HIGH COURT OF AUSTRALIA

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IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

BETWEEN: **Appeal S158/2025**

Gordon Stanley Merchant
First Appellant

GSM Pty Ltd ACN 074 508 124
Second Appellant

and

Commissioner of Taxation
Respondent

BETWEEN: **Appeal S157/2025**

Commissioner of Taxation
Appellant

and

Gordon Stanley Merchant
First Respondent

GSM Pty Ltd ACN 074 508 124
Second Respondent

RESPONDENTS' SUBMISSIONS IN APPEAL S157/2025

CROSS APPELLANTS' SUBMISSIONS ON THE CROSS-APPEAL AND RESPONDENTS' AMENDED NOTICE OF CONTENTION IN APPEAL S157/2025

CROSS RESPONDENTS' SUBMISSIONS IN APPEAL S158/2025

PART I: CERTIFICATION

1. These submissions are in a form suitable for publication on the internet.

PART II: CONCISE STATEMENT OF THE ISSUE

2. The S157/2025 appeal raises two issues. The first issue concerns the essential content of "a scheme by way of or in the nature of dividend stripping" in s 177E (and by extension, the content of a scheme having "substantially the effect of" such a scheme under s 177E(1)(a)(ii)). Although "dividend stripping" is not defined in Part IVA, it has an established meaning in tax avoidance discourse and authority of this Court and contains certain essential elements. The Commissioner seeks to have this Court ignore or set aside those essential elements and adopt the meaning of "dividend stripping" set out in *Fowler's Modern English Usage* (1965) over that derived from a review of the authorities. The result would be a construction that is so "protean" as to be meaningless.

3. The second issue concerns the interaction between s 177D and s 177E. The construction proposed by the Commissioner would prevent the cancellation of a tax benefit obtained by way of a s 177D scheme from being considered in determining the tax outcome of a scheme under s 177E, where the two schemes contain overlapping constituent elements. This construction has no foothold in the text of Part IVA, cuts across the otherwise retrospective operation of determinations made under s 177F and is conceded by the Commissioner to produce unfair and unreasonable results. It should not be adopted.

PART III: NOTICE UNDER S 78B OF THE *JUDICIARY ACT 1903* (CTH)

4. No notice is required under s 78B of the *Judiciary Act 1903* (Cth).

PART IV: RELEVANT FACTS

5. The relevant facts are set out in the taxpayers' primary submissions (**MPS**) on the S158/2025 appeal, and the same defined terms are used in these submissions.

6. The recitation of the facts in the Commissioner's primary submissions (**CPS**) at [5]-[19] requires qualification. *First,* the crystallisation of a capital loss by the BBG share sale (which was a component of both the BBG share sale scheme and the debt forgiveness schemes), would offset a capital gain *only if* MFT were able to sell the Plantic shares, or some other asset, at a future date for a capital gain. Contrary to the Commissioner's characterisation of this prospect at CPS [6], while the sale of Plantic was a "real possibility", previous negotiations with other parties had not eventuated in a sale

(PJ [104], [112]) and the negotiations with Sealed Air (the prospective buyer at the time of the BBG share sale) in fact did not eventuate in a sale (PJ [197]-[212], FCJ [116]). At the time of the BBG share sale, there was no agreement with Sealed Air on either the price or structure of a Plantic sale (PJ [174], [178], [185], [201]). It was therefore objectively reasonable to expect that the sale may not complete (cf PJ [187]). Further, another trading window was available before the end of the 2015 financial year (PJ [377]), such that the BBG share sale could have been deferred – were the dominant purpose to obtain a tax benefit – to a time when there would be greater certainty about any Plantic sale (including as to the sale price and the structure of the sale).

7. *Second,* to suggest that the forgiveness of the Tironui Loan and GSM Loan was a condition of the sale that was entirely driven by the Merchant parties (CPS [7]) is inaccurate. It was Sealed Air that proposed the requirement that the related party debts be "repaid or discharged in full" (PJ [532]). The same requirement was contained in the draft agreement for sale of the Plantic shares to Kuraray, which was based on the Sealed Air agreement (PJ [214]). While the proposed method of addressing these debts (by way of a debt forgiveness) was the subject of discussion between Kuraray and the Merchant parties, any tax issues for Kuraray were evidently addressed in the lead up to the sale (PJ [216]-[221]). Further, as made clear in the taxpayers' submissions on the S158/2025 appeal (at MPS [69]), while there were other ways in which the related party debts may have been addressed, none of these options would have achieved substantially all the same consequences as the loan forgiveness and so were inappropriate comparators.

8. *Third,* the description of the scheme at CPS [8] contains several inaccuracies. First, to say that the shift in value occasioned by the debt forgiveness would be "without any tax consequences" is wrong for all the reasons identified in Part VI below. But more fundamentally, the suggestion that *all* of MFT's capital losses ("including, but not limited to, those crystallised on the sale of the BBG shares") were included in the debt forgiveness schemes is incorrect – MFT's capital losses that were not attributable to the BBG share sale were not an identified component of either debt forgiveness scheme.

PART V: ARGUMENT

A.1 *Structure of these submissions*

9. This appeal (S157/2025) concerns the construction of s 177E and its application to the Tironui scheme and GSM scheme. Neither scheme was contended to be a scheme "by

way of or in the nature of dividend stripping" within s 177E(1)(a)(i) (FCJ [328]). The only question was whether they were schemes "having substantially the effect of a scheme by way of or in the nature of dividend stripping" within s 177E(1)(a)(ii) (see FCJ [329]). The majority of the Full Court found that the Tironui scheme *did* have the necessary effect, while the GSM scheme *did not*.[1] The taxpayers' position is that *neither scheme* had the requisite *effect* under s 177E(1)(a)(ii). Nor, for the reasons addressed in Part B of MPS on the S158/2025 appeal, did either scheme have the requisite *purpose*.

10. **Part V** of these submissions deals with the Commissioner's two grounds of appeal, which concern the scope of the meaning of "dividend stripping" in s 177E. If the taxpayers defeat either or both of the Commissioner's grounds, they retain, at a minimum, the benefit of the current finding that s 177E did not apply to the *GSM scheme*.

11. **Part VI** of these submissions deals with ground 1(b) of the taxpayers' cross-appeal (the effect of the Tironui scheme), and ground 1(b) of the taxpayers' amended notice of contention (the effect of the GSM scheme). If the taxpayers succeed on those interrelated arguments, there will be two consequences. First, the ruling of the Full Court will need to be varied because s 177E did not apply to the *Tironui scheme* (in addition to not applying to the GSM scheme). Second, the Full Court's existing ruling that s 177E did not apply to the GSM scheme is now sustained on additional grounds.

12. **Part VII** responds to the Commissioner's cross-appeal in S158/2025. That cross-appeal should be rejected. If the taxpayers succeed in S158/2025 in establishing that the Full Court should have found that the determination made under s 177F in reliance upon s 177D of the ITAA36 (**s 177D Determination**) was made in error, that does not have the consequence that s 177E now applies to the GSM scheme.

A.2 *The established meaning of "dividend stripping"*

13. An overarching tension in the Commissioner's submissions is the concession on the one hand that the concept of "dividend stripping" was "a well-known part of 'tax avoidance discourse'" when Part IVA was enacted (CPS [24]),[2] and on the other hand, the contradictory assertion that an analysis of prior cases has "limited utility" (CPS [41], [54]). In fact, the Commissioner disavows both previous authority (including authority of this Court) (CPS [41], [42], [50], [54]) as well as relevant extrinsic material (CPS [56]),

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1 Compare FCJ [377]-[381] with FCJ [382]-[395].

2 Citing *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 (***CPH HCA***) at [100], [104]-[105] (the Court).

as a guide to ascertaining the intended meaning of "dividend stripping". Instead, the Commissioner contends that the concept is unconfined and "adaptive", to allow Part IVA "to respond to the various ways in which dividend stripping might emerge" (CPS [44]). This approach ascribes the concept of "dividend stripping" with a meaning that is "so indefinite and uncertain as to remove the matter from the operation of reason and place it exclusively within that of chance".[3] To adopt this course would create great uncertainty as to the scope of s 177E and interfere unacceptably with ordinary commercial dealings.

