TR 97/D1 - Income tax: am I carrying on a business of primary production?

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Draft Taxation Ruling
Income tax: am I carrying on a business of primary production?

other Rulings on this topic

IT 219; IT 289; IT 2006; IT 2301; TR 93/26; TR 95/6; TR 96/7; TD 93/39; TD 93/95; TD 96/16

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What this Ruling is about

1. This Ruling considers the meaning of 'business' of 'primary production' in the *Income Tax Assessment Act 1936* ('the Act'). It provides a guide of the indicators that are relevant to whether or not a person is carrying on a business of primary production. It also indicates the extent to which the Australian Taxation Office ('ATO') is able to provide further guidance to taxpayers on this question via private rulings.

2. The phrase 'carrying on a business of primary production' appears in a number of provisions in the Act, including sections 36AAA, 70, 75AA, 75B, 75D and the 'averaging provisions' (Division 16 of Part III of the Act). **However, this Ruling does not consider the detailed operation of any of these provisions**.

Class of person/arrangement

3. This Ruling applies to persons who carry out activities which might be described as 'primary production' in the Act (see the definition in paragraph 8 below).

4. This Ruling does not deal with the situation of a taxpayer who receives a payment from a one-off transaction but is not carrying on a business.

Other relevant Rulings and Determinations

5. The following Taxation Rulings and Taxation Determinations consider whether specific activities come within the meaning of primary production:

- Income Tax Ruling IT 219 - artificial breeding services;
- Income Tax Ruling IT 289 - orchid growing; mushroom growing;
- Income Tax Ruling IT 2006 - kelp harvesting;
- Income Tax Ruling IT 2301 - prawn farming;
- Taxation Ruling TR 95/6 - forest operations;
- Taxation Determination TD 93/39 - beach worming;
- Taxation Determination TD 93/95 - live sheep export.

6. Taxation Ruling TR 93/26 contains our views on a number of issues to do with the horse industry and when a taxpayer might be considered to be carrying on a business of primary production with respect to horses.

Date of effect

7. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does 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 the Ruling (see paragraphs 22 and 23 of Taxation Ruling TR 92/20).

Ruling

What is primary production

8. Subsection 6(1) of the Act defines 'primary production' as production resulting directly from:

a. the cultivation of land

b. the maintenance of animals or poultry for the purpose of selling them or their bodily produce, including natural increase

c. fishing operations which means

- operations relating directly to the taking or catching of fish, turtles, dugong, crustacea or oysters or other shellfish
- pearling operations; and includes
- oyster farming; but does not include whaling

d. forest operations, which include
- the planting or tending in a plantation or forest of trees intended for felling
- the felling of trees in a plantation or forest

e. horticulture

and includes the manufacture of dairy produce by the person who produced the raw material used in that manufacture.

9. A person will be carrying on a business of primary production for the purposes of the Act if:

a. he/she produces 'primary production', as defined in subsection 6(1)

and

b. that activity amounts to the carrying on of a business.

10. Subsection 6(1) defines 'business' to include 'any profession, trade, employment, vocation or calling, but does not include occupation as an employee'. However, this definition simply states what activities may be included in a business. It does not provide any guidance for determining whether the nature, extent, and manner of undertaking those activities amount to the carrying on of a business. For this purpose it is necessary to turn to case law.

11. The cases provide a number of indicators that are relevant to determining whether primary production activities constitute the carrying on of a business. These indicators are set out below. The indicators are no different, in principle, from the indicators as to whether activities in any other area constitute the carrying on of a business.

Some indicators of carrying on a business of primary production

12. Whilst each case might turn on its own particular facts, the determination of the question is generally the result of a process of weighing all of the relevant indicators. Therefore, although it is not possible to lay down any test which will be conclusive in determining whether a business of primary production is or is not being carried on,

the indicators outlined below provide general guidance. This is explained further at paragraph 25 of this Ruling.

