TR 2017/D7 - Income tax: when does a company carry on a business within the meaning of section 23AA of the Income Tax Rates Act 1986 ?

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Draft Taxation Ruling

Income tax: when does a company carry on a business within the meaning of section 23AA of the *Income Tax Rates Act 1986*?

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Summary – what this ruling is about

1. This draft Ruling sets out the Commissioner's preliminary, but considered, views on when a company carries on a business within the meaning of section 23AA of the *Income Tax Rates Act 1986* (ITR 1986).

2. This draft Ruling does not consider whether a company carries on a relevant business within the meaning of provisions in the ITR 1986 or *Income Tax Assessment Act 1997* (ITAA 1997). The question of whether a company is carrying on business arises directly or indirectly in many different contexts of the income tax law, for differing purposes and with differing consequences. While similar considerations may be involved, the question must be considered in each context by reference to the particular provision in question and its purpose. Consequently caution should be exercised in applying the reasoning expressed in this ruling in relation to other provisions of the law, and it should be borne in mind that this ruling does not bind the Commissioner in respect of those other provisions.

Application

3. This draft Ruling applies only to companies incorporated under the *Corporations Act 2001* (Cth), other than companies limited by guarantee.[1] The discussion and conclusions in this draft Ruling do not apply to:

- other entities or associations of persons that are:
  - deemed to be a company within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936* or subsection 995-1(1) of the ITAA 1997 and taxed as if they a company under the *Income Tax Assessment Acts 1936 and 1997*, or
  - a corporate tax entity within the meaning of section 960-115 of the ITAA 1997
- individuals
- trusts, or
- companies in their capacity as trustee of a trust (including as trustee of a superannuation fund).

4. The Commissioner's views on whether a self-managed superannuation fund is carrying on a business are discussed in Self Managed Superannuation Funds Ruling SMSFR 2009/1 *Self Managed Superannuation Funds: business real property for the purposes of the Superannuation Industry (Supervision) Act 1993*. Similar guidance for working out whether an individual is carrying on a business is contained in Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?*

Ruling

Background

5. A company will be a base rate entity under section 23AA of the ITR 1986 if it carries on a business[2] and meets the aggregated turnover requirement.[3]

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[1] Companies limited by guarantee are typically formed for purposes other than profit, such as a charitable or non-profit organisation. Companies incorporated by statute or charter will be affected by the purposes for which they were formed and need to be dealt with on a case by case basis; unincorporated companies are now rare but also require special consideration.

[2] Paragraph 23AA(a) of the ITR 1986. The concept of 'carrying on a business' is a longstanding feature of the income tax law and is relevant to various provisions of general application, including section 6-5 of the ITAA 1997 about income according to ordinary concepts, the second limb of the general deduction provision (section 8-1 of the ITAA 1997), and the small business tax concessions (Division 328 of the ITAA 1997).

6. 'Business' for the purpose of section 23AA of the ITR 1986 is defined by reference to the meaning of business in section 995-1 of the ITAA 1997. This defines business to include 'any profession, trade, employment, vocation or calling', but excludes 'occupation as an employee'.[4]

7. It is not possible to definitively state what amounts to a business, however in *Federal Commissioner of Taxation v. Murry,*[5] Gaudron, McHugh, Gummow and Hayne JJ observed:

> …A business is not a thing or things. It is a course of conduct carried on for the purpose of profit and involves notions of continuity and repetition of actions.[6]

8. There is extensive case law considering whether a company is carrying on a business. It highlights that companies have different underlying characteristics to individuals and trusts that lead to the conclusion that the same activities carried on by an individual or trust may not amount to the carrying on of a business, whereas they may when carried out by a company. This is in part because of the underlying commercial nature of companies. That is, the same activities carried on by limited and No Liability (NL) companies are more likely to amount to the carrying on of a business than if they were carried out by either an individual or trust.[7]

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[3] Paragraph 23AA(a) of the ITR 1986.
[4] Subsection 995-1(1) of the ITAA 1997.
[5] *Federal Commissioner of Taxation v. Murry* [1998] HCA 42; (1998) 193 CLR 605 (*Murry*).
[6] *Murry* per Gaudron, McHugh, Gummow and Hayne JJ at [1998] HCA 42, [54].
[7] *Western Goldmines N.L. v. C. of T. (W.A.)* (1938) 59 CLR 729 per Latham C.J. at p. 733; *American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia)* [1978] 3 All ER 1185 (*American Leaf*); *Inland Revenue Commissioners v. Korean Syndicate Ltd* [1921] 3 KB 258; (1930) 12 TC 181 (*Korean Syndicate*); *Federal Commissioner of Taxation v. Radnor* (1991) 91 ATC 4689; (1991) 22 ATR 344 (*FCT v. Radnor*); *Charles v. Federal Commissioner of Taxation* [1954] HCA 16; (1954) 90 CLR 598 (*Charles*); *London Australia Investment Co Ltd v. FCT* [1977] HCA 50; (1977) 138 CLR 106 (*London Australia*) per Gibbs J.

