TR 2019/1 - Income tax: when does a company carry on a business?

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Taxation Ruling

Income tax: when does a company carry on a business?

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Relying on this Ruling

This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in the ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this ruling.

Further, if we think that the ruling disadvantages you, we may apply the law in a way that is more favourable to you.

***[Note:** This is a consolidated version of this document. Refer to the Legal Database (*https://www.ato.gov.au/law*) to check its currency and to view the details of all changes.]*

Summary – what this Ruling is about

1. This Ruling sets out the Commissioner's views on when a company carries on a business within the meaning of:

- small business entity in section 23 of the *Income Tax Rates Act 1986* (ITRA 1986) as applicable in the 2015-16 and 2016–17 income years
- section 328-110 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Background

2. Section 23 of the ITRA 1986, as it applied in the 2015–16 and 2016–17 income years, introduced a new lower corporate tax rate for certain companies from the 2015–16 income year. Eligibility for this lower corporate tax rate turned in part on whether the company was a small business entity. This is in turn defined by section 328-110 of the ITAA 1997.[1]

[1] Section 4 of the ITRA 1986 provides that the *Income Tax Assessment Act 1936* (ITAA 1936) is to be read as one with the ITRA 1986. The meaning of a 'small business entity' in section 6 of the ITAA 1936 refers to subsection 995-1(1) of the ITAA 1997.

3. A company is a small business entity under section 328-110 of the ITAA 1997 if, in addition to satisfying other criteria, it carries on a business.[2]

4. This Ruling considers when a company carries on a business within the meaning of small business entity in section 23 of the ITRA 1986 as applicable in the 2015–16 and 2016–17 income years, and section 328-110 of the ITAA 1997.

Applying this Ruling

5. The concept of 'carrying on a business' is a longstanding feature of the income tax law and is relevant to various provisions of general and specific application.[3]

6. However, this Ruling only applies to and binds the Commissioner in relation to section 23 of the ITRA 1986, as it applied in the 2015–16 and 2016–17 income years, and section 328-110 of the ITAA 1997.

7. While similar questions and issues may be involved in applying other provisions in Acts administered by the Commissioner that rely on the concept of carrying on a business, the reasoning and conclusions expressed in this Ruling do not necessarily apply to them. Whether a company carries on a business in the way relevant for those provisions must be considered in light of their words, purpose and context. Consequently, care must be exercised in applying the reasoning and conclusions expressed in this Ruling when applying other provisions.[4]

8. This Ruling applies only to companies incorporated under the *Corporations Act 2001*, other than companies limited by guarantee.[5] The discussion and conclusions in this Ruling do not apply to the activities of:

- entities or associations of persons that are
  - deemed to be a company within the meaning of subsection 6(1) of the ITAA 1936 or subsection 995-1(1) of the ITAA 1997 and taxed as if they were a company under the ITAA 1936 or ITAA 1997, or

[2] Paragraph 23AA(a) of the ITRA 1986.
[3] Including section 6-5 of the ITAA 1997 about income according to ordinary concepts, the second limb of section 8-1 (the general deduction provision) and Division 328 which outlines the small business tax concessions.
[4] For example, in interpreting the meaning of business as used in the note to subsection 152-40(4) of the ITAA 1997.
[5] Companies limited by guarantee are typically formed for purposes other than profit, such as a charitable or non-profit organisation. Companies incorporated by statute or charter will be affected by the purposes for which they were formed and need to be dealt with on a case by case basis; unincorporated companies are now rare but also require special consideration.

- a corporate tax entity within the meaning of section 960-115 of the ITAA 1997

- individuals
- trusts, or
- companies acting in their capacity as the trustee of a trust (including as the trustee of a superannuation fund).

9. A company may conduct activities on its own behalf and in another capacity, such as the trustee of a trust. Where a company does so, this Ruling applies only in relation to the activities it conducts on its own behalf.

10. For those companies and other entities not covered by this Ruling, it is necessary to consider whether their activities amount to the carrying on of a business in the way relevant for the provision in question by reference to:

- the indicia of carrying on a business set out in the case law
- the nature of and purpose for which the entity was established, and
- the words and purpose of the provision and the context in which the concept of carrying on a business appears.

11. The Commissioner's views on whether a self-managed superannuation fund is carrying on a business are discussed in Self-Managed Superannuation Funds Ruling SMSFR 2009/1 *Self Managed Superannuation Funds: business real property for the purposes of the Superannuation Industry (Supervision) Act 1993*.

12. Guidance relevant to identifying whether an individual is carrying on a business is contained in Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?*

Ruling

13. 'Business' for the purpose of section 23 of the ITRA 1986, as it applied in the 2015–16 and 2016–17 income years, and section 328-110 of the ITAA 1997, is defined by subsection 995-1(1) of the ITAA 1997. This defines business to include 'any profession, trade, employment, vocation or calling', but excludes 'occupation as an employee'.[6]

[6] Subsection 995-1(1) of the ITAA 1997.

