares issued by it, credited amounts ... but does not include -*

(a) *where any other amount is included in the amount standing to the credit of such account – that account; or*

(b) *where an amount has been credited to such an account in respect of a premium received by the company on a share issued by it (not being an amount that has been so credited immediately after the receipt by the company of the premium) could not, at any time before it was so credited, be identified in the books of the company as such a premium - that account.*"

41. The amendments with respect to share premium were also enacted to respond to company law concepts. By 1967, it was no longer possible to distribute share premium to a shareholder by way of a dividend;[45] share premium was required to be accounted for as such,[46] and the restrictions under the companies legislation relating to the reduction of share capital applied to share premium. For tax purposes, share premium, both in the hands of the company and in the hands of the recipient, possessed the quality of capital.[47]

42. It will accordingly be seen that the 1936 Act, which is concerned with collecting revenue,[48] will rewrite or reverse the effects of company law principles to suit the legislature's view of what ought, or ought not, to be taxed. It follows that the tax consequences of dealings between companies and their shareholders are not governed by company law concepts; they are governed by the provisions of the income tax legislation.

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[43] *Income Tax Assessment Act (No 4) 1967.*

[44] *Income Tax Assessment Act (No 4) 1967.*

[45] *Drown v Gaumont-British Picture Corp Limited* [1937] Ch 402, *Moore v Carreras Ltd* [1935] VLR 68, cited in Ford's Principles of Corporations Law, Eighth Edition, at [17.270].

[46] Section 60(1) of the *Companies Act 1961* (NSW); later reflected in s 191 of the Corporations Law.

[47] *Re Duff's Settlement; National Provincial Bank Ltd v Gregson* [1951] 1 Ch 721 at 727-8 per Harman J; affirmed on appeal [1951] 1 Ch 923 at 930-1.

[48] *Carr v Western Australia* (2007) 232 CLR 138 at 143.4[6].

43. The mechanism in the 1998 version of s 159GZZZP is one of a number of different legislative mechanisms by which a company distribution has been classified as a dividend for income tax purposes. Thus, for instance, treatment as a dividend has been made to depend upon, as the case may be, the extent to which the distribution: (a) represented income derived by the company (s 47); (b) was not a repayment of moneys paid up on a share (s 6(1), para e)); or (c) was not debited to a particular account (s 6(1), para (d)). All three mechanisms were legislative responses in the 1936 Act to company law.

44. In particular, the mechanism chosen in paragraph (d) of the 1967 s 6(1) definition of "dividend", together with the definition of "share premium account", eliminated the relevance of company law concepts by selecting as the criterion the accounting treatment adopted in relation to the "moneys" distributed. It introduced, for the first time, such an accounts-based methodology.

45. The Commissioner's assertion at AS[37] that the 1967 amendments "continued to exclude the return of paid-up share capital" does not give the full picture. When the 1967 amendments were made there was no comprehensive regime for the taxation of capital gains.[49] The policy that informed the 1967 amendments was that distributions of amounts other than moneys paid up on a share, or moneys debited to an amount standing to the credit of a share premium account, would be treated as taxable dividends rather than tax-free capital distributions.[50] The mischief was the distribution of profits disguised as a tax-free or preferentially taxed return of capital.

46. Comprehensive taxation of capital gains was introduced by the *Income Tax Assessment Amendment (Capital Gains) Act 1986* (applicable from 19 September 1985). However, some receipts of capital were still preferentially taxed. As late as 1998, residual concerns about tax-preferred capital distributions remained and were dealt with by the introduction of specific anti-avoidance provisions (ss 45A and 45B).[51]

Legislative history of section 159GZZZP

47. In the absence of s 159GZZZP(1), for tax purposes the purchase price of shares subject to an off-market buy-back would always be a capital or revenue receipt, but would never be a dividend within the s 6(1) definition. A buy-back is effected by way of a disposal of the relevant shares to the company, even though following this the shares are cancelled;[52] the amount paid to the shareholder is not a distribution on

[49] There were a small number of provisions that brought into assessable income a limited category of capital gains, eg former s 26(a) of the 1936 Act.

