TR 1999/9 - Income tax: the operation of sections 165-13 and 165-210, paragraph 165-35(b), section 165-126 and section 165-132

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Taxation Ruling

Income tax: the operation of sections 165-13 and 165-210, paragraph 165-35(b), section 165-126 and section 165-132

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Preamble

The number, subject heading, ***Class of person/arrangement****,* ***Ruling*** *and* ***Date of effect*** *parts of this document are a 'public ruling' for the purposes of Part IVAAA of the* ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling replicates the Commissioner's views in Taxation Ruling TR 95/31 'Income tax: the operation of section 80E, section 50D, section 63C and section 80F' ('TR 95/31') concerning the application of the same business test in relation to the relevant provisions rewritten by the Tax Law Improvement Project ('TLIP'). In addition, this Ruling includes a brief overview of the relevant rewritten provisions[1], a new paragraph explaining when a 'change in beneficial ownership has occurred' for the purpose of enabling the same business test to apply[2], and two additional examples dealing with a taxpayer that engages in joint ventures[3].

Class of person/arrangement

2. This Ruling is about the tests based on continuity of business that permit losses incurred by a company to be deductible despite events such as a change in ownership of the company's shares. The Ruling describes the operation of sections 165-13 and 165-210, paragraph 165-35(b), section 165-126 and section 165-132 of the *Income Tax Assessment Act 1997* ('ITAA 1997'[4]).

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1 See paragraphs 3 and 4.

2 See paragraph 21.

3 See **Example 15** (paragraphs 172 to 179) and **Example 16** (paragraphs 180 to 184).

4 All legislative references are to the ITAA 1997 unless otherwise specified.

General outline of the operation of the company loss provisions in Subdivisions 165-A and 165-B

3. Subdivision 36-A has the general rules governing the calculation and deduction of tax losses. Section 36-25 lists the special rules that apply to the calculation and deduction of tax losses by companies. The special rules listed in section 36-25 include the provisions in Subdivision 165-A (section 165-5 to section 165-20) and the provisions in Subdivision 165-B (section 165-35 to section 165-90). This Ruling is about the operation of section 165-13 and paragraph 165-35(b) in Subdivisions 165-A and 165-B, and section 165-210.

General outline of the operation of the company bad debt provisions in Subdivision 165-C

4. Subdivision 165-C lists the special rules that apply to the deduction of bad debts, and losses arising from the deduction of bad debts, by companies. This Ruling is about the operation of sections 165-126 and 165-132 in Subdivision 165-C and section 165-210.

General outline of the operation of section 165-13 and section 165-210

5. Where a company does not satisfy the requirements concerning its continuing ownership and control, as described in section 165-12, section 165-15 and sections 165-150 to 165-205, the general rule is that the company cannot claim a deduction for losses incurred prior to the relevant change in ownership or control. The only exception to this general rule is where the company satisfies certain tests pertaining to the continuity of business (see section 165-13).

6. Where a company does not satisfy the requirements concerning the occurrence of certain events or circumstances as described in Division 175, the general rule is that the company cannot claim a deduction for prior year losses incurred prior to the occurrence of the relevant event or circumstance. The exception to this general rule is where the failure to satisfy Division 175 is attributable to a change in the beneficial ownership of shares in a company (not necessarily the taxpayer) and the taxpayer satisfies certain tests pertaining to the continuity of business of the company (see subsection 175-5(2)).

7. The tests relating to the continuity of business in relation to deducting prior year tax losses are set out in section 165-13 and section 165-210. Where the requirements of sections 165-13 and

165-210 ('80E test') are satisfied, the company is not prevented under section 165-10 from claiming a deduction for a prior year loss.

8. The conditions for complying with sections 165-13 and 165-210 are set out in paragraphs 11 to 19 of this Ruling. However, broadly speaking, the 80E test is satisfied where a company, at all times during the year in which it claims a deduction for a prior year loss:

- carried on the same business (meaning the business of the company as an entirety, or its 'overall business') that it carried on immediately before the change in the beneficial ownership of shares by reason of which it ceased to satisfy the continuing ownership and control requirements described in section 165-12;
- did not carry on any business (meaning a particular undertaking or enterprise) other than a business of a kind carried on before the disqualifying change as part of the overall business;
- only derived income from transactions of a kind that it had entered into in the course of the overall business before the change of ownership; and
- the anti-avoidance provisions in subsection 165-210(3) do not apply to the company.

Similar provisions in paragraph 165-35(b), section 165-126 and section 160-132

9. Tests relating to the continuity of business that are similar to the 80E test are also set out in:

- paragraph 165-35(b) and section 165-210 ('50D test');
- section 165-126 and section 165-210 ('63C test'); and
- section 165-132 and section 165-210 ('the 80F test').

Statements made in this Ruling on the application of the 80E test also represent statements on the application of the 50D test, the 63C test or the 80F test to the extent that the 50D test, the 63C test and the 80F test include the same words or use the same concepts as the 80E test.

Previous Rulings

10. TR 95/31, which describes the Commissioner's views on the application of section 80E, section 50D, section 63C and section 80F of the *Income Tax Assessment Act 1936* ('ITAA 1936'), is now withdrawn.

Ruling

11. Subsections 165-210(1) and 165-210(2) include three tests, each of which must be satisfied by a company in order for the company to meet the requirements of section 165-13 and section 165-210 and thereby not be prevented by section 165-10 from deducting prior year losses. The first test is in subsection 165-210(1) and comprises a positive requirement that the company carry on at all times during the **period of recoupment**[5] the same business as the business that it carried on at the **change-over**[6]. The second and third tests are in subsection 165-210(2) and they comprise the respective negative requirements that the taxpayer does not carry on certain businesses and does not enter into certain transactions during the period of recoupment.

12. The requirement in section 165-13 and subsection 165-210(1) (or the equivalent provision in the 50D test, the 63C test and the 80F test) is referred to in this Ruling as the '**same business test**'[7]. For the purpose of the same business test, a company is treated as carrying on one overall business at the change-over and during the period of recoupment since the reference to 'business' in the same business test is a reference to all of the activities carried on by the company at the change-over and during the period of recoupment, irrespective of whether those activities constitute or are treated by the company as constituting separate or distinct activities, enterprises, divisions or undertakings carried on by the company[8].

13. In the same business test, the meaning of the word 'same' in the phrase 'same business as' imports identity and not merely similarity; the phrase 'same business as' is to be read as referring to the same business, in the sense of the identical business. However, this does not mean identical in all respects: what is required is the continuation of the actual business carried on immediately before the change-over. Nevertheless, it is not sufficient that the business carried on after the change-over meets some industry wide definition of a business of the same kind; nor would it be sufficient for there to be mere continuance of business operations from immediately before the change-over into the period of recoupment, if the business had so changed that it could no longer be described as the same business. The analysis of whether the same business continues after the change-over may give rise to questions of degree and ultimately depends on

5 See paragraph 22 for the definition of this term.

6 See paragraph 20 for the definition of this term.

7 See paragraphs 30 to 62 for discussion of this term.

8 See paragraphs 24 to 29.

the facts of the case. In making the analysis it needs to be acknowledged that a company may expand or contract its activities without necessarily ceasing to carry on the same business. The organic growth of a business through the adoption of new compatible operations will not ordinarily cause it to fail the same business test provided the business retains its identity; nor would discarding, in the ordinary way, portions of its old operations. But, if through a process of evolution a business changes its essential character, or there is a sudden and dramatic change in the business brought about by either the acquisition or the loss of activities on a considerable scale, a company may fail the test[9].

14. The requirement in subsections 165-13 and 165-210(2) (or the equivalent provisions in the 50D test (which includes subsection 165-210(4)), the 63C test and the 80F test) relating to 'business of a kind' is referred to in this Ruling as the '**new business test**'[10]. In the new business test there is a reference to 'business of a kind' that the company did not carry on before the change-over. In the new business test the word 'business' has a different meaning from the word 'business' in the same business test; it refers to each kind of enterprise or undertaking comprised in the overall business carried on by the company at the change-over and during the period of recoupment[11]. The new business test puts a limit on the type of expansion the company may undertake if it is to retain the benefit of accumulated losses; for the taxpayer may not engage in an undertaking or enterprise of a kind in which it did not engage before the change-over and still benefit from accumulated losses[12].

15. The requirement in section 165-13 and subsection 165-210(2) (or the equivalent provisions in the 50D test (which includes subsection 165-210(4)), the 63C test and the 80F test) relating to a 'transaction of a kind' not entered into in the course of the taxpayer's business operations is referred to in this Ruling as the '**new transactions test**'[13]. The new transactions test is directed to preventing the injection of income into a loss company that has satisfied the same business test and the new business test. The new transactions test includes all transactions entered into in the course of the company's business operations and not merely those that are 'isolated' or 'independent'. However, generally speaking, the new transactions test is not failed by transactions of a type that are usually unmotivated by tax avoidance, namely, transactions that could have been entered into ordinarily and naturally in the course of the business

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9 See paragraphs 30 to 58, especially paragraphs 38 to 46.

10 See paragraphs 68 to 77 for discussion of this term.

11 See paragraphs 24 to 29 and 68 to 71.

12 See paragraphs 66 to 67 and 70 to 71.

13 See paragraphs 78 to 90 for discussion of this term.

operations carried on by the company before the change-over. Conversely, a transaction entered into during the period of recoupment and which is outside the course of the business operations before the change-over, or which is extraordinary or unnatural when judged by the course of the business operations before the change-over, is usually a transaction of a different kind from the transactions actually entered into by the company before the change-over[14].

16. The content of the word 'kind' in the new transactions test and the new business test, when applied in a particular case, is to be derived from the course of the company's business operations before the change-over. A transaction from which income is derived during the period of recoupment, which could have been entered into before the change-over in the course of the company's business operations, and which is neither extraordinary nor unnatural in the context of the business carried on by the company at the change-over, is generally a transaction of the same kind as transactions actually entered into by the company before the change-over[15].

17. In the new transactions test, 'transaction' refers to any operation or dealing from which income directly or indirectly flows or arises, and a company enters into a transaction for the purposes of the new transactions test if it engages or participates in it. The new transactions test is intended to extend to every means by which a company may derive income, including transactions of a passive or investment character[16]. The words 'business operations' refer to everything that a company undertakes or does; together, the business operations constitute the business, meaning the overall business, of the company[17].

18. The word 'income' in subsection 165-210(2) does not include amounts that are '*de minimis*'[18].

19. The section 80E test is not satisfied by a company if the anti-avoidance provisions in subsection 165-210(3) apply. The anti-avoidance provisions in subsection 165-210(3) are referred to in this Ruling as the '**anti-avoidance test**'[19]. In those anti-avoidance provisions, the word 'business' has the same meaning that it has for the purpose of applying the new business test; and 'transaction', 'entered into', and 'business operations' have the same meanings they have in the new transactions test. The anti-avoidance provisions apply where the purpose, or one of the purposes, of the company in

14 See paragraphs 78 to 79.
15 See paragraphs 81, 86 and 87.
16 See paragraphs 82 to 85.
17 See paragraphs 28 and 85.
18 See paragraphs 89 to 90.
19 See paragraphs 91 to 95 for discussion of this term.

commencing to carry on the business or entering into the transaction was the purpose of enabling the company to take into account prior year losses. This is so notwithstanding that, where there is more than one purpose, the tax avoidance purpose was not the dominant purpose of the company in commencing to carry on the business or enter into the transaction.

What do 'change-over' and 'period of recoupment' mean?

20. In this Ruling '**change-over**' means:

(a) for the 80E test in section 165-13 - subject to meeting the condition in subsection 165-13(2), the point in time when the continuity period referred to in subsection 165-13(2) ends (see subsection 165-13(3));

(b) for the 50D test in paragraph 165-35(b) - at the time when the part of the income year during which the same persons had more than a 50% stake in the company ended (see section 165-35);

(c) for the 63C test in section 165-126 - subject to meeting the condition in subsection 165-126(2), the point in time when the minimum continuity period referred to in subsection 165-126(2) ends (see subsection 165-126(3)); and

(d) for the 80F test in section 165-132 - the point in time when the minimum continuity period referred to in subsection 165-126(2) ends (see subsection 165-132(2)).

21. For the purpose of paragraphs 20(a), (c) and (d) above, the condition in subsection 165-13(2) and the condition in subsection 165-126(2) are intended to 'clarify precisely when a change in beneficial ownership has occurred that results in a company not maintaining majority ownership'[20]. The explanatory memoranda to the Bills that introduced section 165-13 (in its current form) and section 165-126 state that 'Broadly, the section requires a company to carry on the same business at all times during [the relevant period] ... as it did immediately before a change in beneficial ownership of its shares that results in it not maintaining the same majority ownership. The 1936 Act does this but not as clearly'[21]. Accordingly, for the

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20 See page 70 of the explanatory memorandum to the Income Tax Assessment Bill 1996 discussing section 165-13, and page 201 of the explanatory memorandum to the Tax Law Improvement Bill (No 2) 1997 discussing section 165-126.

21 See page 70 of the explanatory memorandum to the Income Tax Assessment Bill 1996 discussing section 165-1, and page 202 of the explanatory memorandum to the Tax Law Improvement Bill (No 2) 1997 discussing section 165-126.

purpose of section 1-3, section 165-13 and section 165-126 'appear to have expressed the same idea [as paragraph 80E(1)(a) or paragraph 63C(1)(a)of the *Income Tax Assessment Act 1936*, respectively] in a different form of words'. See also paragraphs 12 and 13 of Taxation Ruling TR 97/16. Nevertheless, there is an argument that the different words in these provisions may produce a different result than would otherwise be the case under the original provisions, in certain circumstances.

22. In this Ruling '**period of recoupment**' means:

(a) for the 80E test in section 165-13 - the income year in which the company seeks to deduct the tax loss (see subsection 165-13(3));

(b) for the 50D test in paragraph 165-35(b) - the rest of the income year after the part of the income year during which the same persons had more than a 50% stake in the company (see paragraph 165-35(b));

(c) for the 63C test in section 165-126 - the second continuity period within the meaning of section 165-120(2) (see subsection 165-126(3); and

(d) for the 80F test in section 165-132 - the later income year referred to in subsection 165-132(1) (see subsection 165-132(1)).

Date of effect

23. This Ruling applies to a company that deducts a tax loss under section 36-15 or works out its taxable income or tax loss under Subdivision 165-B in the 1997-98 or later year of income[22]. This Ruling also applies to a company that deducts a debt or deducts a tax loss arising from a deduction for a debt in the 1998-99 or later year of income[23]. However, the Ruling does 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 21 and 22 of Taxation Ruling TR 92/20).

22 See sections 136-100, 36-105 and 36-110 of the *Income Tax (Transitional Provisions) Act 1997*.

23 See section 165-135 of the *Income Tax (Transitional Provisions) Act 1997*.

Explanations

The structure of section 165-210

24. Section 165-210 has the following three tests:

- the same business test;
- the new business test; and
- the new transactions test.

These tests form a descending hierarchy that first tests the business of the company as an entirety (its 'overall business'), then the component undertakings or enterprises, if any, of that business and, finally, the individual transactions by which the business is carried on.

