IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No S225 of 2012

BETWEEN

ANDREW VINCENT MILLS
Appellant

AND

COMMISSIONER OF TAXATION
Respondent

APPELLANT'S SUBMISSIONS

Part I – Publication

1. The Appellant certifies that these submissions are in a form suitable for publication on the internet.

Part II – Issue on the Appeal

2. The issues on the appeal are:
   (a) the scope of the criterion "a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit" in s 177EA(3)(e) of the Income Tax Assessment Act 1936;
   (b) whether and to what extent its effect upon the operation of Part 3-6 of the Income Tax Assessment Act 1997 should be taken into account in the construction of s 177EA;
   (c) whether and to what extent
      (i) consideration of what could or might have occurred if the "scheme" had not been carried out (an "alternative postulate"), or
      (ii) the operation of a foreign tax statute,

   is relevant to the construction and application of s 177EA.

3. The contest in the appeal is as to whether the circumstances of the issue by the Commonwealth Bank of Australia to the Appellant of PERLS V securities are such as to authorise the Respondent to make a determination under s 177EA(5) denying to the Appellant the franking credits attached to distributions on the securities.

Filed on behalf of: the Appellant

Freehills
MLC Centre
GPO Box 4227
Sydney NSW 2001

Date of this document: 31 August 2012

Contact: Cameron Hanson
Telephone: 02 9225 5224
Facsimile: 02 9322 4000
E-mail: cameron.hanson@freehills.com

Part III – Section 78B of the Judiciary Act

4. The Appellant has considered whether any notice should be given in compliance with s 78B of the Judiciary Act 1903 and respectfully submits that no such notice should be given.

Part IV – Reports

5. The judgment of the Full Court ([2011] FCAFC 158) is reported at (2011) 198 FCR 89, and also at 2011 ATC ¶20-295.

6. The decision of Emmett J at first instance ([2011] FCA 205) is reported at 2010 ATC ¶20-247.

Part V - Facts

7. The factual context was not in dispute[1] and is referred to in the reasons of the primary Judge at [19-32] and [55-72] and of the members of the Full Court at [4-5], [11-12], and [133-156]. The essential facts are as follows.

8. The Commonwealth Bank of Australia, an Authorised Deposit-taking Institution whose capital adequacy was regulated by APRA, had a need for additional Tier 1 capital. That the Bank's dominant reason for issuing the PERLS V securities was to raise additional Tier 1 capital was not at issue in the Federal Court, either at first instance or on appeal.

9. To improve its regulatory capital position, the Bank could (within APRA limits) have issued any form of Tier 1 capital.[2] The Bank's ordinary share capital had increased substantially in 2008-9,[3] and for reasons of prudent capital management the Bank preferred not to make an issue of further ordinary shares,[4] but rather an issue of hybrid

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1 There were no material objections to the Appellant's evidence, no witnesses were required for cross-

2 In order to qualify as Tier 1 capital, any security which the Bank might issue is required to be a permanent acquisition of funds, freely available to absorb losses, not involving an unavoidable service charge against earnings and ranking behind the claims of creditors (Emmett J, ABxx at [48]; the specific rules are set out in APS111, ABxx). The available categories of securities which could be issued as Tier 1 capital include ordinary shares (fundamental Tier 1 capital), perpetual non-cumulative preference shares, which may be issued stapled to notes provided the notes are issued through an overseas branch (non-innovative residual Tier 1 capital), and other perpetual securities meeting the Tier 1 criteria (innovative residual Tier 1 capital); Emmett J, ABxx at [49-54].

3 Ordinary shares had been issued to raise $4.8 billion, Cobley, ABxx at [26], [27]; Ex LC-1 (CB2) ABxx at 44.

4 Capital management issues included cost (ABxx at [6.2-6.3]) and structural diversity in the Bank's capital (Cobley ABxx at [38-40]).

or "residual Tier 1 capital,"[5] comprising perpetual non-redeemable preference shares stapled to notes which, to comply with APRA standards, were required to be issued through an overseas branch. The PERLS V securities issued comprised a preference share issued by the Bank in Australia and a $200 note issued from its New Zealand branch.[6]

10. Whichever category of Tier 1 capital is issued by a bank, it is necessarily characterised for Australian income tax purposes as an "equity interest" and not as a "debt interest." In consequence, for Australian tax purposes the return on Tier 1 capital is characterised as dividends (either as dividends at company law, or as "non-share dividends") and is both non-deductible and frankable.[7] In contrast, in New Zealand, which has not adopted Australia's debt/equity rules in its tax legislation, the payments on the notes (the proceeds of which were used in the New Zealand branch's activities) were treated for corporate reporting and tax purposes as interest, not dividends, and as a deductible expense for tax purposes.

11. The Bank has consistently fully franked the dividends paid on its ordinary shares.[8] In consequence, it was and is obliged to fully frank the distributions on its other Tier 1 capital.[9]

Part VI – Appellants' Argument

1 The Appellant's submission in summary

12. The Bank, for reasons wholly unrelated to income tax, wished to raise additional Tier 1 capital at a cost of capital lower than that of an issue of ordinary shares.[10] Any Tier 1 issue which met the Bank's prudential and capital management criteria would necessarily be an "equity interest" for tax purposes, such that distributions on it would

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5 Emmett J, ABxx at [60-62], [64]; Cobley ABxx at [18], [24], [71]-[75]; see also ABxx.

6 Emmett J, ABxx at [20].

7 Income Tax Assessment Act 1997 Division 974, summarised by Emmett J, ABxx at [14-18]; s 202-40 (Frankable distributions), s 26-26 (no deduction for non-share distributions). Where the concession afforded by s 215-10 is available (it was not in the case of the PERLS V securities), the distributions are not frankable.

8 Emmett J, ABxx at [112], Cobley ABxx at [85].

9 Edmonds J, AB xx, xx [13(3)] and [113]; Jessup J ABxx [216]. (Distributions on a small quantity of Tier 1 capital, not dealt with in evidence, are not required to be franked either because the Respondent accepts that the capital satisfies s 215-10 or because it comprises undated notes issued before privatisation of the Bank.)

10 The cost of capital (cost to the Bank of servicing, by making distributions in respect of them) of ordinary shares was 14.2% per annum: ABxx. The cost of capital yielding a fixed or floating rate of return was much lower: in the case of the PERLS V it was 5.58% per annum (Emmett J at ABxx [63]).

both be frankable, and be required to be franked, whether or not the holders were entitled to franking credits. The franking of the PERLS V distributions was a "result mandated by the 1997 Act."[11]

13. It is common ground that the Bank (whose purpose is the only purpose in issue) intended that there should be distributions made upon the securities issued (the PERLS V), in order to attract investors; that the distributions should be franked, in accordance with the requirements of the Act; and in consequence that the PERLS V securities should be offered on terms that they would yield franked distributions.

14. That the distributions were frankable, and franked, was not a criterion for choice of the security to be issued: it was a necessary concomitant of the issue. As all distributions by the Bank were required to be franked, franking neither increased nor reduced the difference in cost of capital between the PERLS V and any other form of Tier 1 capital, including ordinary shares.

15. The Appellant submits that the Bank's purpose of franking the distributions (and thereby conferring imputation benefits on investors including the Appellant) was a necessary and ancillary incident of its purpose of raising hybrid Tier 1 capital, and was no more than an "incidental purpose" for s 177EA purposes, having regard to the "relevant circumstances" specified in that section.

16. None of the "relevant circumstances" identified in s 177EA(17) would lead to the conclusion that the issue was made for a non-incidental purpose of enabling the holders of the securities to obtain franking credits. The Full Court unanimously and correctly so held in relation to all of those circumstances save three; in relation to those three the Appellant submits that the view of Edmonds J is to be preferred to that of the majority.

2 The legislation in outline

(i) The imputation provisions

17. Part 3-6 of the 1997 Act enacts the imputation system, which partially integrates the income tax liabilities of an Australian company and its members by allowing the company to pass to its members the benefit of having paid income tax on the profits underlying certain distributions, but only to those who have a sufficient economic interest in it and non-preferentially.[12]

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[11] Jessup J, ABxx [216].

[12] Division 200 (Guide to Part 3-6), s 201-1 (Objects).

