HIGH COURT OF AUSTRALIA

GLEESON CJ,
GAUDRON, GUMMOW, HAYNE AND CALLINAN JJ

COMMISSIONER OF TAXATION APPELLANT

AND

CONSOLIDATED PRESS HOLDINGS LIMITED RESPONDENT

Commissioner of Taxation v Consolidated Press Holdings Ltd
[2001] HCA 32
31 May 2001
S127/2000

ORDER

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation:

B J Shaw QC with G T Pagone QC and G J Davies QC and M K Moshinsky for the appellant (instructed by Australian Government Solicitor)

D H Bloom QC with R F Edmonds SC and A J Payne and J H Momsen for the respondent (instructed by Gilbert & Tobin)

HIGH COURT OF AUSTRALIA

GLEESON CJ,
GAUDRON, GUMMOW, HAYNE AND CALLINAN JJ

COMMISSIONER OF TAXATION APPELLANT

AND

MURRAY LEISURE GROUP PTY LIMITED RESPONDENT

Commissioner of Taxation v Murray Leisure Group Pty Ltd
31 May 2001
S128/2000

ORDER

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation:

B J Shaw QC with G T Pagone QC and G J Davies QC and M K Moshinsky for the appellant (instructed by Australian Government Solicitor)

D H Bloom QC with R F Edmonds SC and A J Payne and J H Momsen for the respondent (instructed by Gilbert & Tobin)

HIGH COURT OF AUSTRALIA

GLEESON CJ,
GAUDRON, GUMMOW, HAYNE AND CALLINAN JJ

Matter Nos S132 and S133/2000

CPH PROPERTY PTY LIMITED APPELLANT

AND

COMMISSIONER OF TAXATION RESPONDENT

CPH Property Pty Ltd v Commissioner of Taxation
31 May 2001
S132/2000 and S133/2000

ORDER

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation:

D H Bloom QC with R F Edmonds SC and A J Payne and J H Momsen for the appellant (instructed by Gilbert & Tobin)

B J Shaw QC with G T Pagone QC and G J Davies QC and M K Moshinsky for the respondent (instructed by Australian Government Solicitor)

CATCHWORDS

Commissioner of Taxation v Consolidated Press Holdings Ltd
Commissioner of Taxation v Murray Leisure Group Pty Ltd
CPH Property Pty Ltd v Commissioner of Taxation

Income Tax – *Income Tax Assessment Act* 1936 (Cth) Pt IVA – *Income Tax Assessment Act* 1936 (Cth) s 79D – Whether allowability of deduction for interest on borrowed funds a tax benefit – Whether allowability of deduction would, but for a scheme, have been defeated by s 79D – quarantining of interest deductions to foreign source income – Whether s 79D capable of application where no income was derived from a foreign source – Whether anticipated income from the transaction of which the borrowing was a part would have been income derived from a foreign source.

Income tax – *Income Tax Assessment Act* 1936 (Cth) Pt IVA – Dividend stripping – Corporate reorganisation – Relocation of holding structure from United Kingdom to Bahamas – Whether transfers of shares in United Kingdom companies a scheme by way of or in the nature of dividend stripping – Whether s 177E intended to apply only to schemes which can be said to have the dominant purpose of tax avoidance.

Words and phrases – "dividend stripping", "income from a foreign source".

Income Tax Assessment Act 1936 (Cth), Pt IVA, ss 51, 79D, 160AFD, 177A, 177C, 177D, 177E, 177F.

1 GLEESON CJ, GAUDRON, GUMMOW, HAYNE AND CALLINAN JJ. These appeals, which were heard together, concern disputes between the Commissioner of Taxation and certain members of the Consolidated Press group of companies (the Group) relating to assessments to income tax for periods beginning on 1 July 1988 and ending on 30 June 1991. The taxpayer companies in question are Australian Consolidated Press Ltd (ACP), which later changed its name to CPH Property Pty Ltd, Consolidated Press Holdings Ltd (CPH) and Murray Leisure Group Pty Ltd (MLG).

2 The relevant tax years are as follows:

ACP – years ended 30 June 1989 and 30 June 1991

CPH – year ended 30 June 1990

MLG – year ended 30 June 1990

3 All the disputes concern the application of Pt IVA of the *Income Tax Assessment Act* 1936 (Cth) ("the Act"). They fall into two categories: one involving the operation of the general provisions of Pt IVA together with s 79D of the Act (referred to by the trial judge as "the Pt IVA/s 79D issue"); the other involving the operation of the special provisions of Pt IVA relating to dividend stripping (referred to as "the dividend stripping issue").

4 The Pt IVA/s 79D issue affects ACP. It arises out of assessments issued in December 1994, which in effect denied the taxpayer the benefit of deductions claimed in respect of moneys borrowed in connection with a takeover scheme. The issue arose in relation to assessments for the 1989 and 1991 years. The assessment for the 1991 year covered tax losses carried forward from the 1990 year. The amount of those losses also depended upon the same issue. In the Federal Court of Australia, the taxpayer succeeded at first instance before Hill J[1]. An appeal by the Commissioner to the Full Court of the Federal Court (French, Sackville and Sundberg JJ) was upheld[2]. The taxpayer appeals to this Court.

5 The dividend stripping issue arises out of a corporate reorganisation within the Group. In December 1994, the Commissioner assessed CPH and

---

1 *CPH Property Pty Ltd v Commissioner of Taxation* (1998) 88 FCR 21.

2 *Commissioner of Taxation v Consolidated Press Holdings Ltd (No 1)* (1999) 91 FCR 524.

MLG to income tax, in respect of the year ended 30 June 1990, upon the basis that certain amounts were in effect treated as dividends paid to the taxpayers. The taxpayers succeeded on this issue both before Hill J[3] and before the Full Court[4]. The reasons which led Hill J to decide in favour of the taxpayers were in some respects different from those upon which the Full Court based its decision. The Commissioner now appeals to this Court.

6 In order to explain how the issues arise, it is necessary to describe some features of the Group business and structure, and to refer to three transactions. The first transaction arose out of a plan for the Group to take over the Valassis group of companies in the United States of America. It is not directly relevant to the disputed assessments, but helps to explain one aspect of the financing arrangements which were made in relation to the second transaction. The second transaction arose out of a proposal that the Group (which is controlled by Mr Kerry Packer) should participate with other interests in the United Kingdom to take over a United Kingdom company, BAT Industries plc (BAT). The proposal did not come to fruition, but the Pt IVA/s 79D issue relates to interest on money borrowed for the purpose of the takeover. The third transaction was a corporate reorganisation undertaken for the purpose of winding up the affairs of two members of the Group which were incorporated in the United Kingdom, Consolidated Press International Ltd (CPIL(UK)) and Consolidated Press International Holdings Ltd (CPIHL(UK)).

The Group

7 The business activities of the Group were conducted in various countries, including the United Kingdom, but the central control and management of the holding company, CPH, was in Australia. One member of the Group, ACP, was a publisher of journals. It had a substantial cash flow. At the relevant time, MLG did not itself carry on any business other than holding shares in subsidiaries. Consolidated Press (Finance) Ltd (CPF) acted as financier to the Australian members of the Group. The policy of the Group, reflecting its Australian control, was to maximise assets in foreign currency but to maintain liability exposure in Australian dollars. Because the Group was better known in Australia than elsewhere, the terms on which it could borrow in this country were

---

3 *CPH Property Pty Ltd v Commissioner of Taxation* (1998) 88 FCR 21.

4 *Commissioner of Taxation v Consolidated Press Holdings Ltd (No 1)* (1999) 91 FCR 524.

often more advantageous. Hill J found that, ordinarily, funds would be borrowed by CPF and on-lent to ACP, which, because of its cash flow, was well placed to service debt. He also found that, tax considerations apart, borrowings for overseas purposes would be expected to take the form of a borrowing by CPF, a loan by CPF to ACP, and further loan or other payment from ACP to an overseas Group member.

8 CPIL(UK) and CPIHL(UK), although incorporated in the United Kingdom, were, under the tax laws of that country, non-resident UK companies. Their central control and management was outside the United Kingdom. Before the BAT takeover bid, their shares were all beneficially owned by CPH.

9 Proposals to alter the manner in which the United Kingdom taxed such non-resident companies, and the effect which such changes would have, in turn, upon the tax position of Australian members of the Group, prompted consideration of the corporate reorganisation earlier mentioned.

The proposed BAT acquisition

10 On 11 July 1989, Hoylake Investments Ltd (Hoylake), a company incorporated in Bermuda, announced a takeover bid for BAT. Hoylake was owned by interests associated with the Group, Sir James Goldsmith, and Mr Jacob Rothschild. The Group's interest was 32.5 per cent. The form in which that interest was held is critical to the present dispute. It was expected that, if the takeover were successful, it would produce substantial profits. Some assets of BAT were to be sold as quickly as possible ("unbundled") and a profitable tobacco business would be retained. For reasons that are presently immaterial, the bid was withdrawn in April 1990. In June 1990, Hoylake went into voluntary liquidation. The present dispute concerns the tax consequences for the Group of the financing arrangements that were made in gearing up for the bid and, in particular, the deductibility of interest on moneys borrowed for that purpose.

11 The form of the financing arrangements was partly explained by reference to advice that was received, and events that occurred, in connection with certain earlier takeover activity of the Group.