14. It is not possible to definitively state what amounts to a business, however in *Federal Commissioner of Taxation v Murry*[7] Gaudron, McHugh, Gummow and Hayne JJ observed:

> …A business is not a thing or things. It is a course of conduct carried on for the purpose of profit and involves notions of continuity and repetition of actions.

Carrying on a business in a general sense vs carrying on a particular business

15. There are two categories of legislative provisions and cases where the question is whether a company carries on a business. The first category is concerned with whether a company carries on a business in a general sense – irrespective of what is the actual business.[8]

16. The second category is concerned with whether a company 'carries on a particular business'.[9] These cases and provisions turn on the scope or nature of the business that is carried on by an entity. For example, the scope of the business carried on is relevant to whether a gain made on a transaction is income or capital in nature.[10] Those cases that consider provisions falling in the second category do not address the broader question of whether a business is carried on by the company in the general sense.

17. The provisions this Ruling deals with are concerned with the first category: whether a company carries on a business in a general sense.

Whether a business is carried on is a question of fact

18. The case law highlights that it is not possible to state a precise test for whether a person is carrying on a business. Whether the activities of an entity constitute the carrying on of a business is a question of fact[11], and must be answered based on a wide survey,

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[7] [1998] HCA 42 (*Murry*).

[8] See, for example, *American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue* [1979] AC 676 (*American Leaf)* and *Inland Revenue Commissioners v Westleigh Estates Co Ltd* [1924] 1 KB 390 (*Westleigh*).

[9] For example, whether amounts are assessable as ordinary income under section 6-5 of the ITAA 1997 (*London Australia Investment Co Ltd v FCT* [1977] HCA 50 (*London Australia*); *AGC (Investments) Ltd v FC of T* 92 ATC 4239; (1992) 23 ATR 287 (*AGC Investments*); *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* [1990] HCA 25 (*GP International Pipecoaters*)); whether outgoings or losses are deductible under section 8-1 of the ITAA 1997, and whether a company carries on the same business for the purpose of the same business test in Subdivision 165-E of the ITAA 1997 (*Avondale Motors (Parts) Pty Ltd v FCT* [1971] HCA 17 (*Avondale*); *Commissioner of Taxation v R & D Holdings Pty Limited* [2007] FCAFC 107 (*R & D Holdings*); *Re Kennedy Holdings and Property Management Pty Ltd v Federal Commissioner of Taxation* [1992] FCA 645 (*Kennedy*); *Commissioner of Taxation v Radnor* [1991] FCA 499 (*Radnor*)).

[10] Section 6-5 of the ITAA 1997. *London Australia*; *AGC Investments*; *GP International Pipecoaters*.

[11] *Brookton Co-operative Society Ltd v FCT* [1981] HCA 28 (*Brookton*) per Aickin J; *Spriggs & Riddell v FCT* [2009] HCA 22, (*Spriggs*), paragraph 59.

and the overall impression gained, of the activities of the entity having regard to the indicia of carrying on a business as a whole.[12]

Presumption that certain companies carry on a business

19. While the indicia set out in the case law are relevant to companies, companies are typically formed for the purpose of carrying on a business.[13] In *Westleigh* and *American Leaf*, it was observed that where a company aims to make, and has a prospect of profit, it is presumed that the company intends to, and does in fact, carry on a business. In *American Leaf*, Diplock LJ observed that this means any gainful use to which a company puts its assets will, on its face, amount to the carrying on of a business. However, this presumption can be rebutted if it can be shown that, on the facts, the company had no aim or prospect of making a profit.[14]

20. A consideration of the relevant indicia of when a business is carried on in light of the characteristics of a company shows why this presumption arises. It can also assist in determining whether the presumption arises and, if it does, whether it is rebutted on the facts of the case.

The indicia of carrying on business

21. The key indicia considered by the courts in determining whether the activities carried on by an entity amount to the carrying on of a business are[15]:

- whether the person intends to carry on a business[16]
- the nature of the activities, particularly whether they have a profit-making purpose
- whether the activities are
  - repeated and regular
  - organised in a business-like manner, including the keeping of books, records and the use of a system
- the size and scale of a company's activities including the amount of capital employed in them, and
- whether the activity is better described as a hobby, or recreation.