14. The concept of "dividend stripping" is not defined in Part IVA, or elsewhere in the Act. However, the drafting of each limb of s 177E(1)(a) "assumes that there is an identifiable activity known as 'dividend stripping' that can serve as a reference point for deciding whether a particular scheme is 'by way of or in the nature of dividend stripping'".[4] As observed by this Court, "the legislature considered its meaning to be sufficiently clear in the context of schemes to reduce income tax".[5] The history of the term "as part of tax avoidance discourse",[6] including its judicial interpretation, is instructive in this respect.

15. The concept of "dividend stripping" has its apparent origin in the United Kingdom.[7] As Windeyer J remarked in *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1970) 120 CLR 177, the term had become "so well known" in the 1960s in English revenue law "that the second edition of *Fowler's Modern English Usage* (1965) has a brief explanation". However, Windeyer J did not adopt, or even set out, that explanation (*contra* the suggestion at CPS [25], [36], [43]), preferring instead the one provided in *Halsbury's Laws of England* (3rd ed, vol 20), which was as follows:

> Dividend stripping is a term applied to a device by which a financial concern obtained control of a company having accumulated profits by purchase of the company's shares, arranged for these profits to be distributed to the concern by way of dividend, showed a loss on the subsequent sale of shares of the company, and obtained repayment of the tax deemed to have been deducted in arriving at the figure of profits distributed as dividend.

16. As already emerges from this basic definition, the core conception of a dividend stripping

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3 See *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 646 (Dixon J). See also *B&F Investments Pty Ltd v Federal Commissioner of Taxation* (2023) 298 FCR 449 (***B&F Investments***) at [111] (the Court).

4 *Commissioner of Taxation v Consolidated Press Holdings Ltd* (1999) 91 FCR 524 (***CPH FC***) at [119] (the Court).

5 *CPH HCA* (2001) 207 CLR 235 at [100] (the Court).

6 *CPH HCA* (2001) 207 CLR 235 at [104] (the Court).

7 Christopher Vincent, "Dividend Stripping: stricto sensu or strictly senseless?" (1989) 24(2) *Taxation in Australia* 82 at 82. See *Collco Dealings Ltd v Inland Revenue Commissioners* [1962] AC 1; *Griffiths v J P Harrison (Watford) Ltd* [1963] AC 1.

at this time entailed all the accumulated profits of the target company being targeted, and both the "stripping entity" and the vendor shareholders escaping tax on the distribution of those profits. The "stripping entity" (the purchaser of the target company's shares) escaped income tax on the declared dividend by, for example, an offsetting loss on the sale of the shares, while the vendor shareholders escaped income tax that would have been paid had the target company's profits been distributed as a dividend by receiving a capital sum for their shares.

17. As set out in CPS [26], these schemes were initially sought to be addressed under s 260 of the ITAA36, which was the predecessor to Part IVA. A number of cases involving "dividend stripping" operations under s 260 were considered by the High Court,[8] although that appellation was only applied in respect of some of those cases in subsequent decisions.[9] Those cases had the following essential characteristics in common:[10]

(a) A target company, which had substantial undistributed profits creating a potential tax liability either for the company or its shareholders;

(b) The sale or allotment of shares in the target company to another party;

(c) The payment of a dividend to the purchaser or allottee of the shares out of the target company's undistributed profits;

(d) The purchaser claiming not to be subject to income tax on the dividend;

(e) The vendor shareholders receiving a capital sum for their shares in an amount not substantially less than the quantum of profits distributed to the purchaser; and

(f) The scheme being carefully planned for the predominant purpose of the vendor shareholders avoiding tax on a distribution of dividends by the target company.

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8 *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548 (***Bell***); *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1 (***Newton***); *Hancock v Federal Commissioner of Taxation* (1961) 108 CLR 258 (***Hancock***); *Mayfield v Commissioner of Taxation* (1961) 108 CLR 303 (***Mayfield***); *Rowdell Pty Ltd v Federal Commissioner of Taxation* (1963) 111 CLR 106 (***Rowdell***); *Federal Commissioner of Taxation v Ellers Motor Sales Pty Ltd* (1972) 128 CLR 602 (***Ellers Motor***); *Federal Commission of Taxation v Patcorp Investments Ltd* (1976) 140 CLR 247 (***Patcorp***); *Slutzkin v Federal Commissioner of Taxation* (1977) 140 CLR 314. See also *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1971) 125 CLR 249 (***Investment & Merchant Finance***); *Mercantile Credits Ltd v Federal Commissioner of Taxation* (1971) 123 CLR 476; *Curran v Federal Commissioner of Taxation* (1974) 131 CLR 409; *Federal Commissioner of Taxation v Westraders Pty Ltd* (1980) 144 CLR 55.

9 See *Ellers Motor* (1972) 128 CLR 602 at 623 (Walsh J, in respect of *Hancock* and *Newton*); *Patcorp* (1976) 140 CLR 247 at 300 (Gibbs J, in respect of *Bell, Newton, Hancock* and *Ellers Motor*); *John v Federal Commissioner of Taxation* (1989) 166 CLR 417 at 439 (Mason CJ, Wilson, Dawson, Toohey and Gaudron JJ, in respect of *Rowdell, Curran* and *Investment & Merchant Finance*).

10 See *CPH HCA* (2001) 207 CLR 235 at [126] (the Court); *CPH FC* (1999) 91 FCR 524 at [136] (the Court); Christopher Vincent, "Dividend Stripping: stricto sensu or strictly senseless?" (1989) 24(2) *Taxation in Australia* 82 at 92.

18. That these were understood as the essential characteristics of a "dividend stripping" scheme was reflected in the explanatory material that accompanied the insertion of s 46A into the ITAA36 by the *Income Tax Assessment Act (No 3) 1972* (Cth) (cf CPS [27]). In the second reading speech for the amending Bill,[11] the Treasurer noted that "[t]he term 'dividend-stripping' has been employed in the courts here and in the United Kingdom and has come to have a widely understood connotation in professional financial circles".[12] The provision was said to be necessary to close a loop-hole in the dividend rebate provisions, which allowed a company, by way of a dividend stripping arrangement, to "effectively receive … income tax-free".[13] Section 46A specified matters that the Commissioner was obliged to consider when determining whether the scheme was by way of dividend stripping (set out at CPS [37]), which were described as "matters which are characteristic of dividend stripping as the term is commonly understood".[14] Contrary to CPS [38], these matters were not intended to capture "different forms of dividend stripping", but rather were considered "common to this kind of operation".[15] It should be borne in mind however that s 46A was directed to removing "[the] incentive[s] for a company to join in a dividend stripping operation" as the "stripping" entity, being "the twin benefits" of a rebate on the dividends and a deduction for the loss on the shares resulting from the declaration of the dividends.[16] No specific consideration was given to the elements of a dividend stripping that bear upon the benefits to the vendor shareholders.

19. It was against this background that Part IVA was introduced by the *Income Tax Laws Amendment Act (No 2) 1981* (Cth) to replace s 260 of the ITAA36. Unlike s 46A, s 177E is concerned with the tax benefits obtained by the vendor shareholders in a dividend stripping scheme. The EM described s 177E as "a supplementary code to deal with dividend-stripping schemes of tax avoidance and certain variations of such schemes, the effect of which is to place company profits in the hands of shareholders in a tax-free form,

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11 Note that the Bill that became the *Income Tax Assessment Act (No 3) 1972* (Cth) was originally introduced in the House as the Income Tax Assessment Bill 1972 (Cth).

12 Commonwealth, *Parliamentary Debates*, House of Representatives, 9 December 1971 at 4453 (Billy Mackie Snedden, Treasurer).