18. The limitation on franking credits which may be attached to a distribution is the amount of the distribution divided by the inverse of the corporate tax rate, not the tax actually paid on the profits appropriated to effect a distribution.[13] The penalty for allocating more franking credits than the tax paid by the company is not denial of the franking credits but imposition on the company of franking deficit tax.[14]

19. An "integral part of the imputation system," from which relief may be granted only in "exceptional circumstances,"[15] is the "benchmark rule"[16] under which "all frankable distributions made within a particular period must be franked to the same extent."[17] If a corporate taxpayer has franked any distributions during an income year, it must frank all other distributions in that year at the same rate, on penalty of over-franking tax (for excessive franking) or forfeiture of franking credits (for under-franking).[18]

20. Division 204 provides for denial of franking credits, or the imposition of franking debits, where there is a transaction with the *effect* of streaming franking credits on distributions.[19] Section 177EA of the 1936 Act empowers the Commissioner to make a determination imposing franking debits, or denying franking credits, where there is a non-incidental *purpose* of "enabling the [recipient] to obtain an imputation benefit." Section 177EA was enacted to remedy, albeit is not limited to, two identified mischiefs (franking credit trading and dividend streaming).[20]

(ii) Section 177EA

21. Relevant portions of s 177EA and s 177D(b) are set out in the judgments below[21] and are attached.

22. The only matter for determination by the Court is whether s 177EA(3)(e) is satisfied. The first four conditions in subs (3) – paras (a)-(d) – are necessarily satisfied in relation

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13 Section 202-60(2) (Maximum franking credit).

14 Section 205-45 (Franking deficit tax).

15 Section 203-55(2).

16 Section 203-25.

17 Section 200-30; Division 203 contains the operative provisions.

18 See section 203-50 (Consequences of breaching the benchmark rule: for overfranking, over-franking tax, s 203-50(1)(a), for underfranking, loss of franking credits, s 203-50(1)(b)), s 203-55.

19 Section 204-1 (Objects: to ensure that the benchmark rule is not escaped, and to prevent streaming of franked distributions), Subdivision 204-D (Streaming distributions).

20 Emmett J at ABxx [80-82], Edmonds J at ABxx [23-24].

21 Edmonds J, ABxx-xx at [14], [20]; Jessup J at ABxx, xx-xx, [121], [159-160].

to all issues of securities on which franked distributions are made, so that the effective criterion for determining whether a recipient is denied the franking credits is that in para (e): whether it would be concluded that the issuer made the issue "for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling" the issuee to obtain imputation benefits, viz, franking credits.

3 The Appellant's argument: an only incidental purpose of franking

(i) The meaning of "incidental" in s 177EA

23. The word "incidental" may be used in either of two senses:[22] one is "casual, inessential, subordinate or merely background,"[23] "fortuitous" or "trivial," and the other is occurring in subordinate conjunction with, in furtherance of or consequential upon something else.[24] Which sense is used in a provision will depend on the context and object of the legislation, but where the question is whether an activity, purpose or result is "incidental" both English[25] and American[26] authorities support the latter sense as that which is appropriate. The language of the Washington Court of Appeal, dealing with

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22 Both the Macquarie Dictionary ("happening or likely to happen in fortuitous or subordinate conjunction with something else") and the Oxford English Dictionary ("occurring or liable to occur in fortuitous or subordinate conjunction with something else of which it forms no essential part; casual") give both meanings.

23 *Football Association Premier League Ltd and others v Panini UK Ltd* [2004] 1 WLR 1147 at [21], concerning the question whether the inclusion of a copyrighted work in another work was an incidental inclusion.

24 See for example *Robson v Dixon* [1972] 1 WLR 1493, 1498, where duties performed by an employee in one place which were incidental to those performed in another place were to be taken to be performed in the other place. Pennycuick VC construed the "incidental" requirement as denoting an activity which "does not serve any independent purpose but is carried out in order to further some other purpose."

25 In *D&J Nicol v Dundee Harbour Trustees* [1915] A.C. 550, 561 Lord Dunedin held that pleasure excursions were not incidental to the business of a ferry company; but in *Bell Houses Ltd v City Wall Properties Ltd (No.1)* [1966] 2 Q.B. 656 the court held that procuring finance for another company was "incidental or conducive" to a company's real estate business. In *Thurogood v Van Den Berghs & Jurgens Ltd* [1951] 2 K.B. 537 it was held that the oiling and testing of machinery was incidental to manufacture of a product by use of the machinery. In *Re Fahy's Will Trusts* [1962] 1 WLR 17 it was held that only costs incurred after commencement of negotiations could be "incidental" to such negotiations, and in *Ex Parte Trinity Mirror plc* [2008] EWCA Crim 50 at [30] the Court of Appeal held that powers are "incidental to" the jurisdiction of the Crown Court only when the powers to be exercised relate to the proper dispatch of the business before it. In all these decisions "incidental" is used in the "subordinate conjunction" sense, not the "casual" or "unimportant" sense.

26 In *Archambault v Sprouse* 218 S.C. 500, 507 (1951), 63 S.E.2d 459, 462 the South Carolina Supreme Court, dealing with whether one building was incidental to residential use of another, adopted the meaning in the Third Edition of Black's Law Dictionary, "Depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another which is termed the principal; something incidental to the main purpose." In *Lowry v. City of Mankato*, 231 Minn. 108, 114, 42 N.W.2d 553, 558 (1950) the Minnesota Supreme Court said that "'[i]ncidental' has much the same meaning as 'accessory' and 'subordinate' and is used to convey the idea of a thing being subordinate to, dependent on, and pertaining to another thing which is the principal one," reasoning adopted by the Court in *Minnesota v Delano Community Development Corp* 571 N.W.2d 233, 237 (1997). In *Kelly v Hill* 104 Cal.App.2d 61, 230 P.2d 864 (1951) the California Appeals Court, considering whether a pipeline construction was incidental to farming so as to be relieved of licensing requirements, said that "'Incidental' obviously means depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another which is termed the principal, something incidental to the main purpose."

whether occupation of premises was incidental to the provision of services to the occupant so as to engage statutory protection, is apposite: incidental "does not mean that room and board must be trivial or unimportant in comparison with the overall institutional purpose; it means that living there is subordinate or attendant to the institutional purpose."[27]

24. In the context of provisions concerned solely with an event or circumstance, either of these meanings may be conveyed. In the context of provisions concerned with a purpose for or consequence of an act or transaction, however, it is the latter meaning which will normally be adopted by the statute, for both purpose (anterior) and consequence (subsequent) impute some relevant relationship with the act or transaction. A purpose does not exist in the abstract: it exists only as the purpose of a party in undertaking some course of conduct.[28] In s 177EA(3)(e) that nexus is made explicit: "the person ... entered into the scheme ... for a purpose." A purpose is "incidental" to the act of entering into or carrying out a scheme if it is subordinate and conducive to another purpose with which the actor enters into or carries out the scheme, or if it follows as a natural incident of pursuit of the other purpose. Any uncertainty as to the sense in which "incidental purpose" is used in the paragraph is resolved by the Treasurer's explanatory memorandum, explicitly explaining that the phrase extends to one which occurs "in subordinate conjunction with one of the main or substantial purposes of the scheme, or merely follows that purpose as its natural incident."[29]

25. In respect of an issue to raise capital, the purpose under consideration in s 177EA(3)(e) is the issuer's[30] purpose of enabling the holder of the securities to obtain franking credits. If that purpose is in furtherance of or consequential upon a principal purpose of raising capital, it will be incidental to the principal purpose, and will not attract s 177EA. If it cannot be characterised as incidental, it will be a proscribed purpose, one which attracts a disqualifying determination under s 177EA.

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27 *Sunrise Group Homes, Inc. v. Ferguson*, 55 Wash.App. 285, 777 P.2d 553 (1989) at 289, 555; followed by the Oregon Court of Appeal in *Burke v. Oxford House of Oregon Chapter V* 196 Or.App. 726, 103 P.3d 1184 (2004).

28 References to the purpose of an act, or the purpose of a thing or provision, are hypallage, transferred references to the purpose of the actor, creator or author: inanimate or abstract things cannot have a purpose, which is fundamentally a subjective state of mind, albeit one which may sometimes (for example, by statutory direction) be ascertained only by reference to objective circumstances and acts (see for example the discussion of Brennan J concerning purpose in *Magna Alloys & Research Pty Ltd v FC of T* (1980) 49 FLR 183, 192-196).

29 Explanatory Memorandum to Taxation Laws Amendment Bill (No 7) 1997, para 8.6.

30 The subscriber's purpose will normally be excluded from consideration by s 177EA(4).

(ii) Legislative context: the imputation scheme

26. The Appellant submits that in the case of an issue made to raise capital, the issuer's purpose of conferring imputation benefits on subscribers is no more than incidental to its purpose of raising capital.

27. To raise capital, an issuer must promise yield on the issued securities,[31] and the legislative purpose manifest in the scheme of Part 3-6 (summarised at [17-20] above) is that as part of that yield the company will, by way of franking credits, pass to investors the benefit of tax paid by the issuing company, and will do so equally to all investors in what the Acts treat as equity. The legislation invites prospective investors to subscribe for securities in the expectation that franking of distributions will be an integral part of – in the language of the majority, will be "central to" and part of the "architecture of" – the investment, and that both the investment made and the yield received will be "calculated by reference to the imputation benefits to be received."