25. The same business test, which is the primary test, is a positive test: it looks to see whether the business of the company in the year of recoupment is actually the same business that was carried on at the change-over. The same business test is intended to ensure continuing identity between the whole of the business activities carried on by the taxpayer at the change-over and the whole of the business activities carried on by the taxpayer during the period of recoupment.

26. Accordingly, for the purpose of applying the same business test to a taxpayer, the taxpayer will always be treated as carrying on only one business at the change-over and during the period of recoupment. The reference in the same business test to 'business' is a reference to all of the activities carried on or undertaken by the company at the change-over and during the period of recoupment, irrespective of whether those activities constitute or are treated by the taxpayer as constituting separate or distinct activities, enterprises, divisions or undertakings carried on by the taxpayer.

27. The second and third tests are secondary, cumulative, negative tests, and they look to see whether the component undertakings or enterprises and the transactions of the overall business are the same **in kind** as previously. These tests are intended to prevent the injection of income into the company while leaving appropriate scope for the development and expansion of the company's business. They do not, however, depend for their operation on the existence of a purpose of tax avoidance.

The meaning of 'business' in section 165-210

28. The word 'business' is capable of different meanings in different contexts. In the new business test in the second limb of section 165-210, and its statutory equivalents, the word 'business' is clearly intended to mean a particular undertaking or enterprise, while the expression 'business operations' must refer to all the activities of

the company[24]. As the tests that the second limb comprises, i.e., the new business test and the new transactions test, are intended to prevent the injection of income into a loss company that has satisfied the primary, positive test in the first limb of section 165-210 and its equivalents, i.e., the same business test, it may be supposed that the second limb is examining activities carried on within **the** business of the company.

29. A purposive interpretation would give to the word 'business', where it first occurs, the meaning 'overall business'[25]. The word 'business' in the same business test has, thus, the same scope as the expression 'business operations' in the new transactions test, but a different meaning from the word where it appears in the new business test. Such an interpretation is consistent with the conclusion of Gibbs J (as he then was) in *Avondale Motors (Parts) Pty Ltd v. FC of T* (1971) 124 CLR 97; 45 ALJR 280; 2 ATR 312; 71 ATC 4101 (*Avondale Motors*)[26] that paragraphs (b) and (c) of subsection 80E(1):

> 'together show that the legislature intended that where there has been the specified change in the beneficial shareholding of a company the accrued losses can only be treated as deductions if the company after the change was carrying on the same business it was carrying on before the change and no other business.'

The same business test

What does the same business test mean?

30. For a company to satisfy the same business test, the company must be able to show that it carried on at all times during the period of recoupment the **same business** as the business that the company carried on at the change-over.

31. *Avondale Motors*, a judgment of Gibbs J sitting as a single justice of the High Court, is the leading authority on the application of section 80E of the ITAA 1936[27]. In *Avondale Motors*, Gibbs J held that the reference to 'same business' in section 80E required that the

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24 See paragraphs 68, 82 and 85 *infra*.

25 See *Cooper Brookes (Wollongong) Pty Ltd v. FC of T* (1981) 147 CLR 297 at 320; (1981) 11 ATR 949 at 961; 81 ATC 4292 at 4305.

26 (1971) 124 CLR 97 at 106; (1971) 2 ATR 312 at 318; 71 ATC 4101 at 4106.

27 The decision of Gibbs J in *Avondale Motors* has been referred to with approval by Sheppard J in *J Hammond Investments Pty Ltd v. FC of T* (1977) 31 FLR 349 at 355; (1977) 7 ATR 633 at 638; 77 ATC 4311 at 4315; by the New South Wales Court of Appeal in *Boyded (Holdings) Pty Ltd v. FC of T* (1982) 13 ATR 127 at 131; 82 ATC 4236 at 4239; and, *semble*, by Campbell J in *Fielder Downs (WA) Pty Ltd v. FC of T* (1979) 45 FLR 242 at 248; (1979) 9 ATR 460 at 464f; 79 ATC 4019 at 4023.

taxpayer carry on the 'identical business' at all times during the period of recoupment rather than a business of the same kind or of a similar kind. Gibbs J said[28]:

> 'The meaning of the phrase "same as", like that of any other ambiguous expression, depends on the context in which it appears. In my opinion in the context of the section the words "same as" import identity and not merely similarity and this is so even though the legislature might have expressed the same meaning by a different form of words. It seems to me natural to read the section as referring to the same business, in the sense of the identical business, and this view is supported by a consideration of the purposes of the section. The relevant sections of the Act show an intention on the part of the legislature to impose, in the case of companies, a special restriction on the ordinary right of a taxpayer to treat losses incurred in previous years as a deduction from income... This restriction [that is, the continuity of majority beneficial ownership and control tests in section 165-12 and sections 165-180 to 165-205] is imposed to prevent persons from profiting by the acquisition of control of a company for the sole purpose of claiming its accrued losses as a tax deduction.
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> ...
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> No injustice would, in my opinion result from a refusal to treat an accrued loss as a tax deduction where the company after the change carried on a different business, although one of a similar kind. In such a case, as a general rule, there would have been no business reason for the purchase of the shares, but only the wish to obtain the right to claim another's losses as a deduction from one's own income.'

32. In *Avondale Motors* the taxpayer company had ceased business completely at the change-over. However, Gibbs J concluded[29] that even if the company's former business had been carried on at the change-over, the taxpayer would not have satisfied the same business test since during the period of recoupment 'it carried on the **same kind**[30] of business but under a different name, at different places, with different directors and employees, with different stock and plant and in conjunction with a motor dealer having different franchises'.

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28 (1971) 124 CLR 97 at 105; (1971) 2 ATR 312 at 317; 71 ATC 4101 at 4106.

29 See (1971) 124 CLR 97 at 104; (1971) 2 ATR 312 at 316; 71 ATC 4101 at 4105.

30 Emphasis added.

Whether the same business is carried on is a question of fact

33. In *Avondale Motors*, Gibbs J said[31]:

> 'The question whether a company has commenced a new business or has continued an old business under different conditions is simply one of fact.'

In *J Hammond Investments*, Sheppard J said[32]:

> 'The answer to the question of whether the business was the same after the entry into the partnership agreement as it was before involves a factual inquiry; *Avondale Motors*.'

Identifying the business carried on by the company at the change-over: what it is relevant to examine

34. The issue of fact to be determined in applying the same business test is to identify the business carried on by the taxpayer immediately before the change-over, and to determine whether the taxpayer carried on the same business at all times during the period of recoupment. In so identifying the business, it is relevant to examine every activity of the business, although those activities must be considered as a whole. However, it is not correct to single out certain activities as the heart or core of the business, and identify it merely by reference to those activities. As Lord Donovan observed in *J G Ingram & Son Ltd v. Callaghan*[33]:

> 'I doubt if one can as a rule segregate the various activities involved in carrying on a trade, select one of them as being of the essence, and then designate the one selected as the real trade. There is, I think, an organic unity about a trade which invalidates this sort of dissection, and I think Rowlatt J was saying much the same thing, though more incisively, when he remarked in *Graham v. Greene*[34] that a trade differs from the individual acts which go to make it up, just as a bundle differs from odd sticks.'

And as Walton J concluded in *Rolls-Royce (Motors) Ltd v. Bamford*[35]:

> '[I]t follows from this that "the essence of the trade" ... comprises every activity which goes to constitute that trade. Or, put in another way, however the trade of [the taxpayer at the change-over] is to be defined, it includes the activities, whatever they were, all ultimately directed towards making the profits, whatever their actual result, in all its ... divisions.'

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31 (1971) 124 CLR 97 at 104; (1971) 2 ATR 312 at 317; 71 ATC 4101 at 4105.
32 (1977) 31 FLR 349 at 355; (1977) 7 ATR 633 at 638; 77 ATC4311 at 4315.
33 (1968) 45 TC 151 at 165f.
34 (1925) 9 TC 309 at 312; [1925] 2 KB 37 AT 40.
35 (1976) 51 TC 319 at 346.

35. Identifying the business carried on by the taxpayer immediately before the change-over, thus, involves looking at all the things done and the activities carried on by the taxpayer in the course of that business, i.e, during the period beginning at the change-over and extending into the past to a point where it can be said the same business was not being carried on. The length of this period varies in each particular case and depends upon the nature of the business activities carried on by the taxpayer.

36. Note that the use of the word '**immediately**' in the same business test does not mean that only those things done immediately before the change-over in the course of the business are relevant to the application of the same business test. The word 'immediately' in the same business test refers to the overall business being carried on at change-over, rather than to the particular activities taking place at that time as part of it. That is to say, the word requires reference to be made to the **business** carried on immediately before the change-over, but it does not require everything which that business comprises to be carried on immediately before the change-over. For not every activity that is properly to be identified as part of the overall business is necessarily taking place at the change-over: some kinds of activity may be intermittent or in temporary suspension.

37. Although all activities that may properly be identified as part of the business, because they form part of the operations by which it is carried on, are relevant when the business at change-over is compared with the business carried on during the period of recoupment, activities carried on some time before the change-over that are different in kind from those carried on immediately before the change-over, and which cannot meaningfully be associated with them, are likely to represent a different business. In particular, activities that have been **permanently** discontinued before the change-over are unlikely to be relevant to the identification of the business carried on **immediately** before that change-over. Moreover, a business is identified and characterised by its ordinary course. Transactions not in the ordinary course of business that occur before the change-over may be of significance in relation to the new transactions test but rarely assist in identifying the business carried on before the change-over.

Changes of activities

38. To satisfy the same business test, a taxpayer must be able to show that it carried on the same business, in the sense of the identical business, at all times during the period of recoupment, as the business it carried on at the change-over. However, this does not mean that the business carried on by the taxpayer during the period of recoupment must be identical in every respect with the business that was carried

on immediately before the change-over. A business may be the same, even though there have been some changes in the **way** in which it is carried on, provided the identity of the business is not changed. In *Laycock v. Freeman, Hardy & Willis*[36], in relation to similar provisions in the United Kingdom, the English Court of Appeal said:

> 'That does not, of course, mean that the business, regarded after the succession [i.e., the change-over] must be in every respect and in every detail identical with the business which was carried on before the succession. The successor may succeed to a business with, let me say, 50 shops. He may choose to shut up some of those shops. He may make alterations in the goods that he sells. All sorts of alterations of that kind may take place. He may change his supplier. He may cut out a particular class of customer or a particular area. All questions of that kind appear to me to be really matters of fact for the determination of the [tribunal of fact] who, when matters of that kind arise, have to set themselves the question whether or not it is true and fair to say that the business in respect of which the successor is said to be making profits is the business to which he succeeded [i.e., the same business[37]]. Changes of that kind may or may not be so substantial as to make it right to say, as a matter of fact ... that the business is not the same as the one to which he succeeded. The differences may be so substantial as to justify a finding to that effect.'

39. Mere expansion or contraction of the taxpayer's business may not result in a change in the identity of the business carried on by the taxpayer. In *Avondale Motors*, Gibbs J said[38]:

> 'In some circumstances a company may expand or contract its activities, it may close an old shop and open a new one, without starting a new business, but the only conclusion that can be drawn from all the circumstances of the present case is that the business of the taxpayer after 15 March 1968 was different from that which it carried on before that date.
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> ...
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> It does not, of course, follow that a business will not be the same because there have been some changes in the way in which it is carried on; some cases under sec 80E may give rise to questions of degree which do not arise in the present case.'[39]

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36 (1938) 22 TC 288 at 297-298; [1939] 2 KB 1 at 8; [1938] 4 All ER 609 at 614.

37 The Commissioner's gloss.

38 (1971) 124 CLR 97 at 104; (1971) 2 ATR 312 at 317; 71 ATC 4101 at 4105.

39 (1971) 124 CLR 97 at 105; (1971) 2 ATR 312 at 318; 71 ATC 4101 at 4106.

40. However, as a practical matter, expansion or reduction of business activities, if carried to a sufficient extreme, is likely to amount to more than a mere change in the scale of the business carried on by the taxpayer and so may result in a change in the identity of the business. In particular, a sudden and dramatic expansion or contraction brought about by the acquisition or loss of activities on a considerable scale could mean the same business is no longer being carried on. As Walton J observed in *Rolls-Royce Motors Ltd v. Bamford*[40]:

> 'There is all the difference in the world between an organic growth of trade and a sudden and dramatic change brought about by either the acquisition or loss of activities on a considerable scale.'

Moreover, the evolution of a business is not necessarily the same as mere expansion and may also lead to change such that the business can no longer be described as the same business as that carried on immediately before the change-over, as was recognised in *Fielder Downs (WA) Pty Ltd v. FC of T*[41].

41. In *Fielder Downs*, Campbell J held that the taxpayer did not satisfy the same business test. Before the change-over, the taxpayer was in the business of growing clover and cereals on land situated in southern Western Australia for sale as seed and grain, whereas during the period of recoupment, the taxpayer carried on the different business of cattle grazing on the same land. Campbell J said[42]:

> 'In my opinion, there is a distinction between the kind or character of a rural business of which the proprietor is described as a pastoralist or a grazier, on the one hand, and one where he is categorised as a producer of, say, fruits, vegetables, fodder or seed, on the other.
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> …
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> Although dictionary definitions may be of assistance in some cases, it seems to me that the determination of the issue whether the business carried on by the company in each of the three relevant years was the same business, or one of a similar kind, as was carried on by it before March 1969 depends upon an investigation of fact so as to characterise the kind of [sic] nature of the business which was undertaken during each respective period. Before the change the company was engaged in growing clover and cereals for the sale of seed and grain, it was not then growing its clover pasture for the

40 (1976) 51 TC 319 at 344.

41 (1979) 45 FLR 242; (1979) 9 ATR 460; 79 ATC 4019.

42 (1979) 45 FLR 242 at 247; (1979) 9 ATR 460 at 465f.; 79 ATC 4019 at 4024.

> breeding or fattening of stock for sale. In view of the plain words of para. (b) of sec. 80E(1), "The same business as it **carried on** immediately before the change", the fact that, had it continued with the development over a period of time of its pastoral business at Bedford Harbour it would inevitably have gone into the grazing business, the raising or the keeping on the property of large numbers of stock for money-making purposes, does not seem to me to be decisive of the issue. **If a business evolves it does not necessarily follow that the essential character of the business is not changed**[43]. It would not be difficult to give illustrations in support of this proposition. Moreover, although many business pursuits or occupations may be correctly included in a broad description such as "agricultural", "retailing", etc., they may be substantially different in kind from others which are in the one general category.
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> ...
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> In my opinion the company did not carry on any grazing or livestock business during the years prior to the change; such livestock as were then on the property were there merely to assist the clover seed production.'

42. The decision in *Case Y45*; *AAT Case 7,272*[44] indicates that the discontinuance, whether by way of cessation or sale, of a significant part of the business carried on by the taxpayer is likely to result in the taxpayer not being able to satisfy the same business test of the 80E test, the 50D test, the 63C test or the 80F test. In that case, Dr Grbich of the Administrative Appeals Tribunal determined that the taxpayer did not satisfy the same business test during the period of recoupment since the taxpayer ceased to carry on part of its business that comprised an agency for selling an agricultural machine, notwithstanding that the taxpayer continued its agricultural consulting business at all times[45]. Dr Grbich said[46]:

> 'But Gibbs J does caution that it does not "follow that a business will not be the same" merely because "there have been some changes in the way ... it is carried on". This raises "questions of degree". Differences in the nature of the business can eventually pass the point where a qualitative

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43 Emphasis added.