[50] Second Reading Speech, Income Tax Assessment Bill (No. 4) 1967 (Cth); Explanatory Memorandum to the Income Tax Assessment Bill (No. 4) 1967 (Cth), notes to clauses 4(2) and 8(a).

[51] see Explanatory Memorandum to *Taxation Laws Amendment (Company Law Review) Bill 1998*, paras 1.2, 1.5, 1.7, 1.21.

[52] ss 257H(3) of the *Corporations Act 2001*; cf *Coles Myer Limited* v *Commissioner of State Revenue* (1998) 4 VR 728.

the shares but rather consideration for the transfer of the shares. In the ordinary case, the amount would be a receipt of a capital nature.[53]

48. In 1990, when s 159GZZZP(1) was enacted it allocated the purchase price for such shares between assessable dividends on the one hand, and other potentially assessable receipts (capital or revenue) on the other.

49. If any part of the consideration was deemed to be a dividend by s 159GZZZP(1), it was also considered necessary to deem it to have been paid out of profits by subparagraph (1)(d), so as to bring the deemed dividend into the shareholder's assessable income under s 44(1).[54] This deeming meant that the source of the distribution – profits or otherwise – was irrelevant.

50. The primary methodology chosen in 1990 for the allocation between dividends, on the one hand, and capital (or revenue) receipts on the other, was by reference to "*the amount to which the share was paid-up immediately before the buy-back*" (s 159GZZZP(1)(a)).

51. While that formulation may be compared with the words used in paragraph (e) of the s 6(1) definition of "dividend", contrary to AS[31], [39], [40] and [44]-[48] no legislative preference for a dividend or a capital or revenue receipt can be inferred. In 1990, unlike in 1967, all would fall into the calculation of the taxable income. However, it was only where the purchase price was deemed to be a dividend that the full amount would always be assessable. A capital or revenue receipt might have given rise to an assessable gain or profit, or to a deductible loss. Accordingly, the classification of the purchase price as wholly or partly a dividend could not have been seen to be a mischief to be avoided. The Appellant's attempt to read the concern about profit distributions "disguised" as tax-free capital returns as the rationale for the original version of s 159GZZZP(1) is therefore misplaced: AS[40] and [44].

52. Furthermore, the Appellant's construction pays no regard to the words of the provision; he relies on words extracted from an Explanatory Memorandum in substitution for the text of the provision.[55] The Explanatory Memorandum in question says nothing about the purpose of the 1990 provision or about any mischief to which it was directed: the sentence on which the Appellant relies, "*that, to the extent that an off-market purchase is funded from a company's distributable profits, the purchase price will be treated as a dividend*", is merely a neutrally expressed statement concerning the effect of the 1990 provision.

53. Even if it was possible to identify a legislative concern of the kind alleged, the Appellant must take his argument one step further; he needs to find the converse

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[53] If the shares were revenue assets of the taxpayer's business then the amount would be a revenue receipt.

[54] cf *Commissioner of Taxation v Comber* (1986) 10 FCR 88 per Fisher J at 96.1-96.8.

[55] *Re Bolton; Ex parte Beane* (1987) 162 CLR 514 per Mason CJ, Wilson and Dawson JJ at 518.3; *Saeed v Minister for Immigration and Citizenship* (2010) 241 CLR 252 per French CJ, Gummow, Hayne, Crennan and Kiefel JJ at 265 [32]-[34].

concern, ie, a concern about returns of capital being "disguised" as dividends. No such concern existed.

54. Contrary to AS[37], the 1967 amendments to the definition of "dividend" did not "exclude the return of paid-up share capital"; rather they excluded a mathematical figure being the amount equal to the "*moneys paid ... by way of repayment by the company of moneys paid up on a share*". The amount excluded did not have to be "funded" by or "sourced" in share capital, it might have been in fact paid from profits, hence the need for (e) in addition to (d). The amount excluded by (e) from being an assessable dividend was the amount equal to the numerical value paid up on the shares in question.

