

TD 2006/D31 - Income tax: capital gains: are there any circumstances in which the premises used in a business of providing accommodation for reward may satisfy the active asset test in section 152-35 of the Income Tax Assessment Act 1997 notwithstanding the exclusion in paragraph 152-40(4)(e) of the Income Tax Assessment Act 1997 for assets whose main use is to derive rent?

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This document has been finalised by TD 2006/78.



Draft Taxation Determination

Income tax: capital gains: are there any circumstances in which the premises used in a business of providing accommodation for reward may satisfy the active asset test in section 152-35 of the *Income Tax Assessment Act 1997* notwithstanding the exclusion in paragraph 152-40(4)(e) of the *Income Tax Assessment Act 1997* for assets whose main use is to derive rent?

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Ruling

1. Yes. In certain circumstances the premises used in a business of providing accommodation for reward will satisfy the active asset test in section 152-35 of the *Income Tax Assessment Act 1997* (ITAA 1997) notwithstanding the exclusion in paragraph 152-40(4)(e) of the ITAA 1997 for assets whose main use is to derive rent. It will depend on the particular circumstances of each case.

Example 1: rental properties

2. *Commercial Property Co owns 5 commercial rental properties. The properties have been leased for several years under formal lease agreements to various commercial tenants which have used them for office and warehouse purposes. The terms of the leases have ranged from 1 year to 3 years with a 3 year option and provide for exclusive possession. The company has not engaged a real estate agent to act on its behalf and manages the leasing of the properties itself.*

3. *In this situation, the company has derived rental income from the leasing of a number of properties. Accordingly, the main (only) use of the properties is to derive rent and they are therefore excluded from being active assets under paragraph 152-40(4)(e) of the ITAA 1997 regardless of whether the activities constitute the carrying on of a business.*

Example 2: commercial storage

4. *Christine carries on a business of providing commercial storage space. The storage facility comprises 50 storage sheds which are available for hire for periods of one week to two years or more. Christine provides office facilities and 24 hour on-site security. She also provides various items of equipment for sale or loan to clients such as trolleys, cardboard, boxes, brooms, tape, pens, locks, bolt cutters, torches and shelves. A cleaning service is also provided and charged for.*

5. *Christine enters into a storage agreement with each client. The agreements provide that in certain circumstances she can relocate the client to another space or enter the space without consent and that the client cannot assign the rights under the agreement.*

6. *The arrangements entered into in this situation indicate that the users of the storage sheds do not have the right to exclusive possession but rather only the right to enter and use the sheds for certain purposes. Some of the arrangements entered into were short term and a range of services were provided to the users. There was also no intention by the parties to grant a lease.*

7. *Having regard to all the circumstances, we consider a tenant/landlord relationship does not exist between the parties in this example and therefore the amounts received are not rent. Accordingly, the storage facility is not excluded by paragraph 152-40(4)(e) of the ITAA 1997 and is therefore an active asset.*

Example 3: boarding house

8. *David owns an 8 bedroom property which he operates as a boarding house. He resides on the premises. Boarders enter into arrangements to occupy single rooms with the average length of stay being 4-6 weeks. No notice is required to quit the rooms. There are rules requiring visitors to leave the premises by a certain time and David retains the right to enter the rooms. David pays for all utilities (gas, electricity, water) and provides the following services and facilities to boarders:*

- *room cleaning and general maintenance;*
- *linen and towels; and*
- *common areas such as a TV/lounge room, kitchen, bathrooms, laundry and a recreation area.*

9. *In this example, the services and facilities provided to boarders are relatively significant and the average length of stay is relatively short. David retains a significant degree of control over the premises through being on the premises most of the time. The arrangements entered into indicate that those staying in the boarding house do not have the right to exclusive possession of a room but rather only a right to occupy the room.*

10. *These circumstances indicate that the relationship between David and those staying at the boarding house is not that of landlord/tenant under a lease agreement. Accordingly, the income derived is not 'rent' and therefore the paragraph 152-40(4)(e) exclusion does not apply. If David's activities amount to the carrying on of a business, the boarding house will be an active asset under section 152-40 of the ITAA 1997.*

Example 4: holiday apartments

11. *Linda owns a complex of 6 holiday apartments. The apartments are advertised collectively as a motel and are booked for periods ranging from one night to one month. The majority of bookings are from one to seven nights.*

12. *Linda is responsible for bookings, checking guests in and out and cleaning the apartments. She also provides clean linen and meal facilities to guests. Linda does not enter into any lease agreements with guests staying at the apartments.*

13. *In this example, the apartments are operated similar to a motel. The guests do not have exclusive possession of the apartment they are staying in but rather only a right to occupy the apartment on certain conditions. The usual length of stay by guests is very short term and room cleaning, linen and meals are also provided to guests.*

14. *These facts indicate that the relationship between Linda and the guests is not that of landlord/tenant under a lease agreement. Accordingly, the income derived is not 'rent' and therefore the paragraph 152-40(4)(e) of the ITAA 1997 exclusion does not apply. If Linda's activities amount to the carrying on of a business, the apartments will be active assets under section 152-40 of the ITAA 1997.*