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[12] *Martin v Commissioner of Taxation (Cth)* [1953] HCA 100 per Webb J; *Spriggs*.
[13] *Brookton* per Aickin J; *Westleigh*. *American Leaf*.
[14] *Westleigh* per Pollock MR, paragraphs 408-409*; Spassked Pty Limited v Commissioner of Taxation* [2003] FCAFC 282 *(Spassked).*
[15] *Ferguson v FCT* [1979] FCA 29 (*Ferguson*) per Bowen CJ and Franki.
[16] *Thomas v Commissioner of Taxation (Cth) (*1972) 46 ALJR 397; 72 ATC 4094 *(Thomas); Inglis v Federal Commissioner of Taxation* 80 ATC 4001*; (*1979) 10 ATR 493 per Brennan J at ATC 4004-4005; ATR 496-497*; Westleigh.*

Intention to carry on a business

22. Whether a person has an intention to carry on a business is relevant to determining whether a person or entity carries on a business.[17] It is not necessary, however, that they have a subjectively formed or express intention to do so. This may be inferred objectively from the circumstances.[18]

23. Limited (including proprietary limited) and no liability (NL) companies are typically formed for the purpose of carrying on a business[19] and are unlike individuals or trusts who may have multiple purposes for undertaking a gainful activity other than to make a profit or carry on a business.[20]

24. As already noted in paragraph 19 of this Ruling, in *Westleigh* and *American Leaf*, it was observed that where a company aims to make and has a prospect of profit, *it is presumed that it intends to,* and does in fact, carry on a business.

The nature of a company's activities and whether they have a purpose of profit

The nature of a company's activities

25. The case law highlights that the differences between companies, individuals and trusts influence the characterisation of the activities they carry on. These differences mean that the same activities carried on by limited (including a proprietary limited) and NL companies are more likely to have a commercial character and amount to the carrying on of a business than if they were carried out by either an individual or trust.[21]

26. Unlike individuals, a company's profitable activities are unlikely to be in the nature of a hobby or be undertaken to meet a domestic need. Thus, any profit-making activities a company conducts are unlikely to have a domestic or personal character, and are likely to be characterised as being commercial in nature.

27. For trusts, their nature, the duties placed on the trustee, the interest of the beneficiaries in the property of the trust, and the wide variety of purposes for which they are typically established[22] may give

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[17] *Ibid.*
[18] *Commissioner of Taxation v Stone* [2005] HCA 21*; G v Commissioner of Inland Revenue* [1961] NZLR 994*.*
[19] *Brookton* per Aickin J*; Westleigh.*
[20] *Inland Revenue Commissioners v Korean Syndicate Ltd* [1921] 3 KB 258 (*Korean Syndicate*).
[21] *Western Gold Mines v Commissioner of Taxation (WA)* [1938] HCA 5, per Latham CJ; *American Leaf*; *Korean Syndicate*; *Radnor*; *Charles v Federal Commissioner of Taxation* [1954] HCA 16; (*Charles*)*; London Australia* per Gibbs J.
[22] *Charles* at [1954] HCA 16, paragraph 10; *Radnor* per Sheppard J; *Re Elders Trustee and Executor Company Limited v EG Reeves Pty Limited; Edward George*

a materially different character to those activities than they would have if carried out by a limited (including a proprietary limited) or NL company.[23] For example, trusts holding income producing assets are commonly established for domestic or other non-commercial purposes, such as a testamentary trust or some other domestic or charitable purpose. This characterisation is unlikely in the case of a company.

28. These differences mean that the same profitable activity undertaken by a trustee is less likely to amount to the carrying on of a business, than if it were to be carried on by a company.[24]

29. For these reasons, the profit-making activities of a company, and those activities it carries on with a profit-making purpose, normally have a commercial character unlike those of an individual or trust. These differences have led the courts to observe that profit-making activities, such as receiving rent from property, do not give rise to a presumption that an individual is carrying on a business, whereas it would if those same activities are undertaken by a company.[25]

Circumstances where a company's activities lack a commercial character or profit-making purpose

30. In some situations a company's activities may have a non-commercial nature or a purpose inconsistent with a conclusion it is carrying on a business.[26] These are discussed below at paragraphs 36 to 37 of this Ruling. Outside these types of situation, the profit-making activities of a company normally have a commercial nature and profit-making purpose on their face. Where a company's activities have a significant commercial nature or purpose and are conducted in a commercially viable manner, they are likely to amount to the carrying on of a business.[27]

Purpose of profit

31. Whether a company's activities have a purpose of profit is critical in determining whether it is carrying on a business.[28] Where they do, it is likely the other indicia support the conclusion that the company is carrying on a business. This is, however, ultimately a question of fact to be determined in light of all the circumstances.

Reeves (Second Respondent) and Daphne Joan Reeves (Third Respondent) [1987] FCA 332.

[23] *London Australia* per Gibbs J at paragraph 7.

[24] *Radnor*; *London Australia* per Gibbs J and Jacobs J.

[25] *American Leaf.*

[26] *Westleigh*.

