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Interpreting tax statutes: imposing purpose on a results based test

Rodney Fisher*

Abstract

The general anti-avoidance provisions in Part IVA include specific provisions to bring within the scope of Part IVA those schemes which are by way of or in the nature of dividend stripping, and schemes having substantially the effect of a dividend stripping scheme. Judicial interpretation of the application of this provision has favoued a construction whereby purpose is implies as an element in the operation of the provisions, although there is no legislative requirement for a purpose.

This paper critically examines and evaluates this judicial construction, arguing that principles of statutory interpretation would suggest that the test in relation to identifying schemes having substantially the effect of dividend stripping is a test based on the effect or outcome of the scheme, and as such, purpose should not be a relevant consideration. It is suggested that the additional requirement for purpose changes the threshold test for the operation of the provision, which, from the legislation, is a results based test based on the effect or result of a scheme.

1. INTRODUCTION AND OUTLINE

This paper examines the judicial approach to statutory interpretation of results based taxation legislation, the particular example for analysis being s 177E in Part IVA of the *Income Tax Assessment Act* 1936. The current general anti-avoidance provision in Part IVA of the *Income Tax Assessment Act 1936* contains a general component requiring for its operation a scheme, a tax benefit, with a dominant scheme purpose being obtaining the tax benefit, with more specific components, including s 177E, providing conditions which are deemed to meet the requirements for the operation of Part IVA.

While the main focus of attention by the courts in the interpretation and application of the general anti-avoidance provision in Part IVA of the *Income Tax Assessment Act* (ITAA) 1936 ha s been directed to the general component, an arguably equally significant component of the anti-avoidance regime is contained in s 177E(1), which can operate to deem a scheme to be one to which Part IVA applies. Section 177E is attracted in circumstances where the scheme is 'by way of or in the nature of dividend stripping', or a scheme which has 'substantially the effect of a scheme by way of or in the nature of a dividend stripping'.

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This paper is concerned with an examination of the judicial interpretation of the alternative limbs in the threshold conditions for s 177E, being a scheme 'by way of or in the nature of dividend stripping', or a scheme which has 'substantially the effect of a scheme by way of or in the nature of a dividend stripping'. The paper is particularly concerned with an analysis of the judicial approach of implying the general threshold tests of a tax benefit and a dominant avoidance purpose, on provisions where the statue specifically excludes these additional threshold tests.

The approach taken is to outline the legislative provision and the purpose behind the statutory approach taken, as explained in the Explanatory Memorandum accompanying the bill, applying principles of statutory interpretation in understanding how the provision may operate. The analysis then critically examines the judicial interpretation of the provision in the light of the statutory purpose, as gleaned from the Explanatory Memorandum and applying principles of statutory interpretation.

2. LEGISLATIVE BACKGROUND

Australian federal income tax legislation has, almost since its inception, employed a general anti-avoidance provision to curb what were seen as abuses of the tax system by taxpayers seeking to minimise their income tax. The provision in force in unchanged form from the enactment of the *Income Tax Assessment Act* 1936 until the early 1980s was s 260,[1] which was a widely drafted provision broadly directed to making certain transactions void as against the Commissioner of Taxation. Prior to 1936, similarly worded Commonwealth legislation had been in operation.

However, from as early as 1921 courts had started to read down and limit the scope of the operation of these broadly drafted general anti-avoidance provisions, and by the late 1970s there had developed a stark contrast between the broad nature of the statutory language and the limited and restricted scope of operations afforded to the statutory provisions. A significant contributing factor, if not the decisive factor, in the emasculation of the general anti-avoidance provision in s 260 and the introduction of the replacement anti-avoidance provision in Part IVA was undoubtedly the literal approach to statutory interpretation of tax statutes followed by the Barwick High Court.

In broad terms, the limitations which courts had developed in restricting the intended operation of s 260 included:

[1] Section 260(1) applied until 27 May 1981, and provided that:
Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly:
(a) altering the incidence of any income tax;
(b) relieving any person from liability to pay any income tax or make any return;
(c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or
(d) preventing the operation of this Act in any respect,
be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.

- the choice principle, which precluded the operation of the anti-avoidance provision in circumstances where the principal act provided choices of forum for a taxpayer;
- the purpose was not that of the taxpayer but the purpose of the arrangement, and this could only be ascertained by examining the arrangement;
- when s 260 applied, it was unclear whether the section operated to wholly void an arrangement, or whether it could partly void an arrangement; and
- the Commissioner had no power to reconstruct a taxable transaction.

The government response to the judicially imposed limitations[2] was to introduce in 1981 a new general anti-avoidance provision, comprising a general component, and specific components. In broad terms, the general part of the provision applied when a scheme produced a tax benefit, and the dominant purpose of the scheme was the production of that tax benefit.[3] When the operation of the general component was attracted, the operative provisions allowed the Commissioner to amend a return, and make compensating adjustments to other returns.[4]

In addition to the provisions directed to anti-avoidance in general terms, s 177E(1) contained measures more specifically directed to preventing avoidance arrangements through the use of dividend stripping, which essentially involved a distribution being made in a more tax effective manner than would otherwise have been the case. It is with the provisions of s 177E that this paper is concerned.

3. SECTION 177E

The operation of s 177E[5] is structured such that there are four threshold tests which must all be satisfied to trigger the operation of the provision, these broadly being:

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[2] Primary limitations included the 'choice principle' whereby the section would not be operative if the principal act offered choices for a transaction; and the inability to reconstruct a taxable transaction if the transaction was made void by s 260.

