


TD 2006/D23 - Income tax: capital gains: is a CGT asset that is leased by a taxpayer to a connected entity for use in the connected entity's business an active asset under section 152-40 of the Income Tax Assessment Act 1997 ?

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This document has been finalised by TD 2006/63.



Draft Taxation Determination

Income tax: capital gains: is a CGT asset that is leased by a taxpayer to a connected entity for use in the connected entity's business an active asset under section 152-40 of the *Income Tax Assessment Act 1997*?

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This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. Yes. A CGT asset leased by a taxpayer to a connected entity for use in the connected entity's business is an active asset of the taxpayer under section 152-40 of the *Income Tax Assessment Act 1997* (ITAA 1997), unless the use by the connected entity is excluded by paragraph 152-40(4)(e) of the ITAA 1997. Paragraph 152-40(4)(e) of the ITAA 1997 excludes, among other things, assets whose main use is to derive rent (unless such use was only temporary).

Example: use by a connected entity

2. Joe owns 100% of the shares in *Smash Repair Co*, which carries on a panel beating business. Joe and the company are therefore connected with each other. Joe also owns the business premises and leases them to the company for the conduct of its business.

3. Although Joe is wholly using the premises to derive rent, *Smash Repair Co* (a connected entity) is wholly using them in the course of carrying on a business. The premises are therefore not excluded under paragraph 152-40(4)(e) of the ITAA 1997 and are therefore an active asset of Joe's under subparagraph 152-40(1)(c)(ii) of the ITAA 1997.

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Date of effect

4. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination 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 Determination.

Commissioner of Taxation

14 June 2006

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Explanation

5. For the small business concessions in Division 152 of the ITAA 1997 to apply to reduce or disregard a capital gain, the relevant CGT asset must satisfy the active asset test in section 152-35 of the ITAA 1997.
6. A CGT asset is an active asset at a given time if, at that time, you own it and:
 - it is used (or held ready for use) in the course of carrying on a business by you, a small business CGT affiliate of yours or an entity connected with you; or
 - it is an intangible asset that is inherently connected with a business you carry on (subsection 152-40(1) of the ITAA 1997).
7. Certain assets are, however, excluded from being active assets under subsection 152-40(4) of the ITAA 1997.

Main use to derive rent

8. Paragraph 152-40(4)(e) of the ITAA 1997 excludes, among other things, assets whose main use is to derive rent (unless such use was only temporary). Such assets are excluded even if they are used in the course of carrying on a business. Of course, if the activities carried on do not amount to the carrying on of a business, it is unnecessary to consider whether the main use of the asset is to derive rent.

Use by a connected entity

9. If a CGT asset, such as land, is leased by a taxpayer to a connected entity for use in the connected entity’s business, the question arises as to whether the main use of the asset is to derive rent. In this situation, the asset is wholly used by the owner to derive rent. However, paragraph 152-40(4)(e) of the ITAA 1997 refers to ‘an asset whose main use in the course of carrying on the business mentioned in subsection (1)’.... . If an asset is used in the business of a connected entity, ‘the business mentioned in subsection (1)’ is the connected entity’s business (subparagraph 152-40(1)(c)(ii) of the ITAA 1997). Accordingly, it is the use of the asset in that business that will determine the active asset status of the asset.

10. An asset that is leased to a connected entity for use in its business is therefore an active asset under subparagraph 152-40(1)(c)(ii) of the ITAA 1997, unless the use by the connected entity itself is excluded by paragraph 152-40(4)(e) of the ITAA 1997 (for example, if the connected entity subleases the asset to an unrelated third party).

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Note

11. As noted in the Treasurer's Press Release No. 38 of 2006 (9 May 2006), the Board of Taxation's report on its Post-Implementation Review of the small business CGT concessions contains a number of administrative recommendations. This Draft Taxation Determination is part of the Commissioner's response to Recommendation 7.3 of the Board's report.

Appendix 2 – Your comments

12. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date: 11 August 2006

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References

Previous draft:

Not previously issued as a draft

Subject references:

- active asset
- active asset test
- basic conditions for relief
- capital gains
- capital gains tax
- CGT assets
- CGT small business relief
- controlling individual
- small business relief

Legislative references:

- ITAA 1997 Div 152
- ITAA 1997 152-35
- ITAA 1997 152-40
- ITAA 1997 152-40(1)
- ITAA 1997 152-40(1)(c)(ii)
- ITAA 1997 152-40(4)
- ITAA 1997 152-40(4)(e)

Other references

- Treasurer's Press Release No. 38 of 2006
-

ATO references

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Income Tax ~~ Capital Gains Tax ~~ small business relief - 'active asset test'