HIGH COURT OF AUSTRALIA

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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

OUTLINE OF ORAL SUBMISSIONS OF THE COMMISSIONER OF TAXATION

Part I: CERTIFICATION

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

Part II: PROPOSITIONS TO BE ADVANCED IN ORAL ARGUMENT

Appeal S158/2025: Response to the Merchant Parties' Appeal on Application of s 177D

1. **There is no legal error in the way the majority approached the application of s 177D**: *First*, there is no "counterfactual enquiry" of the kind contended for by the Merchant Parties: MPS[43]-[44]. An analysis of the "other possibilities" available to a taxpayer is an analytical tool to assist in the application of the s 177D(2) factors. It does not involve an assessment of whether each "other possibility" is capable of achieving all of the (alleged) non-tax consequences of the scheme (c.f. s 177CB(3), (4)). The eight statutory factors are aided by a consideration of other possibilities, where relevant, to identify the objective significance of the tax and non-tax consequences of the scheme: CRS[16]-[19], [38]-[45]; *FCT v Hart* (2004) 217 CLR 216 at [66], [69], [71], [93]-[94]; *FCT v Macquarie Bank Limited* (2013) 210 FCR 164 at [208]-[211], [262]-[264], [285]-[287]; *FCT v Guardian AIT Pty Ltd* (2023) 115 ATR 316 at [181], [209]-[212].

2. *Second*, there is no statutory mandate nor authority that supports the s 177D(2) considerations being applied to each possibility as if each were a scheme.

Ground 1(b) – The "correct" counterfactual enquiry in the context of purpose

3. **The contended non-tax consequences were not objectively significant**: The primary judge made findings, not disturbed on appeal, that Mr Merchant would have retained effective control of the BBG Shares without the scheme, and the non-tax consequences or purposes identified and relied on by the Merchant Parties were not objectively significant nor genuine commercial purposes of the BBG Share Sale: CRS[8]-[9], [61]-[63]; PJ[319], [331], [369], [388], [398]; FC[198], [230], [246], [260]-[265], [272]-[275], [283]-[288]. The Merchant Parties' analysis of the spectrum of possibilities ignores those findings, against which there is no appeal: CRS[54], [62].

4. **The "routine" transaction analogy**: The contrast between the "routine" transaction (third party sale) and the scheme weighs in favour of a finding of dominant purpose. It demonstrates that the scheme was designed to achieve a tax benefit while not altering the effective economic control of the shares. The scheme anticipated that the MFT

would sell Plantic but would not have sufficient capital losses to shelter the anticipated gain. This highlighted the disconnect between form and substance (s 177D(2)(b)). Those features rendered the comparison to an on-market sale inapposite and a wash sale apposite: CRS[10], [57]-[59]; FC[232]-[235], [296].

5. **Relationship between Part IVA and the "CGT Regime"**: Part IVA "outflanks" the "ordinary incidents of ownership" (MPS[40]) where they are exercised in a contrived or artificial manner or at a time and on terms that maximise their tax advantage, and so a dominant tax purpose is objectively ascertainable. By operation of s 177B, Part IVA prevails over other provisions of the 1936 and 1997 Acts: CRS[52]-[53].

Ground 1(a) – The Differences in Legal Entities

6. **Legal entities**: The majority below did not fail to have regard to the differences between the legal rights and obligations pertaining to discretionary trusts and superannuation funds. Rather, their Honours rejected the proposition that there was any objective significance to the theoretical differences relied on by the Merchant Parties. The Merchant Parties' proposition would require those findings (against which there is no appeal) to be reversed: CRS[25]-[26]; PJ[331]-[333], [398]; FC[272]-[275].