12 In December 1986, the Group decided to acquire the shares in a United States corporation which controlled the Valassis group of companies. They were involved in a business compatible with that of ACP. The acquisition was made by a United States subsidiary of a subsidiary of CPIL(UK). An amount of US$200 million was borrowed from banks. The loan facility required the maintenance of certain financial ratios by the Valassis group. Following the

takeover, difficulty was experienced in maintaining the required ratios. Re-financing was necessary in mid-1988. That was to occur in accordance with the policy of maintaining liability in Australian dollars. It was considered that Australian financing would be less expensive than overseas financing.

13 Advice was taken by the Group's financial controller from a firm of chartered accountants, Arthur Young, who acted, amongst other things, as tax advisors to the Group. The senior advisor was Mr Cherry. The advice concerned the form of the refinancing. It took into account various considerations of commercial significance, including fiscal considerations involving both Australian and overseas tax regimes. No financing transaction of this size or complexity could be examined responsibly by the directors and managers of a company without close attention being paid to the fiscal implications of various alternatives. The significance of such considerations in the application of Pt IVA of the Act was discussed in *Federal Commissioner of Taxation v Spotless Services Ltd*[5].

14 Amongst other things, Mr Cherry took into account two announcements by the Australian government concerning proposed future changes to the Act.

15 First, it was announced that, as and from 1 July 1989, dividends received by Australian resident corporations from non-Australian sources would be treated as exempt income for Australian tax purposes. This would have the result that dividends from non-Australian sources received by a company with carried-forward losses would be treated as reducing those losses, so that they would not be available to be used as deductions against assessable income.

16 Secondly, it was announced that, as from the 1989-1990 tax year, income of non-resident entities in which Australian residents had an interest, where the income was derived in a low-tax or no-tax country, or had benefits from certain kinds of taxation concessions, would be taxed on a certain basis. This, in turn, was connected with provisions of the Act dealing with foreign tax credits.

17 Taking account of these and other matters, Mr Cherry proposed a mixed debt-equity arrangement. It was recommended that the necessary funds should initially be borrowed by CPF and lent at interest to ACP. Then it was proposed that ACP should use the funds to subscribe for shares in MLG which would, in turn, use the capital thus subscribed by taking up redeemable preference shares in

---

5 (1996) 186 CLR 404.

CPIL(UK). That company would in turn advance the funds to Valassis through a structure involving the Netherlands and the Netherlands Antilles. Hill J inferred that this part of the proposal had nothing to do with Australian tax, and was related to double tax treaties and interest withholding tax in the United States.

18 These proposals were not implemented at the time, because the need for the Valassis refinancing disappeared. However, in April 1989, when consideration was being given to the form of financing to be used for the BAT takeover, Mr Cherry was again consulted, and he repeated the earlier advice that had been given in connection with the Valassis re-financing.

19 Mr Cherry's evidence was that he gave no consideration, in connection with either Valassis or BAT, to s 79D of the Act. The possible significance of this will appear below. He said he had been advised by counsel, and agreed, that the section had no application to what was proposed. In cross-examination, Mr Cherry agreed that the first of the two problems that led to his Valassis advice had been dealt with by a proposed change in government policy, but he said that the problem about foreign tax credits remained.

20 The following account of the detail of the financing of the BAT bid, as far as the Group's participation was concerned, is set out in the reasons for judgment of Hill J[6], and is not in dispute.

21 On 28 April 1989, ACP applied for and was allotted 600,000 redeemable preference shares of $1 each at a premium of $500 per share in the capital of MLG – a total subscription price of A$300.6 million. On 2 May 1989, CPF lent ACP A$300.6 million to put it in funds to pay for the shares. On 5 May 1989, CPIL(UK) allotted 2.4 million fully-paid ordinary shares of US$100 each to MLG. A subsequent series of loans and share subscriptions resulted in one million fully-paid redeemable preference shares of US$100 each being allotted in CPIL(UK) on 28 November 1989.

22 In the meantime, CP Investment (Singapore) Pte Ltd (CPI(Sing)) was incorporated in Singapore. It subscribed for shares in Hoylake. Those shares represented 32.5 per cent of the capital of Hoylake. Hoylake announced its takeover bid for BAT on 11 July 1989, and began acquiring shares in BAT.

---

6 *CPH Property Pty Ltd v Commissioner of Taxation* (1998) 88 FCR 21 at 28-29.

23 On 10 July 1989, MLG lent, interest-free, the sum of US$100 million to CPIL(UK). On 28 November 1989 those funds were used to pay for one million redeemable preference shares of US$100 each in CPIL(UK) which were allotted to it on that day. The US$100 million was, when received, immediately lent by CPIL(UK) to CPI(Sing). Interest was charged on the loan, first at the rate of 15 per cent per annum and later at the rate of 16.25 per cent per annum.

24 A condition of the takeover bid could not be satisfied, and the bid was withdrawn on 23 April 1990.

The United Kingdom reorganisation

25 Reference has already been made to two proposed changes in the Act concerning foreign source income.

26 In addition, in March 1988, the United Kingdom government announced a proposed change to the laws of that country concerning non-resident United Kingdom companies. Such changes were only to take effect in relation to existing companies after a period of five years. After that time they would be treated as resident in the United Kingdom, and would be taxed on their worldwide income.

27 The Group, in May 1989, began to give consideration to the position of CPIL(UK) and CPIHL(UK). No immediate steps were taken, but Mr Cherry expressed concern that the Group could be taxed both in Australia and overseas and lose the benefit of franking credits that would otherwise be available to CPH. In early 1990, he advised that the corporate structure in the United Kingdom be relocated to a tax haven.

28 The reasons for judgment of Hill J[7] give the following account of the steps that were taken. The account, which was not disputed, begins with a meeting of directors of CPIL(UK) and CPIHL(UK) held on 22 March 1990.

29 The meeting resolved to recommend to members that each company be placed in voluntary liquidation and that an extraordinary general meeting of members be called on 11 April 1990 for that purpose. The directors of CPIL(UK) also resolved to declare dividends payable to members on 8 May 1990 at the rate of US$18.287 per share on the 2,810,000 redeemable preference shares (a total of

---

7 *CPH Property Pty Ltd v Commissioner of Taxation* (1998) 88 FCR 21 at 30-32.

US$51,387,000) and on the 2,658,295 fully-paid ordinary shares (a total of US$48,613,000). The directors of CPIHL(UK) likewise resolved to declare dividends at the rate of US$0.3466 per share on the 66 million fully-paid redeemable preference shares (a total of US$22,878,000) and the 5,000,002 fully-paid ordinary shares (a total of US$1,733,000) and at the rate of US$0.3154 per share on the 90 million redeemable preference shares paid to US$0.91 (a total of US$28,389,000).

30 The board papers of the directors' meeting contain the following statement:

> "The overriding aim of the final structure is to ensure that the passive income referred to earlier is attributed to Australia as thereby franked dividends may be paid to the shareholders, ie dividends which will be tax free in the shareholders' hands. Removal of the UK incorporated entities and their replacement with either Bahamas or Bermudian entities will ensure that:
>
> (a) this passive income flows tax free to Australia; and
>
> (b) there is no possibility of double taxation.
>
> While maintenance of the UK companies may not lead to additional corporate tax being paid overall, ie credit will be given in Australia for UK tax paid. It would not be possible to pay franked dividends out of that income."

31 The Bahamas was chosen as the appropriate location for the new holding structure. On 5 April 1990, Consolidated Press International Holdings Limited (CPIHL(B)) and Consolidated Press International Limited (CPIL(B)) were each incorporated there. On 12 April 1990 MLG and CPH agreed with CPIL(B) to sell their holdings. The consideration was determined subsequently as a certain number of ordinary "A" class shares of US$1 each in the capital of CPIL(B). All of MLG's and CPH's holdings in CPIL(UK) and CPIHL(UK) were to be transferred as a consequence of the agreements entered into on that day. Although a calculation of the number of shares to be issued by the companies newly incorporated in the Bahamas was at the time of the meeting made in accordance with a draft valuation, the formal valuation for this purpose was made by the Australian firm of Ernst & Young (the successor firm to Arthur Young) and issued on 22 April 1990.

32 No transfers were entered at this stage in the register of members of either company nor were any transfers then approved.

33 On 27 April 1990, a meeting of a committee of directors of CPIL(B) was held in Hong Kong to determine the number of shares to be issued as consideration for the proposed transfers in accordance with the Ernst & Young valuation. In the result, 452,346,000 shares were to be issued to CPH, and 118,287,000 to MLG.

34 On 1 May 1990, Ernst & Young were asked to carry out a further valuation of CPIL(UK) as at 7 May 1990 in relation to the proposed acquisition by CPIL(B) of a further 2.4 million fully-paid ordinary shares of US$100 each in CPIL(UK) from MLG. The date of 7 May 1990 was chosen because it was relevant to indexation as by then the shares agreed to be sold would have been held more than one year since acquisition, thus raising the cost base for Australian capital gains tax by the indexation factor relevant. This, Hill J thought, explained why these shares were excluded from the agreement entered into on 12 April.

35 In the meantime, entries were made in the books of account of CPIL(UK) and CPIHL(UK) debiting the dividends which had been declared by the directors and were to be payable as at 8 May. No transfers to give effect to the agreements were ever registered in the register of members of either company, nor did the directors approve any transfer or resolve to direct registration.

36 The consideration received by CPH and MLG for the sale of their shares in CPIL(UK) and CPIHL(UK), that is to say, shares in CPIL(B), was calculated by reference to the net value of the assets of the two United Kingdom companies. The balance sheet of CPIL(UK) as at 10 May 1990 showed net assets of US$550,102,063. The balance sheet of CPIHL(UK) as at 10 May 1990 showed net assets of US$186,356,205.