[3] Section 177A defines a scheme; s 177C identifies a tax benefit; and s 177D provides matters to consider in the objective determination of the purpose of the scheme.

[4] Sections 177F & 177G.

[5] Section 177E(1) Where -
(a) as a result of a scheme that is, in relation to a company -
(i) a scheme by way of or in the nature of dividend stripping; or
(ii) a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping,
any property of the company is disposed of;
(b) in the opinion of the Commissioner, the disposal of that property represents, in whole or in part, a distribution (whether to a shareholder or another person) of profits of the company (whether of the accounting period in which the disposal occurred or of any earlier or later accounting period);
(c) if, immediately before the scheme was entered into, the company had paid a dividend out of profits of an amount equal to the amount determined by the Commissioner to be the amount of profits the distribution of which is, in his opinion, represented by the disposal of the property referred to in paragraph (a), an amount (in this 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;

- a scheme by way of or in the nature of dividend stripping, or having substantially the same effect as a scheme by way of or in the nature of dividend stripping;
- the Commissioner forms the opinion that the disposal of property represents a distribution of profits of the company;
- if the company had paid a dividend out of profits immediately before the scheme was entered into, the amount might reasonably be expected to be included in assessable income; and
- the scheme was entered into after 21 May 1981.

In circumstances where all four threshold tests are satisfied, the provision provides for three consequences, broadly being:

- the scheme is a scheme to which the Part IVA provisions apply;
- the taxpayer is taken to have received a tax benefit (thus satisfying a threshold condition for the general Part IVA provisions); and
- the amount of the tax benefit is the notional amount that would have otherwise been included in assessable income.

It is significant that, unlike the general Part IVA provisions, s 177E(1) has no legislative threshold dependency on either an objective or subjective purpose of the taxpayer or the scheme. On meeting the threshold tests, s 177E(1) could arguably automatically apply, with the scheme being one to which Part IVA applied, and the taxpayer being deemed to obtain a tax benefit.

The consequence of making a dividend stripping scheme a scheme to which Part IVA applies was that the Commissioner could then cancel the tax benefit, and make compensating adjustments to assessments of other taxpayers.[6]

In explaining the need for a separate provision, the Explanatory Memorandum (EM) accompanying the Bill explained that while dividend stripping schemes may fall within the general provisions of Part IVA, it may not always be concluded that without the scheme the relevant dividend might reasonably be expected to have been included in assessable income, in which case there would be no identifiable tax benefit which could attract the operation of the general Part IVA provisions. To overcome this difficulty, s 177E provided a supplementary code to deal with dividend stripping schemes, and variations on these schemes, the effect of the schemes being to distribute company profits in a tax free manner, in substitution for a taxable dividend.[7]

The Explanatory Memorandum (EM) accompanying the Bill also suggested that s 177E(1) was intended to be a self-contained code to apply to dividend stripping schemes which effectively placed company profits in the hands of shareholders in a tax free form.[8] While it was not clear from the legislation whether s 177E(1) was

(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.

[6] Sections 177F & 177G.

[7] *Explanatory Memorandum* accompanying *Income Tax Laws Amendment Bill (No 2)* 1981 p 3.

[8] EM at page 8.

intended to be an exclusive code in relation to dividend stripping arrangements, it would be expected that, as a matter of statutory construction, the existence of a special provision would prevail over the more general provisions of Part IVA.[9]

It is suggested that by placing the provision dealing with dividend stripping schemes outside of the general Part IVA threshold provisions, and by explaining in the EM that s 177E was intended to be a stand-alone code, the drafters were denoting a clear and manifest intention that the threshold conditions to attract the operation of s 177E would be separate and distinct from the threshold conditions under the general Part IVA rules. If this is the intention, then it is suggested that the threshold conditions for s 177E should stand alone, and not be read in conjunction with the threshold tests to attract the general Part IVA operation.

The critical threshold condition to attract the operation of s 177E(1) is the identification of a scheme 'by way of or in the nature of dividend stripping' or a scheme 'having substantially the effect of a scheme by way of or in the nature of a dividend stripping'.

In identifying schemes 'by way of or in the nature of' dividend stripping schemes, the EM outlined a traditional dividend stripping scheme as involving a stripping entity which purchased shares in a target company with accumulated profits, with the stripping entity then paying former shareholders a capital sum that reflected those accumulated profits, and then drawing off the profits in a non-assessable form.[10] It would appear that the use of the wider terminology 'by way of or in the nature of' is to grant a wider purview to attract the operation of the provision than being limited to schemes which align with a traditional dividend stripping operation.

The use in the legislative provision of the terminology of 'schemes having substantially the effect' of a dividend stripping scheme must be seen as providing a potentially very wide ambit in relation to identifying such schemes, the intent being to preclude the use of variations on a theme to circumvent the first limb of s 177E(1)(a) or the general provisions in Part IVA. To identify schemes 'having substantially the effect' of a dividend stripping scheme it is necessary to identify what is the effect of a dividend stripping scheme, and the intent of the drafters is explained in the EM as "… the effect … is to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends".[11]

In relation to schemes having substantially the same effect as a scheme by way of or in the nature of a dividend stripping, the EM provides examples whereby the profits of the target company are not stripped by way of dividends, but by other transactions such as making irrevocable loans to associates of the stripper, or using profits to purchase near-worthless assets from an associate.[12] By the use of such devices the same result is achieved, namely to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends

[9] Broadly *generalia specialibus non derogant*; also see *Reseck v FCT* 75 ATC 4213.
[10] EM at page 9.
[11] EM page 3.
[12] EM at page 9.

