DIVIDEND STRIPPING SCHEMES: TOWARDS A BROADER JUDICIAL INTERPRETATION

Abstract

At issue before the Full Federal Court in *Lawrence v FCT* was the scope of the operation of s 177E(1) ITAA 1936, dealing with schemes by way of or in the nature of dividend stripping, or schemes having the effect of a scheme by way of or in the nature of a dividend stripping. While the taxpayer relied on High Court comments in FCT v Consolidated Press Holdings as limiting the ambit of schemes having the effect of dividend stripping, the Full Federal Court in Lawrence declined to adopt such an interpretation, finding instead that the High Court comments were merely illustrative of such schemes. This decision arguably adopts a potentially much broader interpretation of s177E in identifying schemes having the effect of a dividend stripping scheme.

Introduction and outline

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 has been directed to those provisions dealing with the identification of a scheme, a tax benefit, and the purpose of the scheme.[1] However, an arguably equally significant component of the anti-avoidance regime in Part IVA is contained in s 177E(1), which can operate to deem a scheme to be one to which Part IVA applies in circumstances where the scheme was 'by way of or in the nature of dividend stripping', or a scheme which had 'substantially the effect of a scheme by way of or in the nature of a dividend stripping'.[2]

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[1] 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.

[2] 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;

(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.

While these provisions have previously been the subject of judicial consideration, they were the subject of particular focus in the Federal Court[3] and Full Federal Court[4] decisions in *Lawrence v FCT.* The transactions in the cases were characterised as distributable surplus arrangements, with the courts needing to determine whether such arrangements would fall within s 177E(1), and thus be subject to Part IVA.

This paper analyses the decisions in the *Lawrence* cases, examining in particular the development by the courts of the interpretation as to what would constitute a scheme 'having substantially the effect of a scheme by way of or in the nature of a dividend stripping'. It is suggested that the decisions in the cases arguably demonstrate that with changing community attitudes over time to such schemes, the courts are prepared to respond with a changing interpretation and broader application of taxation law, particularly where the transactions exhibit features which could be characterised as at least lacking any real commercial justification, if not being artificial or contrived.

The analysis in the paper suggests that evidence of the development of this wider judicial interpretation is provided by decisions such as that in *Lawrence* in the Full Federal Court. The court in that case declined to limit or interpret restrictively the comments of the High Court in *FCT v Consolidated Press Holdings*[5] as to the indicia of a scheme having substantially the effect of a scheme by way of or in the nature of dividend stripping. Rather the court in *Lawrence* interpreted the High Court comments in *Consolidated Press Holdings* as illustrative only, thus leaving at large the identification of a scheme having substantially the effect of a scheme by way of or in the nature of dividend stripping.

Legislative background

Following the limitations imposed by the courts on the operation of the then general anti-avoidance provision in s 260 ITAA 1936, the government introduced in 1981 a new general anti-avoidance provision intended to overcome these limitations.[6] In broad terms, the major part of the provision applied when a scheme, as defined in s 177A, produced a tax benefit, defined in s 177C, and the dominant purpose of the scheme was the production of that tax benefit, with s 177D providing matters to consider in determining this objective purpose.

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.

The requirement for the additional code for dividend stripping in Part IVA was explained in the Second Reading Speech introducing the Bill. The additional provisions were said to be needed as a result of the particular feature of these schemes

[3] *Lawrence v FCT* [2008] FCA 1497; referred to hereafter as *Lawrence (FC).*
[4] *Lawrence v FCT* [2009] FCAFC 29; referred to hereafter as *Lawrence (FFC).*
[5] *FCT v Consolidated Press Holdings* (2001) 207 CLR 235.
[6] 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.

when viewed in the context of the structure,[7] the particular feature being that, for schemes of this nature, there may technically be no tax benefit whereby the scheme could be brought within the general Part IVA provisions. To prevent dividend-stripping schemes escaping Part IVA, s 177E(1) was introduced as a supplementary code.

If a scheme is identified as a dividend stripping scheme for the purposes of s 177E(1), the consequence is that the scheme is one to which Part IVA can apply, allowing the Commissioner to cancel the tax benefit[8], and make compensating adjustments.[9]

The circumstances in which a dividend stripping scheme may be a scheme to which Part IVA applies broadly require:

- as a result 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, property of a company is disposed of;
- the Commissioner forms the opinion that the disposal represents a distribution of profits of the company; and
- immediately before the scheme, if 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 represented by the disposal of property, the amount would have, or might reasonably be expected to have, been included in assessable income of a taxpayer.

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'.

