HIGH COURT OF AUSTRALIA

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Details of Filing

File Number:	S157/2025
File Title:	Commissioner of Taxation v. Merchant & Anor
Registry:	Sydney
Document filed:	Appellant's reply
Filing party:	Appellant
Date filed:	10 Feb 2026

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IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

BETWEEN: **Appeal S157/2025**

Commissioner of Taxation
Appellant

and

Gordon Stanley Merchant
First Respondent

and

GSM Pty Ltd ACN 074 508 124
Second Respondent

BETWEEN: **Appeal S158/2025**

Gordon Stanley Merchant
First Appellant

and

GSM Pty Ltd ACN 074 508 124
Second Appellant

and

Commissioner of Taxation
Respondent

APPELLANT'S SUBMISSIONS IN REPLY IN APPEAL S157/2025
CROSS RESPONDENT'S SUBMISSIONS IN APPEAL S157/2025
CROSS-APPELLANT'S SUBMISSIONS IN APPEAL S158/2025

Part I: CERTIFICATION

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

Part II: SUBMISSIONS IN REPLY IN S157/2025

2. The Merchant Parties' Responsive Submissions (**MRS**) in S157/2025 seek to restrict the accepted meaning of the expression 'dividend stripping' in tax avoidance discourse. That approach has no sound foundation in the authorities, the literature, or the legislative design of s 177E, and places unwarranted limitations on the concept, undercutting the effective operation of Part IVA.

3. The Merchant Parties' approach to the interaction between s 177D and s 177E would result in company profits stripped under a scheme with a dominant purpose of tax avoidance being only partially addressed. There can be no doubt that this is contrary to the intention of the legislature. The approach disregards the role of Part IVA within the ITAA 1936 and the ITAA 1997, and the statutory architecture of Part IVA.

4. It is not the case that the Merchant Parties will succeed if they defeat *either* of the Commissioner's grounds of appeal: c.f. MRS[10]. The Commissioner will succeed if he succeeds on Grounds 1(a) and 2, without Ground 1(b), because, in disregarding the s 177D Determination, the GSM Debt Forgiveness Scheme also has the requisite effect (for the purposes of s 177E) of GSM's stripped profits being accessible to Mr Merchant (via the MFT) entirely tax free. The Commissioner will also succeed without Ground 2 if both Grounds 1(a) and 1(b) are successful, as in that event, the Debt Forgiveness Schemes both have the required effect of a dividend stripping scheme notwithstanding the effect of the s 177D Determination.

Relevant Facts

5. The Merchant Parties' "qualifications" to the recitation of facts in the Commissioner's Primary Submissions (**CPS**) are incorrect. *First*, the submission at MRS[6] is in tension with the primary judge's finding that, as at 2 and 4 September 2014, it was objectively likely that a sale of Plantic would occur, "probably by 30 June 2015": PJ[317], [344]. The observation that the sale "could have been deferred … to a time where there would be greater certainty" ignores the finding that the sale of the BBG shares was desirable however the Plantic sale was structured: PJ[344], [375]; see also FC[287].

6. *Second*, MRS[7] mischaracterises the Commissioner's submission. It has never been controversial that the purchasers of the Plantic shares required the GSM and Tironui Loans to be discharged: PJ[160], [532]. But it *was* the Merchant Parties who insisted that this be achieved by a forgiveness (PJ[173], [531],[532]) despite this being a "major issue" for the purchaser: PJ[219], [525], [526]; FC[352]. The fact that the other options for discharging the loans would not achieve precisely the same consequences is not relevant, see Commissioner's Responsive Submissions (**CRS**) in S158/2025 at [71], [72], [74].

7. *Third*, as to MRS[8], the MFT's existing capital losses formed part of the context in which each of the Debt Forgiveness Schemes were pursued and are properly taken into account, despite not comprising a step in each scheme. The Commissioner does not contend they were part of the schemes. As explained below in Part IV, the stripped profits formed part of the corpus of the MFT "without any tax consequences" in the sense that no tax was paid in the execution of the schemes themselves, and no tax will become payable upon distribution of the capital by the MFT to one or more of its beneficiaries.

