IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No S225 of 2012

BETWEEN **ANDREW VINCENT MILLS**
Appellant

AND **COMMISSIONER OF TAXATION**
Respondent

APPELLANT'S SUBMISSIONS IN REPLY

Part I:

It is certified that these submissions are in a form suitable for publication on the internet.

Part II:

1. Save for an assertion of the primacy of s 177EA, the Respondent's submissions do not address the tension between the expansive construction of s 177EA(3)(e) adopted by the majority judgment below and the policy and operation of Part 3-6, identified in the Appellant's principal submissions ("AS") at [26-30]: that the majority construction effectively makes the section applicable to every issue of securities made and priced on the basis that the distributions on them will be franked, notwithstanding the legislative purpose expressed in ss 200-5 and 201-1.

2. It is no answer to say that Part 3-6 operates "in all cases subject to the possible application of s 177EA," or that "*where* s 177EA applies it denies the benefit of franking notwithstanding that the detailed rules contained in Part 3-6 otherwise permit – and even require – a distribution to be franked" (RS [29], [32]). The issue in this appeal is not the effect of s 177EA, but whether it is attracted.

3. Resolution of that issue lies in the interaction of the concepts of "incidental purpose" and "enabling" as they appear in the operative condition in para (e), "for a purpose (whether or not a dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit."

   "A purpose (whether or not a dominant purpose but not including an incidental purpose)"

4. Beyond drawing attention to the statutory distinction between "dominant" and "incidental" purpose, and referring to the Treasurer's reference to "*fortuitously or* in subordinate conjunction with," the Respondent offers the Court no assistance in construing the paragraph (e) criterion.

5. As a matter of ordinary meaning, a reference to an "incidental purpose" is not a reference to a "fortuitous" purpose: fortuitous (importing "chance rather than intention") is

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antithetical to purpose (intent).[1] The context of s 177EA shows that although they fall within its scope, the expression "incidental purpose" is not confined to purposes which are trivial or immaterial. The expression sets a boundary between those purposes which attract the operation of the section and those which do not, and that boundary is to be ascertained by reference to the "relevant circumstances" in subsection (17), which are directed to matters of substance, not to trivia. The boundary is to be found at a higher level of purpose.

6. The boundary does not lie at the level of "dominant purpose," and the Appellant does not so submit.[2] The implicit assumption in the Respondent's submissions that "dominant" and "incidental" exhaust the field is mistaken. A dominant purpose will satisfy the paragraph (as the parenthesis expressly states), but it does not follow that only a dominant purpose will suffice.[3]

7. The construction of "incidental purpose" advanced by the Appellant does not exclude trivial or immaterial purposes. It is sufficient, for s 177EA to have an operation consonant with the scheme of Part 3-6 (and for the section not to extend to the issue of the PERLS V), that the parenthetical exclusion from para (e) extends also to those purposes which are "incidental" in the sense of being in subordinate conjunction with or consequential upon a purpose falling outside the paragraph.

8. Where the element of foreign deductibility is absent, the Respondent accepts as much: "the fact that there was an actual purpose of raising capital by an instrument that would give rise to franked distributions would not cause the provision to apply, even where the prospect of franking was in fact important and had been taken into account."[4] If such an actual purpose, more than "fortuitous," is "incidental," so must be that of the Bank.[5] In the Bank's case, the only further factor identified in the Respondent's submissions is the treatment of the payments under a foreign tax system, a manifestly irrelevant matter.[6]

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1 A reference to an incidental *effect* may be one to a fortuitous effect, but s 177EA is concerned with purpose, not effect.

2 The Respondent's submissions at [43-4] are misdirected, to a proposition not advanced by the Appellant.

3 The section excludes a limitation to dominant purpose as a precaution against the case where a distinct and substantial purpose of enabling the recipient to obtain franking credits is not "dominant" because it is accompanied by another purpose (such as raising capital or changing control) which is of equal or greater importance. Instead the section sets a limitation – excluding an "incidental purpose" – which requires that the enabling purpose be both material and distinct: so that a purpose which is a concomitant of another, non-enabling purpose or accompanies it in subordinate conjunction, and so is properly described as an "incidental purpose," does not attract the section.

4 RS [24]; see also AB436, CR2008/30 at [49-50]; AB491, CR2009/78 at [100-101]; affidavit of Catherine Leslie sworn 9 August 2012 in the special leave application in these proceedings (S9/2012), Ex CAL-1.