37 On 16 May 1990, CPIL(UK) and CPIHL(UK) both resolved to go into voluntary liquidation. Liquidators were appointed to each company on that day, being the day the liquidation took effect under the United Kingdom companies law. At the same meeting the members of each company resolved to authorise the liquidators to distribute the whole or any part of the assets of each company to a member in specie. Subsequent events record the steps necessary to complete the liquidation of each company. They represented, in essence, the distribution in specie of assets.

38 On the same day, at the request of the liquidators appointed to each company, each of CPH and MLG directed and authorised them to make "any payments consequent upon the crediting of dividends declared by the Company

on 8th May 1990" and "any distributions to members ... in the course of the winding up ... direct to CPIL(B) in place of any payment or distribution to [the members]."

39 On the next day the liquidators of CPIHL(UK) purported to satisfy the debt due by CPIL(UK) to CPIL(B) arising from the dividend payable on 8 May 1990 by assigning to CPIL(B) the first US$53 million of a debt of US$84,220,334.05 due to CPIHL(UK) by CPI(Sing). A deed of assignment and satisfaction was executed to effect this transaction. Similar action was taken by the liquidators of CPIL(UK) to satisfy the debt purportedly due as a result of the dividend declaration as well as certain other debts by assigning to CPIL(B) the first US$106,751,299.80 of a debt due to CPIL(UK) from CPI(Sing). The general ledger of CPIL(UK) showed that the amount of US$106,751,299.80 was in part a payment of the US$100 million dividend paid by CPIL(B) on behalf of CPIL(UK).

40 On 8 June 1990, an arrangement was made between the liquidators of CPIHL(UK) and CPIL(B) for the distribution in specie of the balance of the assets of CPIHL(UK) and a deed of assignment between CPIL(B) and CPIHL(UK) was executed whereby CPIHL(UK) assigned the debts referred to in the above-mentioned agreement.

41 The next day a deed of assignment and agreement for novation was entered into assigning certain debts in consideration of CPIL(B) agreeing to assume certain obligations and liabilities of CPIL(UK) to creditors. Formal novation agreements were entered into between 9 June 1990 and 11 June 1990.

The Pt IVA/s 79D issue

42 The interest paid by ACP on the funds borrowed for the immediate purpose of taking up shares in MLG, which, in turn, was part of the wider purpose of enabling the Group to participate in the takeover of BAT, would, subject to the arguments to be considered below, be allowable as a deduction under s 51(1) of the Act. The funds were used to acquire shares which were intended, in the relatively short term, to produce substantial dividends[8].

43 The essence of the Commissioner's case is that, but for tax considerations, it would be expected that the funding of the participation would have taken the

---

8 cf *Steele v Deputy Commissioner of Taxation* (1999) 197 CLR 459.

form of a loan by CPF to ACP, an acquisition of shares by ACP in CPIL(UK), and the funding of CPI(Sing) by CPIL(UK). The interposition of MLG, so it was argued, was critical to securing the deductibility of the interest paid by ACP. This was because, if the anticipated income from the transaction were to have taken the form of dividends flowing from CPIL(UK) to ACP, s 79D, certainly for the year ended 30 June 1989, and probably for the year ended 30 June 1990, would have operated to deny the ACP deductibility of the interest. That proposition was contested. However, the Commissioner went on to argue that, given its correctness, the general provisions of Pt IVA operated to authorise the Commissioner to determine that the interest deduction should not be allowable.

44 The arguments of the parties require consideration of a number of questions as to the meaning and effect of certain provisions of Pt IVA and of s 79D.

45 At the relevant time, Pt IVA, which deals with "Schemes to Reduce Income Tax", contained the following provisions.

46 The word "scheme" is defined in s 177A:

"(1) In this Part, unless the contrary intention appears –

'scheme' means –

(a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and

(b) any scheme, plan, proposal, action, course of action or course of conduct …"

47 The definition is elaborated in two sub-sections:

"177A(3) The reference in the definition of 'scheme' in sub-section (1) to a scheme, plan, proposal, action, course of action or course of conduct shall be read as including a reference to a unilateral scheme, plan, proposal, action, course of action or course of conduct, as the case may be.

…

(5) A reference in this Part to a scheme or a part of a scheme being entered into or carried out by a person for a particular purpose shall be

read as including a reference to the scheme or the part of the scheme being entered into or carried out by the person for 2 or more purposes of which that particular purpose is the dominant purpose."

48 Section 177D defines the schemes to which Pt IVA applies as follows:

"This Part applies to any scheme that has been or is entered into after 27 May 1981, and to any scheme that has been or is carried out or commenced to be carried out after that date (other than a scheme that was entered into on or before that date), whether the scheme has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia, where –

(a) a taxpayer (in this section referred to as the 'relevant taxpayer') has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme; and

(b) having regard to –

(i) the manner in which the scheme was entered into or carried out;

(ii) the form and substance of the scheme;

(iii) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;

(iv) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;

(v) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;

(vi) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;

(vii) any other consequence for the relevant taxpayer, or for any person referred to in sub-paragraph (vi), of the scheme having been entered into or carried out; and

(viii) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in sub-paragraph (vi),

it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme or of enabling the relevant taxpayer and another taxpayer or other taxpayers each to obtain a tax benefit in connection with the scheme (whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers)."

49 The concept of "tax benefit" is explained in s 177C which relevantly provides:

"(1) Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to –

(a) an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out; or

(b) a deduction being allowable to the taxpayer in relation to a year of income where the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out;

and, for the purposes of this Part, the amount of the tax benefit shall be taken to be –

(c) in a case to which paragraph (a) applies – the amount referred to in that paragraph; and

(d) in a case to which paragraph (b) applies – the amount of the whole of the deduction or of the part of the deduction, as the case may be, referred to in that paragraph."

50 Section 177F(1) provides:

"(1) Where a tax benefit has been obtained, or would but for this section be obtained, by a taxpayer in connection with a scheme to which this Part applies, the Commissioner may –

(a) in the case of a tax benefit that is referable to an amount not being included in the assessable income of the taxpayer of a year of income – determine that the whole or a part of that amount shall be included in the assessable income of the taxpayer of that year of income; or

(b) in the case of a tax benefit that is referable to a deduction or a part of a deduction being allowable to the taxpayer in relation to a year of income – determine that the whole or a part of the deduction or of the part of the deduction, as the case may be, shall not be allowable to the taxpayer in relation to that year of income,

and, where the Commissioner makes such a determination, he shall take such action as he considers necessary to give effect to that determination."

51 It should be mentioned that "income tax" and "tax" are defined terms which mean tax assessed under the Act (s 6). Part IVA is in aid of the Australian, not foreign, revenue.

52 In contending that a tax benefit was obtained in connection with a scheme, the Commissioner identified, as the relevant scheme, part only of the total plan or course of conduct involved in the corporate arrangements that were made within the Group for the purposes of the BAT takeover bid. Subject to the arguments of the taxpayer considered below, this was open to the Commissioner: *Federal Commissioner of Taxation v Peabody*[9]. The essence of the scheme was said to be

---

9 (1994) 181 CLR 359.

the interposition of MLG between ACP and CPIL(UK). The plan was said to have been conceived by the tax advisors, Arthur Young, and adopted by ACP and MLG. The key steps were the acquisition by subscription by ACP of redeemable preference shares in MLG and the acquisition by subscription by MLG of redeemable preference shares in CPIL(UK) and, in each case, the payment of the allotment moneys. The tax benefit said to have been obtained in connection with the scheme was the allowability to ACP of a deduction for interest on the money it borrowed from CPF in circumstances where the whole or a part of that deduction would not have been allowable, or might reasonably have been expected not to have been allowable, if the scheme had not been entered into or carried out.

53 The reason why the whole or part of the deduction would not have been allowable, or might reasonably have been expected not to be allowable, but for the scheme, was, according to the Commissioner, to be found in s 79D of the Act.

54 The taxpayer argued, and Hill J held, that the Commissioner's contention was based upon an erroneous interpretation of s 79D. The Full Court of the Federal Court reversed the decision of Hill J on this point. A resolution of that matter in favour of the taxpayer would make it unnecessary to consider any other aspect of the Pt IVA/s 79D issue. Unless the Commissioner's argument about s 79D is upheld, then there was no relevant tax benefit obtained in connection with the alleged scheme. It is convenient to go directly to that argument.

55 For the 1989 and 1990 income years, s 79D of the Act provided:

> "(1) Where the amount of a class of income derived by a taxpayer in a year of income from a foreign source is exceeded by the sum of:
>
> (a) any deductions allowed or allowable from the assessable income of the taxpayer of the year of income that relate exclusively to income of that class derived from that source; and
>
> (b) so much of any other deductions allowed or allowable from that assessable income (other than apportionable deductions) as, in the opinion of the Commissioner, may appropriately be related to income of that class derived from that source;

the deductions to which paragraphs (a) and (b) apply shall be reduced respectively by amounts proportionate to those deductions and equal in total to the amount of the excess.

(2) In subsection (1), 'class of income' and 'foreign source' have the same meanings as in s 160AFD."

56 "Class of income" and "foreign source" were defined in s 160AFD for the relevant years as follows:

"(6) For the purposes of this section,

(a) interest income constitutes a single class of income;

(b) offshore banking income constitutes a single class of income;

(c) all other income constitutes a single class of income.