13 Commonwealth, *Parliamentary Debates*, House of Representatives, 9 December 1971 at 4453 (Billy Mackie Snedden, Treasurer) (emphasis added).

14 Commonwealth, *Parliamentary Debates*, Senate, 25 May 1972 at 2076 (Robert Cotton, Senator). See also Commonwealth, *Parliamentary Debates*, House of Representatives, 24 May 1972 at 3044-3045 (Victor Garland).

15 Commonwealth, *Parliamentary Debates*, House of Representatives, 24 May 1972 at 3045 (Victor Garland).

16 Commonwealth, *Parliamentary Debates*, House of Representatives, 24 May 1972 at 3045. See also Explanatory Memorandum to the Income Tax Laws Amendment Bill (No 2) 1981 (Cth) (**EM**) at 14.

in substitution for taxable dividends" (cf CPS [28]).[17] It was said that "[i]n schemes of this kind, arrangements are generally made to convert into cash the assets of the company to be stripped… [and subsequent] transactions are structured so that profits thus effectively stripped from the company do not bear tax".[18] As the Treasurer noted in the second reading speech, "[i]n the simpler schemes of dividend stripping", "the purchaser arranges for the profits of the company to be stripped by way of a tax free dividend or other payment from the company", "while the former owners have effectively obtained the accumulated profits of the company in a tax free form".[19]

20. It is clear from this history, including the judicial consideration of the term and the understanding of it as reflected in the extrinsic material, that the essential features of a "dividend stripping" scheme are as follows (*contra* CPS [36]):

(a) The stripper acquires shares in a target company with substantial undistributed profits that will attract tax if distributed to the vendor shareholder as dividends. Those profits, or a substantial proportion of them, are paid to the stripper by way of dividend. The stripper does not pay income tax on the dividend, because of an exemption, or a rebate, or an off-setting loss (which might be either pre-existing or crystalise on the subsequent sale of the shares following the payment of the dividend, which substantially decreases the value of the shares).

(b) The vendor shareholders receive a capital sum for their shares that is equal to the quantum of the profits distributed to the stripper, sometimes less an amount reflecting either the costs associated with the transaction or a "fee" paid to the stripper for having engaged in the transaction. The vendor shareholders thereby receive an amount equivalent to, or substantially equivalent to, the undistributed profits of the target company in a tax-free form, avoiding the tax that would have been payable on a distribution of dividends by the target company.

21. In contrast, the Commissioner suggests that the "essence" of a dividend stripping is "the avoidance of tax by the conversion of profits into capital form, followed by a dividend paid to the stripper reducing but not necessarily exhausting the value of shares in the company" (CPS [36]). This formulation is hopelessly broad and imprecise. On the

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17 EM at 4 (emphasis added). See also Commonwealth, *Parliamentary Debates*, House of Representatives, 27 May 1981 at 2684 (John Howard, Treasurer).

18 EM at 4 (emphasis added).

19 Commonwealth, *Parliamentary Debates*, House of Representatives, 27 May 1981 at 2684 (John Howard, Treasurer) (emphasis added).

Commissioner's definition, any person who sells shares in a company with undistributed profits on capital account after holding them for more than a year would have engaged in dividend stripping if the company subsequently pays a dividend to the purchaser. Despite the Commissioner's protestations to the contrary, such a construction would indeed render the concept "so protean as to be meaningless".

22. Of course, s 177E(1)(a) also encompasses schemes having "substantially the effect of" a dividend stripping scheme. However, some meaningful connection is still required between the impugned scheme and the paradigm of a dividend stripping. In this case, in respect to the scheme alleged at PJ [473]-[477], FCJ [306], the Commissioner contends that the target companies were GSM and Tironui and that the stripping entity was MFT (CPS [8]). On this logic, the "vendor shareholder" is Mr Merchant, as the sole shareholder of GSM and Tironui. However, in most respects the present scheme bears no resemblance to a dividend stripping arrangement (even on the Commissioner's definition at CPS [36]):

    (a) The stripping entity, MFT, did not acquire shares in either of the target companies, GSM and Tironui. Rather, Plantic, an associated entity owned by the stripping entity, had prior to the scheme entered into loans with each company.

    (b) The means employed to make the distribution of accumulated profits was not directly by way of dividend or deemed dividend, but instead indirectly by way of a loan forgiveness, which increased the sale price of Plantic (and thereby increased the capital received by the stripper, MFT, on the sale of Plantic).

    (c) At least with respect to the GSM scheme, the profits supposedly "stripped" from the company represented less than 25% of the target company's accumulated profits.

    (d) The "vendor shareholder", Mr Merchant, did not himself receive any property reflecting the profits of the company; instead, any such property was received by a separate legal entity (albeit one associated with him), being MFT.

    (e) None of the transactions involved in the scheme were contrived. Rather, they were ordinary transactions, carried out for the legitimate purpose of facilitating the sale of Plantic for the highest ultimate return to the Merchant Group.

23. That said, these submissions now consider each of the Commissioner's grounds of appeal.

A.3 Ground 1: "Limitations" on the operation of s 177E

24. The Commissioner contends (CPS [20]) that the majority of the Full Court erroneously imposed two "limitations" on the operation of s 177E. *First,* the scheme had to strip all

or a substantial proportion of the target company's accumulated profits. *Second,* the accumulated profits stripped out had to be made substantially tax free, having regard to any tax payable by the recipient of the capital proceeds. The taxpayers disagree that the majority of the Full Court was engaged in an exercise of imposing "limitations" on the text of s 177E. The purported "limitations" on s 177E are more correctly viewed as no more than the majority's teasing out of the concepts built into the enquiry as to effect. No error is shown in the way in which the majority conceived of its task.

A.3.1 Limitation 1: substantial proportion of accumulated profits

25. As to the first "limitation", the majority correctly identified at FCJ [361] that part of the established meaning of a "dividend stripping" scheme is that it will *usually* result in the substantial depletion of the target company's accumulated profits. This is because the impetus for a dividend stripping scheme is *usually* to avoid the potential tax liability created by the target company's undistributed profits.

26. **Terms of s 177E.** The Commissioner's submission at CPS [34]-[35] misconstrues the operation of s 177E as a whole. Section 177E(1)(b) imposes a *qualitative* requirement – it seeks to capture disposals of company property that, in whole or in part, represent a distribution of profits, as opposed to those that represent, for example, a capital return, or a payment for services, or a debt repayment, or an ordinary asset sale. Importantly, s 177E(1)(b) is reached only after identifying a disposal of property that satisfies, relevantly here, s 177E(1)(a)(ii). It is at that anterior s 177E(1)(a)(ii) stage, which is the "initial and key test",[20] that the identification of a disposal of property which represents a *substantial proportion* of the company's profits may be relevant.[21]

27. **Understanding of the term prior to the introduction of s 177E.** Contrary to the Commissioner's submissions at CPS [36]-[39], the understanding of the concept of a "dividend stripping" was consistent with the construction adopted by the Full Court, as set out above at paragraphs [15]-[20]. Two points bear particular note.

28. *First,* the Commissioner's reliance on the definition of *Fowler's* is misplaced. As set out above, that definition was not in fact adopted by Windeyer J, who preferred the *Halsbury's* definition which refers to "these profits", being the accumulated profits of the

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[20] EM at 14.

[21] This is confirmed by the EM at 4. In the context of describing the schemes to which Part IVA applies, the relevant "profit" is described as "the amount of company profits that are represented in the property of the company that is stripped from it under the scheme".

target company, as the object of the scheme. This understanding is reflected in the EM that introduced s 177E, which described "[s]chemes within the category of being, or being in the nature of, dividend stripping schemes" as those where:[22]

> [A] company (the "stripper") purchases the shares in a target company that has accumulated profits that are represented by cash or other readily-realisable assets, pays the former shareholders a capital sum that reflects those profits and then draws off the profits by having paid to it a dividend (or a liquidation distribution) from the target company.