13. The courts have indicated that the following indicators are relevant:

- whether the activity has a significant commercial purpose or character. This particular indicator comprises many aspects of the other indicators (see paragraphs 28 to 38);
- whether the taxpayer has more than just an intention to engage in business (see paragraphs 39 to 46);
- whether the taxpayer has a purpose of profit as well as the profitability of the activity (see paragraphs 47 to 54);
- whether there is repetition and regularity of the activity (see paragraphs 55 to 62);
- whether the activity is of the same kind and carried on in a similar manner to that of the ordinary trade in that line of business (see paragraphs 63 to 67);
- whether the activity is planned, organised and carried on in a businesslike manner such that it is directed at making a profit (see paragraphs 68 to 76);
- the size, scale and permanency of the activity (see paragraphs 77 to 85)
- whether the activity is better described as a hobby, a form of recreation or a sporting activity (see paragraphs 86 to 93).

14. A taxpayer does not need to derive all his/her income from the primary production activity. The taxpayer may also be employed in some other occupation or profession. What is important is that the taxpayer's primary production activity amounts to the carrying on of a business. This activity is considered separately to any other employment or business carried on by the taxpayer. The fact that another business is carried on does not necessarily mean that the primary production activity is also a business.

15. We stress no one indicator is decisive (*Evans v. FC of T* 89 ATC 4540; (1989) 20 ATR 922), and there is often a significant overlap of these indicators. For example, an intention to make a profit will often motivate a person to carry out the activity in a systematic and organised way, so that the costs are kept down and the production and the price obtained for the produce are increased.

16. The indicators must be considered in combination and as a whole. Whether a business is being carried on will depend on the 'large or general impression gained' (*Martin v. FC of T* (1953) 90

CLR 470 at 474; 5 AITR 548 at 551) from looking at all the indicators, and whether these factors provide the operations with a 'commercial flavour' (*Ferguson v. FC of T* (1979) 37 FLR 310 at 325; 79 ATC 4261 at 4271; (1979) 9 ATR 873 at 884). However, the weighting to be given to each indicator may vary from case to case.

17. Subject to all the circumstances of a case, **where an overall profit motive appears absent and the activity does not look like it will ever produce a profit, it is unlikely that the activity will amount to a business**.

18. The following table provides a summary of the main indicators of carrying on a business. The last three items shown are factors which support the main indicators.

Indicators which suggest a business is being carried on	**Indicators which suggest a business is not being carried on**
a significant commercial activity	not a significant commercial activity
purpose and intention of the taxpayer in engaging in the activity	no purpose or intention of the taxpayer to carry on a business activity
an intention to make a profit from the activity	no intention to make a profit from the activity
the activity is or will be profitable	the activity is inherently unprofitable
repetition and regularity of activity	little repetition or regularity of activity
activity is carried on in a similar manner to that of the ordinary trade	activity carried on in an ad hoc manner
activity organised and carried on in a businesslike manner and systematically - records are kept	activity not organised or carried on in the same manner as the normal ordinary business activity - records are not kept
size and scale of the activity	small size and scale
not a hobby, recreation or sporting activity	a hobby, recreation or sporting activity
a business plan exists	there is no business plan
commercial sales of product	sale of products to relatives and friends
taxpayer has knowledge or skill	taxpayer lacks knowledge or skill

Private rulings

19. A person cannot obtain a private ruling under Part IVAA of the *Taxation Administration Act 1953* ('TAA') on the question of whether he/she is carrying on a business: see Taxation Determination TD 96/16. Likewise a person cannot obtain a private ruling on the question of whether he/she is carrying on a business of primary production. These are questions of fact, rather than questions of law.

20. However, it is possible for a person to identify a tax law that depends for its operation on whether the taxpayer is carrying on a business of primary production. A person may seek a private ruling with respect to the operation of a tax law in relation to a particular primary production activity.

21. A taxpayer's application for a private ruling needs to show, if the arrangement has not already begun, that it is being 'seriously contemplated': paragraph 14ZAN(h) of the TAA. The application should point out:

- how the rulee intends to carry out the arrangement; and
- that the rulee has the means to carry out the arrangement; or
- that the rulee has or will soon take steps to obtain the means to carry out the arrangement.