Tax Ruling IT 2627 suggests a wider interpretation for a scheme having the effect of a dividend stripping scheme, with a scheme having the same effect as a dividend stripping scheme if company profits are stripped not only to a shareholder, but to an associate or other party.[13] Further, this second limb of the threshold test looks to the result or effect of the scheme, rather than the process undertaken. The example given is of a company with substantial accumulated profits owned by an individual who sells assets to the company for approximately ten times their real market value. While conceding that this arrangement may not strictly be a scheme by way of, or in the nature of, dividend stripping since there is no dividend or liquidator's distribution, the Ruling notes that it may well be a scheme having substantially the effect of such a scheme since it could involve the removal of profits of a company in a non-taxable form.[14]

It is suggested that this second test as to a scheme having substantially the effect of a dividend stripping scheme should be interpreted, then, in terms of the outcome or result of the scheme, looking more to the result achieved by the scheme rather than the nature or mechanics of the processes undertaken. This approach identifies a clear distinction between the two limbs in the threshold test, with the first limb looking to the nature of the scheme, suggesting a consideration of the steps or processes undertaken, while the second limb is concerned only with the outcome or effect of the scheme, thus being an outcome based test.

While this threshold condition in relation to the scheme is not the only test to be satisfied, in the absence of identifying such a dividend stripping scheme the remaining tests become redundant. The remainder of the paper is concerned with examining how this test has been interpreted and applied by the courts, and whether the interpretation adopted is the better reflection of the legislative intention.

4. INTERPRETING TAXATION STATUTES

Prior to an examination of judicial consideration as to the operation of s 177E, it is worth briefly noting the development in statutory interpretation of taxation statutes in particular, and some of the relevant principles of statutory interpretation, as they may be applied to s 177E.

As discussed earlier, it is generally considered that the Barwick era in the High Court saw a tendency for the High Court to adopt a more literal interpretation of tax statutes, particularly when such an approach would produce a result favourable to the taxpayer. Such an interpretation arguably reached its high water mark in the previously discussed case of *FCT v Westraders Pty Ltd*.[15] In this case, Barwick CJ expounded the view that:

> It is for Parliament to specify, and to do so, in my opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax. The function of the court is to interpret and apply the language in which the Parliament has specified those

[13] IT 2627 para 15.
[14] IT 2627 para 16.
[15] (1980) 11 ATR 24.

> circumstances. The court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament which is discoverable from the language used by the Parliament. It is not for the court to mould or to attempt to mould the language of the statute so as to produce some result which it might be thought the Parliament may have intended to achieve, though not expressed in the actual language employed.[16]

In his strongly worded dissenting judgement, Murphy J sought to limit the literal approach, expressing the view that:

> It is an error to think that the only acceptable method of interpretation is strict literalism. On the contrary, legal history suggests that strict literal interpretation is an extreme, which has generally been rejected as unworkable and a less than ideal performance of the judicial function.
>
> It is universally accepted that in the general language it is wrong to take a sentence or statement out of context and treat it literally so that it has a meaning not intended by the author. It is just as wrong to take a section of a tax Act out of context, treat it literally and apply it in a way which Parliament could not have intended.[17]

However the dominance of the literalist approach appears to have begun waning with the departure of Barwick CJ from the High Court. Decisions such as *Cooper Brookes (Wollongong) Pty Ltd v FCT*[18] demonstrate a more equivocal approach to the vexed question of statutory interpretation of taxation statutes,[19] with Mason and Wilson JJ elaborating on those situations which contemplate a departure from strict literalism, noting that:

> If the choice is between two strongly competing interpretations, as we have said, the advantage may lie with that which produces the fairer and more convenient operation so long as it conforms to the legislative intention.[20]

At around the same time, the Parliamentary preference and endorsement for the purposive approach in preference to the literal approach was confirmed with the introduction of section 15AA of the *Acts Interpretation Act 1901* (Cth).[21] In addition to sanctioning the purposive approach, this Act provided in s 15AB for extrinsic material to which regard may be had in eliciting the legislative purpose, in those circumstances where there may be uncertainty arising as to the intent when regard was had to the statute alone. The relevant extrinsic material includes, among other resources, the EM and Second Reading Speech.

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[16] *Westraders* at 25.
[17] *Westraders* at 40.
[18] (1981) 11 ATR 949.
[19] Neither Barwick CJ nor Murphy J sat on this case.
[20] *Cooper Brookes* , Mason & Wilson JJ at 966.
[21] This provides that "In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object."

The significance of this provision in displacing the common law approaches was recognised by Dawson J in suggesting that "… the literal rule of construction, whatever the qualifications with which it is expressed, must give way to a statutory injunction to prefer a construction which would promote the purpose of an Act to one which would not, especially where that purpose is set out in the Act."[22]

In relation to the current discussion, s 177E effectively provides that schemes by way of or in the nature of dividend stripping, or having the same result as a dividend stripping scheme, would be schemes to which Part IVA would apply. In applying a purposive approach to s 177E, it is suggested that by placing these threshold conditions separate from the main component of Part IVA, the legislative intent was to provide a separate, alternative and stand-alone test which could attract the same consequences as the general Part IVA threshold tests of a scheme, tax benefit, and dominant scheme purpose. It is suggested on this basis that it is arguable that the tests for the general component of Part IVA, namely a tax benefit and scheme purpose, would not be attracted as elements required for s 177E.