28. This legislative structure provides context for the construction of s 177EA, which although concerned solely with franking credits finds its place not in Part 3-6 but in Part IVA, "Schemes to reduce income tax." The role of s 177EA is as a "catch-all" to protect Part 3-6 from "abuse of the imputation system through schemes which circumvent the basic rules for the franking of dividends [and are] not otherwise prevented by those basic rules."[32] It is not the role of s 177EA to effect a substantial reduction in the ordinary operation of Part 3-6.

29. It will ordinarily be the case that an issue of securities which is made with the main purpose of raising capital is also made with a subordinate or attendant, but not fortuitous or trivial, purpose of franking distributions on the securities in accordance with the legislative scheme of Part 3-6. So to construe s 177EA(3)(e) that the subordinate purpose of conferring franking benefits is not "incidental," but instead authorises the making of a determination denying to the holder the franking credits, is to give the section a field of operation which effectively defeats the objects of the imputation provisions.

30. A construction of s 177EA(3)(e) which brings within the exception for "incidental purposes" those which are ancillary or naturally appertaining to, or in subordinate

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31 Investors will take the prospective yield, including franking credits, into account in deciding whether and at what price to invest in securities (Handley, AB xx at [52-56]). The amount which can be raised by an issue of capital is thus affected by the yield and by whether it is franked.

32 Treasurer's Senate Supplementary Explanatory Memorandum to *Taxation Laws Amendment Bill (No. 3) 1998* (by which s 177EA was proposed), at para 2.3.

conjunction with, a non-proscribed purpose would avoid conflict between the operation of s 177EA and the "integration of the income tax liabilities of an Australian corporate tax entity and its members"[33] which Part 3-6 is intended to achieve. Where as a matter of normal capital management a company makes an issue primarily for the purpose of raising capital (as the Bank is accepted as having done here[34]), its concurrent purpose of paying franked dividends on the new issue is ancillary or subordinate, and so on this construction "incidental," to its principal purpose of raising capital, and s 177EA is not attracted. Such a construction achieves the "primary object" of construing the "relevant provision so that it is consistent with the language and purpose of all the provisions of the statute ... on the prima facie basis that its provisions are intended to give effect to harmonious goals."[35]

31. Such a construction does not prevent s 177EA from performing the protective role described by the Treasurer upon its introduction,[36] nor make it any the less an integral and self-operating provision of the Acts.[37] While some transactions implementing the two principal mischiefs to which the provision was directed – franking credit trading and franking credit streaming – involved issues of capital, in such transactions the issue of shares was incidental to the provision of imputation benefits, than the reverse. Typical examples[38] of the schemes which the section defeats include –

(a) an issue of shares for a substantial price returned to the subscriber in the form of a franked distribution, after which the shares are redeemed or cancelled for no further payment (an instance of franking credit trading), or

(b) an issue for nominal consideration of redeemable shares with only discretionary entitlements ("dividend access shares") to subscribers who can fully benefit from franking credits but not to members who cannot, followed by payment of

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33 See section 200-5.

34 Emmett J at ABxx [92], Edmonds J at AB xx,xx [70], [111], Jessup J at ABxx [212], [219].

35 *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, 381 [69-70]; cf *Commissioner for Railways (NSW) v Agalianos* (1955) 92 CLR 390, 397 and *K & S Lake City Freighters Pty Ltd v Gordon & Gotch Ltd* (1985) 157 CLR 309, 315; *Acts Interpretation Act 1901* (Cth), s 15AA.

36 See paragraph [28] above.

37 "Part IVA is as much a part of the statute under which liability to income tax is assessed as any other provision thereof," *FC of T v Spotless Services Ltd* (1996) 186 CLR 404, 414.

38 Other examples are given in the extrinsic materials: Explanatory Memorandum to Taxation Laws Amendment Bill (No 7) 1997 at [8.96], Senate Supplementary Explanatory Memorandum to Taxation Laws Amendment Bill (No 3) 1998 at [2.11-2.13] (streaming schemes), [2.14] (dividend access shares), Explanatory Memorandum to New Business Tax System (Imputation) Bill 2002 at [3.34].

significant franked dividends on the shares (an instance of franking credit streaming).

In particular cases, other matters within (or beyond) the "relevant circumstances" identified in s 177EA(17) may disclose in either of the parties to a share issue a purpose of conferring imputation benefits which goes beyond the limits of what is "incidental" in the ancillary or subordinate sense.

32. The Bank's issue of PERLS V securities did not involve any element of abuse of the imputation system, or of tax avoidance, such as warranted invocation of the protective provisions of Part IVA, or of s 177EA in particular. There was no diversion, nor any inappropriate extraction, of franking credits. The issue was no more than a raising of Tier 1 capital of the type most suited to the Bank's capital needs, and the franking of distributions accorded entirely with the legislative policy that (i) whatever its legal form an issue which qualified as Tier 1 capital should for tax purposes be treated as equity, and (ii) distributions on the issue should be treated as dividends and franked to the same extent as all other dividends paid by the Bank. These are not circumstances which warrant the conclusion that the Bank undertook the issue with the proscribed purpose such as to attract s 177EA.

33. The Appellant submits that while not "unimportant," the Bank's purpose of franking the distributions on the securities to the extent required by the Act was no more than consequential upon, and so no more than incidental to, its purpose of raising Tier 1 capital.

4 The "relevant circumstances" in s 177EA(17)

34. The test posed by para 177EA(3)(e) is whether "having regard to the relevant circumstances ... it would be concluded" that the Bank had a non-incidental purpose of "enabling" subscribers to obtain imputation benefits; it is not simply whether the "relevant circumstances" exist. The Full Court, unanimously and correctly, so concluded, and in relation to all but three of the eighteen "relevant circumstances" also concluded that where present those circumstances did not indicate the presence of such a purpose. The Appellant respectfully submits that the Full Court was correct in the matters on which their Honours agreed. As to twelve of the remaining fifteen relevant circumstances, the Respondent does not contest those conclusions.[39]

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[39] The remaining three circumstances, the subject of the Respondent's notice of contention, are addressed below at [45] and following.

35. As to those "relevant circumstances" on which the majority and minority disagreed (para (17)(f) and subparas 177D(b)(ii) and (iv)), the Appellant, as is set out below, submits that the reasons of Edmonds J are to be preferred.

5 The errors in the decision of the Full Court

36. The majority in the Full Court erred in two significant respects:

(a) first, in considering para (17)(f) and sub-para 177D(b)(iv), Jessup J misconstrued the word "incidental" in para 177EA(3)(e), treating it as denoting a casual or inessential quality rather than as the quality of being subordinate or attendant to, or following as a natural incident from, pursuit of some other purpose;[40] and

(b) second, in considering sub-para 177D(b)(ii), his Honour attributed significance to the consequences of the issue for the Bank under the fundamentally different provisions of New Zealand tax law, a matter which is both beyond the purview of Part IVA and contributes nothing to the drawing of the conclusion required by s 177EA(3)(e).

(i) the "centrality" of the franking

37. Jessup J identified[41] as "most helpful" in resolving the s 177EA(3)(e) question the circumstance referred to in para (17)(f), whether the distributions were "calculated by reference to the imputation benefits to be received by" the holder.[42] In his consideration of that issue, his Honour noted that the distributions included franking "as a specific component."[43]

38. His Honour mistakenly placed emphasis on the purpose of franking distributions being "conspicuous," "intended," part of the "architecture," and so "a central element of the scheme," in contradistinction to being fortuitous, unimportant or casual. His Honour should instead have had regard to the circumstance that the franking of the distributions

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40 For the reasons advanced at paragraphs [23] to [25] above, the Appellant submits that it is in the latter sense that "incidental" is used in para 177EA(3)(e).

41 ABxx at [221].

42 His Honour viewed subpara 177D(b)(iv), "the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme," as also contributing to the conclusion that the Bank had the proscribed purpose, but his reasoning on subpara (iv), at ABxx [216], rests also on the "centrality" of franking to the issue and not on any consideration not relied on in relation to para (17)(f).

43 ABxx at [220]. The substantial reliance placed by Jessup J on para (17)(f) may be contrasted with the concession by the respondent below, ABxx at [27], reflected in his public rulings (for example Public ruling CR2008/30 (ABxx at [50], [84-87]); Public ruling CR 2009/78 (AB xx at [60], [94-102] especially at [101])), that the calculation of distributions by reference to imputation benefits could not, of itself, justify the making of s 177EA determination.

was "mandated by the Act" and to "the practical inevitability that any distributions made in consequence of the raising of [Tier 1] capital would be franked,"[44] and concluded that whether or not fortuitous, the purpose of franking the distributions was incidental, in the sense of being attendant upon and in subordinate conjunction with, the purpose of raising capital, and so within the exception in the parenthesis in para (3)(e).