9. There are two categories of cases where the courts have considered whether a company carries on a business. The first comprises those cases which consider the question of whether a company carries on a business in a general sense.[8] The second category comprises those cases where the relevant question considered by the courts is whether a company 'carries on a particular business' to answer a question that turns on the scope or nature of the business it carries on, such as whether a gain made on a transaction is income or capital in nature.[9] This category of cases does not address the broader question of whether any business is actually carried on by the company more generally. This draft ruling is concerned with the first question: does a company carry on a business in a general sense and therefore whether it carries on a business within the meaning of section 23AA of the ITR 1986.

10. The case law highlights that it is not possible to definitively state whether a person is carrying on a business. Whether the activities of a person constitute the carrying on of a business is a question of fact[10], and must be answered based on a wide survey and the overall impression of the activities of the person and having regard to the indicia of carrying on a business as a whole.[11]

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[8] See, for example, *American Leaf* and *Inland Revenue Commissioners v. Westleigh Estates Company Ltd* [1924] 1 KB 390 (*Westleigh*).

[9] *London Australia* per Gibbs J at [1977] HCA 50, [4] to [6]. For example, whether amounts are assessable as ordinary income under section 6-5 of the ITAA 1997 (*London Australia*; *AGC (Investments) Ltd v. FCT* 92 ATC 4239; (1992) 23 ATR 287; *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1), whether outgoings or losses are deductible under section 8-1 of the ITAA 1997, and whether a company carries on the same business for the purpose of the same business test in Subdivision 165-E of the ITAA 1997 (*Avondale Motors (Parts) Pty Ltd v. FCT* (1971) 124 CLR 97; 71 ATC 4101 (*Avondale*); *Commissioner of Taxation v. R & D Holdings Pty Limited* [2007] FCAFC 107; 2007 ATC 4731; (2007) 160 FCR 248; 67 ATR 790) (*R & D Holdings*); *Re Kennedy Holdings and Property Management Pty Ltd v. Federal Commissioner of Taxation* [1992] FCA 645 (*Kennedy*); *FCT v. Radnor*).

[10] *Brookton Co-operative Society Ltd v. FCT* (1981) 147 CLR 441 per Aickin J at p. 469 (*Brookton*); *Spriggs & Riddell v. FCT* (2009) 239 CLR 1; [2009] HCA 22 at [59] (*Spriggs*).

[11] *Martin v. FCT* (1953) 90 CLR 470 per Webb J at p. 474 (*Martin*). *Spriggs* at [2009] HCA 22, [59].

11. While these indicia are relevant to companies, companies are typically formed for the purpose of carrying on a business[12] and in *Westleigh*[13] and *American Leaf*[14], it was observed that where a company aims to make, and has a prospect of profit, it is presumed that the company intends to, and does in fact, carry on a business. However, the presumption can be rebutted if it can be shown that, on the facts, the company had no aim or prospect of making a profit.[15] In *American Leaf* Diplock LJ further observed that any gainful use to which a company puts its assets will, on its face, amount to the carrying on of a business. An analysis of the indicia of when a business is carried on will assist in determining whether a company satisfies these criteria with the result the presumption arises.

The indicia of carrying on business

12. The indicia considered by the courts in determining whether activities carried on by a person amount to the carrying on of a business by them are[16]:

- the nature of the activities, particularly whether they have a profit-making purpose
- whether the person intends to carry on a business[17]
- whether the activities are:
  - repeated and regular
  - organised in a business like manner, including the keeping of books, records and the use of a system
- the amount of capital employed in those activities, and
- whether the activity is better described as a hobby, or recreation.

The nature of a company's activities and whether they have a purpose of profit

13. Where a company's activities have a significant commercial nature or purpose and are conducted in a commercially viable manner, they are likely to amount to the carrying on of a business.

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[12] *Brookton* per Aickin J at (1981) 147 CLR 441, 470; *Westleigh*. *American Leaf* at [1979] AC 676, 684.
[13] *Westleigh*.
[14] *American Leaf*.
[15] *Westleigh* per Pollock MR at [1924] 1 KB 390, 408-409; *Spassked Pty Limited v. Commissioner of Taxation* [2003] FCAFC 282 (*Spassked*).
[16] *Ferguson v. FCT* [1979] FCA 29; (1979) 37 FLR 310 per Bowen CJ and Franki J at [15] (*Ferguson*).
[17] *Thomas v. FC of T* 72 ATC 4094 (*Thomas*); *Inglis v. FC of T* 80 ATC 4001 at pp. 4004-4005; (1979) 10 ATR 493 per Brennan J at pp. 496-497; *Westleigh*.