The 1998 amendment

55. In 1998, s 159GZZZP(1) was amended, and a new and different methodology for allocating the purchase price was introduced. It is the 1998 provision with which this Court is concerned. The portion which would now be a capital or revenue receipt was that part of the purchase price which was "*debited against amounts standing to the credit of the company's share capital account*" (s 159GZZZP(1)(b)). This formulation can again be compared to paragraph (d) of the s 6(1) definition of "dividend", and, at the same time, contrasted with paragraph (e) of the same definition.

56. As has been seen, the Appellant seeks to discern the purpose of the 1998 version of s 159GZZZP(1) by reference to a sentence in the Explanatory Memorandum concerning its predecessor, which had a different allocation methodology. This means that even if the Appellant succeeds in: (a) translating a concern that existed in 1967 under a very different tax regime to 1990; and (b) converting that concern from one relating to "disguised" dividends to one relating to "disguised" capital returns, he still faces the difficulty of a deliberate change in language from the 1990 version of s 159GZZZP(1) to the 1998 version which is the subject of this case.

57. The Appellant's submissions concerning "disguised" returns of capital proceed on the basis that paid-up share capital has a significance that it does not. Paid-up share capital is not a "guarantee fund" to which creditors look for discharge of their debts, and it is "wholly irrelevant" to a shareholder who has acquired fully paid shares on market.[56] There is no general principle of company law that dictates the construction of the income tax legislation in general, or s 159GZZZP(1) in particular. One must, with respect, focus on the words of the statute.[57]

58. Instead, in particular, if it were correct to contend that s 159GZZZP(1) was not intended to deem an amount in fact paid other than from profits to be a dividend, there would be no need to deem the payment to have been made "out of profits"; yet s 159GZZZP(1)(d) does precisely that. The Full Court recognised this at FC[44],

[56] *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160 at 176 [5] per Gleeson CJ; at 190 [53], 200 [84] per Gummow J; at 229 [190] per Hayne J; at 250 [250] per Callinan J; at 258 [272] per Crennan J.

[57] *Sons of Gwalia* at 179 [16] per Gleeson CJ; at 186 [35], 203 [93] per Gummow J.

AB-xx. If the actual source of the funding of the purchase price was to be the controlling factor, it would have been a simple matter to adopt an "out of" test, as found in s 44 of the 1936 Act, or an "attributable directly or indirectly" test, as found elsewhere in Division 16K (eg s 159GZZZQ(5)(b)). The legislature preferred instead to adopt a "debit" test as the sole criterion.

59. The authors of the "Ralph Report"[58] described the position under the 1998 s 159GZZZP(1) in this way: "[u]nder existing tax law the source of funds for distributions (profits or contributed capital) is a matter of choice for companies, and operates by reference to a company's accounts. Recent changes to the Corporations Law give companies greater flexibility to distribute capital, providing them with more scope to exercise the choice allowed by the tax law".

60. Section 159GZZZP(1) is not an anti-avoidance provision. It is neutral as to whether an amount is treated as a dividend or a capital or revenue receipt: as noted above, all will enter into the calculation of the taxable income, although only the dividend is certain to be wholly assessable.[59] Not all dividends were rebatable under s 46 (now repealed). The presence of specific anti-avoidance provisions which operated at the rebate level,[60] and of the general anti-avoidance rule in Part IVA of the 1936 Act, make it "impossible" to place upon s 159GZZZP(1) a qualification which it does not express,[61] so as to achieve the same end result as those provisions.

61. Section 159GZZZP(1) must also be read in the context of s 159GZZZQ, which provides for the consequences of a s 159GZZZP(1) deemed dividend that is rebatable. Section 159GZZZQ ensures that so much of the buy-back consideration as is deemed to be a dividend is not also taken into account as capital or revenue proceeds on the disposal of the shares. Where the dividend is rebatable, ss 159GZZZQ(8) ensures that any capital loss which might also arise on the disposal of the shares is eliminated or reduced. In this case, the Respondent included in its assessable income a dividend of $1,000,000,000. But for ss 159GZZZQ(8), the capital proceeds with respect to the disposal of the shares would have been reduced to nil, and a capital loss in the order of $600,000,000 would have resulted.[62] Subsection 159GZZZQ(8) operated to eliminate that $600,000,000 loss.

[58] "Review of Business Taxation - A Platform for Consultation" (Discussion Paper 2 Volume 2), 22 February 1999 at [19.2].