The Explanatory Memorandum (EM) accompanying the Bill 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.[10] While it is not clear from the legislation whether s 177E(1) was 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.[11]

The EM explained the need for the additional provision in Part IVA in terms such that, although profits may have been stripped from a company, it may not be a reasonable hypothesis that, but for the scheme, the profits would have been paid as dividends. They may, in fact, have been retained in the company, in which case there would not have been a tax benefit.[12]

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[7] Second Reading Speech for *Income Tax Laws Amendment Bill (No 2)* 1981.
[8] Section 177F ITAA 1936.
[9] Section 177G ITAA 1936.
[10] *Explanatory Memorandum* accompanying *Income Tax Laws Amendment Bill (No 2)* 1981,at page 8.
[11] Broadly *generalia specialibus non derogant*; also see *Reseck v FCT* 75 ATC 4213.
[12] Above, note 10 - Section 177E: Stripping of company profits.

In Taxation Ruling IT2627, the point is made that the term 'dividend stripping' has no precise legal meaning, with the EM and the Ruling outlining a traditional dividend stripping scheme as involving a stripping entity which purchased shares in a target company with accumulated profits, with the stripping entity paying shareholders a capital sum representing the profits, and then drawing off the profits in a non-assessable form.[13]

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 suggested that such schemes may be those where 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.[14]

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. As noted in the EM, s 177E is intended to be "… a supplementary code to deal with dividend-stripping schemes of tax avoidance and certain variations on such schemes."[15]

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 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. However, it may be expected that the purpose of parties to the scheme may assist in determining whether the scheme is by way of or in the nature of dividend stripping, or a scheme having substantially that effect.

That purpose is now a relevant component of s 177E(1) has been affirmed by the High Court in *Consolidated Press*, as discussed later in the paper.

The following analysis examines the interpretation by the Federal Court and Full Federal Court of the dividend stripping provisions, and application by the courts of these provisions to the issues raised in *Lawrence*.

The transactions in *Lawrence*

The facts of the *Lawrence* case were quite complex, involving two discrete but substantially identical series of transactions which effectively amounted to distributable surplus arrangements.[16] As the two series of transactions were essentially the same, this paper outlines only one of the series of transactions. The diagram and details below summarise the main effects of the fifteen steps which were undertaken in the period between 10:30am and 12:55pm on June 8, 2003, with this process in itself leaving open the suggestion that the transactions could be

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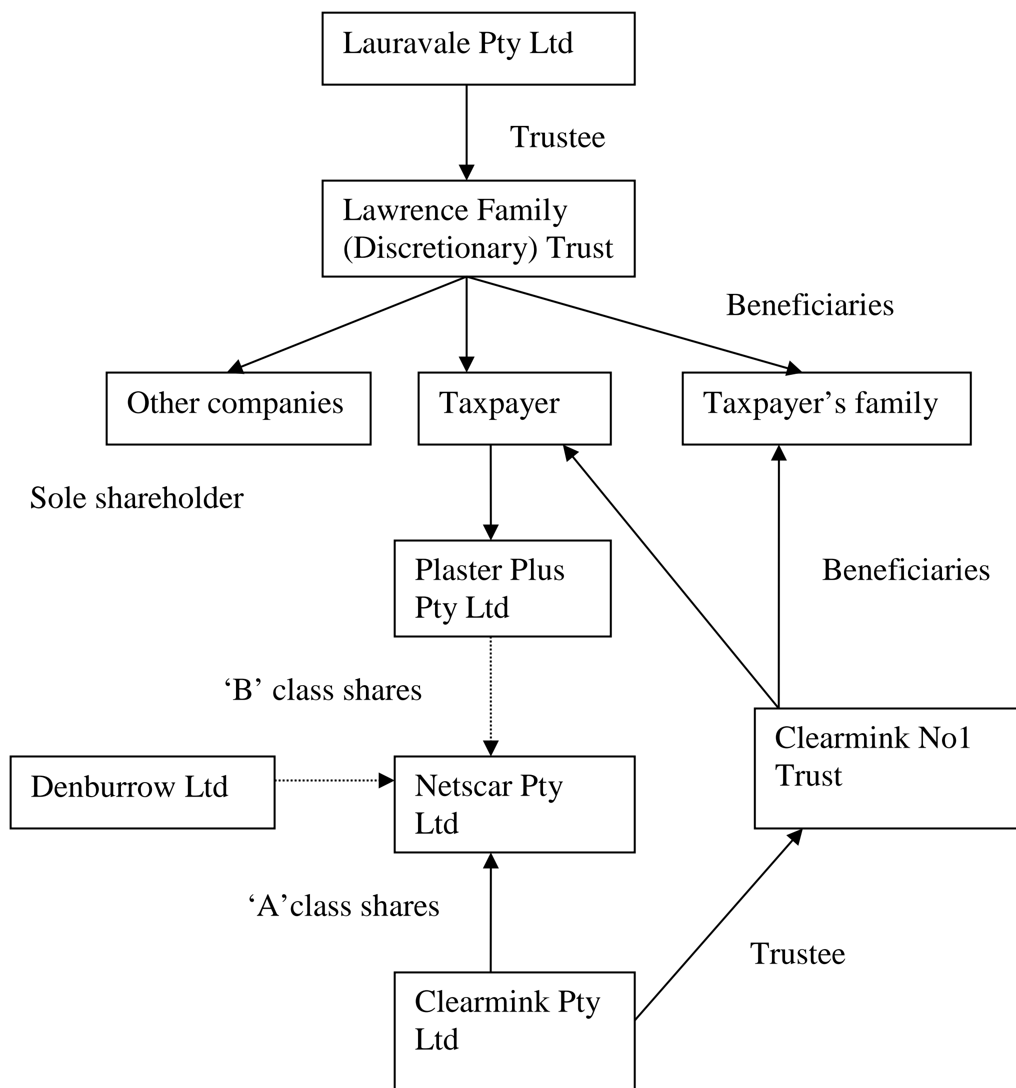
[13] Taxation Ruling IT2627 paras 8, 9; EM at page 9.
[14] Above, note 10.
[15] EM at p 3; Note that this theme of variations on a dividend stripping scheme was reinforced by the finding of Jessop J in the Federal Court decision in *Lawrence*, as discussed later in the paper.
[16] The facts were outlined by the primary judge, Jessop J, in *Lawrence (FC)* at paras 8 – 30.

