IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY **No S228 of 2012**

COMMISSIONER OF TAXATION
Appellant

CONSOLIDATED MEDIA HOLDINGS LTD
(ACN 009 071 167)
Respondent

APPELLANT'S REPLY

Part I: *Certification for publication*

1. These written submissions are in a form suitable for publication on the internet.

Part II: *Reply*

2. **RS[15]**: Contrary to RS[15], there is nothing new about the argument put by the appellant. The argument was recorded at FC[30], AB455. The Full Court did not address it.

3. **RS[16] – [30]**: Contrary to RS[16] and [17] the financial statements of Crown do confirm that $1,000,000,000 was debited against amounts standing to the credit of the share capital account and that Crown's share capital was reduced by $1,000,000,000.

4. Nothing put by the respondent in RS[18] to [30] indicates otherwise. The respondent's reliance on the argument (RS[12] and [21]) that the relevant shares were not transferred and cancelled until 6 August 2002 is misplaced for the following reasons:

   4.1. The respondent prepared its income tax return on the basis that it received a dividend in the year ended 30 June 2002. Crown also prepared its Financial Statements on the basis that the consequences of the buy-back occurred in the year ended 30 June 2002.

   4.2. The Commissioner issued an amended assessment on the same assumed state of affairs, but treating as a return of capital the amount returned as a dividend.

   4.3. The respondent did not object on the basis that the return of capital occurred in the year ended 30 June 2003 and, therefore, cannot now raise that as an issue going to the excessiveness of the assessment – see: s 14ZZO(a) of the *Taxation Administration Act* 1953 (Cth); *Lighthouse Philatelics Pty Ltd v FCT* (1991) 32 FCR 148.

Filed on behalf of the Appellant, the Commissioner of Taxation, by:

Australian Government Solicitor
Level 42
MLC Centre
19 Martin Place
SYDNEY 2000 NSW
DX 444 SYDNEY

Date of this document: 21 September 2012
Contact: Catherine Leslie
File ref: 12057504
Telephone: (02) 9581 7481
Facsimile: (02 9581 7430
E-mail: Catherine.leslie@ags.gov.au

4.4. The respondent did not conduct the trial, or the appeal, on the basis that the income tax consequences of the dividend or return of capital occurred in the year ended 30 June 2003. The respondent's Appeal Statement filed on 5 August 2009[1] did not contend that any capital gain arose in the year ended 30 June 2003.

4.5. There is no cross-appeal or contention made in this appeal concerning that matter.

4.6. In any event, it is irrelevant to the operation of s 159GZZZP that the shares were not in fact cancelled until 6 August 2002. The statutory question is whether the purchase price was debited against amounts standing to the credit of the company's share capital account. There is no requirement that the purchase price be debited only after the shares are cancelled and that did not in fact occur. The debit to the SBBR was made on 28 June 2002[2]. (On that day, a credit entry was made to an intercompany receivables account. That credit entry was "corrected" on 25 July 2002, but with effect from 30 June 2002[3].) The debit to the SBBR which occurred on 28 June 2002 did not require correction and remains[4].

5. The debit made on 28 June 2002 was made against amounts standing to the credit of Crown's share capital (which was recorded in the Shareholders Equity Account and the SBBR) as was demonstrated by the Financial Statements. The fact that the debit was made in a newly created account (the SBBR) rather than in the existing Shareholders Equity Account does not mean that the debit was not made against amounts standing to the credit of the company's share capital account. The Financial Statements evidenced that the debit in the SBBR was made against amounts standing to the credit of the company's share capital account, whether or not the SBBR was itself an account which Crown kept of its share capital. Those Financial Statements showed that contributed equity reduced from $2,411,823,000 to $1,411,823,000. The auditor's evidence confirmed that to be the case[5].

6. The amount of share capital returned is a matter relevant to determining whether amounts debited were debited against amounts standing to the credit of the share capital account. Both the primary judge (at J[70], AB428-29) and the Full Court (at FC[42], AB461) were of the view, with respect correctly, that the present buy-back resulted in $1,000,000,000 of share capital being returned. The "fundamental proposition" put by the respondent at RS[30] incorrectly assumes that the character of the transaction from a company law perspective is irrelevant. The question is whether the relevant facts fall within the statutory language. If what occurred involved a return of paid-up capital, that fact is a matter which is clearly relevant to determining whether the debit to the Share Buy Back Reserve was a debit against amounts standing to the credit of the share capital account, within the meaning of s 159GZZZP(1)(b).