[59] For example, the purchase price for the shares in this case was $1,000,000,000: if a dividend, the whole $1,000,000,000 is assessable; if a capital receipt, then the gain is $402,461,564 (after taking into account the cost base of the shares). The tax payable is $30 due to carried forward capital losses. That is the amount in issue in this case.

[60] Such as ss 46A, 46C, 46E, 46G, 46H and 46K of the 1936 Act.

[61] cf *Commissioner of Taxation v Patcorp Investments Limited* (1976) 140 CLR 247 per Gibbs J at 292.2 - 292.5; approved in *John v Federal Commissioner of Taxation* (1989) 166 CLR 417 per Mason CJ, Wilson, Dawson, Toohey and Gaudron JJ at 434.6-435.6.

[62] That is because the cost base of the shares cancelled was $597,538,436: J[26]:, AB-xx.

62. Thus, the possibility of a rebatable deemed dividend was not only foreseen by the legislature,[63] but the consequence specifically provided for was a denial of the capital loss, not of the rebate.

63. The Appellant's submissions at AS[31] reveal that his real complaint in this case is that the deemed dividend, in the unique circumstances of this case, attracts the inter-corporate dividend rebate under s 46. In the Respondent's submission, the purpose or object of s 159GZZZP cannot have been to prevent a company otherwise entitled to a rebate from obtaining that rebate where the section operated by virtue of its express criteria, so as to deem the relevant part of the purchase price to be a dividend. There is no warrant for departing from the clear words of the provision or colouring them to achieve a particular result on the facts of this case.

64. The rebate under s 46 was only available to the Respondent because it was a public company and because specific anti-avoidance rules[64] that might have otherwise denied the rebate did not apply. It is because of this result that the Appellant prefers to adopt a construction of s 159GZZZP (whether with or without s 6D) that removes the amount in question from the realm of assessability as a dividend altogether.

Introduction of tainting rules

65. In 1998 the concept of the "par value" of a share was abolished in the Corporations legislation, and as a result, the amounts standing to the credit of the company's share premium account and capital redemption reserve became part of the company's share capital.[65] In addition, s 254S of the Corporations Law now permitted the transfer of profits to the share capital account. These significant reforms were seen as requiring further amendments to the 1936 Act, including, but not limited to, s 159GZZZP(1).

66. In particular, the ability under company law to now transfer profits to the share capital account led to the introduction of so-called "tainting rules" in Division 7B of Part IIIAA of the 1936 Act.[66] The tainting rules were designed to prevent companies from disguising a profit distribution as a capital distribution from the share capital account by transferring profits into that account and then debiting that account.

67. The definition of "dividend" in s 6(1) was amended by the same reforms to specifically exclude, in subparagraph (d), a distribution that is "*debited against an amount standing to the credit of the share capital account of the company*". A "tainted" account was not a "share capital account" for that purpose, and so a distribution debited against an amount standing to the credit of such an account would be within the s 6(1) definition of "dividend". At the same time the definitions

[63] See also former s 159GZZZMA of the 1936 Act.

[64] ss 46A, 46C, 46E, 46G, 46H and 46K of the 1936 Act.

[65] By operation of section 1446 of the Corporations Law, enacted in 1998 by the *Company Law Review Act 1998.*

[66] The tainting rules are now located in Division 197 of the *Income Tax Assessment Act 1997.*

of "share capital account" and "paid-up share capital" were introduced for the first time into section 6(1):

> *"share capital account, for the purposes of this Act other than the definition of paid-up share capital, subsection 44(1B), section 46H, subsection 159GZZZQ(5), Division 7B of Part IIIAA and subsection 160ZA(7A), does not include an account that is tainted for the purposes of Division 7B of Part IIIA"*
>
> *"paid-up share capital of a company means the amount standing to the credit of the company's share capital account reduced by:*
> *(a) the amount (if any) that represents amounts unpaid on shares; and*
> *(b) the tainting amount (if any)"*

68. A distribution debited against an amount standing to the credit of a tainted account was deemed by s 44(1B) to have been paid by the company out of profits, thereby engaging s 44(1)(a) so as to bring the amount into the assessable income of the shareholder. While such a distribution was assessable as a dividend, it could not only not be franked, but it also did not attract the inter-corporate dividend rebate;[67] this was despite an automatic debit to the company's franking account.[68] In summary, the shareholder received an assessable dividend, while the company suffered a reduction in franking credits without being able to confer those credits on its shareholder(s).