14. Limited and NL companies are typically formed for the purpose of carrying on a business and are unlike individuals, who may have multiple purposes for undertaking an activity.[18] Unlike individuals, a company's profitable activities are unlikely to be in the nature of a hobby or be undertaken to meet a domestic need. Thus its profit making activities are unlikely to have a domestic or personal nature.

15. For these reasons, the profit-making activities of a company will normally have a fundamentally different character to those of an individual. This difference has led the courts to observe that profit-making activities, such as receiving rent from property, will not give rise to the presumption that an individual is carrying on a business, whereas it would if those same activities are undertaken by a company.[19]

16. This is also true for trusts whose nature[20], and the variety of purposes for which they are established[21] place them in a materially different position to limited and NL companies.[22] These differences mean that the same activity undertaken by a trustee is similarly less likely to amount to the carrying of a business, than if it were to be carried on by a company.[23]

17. However, in some situations a company's activities may have a non-commercial nature or a purpose inconsistent with carrying on a business.[24] These are discussed at paragraphs 18–19. Outside these types of situation, the profit making activities of a company will normally have a commercial nature and profit-making purpose on their face.

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[18] *Korean Syndicate* at (1930) 12 TC 181, 201.
[19] *American Leaf* at [1979] AC 676, 684.
[20] Including the duties placed on the trustee and the interest of the beneficiaries in the property the subject of the trust.
[21] *Charles* at [1954] HCA 16, [10]; *FCT v. Radnor* per Sheppard J at 91 ATC 4689, [6]; *Re Elders Trustee and Executor Company Limited v EG Reeves Pty Limited; Edward George Reeves (Second Respondent) and Daphne Joan Reeves (Third Respondent)* [1987] FCA 332.
[22] *London Australia* per Gibbs J at [1977] HCA 50, [7].
[23] *FCT v. Radnor*; *Radnor Pty Ltd v. FCT* 90 ATC 4637; *London Australia* per Gibbs J at [1977] HCA 50, [7] and Jacobs J at [1977] HCA 50, [27].
[24] *Inland Revenue Commissioners v. Eccentric Club* Ltd [1924] 1 KB 390.

Circumstances where a company's activities lack a commercial character or profit-making purpose

18. While on their face, a company's profit-making activities have a commercial character, there are circumstances where a company's activities will not. For example, a company may exist solely to provide services or facilities to its members, without any intention to make a profit that could be distributed to its members. Examples may include:

- holding land to secure access to a beach for the company's shareholders[25], and
- providing social and recreation facilities for members without seeking a profit to distribute to its members.[26]

19. Other examples where a company is likely to be characterised as having no profit-making purpose and whose activities are unlikely to have a commercial nature include:

- an incorporated charity
- a body corporate whose sole purpose is to maintain and manage land for its owners
- a statutory body serving a public function, and
- an incorporated not-for-profit organisation that exists to provide community services.

Purpose and prospect of profit

20. Whether a company's activities have a purpose and prospect of profit is critical in determining whether it is carrying on a business.[27] Where they do, it is likely the other indicators will also support the conclusion that it is carrying on a business. This is ultimately a question of fact to be determined in light of all the circumstances.

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[25] In *Whitfords Beach Pty Ltd v. Commissioner of Taxation* [1983] FCA 97; 67 FLR 151; (1983) 14 ATR 247 (*Whitfords*), the company was incorporated for this purpose, prior to it being acquired and changing its purpose and activities so that it started carrying on a land development business.

[26] *Westleigh*.

[27] *American Leaf* at [1979] AC 676, 684; *Westleigh*; *Murry* at [1998] HCA 42, [54]; *Whitfords* per Fisher J at 79 ATC 4648, 4659; Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?* at [47]-[54].

21. In determining whether a company has a profit-making purpose, the purposes of those who set up the company, maintain and control it may be considered.[28] The objects as stated in the company's constitution can also be considered, although this is not conclusive of whether a company carries on a business.[29]

22. If a company is a member of a group of companies its purpose, and whether it carries on a business may be determined by reference to its role within the group[30], the activities of the wider group[31], and the intended activities of any of its subsidiaries at the time they are set up.[32]

23. A company may have a profit-making purpose, even where on the objective evidence, it is unlikely that a profit will be made in the short term.[33] Where this is the case, the company may still carry on a business, although the other indicators of whether a business is carried on will carry more weight.

Example: A dividend trap

24. In *Spassked*[34], a company that lacked a purpose or clear prospect of making a profit was not held to carry on business, despite owning shares that would ordinarily have meant it carried on a business. Its activities involved borrowing funds to invest in subsidiaries, engaging in 'dividend trapping', and being conducted with no intent or purpose to derive a profit. This led to the conclusion it was not carrying on a business.