39. The view which his Honour took, founded on the conception of "incidental" as not extending to anything "intended" or "central" to the issue whether or not it was attendant upon another purpose, had the effect of characterising a relatively straightforward issue of hybrid Tier 1 capital, of a form regulated by and acceptable to APRA, as a tax avoidance device exposed to the operation of Part IVA. His Honour reached this conclusion notwithstanding that no tax was avoided: the investors in PERLS V paid tax at the same rate and on the same basis as holders of ordinary shares and other securities issued by the Bank, and the Bank distributed its franking credits pari passu among all holders, in accordance with the benchmark rule, neither more nor less.

40. In any consideration of the existence of a purpose, whether dominant or incidental or somewhere between, of obtaining or conferring a tax advantage, it is material to consider the commercial effect of the scheme concerned and whether there was an alternative course of action which would result in a similar commercial outcome without the tax advantage.[45] In the case of the franking trading transaction instanced in para [31] above, for example, the amount subscribed approximates the amount distributed (apart from the "sale price" of the franking credits), and it is readily concluded that what contributed to implementation of the scheme was a purpose of directing the provision of franking credits. In the case of the PERLS V securities, however, the commercial outcome was that the Bank raised additional, lower cost Tier 1 capital; and any other course which might have been taken to raise Tier 1 capital would have had the same consequences under the Income Tax Assessment Acts: the yield on the securities would have been non-deductible,[46] the distributions would have been frankable and required to be franked and the holders would have been subjected to the same tax consequences. Whether or not elevated to the status of "alternative postulates"[47] or "counterfactuals," these circumstances are relevant to the conclusion required under s 177EA(3)(e). Jessup J erred in holding that a consideration of whether

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44 Jessup J at ABxx, [216], [219].

45 See *FC of T v Hart* (2004) 217 CLR 216, 243 [66], and see paras (c) and (d) of s 177EA(17), directing a comparison with the position "apart from the scheme."

46 Section 26-26.

47 *Hart* at [66].

the Bank could have issued Tier 1 capital *without* franking distributions was "not … to the point."[48]

(ii) the significance of the New Zealand tax treatment

41. Jessup J reasoned[49] that "in substance" the scheme involved an outlay reduced by a saving in New Zealand tax ("a benefit for the Bank"), that this is "an exemplar" of the distinction between form and substance specified as a relevant circumstance in s 177D(b)(ii), and that "frankability … was a central feature."[50] From this his Honour concludes that the subparagraph points to a purpose of conferring franking credits. In this reasoning his Honour fell into error in at least two respects.

42. First, it disregards the operation of Division 974, which required that for the purposes of Australian tax (as for APRA purposes) the distributions, although in legal form interest, should be treated according to their economic substance, and so as dividends. While the adoption of a legal form with one tax consequence to achieve an outcome whose economic substance if more directly achieved would yield another tax consequence may warrant invocation of Part IVA, there can be no justification for applying Part IVA on grounds of "form and substance" where the statute itself mandates that whatever its form the transaction shall be treated according to its substance. In the present case, subpara (ii) can only point away from forming the s 177EA(3)(e) conclusion: from the outset the Bank accepted that it was the substance, not the form, that fixed the tax consequences.

43. Second, if it were open to have regard to the deductibility of the outgoing for New Zealand tax purposes, either as a matter of fiscal law or as a matter of its effect on commercial profit, that effect would not assist the issue "scheme" to "enable" a holder to obtain imputation benefits. The reduced net outgoings in New Zealand has no effect on the distributions on the PERLS V securities and adds nothing to the franking credits available to be distributed to security holders. As Edmonds J observed,[51] "even if New Zealand tax treatment were relevant, the only conclusion thence to be drawn is that there was some concurrent purpose of obtaining a deduction against New Zealand assessable income."

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48 ABxx at [198].

49 ABxx [214-5].

50 It is not easy to reconcile the statement in [215] that "in point of form" as distinct from substance the distributions were frankable with the statement in [216] that "frankability … was a conspicuous aspect of substance" as opposed to form (the distinction drawn in s 177D(b)(ii)).

51 ABxx [109].

44. That the Bank is entitled to a deduction in the assessment of its liability to New Zealand tax, however much it may grate upon the Australian fish, is a matter wholly foreign not only to the question posed by s 177EA(3)(e) but to the entirety of Part IVA: "Pt IVA is in aid of the Australian, not foreign, revenue."[52] In adopting the reasoning of the primary Judge,[53] the majority adopted his Honour's fundamental error of characterising the distributions on PERLS V as both "deductible and frankable" and relying upon that circumstance as supporting the existence of the proscribed purpose.[54] The distributions explicitly are *not* deductible under Australian law.[55] To characterise the distributions as both deductible and frankable incorrectly assimilates two independent, and quite different, tax regimes.

The Respondent's notice of contention

45. The Respondent by notice proposes to rely also on "the provisions of paragraphs 177EA(17)(ga) and (h) and subpara 177D(b)(vi)." For the reasons given by Edmonds J, and to the extent that his Honour concurred with them those of Jessup J,[56] the Appellant submits that the circumstances identified in those paragraphs are relevantly absent and moreover do not support any conclusion that the Bank had the proscribed purpose.

(i) Paragraph 177EA(17)(ga)

46. Before the Full Court, as in the special leave application in this Court, this circumstance (whether a distribution that is made under the scheme to the appellant is sourced, directly or indirectly, from unrealised or untaxed profits) was the foundation on which the Respondent erected his argument. The reasons of Edmonds J[57] lucidly demonstrate the errors in that argument:

(a) as the legislative history demonstrates,[58] the purpose of para (ga) was to allow a conclusion that there was a proscribed purpose, and so to authorise a s 177EA(5)

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52 *FC of T v Consolidated Press Holdings Limited* (2001) 207 CLR 235 at [51].

53 At [214], Jessup J rejected the appellant's criticism of Emmett J's reasons on this issue; see also [183].

54 Emmett J at [133].

55 Section 26-26; cf Edmonds J at [109]. The Appellant does not understand this point to be disputed by the Commissioner.

56 Jessup J concurred in relation to the matters in [46(b)-(d)] but not that in [46(a)], see ABxx [201]-[207].

57 ABxx [87-99].

58 Edmonds J briefly describes the legislative history at ABxx [88-9] and [92].

determination, where the scheme was one to allow the extraction of franking credits from a company by devices involving the creation of untaxed distributable reserves which could then be distributed as franked dividends. No such circumstances as the provision was directed to were present in the issue of PERLS V.

(b) a distribution is "sourced from" a fund of profits when the fund is appropriated to make the distribution, formally or informally. There was here no appropriation, formal or informal, of any profits which were unrealised or untaxed.[59]

(c) there is no requirement in the legislation that franked dividends be paid out of a discrete fund of profits on which tax has been paid (even if such a concept were meaningful in the context of the Assessment Acts, which it is not). All that Part 3-6 imposes as a limit on the amount of franking credits is that (i) they should not exceed the amount standing to the credit of the franking account, however it came to be that the balance was generated,[60] and (ii) the maximum franking credit on any distribution is the distribution multiplied by the inverse of the corporate tax rate.[61] The legislation does not contemplate tracing distributions to particular tax payments.[62]

(d) even if it could be said that the distributions were out of untaxed profits of the New Zealand branch, there is no logical connection between that circumstance and enabling the holders of the securities to obtain franking credits: the franking credits originated in the payment of Australian tax on profits of the Bank, and the origin of the money or funds used to pay the distributions had no bearing on the availability of the imputation benefits.[63]

(ii) Paragraph 177EA(17)(h)

47. The circumstance specified in paragraph (h) (whether the distribution is equivalent to, similar to or in the nature of interest) was also considered by the whole Court not to

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59 ABxx [93-98].

60 Section 205-45.

61 Section 202-60.

62 See the example given by Edmonds J at ABxx [27-28].

63 ABxx [90(2)], [91], where his Honour points out that in the circumstances to which the provision was directed – franking credits "locked up" in a company which had no distributable profits – the conclusion could be drawn, but in the present circumstances, where both credits and funds were freely available for distribution, the para (ga) circumstances if present would not point to any relevant purpose.

contribute to a conclusion that the Bank had the proscribed purpose, and it is submitted correctly so.

48. The Full Court was divided (but not starkly) on the question whether the distribution was in the nature of interest,[64] Edmonds J concluding on balance that it was not and Jessup J that it was "similar to interest." The Court was however unanimously of the view[65] that there was no logical connection between such a character and the holding by the Bank of the proscribed purpose.