[27] Cf *Hart v Commissioner of Taxation* (2003) ATC 466.

[28] *American Leaf* at AC 684; *Westleigh*; *Murry,* at paragraph 54; *Whitfords Beach Pty Ltd v Commissioner of Taxation* [1983] FCA 97 (*Whitfords*) per Fisher J; paragraphs 47 to 54 of Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?*

32. In determining whether a company has a profit-making purpose, the purposes of those who set up the company, maintain and control it may be considered.[29] The objects as stated in the company's constitution can also be considered, although this is not conclusive of whether a company carries on a business.[30]

33. If a company is a member of a group of companies, its purpose, and whether it carries on a business, may be determined by reference to its role within the group[31], the activities of the wider group[32], and the intended activities of any of its subsidiaries at the time they are set up.[33]

34. Relevant to whether activities have a profit-making purpose is whether they have a prospect of profit. [34] If the activities in question are carried out in a way that means they have no prospect of ever making a profit, it is unlikely that the activities themselves can be said to have a profit-making purpose. For example:

- A company whose only asset is a non-interest bearing debt owing following the winding up of its active business. As there was no right to interest, but merely a hope the debtor may choose to pay it interest, it could not be said to engage in activities with a purpose or prospect of profit. It was found not to carry on a business.[35]
- In *Spassked*[36], the company's activities involved borrowing funds to invest in subsidiaries, engaging in 'dividend trapping', and was conducted in a way which meant they had no intent or purpose of deriving a profit. It was held not to carry on a business. This was despite the company investing in shares that would ordinarily have meant it carried on a business.

35. A company's activities may have a profit-making purpose, even where on the objective evidence it is expected, and indeed likely, that they will not make a profit in the short term.[37] Where this is

[29] *Elsey v Commissioner of Taxation* [1969] HCA 48, *Whitfords* per Gibbs CJ; *Brookton* per Mason J
[30] *A & S Ruffy Pty Ltd v Commissioner of Taxation (Cth)* [1958] HCA 18; *Brookton* per Aickin J; *Westleigh*; *Korean Syndicate*; *American Leaf*; *Kwikspan Purlin System Pty. Ltd v y Commissioner of Taxation* [1984] QSC 141.
[31] *Spassked*; *News Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCA 645.
[32] *The Commissioner of Taxation of the Commonwealth of Australia v Total Holdings (Australia) Pty Ltd* [1979] FCA 53 (*Total Holdings*); *Commissioner of Taxation of the Commonwealth of Australia v EA Marr & Sons (Sales) Ltd (EA Marr)*.
[33] *Brookton* per Mason J; *Spassked*.
[34] *Westleigh*, *American Leaf*; *Hart v Commissioner of Taxation* [2003] FCAFC 105; *Case H11* 76 ATC 59; *Nelson v Commissioner of Taxation* [2014] FCAFC 163, paragraph 21.
[35] *Northern Engineering Pty Ltd v The Commissioner of Taxation* [1979] FCA 137 (*Northern Engineering*).
[36] *Spassked*.
[37] *Ferguson* at FLR 314; *Tweddle v Federal Commissioner of Taxation* [1942] HCA 40.

the case, the company may still carry on a business, although the other indicia will carry more weight in reaching that conclusion.

36. Examples of companies whose activities would not have commercial nature or purpose of making a profit, and would not carry on a business, include a company that exists solely to:

- hold and maintain personal use assets; for example, a boat or holiday house, for the sole use of its members who are the sole source of funding used to cover the running costs of those assets
- hold land to secure access to a beach for the company's shareholders[38], and
- provide social and recreation facilities for members without seeking to make a profit to distribute to its members.[39]

37. Other examples where a company is likely to be characterised as having no profit-making purpose and whose activities are unlikely to have a commercial nature include:

- an incorporated charity
- a body corporate whose sole purpose is to maintain and manage land for its owners
- a statutory body serving a public function, and
- an incorporated not-for-profit organisation that exists to provide community services.

Repetition and regularity

38. The degree of repetition or regularity of the company's activities is relevant to determining whether it carries on a business.[40] While there is a need for activity, this may be satisfied even if a company's activity is relatively limited, irregular or has periods of inactivity.[41]

39. Companies have been held to carry on a business where its ongoing activities are relatively limited and its key activities consist of:

- letting the company's premises for rent on an ongoing basis[42],

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[38] In *Whitfords* the company was incorporated for this purpose, prior to it being acquired and changing its purpose and activities so that it started carrying on a land development business.
[39] *Westleigh*.
[40] *Ferguson*; *Hope v Bathurst City Council* [1980] HCA 16; *Smith v Anderson* (1880) 15 Ch D 247 (*Smith*) per Brett LJ.
[41] *American Leaf*. *South Behar Railway Co. Ltd. v Commissioners of Inland Revenue* (1925) AC 476, 488.
[42] *American Leaf*.