This much is made clear in the EM, which explains that the need for a separate s 177E arose as schemes to which s 177E applied may not be caught within the general component of Part IVA, because it would not be possible to identify a tax benefit or a dominant scheme purpose.

Accordingly, it would be suggested that on the face of the legislation, both the plain language of the statute, and the intent of the legislature, would appear to suggest that neither identifying a tax benefit, nor identifying a dominant scheme purpose, would be relevant to the operation of the threshold tests in s 177E, particularly in relation to the second limb which is based only on the result or outcome of the scheme.

Additionally, it is further suggested that some of the principles of statutory interpretation would also advocate for the position that there was no requirement in the threshold tests in s 177E for a tax benefit or dominant scheme purpose.

The syntactical presumption *generalia specialibus non derogant* provides, in general terms, that a specific provision will prevail over a more general provision. In relation to Part IVA, the general component requires a scheme, tax benefit and dominant scheme purpose. However, s 177E constitutes a more specific provision requiring a scheme of a certain type (by way of or in the nature of dividend stripping), or a scheme having a particular result (the same effect as a dividend stripping scheme). Being the more specific provision, it is suggested that s 177E should stand alone, as explained in the EM, rather than incorporating the threshold elements for the general component of Part IVA This would preclude the tax benefit and dominant scheme purpose from being elements in the s 177E threshold test, again particularly in relation to the results based test.

[22] *Mills v Meeking* (1990) 91 ALR 16 at 30-1.

Finally, it is also suggested that the syntactical presumption *expression unius est exclusion alterius*, the express reference to one matter means other matters are excluded, also indicates a legislative intent that the s 177E tests be limited to the type of scheme, or the result of the scheme. These tests should apply without importing additional requirements which the legislature had chosen not to include in the specific provision s 177E, but had included in the general component of Part IVA. It is suggested that this elicits an intention that the further tests of tax benefit and scheme dominant purpose were not intended to form part of the s 177E threshold, in particular where the test is based on the result of the scheme.

5. JUDICIAL CONSIDERATION OF DIVIDEND STRIPPING SCHEMES

The identification of dividend stripping schemes, and the application of s 177E, was at issue in *CPH Property v FCT*[23] in the Federal Court. Hill J recognised that the legislative purpose in enacting s 177E as a separate code from the general Part IVA provisions was clear, as there could be difficulty identifying tax benefit and purpose, both of which are essential threshold elements under the general Part IVA regime. By having a separate code, his Honour considered that these difficulties were overcome by s 177E, in that a tax benefit could be deemed if s 177E applied, and there was no requirement to test the scheme against conclusion as to dominant purpose.[24] As noted earlier, the statute makes no mention of any requirement to identify a purpose as a threshold condition for attracting the operation of s 177E, and the comments of Hill J appeared to confirm this.

However, what was not so clear to his Honour was identifying the distinction between a scheme of dividend stripping, a scheme that was in the nature of dividend stripping, and a scheme that had the effect of dividend stripping.[25]

5.1 First limb - Schemes in the nature of dividend stripping

In looking to identify the first two of these types of schemes, Hill J had regard to the judgment of Windeyer J in *Investment & Merchant Finance v FCT*, that:

> Dividend stripping is a term applied to a device by which a financial concern obtained control of a company having accumulated profits by purchase of the company's shares, arranged for these profits to be distributed to the concern by way of dividend, showed a loss on the subsequent sale of shares of the company, and obtained repayment of the tax deemed to have been deducted in arriving at the figure of profits distributed as dividend.[26]

Windeyer J continued, "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."[27]

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[23] *CPH Property* (FC) (1998) 40 ATR 151.
[24] *CPH Property* (FC) at 171.
[25] *CPH Property* (FC) at 171.
[26] *CPH Property* (FC) at 172 quoting *Investment & Merchant Finance* from Windeyer J quoting Halsbury's Laws of England, 3rd ed, Vol 20, p 201.
[27] *CPH Property* (FC) at 172 quoting Windeyer J.

In seeking to identify this essence of such a scheme, Hill J concluded that "… a scheme will be a dividend scheme or in the nature of a dividend scheme if a reasonable observer looking at the transaction would say of it that its essential character is dividend stripping."[28] His Honour identified the essential character as involving a number of elements, including:

- a company with profits or likely to receive profits;
- out of which a dividend is reasonably likely to be declared;
- shareholders would be liable to pay tax on the dividend;
- shares are sold or allotted in the target company to a stripper; and
- subsequent payment of a dividend or deemed dividend to the stripper to recoup the outlay for the shares.

While questioning whether a dividend stripping scheme was a significantly different thing from a scheme in the nature of dividend stripping,[29] Hill J recognised that not all transactions with these features would constitute dividend stripping. His Honour identified as a critical factor in the characterisation the conclusion that an objective observer would reach as to why the scheme had taken place, thus raising purpose as an element in categorising schemes as dividend stripping schemes, or schemes by way of or in the nature of dividend stripping.

His Honour considered purpose to be a defining element in these schemes, and considered that:

> … a scheme will only be a dividend stripping scheme if it would be predicated of it that it would only have taken place to avoid the shareholders in the target company becoming liable to pay tax on dividends out of the accumulated profits of the target company. It is that matter which distinguishes a dividend stripping scheme from a mere reorganisation.[30]

The requirement to identify a purpose for the scheme had not been an element of the legislative provision, and Hill J had recognised this, as discussed above. However, in looking to the essential elements that would qualify a scheme as dividend stripping, or in the nature of dividend stripping, his Honour appears to add a judicial gloss to the statutory requirement by suggesting that there was not only a requirement to look to purpose, but that this purpose element was the critical factor in distinguishing a scheme in the nature of dividend stripping from more benign transactions.