(7) In this section –

'foreign source' in relation to a taxpayer, means –

(a) a business carried on by the taxpayer at or through one or more permanent establishments in a foreign country;

(b) any other business, commercial or investment activity carried on by the taxpayer in a foreign country."

57 The Commissioner's contention that ACP obtained a tax benefit in connection with the interposition of MLG between ACP and CPIL(UK) was based upon the view that, but for such interposition, s 79D would have operated to quarantine deductions for interest allowable to ACP, the relevant income from a foreign source being the dividends that were expected to flow from CPIL(UK) as a result of the BAT takeover. While it might reasonably be expected that a time would come in the future when that dividend flow would be such that the quarantine would not matter, during the year ended 30 June 1989, and probably during the year ended 30 June 1990, the quarantine effect would be significant and adverse to ACP. By the interposition of MLG, that effect was avoided.

58 On the taxpayer's argument there were two reasons why this could not be so: first, s 79D in the form it took in the 1989 and 1990 years did not apply where, as in the present case, no income was derived from the relevant foreign

source; secondly, even if dividend income had been received from CPIL(UK) by ACP, it would not have been income derived from a foreign source because the source would have been Australia. Hill J agreed with the first of those propositions although, if it had been necessary to decide the point, he would have rejected the second. The Full Court of the Federal Court disagreed with both.

59 Before expressing his views as to the arguments about the meaning and effect of s 79D, Hill J explained the history and purpose of the provision. His explanation was as follows.

60 Section 79D was inserted into the Act by Act No 78 of 1988, s 16 being first applicable to assessments for the year of income commencing 1 July 1988. It was enacted to overcome a perceived deficiency in ss 51(6) and (7) as those sections stood at the time of the amendment.

61 Section 51(1) is the general provision for deduction of business expenses. Section 51(6) had provided:

> "Where the amount of a class of foreign income derived by a taxpayer in a year of income from a foreign source is exceeded by the sum of –
>
> (a) any deductions allowed or allowable from the assessable income of the taxpayer of the year of income that relate exclusively to income of that class derived from that source; and
>
> (b) so much of any other deductions allowed or allowable from that assessable income (other than apportionable deductions) as, in the opinion of the Commissioner, may appropriately be related to income of that class derived from that source,
>
> a deduction is not allowable under sub-section (1) in respect of the amount of the excess."

62 Section 51(7) provided that the expressions "class of income" and "foreign source" were to have the same meanings as in s 160AFD.

63 Section 160AFD formed part of the provisions concerned with credit being given in Australia for taxes payable elsewhere, generally referred to as the "foreign tax credit", which were enacted in 1986, first applicable to the year of income commencing 1 July 1987 and replacing earlier provisions dealing with credits to be given in respect of tax payable in Papua New Guinea.

64 The basic scheme of the foreign tax credit provisions was that if a resident taxpayer had assessable income of a year which included foreign income and, being liable so to do, had paid foreign tax on that foreign income, the taxpayer was entitled to a credit of whichever was the lesser of the foreign tax (subject to an immaterial reduction in amount) and the Australian tax. Because of the dual requirement of foreign income of a year of income and tax paid in respect of that income in the year, the provisions of s 160AFD(1) operated only in a year where there was a derivation of foreign income, and not in a year where no foreign income was derived.

65 Section 51(6) was expressed to operate only where there was a class of foreign income derived in the year of income and was not expressed as operating where none was derived.

66 However, s 160AFD dealt with the situation where a resident taxpayer had foreign losses in the preceding seven years. Such foreign losses were required to be recouped against the relevant class of foreign income before the taxpayer was taken to have foreign source income in the year of the particular class.

67 The purpose of s 51(6) was to quarantine deductions allowable under s 51(1) but relating exclusively, or in the Commissioner's opinion appropriately related, to the foreign source income so that those deductions were to offset foreign source income, rather than other non-foreign source income. Certain deductions (referred to as "apportionable deductions", a defined expression in s 6(1)) were excluded from the quarantining regime.

68 Two defects were perceived in s 51(6). The first was that it quarantined (subject to "apportionable deductions") only deductions under s 51(1). Deductions under other sections of the Act were not quarantined. Secondly, it did not deal at all with cases where there were foreign losses. These related defects were cured by ensuring that s 79D operated to extend the quarantining to "any deductions allowed or allowable" provided that they related to the relevant class of foreign income. The Explanatory Memorandum which accompanied the Taxation Laws Amendment Bill (No 2) 1988, after referring to the proposed deletion of s 51(6), said:

> "Clause 16 will insert in the Principal Act proposed new section 79D which will in effect ensure that a current year foreign loss can only be carried forward in terms of section 160AFD of the Principal Act for offset against future foreign income of the same class from the same foreign source.

> Subsection 79D(1) specifies that where the amount of a 'class of income' derived by a taxpayer in a year of income from a 'foreign source' is exceeded by the sum of certain deductions, the respective deductions are to be reduced by amounts proportionate to those deductions and equal in total to the amount of the excess. In practical terms this means that each deduction will be reduced by a proportionate amount of the excess.
>
> …
>
> To illustrate the operation of new section 79D, consider a situation where the amount of a class of income derived by a taxpayer in a year of income from a foreign source is $1000. The deductions allowable under the Principal Act against that income are $200, $400 and $600 under subsections 51(1), 53(1) and 54(1) respectively. The aggregate deductions allowable exceed the amount of income by $200 so that the respective deductions are to be reduced by a proportionate amount of the excess. This means that the deductions allowable in the year of income under subsections 51(1), 53(1) and 54(1) will be reduced respectively by 200/1200 of 200 ie $33, 400/1200 x 200 ie $67 and 600/1200 x 200 ie $100. The reductions equal in total $200, being the amount of the excess."

69 At the same time, s 160AFD was amended to ensure that it too related to all relevant deductions and income and required, therefore, a carry forward of foreign losses of the preceding seven years, the overall loss being calculated in effect as the excess of allowable deductions over the amount of the taxpayer's income of a relevant class of income derived from a foreign source.

70 A new s 79D was substituted by Act No 5 of 1991, applicable to assessments for the 1990-1991 year of income and subsequent years, to deal specifically with the issue which has arisen in the present case. As substituted, the new s 79D spelt out what was to happen where the taxpayer did not derive any assessable foreign income of a class in the year of income. Section 160AFD operated only in relation to pre-1990 losses and s 79E was substituted, inter alia, to allow post-1989 losses against assessable foreign income where an election was made under sub-s (6). The substitution of the new s 79D was, however, to play no part in the process of interpretation of the old s 79D.

71 Although the amendment to s 79D occurred in the last of the years the subject of a disputed assessment, it has no bearing on the outcome of the dispute. Hill J pointed out that the application of Pt IVA ordinarily depends upon the state of the law at the time an alleged scheme is entered into or carried out. In dealing with the arguments as to purpose it will be necessary to make further reference to

what was anticipated, in 1989, as to the future flow of dividends to MLG and ACP. However, on the threshhold issue of whether there was a tax benefit obtained in connection with the scheme, the relevant fact is that no dividends were received as a result of the takeover, which did not proceed. On the taxpayer's argument, which was accepted by Hill J, there having been no income derived from a foreign source during the years ended 30 June 1989 and 30 June 1990, s 79D did not operate to quarantine interest deductions, therefore the interposition of MLG between ACP and CPIL(UK) did not have the effect of overcoming any such quarantine, and so there was no relevant tax benefit obtained in connection with the scheme.

72 Hill J identified the question as being whether, as the taxpayer contended, s 79D had no application where in the year of income no foreign source income is derived, or whether, as the Commissioner contended, the section operated to disallow deductions available to a resident taxpayer even where no foreign source income is, in the year of income, derived. Another way of expressing the question would be to ask whether s 79D meant that if ACP had derived a small amount of foreign source income flowing from the BAT takeover proposal during the year ended 30 June 1989 s 79D would apply, but, if no amount was derived during that year, the section would have no application in that year. As Hill J pointed out, and the Full Court accepted, deductions may be incurred, and allowable in a period prior to income being derived, and may be incurred and allowable in a period after the income to which those deductions are related may have ceased[10]. On the Commissioner's approach, a deduction would be lost in the latter case, and might never be allowed in the former. Hill J concluded that the ordinary and natural meaning of the language of s 79D before its amendment was that the section only applied when there was some foreign source income derived in a given year. This followed, not only from the use of the word "amount", but also from the requirement to relate deductions exclusively to income of a certain class. On that basis, there was no tax benefit in the years ended 30 June 1989 and 30 June 1990. (While the amendment would, subject to other arguments, have produced a tax benefit in the next year, the sequence of events meant that the scheme could not be said to have had the purpose of producing that benefit).

73 The reasoning of the Full Court on the point was as follows. Section 79D is concerned with more than the relationship between actual income and allowable deductions. The expression "class of income derived by a taxpayer in

---

10 *AGC (Advances) Ltd v Federal Commissioner of Taxation* (1975) 132 CLR 175 at 188 per Barwick CJ.

a year of income from a foreign source" is adjectival. It defines the category of income to which a deduction must relate if it is to be burdened by the quarantining operation of the section. It therefore identifies the class of deduction upon which the section operates. The Full Court, holding that such a construction was open on the wording, preferred it for reasons related to the purpose of the provision. Their Honours said[11]:

> "For a given deduction related to a class of foreign income, the less the amount of the income the greater the excess of the deduction over it. Therefore the greater will be the proportion of that deduction not able to be claimed as an allowable deduction. That is to say, the less the foreign source income for a given deduction, the greater the amount of the deduction that is quarantined. But if the section does not touch the case of zero income in the relevant class then, when the income diminishes to zero, the whole of the deduction becomes potentially allowable against non-foreign source income. On the construction for which ACP contends, the case of zero foreign source income creates a singularity or discontinuity which annihilates the operation of s 79D. There is no requirement in logic nor reason in policy why this should be so."