The Meaning of 'Dividend Stripping': MRS[13]-[23]

8. Contrary to the submission at MRS[13], [21], while the Commissioner contends that the meaning of the expression "dividend stripping" is adaptive, it is neither unconfined nor untethered from previous authority. The Commissioner agrees (c.f. MRS[20]) that the essential characteristics of dividend stripping are the disposal of property of a company, representing in whole or in part profits of the company, in a manner by which:

   (a) the purchaser (the stripping entity) escapes tax on a dividend paid to it (by a rebate or offsetting losses); and

   (b) the pre-scheme shareholder (or their associate) receives a capital sum equivalent to (or closely equivalent to) those profits and, in doing so, avoids tax that would have been payable had that sum been distributed as a dividend: *CPH FC* at [136].

9. These are the central characteristics of a dividend stripping scheme that emerge from the case law and the tax avoidance discourse: *CPH FC* at [137], [157]; *BandF Investments* [101]-[103]. CPS[36] does not suggest the contrary. But to say, as Windeyer J and subsequent courts have,[1] that the meaning is *protean* is to recognise that forms of tax-

[1] *Investment & Merchant Finance* (1970) 120 CLR 177 at 179; *CPH FC* (1999) 91 FCR 524 at [132]; *BBlood Enterprises Pty Ltd v Federal Commissioner of Taxation* (2022) 114 ATR 851 at [301]; *BandF Investments* (2023) 298 FCR 449 at [111(2)].

avoidance schemes will evolve,[2] and that because the legislature adopted a term which is not *legislatively* defined, it is capable of applying to schemes which retain these core characteristics but lack some of the traditional features (such as a sale of the shares by the new shareholder at a loss: *BandF Investments* [104]). This element of adaptability is reflected by the words "by way of or in the nature of" in s 177E(1)(a)(i), and by the inclusion of s 177E(1)(a)(ii). The Merchant Parties' approach, which seeks to limit the ambit of a dividend stripping to the factual minutiae of previously decided cases, denudes the concept of its protean quality and seeks to introduce limitations that are: (a) not identifiable in the history of the term as part of tax avoidance discourse; (b) inconsistent with the statutory language and purpose; and (c) uncertain in their adoption of the imprecise concept of "substantiality". Five specific errors should be noted.

10. *First*, at MRS[15]-[16], the Merchant Parties contend that, in *Investment & Merchant Finance* (at 179), Windeyer J preferred the definition of dividend stripping in *Halsbury's Laws of England* (3rd ed, vol 20), to that in *Fowler's*, and that a core conception of the former was a stripping of "all the accumulated profits" of the target. However, his Honour did not express a preference. In any event, both formulations communicated the same core conception of dividend stripping. Neither definition draws a distinction between *some* or *all* of the accumulated profits. MRS[16] and [28] seek to parse the definition in *Halsbury's* as if it were in a statute, reading in a requirement that *all* accumulated profits must be distributed, where that qualitative requirement is not express, let alone a concept apparently considered by the authors or any court. Windeyer J also emphasised the importance of applying the specific legislative provisions to the facts at hand (at 180).

11. *Second*, at MRS[18]-[20], the Merchant Parties submit that in enacting s 46A and then s 177E, the legislature understood the essential characteristics of a "dividend stripping" to be as subsequently described in *CPH FC* (see MRS[17] and *CPH* at [126]),[3] and that this is reflected in the references in the explanatory materials to the receipt of profits in a tax-free form (MRS[18]-[19], [52]). That submission involves a non-sequitur, as none of the essential characteristics described in *CPH FC* include a requirement that there be a

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2 *Investment & Merchant Finance* at 179-80.

3 The characteristics identified in *CPH FC* at [136] are drawn from the analysis in Christopher J. Vincent, "**Dividend Stripping**: stricto sensu or strictly senseless?" (1989) 24(2) *Taxation in Australia* 82 at 92, of the cases including (but not limited to) those identified by Gibbs J in *Commissioner of Taxation (Cth) v Patcorp Investments Ltd* (1976) 140 CLR 247 at 300.

complete or substantially complete avoidance of tax on a substantial proportion of the accumulated profits. Rather, the references to the receipt of profits in a "tax free" form reflect the absence of a capital gains tax regime at the time (see *CPH FC* at [163]), and the operation of such a scheme in its "simplest form". Further, in this case, even if the effect of the s 177D Determination is taken into account, there remains an amount of some $16 million of profits received by the MFT tax-free: FC[386]. Nor does the Merchant Parties' submission seek to identify any principled basis in the authorities to explain *why* profits must be received totally "tax free" to constitute a dividend stripping scheme, let alone explain how such a requirement would advance the purpose of s 177E when a scheme has, as its dominant purpose, the avoidance of tax.