22. An application should contain 'sufficient information' to enable the Commissioner to give the ruling. 'Sufficient information' in relation to a private ruling, where the matter(s) in issue include the carrying on of a business of primary production, will include information which covers the indicators set out at paragraph 13. (See also paragraphs 104 to 109).

Explanations

Indicators of a business of primary production

23. There are no hard and fast rules for determining whether the activities of the taxpayer amount to the carrying on of a business of primary production. The facts of each individual case must be examined to determine whether a business of primary production is being carried on. In *Martin* at CLR 474; AITR 551 Webb J said:

> 'The test is both subjective and objective: it is made by regarding the nature and extent of the activities under review, as well as the purpose of the individual engaging in them, and, as counsel for the taxpayer put it, the determination is eventually based on the large or general impression gained.'

24. The nature of the activity, the taxpayer's intention and the method of operation will help determine whether a business of primary production is being carried on. Many of the indicators of whether the taxpayer is carrying on a business of primary production are stated in the decision of the Full Federal Court in *Ferguson*. Bowen CJ and Franki J said in their joint judgment at FLR 314; ATC 4264-4265; ATR 876-877:

> 'Section 6 of the *Income Tax Assessment Act* defines 'business', stating that it includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee. This does not afford much assistance in the present case. It is necessary to turn to the cases. There are many elements to be considered. The **nature of the activities**, particularly whether they have the **purpose of profit-making**, may be important. However, an immediate purpose of profit-making in a particular income year does not appear to be essential. Certainly it may be held a person is carrying on business notwithstanding his profit is small or even where he is making a loss. **Repetition and regularity** of the activities is also important. However, every business has to begin, and even isolated activities may in the circumstances be held to be the commencement of carrying on business. Again, **organization of activities in a businesslike manner, the keeping of books, records and the use of system** may all serve to indicate that a business is being carried on. The fact that, concurrently with the activities in question, the taxpayer carries on the practice of a profession or another business, does not preclude a finding that his additional activities constitute the carrying on of a business. The **volume of his operations and the amount of capital employed** by him may be significant. However, if what he is doing is **more properly described as the pursuit of a hobby or recreation or an addiction to a sport,** he will not be held to be carrying on a business, even though his operations are fairly substantial.' (emphasis added)

25. In *Evans* Hill J agreed that no one indicator could determine whether a business is being carried on. He said at ATC 4555; ATR 939:

> 'The question of whether a particular activity constitutes a business is often a difficult one, involving as it does questions of fact and degree. Although both parties referred me to comments made in decided cases, each of the cases depends upon its own facts and in the ultimate is unhelpful in the resolution of some other and different fact situation.

There is no one factor that is decisive of whether a particular activity constitutes a business. As Jessel MR said in the famous dictum in *Erichsen v Last* (1881) 8 QBD 414 at 416:

> "There is not, I think, any principle of law which lays down what carrying on trade is. There are a multitude of things which together make up the carrying on of trade."

Profit motive (but see *IRC v. Incorporated Council of Law Reporting* (1888) 22 QBD 279), scale of activity, whether ordinary commercial principles are applied characteristic of the line of business in which the venture is carried on (*The Commissioners of Inland Revenue v. Livingston* (1926) 11 TC 538), repetition and a permanent character, continuity (*Hope v Bathurst City Council* (1980) 144 CLR 1 at 9; 80 ATC 4386 at 4390; (1980) 12 ATR 231 at 236; *Ferguson v. FC of T* 79 ATC 4261 at 4264; (1979) 9 ATR 873 at 876), and system (*Newton v. Pyke* (1908) 25 TLR 127) are all indicia to be considered as a whole, although the absence of any one will not necessarily result in the conclusion that no business is carried on.'