44 (1991) 22 ATR 3395; 91 ATC 426.

45 Contrast *Highland Railway Company v. Special Commissioners of Income Tax* (1885) 2 TC 151. The discontinued activity accounted for only a small part of the business and was replaced by a subcontracting arrangement. It was held the same business was carried on.

46 (1991) 22 ATR 3395 at 3399; 91 ATC 426 at 430.

change in the nature of the business takes place. The issue is when that point is reached in a particular case.

The inquiry is basically a factual inquiry but such facts should be analysed in the framework of a principled set of guidelines and previous decisions have gone some way to structure the Tribunal's leeways of choice in the way it characterises particular changes. The following changes have been held sufficient for it to be held the business was not the same as that in the benchmark period:

- Company sells wholesale and retail motor parts and accessories. It disposes of its stock. Eight to nine months later it commences a similar activity with different types of trading stock (*Avondale Motors (Parts) Pty Ltd v. FC of T*[47]; High Court);

- Company was a brewer. It ceased brewing but bottled and sold beer brewed by another company (*Gordon & Blair Ltd v. CIR*[48]; Scottish Court of Sessions);

- Company manufactured, sold and installed swimming pools. After the change it merely sold and installed another company's pools (*Case K20*[49]; *22 CTBR (NS) Case 40*; No 2 Board of Review);

- Company was a business offering its land for stock agistment for a fee. After the change it entered into a partnership which conducted a full business of producing wool, lamb and beef (*Case K36*[50]; *22 CTBR (NS) Case 56*; No 1 Board of Review);

- Company was in the business of growing clover and cereals to sell seed and grain. After the change it fattened stock with its seed and grain and became a pastoralist (*Fielder Downs (WA) Pty Ltd v. FC of T*[51]; Queensland Supreme Court);

- Before the change the company carried on the business of buying partly finished houseboats, completing construction and selling them. After the change it bought other types of boats, did not carry out construction and sold them (*Case M19*[52]; *23 CTBR (NS) Case 91*; No 2 Board of Review);

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47 (1971) 124 CLR 97; (1971) 2 ATR 312; 71 ATC 4101.

48 (1962) 40 TC 358.

49 78 ATC 184.

50 78 ATC 341.

51 (1979) 45 FLR 242; (1979) 9 ATR 460, 79 ATC 4019.

52 80 ATC 105.

> - Rolls Royce Motors Ltd produced motor cars and aero engines. The aero engine division was the largest of six divisions. It caused large losses and put the company into financial difficulties. Four divisions of the company (including the ill-fated aero engine division) were hived off to a government owned company by special legislation. The company carried on with the two remaining divisions (*Rolls Royce Motors Ltd v. Bamford*[53]; English High Court);
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> ...
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> The problem [of identifying the business at the change-over] is not to be resolved by empty verbal debates about denotation and connotation of particular labels for the business. Whether the business is to be characterised as an "agricultural investment and management consultant" or as a "general rural entrepreneur" cannot resolve the issue. Such denotation is the end point rather than the foundation on which reasoned decision-making should be constructed ...
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> [Dr Grbich concluded the taxpayer did not satisfy the same business test] ... having regard to the types of changes considered sufficient in the authorities and to the fact that the profits of the ... agency were such an important part of the taxpayer company's income-generating activities in its early years, even allowing for the fact that most of the taxpayer's resources were deployed to building up its investment and management advisory services. This was more than a mere change in the process by which it ran its business.'

43. The question of whether the discontinuation of an activity will produce a change of business is, however, ultimately one of degree[54]. Sudden and dramatic change brought about by either the loss or acquisition of activities on a considerable scale is to be contrasted with an organic growth of a business: per Walton J in *Rolls-Royce (Motors) Ltd v. Bamford*[55]. As his Lordship there observed[56]:

> 'Doubtless the trade of the company would remain the same trade even though, as a result of organic growth in response to every factor which might influence it, the company adopted new compatible operations and discarded portions of its old.'

44. These principles are equally applicable to the acquisition or merger of businesses. Thus, a company may generally expand and develop its business by a process of organic growth. However, if a

53 (1976) 51 TC 319.

54 (1976) 51 TC 319 at 344.

55 (1976) 51 TC 319 at 344.

56 (1976) 51 TC 319 at 346.

company acquires and merges with its original business another undertaking or enterprise, even if the amalgamated businesses are of a similar kind, the company fails the same business test when, considered as a whole, the business of the company in the year of recoupment cannot fairly be regarded as the same, albeit expanded, business carried on at the change-over. This could occur, for example, if a company whose original business had greatly contracted, commenced, or acquired as a going concern, another distinct undertaking of the same kind that preponderated in the overall business of the taxpayer. Thus, in *Seaman v. Tucketts Ltd*[57] a manufacturing confectionery company whose business had greatly run down but perhaps not entirely ceased[58], and which had formerly bought sugar and cellophane on its own account for use in its manufacturing business, began to purchase those items for resale to its new parent, another manufacturer of confectionery. It was held the company had commenced a new trade and that it was open to find it had discontinued its former trade: on such facts, in Australia, the same business test would clearly be failed[59].

45. Similarly, the acquisition of an undertaking that alters the nature of the overall business causes a company to fail the same business test. In *George Humphries & Co v. Cook*[60], two complementary businesses were merged, namely, a clerical business of obtaining and subcontracting orders from film companies for photographic development and a business of developing film. It was held the result was a new business, as the merged business was of a different nature. In the words of Singleton J[61]:

> 'It seems to me that prior to the date of the partnership [i.e., the change-over] the business ... was purely a business of a clerical nature, the getting of orders and the arranging for somebody else by contract to execute those orders. From the time the partnership began the business was of an entirely different nature. It was making things and doing work; it involved the employment of a considerable quantity of machinery brought in by Mr Terraneau, and the business, by whatever name you call it, was of a different nature altogether.'

46. Yet another illustration of the circumstances in which a change of activities may lead to a change of business is afforded by *Yarmouth*

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57 (1963) 41 TC 422.

58 It no longer engaged in manufacture; but it continued after a period of inactivity to buy and sell sweets in a small way, and some efforts were made to keep its goodwill alive.

59 See also paragraphs 75 and 76 *infra* in relation to the new business test.

60 (1934) 19 TC 121.

61 (1934) 19 TC 121 at 130.

Industrial Leasing Ltd v. The Queen[62]. Here, a company that had leased a building and equipment to its parent for use in the manufacturing of textiles, began to engage in equipment leases to a variety of customers throughout Canada; the equipment leased consisted of heavy equipment and office equipment. Walsh J concluded that[63]:

> '[T]he leasing of a building and equipment to a single lessee, irrespective of whether that lessee is the parent company or not, is a business of a different nature from purchasing office equipment and heavy equipment and leasing same to a series of lessees throughout Canada.'

Business must continue from the change-over until the end of the period of recoupment

47. The existence of a period of 'dormancy' often raises an issue as to whether the business is truly still in existence, though greatly reduced in scale, or has actually ceased altogether. If, before the end of the period of recoupment, the taxpayer **completely** ceases to carry on the business it carried on immediately before the change-over, it necessarily fails the same business test. Any other business it thereafter carries on must be a new business that it has commenced after the cessation of the old business and, therefore, a different business from the business carried on before the change-over.

48. In *Avondale Motors*, Gibbs J held the taxpayer company did not satisfy the same business test on the basis that prior to the change-over, the business activities of the company, which comprised dealing in motor vehicle spare parts and accessories, had ceased completely. Gibbs J said[64]:

> 'It is further submitted on behalf of the taxpayer that, quite apart from the rather artificial rule to which I have just referred, it should be held that it was still carrying on business after 29 February 1968 notwithstanding its inactivity after that date. It is said that those controlling the taxpayer had no intention of putting it into liquidation and that on the contrary it was obviously their intention that it should again engage in business of a similar kind, after its shares had been sold to a purchaser who wished to benefit by its accrued losses. To say this, however, clearly does not mean that the taxpayer was still carrying on business. There are cases in which it has been held that a company does not cease to carry on business

62 [1985] 2 CTC 67.

63 [1985] 2 CTC 67 at 71.

64 (1971) 124 CLR 98 at 103; (1971) 2 ATR 312 at 315f; 71 ATC 4101 at 4105.

> notwithstanding that its activities are reduced to a minimum or indeed are almost entirely suspended. In *South Behar Railway Company Limited v. IRC*[65] Lord Sumner said: "Business is not confined to being busy; in many businesses long intervals of inactivity occur." In some cases the very nature of the business is such that its conduct may require little activity, e.g. the business ... of acquiring a concession and turning it to financial benefit.
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> ...
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> In other cases it has been held that a company continues to carry on business notwithstanding a suspension of activity due to causes beyond its control, e.g. where a steamship company had lost its only ship and was in the course of building another ... In the present case the taxpayer's activity had ceased completely. The cessation of activity was not due to the nature of the business which the taxpayer carried on, or to some temporary adversity which the taxpayer intended to endeavour to overcome; it was due to a decision to discontinue the business previously carried on because it had been unprofitable and there was no intention to resume the conduct of that business. The plain fact of the matter is that the taxpayer was not carrying on any business immediately before 15 March 1968. It follows that [the same business test is] not satisfied.'

49. In *Northern Engineering Pty Ltd v. FC of T*[66], the Full Federal Court upheld the decision of Jenkinson J in the Supreme Court of Victoria that the taxpayer company ceased to carry on its business of trading in vehicles and equipment during the period of recoupment when the taxpayer disposed of all its trading stock and assets, with the exception of a debt owing by its holding company.

50. Brennan J, as he then was, in the full Federal Court in *Northern Engineering* said[67]:

> 'The question is whether after the last payment of the price of trading stock was received the appellant continued to carry on until 30 June 1967 a business which it had carried on at the time specified in [subsection 165-13(3) and subsection 165-210(1)]. In my judgment the question must be answered in the negative for the reason that no business was carried on after the appellant's trading credits were paid and its trading liabilities discharged. When a company's business is closing down there comes a time when the activity of a trading or

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65 [1925] AC 476 at 488.

66 (1980) 42 FLR 301; 29 ALR 563; (1979) 10 ATR 584; 80 ATC 4025.

67 (1980) 42 FLR 301 at 304; 29 ALR 563 at 565; (1979) 10 ATR 584 at 586; 80 ATC 4025 at 4027.

> profit-making nature comes to an end. The business of the company is not carried on merely by managing or disposing of the company's assets otherwise than in a business.
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> ...
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> The depositing or leaving of the appellant's funds with the holding company appears merely to have been a mode of keeping, not of employing, its assets. Merely to preserve assets is not, at least in the circumstances of this case, to carry on a business.
>
> There was, as it seems to me, no element of business in the circumstances of the case here appearing in the movement of funds between the [taxpayer] and the other companies in the group.'

51. In *Northern Engineering*, Deane J also held[68] the rule of bankruptcy law in *Theopile v. The Solicitor-General*[69] was not authority for the proposition that a taxpayer is carrying on business for the purposes of section 80E of the ITAA 1936 whilesoever any debt owing to him remains uncollected or unpaid[70].

52. Another Australian example of a business that had ceased may be found in *Case U105*; *AAT Case 74*[71]. *Garage Henri Brassard Ltée v. Minister of National Revenue*[72] furnishes an example from Canada in connection with provisions similar to sections 165-13 and 165-210, while *Tryka Ltd v. Newall*[73] furnishes another from England.

53. To be contrasted with these cases is the case of a company whose business, while not discontinued, is undergoing a period of inactivity, e.g., the case of the taxpayers in *The Merchison Steamship Co Ltd v. Turner*[74]; *Kirk and Randall Ltd v. Dunn*[75]; and *FC of T v. Broken Hill South Limited*[76]: although the last must be regarded as a borderline example. The circumstances accounting for the inactivity[77], whether the company is actively holding itself out for

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68 (1980) 42 FLR 301 at 306-307; 29 ALR 563 at 567; (1979) 10 ATR 584 at 587; 80 ATC 4025 at 4028.

69 [1950] AC 186.

70 See also *Tryka Ltd v. Newall* (1963) 41 TC 146 at 158.

71 (1987) 18 ATR 3537; 87 ATC 637.

72 [1960] CTC 321 at 327f.

73 (1963) 41 TC 146. See also *Goff v. Osborne & Co (Sheffield) Ltd* (1953) 34 TC 441.

74 (1910) 5 TC 520.

75 (1924) 8 TC 663.

76 (1941) 65 CLR 150.

77 See *Avondale Motors* (1971) 124 CLR 97 at 103; (1971) 2 ATR 312 at 316; 71 ATC 4101 at 415.

business though obtaining none[78], and whether there is the expectation of a resumption of active operations within a reasonable time[79], are matters to be examined in determining whether the business is still being carried on.

54. In determining whether a business carried on during the period of recoupment is a new business commenced after the cessation of the business carried on immediately before the change-over, or the same business (having undergone a period of reduced activity) as the business then carried on, it is also relevant to examine the circumstances in which activity resumed, changes in those activities when resumed[80], their location, and whether there is continuity of name, custom and goodwill. Thus, in *Kirk and Randall Ltd v. Dunn*, Rowlatt J noted that the 'galvanising' of a dormant company by new shareholders might happen 'in such a striking way as clearly to indicate that there was a new business altogether'[81]; while *The Merchison Steamship Company* case may usefully be contrasted with *Watson Bros v. Lothian*[82].

55. *Watson Bros v. Lothian*, though decided in a statutory context of succession to business differing somewhat from that of sections 165-13 and 165-210[83], illustrates the importance of the continuity of custom and goodwill in deciding whether the same business or a new business is being carried on after a change-over. In that case, a ship was used to conduct a 'tramp steamer' business; the ship was sold, and the question was whether the purchasers had succeeded to the trade of the former owners, i.e., whether they were carrying on the same business as the former owners. The taxpayers lost: it was observed that there were 'no introductions of customers' after the change-over:

> 'If the books had been transferred, if a list of customers had been transferred, if there had been any introductions or

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78 See *Kirk and Randall Ltd v. Dunn* (1924) 8 TC 663 at 669f.

79 See *FC of T v. Broken Hill South Ltd* (1941) 65 CLR 150 at 159 per McTiernan J.

80 See paragraphs 41 to 46 *supra*.

81 (1924) 8 TC 663 at 670. Cf *Rolls-Royce (Motors) Ltd v. Bamford* (1976) 51 TC 319 on 'sudden and dramatic change'.

82 (1902) 4 TC 441.

83 In both sections 165-13 and 165-210 and the English provision, the question posed by the statute is whether the same business is being carried on after a change-over; but, in the English context, the question is asked in relation to another taxpayer that has acquired the business from the original taxpayer: if it has, and if certain other tests are met, the losses of the original company are deductible in the hands of the second taxpayer.

