HIGH COURT OF AUSTRALIA

GAGELER CJ,
GORDON, EDELMAN, STEWARD, GLEESON, JAGOT AND BEECH-JONES JJ

Matter No S157/2025

COMMISSIONER OF TAXATION — APPELLANT

AND

GORDON STANLEY MERCHANT & ANOR — RESPONDENTS

Matter No S158/2025

GORDON STANLEY MERCHANT & ANOR — APPELLANTS

AND

COMMISSIONER OF TAXATION — RESPONDENT

Commissioner of Taxation v Merchant
Merchant v Commissioner of Taxation
[2026] HCA 39
Date of Hearing: 17 & 18 March 2026
Date of Judgment: 4 November 2026
S157/2025 & S158/2025

ORDER

Matter No S157/2025

1. *Appeal dismissed with costs.*

2. *Special leave to cross-appeal be granted and the cross-appeal be allowed with costs.*

3. The orders of the Full Court of the Federal Court of Australia made on 18 June 2025 be set aside and, in their place, it be ordered that:

(a) The appeal to that Court be allowed insofar as it relates to proceedings NSD907/2021.

(b) The orders of the primary judge made on 29 May 2024 in proceedings NSD907/2021 be set aside and, in their place, it be ordered that:

(i) The appeal be allowed.

(ii) The respondent's objection decision made on 27 July 2021 be set aside.

(iii) The applicant's objection be allowed.

(iv) The matter be remitted to the respondent for reassessment to give effect to the High Court's reasons for judgment.

(v) The respondent pay the applicant's costs of the appeal.

(c) The respondent pay the appellants' costs of the appeal insofar as they relate to proceedings NSD907/2021.

(d) That part of the appeal to that Court which relates to proceedings NSD908/2021 be dismissed with costs.

Matter No S158/2025

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation

K J Deards SC with D J Ananian-Cooper and N J Derrington for the appellant in S157/2025 and the respondent in S158/2025 (instructed by Gadens)

J T Gleeson SC with M J May and P F Bristow for the respondents in S157/2025 and the appellants in S158/2025 (instructed by HLS Tax Law)

Notice: This copy of the Court's Reasons for Judgment is subject to formal revision prior to publication in the Commonwealth Law Reports.

CATCHWORDS

Commissioner of Taxation v Merchant
Merchant v Commissioner of Taxation

Income tax (Cth) – Scheme to reduce tax – Tax benefit in connection with scheme – Dividend stripping – Where related entities – Where trustee of discretionary trust sold shares in Billabong International Ltd ("Billabong") to related self-managed superannuation fund resulting in capital loss – Where trustee of discretionary trust owned shares in Plantic Technologies Ltd ("Plantic") – Where other related companies forgave debts owed by Plantic for nil consideration – Where forgiveness of debts increased value of shares in Plantic – Where trustee of discretionary trust subsequently sold shares in Plantic resulting in capital gain – Where capital loss used to offset capital gain – Whether sale of Billabong shares entered into or carried out for dominant purpose of enabling taxpayer to obtain tax benefit within meaning of s 177D of *Income Tax Assessment Act 1936* (Cth) – Whether subsequent forgiveness of Plantic's debts by other related companies had substantially the effect of schemes by way of or in the nature of dividend stripping within meaning of s 177E(1)(a)(ii) of *Income Tax Assessment Act 1936* (Cth) – Whether cancellation of capital loss should be taken into consideration in determining application of s 177E.

Words and phrases – "alternative postulate", "anti-avoidance", "anti-avoidance provisions", "by way of or in the nature of", "capital gain", "capital loss", "common characteristics of dividend stripping", "counterfactual", "debt forgiveness", "debt forgiveness schemes", "deemed dividend", "disposal of property", "dividend", "dividend stripping", "dominant purpose", "essential meaning of dividend stripping", "notional amount", "objective purpose", "related entities", "sale of shares", "scheme", "substantial liability", "substantially the effect of a scheme", "supplementary code", "tax avoidance purpose", "tax benefit", "tax-free form", "taxable fact", "wash sale".

Income Tax Assessment Act 1936 (Cth), ss 177A, 177C, 177CB, 177D, 177E, 177F.
Income Tax Assessment Act 1997 (Cth), Pts 3-1, 3-6, s 100-50.
Taxation Administration Act 1953 (Cth), Pt IVC.

1 GAGELER CJ, JAGOT AND BEECH-JONES JJ. This matter involves the proper construction and application of provisions of Pt IVA of the *Income Tax Assessment Act 1936* (Cth) ("the 1936 Act"). The provisions concern schemes to reduce income tax, being either: (i) a scheme enabling a taxpayer to obtain a tax benefit (s 177D); or (ii) a scheme by way of or in the nature of dividend stripping or having substantially the effect of such a scheme (s 177E). If the provisions concerning the existence of either kind of scheme are satisfied, the powers of the Commissioner of Taxation ("the Commissioner") concerning the cancellation of tax benefits obtained by a taxpayer in connection with the scheme (s 177F) are engaged.

2 The Commissioner found that certain transactions satisfied the provisions of s 177D (a tax benefit scheme) and s 177E (a scheme having substantially the effect of a scheme by way of or in the nature of dividend stripping) of the 1936 Act. The transactions involved the "Merchant Group" of companies controlled by Gordon Merchant. The transactions accorded with advice from Ernst & Young ("EY") to Mr Merchant and the Merchant Group. The obtaining of the EY advice was prompted by a possible sale of a company within the Merchant Group, Plantic Technologies Ltd ("Plantic"), to a third party.

3 Gordon Merchant No 2 Pty Ltd ("GM2"), as trustee for the Merchant Family Trust ("the MFT"), owned all the shares in Plantic. Other companies within the Merchant Group, GSM Pty Ltd ("GSM"), Tironui Pty Ltd ("Tironui"), and Kahuna Pty Ltd ("Kahuna") as trustee for the Angourie Trust, had lent money to Plantic ("the Plantic loans"). GSM had lent Plantic about $50 million. Tironui had lent Plantic about $4 million. Kahuna as trustee for the Angourie Trust had lent Plantic about $1 million.

4 GM2, as trustee for the MFT, also owned shares in Billabong Ltd ("BBG"), then a publicly listed company. Another company within the Merchant Group was GSM Superannuation Pty Ltd ("GSMS"), the trustee for the Gordon Merchant Superannuation Fund ("the GMSF").

5 EY anticipated that the sale of Plantic might result in a significant capital gain in the MFT.

6 EY recommended that:

> "(a) the MFT to sell its shares in Plantic rather than for Plantic to sell its assets;
>
> (b) the relevant Merchant Group entities to forgive the Plantic Loans of about $55 million; and

(c) the [GMSF] ([GSMS] as trustee for the GMSF) to acquire from the MFT a substantial number of the MFT's high cost shares in BBG, with the result that the MFT would crystallise a significant capital loss."

7 The transactions thereafter occurred in accordance with EY's advice.

8 One transaction, found by the Commissioner to engage s 177D, is referred to as "the BBG share sale scheme". As the name indicates, this transaction involved GM2 as trustee for the MFT selling shares in BBG to GSMS as trustee for the GMSF, resulting in a capital loss to the MFT of $56,561,940.

9 The other transactions, found by the Commissioner to engage s 177E, are referred to as "the GSM and Tironui debt forgiveness scheme". GSM, Tironui, and Kahuna as trustee for the Angourie Trust each forgave their Plantic loans, such forgiveness being a condition precedent to a sale of all of the shares in Plantic by GM2 as trustee for the MFT to a third party company, Kuraray Co Ltd ("Kuraray"). The Commissioner did not contend that Kahuna's forgiveness of its Plantic loan engaged s 177E. The MFT's capital gain on the sale of the shares in Plantic to Kuraray was about $85 million.

10 Based on the Commissioner's s 177D finding in respect of the BBG share sale scheme, the Commissioner determined under s 177F(1)(c) of the 1936 Act that the MFT's capital loss of $56,561,940 in the year ended 30 June 2015 "was not incurred by [the MFT] during that year of income". This is referred to as "the s 177D determination". The Commissioner gave effect to the s 177D determination by: (i) issuing an amended assessment to GSM ("the GSM amended assessment") because GSM was the beneficiary with a 100% present entitlement to the income of the MFT in the 2015 year of income and, by reason of the s 177D determination, the MFT's net income for that year had increased to reflect the net capital gain of the sale of shares in Plantic ($22,628,756, based on the 50% discount for such gains); and (ii) issuing a penalty assessment to the MFT for the scheme shortfall amount calculated in accordance with Subdiv 284-C of Sch 1 of the *Taxation Administration Act 1953* (Cth) ("the 1953 Act").

11 Based on the Commissioner's s 177E finding in respect of the GSM and Tironui debt forgiveness scheme, the Commissioner determined under s 177F(1)(a) of the 1936 Act that the debts of Plantic forgiven by GSM and Tironui be included in Mr Merchant's assessable income in relation to the 2015 year of income. This is referred to as "the s 177E determination". The Commissioner gave effect to the s 177E determination by issuing an amended assessment to Mr Merchant in respect of the 2015 year of income in which his assessable income was increased by $54,407,000 to reflect the deemed tax benefit the Commissioner considered Mr Merchant had obtained from the GSM and Tironui debt forgiveness

scheme so that Mr Merchant's tax liability for that year increased to $30,570,438.12, comprising increased tax and a shortfall interest charge ("the Merchant amended assessment").

12 Mr Merchant, the MFT and GSM lodged objections in respect of the amended assessments. The Commissioner disallowed those objections. GSM and Mr Merchant each appealed to the Federal Court of Australia against the disallowance of their objections to the GSM amended assessment and the Merchant amended assessment respectively under Pt IVC of the 1953 Act. Under Pt IVC of the 1953 Act (ss 14ZZ(1)(a)(ii) and 14ZZO(b)(i)), GSM and Mr Merchant, as the persons objecting to the assessments, had the burden of proving, relevantly, that the amended assessments are "excessive or otherwise incorrect and what the assessment[s] should have been". The proceeding concerning the GSM amended assessment is referred to as "the s 177D proceeding". The proceeding concerning the Merchant amended assessment is referred to as "the s 177E proceeding".

13 The primary judge (Thawley J) rejected the substance of the arguments of GSM and Mr Merchant in the s 177D proceeding and the s 177E proceeding. The primary judge allowed the appeal in the s 177D proceeding only to the extent that GSM had proved that the Commissioner had made an error in the calculations leading to the GSM amended assessment and remitted that matter to the Commissioner to enable that error to be corrected. The primary judge dismissed the appeal in the s 177E proceeding.[1] In so doing, his Honour construed the relevant statutory provisions to mean that: (i) s 177E is to be applied without taking into account the s 177D determination (meaning, in this case, that the GSM and Tironui debt forgiveness scheme "included the BBG [s]hare [s]ale resulting in the crystallisation of the capital loss");[2] and (ii) s 177E does not require a complete, or a substantially complete, avoidance of tax, s 177E being capable of applying "where the tax avoidance purpose is to avoid the higher tax which would have been payable on dividends, albeit a lower amount of tax is still payable as a result of the scheme".[3]

14 GSM and Mr Merchant appealed to the Full Court of the Federal Court of Australia. The majority in the Full Court (McElwaine and Hespe JJ) dismissed GSM's appeal in relation to the s 177D proceeding and allowed Mr Merchant's appeal in relation to the s 177E proceeding to the extent that it concerned GSM

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1 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480.

2 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 566-567 [488].

3 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 568 [497].

forgiving Plantic's debts to GSM but rejected Mr Merchant's appeal in the s 177E proceeding to the extent that it concerned Tironui forgiving Plantic's debts to Tironui. Logan J in the Full Court would have allowed the appeal in full in relation to both the s 177D proceeding and the s 177E proceeding.[4]

15 To the extent they allowed the appeal, the principal basis of the reasoning of McElwaine and Hespe JJ was that the primary judge erred in respect of the two issues of statutory construction set out above.

16 First, McElwaine and Hespe JJ concluded that the primary judge erred in considering the GSM and Tironui debt forgiveness scheme under s 177E without regard to the s 177D determination. Distinguishing between the focus of s 177D on "purpose" and the focus of s 177E on "effect", their Honours said that "purpose looks to the intended outcome, the effect looks to the outcome in fact produced by the scheme. In other words, purpose has a prospective connotation whereas effect is evaluated with the benefit of hindsight."[5] In this case, by reason of the s 177D determination, the capital losses incurred by the MFT on the transfer of the BBG shares were cancelled and the MFT's net income for the 2015 year thereby increased to reflect the MFT's net capital gain on the sale of shares in Plantic.

17 According to McElwaine and Hespe JJ, while this circumstance was irrelevant to the question of the dominant tax avoidance purpose required by s 177E, it was relevant to the question of the effect of the scheme. Their Honours said:[6]

> "Once made, the [s 177D] determination had the retrospective effect of deeming the capital loss to have not been incurred. The effect of the statutory language is to deny the crystallisation of the capital loss. One cannot properly determine the effect of each of the GSM and Tironui [d]ebt [f]orgiveness [s]chemes without having regard to the statutory effect of the s 177D [d]eterminations [sic] that were in fact made. It follows, in our view, that in evaluating the effect of the two [d]ebt [f]orgiveness [s]chemes, it is necessary to have regard to and take into account the effect of the s 177D [d]eterminations [sic]."

18 Second, McElwaine and Hespe JJ considered that a scheme having the effect of a dividend stripping scheme is one in which there is a "quantitative

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4 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144.

5 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 218 [373].

6 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 218 [373].

element[]", s 177E not being satisfied merely by "some potential ... saving" on a dividend.[7] Rather, what is required to satisfy s 177E includes "the avoidance of a substantial liability to tax on a substantial proportion of the balance of the accumulated profits of" the entity said to be the subject of a scheme having substantially the effect of a scheme by way of or in the nature of dividend stripping.[8]

19 Taking into account the effect of the s 177D determination, their Honours concluded that, as the "amount of the [Tironui] debt forgiveness represented substantially all of the retained profits of Tironui" and the "purpose of the [Tironui debt forgiveness] scheme was to enable an associate of Mr Merchant [the MFT] to receive capital proceeds in an untaxed form whilst relieving him of the potential liability for top up tax on a distribution of profits of Tironui", the "Tironui [d]ebt [f]orgiveness [s]cheme had the substantial effect of a scheme by way of or in the nature of dividend stripping".[9]

20 Their Honours concluded that as the GSM debt forgiveness "represented about 25% of the accumulated profits of GSM"[10] and, taking into account the effect of the s 177D determination, the "capital gain made on the MFT's sale of the Plantic shares attributable to the GSM debt forgiveness is taxed in the hands of GSM (as the beneficiary of the MFT presently entitled to the income of that trust) in the year ended 30 June 2015",[11] the GSM debt forgiveness scheme "does not have the substantial effect of a scheme by way of or in the nature of dividend stripping".[12]

21 Given the mixed success each party achieved before the Full Court, each party appealed, cross-appealed or filed a notice of contention in respect of the parts

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7 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 222 [395], [399].

8 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 223 [402].

9 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 219 [381], 223 [400].

10 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 221 [392].

11 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 221 [393].

12 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 222 [394]. See also at 223 [402].

of the orders of the Full Court with which they disagreed. As will be explained, the primary judge did not err in construing or applying the statutory provisions.

Principal statutory provisions

22 In Pt IVA of the 1936 Act, s 177A provides in part that:

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

capital loss has the meaning given by subsection 995-1(1) of the *Income Tax Assessment Act 1997*.

...

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.

taxpayer includes a taxpayer in the capacity of a trustee.

...

(3) The reference in the definition of ***scheme*** in subsection (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.

(4) A reference in this Part to the carrying out of a scheme by a person shall be read as including a reference to the carrying out of a scheme by a person together with another person or other persons.

(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."

23 Section 177C includes the following:

"(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:

...

(ba) a capital loss being incurred by the taxpayer during a year of income where the whole or a part of that capital loss would not have been, or might reasonably be expected not to have been, incurred by the taxpayer during the year of income if the scheme had not been entered into or carried out; or

...

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

...

(e) in a case to which paragraph (ba) applies – the amount of the whole of the capital loss or of the part of the capital loss, as the case may be, referred to in that paragraph; and

..."

24 Section 177CB includes these provisions:

"(1) This section applies to deciding, under section 177C, whether any of the following (***tax effects***) would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:

...

(c) the whole or a part of a capital loss not being incurred by the taxpayer;

...

(2) A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).

(3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.

(4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:

(a) have particular regard to:

(i) the substance of the scheme; and

(ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but

(b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme)."

25 Section 177D includes the following:

"(1) This Part applies to a scheme if it would be concluded (having regard to the matters in subsection (2)) 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:

(a) enabling a taxpayer (a ***relevant taxpayer***) to obtain a tax benefit in connection with the scheme; or

(b) 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.

(2) For the purpose of subsection (1), have regard to the following matters:

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

(b) the form and substance of the scheme;

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

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

(e) 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;

(f) 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;

(g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;

(h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

(3) Despite subsection (1), this Part applies to the scheme only if the relevant taxpayer has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme.

..."

26 Section 177E includes the following:

"(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 or her opinion, represented by the disposal of the property referred to in paragraph (a), an amount (in this subsection 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 subsection (1), a reference in that subsection to the disposal of property of a company shall be read as including a reference to:

...

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

...

(3) In this section, ***property*** includes a chose in action and also includes any estate, interest, right or power, whether at law or in equity, in or over property."

27 Section 177F includes the following:

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

...

(c) in the case of a tax benefit that is referable to a capital loss or a part of a capital loss being incurred by the taxpayer during a year of income – determine that the whole or a part of the capital loss or of the part of the capital loss, as the case may be, was not incurred by the taxpayer during that year of income; or

...

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

...

(3) Where the Commissioner has made a determination under subsection (1) or (2A) in respect of a taxpayer in relation to a scheme to which this Part applies, the Commissioner may, in relation to any taxpayer (in this subsection referred to as the ***relevant taxpayer***):

(a) if, in the opinion of the Commissioner:

(i) there has been included, or would but for this subsection be included, in the assessable income of the relevant taxpayer of a year of income an amount that would not have been included or would not be included, as the case may be, in the assessable income

of the relevant taxpayer of that year of income if the scheme had not been entered into or carried out; and

(ii) it is fair and reasonable that that amount or a part of that amount should not be included in the assessable income of the relevant taxpayer of that year of income;

determine that that amount or that part of that amount, as the case may be, should not have been included or shall not be included, as the case may be, in the assessable income of the relevant taxpayer of that year of income; or

...

(5) Where, at any time, a taxpayer considers that the Commissioner ought to make a determination under subsection (3) in relation to the taxpayer in relation to a year of income, the taxpayer may post to or lodge with the Commissioner a request in writing for the making by the Commissioner of a determination under that subsection.

(6) The Commissioner shall consider the request and serve on the taxpayer, by post or otherwise, a written notice of the Commissioner's decision on the request.

(7) If the taxpayer is dissatisfied with the Commissioner's decision on the request, the taxpayer may object against it in the manner set out in Part IVC of the [1953 Act]."

The primary judge's key factual findings

The surrounding circumstances

28 Mr Merchant founded BBG, which was listed on the Australian Stock Exchange in 2000. Mr Merchant was and remained in control of BBG, the MFT being the largest shareholder in BBG until March 2014.

29 From about 2007 the price of shares in BBG was declining. BBG ceased paying dividends in 2012. There was no realistic possibility that BBG would pay dividends in the future.