Intention to carry on a business

25. Whether a person has an intention to carry on a business is relevant to determining whether a person or entity carries on a business. It is not necessary, however, that they have an express intention to do so. The intention may be inferred objectively from the circumstances.[35]

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[28] *Bernard Elsey Pty. Ltd. v. Federal Commissioner of Taxation* (1969) 121 CLR 119 at p. 121; *Whitfords* per Gibbs CJ at (1982) 150 CLR 355, 371; *Brookton* per Mason J at (1981) 147 CLR 441, 453

[29] *A. & S. Ruffy Pty. Ltd. v. Federal Commissioner of Taxation* (1958) 98 CLR 637 per Fullagar J at p. 656; *Brookton* per Aickin J at (1981) 147 CLR 441, 463;*Westleigh*; *Korean Syndicate*; *American Leaf*; *Kwikspan Purlin System Pty. Ltd. v. Federal Commissioner of Taxation* 84 ATC 4282.

[30] *Spassked*; *News Australia Holdings Pty Ltd v. Commissioner of Taxation* [2017] FCA 645.

[31] *FCT v. Total Holdings (Australia) Pty Ltd* (1979) 43 FLR 217; 79 ATC 4279 (*Total Holdings*); *FC of T v. EA Marr & Sons (Sales) Ltd* (1984) 2 FCR 326 *(EA Marr)*.

[32] *Brookton* per Mason J at (1981) 147 CLR 441, 453; *Spassked*.

[33] *Ferguson* at (1979) 37 FLR 310, 314; *Tweddle v. FC of T* (1942) 7 ATD 186; (1942) 2 AITR 360.

[34] *Spassked*.

[35] *FC of T v. Stone* (2005) 222 CLR 289; 2005 ATC 4234; *G v. Commissioner of Inland Revenue* [1961] NZLR 994.

26. Companies are typically formed for the purpose of carrying on a business.[36] In *Westleigh*[37] and *American Leaf*[38], it was observed that a where a company aims to make and has a prospect of profit, it is presumed that it intends to, and does in fact, carry on a business. However, the presumption can be rebutted if it can be shown that on the facts the company had no aim or prospect of making a profit.[39]

Repetition and regularity

27. The degree of repetition or regularity of the company's activities is relevant to determining whether it carries on a business.[40] While there is a need for activity, this may be satisfied even if it is irregular or there are periods of inactivity[41], or the company does nothing but receive rent on its investments.[42]

28. A company that holds assets which generate ongoing returns will still be engaged in activity sufficient to amount to the carrying on of a business, even though there is little work for it to do in managing those income-producing activities and assets.[43] Its activities may be limited to its ongoing management, receipt and distribution of income and other matters of an administrative nature.

29. Periods of inactivity, where a company's activities amounting to a business are temporarily paused because of circumstances beyond the company's control, may be distinguished from ceasing activities where there is no intention to resume the business. In the former case, there is no cessation of business. In the latter case, it is likely the company has become dormant and the company is unlikely to still be carrying on a business.[44]

30. A company has been held to carry on business where its ongoing activities are relatively limited and its key activities consist of:

- letting the company's premises for rent on an ongoing basis[45]
- leasing its plant to its subsidiaries for no fee[46]

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[36] *Brookton* per Aickin J at (1981) 147 CLR 441, 470; *Westleigh*.
[37] *Westleigh*.
[38] *American Leaf*.
[39] *Westleigh* per Pollock MR at [1924] 1 KB 390, 408-409; *Spassked*.
[40] *Ferguson* at (1979) 37 FLR 310, 314; *Hope v. Bathurst City Council* (1980) 144 CLR 1 at p. 8; *Smith v. Anderson* (1880) 15 Ch D 247 per Brett LJ at pp. 277-8 (*Smith*).
[41] *American Leaf*.
[42] *Westleigh*; *Korean Syndicate*; *American Leaf*.
[43] *Westleigh* per Warrington LJ at [1924] 1 KB 390, 417; *American Leaf*; *Spassked* cf. *Northern Engineering Pty Ltd v. FCT* (1979) 42 FLR 301; 10 ATR 584; 29 ALR 563; 80 ATC 4025 (*Northern Engineering*).
[44] *Avondale*.
[45] *American Leaf*.
[46] *EA Marr*.

- providing secretarial, budgeting and financial services to its subsidiaries that carry on active businesses[47], and
- holding shares in subsidiary companies which are engaged in trading.[48]

Single acts or transactions

31. An isolated act or one-off transaction may amount to carrying on a business if it is intended to be repeated[49], or it can be shown that the transaction was the first step in the carrying on of a business.[50]

Organisation of activities in a systematic and business-like manner

32. Whether the activities in question are carried out in a systematic and organised way, or carried on in a business-like manner, are relevant to determining whether they amount to carrying on a business. This may involve, for instance, keeping detailed records of income[51], preparing formal business plans or budgets[52], or seeking professional advice.[53]

33. Limited and NL companies are formal business entities typically formed for the purpose of carrying on a business. The statutory framework governing them creates a formal structure under which their activities are conducted and includes rules about how they are to be managed.