> recommendations given, a very different state of facts would have occurred.'[84]

It followed that the business had not been transferred and the purchasers had commenced a new business. See also *Tryka Ltd v. Newall*[85] and *Wadsworth Morton Ltd v. Jenkinson*[86].

56. For the sake of completeness, it should be noted in *AGC (Advances) Ltd v. FC of T*[87] the High Court by majority (Barwick CJ and Mason J, Gibbs J dissenting) found that, notwithstanding a change of name and address and a break in the business operations, there was 'no change in the nature of the business at all'. However, this case concerned the 'continuing business' judicial test relating to section 51 of the ITAA 1936 and not the same business test in sections 165-13 and 165-210, and is not, it is believed, relevant to the same business test.

The business carried on by a company is not identified by reference to the business carried on by related companies

57. In *Case K20*[88]; *22 CTBR (NS) Case 40*, the Board of Review said[89]:

> 'It should also be mentioned that we can take no account of the fact, if it be a fact, that the overall business had remained the same in so far as it was being carried on within a "group" of companies.'

The Board of Review in *Case N109*[90]; *25 CTBR (NS) Case 63* expressed a similar view and followed the general principle that each company is a separate entity for taxation purposes (see also Phillimore J in *Kodak Ltd v. Clark*[91] and Kitto J in *Hobart Bridge Co Ltd (in liq) v. FC of T*[92]). Accordingly, the business of a company is identified, for the purpose of applying the same business test, by reference to the business activities carried on by that company and not by reference to the business activities carried on by a commonly owned or controlled group of companies to which that company belongs.

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84 (1902) 4 TC 441 at 444.
85 (1963) 41 TC 146 at 156.
86 (1966) 43 TC 479 at 487.
87 (1975) 132 CLR 175; (1975) 5 ATR 243; 75 ATC 4057.
88 78 ATC 184.
89 78 ATC 184 at 187.
90 81 ATC 620.
91 [1902] 2 KB 450 at 459.
92 (1951) 82 CLR 372; 9 ATD 273; 5 AITR 184.

58. However, where a company transacts much or all of its business with other members of the same group of companies, a change in the businesses or identities of those companies may be reflected by a change in the business of the taxpayer. For example, there might be a complete change in the goodwill of the taxpayer and it might, therefore, be concluded the taxpayer is carrying on a different business. Thus, in *Yarmouth Leasing Ltd v. The Queen*[93], the cessation of dealings with its former parent resulted in a change of business, while in *Avondale Motors*[94], where the custom of the taxpayer in its spare parts business derived from its connection with an associated retailer of motor vehicles, a change in parent also resulted in a change of business.

Summary of how to determine whether the same business test is satisfied

59. There are various relevant factors to take into account in determining whether the same business test is satisfied by a taxpayer. A single factor or matter might be so important that it determines the issue but, usually, it is a combination of factors, appropriately weighted, that decides whether the same business is carried on during the period of recoupment. A factor that in isolation has little weight, may in combination with other factors have great weight and, conversely, something that is significant when it appears with other changes, may have no importance when it appears alone. Nor is it only changes that must be weighed: answering the question of whether the business carried on in the year of recoupment is the same business carried on at change-over requires one to have due regard to what remains the same. In determining whether the same business test is satisfied, significant weight is given to changes after the change-over in the income producing product or service of the taxpayer, how it is produced, acquired or provided and/or changes in the market for that product or service. But even these are a question of fact and degree often to be decided in the context where some expansion or contraction would be expected.

60. Subject to the foregoing observations, the reported decisions on the application of the **80E test** may be said to provide the following guidelines in determining whether a taxpayer has satisfied the same business test:

(a) Identifying the business carried on by the taxpayer at the change-over involves identifying with specificity the actual business activities carried on and transactions entered into by the taxpayer at the change-over. The

93 [1987] 2 CTC 67.

94 (1971) 124 CLR 97; 45 ALJR 280; (1971) 2 ATR 312; 71 ATC 4101.

business of the taxpayer is not identified by reference to the kind of industry to which the taxpayer belongs, or by reference to certain activities only, on the grounds they constitute the heart or core of the business- all activities are relevant (see *Fielder Downs*[95]; *Case Y45*; *AAT Case 7,272*[96]; *Rolls-Royce (Motors) Ltd v. Bamford*[97]).

(b) The business carried on by the taxpayer is not characterised by reference to business activities or transactions that the taxpayer intended to carry on or enter into before the change-over, or that the taxpayer had power or expressed the intent to carry on or enter into under its constituent documents before the change-over, if the evidence discloses the taxpayer did no, in fact, carry on those activities or enter into those transactions at or before the change-over (see *Fielder Downs*[98]).

(c) There is a distinction between a change of business and a 'mere change in the process by which [the business] is carried on' (see *Avondale Motors*[99] and *Case Y45*; *AAT Case ,272*[100]). The second kind of change does not, of itself, result in a taxpayer not satisfying the same business test. However, when a change in the taxpayer's business operations or processes affects the identification of the taxpayer's business by going beyond a mere change in the way in which the business is carried on, it is likely to result in a change in the business itself, e.g., *Gordon & Blair Ltd v. IRC*[101].

(d) An expansion or contraction of the taxpayer's business activities may not, in itself, result in a change in the identity of the business carried on by the taxpayer: Gibbs J in *Avondale Motors*[102]. However, the expansion or contraction of activities may result in a change in the identity or character of the business, taking into account the nature and extent of the expansion or contraction. In particular, the organic

95 (1979) 45 FLR 242; (1979) 9 ATR 460; 79 ATC 4019.
96 (1991) 22 ATR 3395; 91 ATC 326.
97 (1976) 51 TC 319 at 346.
98 (1979) 45 FLR 242; (1979) 9 ATR 460; 79 ATC 4019.
99 (1971) 124 CLR 97; 45 ALJR 280; (1971) 2 ATR 312; 71 ATC 4101.
100 (1991) 22 ATR 3395; 91 ATC 426.
101 (1962) 40 TC 358.
102 (1971) 124 CLR 97; 45 ALJR 280; (1971) 2 ATR 312; 71 ATC 4101.

growth of a business through the adoption of new compatible operations in the ordinary way and, similarly, the discarding of old operations in that way, may not cause a taxpayer to fail the same business test, but a sudden and dramatic change brought about by the loss or acquisition of business operations on a considerable scale is likely to do so: Walton J in *Rolls-Royce (Motors) Ltd v. Bamford*[103].

(e) Hence, the discontinuance during the period of recoupment, whether by way of cessation or sale, of a significant part of the business that was carried on by the taxpayer at the change-over, is likely to result in the company failing to satisfy the same business test (see the decisions in *Case K20*[104]; *22 CTBR (NS) Case 40*; *Case N109*[105]; *25 CTBR (NS) Case 63*; *Case U105*; *AAT Case 74*[106]; and *Case Y45*; *AAT Case 7,272*[107]).

(f) The commencement or acquisition, by merger or otherwise, of new undertakings (including going concerns and similar or complementary undertakings) may cause a company to fail the same business test, e.g., if the result is to alter the character of the overall business: *George Humphries & Co v. Cook*[108]; *Seaman v. Tucketts Ltd*[109].

(g) Other factors relevant to the issue of whether the same business is being carried on after the change-over include the name of the taxpayer, the location of the business, the existence of a period or periods of dormancy, and the circumstances accounting for the inactivity and in which activity is resumed: *Avondale Motors*[110]; *Yarmouth Industrial Leasing v. The Queen*[111]. And, also, the extent to which there is continuity of, or change in, custom and goodwill:

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103 (1968) 51 TC 319 at 346.
104 78 ATC 184.
105 81 ATC 620.
106 (1987) 18 ATR 3537; 87 ATC 637.
107 (1991) 22 ATR 3395; 91 ATC 426.
108 (1934) 19 TC 121.
109 (1963) 41 TC 422.
110 (1971) 124 CLR 97; 45 ALJR 280; (1971) 2 ATR 312; 71 ATC 4101.
111 [1987] 2 CTC 67.

Tryka Ltd v. Newall[112]; *Wadsworth Morton Ltd v. Jenkinson*[113].

(h) Where the taxpayer's activities have wound down to the extent that justifies a finding of fact that the taxpayer had ceased to carry on a business, either at the change-over or before or during the period of recoupment, the taxpayer does not satisfy the same business test (see *Northern Engineering*[114]).

(i) The business carried on by one company in a commonly owned or controlled corporate group is not characterised by reference to the business of the group as a whole (see *Case K20*[115]; *22 CTBR(NS) Case 40*). But changes in the businesses or identities of other companies in the group may result in a change of business: *Avondale Motors*[116]; *Yarmouth Leasing Ltd v. The Queen*[117].

Illustration of what factors are to be considered and how they are to be weighed in applying the same business test

61. By way of illustration of the way in which the same business test applies, consider the case of a hypothetical manufacturer of widgets where there has been a change of ownership following a loss year. Each of the following matters would be **relevant** to consider although not necessarily **significant** in itself:

(a) Changes in the widget manufactured by the taxpayer. A change in the product manufactured may vary from merely updating the model of the widget offered on one hand, say, the latest compact disc player in a company whose business it is to manufacture only CD players, to, on the other hand, a wholesale transformation of the business, as would be so in the extreme case of a manufacturer of compact disc players who changed the product to television sets[118].

(b) Whether the taxpayer commences any other activities in addition to manufacturing the widget (for example, the manufacture of a product that is different from the

112 (1963) 41 TC 146.
113 (1966) 43 TC 479.
114 (1980) 42 FLR 301; 29 ALR 563; (1979) 10 ATR 584; 80 ATC 4025.
115 78 ATC 184.
116 (1971) 124 CLR 97; 45 ALJR 280; (1971) 2 ATR 312; 71 ATC 4101.
117 [1987] 2 CTC 67.
118 Cf *J G Ingram & Son Ltd v. Callaghan* (1968) 45 TC 151.

widget). Here, the relative significance of what remained the same and what was novel would be particularly important.

(c) Changes in the manufacturing activities of the taxpayer (for example, reduced manufacturing activities arising from the purchase of some parts that were previously manufactured, or the cessation of all manufacturing activities by converting to a purchasing and assembling operation). The outsourcing of some components in a manufacturing business might well be a natural step in turning a loss company's business into a profitable one which, in its context, has no particular significance for the same business test; on the other hand, the conversion of what had hitherto been a manufacturing business into one of assembling parts manufactured by others is not unlikely to result in the company failing the test, even though it, too, is a means of making the operation a profitable one[119].

(d) Changes in the persons to whom the taxpayer sells the widget (for example, different industrialists or wholesalers). The market for a company's products or services is an important indicator of whether the business is the same, and should be examined carefully. Consequently, it is relevant to look at the persons to whom the product is sold or the service is provided. In the case of a company with just one customer, or a very few customers, a change in the identity of that customer or those customers is often a matter of significance[120]. Similarly, where the custom of a company is derived from a connection with another, perhaps associated, company, a sudden change in that custom following the severing of the connection often points to a change of business[121]. On the other hand, the identity of the business of a manufacturer who sells to a multiplicity of customers in the same market, assuming the absence of any sudden or dramatic change, is unlikely to change merely on this account. Business considerations for the change in market would also be relevant.

(e) Changes in the mix of customers of the taxpayer (for example, selling only to wholesalers). Again, this may mean no more than a refocusing of attention on the

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119 Cf *Gordon & Blair Ltd v. IRC* (1962) 40 TC 358.

120 See *Yarmouth Industrial Leasing Ltd v. The Queen* [1985] 2 CTC 67.

121 As was found to be the case in *Avondale Motors* (1971) 124 CLR 97; 45 ALJR 280; (1971) 2 ATR 312; 71 ATC 4101.

most profitable segment of the taxpayer's market within what is obviously the same business. But, at the other extreme, the transformation of a retailer with an insignificant wholesale market into a wholesaler with an insignificant retail market, would have obvious significance for the same business test[122].

(f) Changes in the turnover or gross assets of the taxpayer attributable to sale of the widgets directly to companies for industrial use or attributable to the sale of the widgets to wholesalers[123]. As in the case of paragraph (e) above, changes of this character may reflect no more than the consequences of better management of what is obviously the same business: but, if one were to assume that industrial widgets are quite different from domestic widgets, it could equally be the case that this is one of a number of matters leading to the conclusion that better management has resulted in the taxpayer carrying on a different business.

(g) Changes in the method of selling the widgets (for example, a change from outright sale to sale on consignment, sale on terms, sale by floor plan, or sale by hire purchase or leasing). In some businesses, the mode of sale is significant and a change in it may result in (or be the result of) a different class of customer forming the taxpayer's market. Often, however, it has little importance. If, however, a taxpayer was in the business of selling a product and then changed its operations so that it thereafter only leased it, there is likely to be a change of business.

(h) Changes in the taxpayer's capital and working capital (for example, the manner and source of finance). This a good example of a factor that is unlikely, of itself, to lead to a different business being carried on (except, perhaps, on some occasions in relation to a finance company), but which is not uncommonly the **result** of a different business being carried on. The nature of some changes in working capital may assist one to conclude other factors have caused a change of business; conversely, the absence of any important changes might help deprive other matters of their apparent significance.

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122 See, for example, *Laycock v. Freeman, Hardy and Willis Ltd* (1938) 22 TC 288; [1939] 2 KB 1; [1938] 4 All ER 609.

123 Note paragraphs (d) and (f) of Revenue Canada Ruling IT 376 approved in *Yarmouth Industrial Leasing Ltd v. The Queen* [1987] 2 CTC 67 at 71.

(i) Changes in the goodwill of the taxpayer. Goodwill is an important indicator. Even businesses selling virtually identical products to an identical market may be sharply differentiated by goodwill and, conversely, undertakings that might otherwise be thought of as distinct businesses, may form part of the one business because they share the same goodwill. Where goodwill remains the same, other changes, even if fairly substantial, are likely to amount to no more than a variation in the way in which the same business is being carried on, whereas a complete change of goodwill is very likely to support a conclusion that the same business is no longer being carried on, even if the means by which the business is carried on have hardly altered[124].

(j) Changes in the location or locations where the taxpayer carries on business and/or changes in the location of the taxpayer's customers. Location is one of the more important matters affecting goodwill and the market of the taxpayer. Note, however, that often one has to be careful to distinguish the expansion (or contraction) of an existing business, which results in a change in locale, from the commencement of a new business (or the cessation of an old business) which has the same result.

(k) Changes in the trade names, trade marks, patents, royalty arrangements or other intellectual property rights of the taxpayer. A business of manufacturing may acquire new patents as a result of research that merely leads to innovation within the same business, as would be the case of a manufacturer of compact disc players that patented a new digital to analogue converter. Or the patent may be in respect of an innovation so profound that it transforms the business of the manufacturer. A change of trade name is commonly associated with a change in goodwill and may well point to a change in business, particularly if the trade name was associated with the new owners before they acquired the taxpayer. In other cases, it may only be a marketing ploy. A wholesale change of intellectual property rights would normally be associated with a change in business, whereas minor changes are almost always found in manufacturers with research and development programmes.

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124 See paragraphs 54 and 55 *supra*.