characterised as not having a commercial basis, but being arguably little more than artificial and contrived.

Essentially the transactions involved a target company (Plaster Plus) with a distributable surplus acquiring shares which had an unpaid call and then subsequently paying the call on the shares. Value was then stripped from these shares purchased by Plaster Plus, with the stripped value being directed to Clearmink Trust, of which the shareholder in Plaster Plus was a discretionary beneficiary. Clearmink then made loans to this beneficiary (the shareholder in Plaster Plus) who received the amount as capital from Clearmink instead of as an assessable distribution from Plaster Plus.

Critical to the series of transactions was that there was no change in the shareholding in Plaster Plus, the target company, as might be expected in a traditional dividend strip. Rather it was the value strip from Plaster Plus in favour of Clearmink, followed by a non-assessable distribution from Clearmink to the shareholder of Plaster Plus, which were the transactions at issue.



The taxpayer in the case was the sole shareholder in Plaster Plus, which in the relevant year of income had $1.9 million in taxable income, leaving the company with $1.3 million in undistributed profits. Plaster Plus was thus the target company with distributable profits. The transactions outlined below were essentially designed to allow the taxpayer shareholder to access these distributable profits in a tax effective manner.

Netscar Pty Ltd had available 900,000 shares in a number of different share classes, with Clearmink Pty Ltd holding the only two issued shares in Netscar. Netscar amended its company constitution so that ‘B’ class shares for return of capital ranked pari passu inter se with all other shares in the capital of the company and in surplus assets and profits, with the two shares held by Clearmink being converted to ‘A’ class shares.

Denburrow Pty Ltd, a company controlled by the taxpayer’s solicitors, applied to Netscar for 1700 ‘B’ class shares which had a nominal value of $1000, but were paid as to only $1 per share. Netscar then issued a call on the ‘B’ class shares issued to Denburrow. Prior to paying the call, Denburrow sold the ‘B’ class shares to Plaster Plus at market value of the paid up amount of $1700, with Plaster Plus then becoming liable for the call on the unpaid amount. Plaster Plus paid this call by a Promissory Note payable to Netscar for approximately $1.7 million.

Plaster Plus, the target company, has thus purchased shares with an unpaid call, and had then paid the call on these purchased ‘B’ class shares.

At this stage the shareholding in Netscar comprised 2 ‘A’ class shares held by Clearmink, and 1700 ‘B’ class shares held by Plaster Plus, which had paid the call on the shares to Netscar.

Netscar again amended its constitution so that the ‘B’ class shares were entitled to a return of only $1 per share, with no further entitlement, the consequence of which was that the ‘A’ class shares held by Clearmink had a substantial increase in value. The ‘B’ class shares held by Plaster Plus had a corresponding diminution in value which was recorded as an extraordinary loss in the accounts of Plaster Plus.

Effectively the value of the shares in Netscar held by Plaster Plus, the target company, had been stripped in favour of Clearmink, with the discretionary beneficiaries of Clearmink including the shareholder in Plaster Plus.