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[47] *Carapark Holdings Ltd v. Federal Commissioner of Taxation* [1967] HCA 5; (1967) 115 CLR 653 at p. 659. (*Carapark*).
[48] *Brookton* per Gibbs CJ at (1981) 147 CLR 441, 445 and Mason J at (1981) 147 CLR 441, 453.
[49] *Re Griffin Ex Parte Board of Trade* (1890) 60 LJQB 235 at p. 237.
[50] *Fairway Estates Pty Ltd v. Federal Commissioner of Taxation* (1970) 123 CLR 153 at p. 165.
[51] *Brookton*.
[52] *T & S Liapis Pty Ltd v. Commissioner of State Taxation* [2015] SASC 63 at [164].
[53] *Smith* at [2010] AATA 576, [61].

34. For example, companies are required to have at least one director who formally controls and manages the activities of the company.[54] The *Corporations Act 2001* (Cth) imposes duties on the directors of a company and its shareholders.[55] This includes a duty to ensure that the company does not trade while insolvent[56], to keep financial records[57], and the requirement of the Australian Securities and Investment Commission (ASIC) that all companies make an annual resolution as to solvency. This formal organisation and structure is even stronger for those companies who are required to prepare and lodge annual financial reports with ASIC.[58]

35. A company's formal structure and the statutorily imposed requirements regarding how they must be managed and run are a point of difference to the activities of an individual. As a consequence, the activities of a company will, typically, be systematic, organised and carried on in a business like manner. They will normally support a conclusion that the activities of a company undertaken for the purpose of making a profit will amount to carrying on a business.

Size and scale of the company's operations

36. The size and scale of the activities in question are relevant, but not necessarily conclusive, of whether they amount to carrying on a business.[59] Where the company carries out its activities with the purpose and prospect of making a profit, the amount of capital it has invested in the activities and the scale of its activities, even if limited and small, carries less weight than it would in the case of an individual.[60]

37. Where small-scale activities conducted by individuals do not amount to the carrying on of a business, other factors are normally present which support the conclusion that the individual is not carrying on a business. These will typically not be present in the case of a company carrying on activities which have a purpose and prospect of profit.[61] For example:

- the activities are better classified as a hobby[62], or
- the activity serves a domestic need[63], or arises from a purely domestic arrangement.[64]

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[54] *Corporations Act 2001* section 198.
[55] See for example, *Corporations Act 2001* Chapters 2D and 2M and section 588G.
[56] *Corporations Act 2001* section 588G.
[57] *Corporations Act 2001* section 286.
[58] *Corporations Act 2001* section 292.
[59] *FC of T v. JR Walker* (1985) 79 FLR 161; 85 ATC 4179 (*Walker*); *Thomas*; *Ferguson* at (1979) 37 FLR 310, 323.
[60] *Thomas* per Walsh J at 72 ATC 4094, 4099.
[61] *Ferguson*; *Martin*; *Thomas; Evans v. Federal Commissioner of Taxation* [2007] AATA 1062 (*Evans*) cf. *Walker*.
[62] *Ferguson*; *Martin* per Webb J at (1953) 90 CLR 470, 481.
[63] *T*homas per Walsh J at 72 ATC 4094, 4099.

38. In the case of a company, its activities may be so small and limited in scope that they lead to the conclusion that it has neither an objective purpose nor prospect of profit. An example is a company that is effectively dormant and whose only income is interest on a small amount of cash in the bank that is never likely to exceed its annual ASIC company review fee.[65]

Need for an ongoing assessment – changes in activities and purpose

39. A company may commence, or cease carrying on, a business at various times throughout its life because of a change in its activities and purpose.[66] Whether a company carries on a business must be reassessed whenever there are changes in the activity and status of the company.

40. A company may not be carrying on a business because its activities are preliminary to carrying on a business and are merely carried out to determine whether it is feasible to carry on a business.[67] However, it may commence carrying on a business once it has confirmed that the business is feasible.