7. *Inland Revenue Commissioners v Universal Grinding Wheel Co Ltd* [1955] AC 807 was a case concerned with a reduction of capital, not a buy-back, and with a quite different legislative regime utilising distinctly different language. It does not provide useful guidance in relation to the present statutory question.

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1 AB31.

2 Affidavit of John Salomone, paragraph 9, AB108

3 Affidavit of John Salomone, paragraph 10, AB108

4 Exhibit JS-8 to the Affidavit of John Salomone, AB 372-381.

5 See paragraph 22

8. **RS[31] – [54]**: By asserting that the appellant needs to establish that the legislative concern was one about returns of capital being disguised as dividends, the respondent (at RS[53]) misunderstands the appellant's point. Section 159GZZZP(1) was enacted with a view to preventing a distribution of profits being disguised as a tax-free or preferentially taxed return of capital. It was enacted at a time when the company's share capital had to be reduced by the nominal value of the shares bought back. The section operated on the basis of a statutory presumption (s 159GZZZP(1)(a)) that the first amount paid back would be "the amount to which the share was paid-up immediately before the buy-back".

9. Division 16K was introduced by Act No 58 of 1990. When it was introduced, Subdivision P of Part IV, Division 3A of the *Companies Code* applied where a company bought back its shares.[6] Section 133PC(2) provided that, on cancellation of the shares bought back, the company's issued share capital "is reduced by the nominal value of the shares, but the company's nominal share capital is not affected". Section 133PD(2) required that any "buy-back premium"[7] be applied first to amounts standing to the credit of any share premium account and, next, to distributable profits.

10. Equivalent provisions were contained in Subdivision N of Part 2.4 of the *Corporations Act 1989* (Cth), see ss 206PC, 206PD.[8]

11. Thus, Division 16K operated on the hypothesis that, in a share buy-back, the first amount returned would be the paid-up share capital in respect of the shares bought back. The occasion for a legislative concern about returns of capital being disguised as dividends did not arise.

12. Rather, Division 16K was concerned with ensuring that, to the extent the amount paid in respect of the buy-back exceeded the aggregate of the amount to which the share was paid up, and the amount debited against the share premium account, that excess would be deemed to be a dividend paid out of profits and thus taxable under s 44 of the ITAA 1936. Without s 159GZZZP(1), that excess might still be a return of capital: *Uther*.

13. In contrast, the respondent now seeks to have s 159GZZZP(1) achieve a deeming it was never intended to achieve, namely to deem the whole buy-back consideration to be a dividend.

14. **RS[55] – [64]**: The 1998 amendments did not change the legislative purpose of Division 16K. The legislative object remained one of ensuring that so much of the buy-back consideration as exceeded paid-up capital returned would be deemed to be a dividend, paid out of profits and taxable under s 44(1). There is nothing in the legislative history behind Division 16K or in the 1998 amendments, or in any extrinsic material, which suggests that the legislative object changed in 1998 to an object whereby a return of capital would be deemed to be a dividend.

15. The reliance on s 159GZZZQ, at RS[61, 62], is misplaced. It is plain that the legislature appreciated that s 159GZZZP(1) deemed a portion of the buy-back consideration (which would otherwise be a return of capital) to be a dividend and that, as such, it might be

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6 Subdivision P had been introduced by Act No 92 of 1989.

7 Defined in s 133PD(4).

8 Subdivision N was introduced by Act 110 of 1990, Schedule 5, effective 1 January 1991.

rebatable. However, that says nothing about whether the section was intended to achieve a quite different deeming, namely to deem that portion of the consideration which was a return of paid-up capital to be a dividend.