12. *Third*, as to MRS[18], the fact that s 46A was focused on the stripping entity and not the pre-scheme shareholder is not a relevant distinction for understanding dividend stripping, if it is to carry a consistent meaning in both s 46A and s 177E, or insofar as a particular characteristic (such as any proportion of profits required to have been stripped) is relevant to the position of both the pre-scheme shareholder and the stripper.

13. *Fourth*, MRS[21] mischaracterises the Commissioner's position. A person who sells shares in a company with undistributed profits will not ordinarily engage in dividend stripping, even if the company subsequently pays a dividend, unless the sale of the shares and the subsequent payment of the dividend were part of a single scheme, and that scheme had the requisite dominant purpose. Excluding such cases is the very function envisaged for the dominant purpose test by this Court in *CPH* at [138].

14. *Fifth*, the points of supposed difference identified at MRS[22] do not advance the Merchant Parties' argument. As to (a) and (b), they are the differences which place the scheme under s 177E(1)(a)(ii) rather than s 177E(1)(a)(i), which all parties accept does not apply on these facts: FC[328]. As to (c), the existence of such a requirement as inherent in the concept of dividend stripping is the very matter in dispute. As to (d), the receipt of the profits by an associated entity (the MFT), rather than by the pre-scheme shareholder himself (Mr Merchant), draws an artificial distinction that was not drawn by the Full Court (FC[345]),[4] that is not the subject of this appeal, and which is contrary to

[4] It is also contrary to the decision of the Full Court in *Federal Commissioner of Taxation v Michael John Hayes Trading Pty Ltd* (2024) 303 FCR 62 at [47].

the reference to "another person" in s 177E(1)(b). As to (e), the premise is wrong; the transactions were contrived, for the reasons given in PJ[568]; FC[354], [357].

Ground 1(a): First Limitation – Substantial proportion of accumulated profits

15. Contrary to MRS[25], the stripping of part of the profits of a company is consistent with the impetus of a dividend stripping scheme being "to avoid the potential tax liability created by the target company's undistributed profits". The reasons for stripping only some profits are varied, but they include (as in this case) that the means available to do so are limited by the opportunities that arise.

16. ***Text of s 177E:*** The submission at MRS[26] fails to explain why, if a disposal of property represents, "*in part*", a distribution of profits of the company, s 177E(1)(a) imposes an implicit requirement that the disposal must represent a substantial proportion of those profits. The purely qualitative nature of the requirement in s 177E(1)(b) as to the disposal of property representing "in whole or in part" instead tends to suggest the absence of any quantitative requirement. There is nothing in the text in s 177E(1)(b) that supports limiting the operation of s 177E (and therefore a scheme that would be covered by subss (a)(i) or (ii)) to the stripping of accumulated profits. The property disposed of could reflect the profits of any accounting period. Further, if substantiality were a requirement in s 177E(1)(a), it would be expected that s 177E(1)(b) would refer to a substantial proportion of the profits of a particular accounting period (such as a future accounting period in the case of a forward dividend strip). These features make plain that s 177E(1)(a) does not require the stripping of any particular *proportion* of the accumulated profits of a company.

17. ***Understanding of the expression in tax avoidance discourse:*** Contrary to the submission in MRS[27]-[38], the historical understanding of the concept in tax avoidance discourse did not include a requirement that substantially all profits be stripped. The Merchant Parties do not point to any positive matter of historical context, beyond the weak indication in the use of the words "these profits" in the definition in Halsbury's. Further, they dismiss the language of s 46A(3) based on the different focus of that provision, notwithstanding that the matters listed in that provision are informative of the legislature's understanding of the expression: CPS[37]-[38].

18. As to the authorities, it is correct that many (but not all) of the historic cases involved the stripping of substantially all accumulated profits, which reflected the opportunities available in the legislative environment. However, the Merchant Parties point to no case,

before the Full Court below, in which the expression "dividend stripping" was held *not* to be applicable to a scheme because substantially all profits were not stripped. Nor are there any cases dealing with debt forgiveness as a means of dividend stripping.