41. Similarly, a company may cease to carry on a business altogether.[68] For example, where a company has entered liquidation, the courts consider whether there has been a change in the purpose of the company's activities. If the liquidator is seeking only to realise a company's assets in the most advantageous manner for the purpose of liquidating the company and distributing assets to its creditors and members, it may no longer carry on a business.[69] Another example is a company that, having wound up its active business, retained a single asset – a debt owed to it that did not carry an entitlement to interest. As there was no right to interest, but merely a hope it may receive it, it could not be said to engage in activities with a purpose or prospect of profit. A company in these circumstances does not carry on a business.[70]

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[64] *Evans.*
[65] As of 22/7/2017, the annual company review fee is $254 for a proprietary company, $48 for a special purpose company and $1,201 for a public company, Australian Securities & Investments Commission, viewed 22 July 2017, http://asic.gov.au/for-business/running-a-company/annual-statements.
[66] *Whitfords*.
[67] *Softwood Pulp and Paper Ltd v. FC of T* 76 ATC 4439; (1976) 7 ATR 101*; Goodman Fielder Wattie Ltd v. FC of T* 91 ATC 4438; (1991) 22 ATR 26.
[68] See, for example, *Amalgamated Zinc (De Bavay's) Ltd v. FCT* (1935) 54 CLR 295; *Northern Engineering*.
[69] *IR Commissioners v. Olive Mill Ltd (In Liq)* [1963] 2 All ER 130; [1963] 1 WLR 712; *Commissioner of Taxation (Western Australia) v. Newman* (1921) 29 CLR 484; *Northern Engineering* per Brennan J at 80 ATC 4025, 4027.
[70] *Northern Engineering*.

42. In contrast, where a company enters into administration to resolve financial difficulties but continues its business activities with the expectation that they will continue profitably in the future, it will still carry on business.[71]

Court cases considering whether a company carries on business

43. Examples of cases where the courts have held a company was carrying on a business include where a company:

- is a holding company that has an expectation of receiving dividends from its subsidiaries[72], where it:
  - acquired the shares in its subsidiaries by way of gift[73]
  - made interest bearing loans to those subsidiaries and provided management services to the group[74]
  - leased plant and equipment to its subsidiaries free of charge[75], or
  - made interest-free loans to those subsidiaries[76]
- holds and rents out single[77] or multiple real properties[78]
- invested in real property, intended to be held indefinitely for the purpose of deriving rent, and subsequently sells the property for profit[79], and
- receiving interest and royalties.[80]

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[71] *Joshua Bros Pty Ltd v. FCT* (1923) 31 CLR 490; 29 ALR 73; *AGC (Advances) Ltd v. FCT* (1975) 132 CLR 175 per Barwick CJ at p. 189; *Official Receiver in Bankruptcy (Fox's Estate) v. Federal Commissioner of Taxation* (1956) 96 CLR 370; (1956) 11 ATD 119.

[72] In *Korean Syndicate*, Atkin LJ observed being a holding company was a well-known method of carrying on business at (1930) 12 TC 181, 205.

[73] *Brookton* per Mason J at (1981) 147 CLR 441, 453.

[74] *Carapark*.

[75] *EA Marr*.

[76] *Total Holdings*.

[77] *R & D Holdings*; *Lilydale Pastoral Co. Pty. Ltd. v. Federal Commissioner of Taxation* 87 ATC 4235 cf. *Kennedy*, where this view was formed in the context of characterising a one-off lease payment made by the company. In finding that the payment was capital in nature, Hill J said that a different view may have been reached if the company's business 'consisted of granting leases and obtaining surrenders of them as part of the normal ebb and flow of the business' (at [1992] FCA 645, [17]).

[78] *American Leaf*; *R & D Holdings*; *CMI Services Pty Ltd v. Federal Commissioner of Taxation*; 90 ATC 4428 at 4437 (*CMI*).

[79] *CMI* cf. *Equitable Life and General Insurance Co. Ltd. v. Federal Commissioner of Taxation* 21 ATR 364; (1990) 93 ALR 609, where, on the facts, the company was not found to carry on such a business.

[80] *Korean Syndicate*.

Conclusion

44. Whether a company is carrying on a business within the meaning of section 23AA of the ITR 1986 ultimately depends on an overall impression of the company's activities. However, where a limited or NL company is established and maintained to make a profit for its shareholders, and invests its assets in gainful activities that have both a purpose and prospect of profit, it is likely to be carrying on a business in a general sense[81] and therefore to be carrying on a business within the meaning of section 23AA of the ITR 1986. In these circumstances, it is likely the other indicia of carrying on a business will support this conclusion. This is so even if the company's activities are relatively limited, and its activities primarily consist of passively receiving rent or returns on its investments and distributing them to its shareholders.[82]

45. While it is likely that a limited or NL company will carry on a business in a general sense, this may be rebutted on the facts. For example, if the company has no purpose or prospect of profit, and its activities lack a commercial character, it is unlikely to be carrying on a business.[83]

46. If it is concluded that a company carries on a business in a general sense, it is still necessary to determine the scope and nature of that business when determining the taxation consequences of its activities and transactions. This includes whether an amount it receives is income or capital in nature, or whether losses are capital in nature. These are separate questions that must be considered on the facts of each case.