Netscar, with the $1.7 million received from Plaster Plus for the call on the ‘B’ class shares, resolved to advance by way of a loan approximately $1.7 million to Clearmink in Clearmink’s capacity as trustee for the Clearmink No 1 Trust. The beneficiaries of the Clearmink No 1 Trust were the taxpayer and his family. The accounts of Clearmink No1 Trust showed loans made to the taxpayer, his wife, and Lauraval Pty Ltd, the trustee of the taxpayer’s family discretionary trust.

With the value stripped from Plaster Plus to Clearmink, Clearmink had then made loans to the taxpayer. These amounts, representing the stripped distributable surplus of Plaster Plus, were received by the beneficiary in Clearmink (the shareholder in

Plaster Plus) in a capital form from Clearmink rather than an assessable form from Plaster Plus.

At no stage in the transactions had there been any change in the shareholding in Plaster Plus, the target company. As noted by Jessop J, the primary judge in the Federal Court, the end result of the series of transactions was that profits held for distribution by a company (Plaster Plus) in which the taxpayer was the only shareholder had been effectively converted to capital sums held by another company (Clearmink) on trust for a class of discretionary beneficiaries confined to the taxpayer and members of his family.[17]

Issues arising

For the purposes of the current discussion, the significant issues which arose from the case concern three major areas:

- identifying the scope of the scheme;
- whether the scheme was by way of or in the nature of dividend stripping; and
- whether the scheme had substantially the effect of a scheme by way of or in the nature of a dividend stripping.

Scope of the scheme

In seeking to limit the scope of an identified scheme in relation to the series of transactions, the taxpayer essentially argued that the relevant 'scheme' could not extend past the diminution in the rights of 'B' class shareholders in Netscar, and that the subsequent loans by the Clearmink No 1 Trust to the taxpayer, his wife and Lauravale could not be part of an identified scheme.

The taxpayer in *Lawrence* argued that the decision in *FCT v Hart*[18] was authority for the proposition that a Part IVA scheme must be recognised in a way that gave it a sensible relation to the tax benefits sought and the dominant purpose, the result being that in the current case, the scheme should be confined to the transactions which were, according to the Commissioner, identified as being those in the nature of dividend stripping, or which had the effect of dividend stripping.[19] Effectively, the argument suggested that a scheme, for the purposes of s 177E(1), could not include transactions which occurred later in time than the disposal of property under s 177E(1), and any later transactions should be ignored.[20]

While accepting this submission at a general level, Jessop J distinguished the decision in *Hart*, which was concerned with a tax benefit under s 177C and a purpose under s 177D, from the current case which relied on s 177E, with no recourse to s 177C to identify the tax benefit.

In rejecting this temporal limitation on the scope of a scheme, his Honour suggested that "… the court should not, in my view, turn a Nelsonian eye to facts, circumstances

[17] Above, note 3 at para 2.
[18] *FCT v Hart* (2004) 217 CLR 216.
[19] Above, note 3 at para 55.
[20] Ibid.

or transactions which have the capacity to throw light on the matter merely because they post-date the property by reference to which the operation of the section is complete."[21] His Honour added a further reason for not limiting the scope of a scheme, being that the concept of dividend stripping involved, as one of its aspects, a consideration of purpose, and in determining this purpose there was "… no warrant in s 177E for the *a priori* exclusion of facts or events, before or after the actual disposal… "[22] from the considerations reflecting on the purpose.

Although his Honour found that there was probably little that turned on whether the scheme went beyond the particular transactions or not, he took the view that whether schemes were by way of, or had substantially the effect of, dividend stripping should be approached as a composite enquiry, with all proven facts that had a rational tendency to provide the answer, being placed on the table.[23]

While the scope and identification of a scheme has proven problematic in other Part IVA cases, it would appear that this finding of the primary judge was accepted, as the issue was not taken on appeal to the Full Federal Court.

Schemes 'by way of or in the nature of dividend stripping'

In relation to the issue of whether the scheme was a scheme 'by way of or in the nature of dividend stripping', Jessop J noted that no legislative definition was provided of what would constitute dividend stripping, but that the question has received considerable judicial deliberation in the *Consolidated Press* cases.[24]

In *FCT v Consolidated Press Holdings Ltd (No 1)* in the Full Federal Court, the Court had regard to the identification of dividend stripping operations, the court finding that:

> These four cases[on dividend stripping] had the following characteristics in common:
>
> • a target company, which had substantial undistributed profits creating a potential tax liability either for the company or its shareholders;
> • the sale or allotment of shares in the target company to another party...;
> • the payment of a dividend to the purchaser or allottee of the shares out of the target company's profits;
> • the purchaser escaping Australian income tax on the dividend so declared (whether by reason of a s 46 rebate, an offsetting loss on the sale of the shares, or the fact that the shareholders were resident outside Australia); and
> • the vendor shareholders receiving a capital sum for their shares in an amount the same as or very close to the dividends paid to the purchasers (there being no capital gains tax at the relevant times)….
>
> A further common characteristic of each of the schemes in the cases considered by Gibbs J, was that they were carefully planned, with all the parties acting in concert, for the predominant if not the sole purpose of the vendor shareholders, in particular, avoiding tax on a distribution of dividends by the target company. [25]