30 By November 2010, GM2 as trustee for the MFT owned all the shares in Plantic, a start-up technology company, the assets of which consisted mainly of intellectual property and bespoke machinery. The Plantic loans from GSM ($50 million), Tironui ($4 million), and Kahuna as trustee for the Angourie Trust

($1 million) were made between November 2010 and April 2015. Plantic's funding needs were unpredictable, and it had never made a profit.

31 From 2012, when BBG stopped paying dividends, the MFT's operating expenses exceeded its income. The shortfall was managed by GM2 as trustee for the MFT selling substantial assets between 2012 and 2015. The primary judge referred to these as the ten "realisation events".[13]

32 From 2009 to 2015, the GMSF had paid Mr Merchant a pension, ranging from about $450,000 to $520,000.

33 In 2012, the GMSF resolved to adopt an investment strategy in which, amongst other things, it would invest 0-40% in shares in listed companies.

The anticipated sale of Plantic and consequences

34 By June 2014, Mr Merchant had "cold feet" about Plantic and wanted to sell it. EY was the tax adviser appointed for the proposed sale. Negotiations proceeded with an initial potential purchaser. EY considered that a sale of the shares in Plantic would be "best" for Mr Merchant "because of the ability to realise capital losses on BBG shares". EY continued to advise to this effect, noting on 27 August 2014 that a "key aspect of the transaction that delivers a favourable outcome to [Mr Merchant] is that the amounts owed by Plantic to his related entities are waived/forgiven".

35 On 2 September 2014, GM2 as trustee for the MFT transferred 10,344,828 BBG shares to GSMS as trustee for the GMSF for $5,844,827.82. By this BBG share sale, the MFT realised a capital loss of $56,561,940 in the 2015 income year.

36 On 3 September 2014, EY summarised a range of tax outcomes in a table on the basis of assumptions that included: (i) the "value of the loans to Plantic from [GSM] and [Tironui] at the time of the transaction is $50M"; and (ii) "[the] MFT has $10M capital losses at 30 June 2013. [The] MFT will sell [BBG] shares to the [GMSF] during the 2015 year and realise further capital losses of $60M." The table included the following:

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13 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 537 [293].

	Tax paid by Plantic	Top up tax paid on GSM dividend	Top up tax paid on Plantic dividend	Total tax paid	Capital losses used	Comments
Share sale – related party loans forgiven	-	-	-	-	$76,000,000	Best outcome and least complex option

37 An accompanying summary made two points: (i) "[d]ebt forgiveness gives a higher capital gain (and therefore use of more capital losses) but a reduction in top-up tax payable ie reduce current tax but potentially increase future taxes if would otherwise be able to use capital losses"; and (ii) "[r]isk of anti-avoidance provisions applying to this tax benefit mitigated because occurs as normal part of commercial sale process with an arms length party".

38 The negotiations for the sale of shares in Plantic to the first potential buyer fell through but another buyer, Kuraray, emerged. The share sale agreement in respect of the sale of the shares in Plantic by GM2 as trustee for the MFT to Kuraray was executed on 31 March 2015. Clause 2.1 provided that completion of the sale must not occur until all conditions in that clause were fulfilled or waived. Condition 3 required GM2 as the vendor to procure the forgiveness of the Plantic loans. Clause 12 included an indemnity from GM2 as the vendor to Kuraray as the purchaser in respect of "Tax Claims". Completion of the Plantic share sale agreement occurred on 2 April 2015. The upfront payment from Kuraray to GM2 as trustee for the MFT was US$45,558,827.30.

39 Also on 2 April 2015, GSM, Tironui, Kahuna as trustee for the Angourie Trust, and Plantic executed a deed of forgiveness, which provided that with effect "from the Effective Time" each of GSM, Tironui and Kahuna as trustee for the Angourie Trust would irrevocably and unconditionally forgive and release Plantic from all liability under or in respect of the total amount owing (including any outstanding principal and accrued interest) by Plantic to each of those entities. The "Effective Time" was defined to mean immediately prior to "Completion". "Completion" was defined to mean "completion of the sale and purchase of all of the shares in Plantic pursuant to a share sale agreement dated on or around the date of this deed between [the MFT and Kuraray]".

The BBG share sale scheme

40 The primary judge recorded that the Commissioner identified the BBG share sale scheme in these terms:[14]

> "The scheme includes all of the actions and decisions that resulted in the transfer of 10,344,828 BBG shares from [the] MFT to [the] GMSF. This includes Mr Merchant and Ms Paull, as directors of GM2 executing a standard share transfer form to transfer the BBG shares off-market to [the] GMSF for $5.8 million, with a recorded transfer date of 2 September 2014."

The primary judge recorded that the parties to the scheme included "Mr Merchant, the (trustee of) the MFT [GM2], and the (trustee of) the GMSF [GSMS]".[15]

41 It is apparent that the first sentence of the Commissioner's description refers to "all of the actions and decisions that resulted in the transfer of" the BBG shares, whereas the second sentence describes only one action included in that description. The primary judge, later in his reasons, made clear that the context of the BBG share sale scheme also included the anticipated and actual sale of the shares in Plantic on the basis that the Plantic loans would be forgiven, with the result that the sale of Plantic, be it by share sale or otherwise, would result in the MFT realising a capital gain which could be substantially offset by the MFT realising a capital loss on the sale of the BBG shares by the MFT to the GMSF.[16]

The GSM and Tironui debt forgiveness scheme

42 The primary judge recorded that the Commissioner (ultimately) identified the GSM and Tironui debt forgiveness scheme in these terms:[17]

> "(1) *First*, the MFT sold the BBG [s]hares to the GMSF on 4 September 2014, crystallising a capital loss of $56,561,940 in the 2015 income year.
>
> (2) *Secondly*, on 31 March 2015, the MFT entered a contract for the sale of the Plantic shares to Kuraray containing as Condition 3 of cl 2.1

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14 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 528 [241].

15 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 528 [242].

16 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 546 [344], 547 [353]-[355].

17 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 564 [473].

> of the [Plantic share sale agreement] a condition precedent that the MFT must procure the release and forgiveness of Plantic's loans to GSM and Tironui.
>
> (3) *Thirdly*, on 2 April 2015, GSM and Tironui released and forgave the Plantic Loans for nil consideration from either Plantic or the MFT, with a corresponding increase in the market value of the Plantic shares."

43 The parties to the GSM and Tironui debt forgiveness scheme as identified by the Commissioner included GSM, Tironui, Plantic, and GM2 as trustee for the MFT, but did not include Kuraray.

The Courts below – s 177D proceeding

The primary judge

44 According to the primary judge, Mr Merchant believed BBG could be successful under different management and wanted to retain control of BBG. As the primary judge recorded:[18]

> "Whilst the MFT sold a substantial number of shares in BBG in 2006, Mr Merchant wanted to maintain a substantial shareholding by the Merchant Group in BBG and wanted to retain a position on the BBG Board. From November 2007 until sometime after the sale of the Plantic shares on 2 April 2015, Mr Merchant consistently acquired BBG shares, including in share issues or capital raisings so as not to have the Merchant Group's shareholding diluted ...
>
> [He] did not want to sell, and would not have sold, BBG shares to unrelated third parties."

45 Mr Merchant authorised GM2 as trustee for the MFT to sell BBG shares to GSMS as trustee for the GMSF "because it was recommended to him by EY as part of what EY considered desirable for the structure of the anticipated sale of shares in Plantic, in particular because the BBG [s]hare [s]ale would crystallise a capital loss which could be used against the capital gain which was anticipated to be higher by reason of the proposed forgiveness of the Plantic Loans".[19] "The BBG [s]hare [s]ale was undertaken for the purpose of a future sale of Plantic to an

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18 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 533-534 [267]-[268].

19 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 517 [189].

interested third party. A sale of Plantic was the desired outcome and it was also objectively likely as at 2 September 2014."[20]

46 As the primary judge put it, the BBG share sale was not "undertaken for a purpose of funding any cash shortfall in the MFT".[21] Accordingly, the primary judge rejected Mr Merchant's assertion that he "transferred the BBG shares to [the] GMSF on 2 September 2014 because [he] needed to free up cash as soon as possible to continue funding Plantic".[22] In so doing the primary judge considered, amongst other things: (i) that there was no documentary evidence in the months immediately before 4 September 2014 suggesting a need for the GMSF's cash to fund Plantic or any other expenses of the MFT; (ii) the amount of cash available to the MFT as at 4 September 2014; (iii) the availability of easy means for the MFT to obtain cash, if it were really necessary, from the sale of assets, consistently with how the MFT had been funded from 2012, including the availability of a facility with the Commonwealth Bank of Australia having an approved credit limit of $35 million; (iv) the evidence that EY advised that the BBG share sale would provide "a good 'loss' on paper" so that there would be "zero tax payable" in the context of the contemplated sale of Plantic either by a share sale or an asset sale; and (v) Mr Merchant's evidence that he undertook the BBG share sale because he was "directed" to by EY.[23]

47 Further, the primary judge found that the GMSF did not buy the BBG shares because "they were considered to be a good investment from the perspective of the GMSF".[24] Rather, the purchase of the BBG shares by the GMSF was inconsistent with the GMSF's investment strategy and the BBG share sale was carried out "for the predominant purpose of crystallising a capital loss in the MFT"[25] and not for any investment purpose of the GMSF.[26]

48 Having considered the factors in s 177D(2), the primary judge found that: (i) the objective dominant purpose of Mr Merchant, the MFT and the GMSF in

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20 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 541 [317].

21 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 538 [295].

22 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 539-540 [309].

23 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 541 [319].

24 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 544 [333].

25 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 544 [335].

26 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 545 [339].

entering into the BBG share sale scheme was to obtain a tax benefit, being the capital loss on the sale of the BBG shares by the MFT to the GMSF; (ii) it was not a substantial purpose of the BBG share sale to provide funding to the MFT; and (iii) accordingly, Mr Merchant and GSM had not discharged the onus of establishing that the general anti-avoidance provisions in Pt IVA of the 1936 Act did not apply.[27]

The Full Court

49 As noted, the majority in the Full Court found no error in the reasoning or conclusions of the primary judge in respect of the s 177D proceeding.[28]

The Courts below – s 177E proceeding

The primary judge

50 The primary judge considered that the "debt forgiveness transform[ed] the undistributed profits of GSM and Tironui into equity, thereby increasing the amount a purchaser would pay for the Plantic shares" and, on the sale of the shares in Plantic, "the profits of GSM and Tironui have been converted to [the MFT's] equity [in Plantic] and ... tax is avoided".[29]

51 As the primary judge put it, the "assets of the target companies (GSM and Tironui) were, through the debt forgiveness in the context of the sale of Plantic, in substance transferred to the MFT. ... [O]bjectively, the purpose of that was to enable Mr Merchant to access the profits via the trust in a tax effective manner, rather than receiving dividends from GSM and Tironui on which he would have had to pay tax at marginal rates."[30] Further, "Mr Merchant would not choose to make a capital distribution to GSM and Tironui, and thereby expose himself again to top up tax as a shareholder of those entities, rather than to distribute the profits to himself in a manner which avoided that consequence".[31] Therefore, "the objective purpose of the loan forgiveness was to permit the amounts forgiven to be accessed in a way in which substantially less tax would be paid than if those

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27 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 554-555 [405]-[408].

28 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 203 [299].

29 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 565 [477].

30 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 568 [505].

31 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 568-569 [506].

amounts were repaid to GSM and Tironui and received by Mr Merchant by way of dividends".[32]

52 The primary judge found:[33]

> "The debt forgiveness was undertaken for the dominant purpose of moving value away from GSM and Tironui into the MFT. The BBG [s]hare [s]ale was undertaken for the dominant purpose of obtaining a tax benefit, namely the crystallisation of a capital loss. These transactions were entered into with the purpose of maximising the outcome for Mr Merchant on the basis of a share sale in which the potential purchasers were prepared to pay the amounts they were relevantly offering."

53 The primary judge further found:[34]

> "Were it not for the forgiveness of the Plantic Loans, GSM (the target company) would have had substantial undistributed profits creating a potential tax liability for Mr Merchant who would have had to pay tax at marginal rates on dividends paid to him. No consideration was provided for the forgiveness of the loans such that the forgiveness had the effect of:
>
> - reducing the undistributed profits of GSM and Tironui; and
> - converting the Plantic Loans to equity, thereby increasing the value of Plantic's shares and the consideration paid by Kuraray for those shares.
>
> Because of the BBG [s]hare [s]ale, the MFT would not have a capital gain. The effect of the scheme was, in substance, to transfer undistributed profits in GSM and Tironui to the MFT from where they could be distributed (including to Mr Merchant) at substantially lower rates of tax.
>
> Mr Merchant has not discharged the onus of establishing that the broader scheme did not have substantially the effect of a scheme by way of or in the nature of dividend stripping."

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32 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 569 [508].

33 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 575 [548].

34 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 580 [571]-[573].

The Full Court

54 As noted, the majority in the Full Court concluded that the primary judge had erred in construing s 177E of the 1936 Act on the basis that the "effect of a scheme" was to be determined without reference to the s 177D determination.[35] Their Honours also considered that the primary judge had otherwise erred in his reasoning and conclusions about the application of s 177E(1)(a)(ii) to the facts as found, in that their Honours considered the provision required avoidance of a substantial liability to tax on a substantial proportion of the relevant entity's accumulated profits.[36]

Statutory construction issues

Applying ss 177D, 177E and 177F of the 1936 Act

55 While the first issue of statutory construction can be expressed as confined to the meaning of "effect" in s 177E(1)(a)(ii) of the 1936 Act and resolved on that basis, there is a more fundamental matter underlying this issue. The more fundamental matter is the interaction of ss 177D and 177E with s 177F.

56 It may be accepted that, as McElwaine and Hespe JJ said, because "purpose" in s 177D(1) of the 1936 Act focuses on objectively ascertained intended outcomes it has a "prospective connotation",[37] the relevant purpose being the objectively ascertained end, object or outcome a person who entered into or carried out the scheme intends to be achieved, whether or not that end, object or outcome is in fact achieved by the carrying out of the scheme. For this reason, their Honours rightly agreed with the primary judge that "the s 177D [d]etermination made by the Commissioner to cancel the capital loss on the transfer of the BBG shares was not relevant to a consideration of the purpose of the GSM and Tironui [d]ebt [f]orgiveness [s]cheme[]".[38] It may also be accepted that, as their Honours observed, the "effect" of a scheme as referred to in s 177E(1)(a)(ii) involves hindsight as the focus is the outcome the scheme in fact has had.[39]

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35 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 218 [373].

36 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 223 [402].

37 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 218 [373].

38 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 212 [343].

39 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 218 [373].

57 This does not mean, however, that in determining if there is a scheme having substantially the effect of a scheme by way of or in the nature of dividend stripping, s 177E(1)(a)(ii) permits the effect of any determination by the Commissioner under s 177F(1)-(2A) to be taken into account as part of the "effect of a scheme" under s 177E(1)(a)(ii). Rather, the relevant "effect" in s 177E(1)(a)(ii) is confined to the effect of the scheme itself. So much is apparent from the terms of s 177E(1)(a)(ii), which refer to "*a scheme having* substantially *the effect of* a scheme by way of or in the nature of a dividend stripping" (emphasis added).

58 More fundamentally, if "effect" in s 177E(1)(a)(ii) were construed to mean the "effect" of the scheme including any effect of a determination made by the Commissioner under s 177F, the legislation would be self-defeating. Take s 177E(1)(a)(ii) itself as an example. If the provision is satisfied, s 177E(1)(e)-(g) "have effect". By those provisions there is a deemed tax benefit to the taxpayer of the notional amount. The Commissioner's powers under s 177F(1)-(2A) are then available. On the approach of McElwaine and Hespe JJ, however, if the Commissioner makes a determination in exercise of those powers, the determination would mean that the scheme did not have the required "effect" in order to satisfy s 177E(1)(a)(ii), so that the powers under s 177F(1)-(2A) would not then be available. This self-defeating circularity in the operation of Pt IVA of the 1936 Act is untenable. Nor can Pt IVA be construed so as to operate by reference to the arbitrary matter of the making of determinations or not by the Commissioner.

59 It is necessary to recognise that ss 177D and 177E have no function beyond the enabling of the Commissioner to make a determination under s 177F. Each of ss 177D and 177E enables the Commissioner to make a determination under s 177F because each provision involves a tax benefit which, as referred to in s 177F(1), "has been obtained, or would but for this section be obtained". These words disclose that ss 177D and 177E are to be applied to the scheme by reference to the tax benefit obtained or deemed to be obtained (if the tax benefit has been obtained at the time the decision-maker applies the provisions) or to the tax benefit or deemed tax benefit that would be obtained (if the tax benefit has not yet been obtained at the time the decision-maker applies the provisions), irrespective of any determination under s 177F. So construed, whether the Commissioner has made or intends to make any determination under s 177F at the time ss 177D and 177E are applied is immaterial to the application of both provisions.

60 To the extent that such a construction might result in unfairness to a taxpayer, s 177F(3) is a satisfactory answer. While the ameliorative effect of that provision depends on the opinion of the Commissioner, the formation of that

opinion must be in accordance with law[40] in circumstances where: (i) a taxpayer may request in writing that the Commissioner makes a determination under s 177F(3) – in which event s 177F(6) ensures that the Commissioner is bound to consider doing so in accordance with law and would be amenable to a writ in the nature of mandamus requiring such a determination to be made within a reasonable time one way or another;[41] and (ii) s 177F(7) provides the taxpayer with a right of review under Pt IVC of the 1953 Act in respect of the Commissioner's decision.

61 For these reasons, the majority's construction in the Full Court of the meaning of "effect" in s 177E(1)(a)(ii) of the 1936 Act, as extending to include the effect of a determination under s 177F(1)-(2A), was in error. The primary judge's approach to the meaning of "effect" in s 177E(1)(a)(ii), confining it to the effect of the scheme itself and not the effect of any determination under s 177F(1)-(2A), was correct. More fundamentally, neither s 177D nor s 177E is to be applied taking into account any existing or potential determination under s 177F.

"For the purpose of" – s 177D

62 Section 177D(1) expressly requires that it would be concluded that a person entered into or carried out the scheme "for the purpose of", relevantly, enabling a taxpayer to obtain a tax benefit. Section 177A(5) therefore applies so that, to satisfy the provision, that purpose must be "the dominant purpose" if the scheme has been entered into for "2 or more purposes".

63 The orthodox approach to that requirement in s 177D(1) was accordingly explained in *Federal Commissioner of Taxation v Spotless Services Ltd*[42] as involving the question whether "a reasonable person would conclude that the taxpayers entered into or carried out the scheme for the dominant purpose of enabling the taxpayers to obtain a tax benefit in connection with the scheme",[43] the

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40 eg, *R v Connell; Ex parte The Hetton Bellbird Collieries Ltd* (1944) 69 CLR 407 at 431, referring to *Metropolitan Gas Co v Federal Commissioner of Taxation* (1932) 47 CLR 621 at 632, quoting *Sharp v Wakefield* [1891] AC 173 at 179; *Water Conservation and Irrigation Commission (NSW) v Browning* (1947) 74 CLR 492 at 496, 498, 504-505; *Avon Downs Pty Ltd v Federal Commissioner of Taxation* (1949) 78 CLR 353 at 360.

41 eg, *The Commonwealth v AJL20* (2021) 273 CLR 43 at 73-74 [52]-[53].