Examples

Example 1 – Dormant company with retained profits

47. *DormCo is a company incorporated in Australia. DormCo carried on a trading business that was wound up in the 2012-13 income year. DormCo has $300,000 of retained earnings which it holds in a bank account. In the 2013-14 and later income years, the company's income has consisted solely of interest of less than $100 a year. DormCo has no intention of resuming its trading business. DormCo pays an annual company review fee of $254 to ASIC. The company's expenses have been consistently greater than its interest income. As a result, the company has had no income tax liability since the 2012-13 income year and has generated small losses.*

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[81] *Brookton* per Aickin J at (1981) 147 CLR 441, 469*; American Leaf* per Lord Diplock at [1978] 3 All ER 1185, 1189; *Westleigh*.
[82] *Brookton* per Aickin J at (1981) 147 CLR 441, 469; *Westleigh*; *American Leaf* at [1978] 3 All ER 1185, 1189; *Total Holdings*; *EA Marr* at (1984) 2 FCR 326, 330-1; *Korean Syndicate*; *Brookton*.
[83] *Westleigh*.

48. *DormCo's activities are limited to holding retained earnings, on which it derives small amounts of interest. DormCo's expenses are greater than the interest income derived. It has no intention of resuming business and no objective purpose or prospect of profit. DormCo is not carrying on a business.*

Example 2 – Company is engaged solely in preliminary activities

49. *R&D Co is a newly incorporated company. Its activities consist solely of investigating whether it would be viable to carry on a particular business in the future. R&D Co's activities are preliminary in nature and it does not carry on a business.*

Example 3 – Property investment company

50. *InveproCo is a company incorporated in Australia. InveproCo owns a commercial property, which it rents to a third party at a market rate rent on normal commercial terms. InveproCo does not engage an agent to manage the rental property and its directors find tenants. All maintenance and inspections are carried out by its directors. InveproCo has produced a profit in each of the income years it has rented out the property.*

51. *InveproCo is engaged in ongoing activities that have a purpose and prospect of profit, including letting out the property, maintaining the property and conducting inspections, collecting rent and distributing profits to its shareholders.*[84]

52. *InveproCo carries on a business.*

Example 4 – Share investment company

53. *ShareCo is a company incorporated in Australia. ShareCo holds a portfolio of listed shares worth $400,000. The shares generate $20,000 in income a year after expenses. ShareCo does not engage a third party to manage its portfolio of shares.*

54. *ShareCo was formed for the purpose of investing in shares with the intention of earning income from dividends. Its portfolio was selected with this in mind.*

55. *ShareCo has applied its assets in ongoing activities that have both a purpose and a prospect of profit. ShareCo has also invested a substantial amount of capital, and the dividend income is received by way of periodic payments. ShareCo carries on a business.*

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[84] The outcome would not change if InveproCo were to engage third party professionals to manage the property, find tenants and do all the maintenance and ongoing inspections to the property.

Example 5 – Family company

56. *FamCo is a company incorporated in Australia. FamCo is a discretionary object of the Pail Family Trust. It otherwise has no income or assets. The Pail Family Trust carries on a profitable trading business. The trustee of the Pail Family Trust exercises its discretion and makes FamCo presently entitled to $50,000 of the trust income, but does not pay this amount to FamCo. It remains as an unpaid present entitlement (UPE) of FamCo.*

Possibility A – FamCo does not reinvest its UPE

57. *FamCo's income consists only of the trust entitlement. FamCo's only asset is the UPE from the Pail Family Trust. FamCo has no entitlement to receive interest on the UPE. The company does nothing to demand receipt of its UPE, nor does it enter into any arrangement that would give it an entitlement to any type of profit. FamCo has not invested its assets in any activity that has a purpose or prospect of profit. It only has a mere hope of receiving future appointments of income from the Pail Family Trust, of which it is an object. FamCo does not carry on a business.*

Possibility B – FamCo reinvests its UPE

58. *After being made presently entitled to the $50,000 of trust income, FamCo enters a written loan agreement on commercial terms with the trustee of the Pail Family Trust. Under this agreement, FamCo loans the money back to the trust in return for a commercial rate of interest secured against the assets of the trust. The interest income received is then either distributed to FamCo's shareholders by way of annual dividends, or reinvested back in the trust by way of further loans made on the same terms under written loan agreements. FamCo's activities consist of investing its assets in a business like way with both a purpose and prospect of profit. FamCo carries on a business.*

Possibility C – FamCo receives trust distributions in cash

59. *FamCo's income consists only of trust distributions from the Pail Family Trust which it receives in cash. FamCo distributes part of these distributions to its shareholders and retains the balance. Its only assets are the part of the trust distributions it retains and holds in a bank account, pending distribution to its shareholders. This account does not bear interest.*

60. *FamCo has not applied its assets in any activity that has a purpose or prospect of profit. It only has a mere hope of receiving future appointments of income from the Pail Family Trust, of which it is an object. FamCo does not carry on a business.*