[21] Ibid at para 56.
[22] Ibid.
[23] Ibid at paras 57-58.
[24] *CPH Property v FCT* (1998) 88 FCR 21 in the Federal Court; *FCT v Consolidated Press Holdings Ltd (No 1)* (1999) 91 FCR 524 in the FFC; and *FCT v Consolidated Press Holdings* (2001) 207 CLR 235 in the High Court.
[25] *FCT v Consolidated Press Holdings Ltd (No 1)* (1999) 91 FCR 524 at 561.

In relation to what might constitute a scheme ‘by way of or in the nature of dividend stripping, the Full Federal Court further noted that:

> The terms of the first limb of s 177E(1)(a) suggest that a scheme may fall within its scope, even though not all the elements of a dividend standard dividend stripping scheme are present. The use of the words "by way of or in the nature of" suggests that variations from the paradigm will not necessarily result in the scheme being excluded from the first limb, provided it retains the central characteristics of a dividend stripping scheme.[26]

These central characteristics to which the court referred were the six points noted above, one of which was the purpose of the scheme. While the statute had not specifically required a purpose component for s 177E(1), the Full Federal court had added this requirement, and this was subsequently confirmed by the High Court.[27]

The taxpayer in *Lawrence* submitted[28] that there existed no potential tax liability for Plaster Plus or the taxpayer in relation to the undistributed profits held by Plaster Plus as tax had been paid on the profits. On this basis it was argued that the first of the conditions identified in *Consolidated Press No (1)* could not be satisfied.

While accepting that there could be no potential tax liability for Plaster Plus, Jessop J was not satisfied on this matter in relation to the taxpayer, and concluded that the first of the elements identified in *Consolidated Press No (1)* could be satisfied. His Honour considered that the first requirement in the *Consolidated Press* test was not that profits would necessarily have been distributed as dividends in the year of disposal, but rather, “(i)t is merely that the existence of the undistributed profits created a potential tax liability for shareholders.”[29] As explained by his Honour, the very point of introducing s 177E(1) was to catch those schemes which may not otherwise have been caught as it would not be possible to say that dividends would likely be paid but for the scheme.[30]

However, while finding this first test satisfied, His Honour could not be satisfied that the other characteristics were present in the current case, and therefore concluded that the scheme did not meet the s 177E(1) test of being ‘by way of or in the nature of dividend stripping’.

The Full Federal Court in *Lawrence* noted that it was not surprising that this finding by the primary judge was not subject to appeal, affirming that the scheme did not possess the characteristics required to be a scheme ‘by way of or in the nature of dividend stripping’.[31]

Schemes ‘having substantially the effect of a scheme by way of or in the nature of a dividend stripping’

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[26] Ibid at 566.
[27] Above, note 5 at para 133.
[28] Above, note 3 at para 54.
[29] Ibid at para 72
[30] Ibid at para 64.
[31] Above, note 4 at para 30.

The second threshold test to attract the operation of s 177E(1) is that a scheme has 'substantially the effect of a scheme by way of or in the nature of a dividend stripping,' and the discussion below considers the interpretation by the court of this phrase, and the apparent broadening in the interpretation arising from the decision in *Lawrence*.

On this issue, the taxpayer had argued that the only way in which paragraph (ii) of s 177E(1)(a) operated to extend paragraph (i) was that profits of a target company were distributed by some means other than payment of a dividend, but that the provision still required that the shares of the target company had been purchased from the original shareholders. As the shares in Plaster Plus had not changed hands, and there had been no distribution of the profits of Plaster Plus to new owners, the taxpayer's view was that the scheme could not be said to substantially have the effect of a dividend stripping scheme.

In the Federal Court, Jessop J noted that "… the distinction between a scheme which is by way of or in the nature of dividend stripping and a scheme which is not such a scheme but which has substantially the effect of such a scheme is not an easy one,"[32] with the legislation requiring the courts "… to look at circumstances other than the mere fact that company property has been disposed of in a way which represents a distribution of profits."[33] His Honour had regard to the EM, noting that "… Parliament wanted to catch 'variations' on dividend stripping schemes, and considered that the unifying principle of all such schemes and variations was that they had the *effect* of placing company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends.[34]

His Honour noted that the EM stated that the category of schemes having substantially the effect of a dividend stripping scheme would include:

> …schemes in which the profits of the target company are not stripped from it by a formal dividend payment but by way of such transactions as the making of irrevocable loans to entities that are associates of the stripper, or the use of the profits to purchase near-worthless assets from such associates.[35]

It is suggested that this highlighted the legislative intention that schemes having substantially the effect of a dividend stripping could diverge greatly from a traditional dividend stripping arrangement, and still be squarely within the scope of the application of s 177E(1).