- leasing plant to its subsidiaries which themselves carried on a business for no fee[43],
- providing secretarial, budgeting and financial services to its subsidiaries that carry on active businesses[44], or
- holding shares in subsidiary companies which are engaged in trading.[45]

40. The activities of a company that holds assets which generate ongoing returns may be limited to its ongoing management, ensuring it meets ASIC regulatory requirements, decisions (whether express or implicit) to continue holding a relatively static investment portfolio, the receipt and distribution (or retention) of income and other matters of an administrative nature. While relatively limited, this level of activity is sufficient to amount to the carrying on of a business.[46]

Single acts or transactions

41. An isolated act or one-off transaction may amount to carrying on a business; for example, if it is intended to be repeated[47], or it can be shown that the transaction was the first step in the carrying on of a business.[48]

Organisation of activities in a systematic and business-like manner

42. Whether activities are carried out in a systematic and organised way, or carried on in a business-like manner, is relevant to determining whether they amount to carrying on a business. This may involve, for instance, keeping detailed records of income[49], preparing formal business plans or budgets[50], or seeking professional advice.[51]

43. Limited (including proprietary limited) and NL companies incorporated under the *Corporations Act 2001* are typically created for the purpose of carrying on a business.[52] The statutory framework under which they are formed creates a formal structure under which their activities are conducted and sets out rules about how they must be managed.

44. For example, they are required to have at least one director who formally controls and manages the activities of the company.[53] The *Corporations Act 2001* imposes duties on the directors of a company and its shareholders.[54] This includes a duty to ensure that the company does not trade while insolvent[55], to keep financial records that record and explain its transactions, financial position and

[43] *EA Marr*.
[44] *Carapark Holdings Ltd v Federal Commissioner of Taxation (Cth)* [1967] HCA 5 (*Carapark*).
[45] *Brookton* per Gibbs CJ and Mason J; *Spassked*; *Korean Syndicate*, per Atkin.
[46] *Westleigh* per Warrington LJ;*Korean Syndicate; American Leaf*; *Spassked.*
[47] *Re Griffin Ex Parte Board of Trade* (1890) 60 LJQB 235, 237.
[48] *Fairway Estates Pty Ltd v Federal Commissioner of Taxation* [1970] HCA 29.

performance that would enable true and fair financial statements to be prepared and audited and the Australian Securities and Investment Commission (ASIC) requirement that all companies pass a solvency resolution after being issued an annual company statement.[56] This formal organisation and structure is stronger for those companies that are required to prepare and lodge annual financial reports with ASIC.[57]

45. A company's formal structure and the statutorily imposed requirements regarding how they must be managed and run are a point of difference to the activities of an individual. As a consequence, the gainful activities of a company must, as a matter of law, and typically are, carried on in a business-like manner. They normally support a conclusion that the activities of a company undertaken for the purpose of making a profit amount to carrying on a business.

Size and scale of company's operations including the amount of capital employed in them

46. The size and scale of the activities in question are relevant, but not necessarily conclusive, of whether they amount to the carrying on of a business.[58] Where the company carries out activities which have a purpose and prospect of making a profit, the amount of capital it has invested in the activities and the scale of its activities, even if limited and small, will carry less weight than it would in the case of an individual or trust.[59]

47. Where small-scale activities conducted by individuals do not amount to the carrying on of a business, there are normally other factors present which support the conclusion that the individual is not carrying on a business. For example:

- the activities are better classified as a hobby[60], or
- the activity serves a domestic need[61], or arises from a purely domestic arrangement.[62]

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[49] *Brookton*.
[50] *T & S Liapis Pty Ltd v Commissioner of State Taxation* [2015] SASC 63, paragraph 164.
[51] *Smith and Commissioner of Taxation* [2010] AATA 576.
[52] *Brookton* per Aickin J; *Westleigh.*
[53] Section 198 of the *Corporations Act 2001*.
[54] See, for example, Chapters 2D and 2M, and section 588G of the *Corporations Act 2001*.
[55] Section 588G of the *Corporations Act 2001*.
[56] Section 286 of the *Corporations Act 2001*.
[57] Section 292 of the *Corporations Act 2001*.
[58] *Commissioner of Taxation (Cth) v Walker* [1985] QSC 112 (*Walker*); *Thomas*; *Ferguson*.
[59] *Thomas* per Walsh J.
[60] *Ferguson*; *Martin* per Webb J.
[61] *Thomas* per Walsh J.
[62] *Evans v Federal Commissioner of Taxation* [2007] AATA 1062 (*Evans*).