42 (1996) 186 CLR 404.

43 (1996) 186 CLR 404 at 422.

dominant purpose being the "purpose which was the ruling, prevailing, or most influential purpose".[44]

64 The requirement of a dominant purpose of avoiding a tax liability applies also to s 177E(1) even though that provision does not contain an express purposive requirement.[45]

65 The submissions for Mr Merchant and GSM emphasised the part of the Explanatory Memorandum associated with the introduction of Pt IVA of the 1936 Act, which explained s 177A(5) in these terms:[46]

> "Sub-section (5) is a provision of some consequence and is designed as part of the measures necessary to give effect to the intention that the relevant tax-motivated purpose that may bring Part IVA into operation is a sole or dominant purpose. Sub-section (5) relates principally to the words at the end of proposed section 177D which refer to a person having acted for 'the purpose' of enabling a taxpayer to obtain a tax benefit. That language refers to a person's sole purpose but, by reason of sub-section 177A(5) the expression is in the case of a scheme with more than one purpose to include also a dominant purpose, ie, *a purpose that outweighs all other purposes put together*."

66 It was submitted for Mr Merchant and GSM that this meaning of "dominant", as "a purpose that outweighs all other purposes put together", is not uncommon. The contrary meaning of "dominant purpose" would be a purpose that outweighs each other purpose (but not necessarily all such other purposes together).[47] The potential problem with applying the distinction between a purpose that outweighs each other purpose and a purpose that outweighs all other purposes put together is that it may encourage a form of arithmetical thinking, in that a purpose that outweighs all other purposes together must be a purpose that, if

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44 (1996) 186 CLR 404 at 416. See also *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216 at 227 [16].

45 *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 at 274-275 [131]-[132].

46 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 8 (emphasis added).

47 See, eg, *Sydney Airports Corporation Ltd v Singapore Airlines Ltd* [2005] NSWCA 47 at [55]; *Commissioner of Taxation v Pratt Holdings Pty Ltd* (2005) 225 ALR 266 at 278-280 [30]; *AWB Ltd v Cole* (2006) 152 FCR 382 at 411 [105]-[106].

capable of being expressed arithmetically, would be greater than 50% of all of the purposes.

67 Where the concept of "purpose" itself, however, means the end, object or outcome a reasonable person in the circumstances would attribute as the end, object or outcome sought to be achieved by the entering into or carrying out of the scheme, the concept of a "dominant" purpose (in the event more than one such purpose is so attributable) does not lend itself to arithmetical expression. The question is one of overall characterisation in which the task is to determine if, in the case of more than one purpose, the tax benefit purpose was the "ruling, prevailing, or most influential purpose". No doubt if, on the facts, the objectively ascertainable purposes were of equal weight, the test of "dominant" purpose would not be satisfied as neither one nor any other purpose would rule, prevail, or be more influential than any other. Beyond these considerations, no more should be said than that each case is to be determined on its own facts at the time of the entry into or the carrying out of the scheme (as applicable).

A scheme by way of or in the nature of dividend stripping or having substantially the effect of such a scheme – s 177E

68 The next issue of statutory construction is whether the concept of "dividend stripping" in the 1936 Act, including s 177E(1), involves the quantitative elements which McElwaine and Hespe JJ expressed as "the avoidance of a substantial liability to tax on a substantial proportion of the balance of the accumulated profits of" the entity said to be the subject of a scheme having the effect of a dividend stripping scheme.[48] In support of this conclusion their Honours particularly relied on *Commissioner of Taxation v Consolidated Press Holdings Ltd [No 1]*,[49] in which French, Sackville and Sundberg JJ observed that the "critical point" in a dividend stripping scheme is "that the vendor shareholders receive a consideration which is in a tax-free or largely tax-free form".[50] While French, Sackville and Sundberg JJ said that s 177E(1)(a)(i), in referring to a "scheme by way of or in the nature of dividend stripping", "suggests that variations from the paradigm will not necessarily result in the scheme being excluded from the first limb, provided it retains the central characteristics of a dividend stripping scheme",[51] the emphasis which McElwaine and Hespe JJ placed on the outcome or effect of the scheme

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48 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 223 [402].

49 (1999) 91 FCR 524.

50 (1999) 91 FCR 524 at 567 [159].

51 (1999) 91 FCR 524 at 566 [156].

being "consideration ... in a tax-free or largely tax-free form" appears to underlie their Honours' conclusions in the present case.[52]

69 Construing "dividend stripping" to require "the avoidance of a substantial liability to tax on a substantial proportion of the balance of the accumulated profits of" the relevant entity imposes limitations on the concept of dividend stripping not apparent from the term itself or its context or purpose in the 1936 Act. As Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ explained in *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* ("*Consolidated Press HCA*"):[53]

> "s 177E ... 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. ... [T]hat 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."

70 Their Honours recorded that the explanatory materials that accompanied the Bill first introducing the concept of dividend stripping into the 1936 Act[54] distinguished between: (i) a "dividend-stripping operation involv[ing] the purchase by a share-trading company of shares in another company which has accumulated profits" where a "payment of a dividend is ... 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", with the result 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

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52 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 209 [324], 217 [368], 223 [402].

53 (2001) 207 CLR 235 at 265 [100].

54 *Income Tax Assessment Bill 1972* (Cth), enacted as the *Income Tax Assessment Act (No 3) 1972* (Cth).

full tax";[55] and (ii) "normal commercial transactions, eg, in the purchase in the ordinary way of shares cum div [ie, with the right to receive any dividend owing] and the subsequent sale of those shares".[56] In fact, however, as their Honours explained, 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".[57] As their Honours put it:[58]

> "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."

71 The statements in the subsequent Explanatory Memorandum associated with the introduction of Pt IVA into the 1936 Act nearly a decade later[59] (to which Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ also referred in *Consolidated Press HCA*[60]) expose the legislature's concern that the previous anti-avoidance provisions, despite the wide ambit of their language, had been given a

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55 (2001) 207 CLR 235 at 267 [102], referring to Australia, House of Representatives, *Income Tax Assessment Bill 1972* and *Income Tax (International Agreements) Bill 1972*, Explanatory Memorandum at 3-4.

56 (2001) 207 CLR 235 at 267 [103], referring to Australia, House of Representatives, *Income Tax Assessment Bill 1972*, Explanatory Notes to Amendments at 2.

57 (2001) 207 CLR 235 at 267 [104].

58 (2001) 207 CLR 235 at 267-268 [104].

59 *Income Tax Laws Amendment Bill (No 2) 1981* (Cth), enacted as the *Income Tax Laws Amendment Act (No 2)* 1981 (Cth).

60 (2001) 207 CLR 235 at 268-269 [108]-[110].

"very restricted operation ... by the course of judicial decision".[61] This Explanatory Memorandum explained that Pt IVA of the 1936 Act was designed to be:[62]

> "an effective general measure against those tax avoidance arrangements that – inexact though the words be in legal terms – are blatant, artificial or contrived. In other words, the new provisions are designed to apply where, on an objective view of the particular arrangement and its surrounding circumstances, it would be concluded that the arrangement was entered into for the sole or dominant purpose of obtaining a tax deduction or having an amount left out of assessable income."

72 Against that background, the Explanatory Memorandum also said that:[63] (i) s 177E is 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 taxable dividends"; (ii) s 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" (ie, as required by s 177D(1)); (iii) dividend stripping transactions "are structured so that profits ... effectively stripped from the company do not bear tax"; and (iv) in "the category of schemes having substantially the same effect [as a dividend stripping scheme] 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".

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61 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 1-2, referring to *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330 at 337.

62 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 2.

63 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 4, 14. See also *Consolidated Press HCA* (2001) 207 CLR 235 at 268-269 [108], [110].

73 To the same effect, in the Second Reading Speech in respect of the introduction of Pt IVA into the 1936 Act, it was explained that:[64]

> "Part IVA contains a supplementary code applicable to schemes that are commonly called dividend stripping – and to similar schemes – under which shareholders in effect receive company profits in a tax free form, in substitution for taxable dividends. The reason for such specially tailored provisions within the new general measures is to be found in particular features of such schemes when viewed in the context of the structure it has been necessary to give to the basic provisions of Part IVA. It is this: When profits have been accumulating in a company, possibly for extended periods, there will be no clear answer to the question whether those profits might reasonably be expected to have been distributed as dividends if the scheme had not been entered into. As often as not, that expectation could not be established to exist. Where this is so – and despite the fact that the company had been stripped of profits – the result under the basic provisions would be that there is technically no 'tax benefit' obtained. Dividend stripping cannot be allowed to escape the new provisions on a technicality of this kind.
>
> ...
>
> The dividend stripping provisions will treat a shareholder who disposes of his or her shares in the context of one of these schemes as having obtained a tax benefit of the amount which he or she would have derived as a dividend if the profits stripped under the scheme had been paid as a dividend. A tax benefit so obtained will be subject to the new general provisions for cancellation of tax benefits that I have described. Where a tax benefit has been cancelled under Part IVA, the Commissioner of Taxation will be empowered to effect corresponding adjustments to reduce the tax liability of others affected by the arrangements, if it is fair and reasonable in the circumstances to do so."

74 The references to "stripping" profits and the receipt of money in a "tax free form" in this extrinsic material, read in context, cannot mean stripping the whole or a substantial part of the profits of the company and receipt of money in a wholly or a substantially tax-free form – that would be irreconcilable with the proposition that the tax benefit is "the amount which [the taxpayer] would have derived as a dividend if the profits stripped under the scheme had been paid as a dividend". That is, the tax benefit amount depends on the scheme existing for the sole or

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64 Australia, House of Representatives, *Parliamentary Debates* (Hansard), 27 May 1981 at 2684-2685.

dominant tax avoidance purpose that has the effect of converting profits into capital. The concept of the tax benefit is limited to the amount of tax that would have been payable but for the entering into or carrying out of the scheme. The extent of the stripping of profits and of the tax liability avoided, in this context, is relevant to but not determinative of the existence of a scheme for the sole or dominant tax avoidance purpose having the substantial effect of "schemes that are commonly called dividend stripping – and ... similar schemes".

75 In *Consolidated Press HCA*, Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ did not have to deal with the proposition that the "critical point" in a dividend stripping scheme is "that the vendor shareholders receive a consideration which is in a tax-free or largely tax-free form".[65] Their Honours agreed with French, Sackville and Sundberg JJ that the case failed because "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".[66] In this formulation, the reference to "a substantially tax-free form" is an aspect of the tax avoidance purpose rather than the tax avoidance effect and, in any event, is merely descriptive of the required purpose in the "ordinary" course. No principle is expressed that the outcome or effect of the scheme must be the receipt of money in a tax-free or substantially tax-free form.

76 Nor is it possible to elevate to the level of construction of the term "dividend stripping" or principle in respect of the application of that term, the common characteristics of dividend stripping schemes that French, Sackville and Sundberg JJ identified,[67] referring to the analysis of Gibbs J in *Federal Commissioner of Taxation v Patcorp Investments Ltd* ("*Patcorp Investments*").[68] French, Sackville and Sundberg JJ's point was that the identified characteristics were "helpful" in characterising a scheme as a dividend stripping scheme. Their Honours did not suggest that these characteristics were each essential to the characterisation of a scheme as a dividend stripping scheme. That would have been

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65 *Commissioner of Taxation v Consolidated Press Holdings Ltd [No 1]* (1999) 91 FCR 524 at 567 [159].

66 (2001) 207 CLR 235 at 274 [129].

67 *Commissioner of Taxation v Consolidated Press Holdings Ltd [No 1]* (1999) 91 FCR 524 at 561 [136]-[137].

68 (1976) 140 CLR 247.

inconsistent with the essence of Gibbs J's analysis in *Patcorp Investments*, in which his Honour said that dividend stripping involved an "arrangement [that] had the purpose of giving the character of capital to what, apart from the arrangement, would have been received as income and thus of avoiding liability for tax on the amounts received".[69] As Gibbs J also said, of course, "an arrangement whose purpose is to reduce the amount of tax that a taxpayer will have to pay is not necessarily an arrangement whose purpose is to avoid a liability to tax".[70] Understood in the context of the introduction of capital gains tax in Australia in 1985, the sole or dominant tax "avoidance" purpose (and outcome or effect) need not be to avoid tax altogether, but to avoid tax otherwise payable to an extent by giving income a character of capital. The sufficiency of the extent of the intended avoidance of tax, and, under s 177E(1)(a)(ii), of the effect by way of or in the nature of a dividend stripping scheme, is dependent on the facts and circumstances of each case.

77 The argument to the contrary for Mr Merchant and GSM, that to so construe "dividend stripping" in s 177E(1)(a)(ii) would make s 177E(1)(a)(i) redundant (the scope of that provision being wholly within the scope of s 177E(1)(a)(ii)), is unpersuasive.

78 First, and as submitted for the Commissioner, a scheme by which profits are converted into capital cannot amount to "dividend stripping" under either provision unless the profits, apart from the scheme, would have been received as income and the taxpayer's sole or dominant purpose in entering into or carrying out the scheme was to avoid liability for tax.

79 Second, the difference between s 177E(1)(a)(i) and s 177E(1)(a)(ii) is not that the former involves a "dividend stripping scheme" and the latter involves a scheme having substantially the effect of a "dividend stripping scheme". Both provisions refer to a scheme "by way of or in the nature of" dividend stripping. The concepts "by way of" and "in the nature of" are to be understood as expanding the concept of "dividend stripping" beyond its historical meaning. In the context of s 177E(1)(a)(i) and (ii), the meaning of "by way of" is not to be understood as confined to "by", "through" or "via" but extends to "[a]s a form or example of; in the capacity or with the function of; as something equivalent to. Also occasionally:

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69 (1976) 140 CLR 247 at 300.

70 (1976) 140 CLR 247 at 299.

as a means of"[71] and "as a method or means of".[72] The meaning of "in the nature of" is as a phrase of further expansion, that term's ordinary meaning extending to "of the type, form, or character of; similar to, like; equivalent to"[73] and "having the qualities of".[74]

80 Third, that the provisions use the concepts of "by way of or in the nature of" to expand the historical concept of "dividend stripping" accords with the terms of the extrinsic material associated with the introduction of Pt IVA into the 1936 Act. The extrinsic material exposes that the enactment of anti-avoidance provisions such as Pt IVA resulted from what has been described as a "duel provoked by [dividend stripping arrangements] between the tax avoider and the legislature", a duel which had led to the development of "a protean variety of detail" with the same tax avoidance function and effect.[75] In that context, a legislative focus on: (i) a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme in s 177E(1)(a)(i); and (ii) a scheme having substantially the effect of a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme in s 177E(1)(a)(ii), is readily explicable, the essential function and character of such a scheme being as Gibbs J described in *Patcorp Investments*.[76]

81 Fourth, as a matter of ordinary English, it is to be expected that a provision in the terms of s 177E(1)(a)(ii) ordinarily would encompass a scheme also within the terms of s 177E(1)(a)(i). The overlap is an inevitable consequence of the language in which the provisions are expressed, where the only difference is that s 177E(1)(a)(i) refers to the existence in fact of a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme, whereas s 177E(1)(a)(ii) refers to the existence in fact of a scheme having substantially the effect of a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme. In the former case, the scheme must be a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme – and if the scheme is such a

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71 *Oxford English Dictionary* (online), "way" (def P.2.c.i).

72 *Macquarie Dictionary* (online), "way" (def 28).

73 *Oxford English Dictionary* (online), "nature" (def P.4.a).

74 *Macquarie Dictionary* (online), "nature" (def 16).

75 *Commissioner of Taxation v Consolidated Press Holdings Ltd [No 1]* (1999) 91 FCR 524 at 560 [132], quoting Fowler, *A Dictionary of Modern English Usage*, 2nd ed (1965) at 62.

76 (1976) 140 CLR 247 at 300.

scheme, then s 177E(1)(a)(i) applies. In the latter case, the scheme need not be a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme, it need only be a scheme having substantially the effect of such a scheme – and if the scheme is a scheme with that effect, then s 177E(1)(a)(ii) applies.

82 Accordingly, s 177E(1)(a)(i) and (ii) are not confined to "a dividend stripping scheme" the common historical characteristics of which were identified by French, Sackville and Sundberg JJ in *Commissioner of Taxation v Consolidated Press Holdings Ltd [No 1]*.[77] Those characteristics are not essential prerequisites to the application of s 177E(1)(a)(i) or (ii). They are considerations which may assist the decision-maker in understanding the historical concept of "dividend stripping" to which neither s 177E(1)(a)(i) nor (ii) is confined. Nor does s 177E(1)(a)(i) or (ii) contain any essential quantitative prerequisite.

83 Rather, s 177E(1)(a)(i) refers to a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme and s 177E(1)(a)(ii) refers to a scheme having substantially the effect of a scheme that is, or is functionally equivalent or similar to, a dividend stripping scheme. In both cases, the function of such a scheme is that of "giving the character of capital to what, apart from the arrangement, would have been received as income and thus of avoiding liability for tax on the amounts received".[78]

The s 177D proceeding

84 Mr Merchant and GSM contended in this Court that the majority in the Full Court failed to conduct the correct counterfactual inquiry required by s 177D by: (i) rejecting the usefulness of a counterfactual comparison between the BBG share sale and a sale to a third party; (ii) purporting to distinguish the BBG share sale from a routine sale to a third party at market value; and (iii) relying on a series of further counterfactuals, which each only achieved a singular commercial consequence of the BBG share sale, to reject the objective benefit of the commercial consequences of the BBG share sale.

85 Mr Merchant and GSM also contended that a central aspect of the primary judge's reasoning and the majority's reasoning in the Full Court as to the purpose of the BBG share sale scheme was that Mr Merchant maintained effective control of the BBG shares before and after the sale, such that the sale had no practical, commercial or economic consequence for Mr Merchant beyond the identified tax

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77 (1999) 91 FCR 524 at 561 [136]-[137].

78 *Patcorp Investments* (1976) 140 CLR 247 at 300.

benefit. This analysis was said to involve two problems in that: (i) relevant differences between the entities involved in the BBG share sale were not considered; and (ii) in respect of the differences that were considered, the significance of those differences was erroneously dismissed.

86 These contentions are not sustainable.

87 The majority in the Full Court rightly characterised the overall case for Mr Merchant and GSM in respect of s 177D as "an invitation for this Court to reconsider all of the evidence without identifying why the primary judge erred in his ultimate conclusion", in circumstances where the primary judge "extensively analysed the genuine commercial purpose submission [on behalf of Mr Merchant and GSM] ... applied the correct principles and reached the correct conclusion".[79] Having given detailed consideration to the contention for Mr Merchant and GSM that the primary judge "did not identify all purposes of the transaction or, having done so, did not weigh those purposes in reaching his overall conclusion",[80] their Honours rightly concluded that "the primary judge well-understood the need to evaluate and balance the s 177D(2) matters"[81] and had not erred in so doing.

88 Mr Merchant and GSM's challenge to the majority in the Full Court's analysis of further counterfactuals to the BBG share sale scheme was expressed as follows:

	Actual transaction	Sell on market	Do nothing	GMSF cash withdrawal	MFT draw on debt	MFT sell other assets
Capital loss	Yes	Yes	No	No	No	Depends
Control maintained	Yes	No	Yes	Yes	Yes	Yes
MFT gets cash	Yes	Yes	No	Yes	Yes	Yes
[GMSF] gets BBG exposure	Yes	No	No	No	No	No
[GMSF] can pay pension	No	Yes	Yes	No	Yes	Yes

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79 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 188 [227].