69. It was realised shortly after the introduction of the tainting rules that their operation would give rise to "unintended outcomes".[69] Thus, for instance, the compulsory merger of the share premium account with the share capital account as a result of the abolition of par value could give rise to a tainting of the share capital account in circumstances where the share premium account was itself already tainted. This would give rise to a debit to the company's franking account, even though the company had not sought to make any distribution to shareholders and so had not engaged in the mischief to which the tainting rules were directed. In addition, the delayed crediting to the share capital account of amounts that were originally credited to another account could, similarly, taint the share capital account and give rise to an automatic franking debit.

70. It was to avoid the second of those unintended outcomes that s 6D was introduced in 1999. While s 6D(1)(a) refers to a company's "ordinary" share capital account,[70] ie, the account to which the paid up capital of the company had originally been credited, s 6D(1)(b) was intended to cover any other account to which the first amount credited was share capital and which was created on or after 1 July 1998 (such as a liability account to which redeemable preference shares must be credited

[67] By former sections 46G and 46H of the 1936 Act.

[68] Former section 160ARDQ of the 1936 Act (the tainting rules have since been replaced).

[69] Explanatory Memorandum to Taxation Laws Amendment Bill (No. 7) 1999, [1.7].

[70] Explanatory Memorandum to Taxation Laws Amendment Bill (No. 7) 1999, [1.26].

on issue[71]). Section 6D(2) ensured that a transfer between one of those latter accounts and the ordinary share capital account would not "taint" the ordinary share capital account, by deeming the latter accounts to have always been part of the share capital account.[72] Thus, any transfer would occur within a single account and would not cause the share capital account to become "tainted". Section 6D(3) maintained the position that whilst a tainted account was not treated as a share capital account for the purposes of the s 6(1) definition of "dividend", it was treated as a share capital account for the purposes of s 44(1B), which ensured that distributions to shareholders debited against tainted share capital accounts would be assessable under s 44(1).

71. In analysing the amendments effected by the *Taxation Laws Amendment Act (No. 7) 1999*, the Full Court incorrectly, with respect, suggested that s 6D was the solution to both "unintended outcomes" summarised in paragraph [69] above. In fact, it was the solution to the second of them, as explained in the passages of the Explanatory Memorandum extracted by the Full Court at FC[37], AB-xx; the first was addressed by a transitional provision.[73] The reference at FC[43], AB-xx to transfers from a share premium account or a capital reserve account, and the merger of those accounts with share capital, does not in any way affect the reasoning of the Full Court in relation to s 6D. The Full Court correctly found (and the Appellant does not dispute) that:

(a) s 6D was introduced to ameliorate problems which had emerged in the adaptation of the 1936 Act to changes to the Corporations Law (FC[33], AB-xx);

(b) it was introduced to ensure that the share capital tainting provisions were not triggered in inappropriate circumstances (FC[36], AB-xx);

(c) the purpose of s 6D(2) was to treat the ordinary share capital account and any other accounts falling within paragraph (1)(b) as a single account thereby facilitating transfers between them (FC[43], AB-xx);

(d) it thereby avoided unintended adverse tainting consequences (FC[43], AB-xx).

72. Section 6D is properly viewed as an ameliorating provision designed to address a particular problem created by the 1998 amendments to the 1936 Act to deal with the changes to the Corporations Law. It had nothing to do with Division 16K. In particular, it was not intended to enlarge the operation of s 159GZZZP(1).

[71] That is the example given at para [1.23] of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 7) 1999.

[72] Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 7) 1999, [1.27].

[73] Section 9 of Schedule 2 to the *Taxation Laws Amendment (Company Law Review) Act 1998*, amended by item 7 of Schedule 1 to the *Taxation Laws Amendment Act (No. 7) 1999*.