26. From the judgments it is clear that the relevant indicators to consider when examining whether a business of primary production is being carried on by a taxpayer are:

- does the activity have a significant commercial purpose or character?
- does the taxpayer have more than a mere intention to engage in business?
- is there an intention to make a profit or a genuine belief that a profit will be made? Will the activity be profitable?
- is there repetition and regularity in the activity? i.e., how often is the activity engaged in? What amount of time does the taxpayer spend on the activity?
- is the activity of the same kind and carried on in a similar way to that of the ordinary trade?
- is the activity organised in a businesslike manner?
- what is the size or scale of the activity?
- is the activity better described as a hobby, a form of recreation or a sporting activity?

27. **Note:**

- The following Explanations and Examples have generally been designed to highlight the importance or significance

of one indicator or several indicators in certain situations, before considering the next indicator.

- The Examples are not meant to detract from our view that all the relevant indicators need to be considered when deciding whether a primary production activity amounts to a business.
- Similarly, the amount of detail contained in the Examples is well short of the amount of information needed to properly determine the question of whether the taxpayer is carrying on a business of primary production. Refer to *CTC Resources NL v. FC of T* 94 ATC 4072; (1994) 27 ATR 403 about the need for sufficient information, and note, for example, that the High Court in *Hope* could not determine the question of whether the activities amounted to a grazing business on the case stated before the court.
- The Examples are not intended to set a minimum number of plants or animals, required by a taxpayer before he/she can show that he/she is carrying on a business of primary production.

Significant commercial purpose or character

28. It is frequently those taxpayers who earn income from employment or other sources and/or enter into some sort of primary production activity in a small way who will want to show that they are in a business of primary production. These taxpayers will usually claim deductions for losses for taxation purposes in the first years of being involved in this activity. In showing that a business is being carried on it is important that the taxpayer is able to provide evidence that shows there is a significant commercial purpose or character to the primary production activity, i.e., that the activity is carried on for commercial reasons and in a commercially viable manner.

29. The phrase 'significant commercial purpose' is referred to by Walsh J in *Thomas v. FC of T* 72 ATC 4094; (1972) 3 ATR 165, (refer to paragraph 81) and discussed further by Gibbs CJ and Stephen J in *Hope*. The 'significant commercial purpose or character' indicator is closely linked with the other indicators and is a generalisation drawn from the interaction of the other indicators. It is particularly linked to the size and scale of activity (refer to paragraphs 77-85), the repetition and regularity of activity (refer to paragraphs 55-62) and the profit indicators (refer to paragraphs 47-54). A way of establishing that there is a significant commercial purpose or character with respect to the primary production activities is to compare them with those of a taxpayer who is carrying on a similar activity that is a business. Any

knowledge, previous experience or skill of the taxpayer in the activity, and any advice taken by the taxpayer in the conduct of the business should also be considered but are not necessarily determinative: see *Thomas*. In that case Walsh J found that the taxpayer's activities in growing macadamia nut trees and avocado pear trees amounted to the carrying on of a business. The court was influenced by the scale of the activity, and the taxpayer's expectation of an ongoing financial return. Consideration should also be given to whether the taxpayer is a pioneer in the activity or has developed a new method of undertaking the activity, whether successful or not.

30. In order to show that there is a significant commercial purpose or character we suggest that the following may help:

Whether the taxpayer has:

- drawn up a business plan (refer to paragraphs 110-115);
- in circumstances where the taxpayer is not an expert, sought expert advice from the relevant authorities, experienced farmers or agents that work in the area of primary production that the taxpayer intends to carry on;
- in circumstances where the taxpayer is not an expert, obtained technical literature on the activity which the taxpayer intends to carry on;
- obtained soil and water analyses of the land that will be used for the activity;
- established that his/her land is suitable for the activity which the taxpayer intends to carry on;
- considered whether there is a market for his/her product and looked into potential markets for the product (the taxpayer is more likely to be regarded as carrying on a business if he/she sells in a commercial market instead of casual sales to relatives, friends or the public);
- investigated properly the capital requirement of the venture and has a plan that shows how that capital will be obtained and used;
- conducted research into the activity. This should confirm that profits can be expected based on the market prospects, the expected level of production and the running costs of the business (support for this research by reference to authenticated source material will assist the taxpayer);
- ensured that the size and scale of the activity is sufficient for a commercial enterprise;

- complied with any legal requirements, i.e., that they have obtained any necessary licences, permits and registrations required to operate on a commercial level or can show that these requirements can and will be complied with at the appropriate time, e.g., at the time that produce becomes available for sale;
- an intention to make a profit. (This could be shown, for example, by a business plan. Further, the taxpayer should have a reasonable belief that the activity is likely to generate a profit.)