74 In considering this difference of opinion between Hill J and the Full Court, it is to be noted that the provisions of s 79D for quarantining deductions related to income from foreign sources operate in a legislative context which includes s 51, and the provisions relating to carrying forward of losses. It is s 51(1) which, subject to s 79D, provided for the deductibility of the interest paid by ACP. The retention of that deductibility, notwithstanding s 79D, is said to constitute the relevant tax benefit. Section 51(1) provided that losses and outgoings to the extent to which they are incurred in gaining or producing "the assessable income" or are necessarily incurred in carrying on a business for the purpose of gaining or producing "such income" shall be allowable deductions. It was pointed out in *Fletcher v Federal Commissioner of Taxation*[12] that the expression "the assessable income" is not confined to assessable income derived in the particular tax year. It is an abstract phrase which also refers to assessable income which the relevant outgoing would be expected to provide. An outgoing may qualify for deduction even though no assessable income to which the outgoing is shown to be incidental and relevant is gained or produced in the year

---

11 (1999) 91 FCR 524 at 543-544.

12 (1991) 173 CLR 1 at 16-17.

in which the outgoing is incurred, or at all[13]. But it is the relevance of the loss or outgoing to some kind of income, actual or potential, that warrants the conclusion that it is incurred in a manner necessary for the application of s 51(1). It was the purpose of the borrowing, that is to say, the acquisition of shares expected to produce dividends as a result of the BAT takeover, that gave rise to the potential application of s 51(1). On the hypothesis (which is in dispute) that it would be reasonable, in the absence of the tax purpose, to expect that ACP would have subscribed directly for shares in CPIL(UK), and that income in the form of dividends paid by CPIL(UK) as a result of the BAT takeover would have had a foreign source, then it is the fact that the purpose of the borrowing was to obtain such income that made the interest potentially deductible under s 51(1).

75 When s 79D refers to "income from a foreign source" then, bearing in mind its relationship to s 51(1), it is to be understood as comprehending the possibility that, in a given year of potential deductibility, the potential or prospective income which makes the loss or outgoing otherwise deductible under s 51(1) has not yet commenced to be derived, or has ceased to be derived. It is not impossible to relate deductions to income which remains merely prospective or potential. Making such a relation may be necessary for s 51 to apply. It was necessary in the present case.

76 When regard is had to the legislative context, it is not impossible to apply the words of s 79D to a case where, in a given year, income has not yet begun to be derived or, indeed, where, in the events that happen, no income is derived. And it is possible to identify the class and source of prospective or potential income, bearing in mind the necessity to know enough about such income to conclude that s 51(1) would apply. There is no apparent legislative policy to be served by distinguishing, in s 79D, between a small amount of income and a case where income has not yet commenced to flow.

77 Although the taxpayer's argument on this point has considerable force, the meaning given to s 79D by the Full Court is to be preferred.

78 That makes it necessary to consider the remaining arguments about the Pt IVA/s 79D issue, which were all dealt with by Hill J although, on his first conclusion, it was strictly unnecessary for him to do so. On all of these arguments, Hill J and the Full Court decided against the taxpayer.

---

13 *Steele v Deputy Commissioner of Taxation* (1999) 197 CLR 459 at 474 [43].

79 The next argument to be considered also concerns the meaning and effect of s 79D.

80 The taxpayer contends that the supposed tax benefit relied upon by the Commissioner, (in effect, avoiding the operation of s 79D) depends upon the false hypothesis that the potential or prospective income to be derived by ACP if it had directly taken up shares in CPIL(UK), without the interposition of MLG, would have been income from a foreign source as defined in s 79D(2) and s 160AFD. The taxpayer submits that such income would have had an Australian source.

81 There are two aspects of the argument about foreign source. The relevant part of the definition of that expression in s 160AFD refers to commercial or investment activity carried on by the taxpayer in a foreign country. It is submitted, first, that the expression "carried on" requires an element of repetition which is not satisfied by the making of a single investment, and, secondly, that, on the hypothesis under consideration, the place where ACP would be carrying on its commercial or investment activity would be the place where its central control and management was located, that is to say, Australia.

82 Both of those submissions depend upon an unduly narrow view of the commercial dealings which would be expected to result in the flow of dividend income to ACP, from the Group's participation in a takeover of BAT in the United Kingdom, the profitable disposal of a substantial part of BAT's assets, and the continuing of part of its business.

83 In the submissions for the taxpayer, reference was made to ACP's "passive investment", as though what was in contemplation was not materially different from an Australian investor instructing a Sydney stockbroker to arrange for the acquisition of a parcel of shares in a company listed on the London Stock Exchange. This is not a true analogy. Assuming that dividends had flowed to ACP as anticipated, there is no reason to deny that such income would have resulted from a commercial or investment activity carried on by ACP. The expressions "carried on" and "activity" do not necessarily require repetition[14]. As Hill J pointed out, in the context of s 79D it seems unlikely that the legislature intended to quarantine deductions against income from a foreign activity when there was repetition of the activity, but not to do so where the activity occurred only once.

---

14 cf *Thiel v Federal Commissioner of Taxation* (1990) 171 CLR 338 at 344 per Mason CJ, Brennan and Gaudron JJ.

84 The fund of profits of CPIL(UK), which would have been the source of dividends paid to ACP, would have been in the United Kingdom[15].

85 Hill J and the Full Court were correct to conclude that these arguments of the taxpayer should be rejected.

86 The remaining arguments on the Pt IVA/s 79D issue concern the application of Pt IVA, upon the basis that the Commissioner's contentions as to the meaning and effect of s 79D are correct, and that the interposition of MLG between ACP and CPIL(UK) resulted in a tax benefit.

87 Hill J considered, and the Full Court agreed, that it was reasonable to expect that, had the scheme not been entered into or carried out, ACP would either have subscribed for shares in CPIL(UK) or made loans to that company. The making of a share investment was regarded as more likely, since that was the way the actual investment of MLG was structured. The reasonableness of that expectation has been challenged, but no error in the reasoning of Hill J or the Full Court has been shown.

88 There was a challenge to the findings of Hill J and the Full Court on the question of purpose. The finding of Hill J, which was confirmed by the Full Court, was made with some hesitation.

89 Applying the decision of this Court in *Federal Commissioner of Taxation v Spotless Services Ltd*[16], Hill J commenced by observing that the conclusion to be drawn under s 177D depends upon objective facts, and is not concerned with subjective motivation. The conclusion must relate to the dominant purpose of a person who either entered into or carried out the scheme or a part of it.

90 Since the scheme particularised by the Commissioner was the narrow scheme earlier identified, the use of various tax haven companies and other tax-related aspects of the wider commercial transaction was irrelevant. The purpose in question concerned ss 51(1) and 79D.

---

15 cf *Esquire Nominees Ltd v Federal Commissioner of Taxation* (1973) 129 CLR 177 at 212 per Barwick CJ and 229 per Stephen J.

16 (1996) 186 CLR 404.

91 Hill J found that, on the assumption that he was wrong about the meaning of s 79D, there were two purposes which caused the scheme to be adopted: first, the negating of the operation of s 79D; secondly, the need to adopt a structure which would not detract from tax credit relief. The question was whether the first was dominant.

92 At this point, questions of timing became important. Once a sufficient flow of profits, and dividends, from the anticipated BAT takeover was established, s 79D would cease to matter. But the immediate problem, certainly for the year ended 30 June 1989 and probably for the year ended 30 June 1990, was that until such a sufficient flow was established the quarantine was a significant problem. On the other hand, the tax credit problem lay further in the future.

93 Hill J concluded[17]:

> "With some doubt I am of the view that a conclusion would be drawn that the dominant purpose of some person who participated in the scheme, and in particular those (perhaps not Mr Cherry, but there were others) who advised the group at Arthur Young and later Ernst & Young, was to bring about the result that a deduction would be allowed … which, but for the scheme, would have been disallowed … because of the application of s 79D. I reach this conclusion because it seems to me that the interest deduction was more immediate than the adoption of a neutral structure for non interference with tax credits."

94 In the Full Court, the taxpayer argued that Hill J's reasoning did not refer to, or pay regard to, the eight matters listed in s 177D(b). This argument was rejected. It was pointed out, correctly, that it was not necessary for the judge to refer to the matters individually, and that an examination of the whole of his reasons for judgment showed that he took all the specified matters into account in forming "a global assessment of purpose". The Full Court went through the eight matters individually, and demonstrated how they had been taken into account by Hill J. The Full Court substantially agreed with, and adopted, the reasoning of Hill J.

95 The finding made by Hill J, set out above, was criticised both in the Full Court and in this Court on the ground that, as the case was particularised by the

---

17 (1998) 88 FCR 21 at 42.