19. In respect of *Hancock*, the facts identified by the Merchant Parties at MRS[32] are incomplete. Although the stripper acquired all of the shares for £63,500 (£23,500 for the shares held by the Hancocks and £40,000 for the shares held by the Lefroys), it received a dividend of only £50,000 before re-selling all of the shares to the Hancocks for £21,000, retaining a profit of £7,500: 108 CLR at 267-8. As such, the net capital sum received by the vendor shareholders was £42,500 not £63,500 (c.f. MRS[32]), representing 60% of net assets of £70,500 (a figure that was itself based on an undervaluation of the cattle station in the company's accounts: 108 CLR at 261).

20. As to *Newton*, the Merchant Parties acknowledge at MRS[37] that less than substantially all profits were stripped, but seek to explain that on the basis that the purpose of the scheme was to avoid Div 7 tax to which only current year profits would be susceptible. That is correct. But, if the expression is sufficiently flexible to cover such a case, why not also cases (such as the present) where the mechanism for stripping profits, as afforded by the opportunities available at the relevant time, is exhausted by the scheme? Or cases where substantially all profits are not stripped for some other reason, but the dominant purpose is still avoidance of tax on the profits which are stripped? There is no reasoned or rational basis for the exclusion of such cases identified in any of the cases identified at MRS[31]-[37].

21. ***Piecemeal stripping:*** In MRS[38], the Merchant Parties contend that piecemeal stripping is capable of capture by the definition of a 'scheme'. It would not be expected that 'piecemeal stripping' would occur as a series of transactions effecting a substantial depletion of profits (as that might be treated as a single scheme). Rather, parties could enter into unrelated schemes to strip profits, using any number of means available as the opportunities arise, without offending s177E on the Full Court's reasoning.

22. Further, a course of transactions involving piecemeal stripping of profits could be designed to take place over multiple income years, with the substantiality threshold only met after the expiry of the limited amendment period (under s 170 of ITAA 1936 or otherwise). This would preclude the Commissioner amending the assessment issued for the year of income in which the date immediately before the scheme was entered into

occurred, that being the assessment that ss 177E(1)(c), (f) and (g), and s 177F(1)(a) require to be amended to give effect to a determination under s 177F.

23. ***A required "connection":*** Contrary to the suggestion in MRS[40], s 177E(1)(a)(ii) does not impose a requirement for a "meaningful" connection of the kind contended for by the taxpayer. Rather, it requires a comparison between the effect of the scheme, and that of a scheme by way of or in the nature of a dividend stripping: FC[332]. It expands the scope of s 177E to schemes which strip the target company's profits other than by way of a dividend (or deemed dividend). The fact that the alternative means adopted may not allow for the stripping of substantially all of the profits indicates that such a limitation was not considered by the legislature to be a core characteristic of dividend stripping.

Ground 1(b): Second Limitation – Substantially tax free

24. The Merchant Parties ground the requirement that the profits of the company be made "substantially tax free" solely in the meaning of the term "dividend stripping". However, the historical usage in tax avoidance discourse does not support that requirement, and the contrary is reflected in the text and structure of Part IVA as a whole.

25. ***Text of s 177E:*** Contrary to MRS[43], the reference to "an amount" in s 177C(1)(a) is not just indicative of the absence of a threshold requirement, but of the absence of any quantitative requirement of substantiality. That is because, contextually, that section makes clear that the general framework of Part IVA, in which s 177E is situated, does not impose such a quantitative requirement. Further, as to s 177E specifically, the tax benefit for the purposes of s 177F(1)(a) is fixed with reference only to the notional amount described in s 177E(1)(c), without regard to the taxation consequences of the disposal of the profits pursuant to the scheme: see CPS[52]. As such, although those taxation consequences may be relevant to a dominant purpose enquiry, the structure of the statutory provisions is not consistent with the existence of a threshold quantitative requirement that the disposal be substantially tax free.

26. ***Caselaw and extrinsic material:*** The Merchant Parties are correct that there exists supportive *obiter*, indicating that the stripped profits in a simple dividend stripping scheme are ordinarily received in "substantially" tax-free form (MRS[44]-[50], [52]). However, that analysis must be understood in context.