80 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 190 [236].

81 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 193 [251].

Total assets in [GMSF] maintained	Yes	Yes	Yes	No	Yes	Yes
No additional debt	Yes	Yes	Yes	Yes	No	Yes
Other assets of MFT maintained	Yes	Yes	Yes	Yes	Yes	No

89 This aspect of the challenge does not address the primary judge's undisturbed finding that Mr Merchant would not have authorised the sale of BBG shares to a third party.[82] It follows that for the purpose of s 177CB(3) of the 1936 Act (concerning whether a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out), the only "postulate that is a reasonable alternative to entering into or carrying out the scheme" for the purpose of ascertaining a "tax benefit" in respect of a capital loss as provided for in s 177C(1)(ba) is that the BBG share sale scheme would not have been undertaken at all. The point being made in *Federal Commissioner of Taxation v Hart*[83] (on which Mr Merchant and GSM relied) was that in a case where a "particular commercial transaction is chosen from a number of possible alternative courses of action"[84] that has a tax benefit, the question of the purpose(s) and the dominant purpose of the transaction remains to be determined. As Gummow and Hayne JJ explained:[85]

> "In the present matters, the respondents would obtain a tax benefit if, in the terms of s 177C(1)(b), had the scheme not been entered into or carried out, the deductions 'might reasonably be expected not to have been allowable'. When that is read with s 177D(b) it becomes apparent that the inquiry directed by Pt IVA requires comparison between the scheme in question and an alternative postulate. To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed."

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82 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 534 [268].

83 (2004) 217 CLR 216.

84 (2004) 217 CLR 216 at 227 [15].

85 (2004) 217 CLR 216 at 243 [66].

90 In other words, the requirement to consider "other possibilities" depends on the evidence. If, in considering another possibility on which a party may rely, the conclusion on the evidence is that there was no such other possibility, that possibility is not a reasonable alternative postulate for the purpose of deciding the question posed by s 177CB(3). If this is true of all other possibilities on which a party relies, the remaining possibility and only reasonable alternative postulate under s 177CB(3) is that the scheme would not have been entered into or carried out. The matter need be complicated no further by positing that s 177D requires a counterfactual (meaning simply hypothetical) inquiry into every possibility (reasonable or not) or that each such possibility must be tested against every factor in s 177D(2) as if that possibility was itself a scheme under the statutory provisions.

91 For this reason alone, none of the errors which Mr Merchant and GSM attributed to the majority in the Full Court are sustainable. In distinguishing between the BBG share sale and a "routine transaction where a shareholder sells shares and incurs a capital loss in a year of income, which is then applied to offset a capital gain achieved on the sale of other shares in the same or subsequent years",[86] the majority was testing the competing cases of the parties. The majority recognised that the commercial and economic consequences of such a "routine transaction" were different in several respects from the BBG share sale but correctly recognised also that "resolution of the dominant purpose question ... does not turn on a high level analogy as though it stands apart from the specific and limited matters at s 177D(2) to which regard must be had" and focusing on such a comparison risked "distract[ing] attention from what objectively occurred in this case".[87]

92 The majority in the Full Court also did not err in referring to the concept of a "wash" sale. As the primary judge had recorded, the Commissioner "considered that the BBG [s]hare [s]ale was analogous to a 'wash sale' given that the BBG [s]hares would remain in the Merchant Group of which Mr Merchant was the ultimate owner".[88] The majority explained this concept as a "sale and repurchase of the same security for tax purposes", which "allows an investor to lock-in capital losses for tax purposes even though the fall in share or asset price may be

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86 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 189 [231].

87 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 189 [233].

88 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 485 [11].

temporary".[89] The majority correctly identified the submission for Mr Merchant and GSM rejecting the analogy between the BBG share sale and a "wash" sale as having been made on the basis that an objective purpose of Mr Merchant was to retain control of the BBG shares at all times (so those shares would not be sold to a third party).[90] The majority's key conclusion was not that the BBG share sale was analogous to a "wash" sale (although the majority did accept that the two were analogous), but that "if there could not be a divestment of the BBG [s]hares because Mr Merchant was not willing to relinquish control, one is outside the paradigm example of a sale to an arms-length party".[91]

93 On this basis, it is untenable that, as contended for Mr Merchant and GSM, the majority's reasoning in the Full Court means that once the sale of Plantic was in prospect, the MFT had to elect between selling the BBG shares (and thereby reducing Mr Merchant's stake in BBG contrary to his objectives) or deferring the sale of the BBG shares until such time as the capital gain was not in prospect, an election which cannot represent the intended operation of s 177D. The purported election involves a false assumption which the primary judge and the majority in the Full Court considered disproved by the evidence – that but for the Plantic sale and the objective of realising a capital loss in the MFT to offset the capital gain from the sale of Plantic, the BBG share sale would still have occurred at any time.

94 Accordingly, the contention for Mr Merchant and GSM that the majority in the Full Court failed to conduct the correct counterfactual inquiry required by s 177D must be rejected.

95 Further, in respect of the contention for Mr Merchant and GSM that the majority failed to consider "the different legal, commercial and tax considerations that governed the entities involved in the scheme", the "yes" and "no" entries under the second and fourth columns of the above table ("Actual transaction" and "Do nothing" respectively) do not reflect the undisturbed findings of the primary judge in several respects. To reflect the primary judge's undisturbed findings in respect of each of the selected integers in the first column of the table, a "yes" or "no" approach is inadequate. The primary judge's undisturbed findings, if expressed in

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89 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 190 [234], quoting *Cumins v Federal Commissioner of Taxation* (2006) 61 ATR 625 at 634 [38].

90 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 190 [235].

91 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 190 [235].

tabular form in respect of the same selected integers for the second and fourth columns, would look like this:

Selected integer	Actual transaction	Do nothing
Capital loss	✓	**x**
Control maintained	✓	✓
MFT gets cash	**O**	**O**
[GMSF] gets BBG exposure	**x**	✓
[GMSF] can pay pension	**x**	✓
Total assets in [GMSF] maintained	✓	✓
No additional debt	✓	✓
Other assets of MFT maintained	✓	✓

✓ = objectively ascertained positive factor

x = objectively ascertained negative factor

O = objectively ascertained neutral factor

96 In other words, compared to the MFT not selling the BBG shares, the BBG share sale, objectively, had: (i) two material negative consequences – it involved the GMSF acquiring an asset in breach of its own investment strategy without a real prospect of returns by way of payment of dividends irrespective of the vehicle holding the shares, and it meant that the GMSF could no longer pay Mr Merchant a pension and had to revert from paying a pension back to an accumulation phase; and (ii) one material positive consequence – the realisation of a capital loss in the MFT in contemplation of the sale of Plantic (an integer or contextual matter not apparent from the table). Otherwise, on the concurrent findings of the primary judge and the majority in the Full Court, there was no *material* difference between the two alternatives in respect of each of the selected integers identified as relevant on behalf of Mr Merchant and GSM.

97 To explain further, in respect of the selected integer "MFT gets cash", the primary judge found that the BBG share sale scheme was not undertaken "to free

up cash for the MFT".[92] Accordingly, that integer ought not to be identified as a material "different legal, commercial and tax consideration[] that governed the entities involved in the scheme". In any event, it cannot be said that the majority in the Full Court failed to consider that matter. While Logan J in the Full Court considered it to be "just a distraction as to whether GM2 [as trustee for the MFT] really then needed that cash" because the MFT received an immediate cash benefit of $5.8 million from the BBG share sale,[93] McElwaine and Hespe JJ reached the contrary view. Their Honours concluded that: (i) the primary judge's analysis had not miscarried by focusing on Mr Merchant's subjective intentions instead of the objectively ascertained dominant purpose of the BBG share sale or otherwise;[94] and (ii) on analysis of the evidence, the primary judge did not err "in his reasoning to conclude that the BBG [s]hares were not sold to address a need for cash [of the MFT] in early September 2014".[95]

98 In respect of the selected integer "[GMSF] gets BBG exposure", the primary judge found that the GMSF's purchase of the BBG shares was contrary to the GMSF's investment strategy,[96] and otherwise: (i) rejected Mr Merchant's evidence that he considered that BBG would return to paying dividends at any time in the then-reasonably foreseeable future, as there was no objective basis for such a view;[97] (ii) rejected the evidence (such as it was) that Mr Merchant's advisers considered that BBG shares were a good investment for the GMSF and so advised Mr Merchant;[98] (iii) rejected the contention that "a substantial reason for the transfer of the shares from the MFT to the GMSF was for a purpose of providing a good investment to the GMSF";[99] (iv) rejected the contention that the GMSF's purchase of the BBG shares involved "a formulation or review of the GMSF

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92 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 541 [319]. See also at 538 [295], 539 [309].

93 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 152 [43].

94 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 182-183 [189]-[196].

95 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 185-187 [209]-[216], 196 [265].

96 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 554 [401].

97 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 543 [331].

98 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 543-544 [331]-[333].

99 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 544 [335].

investment strategy";[100] and (v) found that the "proposal to transfer BBG shares from the MFT to the GMSF ... originated from [EY] as something which should occur in connection with the proposed sale of Plantic in order to provide a loss", as Mr Merchant had been advised in July 2014.[101]

99 The majority in the Full Court referred to these findings of the primary judge[102] and recorded that Mr Merchant and GSM contended that the primary judge had erred by not considering all the "objective purposes" of the BBG share sale "to maintain control over the BBG shares, to liberate cash from the GMSF, to place the BBG shares in the protected environment of the GMSF and to provide for the funding needs of the MFT".[103] Their Honours expanded on these matters subsequently in their reasons by referring to the object of providing "the GMSF with the prospect of greater returns than it was receiving from its cash deposits".[104] Their Honours then expressly dealt with the asserted purposes of both "moving the BBG shares into the protected environment of the GMSF" and "liberating cash from the GMSF".[105] Their Honours emphasised that: (i) in September 2014, the GMSF was in the pension phase and it was open to Mr Merchant to withdraw cash in any amount from the fund and apply it to the MFT;[106] (ii) "the BBG shares were a risky asset, unlikely to earn dividends in the future, and the effect of the purchase was to impair the capacity of the [GMSF] to continue paying Mr Merchant a pension. Objectively, that was not an advantage";[107] and (iii) "the liberation of cash purpose was disproportionate in value [$5.8 million] to the ultimate economic advantage to GSM of the BBG [c]apital [l]oss",[108] in circumstances where "the net

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100 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 545 [339].

101 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 545 [337].

102 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 169 [140].

103 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 175 [157].

104 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 182 [186].

105 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 196 [266].

106 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 197 [272].

107 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 198 [273].

108 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 198 [275].

tax effect obtained in respect of the capital loss incurred on the BBG [s]hares in the year ended 30 June 2015 by GSM was approximately $12.8 million".[109]

100 In respect of the purpose of Mr Merchant retaining control of the BBG shares, the majority in the Full Court reasoned that: (i) "objectively there was no need or requirement for any step to be taken by the Merchant Group to maintain control of the BBG shares in September 2014" as the "effective economic ownership of the shares remained the same", the "scheme did not result in divestment of the risk of ownership of the shares", and the scheme "did not add to the benefits of being a shareholder";[110] (ii) the timing of the sale of the BBG shares was determined by the likelihood that Plantic would be sold and is explicable by reason of that anticipated sale;[111] and (iii) the object of retaining control of the BBG shares did not and could not explain the inconsistency between the sale of the shares to the GMSF and the GMSF's investment strategy.[112]

101 Otherwise, the different legal regimes applicable to the different entities involved in the BBG share sale on which Mr Merchant and GSM relied may be accepted. The difficulty, however, is that nothing in the evidence supported their position that these different legal regimes formed any part of the end, object or outcome of the BBG share sale scheme. It cannot be said that the majority in the Full Court did not consider these matters.[113] It is merely that the majority did not consider that these matters could be ascribed weight in ascertaining if there was an objective dominant purpose of the BBG share sale scheme and, if so, if that objective dominant purpose was the obtaining of a tax benefit.

102 The appeal of Mr Merchant and GSM in respect of s 177D of the 1936 Act must therefore be rejected.

The s 177E proceeding

103 The issues of statutory construction have been resolved above. The consequence is that the primary judge was correct to have applied s 177E to the

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109 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 198 [274].

110 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 200 [285].

111 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 200 [287].

112 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 200-201 [289]-[290].

113 eg, *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 197-198 [272]-[275], 213 [346].

facts as found, excluding the fact (resulting from the operation of s 177D) that the Commissioner had made the s 177D determination under s 177F(1)(c) in respect of the BBG share sale scheme, which cancelled the MFT's capital loss of $56,561,940 in the year ended 30 June 2015. The analysis of the majority in the Full Court on the contrary basis, that the "effect" of the scheme had to be considered having regard to the s 177D determination, thereby miscarried. Rather, in common with the purpose of the scheme, the effect of the scheme under s 177E is to be ascertained irrespective of the s 177D determination.

104 Mr Merchant and GSM otherwise contended that the majority erred in concluding that the dominant purpose of the GSM and Tironui debt forgiveness scheme was tax avoidance. To the extent those contentions relied on the case put for these parties in respect of s 177D, they must be rejected. To the extent those contentions were that the majority (in common with the primary judge) erred in focusing on alternative ways in which the Plantic loans could have been dealt with and in not concluding that the dominant purpose of the GSM and Tironui debt forgiveness scheme was to facilitate the sale of Plantic for the highest possible return, they must also be rejected.

105 That the GSM and Tironui debt forgiveness scheme could not have attracted the application of s 177E but for the sale of Plantic, as the primary judge and the majority in the Full Court accepted,[114] is immaterial. The GSM and Tironui debt forgiveness scheme included the contemplated sale of Plantic and would have failed to achieve its objective end, object or outcome but for that sale occurring as contemplated. Mr Merchant and GSM also recognised the contextual importance of the contemplated sale of Plantic by positing that the dominant purpose of the GSM and Tironui debt forgiveness scheme was to facilitate the sale of Plantic for the highest return to the MFT. The majority's conclusion, consistent with that of the primary judge, was that the dominant purpose of the GSM and Tironui debt forgiveness scheme was "to permit the amounts forgiven to be accessed by Mr Merchant or his associates in a way in which substantially less tax would be paid than if those amounts were repaid to GSM and Tironui and received by Mr Merchant by way of dividends".[115] In this case, that conclusion was facilitated by the fact that, as found by the primary judge and the majority, "there was an expectation by the Merchant Group parties to the scheme that an amount equal to the total debt forgiven amounts would be sheltered by capital losses in the hands

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114 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 564 [472], 565 [477]; *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 206-207 [315].

115 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 213 [345].

of an associate of Mr Merchant",[116] but that fact was by no means essential for the finding of the dominant purpose of tax avoidance.

106 There was no error in the primary judge or the majority in the Full Court assessing the contention for Mr Merchant and GSM that the dominant purpose of the GSM and Tironui debt forgiveness scheme was to facilitate the sale of Plantic for the highest possible return by considering other possibilities as to how Plantic's debts to GSM and Tironui might have been accommodated in the sale of Plantic. In common with s 177D, depending on the evidence and submissions, consideration of such alternative possibilities to the transaction in fact undertaken may be an essential part of the analysis under s 177E. As the majority put it, in this case an "objective consideration of purpose without regard to the alternatives open to address the related party loans [would be] artificial and sterile".[117]

107 The key point for both the primary judge and the majority was that the contextual considerations led inexorably to the conclusions that the evidence established that: (i) there "was no economic reason for GSM and Tironui to each bear a loss on fully recoverable loans";[118] (ii) "the loss incurred by GSM and Tironui on their respective loans to Plantic was not reflective of nor justified by Plantic's financial position", and was not required by the purchaser of Plantic;[119] and (iii) those losses were "predominantly explicable by the tax advantages expected to be conferred on the Merchant Group and in particular by the expectation that it would avoid tax otherwise becoming payable on a distribution of the profits of GSM and Tironui without a substantial tax liability being incurred by the trustee or beneficiaries of the MFT".[120] That it was also obvious that if the Plantic loans were not dealt with within the Merchant Group, a purchaser would have paid "less for the Plantic shares on the basis that Plantic would need to refinance or pay out the loans which had been made to Plantic",[121] did not mean that the primary judge or the majority in the Full Court ought to have accepted the

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116 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 213 [345].

117 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 215 [356].

118 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 214 [350], see also *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 573 [539]-[540].

119 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 215 [357].

120 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 215 [357].

121 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 213 [349], quoting *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 571 [524].

contention for Mr Merchant and GSM as to the dominant purpose of the GSM and Tironui debt forgiveness scheme. The evidence amply supported the majority's conclusions in the Full Court that the dominant purpose of the GSM and Tironui debt forgiveness scheme was tax avoidance.

108 No error is apparent in the primary judge's approach to s 177E(1)(a)(i)-(ii) of the 1936 Act. As the primary judge recorded, it "has long been recognised that dividend stripping schemes evolve and change in that they 'have adopted one ingenious and complicated tactic after another'".[122] In that context, overlap between s 177E(1)(a)(i) and (ii), even if extensive, remains what his Honour aptly described as a "convenient legislative device to convey what is intended to be captured by the provision, and to make sure that the provision hits the intended targets".[123] There is no inconsistency between this approach and the observations of this Court in *Consolidated Press HCA* that:[124]

> "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."

109 The primary judge proceeded on the correct basis that: (i) s 177E(1)(a)(i) "by speaking of a scheme 'by way of *or in the nature of* – does not itself require strict adherence to a paradigm example of a dividend stripping scheme";[125] (ii) in "determining whether a scheme falls within [s 177E(1)(a)(ii)], it is always necessary to examine the substantial effect of the scheme, this being the central inquiry under [s 177E(1)(a)(ii)], and it is always necessary to compare that effect with the effect of a scheme in the nature of dividend stripping in order to reach a conclusion about whether the effect of the scheme being considered is substantially

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122 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 561 [456], quoting *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1970) 120 CLR 177 at 179.

123 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 561 [457].

124 (2001) 207 CLR 235 at 276 [138].

125 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 562 [460] (primary judge's emphasis).

the same as the effect of a scheme by way of or in the nature of dividend stripping";[126] (iii) "a dominant tax avoidance purpose is essential for a scheme to fall within either" s 177E(1)(a)(i) or (ii);[127] (iv) "an assessment issued to give effect to a determination made by the Commissioner under s 177E is not necessarily shown to be excessive by establishing that a particular step in the scheme, viewed in isolation, did not have the dominant purpose of tax avoidance";[128] and (v) s 177E "does not require a complete, or a substantially complete, avoidance of tax to apply. Section 177E is capable of applying where the tax avoidance purpose is to avoid the higher tax which would have been payable on dividends, albeit a lower amount of tax is still payable as a result of the scheme."[129]

110 Consistently with these principles, the primary judge correctly observed that the posited scheme on which the Commissioner ultimately relied did not include the actual sale of the shares in Plantic. As his Honour put it, the "debt forgiveness transforms the undistributed profits of GSM and Tironui into equity, thereby increasing the amount a purchaser would pay for the Plantic shares. There is no relevant tax avoided at this point. Without the sale of the Plantic shares to Kuraray, the scheme merely shifts value. No tax is avoided. With a sale of the shares in Plantic, the scheme is one in which the profits of GSM and Tironui have been converted to equity and ... tax is avoided."[130] His Honour rightly decided on the evidence, however, that the *contemplated* sale of the shares in Plantic, which was part of the scheme, sufficed to engage s 177E(1)(a)(ii) in circumstances where: (i) the "debt forgiveness was undertaken for the dominant purpose of moving value away from GSM and Tironui into the MFT";[131] and (ii) "the debt forgiveness was connected to the sale of the Plantic shares. The idea of forgiving debts was conceived in connection with the sale of the Plantic shares, together with the idea of the MFT selling the BBG [s]hares to the GMSF, as ways in which to maximise the return to Mr Merchant by minimising the amount of tax payable."[132]

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126 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 562 [460].