Commissioner, the persons who entered into or carried out the scheme were CPIL(UK), MLG and ACP. They were the persons referred to in s 177D; not some unidentified advisors. There is no point in making a finding about what would be concluded concerning the purpose of an advisor unless that purpose is then attributed to a relevant person. It is reasonably clear that, albeit in a slightly elliptical fashion, Hill J was doing that. He was justified in doing so. As was mentioned above, it is to be expected that those who participate in a complex, international, commercial transaction will be concerned about its tax implications, and will seek expert advice. Attributing the purpose of a professional advisor to one or more of the corporate parties in the present case is both possible and appropriate. In some cases, the actual parties to a scheme subjectively may not have any purpose, independent of that of a professional advisor, in relation to the scheme or part of the scheme, but that does not defeat the operation of s 177D. If, in the present case, there had been evidence which showed that no director or employee of any member of the Group had ever heard of s 79D, that would not conclude the matter in favour of the taxpayer. One of the reasons for making s 177D turn upon the objective matters listed in the section, it may be inferred, was to avoid the consequence that the operation of Pt IVA depends upon the fiscal awareness of a taxpayer.

96 Objection was also taken to what was said to be the artificiality of the selection of part of the overall transaction as the scheme. This, it was said, was not warranted by *Peabody* or *Spotless*. The artificiality was said to result from the fact that the overall transaction was for the clearly commercial purpose of financing the Group's participation in the takeover bid for BAT. However, as was held in *Spotless*[18], a person may enter into or carry out a scheme, within the meaning of Pt IVA, for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit where that dominant purpose is consistent with the pursuit of commercial gain in the course of carrying on a business. The fact that the overall transaction was aimed at a profit making does not make it artificial and inappropriate to observe that part of the structure of the transaction is to be explained by reference to a s 177D purpose. Nor is there any inconsistency involved, as was submitted, in looking to the wider transaction in order to understand and explain the scheme, and the eight matters listed in s 177D.

97 It was argued for the taxpayer that the argument for the Commissioner, and the reasoning of the Full Court, in effect attempted to introduce into Pt IVA a

---

18 (1996) 186 CLR 404 at 415 per Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ.

principle of fiscal nullity, without accepting the consequences of such a principle[19]. In the present case the consequence would be that what remained after the disappearance of the scheme would be a loan by ACP to CPI(Sing). This does not follow, but in any event there is no submission of fiscal nullity involved. These questions only arise after it has been established that ACP obtained a tax benefit. That benefit was obtained by interposing MLG between ACP and CPIL(UK). The benefit was the allowability of a deduction which would not have been allowable or might reasonably be expected not to be allowable. In those circumstances a determination that the deduction shall not be allowable is within the power conferred by s 177F.

98 The decision of the Full Court on the Pt IVA/s 79D issue was correct. The appeal of ACP should be dismissed.

The dividend stripping issue

99 This issue arises out of the corporate reorganisation, involving CPIL(UK) and CPIHL(UK), described above.

100 Although at first instance, before Hill J, the Commissioner relied (unsuccessfully) upon s 177D of the Act as an alternative ground in support of the relevant assessments, that argument was not pressed in the Full Court, or in this Court. The Commissioner's primary ground before Hill J, and his sole ground in the Full Court and in this Court, depends upon the operation of s 177E, which is a special provision of Pt IVA of the Act inserted to deal with a particular form of scheme to reduce income tax, known as dividend stripping. For a reason that will appear, that form of scheme was difficult to accommodate to the mechanics of the general anti-avoidance provisions, and so it was dealt with specifically, and somewhat differently. It is a provision which is to be understood in the context in which it appears, and in the light of the legislative purpose it serves, which cannot adequately be explained independently of that context. The expression "dividend stripping" is not a legal term of art, having a literal meaning which can be clearly defined apart from its context. It is not defined in Pt IVA, presumably because the legislature considered its meaning to be sufficiently clear in the context of schemes to reduce income tax.

101 Section 177E provides:

---

19 cf *Furniss v Dawson* [1984] AC 474 per Lord Brightman at 527.

"(1) Where –

(a) as a result of a scheme that is, in relation to a company –

(i) a scheme by way of or in the nature of dividend stripping; or

(ii) a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping,

any property of the company is disposed of;

(b) in the opinion of the Commissioner, the disposal of that property represents, in whole or in part, a distribution (whether to a shareholder or another person) of profits of the company (whether of the accounting period in which the disposal occurred or of any earlier or later accounting period);

(c) if, immediately before the scheme was entered into, the company had paid a dividend out of profits of an amount equal to the amount determined by the Commissioner to be the amount of profits the distribution of which is, in his opinion, represented by the disposal of the property referred to in paragraph (a), an amount (in this sub-section referred to as the 'notional amount') would have been included, or might reasonably be expected to have been included, by reason of the payment of that dividend, in the assessable income of a taxpayer of a year of income; and

(d) the scheme has been or is entered into after 27 May 1981, whether in Australia or outside Australia,

the following provisions have effect:

(e) the scheme shall be taken to be a scheme to which this Part applies;

(f) for the purposes of section 177F, the taxpayer shall be taken to have obtained a tax benefit in connection with the scheme that is referable to the notional amount not being included in the assessable income of the taxpayer of the year of income; and

(g) the amount of that tax benefit shall be taken to be the notional amount.

(2) Without limiting the generality of sub-section (1), a reference in that sub-section to the disposal of property of a company shall be read as including a reference to –

(a) the payment of a dividend by the company;

(b) the making of a loan by the company (whether or not it is intended or likely that the loan will be repaid);

(c) a bailment of property by the company; and

(d) any transaction having the effect, directly or indirectly, of diminishing the value of any property of the company.

…"

102 The expression "dividend stripping" was used in the Act in 1972, in the context of a specific anti-avoidance provision. The legislative history was explained in the reasons of the Full Court in the present case[20]. The *Income Tax Assessment Act (No 3)* 1972 (Cth) was enacted to limit the rebates of tax on dividends received by a share trading company as a result of dividend stripping operations. It introduced into the Act s 46A, which operated on the basis of the Commissioner's satisfaction that a transaction, operation, undertaking, scheme or arrangement was by way of dividend stripping. In considering that question, the Commissioner was directed to have regard to certain particular matters and any other relevant matters. The Explanatory Memorandum explained:

> "In its simplest form, a dividend-stripping operation involves the purchase by a share-trading company of shares in another company which has accumulated profits. A payment of a dividend is then made to the share-trading company which, in effect, wholly or substantially recoups its outlay on purchase of the shares that are then resold for a reduced price or are retained at a reduced value for income tax purposes.

---

20 (1999) 91 FCR 524 at 562-564.

> Although, in a commercial sense, the share-trading company may make an overall profit on the transaction, no part of the deduction allowable for the cost price of the shares can be set off against dividend income to determine the part of the dividends included in taxable income on which the rebate is allowable. The result is that, while the dividends are effectively freed from tax by the rebate, the deduction allowed for the cost of acquiring the shares is applied against non-dividend income which thereby escapes full tax."

103 The Explanatory Memorandum also said that there were features common to dividend stripping as the term is ordinarily understood and that those features "do not exist in normal commercial transactions, eg, in the purchase in the ordinary way of shares cum div and the subsequent sale of those shares".

104 In the days before capital gains tax, a sale of shares cum dividend was a simple and obvious example of a transaction which avoided the incidence of tax but could not ordinarily be characterised as a scheme for that purpose. If one were to ask why, when a vendor of shares in a company which had accumulated profits decided to take the full value of the shares in a capital form by selling them, and the purchaser later received the benefit of the accumulated profits in the form of dividends, that did not constitute a dividend stripping scheme, the answer might have been given in terms of the Explanatory Memorandum: that this was a "normal commercial transaction". The distinction between normal commercial transactions and schemes of tax avoidance was never clear-cut, and ultimately proved incapable of carrying the weight it was given to bear, but for a long time it played an important part in decisions which sought to explain the concept of tax avoidance. The distinction lay at the heart of the decision of the Privy Council in *Newton v Federal Commissioner of Taxation*[21], and was employed in the Explanatory Memorandum accompanying the Bill which introduced Pt IVA. As was pointed out in connection with the Pt IVA/s 79D issue, there is no strict dichotomy between commercial considerations and tax considerations. That does not mean, however, that the expression "dividend stripping", used in the context of Pt IVA, can be understood without regard to its history as part of tax avoidance discourse.

105 In *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation*[22], decided in 1970, Windeyer J noted that the term

---

21 (1958) 98 CLR 1; [1958] AC 450.

22 (1970) 120 CLR 177 at 179.

"dividend stripping operation" had become well known in English revenue law. He quoted from the third edition of *Halsbury*[23]:

> "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."

106 He also referred to *Fowler's Modern English Usage* (1965), which described the terms "bond washing" and "dividend stripping" as "devices for the legal avoidance of taxation".

107 The Full Court referred to a number of decisions of this Court and of the Privy Council in which dividend stripping operations were examined. They included *Bell v Federal Commissioner of Taxation*[24], *Newton*[25], *Hancock v Federal Commissioner of Taxation*[26], *Federal Commissioner of Taxation v Ellers Motor Sales Pty Ltd*[27] and *Federal Commissioner of Taxation v Patcorp Investments Ltd*[28].

108 When Pt IVA was enacted in 1981, the Explanatory Memorandum explained s 177E as follows:

> "Part IVA will have within it, in section 177E, a supplementary code 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

---

23 *Halsbury's Laws of England*, 3rd ed, vol 20 at 201.

24 (1953) 87 CLR 548.

25 (1958) 98 CLR 1; [1958] AC 450.

26 (1961) 108 CLR 258.

27 (1972) 128 CLR 602.