27. *First*, the earlier cases at MRS[46]-[50], and the extrinsic materials identified at CPS[56] and MRS[52], predate the introduction of the capital gains tax regime. As such, these

statements are no more than a recitation of what was, at the time, an obvious corollary of a conversion of profits into capital form. However, as the Full Court expressly acknowledged in *CPH FC* at [163], s 177E survived the introduction of the capital gains tax regime. The Court rightly observed that the receipt by the vendor shareholder of a relatively small assessable capital gain may still be compatible with a scheme being characterised as a traditional dividend stripping scheme, but otherwise did not finally decide this issue, nor did this Court in *CPH*: see CPS[48]-[51]. As a matter of principle, there is no reason why a scheme that results in a lower total amount of tax for the vendor shareholder and their associates—albeit not avoiding all or substantially all tax—is not consistent with the core characteristics of a dividend stripping scheme. The Merchant Parties do not identify one.

28. *Second*, more recent references tend to arise in the context of the identification of common characteristics of past cases, e.g. the discussion in *CPH FC* at [157]. Nevertheless, the identification of common characteristics by this Court in *CPH* (2001) 207 CLR 235 at [126] (see also MRS[17]), and in the literature referred to by the Merchant Parties,[5] include the receipt of "a capital sum not substantially less in monetary terms than the quantum of profits distributed to the purchaser", but do *not* require the receipt to be entirely tax free.

29. ***Facts:*** In this case, if the effect of the s 177D Determination is taken into account, the effect of the GSM Debt Forgiveness Scheme was still to make *some* profits entirely tax free, namely some $16 million that continued to be offset by the MFT's other capital losses: FC[386].

Ground 2: The retrospectivity of the s 177D Determination

30. The central flaw in the Merchant Parties' submissions as to the relevance of the s 177D Determination to the application of s 177E is that it fails to recognise that the object of the effect analysis under s 177E(1)(a) is *not* to determine the full consequences of the implementation of a scheme. Rather it is to characterise the scheme itself, that is, to determine whether it is in the nature of a dividend stripping. That is a question that can only be answered by assessing what result the steps of the scheme brings about, not the consequences of events that might indirectly flow from a step in the scheme being carried out but are not part of the scheme. If it were otherwise, the Court would not be

[5] Vincent, *Dividend Stripping*, fn. 3 above at 86, 92, 95.

characterising whether the scheme as implemented is a scheme by way of or in the nature of a dividend stripping, or a scheme having substantially that effect. Instead, contrary to what s 177E(1)(a) requires, it would be characterising a scheme (the character of which is dependent upon the result it brings about) as *subsequently* affected by events which occur only after the scheme has been executed.

31. Thus, the Full Court's error in taking into account the s 177D Determination in assessing the effect of the Debt Forgiveness Schemes was that it did not strictly assess the effect of those schemes (which *included* the crystallisation of a capital loss by the BBG Share Sale: FC[306]). Instead, the Court assessed the effect of two different schemes which did not include the realisation of a capital loss on the sale of the BBG shares.

32. Part IVA is not self-executing. It requires the Commissioner to make a determination and to give effect to that determination. Despite the fact that the BBG Share Sale Scheme objectively satisfied the criteria for the application of s 177D, it could not be assumed in advance that the Commissioner *would* make a determination under s 177F to cancel the tax benefit. Considered in this light, contrary to MRS[57], the retrospective effect of a cancellation of a tax benefit under s 177F is *not* effectively coterminous with the 'effect' analysis required by s 177E(1)(a), because they each have different objects. A determination under s 177F has retrospective effect so as to enable the Commissioner to give effect to it by amending the taxpayer's assessment. However, it does not follow from this that the retrospective effect of s 177F must also impact the application of s 177E(1)(a), the object of which is to characterise a scheme said to be by way of or in the nature of dividend stripping.

33. ***Effect and result – the text:*** The submission at MRS[58]-[59] as to the terms of s 177F(1)(c) does not take the matter any further. The making of a determination that a capital loss "was not incurred" in a particular prior year creates a statutory fiction that facilitates the amendment of the assessment of the taxpayer in that prior year by determining that to be so: c.f. MRS[62]. However, that does not change the fact that a capital loss *was* crystallised pursuant to the terms of ITAA 1997 on the occurrence of the relevant CGT event. Further, given the statutory architecture, there is nothing incongruous or artificial in the application of Part IVA being different to the application of s 6-5 or s 6-10 of the ITAA 1997.