127 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 562 [461].

128 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 563 [467].

129 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 568 [497].

130 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 565 [477].

131 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 575 [548].

132 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 579 [562].

111 None of the additional submissions on behalf of Mr Merchant and GSM which concern the reasoning of the majority in the Full Court expose error in the reasoning and conclusions of the primary judge in respect of s 177E or have the effect of undermining them.

Conclusions and orders

112 The primary judge did not err. Accordingly, the appeal to the Full Court of the Federal Court ought to have been dismissed with costs. It follows that: (1) each party should be granted special leave to cross-appeal; (2) the Commissioner's appeal to this Court should be allowed with costs and the cross-appeal of Mr Merchant and GSM dismissed with costs; and (3) Mr Merchant and GSM's appeal to this Court should be dismissed with costs, and it is unnecessary to decide the Commissioner's cross-appeal.

GORDON, EDELMAN, STEWARD AND GLEESON JJ.

Introduction

113 In the 2015 income year, entities controlled by a Mr Gordon Merchant (referred to collectively as "the Merchant Group") entered into transactions that generated tax consequences under the *Income Tax Assessment Act 1997* (Cth) ("the 1997 Act") and the *Income Tax Assessment Act 1936* (Cth) ("the 1936 Act"): first, a sale by the Merchant Family Trust ("MFT")[133] of shares in Billabong International Ltd ("BBG") to the Gordon Merchant Superannuation Fund ("GMSF"),[134] which generated a capital loss of about $56 million ("the BBG capital loss") and, secondly, a subsequent sale by MFT of all the shares it held in Plantic Technologies Ltd ("Plantic") to a third party purchaser, Kuraray Co Ltd ("Kuraray"), which generated a capital gain of about $85 million ("the Plantic capital gain"). Prior to the sale by MFT of the shares in Plantic, two debts Plantic owed to other companies in the Merchant Group, namely GSM Pty Ltd ("GSM") and Tironui Pty Ltd ("Tironui"), totalling around $54 million were forgiven by GSM and Tironui (for nil consideration), thereby increasing the sale price of Plantic. MFT sought to use the BBG capital loss, together with other capital losses it held, to eliminate the income tax otherwise payable on the Plantic capital gain, resulting in a reduction in the assessable income of a beneficiary of MFT, namely GSM.[135] The two appeals outlined below arose from these broad facts.

S158/2025: BBG Share Sale Scheme[136]

114 The Commissioner of Taxation exercised the power conferred by s 177F(1)(c) in Pt IVA of the 1936 Act to cancel the BBG capital loss. The Commissioner determined under s 177D(1), having regard to the matters in s 177D(2), that one or more persons had entered into or carried out a scheme comprising the sale of the BBG shares for the dominant purpose of enabling MFT to obtain a tax benefit, being the BBG capital loss ("the BBG Share Sale Scheme"). The parties to the BBG Share Sale Scheme included Mr Merchant, MFT, and

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133 Gordon Merchant No 2 Pty Ltd ("GM2") is the trustee of MFT.

134 GSM Superannuation Pty Ltd ("GSMS") is the trustee of GMSF.

135 GSM had a 100 per cent present entitlement to the income of MFT in the 2015 income year under Div 6 of the 1936 Act.

136 In relation to the BBG Share Sale Scheme, the taxpayer was GSM, the second appellant in S158/2025. The first appellant was Mr Merchant.

GMSF. The Commissioner increased MFT's net income to reflect the net capital gain. The Commissioner then issued an amended assessment to GSM increasing GSM's tax payable. There was no dispute that, for the purposes of Pt IVA of the 1936 Act, the BBG Share Sale Scheme was a "scheme"[137] that resulted in a tax benefit,[138] namely the BBG capital loss. There was also no dispute that GSM was properly assessed as presently entitled to 100 per cent of the net income of MFT.

115 The question in this appeal is whether the majority of the Full Court of the Federal Court of Australia ("the Full Court") was correct to conclude that the dominant purpose of a person who entered into or carried out the BBG Share Sale Scheme was to obtain the tax benefit, the BBG capital loss, arising from the sale by MFT of the BBG shares. The answer is yes. For the reasons that follow, the appeal by GSM in S158/2025 must be dismissed with costs.

S157/2025: Debt Forgiveness Schemes

116 The Commissioner also determined that the forgiveness of each of the debts Plantic owed to GSM and Tironui constituted a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping for the purpose of s 177E(1)(a)(ii) of the 1936 Act. The "Debt Forgiveness Schemes" were identified by the Commissioner, and then described by the Full Court below, as involving the following steps:[139]

> "(1) *First*, the MFT sold the BBG Shares to the GMSF on 4 September 2014, crystallising a capital loss of $56,561,940 in the 2015 income year.
>
> (2) *Secondly*, on 31 March 2015, the MFT entered a contract for the sale of the Plantic shares to Kuraray [a third party purchaser] containing as condition 3 of cl 2.1 of the [share sale agreement] a condition precedent that the MFT must procure the release and forgiveness of Plantic's [debts] to GSM and Tironui.
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> (3) *Thirdly*, on 2 April 2015, GSM and Tironui released and forgave the [debts that Plantic owed], in the sums of $50.192 million and $4.215 million respectively, for nil consideration from either Plantic

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137 1936 Act, s 177A(1) (definition of "scheme").

138 1936 Act, s 177CB(2).

139 *Merchant v Federal Commissioner of Taxation* (2025) 309 FCR 144 at 205 [306].

or the MFT, with a corresponding increase in the market value of the Plantic shares.

(4) *Fourthly*, the sale of the shares in Plantic to Kuraray."

117 The Commissioner included in the assessable income of Mr Merchant an amount equal to each of the debts forgiven as a deemed dividend under s 177E of the 1936 Act. An amended assessment was issued to Mr Merchant, increasing his liability to tax in the 2015 income year.[140]

118 The principal issue in this appeal was whether each Debt Forgiveness Scheme was a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping for the purpose of s 177E(1)(a)(ii) of the 1936 Act. For the reasons that follow, the answer is no. The Commissioner's appeal in S157/2025 should be dismissed and the cross-appeal by Mr Merchant in relation to the Tironui Debt Forgiveness Scheme allowed. It is unnecessary to address Mr Merchant's Notice of Contention.

119 These reasons will consider the background to the issues raised in these appeals and then address the legislative framework and each appeal in turn: S158/2025 in relation to the BBG Share Sale Scheme and then S157/2025 in relation to the Debt Forgiveness Schemes.

Background

120 The facts are not in dispute, as distinct from their proper characterisation.

121 Mr Merchant was the co-founder of a business which manufactured surf-wear. BBG, which came to conduct that business, was listed on the Australian Stock Exchange in 2000. Mr Merchant "always believed" in the business and had an "affinity" for maintaining a substantial shareholding in BBG.[141]

122 At all relevant times, Mr Merchant was the director and controlling mind of the entities in the Merchant Group. Mr Merchant was heavily involved in the affairs of the Merchant Group, did not like debt, and would discuss the Merchant Group's affairs on a daily basis. Mr Merchant held 100 per cent of the shares in GSMS, GSM, Tironui, and GM2. GMSF had been paying Mr Merchant a pension.

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140 In relation to the Debt Forgiveness Schemes, the taxpayer was Mr Merchant, the first respondent in S157/2025. The second respondent was GSM.

141 *Merchant* (2025) 309 FCR 144 at 149 [27], 168 [133].

MFT was a family discretionary trust which described Mr Merchant, GSM, and Tironui as discretionary beneficiaries.[142] Mr Merchant sought to maintain, through MFT, GSM, and GMSF, a controlling shareholding in BBG. Over time, MFT, GSM and GMSF acquired further shares in BBG.

123 From 2012 to 2014, the operating expenses of MFT substantially exceeded its income from BBG shares and unlisted investments. Over this period of time, MFT sold a number of assets. In December 2011, the possibility of transferring BBG shares from MFT to GMSF was raised with Mr Merchant as a way of obtaining "extra money" for GM2, as trustee of MFT, noting that if the BBG share price increased, there would be no capital gains tax payable.[143]

124 Relevantly, GM2 as trustee of MFT had been the sole shareholder in Plantic since November 2010. Plantic was a "start-up" company.[144] Its business was to develop technologies in the manufacture and distribution of plant-based packaging materials as a substitute for oil-based products. Unfortunately, Plantic's operations were not profitable and obtaining loans from banks proved difficult because of Plantic's lack of profits and the fact that its assets mostly consisted of intellectual property and bespoke machinery. Between November 2010 and April 2015, the Merchant Group provided loans to Plantic totalling about $55.2 million. By April 2015, Plantic had debts of approximately $50.192 million to GSM and $4.215 million to Tironui.

125 From at least early 2011, Plantic was exploring commercial relationships with a number of different overseas entities. In August 2012, Kuraray expressed interest in potential cooperation with Plantic. By November 2013, Sealed Air Corporation ("Sealed Air") had expressed an interest in potentially acquiring Plantic. In March 2014, Plantic and Multivac Inc ("Multivac") entered into an exclusive distribution agreement for certain products in the United States, with an "Introductory Period" during which either party could terminate at will ending on 30 September 2014.

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142 It is convenient in these reasons to adopt that description as nothing turns on their strict status as objects of the trust power rather than beneficiaries in the strict sense: *Federal Commissioner of Taxation v Bendel* (2026) 100 ALJR 831 at 842 [37]; 430 ALR 223 at 234.

143 *Merchant v Commissioner of Taxation* (2024) 119 ATR 480 at 493 [62].

144 *Merchant* (2025) 309 FCR 144 at 163 [98].

126 By May 2014, Mr Merchant had become "frustrated" that Plantic continued to require funds from him, via the Merchant Group.[145] Mr Merchant considered that Plantic should have been self-funding. At this point, Ernst & Young ("EY") was approached to provide taxation advice in relation to an appropriate structure for the sale of Plantic.

127 By June 2014, Mr Merchant wanted to find a buyer for Plantic. On 8 July 2014, at a Plantic board meeting, the options discussed were: (1) proceeding with distribution licence options (including with Multivac); or (2) evaluating a sale with Sealed Air. The end of the "Introductory Period" in the distribution agreement with Multivac, being 30 September 2014, was noted as a "critical deadline". Shortly after, Mr Merchant agreed to obtain a conditional letter of offer from Sealed Air.[146]

128 On 21 July 2014, Mr Merchant asked his investment adviser about the tax implications of selling Plantic. He was informed that "EY have modelled it and the way to go would be a share purchase by Sealed Air of Plantic shares". Mr Merchant was also informed that transferring particular BBG shares from MFT to GMSF would produce "a good 'loss' on paper so [EY] reckon there will be zero tax payable on a lump sum payment". On 24 July 2014, Sealed Air provided its conditional letter of intent to acquire Plantic, as either an asset sale or a share sale. The purchase price was based on Plantic being debt-free. The letter of intent provided for a period of exclusive negotiations up until 15 September 2014.

129 On 11 August 2014, EY suggested that "it is going to be best to make it a requirement under [a share sale agreement] that all loans from associated entities are waived or forgiven". Discussions about the most advantageous form of sale of Plantic continued.

130 On 3 September 2014, EY provided Mr Merchant with a document titled "Project Maize – Summary of Sale Options and Tax Outcomes". The email attaching the document stated that a share sale, rather than an asset sale, was the "most tax effective option". One of the assumptions upon which this analysis was based was that MFT would sell its shares in BBG to GMSF "and realise further capital losses of $60M" (in addition to MFT's pre-existing capital losses). The document summarised the tax consequences of a sale of the shares in Plantic, as well as five different options to sell the assets of Plantic. The share sale option envisaged an application of $76 million of capital losses to shelter fully from taxation the expected capital gain arising from the disposal of the shares in Plantic;

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145 *Merchant* (2024) 119 ATR 480 at 505 [133].

146 *Merchant* (2024) 119 ATR 480 at 507 [143], 508 [147].

this was described as the "[b]est outcome and least complex option". The document also described the attributes of a "Share Sale and Loan Forgiveness" in more detail. It was proposed that GSM and Tironui forgive the debts that Plantic owed to them before MFT sold its shares in Plantic. The document described that this would increase the capital gain arising from the sale and would thus use more capital losses.

131 On 2 September 2014, MFT transferred approximately ten million BBG shares to GMSF for $5,844,827.82. The sale price was market value. In doing so, MFT incurred the BBG capital loss of $56,561,940. The effect of the sale was that GMSF exchanged cash for BBG shares, which were a riskier asset than cash and were unlikely to earn dividend income.

132 Negotiations continued. In October 2014, Kuraray re-entered the picture, indicating an intention to buy Plantic. Both options – namely an asset sale or a share sale – continued to be explored, and there was an amendment extending the "Introductory Period" in the distribution agreement between Plantic and Multivac. By 26 February 2015, Kuraray's board had approved the acquisition of Plantic. It seems that the draft agreement for the sale of shares in Plantic to Kuraray was based on the draft agreement for the sale of those shares to Sealed Air. Kuraray expressed some concerns about the tax implications for Plantic of the proposed debt forgiveness arrangements. On 18 March 2015, correspondence recorded that "Kuraray need to understand why the loans are being repaid etc. as they are actually buying the shares of the company not the assets and need to be comfortable that performing the [debt] forgiveness will not result in any potential liability when they own the company". By 20 March 2015, all outstanding points had been resolved.

133 On 31 March 2015, an agreement providing for the sale of shares in Plantic to Kuraray was executed. The share sale resulted in MFT deriving a capital gain assessed at around $85 million.[147] Consistent with the prior discussions, one of the conditions of the sale required MFT to procure the forgiveness of the debts that Plantic owed to GSM and Tironui.

134 On 2 April 2015, a deed of forgiveness between parties including GSM, Tironui, and Plantic was executed. Relevantly, GSM forgave $50.192 million

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147 The Plantic capital gain was originally assessed to be $84,885,502, but the primary judge was satisfied that the amended assessment was excessive to the extent of $11,346,205.

owed to it by Plantic, and Tironui forgave $4.215 million owed to it by Plantic. There was no consideration paid by either Plantic or MFT.

135 The sale by MFT of the Plantic shares to Kuraray took place that day. MFT was paid US$45,558,827.30 and was also entitled to certain other, including "earn-out", amounts. MFT made a capital gain of around $85 million, which was offset in full by its pre-existing capital losses and the BBG capital loss.

S158/2025: BBG Share Sale Scheme – s 177D of the 1936 Act

136 As stated, the issue in this appeal is whether the BBG Share Sale Scheme was entered into or carried out for the dominant purpose of obtaining a tax benefit for the purposes of s 177D(1) of the 1936 Act. It is thus necessary to begin with an overview of s 177D in the context of Pt IVA of the 1936 Act.

Part IVA

137 Part IVA was introduced into the 1936 Act in 1981.[148] It was enacted as a general anti-avoidance rule to address perceived shortcomings of and difficulties arising from the application of s 260 of the 1936 Act, the previous general anti-avoidance rule.[149] The applicable Explanatory Memorandum states:[150]

> "The proposed new Part IVA ... is designed to ... provide – with paramount force in the income tax law – an effective general measure against those tax avoidance arrangements that – inexact though the words be in legal terms – are blatant, artificial or contrived. In other words, the new provisions are designed to apply where, on an objective view of the particular arrangement and its surrounding circumstances, it would be concluded that the arrangement was entered into for the sole or dominant purpose of obtaining a tax deduction or having an amount left out of assessable income."

138 The general anti-avoidance rule in Pt IVA operates where the Commissioner decides to exercise his powers to make a determination contained in s 177F. The powers conferred by s 177F(1) are exercisable where a tax benefit has been obtained, or would but for that section be obtained, by a taxpayer in

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148 *Income Tax Laws Amendment Act (No 2) 1981* (Cth), s 7.

149 See 1936 Act, s 260, as amended by *Income Tax Laws Amendment Act (No 2) 1981* (Cth), s 10.

150 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 2.

connection with a scheme[151] to which Pt IVA applies.[152] In relation to the BBG Share Sale Scheme, the particular power that was exercised was that in s 177F(1)(c), which is relevantly in the following terms:

> "Where this Part applies to a scheme in connection with which a tax benefit has been obtained, or would but for this section be obtained, the Commissioner may:
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> ...
>
> (c) in the case of a tax benefit that is referable to a capital loss or a part of a capital loss being incurred by the taxpayer during a year of income—determine that the whole or a part of the capital loss or of the part of the capital loss, as the case may be, was not incurred by the taxpayer during that year of income".

139 Section 177D defines when Pt IVA applies to a scheme. Section 177D(1) relevantly provides that Pt IVA applies to a scheme if it would be concluded, having regard to the matters under s 177D(2), 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 dominant[153] purpose of enabling a taxpayer to obtain a tax benefit in connection with the scheme.[154] The eight matters that must be considered under s 177D(2) in determining whether a person who was a party to a scheme to which Pt IVA allegedly applies had the requisite dominant purpose are:

> "(a) the manner in which the scheme was entered into or carried out;
>
> (b) the form and substance of the scheme;

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151 Section 177A(1) of the 1936 Act defines "scheme" broadly.

152 The powers conferred by s 177F may also be exercised where another condition is present, namely, and in general terms, where there is a scheme by way of dividend stripping. That condition is defined in s 177E and is addressed in S157/2025 in relation to the Debt Forgiveness Schemes.

153 1936 Act, s 177A(5).

154 *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404 at 413.

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

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

(e) 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;

(f) 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;

(g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;

(h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f)."

Dominant purpose

140 The inquiry as to the dominant purpose is objective.[155] In its ordinary meaning, "dominant indicates that purpose which was the ruling, prevailing, or most influential purpose".[156] And the purpose which is the subject of the objective inquiry in s 177D(1) is the purpose of a person in the position, and all the circumstances, of the person or persons who entered into or carried out the scheme or any part of the scheme.[157]

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155 *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216 at 233 [37]. See also *Automotive Invest Pty Ltd v Federal Commissioner of Taxation* (2024) 283 CLR 291 at 328-329 [115]-[117].

156 *Spotless Services* (1996) 186 CLR 404 at 416.

157 *Hart* (2004) 217 CLR 216 at 242-243 [63]. See also *Federal Commissioner of Taxation v Guardian AIT Pty Ltd* (2023) 115 ATR 316 at 355 [179]; *Minerva Financial Group Pty Ltd v Federal Commissioner of Taxation* (2024) 302 FCR 52 at 65 [60(2)].