16. The respondent relies, at RS[59], upon a general statement contained in a discussion paper, namely Chapter 19 of the "Ralph Report" dealing with "distributions", which points out that there is flexibility in the source from which such distributions might be made. The paragraph quoted says nothing about whether it is permissible not to debit the share capital account by the amount of paid-up capital returned. Appendix C of that chapter in fact refers to the accounting treatment for the buy-back of a no par share, stating: "The share capital account of the entity must be reduced by the amount in share capital attributable to the shares bought back".[9]

17. The understanding of the Ralph Review with respect to the operation of s 159GZZZP was made clear in comments at Chapter 20 where it specifically addressed off-market buy-backs. It stated: "The amount of the buy-back sourced from profits is treated as a dividend. Only the amount sourced from capital is treated as consideration for the disposal of the shares – so allowing the offsetting capital loss to the shareholder."[10]

18. **RS[65] – [73]**: When Division 16K was introduced, there was no definition of "share capital account" in the ITAA 1936. The first time a definition was introduced was by the *Taxation Laws Amendment (Company Law Review) Act* 1998 which commenced on 1 July 1998. That same Act introduced the share tainting rules in Division 7B of Part IIIAA and a definition of "paid-up share capital". The definition of "share capital account" introduced into s 6(1) did not state what a share capital account was. It was an exclusory definition which excluded "an account that is tainted for the purposes of Division 7B of Part IIIAA"[11]. It was this definition that was soon replaced by s 6D, introduced by the *Taxation Laws Amendment (No 7) Act* 1999.

19. It may be accepted that the introduction of the tainting rules gave rise to "unintended outcomes" as indicated at RS[69]. However, it is erroneous to suggest, as the respondent does at RS[72], that s 6D "had nothing to do with Division 16K". The legislature was cognisant of the fact that the s 6D definition – which was the first time the legislature had defined what a share capital account was (as opposed to what it was not) – operated for all purposes of the legislation, including in respect of Division 16K; indeed, s 6D(3)(d) specifically provided that an account which was tainted for the purposes of Division 7B of Part IIIAA of the ITAA 1936 was not a share capital account except for the purposes of ss 159GZZZQ(5).

20. It may also be accepted that the definition of "share capital account" introduced by s 6D sought to address the "unintended outcomes". It did that through s 6D(1)(b) which dealt with accounts created on or after 1 July 1998 being the date from which the tainting provisions were operative[12].

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9 *Review of Business Taxation – A Platform for Consultation*, Discussion Paper 2, Volume 2, 22 February 1999 at page 445.

10 *Review of Business Taxation – A Platform for Consultation*, Discussion Paper 2, Volume 2, 22 February 1999 paragraph 20.4 at page 453.

11 See FC[18].

12 Explanatory Memorandum to the *Taxation Laws Amendment Bill (No.7)* 1999 at paragraphs [1.25], [1.26].

21. Section 6D(1)(a) is not to be read down in the peculiar way suggested by the respondent or the Full Court. It was not introduced in order to meet the unintended outcomes.

22. **RS[74] – [88]**: The respondent submits at RS[74] that there is no inconsistency between Crown's paid-up share capital for tax and accounting purposes. It makes that submission by ignoring the existence of the debit to the SBBR and noting that the amount standing to the credit of the Shareholders Equity Account is $2,411,823,000. However, the submission underscores that the SBBR is a share capital account. Crown's Financial Statements acknowledges that the company's share capital was reduced by $1,000,000,000 through the buy-back and is, accordingly, $1,411,823,000. That was also the evidence of its auditor[13]. The assertion now made (for the first time) that there is no inconsistency between Crown's paid-up share capital for accounting and income tax purposes is itself inconsistent with the stance adopted by Crown to date both vis-à-vis the public (through its reporting) and in the proceedings to date.

23. At RS[79], the respondent asserts that it is "unusual" for a company to have more than one account in which a company ordinarily keeps its share capital. The basis for that submission, or precisely what is meant by it, is not clear. It certainly occurs. It is not surprising that the appellant did not put to the Full Court the difficulties with the construction it ultimately decided to adopt, that construction not being evident until the Full Court delivered its reasons, which included the constructions referred to at FC[40], AB460 and FC[43], AB461.

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Brendan Sullivan SC
Tel: (02) 9223 1736
Fax: (02) 9221 3724
sullivan@tenthfloor.org

Tom Thawley
Tel: (02) 9232 7140
Fax: (02) 9233 1850
thawley@sevenwentworth.com.au

13 Transcript 7/3/2011 page 33 line 24 to page 34 line 8 (AB78-79); page 34, lines 28-37(AB79); page 35 line 32 to page 36 line (AB80-81).