73. In the Respondent's submission, s 6D must be construed in the context of both the mischief it was intended to remedy and the legislative history set out above.[74]

Appellant's secondary argument: s 6D

74. The proposition on which the Appellant founds his alternative argument (AS[58]) is incorrect. There is no inconsistency between Crown's paid-up share capital for accounting and income tax purposes. The paid-up share capital for tax purposes (according to the definition in s 6(1) as at 30 June 2002) was $2,411,823,000, which is exactly as it should be, given that, if the Respondent is correct, the purchase price was for tax purposes deemed to be a dividend. Further, even for accounting purposes, the amount standing to the credit of the Shareholders Equity account in the ledger as at 30 June 2002 was also $2,411,823,000. A divergence between tax and accounting treatment would not, given the legislative history set out above, be remarkable in any event.

(1) The reserve was not a share capital account

75. The premise of the Appellant's submissions in AS[60]-[65] is that the Share Buy-Back Reserve account is a share capital account because its "function ... was to record movements or dealings in share capital". That is not so: the function of the Share Buy-Back Reserve account was to record the obligation to pay the buy-back consideration in the following year of income. No other entry has been made to that account.

76. There is another fundamental problem with a construction of s 6D(1)(a) that turns on whether an account "records movements in share capital".[75] If that characteristic alone is sufficient, then there would be no work for s 6D(1)(b) to do. Section 6D(1)(b) refers to accounts created on or after 1 July 1998 to which the first amount credited was an amount of share capital. Thus, any account that falls within s 6D(1)(b) will record a movement in share capital and so, on the Appellant's construction, will fall within s 6D(1)(a). Section 6D(1)(b) is, accordingly, otiose on his interpretation. A construction that renders part of a provision inoperative should not, with respect, be preferred.[76]

77. Additionally, the Appellant's construction somewhat conveniently ignores the reason for the insertion of s 6D. As detailed earlier, the purpose of the provision was to ensure that the delayed crediting of share capital did not give rise to "inappropriate" tainting.

78. The language used in s 6D(1)(a), "an account", suggests that what is intended to be covered is the account to which the share capital of the company is ordinarily

[74] *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 per Brennan CJ, Dawson, Toohey and Gummow JJ at 408.4.

[75] AS[61], [65].

[76] *Project Blue Sky v Australian Broadcasting Authority* (1998) 194 CLR 355 per McHugh, Gummow, Kirby and Hayne JJ at 382 [71].

credited on contribution: FC[43], AB-xx. As the Minister envisaged, that will mean "the ordinary account which a company keeps of its share capital".[77]

79. The Appellant submits at AS[69], that more than one s 6D(1)(a) account might exist, each in the hypothesis being an ordinary account which the company keeps of its share capital. So much may be accepted, although such an – unusual – hypothetical was not put to the Full Court. The Full Court's conclusion based upon there ordinarily being only one such ordinary account as the s 6D(1)(a) account[78] was also based on the submissions put to it.

80. As the Full Court found at FC[38], AB-xx and FC[40], AB-xx, the Appellant's construction of s 6D would create a further unintended tainting consequence.[79] If the Appellant is correct, then any subsequent transfer of profits to the Share Buy-Back Reserve account will cause not only the Share Buy-Back Reserve account but also the Shareholders Equity account to become tainted. That is not disputed. If the company then decides to make a distribution to shareholders debited against the Shareholders Equity Account to which only share capital has been credited, the result, in addition to an automatic franking debit arising in the company's franking account,[80] is that:

(a) the distribution would be a dividend because it would fall within the s 6(1) definition of "dividend" (it will not be excluded by s 6(1)(d) because a tainted share capital account is not a "share capital account": s 6D(3));

(b) that "dividend" would be assessable by reason of s 44 because it would be deemed by s 44(1B) to have been paid out of profits; and

(c) the dividend would have been unrebatable because s 46G disallowed the rebate for dividends debited to "disqualifying accounts", which was defined in s 46H to include an account of this kind.

81. In other words, a distribution of what is undeniably share capital – which might have been paid up years before – would have been treated as an assessable, and unrebatable, dividend. The Appellant's submission with regard to this anomaly does not address the substance of this point; he merely says that because it is a consequence of his view of the tainting rules read with s 6D (which was intended to reduce, not enlarge, instances of tainting), it must be the intended consequence: AS[67].