48. These factors are typically not present in the case of a company carrying on gainful activities.[63]

49. Similarly for a trust, the trustee may hold income producing assets for purposes other than deriving income, such as under a testamentary trust or for some other domestic arrangement.

50. In the case of a company, even where these types of factors are not present, its activities may nonetheless be so small and limited in scope that they lead to the conclusion that they have neither a purpose, nor prospect of profit. An example is a company that is effectively dormant and whose only income is interest on a small amount of cash in the bank and that is never likely to exceed its annual ASIC company review fee.[64]

Companies that are beneficiaries of trusts

51. A company does not carry on a business merely because it is the object or a potential beneficiary of a trust. However, the activity of investing in trusts, including family trusts, or investing money derived from trusts, including family trusts, is a common way companies carry on a business of investment. It is possible for a company to become a beneficiary of a trust without any action on its part. For example, it may not invest any money of its own, or participate in the affairs of the trust and it may have no expectation of deriving any income. Of itself, this may not amount to carrying on a business, since the company does nothing. The unexpected windfall of being appointed income by the trustee, without any participation by the company, is an example of a company that has acquired a right to receive income without having carried on any business.

52. Most corporate beneficiaries of family discretionary trusts are formed and appointed beneficiaries of trusts, with the clear expectation of being made entitled to any trust income that exceeds the amounts the trustee will appoint to individuals in the family. They are usually appointed income, often repeatedly. They either reinvest the income in the trust, by way of a formal loan, by leaving the income uncalled for, or invest it in other ways that give rise to an entitlement to a return of profits. These companies are carrying on a business to profit in connection with the trust. This conclusion is stronger for companies investing in widely held or fixed trusts.

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[63] *Ferguson*; *Martin*; *Thomas; Evans* cf. *Walker*.

[64] As of 3 April 2019, the annual company review fee was $263 for a proprietary company, $53 for a special purpose company (proprietary), $49 for a special purpose company (public) and $1,224 for a public company, Australian Securities & Investments Commission, viewed 3 April 2019, http://asic.gov.au/for-business/running-a-company/annual-statements.

Need for an ongoing assessment – changes in activities and purpose

53. Whether a company carries on a business must be assessed based on its activity and status at that time.

54. A company may not be carrying on a business if its activities are preliminary to the carrying on a business and are merely carried out to determine whether it is feasible to carry on a business.[65] That said, in some cases a company will have commenced business in a general sense (for example, through investing capital), even though it is still assessing the feasibility of another business that it has not yet commenced.

55. Whether a company ceases to carry on any business requires careful consideration of all the facts. A company that becomes dormant and where there is no further activity or no intention to resume its former or any other business, may cease to carry on a business.[66] This is not likely to be the case where its activities are simply limited in nature (see paragraph 39 of this Ruling). It is also not likely if activities are paused, even for a lengthy period, where there is an intention to resume them.[67] As with starting a business, care needs to be taken to distinguish situations where the company has ceased a particular business, from the situation where the company has ceased carrying on any business. For example, a company may cease trading operations permanently but retain some investments. For this reason, it may still be carrying on a business in the general sense.

56. Where a company has entered liquidation, the courts consider whether there has been a change in the company's activities, their purpose and nature. If the liquidator is no longer carrying on any of the company's profit-making activities and whose only aim is to realise the company's assets in the most advantageous manner for the purpose of liquidating the company and distributing assets to its creditors and members, it may no longer carry on a business.[68] In contrast, if it continues to trade in the process of winding a business down, it likely still carries on that business.[69] If a company sells the entirety of its former business it ceases to carry on that business from the date it is sold.[70]

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[65] *Softwood Pulp & Paper Limited v Federal Commissioner of Taxation*76 ATC 4439; 91976) 7 ATR 101*; Goodman.*

[66] *Inglis*; cf *Avondale and AGC (Advances) Ltd (formerly Waymouth Guarantee 7 Discount Ltd) v Commissioner of Taxation (Cth)* [1975] HCA 7 (*AGC (Advances) Ltd*).

[67] *Federal Commissioner of Taxation* v *Broken Hill South Ltd* [1941] HCA 33 (*Broken Hill South*).

[68] *Coal Developments (German Creek) Pty Ltd v FC of T [*2007] FCA 1324 *(Coal Developments); IR Commissioners v Olive Mill Ltd (In Liq)* [1963] 2 All ER 130; [1963] 1 WLR 712; *Northern Engineering* per Brennan J.