(iii) Subparagraph 177D(b)(vi)

49. The circumstance specified in subparagraph (vi) (any change in the financial position of any person connected with taxpayer resulting from the scheme) was not the subject of submissions to the primary judge beyond the written observation that "this factor might easily contemplate the Bank," while in the Full Court it was mentioned only as a conceivable alternative argument to para 177EA(17)(ga). In consequence there was no finding by the primary Judge, and the paragraph was not addressed by Edmonds J. Jessup J considered that the only relevant uncontested facts (that the Bank increased its Tier 1 capital) did not support a finding of a proscribed purpose.[66] The Appellant submits that there is no evidentiary or logical basis for a conclusion that this was a relevant circumstance supporting a s 177EA(3)(e) conclusion.

Part VII – Legislation

50. The relevant statutory provisions, as in force in the relevant year of income, are attached as Appendix A.

Part VIII – Orders sought

51. The Appellant seeks the following orders:

    1. Appeal allowed with costs.
    2. Set aside the orders of the Full Court of the Federal Court dated 8 December 2011 and in their place order that:

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64 Edmonds J at ABxx [103-4] and Jessup J at ABxx [208-10].

65 Edmonds J at ABxx [104] and Jessup J at ABxx [211-212].

66 Jessup J at ABxx [217].

(1) the appeal be allowed with costs;

(2) the orders of the primary judge dated 11 March 2011 be set aside, and in place thereof, it be ordered that:

(a) the application be allowed with costs;

(b) the objection decision dated 12 January 2010 be set aside; and

(c) the objection dated 29 December 2009 lodged by the Appellant against the Respondent's determination of 14 December 2009 under s 177EA(5)(b) be allowed and the determination be set aside.

Part IX – Estimate

52. The estimate of hours required for the presentation of the appellant's oral argument (including reply) is 2.5 hours.

Date: 31 August 2012

David Thomas
Tel 02 9232 4478
Fax 02 9232 1069
dthomas@sixthfloor.com.au

A H Slater QC
Tel: 02 9230 3232
Fax: 02 9232 8435
aslater@aslater.com

Counsel for the Appellant

IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No S225 of 2012

BETWEEN

ANDREW VINCENT MILLS
Appellant

AND

COMMISSIONER OF TAXATION
Respondent

APPENDIX A: LEGISLATION

(A) RELEVANT PROVISIONS IN FORCE AT RELEVANT TIME

The relevant statutory provisions as they existed at the relevant time, being December 2010, are as follows:

Income Tax Assessment Act 1997

Act No. 38 of 1997 as amended

This compilation was prepared on 17 December 2010
taking into account amendments up to Act No. 145 of 2010

...

Chapter 3—Specialist liability rules

...

Part 3-6—The imputation system

Division 200—Guide to Part 3-6

Guide to Division 200

200-1 What this Division is about

This Division provides an overview of the imputation system.

...

200-5 The imputation system

The *imputation system partially integrates the income tax liabilities of an Australian corporate tax entity and its members by:

(a) allowing the entity, when distributing profits to its members, to pass to those members credit for income tax paid by the entity on those profits; and

(b) allowing the entity's Australian members to claim a tax offset for that credit; and

(c) allowing the entity's Australian members to claim a refund if they are unable to fully utilise the tax offset in reducing their income tax.

200-10 Franking a distribution

When an Australian corporate tax entity distributes profits to its members, the entity has the option of passing to those members credit for income tax paid by the entity on the profits. This is done by franking the distribution.

200-15 The franking account

(1) A franking account is used to keep track of income tax paid by the entity, so that the entity can pass to its members the benefit of having paid that tax when a distribution is made.

(2) Each corporate tax entity has a franking account.

(3) Typically, a corporate tax entity receives a credit in the account if the entity pays income tax or receives a franked distribution. A credit in the franking account is called a franking credit.

(4) Typically, a corporate tax entity receives a debit in the account if the entity receives a refund of tax or franks a distribution to its members. A debit in the franking account is called a franking debit.

200-20 How a distribution is franked

(1) A corporate tax entity franks a distribution by allocating a franking credit to it.

(2) The amount of the franking credit on the distribution is the amount specified in a statement that accompanies the distribution.

(3) Only some kinds of distribution can be franked. These are called frankable distributions.

200-25 A corporate tax entity must not give its members credit for more tax than the entity has paid

(1) A corporate tax entity must not frank a distribution from profits with a franking credit that exceeds the maximum amount of income tax that could have been paid by the entity on the profits distributed.

(2) If a distribution is franked in excess of this limit, the entity will be taken to have franked the distribution with the maximum franking credit for the distribution.

200-30 Benchmark rule

(1) All frankable distributions made within a particular period must be franked to the same extent. This is the benchmark rule.

(2) It is designed to ensure that one member of a corporate tax entity is not preferred over another by the manner in which distributions are franked.

200-35 Effect of receiving a franked distribution

(1) Under Division 207, if an Australian member of a corporate tax entity receives a franked distribution, the member can usually offset, against the member's own income tax liability, income tax paid by the entity on the profits underlying the distribution.

(2) The tax offset to which the member is entitled is equal to the franking credit on the distribution.

Note 1: A member may be entitled to a refund under Division 67 if the sum of the tax offset and certain other tax offsets exceeds the amount of income tax that the member would have to pay if the member had not got those tax offsets.

Note 2: If the member is not a resident, the tax effects of receiving a distribution will be dealt with under Division 11A of Part III of the *Income Tax Assessment Act 1936*, and Subdivision 207-D of this Part.

200-40 An Australian corporate tax entity can pass the benefit of having received a franked distribution on to its members

If an Australian corporate tax entity receives a franked distribution, it can pass the benefit of having received a franking credit on the distribution to its own members by franking distributions to those members.

...

Division 201—Objects and application of Part 3-6

...

201-1 Objects

(1) The main object of this Part is to allow certain *corporate tax entities to pass to their *members the benefit of having paid income tax on the profits underlying certain *distributions.

(2) The other objects of this Part are to ensure that:

(a) the imputation system is not used to give the benefit of income tax paid by a *corporate tax entity to *members who do not have a sufficient economic interest in the entity; and

(b) the imputation system is not used to prefer some members over others when passing on the benefits of having paid income tax; and

(c) the *membership of a corporate tax entity is not manipulated to create either of the outcomes mentioned in paragraphs (a) and (b).

...

Division 202—Franking a distribution

...

Subdivision 202-A—Franking a distribution

...

Operative provisions

202-5 Franking a distribution

An entity ***franks*** a *distribution if:

(a) the entity is a *franking entity that satisfies the *residency requirement when the distribution is made; and

(b) the distribution is a *frankable distribution; and

(c) the entity allocates a *franking credit to the distribution.

Note 1: Division 205 deals with a corporate tax entity's franking account and sets out when credits, known as franking credits, and debits, known as franking debits, arise in that account.

Note 2: The mechanism by which an entity allocates a franking credit to a distribution (for example, whether it is done by resolution or some other means) is determined by the entity.

...

Subdivision 202-C—Which distributions can be franked?

Guide to Subdivision 202-C

202-25 What this Subdivision is about

Generally, distributions that are made out of realised profits can be franked.

Those distributions that are not frankable are identified.

...

202-30 Frankable distributions

Distributions and non-share dividends are frankable unless it is specified that they are unfrankable.

Operative provisions

202-35 Object

The object of this Subdivision is to ensure that only distributions equivalent to realised taxed profits can be franked.

202-40 Frankable distributions

(1) A *distribution is a ***frankable distribution***, to the extent that it is not unfrankable under section 202-45.

(2) A *non-share dividend is a ***frankable distribution***, to the extent that it is not unfrankable under section 202-45.

202-45 Unfrankable distributions

The following are ***unfrankable***:

(b) a distribution to which paragraph 24J(2)(a) of the *Income Tax Assessment Act 1936* applies that is taken under section 24J of the *Income Tax Assessment Act 1936* to be *derived from sources in a prescribed Territory, as defined in subsection 24B(1) of the *Income Tax Assessment Act 1936* (distributions by certain *corporate tax entities from sources in Norfolk Island);

(c) where the purchase price on the buy-back of a *share by a *company from one of its *members is taken to be a dividend under section 159GZZZP of that Act—so much of that purchase price as exceeds what would be the market value (as normally understood) of the share at the time of the buy-back if the buy-back did not take place and were never proposed to take place;

(d) a distribution in respect of a *non-equity share;

(e) a distribution that is sourced, directly or indirectly, from a company's *share capital account;

(f) an amount that is taken to be an unfrankable distribution under section 215-10 or 215-15;

(g) an amount that is taken to be a dividend for any purpose under any of the following provisions:

(i) unless subsection 109RB(6) or 109RC(2) applies in relation to the amount—Division 7A of Part III of that Act (distributions to entities connected with a *private company);

(iii) section 109 of that Act (excessive payments to shareholders, directors and associates);

(iv) section 47A of that Act (distribution benefits—CFCs);

(h) an amount that is taken to be an unfranked dividend for any purpose:

(i) under section 45 of that Act (streaming bonus shares and unfranked dividends);

(ii) because of a determination of the Commissioner under section 45C of that Act (streaming dividends and capital benefits);

(i) a *demerger dividend;

(j) a distribution that section 152-125 or 220-105 says is unfrankable.