28 (1976) 140 CLR 247.

taxable dividends. Section 177E is designed against the background that, while such schemes are of the general kind to which preceding provisions of Part IVA are to apply, it may not always be able to be concluded that, if the scheme had not been entered into, the relevant dividends would have been (or might reasonably be expected to have been) included in assessable income: the company may simply have retained the profits for the time being.

In schemes of this kind, arrangements are generally made to convert into cash the assets of the company to be stripped and, following the sale by shareholders of their shares in the company for a capital sum, subsequent transactions ensure either that the purchaser is reimbursed for the price of the shares in the form of a dividend or other payment from the company or that an entity which has a close association with the shareholder obtains the enjoyment of property of the company in one form or another. These transactions are structured so that profits thus effectively stripped from the company do not bear tax.

Section 177E will treat such schemes as schemes to which the Part applies so that, for example, a shareholder who disposes of his or her shares in the context of a dividend-stripping scheme will be treated as having obtained a 'tax benefit' of the amount which the person would have derived as a dividend had the company paid as a dividend the amount of company profits that are represented in the property of the company that is stripped from it under the scheme."

109 The first of the above three paragraphs explained why it was necessary to have a supplementary code for dividend stripping schemes, even though they otherwise fell within the general provisions. The conclusion that was critical to the operation of the general provisions, that is to say, the s 177D conclusion, would be likely to be unavailable in the case of this particular kind of tax avoidance scheme, and so it was to be dealt with in a manner that did not require such a conclusion.

110 The Explanatory Memorandum said:

"Paragraph (a) sets out the initial and key test that there be a scheme that in fact is either one by way of or in the nature of dividend stripping or one having substantially the effect of such a scheme. Schemes within the category of being, or being in the nature of, dividend stripping schemes would be ones where 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.
>
> In the category of schemes having substantially the same effect would fall schemes in which the profits of the target company are not stripped from it by a formal dividend payment but by way of such transactions as the making of irrecoverable loans to entities that are associates of the stripper, or the use of the profits to purchase near-worthless assets from such associates."

111 It will be necessary to make further reference to the second of these paragraphs.

112 The taxpayers' primary submission was that in the present case there was no scheme by way of or in the nature of dividend stripping, and no scheme having the effect of dividend stripping. Hill J agreed that there was no scheme by way of or in the nature of dividend stripping, but held that, in relation to CPIHL(UK) (but not in relation to CPIL(UK)), there was a scheme having the effect of dividend stripping. The Full Court accepted the whole of the taxpayers' submission.

113 The taxpayers relied on additional arguments which only arise if their primary submission is rejected. Two of those arguments were rejected by Hill J. The first was that, in the events that occurred, there was no disposal of property by the United Kingdom companies, CPIL(UK) and CPIHL(UK). The second was that no dividends were paid by the United Kingdom companies, the purported declarations of dividend being void. The Full Court found it unnecessary to deal with those arguments.

114 A third argument, concerning the process of determination employed by the Commissioner under s 177F, was accepted by Hill J, and was the basis upon which he decided the case against the Commissioner.

115 In order to explain that argument, it is necessary to refer in some further detail to the facts.

116 Before the reorganisation, each of the taxpayers had shares in CPIL(UK) and CPIHL(UK). As at 30 June 1989 CPIHL(UK) had, according to its audited accounts to that date, accumulated profits of US$86,825,000. As at the same date, CPIL(UK) had accumulated losses of US$69,449,000. Even more losses

were to be found in the consolidated accounts as at the same date. In the period from 1 July 1989 to 31 December 1989, CPIL(UK) derived an operating profit after tax in the sum of US$65,147,000 which, while available to be used as the source of a company law dividend could, if not paid out as a dividend, be used to replace lost share capital. Since, ultimately, the directors of CPIL(UK) purported to pay a dividend of US$100 million, Hill J assumed that to that extent, at least, a fund of profits was available, albeit for the current year, out of which a dividend could have been paid.

117 In the period from 1 July 1989 to 30 September 1989, CPIHL(UK) had an operating profit after taxation of US$17,557,000, bringing retained profits carried forward to US$94,048,000. As at 10 May 1990, an unaudited balance sheet of CPIHL(UK) showed accumulated profits of US$33,456,205.29.

118 The consideration for the shares in CPIL(UK) and CPIHL(UK), which was shares in CPIL(B), was calculated by reference to the net value of the assets of the companies. Reference has already been made to the fact that the balance sheet of CPIL(UK) as at 10 May 1990 showed net assets of US$550,102,063 and the balance sheet of CPIHL(UK) as at 10 May 1990 showed net assets of US$186,356,205.

119 CPH, in its income tax return for the year ended 30 June 1990, returned a net assessable capital gain of $11,511,405 in respect of the sale of the shares in the United Kingdom companies. MLG returned an assessable capital gain in respect of the sale of shares in CPIL(UK) of $40,132,953.

120 The Commissioner formed the view that Pt IVA applied to the transfers by MLG and CPH of shares in CPIL(UK) and CPIHL(UK), and to the liquidation of the two United Kingdom companies, loans, payment of dividends and liquidation distributions. Under s 177F(1) he made determinations to include in the assessable income of CPH for the year ended 30 June 1990 the sum of $69,681,830 apparently as though it were a dividend from CPIHL(UK), and the sum of $49,726,875 as though it were a dividend from CPIL(UK). He made a determination under s 177F(1) including in the assessable income of MLG the sum of $81,748,275 as though it were a dividend from CPIL(UK). The sum of $69,681,830 was the Australian dollar equivalent of the dividend of US$53 million declared by CPIHL(UK) on 22 March 1990. The sum of $49,726,875 was the Australian dollar equivalent of that portion of the dividend of US$100 million declared by CPIL(UK) on 22 March 1990 attributed by the Commissioner to CPH. The sum of $81,748,275 was the Australian dollar equivalent of that portion of the dividend of US$100 million declared by CPIL(UK) on 22 March 1990 attributed by the Commissioner to MLG.

121 The taxpayers argued, and Hill J agreed, that the Commissioner's determinations depended upon an impermissible pooling of the assets of CPIL(UK) and CPIHL(UK), because the profits available in CPIL(UK) for distribution were less than the amounts the Commissioner considered to have been distributed. The actual form of the determinations themselves appeared to show that such a process of pooling had been undertaken. Hill J concluded[29]:

> "What the determination makes clear is that the Commissioner never turned his mind to the question of what amount of profits existed in each company, let alone how much thereof was represented by the relevant disposal which he identified. The determination was made at a time when it was known that each target company had been liquidated. Once liquidated it could never have more profits than it had immediately before. It is clear that the discretion of the Commissioner under s 177E(1)(b) miscarried.
>
> As Pt IVA can not apply to a case under s 177F unless the Commissioner has formed the relevant opinion, and as he did not, the assessments, so far as they are dependent upon s 177E, must be set aside."

122 The Full Court found it unnecessary to deal with that matter.

123 The primary question is whether there was a scheme by way of or in the nature of dividend stripping, or one having substantially the effect of such a scheme. Unless the decision of the Full Court on that question is reversed, the other questions do not arise, and the Commissioner's appeals fail.

124 Hill J and the Full Court accepted the submission of the taxpayers that there was no scheme by way of or in the nature of dividend stripping. Their reasoning on the point was similar[30].

125 Hill J accepted that it was not essential to the character of a dividend stripping scheme that it produced advantages to the stripper, or that the stripper was unrelated, in a corporate sense, to the shareholders of the target company.

---

29 (1998) 88 FCR 21 at 52-53.

30 *CPH Property Pty Ltd v Commissioner of Taxation* (1998) 88 FCR 21 at 47-48; *Commissioner of Taxation v Consolidated Press Holdings Ltd (No 1)* (1999) 91 FCR 524 at 566-571.

He considered that what must be involved was a company, pregnant with accumulated profits out of which a dividend had been or would be likely to be declared; the anticipated liability of the shareholders to pay tax on such dividends; the preparation of the company for sale; the sale or allotment of shares in the company to the stripper; and the payment of a dividend to the stripper. But, obviously, not all sales of shares cum dividend, involve dividend stripping. In order to explain why, Hill J reverted to a familiar notion. He asked what conclusion an objective observer would reach as to why the scheme had taken place. He said[31]:

> "[A] scheme will only be a dividend stripping scheme if it would be predicated of it that it would only have taken place to avoid the shareholders in the target company becoming liable to pay tax on dividends out of the accumulated profits of the target company. It is that matter which distinguishes a dividend stripping scheme from a mere reorganisation.
>
> In my view an objective examination of what took place here would not lead to the conclusion that there was a dividend stripping scheme, or for that matter a scheme in the nature of dividend stripping, if that is a significantly different thing. At least one of the United Kingdom companies did have substantial accumulated profits – that much is clear. Both also had substantial investments in overseas companies from which dividends could be derived. The United Kingdom companies had no need to distribute accumulated profits. Any accumulated profits could have sat there forever. The sale of shares and subsequent liquidations were brought about not to enable the shareholders to receive capital instead of dividend distributions, although that was one consequence of what happened, but as part of a reorganisation of the United Kingdom companies for reasons which had to do with United Kingdom and Australian tax other than in respect of dividends which might be derived from the accumulated profits by way of dividend."

126 The Full Court[32] commenced by referring to four decided cases as examples of dividend stripping: *Bell, Newton, Hancock* and *Ellers Motor Sales*. Those cases had the following common characteristics: a target company, with substantial undistributed profits creating a potential tax liability; the sale or

---

31 (1998) 88 FCR 21 at 47-48.