29. *Second,* the Commissioner's reliance on the terms of s 46A(3) is equally misplaced. The matters listed in s 46A(3) were considered "common" to dividend stripping schemes but were not expressed as, or intended to be, exhaustive. As set out above, the provision was directed to the tax benefits obtained by the stripping entity, and so necessarily did not include the aspects of a dividend stripping scheme that bear upon the vendor shareholder. This includes the proportion of the accumulated profits that are "stripped", which determines the extent of the tax benefit obtained by the vendor shareholder.

30. **Utility of prior cases.** The Commissioner disavows the utility of prior cases in determining the essential characteristics of a dividend stripping (CPS [40]-[43]), characterising previous decisions as confined to their facts and self-selecting, despite acknowledging that "many of the schemes historically challenged by the Commissioner did involve the stripping of all or a large part of the accumulated profits of a company" (CPS [42]). Indeed, it appears that practically all the dividend stripping schemes identified in the decided cases of this Court dealing with s 260 have resulted in a substantial depletion of the target company's accumulated profits.[23]

31. In *Bell,* the scheme was "designed to enable the members of the firm to enjoy at once the whole profits of their venture and to avoid the payment of any income tax in respect of the profits".[24] The target company had approximately £78,520 in undistributed profits, of which £77,000 (or about 98%) was paid to the vendor shareholders as a capital sum.[25]

32. In *Hancock,* the target company's net assets prior to the scheme taking effect were £63,500, which included an anticipated current year profit of £24,000 and a provision of £7,000 for undistributed profits tax. The vendor shareholders received a capital sum of

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22 EM at 14 (emphasis added).
23 The only case of this Court which considered a scheme under s 177E is *CPH HCA,* and that scheme was ultimately not held to be a scheme by way of or in the nature of a dividend stripping.
24 *Bell* (1953) 87 CLR 548 at 555 (McTiernan J) (emphasis added).
25 *Bell* (1953) 87 CLR 548 at 571 (Dixon CJ, Williams, Webb, Fullagar and Kitto JJ).

£63,500 (or 100% of the net assets – cf CPS [43]).[26]

33. In *Mayfield,* the target company had £43,221 in assets, of which £40,975 (or 94%) was stripped by the vendor shareholders, including the entirety of its undistributed profits, the difference being an agreed amount of profit for the stripping company.[27]

34. In *Rowdell,* the schemes differed in detail, but they were described as having "certain main features in common", including "stripping the company of the whole or a large part of its accumulated profits".[28]

35. In *Ellers Motor,* "profits were … ultimately concentrated in [the target company], which then had a large sum available for distribution. At the end of the transaction, [the target company] had distributed that money and its former shareholders had received amounts… the total of which corresponded closely to the amount distributed".[29] Its "unappropriated profits" amounted to £358,922, of which £356,900 (or 99%) was paid to the vendor shareholders as a capital sum.[30]

36. In *Patcorp,* the Court considered several similar schemes, all of which resulted in the vendor shareholder receiving a capital sum that was greater than the target company's undistributed profits. For example, in respect of "Remfore", its assets comprised a $208,033 loan and $200 cash at bank, of which its undistributed profits were $138,233.[31] The vendor shareholder received $208,233 as a capital amount for the sale of its shares. Similarly, in respect of "Fraser", its assets comprised a loan of $190,497 and its undistributed profits were $55,206. The vendor shareholder received $190,497 as a capital amount for the sale of its shares.

37. The only case where it cannot be said that the target company's accumulated profits were "exhausted" is *Newton.* In *Newton* there were several schemes, however "all three carried out similar transactions".[32] Taking the example of the target company in "Lane's Transaction", beyond its paid up share capital of £242,321 it had other "shareholder's funds" of £801,134 (comprising undistributed profits of £387,125, a tax-paid profit

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26 *Hancock* (1961) 108 CLR 258 at 287 (Kitto J).
27 *Mayfield* (1961) 108 CLR 303 at 313, 314 (Menzies J).
28 *Rowdell* (1963) 111 CLR 106 at 121 (Kitto J) (emphasis added). See also at 116 (Dixon CJ), describing the schemes as designed "to exhaust the accumulated profits" in the target companies.
29 *Ellers Motor* (1972) 128 CLR 602 at 619 (Walsh J) (emphasis added).
30 *Ellers Motor* (1972) 128 CLR 602 at 608-609 (McTiernan J) and 616 (Walsh J).
31 *Patcorp* (1976) 140 CLR 247 at 255 (Mason J).
32 *Newton* (1958) 98 CLR 1 at 4 (Lord Denning).

reserve of £250,000 and a loan of £164,009).[33] The vendor shareholders received £458,820 as a capital sum.[34] The better way to view the schemes in this case is that they only targeted undistributed current year profits to avoid "Div 7 tax" (cf CPS [43]). "Div 7 tax" was an "undistributed profits tax", paid *in addition to* corporate income tax. If a private company failed to make a sufficient distribution of the current year profits, additional tax was calculated as if the undistributed amount were paid as a dividend.[35] In the case of "Lane's transaction", the effect of the scheme was that £402,679 of profits was replaced by paid-up capital. This was broadly equivalent to the £410,000 which would have needed to be distributed out of the relevant current year profits and anticipated profits for the next year to avoid the Div 7 tax.[36] The past years' accumulated profits (comprised of the £250,000 "tax-paid profit reserve")[37] did not stand to attract Div 7 tax, and so there was no incentive to "strip" them.

38. Further to this point, CPS [41] raises a false issue. Any such "piecemeal stripping" would be capable of being captured by the definition of "scheme" under s 177A, which is not restricted to a scheme composed of a single transaction.

39. **Imprecision of "substantial".** The Commissioner's complaint about the supposed imprecision of this quantitative requirement attached to the concept of a "dividend stripping" (CPS [44]) would, contrary to the Commissioner's own assertions, seem entirely consistent with the term being given a protean, but appropriately confined, scope. Further, this complaint is particularly thin in circumstances where the Commissioner seeks to take advantage of the same "imprecision" expressly sanctioned by the words of s 177E(1)(b)(ii) in capturing a scheme having "substantially" the effect of a scheme by way of or in the nature of a dividend stripping.

40. **Required strength of connection.** Finally, the Commissioner suggests at CPS [46] that a scheme might still have a sufficient connection with a "dividend stripping" arrangement and therefore fall within s 177E(1)(a)(ii) if the scheme fully exhausts the means by which profits are capable of being stripped. While s 177E(1)(a)(ii) encompasses schemes "that depart from the paradigm of a dividend stripping operation, the term cannot be so protean

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33 *Federal Commissioner of Taxation v Newton* (1957) 96 CLR 577 (***Newton HC***) at 584 (Kitto J).
34 *Newton HC* (1957) 96 CLR 577 at 590 (Kitto J).
35 *Hancock* (1961) 108 CLR 258 at 276 (Dixon CJ), 287 (Kitto J). See also Lynne Oats, "Undistributed Profits Tax in Australia" (2000) 15(4) *Australian Tax Forum* 427 at 439.
36 *Newton HC* (1957) 96 CLR 577 at 602-603 (Kitto J).
37 *Newton HC* (1957) 96 CLR 577 at 584 (Kitto J).

as to be meaningless".[38] As set out above at [22], a meaningful connection must be maintained between the scheme in question and the paradigm of a dividend stripping. For all the reasons given in that paragraph, the Commissioner's proposed construction would sever that connection.