[69] *Coal Developments.*

[70] *Ibid.*

57. Where a company enters into administration to resolve financial difficulties but continues its business activities with the expectation that they will continue profitably in the future, it still carries on a business.[71]

Cases considering whether a company carries on business

58. Examples of when the courts have held a company carried on a business include a company that:

- is a holding company with an expectation of receiving dividends from its subsidiaries[72], where it
  - acquired the shares in its subsidiaries by way of a gift[73]
  - made interest bearing loans to those subsidiaries and provided management services to the group[74]
  - leased plant and equipment to its subsidiaries free of charge[75], or
  - made interest-free loans to those subsidiaries[76]
- holds and rents out single[77] or multiple real properties[78]
- invested in real property, intended to be held indefinitely for the purpose of deriving rent, and subsequently sold for profit[79], and
- receives interest and royalties.[80]

Conclusion

59. Whether a company is carrying on a business within the meaning of section 23 of the ITRA 1986, as it applied in the 2015–16

[71] *Joshua Brothers Pty Ltd v Federal Commissioner of Taxation* [1923] HCA 3; *AGC (Advances) Ltd* per Barwick CJ*; Official Receiver v Commissioner of Taxation (Cth) (Fox's Case) [*1956] HCA 63 ; *Broken Hill South*.
[72] *Spassked*; *Korean Syndicate*.
[73] *Brookton* per Mason J.
[74] *Carapark*.
[75] *EA Marr*.
[76] *Total Holdings*.
[77] *R & D Holdings*; *Lilydale Pastoral Co Pty Ltd v Commissioner of Taxation* [1987] FCA 137 cf. *Kennedy*, where this view was formed in the context of characterising a one-off lease payment made by the company. In finding that the payment was capital in nature, Hill J said that a different view may have been reached if the company's business 'consisted of granting leases and obtaining surrenders of them as part of the normal ebb and flow of the business'.
[78] *American Leaf*; *R & D Holdings*; *CMI Services Pty Ltd v The Commissioner of Taxation of the Commonwealth of Australia* [1990] FCA 259 (*CMI*).
[79] *CMI;* cf. *Commissioner of Taxation of the Commonwealth of Australia v Equitable Life & General Insurance Co Ltd.*[1990] FCA 257, where, on the facts, the company was not found to carry on such a business.
[80] *Korean Syndicate*.

and 2016–17 income years, or section 328-110 of the ITAA 1997, ultimately depends on an analysis of and the overall impression of the company's activities. However, where a limited (including a proprietary limited) or NL company is established and maintained to make a profit for its shareholders, and invests its assets in gainful activities that have both a purpose and prospect of profit, it will normally be carrying on a business in a general sense.[81] If so, it carries on a business within the meaning of section 23 of the ITRA 1986, as it applied in the 2015–16 and 2016–17 income years, and section 328-110 of the ITAA 1997. This is so even if the company's activities are relatively limited, and its activities consist of passively receiving rent or returns on its investments and distributing them to its shareholders.[82]

60. A limited (including a proprietary limited) or NL company engaged in gainful activities may be able to establish that it is not carrying on a business in limited circumstances. The most common situations are where it can be shown, on the facts, that the company has no purpose or prospect of profit, and its activities lack a commercial character.[83]

61. If it is concluded that a company carries on a business in a general sense, it is still necessary to determine the scope and nature of that business when determining the taxation consequences of its activities and transactions. This includes whether an amount it receives is income or capital in nature, or whether losses are revenue or capital in nature. These are separate questions that must be considered on the facts of each case.

Examples

Example 1 – inactive company with retained profits

62. *InactiveCo is a company incorporated in Australia. InactiveCo carried on a trading business that was wound up in the 2015–16 income year. InactiveCo has $400,000 of retained earnings which it holds in a bank account.*

63. *In the 2016–17 and later income years, the company's income has consisted solely of interest of $12,000 a year. InactiveCo has no intention of resuming its trading business. InactiveCo pays an annual company review fee of $254 to ASIC[84]. The company's income is consistently greater than its expenses. As a result, the company has made a profit in each income year from 2016–17.*

64. *InactiveCo's activities have both a purpose and prospect of profit. InactiveCo is carrying on a business.*

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[81] *Brookton* per Aickin J*; American Leaf* per Lord Diplock at [1978] 3 All ER 1185, 1189; *Westleigh*.
[82] *Brookton* per Aickin J; *Westleigh*; *American Leaf* [1978] 3 All ER 1185 at 1189; *Total Holdings*; *EA Marr*; *Korean Syndicate.*
[83] *Westleigh*.
[84] The amount of this fee is subject to change over time.