5 The identified actual purpose would also be one objectively ascertained having regard to the "relevant circumstances." It is specifically the Bank's purpose which is dealt with in CR2008/30 and CR2009/78.

6 See [13] below and AS [41-44].

"A purpose ... of enabling the relevant taxpayer to obtain an imputation benefit"

9. The purpose on which the operation of s 177EA hinges is a purpose of *enabling* a taxpayer to obtain an imputation benefit. To "enable" is to make something possible: an enquiry into whether an act (a "scheme"[7]) enables an effect necessarily assumes a premise that absent the "scheme" the effect is not possible, and requires "consideration of what other possibilities existed."[8] If absent the scheme the effect nonetheless occurs, or if the effect follows from the course or each of the courses which absent the scheme would be taken, the scheme does not "enable" the effect to be obtained.

10. The criterion in s 177EA(3)(e) is that there should be a purpose of enabling a holder to obtain imputation benefits, not an effect of doing so. To confine the enquiry to a "before and after" analysis[9] is to examine only the latter. Consideration of an actor's purpose in entering into a scheme entails an enquiry into what the actor in doing so sought to enable that would not otherwise have been enabled.

11. In the present case the Bank (the relevant actor) sought to raise Tier 1 capital. Any course taken to raise such capital necessarily was one in which the securities would be offered on terms that distributions would be franked,[10] and any securities issued would be priced accordingly. Insofar as the Bank had a purpose of enabling investors to obtain franking credits,[11] that purpose was no more than incidental to the purpose of raising capital: the Bank did not choose to issue PERLS V[12] in order to "enable" investors to obtain credits not available on another form of Tier 1 capital. It did so because the cost of capital of the PERLS V was lower than that of alternative Tier 1 capital, but the lower cost was not attributable to the franking of the distributions – all alternative Tier 1 issues would have involved franking to the same extent.[13]

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7 Section 177A(1) defines "scheme" to include (inter alia) any arrangement, action or course of action.

8 *FC of T v Hart* (2004) 217 CLR 216, 243 [66]; a "comparison between the scheme in question and an alternative postulate," *ibid.*

9 Jessup J at AB668 [198]; Respondent's submissions (RS) at [34].

10 The suggestion (RS[15], [57], [85]) that the Bank could have raised capital to which s 215-10 applied should be rejected. Before trial the Respondent had published a draft ruling (TD2009/D2) effectively denying that the concession offered by that section is available in respect of non-innovative Tier 1 securities. In pre-trial submissions he accepted that the Bank could not issue innovative Tier 1 securities, that franking of distributions on any Tier 1 capital was "mandated by the Act," and that s 215-10 had no application, concessions repeated in the Full Court. It is not open to the Respondent, in this court for the first time, to argue to the contrary.

11 "Imputation benefits" extend beyond obtaining franking credits, s 177EA(2) and s 204-30(6), but the other instances of imputation benefits are not material to the analysis of issues in this appeal.

12 Cf RS [13], [14], [19].

13 The cost was lower because the securities carried only a (franked) BBSW-linked yield, and gave rise to a deduction from New Zealand tax. Contrary to RS[18], the Board did not compare the economic cost of franked and unfranked distributions, and the primary Judge did not find that it had. The Board proceeded on the basis that the distributions must be franked. What it compared was the cost if the present appeal is unsuccessful, in which case it must take the steps agreed under the deed (AB58[62]) between the Bank and the Respondent: AB265.20-28.

12. The subs (17) circumstances on which the Respondent places reliance, to the extent that they were present,[14] do not contribute to any conclusion that the Bank had a non-incidental purpose of *enabling* investors to obtain franking credits, for the reasons advanced at AS [38]-[49]. None of those circumstances was relevant to the existence of a purpose of the Bank of securing that the holders of PERLS V should obtain a franking credit which absent the scheme comprised in the structure and issue of PERLS V would not have been provided to investors. While the Respondent controverts the irrelevance of the circumstances relied on, he advances no reasoning in support of his contention.[15]