A.3.2 Limitation 2: substantially tax free

41. As to the second "limitation", the majority correctly observed (FCJ [368]) that dividend stripping "generally involves the recipient of the profits (or the value of the profits) of the company not being subject to substantial tax on those profits".[39]

42. **The text of s 177E.** It is axiomatic that the text of s 177E requires that the profits of the company must be "substantially tax free" in the hands of the recipient of those profits (*contra* CPS [52]). That requirement is found in the need for the scheme to be "by way of or in the nature of dividend stripping" or have substantially that effect under s 177E(1)(a). As discussed further below, both the decided caselaw and the extrinsic materials support this construction of "dividend stripping". The concept was clearly intended to bear its "established meaning" as part of "tax avoidance discourse".[40]

43. The fact that the non-inclusion of "an amount" in taxable income is sufficient for there to be a tax benefit within the meaning of s 177C(1)(a) takes the matter nowhere (cf CPS [52]-[53]). The use of the indefinite article simply reflects the fact that there is no threshold requirement under Part IVA for the amount to be greater than a certain total. It is not inconsistent with a requirement of substantiality. The deemed definition of this "amount" in ss 177E(1)(c), (1)(f) and (1)(g) takes the matter no further – it simply provides that the tax benefit obtained by the taxpayer will be taken to be the amount of tax that would have been payable in the event the property disposed of (which represents a distribution of profits of the company) had instead been distributed as a dividend.

44. **Support in the caselaw.** The decided cases clearly establish that the profits of the company must be made "substantially tax free" in order for a scheme to be by way of or in the nature of a dividend stripping. As the Full Court in *CPH FC* said at [159], "[t]he critical point is that the vendor shareholders receive a consideration which is in a tax-free or largely tax-free form".[41] The Full Court considered it a "departure… from the paradigm

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38 See *B&F Investments* (2023) 298 FCR 449 at [111] (the Court).
39 See also FCJ [324]-[325], [332].
40 *CPH HCA* (2001) 207 CLR 235 at [104] (the Court).
41 *CPH FC* (1999) 91 FCR 524 at [159] (the Court) (emphasis added).

of a dividend stripping operation", that the vendor shareholders in that case reported a significant assessable capital gain by reason of the sale of their shares, which (although not necessary to decide) was said to "suggest that the scheme may not fall within the first limb of s 177E(1)(a)".[42] Indeed, the fact that the consideration received by each of the taxpayers for the sale of its shares attracted capital gains tax in Australia was described as "[t]he objective feature perhaps most strongly suggesting" that the scheme was not by way of or in the nature of a dividend stripping.[43] These remarks were made following a detailed analysis of the decided cases and the extrinsic materials accompanying the relevant legislation to ascertain the "central characteristics" of a dividend stripping scheme.[44] Further, and contrary to CPS [54], the "central characteristics" listed by the Full Court clearly drew upon the analysis contained in Vincent's article, which considered each of the cases listed in fn 8 above, to conclude that the listed characteristics were common to all of those cases.

45. This requirement was also referred to with approval by a unanimous judgment of this Court in *CPH HCA* at [129], where it was remarked that s 177E was intended to apply only to "schemes which can be said to have the dominant purpose of tax avoidance… ordinarily being that of enabling the vendor shareholders to receive profits of the target company in a substantially tax-free form, thereby avoiding tax that would or might be payable if the target company's profits were distributed to shareholders by way of dividends".[45] Indeed, contrary to the suggestion at CPS [50] and CPS [54], it is well-established that it is necessary for the profits of the company to be made "substantially tax free" in the hands of the recipient of the capital proceeds (i.e. the vendor shareholders in the paradigm of a dividend strip) in order for a scheme to be characterised as a "dividend strip". This requirement is reflected in the prior decisions of this Court concerned with "dividend stripping" arrangements under s 260.

46. In *Bell,* it was observed that the steps taken to effect the scheme in that case "made all the difference between… deriving £11,000 as assessable income and deriving £11,000 as a capital receipt not liable to inclusion in assessable income", and that the scheme was planned and carried through "to ensure that [the vendor shareholders] should each receive

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42 *CPH FC* (1999) 91 FCR 524 at [163]-[164] (the Court).
43 *CPH FC* (1999) 91 FCR 524 at [162] (the Court) (emphasis added).
44 *CPH FC* (1999) 91 FCR 524 at [130]-[153]; [157] (the Court).
45 *CPH HCA* (2001) 207 CLR 235 at [129] (the Court) (emphasis added). See also *Patcorp* (1976) 140 CLR 247 at 300 (Gibbs J); *Bell* (1953) 87 CLR 548 at 571, 573 (the Court).

£11,000 tax-free instead of £11,000 subject to tax".[46]

47. In *Newton,* the relevant target companies distributed £1,764,136 in dividends, of which £1,661,772 "found its way back" to the vendor shareholders in the form of a capital payment, in respect of which they were "not liable to tax".[47] It was observed that the purpose and effect of the arrangement was to enable the vendor shareholders "to receive a large sum… without paying tax on it".[48]

48. In *Hancock,* the scheme was similarly arranged so that the vendor shareholders received a capital payment "upon which… no income tax would be payable",[49] and indeed "no tax was paid or incurred by any party to the transaction", with the exception of the stripper company who was taxed on the profit made on the transaction.[50] An "essential feature" of the scheme was "the escape of the tax that must attach either to the company or to the shareholders if the profits were undistributed and alternatively of the tax which as shareholders they would pay if the profits were simply distributed as dividends".[51]

49. In *Mayfield,* the complicated series of arrangements had the "purpose and effect" of allowing the vendor shareholders to have the benefit of the accrued profits of the target company "without them or their companies incurring any tax liability".[52]

50. In *Ellers Motor,* the relevant transactions had the "end result" that "the profits had gone out from [the target company] and that an equivalent amount had come into the hands of its shareholders",[53] "in such a form that it [was] not taxable unless s. 260 operate[d]".[54]

51. Given the positive evidence that Parliament was aware of the judicial consideration and interpretation of the concept of a "dividend stripping" arrangement when it enacted s 46A (and subsequently s 177E),[55] it should be "taken to have intended the words to bear the meaning already 'judicially attributed to [them]'".[56]

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46 *Bell* (1953) 87 CLR 548 at 571 (the Court) (emphasis added).
47 *Newton* (1958) 98 CLR 1 at 5-6 (Lord Denning).
48 *Newton* (1958) 98 CLR 1 at 9 (Lord Denning, delivering the judgment of the Privy Council) (emphasis added).
49 *Hancock* (1961) 108 CLR 258 at 276 (Dixon CJ, Windeyer J agreeing).
50 *Hancock* (1961) 108 CLR 258 at 277 (Dixon CJ, Windeyer J agreeing) (emphasis added).
51 *Hancock* (1961) 108 CLR 258 at 278 (Dixon CJ, Windeyer J agreeing) (emphasis added).
52 *Mayfield* (1961) 108 CLR 303 at 319 (Menzies J) (emphasis added).
53 *Ellers Motor* (1972) 128 CLR 602 at 620 (Walsh J, Windeyer and Gibbs JJ agreeing).
54 *Ellers Motor* (1972) 128 CLR 602 at 622 (Walsh J, Windeyer and Gibbs JJ agreeing) (emphasis added).
55 See Part A.2 above.
56 *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 254 CLR 489 at [15] (the Court), quoting *Re Alcan Australia Ltd; Ex parte Federation of Industrial, Manufacturing and Engineering Employees* (1994) 181 CLR 96 at 106 (the Court). See also *Electrolux Home Products Pty Ltd v Australian Workers' Union* (2004) 221 CLR 309 at [7]-[8] (Gleeson CJ), [81] (McHugh J), [161]-[162] (Gummow, Hayne and

52. **Support in the extrinsic materials.** The EM also provides strong support for the existence of this requirement (*contra CPS* [56]). There it is stated that s 177E was designed "to deal with dividend-stripping schemes of tax avoidance and certain variations on such schemes, the effect of which is to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends".[57] This accords with the pre-existing understanding of a dividend-stripping scheme at that time, which is reflected in the Explanatory Memorandum to the Income Tax Assessment Bill (No 3) 1972 (which introduced the concept of "dividend stripping" into the ITAA36). There it is explained that a dividend stripping operation, "[i]n its simplest form", has the result that "the dividends are effectively freed from tax".[58]

53. The reasoning of the majority of the Full Court reflects this orthodox understanding of the nature of a dividend stripping. As explained at FCJ [399], "s 177E is not engaged merely because some potential tax saving on a dividend can be identified. The history of dividend stripping and its core characteristics have quantitative elements". That this was the understanding of dividend stripping prior to the introduction of s 177E tells against the majority's reasoning having the effect of creating a lacuna (*contra* CPS [55]). Indeed, the reasoning deployed by the Commissioner in this respect is circular – merely because the statutory language chosen by Parliament in s 177E was objectively intended only to apply to schemes bearing the character of a dividend stripping, does not therefore mean that schemes which do not fit this character are therefore somehow intended to be included in s 177E because they would otherwise fall outside the operation of Part IVA.