Example 2 – company is engaged in preliminary activities invests its assets in producing income

65. *Future Co is a newly incorporated company. Its activities consist of investigating whether it would be viable to carry on a particular business in the future and investing its $300,000 in share capital in income producing bank accounts. No decision has been made to carry on the business under investigation. However, it derives $9,000 a year in interest from its bank accounts. While Future Co's activities of investigating the potential business may be preliminary in nature and not a business, it nonetheless carries on a business as a result of its activity of investing for profit.*

Example 3 – property investment company

66. *InveproCo is a company incorporated in Australia. InveproCo owns a commercial property, which it rents to a third party at a market rate on normal commercial terms. InveproCo provides no other services in relation to the property and conducts no other activities. InveproCo has produced a profit in each of the income years it has rented out the property. InveproCo is engaged in ongoing activities that have a purpose and prospect of profit, including letting out the property.*

Possibility A

67. *InveproCo engages a professional property manager to manage the property, find tenants and do all the maintenance and ongoing inspections in relation to the property.*

68. *InveproCo carries on a business.*

Possibility B

69. *InveproCo does not engage a professional property manager to manage the rental property and its directors find tenants. All maintenance and inspections are carried out by its directors.*

70. *InveproCo carries on a business.*

Example 4 – share investment company

71. *ShareCo is a company incorporated in Australia. ShareCo holds a portfolio of listed shares worth $400,000. The shares generate $20,000 in income a year, after expenses.*

72. *ShareCo was formed for the purpose of investing in shares with the intention of earning income from dividends. Its share portfolio was selected with this in mind.*

73. *ShareCo has applied its assets in ongoing activities that have both a purpose and a prospect of profit. ShareCo has also invested a substantial amount of capital, and the dividend income is received by way of periodic payments.*

Possibility A

74. *ShareCo does not engage a third party to manage its portfolio of shares. ShareCo carries on a business.*

Possibility B

75. *Share Co engages a professional investment advisor and manager to manage its investment portfolio. ShareCo carries on a business.*

Example 5 – Company leases multiple boats to unrelated party

76. *CharterCo owns three passenger boats which it previously used to operate charter services. Following the loss of its operator's licence, the company sought to and leased its boats to an independent third party under a commercial lease agreement.*

77. *The rental income derived from letting the boats is CharterCo's only source of income, which greatly exceeds the outgoings associated with holding the boats for lease.*

Possibility A: CharterCo self manages its leasing activity

78. *CharterCo's directors directly manage the leasing of the boats, including finding lessees and personally carrying out minor repairs to the boats. The leasing activities include obtaining insurance, maintaining and registering the boats.*

79. *CharterCo's ongoing activities are carried on in a business-like manner and have both a purpose and prospect of profit. CharterCo carries on a business.*

Possibility B: CharterCo engages a management company

80. *CharterCo engages a management company to manage its chartering activities and maintenance of its boats. CharterCo's ongoing activities are carried on in a business-like manner and have both a purpose and prospect of profit. Charter Co carries on a business.*

Example 6 – holding company

81. *HoldCo is a company incorporated in Australia. HoldCo owns all the shares in SBE Co, which carries on a profitable trading business in Australia.*

Possibility A: holding company only holds shares in subsidiary

82. *HoldCo's only asset is its shares in SBE Co. HoldCo's activities consist of investing in shares in SBE Co and managing the company group. HoldCo's activities are carried on with a purpose and prospect of profit and reflect a normal commercial business structure. HoldCo carries on a business.*

Possibility B: holding company holds shares in, and provides loan to, subsidiary

83. *In addition to owning all the shares in SBE Co, HoldCo provides an interest-free loan to SBE Co and provides plant and capital equipment that SBE Co uses in its business rent free.*

84. *HoldCo's income consists of dividend income derived from the shares it holds in SBE Co. While it does not derive a direct return on the loan or provision of equipment, these enhance SBE Co's profitability and improve the return on Holdco's shares in SBE Co. The profits are distributed by HoldCo to its shareholders.*

85. *HoldCo's activities consist of investing in shares in SBE Co, managing the group, providing a loan to SBE Co and deriving interest income from the loan. HoldCo carries on a business.*

Example 7 – taxation consequences of a transaction

86. *RedCo is a company incorporated in Australia which invests in dividend-yielding listed shares. The dividends are assessable income. The dividends from the shares are greater than RedCo's expenses. RedCo conducts its investments to derive profits for distribution to its shareholders. RedCo does not engage a third party to manage its portfolio of shares. From time to time RedCo buys or sells shares. RedCo carries on a business in a general sense.*

87. *RedCo sells a parcel of shares making a significant profit. The taxation consequences of this transaction depends not only on whether RedCo carries on a business but also:*

- *what kind of business it carries on (for example, whether it is carrying on a business of trading in shares for a profit)*
- *the relationship of the transaction with that business, and*
- *the circumstances in which the transaction occurred.*

88. The answers to these questions turn on additional facts and an analysis of the scope of nature of RedCo's business. These questions are not dealt with by this Ruling.

Date of effect

89. This Ruling applies to income years commencing both before and after its date of issue. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

Commissioner of Taxation
5 April 2019

Appendix 1 – Detailed contents list

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