...

Subdivision 202-D—Amount of the franking credit on a distribution

Guide to Subdivision 202-D

202-50 What this Subdivision is about

The amount of the franking credit on a distribution is that stated in the distribution statement, unless the amount stated exceeds the maximum franking credit for the distribution.

In that case, the amount of the franking credit on the distribution is taken to be the maximum franking credit for the distribution, worked out under this Subdivision.

...

202-55 What is the maximum franking credit for a frankable distribution?

The maximum franking credit for a distribution is equivalent to the maximum amount of income tax that the entity making the distribution could have paid, at the current corporate tax rate, on the profits underlying the distribution.

Operative provisions

202-60 Amount of the franking credit on a distribution

(1) The amount of the *franking credit on a *distribution is that stated in the *distribution statement for the distribution, unless that amount exceeds the *maximum franking credit for the distribution.

(2) The ***maximum franking credit*** for a *distribution is worked out using the formula:

$$\text{Amount of the *frankable distribution} \times \left(\frac{\text{*Corporate tax rate}}{100\% - \text{*Corporate tax rate}} \right)$$

...

Division 203—Benchmark rule

Guide to Division 203

203-1 What this Division is about

Distributions within a particular period must all be franked to the same extent.

...

203-5 Benchmark rule

(1) A corporate tax entity must frank all frankable distributions made within a particular period at a franking percentage set as the benchmark for that period. This is the benchmark rule.

(2) The benchmark rule does not apply to some corporate tax entities. Those entities are identified in section 203-20.

203-10 Benchmark franking percentage

(1) The benchmark franking percentage for an entity is set by reference to the franking percentage for the first frankable distribution made by the entity during the relevant period.

(2) An entity has a benchmark franking percentage, even if it is not subject to the benchmark rule.

Operative provisions

203-15 Object

The object of this Subdivision is to ensure that one *member of a *corporate tax entity is not preferred over another when the entity *franks *distributions.

203-20 Application of the benchmark rule

(1) The *benchmark rule does not apply to a company in a *franking period if either:

(a) the company satisfies each of the following criteria:

(i) at all times during the franking period, the company is a *listed public company;

(ii) the company cannot make a *distribution on one *membership interest during the franking period without making a distribution under the same resolution on all other membership interests;

(iii) the company cannot *frank a distribution made on one membership interest during the franking period without franking distributions made on all other membership interests under the same resolution with a *franking credit worked out using the same *franking percentage; or

(b) the entity is a *100% subsidiary of a company that satisfies the criteria set out in paragraph (a).

(2) The following are examples of cases in which a company satisfies the criteria set out in paragraph (1)(a):

(a) the company is a *listed public company with a single *class of *membership interest at all times during the relevant *franking period;

(b) the company is a listed public company that, under its constituent documents, must not:

(i) make a *distribution on one membership interest during the relevant franking period without making a distribution under the same resolution on all other membership interests; or

(ii) *frank a distribution made on one membership interest during the relevant franking period without franking distributions made on all other membership interests under the same resolution with a *franking credit worked out using the same *franking percentage;

(c) the company is a listed public company with more than one class of membership interest, but the rights in relation to distributions and the franking of distributions are the same for each class of membership interest.

This is not an exhaustive list.

(3) For the purposes of subsection (1), ignore *membership interests that do not carry a right to receive *distributions (other than distributions on the winding up of the company).

203-25 Benchmark rule

An entity must not make a *frankable distribution whose *franking percentage differs from the entity's *benchmark franking percentage for the *franking period in which the distribution is made. This is the ***benchmark rule***.

Note: If a corporate tax entity franks a distribution in breach of this rule, the distribution will still be a franked distribution, although consequences will flow under section 203-50.

203-30 Setting a benchmark franking percentage

The ***benchmark franking percentage*** for an entity for a *franking period is the same as the *franking percentage for the first *frankable distribution made by the entity within the period.

Note: If no frankable distribution is made during the period, there is no benchmark franking percentage for the period.

203-35 Franking percentage

(1) Subject to subsection (2), the ***franking percentage*** for a *frankable distribution is worked out using the formula:

$$\frac{\text{*Franking credit allocated to the *frankable distribution}}{\text{*Maximum franking credit for the distribution}} \times 100$$

(2) If the *franking percentage for a *frankable distribution would exceed 100% if it were worked out under subsection (1), it is taken to be 100%.

203-40 Franking periods—where the entity is not a private company

(1) Use this section to work out the franking periods for an entity in an income year where the entity is not a *private company for the income year.

(2) If the entity's income year is a period of 12 months, each of the following is a ***franking period*** for the entity in that year:

(a) the period of 6 months beginning at the start of the entity's income year;

(b) the remainder of the income year.

(3) If the entity's income year is a period of 6 months or less, the ***franking period*** for the entity in that year is the same as the income year.

(4) If the entity's income year is a period of more than 6 months and less than 12 months, each of the following is a ***franking period*** for the entity in that year:

(a) the period of 6 months beginning at the start of the entity's income year;

(b) the remainder of the income year.

(5) If the entity's income year is a period of more than 12 months, each of the following is a ***franking period*** for the entity in that year:

(a) the period of 6 months beginning at the start of the entity's income year (the ***first franking period***);

(b) the period of 6 months beginning immediately after the end of the first franking period;

(c) the remainder of the income year.

...

203-50 Consequences of breaching the benchmark rule

(1) If an entity makes a *frankable distribution in breach of the *benchmark rule:

(a) the entity is liable to pay over-franking tax imposed by the *New Business Tax System (Over-franking Tax) Act 2002* if the *franking percentage for the *distribution exceeds the entity's *benchmark franking percentage for the *franking period in which the distribution is made; and

(b) a *franking debit arises in the entity's *franking account if the franking percentage for the distribution is less than the entity's benchmark franking percentage for the franking period in which the distribution is made.

(2) Use the following formula to work out:

(a) in a case dealt with under paragraph (1)(a)—the amount of the *over-franking tax; and

(b) in a case dealt with under paragraph (1)(b)—the amount of the *franking debit:

$$\text{Franking \% differential} \times \text{Amount of the *frankable distribution} \times \frac{\text{*Corporate tax rate}}{100\% - \text{*Corporate tax rate}}$$

where:

franking % differential is the difference between:

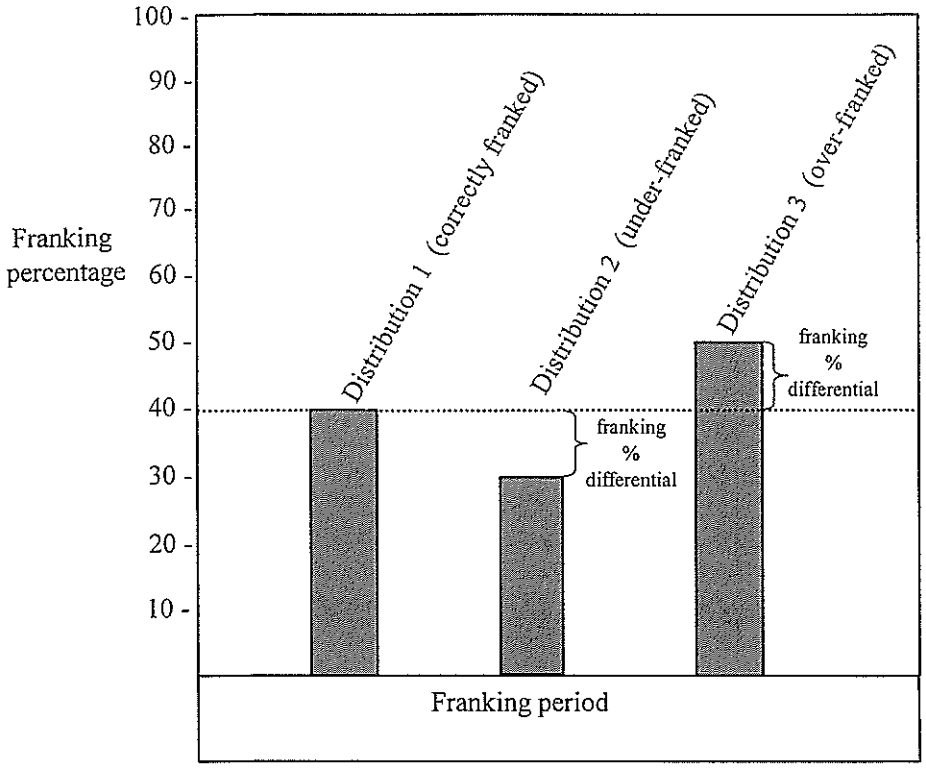
(a) the *franking percentage for the *frankable distribution; and

(b) either:

(i) if subparagraph (ii) does not apply—the entity's *benchmark franking percentage for the *franking period in which the *distribution is made; or

(ii) if the Commissioner in the exercise of the Commissioner's powers under subsection 203-55(1), permits the entity to frank the distribution at a different franking percentage—that percentage.