54. **Purpose.** As to CPS [57], the taxpayers rely on the submissions in Part B of MPS that neither debt forgiveness scheme had the requisite tax avoidance purpose.

A.3.3 Conclusion as to ground 1

55. A dividend stripping has several essential features, two of which are: (1) the scheme will target a substantial proportion of the target company's accumulated profits; and (2) both the stripper entity, but also importantly the vendor shareholders as the recipient of the value of those profits, will not be liable, or will not be substantially liable, to pay tax on those profits. The Full Court correctly found that the GSM scheme did not have the first

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Heydon JJ); *Vella v Commissioner of Police (NSW)* (2019) 269 CLR 219 at [19] (Kiefel CJ), [52] (Bell, Keane, Nettle and Edelman JJ).

57 EM at 4 (emphasis added). See also EM at 13-14.

58 As replicated in *Commissioner of Taxation v Consolidated Press Holdings Ltd* (1999) 91 FCR 524 at [144] (the Court) (emphasis added).

or second of those features which is *sufficient* to sustain its conclusion in respect of the effect of the *GSM scheme* (while noting that the majority of the Full Court should have gone further in relation to the effect of both schemes – see Part VI below – and should also have found that the requisite purpose was lacking – see Part B of MPS).

A.4 Ground 2: The retrospectivity of the s 177D Determination

56. The s 177D Determination had the effect of cancelling the capital loss incurred by MFT on the BBG share sale (PJ [12]). This increased MFT's net income and meant that MFT (as the supposed stripper) had only $40m of capital losses (being those losses not attributable to the disposal of the BBG shares). The Commissioner contends that the majority erred in reasoning that the effect of each debt forgiveness scheme under s 177E was to be assessed taking into account the s 177D Determination. (The following submissions proceed on the assumption (which the taxpayers seek to contest in the related S158/2025 appeal) that the s 177D Determination was properly made. In the event the Court finds that the s 177D Determination was not properly made, then the taxpayers rely on the submissions made in Part VII below.)

57. **General response.** The analysis of the majority correctly identified that the effect of the scheme "looks to the outcome in fact produced", which is to be determined with the benefit of hindsight, in contrast with the inquiry as to the purpose of the scheme, which looks to the intended outcome (FCJ [373], emphasis added). Contrary to CPS [61], this analysis did not conflate "two distinct questions". If, as the Commissioner appears to have acknowledged, a determination under s 177F has a retrospective effect, then it would be incongruous, in the absence of clear legislative intent to the contrary, if that determination were not taken into account in assessing whether a scheme has the effect of a dividend stripping scheme. Far from being "distinct", these two "questions" (as described by the Commissioner) – to what extent a determination under s 177F has retrospective effect and whether that effect is taken into account in assessing whether a scheme has the effect of a "dividend stripping" scheme – are effectively coterminous.

58. **The text (CPS [62]-[63]).** On the plain terms of s 177F(1)(c), the effect of the s 177D Determination was that the capital loss incurred by MFT on the transfer of the BBG shares "was not incurred by the taxpayer during that year of income". It was therefore open on the terms of s 177F(1)(c) for the majority to conclude (FCJ [373]) that the determination had the retrospective effect of deeming the capital loss to have not been incurred, for all purposes, including in determining under s 177E the schemes' effect (i.e. the outcome *in*

fact produced). As indicated above, the Commissioner accepts that determinations under s 177F may have a retrospective effect "for some purposes" (CPS [61]) but provides no reason referrable to the text or purpose of s 177E or s 177F that would limit or exclude that retrospective effect in assessing whether a scheme has substantially the effect of a scheme by way of or in the nature of a dividend stripping scheme for the purposes of s 177E. In the absence of clear legislative intent to the contrary, it would be incongruous for the express language of s 177F(1)(c) to be subservient to the vague qualifying condition identified at CPS [62]-[63], which does not clearly prohibit the retrospective deeming operation of s 177F(1)(c).

59. Further, the tax outcome *in fact produced* by the scheme is dictated by the operation of the ITAA36 and ITAA97. It would be highly artificial to disregard the effect of a determination made under s 177F in circumstances where s 177F has a substantive effect on the tax liability of a taxpayer that is no different in nature from other provisions of these Acts, like (for example) s 6-5 or s 6-10 of the ITAA97. The Commissioner offers no justification for disregarding the former and not the latter.

60. The submission at CPS [62]-[63] (and CPS [64]) also erroneously elides two distinct enquiries required under s 177E(1)(a). Section 177E distinguishes between the <u>effect</u> of the relevant transactions that make up the impugned scheme, which is the concern of s 177E(1)(a)(i) and (ii), and the <u>result</u> of those transactions, being the disposal of property of the company which represents, in whole or in part, a distribution of profits of the company (as per ss 177E(1)(a) and (1)(b)). As explained by Jessup J in *Lawrence v Federal Commissioner of Taxation*:[59]

> Clearly, for a scheme to have such a result is insufficient to justify the conclusion that it has the effect to which para (a)(ii) refers. In other words, that paragraph requires the court to look at circumstances <u>other than the mere fact that company property has been disposed of in a way which represents a distribution of profits</u>.

61. In other words, the steps in the scheme that bring about the disposal of property are necessary, but not sufficient, for a scheme to be a "dividend stripping" scheme. So, while it may be accepted that s 177E(1)(a) requires property of the company to have been disposed of "as a result of" the scheme (CPS [63]), this enquiry as to <u>result</u> is distinct from the enquiry as to <u>effect</u>, and does not require any consideration of the tax benefit (or lack thereof) obtained by the taxpayer (to which any determination made under s 177D is

[59] (2008) 70 ATR 376 at [76] (Jessup J) (emphasis added).

relevant). Indeed, it may not be possible to judge whether a scheme meets s 177E(1)(a)(i) or (ii) "at the time the steps in the scheme that bring about the disposal of property have been completed" (cf CPS [63]), because the other elements of the scheme, essential to its characterisation as a "dividend stripping" arrangement, have not yet been carried out or crystallised. For example, in the present case, it was accepted by the primary judge and the majority that if the schemes had been identified as comprising solely of the forgiveness of the debts (i.e. the relevant disposal of property), or had excluded the actual sale of the Plantic shares, then s 177E would not have been attracted (PJ [472], [476], [477], FCJ [315]). The submissions made at CPS [62]-[63] are therefore beside the point.

62. **Scope of "effect" (CPS [64]-[65])**. The submission at CPS [64] does not take the matter any further. Section 177E(1)(a)(ii) aims to capture "a scheme that would be within sub-par (i) except for the fact that the distribution by the target company was not by way of a dividend or deemed dividend".[60] However, that fact does not remove from the inquiry the need to consider the outcome in fact produced by the scheme (which must be considered under either limb to determine if the scheme is, or has substantially the effect of, "a scheme by way of or in the nature of dividend stripping"). That enquiry does not therefore entail, contrary to the suggestion at CPS [64], "a broader enquiry into the events which may ultimately flow from the scheme… not required in the application of the first limb". Further, and contrary to CPS [65], the s 177D Determination is indispensable in determining the tax outcome that was, in fact, achieved by the scheme. To conclude otherwise would, in effect, require a statutory fiction to be constructed. If this were intended, it would be expected that the drafters would have made this clear, as they have elsewhere in the provision and Part IVA[61] where a "deemed" outcome is intended.[62]

63. **Differential timing of enquiry as to effect vs purpose (CPS [66]).** The Commissioner complains at CPS [66] that the majority's construction "has the consequence that the assessment of purpose and effect may occur at different times and on different 'taxable facts'". The difference between the enquiries simply reflects the difference in the question being asked. As to purpose, the question is what would be concluded to have been the *intended* outcome? This is a prospective enquiry which takes into account the objective

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60 *CPH HCA* (2001) 207 CLR 235 at [140] (the Court).