The above are suggestions that will assist the taxpayer to show that they are carrying on a business of primary production. It will assist the taxpayer if they are able to provide evidence in writing of the above.

Example 1 - significant commercial purpose or character

31. Mark, a barrister, and his wife Tina, a medical researcher, bought 4 hectares of land and built a home. They realised that the land was fertile and capable of producing fruit. Mark spent a year seeking advice from the Department of Primary Industries and local farmers. He collected technical literature on citrus farming and obtained soil and water analyses of the land which showed the land was fertile and suitable for the intended activity. He drew up a business plan and a budget of capital and recurrent costs. After clearing the land he and Tina planted 700 mandarin trees, 700 orange trees and 700 lemon trees. They did not expect to make a profit for eight years. Mark also installed an irrigation system. Mark and Tina spent many months investigating the market for citrus fruit and established that there would be no problems in selling their product to wholesalers if it was of good quality. They complied with all registration and licensing requirements. The trees grew well. Mark and Tina devoted a substantial part of their weekends to looking after the trees. They employed casual labour to spray for weeds and pests and to prune the trees. But before they received any income from the sale of fruit, the trees were destroyed by fire. Were Mark and Tina carrying on a business of citrus fruit farming?

32. Yes, we consider that they were carrying on a business. This is so, even though no income was gained, because:

- the scale of their activity was far in excess of their personal needs, and large enough to ensure the venture would be profitable;
- there was a clear intention to make a profit, even though this would take some time to occur;

- the intention to make a profit was based on reasonable grounds and backed up by appropriate research;
- there were likely to be buyers for their produce for some time ahead;
- the trees were looked after in a manner consistent with business operations;
- they established and conducted the activity in a businesslike manner;
- they asked for and followed advice from professionals;
- there was an overall permanence about their activity, and the trees would have yielded fruit for a number of years.

33. What if Mark and Tina had not done the above research and analysis but had only planted a small number of different types of trees to test which type would grow best, and they were still investigating the likelihood of potential buyers? This would suggest that their activity was only of a 'preliminary or preparatory' nature and did not amount to the carrying on of a business. (Refer to paragraph 41).

(Note: refer to paragraph 27.)

Example 2 - significant commercial purpose or character

34. Nick, a tax lawyer and avid fisherman, owned a 60 foot yacht which he used to go fishing. Several years ago he took advantage of an opportunity to purchase a commercial fishing licence. He rescheduled any other commitments so that he was able to spend every second weekend fishing. His crew comprised his sons, David and Michael, and a couple of their acquaintances. Usually Nick and his crew were successful and caught a lot of fish. The crew were paid with fish and the remaining fish were sold to a fish wholesaler. Nick had not conducted any research into the market or methods of fishing. He fished for the best sport fish, and was not concerned with finding fish with the best market returns. Nick had no business plan and was not particularly worried whether his costs were covered by the sale of the fish or not. Further, trips were only made in sunny conditions. Was Nick carrying on a business of fishing?

35. No, this does not appear to be a business. Where the activity is one that many other people take part in for sport or recreational purposes we believe there is a need to show a strong 'commercial flavour' about the activity before it would ordinarily be regarded as a business (refer to paragraph 86). In this case:

- there was no apparent intention to make a profit;

- the activity lacked the degree of organisation and system that would be found in the activities of people who normally would be regarded as carrying on a business of fishing;
- the scale of the activity was not small and exceeded the personal needs, but this does not seem to outweigh the sporting or recreational motive behind the fishing trips;
- similarly, the trips were conducted regularly, as were sales of the fish, but this also could be explained by the fact that Nick just likes to go fishing often.