Appeal S157/2025: Commissioner's Appeal on Application of s 177E

7. **Dividend stripping**: When s 177E was enacted, "dividend stripping" had a well understood, protean meaning in "tax avoidance discourse" used in "professional and financial circles". The core characteristic of such schemes was that they were collusive transactions for the conversion of profits to capital, by which the revenue was denied tax which would have been payable if a dividend had been declared to the pre-scheme shareholder: CPS[24]-[32]; CRep[8]-[14]; *Investment & Merchant Finance Corporation Ltd v FCT* (1970) 120 CLR 177 at 179-80; *FCT v Patcorp Investments Ltd* (1976) 140 CLR 246 at 299.

Ground 1(a) – Substantial proportion of accumulated profits

8. **Prior authority**: Prior authority does not demand recognition of a "quantitative requirement" in the form of a "substantial proportion of accumulated profits" being stripped: c.f. FC[361]. The observations in *CoT v Consolidated Press Holdings Ltd (No 1)* (1999) 91 FCR 524 (*CPH FC*) at [136], [161] must be considered in light of the facts in that case: CPS[40], and cannot be approached as a statutory formula: *CoT*

*v Michael John **Hayes** Trading Pty Ltd* (2024) 303 FCR 62 at [30]. Dissecting previous cases has limited utility: CPS[36], [40]-[43]; CRep[18]-[20].

9. **Role of s 177E in Part IVA**: The "supplementary role" of s 177E in Part IVA weighs against the existence of a 'proportion of profits requirement'. The object of s 177E was to engage s 177C where it could not be proved that a dividend would have been declared by the target company but for the scheme in the relevant income year. However, the tax benefit that arises under s 177C is not required to have any particular relationship with the profits from which it is deemed to have been paid: CPS[37]-[39].

10. **Statutory text**: The text of s 177E(1)(a) and s 177E(1)(b) does not support the proportion of profits requirement. The phrase "by way of or in the nature of" in s 177E(1)(a) are words of expansion: *Hayes* at [50]-[52]. Section 177E(1)(b) provides for a disposal representing the profits of a single accounting period, or future profits, rather than all accumulated profits. Section 177E(1)(a) should not be read in a way that would exclude schemes contemplated by s 177E(1)(b): CPS[34]-[35]; CRep[16].

11. **Second limb**: Irrespective of whether the 'proportion of profits requirement' is a characteristic of schemes within the first limb (s 177E(1)(a)(i)), it is not a necessary feature of the second limb (s 177E(1)(a)(ii)). The second limb encompasses variations, including but not limited to mechanisms to strip profits other than dividends. This does not mean that "dividend stripping" bears a different meaning in each limb; it gives effect to the phrase "substantially the effect of" in the second limb: CPS[46]; *CPH FC* at [181]-[182]; ***Lawrence** v FCT* (2009) 175 FCR 277 at [41], [50]-[52]; *B&F Investments Pty Ltd v FCT* (2023) 298 FCR 449 at [115]-[117].

12. **Mechanism adopted**: Even if the 'proportion of profits requirement' *is* a feature of the first limb, in the second limb it does not require more than the substantial exhaustion of the mechanism adopted. The mechanism here was debt forgiveness, and the Debt Forgiveness Schemes fully exhausted that means: CPS[46]; CRep[23].

Ground 1(b) – Substantially tax free

13. **Taxation of capital gains**: Dividend stripping involves the conversion of what would have been income into capital, for the purpose of avoiding liability for the tax usually imposed on dividends. Prior to the introduction of capital gains taxation, the absence of any alternative tax was a corollary which provided the incentive (*CPH FC* at [162]-[163]), but is not a central characteristic. It suffices that the dominant purpose of the

scheme is the avoidance of any of the tax otherwise imposed on the hypothetical dividend: MPS[52]-[53]; CRep[27]; *FCT v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 at [129] (*CPH HC*); *Lawrence* [43]-[44].

14. **Part IVA context**: If the counterfactual required by s 177C can be satisfied, then a scheme resulting in the disposal of property representing profits of a company will be caught regardless of whether any other tax is payable. The supplementary role of s 177E in Part IVA thus also contraindicates the tax-free "quantitative requirement": CPS[52], [53], [55]; MPS[52]; CRep[25]; *CPH HC* at [132].