These comments from the EM would also appear to be reflected in the decision in *Consolidated Press Holdings* in the High Court, where the court had concluded that schemes having substantially the effect of a dividend stripping scheme were those schemes where some means other than a dividend or deemed dividend was used in making the distribution.[36] As noted by the High Court,

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[32] Above, note 3 at para 76.
[33] Ibid.
[34] I*bid.*
[35] Ibid at para 78
[36] Above, note 5.

> But a scheme may have substantially the effect of a scheme by way of or in the nature of dividend stripping even though some means other than a dividend or deemed dividend is employed to make the distribution.[37]

The High Court in *Consolidated Press* had also examined the requirement for a tax-avoidance purpose in the application of s 177E(1), and had concluded that there did need to be such a purpose. As noted by the Court, s 177E had been placed in Part IVA to supplement the anti-avoidance provisions, and as a result "… (t)his 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."[38]

Jessop J noted that if this formulation of a scheme having the effect of a dividend stripping scheme by the High Court, and the examples in the EM, were read as an exhaustive statement of what would constitute a scheme having substantially the effect of a dividend stripping, then this would provide support for the taxpayer's position. However, His Honour did not read this formulation as being definitive, but merely as providing examples or illustrations only.[39]

In relation to the EM, his Honour stated that

> … the relevant paragraph is expressed as providing examples or indications only, and not as though definitive. I do not read the paragraph as indicating a legislative intention that there always need be a separate person or entity, into whose hands the relevant shareholding has first passed. Indeed, the reference to near-worthless assets, as an alternative to a formal dividend payment, amply accommodates a situation in which the target company itself purchases such assets from associates of its existing shareholders.[40]

It is suggested that Jessop J, by this interpretation, is distinguishing schemes 'by way of or in the nature of dividend stripping' from schemes 'having substantially the effect' of a dividend stripping scheme, and in so doing, is providing a broader formulation for the latter category of scheme. In particular, his Honour is suggesting that the characteristic of schemes in the nature of dividend stripping, whereby there is a disposal of interests in the target company, is not a requirement for schemes having substantially the effect of dividend stripping schemes, thus extending the realm of schemes having substantially the effect of dividend stripping beyond the more traditional view of a scheme by way of or in the nature of dividend stripping.

In relation to the High Court finding in *Consolidated Press*, Jessop J noted that :

> I do not think that the High Court's words – "except for the fact that the distribution by the target company was not by way of a dividend or deemed dividend" – should be pressed into service to justify the conclusion that a scheme will never fall within subpar (ii) unless it involves the transfer of shares in the target company to a person or entity separate from the original shareholders. That would be to extend the meaning of those words beyond anything that their Honours had in contemplation.

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[37] Ibid at para 140.
[38] Ibid at para 132.
[39] Above, note 3 at para 80.
[40] Ibid.

> When (the High Court) pointed put that the subparagraph was 'aimed at' a scheme that would be within subpara (i) save for the fact `that the distribution was not by way of dividend, their Honours were, in my respectful view, stressing that the difference between subpara (i) and subpara (ii) lay in the means adopted to distribute the profits of the target company.[41]

Again this highlights the broader interpretation of schemes 'having substantially the effect' of dividend stripping, with the High Court suggesting that there is no requirement under this second limb for there to be a change in ownership of interests in the target, as would be required to satisfy the first limb of a sheme 'by way of or in the nature of dividend stripping'. Because there is no requirement under the second limb for a change in ownership of interests in the target, the distribution by the target need not be by way of a dividend or deemed dividend, which would be the expected means of distribution with a traditional dividend strip where there would be new ownership of the target.

In his consideration of the High Court decision in *Consolidated Press*, Jessop J also reinforced the finding of the High Court as to the requirement for a tax-avoidance purpose for the second limb of s 177E(1):

> … their Honours' concern was to lay out their reasons for holding that the presence of a tax-avoidance purpose was a requirement of subpara(ii), no less than of subpara (i) … It followed that the requirement for a tax-avoidance purpose, being basic to the idea of dividend stripping in any form, existed equally under subpara (ii).[42]

On this basis of the foregoing considerations, Jessop J was prepared to find that "(b)oth for the taxpayer and for the revenue, the effects of the schemes in the present case were substantially the same as the effect of a scheme by way of or in the nature of dividend stripping."[43]

His Honour considered that the facts in the current case provided an example of the way that profits of a company could be placed in the hands of an associate of the taxpayer in a tax free form, and he considered it consistent with the aims of the section that the second limb of s 177E(1)(a) be construed to cover examples of this kind.[44] As noted by his Honour, "… the value … that started out as undistributed profits in Plaster Plus … had become accretions to the capital of the Clearmink trusts. Subject only to the discretionary nature of these trusts, the applicant and his associates were beneficially entitled to that capital."[45]

This component of the judgment in *Lawrence* was subject to appeal to the Full Federal Court.