(Note: refer to paragraph 27.)

Example 3 - significant commercial purpose or character

36. Naida and her family kept twelve chickens. Twelve was the minimum that she liked to have around. She knew that her relatives and friends liked her home grown eggs, especially the double yolks that were often produced. The chickens produced about six dozen eggs per week. Of these Naida and her family consumed one dozen. She sold the remaining five dozen eggs to relatives and friends. She found that after taking into account her direct feed costs she usually managed, in her estimation, to make a modest profit of $5.00 per week. Was Naida carrying on the business of egg production?

37. No. Even though she had repetition and regularity in her operations and was making a modest gross profit:

- she was not conducting the activity in the same way as that of a commercial poultry farmer;
- she did not try to sell in a commercial market;
- she did not seek the best price for her eggs;
- she did not sell chickens that were culled because of falling productivity;
- the scale of her operations were such that she could never produce a net profit;
- she had not conducted any research into the egg industry;
- she had not looked at the full costs of production and distribution in determining the commercial viability of her enterprise.

38. If Naida's activities changed significantly and she:

- had considerably more chickens; and
- sold the eggs to the public at large at market prices; or

- sold to retail egg sellers; and
- established by research that this level of activity was profitable after taking all her costs into account;

this would point to a significant commercial character and a profit motive. She may then be carrying on a business of egg production.

(Note: refer to paragraph 27.)

The intention of the taxpayer

39. The intention of the taxpayer for engaging in the activity is a relevant indicator: see *Thomas*. However, a mere intention to carry on a business is not enough. There must be activity. Brennan J in *Inglis* v. *FC of T* 80 ATC 4001; (1979) 10 ATR 493 said at ATC 4004-4005; ATR 496-497 that:

> 'The carrying on of a business is not a matter merely of intention. It is a matter of activity. ... At the end of the day, the extent of activity determines whether the business is being carried on. That is a question of fact and degree.'

See also *J&R O'Kane & Co v. IR Commissioners* (1920) 12 TC 303 at 347 and *Case K9* 78 ATC 98 at 103; 22 CTBR (NS) *Case 29* at 302.

40. This indicator is particularly related to:

- whether the activity is preparatory or preliminary to the ultimate activity;
- whether there is an intention to make a profit;
- whether the activity is better described as a hobby or the pursuit of a recreational or sporting activity.

Preparatory activities

41. Sometimes a taxpayer may have incurred expenses prior to the commencement of a particular business of primary production. For example, expenses associated with experimental or pilot activities which do not amount to a business and which do not result in any assessable income being produced are not deductible: see *Softwood Pulp and Paper Ltd v. FC of T* 76 ATC 4439; (1976) 7 ATR 101 and *Goodman Fielder Wattie Ltd v. FC of T* 91 ATC 4438; (1991) 22 ATR 26. Experimental or pilot activities of this nature should be distinguished from the activities in *Ferguson*, which were found to have a sufficient commercial character to be regarded as a business in their own right. However, where a business has commenced, expenses may be deductible even if no income is derived in the relevant year: see *Thomas*.

Example 4 - the intention of the taxpayer

42. Pat and Laurie purchased 1,500 acres of rural land in 1980. They heard of an experimental variety of cattle which was bred on the other side of the country. Their friends told them that if this breed became successful they might make a lot of money from establishing a herd. Through friends, they arranged for the transport of one steer to their property. This steer remained on the property from 1980 to 1985 when it died due to lack of veterinary care. They took no further action with respect to the land, preferring to save for the purchase of either cows or sheep in the future. Were Pat and Laurie carrying on a business of primary production?

43. Pat and Laurie were not carrying on a business of primary production as:

- they had no clear purpose of how they would use the land to earn money;
- the one steer was purely experimental and the scale of this activity was insufficient to constitute a business.