141 The eight matters that must be considered raise different attributes of what in fact took place within the parameters of the scheme identified by the Commissioner and any applicable context.[158] The relevance of these matters will primarily be ascertained by a consideration of the contemporaneous evidence adduced by the parties to the proceedings. Some matters may favour a conclusion that obtaining the tax benefit was the dominant purpose of a party to the scheme; others may favour the opposite conclusion.[159] It is not a matter of merely deciding what conclusion a majority of s 177D(2) matters point to; in a given case, some of those matters may be more important than others in assessing the dominant purpose of a party to a scheme.[160]

142 While regard must be had to all eight matters in s 177D(2), the assessment of purpose should be undertaken globally by directing attention to those matters that are relevant and probative in the circumstances.[161] The drawing of a conclusion about purpose from the eight matters identified in s 177D(2) will require consideration of what other possibilities existed to achieve the same commercial end.[162] Having considered each of the matters mandated by s 177D(2), an evaluative analysis is required to determine what stands out as prominent. In that respect, it will usually be relevant to ask whether the scheme is attended with elements of artificiality or contrivance that are primarily directed to the obtaining of the identified tax benefit, so that any commerciality of the scheme is thereby overshadowed.[163]

143 But Pt IVA does not authorise the Commissioner to make a determination under s 177F(1) merely because a taxpayer has arranged its business or

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158 *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 at 264 [96].

159 *Spotless Services* (1996) 186 CLR 404 at 416.

160 *Minerva* (2024) 302 FCR 52 at 66 [60(10)].

161 *Consolidated Press Holdings* (2001) 207 CLR 235 at 263 [94]; *Hart* (2004) 217 CLR 216 at 241 [58]; *Mills v Federal Commissioner of Taxation* (2012) 250 CLR 171 at 205 [73]; *Minerva* (2024) 302 FCR 52 at 66 [60(10)].

162 *Hart* (2004) 217 CLR 216 at 243 [66]; *Minerva* (2024) 302 FCR 52 at 67 [60(12)].

163 *Spotless Services* (1996) 186 CLR 404 at 408 (argument).

investments in a way that derives a tax benefit.[164] More is required. As Gleeson CJ and McHugh J observed in *Federal Commissioner of Taxation v Hart*:[165]

> "[T]he fact that a particular commercial transaction is chosen from a number of possible alternative courses of action because of tax benefits associated with its adoption does not of itself mean that there must be an affirmative answer to the question posed by s 177D. Taxation is part of the cost of doing business, and business transactions are normally influenced by cost considerations. Furthermore, even if a particular form of transaction carries a tax benefit, it does not follow that obtaining the tax benefit is the dominant purpose of the taxpayer in entering into the transaction."

144 And as McHugh J also observed in *Federal Commissioner of Taxation v Spotless Services Ltd*, a conclusion that a party to a scheme had a dominant purpose of obtaining a tax benefit "will seldom, if ever, be drawn if no more appears than that a change of business or investment has produced a tax benefit for the taxpayer".[166] Put in different terms, the bare fact that a taxpayer pays less tax in one form of a transaction than in another does not demonstrate that Pt IVA applies; neither does it suffice to show that there was another means of achieving the same or a similar outcome which would have resulted in more tax payable. However, as stated in *Hart*,[167] whilst there is a "false dichotomy between a 'rational commercial decision' and 'the obtaining of a tax benefit ...'", nonetheless there is a distinction between being influenced by taxation considerations and having the dominant purpose of obtaining a tax benefit.

Identification of tax benefit

145 Section 177C(1) provides that a reference in Pt IVA to "the obtaining by a taxpayer of a tax benefit in connection with a scheme" is to be read in one of a number of ways, including, under para (ba), as a reference to "a capital loss being incurred by the taxpayer during a year of income where the whole or a part of that capital loss would not have been, or might reasonably be expected not to have

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164 *Spotless Services* (1996) 186 CLR 404 at 425; *Hart* (2004) 217 CLR 216 at 240 [53].

165 (2004) 217 CLR 216 at 227 [15].

166 (1996) 186 CLR 404 at 425.

167 (2004) 217 CLR 216 at 243 [64], quoting *Spotless Services* (1996) 186 CLR 404 at 415.

been, incurred by the taxpayer during the year of income if the scheme had not been entered into or carried out".

146 Section 177CB makes clear that s 177C contains two bases upon which a tax benefit can be identified. The phrases "would have" and "might reasonably be expected to" (as they appear in s 177CB) are different limbs, not ends of a spectrum of degrees of certainty.

147 Section 177CB(2) provides that a decision that a tax effect would have occurred if the scheme had not been entered into or carried out "must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme)". This is known as the "annihilation" approach, because the scheme is assumed not to have happened.[168] Relevantly, the word "must" mandates that there cannot be a tax benefit for the purposes of s 177C if there is no "coherent taxable situation" that is the postulate.[169]

148 Section 177CB(3) provides that "[a] decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme". This is known as the "reconstruction" approach, because it considers other ways in which the non-tax results and consequences of the scheme could reasonably have been achieved without the impugned tax advantages.[170]

Courts below

149 The primary judge (Thawley J) found in favour of the Commissioner. His Honour carefully evaluated the matters prescribed by s 177D(2) and decided that each of them favoured a conclusion that the dominant purpose of each of

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168 Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 19 [1.78].

169 *Federal Commissioner of Taxation v PepsiCo Inc* (2025) 99 ALJR 1211 at 1254 [207]; 424 ALR 294 at 350-351. See also Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 20 [1.81].

170 Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 22 [1.92]-[1.93].

Mr Merchant, MFT, and GMSF in entering into the BBG Share Sale Scheme was to obtain a tax benefit, namely the BBG capital loss. His Honour concluded that s 177D(1) of the 1936 Act was satisfied and that Pt IVA applied to the BBG Share Sale Scheme.[171]

150 His Honour rejected the commercial reasons identified by GSM as explanations for the sale of the BBG shares. His Honour found, amongst other things, that:[172] (1) the BBG Share Sale Scheme was conceived or established, and then carried out, in the context and for the purposes of the anticipated sale of Plantic by MFT; (2) at the time of the BBG Share Sale Scheme, it was contemplated that a future sale of Plantic would involve the forgiveness of the debts that Plantic owed to GSM and Tironui (or most of them) with the consequence that a third party purchaser would pay more for the Plantic shares; (3) objectively assessed, the BBG Share Sale Scheme was not otherwise required for the purposes of funding MFT; (4) after the transfer of the BBG shares to GMSF, the BBG shares remained in the Merchant Group with no change to the ultimate economic owner; and (5) the acquisition of the BBG shares by GMSF was inconsistent with GMSF's documented investment strategy and the regulatory regime imposed by the *Superannuation Industry (Supervision) Act 1993* (Cth) ("the SIS Act"). Since the BBG shares were unlikely to generate dividend income in the future (and had not paid a dividend since 2012), GMSF ceased paying the pension it had been distributing to Mr Merchant, and it instead was obliged to return to an accumulation phase of investment. However, the primary judge concluded that Mr Merchant's position was still improved by the benefits that accrued to MFT through the BBG Share Sale Scheme.

151 The majority of the Full Court (McElwaine and Hespe JJ, Logan J dissenting) rejected GSM's appeal in relation to the BBG Share Sale Scheme. In particular, the majority rejected GSM's submissions that the primary judge had misapplied s 177D by making findings about the actual subjective purposes of the parties to the BBG Share Sale Scheme (at one stage of his reasons, the primary judge had referred to the "actual purpose" of a party to a scheme); that the primary judge had failed to give sufficient weight or prominence to the objective purposes of the BBG Share Sale Scheme, being to maintain control over the BBG shares, to liberate cash from GMSF, to place the BBG shares in the protected environment

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171 However, his Honour allowed the appeal in part on the basis that the capital proceeds had been incorrectly calculated.

172 *Merchant* (2024) 119 ATR 480 at 554-555 [406]-[408].

of GMSF, and to provide for the funding needs of MFT; and that, looked at as a whole, the BBG Share Sale Scheme was not artificial or contrived.

152 The majority upheld the findings of fact made by the primary judge. Their Honours decided that the primary judge's reasons, read in their entirety, demonstrated that his Honour understood and carried out the statutory task of determining an imputed purpose objectively based on the matters mandated by s 177D(2). Moreover, the majority held that the primary judge had properly taken into account the supposed objective purposes of the BBG Share Sale Scheme, but that these purposes – if they existed – were far less prominent than the purpose of obtaining the BBG capital loss, and the ability of that loss to reduce tax payable on the sale of the Plantic shares. Their Honours likened the BBG Share Sale Scheme to a "wash sale",[173] whereby Mr Merchant retained economic ownership and control over the BBG shares, and concluded as follows:[174]

> "As we have explained, what stands this case apart from the 'routine' realisation of a capital loss to be offset against an actual or anticipated capital gain are the objective facts that the BBG shares would not have been sold to an outside party, the control of the shares and the effective economic ownership did not alter and there was no divestment of investment risk. These matters, when considered with each of the other findings of the primary judge concerning the absence of need in the MFT for a cash injection of $5.8 million, the acquisition was contrary to the investment strategy of the GMSF and the absence of a link between the BBG [s]hare [s]ale and the objective of obtaining the best price for the sale of Plantic, distinguish this scheme from ordinary commercial transactions with real economic and practical consequences where the dominant purpose is not to obtain a tax benefit. The primary judge was correct to reject the appellants' submission that there was no contrived capital loss".

Appeal to this Court

153 GSM advanced two submissions in this Court to seek to demonstrate that no person who entered into or carried out the BBG Share Sale Scheme had a dominant purpose of obtaining a tax benefit. The first submission was that differences arising from the change in ownership of the BBG shares were not considered below or were erroneously dismissed or set aside. That is, the majority of the Full Court failed to take into account the legal, "commercial financial" and

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173 *Merchant* (2025) 309 FCR 144 at 190 [234]-[235].

174 *Merchant* (2025) 309 FCR 144 at 202 [297].

taxation differences between MFT and GMSF. In support of this submission, GSM largely repeated the submissions made in the courts below, highlighting the transfer of cash to MFT, the different regulatory regime in which the BBG shares commenced to be held as a result of the BBG Share Sale Scheme, the fact that the beneficiaries (and their interests in relation to the assets) of MFT differed from those of GMSF, and that there was objective potential for the BBG shares to appreciate in value in the concessionally taxed environment in which GMSF operated.

154 GSM, for example, highlighted that GM2 was the trustee of MFT, a "discretionary trust". MFT's trust deed gave GM2 a very broad discretion to deal with trust assets, including broad powers of investment and acquisition. In contrast, GMSF was subject to the SIS Act, which provides for specific statutory covenants and other rules[175] over and above ordinary trust law principles. These included strict rules concerning how a trustee is to deal with related parties. GSM submitted that these differences demonstrated that the sale of the BBG shares could not be analogised to a "wash sale", and that the sale allowed GMSF to obtain a valuable capital asset which, if the BBG shares ultimately increased in value and were later sold, would result in the realisation of a capital gain in a concessionally taxed environment.

155 The second submission was that a comparison of five alternative ways of carrying out the scheme showed that none of them were capable of securing the commercial outcomes achieved by the BBG Share Sale Scheme. This analysis was said to support a conclusion that the BBG Share Sale Scheme was explicable having regard to its non-fiscal attributes. The five alternative ways of carrying out the scheme were said to be: (1) for MFT to sell the BBG shares to a third party; (2) to do nothing; (3) for Mr Merchant to withdraw money from GMSF, which might then be contributed to MFT (to make good MFT's cash needs); (4) for MFT to draw down on its margin facility with the National Australia Bank (for the same reason); and (5) for MFT to sell other assets (for the same reason). GSM argued that none of these alternatives were capable of achieving the following suggested commercial benefits of the BBG Share Sale Scheme: Mr Merchant maintaining control over the BBG shares; MFT securing cash; exposing the BBG shares to the regulatory environment of GMSF and the SIS Act; maintaining the value of the total assets of GMSF; avoiding the incurrence of additional debt; and not selling other assets of MFT.

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175 See, eg, SIS Act, s 65(1).

156 This comparison was said to support a conclusion that the BBG Share Sale Scheme "made ... sense"[176] without the obtaining of the BBG capital loss. In that respect, GSM emphasised that the transfer of the BBG shares was an ordinary commercial transaction that took place at market value. GSM relied on the Commissioner's concession below that Pt IVA would not have applied if the BBG shares had been sold to a third party. Yet such a sale would, it was said, have generated the very same capital loss.

The first submission

157 GSM did not dispute the reasons of the majority below except for the following observations:[177]

> "The protection afforded to assets held in the GMSF submission is inconsistent with [the primary judge's] findings that the BBG shares were a risky asset, unlikely to earn dividends in the future, and the effect of the purchase was to impair the capacity of [GMSF] to continue paying Mr Merchant a pension. Objectively, that was not an advantage."

158 GSM pointed out that the primary judge did not find that the BBG shares were a risky asset; rather, his Honour found that the BBG shares were "a riskier asset than cash".[178] This reservation makes no difference to the central conclusion that the sale of the BBG shares to a complying superannuation fund made no commercial sense. Indeed, the sale endangered the very rationale of GMSF, namely the responsibility of paying Mr Merchant his pension. And this occurred in circumstances where, as the primary judge found: objectively, MFT had no need of additional cash; the acquisition was inconsistent with GMSF's own investment strategy and gave rise to regulatory problems under the SIS Act including, in 2020, the disqualification of Mr Merchant from acting as a trustee or responsible officer of a corporate trustee of a superannuation entity for GSMS's contravention of three provisions of the SIS Act when GMSF acquired the BBG shares; and the sale was made, in apparent accordance with tax advice from EY and in anticipation of the divestment to a third party of the Plantic shares, with the intention of MFT

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176 cf *Spotless Services* (1996) 186 CLR 404 at 422, quoting *Commissioner of Taxation v Spotless Services Ltd* (1995) 62 FCR 244 at 271.

177 *Merchant* (2025) 309 FCR 144 at 198 [273].

178 *Merchant* (2024) 119 ATR 480 at 553 [398].

concurrently making a large capital gain as a result of the forgiveness by GSM and Tironui of Plantic's debts for nil consideration.

159 This is not a case where there is a need to balance the commercial or other objectives achieved by a scheme against the prominence of a tax benefit secured. In this case, no other meaningful or realistic commercial objective was achieved for Mr Merchant, MFT, or GMSF by the BBG share sale.

160 The differences, for example, in the terms of the trust deed of MFT and the regulatory regime applicable to GMSF under the SIS Act do not reveal a rational explanation for the BBG share sale, save that it would generate capital losses to be used to shelter the anticipated capital gain on the Plantic share sale from taxation. Further, and again by way of example, the fact that the trusts had different beneficiaries with different interests goes nowhere given that those beneficiaries were all controlled by Mr Merchant. None of the differences raised by GSM provide a logical or commercial foundation for the sale of the BBG shares to GMSF. All that is then left of substance, and which is glaringly prominent, is the value of using the BBG capital loss to shelter from taxation the Plantic capital gain.

161 The foregoing is not a conclusion about actual or subjective purpose, although the evidence would support that inference. It is a conclusion about the purpose of a person in the position of each of Mr Merchant, MFT, and GMSF based on an objective assessment of what took place and having regard to the matters set out in s 177D(2). In that respect, the analysis of the primary judge concerning those matters, which is summarised above and which need not be repeated, was correct for the reasons that his Honour gave. In particular: the BBG share sale was conceived and carried out in the context of the anticipated sale of Plantic by MFT; the substance of the BBG Share Sale Scheme was to allow Mr Merchant to retain economic ownership of the BBG shares but crystallise a capital loss for MFT; and GMSF's acquisition of the BBG shares was to the detriment of Mr Merchant's pension and the income of GMSF.

The second submission

162 This leaves GSM's second submission and its reliance on five counterfactuals, based upon the following passage from the reasons of Gummow and Hayne JJ in *Hart*:[179]

> "In the present matters, the respondents would obtain a tax benefit if, in the terms of s 177C(1)(b), had the scheme not been entered into or

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179 (2004) 217 CLR 216 at 243 [66].

carried out, the deductions 'might reasonably be expected not to have been allowable'. When that is read with s 177D(b)[180] it becomes apparent that the inquiry directed by Pt IVA requires comparison between the scheme in question and an alternative postulate. To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed."

163 With respect, GSM's submission is misconceived. And all but the "do nothing" alternative were premised on an assumption that MFT needed cash or that GMSF would benefit from owning the BBG shares transferred to it. But as already mentioned, the primary judge found that MFT did not have any need for additional funds and that transferring the BBG shares did not benefit GMSF. In contrast, two commercial benefits of various of the alternatives identified by GSM were real – namely the obtaining of the BBG capital loss from the BBG share sale, and the payment of a pension to Mr Merchant by GMSF. The BBG Share Sale Scheme resulted in securing that capital loss, but resulted in no pension being paid to Mr Merchant by GMSF. This again highlights the dominance of the BBG capital loss.

164 The Commissioner's acceptance that a sale of shares to a third party to realise a capital loss for the purpose of offsetting a likely corresponding capital gain does not attract Pt IVA compels no different analysis. A sale of the BBG shares to a third party would have involved real commercial outcomes and, as such, would not have been comparable to what took place here. In contrast, as the majority of the Full Court found below, the BBG Share Sale Scheme was analogous to a "wash sale", whereby a sale occurs without any transfer of ultimate economic ownership and control but results in tax advantages.

165 The scheme considered by the Full Court in *British American Tobacco Australia Services Ltd v Federal Commissioner of Taxation*[181] is analogous to the BBG Share Sale Scheme. In that case, the group of companies to which the taxpayer belonged had merged with the Rothmans Group of companies. It was a condition of the merger, imposed by the Australian Competition and Consumer Commission, that the taxpayer divest certain of its brands. One of the attributes of the Rothmans Group was that it had available to it capital losses in excess of $163 million. The taxpayer did not sell its brands directly to a third party. Rather,

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180 Section 177D(b) was the predecessor provision to s 177D(2). The provision was substituted by the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth), Sch 1, item 5.

181 (2010) 189 FCR 151.

it sold them first to an entity in the Rothmans Group for $181.7 million, which then immediately sold them to companies within a third party group for the same price. The sale by the taxpayer to the Rothmans Group entity had no tax consequences for the taxpayer as it claimed capital gains tax rollover relief. This meant that the Rothmans Group entity inherited the capital gains tax historical cost bases of the brands. The Rothmans Group entity made a considerable capital gain when it sold those brands to companies in the third party group, but it used its existing capital losses to reduce the tax payable.

166 The Commissioner applied Pt IVA to include in the assessable income of the taxpayer the net capital gain it would have derived had it sold the brands directly to the third party group, rather than to the Rothmans Group entity. The taxpayer complained that, whilst tax considerations had featured in its planning, the dominant purpose for the sales was to comply with a condition of merging with the Rothmans Group. This complaint was rejected by the Full Court, which identified as the relevant alternative counterfactual a direct sale of the brands by the taxpayer. The Full Court concluded as follows:[182]

> "A comparison between the Scheme carried out and the counterfactual was important in the present case because it revealed that the manner in which the Scheme was formulated and carried out was, when compared with the counterfactual, explicable only by taxation consequences".

167 A similar conclusion should be reached here. The BBG Share Sale Scheme was a purely internal transfer of shares between entities controlled by Mr Merchant. As a commercial proposition, it "made no sense",[183] as is clear from the findings of the primary judge. But as an example of tax planning, it made perfect sense: it produced a large capital loss which was then available to shelter from taxation the expected capital gain from the sale of the Plantic shares. As such, the BBG Share Sale Scheme is only explicable by reference to its valuable tax consequences.

168 GSM's appeal must be dismissed with costs.

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182 *British American Tobacco Australia Services Ltd v Federal Commissioner of Taxation* (2010) 189 FCR 151 at 163 [53].