Example: An entity makes 3 successive frankable distributions in a franking period. Each of those distributions is represented in the following diagram. The franking percentage for the first distribution is 40%, and so the entity's benchmark franking percentage for the period is 40%.



Note: Distribution 2 is under-franked to the extent of the franking % differential. This is used to work out the amount of the under-franking debit under subsection (2).

Distribution 3 is over-franked to the extent of the franking % differential. This is used to work out the amount of over-franking tax on the distribution under the *New Business Tax System (Over-franking Tax) Act 2002*. The amount of the tax is calculated using the same formula as that set out in subsection (2).

(3) A *franking debit arising under paragraph (1)(b) is in addition to any franking debit that would otherwise arise for the entity because of the *distribution.

(4) The *franking debit arises on the day on which the *frankable distribution is made.

203-55 Commissioner's powers to permit a departure from the benchmark rule

Powers of the Commissioner

(1) The Commissioner may, on application by an entity, make a determination in writing permitting the entity to *frank a *distribution at a *franking percentage that differs from the entity's *benchmark franking percentage for the *franking period in which the distribution is made.

(2) Because the *benchmark rule is an integral part of the imputation system, the Commissioner's powers under this section may only be exercised in extraordinary circumstances.

Matters to which the Commissioner must have regard in exercising the power

(3) In deciding whether there are extraordinary circumstances justifying the exercise of the Commissioner's power to make a determination under subsection (1), the Commissioner must have regard to:

(a) the entity's reasons for departing, or proposing to depart, from the *benchmark rule; and

(b) the extent of the departure, or proposed departure, from the benchmark rule; and

(c) if the circumstances that give rise to the entity's application are within the entity's control, the extent to which the entity has sought the exercise of the Commissioner's powers under this section in the past; and

(d) whether a *member of the entity has been or will be disadvantaged as a result of the departure, or proposed departure, from the benchmark rule; and

(e) whether a *member of the entity will receive greater *imputation benefits than another member of the entity because a distribution *franked at a *franking percentage that differs from the *benchmark franking percentage for the *franking period is made to one of them; and

(f) any other matters that the Commissioner considers relevant.

When may the powers be exercised?

(4) The Commissioner may make a determination under subsection (1) either before or after the *frankable distribution is made.

Consequence of the Commissioner exercising the power under this section

(5) An allocation of a *franking credit at a percentage specified by the Commissioner in a determination under subsection (1) is taken to comply with the *benchmark rule.

Applying to the Commissioner

(6) The entity must:

(a) make its application under this section in writing; and

(b) include in the application all information relevant to the matters to which the Commissioner must have regard under subsection (3).

Review

(7) If the entity or a *member of the entity is dissatisfied with the determination under subsection (1), the entity or member may object to it in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

Division 204—Anti-streaming rules

...

Subdivision 204-A—Objects and application

...

204-1 Objects

The objects of this Division are to ensure that:

(a) an entity and its *members cannot avoid the effect of the *benchmark rule by exploiting the *benchmark franking percentage of another entity; and

(b) an entity does not stream *franked distributions and *tax-exempt bonus shares; and

(c) an entity does not stream *distributions to members of the entity who *derive a *greater benefit from franking credits than other members.

...

Division 205—Effect of receiving a franked distribution

...

205-45 Franking deficit tax

Object

(1) While recognising that an entity may anticipate *franking credits when *franking *distributions, the object of this section is to prevent those credits from being anticipated indefinitely by requiring the entity to reconcile its *franking account at certain times and levying tax if the account is in *deficit.

Franking deficit at end of income year

(2) An entity is liable to pay franking deficit tax imposed by the *New Business Tax System (Franking Deficit Tax) Act 2002* if its *franking account is in *deficit at the end of an income year.

Corporate tax entity ceases to be a franking entity

(3) An entity is liable to pay *franking deficit tax imposed by the *New Business Tax System (Franking Deficit Tax) Act 2002* if:

(a) it ceases to be a *franking entity; and

(b) immediately before it ceases to be a franking entity, its *franking account is in *deficit.

Note: The tax is imposed in the *New Business Tax System (Franking Deficit Tax) Act 2002* and the amount of the tax is set out in that Act.

...

Division 207—Effect of receiving a franked distribution

...

Guide to Division 207

...

207-5 Overview

(1) If a corporate tax entity makes a franked distribution to one of its members, then, as a general rule:

(a) an amount equal to the franking credit on the distribution is included in the member's assessable income; and

(b) the member is entitled to a tax offset equal to the same amount.

(2) In some cases a residency requirement must be satisfied for the general rule to apply.

(3) If a franked distribution is made to a member that is a partnership or the trustee of a trust, an amount equal to the franking credit on the distribution is also included in the member's assessable income as mentioned in paragraph (1)(a).

(4) However, a tax offset in relation to that distribution is only available to an entity (who may be a partner, beneficiary or a trustee) if the distribution flows indirectly to it and does not flow indirectly through it to another entity. The tax offset is equal to its share of the franking credit on the distribution.

Note: That share is a notional amount and the entity can have that share without actually receiving any of that franking credit or distribution.

(5) There are exceptions to both the general rule mentioned in subsection (1) and the special rule mentioned in subsection (4). Basically, these exceptions are created:

(a) where the relevant entity would not have paid tax on the distribution or a share of the distribution (see Subdivisions 207-D and 207-E); and

(b) where there is a manipulation of the imputation system in a manner that is not permitted under the income tax law (see Subdivision 207-F).

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Income Tax Assessment Act 1936

Act No. 27 of 1936 as amended

This compilation was prepared on 22 December 2010
taking into account amendments up to Act No. 145 of 2010

...

Part IVA—Schemes to reduce income tax

177A Interpretation

(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*.

foreign income tax offset means a tax offset allowed under Division 770 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.

(2) The definition of *taxpayer* in subsection (1) shall not be taken to affect in any way the interpretation of that expression where it is used in this Act other than this Part.

(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.

...

177D Schemes to which Part applies

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

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

(b) having regard to:

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

(ii) the form and substance of the scheme;

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

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

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

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

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

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

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

Note: Section 960-255 of the *Income Tax Assessment Act 1997* may be relevant to determining family relationships for the purposes of subparagraphs (b)(vi) and (viii).

...

177EA Creation of franking debit or cancellation of franking credits

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

relevant circumstances has a meaning affected by subsection (17).

relevant taxpayer has the meaning given by subsection (3).

scheme for a disposition, in relation to membership interests or an interest in membership interests, has a meaning affected by subsection (14).

(2) An expression used in this section that is defined in the *Income Tax Assessment Act 1997* has the same meaning as in that Act, except to the extent that its meaning is extended by subsection (16), (18) or (19), or affected by subsection (15).

Application of section

(3) This section applies if:

(a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and

(b) either:

(i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or

(ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and

(c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and

(d) except for this section, the person (the ***relevant taxpayer***) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and

(e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

Bare acquisition of membership interests or interest in membership interests

(4) It is not to be concluded for the purposes of paragraph (3)(e) that a person entered into or carried out a scheme for a purpose mentioned in that paragraph merely because the person acquired membership interests, or an interest in membership interests, in the entity.

Commissioner to determine franking debit or deny franking credit

(5) The Commissioner may make, in writing, either of the following determinations:

(a) if the corporate tax entity is a party to the scheme, a determination that a franking debit or exempting debit of the entity arises in respect of each distribution made to the relevant taxpayer or that flows indirectly to the relevant taxpayer;

(b) a determination that no imputation benefit is to arise in respect of a distribution or a specified part of a distribution that is made, or that flows indirectly, to the relevant taxpayer.

A determination does not form part of an assessment.