61 See, eg, ss 177C(1), 177E(1)(f).

62 Of course, a deeming provision does not always create a "statutory fiction", as it may be used for the purpose of definition or for expressing a conclusion, but in any event the same language is often deployed. See *Mutual Pools & Staff Pty Ltd v Federal Commissioner of Taxation (Cth)* (1992) 173 CLR 450 at 468 (Dawson, Toohey and Gaudron JJ).

facts that were knowable at the time of the scheme. As to effect, the question is what was the *actual* outcome? This enquiry is evaluated with the benefit of hindsight, taking into account the tax consequences, as dictated by the ITAA36 and ITAA97, as they stand at the date of the enquiry. The Commissioner does not identify *why* or *how* this construction is problematic. It is perfectly orthodox for different statutory enquiries, with different aims, to require different scopes of analysis or different approaches.

64. **Broader legislative context (CPS [67]-[69]).** The Commissioner contends that the majority's construction "allows s 177D to limit or deny the operation of s 177E (or, indeed, other sections such as s 46A before its repeal) to a distinct tax mischief" (CPS [68]). There are several problems with this submission.

65. *First,* it overstates the possible interaction between s 177D and s 177E. A determination to cancel a tax benefit is unlikely to be relevant except in narrow circumstances such as the present where: (a) an element of the s 177D scheme is the transaction the subject of the s 177D Determination; and (b) the s 177D Determination affects the tax liability of a participant in the dividend-stripping scheme. This is because the relevant aspect of the enquiry as to effect under s 177E, to which a determination under s 177D may be relevant, is the tax consequences of the scheme for the participants. The confined interaction between ss 177D and 177E has two consequences:

(a) The operation of the broader legislative regime is not affected so far as it seeks to respond to the "tax mischiefs" of the other parties to the scheme (cf CPS [68]). Indeed, the Commissioner fails to identify how any other provisions of the *current* regime, beyond s 177D and s 177E, would be affected by the construction adopted by the majority (noting that s 46A has since been repealed).

(b) There will be no interaction between s 177D and s 177E where each are responding to "distinct tax mischief[s]" (cf CPS [68]) of the vendor shareholders. Here, for example, the s 177D Determination was only relevant because the schemes were interconnected and involved *overlapping* tax consequences.

66. *Second,* to say that s 177D operates, on the majority's construction, "to limit or deny the operation of s 177E" (CPS [68]) is merely a reflection of the fact that a determination under s 177F operates retrospectively, which may deprive a scheme of being, or having the effect of "a scheme by way of or in the nature of dividend stripping", because it does not *in fact* result in the substantial avoidance of tax. It is not evidence of an unintended lacuna in the operation of the Act, created by the interaction between s 177D and s 177E.

67. **Compensating adjustments (CPS [70]-[72]).** The construction proposed at CPS [69] would have results that are manifestly unfair. As much was conceded by the Commissioner before the Full Court, with the majority noting that the Commissioner "conceded that the outcome of the decision of the primary judge (which upheld both the s 177E Determinations and the s 177D Determinations) was not 'fair and reasonable'" (FCJ [410]). This is because here the debt forgiveness schemes were defined to include the BBG share sale as the first and integral step (FCJ [306], [315]). Given the s 177D Determination cancelled the tax benefit in respect of that aspect of the schemes, the Commissioner cannot be allowed to ignore the "new reality" created by s 177F, so as to tax the Respondents twice in respect of the very same transaction. Such a construction would be contrary to the presumption against unreasonable or unjust consequences.[63]

68. Contrary to CPS [70], this unfairness is incapable of being cured by s 177F(3). Any given set of circumstances can be construed as involving any number of "schemes" that would support the making of multiple lawful but inconsistent s 177F(1) determinations and related assessments – including those having the effect of double taxation. The only avenue to challenge such assessments is by Part IVC review. Parliament is unlikely to have intended relevantly to limit that review to challenging the making or non-making of a compensating adjustment under s 177F(3). Section 177F(3) involves a discretion conditioned on the formation of an opinion about a nebulous question of fact. The only thing capable of challenge in a court is the lawfulness of that opinion or exercise of discretion;[64] and a court would generally not substitute its own view about those matters (except, perhaps, if it could be said that there is only one conclusion legally open).[65] Even then, s 177F(3) does not require the Commissioner to give effect to (or even consider) the *full* tax consequence of the counterfactual (i.e. the scheme not having been entered into or carried out) and for *all* affected taxpayers collectively. This is illustrated by the proposal at CPS [72], which does not take into account the full tax consequences for all parties of the "Debt Forgiveness Schemes" not having been entered into (noting that those schemes include the BBG share sale and the Plantic sale).

69. Further, as this case demonstrates, the fact that a compensating adjustment may be made

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63 See *MacAlister v The Queen* (1990) 169 CLR 324 at 330 (the Court); *Shahi v Minister for Immigration and Citizenship* (2011) 246 CLR 163 at [38] (French CJ, Gummow, Hayne and Bell JJ).

64 That is, a challenge on *Avon Downs* grounds, or an appeal from the Tribunal limited to a question of law.

65 See *Federal Commissioner of Taxation v Addy* (2020) 280 FCR 46 at [26] (Davies J); [167]-[169] (Derrington J) and [306]-[312] (Steward J).

"well after" a s 177F(1) determination (CPS [70]), further undermines the curative effect of s 177F(3). As the majority of the Full Court noted, the Commissioner's failure to articulate – prior to its submissions before this Court (see CPS [72]) – what, if any, s 177F(3) compensating adjustments were contemplated was "of concern when one appreciates that the assessments giving effect to those determinations relate to income tax years ending nearly a decade ago" (FCJ [410]).

70. **Arbitrary results (CPS [73]-[75]).** Finally, the Commissioner submits that arbitrary results follow from the construction adopted by the majority – both in terms of the order in which to analyse s 177D and s 177E, and in terms of the order in which to analyse the two debt forgiveness schemes under s 177E. As to the former, the solution is simple: where a constituent element of a scheme under s 177E may otherwise be affected by the operation of s 177D, the effect of s 177D should be considered first, before turning to consider the effect of s 177E. As to the latter, this is dealt with in [74]-[75] below.

71. **Conclusion.** In light of the above it was necessary for the majority to take the s 177D Determination into account in assessing the validity of the determination made under s 177F in reliance upon s 177E of the ITAA36 (**s 177E Determination**) in circumstances where the schemes the subject of the s 177E Determination were defined to *include* the BBG share sale as a central aspect, and the tax effect of those schemes was dependent upon the tax benefit in relation to the BBG share sale in fact being obtained.

PART VI: TAXPAYERS' CROSS-APPEAL AND NOTICE OF CONTENTION

72. The majority found that the amount of net non-BBG capital losses available to MFT after taking account of the s 177D Determination was "sufficient to entirely shelter any increased capital gain on the Plantic shares attributable to the Tironui debt forgiveness of $4,215,000" (FCJ [380]). In contrast, it was said that the GSM debt forgiveness amount exceeded the net non-BBG capital losses available to MFT after taking account of the s 177D Determination. Because 100% of MFT's income was distributed to GSM, GSM was liable for tax on any capital gain made by MFT. The capital gain made on MFT's sale of the Plantic shares attributable to the GSM debt forgiveness was therefore taxed in the hands of GSM (as the beneficiary of MFT that was presently entitled to MFT's income) at a higher rate than the effective rate of tax that would have been payable by Mr Merchant on a fully franked dividend paid out of those accumulated profits (FCJ [393]). For the inter-related reasons that follow, the majority's conclusion that the GSM scheme did not attract s 177E(1)(a)(ii) was correct for additional reasons to those it gave; whereas

its conclusion that the Tironui scheme had the requisite effect under s 177E was in error.