On appeal to the Full Federal Court in *FCT v CPH Property*,[31] their Honours[32] considered the operation of s 177E, noting that the provision required four threshold tests be met, resulting in the consequence of the scheme being within the general provisions of Part IVA, without anything further needed. In particular their Honours noted that "The effect of subpara (e) is that a scheme satisfying the conditions laid down in s 177E(1)(a)-(d) need not independently satisfy the terms of s 177D (which identifies the characteristics of a scheme to which Part IVA applies, including the

[28] *CPH Property* (FC) at 173.
[29] *CPH Property* (FC) at 174.
[30] *CPH Property* (FC) at 174.
[31] *CPH Property* (FFC) (1999) 42 ATR 575.
[32] Joint judgment of French J (as he then was), Sackville & Sundberg JJ.

necessary purpose of 'enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme'."[33]

This would appear to be an recognition by the court that s 177E operates independently as a se parate code in terms of the threshold tests, and in particular an acknowledgement that there was no requirement to meet a threshold purpose test in s 177D for a scheme to be classed as a dividend stripping scheme, and thus attract the operation of s 177E.

As Hill J had done at first instance, their Honours looked to the authorities to provide guidance as to what would constitute a dividend stripping scheme or a scheme having the nature of a dividend stripping scheme, noting that Gibbs J had identified cases involving dividend stripping, with the court noting that characteristics common to these cases included:[34]

- a target company with substantial undistributed profits, creating a potential tax liability;
- sale or allotment of shares in the target company to another person;
- payment of a dividend from the profits to the purchaser or allottee of the shares;
- the purchaser escaping Australian income tax on the dividend; and
- the vendors receiving a capital sum for their shares in an amount close to the dividend paid to the purchasers.

Their Honours further opined that "A further common characteristic of each of the schemes in the cases considered by Gibbs J, was that they were carefully planned, with all 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 company."[35]

On this basis, despite having earlier noted that the operation of s 177E precluded the requirement to establish the purpose of the scheme, and despite the omission of any express reference to purpose in the statute, their Honours went to some lengths to justify the inclusion of a purpose test as an element in a dividend stripping scheme.

The judgment suggested, without further explanation, that the lack of an express reference to purpose was consistent with the drafter intending that the first limb test required a scheme with a tax avoidance purpose. Further, the concept of dividend stripping scheme carried a "widely understood connotation" that such schemes invariably had as their dominant, if not exclusive purpose, the avoidance of tax otherwise payable by vendor shareholders. Their Honours suggested that case law preceding the introduction of s 177E strongly supported the view that Parliament intended dividend stripping operations would necessarily involve a predominant tax avoidance purpose.[36]

[33] *CPH Property* (FFC) at 607.
[34] *CPH Property* (FFC) at 610.
[35] *CPH Property* (FFC) at 610.
[36] *CPH Property* (FFC) at 617.

In relation to extrinsic materials, their Honours noted that the EM and second reading speech emphasised that Part IVA was to deal with "blatant, artificial and contrived" arrangements, and that s 177E was to deal with "dividend stripping schemes of tax avoidance and certain variations on such schemes." The court took the view that these "… carefully formulated observations, in our opinion, clearly indicate that s 177E was intended to apply only to schemes which can be said to have the dominant purpose of tax avoidance."[37] What was not noted by the court was that if the drafter intended purpose to be a threshold test this could have been easily expressly incorporated, thus avoiding the need to contrive these rather opaque 'carefully formulated observations'. Ultimately, the court took the view that the first limb of s 177E(1) only embraced schemes which could objectively be said to have a dominant purpose of tax avoidance, since the "… requirement of a tax avoidance purpose flows from the use by Parliament of the undefined expression 'a scheme by way of or in the nature of dividend stripping."[38] Purpose was to be the objective purpose of the scheme as judged by a reasonable observer, having regard to the scheme characteristics and the objective circumstances of the design and operation of the scheme.[39]

The court appears not to have specifically addressed the Commissioner's submission that to imply a purpose test as an essential ingredient of a dividend stripping scheme was to introduce the purpose test into s 177E by the 'back door method'.[40] Neither did the court appear to turn its attention to the reason why the drafter specifically excluded purpose from the s 177E regime, while including purpose in s 177D as part of the general Part IVA provisions.

Rather, the court appears to have affirmed the view of Hill J that purpose should be an element in identifying a scheme as a dividend stripping scheme, or a scheme by way of or in the nature of a dividend stripping scheme, but to have done so by straining the language of the extrinsic material, and by straining the intention of the drafter that the test apply even though omitted.

The Full Federal court finding was not the end of the matter, however, as the case went on appeal to the High Court in *FCT v Consolidated Press Holdings*.[41] In a joint judgment, the High Court had regard to the context in which s 177E appeared, and to the history of the use of the expression 'dividend stripping', in reaching the conclusion that notions of tax avoidance inevitably attached to the concept of dividend stripping in s 177E(1)(a)(i).

In response to the notion that s 177E acted independently of the general Part IVA provisions, the court articulated the opinion that:

> If 'dividend stripping scheme' were a term of art with a defined or definable literal meaning that could be identified separately from the context in which it appears, then it might be possible to construe and apply s 177E uninfluenced by notions of tax avoidance. But the expression does not have such a meaning. In

[37] *CPH Property* (FFC) at 617.
[38] *CPH Property* (FFC) at 618.
[39] *CPH Property* (FFC) at 618.
[40] *CPH Property* (FFC) at 617.
[41] *Consolidated Press Holdings* (2001) 207 CLR 235.