The Full Federal Court[46] concurred with the findings of the primary judge that the passage from *Consolidated Press* in the High Court was not definitive but merely

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[41] Ibid at para 81 – 82.
[42] Ibid at para 81.
[43] Ibid at para 85.
[44] Ibid at para 80.
[45] Ibid at para 85.
[46] Ryan, Stone and Edmonds JJ.

illustrative of schemes which would substantially have the effect of a dividend stripping scheme. Their Honours concluded that "(h)aving regard to the terms of the second limb of s 177E(1)(a) and the extrinsic material … the Plaster Plus transactions … are paradigm examples of a scheme to which the second limb was intended to apply."[47]

Their Honours went further, however, suggesting that the passage from *Consolidated Press* which was relied on by the taxpayer was in fact obiter. As noted by their Honours, "*Consolidated Press* was a first limb case … The only reason the second limb of s 177E(1)(a) was considered by the Full Court and the High Court was because of the primary judge's reasoning that the second limb did not require the presence of a tax avoidance purpose." [48]

With the comments of the High Court in *Consolidated Press* being cast as obiter, the comments could not be relied on by the taxpayer in this case as limiting the scope of application of the second limb of s 177E(1)(a). It is suggested that this again illustrates that the decision in *Lawrence* provides evidence that courts will not consider themselves constrained or limited in the application of anti-avoidance provisions, particularly if they consider the transactions appear to lack a commercial rationale, but appear to have the characteristics of being artificial or contrived.

Broadened scope of schemes 'having substantially the effect'

Prior to the decisions by the Federal Court in the *Lawrence* cases, the prevailing guidance as to whether a scheme had substantially the effect of a dividend stripping scheme lay in the EM and in the finding of the High Court in *Consolidated Press*. This decision held that:

> What sub-par (ii) was aimed at was a scheme that would be within sub-par (i) except for the fact that the distribution by the target company was not by way of a dividend or deemed dividend. Dividend stripping does not lose its connotation of tax avoidance purpose. But a scheme may have substantially the effect of a scheme by way of or in the nature of dividend stripping even though some means other than a dividend or deemed dividend is employed to make the distribution.[49]

This finding suggested that the court saw the additional ground covered by sub-par (ii), relating to schemes having substantially the effect of a dividend stripping scheme, involving a target company making a distribution in a manner other than a dividend or a deemed dividend. Such an interpretation would be in accord with the traditional concept of dividend stripping, where the rationale involved new owners accessing profits held by the target company in a more tax effective manner than would have been available to the previous shareholders.[50]

If such was intended by the court, then a distribution in a manner other than as a dividend or deemed dividend by an entity other than the target company would presumably be outside the scope of sub-par (ii), and not fall within Part IVA. This

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[47] Above, note 4 at para 52.
[48] Ibid.
[49] Above, note 5.
[50] See, for example, *Investment and Merchant Finance Corp. v FCT* (1971) 125 CLR 249.

was the very argument relied on by the taxpayer, and presumably the rationale underlying the taxpayer's complex arrangement, whereby the tax effective distribution was not made by the target company but an associate of the target.

However, the finding of the primary judge in *Lawrence*, with which the Full Federal Court agreed, was that this narrow interpretation of the decision in *Consolidated Press* was not what the court had intended. By finding that the court in *Consolidated Press* was merely providing non-exhaustive illustrative examples of the situations where the second limb of s 177E(1)(a) may apply, the decision in *Lawrence* rejects the notion that a dividend stripping scheme requires a distribution by the target to new shareholders. The decision broadens the scope of s 177E(1)(a)(ii) so that a distribution by another entity, other than the target, can still taint the transaction, rendering it subject to Part IVA.

The Full Federal Court in *Lawrence* went further, suggesting that by having regard to the terms of the legislation and the extrinsic material, the transactions in this case were "… paradigm examples of a scheme to which the second limb (of s 177E(1)(a)) was intended to apply."[51] It may be suggested that the apparent artificial and contrived nature of the arrangements can only have assisted the court in reaching such a conclusion.