183 *Spotless Services* (1996) 186 CLR 404 at 422, quoting *Spotless Services* (1995) 62 FCR 244 at 271.

S157/2025: Debt Forgiveness Schemes – s 177E of the 1936 Act

169 As stated, the issue in this appeal is whether each Debt Forgiveness Scheme was a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping for the purpose of s 177E(1)(a)(ii) of the 1936 Act.

History of dividend stripping

170 Dividend stripping is a particular form of historical tax avoidance arrangement that emerged in the United Kingdom and Australia. Whilst there were and are important differences in the taxing regimes in each country, dividend stripping schemes in the two jurisdictions ostensibly exhibited similar features. They were: the identification of a target company with large accumulated current and retained earnings; the purchase of the shares in that company by the "stripper" (who would be a dealer in shares); the stripping out of those retained earnings by the stripper in a tax advantaged way; and then the sale by the stripper of the shares at a loss which would be tax deductible.[184]

171 Before 1972, the efficacy and fiscal attractiveness of such an arrangement in Australia depended upon certain features of the income tax regime which no longer exist. The first feature was the absence of any comprehensive tax on capital gains; the second feature was the availability of a rebate for the payment of a dividend by a company to a resident company;[185] and the third feature was the absence of any anti-avoidance rule directed specifically at dividend stripping.[186] As a result, a vendor of shares in a target company effectively converted into a tax-free amount of capital what would otherwise have been paid to that person as an assessable dividend; the stripper was able to have that dividend paid instead to it, but subject to a rebate of tax; and the stripper, being a trader in shares, was then

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184 See the description at [185]-[186] below of the common characteristics of dividend stripping.

185 1936 Act, s 46, repealed by *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006* (Cth), Sch 1, item 60.

186 cf 1936 Act, s 260, as amended by *Income Tax Laws Amendment Act (No 2) 1981* (Cth), s 10. See also *Federal Commissioner of Taxation v Patcorp Investments Ltd* (1976) 140 CLR 247.

able to sell the company, now stripped of value, at a loss, but was able to claim this loss as a deduction.[187]

172 In 1972, a specific anti-avoidance provision, s 46A, which targeted dividend stripping arrangements by limiting the availability to the stripper of the rebate on dividends paid to it, was introduced into the 1936 Act.[188]

173 In 1981, s 177E of the 1936 Act was enacted.[189] This provision was an anti-avoidance rule directed specifically at dividend stripping. At that time, while the third of the three fiscal attributes of the pre-1972 income tax regime had been removed, the first two remained in place, namely, the availability of a rebate for dividends paid to resident companies (notwithstanding and subject to s 46A of the 1936 Act) and the absence of a general tax on capital gains. As to the latter feature, this Court observed in *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* as follows:[190]

> "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".

174 Today, the Commonwealth's regime for taxing income, as prescribed by the 1936 Act and the 1997 Act, comprehensively taxes capital gains,[191] and has eliminated the dividend rebate. Instead, it provides for certain corporate taxpayers to pass to their shareholders the benefit of having already paid income tax on the profits underlying certain distributions in the form of franked dividends, subject to specific anti-avoidance rules which are similar in application to former s 46A.[192]

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187 See, eg, *Investment and Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1971) 125 CLR 249.

188 *Income Tax Assessment Act (No 3) 1972* (Cth), s 4. See 1936 Act, s 46A, later repealed by *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006* (Cth), Sch 3, item 6.

189 *Income Tax Laws Amendment Act (No 2) 1981* (Cth), s 7.

190 (2001) 207 CLR 235 at 267 [104].

191 See 1997 Act, Pt 3-1.

192 1997 Act, Pt 3-6. See, in particular, Subdiv 207-F.

Legislative regime

175 Within the structure of Pt IVA, s 177E prescribes specific conditions to be satisfied before the Commissioner can exercise the power in s 177F to include an amount in the assessable income of a taxpayer, here Mr Merchant, because of the entry into of a dividend stripping arrangement.

176 Section 177E relevantly provides:

"(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 or her opinion, represented by the disposal of the property referred to in paragraph (a), an amount (in this subsection 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 subsection (1), a reference in that subsection 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.

...

(3) In this section, ***property*** includes a chose in action and also includes any estate, interest, right or power, whether at law or in equity, in or over property."

177 The power exercised by the Commissioner to include a sum in the assessable income of Mr Merchant as a deemed dividend is found in s 177F(1)(a), which is in the following terms:

"Where this Part applies to a scheme in connection with which a tax benefit has been obtained, or would but for this section be obtained, 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".

178 Section 177E(1) prescribes four matters that must be satisfied before the power in s 177F can be exercised. The first is that property of a company has been disposed of as a result of a scheme in one of two ways: (i) there has been a scheme by way of or in the nature of dividend stripping (s 177E(1)(a)(i)) or (ii) there has been a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping (s 177E(1)(a)(ii)). The Commissioner only contended that the Debt Forgiveness Schemes satisfied the second of these two ways of disposing of company property.

179 The second is that in the opinion of the Commissioner, the disposal of property represents, in whole or in part, a distribution of profits of that company (s 177E(1)(b)). The third is that those profits (called the "notional amount") would otherwise have been included, or might reasonably be expected to have been included, by reason of the payment of a dividend, in the assessable income of a taxpayer (s 177E(1)(c)). The fourth is that the scheme has been entered into after 27 May 1981 (s 177E(1)(d)).

180 If all four conditions are satisfied the following consequences arise: the scheme is taken to be a scheme to which Pt IVA applies (s 177E(1)(e)); the taxpayer is taken to have obtained a tax benefit referable to the notional amount not being included in that taxpayer's assessable income (s 177E(1)(f)); and the amount of that tax benefit is taken to be the notional amount (s 177E(1)(g)).

181 Section 177E(2) supplies a broad reading of what constitutes a disposal of property for the purposes of s 177E(1). In this appeal, it was not in dispute that the forgiveness of each debt was a disposal of property by GSM and Tironui respectively.

"Dividend stripping" in the Explanatory Memorandum

182 Whilst Pt IVA was intended to be a comprehensive expression of what arrangements would be considered to be tax avoidance, the Explanatory Memorandum describes s 177E as a "supplementary code" and as a "self contained code".[193] The need for such a code arose from a concern that some dividend stripping schemes may not satisfy the requirement in s 177C that there be a tax

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193 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 4, 13. See also *Income Tax Laws Amendment Act (No 2) 1981* (Cth), s 7.

benefit obtained by the taxpayer. That is the explanation given in the Explanatory Memorandum in the following passage, which should be set out in full:[194]

> "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 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."

183 The first paragraph identifies the effect of dividend stripping: company profits are placed in the hands of shareholders in a tax-free form, in substitution for taxable dividends. The second paragraph identifies common badges of dividend stripping: converting the assets of a target company into cash by a shareholder selling their shares for a capital sum to the stripper; the subsequent reimbursement to the stripper of the price paid for the shares by the payment of a

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194 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 4, reproduced by this Court in *Consolidated Press Holdings* (2001) 207 CLR 235 at 268-269 [108].

dividend or other payment from the target company; or a party related to the stripper obtaining the "enjoyment" of property of the target company. The result was that "profits thus effectively stripped from the company do not bear tax". Those badges are identified again in the Explanatory Memorandum when it states:[195]

> "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."

Those passages explain the concept of "dividend stripping" for the purposes of s 177E.

184 Another passage in the Explanatory Memorandum explains what was intended by the enactment of s 177E(1)(a)(ii) and its reference to a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping. The purpose of this sub-paragraph is to make it clear that s 177E will apply to a scheme that strips retained and current year earnings out of a company by means other than the payment of a dividend. The Explanatory Memorandum thus states:[196]

> "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."

Consolidated Press Holdings *on the concept of "dividend stripping" in s 177E*

185 The Explanatory Memorandum's explanation of what constitutes dividend stripping coheres with the description given by the Full Court in *Consolidated*

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195 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 14.

196 Australia, House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 14.

Press Holdings,[197] which considered four decisions of this Court on appeal and of the Privy Council.[198] The Full Court said:[199]

> "These four cases had the following characteristics in common:
>
> - a target company, which had substantial undistributed profits creating a potential tax liability either for the company or its shareholders;
> - the sale or allotment of shares in the target company to another party (a company in three cases and individuals resident in the then Territory of New Guinea in *Bell*[200]);
> - the payment of a dividend to the purchaser or allottee of the shares out of the target company's profits;
> - the purchaser escaping Australian income tax on the dividend so declared (whether by reason of a s 46 rebate, an offsetting loss on the sale of the shares, or the fact that the shareholders were resident outside Australia); 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 (there being no capital gains tax at the relevant times)."

186 The Full Court went on to identify a sixth common characteristic of dividend stripping, namely that such schemes were "carefully planned, with all the parties acting in concert, for the predominant if not the sole purpose of the vendor shareholders, in particular, avoiding tax on a distribution of dividends by the target

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197 See *Consolidated Press Holdings* (2001) 207 CLR 235 at 273 [126].

198 *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548; *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1; [1958] AC 450; *Hancock v Federal Commissioner of Taxation* (1961) 108 CLR 258; *Federal Commissioner of Taxation v Ellers Motor Sales Pty Ltd* (1972) 128 CLR 602.

199 *Commissioner of Taxation v Consolidated Press Holdings Ltd [No 1]* (1999) 91 FCR 524 at 561 [136].

200 (1953) 87 CLR 548.

company".[201] The need for a tax avoidance purpose was decisive to the outcome in *Consolidated Press Holdings*.[202]

187 On appeal, this Court observed that the Explanatory Memorandum had recognised that dividend stripping schemes had "common" features. This Court said:[203]

> "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'."

188 This Court went on to affirm what those common features are: they are precisely the "common characteristics" identified by the Full Court.[204] This Court also confirmed that the term "dividend stripping" bore the same meaning in both s 177E(1)(a)(i) and (ii).[205] And it explained the function of s 177E(1)(a)(ii) in accordance with the explanation given by the Explanatory Memorandum. This Court said:[206]

> "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."

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201 *Consolidated Press Holdings [No 1]* (1999) 91 FCR 524 at 561 [137].

202 (2001) 207 CLR 235 at 275 [133]-[134]. See also *Consolidated Press Holdings [No 1]* (1999) 91 FCR 524 at 570-571 [175]-[178].

203 *Consolidated Press Holdings* (2001) 207 CLR 235 at 267 [103].

204 *Consolidated Press Holdings* (2001) 207 CLR 235 at 273 [126].

205 *Consolidated Press Holdings* (2001) 207 CLR 235 at 276 [138].

206 *Consolidated Press Holdings* (2001) 207 CLR 235 at 276 [140].

Conclusion on the concept of dividend stripping in s 177E(1)

189 Parliament took care not to define the term "dividend stripping". Inferentially, Parliament considered the term to bear an ascertainable meaning. Indeed, writing in 1970, Windeyer J was of the view that the term had become "well known" in English revenue law.[207]

190 That essential meaning of dividend stripping must now be considered to have been settled by the decision of this Court in *Consolidated Press Holdings*. When the Full Court in that case described the "characteristics in common" in dividend stripping arrangements, it was not expressing a non-exclusive list of attributes that may or may not be evident in dividend stripping, leaving "dividend stripping" as a malleable concept without any real connection with the core aspects of the sense in which the term was historically used. Rather, the Full Court was identifying the essence of a particular type of tax avoidance arrangement that had been the subject of past decisions of this Court and the Privy Council. Those common characteristics were not mere illustrations or hypothetical examples of some more abstract conception of dividend stripping. They were essential.

191 Although there is flexibility in its application to the different circumstances in which these common characteristics might be present, the concept of dividend stripping would be deprived of its essential meaning if it were expressed at a level of generality that did not contain these common characteristics of the historical tax avoidance arrangement that became known as dividend stripping. Therefore, when Parliament used the term "dividend stripping" in 1981, it must have intended it to import that essential meaning. And its manifest description of s 177E as a "code" supports giving the term "dividend stripping" a clear and fixed meaning.

192 It follows that arrangements that bear some, but not all, of these common characteristics do not constitute dividend stripping schemes. To the extent that they result in an avoidance of tax they should be addressed either by the general anti-avoidance provisions in Pt IVA, or by some other, specific anti-avoidance rule, or not at all. Nevertheless, Parliament recognised, in s 177E(1)(a)(ii), that there may be some arrangements that have "substantially the effect" of a scheme "by way of or in the nature of a dividend stripping". To apply s 177E to cases that neither involve dividend stripping nor are sufficiently akin to it to have "substantially the effect" of dividend stripping would diminish the reach and function of Pt IVA as an overriding anti-avoidance regime of paramount application; it would promote s 177E as a parallel general anti-avoidance regime

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207 *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1970) 120 CLR 177 at 179.

within Pt IVA. But that is not what Parliament intended. Section 177E is but a "supplementary code" designed to plug a specific perceived gap in the application of Pt IVA to an historical and particular avoidance arrangement.

193 That is not to deny that some variations on the particular form of the historical tax avoidance arrangement of dividend stripping are not caught by s 177E. That is the function of s 177E(1)(a)(ii) and its reference to a "scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping". But wholesale variations which bear little resemblance to the common characteristics, save for the presence of a purpose of tax avoidance, are not within the reach of s 177E(1)(a)(ii).

194 Thus, the scope and application of s 177E(1)(a)(ii) is not open-ended; it does not apply to any scheme involving a transfer of corporate value in a tax advantaged way. That might be, if necessary, a matter for the general anti-avoidance provisions in Pt IVA. Rather, s 177E(1)(a)(ii) is concerned with schemes with only limited deviation from the essential meaning of dividend stripping, thus still substantially corresponding to the common characteristics of dividend stripping and remaining directed to securing the "effect" of avoiding tax on company profits. To the extent that any decisions of the Full Court are inconsistent with this approach, they should not be followed.[208]

Courts below

195 Before the primary judge, the Commissioner contended that there was a relevant disposal of property by the forgiveness by GSM and Tironui of Plantic's debts for nil consideration. Importantly, the primary judge did not accept that this disposal made commercial sense from the perspective of either GSM or Tironui. Further, the Commissioner contended that the value of the debts (in the sum of $50.192 million owed to GSM, and $4.215 million owed to Tironui) had been stripped out. That stripped value was ultimately reflected, it was said, in the Plantic capital gain, which gain was sheltered in part by the BBG capital loss. It was contended that by this arrangement Mr Merchant avoided liability to a top-up tax[209] on dividends that would otherwise have been distributed to him as the sole shareholder of GSM and Tironui. The amended assessment issued to Mr Merchant treated the amount of the forgiven debts as a dividend paid to him. Critically, the

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208 See, eg, *Lawrence v Federal Commissioner of Taxation* (2009) 175 FCR 277.

209 This is the tax payable on the dividends that would have been paid after taking into account the imputation credits on the basis that the dividends would have been fully franked.

Commissioner's case was conditioned upon the availability of the BBG capital loss. Mr Merchant made submissions to the primary judge primarily directed to whether a tax avoidance purpose existed for this scheme. The primary judge rejected Mr Merchant's submissions.

196 The primary judge accepted that there was an arrangement which had substantially the effect of a scheme by way of or in the nature of a dividend stripping. His Honour also agreed with the Commissioner that s 177E was to be applied on the assumption that the BBG capital loss was available to shelter much of the Plantic capital gain from taxation. The primary judge dismissed Mr Merchant's appeal and confirmed the Commissioner's objection decision.

197 The majority of the Full Court upheld part of Mr Merchant's appeal in relation to the Debt Forgiveness Schemes. Their Honours accepted that a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping could arise by the forgiveness of the debts by GSM and Tironui and the sheltering of the capital gain from the Plantic share sale with capital losses from the BBG share sale. However, their Honours did not accept the existence of the BBG capital loss as a step of the Commissioner's alleged Debt Forgiveness Schemes, since the BBG capital loss had been cancelled by the Commissioner pursuant to s 177F(1),[210] and the resulting amended assessments giving effect to this had been upheld by the primary judge.

198 Nonetheless, the majority went on to consider the Debt Forgiveness Schemes. Their Honours found that MFT's pre-existing capital losses, unrelated to the BBG share sale, were available to shelter, and did shelter in part, the Plantic capital gain. On that basis, because the effect of the forgiveness of the amount owed to Tironui was very substantially to strip out the value of its retained and current year earnings, and because their Honours found that a purpose of tax avoidance attended the Tironui Debt Forgiveness Scheme, the majority were satisfied that s 177E(1)(a)(ii) applied to that scheme. In contrast, because the effect of the forgiveness of the amount owed to GSM represented less than 25 per cent of its retained and current year earnings, s 177E(1)(a)(ii) was not satisfied in the case of the GSM Debt Forgiveness Scheme. That result was based on a conclusion that a scheme by way of or in the nature of a dividend stripping must exhibit two features which were absent in the case of the GSM Debt Forgiveness Scheme: first, that the assets of the target company will usually be substantially reflected in the accumulated past and current year profits and these are then stripped out of the company by the stripper; and secondly, substantial tax is thereby avoided on those profits. As to the latter, the majority of the Full Court calculated that some

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210 See [114] above.

$34 million of the proceeds of the Plantic share sale was still subject to capital gains tax and was not sheltered by MFT's pre-existing capital losses. That calculation was not challenged on appeal to this Court.

Appeal and cross-appeal

199 In this Court, the Commissioner contended that the majority of the Full Court erred in holding that the existence of a scheme satisfying s 177E(1)(a)(ii) (and inferentially s 177E(1)(a)(i)) in Pt IVA of the 1936 Act requires a "substantial liability" to tax to have been avoided on a "substantial proportion" of the "accumulated profits" of a target company. The Commissioner contended that the Full Court ought to have held that the provision is engaged if tax is avoided by the taxpayer referred to in s 177E(1)(c) on the profits that are the subject of s 177E(1)(b) of the 1936 Act. The Commissioner also sought to challenge the decision of the majority to take into consideration the Commissioner's successful cancellation of the BBG capital loss.

200 Mr Merchant cross-appealed in this Court in respect of the forgiveness of the debt owed to Tironui by Plantic, having succeeded in the Full Court in relation to the forgiveness of the debt owed to GSM by Plantic.[211] Mr Merchant contended that the majority of the Full Court erred in finding that the Tironui Debt Forgiveness Scheme involved a tax avoidance purpose and further erred in finding that that scheme had substantially the effect of a scheme by way of or in the nature of a dividend stripping. Mr Merchant also relied upon a Notice of Contention which contended that the majority of the Full Court were correct to conclude that s 177E did not apply in relation to the GSM Debt Forgiveness Scheme, but erred in finding that that scheme had the requisite purpose of tax avoidance.

Commissioner's submissions on "dividend stripping"

201 The Commissioner submitted that the scope and operation of s 177E(1)(a)(ii) should be controlled by an assessment of what is dividend stripping conceived of at a much more abstract level than adopted by the majority of the Full Court. He relied on two highly generalised descriptions of dividend stripping. The first was a single sentence from the reasons of Gibbs J in *Federal Commissioner of Taxation v Patcorp Investments Ltd* where his Honour, after referring to *Bell v Federal Commissioner of Taxation*,[212] *Newton v Federal*

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211 The relevant taxpayer in S157/2025 is Mr Merchant.

212 (1953) 87 CLR 548.