> framing s 177E, the legislature has adopted the language of tax avoidance, and it has placed s 177E in Part IVA, for a reason related to the necessity to supplement, in a particular respect, the general anti-avoidance provision. This is not an example of a statutory provision in respect of which a purposive construction is merely an available choice; such a construction is necessary.[42]

Because s 177E stands apart from, but extends, the operation of Part IVA, the suggestion is that the elements for the general Part IVA operation, being a scheme, tax benefit, and relevant purpose, in ss 177A, 177C and 177D, would not be threshold elements to attract the operation of s 177E. The link between the provisions is that when the separate threshold requirements for s 177E are satisfied, thus triggering the operation of the section, the outcome is that the scheme is one to which the general Part IVA outcomes apply, being cancellation of the tax benefit, and compensating amendments, in ss 177F and s 177G.

Accordingly, there is no statutory requirement under s 177E to satisfy either the tax benefit test, or the dominant purpose test.

However, in relation to the first limb of s 177E(1)(a), the judicial view at all levels from the Federal Court at first instance, to the Full Federal Court on appeal, and subsequently the High Court was that in identifying a scheme 'by way of or in the nature of dividend stripping', one of the core elements in the nature of a dividend stripping scheme would be identifying a tax avoidance purpose.

It is considered that, based on judicial reasoning in these cases, with the rationale possibly best elucidated by Hill J at first instance, it is arguable that the reference to a dividend stripping scheme, or a scheme 'by way of or in the nature of dividend stripping' in s 177E(1)(a) must carry with it the implication that one of the intrinsic elements of such a scheme must be a tax avoidance purpose. As explained by Hill J, it was only by importing this element of purpose into the test that schemes which attract the operation of s 177E may be distinguished from those which are 'mere reorganisations'.

Whether the same reasoning applies in relation to s 177E(1)(a)(ii) may be a more contentious issue, as this threshold test looks not to the nature of a scheme, but only to the effect or result of a scheme.

5.2 Second limb - Schemes having the effect of a dividend stripping scheme

There are two limbs of the threshold test to identify a scheme which triggers s 177E, and if a scheme is not found to be a scheme by way of or in the nature of dividend stripping, the provision can still be activated if the scheme has substantially the effect of a scheme by way of or in the nature of dividend stripping. From the plain words of the statute, the legislative intent embodied in this test would appear to be an intention that the test be an outcome or results based test, and if a particular scheme produced substantially the same result as would be associated with a dividend stripping scheme, then it might be expected that this threshold test had been satisfied, and the remaining

[42] *Consolidated Press Holdings* at para 132.

threshold tests would come into play; if a particular scheme did not have substantially the same result as would a dividend stripping scheme, then it might be expected that this threshold test had failed, the consequence of which would be that s 177E would not be triggered.

If this was the legislative intent, then the application of the test would turn on what would be the expected outcome or effect from a dividend stripping scheme, and it is suggested that to assist in identifying what is the effect of a dividend stripping scheme, the EM provides useful guidance. The EM explains that s 177E would be a supplementary code to deal with dividend stripping schemes of tax avoidance, and variation 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."[43] On this basis, if a particular scheme had substantially the result of placing company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends, then the scheme would satisfy this threshold test and the other threshold tests would become relevant; if a scheme did not substantially have this result, this threshold would not be satisfied, and the other tests in s 177E(1) would be redundant.

Further, the EM provides examples of schemes that would be considered to have the substantially the same effect as a dividend stripping scheme, including schemes where the profits of the company were not stripped by a formal dividend payment, but by other means such as irrevocable loans to associates, or the use of profits to purchase near-worthless assets from an associate at an inflated price.[44]

On this interpretation of the test, whereby the effect or result of the scheme is the critical issue, with the relevant effect being explained in the EM, it would appear that there would be no role for other matters to be relevant considerations in determining whether the scheme was one to which the section applied. In particular, as the provision would clearly appear to be an results based test, with the criterion for evaluation delineated in the EM, there would be appear to be no role for consideration of the purpose of entering the scheme, as this would have no relevance to a judgment as to the result of the scheme.

Such an interpretation of s 177E(1)(a)(ii) found favour with Hill J at first instance in *CPH Property* (FC), with his Honour suggesting that for this alternative second lime, the focus shifted from the nature and essential character of the scheme to the effect of the scheme.[45] In addressing the relevance of purpose to the second limb, his Honour opining that:

> Here purpose plays no part of the statutory language, but is present only so far as it aids the characterisation of the scheme. In my view there is a clear difference between a dividend stripping scheme on the one hand and one that has the effect of such a scheme on the other. In my view the relevant 'effect' is to be judged by reference to the vendor of the shares in the target company and

[43] EM at page 3.
[44] EM at 9.
[45] *CPH Property* (FC) at 175.

> the target company itself, although there may be some relevance in the effect of the scheme upon the purchaser.[46]

In addressing the issue of what was added by the qualification of the effect being substantially the same, Hill J suggested that this may mean that while some of the effect may be different, overall the effect would be either virtually the same or to a large extent the same.[47]

However, on appeal to the Full Federal Court these views of Hill J did not find favour with the court, with the court expressing the view that purpose was still an element in the second limb test, despite the test being an results based test couched in terms of the effect of the scheme.