44. Pat and Laurie's experimental activities did not have a sufficient commercial character to be regarded as a business. These activities pointed to a decision not yet having been made to carry on business and a lack of commitment at that time to do so (see also the contrasting situations described in **Example 1** at paragraph 31).

(Note: refer to paragraph 27.)

Example 5 - the intention of the taxpayer

45. Lindsay and Loretta bought 700 hectares of run down rural land in 1980. They intended to start a cattle farming business. Over the next five years they spent several thousand dollars on farm machinery. They used this to clear the land, build roads and mend fences. They also bought and erected some farm buildings. No income was derived from the property until 1986 when they stocked the property with 100 cattle. Were Lindsay and Loretta carrying on a business from 1980 to 1985?

46. No, they were not carrying on a business:

- the activities of Lindsay and Loretta from 1980 to 1985 would be regarded as preparatory to the commencement of business;
- whilst they had a clear purpose to engage in cattle farming they recognised that certain things needed to be done to

the land before they were able to buy the cattle and put them on the land;

- until 1986 there was no size or scale of the relevant activity in the sense that there was no stock;
- nor was there any repetition or regularity of activity with respect to cattle farming until the land was stocked.

(Note: refer to paragraph 27.)

Prospect of profit

47. We consider this to be a very important indicator. In *Hope* at CLR 8-9; ATC 4390; ATR 236, Mason J indicated that the carrying on of a business is usually such that the activities are:

> '... engaged in for the purpose of profit on a continuous and repetitive basis.'

In *Smith v. Anderson* (1880) 15 Ch D 247 at 258, Jessell MR said that:

> '... anything which occupies the time and attention and labour of a man for the purpose of profit is business.'

In *Case H11* 76 ATC 59 at 61; 20 CTBR (NS) *Case 65* at 603, the Chairman of Board of Review No 1 said:

> 'In determining whether a business is being carried on it is, in my view, proper to consider, as one of the elements, whether the activities under consideration could ever result in a profit...'

48. We believe that it is important for the taxpayer to be able to show how the activity can make a profit. Where the taxpayer has conducted research into his/her proposed activity, consulted experts or received advice on the running of the activity and the profitability of it before setting up the business, there will be stronger evidence of an intention to make a profit. This was the situation in *FC of T v. JR Walker* 85 ATC 4179; (1985) 16 ATR 331. However, it is not necessary for the primary production activities to make a profit in every year of income in order to classify the activities as a business of primary production. Thus, a taxpayer may be carrying on a business of primary production even though they are making a small profit or a loss.

49. The situation may arise where a taxpayer is carrying on a business and has an intention to make a profit but the objective evidence is such that a profit is unlikely to be made in the short term. Bowen CJ and Franki J in *Ferguson* at ATC 4264; ATR 876 stated that '... an immediate purpose of profit-making in a particular income

year does not appear to be essential ...'. Thus, where short term losses are expected it may be that a business is nevertheless being carried on: see *Tweddle v. FCT* (1942) 7 ATD 186; (1942) 2 AITR 360.

50. Where an activity is being carried on and it is unlikely that a profit will ever be made, this fact in itself will not necessarily mean that a business is not being carried on, if the taxpayer believes that the activity will become profitable. As Walsh J said in *Thomas* at ATC 4100; ATR 171:

> 'It is not in doubt that he made mistakes. But many persons carry on a business for the competent conduct of which they have not previously acquired much knowledge or experience.'

See also *Tweddle's* case at ATD 190; AITR 364. However, taxpayers will need to show that the other indicators of business are present in sufficient strength to outweigh any objective view that the activity may be inherently unprofitable. A number of Board of Review and Administrative Appeals Tribunal decisions show that a taxpayer in this situation bears a heavy onus: see *Case M50* 80 ATC 349; 24 CTBR (NS) *Case 24*; *Case K9* 78 ATC 98; 22 CTBR (NS) *Case 29*; *Case L16* 79 ATC 84; 23 CTBR (NS) *Case 20* and *Case L22* 79 ATC 106; 23 CTBR (NS) *Case 25*.