What the decision of the court in this case suggests is that there can be variations from the traditional dividend strip, and the arrangement may still have substantially the effect of a dividend stripping scheme. The particular variations encompassed in this case were that there need be no change of ownership interests in the target, and consequently the distribution need not be by the target in the form of dividend or deemed dividend, which would be the traditional manner of distribution if the target was subject to new ownership.

Additionally, the Full Federal Court in *Lawrence* also suggested that the comments of the Full Federal Court and the High Court in *Consolidated Press* in relation to s 177E(1)(a)(ii) were obiter, as the cases had been determined on the basis of the first limb in s 177E(1)(a). On this basis, the decision of the court in *Lawrence* becomes the *ratio* for applying the second limb, and as noted, this provides a much broader application for the second limb of s 177E(1)(a), as a scheme having the effect of a dividend stripping scheme can be identified where the tax effective distribution is made not only in a form other than as a dividend or deemed dividend, but it is made by an entity other than the target entity.

The Full Federal Court also made it clear that each of the limbs will have an independent operation, as each is directed to different circumstances. While the first limb is directed to identifying schemes that could be seen as schemes by way of or in the nature of dividend stripping schemes, the second limb is not so constrained. Rather, the second limb is directed to identifying other schemes which might have the same outcome or consequence as a scheme by way of or in the nature of a dividend stripping schemes, but which are not schemes by way of or in the nature of a dividend stripping schemes. As noted by the Court, "(a) scheme falling within the second limb

[51] Above, note 4 at para 52.

may not, as in this case, fall within the first limb. On the other hand, a scheme falling within the first limb will never fall within the second limb."[52]

This delineation by the court of the independent operation of the two limbs also arguably broadens the operation of the second limb of s 177E(1)(a). The second limb would be no longer limited to a scheme identified as a dividend stripping scheme, but would have a broader ambit to also encompass those other schemes not so characterised as dividend stripping schemes, but which have the same effect or outcome as a dividend stripping scheme. On this basis, s 177E(1)(a)(ii) has a potentially very wide scope, and becomes a provision to which tax planners may need to pay greater attention.

Concluding remarks

As noted, s 177E(1) stands as part of the Part IVA anti-avoidance regime, but operates as an independent component separate from the general regime. The need for this separate provision was noted in the EM as relating to circumstances where it may not have been possible to identify a tax benefit to a taxpayer.

Within the first limb of s 177E(1)(a), the courts have been prepared to identify those characteristics which need to be present to conclude the existence of a scheme by way of or in the nature of dividend stripping. Schemes by way of, or in the nature of, dividend stripping would be expected to display some of the characteristics of a traditional dividend stripping arrangement, with a change in ownership of a target entity holding undistributed profits, and the new owners being able to access these profits in a more tax effective manner than would have been available to the former owners.

Under the operation of the second limb, the characterisation of schemes as having substantially the effect of a scheme by way of or in the nature of a dividend stripping has proven more problematic. While the High Court in *Consolidated Press* was prepared to identify some features which identify these schemes, the decision in *Lawrence* has demonstrated that these features cannot be seen as either exhaustive or determinative, and subsequent courts will not feel constrained or limited by the identification of these features. Rather, the decision highlighted that the factors identified in *Consolidated Press* were merely illustrative examples, and should not be relied on as prescribing limits on schemes which may fall within the characterisation of a scheme 'substantially having the effect of a scheme by way of or in the nature of a dividend stripping.'

This suggests that the second limb of s 177E(1) will be interpreted more broadly in identifying schemes having substantially the effect of dividend stripping. In particular, such schemes need not display the feature of a change in ownership of the target, and a distribution by the target as a dividend or deemed dividend, both of which would be features of a traditional dividend strip or a scheme by way of or in the nature of dividend stripping.

[52] Ibid.

With the second legislative limb of s 177E(1)(a) being drafted in terms of a test determined by the effect or outcome, regard needs to be had to whether the outcome of a transaction or scheme could also have been achieved by a scheme by way of or in the nature of dividend stripping. If an effectively equivalent outcome could have been achieved by a scheme by way of or in the nature of dividend stripping, then it would appear open to the courts to determine that the particular scheme is a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping, which then must make that scheme vulnerable under Part IVA.

With the Full Federal Court in *Lawrence* declining to adopt a narrow interpretation of the examples of schemes having the effect of dividend stripping provided by the High Court in *Consolidated Press*, the operation of the second limb on s 177(1)(a) would appear to be at large, being able to be applied to any scheme where the outcome could have been achieved by a more traditional dividend stripping arrangement. It is suggested that this provides evidence that the courts are prepared to adopt a broader application of anti-avoidance taxation law, particularly in relation to transactions which may be open to characterisation as little more than artificial or contrived. The extent of this broader interpretation remains to be seen.