In the opinion of their Honours, if the second limb test was based only on effect, then the second limb would subsume the first limb, meaning the only test would become the effect of the scheme, as there would be no case within the first limb which was not also within the second limb. By reference to the examples in the EM as to when a scheme would have substantially the effect of a dividend stripping scheme, their Honours approach appeared to have effectively incorporated the first limb test into the second limb, being of the view that:

> … the second limb of s 177E(1)(a) is intended to catch schemes by way of or in the nature of dividend stripping, where the distribution by the target company takes a form other than a formal dividend or a deemed dividend. The reference to 'having substantially the effect of' a dividend stripping scheme is to a scheme that would be within the first limb, except for the fact that the distribution by the target company is not by way of a dividend or deemed dividend. If the distribution has substantially the effect of a dividend or deemed dividend, it will be within the second limb.[48]

By incorporating the first limb test, for schemes by way of or in the nature of dividend stripping, as a component of the second results based test, the court was able to ascribe a purpose test into the second limb. In justifying this, the court considered that the ordinary meaning and statutory definition of scheme connoted a purpose, suggesting then that a scheme could not fall within the second limb unless the dominant purpose of the scheme was tax avoidance.[49] Their Honours found support for a purposive construction from the policy rationale underlying Part IVA, being to attack contrived arrangements while saving normal commercial transactions.[50]On appeal to the High Court, the court was in agreement with the Full Federal Court. The court took the view that:

> The expression 'dividend stripping' must have the same meaning in sub-para (ii) as it has in sub-para (i). If it is proper to import a particular element of purpose into that meaning in sub-para (i), it is proper, and consistent, to do the

[46] *CPH Property* (FC) at 175.
[47] *CPH Property* (FC) at 175.
[48] *CPH Property* (FFC) at 619.
[49] *CPH Property* (FFC) at 620.
[50] *CPH Property* (FFC) at 620.

> same in sub-para (ii). The reference in sub-para (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.[51]

It is suggested that by importing the dominant scheme purpose test into what is legislated as effectively a results based test, the judiciary may be acting to limit the scope of s 177E, in a similar way to the manner in which the implication of additional requirements operated to limit the scope of the former s 260. By imposing the additional test as a further requirement to the threshold compelled by the legislative provision, there is then an added burden of proof to establish the operation of s 177E, thus acting to raise the threshold and making it more unlikely that the provision would be triggered.

The operation of s 177E again arose for judicial consideration in the Federal Court case of *Lawrence v FCT*,[52] which went on appeal to the Full Federal Court in *Lawrence v FCT*.[53] While the cases dealt with transactions which could probably reasonably be characterised as 'blatant, artificial and contrived', being the terms used in the EM to identify schemes to which Part IVA was intended to apply, there are some noteworthy comments from their Honours[54] in the Full Court judgment.

While agreeing with the judgment of Jessop J at first instance, their Honours evidently felt compelled to make some observations on the considerations of the court in the three *CPH* and *Consolidated Press* cases. In particular, their Honours pointed out that the comments in relation to whether scheme purpose was an element to be considered in applying the second limb of the threshold in s 177E(1)(a) were clearly obiter. In relation to the primary judge, the court considered the comments of Hill J obiter, as his Honour had decided the case on the basis of the Commissioner's opinion under s 177E(1)(b) having miscarried. The comments of the Full Federal Court and High Court were obiter as the case had been decided in each circumstance under the first limb of s 177E(1)(a), and the only reason that the courts had expressed an opinion in relation to the second limb was because Hill J had reasoned that the second limb did not require the presence of a tax avoidance purpose.[55]

Their Honours noted that:

> The first limb is concerned with schemes which are by way of or in the nature of dividend stripping; the second limb is concerned with other schemes, that is, schemes that are not by way of or in the nature of dividend stripping but which are schemes having substantially the same effect. A scheme falling within the second limb may not, as in this case, fall within the first limb. On the other

[51] *Consolidated Press Holdings* at para 138.
[52] *Lawrence* (FC) [2008] FCA 1497.
[53] *Lawrence* (FFC) [2009] FCAFC 29.
[54] Ryan, Stone, Edmonds JJ.
[55] *Lawrence* (FFC) at para 52.

> hand, a scheme falling within the first limb will never fall within the second limb.[56]

As noted earlier, there is no statutory requirement that there be identification of a tax benefit or a dominant tax avoidance scheme purpose for the operation of s 177E, but the courts have expressed the view that the purpose test is relevant to the second limb of s 177E(1)(a), despite the test being a test of effect or outcome.

In relation to the operation of the second limb of s 177E(1)(a), it is suggested, with respect, that the approach taken by the Full Federal Court and the High Court of implying a purpose test to the second limb is, applying principles of statutory interpretation, arguably at odds with the legislative intent.

The earlier discussion has recognised that, while there is no statutory requirement for a purpose test in applying the first limb of s 177E(1), it is arguable that principles of statutory interpretation would be consistent with implying a purpose test in identifying schemes within the first limb, that is schemes 'by way of or in the nature of dividend stripping'. It is suggested that such an interpretation may be justified on the basis that, to identify a scheme by way of or in the nature of dividend stripping, it is necessary to distil the essential core elements that constitute the nature of such a scheme, and a tax avoidance purpose is arguably one of these essential ingredients.

However, it is suggested that in relation to the operation of the second limb, the approach taken by the courts is arguably not consistent with principles of statutory interpretation, and with the legislative intent revealed by applying principles of statutory interpretation. In particular, the two limbs of s 177E(1)(a) are enacted as distinct and separate alternative tests, the tests being either a scheme by way of or in the nature of dividend stripping scheme, or a scheme having substantially the effect of such a scheme.