(l) Reductions or increases in the number of persons employed by the taxpayer or who are contracted by the taxpayer to perform services for the taxpayer, and changes in the nature of services performed by persons who are employed or contracted by the taxpayer. Once again, rationalisations of staff are to be expected with the conversion of a loss making company into a profitable operation, even where the same business is being carried on, but there are many changes of staff that point to a change of business. For example, the sacking of all staff usually means a business has ceased and, if new staff are recruited from the new owner, that may mean the taxpayer is acquiring its new owner's business. A huge increase in staff devoted to what previously was a minor activity may be the result of a change in business. Contracting out of staff, as in the case of outsourcing, may range from mere efficiency gains in the same business to a change in the kind of business being carried on.

(m) Changes in the directors and/or management of the taxpayer. This was a factor considered in *Avondale Motors*. Generally speaking, however, it has little significance as it is usually follows a change in ownership, regardless of what business is carried on, but its absence could point to a favourable answer to the question posed by the same business test.

It is to be emphasised that the above is not a checklist and not exhaustive.

62. To recapitulate, determining whether the taxpayer has carried on the same business at all times during the year of recoupment as the business the taxpayer carried on immediately before the change-over, means drawing an inference of fact after considering and weighing all the factors going to the matters listed above and any other relevant matters, and then attaching the appropriate weight to each factor, having regard to all the circumstances. The application of the same business test to each case requires close analysis of the facts of each case. As Lord Kinross said in *Watson Bros v. Lothian*[125], there must be:

> 'regard to the previous history of that trade, manufacture, adventure or concern, all upon the view that what was bought was a continuing thing, a continuing adventure, with all its prospects, with all its trade connections, and with all those things which result in the making of a profit.'

125 (1902) 4 TC 441 at 444.

The second limb of the 80E test, the 50D test, the 63C test and the 80F test

63. The second limb of the 80E test, the 50D test, the 63C test and the 80F test, respectively, comprises:

- section 165-13 and subsection 165-210(2);
- paragraph 165-35(b) and subsections 165-210(2) and (4);
- section 165-126 and subsection 165-210(2); and
- section 165-132 and subsection 165-210(2).

The second limb of the 80E test (or the equivalent provision in the 50D test, the 63C test and the 80F test) comprises two separate and cumulative negative tests, being the **new business test** and the **new transactions test**, which must both be met by a taxpayer in addition to satisfying the same business test in order to fulfil the requirements of section 165-13 and section 165-210 (or the 50D test, the 63C test or the 80F test).

64. The new business test requires that the taxpayer company did not, at any time during the period of recoupment, derive income from (or, in the case of the 50D test, incur expenditure in carrying on) a business of a kind it did not carry on before the change-over.

65. The new transactions test requires that the taxpayer company did not, at any time during the period of recoupment, derive income from (or, in the case of the 50D test, incur expenditure as a result of) a transaction of a kind it had not entered into in the course of its business operations before the change-over.

66. Whether the new business test or the new transactions test is satisfied by a company in a particular case is a question of fact. The legislative intention underlying these provisions is to prevent the injection of income into the loss company while permitting, within limits consistent with the prevention of tax avoidance, the development and expansion of the overall business carried on immediately before the change-over. Such an injection of income might occur by means of activities that form part of the business and would not cause the business to cease to be the same; this might occur, for example, through a new undertaking or enterprise that had not been carried on before the change-over, or through entering into a transaction, in the course of the business operations of the business, which was not one that would have been expected to be entered into in the natural flow of the taxpayer's business prior to the change.

67. The new business test and the new transactions test do not depend for their operation on the existence of a purpose of tax

avoidance and may, therefore, operate in some cases to prevent a company obtaining a deduction for a prior year loss where there is no purpose of tax avoidance. However, the new business test and the new transactions test allow a business to expand and develop, provided the activities by which it produces its income remain of the same kind. The limits to expansion and development provided by these tests express the balance decided by Parliament between the prevention of tax avoidance and the facilitation of takeovers and mergers carried out for sound commercial reasons and that are unassociated with tax avoidance.

New business test

68. In the new business test the word 'business' has a different meaning from the word 'business' in the same business test: It is a reference to each of the different kinds or types of activities (if there be more than one kind or type of activity) comprised in the one business that is referred to in the same business test and is carried on by the taxpayer at the change-over. Thus, each particular undertaking or enterprise carried on or out by the taxpayer, as part of its overall business in the period of recoupment, is tested by the new business test.

69. The question of whether an undertaking of a new kind has been commenced is a question of fact. If activities different in kind from those carried on before the change-over are carried on after the change-over with some degree of system, repetition and continuity and are distinguishable from the other activities of the taxpayer, it is likely a new undertaking different in kind from the old undertakings of the taxpayer has been commenced.

70. The new business test is intended to limit the expansion available under the same business test. That is, the taxpayer cannot add to its operations a business, that is, an undertaking or enterprise, of a kind it had not carried on before the change-over. This test ensures that, even if a company satisfies the same business test in respect of the whole of the business activities carried on by the company during the period of recoupment, the company is not able to obtain the benefit of sections 165-13 and 165-210 (or the 50D test, the 63C test or the 80F test) if the company derives income from carrying on, during the period of recoupment, activities of a different kind from the activities comprised by the one business carried on at the change-over.

71. Hence, where a taxpayer acquires or commences a new undertaking and amalgamates it in its overall business, the question posed by the legislation, in the Commissioner's view, is whether the amalgamated business is the same business as the business carried on by the taxpayer immediately before the change-over and, second,

whether the new undertaking was of the same kind as the undertakings of that business. The first question involves considerations including, for example, the relative proportions of the undertakings, which, in some cases, could permit a company to pass the same business test notwithstanding that it had commenced an undertaking of a novel kind or character. In relation to the second question, the new business test looks at whether the same business, though expanded in scale and operations, includes business activities of a kind it did not carry on before the change. If it did, then the new business test would disqualify the company from claiming a deduction for losses incurred before the change-over. (Conversely, it might be noted, some amalgamated businesses might fail the same business test even where the new undertaking is not of a different kind and would pass the new business test.)

72. Generally speaking, the new business test permits a company to expand or develop during the period of recoupment within the same fields of endeavour as it was engaged in before the change-over, provided the effect of expansion or development is not such as to cause it to fail the same business test. Cases where such failure occurs tend to be where the injection of income is occurring or could occur and, thus, not appropriate cases for the protection of sections 165-13 and 165-210 or equivalent provisions.

73. However, this is not always the case. For example, in takeover situations, it may be that acquisition of the additional operations does not result in a change in the same business. However, some of the new business operations might constitute an undertaking or enterprise of a kind that had not been carried on by the taxpayer prior to the change-over. In these circumstances, to maintain the benefit of accumulated losses, it would be necessary to avoid the acquisition of business operations that are of a kind not carried on by the taxpayer before the change-over.

74. As stated above, whether a new business, in the sense of a particular undertaking or enterprise, is of a different kind from the old undertakings or enterprises of a company, is a question of fact. In characterising an undertaking or enterprise, regard must be had to the undertaking or enterprise as a whole. A new undertaking or enterprise may be of a different kind from an old one, even though some or all of the transactions that it comprises or by which it is carried on, occurred in the old undertaking or enterprise[126] because, in a different context, those transactions, considered with the other business operations of the taxpayer, may be such as to lend a different character to the undertaking or enterprise considered as whole.

126 See **Example 8**.

75. The facts of *Seaman v. Tucketts Ltd*[127] may be used to illustrate one case in which a taxpayer would, in the Commissioner's view, fail the new business test. A loss company that manufactured and sold confectionery was acquired by another company in a similar line of business. After the change-over the taxpayer began to purchase cellophane and sugar to sell to the new owner; it had previously purchased these items for its own use. It also purchased and sold, although it no longer manufactured, sweets; these were mostly sold to the new owner. The name 'Tucketts' had goodwill value, which was kept alive by small scale trading. It was held to be open, on these facts, to conclude the original undertaking had not been discontinued[128].

76. Supposing the taxpayer passed the same business test[129], the taxpayer would, nevertheless, fail the new business test, as the new business of purchasing and selling sugar and cellophane would be of a different kind from the taxpayer's original business. As Pennycuick J observed[130]:

> 'It seems to me that these activities, even when glorified by the title of sugar merchants have no single significant feature in common with its previous trade of manufacturing confectioners ... [Even though the company still purchased and sold sweets] I do not think these matters are sufficient to support the conclusion that Tucketts' activities by way of the purchase and sale of sugar represent an extension or development of its former trade of manufacturers of confectionery.'

77. Similarly, in *Tryka Ltd v. Newall*[131], a manufacturer of horticultural boxes, wooden crates and utility mark furniture, was held to have commenced a business of a different kind when it commenced to trade as timber merchants and purchased plant to plasticise a chipboard that it had not previously dealt in. Wilberforce J, as he then was, said[132]:

> 'What is said, it should be noted, is two things: first of all, it manufactured no goods ... and secondly, that it acted as timber merchants in the sale of timber. Now that seems to me to be a statement that it embarked on an activity of a different character from that which it had previously carried on ... I think I should reach the conclusion that the [tribunal of fact]

127 (1963) 41 TC 422.

128 (1963) 41 TC 422 at 439.

129 Which, on the actual facts of this case, it would not; see paragraph 44 *supra*.

130 (1963) 41 TC 422 at 439.

131 (1963) 41 TC 146.

132 (1963) 41 TC 146 at 157-158.

> did draw the inference that the 1954 activity was of a different type and was a different kind of trade from that which it had previously carried on.'

Thus, the taxpayer would, in Australia, fail the new business test on those facts even if it passed the same business test.

New transactions test

78. The new transactions test was considered at length by Sheppard J in *J Hammond Investments*. Sheppard J said[133]:

> 'Upon reflection I think it is correct, as both counsel concluded, that the word 'transaction' means 'dealing'.
>
> One could imagine a situation where a company was taken over for the purpose of its tax losses in order to gain the benefit thereof, not for the purpose of offsetting income derived from the business against the losses of previous years, but for the purpose of offsetting against those losses an isolated or chance profit which might have been foreseen, perhaps a profit taxable by reason of the provisions of section 26(a) of the Act or some other income resulting in a chance or isolated profit or gain to the company.
>
> The matters I have so far mentioned do not, however, in my opinion, take the matter sufficiently far to explain the presence in both provisions of the words, "in the course of its business operations". But I have come to the conclusion that there is a different type of transaction which probably does explain their presence. There are of course many receipts which are not properly described as being income from a business. There is an example of such a receipt in the present case. The partnership acquired a new building with a tenant in it, who remained in occupation for a short time after the acquisition. The sum of $160 was received by way of rental. It does not seem to me that that was income derived from the business being carried on by the partnership but it was certainly income derived from a transaction entered into in the course of the partnership's business operations. Many other transactions of this general type can be imagined.
>
> Whilst, therefore, I do not regard the matter as free from difficulty, I have reached the conclusion that the second limb of the paragraph is not intended to refer to the daily transactions involved in carrying on a business but to transactions of an isolated and independent kind, which

133 (1977) 31 FLR 349 at 357-359; (1977) 7 ATR 633 at 639-640; 77 ATC 4311 at 4317-4318.

> transactions have nevertheless arisen in the course of the taxpayer's business operations.'

79. In *Fielder Downs*, Campbell J indicated a company fails the new transactions test if the company derives income during the period of recoupment from a transaction that was of a different kind from the transactions the company had entered into in the course of the business carried on by the company at the change-over, even if the first mentioned transaction is a transaction ordinarily involved in carrying on the business of the taxpayer during the period of recoupment. In *Fielder Downs*, Campbell J said[134]:

> 'If the business carried on beforehand should properly be held to be a business of the development of pastoral land for the eventual grazing of stock and one which was at all material times the one and the same business continuing from its commencement until the lands were fully developed and stocked [that is, if the same business test was satisfied[135]], it seems to me that the transaction of selling cattle (or wool or sheep) [that is, a day to day transaction or a transaction that was entered into in the ordinary course of the taxpayer's business[136] after the change-over] was a transaction of a kind that the company had not entered into in the course of its business operations of developing the property prior to the sale. There is a difference in kind between a dealing or transaction concerned with the selling of seed or cereals for income and a dealing involved with obtaining income from the sale of stock.
>
> In *J Hammond Investments Pty Ltd v. FC of T* (supra) Sheppard J at 4318 expressed the view that the [new transactions test] "is not intended to refer to the daily transactions involved in carrying on a business but to transactions of an isolated and independent kind, which transactions have nevertheless arisen in the course of the taxpayer's business operations".
>
> I think that the [new transactions test] contemplates that the transaction not previously carried on was one which could have been carried on in the course of the company's business operations prior to the change-over. Sales of stock had not been carried on prior to that time, and indeed prior to that time the company had no stock available which it could have sold. So, it seems to me, that the sale of stock was a transaction of a

134 (1979) 45 FLR 242 at 251-252; (1979) 9 ATR 460 at 467; 79 ATC 4019 at 4025.

135 The Commissioner's gloss.

136 The Commissioner's gloss.

different character from any which had been previously entered into by the company.'

80. Thus, Campbell J treated the reference to 'transaction of a kind' in the new transactions test as being a reference to all transactions entered into in the course of the taxpayer's business operations, regardless of whether they were transactions entered into as part of the daily or regular conduct of the business carried on by the taxpayer or were transactions that were 'independent' or 'isolated' transactions, when judged by reference to the business carried on by the taxpayer. But, importantly, it would seem he did not regard transactions as being caught by the test if they were transactions that could have been carried on in the course of the company's operations prior to the change-over.

81. Interpretation of the new transactions test is not without its difficulties. However, a purposive approach would regard it as applying to all transactions entered into the course of the company's business operations and not merely those that are 'isolated' or 'independent'. But transactions that could have been entered into in the course of business operations before the change-over consistently with its ordinary course, are usually transactions of the same kind as those that actually had been entered into.

'Transaction', 'entered into' and 'business operations' have a broad meaning

82. In the new transactions test 'transaction' has a broad meaning. The meaning of the word 'transaction' depends upon its context. It is clear that, in the context of the second limb of sections 165-13 and 165-210, 'transaction' refers to every means or event by which the taxpayer derives income, for the word appears in association with the expression 'business operations' as the last of a descending hierarchy of tests that examines, first, the overall business of the company, then its component undertakings or enterprises and, finally, the individual acts by which the business is carried on. The new transactions test is concerned to ensure that a company deducts losses from income from transactions of the same kind as the operations by which it generated income before the change-over.

83. But the test is not concerned to distinguish income-producing activities of a bilateral kind from those of a unilateral kind. As Lord Reid noted in a case on English anti-avoidance provisions, *Greenberg v. IRC*[137]:

137 [1972] AC 109 at 136f; [1971] 3 All ER 136 at 149; (1972) 47 TC 240 at 271.

> 'The word "transaction" is normally used to denote some bilateral activity but it can be used to denote an activity in which only one person is engaged. It would not be wrong to say of a person doing office work that he is transacting business.'