Ground 2 – The Interaction between s 177D and s 177E

15. **Effect of scheme**: The effect of a scheme is assessed from the result the steps of the scheme directly bring about. The effect of a scheme is not assessed by determining, with the full benefit of hindsight, all of the downstream consequences of the implementation of the scheme. The s 177D Determination was a consequence of the Commissioner's exercise of his discretion, and of the objective dominant purpose of a participant in the BBG Share Sale Scheme: CPS[64]-[65]; CRep[32].

16. **Retrospectivity**: A determination under s 177F(1)(c) that a capital loss "was not incurred" does not change the fact that a capital loss was in fact crystallised by a scheme. The determination has retrospective effect to facilitate the amendment of a taxpayer's assessment. But it does not follow that the characterisation of a scheme within s 177E(1)(a) is retrospectively changed. A contrary conclusion would have this Court characterise a scheme different to that implemented, which included the capital loss crystallised by the BBG Share Sale: CPS[61]; CRep[30].

17. **Section 177F(3)**: Any unfairness in the application of ss 177D and 177E is capable of remedy by s 177F(3). The Commissioner will make a s 177F(3) adjustment: CPS[72]. The majority's construction leaves unaddressed the transfer of some $16 million to the corpus of the MFT, available to beneficiaries tax free: CPS[69]; FC[386]. Further, if a s 177D determination is relevant to "effect", so is any impending s 177F(3) adjustment.

Merchant Parties' Cross-Appeal and Notice of Contention in S157/25

18. **Section 177E purpose**: It does not follow from a conclusion under s 177D that no participant in the BBG Share Sale Scheme had a dominant purpose (objectively determined) of obtaining a tax benefit that the question of purpose under s 177E should

be decided against the Commissioner. The purpose analysis for ss 177E and 177D relates to different schemes, different tax benefits, and different taxpayers. The s 177E enquiry is conceptually different and not limited by the eight factors in s 177D(2): CRS[68]-[69]; PJ[487]; FC[343]-[345].

19. **Tax avoidance purpose**: Fully recoverable loans were forgiven for nil consideration, and the selection of the BBG Shares to sell was carefully coordinated to produce a sufficient capital loss to offset the additional capital gain produced by the increase in Plantic's value. This points to a dominant tax purpose of the debt forgiveness schemes, objectively determined: CRS[70]; PJ[167]-[168], [316]; FC[350].

20. **"Counterfactual analysis"**: The Full Court did not err in failing "to conduct a counterfactual analysis". A requirement that the Court conduct a counterfactual analysis, directed at ascertaining how else the scheme could have been implemented to identify dominant purpose, is not consistent with the text or statutory purpose of s 177E. In any event, a comparison with "other possibilities" assists the Commissioner, not the Merchant Parties: CRS[71]-[76]; FC[344]-[345], [355], [357].

21. **Part 3-1**: The CGT sequencing rules do not assist the Merchant Parties. There is no "part" of the single capital gain upon the sale of the Plantic Shares that is attributable to the GSM scheme or the Tironui scheme against which losses can be separately applied. It is incorrect to assess the effect of the Schemes collectively: CRep[44]-[47].

22. **Future tax**: It is not necessary that the capital be forever sterilised from tax. Mr Merchant controls the trustee of the MFT, the capital is *available* to him tax free by capital distribution directly to him as a beneficiary of the MFT, and any re-exposure of the capital to taxation would be voluntary and unlikely: CRep[49]-[50]; *Hayes* at [45]-[48].

Commissioner's Cross-Appeal in S158/25

23. **GSM Debt Forgiveness**: Section 177E will be satisfied if s 177D does not apply to the BBG Share Sale. The increased capital gains would be received by the MFT entirely tax free, and the tax-free requirement *would* be satisfied: MPS[80]-[84]. The proportion of profits requirement would remain unsatisfied, but see [8]-[12] above.

K Deards.

Kristen Deards SC David Ananian-Cooper Nichola Derrington 16 March 2026