32 (1999) 91 FCR 524 at 561. See also 566-571.

allotment of shares to another party; the payment of a dividend to the purchaser or allottee; the purchaser escaping Australian tax on the dividends so declared; and the vendor shareholders receiving a capital sum for their shares in an amount the same as or very close to the dividends paid to the purchasers. A further common characteristic of each case was that the scheme was carefully planned for the predominant if not sole purpose of the vendor shareholders avoiding tax on a distribution of dividends.

127 The Full Court pointed out that there were two features of the present case which were difficult to reconcile with a dividend stripping scheme. The first was that the assets of the United Kingdom companies did not consist wholly or even primarily of accumulated or current year profits. The net assets of CPIL(UK) (US$550,102,063) and CPIHL(UK) (US$186,356,205) substantially exceeded the amounts of such profits. The second was that the consideration received by each of the taxpayers for the sale of its shares in the United Kingdom companies (an allotment of shares in CPIL(B)) attracted capital gains tax in Australia. However, it was the purpose, or absence of purpose, which the Full Court regarded as decisive. Their Honours said[33]:

> "The widely understood connotation [of the expression 'dividend stripping'] was explained in the pre-1981 case law to which we have referred. The so-called dividend stripping cases invariably had as their dominant, if not exclusive, purpose the avoidance of tax that otherwise would or might be payable by the vendor shareholders in respect of the profits of the target companies. The apparent exceptions … are readily explicable on the basis that the particular scheme, insofar as it involved vendor shareholders, was complete before the dividend stripper began its operations and thus could not itself be described as a dividend stripping operation. The case law preceding the 1981 Act strongly supports the view that Parliament framed s 177E(1)(a) on the basis that dividend stripping operations necessarily involve a predominant tax avoidance purpose."

128 The Full Court agreed with Hill J that no purpose, let alone a dominant purpose, of avoiding tax on a distribution of dividends could be found in the present case. What was involved was a corporate reorganisation of which it could not be predicated that the purpose, or a purpose, was to convert an entitlement to dividends into a receipt of a capital sum.

---

33 (1999) 91 FCR 524 at 569.

129 In one respect, immaterial on the facts of the present case, there may have been a difference between Hill J and the Full Court as to the operation of s 177E(1)(a)(i). Hill J considered that a scheme would only be a scheme by way of or in the nature of dividend stripping if it would be predicated of it that it would only have taken place to avoid the shareholders in the target company becoming liable to pay tax on dividends out of the accumulated profits of the target company[34]. The Full Court considered that s 177E was intended to apply only to schemes which can be said to have the dominant purpose of tax avoidance; the required tax avoidance purpose 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[35]. Hill J may not have intended anything different from what was said by the Full Court. If there is a difference, the formulation of the Full Court is to be preferred, being consistent with the scheme of Pt IVA, and s 177A(5) in particular.

130 Reference has earlier been made to the fact that, before Hill J, although not in the Full Court or in this Court, the Commissioner sought to rely, in the alternative, upon the general provisions of s 177D to support the assessments. The basis on which Hill J rejected that argument is worth noting in the present context[36]. He said there was no tax benefit as defined in s 177C, and no conclusion could be drawn under s 177D as to a dominant purpose. He reiterated that there was no need for the United Kingdom companies to pay a dividend in the year in question, and there was nothing in the evidence to suggest that this was remotely likely to happen.

131 It was argued on behalf of the Commissioner that, within Pt IVA, s 177E operates independently of ss 177C and 177D, and that it is not a requirement of the operation of s 177E(1)(a) that there be an objective sole or dominant purpose of tax avoidance. Alternatively, it was submitted that, if an objective tax avoidance purpose is a requirement of s 177E, on an analysis of the scheme presently in question it should be concluded that a substantive or not incidental, if not the sole or dominant, purpose of the scheme "in relation to the

---

34 (1998) 88 FCR 21 at 49.

35 (1999) 91 FCR 524 at 569.

36 (1998) 88 FCR 21 at 53.

profits of the UK companies" was to enable CPH and MLG to receive capital instead of assessable dividend distributions and to enable the new shareholder, CPIL(B), to strip the UK companies of their profits in a tax free manner.

132 The argument of the Commissioner comes close to treating the words "a scheme by way of or in the nature of dividend stripping" as meaning a plan of action involving a transfer of the shares in a company with some accumulated profits, in consideration for a capital payment, followed by a payment of a dividend to the transferee. It pays insufficient regard to the context in which s 177E appears in the Act, and to the history of the use of the expression "dividend stripping" in the context of tax avoidance, and it treats the explanation that was given to Parliament as to the purpose of s 177E as, at the least, highly selective. To assert that s 177E operates "independently" takes the argument no further. It simply raises a question as to the nature and degree of independence involved. If it is intended to assert that s 177E has a meaning unaffected by its context, the assertion is wrong. If "dividend stripping scheme" were a term of art with a defined or definable literal meaning that could be identified separately from the context in which it appears, then it might be possible to construe and apply s 177E uninfluenced by notions of tax avoidance. But the expression does not have such a meaning. In framing s 177E, the legislature has adopted the language of tax avoidance, and it has placed s 177E in Pt IVA, for a reason related to the necessity to supplement, in a particular respect, the general anti-avoidance provisions. This is not an example of a statutory provision in respect of which a purposive construction is merely an available choice; such a construction is necessary.

133 Hill J and the Full Court found that there was no purpose of avoiding tax on distributions of profits. For the reasons already given, it is dominant purpose which matters. There was a corporate reorganisation, entered into for reasons related to the United Kingdom tax treatment of future earnings, and a desire to avoid double taxation. The disposal of shares involved in the reorganisation attracted liability in Australia to capital gains tax. A number of the characteristics common to schemes that have been regarded as typical dividend stripping schemes were absent. Above all, there was an absence of the particular taxation purpose which is the hallmark of such a scheme, and which is the reason why such schemes were intended to be covered by Pt IVA of the Act.

134 The conclusion of Hill J and the Full Court on this issue was correct.

135 It is necessary to turn to the issue on which Hill J and the Full Court disagreed: whether s 177E(1)(a)(ii) applies, ie, whether there was such a scheme

having substantially the effect of a scheme by way of or in the nature of dividend stripping.

136 Hill J took the view that there was a difference between a dividend stripping scheme and a scheme that has the effect of such a scheme; that a tax avoidance purpose was relevant to a characterisation of a scheme but not to a determination of its effect; and that effect is to be judged by reference to the vendor of shares in the target company and the target company itself[37]. He did not say exactly what kind of effect would suffice, although his views appear by inference. In the case of CPIL(UK), Hill J held, the necessary effect was absent. The company had a negative balance in its accumulated profits account. By the time the scheme was undertaken, no further profits were to be earned. The current year's profit could be offset by prior years' losses. On the other hand, in the case of CPIHL(UK), Hill J held that the necessary effect was present. As well as current year profits there were accumulated profits. The shareholders received capital for their shares in an amount including the amount standing to the credit of the accumulated profits account, and as a result of the liquidation there was a distribution in specie to the purchaser.

137 The difficulty with this process of reasoning is that it fails to follow through the logic of the purposive construction which Hill J had earlier applied to s 177E(1)(a)(i). Furthermore, as the Full Court observed, it gives s 177E(1)(a)(ii) a meaning which appears to make s 177E(1)(a)(i) otiose[38]. If sub-par (ii) meant what Hill J said, it would never be necessary to look past the effect of a scheme.

138 The expression "dividend stripping" must have the same meaning in sub-par (ii) as it has in sub-par (i). If it is proper to import a particular element of purpose into that meaning in sub-par (i), it is proper, and consistent, to do the same in sub-par (ii). The reference in sub-par (ii) to effect does not require the element of purpose to be discarded. In particular, it does not require that any scheme which produces a substantial consequence which is in any respect the same as a consequence of a dividend stripping scheme is within the sub-paragraph. If it were otherwise, a sale of shares cum dividend, followed by a payment of a dividend to the purchaser, would ordinarily be caught.

---

37 (1998) 88 FCR 21 at 49-50.

38 (1999) 91 FCR 524 at 571.

139 As the Full Court pointed out, a clue to the understanding of s 177E(1)(a)(ii) is to be found in the second of the two paragraphs in the Explanatory Memorandum last quoted above.

140 The Explanatory Memorandum had earlier referred, in connection with sub-par (i), to dividends or deemed dividends which, by reason of s 47(1) of the Act, would include distributions to shareholders by a liquidator to the extent to which they represented income, other than income applied to replace paid-up capital. What sub-par (ii) was aimed at was 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. Dividend stripping does not lose its connotation of tax avoidance purpose. But a scheme may have substantially the effect of a scheme by way of or in the nature of dividend stripping even though some means other than a dividend or deemed dividend is employed to make the distribution.

141 This construction of the provision is to be preferred. It is consistent, not only with the language of the statute, but also with the purposive construction to be given to sub-par (i). It carries the logic of that purposive construction through to sub-par (ii). It fits in with the context of Pt IVA.

142 The reasoning of the Full Court on this issue was correct.

143 It is unnecessary to consider the point on which Hill J decided the case in favour of the taxpayers in relation to CPIHL(UK), or the other points on which the taxpayers rely.

144 The dividend stripping issue should be resolved in favour of the taxpayers.

Conclusion

145 All these appeals should be dismissed with costs.