The principles of statutory interpretation, it is suggested, would classify the first limb as relating to a scheme with certain characteristics, namely the features that would be identifiable in a scheme in the nature of a dividend stripping scheme. The second limb, it is suggested, is not related to the character or nature of the scheme undertaken, but to the outcome or effect of the scheme, being an outcome or results based test. It is suggested this much is made clear in the EM, which specifies the effect of a scheme by way of or in the nature of a dividend stripping scheme, with the legislation providing that a scheme which has this effect of result is to satisfy the first of the threshold tests in s 177E(1).

While the EM provides examples of schemes which may generate an outcome which may satisfy the second limb, it is suggested that this was not intended to be an exhaustive enumeration of possible alternatives. Rather, it is suggested that the particular approach was taken as the drafters could not hope to foresee all or every possible scheme that may be designed to produce an effect or outcome substantially the same as would be generated by a dividend stripping scheme, but which may not be classified as a scheme by way of or in the nature of dividend stripping, consequently

[56] *Lawrence* (FFC) at para 52.

taking a broad approach to enliven the second limb when a scheme generated a result or effect substantially the same as would be expected from a dividend stripping scheme.

Further, it is suggested that by incorporating the first limb as an additional precursor element in the second limb, that is, by stating the second limb test as applying to 'schemes by way of or in the nature of dividends stripping schemes which produce an effect substantially the same as a scheme by way of or in the nature of a dividend stripping scheme, it is arguable that the court has substantially narrowed the operation of the second limb in a way not intended by the legislature. As argued above, it is suggested that principles of statutory interpretation would allow the second limb an alternative independent operation based on the effect or outcome of the schemes, whether or not the scheme was a scheme by way of or in the nature of dividend stripping scheme.

By implying the first limb as a pre-condition in the second limb, the second limb would only apply to schemes by way of or in the nature of dividend stripping schemes which have the effect substantially of a scheme by way of or in the nature of dividend stripping. On this basis it may be arguable the second limb then becomes redundant. If the second limb can only apply to a scheme by way of or in the nature of a dividend stripping scheme, then the scheme must of necessity fall within the first limb. If the scheme is a scheme by way of or in the nature of a dividend stripping scheme, arguably nothing is added by the requirement that the effect be substantially the same as a dividend stripping scheme, as it must be seen as rather unlikely that a scheme by way of or in the nature of a dividend stripping scheme would produce an effect not substantially the same as a scheme by way of or in the nature of a dividend stripping scheme.

A consequence of importing the first limb as an element of the second limb would be that the purpose test applicable to the first limb would then become an element of the second limb. As noted earlier, it is suggested that principles of statutory interpretation would envisage that the first and second limbs in s 177E(1)(a) have an independent and alternative operation. While the first limb related to identifying a scheme of a particular nature with particular features, the second limb looks only to the effect of result of a scheme. This would appear to suggest that, being an outcome based or results based test, there is no legislative intent that the second limb carry the requirement element of purpose. The intent would arguably appear to be that consideration be given to the effect of the scheme, and if the effect as specified in the EM had been satisfied, the threshold test would be satisfied.

It is suggested that the approach taken by the courts would operate to narrow the operation of the threshold test in s 177E(1)(a), as the approach would require the establishment of a tax avoidance purpose underlying the scheme, while the legislation itself looks only to the effect of the scheme, with no suggestion that an element of purpose need be established.

It should be noted that it is suggested that the broader approach suggested for the operation of the second limb of s 177E(1)(a) would not automatically attract the operation of s 177E, and thus Part IVA, in inappropriate circumstances. The threshold tests in the two limbs of s 177E(1)(a) are not the end of the matter, with further

threshold requirements in s 177E(1)(b), (c) and (d). By broadening the test in the second limb to be a results based or effect based test, without a need for consideration of purpose, it is suggested that the provision would not ipso facto be triggered by any scheme having the substantially the effect of a dividend stripping schemes, as there are further conditions to be satisfied before the provision is triggered.

6. CONCLUSION

This paper has been concerned with an examination of the judicial interpretation of results based legislation, the particular example being examined relating to the threshold conditions to enliven the operation of s 177E dealing with schemes 'by way of or in the nature of dividend stripping', or a scheme which has 'substantially the effect of a scheme by way of or in the nature of a dividend stripping'.

The paper has suggested that, applying principles of statutory interpretation, it is arguable that the legislative intent was not to include within the threshold tests for s 177E a requirement for a tax benefit, or a dominant scheme purpose. Rather, the threshold should be limited to the two elements of the nature of the scheme, of the result of the scheme.

As outlined, the approach adopted by the judiciary has been to imply a general threshold requirement for a dominant tax avoidance purpose to the s 177E tests of a scheme by way of or in the nature of dividend stripping, or a scheme having substantially the effect of dividend streaming. The paper has suggested that in relation to the first limb of s 177E(1)(a), being a scheme by way of or in the nature of dividend stripping, it may be arguable that a dominant purpose test can be implied, as a feature of the nature of a dividend stripping scheme may be a dominant tax avoidance purpose.

However, in relation to the second limb, being a results based test for a scheme having substantially the effect of a dividend stripping scheme, the paper argues that principles of statutory interpretation require that the test be interpreted as a result based or outcome based test, with no scope for implying a purpose test. Rather, the test should be evaluated on the basis of the effect of the scheme, with the EM explaining the relevant effect as being to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends.