TR 94/D37 - Income tax: development allowance: investment allowance: meaning of 'rights to use'

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Draft Taxation Ruling
Income tax: development allowance: investment allowance: meaning of 'rights to use'

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IT 69; IT 190; IT 2278; IT 2383; TR94/11

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What this Ruling is about

1. This Ruling considers the meaning of the phrase 'rights to use' and its related term '...contract or arrangement with another person for the use of the property by that other person' used in the Development Allowance and General Investment Allowance provisions of the *Income Tax Assessment Act 1936* (ITAA) (Subdiv B and BA, Div 3 of Part III respectively). (See legislative references at the end of this Ruling.)

Ruling

2. The words 'rights to use' in section 82AA are to be given their ordinary and natural meaning (*Tourapark Pty Ltd v FC of T* 82 ATC 4105 at 4107 and 4108; (1982) 12 ATR 842 at 845 and 846).

3. The ordinary and natural meaning of the word 'use' is of 'wide import' and 'its meaning in any particular case depends to a great extent on the context in which it is employed' (*Ryde Municipal Council v Macquarie University* (1978) 139 CLR 633 per Gibbs ACJ 637, see also *Council of the City of Newcastle v Royal Newcastle Hospital* (1956-57) 96 CLR 493 (High Court), (1959) 100 CLR 1 (Privy Council)).

4. The rights to use restriction in the Development Allowance and General Investment Allowance provisions is not limited simply to situations where there is a direct payment for the use of eligible property (*Ryde Municipal Council* v *Macquarie University* (1978) 139

CLR 633 at 638; *Glasgow Corporation v Johnstone* [1965] AC 609). The restriction potentially applies where the owner of the eligible property has given a right to use the property to another person. The restriction may apply if the use of the eligible property by the other person, directly facilitates the carrying out of the owner's income earning activities. Whether there is such a use - that is, a use by which the claimant of the allowance derives assessable income - depends on the details of each case.

5. There is a continuum of situations starting with those which clearly trigger the operation of the rights to use restriction and ending with those situations which clearly do not trigger the restriction. The precise dividing line between the two situations has to be determined on all the facts of a particular case.

6. There must be a careful analysis of the relationship between the owner of the eligible property and any person who may use that eligible property (see the Full Federal Court's approach in *Hamilton Island Enterprises Pty Ltd v FC of T* 82 ATC 4302 at 4306-7; (1983) 13 ATR 220 at 225-226, where the court had regard to both the specific contractual terms and to the overall effect of the arrangement. See also *International Cellars Pty Ltd v FC of T* 92 ATC 4624; (1992) 23 ATR 512)).

7. By way of illustration, situations which clearly do not trigger the restrictions include:

(a) the use of eligible property by an employee or agent of the owner of the property for the purpose of producing the owner's trading stock. In such cases the employee's or agent's action can in law be viewed as the action of the owner, ie. there is no granting of a right to use in the relevant sense. (See *Watteau v Fenwick [1893] 1QB 346; Performing Right Society Ltd v Mitchell and Booker (Palais de Danse) Ltd [1924] 1KB 762 at 768; Bugge v Brown (1919) 26 CLR 110; Petersen v Moloney (1951) 84 CLR 91 at 94; Attorney-General for NSW v The Perpetual Trustee Company Ltd (1951-1952) 85 CLR 237 at 299-300);*

(b) the use of eligible property by an independent contractor to produce trading stock of the owner of the eligible property, where the contract is one essentially for labour. Such a contract is for the provision of services rather than for the granting of a right to use. In these cases the owner of the eligible property uses that property directly, albeit with contract labour, to produce its own trading stock. The services may be provided on the premises of the owner of the eligible property or on the premises of the independent

contractor. It is irrelevant in such cases (subject to the question of the property becoming a fixture) as to where the eligible property is located.

(c) the eligible property is operated by the customer in the course of purchasing goods. The use of an eligible property by the customer is permitted by the owner simply to complete the sale. The use of the machine by the customer is simply incidental to the completion of a contract of sale. It is a misuse of the language to describe the position as a use of property to earn assessable income from granting to customer a right to use them. (*International Cellars)*

(d) the use of the eligible property under an arrangement in which the owner has contracted to perform a service and in order to meet that contract provides both the equipment and operators. The equipment is not used by the other contracting party to meet a contracted obligation to a third party. In such a case, the equipment is not used by the customer in the relevant sense. The equipment is used by the owner in the carrying on of his business of providing particular services. (See the examples in paragraphs 20(e), 21 and 25.)

(e) the use of eligible property owned privately by one of the partners in the partnership business. The restriction does not apply in such case, because there is not any assessable income directly flowing from the decision by a partner to use the privately owned property in the partnership business. There is not any amount payable for the use of the property.

8. Again by way of illustration, situations which clearly trigger the restrictions include:

(a) deriving assessable income by way of fee or charge directly from the granting of a right to use (In *U231*, 87 ATC 1276; AAT Case 3994 (1987-88) 19 ATR 3026*,* the proprietor of the laundromat derived income by the granting of rights to use washing machines. The right to use the washing machines was the core of the contract.); or

(b) deriving assessable income indirectly (no direct payment for the use) from the granting of a right to use an item of eligible property. The exclusion may apply if the use of the eligible property by an other person directly facilitates the carrying out of the owner's assessable income earning

activities. The restriction will clearly apply in situations where, under a contract for the sale of goods, the owner of eligible property allows another person to use the eligible property to produce the goods which may be purchased under the contract by the owner of the eligible property. This is particularly the case where the vendor uses their own raw materials and equipment in conjunction with the purchaser's eligible property to produce trading stock of the vendor which is to be or may be sold to the purchaser. It does not matter whether the vendor only uses the purchaser's eligible property to produces goods for the purchaser or also uses the property to produce goods for sale to other parties. In both situations the essential character of the contract includes the granting of a right to use in the relevant sense.

(c) deriving assessable income from day-to-day hiring (or otherwise granting the right to use) of the eligible property to casual or occasional users. Provided the contract is one of hire, rather than one for the provision of a particular service, then it does not matter whether an operator is also provided for the property. In such a case, the use of the property is at the direction and under the control of the hirer. For example, if plant is hired with a licenced operator the contract is still one of hire. The investment allowance is available only in relation to owner operated eligible plant or eligible plant held by a taxpayer who is operating it under hiring or leasing agreement for term of 4 years or more with a "leasing company" as defined in the relevant provisions of the income tax law. (Sections 82AA and 82AQ)

9. The ATO is of the view that the phrase 'a contract or arrangement with another person for the use of property by that other person' has substantially the same meaning as the phrase 'rights to use'. Accordingly, for the purposes of this ruling no distinction is made between these phrases and the ruling applies to both.

Date of effect

10. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute

agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Background

11. In all material aspects the present investment allowance provisions are identical to the former investment allowance provisions. Consequently, the cases dealing with the former investment allowance are equally relevant to the present provisions. Likewise, the 'rights to use' restrictions in the development allowance provisions are substantially the same as, and were introduced for essentially the same reasons as, the restrictions in the investment allowance. Therefore, the investment allowance cases are also of assistance in interpreting the development allowance provisions.

Meaning of the word 'use'

12. In *Council of the City of Newcastle v Royal Newcastle Hospital* (1956-57) 96 CLR 493 Taylor J stated at 515:

> 'The word "use"' is, of course, a word of wide import and its meaning in any particular case will depend to a greater extent upon the context in which it is employed. The uses to which property of any description may be put are manifold and what will constitute "use" will depend to a great extent upon the purpose for which it has been acquired or created'.

13. Both Gibbs ACJ's comments in *Ryde Municipal Council* (see paragraph 3 above) and the High Court's comments on the meaning of 'use' in *Council of the City of Newcastle* were cited with approval in *International Cellars* (92 ATC 4624 at 4627; (1992) 23 ATR 512 at 515) are of assistance in understanding the meaning of 'use' in the context of the former investment allowance.

14. In *Ryde Municipal Council* (1978) CLR 633 Gibbs ACJ stated at 638 that:

> 'In the ordinary accepted meaning of the word a building is "used" for the purposes of acquiring income if rents are derived from it, and the owner of the premises who leases them is making use of those premises by employing or applying them for the purpose of letting. ... But that is not the only way in which an owner of land may use it by letting it to someone else'.

15. In *Knowles v The Council of the Municipality of Newcastle* (1909) 9 CLR 534 a house was occupied by a railway station-master

rent free. The station-master was required to live there as a condition of his employment, so that he might be available in case of emergency. The question before the High Court was whether the house was 'used' for the purpose of Government railways. O'Connor J stated (at 543) that:

> 'It is said that the actual use is by the station-master, not by the Commissioners [of State Railways], but if the station-master actually does use the house under the direction of the Commissioners, I find it difficult to see how it can be said that it is the station-master and not the commissioners who uses the house'.

16. In *Glasgow Corporation* the House of Lords considered whether a house occupied rent free by a church officer, who was required to occupy the house during the course of his employment with the church, was 'wholly or mainly used for charitable purposes'. Lord Reid (at 622) stated:

> 'They [the congregational board of the church] use the house to have a servant on the spot to assist them in the more efficient performance of their charitable activities. I think that it is much too narrow a view simply to see whether any charitable activity is carried on in the house... If the use which the charity makes of the premises is directly to facilitate the carrying out of its main charitable purposes, that is, in my view, sufficient to satisfy the requirement that the premises are used for charitable purposes'.

17. If the approaches in the cases discussed above were applied to the development and investment allowance, then a taxpayer could be viewed as using eligible property for the purpose of producing assessable income '... by granting to other persons of rights to use the eligible property' even though no assessable income, by way of rent, fee, or charge, is directly produced. The restriction would be triggered if the use to which the other person puts the eligible property can be said to facilitate directly the carrying out of the owners assessable income earning activities.

The underlying rationale of the 'right to use' exclusion

18. The policy behind the rights to use restriction in both the old and the new investment allowance provisions is set out in Gibbs CJ's judgment in *Tourapark* (82 ATC 4105 at 4108; (1982) 12 ATR 842 at 845-846):

> 'All these provisions support the view that (except in the case of leasing companies) the Parliament intended that the allowance should not be payable unless the taxpayer kept both the property

> and the exclusive right to use it, and did use it only for the purpose of producing assessable income'.

and also:

> 'It is apparent that the investment allowance is made available for the purpose of encouraging particular behaviour which the Parliament regarded as desirable, namely, the expenditure of money on certain plant which (except in the case of leasing companies) is intended to be used and is in fact used by the taxpayer himself wholly and exclusively for the production of assessable income and which others have no right to use. The Parliament attached conditions to the right to the allowance, no doubt with a view to preventing the right being used simply as a means of tax avoidance, and no reason appears why the words imposing the conditions should be given any other than their ordinary and natural meaning' (emphasis added).

19. Given that the 'rights to use' restrictions in the development allowance are substantially the same as those for the investment allowance the above passages also accurately summarise the policy behind the development allowance provisions.

The 'right to use' restriction in judicial decisions

20. The operation of the former investment allowance has been considered on number of occasions by the Australian courts. These cases demonstrate the need to examine carefully the relevant contractual relationship between the owner of the property and any one else who may use that property. In:

(a) *Tourapark* the taxpayer derived assessable income from the hiring of caravans and the contract was one clearly granting a right to use in the relevant sense;

(b) *Case W120* (89 ATC 951 at 955, paragraph 14; Case 5470, (1988-89) 20 ATR 4149 at 4154) the contract was essentially one for the provision of labour by New-co to Fabrico, the owner of the eligible property. This fact was recognised by Mr Roach**:**

> 'The arrangements so entered into were such that Fabrico was able to procure the knitting of the yarn to its own specifications just as surely as if it had directly controlled the employees of New-co as its employees and had provided an incentive reward to the person who had managed the work'.

Fabrico supplied the raw materials. Fabrico's eligible property was used only to produce trading stock which

was itself the property of the Fabrico. New-co was essentially paid for the provision of labour and management services. Thus while we do not accept all of the theoretical discussion in that case we do accept that given the particular facts the correct result was obtained;

(c) *International Cellars* there was no granting of a right to use in the relevant sense. The essential nature of the contract was the sale of cigarettes, not the granting of a right to use the cigarette machine. The taxpayer derived its income from the sale of the cigarettes, not from the granting of any right to use.