Commissioner of Taxation,[213] *Hancock v Federal Commissioner of Taxation*,[214] and *Federal Commissioner of Taxation v Ellers Motor Sales Pty Ltd*,[215] said:[216]

> "Those were all cases in which the arrangement had the purpose of giving the character of capital to what, apart from the arrangement, would have been received as income and thus of avoiding liability for tax on the amounts received."

202 The second was a definition of "bond washing and dividend stripping" extracted from *Fowler's Modern English Usage*.[217] In his reasons in *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation*, at first instance Windeyer J had referenced an extract of this definition as follows:[218]

> "Most of us are familiar with these terms, but few know much more about them than that they are devices for the legal avoidance of taxation. In the course of the duel provoked by them between the tax avoider and the legislature they have developed a protean variety of detail, but their essence remains the same."

203 In this appeal, the Commissioner also relied upon the balance of Fowler's definition, which was as follows:[219]

> "In their original and simplest form they were collusive transactions by which a person liable to high rate of surtax would avoid liability by selling investments cum dividend and buying them back at a lower price after the dividend had been paid to the purchaser; in this way he converted what would have been taxable income in his hands into a non-taxable gain. The other party to the deal would be either a tax-exempt body (e.g. a charity) or someone (e.g. a dealer in securities) who, unlike the ordinary taxpayer, was

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213 (1958) 98 CLR 1; [1958] AC 450.

214 (1961) 108 CLR 258.

215 (1972) 128 CLR 602.

216 *Patcorp* (1976) 140 CLR 247 at 300.

217 Fowler, *A Dictionary of Modern English Usage*, 2nd ed (1965) at 61-62.

218 (1970) 120 CLR 177 at 179.

219 Fowler, *A Dictionary of Modern English Usage*, 2nd ed (1965) at 62.

taxable on his gains from transactions in securities and so could set off his loss on resale against his liability. Thus, provided that the difference between the two prices, with incidental expenses, did not exceed the amount of the dividend, the only loser would be the Revenue."

204 The Commissioner, relying on the foregoing, submitted that dividend stripping is a "protean" concept. Its essence, it was said, extended to any arrangement whereby there has been a denial to the revenue of tax that would have been payable on the declaration of the expected dividend, because profits have been converted to capital, in the context of a presence of a purpose of tax avoidance. That essence, it was said, marked the metes and bounds of s 177E(1)(a)(ii).

205 Here, the Commissioner submitted that this essence could be found in the elements of the Debt Forgiveness Schemes on the basis that value was stripped out of GSM and Tironui, as the target companies, which might have been paid as a dividend to Mr Merchant. That value increased the capital value of Plantic. The capital value was realised when Plantic was sold by MFT, but no or little tax was paid by MFT on that capital gain due – in part at least – to the capital loss arising from the BBG share sale (on the assumption that this loss was lawfully available). For the reasons given below, this was not a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping. It bore little resemblance to the concept of dividend stripping. In any event, the submission was misconceived.

No dividend stripping

206 As explained above,[220] when Parliament used the term "dividend stripping" in 1981 it did so by reference to the characteristics identified by this Court in *Consolidated Press Holdings*.[221] Not only was it not the intention of Parliament to express the essential meaning of dividend stripping by such a generic description so as to create a parallel anti-avoidance scheme, but such a description of a revenue concept would defeat the usual purpose of revenue law where a taxpayer must know with certainty the criterion for a liability to pay tax. Fowler's description of "bond washing and dividend stripping"[222] – a definition applicable to English law –

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220 See [182]-[184] above.

221 (2001) 207 CLR 235 at 273 [126].

222 Fowler, *A Dictionary of Modern English Usage*, 2nd ed (1965) at 61-62.

is thus of no assistance in determining whether an actual arrangement does or does not comprise dividend stripping.

207 It was also an error to rely on a single sentence from the reasons of Gibbs J in *Patcorp*.[223] Read in context, his Honour was not expressing a principle of law. Gibbs J was doing no more than pointing to a crucial distinction between the case at hand and four dividend stripping schemes which had been struck down by s 260, namely that the former could not be "predicated to be an attempt to avoid tax", while the latter each had a purpose of tax avoidance. Thus, Gibbs J dismissed the Commissioner's appeal as an "attempt to deny to [the taxpayer] a rebate to which the [1936] Act gives it an entitlement". As the Full Court correctly observed in *Consolidated Press Holdings*, when distilled at the level of identifying what – at law – is a scheme by way of dividend stripping, the cases involving dividend stripping exhibit the common characteristics or features set out above, and they do so as an historical fact.[224] That history denies the Commissioner's central thesis that the protean quality of dividend stripping schemes somehow expands the essential nature of such a scheme. It does not. Dividend stripping was, and is, a distinct type of tax avoidance arrangement with a fixed essential meaning although flexible in application. It is by a strict "following of ... legal forms" – namely the classic elements of dividend stripping – that the name "dividend stripping" becomes "in law a thing".[225]

208 The Commissioner accepted that the Debt Forgiveness Schemes lacked the common characteristics of dividend stripping identified in previous cases. First, there was no sale of the shares in each of the target companies, namely GSM and Tironui. The profits in those companies were not converted into capital by Mr Merchant; he remained at all times the sole shareholder of those companies. Secondly, there was no payment of a dividend to any stripper; the stripper was said to be MFT. Thirdly, no stripper sold the shares in the target companies at a loss. Fourthly, MFT was identified both as being the stripper (even though it held no shares in the target companies) and as being equivalent to the vendor of shares in the target company who receives a capital sum (even though the shares in the target companies were never sold). Fifthly, any dividend that might have otherwise been paid to Mr Merchant by GSM and Tironui would not have been fully taxable in his hands. The Commissioner accepted that such dividends would have been fully franked, leaving Mr Merchant to pay only top-up tax if necessary. And for the

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223 (1976) 140 CLR 247 at 300.

224 *Consolidated Press Holdings [No 1]* (1999) 91 FCR 524 at 561 [136]-[137].

225 *Federal Commissioner of Taxation v Casuarina Pty Ltd* (1970) 127 CLR 62 at 77.

reasons set out below, there was, in any event, no substantial avoidance of tax by reason of the entering into and carrying out of the Debt Forgiveness Schemes.

209 The foregoing deviations from the essential characteristics of dividend stripping are extreme. They are not mere variations in form. The Debt Forgiveness Schemes bear no resemblance, or any substantive resemblance, to commonly deployed dividend stripping schemes, which have been the subject of cases before this Court. Nor can it be said that these are schemes which substantially exhibit the common characteristics of dividend stripping, but with taxable profits being stripped in a way other than by the payment of a dividend.[226] The Debt Forgiveness Schemes fall well outside the widest possible concept of dividend stripping or a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping.

210 Whilst, as the Full Court correctly observed, it may be accepted that typical attributes of a scheme by way of dividend stripping include that the assets of the target company will usually be substantially reflected in the accumulated past and current year profits and these are then stripped out of the company by the stripper with substantial tax being avoided on those profits, it is unnecessary to decide whether these are necessary attributes of such schemes. Suffice to say, the smaller the amount of value stripped out of a target company, and the smaller the amount of tax thereby avoided, the less likely it will be found that an arrangement has a dominant purpose of avoiding tax.

211 But even if dividend stripping were an almost barren concept, bearing only the essential elements propounded by the Commissioner (and it is not), there are two further difficulties with his application of s 177E. First, it was a key component of his conception of dividend stripping that profits of the target companies were to be converted to capital. That did not take place in the Debt Forgiveness Schemes. The profits of GSM and Tironui were not converted into capital. Instead, a capital asset of each of GSM and Tironui – the debts owed by Plantic, being loans receivable – was converted into profits of Plantic when those debts were forgiven. On any view, this increased Plantic's current year profits. It is true that those profits were then converted into capital by MFT; but Plantic was not the target company from which profits were stripped. Its profits, not the profits of GSM and Tironui, were converted into capital. Moreover, but for the Debt Forgiveness Schemes, GSM and Tironui would simply have had their debts repaid.

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226 See 1936 Act, s 177E(2).

212 The second difficulty is that, even assuming the availability of the BBG capital loss,[227] the income or gain purportedly stripped out of GSM and Tironui remained within the Merchant Group (in the form of the proceeds of sale of the Plantic shares) and it was probably the case that some entity within the Merchant Group or Mr Merchant would be liable – at some point – to be taxed on it in some way. In that respect, the likelihood of the future taxation of this income or capital gain was – as a matter of logic – similar to the probability that, but for the Debt Forgiveness Schemes, GSM and Tironui would have paid franked dividends to Mr Merchant. The gain made on the sale of the Plantic shares by MFT, if sheltered by the BBG capital loss, would still need to be distributed – at the latest by the vesting day of the trust – to one or more of the beneficiaries as either income or corpus and be taxed accordingly. It is impossible on the evidence before the Court to calculate the tax that might then be payable. But the point is that the taxing of the Plantic capital gain, at least in part, may only be an issue of timing.

213 It follows that the Debt Forgiveness Schemes fail to achieve their fiscal objectives and fail as a means of sheltering the retained and current year earnings of GSM and Tironui – as represented by the Plantic capital gain – from significant taxation. Moreover, for the reasons set out below,[228] there was no denial to the revenue of tax as a result of the entering into and carrying out of all of the steps that comprised the Debt Forgiveness Schemes.

Pre-existing capital losses

214 The Commissioner alternatively submitted that even without the availability of the BBG capital loss, there existed a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping because part of the Plantic capital gain was sheltered by other capital losses which MFT already had. Those losses totalled $40,093,792.12. The Commissioner thus submitted that MFT was like the tax-exempt stripper mentioned in Fowler's definition.

215 There are a number of difficulties with this alternative submission. First, the utilisation of the pre-existing capital losses never formed part of the scheme identified by the Commissioner as having substantially the effect of a scheme by way of or in the nature of a dividend stripping. Secondly, the pre-existing losses were not artificially created; it was not suggested that they were not legitimate carry forward capital losses. Thirdly, given that the shares in Plantic were expected

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227 See [221] below.

228 See [224] below.

to be sold, the capital gain that might have thereby been made would always have been sheltered by these losses. Fourthly, it is difficult to conclude that such a scheme would exhibit a dominant purpose of tax avoidance; the 1997 Act expressly permits a capital loss genuinely incurred to be used to reduce a capital gain.[229] Fifthly, the scheme retains the same acute deviations from a scheme by way of or in the nature of a dividend stripping as described above. The Commissioner's alternative submission is rejected.

Interrelationship between ss 177D and 177E

216 The final issue in the appeal in S157/2025, concerning the Debt Forgiveness Schemes, is the relationship between ss 177D and 177E. The Commissioner submitted that the "taxable fact" of the cancellation of the tax benefit under s 177F(1), being the benefit that would have been obtained as a result of the BBG Share Sale Scheme (see S158/2025), should have been ignored when determining the tax outcome of the Debt Forgiveness Schemes under s 177E.

217 The appeals in S158/2025 and S157/2025 are separate appeals dealing with separate taxable events, different participants and different taxpayers. They are, however, connected by the same factual substratum and, importantly, the sale of the BBG shares by MFT to GMSF on 4 September 2014, which crystallised the BBG capital loss, constitutes the first step of each of the Debt Forgiveness Schemes.

218 The relevant jurisdiction of the court in a tax appeal made pursuant to Pt IVC of the *Taxation Administration Act 1953* (Cth) ("the TAA") against an objection decision is to determine whether the taxpayer has discharged the burden of proving that the assessment in question is excessive or is otherwise incorrect and what the assessment should have been.[230] The power of the court to make orders in such an appeal is plenary in nature: the court "may make such order in relation to the decision as it thinks fit".[231] In *Federal Commissioner of Taxation v ANZ Savings Bank Ltd*, this power was described by Brennan, Deane, Dawson and Toohey JJ as being expressed "in the widest terms".[232] Speaking of former s 199

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229 1997 Act, s 100-50.

230 TAA, s 14ZZO(b)(i).

231 TAA, s 14ZZP.

232 (1994) 181 CLR 466 at 476.

of the 1936 Act, the predecessor to the current s 14ZZP of the TAA, which confers a like power on the court, the plurality said:[233]

> "A power to make such order as the Court thinks fit is clearly not unconstrained but there is nothing in s 199 to suggest that the Federal Court may not make such order in relation to the objection decision as is appropriate in all the circumstances once the subject matter of the taxpayer's dissatisfaction with the assessment has been resolved."

219 The key phrase in the foregoing quote is "the subject matter of the taxpayer's dissatisfaction with the assessment". It is the entirety of that dissatisfaction with which the court is seized. Thus, in *ANZ Savings Bank*, the taxpayer claimed its share of a partnership loss as an allowable deduction; this included a deduction for interest incurred on a partnership borrowing. The Commissioner disallowed the deduction and the taxpayer objected. In the Commissioner's objection decision he reversed his position and allowed the expenses, including interest, as a deduction, but re-calculated the income of the partnership on a different basis (applying Div 16E of Pt III of the 1936 Act). This left the taxpayer with a smaller deductible loss. In the Full Court, faced with a submission that his application of Div 16E was incorrect, the Commissioner contended that he could instead defend the assessment in question by reversing – again – his position on the deductibility of the interest (which he had previously allowed in his objection decision). The taxpayer contended that this issue was not before the Full Court and that the Commissioner would need to issue a fresh amended assessment to disallow the interest deduction. A majority of this Court disagreed. Brennan, Deane, Dawson and Toohey JJ said:[234]

> "[I]t is a very large and, in our view, unwarranted step to say that the only matter before the Federal Court was that part of each objection decision with which the taxpayer was dissatisfied. It is the Commissioner's decision which, in each case, was referred to the Court. True it is that the decision was referred by the taxpayer so that the inclusion of income by the Commissioner might be challenged. But it does not follow that the Court was not then seized of the decision in its entirety."

220 The Commissioner's objection decision, which was appealed to the Federal Court in the present case, necessarily depended upon an assertion that MFT had incurred a capital loss on the sale of the BBG shares. That fiscal consequence is as

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233 *ANZ Savings Bank* (1994) 181 CLR 466 at 476.

234 *ANZ Savings Bank* (1994) 181 CLR 466 at 476.

much a taxable fact as any other matter that is relevant to a determination as to whether the assessment under challenge is or is not excessive. It would, with respect, be entirely artificial and unfair for a court to uphold the accuracy of an assessment upon an acceptance of a taxable fact which it knows to be false. That would contradict the statutory scheme of review and appeal described by Gummow, Hayne, Heydon and Crennan JJ in *Federal Commissioner of Taxation v Futuris Corporation Ltd* in the following terms:[235]

> "[A] dissatisfied taxpayer may object to the assessment in the manner set out in Pt IVC of the [TAA]; in review or appeal proceedings under Pt IVC the amount and all the particulars of the assessment may be challenged by the taxpayer but with the burden of proof provided in ss 14ZZK and 14ZZO of the [TAA]."

221 Here, it is an error to determine the excessiveness of the assessment issued to Mr Merchant in relation to the Debt Forgiveness Schemes on the basis that the BBG capital loss, and the tax benefit, existed. It did not, for the reasons given above in upholding the cancellation of that tax benefit and dismissing GSM's appeal in S158/2025. That was the conclusion of the Full Court, and, with respect, it is correct.

222 The first step in each of the Debt Forgiveness Schemes was the sale of the BBG shares, "crystallising a capital loss of $56,561,940 in the 2015 income year".[236] This step was an important attribute of the Debt Forgiveness Schemes which was said to deliver to MFT and its beneficiaries a tax advantaged capital gain from the sale of the Plantic shares. This, in turn, founded, at least in part, the submission that the Debt Forgiveness Schemes had a dominant purpose of avoiding tax: the Commissioner accepted that the presence of such a purpose was a necessary element of dividend stripping. As such, that loss is an essential fiscal attribute of the Debt Forgiveness Schemes, and constitutes one of the taxable facts[237] that, subject to the matter of pre-existing capital losses addressed above, must exist if the Debt Forgiveness Schemes are to constitute dividend stripping.

223 The Commissioner contended otherwise. He submitted that the BBG Share Sale Scheme and the assessment issued in reliance upon it, and the Debt Forgiveness Schemes and the assessment issued in reliance upon them, should be

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235 (2008) 237 CLR 146 at 157 [24].

236 *Merchant* (2025) 309 FCR 144 at 205 [306].

237 *Bailey v Federal Commissioner of Taxation* (1977) 136 CLR 214 at 217.

considered in isolation from each other. They were, it was argued, independent silos of liability to pay income tax. It was thus proper for the Commissioner to assess Mr Merchant on the basis that the BBG capital loss existed, even though, the Commissioner contended in his assessment issued to GSM, it did not, and even if (as is the case) this Court were to uphold that contention.

224 It follows that in considering the Debt Forgiveness Schemes, the cancellation of the capital loss arising from the sale of the BBG shares – arising from the Commissioner's successful application of Pt IVA of the 1936 Act – must be taken into account given that it is relevant to the issue of the excessiveness of the assessment issued to Mr Merchant. Because substantial tax is payable by GSM following the cancellation of the BBG capital loss, it now cannot be said that there had been a denial to the revenue of tax as a result of the Debt Forgiveness Schemes.

Commissioner's undertaking

225 Before this Court, the Commissioner gave an undertaking that if he were to succeed in both the appeal concerning the BBG Share Sale Scheme (S158/2025) and the appeal concerning the Debt Forgiveness Schemes (S157/2025), he would determine to make a compensating adjustment pursuant to s 177F(3)(a) whereby he would: exclude the net capital gain made in the 2015 income year by MFT; reduce consequentially GSM's liability to shortfall interest charge and general interest charge; and remit fully MFT's liability to scheme shortfall penalty.

226 The Commissioner gave the undertaking because he conceded that success in both matters gave rise to an economic overlap, such that it would be unfair for him to retain all of the tax that would be collected from all of the assessments. The unfairness is glaring: economically the effect of the assessments would be to tax the amount stripped out of GSM and Tironui twice: once in the hands of MFT and its beneficiaries, including GSM, as a capital gain and again in the hands of Mr Merchant as income. That erroneous interpretation is not corrected by the Commissioner giving a voluntary undertaking.

227 The giving of the undertaking – a step which would follow this Court's adjudication of the correctness of the assessments before it – does not in any way affect the analysis set out above concerning the issue of the function and jurisdiction of a court in considering the excessiveness of an assessment under Pt IVC of the TAA. The Commissioner's undertaking is entirely irrelevant to that issue.

Disposition

228 In S158/2025, the appeal should be dismissed with costs.

229 In S157/2025, the appeal should be dismissed with costs. Special leave to cross-appeal should be granted and Mr Merchant's cross-appeal should be allowed with costs. The orders of the Full Court of the Federal Court of Australia made on 18 June 2025 should be set aside and, in their place, it should be ordered that:

(a) The appeal to that Court be allowed insofar as it relates to proceedings NSD907/2021.

(b) The orders of the primary judge made on 29 May 2024 in proceedings NSD907/2021 be set aside and, in their place, it be ordered that:

(i) The appeal be allowed.

(ii) The respondent's objection decision made on 27 July 2021 be set aside.

(iii) The applicant's objection be allowed.

(iv) The matter be remitted to the respondent for reassessment to give effect to the High Court's reasons for judgment.

(v) The respondent pay the applicant's costs of the appeal.

(c) The respondent pay the appellants' costs of the appeal insofar as they relate to proceedings NSD907/2021.

(d) That part of the appeal to that Court which relates to proceedings NSD908/2021 be dismissed with costs.