Notice of determination

(6) If the Commissioner makes a determination under subsection (5), the Commissioner must:

(a) in respect of a determination made under paragraph (5)(a)— serve notice in writing of the determination on the corporate tax entity; or

(b) in respect of a determination made under paragraph (5)(b)— serve notice in writing of the determination on the relevant taxpayer.

The notice may be included in a notice of assessment.

Publication in national newspaper of determination in relation to listed public company denying imputation benefit

(7) If the Commissioner makes a determination under paragraph (5)(b), in respect of a distribution made by a listed public company, the Commissioner is taken to have served notice in writing of the determination on the relevant taxpayer if the Commissioner causes the notice to be published in a daily newspaper that circulates generally in each State, the Australian Capital Territory and the Northern Territory. The notice is taken to have been served on the day on which the publication takes place.

Evidence of determination

(8) The production of:

(a) a notice of a determination; or

(b) a document signed by the Commissioner, a Second Commissioner or a Deputy Commissioner purporting to be a copy of a determination;

is conclusive evidence:

(c) of the due making of the determination; and

(d) except in proceedings under Part IVC of the *Taxation Administration Act 1953* on an appeal or review relating to the determination, that the determination is correct.

Objections

(9) If a taxpayer to whom a determination relates is dissatisfied with the determination, the taxpayer may object against it in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

Effect of determination of franking debit or exempting debit

(10) If the Commissioner makes a determination under paragraph (5)(a):

(a) on the day on which notice in writing of the determination is served on the entity, a franking debit or exempting debit of the corporate tax entity arises in respect of the distribution; and

(b) the amount of the franking debit or exempting debit is such amount as is stated in the Commissioner's determination, being an amount that:

(i) the Commissioner considers reasonable in the circumstances; and

(ii) does not exceed the amount of the franking debit or exempting debit of the entity arising under item 1 of the table in section 205-30 of the *Income Tax Assessment 1997* or item 2 of the table in section 208-120 of that Act in respect of the distribution.

Effect of determination that no imputation benefit is to arise

(11) If the Commissioner makes a determination under paragraph (5)(b), the determination has effect according to its terms.

Application of section to non-share dividends

(12) This section:

(a) applies to a non-share equity interest in the same way as it applies to a membership interest; and

(b) applies to an equity holder in the same way as it applies to a member; and

(c) applies to a non-share dividend in the same way as it applies to a distribution.

*Meaning of **interest in membership interests***

(13) A person has an interest in membership interests if:

(a) the person has any legal or equitable interest in the membership interests; or

(b) the person is a partner in a partnership and:

(i) the assets of the partnership include, or will include, the membership interests; or

(ii) the partnership derives, or will derive, income indirectly through interposed companies, trusts or partnerships, from distributions made on the membership interests; or

(c) the person is a beneficiary of a trust (including a potential beneficiary of a discretionary trust) and:

(i) the membership interests form, or will form, part of the trust estate; or

(ii) the trust derives, or will derive, income indirectly through interposed companies, trusts or partnerships, from distributions made on the membership interests.

Meaning of scheme for a disposition

(14) A scheme for a disposition of membership interests or an interest in membership interests includes, but is not limited to, a scheme that involves any of the following:

(a) issuing the membership interests or creating the interest in membership interests;

(b) entering into any contract, arrangement, transaction or dealing that changes or otherwise affects the legal or equitable ownership of the membership interests or interest in membership interests;

(c) creating, varying or revoking a trust in relation to the membership interests or interest in membership interests;

(d) creating, altering or extinguishing a right, power or liability attaching to, or otherwise relating to, the membership interests or interest in membership interests;

(e) substantially altering any of the risks of loss, or opportunities for profit or gain, involved in holding or owning the membership interests or having the interest in membership interests;

(f) the membership interests or interest in membership interests beginning to be included, or ceasing to be included, in any of the insurance funds of a life assurance company.

(15) In determining whether a distribution flows indirectly to a person, assume that the following provisions of the *Income Tax Assessment Act 1997* had not been enacted:

(a) section 295-385 (about income from assets set aside to meet current pension liabilities), section 295-390 (about income from other assets used to meet current pension liabilities) and 295-400 (about income of a PST attributable to current pension liabilities); or

(b) paragraph 320-37(1)(a) (about segregated exempt assets) or paragraph 320-37(1)(d) (about income bonds, funeral policies and scholarship plans).

When imputation benefit is received

(16) A taxpayer to whom a distribution flows indirectly receives an ***imputation benefit*** as a result of the distribution if:

(a) the taxpayer is entitled to a tax offset under Division 207 of the *Income Tax Assessment Act 1997* as a result of the distribution; or

(b) where the taxpayer is a corporate tax entity—a franking credit would arise in the franking account of the taxpayer as a result of the distribution.

Note: Where the distribution is made directly to the taxpayer, see subsection 204-30(6) of the *Income Tax Assessment Act 1997* for a definition of ***imputation benefit***.

Meaning of ***relevant circumstances*** *of scheme*

(17) The ***relevant circumstances*** of a scheme include the following:

(a) the extent and duration of the risks of loss, and the opportunities for profit or gain, from holding membership interests, or having interests in membership interests, in the corporate tax entity that are respectively borne by or accrue to the parties to the scheme, and whether there has been any change in those risks and opportunities for the relevant taxpayer or any other party to the scheme (for example, a change resulting from the making of any contract, the granting of any option or the entering into of any arrangement with respect to any membership interests, or interests in membership interests, in the corporate tax entity);

(b) whether the relevant taxpayer would, in the year of income in which the distribution is made, or if the distribution flows indirectly to the relevant taxpayer, in the year in which the distribution flows indirectly to the relevant taxpayer, derive a greater benefit from franking credits than other entities who hold membership interests, or have interests in membership interests, in the corporate tax entity;

(c) whether, apart from the scheme, the corporate tax entity would have retained the franking credits or exempting credits or would have used the franking credits or exempting credits to pay a franked distribution to another entity referred to in paragraph (b);

(d) whether, apart from the scheme, a franked distribution would have flowed indirectly to another entity referred to in paragraph (b);

(e) if the scheme involves the issue of a non-share equity interest to which section 215-10 of the *Income Tax Assessment Act 1997* applies—whether the corporate tax entity has issued, or is likely to issue, equity interests in the corporate tax entity:

(i) that are similar, from a commercial point of view, to the non-share equity interest; and

(ii) distributions in respect of which are frankable;

(f) whether any consideration paid or given by or on behalf of, or received by or on behalf of, the relevant taxpayer in connection with the scheme (for example, the amount of any interest on a loan) was calculated by reference to the imputation benefits to be received by the relevant taxpayer;

(g) whether a deduction is allowable or a capital loss is incurred in connection with a distribution that is made or that flows indirectly under the scheme;

(ga) whether a distribution that is made or that flows indirectly under the scheme to the relevant taxpayer is sourced, directly or indirectly, from unrealised or untaxed profits;

(h) whether a distribution that is made or that flows indirectly under the scheme to the relevant taxpayer is equivalent to the

receipt by the relevant taxpayer of interest or of an amount in the nature of, or similar to, interest;

(i) the period for which the relevant taxpayer held membership interests, or had an interest in membership interests, in the corporate tax entity;

(j) any of the matters referred to in subparagraphs 177D(b)(i) to (viii).

*Meaning of **greater benefit from franking credits***

(18) The following subsection lists some of the cases in which a taxpayer to whom a distribution flows indirectly receives a ***greater benefit from franking credits*** than an entity referred to in paragraph (17)(b). It is not an exhaustive list.

(19) A taxpayer to whom a distribution flows indirectly receives a ***greater benefit from franking credits*** than an entity referred to in paragraph (17)(b) if any of the following circumstances exist in relation to that entity in the year of income in which the distribution giving rise to the benefit is made, and not in relation to the taxpayer if:

(a) the entity is not an Australian resident; or

(b) the entity would not be entitled to any tax offset under Division 207 of the *Income Tax Assessment Act 1997* because of the distribution; or

(c) the amount of income tax that would be payable by the entity because of the distribution is less than the tax offset to which the entity would be entitled; or

(d) the entity is a corporate tax entity at the time the distribution is made, but no franking credit arises for the entity as a result of the distribution; or

(e) the entity is a corporate tax entity at the time the distribution is made, but cannot use franking credits received on the distribution to frank distributions to its own members because:

(i) it is not a franking entity; or

(ii) it is unable to make frankable distributions.

Note: Where the distribution is made directly to the taxpayer, see subsections 204-30(7), (8), (9) and (10) of the *Income Tax Assessment Act 1997* for a list of circumstances in which the taxpayer will be treated as deriving a greater benefit from franking credits than another entity.

...

(B) WHETHER PROVISIONS STILL IN FORCE IN THIS FORM

The above provisions are still in force, in that form, at the date of these submissions.