TD 2006/D32 - Income tax: capital gains: is a bank account or cash on hand included in the numerator of the '80% test' calculation in paragraph 152-40(3)(b) of the Income Tax Assessment Act 1997 ?

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Australian Government
Australian Taxation Office

Draft Taxation Determination
TD 2006/D32

Draft Taxation Determination

Income tax: capital gains: is a bank account or cash on hand included in the numerator of the '80% test' calculation in paragraph 152-40(3)(b) of the *Income Tax Assessment Act 1997*?

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Ruling

1. No, unless subparagraph 152-40(3)(b)(ii) of the *Income Tax Assessment Act 1997* (ITAA 1997) is satisfied. Subparagraph 152-40(3)(b)(ii) of the ITAA 1997 deals with capital proceeds received from CGT events happening to active assets.

2. A bank account is not included in the numerator of the '80% test' under subparagraph 152-40(3)(b)(i) of the ITAA 1997 because it is not an active asset. The bank account is a financial instrument and therefore excluded under paragraph 152-40(4)(d) of the ITAA 1997.

3. Cash on hand is not included in the numerator of the '80% test' under subparagraph 152-40(3)(b)(i) of the ITAA 1997 because it is not a CGT asset for the purpose of section 152-40 of the ITAA 1997 and accordingly it is not an active asset.

Example

4. *A company carries on business. As part of its normal operations the company makes sales on credit and issues accounts. At any particular time it also has Australian currency on hand (that is, notes and coins) and funds deposited in bank accounts (both of which are not held in the circumstances described in subparagraph 152-40(3)(b)(ii) of the ITAA 1997).*

5. *In determining whether the shares in the company are active assets, the bank deposits and Australian currency are not included in the numerator of the '80% test' calculation under subparagraph 152-40(3)(b)(i) of the ITAA 1997 as they are not active assets. The trade debtors are active assets and are therefore included in the calculation.*

Date of effect

6. 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

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

7. 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.

8. 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).

9. A bank account (in credit) used by a taxpayer in the operation of their business is likely to satisfy paragraph 152-40(1)(a) of the ITAA 1997, that is, an asset used in the course of carrying on a business. It could also reasonably be seen as being 'inherently connected' with the taxpayer's business and therefore satisfy paragraph 152-40(1)(b) of the ITAA 1997.

10. In this respect, it should be noted that the purpose and effect of paragraph 152-40(1)(b) of the ITAA 1997, which specifically refers to intangible assets, is to extend (not impliedly limit) paragraphs 152-40(1)(a) and (c) of the ITAA 1997. As such, it is not intended that intangible assets can only qualify as active assets under paragraph 152-40(1)(b) of the ITAA 1997.

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

12. In particular, paragraph 152-40(4)(d) of the ITAA 1997 excludes financial instruments (such as loans, debentures, bonds, promissory notes, futures contracts, forward contracts, currency swap contracts and a right or option in respect of a share, security, loan or contract).

13. A bank account represents a contractual arrangement between the depositor and the bank. The depositor in effect lends their money to a bank by depositing money into an account. A savings or deposit account is in law a loan to the banker (Tyree, A 2002, *Banking Law in Australia*, 4th edn, Lexis Nexus Butterworth's, Australia, p. 68, *Pearce v. Creswick* (1843) 2 Hare 286; 12 LJ Ch 251, *Dixon v. Bank of New South Wales* (1896) 12 WN (NSW) 101 and *Akbar Khan v. Attar Singh* [1936] 2 All ER 545).

14. A loan is listed as a financial instrument in paragraph 152-40(4)(d) of the ITAA 1997. A bank account is therefore a financial instrument and accordingly is excluded from being an active asset. A bank account may also be excluded from being an active asset under paragraph 152-40(4)(e) of the ITAA 1997 if its main use is to derive interest.

The '80% test'

15. The main effect of bank accounts not being active assets is that they will not be included in the numerator in the '80% test' calculation in paragraph 152-40(3)(b) of the ITAA 1997 (except in the circumstances outlined in subparagraph 152-40(3)(b)(ii) of the ITAA 1997). This test is used to determine whether a share in a company or an interest in a trust is an active asset. The bank account is however still part of the total assets of the company or trust and so will be included in the denominator in the '80% test' calculation.

16. A bank account (being a debt) may be included in the numerator in the '80% test' calculation via subparagraph 152-40(3)(b)(ii) of the ITAA 1997 if it represents capital proceeds received during the previous two years from CGT events happening to active assets, and which are held pending the acquisition of new active assets.

17. Notes and coins (being cash on hand) may also be included in the numerator in the '80% test' calculation via subparagraph 152-40(3)(b)(ii) of the ITAA 1997 if they represent capital proceeds received during the previous two years from CGT events happening to active assets, and which are held pending the acquisition of new active assets.

18. Cash on hand can not be included in the numerator in the '80% test' calculation under subparagraph 152-40(3)(b)(i) of the ITAA 1997 because it is not a CGT asset for the purpose of 152-40 of the ITAA 1997 and accordingly not an active asset. It is however, still included in the denominator of the '80% test' calculation as it is an asset of the company or trust.

Trade debtors

19. Funds not yet received, being the trade debtors of a taxpayer carrying on business, can also reasonably be seen as being 'inherently connected' with the taxpayer's business and therefore satisfy paragraph 152-40(1)(b) of the ITAA 1997. Furthermore, the Tax Office considers that trade debtors are not financial instruments but rather a business facilitation mechanism that assists in the conduct of the business. Accordingly, trade debtors are an active asset and can be included in the numerator in the '80% test' calculation under subparagraph 152-40(3)(b)(i) of the ITAA 1997.

Note

20. 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. The Board's report also contains a number of legislative recommendations. This Draft Taxation Determination may be affected by the legislative change relating to Recommendation 7.5 of the Board's report.

Appendix 2 – Your comments

21. 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.)

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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
- financial instruments
- intangible assets
- 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)(a)
- ITAA 1997 152-40(1)(b)
- ITAA 1997 152-40(1)(c)
- ITAA 1997 152-40(3)(b)
- ITAA 1997 152-40(3)(b)(i)
- ITAA 1997 152-40(3)(b)(ii)
- ITAA 1997 152-40(4)
- ITAA 1997 152-40(4)(d)
- ITAA 1997 152-40(4)(e)

Case references:

- Akbar Khan v. Attar Singh [1936] 2 All ER 545
- Dixon v. Bank of New South Wales (1896) 12 WN (NSW) 101
- Pearce v. Creswick (1843) 2 Hare 286; 12 LJ Ch 251

Other references:

- Tyree, A 2002, Banking Law in Australia, 4th edn, Lexis Nexus Butterworth's, Australia
- Treasurer's Press Release No. 38 of 2006

ATO references

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