The New Zealand tax effect

13. The Respondent's submissions on the consequences of the distributions being paid from New Zealand are inchoate: there is no coherent nexus between the offending deduction from New Zealand tax, or the payments originating in New Zealand, and any "enabling" of the franking of the distributions. The "cost saving" to the Bank resulting from the reduction in New Zealand tax does not enable the Bank to frank the distributions (capacity to frank rests on whether Australian tax has been paid, s 205-5). Nor do any of the legal form of the distributions as interest, the New Zealand tax recognition of that form, or the difference between New Zealand's acceptance of legal form and Australia's adoption of economic substance (via Division 974) as the basis of taxation treatment of the distributions, indicate a purpose of enabling the Bank to frank the distributions. The repeated claim that the distributions were "frankable and deductible" (but under different tax regimes) does not advance the analysis, nor does describing the effect of those regimes as a "uniquely favourable financial outcome."[16]

14. In any event, the fact of payment from New Zealand does not comprise a "relevant circumstance" within para 177EA(17)(ga), for the reasons given in the Full Court judgments.[17] The Respondent's submissions on the paragraph mistakenly invert its criterion: it does not require that the distributions should be "of taxed Australian profits,"[18] but that they should not be sourced in "untaxed or unrealised profits."[19] That

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14 The circumstance in paragraph 177EA(17)(ga) was absent, for the reasons given at AS [46], AB625-9 [88-92] and [95-98] (Edmonds J) and AB670-71 [203-206] (Jessup J). That in para 177EA(17)(h) was, for the purposes of the Act and having regard to the scheme embodied in Division 974, also absent, for the reasons recounted by Edmonds J at AB630 [103].

15 The Respondent's submissions at [58] and [63] advance no connection between the payment of the distributions from New Zealand and the franking of the distributions which suggests a purpose of "enabling" the franking. The submissions at RS [80-82] advance no connection between the interest "form" of the distributions and any enabling of the franking of the distributions. Paragraph (vi) of s 177D(b) was mentioned at the points cited by the Respondent in RS[83] but no argument as to its relevance to purpose was advanced and, as Jessup J observed, no factual findings were made, nor were they sought.

16 RS [83-85] and [87].

17 See footnote 14 above. The decision in *FC of T v Sun Alliance Investments Pty Ltd* (2005) 225 CLR 488, directed to quite different statutory language and a different statutory context and purpose, does not assist in the construction of para (ga).

18 RS [74].

there is no requirement in the Act that a franked distribution be "paid out of," "sourced in" or traceable to Australian taxed profits is explained by Edmonds J in reasoning[20] which the Respondent does not controvert.

15. The error, and the consequent emphasis on the New Zealand tax treatment of the distributions, pervades the Respondent's submissions,[21] which also confuse and conflate two different constraints, that in Subdivision 202-C (that the distributions not be unfrankable: the Respondent concedes that the subdivision is inapplicable) and that in para (ga). Subdivision 202-C casts no light on the construction or scope of para (ga), and neither provision limits frankable distributions to those from "taxed Australian profits." Had the legislature intended such a constraint, it would readily have been enacted; instead, the legislature chose a limitation based on the amount of Australian tax paid[22] and on the amount of the frankable distribution.[23]

16. Payment of the distributions from the New Zealand branch neither offends the "architecture" of the imputation provisions nor supports a para 177EA(3)(e) conclusion. The franking credits which were allocated to the holders of the securities, including the Appellant, had their origin in tax paid by the Bank in Australia; the franking of the distributions achieved the purpose of "partially integrating the income tax liabilities of" the Bank and its members.[24]

17. Neither the legal form of the distribution, nor the acceptance by New Zealand of that form as the basis for taxation, justifies a para (e) conclusion based on paragraph 177EA(17)(h) or s 177D(b)(ii) or (vi). The Australian legislature has deliberately and expressly chosen substance over form for imputation purposes, in the enactment of Div 974, and the Respondent cannot approbate that choice by invoking s 177EA (which has no application to deductible interest) but reprobate it by invoking paragraphs (h), (ii) and (vi).

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19 For example, an asset revaluation reserve (recording an unrealized profit), or a gain on release from or indemnity for a liability (an untaxed profit; for an instance, see *FC of T v Orica Ltd* (1998) 194 CLR 500 at 502.7, 531-6).

20 AB611 [28-9]

21 See for example RS [30], [58], [61], [63], [84-87]

22 Division 205, limiting the total amount of franking credits available for franking.

23 Subdivision 202-D.

24 Section 200-5.