34. As to MRS[60]-[61], the Merchant Parties are right that the "result" referred to in the chapeau and concluding words "any property of the company is disposed of" in

s 177E(1)(a) is a necessary but not a sufficient step required for a scheme to be in the nature of dividend stripping within s 177E(1)(a)(i) and s 177E(1)(a)(ii). But it is part of the same enquiry—the reference to "effect" in s 177E(1)(a)(ii) is to the results or outcomes of the steps constituting the scheme, which includes (or in other cases could solely consist of) the disposal of property, judged at the time of completion—not in conjunction with other matters, circumstances, or events that may ultimately flow from, but are not part of, the scheme.

35. Further, regardless of whether the "effect" is to be assessed at the time of the disposal of the relevant property or upon the completion of all steps in the scheme (see CPS[62]-[63]), the point is that on no view can the effect or consequences of events that might indirectly flow from the scheme, but are not part of the scheme, be taken into account in the characterisation process because they do not assist in determining "the tax outcome in fact produced *by the scheme*": c.f. MPS[59]. Taking the effect or consequences of such events into account leads to the characterisation of something other than the scheme referred to in s 177E(1)(a).

36. Finally, as to MRS[62], the Merchant Parties are right that consideration of the outcome of a scheme is necessary for both limbs, albeit the word "effect" is only used in s 177E(1)(a)(ii). However, the fact remains that the cancellation of the tax benefit following the s 177D Determination was a consequence of the Commissioner's exercise of his discretion, and of the objective presence of the requisite dominant purpose of a participant in the BBG Share Sale Scheme, not of the Debt Forgiveness Schemes.

37. ***Timing of enquiry as to effect and purpose:*** Contrary to the submission at MRS[63], the ultimate question being asked to which both the "effect" and "purpose" enquiries are relevant is the same, that is, whether the scheme can be characterised as a scheme by way of or in the nature of dividend stripping. The enquiries themselves are also linked—the objective effect of the scheme will be relevant (but not necessarily determinative) to an objective assessment of its dominant purpose. As such, a construction of s 177E which requires that these two related and linked enquiries be conducted by reference to different points in time, would give to the term "dividend stripping" a fractured meaning, inviting unnecessary and undesirable incoherence into the analysis.

38. ***Broader legislative context:*** As to MRS[64]-[65], that the particular facts giving rise to the present issue only arise in a narrow category of schemes, does not advance the matter. In this case, the s 177D Determination addressed a tax mischief of the stripper (the

contrived creation of a capital loss), whereas the s 177E Determination addressed a tax mischief of the pre-scheme shareholder (the avoidance of tax on dividends by Mr Merchant). Where both tax mischiefs overlap (they both respond to part or all of the economic value of the capital gain from the sale of the Plantic shares), the approach adopted below by the majority and the Merchant Parties would see only part of the tax mischief addressed, leaving unaddressed the transfer of some $16 million to the corpus of the MFT, which is then available for distribution to any of its beneficiaries tax free: CPS[69]; FC[386]. Contrary to MRS[65], this would be a lacuna in the operation of s 177E, as it fails to target a tax benefit which would have been cancelled *if* the Commissioner had not made the s 177D Determination and instead taken the risk of seeking to rely solely on the application of s 177E to the facts, and potentially prejudicing the revenue by forgoing the opportunity to rely on s 177D as against a different (but related) taxpayer.

39. ***Compensating adjustments:*** Contrary to MRS[67]-[69], the Commissioner did not concede that his proposed *construction* would have unfair results. The Commissioner's position is that any unfairness in the application of both ss 177D and 177E is capable of remedy by the subsequent application of s 177F(3), and in this case s 177F(3) is satisfied. Further, contrary to MRS[67], and notwithstanding that the Commissioner concedes that it would be fair and reasonable on the particular facts of this case for s 177F(3) to respond, the application of the two provisions does not involve the taxation of the Merchant Parties "twice in respect of the very same transaction". The two provisions were applied to different taxpayers, in relation to different transactions, and in respect of different tax benefits.

40. The submission at MRS[68], that the making of multiple lawful but inconsistent s 177F(1) determinations would be unreviewable except under s 177F(3), is wrong. The assessments to give effect to the s 177D and s 177E determinations *are* reviewable under Part IVC in the usual way, even where the making of a s 177F(3) determination is in issue. As to the criticism of the delay in exercising that power, both the s 177D Determination and the s 177E Determination have been under continuous challenge by the Merchant Parties, such that the circumstances have not to date ripened for the Commissioner to exercise that power, which cannot be unwound once exercised. The criticism that the Commissioner's proposed s 177F(3) determination does not address "the full tax consequences" fails to identify those further tax consequences, and why they are unfair or unreasonable.