The payment of a dividend was held to be a transaction in that case. 'Transaction' has also been said in another context to be "a comprehensive word which includes any dealings with property": *Barron v. Littman*[138] per Lord Normand. To allow the injection of income into a loss company from unilateral dealings would defeat the purpose of the test, and the existence or otherwise of another party in relation to a dealing is not germane to the real issue, which is the way in which the taxpayer conducts business so as to produce income. Accordingly, the new transactions test is not confined to bilateral dealings. Appointment of the taxpayer as an object of a discretionary trust and appointment of income to the taxpayer pursuant to a discretionary trust are transactions for the purposes of subsections 165-210(2) and (4). *Barron v. Littman* also shows that a transaction may consist of a number of acts and even omissions, as the transaction in that case was the acquisition of property and a subsequent failure to let it.

84. The expression 'entered into' also has a broad meaning; it has, for example, the meanings 'to begin, to join, to engage, to become a participator, to be concerned or involved in, to be interested in'[139]. Its function is to indicate the connection between the kind or class of transaction and the course of business operations before the change-over, and not the mode by which the taxpayer becomes concerned in the transaction after the change-over: the connection between the taxpayer and the transaction after the change-over is supplied by the taxpayer deriving income from it.

85. The words 'business operations' refer to everything that a company undertakes or performs or does in the course of the business, which is the same business, i.e., the overall business of the company.

Whether a business or a transaction is 'of a kind' entered into in the course of business operations before the change-over

86. The content of the word 'kind' in the new transactions test (and the new business test), when applied in a particular case, is to be derived from the course of the taxpayer's business operations before the change-over. A transaction that is entered into during the period of recoupment, which could have been entered into in the course of

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138 [1953] AC 96 at 113; [1952] All ER 548 at 555; (1952) 33 TC 373 at 405.

139 Gibbs J used the word 'engaged' as a synonym for it: *Avondale Motors* (1971) 124 CLR 97 at 105; (1971) 2 ATR 312 at 318; 71 ATC 4101 at 4106.

business operations before the change-over, and which is neither extraordinary nor unnatural in the context of the business carried on by the company at the change-over, is generally a transaction of the same kind as transactions actually entered into by the company before the change-over. Conversely, a transaction that is entered into during the period of recoupment, and which is outside the course of the business operations carried on before the change-over, or which is extraordinary or unnatural when judged by the course of the business operations before the change-over, or which otherwise could not have been entered into in the course of the taxpayer's business operations before the change-over, is a transaction of a different kind from the transactions actually entered into by the taxpayer before the change-over.

87. For example, technical innovations occurring during the period of recoupment, which lead to transactions that could naturally have been entered into in the course of the business operations of the taxpayer carried on before the change-over, had the innovation been available, and which do not have the effect of changing the ordinary course or character of the company's operations[140], generally produce income from transactions of the same kind as the transactions actually engaged in before the change-over. On the other hand, transactions of the type discussed in *Myer Emporium v. FC of T*[141], when undertaken for the first time after the change-over, or an extraordinary dealing with an associate that is not for an arm's length price[142], are generally different in kind from those previously engaged in. However, the application of this test, like the others in sections 165-13 and 165-210, is very much a matter of fact.

The meaning of 'before the test time' in subsections 165-210(2) and (4)

88. Applying the new business test and the new transactions test thus involves identifying the nature of the business before the change-over and the kinds of business operations, undertakings and transactions entered into during its course. In so doing, it is relevant to examine the period from immediately before the change-over to the point in the past where the business can no longer be described as the

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140 For an illustration of the circumstances in which technical innovation will result in a failure of the same business test because the adoption of the innovation actually involves the permanent discontinuance of the previous business, see *J G Ingram & Son Ltd v. Callaghan* (1968) 45 TC 151.

141 (1987) 163 CLR 199 at 208ff; (1987) 18 ATR 693 at 696ff; 87 ATC 4363 at 4366ff.

142 Note the observation of Wilberforce J in *Tryka Ltd v. Newall* (1963) 41 TC 146 at 156 that such a transaction may not be 'strictly a commercial transaction at all'.

business carried on immediately before the change-over. It is to be observed that the word 'immediately' is absent from the new business test and the new transactions test because not all undertakings or transactions carried on or out by the taxpayer in the course of the overall business are necessarily actively carried on or out immediately before change-over; some may be intermittent or dormant. Nevertheless, while the transactions and undertakings need not themselves be carried on or out immediately before the change-over, only those transactions and undertakings that form part of the business being carried on immediately before the change-over are relevant to the new business test and new transactions test, and permanently discontinued undertakings and transactions do not qualify. The purpose of the second limb is only to examine the businesses (in the sense of undertakings) and transactions that make up the overall business of the taxpayer, in order to ensure they are the same in kind before and after the change-over. Transactions and businesses that were not relevantly part of the overall business of the company carried on by it immediately before the change-over, have no role to play in this examination.

De minimus *exception to the new business test and the new transactions test*

89. There is a well established principle by which the law disregards certain things as '*de minimis*'. In *Wilkes v. Goodwin*[143], Bankes LJ stated the legal maxim *de minimus non curat lex* applies where something is 'so trifling in value, or in amount, as to be negligible'[144]. In the same case, Scrutton LJ said the maxim involves 'excluding things so insignificant as to be negligible'[145].

90. Derivation of an amount of income that is so trifling in amount as to be negligible as, for example, the amount of $160 in rent that Sheppard J disregarded in *J Hammond Investments*[146], does not cause a taxpayer to fail the new business test or the new transactions test. Whether an amount is so trifling or insignificant as to be negligible in a particular case, requires consideration of the amount of the losses (or other relevant deduction) involved in that case, and the absolute size of the amount in question.

143 [1923] 2 KB 86; [1923] All ER 61.

144 [1923] 2 KB 86 at 94; [1923] All ER 61 at 64.

145 [1923] 2 KB 86 at 97; [1923] All ER 61 at 66.

146 (1977) 31 FLR 349; (1977) 7 ATR 633; 77 ATC 4311.

The anti-avoidance test

91. Subsection 165-210(3) is a provision designed to prevent a taxpayer company satisfying the 80E test, the 50D test, the 63C test, or the 80F test, respectively, where the company commenced to carry on new businesses or entered into a new kind of transaction prior to the change-over, in anticipation of obtaining a deduction for a prior year loss, a current year loss or a bad debt respectively. Those provisions are referred to as the '**anti-avoidance test**'.

92. The anti-avoidance test is failed by a taxpayer where:

(a) before the change-over, the taxpayer commenced to carry on a business it had not previously carried on, or entered into, in the course of its business operations, a transaction of a kind it had not previously entered into; and

(b) the taxpayer commenced to carry on the business or entered into the transaction for the purpose (or for purposes that included the purpose) of satisfying the requirements of the 80E test, the 50D test, the 63C test, or the 80F test (as the case may be) in relation to a prior year tax loss, a current year loss, or a bad debt deduction or swap loss respectively ('**specified purpose**').

93. There are no reported decisions that clarify the operation of the anti-avoidance test. Nevertheless, the word 'business' is clearly intended to have the same meaning it has for the purpose of applying the new business test and is a reference to each of the kinds or types of activities (if there be more than one kind or type of activity) carried on by the company as part of the one business carried on at the change-over. If there are no activities other than the business commenced to take advantage of the losses, that business would, of course, be the 'same business' for the purposes of the same business test.

94. Similarly, the reference in the anti-avoidance test to a taxpayer entering into 'in course of its business operations ... a transaction of a kind' has the same meaning as the corresponding provision in the new transactions test.

95. Where the taxpayer commenced to carry on the same business or entered into a transaction in the course of its business operations before the change-over for a variety of purposes, the anti-avoidance test nevertheless operates to prevent a taxpayer from satisfying the 80E test, the 50D test, the 63C test or the 80F test, as the case may be, where one of the purposes was the specified purpose.

Examples

Important note: the **Examples** are only intended to illustrate various points in the Ruling; they do not have the level of detail necessary to apply sections 165-13 and 165-210, or the related provisions, in an actual case.

Example 1

96. StoreCard Ltd is a member of the Store group of companies. The Store group operates a chain of departmental stores across Australia, selling a diverse range of products. The name and logo of the Store group is heavily advertised, widely recognised and has significant goodwill attached to it.

97. StoreCard Ltd provides a charge card, called 'Storecard', to approved customers of the other members of the group for purchases from them. By means of the card, customers are offered financial accommodation at interest. 'StoreCard' is advertised in Store shops and on television and radio as part of the Store group's advertising; it has the 'Store' logo on it; and it is associated with the Store group in the minds of its customers.

98. Store group suffers financial difficulties. Its members are eventually placed in liquidation and are wound up. The Store shops close, and the goodwill associated with its name and reputation is eventually lost. StoreCard Ltd, however, is made the subject of a scheme of arrangement. Under the scheme, the company ceases to offer fresh credit or to issue new cards: all operations cease except for the collection of outstanding debts, and all staff, except collection staff, are laid off; the company's creditors are assigned, upon collection, all debts collected, but bad debts remain beneficially the property of the company.

99. When all good debts have been collected, the remaining staff are sacked and the shares in the company are sold to Bank Ltd. The parties are not unmindful of the tax advantage connected with the bad debts of the company, which have yet to be written off. StoreCard Ltd is renamed Bank (Vista) Ltd, and it acquires the staff and business of Bank connected with Bank's Vista card. The company now issues Vista cards to customers of Bank and, by means of the card, provides financial accommodation at interest to the customers of Bank. 'Bank Vista' is advertised by Bank as part of Bank's advertising, and has Bank's logo on it. The taxpayer now writes off its bad debts.

100. For the purposes of section 63C of the ITAA 1936, immediately before the sale of the shares in StoreCard Ltd to Bank, the taxpayer was not carrying on any business: *Northern Engineering*; *Avondale*. The taxpayer had ceased trading operations and was no longer deriving assessable income. The mere collection of

outstanding debts is not, of itself, carrying on business, especially where that collection does not beneficially enure for the taxpayer. Here, the collection is for the purpose of discharging the indebtedness of the taxpayer to its creditors, as part of an arrangement entered into as a result of the taxpayer's insolvency and the failure and cessation of its business: it is not a step in the business itself. Although there is an intention to resume business, it is not an intention to resume the business formerly carried on. Here, the intention is to commence another business of a similar kind after the failure and cessation of its original business, rather than to resume the same business after a lull in activities in that business.

101. If the taxpayer could be said to be carrying on business immediately before the change-over, it was carrying on a different business in the period of recoupment. If there is a business being carried on immediately before the change-over, it is the Store business in its final stages; and the Vista business is not the same business, although it is a similar business. The two businesses have different goodwill, customers, products, staff, management, outlets and so on.

102. Even if the taxpayer was carrying on the same (overall) business, it fails the new business test because Vista is different in kind from a retail charge card. Although the businesses are similar in kind, they are not the same in kind. Note, however, the grounds for concluding the businesses are different in kind (different range of customers, different financial product, lack of association with a trader, etc.) also tend to lead to the view the businesses are not the same.

Example 2

103. **Scenario 1**. Bloggs (Finance) Pty Ltd was a wholly owned subsidiary of Bloggs (Holdings) Ltd. Its business was to act as financier and broker to members of the Bloggs group of companies. The other subsidiaries of Bloggs (Holdings) Ltd manufactured and sold grommets. Owing to adverse currency and interest rate movements, the company incurred huge losses. As the debts of the company were guaranteed by Bloggs (Holdings) Ltd and its subsidiaries, the group collapsed and its members, except the taxpayer, were liquidated. During the liquidation period, the taxpayer ceased to raise funds and either repaid or transferred its liabilities. By the end of the liquidation period, the company transacted no business and had neither assets nor liabilities. Immediately prior to the liquidation of Bloggs (Holdings) Ltd, the taxpayer was sold to Nerk (Holdings) Ltd. Nerk (Holdings) Ltd owns subsidiaries that manufacture and sell ferrules. After the change-over the taxpayer changed its name to Nerk (Finance) Ltd. Its business was to act as financier and broker to members of the Nerk group of companies.

104. Nerk (Finance) Pty Ltd fails the same business test. The taxpayer was not carrying on business immediately before the change-over. If it was carrying on business, that business was to provide financial services to the Bloggs group in connection with the manufacture and sale of grommets whereas, after the change-over, its business was to provide financial services to the Nerk group in connection with the manufacture and sale of ferrules.

105. **Scenario 2**. The facts are as above except that, instead of liquidating the other companies, the entire Bloggs group is sold to Nerk (Holdings). The group commences to manufacture ferrules, having acquired the businesses of Nerk group. The taxpayer resumes the provision of financial services to the same companies to which it formerly furnished such services. Ferrule manufacturing, however, has different capital needs from grommet manufacturing, and the sales of the products are for dollars rather than yen, as had hitherto been the case. Cash flows are different, and the conditions and methods of raising and managing funds have changed. Its risk management operations also differ. It has different management and staff and is located in new premises. It changes its name to Nerk (Finance) Ltd.

106. If the taxpayer was carrying on business at the change-over, its business thereafter is, nevertheless, not the same business it carried on immediately before the change-over.

Example 3

107. A company (Restaurant Pty Ltd) owned and operated a restaurant located in a Sydney suburb, which served a distinctive style of Northern Japanese cuisine. The restaurant attracted heavy trade from Japanese businessmen and was notably expensive. The name of the restaurant reflected the style of the cuisine and the name was a registered tradename of Restaurant Pty Ltd. The style of operation was suitable for franchise. The restaurant made losses and the company changed hands.

108. During the year of recoupment, the taxpayer continues to own and operate the Japanese restaurant ('Original Japanese Restaurant'). During that year the taxpayer also purchases an Italian restaurant, situated some distance away, from an unrelated party. The restaurant attracts a random cross selection of locals; it is notably cheap.

109. In **Scenario 1**, Restaurant Pty Ltd never operates the Italian restaurant and converts the premises where the Italian restaurant is located into a restaurant serving Japanese food ('Second Japanese Restaurant'). During the year of recoupment, the taxpayer commences to operate the Second Japanese Restaurant. The Second Japanese Restaurant uses the same registered tradename as the

Original Japanese Restaurant, with similarities in service, menu and decor.

110. The taxpayer passes the same business test and, if the Second Japanese Restaurant constitutes a distinct undertaking, the new business test; the new transaction test does not arise for consideration.

111. In **Scenario 2**, the taxpayer commences to operate the Italian restaurant during the period of recoupment.

112. The taxpayer is likely to fail either the same business test or the new business test. The answer to the question of whether the same (overall) business is being carried on after the change-over as was carried on immediately before it, depends, in practical result, on the extent to which the business of the second restaurant resembles the business of the first restaurant. Opening an Italian restaurant would not ordinarily be regarded as an expansion of a Japanese restaurant business. Assuming the second restaurant is, say, an equal part of the business, it would be difficult to describe the business in the year of recoupment as the same but expanded business carried on before the change-over[147].

113. In regard to the new business test, the answer to the question of whether a new business of a different kind has been commenced depends on the 'kind' of business operated before the change-over. The content of the word 'kind' derives from the nature of the business being carried on before the change-over. While the 'kind' of business carried on by a company, with several restaurants of differing cuisines catering to various segments of the market, might be that of operating restaurants, in this case, where only one type of restaurant was operated before the change-over, it is that of operating Japanese restaurants. Hence, the taxpayer commenced to carry on a business of a different kind in the year of recoupment.