Example 6 – Company leases multiple boats to unrelated party

61. *CharterCo owns three passenger boats which it previously used to operate charter services. Following the loss of its operator's licence, the company sought to and leased its boats to an independent third party under a commercial lease agreement.*

62. *CharterCo's directors directly manage the leasing of the boats, including finding lessees and personally carrying out minor repairs to the boats. The leasing activities include obtaining insurance, maintaining and registering the boats. The rental income derived from letting the boats is CharterCo's only source of income, which greatly exceeds the outgoings associated with holding the boats for lease.*

63. *CharterCo's ongoing activities are carried on in a business like manner and have both a purpose and prospect of profit. CharterCo carries on a business.*

Example 7 – Holding company

64. *HoldCo is a company incorporated in Australia. HoldCo owns all the shares in SBE Co, which carries on a profitable trading business in Australia.*

Possibility A – Holding company only holds shares in subsidiary

65. *HoldCo's only asset is shares in SBE Co. HoldCo's activities consist of investing in shares in SBE Co and managing the company group. HoldCo's activities are carried on with a purpose and prospect of profit and reflect a normal commercial business structure. HoldCo carries on a business.*

Possibility B – Holding company holds shares in, and provides loan to, subsidiary

66. *In addition to owning all the shares in SBE Co, HoldCo provides a loan to SBE Co. HoldCo's income consists of dividend income derived from the shares it holds in SBE Co, as well as interest income accruing on the loan to SBE Co. The profits are distributed by HoldCo to its shareholders.*

67. *HoldCo's activities consist of investing in shares in SBE Co, managing the group, providing a loan to SBE Co and deriving interest income from the loan. HoldCo carries on a business.*

Example 8 – RedCo – taxation consequences of a transaction

68. *RedCo is a company incorporated in Australia which invests in dividend yielding listed shares. The dividends are assessable income. The dividends from the shares are greater than RedCo's expenses: it conducts its investments to derive profits for distribution to its shareholders. RedCo does not engage a third party to manage its portfolio of shares. From time to time RedCo buys or sells shares. RedCo carries on a business in a general sense.*

69. *RedCo sells a parcel of shares making a significant profit. The taxation consequences of this transaction depends not only on whether RedCo carries on a business but:*

i. what kind of business it carries on, and

ii. the relationship of the transaction with that business.

70. *The answer to these questions turn on additional facts and an analysis of the scope and nature of RedCo's business.*

Possibility A: RedCo carries on a business of trading in shares for profit

71. *RedCo is carrying on a business of trading in shares for profit. The shares are its trading stock within the meaning of section 70-10 of the ITAA 1997. The gross receipts from the sale are assessable as ordinary income under section 6-5 of the ITAA 1997.*[85]

Possibility B: RedCo carries on a business of investing for profit, including profit from regular disposals of shares

72. *RedCo is not carrying on a business of trading in shares and so its shares are not trading stock. It does however carry on a business of investing in shares for dividends where the disposal of the shares was a transaction undertaken in the ordinary course of that business. The net profit from the sale of shares is assessable income.*[86]

[85] Section 70-80 of the ITAA 1997.
[86] *London Australia*.

Possibility C: The disposal is outside the ordinary course of RedCo's business but is part of a profit making scheme

73. *RedCo is not carrying on a business of trading in shares of which the shares are trading stock, nor is the sale in the ordinary course of its business. The profit on the sale of shares was a commercial transaction made as part of a scheme entered into for the specific purpose of profit-making by sale. The profit is ordinary income assessable under section 6-5 of the ITAA 1997.*[87]

Possibility D: The disposal is a mere realisation of an investment

74. *RedCo is not carrying on a business of trading in shares of which the shares are trading stock, nor is the sale in the ordinary course of business, nor is the sale part of a scheme entered into for the purpose of profit-making by sale. The gain arose from a mere realisation of a capital asset. It is a capital receipt and not assessable as ordinary income. CGT Event A1 occurs on the disposal of the shares.*[88]

Date of effect

75. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
18 October 2017

[87] Taxation Ruling TR 92/3 *Income tax: whether profits on isolated transactions are income* at paragraph [15]; FC of T v. The Myer Emporium Ltd (1987) 163 CLR 199; 87 ATC 4363; 18 ATR 693.
[88] *AGC (Investments) Ltd* v *FC of T* 92 ATC 4239; section 104-10 of the ITAA 1997.

Appendix 1 – Your comments

76. You are invited to comment on this draft Ruling, including the proposed date of effect. Please forward your comments to the contact officer by the due.

77. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**1 December 2017**
Contact officer:	**Renee George**
Email address:	**CompanyCarryingOnBusiness@ato.gov.au**
Telephone:	**(07) 4753 7974**

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Previous draft:

Not previously issued as a draft

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