41. Any unfairness of the "double taxation" complained of in MRS[68] is therefore answered by s 177F(3). The very presence of s 177F(3) indicates that unfairness is anticipated to arise sometimes from the proper application of Part IVA. The legislature has provided a mechanism for resolving that unfairness according to fixed statutory criteria (see CPS[74], which the Merchant Parties fail to address at all).

42. ***Arbitrary results:*** Contrary to MRS[70], there is no statutory basis for imposing, by implication, a requirement to consider the effect of the s 177D Determination as part of the effect enquiry required by s 177E(1)(a). This would impose a limitation on the Commissioner's administration of the taxation laws. The "simple answer" suggested by the Merchant Parties has nothing to commend it beyond the fact it suits them on the present facts.

Part III: SUBMISSIONS IN RESPONSE ON MERCHANT'S CROSS-APPEAL AND NOTICE OF CONTENTION IN S157/2025

43. By their cross-appeal and notice of contention in S157/2025, the Merchant Parties contend that both the GSM and Tironui Debt Forgiveness Schemes did not fall within s 177E, for additional reasons to those articulated by the Full Court.

44. ***Incorrect Sequencing:*** The Merchant Parties seek to rely on sequencing rules for the use of capital losses to offset capital gains. The Merchant Parties rely on s 100-50, which is not the relevant operative provision.[6] The relevant section is s 102-5 of the ITAA 1997, which in sub (1) provides "Step 1. Reduce the capital gains you made during the income year by the capital losses (if any) you made during the income year". Note 1 relevantly provides "You choose the order in which you reduce your capital gains". In s 102-5(1) Step 2, there is similar text applying to previously unapplied net capital losses from previous income years.

45. Neither s 102-5, nor s 100-50 (to the extent it is relevant) permit the Merchant Parties to choose the order in which the non-BBG capital losses are applied to the part of the Plantic capital gain that was "attributable to the GSM scheme" ahead of the part of the Plantic capital gain that was "attributable to the Tironui scheme". There is no provision that

[6] Section 100-50 is part of Division 100, which "is a simplified outline of the capital gains and capital loss provisions": s 100-1. It is a "Guide" which can only be considered for the limited purposes set out in s 950-150(2): s 100-5.

allows the capital gain on the sale of the Plantic shares to be so delineated. The submission in MRS[75] to the contrary is wrong.

46. Furthermore, contrary to MRS[74], it is not correct to assess the effect of the Debt Forgiveness Schemes collectively in the manner suggested by the Merchant Parties, whereby the capital gain on the Plantic shares is compared to the non-BBG capital losses and the fact that those losses were insufficient to shelter the gains leads to the conclusion that neither scheme had the requisite effect. They are distinct schemes involving the profits of distinct entities, and s 177E requires them to be characterised separately: FC[371]; PJ[478]. The Full Court was correct to take the existing capital losses into account in analysing each of the Debt Forgiveness Schemes: FC[380], [385]-[386]. The error, in the Commissioner's respectful submission, lay in excluding the capital loss from the sale of the BBG shares from that exercise.

47. Further, as to the adoption at MRS[76] of Logan J's observations at FC[53]-[54], the effect of the BBG Share Sale within the context of the Debt Forgiveness Schemes was to maintain artificially, pre-existing capital losses within the MFT for future use. The observations at FC[54] are also not to the point for the reasons explained below at [50]. The possible flow on consequences of other events (such as future capital gains made by the MFT or the release of those profits from the MFT), are not relevant in characterising a scheme for the purposes s177E. Further, there is no evidence that, without the scheme, Mr Merchant had deductions available to offset dividend income from GSM. Conversely, following the scheme, there were capital losses in the MFT (because of the MFT's existing capital losses and the further capital losses from the sale of the BBG shares) to offset the increased capital gain. As such, Mr Merchant's fiscal position was materially improved by the scheme as no tax would be payable on the increased capital gain in the 2015 income year, received in lieu of a dividend, even if there was a possibility that tax would be payable on entirely hypothetical future capital gains in later income years.