(d) *Case U59* (87 ATC 382; (1986-87) 18 ATR 3283) the taxpayer used amusement machines for the purpose of producing its assessable income. Customers were able to use the machines upon payment. The machines were housed in hotels and clubs, the owners of which received 50% of the machines' takings. The owner's income from the machines arose because the owner of the machines authorised someone else to use the machines. This case is no different from Case U231. The investment allowance was not available as the taxpayer did not retain both the property and the exclusive right to use the machine.

(e) *Hamilton Island* it was held that the chartering of a helicopter with crew to a related company to carry that company's passengers on scenic and joy flights would constitute the granting of right to use. This case is different from the situation in paragraph 7(d) above. In the earlier situation, the owner of the plant is responsible for its operation and uses it to fulfil his/her contractual obligations to perform particular work. In such a case the owner of the property is earning his/her assessable income not from the granting of a right to use but from the carrying out of a business which involved the provision of services. For example, a subcontractor whose employees use earthmoving equipment in the course of constructing a building makes his income as a builder, not from the granting of a right to use the equipment to the head contractor. However, in the Hamilton Island case, the helicopter was under the control of the related company. The helicopter was not in the course of fulfilling the owner's contractual obligation to perform a particular service, but instead was used to meet the related company's contractual obligation to perform a service.

Examples

21. The Speedy Bus Company purchases buses for use in transporting paying passengers along its established routes. In this case the contract is one of transportation rather than a contract for the right to use the bus. The Company derives the relevant assessable income from the transporting of passengers, not from the granting of rights to use buses. Passengers do not have any right to control the operation of the bus. The Company does not earn income from the granting of rights to use.

22. The Quick Charter Bus Company charters buses without a driver to other persons who then operate them for their own income earning purposes. In this case there is a granting of a relevant right to use. The taxpayer in such a situation is carrying on a business as a charterer of buses. The owner derives income from the grant of rights to use.

23. The Patrol Company Ltd chartered a 4WD vehicle with a crew to an associated company Camping Pty Ltd to carry that company's customers on outback camping trips. The owner of the 4WD vehicle was to be paid a percentage of the proceeds of seats sold. The associated company undertook to construct the necessary infrastructure for use by the 4WD vehicle. Its emblems were placed on the 4WD vehicle. The Camping Pty Ltd used the 4WD vehicle in the course of its business activity of arranging and operating camping trips. Under that contract the owner of the eligible property (4WD vehicle) derived assessable income from the grant of a right to use or more correctly 'the use' of the 4WD vehicle by an associated company, which incorporated them as a part of its own business activities.

24. The Manufacturing Company Ltd (MCL) enters into a contract with independent suppliers for the purchase of components which will be used in MCL's own trading stock. Under the contract MCL provides the supplier with tools and dies for the relevant components. The parts supplier will use its own raw materials, together with its own equipment and the tools and dies owned by MCL, to produce trading stock which will be owned by the supplier. That trading stock may then be sold, under the contract, to MCL. In our view, the contract of sale between MCL and the supplier involves the granting of a right to use in the relevant sense by MCL. MCL derives assessable income from the granting of that right to use as the goods obtained under the contract are either incorporated into MCL trading stock or be resold separately as its trading stock of spare parts.

25. The Builders' Service Company Pty Ltd provides specialised pieces of equipment such as large mobile cranes and earth moving equipment which are normally operated on a contract basis by the company. That is, Builders' Services contracts to perform a particular

service, the preparing of a building site prior to construction using its own plant. Such plant, if operated by a Builders' Service's employee will attract investment allowance. In arrangement of this kind, which is quite different from a simple hiring of the plant, the firm, and not its customer would be actually using the plant in performing the contract or rendering the service. On the other hand, if a smaller piece of equipment is provided under an arrangement in which the plant is used by the hirer to fulfil his/her contractual obligation then the investment allowance will not be available. Then is irrespective of whether an operator is also provided.

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- Case U59 87 ATC 382; Case 45 (1986-87) 18 ATR 3283
- Case U231 87 ATC 1276, AAT Case 3994 (1987-88) 19 ATR 3026
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- Case W120 89 ATC 951; Case 5470 (1988-89) 20 ATR 4149