Example 4

114. Mad Cow Ltd operates a chain of hamburger stores. The stores have distinctive layouts, the product is distinctively branded, the staff have distinctive uniforms, and the chain is heavily advertised. Scrapie Ltd operates a rival chain of hamburger stores selling essentially the same product with minor differences. Its layout, product brand and uniforms are distinctive, and it is heavily advertised. Following a health scare and resulting heavy losses, Mad Cow is obliged to close all but a few of its stores: it is sold to Scrapie. After the change-over, Scrapie transfers its business to Mad Cow, while continuing to operate the remaining Mad Cow outlets. Except

147 See the discussion at 345f in *Rolls-Royce v. Bamford* (1976) 51 TC 319, and in *George Humphries v. Cook* (1934) 19 TC 121.

at the most senior levels the two businesses are run separately, and continue to be readily distinguishable. The original business of Mad Cow is now only a minor component of the overall business of Mad Cow.

115. While the business transferred from Scrapie would pass the new business test, the overall business of the taxpayer is not the same business carried on by the taxpayer immediately before the change-over and so the taxpayer fails the same business test.

Example 5

116. **Scenario 1**. The taxpayer, Dale-Avon Motors, is a retail seller of Holden and Mitsubishi motor vehicles, in Sydney. The vehicles are purchased through an associated wholesaler company from General Motors Holden and Mitsubishi, pursuant to Dealer Sales and Service Agreements. They are sold from one site in respect of which the taxpayer has a dealer licence under the *Motor Dealers Act 1974*. Dale-Avon has an excellent reputation, and advertises widely.

117. Owing to a recession, Dale-Avon incurs losses and changes hands. The company renegotiates and continues the Dealer and Service Agreements. The new owner does not acquire the original wholesaler, but uses an associated wholesaler company, which does not engage in any other business than to sell to Dale-Avon. Under its new owner, Dale-Avon, capitalising on its reputation, opens another outlet on the Prince's Highway in Sydney, under the same name, and continues to advertise widely. It obtains another dealer's licence in respect of that site, but sells the same cars under the same agreements. Site goodwill is comparatively trivial; both sites share in the same reputation goodwill, and many customers are attracted to the second site by reason of Dale-Avon's reputation.

118. The same business test is passed because the original (overall) business has merely expanded, and the new business and new transactions test re also passed as no new business or transaction of a different kind has been commenced or entered into.

119. Dale-Avon continues in the organic growth of its business to acquire outlets under the same name, using the same goodwill in Sydney and selling the same cars, until it has ten sites. Over time there is gradual change in the brands sold, and new Dealer and Service Agreements are negotiated with other manufacturers, but at all times only ordinary passenger vehicles are sold.

120. The same business is still passed because the same business has merely continued to expand.

121. **Scenario 2**. Dale-Avon, which had previously sold most of its trade-ins to used car dealers (although occasionally selling a trade-in

to retail customers itself), now opens a used car outlet. It begins to purchase used cars from other retail dealers and from the public. It sells them under the name 'Dale-Avon' and, to some extent, its existing reputation is exploited by the taxpayer. However, it begins to advertise the used car business separately and it acquires separate goodwill. Its market and suppliers are different from the market and suppliers for new cars. It then commences to sell Mack trucks at a separate site and, in respect of this undertaking, its existing goodwill has no value. Used cars and the trucks each initially constitute about 10% of the business. Later, however, they grow greatly in size and Dale-Avon begins to reduce its involvement in the new car business, so that used cars and trucks constitute about 50% and 30% of the business, respectively.

122. This scenario raises questions of degree. Initially, the taxpayer is likely to pass the same business test, but fail the new business test. As the trucks and used cars come to predominate in its overall business, it will also fail the same business test.

123. **Scenario 3**. The facts are as for Scenario 1 but, in this scenario, Dale-Avon has a poor reputation before the change-over. Immediately after the change-over, the new owner, Genauto, transfers to it an existing business of ten sites in Sydney, all selling passenger cars under the name 'Genauto'. Existing Dealer Sales and Service Agreements with manufacturers and existing dealer licences are transferred from Genauto, and the cars are purchased from an existing wholesaler associated with Genauto from whom Genauto had previously bought its vehicles. Dale-Avon is permitted to exploit Genauto's goodwill by using 'Genauto' as its trade name. Dale-Avon's existing site continues to sell cars under that name and through its existing licence and Dealer Sales and Service agreement. However, the transferred sites account for 80% of the business in the year of recoupment.

124. Dale-Avon fails the same business test: see *Rolls-Royce v. Bamford*[148].

Example 6

125. Iron Mine NL operates an open cut iron mine on a mining lease. Gold is discovered on another part of the lease. After frenzied speculation and turnover in its shares, the taxpayer, which has large section 79E losses, fails the continuity of ownership test in section 165-12. After the change-over, the taxpayer commences to mine and sell gold. The taxpayer fails the new business and new transactions

148 (1976) 51 TC 319.

tests. It may also fail the same business test, depending on the effect on the overall business.

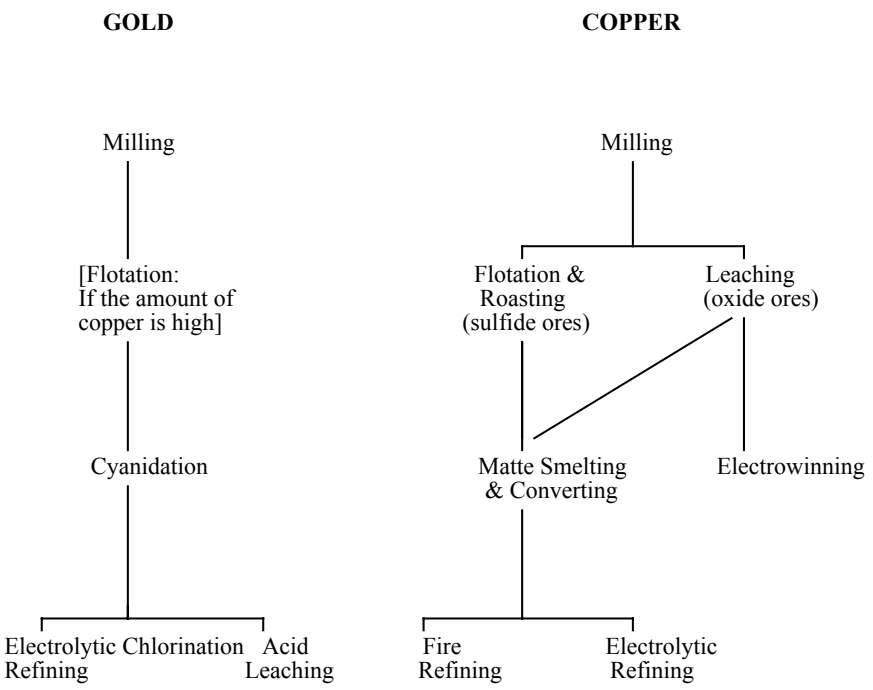
Example 7

126. A resident company ('Mammon') carries on a gold mining operation in New South Wales, from which copper can also be produced. However, no copper is being produced because copper prices have been severely depressed since the opening of the mine and, although the ore is of a high-grade as a percentage of copper to ore, the copper is not worth extracting at current market prices. It is generally expected that copper prices will recover, although when that will occur is a matter for speculation.

127. Mammon's business has involved mining ore, extracting gold from ore, and selling extracted gold to customers worldwide.

128. As the purpose of this Example is to illustrate the practical significance of close examination of a taxpayer's operations in applying the same business, new business and new transactions tests, the processes of the gold/copper mining industry are detailed. Information regarding markets or means of selling gold/copper is not provided.

129. The following chart outlines the different processes for extraction of gold and copper. The two processes are entirely different except for the first step. Each step requires distinct plant and is impossible without it. Such plant often requires significant expenditure to install and operate it.



130. The association of gold and copper in a common ore body is not uncommon. Copper may be economically mined from ores containing 0.4% to 0.8% copper. When found in association with gold, copper may be wasted, i.e., dissolved in the process of extraction (as in this Example), although this rare[149]; or it may be recovered, provided processes for doing this are installed. Developing a gold/copper deposit as a mine usually depends upon whether the primary metal, gold, is worthwhile mining, although the mining of a gold rich cap may be a prelude to the further development of the mine primarily to produce copper. If the relevant processes for recovering copper have not been installed, copper cannot be produced from a gold/copper deposit.

131. In this Example, ore is mined from solid rock. Ores mined from solid rock must usually be finely ground and subjected to chemical treatment to extract the gold. After milling, initial separation takes place using vibrating tables or jigs. Then follows cyanidation. Cyanidation dissolves the gold, leaving the undesirable ingredients of the ore unaffected The gold solution is then treated to prepare it for smelting. Upon smelting, impurities (e.g., copper, iron and zinc) combine with flux and are eliminated as slab (solid waste). Thus, copper is not and cannot be recovered, for it is eliminated as waste. The operation is sometimes repeated to flux off more base metal. The amount of copper removed by this process is minimal. Most of it would already have been dissolved through cyanidation.

132. The gold may then be further refined by electrolytic refining and chlorination. Mammon uses those processes to obtain gold as pure as possible before sale. Following cyanidation, smelting takes place and the resulting gold and silver alloy is refined by electrolytic refining, which produces gold of differing degrees of purity for sale for different uses.

133. Mammon incurs large losses and changes hands.

134. **Scenario 1**. In the loss year, the copper in the ore is dissolved by cyanidation and wasted; it is not separated and concentrated. The taxpayer does not possess plant to separate copper concentrate from gold, since copper recovery has not been economically worthwhile. The business is one that produces, and can only produce, gold for sale. After the change-over, the price of copper rises sharply and the new management decides to recover, concentrate and sell copper ore. To do this, it acquires a flotation plant and appropriately trained staff at a

149 Given the economic production of pure copper metal suitable for fabrication and use is possible from ores with ores containing as little as 0.4% copper, it is unlikely that copper as a by-product would be wasted in most cases. Hence a flotation circuit would usually be undertaken in gold mining where copper is present, and most gold mines with recoverable grades of copper ore sell copper concentrate as well as gold.

cost of around $30-35M (using funds from its parent) and commences concentrating and selling copper concentrate.

135. Flotation takes place between milling and cyanidation to extract copper that would otherwise be wasted in the cyanidation process; and involves treating the ground ore in water to produce a heavy froth that is scraped off and dried. The resulting product is a concentrate rich in copper. Gold remains in the solution and is transferred to cyanide processing and treated as outlined above, while the copper concentrate is transferred for the processes preparatory to sale.

136. In the recoupment year, the company acquires the plant and appropriately trained staff at a cost of around $30M and commences concentrating and selling copper concentrate. Mammon sells copper concentrate in accordance with usual practice in the industry.

137. If the taxpayer passes the same business test because its overall business is not altered so as not to be the same business (perhaps because of the comparative insignificance of the copper concentration undertaking), it fails the new business and new transactions tests. Before the installation of the flotation circuit, the taxpayer was not in the copper concentrate business. When the taxpayer installed the selective flotation process and began to produce and sell copper concentrate, it commenced to carry on a new business (in the sense of a distinct undertaking) different in kind from the business it previously carried on, which was the business of extracting and selling gold. Nor, in the absence of appropriate plant and staff to extract copper concentrate, could it have sold copper concentrate in the course of its business operations before the change-over. The sale of copper concentrate is, therefore, different in kind from transactions actually entered into in the course of business operations prior to the change-over, which were exclusively transactions concerned with extraction and sale of gold. This is so, notwithstanding it is common in the industry for gold mining companies to concentrate copper and sell it.

138. **Scenario 2**. Mammon has plant to recover copper, viz, the flotation tank, in the loss year, and has been extracting copper concentrate in expectation of selling it when prices recover; but it has sold none and the concentrate has been stockpiled, pending a recovery in world prices. The copper concentrate is trading stock of the taxpayer and the taxpayer's assessable income for the loss year includes the cost price of the closing stock of concentrate. There exist no formal agreements, arrangements or negotiations in relation to future sales of copper concentrate.

139. The taxpayer commences to sell copper concentrate in the recoupment year because of a significant increase in the world price for copper. The business of the taxpayer in this Example is the same in the recoupment year as it was immediately before the takeover: it

is the same business of mining and treating the gold/copper ore and selling the product of the treatment process. For the purposes of the new business test, no new business was commenced after the change-over because the business of mining, concentrating and selling copper minerals commenced with the mining and concentration of those minerals. For the purposes of the new transactions test, income was not derived from a transaction of a kind not previously entered into in the course of the taxpayer's business operations because the sale of copper ore is a transaction of the same kind as those entered into in the course of the company's business operations, the extraction and concentration of copper minerals. As copper concentrate was produced in a saleable state before the change-over, sale of copper concentrate could have occurred naturally in the course of the company's business operations before the change-over, and is not extraordinary judged by reference to those operations: it is, in fact, the intended outcome.

140. However, if the taxpayer went further, and began to refine the copper concentrate into pure copper, it would need to install further processes for roasting, smelting and refining, with attendant plant and substantial capital costs. This would be a business different in kind from a business of extracting copper concentrate, with transactions different in kind from those entered into before the change-over.

141. Examination of the different markets for gold, copper concentrate and refined copper, and the different processes for transporting, marketing and selling those products, indicates the commencement of copper concentration or copper refining, as in this Example, involves the taxpayer in carrying on new businesses or engaging in new transactions different in kind from the business or transactions in which it was engaged before the change-over.

Example 8

142. **Scenario 1**. Portfolio Ltd owns shares that it holds for their yield, not as trading stock (profits on the disposal of shares are assessable income in accordance with the principles in *London Australia Investment Co Ltd v. FC of T*[150]). Occasionally, during bull runs on the stock market, it has bought mining shares for speculative profit-making by sale. Such transactions have been few, irregular, and separated by long periods. In October 1987, the last occasion on which it did this, the taxpayer made significant losses on revenue account. In 1994, it is sold to new owners who continue the previous business of holding shares for their yield. There is no important change in the portfolio after the change-over. The taxpayer now buys shares in Lasseter's Mine Ltd, as a speculation, without any intention

150 (1977) 138 CLR 106; (1977) 7 ATR 757; 77 ATC 4398.

to do this with any greater repetition or regularity than had hitherto prevailed.

143. The taxpayer passes the same business test, the new business test (there being no new business) and the new transactions test: the transactions are not different in kind from those previously entered into in the course of the business operations before the change-over.

144. **Scenario 2**. Owing to the success of the speculation in Lasseter's Mine, it purchases shares in Solomon's Reef for profit making by sale and, now, intends regularly transacting similar business. Solomon's Reef shares are sold for a profit.

145. The shares in Solomon's Reef were trading stock and the taxpayer has commenced a new business of trading in shares. As the enterprise is a comparatively insignificant part of the overall business at this stage, the taxpayer passes the same (overall) business test and the new transactions test. However, it fails the new business test because a business of trading in mining shares is different in kind from its business of holding shares for their yield.

146. **Scenario 3**. Portfolio's new owner, Paris Australia, carries on a similar business of holding shares for their yield, not as trading stock. Some of those shares have appreciated enormously in value. Paris Australia would like to sell them, but this will result in Paris Australia deriving a large taxable income. It transfers them at cost, a fraction of their market value, to the taxpayer. After a time, the taxpayer realises them at their true value.