Example 5: mixed use

15. *Mick owns land on which there are a number of industrial sheds. He uses one shed (45% of the land by area) to conduct a motor cycle repair business. He leases the other sheds (55% of the land by area) to unrelated third parties. The income derived from the motor cycle repair business is 80% of the total income (business plus rentals) derived from the use of the land and buildings.*

16. *In determining if the main use of the land is to derive rent, it is appropriate to consider a range of factors. In this case, a substantial (although nevertheless not a majority) proportion by area of the land is used for business purposes. As well, the business proportion of the land derives the vast majority (80%) of the total income. In all the circumstances, we consider the main use of the land in this case is not to derive rent and accordingly the land is not excluded from being an active asset by 152-40(4)(e) of the ITAA 1997.*

Date of effect

17. *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.*

Appendix 1 – Explanation

❶ *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

18. 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.

19. 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 (paragraphs 152-40(1)(a) and (c) of the ITAA 1997; or
- it is an intangible asset that is inherently connected with a business you carry on (paragraph 152-40(1)(b) of the ITAA 1997).

20. Certain assets are however excluded from being active assets under subsection 152-40(4) of the ITAA 1997.

Main use to derive rent

21. 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.

22. Whether an asset's main use is to derive rent will depend on the particular circumstances of each case. The term 'rent' has been described as follows:

- the amount payable by a tenant to a landlord for the use of the leased premises (*C.H. Bailey Ltd v. Memorial Enterprises Ltd* [1974] 1 All ER 1003 at 1010, *United Scientific Holdings Ltd v. Burnley Borough Council* [1977] 2 All ER 62 at 76, 86, 93, 99);
- a tenant's periodical payment to an owner or landlord for the use of land or premises (*The Australian Oxford Dictionary*, 1999, Oxford University Press, Melbourne); and
- recompense paid by the tenant to the landlord for the exclusive possession of corporeal hereditaments. The modern conception of rent is a payment which a tenant is bound by contract to make to his landlord for the use of the property let (*Halsbury's Laws of England* 4th Edition Reissue, Butterworths, London 1994, Vol 27(1) 'Landlord and Tenant', paragraph 212).

23. A key factor therefore in determining whether an occupant of premises is a lessee is whether the occupier has a right to exclusive possession (*Radaich v. Smith* (1959) 101 CLR 209). If, for example, premises are leased to a tenant under a lease agreement granting exclusive possession, the payments involved are likely to be rent and the premises not an active asset. On the other hand, if the arrangement allows the person only to enter and use the premises for certain purposes and does not amount to a lease granting exclusive possession, the payments involved are unlikely to be rent.

24. If premises are operated as a boarding house, the issue arises as to whether an occupant of part of the premises is a tenant or alternatively only a lodger/boarder with a licence to occupy. Similarly, if residential units are operated as holiday apartments, the issue arises as to whether the occupants of the apartments are tenants/lessees or only have licences to occupy.

25. Ultimately, these are questions of fact depending on all the circumstances involved. Relevant factors to consider in determining these questions (in addition to whether the occupier has a right to exclusive possession) include the degree of control retained by the owner and the extent of any services provided by the owner such as room cleaning, provision of meals, supply of linen and shared amenities (*Allen v. Aller* (1966) 1 NSW 572), *Appah v. Parncliffe Investments Ltd* [1964] 1 All ER 838 and *Marchant v. Charters* [1977] 3 All ER 918).

26. If an asset is used partly for business and partly to derive rent, it will be a question of fact dependent on all the circumstances as to whether the main use of the asset is to derive rent. No one single factor will necessarily be determinative, and resolving the matter is likely to involve a consideration of a range of factors such as:

- the comparative areas of use of the premises (between deriving rent and other uses);
- the comparative times of use of the premises (between deriving rent and other uses); and
- the comparative levels of income derived from the different uses of the asset.

Note

27. 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

28. 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

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Subject references:

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

Legislative references:

- ITAA 1997 Div 152
- ITAA 1997 152-35
- ITAA 1997 152-40
- ITAA 1997 152-40(1)(a)
- ITAA 1997 152-40(1)(b)
- ITAA 1997 152-40(1)(c)
- ITAA 1997 152-40(4)

- ITAA 1997 152-40(4)(e)

Case references:

- Allen v. Allen (1996) 1 NSW 572
- Appah v. Parncliffe Investments Ltd [1964] 1 All ER 838
- C.H. Bailey Ltd v. Memorial Enterprises Ltd [1974] 1 All ER 1003
- Marchant v. Charles [1997] 3 All ER 918
- Radaich v. Smith (1959) 101 CLR 209
- United Scientific Holdings Ltd v. Burnley Borough Council [1997] 2 All ER 62

Other references:

- The Australian Oxford Dictionary, 1999, Oxford University Press, Melbourne
- Halsbury's Laws of England 4th Edition Reissue, Butterworths, London 1994, Vol 27(1) 'Landlord and Tenant'
- Treasurer's Press Release No. 38 of 2006

ATO references

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