A. The first problem – incorrect sequencing

73. First, the majority of the Full Court erred in the way it determined the tax consequences of both debt forgiveness schemes (FCJ [375], [380], [385]). The approach taken, as set out above, was at odds with the method for calculating a net capital gain as set out in ITAA97 s 100-50. That provision provides that in working out your net capital gain or loss, you reduce your capital gains for the income year, in the order you choose, by your capital losses for the income year, and then reduce any remaining capital gains, again in the order you choose, by any unapplied net capital losses from previous income years.
10 The majority's approach was problematic in two ways.

74. *First*, if the majority had considered MFT's net capital gain by comparing its total capital gains as against its total available capital losses, as contemplated by s 100-50 ITAA97, it would have been clear that those losses were insufficient to "shelter" MFT's capital gains (i.e. that MFT made a substantial net capital gain), compelling a conclusion that neither scheme had the requisite tax effect. In this respect, MFT's net capital gain was $74,005,102,[66] while its total capital losses, taking into account the s 177D Determination, were $40,093,792, leaving a net capital gain of $33,911,310.

75. *Second,* even if the correct approach was to consider MFT's "net capital gain" by reference to individual capital gains and capital losses, the majority erred by applying the
20 capital losses in the order that was the least favourable to the taxpayers. This was contrary to the clear intent of s 100-50 of the ITAA97, which expressly allows the taxpayer to choose the order in which to apply any capital losses in order to optimise their tax position. If the capital losses were first applied to the capital gain attributable to the GSM scheme, ahead of those attributable to the Tironui scheme, there would be no remaining capital losses to offset or "shelter" the capital gains attributable to the Tironui scheme, such that neither scheme would have the requisite tax avoidance effect. This is acknowledged by the Commissioner at CPS [73].

76. Relatedly, as Logan J correctly observed at [53]-[54], while the forgiveness of the GSM Loan and Tironui Loan increased the amount that MFT received for the sale of the Plantic

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[66] This was comprised of $465,805 derived by MFT on other disposals and $73,539,297 derived from the sale of the Plantic shares (being $19,132,297 that would otherwise have been derived on the sale of the Plantic shares regardless of the debt forgiveness schemes, the $50,192,000 attributable to the GSM debt forgiveness and $4,215,000 attributable to Tironui debt forgiveness schemes).

shares, it did so in a way that was subject to the capital gains tax regime (even if only by "soaking up" capital losses available to MFT, which were not a result of the debt forgiveness). This had the result that those capital losses ceased to be available to be applied to reduce other capital gains made in later years.

B. The second problem – the non-BBG losses

77. Second, the majority's conclusion that the Tironui scheme had the relevant effect (at FCJ [381]) is at odds with its view that the mere forgiving of the debts did not in and of itself have the effect of dividend stripping (at FCJ [315]). This is because, to have the relevant effect, the schemes had to involve the presence of losses to offset the increased capital gain resulting from the debt forgiveness, and MFT having the non-BBG losses was not an identified component of either scheme (*contra* CPS [8]).

C. The third problem – the tax consequence for Mr Merchant

78. Finally, the majority also failed to properly consider the tax consequences of the GSM scheme and the Tironui scheme on Mr Merchant, the "vendor shareholder". As set out above, in relation to s 177E, "[t]he critical point is that the vendor shareholders receive a consideration which is in a tax-free or largely tax-free form". The majority found that the Tironui scheme "enable[d] an associate of Mr Merchant to receive capital proceeds in an untaxed form whilst relieving him of the potential liability for top up tax on a distribution of profits of Tironui" (FCJ [381]). In respect of the GSM scheme, the majority found that if a fully franked dividend had been paid to Mr Merchant by GSM, he would have been liable for tax of $13,602,000 (instead GSM paid around $10,173,600) (FCJ [388]-[389]).

79. The problem with this reasoning is that the effect of the transaction was not to immunise the additional capital received by MFT from being a potential source of tax obligations in the hands of Mr Merchant. A dividend stripping scheme converts something that *might have been* taxed into something that *will not be* taxed.[67] To the extent that the Full Court's decision in *Federal Commissioner of Taxation v Michael John Hayes Trading Pty Ltd* (2024) 303 FCR 62 suggests to the contrary,[68] it should not be followed.

80. In the same way that the relevant capital was a potential source of tax obligations while

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[67] Compare *Lawrence v Federal Commissioner of Taxation* (2008) 70 ATR 376 at [84] (Jessup J), referring to the effect of the transaction there being that the relevant amount would "no longer have been a potential source of income tax obligations, either for the taxpayer or for anyone else".

[68] The conclusion in *Federal Commissioner of Taxation v Michael John Hayes Trading Pty Ltd* (2024) 303 FCR 62 at [40] (the Court) is expressed in terms of "purpose"; the present point is not about purpose, but rather about the effect a scheme must have in order to have substantially the effect of a dividend stripping scheme.

it was sitting on GSM's balance sheet (i.e. if GSM paid a dividend to its shareholder, Mr Merchant), it remained a potential source of tax obligations after it moved to MFT's balance sheet (e.g. if MFT distributed capital to GSM, and GSM in turn paid that capital out as a dividend or as capital to its shareholder). It is not necessary to say that the former event was *likely* in order for there to be a dividend stripping scheme – indeed, avoiding that inquiry is the very reason s 177E was enacted.[69] By the same logic, it is not material whether the latter event was likely or not (cf CPS [82]).

PART VII: THE COMMISSIONER'S CROSS-APPEAL

81. In the event the taxpayers' related appeal (S158/2025) is successful, the s 177D Determination will have been made in error and MFT will have suffered a capital loss on the BBG share sale of $56.5m in the year ended 30 June 2015. Contrary to the Commissioner's submissions on its own cross-appeal (CPS [78]), this will not have the effect that s 177E should be applied to the GSM scheme. If, as the taxpayers assert, the s 177D Determination was made in error, s 177E still does not apply to the GSM scheme:

    (a) The *purpose* of the GSM scheme was not tax avoidance (for all the reasons set out in Part B of MPS in respect of the taxpayers' notice of contention); and/or

    (b) The GSM scheme did not have the requisite *effect* as a scheme by way of or in the nature of a dividend stripping scheme. First, because it did not strip a substantial proportion of GSM's accumulated profits (this finding by the majority of the Full Court would be unaffected, as it did not rely in any way on the s 177D Determination). Second (or in the alternative), because it did not avoid substantially all tax on the distributed profits for the reasons given above at paragraph [77]-[80], which are unaffected by, and independent from, the s 177D Determination.

82. For all these reasons, the Commissioner's cross-appeal should be dismissed.

PART VIII: TIME ESTIMATE

83. It is estimated that up to 4.5 hours will be required for oral argument in both appeals.

Dated 20 January 2026

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[69] *CPH HCA* (2001) 207 CLR 235 at [108]-[109] (the Court).

ANNEXURE TO RESPONDENTS' SUBMISSIONS

No	Description	Version	Provision(s)	Reason for providing this version	Applicable date or dates
1	*Income Tax Assessment Act 1936* (Cth)	Compilation dated 20 March 2015 to 13 April 2015	Part IVA	Act in force on the date of the relevant transaction	2 April 2015: date of Plantic share sale
		As made	s 260	For illustrative purposes only	N/A
2	*Income Tax Assessment Act 1997* (Cth)	Current	ss 6-5, 6-10	For illustrative purposes only	N/A
		Compilation dated 20 March 2015 to 13 April 2015	s 100-50	Act in force on the date of the relevant transaction	2 April 2015: date of Plantic share sale
3	*Income Tax Assessment Act (No 3) 1972* (Cth)	As made	s 46A	For illustrative purposes only	N/A
4	*Income Tax Laws Amendment Act (No 2) 1981* (Cth)	As made	Part IVA	For illustrative purposes only	N/A