147. The taxpayer fails the new transactions test: a non arm's-length transaction at grossly artificial prices is extraordinary when judged by reference to the ordinary course of its business before the change-over, and is of a different character to the transactions in which it had previously engaged.

Example 9

148. A large retailer has bad debts not yet written off. It changes hands and, after the change-over, the taxpayer engages in a transaction under which it lends money to an associated finance company. As part of the same transaction, the taxpayer then assigns its right to receive interest on the loan from the finance company to another company for a lump sum. It has never done anything like this before.

149. The taxpayer fails the new transactions test. The transaction, being extraordinary judged by reference to the ordinary course of the taxpayer's business before the change-over, differs in kind from the transactions by which it derived income before the change-over. See

Myer Emporium v. FC of T[151] for further discussion of such a transaction.

Example 10

150. Jones is the controller of the Jones Family Trust. He and Underling, his accountant, are directors of Trustee Co Pty Ltd, the trustee. The trust is a discretionary trust and the objects of the trust are members of the Jones family. There is a power to add to trust objects. The subject of the trust is income producing property. Jones buys Loss Co Pty Ltd, a loss company, and has Underling and himself appointed as directors. Loss Co has never been the beneficiary of a trust previously. Loss Co is appointed as an object of the Jones Family Trust. Jones and Underling resolve, as directors of Trustee Co, to appoint income to Loss Co.

151. Loss Co has derived income from a transaction of a kind into which it had not entered before the change-over. It therefore fails the new transactions test.

Example 11

152. On land it owns, Pasture Ltd exclusively grows clover for sale as fodder. From time to time, it buys virgin land from the Crown, clears it and sows clover. It is usually a term of sale that the land be cleared and a crop sown within twelve months of purchase. A drought ensues and Pasture loses money; it has section 79E losses. Pasture is sold and fresh equity is subscribed so that Pasture can resume its expansion. Pasture buys more virgin land but, due to a shortage of clover seed, it sows with wheat, and a crop of wheat is harvested and sold. Thereafter, it sows only clover.

153. **Scenario 1**. Although Pasture has never sown and sold wheat before, it passes the new transaction test. The transaction in question is the sowing of a crop to comply with the terms of purchase of virgin land and the subsequent sale of the product. The transaction is one that could have been entered into in the course of business operations before the change-over and is not extraordinary, judged by reference to the ordinary course of the company's business operations.

154. **Scenario 2**. Pasture, pleased at the price for which it sold the wheat, sows another crop purely for gain. (The crop is sold ultimately for milling into flour.) Pasture now fails the test: the production of wheat for profit, otherwise than as an incident of carrying on business of growing clover, is extraordinary, judged by reference to the course of business before the change-over and, thus, not a transaction of a

151 (1987) 163 CLR 199; (1987) 18 ATR 693; 87 ATC 4363.

kind into which it had previously entered. Pasture may also have commenced a new business of a different kind from that carried on before the change-over.

155. **Scenario 3**. Pasture grazed cattle on the land on which it grew clover before the change-over, with a view to selling the cattle, but never sold any; after the change-over, it sold cattle for the first time. The sale does not fail the new business test or the new transactions test because it was carrying on business as a cattle grazier (and the cattle were trading stock of that business). The sale of cattle, a natural incident of carrying on such a business, is thus of the same kind as the transactions into which it entered in the course of carrying on that business.

Example 12

156. **Scenario 1**. Tins Ltd is a grocery retailer. It has incurred losses and changed hands. Before the change-over, Tins had offered selected customers a cheque cashing facility for a fee. It advanced customers cash from its takings and later banked the cheques at its bank. It also accepted cheques in payment of the sale price of groceries, in certain cases. After the change-over the new management installs cash registers with EFTPOS. A deal is struck with Bank Ltd by which customers of Bank and Tins may pay for groceries purchased from Tins at the point of sale by the electronic transfer of funds. Moreover, customers may withdraw cash from their accounts with Bank, and Tins will furnish the cash. Bank subsequently credits Tins for this cash, and it also pays Tins a fee, based on turnover, for providing the service to its customers. Because Tins now has less cash in its registers, the risk of robbery and embezzlement is reduced. Tins had not received income in the form of fees from EFTPOS before the change-over.

157. Tins passes the new transactions test as it is engaging in an old type of transaction by new means. The relevant transaction is the sale of groceries and the receipt from the taxpayer of the sale price; the transfer of funds from the customer's bank account, by electronic means, to pay for the groceries is part and parcel of the sale of groceries. The provision of cash to the customer is not different in kind from the previous bank cashing facility and may, moreover, be regarded as part of the sale of groceries. The EFTPOS fee income is not different in kind from the fees charged for cashing the cheques.

158. **Scenario 2**. Tins buys some its groceries from Europe. After the change-over the new management, for the first time, hedges the company's exposure to exchange rate movements on account of purchases of trading stock. It does so through a derivative based on an index of a weighted basket of European currencies matching Tins' aggregate exposure to movements in those currencies. On average,

the exchange rates fluctuate adversely to Tins, which derives a profit under the derivative approximately equivalent to the losses it incurs on its debts in respect of stock: this profit is income.

159. Tins passes the new transactions test because the transaction, judged by reference to its context in the ordinary course of the taxpayer's business, is merely a means of fixing the taxpayer's cost of stock and is of the same character as existing operations in respect of the acquisition of stock.

160. **Scenario 3**. Tins' treasury department begins to take a position on the movement of the Australian dollar in the hope of making a profit by speculation. It succeeds and, therefore, fails the new business test or the new transactions test because it has never previously carried on a business or engaged in transactions of this kind.

161. **Scenario 4**. Tins opens a branch office in Kiribati after the change-over and begins to sell groceries in Kiribati. Tins then begins to engage in profitable wholesale dealings in coconuts through its branch. Tins had not engaged in any wholesale trade whatever before the change-over, nor had it dealt in coconuts, nor had it operated in Kiribati nor elsewhere out of Australia. It has, therefore, commenced a business of a kind that it had not previously carried on. However, the income of the new business is exempt by reason of Article 7 of the Treaty with Kiribati for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion. Tins does not fail the new business test because the income it has derived is not assessable income.

Example 13

162. Fastbus Ltd, a bus company, buys Slowbus Ltd, another bus company. Fastbus owns a hotel. Slowbus has losses from operating buses. Fastbus transfers the business of Fastbus to Slowbus. Slowbus has never operated hotels before. The income it derives from carrying on the business of hotelier causes it to fail the new business test.

Example 14

163. **Scenario 1**. Site Ltd is a specific purpose vehicle incorporated in Year 1 to acquire, subdivide and sell a particular large parcel of land for residential use. The subdivision requires the laying out of culverts, roads, sewerage and so on, but it does not involve the construction of housing. The land is trading stock. Site incurs interest on borrowings to fund the acquisition during the year. Site also incurs section 79E losses in consequence of these interest charges. Interest is also incurred during the next year of income. In Year 2, Site grants an option over the land to Buyer Ltd, a land developer, for a small fee of

$20,000, but the beneficial owners contract to sell Site Ltd itself. This contract has no conditions that cannot be waived by the purchasers. (The beneficial owners of Site have elected to sell the shares in it to Buyer, rather than the land itself, as less stamp duty is payable in this way under the local law.) The contract of sale is specifically enforceable and beneficial ownership of the shares in Site thereupon changes. After the change-over, but before the end of the year of income, Site derives a very large fee by undertaking to develop another site for an associate of Buyer by constructing thereon an office building. The change-over is a disqualifying event for the purposes of the current year loss provisions.

164. Site has changed the character of its business from a land developer of broadacres to that of a land developer and construction company. As a specific purpose vehicle, its business was to subdivide and sell one particular site only, and the undertaking of construction work on another site cannot be regarded as the expansion or continuation of the business carried on immediately before the change-over. Thus, it fails the same business test in sections 165-13 and 165-210 and cannot deduct prior year losses. It fails the equivalent test in paragraph 165-35(b) and section 165-210 and cannot, moreover, deduct the notional loss of the loss period before the change-over from the notional taxable income of the subsequent continuous business period.

165. If it is carrying on the same business, it nevertheless fails the new business test because the business of constructing buildings is not of a kind which it carried on prior to the change-over: a construction business is markedly different from a business of subdividing broadacres.

166. Moreover, the receipt of the large fee for undertaking to construct a building on the associated company's land is, judged by reference to the course of Site's business before the change-over, an extraordinary transaction because it is not one that could naturally have been entered into in the course of carrying on a business of subdividing and selling, on one's own account, a particular broadacre parcel. It is, therefore, different in kind from the transactions entered into before the change-over.

167. **Scenario 2**. The facts are as above, but shortly before the sale, Site's directors resolve that the company's intention is to acquire further sites and develop them.

168. If nothing is done before change-over to carry into effect this decision, the business carried on before the change-over is as above and carrying into effect the decision thereafter causes Site to fail the same business test. Site also fails the new business test and new transactions test as above.

169. If the decision is carried into effect before the change-over, the company has commenced a new business before the change-over and, unless there was a purpose of enabling the company to take into account the carry forward losses or the current year losses, Site passes the anti-avoidance test.

170. **Scenario 3**. Site Ltd is incorporated specifically for the purpose of acquiring and developing one particular site by constructing thereon a building and selling it. The site is not trading stock. It incurs interest expenses and changes hands as above.

171. The mere development of the site after the change-over does not cause the taxpayer to fail the same business test. However, should the taxpayer purchase other sites with the same intention, a business of purchasing and developing a series of sites has come into existence. (The land would have to be brought to account as trading stock.) This is a different business from the business of a specific purpose vehicle incorporated to acquire and develop one site only, and either the same business test is failed or the new business test is failed. If, after disposing of the developed land, the taxpayer acquires another site with a view to developing it in a profit making scheme, i.e., without intending to commence a continuing business so that the land is not trading stock, there has been a cessation of the first business and this is a different business because it is a different profit making scheme. Thus, the same business test is failed.

Example 15

172. A resident company ('Baux Head') has carried on the business of mining bauxite and refining the ore into alumina in Queensland. It has sold bauxite and alumina domestically and in limited overseas markets. After incurring substantial tax losses under section 36-15, Baux Head fails the continuity of ownership test in section 165-12 but satisfies the condition in subsection 165-13(2). After the time at which Baux Head fails the continuity of ownership test in section 165-12 ('change-over'), the owners of Baux Head consider the best means to achieve profitability is to enter into a joint venture arrangement with another resident company ('Ace Venturer'). Ace Venturer has superior technology in relation to both the mining and refinement processes, access to cheaper raw materials, and can provide opportunities for sale of bauxite and alumina in wider global markets.

173. Ace Venturer prefers a joint venture arrangement over licensing or selling the technology to Baux Head as it is keen not to lose its competitive advantage in respect of the technology. It also believes sites mined by Baux Head have significant deposits of relatively high grade ore. With greater efficiencies to be achieved in the mining and refinement process through the new technology and

the potential for sale in wider markets, the venture partners believe there is considerable scope for an increased amount of product to be more efficiently extracted from the mine sites and refined.

174. Baux Head and Ace Venturer agree to establish an incorporated joint venture vehicle ('Operator') that manages the day to day operations of the business as their agent. Although Baux Head retains the mining leases over the mine sites, Operator is granted exclusive possession of the mine sites by way of sublease from Baux Head. Operator acquires other assets and is responsible for the purchase or construction of new assets to be used in the conduct of the joint venture business. Some employees of Baux Head are transferred to Operator, and Operator assumes responsibility for hiring future employees.

175. In accordance with the terms of an operating agreement, the day to day management of the business operations carried on at the mine sites and the refinery is assumed by Operator. Baux Head and Ace Venturer are entitled to equal representation and voting rights on a Joint Venture Committee that has the power to make decisions in relation to the executive management of the business operations carried on by Operator.

176. Under this joint venture arrangement, Baux Head and Ace Venturer share equally in the output of the business by each purchasing half of the output from Operator at a price approximating the cost of its production. Under a distribution agreement between the joint venture and Ace Venturer, Ace Venturer markets and sells the output of the joint venture in previously serviced markets, as well as in wider global markets, on behalf of the joint venture.

177. In relation to the tax losses incurred prior to the change-over, Baux Head fails both the same business test and the new transactions test for the income years ending after Baux Head enters into the joint venture arrangement with Ace Venturer.

178. Immediately before the change-over, Baux Head carried on the business of mining and refining bauxite in Queensland. After Baux Head enters into the joint venture arrangement with Ace Venturer, Baux Head merely shares executive management with Ace Venturer, of the business carried on by the Operator as agent for and on behalf of the joint venture parties. This is not the same business as the business carried on by Baux Head immediately before the change-over.

179. Under the joint venture arrangement, Baux Head derives income from the sale of its joint venture share of the output of the business in Queensland under the distribution agreement with Ace Venturer. This constitutes the derivation of assessable income from a transaction of a kind that Baux Head had not entered into in the course of its business operations before the change-over. Baux Head may not

have failed the new transactions test, with respect to sale of its share of the output, if Baux Head had not entered into the distribution agreement with Ace Venturer.

Example 16

180. Ziggy is a resident company that is a party to a number of Australian gold exploration and mining joint ventures with various other parties. Ziggy also wholly owns a number of Australian gold mining tenements in relation to a number of different mine sites, which it operates on its own behalf. The extent of Ziggy's interest as a joint venture participant is different in relation to each different joint venture. For example, Ziggy has a 50% joint controlling interest in one joint venture, and has a 25% non-controlling interest in another joint venture. Ziggy has incurred tax losses under section 36-15.

181. After failing the continuity of ownership test in section 165-12 but satisfying the condition in subsection 165-13(2) ('change-over'), Ziggy enters into a joint venture arrangement with Zelda in relation to one of Ziggy's wholly owned gold mining tenements.

182. The joint venture arrangement entered into by Ziggy with Zelda after the changeover, is similar in kind to the joint venture arrangement entered into by Baux Head and Ace Venturer described in paragraphs 174 to 176 of **Example 15**. For example, Ziggy and Zelda establish and jointly own an operating company to operate the mining tenement as their joint agent and each of them is entitled to half of the production from the mine. Both of them have equal voting rights and representation on a Joint Venture Committee that makes executive decisions in relation to the gold mining operation carried on by their agent operator.

183. In relation to the tax losses incurred prior to the change-over, Ziggy does not fail the same business test, the new transactions test or the new business test in the income years ending after the change-over merely because Ziggy entered into the joint venture arrangement with Zelda in relation to one of its existing mines.

184. At the change-over, Ziggy carried on the business of exploring and mining for gold in Australia as both a participant in various joint ventures and on its own behalf. Entering into the joint venture arrangement with Zelda and deriving income from the sale of its share of the gold production of the mining joint venture with Zelda, does not change the identity of the business carried on by Ziggy immediately before the change-over and does not result in Ziggy deriving assessable income from a business of a kind that Ziggy did not carry on before the change-over, or from a transaction of a kind that Ziggy had not entered into in the course of its business operations before the change-over.

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- losses
- new business test
- new transactions test
- same business test

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