82. Furthermore, the Appellant's submission with regard to the anomaly is not assisted by reference to the note to s 6D(2): AS[67]. The note merely acknowledges the fact that in those circumstances where s 6D(2) is intended to and does operate to

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[77] Explanatory Memorandum to the Taxation Laws Amendment (No 7) Bill 1999, para [1.26].

[78] FC[43], AB-xx.

[79] There appear to be two typographical errors in FC[38], AB-xx. The word "if" appears to be missing in the fifth line between "below," and "that", and a comma appears to be missing on the sixth line between "company" and "the" [see Transcript, 17 November 2011, P-25.22-27, AB-xx]

[80] Section 160ARDQ(1) of the 1936 Act.

combine two or more accounts, and one of those accounts is subsequently "tainted" (eg by a transfer to it of profits), then the accounts which comprise the share capital account combined under s 6D are tainted. It does not indicate that s 6D contemplates the possibility of a company having more than one share capital account in the sense asserted by the Appellant. The amelioration intended and achieved by s 6D is anterior to, and separate from, the consequences to which the note refers.

83. The anomaly is also an answer to the criticism made by the Appellant that the Full Court did not explain why his construction of s 6D would exacerbate or perpetuate the problems caused by the introduction of the tainting rules: AS[64]. The anomaly demonstrates that the Appellant's construction would have s 6D introducing the very sort of problem which the 1999 amendments were designed to remove.

84. With respect to the Appellant's purported "anomalies" at AS[69]:

(a) the first is a repetition of the point made at AS[58]. That matter is addressed in paragraph [74] above. That the "paid-up share capital" is – for tax purposes – $2,411,823,000 is the correct result given that the consideration of $1,000,000,000 was, on the Respondent's case, deemed – again for tax purposes – to be a dividend by operation of s 159GZZZP;

(b) the second does not identify any anomaly going to the construction of s 6D; it is – again – a repetition of the point addressed at paragraph [76] above, and amounts to no more than a complaint about the income tax result in this case. Even to that extent it is misguided because the outcome in this case was a direct result, not of s 6D or Division 16K, but the undisputed application of the s 46 inter-corporate dividend rebate in relation to the Respondent as a public company and the non-application in relation to it of the specific rebate anti-avoidance provisions;

(c) the third describes an unusual hypothetical case in which there exist multiple accounts to each of which share capital has been credited. That situation is addressed in paragraph [79] above.

(2) No debit against the amount standing to the credit of the share capital account

85. The Full Court was correct, with respect, in observing that s 6D(2) does not deem the act of debiting in one ledger account to have been an act of debiting *against* an amount *standing to the credit of* a different ledger account: FC[46], AB-xx. There is nothing in the statutory language of s 6D(2) that would authorise that conclusion.

86. As the Full Court found,[81] the purpose of s 6D is to treat two or more accounts as one so that there is no "transfer" between them for the purposes of the tainting rules. As a deeming provision it should be construed by reference to this purpose: *Federal Commissioner of Taxation v Comber*.[82] It does not "necessarily follow" even where

[81] FC[43], AB-xx.

[82] Supra per Fisher J at 96.5.

s 6D(2) deems two or more accounts to be one (which the Respondent denies occurred here) that "what occurs in any account occurs in the one share capital account": AS[72]. That construction goes beyond the deeming in s 6D.

87. Nor is it to correct to say that the Respondent's construction "in truth merely nullifies the deeming": AS[72]. The deeming takes effect to achieve the purpose for which it was introduced, namely, the prevention of unintended tainting in circumstances of the delayed crediting of share capital to the share capital account. There is no warrant to extend the statutory fiction to accommodate what the Appellant desires.

88. The "errors" in AS[71] are merely a repetition of the argument in AS[54]-[56]. They are addressed above at paragraph [74].

Part VII – Notice of contention

89. No notice of contention has been filed by the Respondent.

Part VIII – Estimate

90. The Respondent estimates that it requires 2 hours to present its oral argument.

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