48. ***Non-BBG capital losses not a step in the schemes:*** Contrary to MRS[77], the non-BBG capital losses already existed and were part of the context in which the Debt Forgiveness Schemes were implemented, such that there was no call to include them as a "step" in either of the Debt Forgiveness Schemes. In any event, it was the inclusion of the sale of the Plantic shares which was critical to the characterisation of the schemes within

s 177E(1)(a)(ii) as it converted the stripped profits into a capital sum: PJ[476]-[477]; FC[315].

49. ***Tax Consequence for Mr Merchant:*** The submission at MRS[79]-[80], that it was necessary for the Debt Forgiveness Schemes to forever immunise the additional capital as being a potential source of tax obligations in the hands of Mr Merchant, is contrived. It is contrived because Mr Merchant himself controlled the trustee of the MFT: PJ[3]-[4]; FC[8], [277]. As such, the result of the schemes was that the capital was immediately *available* to him tax free, as he could decide, at any time, to cause the trustee of the MFT to distribute it to him as capital. There is nothing in *Lawrence v Federal Commissioner of Taxation* (2008) 70 ATR 376 which suggests that there must be a permanent sterilisation of the profits from tax. In any event, the capital in the MFT *was* immunised against all potential sources of future taxation obligations. The fact that Mr Merchant could elect not to avail himself of that immunity by voluntarily re-exposing himself to tax by causing the trustee of the MFT to distribute the capital first to GSM does not alter this conclusion. That is because it would be a voluntary step entirely within Mr Merchant's control, it was not a likely step for Mr Merchant to decide to take (CPS[82]), and it would be a step which no sensible onlooker would conclude was the object of the scheme: PJ[506].

50. In any event, as discussed above, a scheme must be characterised for the purpose of s 177E having regard to the immediate effect of its steps, not something that may or may not happen in the future. The decision of the Full Court in *Federal Commissioner of Taxation v Michael John **Hayes** Trading Pty Ltd* (2024) 303 FCR 62 at [45] is thus both correct, and not capable of being distinguished as concerning dominant purpose, as the dominant purpose and the effect tests both concern the characterisation of a scheme as being in the nature of dividend stripping.

Part IV: SUBMISSIONS IN RESPONSE ON COMMISSIONER'S CROSS-APPEAL IN S158/2025

51. In the event that the Merchant Parties are successful with respect to s 177D in S158/2025, but the Commissioner is unsuccessful on either or both of Grounds 1(b) and 2 of his s 177E appeal, then the Commissioner contends that the changed context of the GSM Debt Forgiveness Scheme is to the effect that the Commissioner should still be successful in his contention that the scheme is within the scope of s 177E(1)(a)(ii). That is because,

if the Merchant Parties are successful, the capital loss from the sale of the BBG shares would no longer be cancelled and the increased capital gain as a result of the Debt Forgiveness Schemes would be entirely offset by capital losses and thus received by the MFT entirely free of tax: CPS[76]-[84].

52. As to the submission in MRS[81(a)], that the (dominant) purpose of the GSM Debt Forgiveness Scheme was not tax avoidance, the Commissioner relies on his responsive submissions in S158/2025 (CRS) at [68]-[82]. The purpose analysis required for s 177E is fundamentally distinct from the analysis required under s 177D for the BBG Share Sale Scheme (CRS[68]), the dominant purpose of a participant in the BBG Share Sale Scheme was not relevant to a consideration of the purpose of the Debt Forgiveness Schemes (CRS[69], FC[344]), and the arguments in respect of the alleged 'counterfactual error' must be rejected for the reasons given at CRS[71]-[82].

53. As to the submission at MRS[81(b)], that the GSM Debt Forgiveness Scheme did not have the requisite *effect*, because it (still) did not strip a substantial proportion of GSM's accumulated profits, and (alternatively) because it did not avoid substantially all tax on those profits, the Commissioner refers to his submissions as to Ground 1(a) above at [15]-[23] (*vis.* there is no quantitative requirement that a substantive proportion of profits be stripped), and at [48] to [50] above (*vis*. the submission that the scheme must forever immunise the additional capital as being a potential source of tax obligations in the hands of Mr Merchant is both irrelevant (*Hayes* at [45]) and contrived in the context of Mr Merchant's control over the affairs of the MFT, and the non-BBG capital losses is relevant context which does not need to be identified as part of the scheme).

Dated: 10 February 2026

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