Example 6 - prospect of profit

51. For a number of years Peter used his four hectare property to cultivate 100 pawpaw trees on the outskirts of Fremantle. He had planted the trees on his return from a trip to the tropics. He had thought that there must be a good market for locally grown tropical fruit in Fremantle. However, he had not conducted any research into the growing conditions they would need including climate, their care or potential markets. He had not undertaken any soil analysis. He was always unable to market the limited amount of produce that he did obtain, because of its poor quality. His only disposals of fruit were to friends and relatives for which no money was received. Expert advice was that commercially saleable fruit would never grow in the location, and that there was little likelihood of a profit ever being made. Was Peter carrying on a business of primary production?

52. No, Peter would not be considered to be carrying on a business of primary production. Not only was there no reasonable expectation that the activity would be profitable, there was also:

- a lack of system and organisation about the activity, including inadequate preparation;

- a lack of use of the type of methods commercial pawpaw growers use, including suitability of location for growing the fruit;
- a general lack of 'significant commercial purpose or character' about the activity.

(Note: refer to paragraph 27.)

Example 7 - prospect of profit

53. Fay's friends were avid growers of olive trees and were making a small profit on the sale of olive oil they produced from their olives. Fay decided to grow olive trees on her modest property. She researched the varieties and selected those best for olive oil production. Fay planted 50 olive trees on her property. She knew they were hardy trees which required minimum maintenance. She spent the minimum amount of time necessary to care for the trees. She had spoken to her friends and had calculated that after four years she would be able to make a profit on the production of olive oil from the olives she picked. The trees thrived. In the fifth year after planting, a sizeable crop was produced. Fay employed casual labour to pick the olives, borrowed a friend's trailer and took the olives to be pressed. She sold the barrels of olive oil to friends, work colleagues and members of the public who responded to her newspaper advertisements. She derived a substantial profit in that year, which she was told by her friends in the industry was typical. Was Fay carrying on a business of olive production?

54. Yes, Fay would be considered to be carrying on a business of primary production. The activities were carried out with a purpose to make a profit, even if no income was made in the first four years of operation. In addition:

- Fay clearly had a plan to make the activity succeed. She had conducted research by consulting friends in the industry and the local growers association;
- though the activity was small it was organised. By its nature the activity required minimum maintenance. It was not carried on in an ad hoc manner. Rather, it was carried on in a manner similar to that of other olive producers;
- there was repetition and regularity of the activity.

(Note: refer to paragraph 27.)

Repetition and regularity

55. It is often a feature of a business that similar sorts of activities are repeated on a regular basis. The repetition of activities by the same person over a period of time on a regular basis will help to determine whether there is the 'carrying on' of a business. For example, in *Hope* the 'transactions were entered into on a continuous and repetitive basis', such that the taxpayer's activities 'manifested the essential characteristics required of a business'. Similarly, in *JR Walker* the court held that there was repetition and regularity in his activities directed to the breeding of high quality Angora goats and with respect to the keeping up with the latest information on Angora goats.

56. The taxpayer should undertake at least the minimum activities that are necessary to maintain a commercial quantity and quality of product for sale. It may be that there are no minimum levels for this activity. Where there are minimum levels necessary for this activity and the taxpayer fails to maintain them it may be that for a period the taxpayer has ceased to carry on a business of primary production.

Example 8 - repetition and regularity

57. George owned a pastoral property, 'Wytelaidee', which consisted of 600 hectares. He had acquired the property in 1970. Two hundred hectares were suitable for cultivation and the rest was open grazing country. Cattle and sheep were grazed for a number of years. George grew his own feed for the animals and also grew 200 olive trees. The cattle and sheep were the main primary production activities. The olive trees were a secondary activity as they required limited care. George did ensure that they were adequately cared for with respect to spraying and watering. The olives were bottled and pickled or olive oil was extracted from them, and this was sold on a regular basis. He usually made a profit from his primary production activities.

58. However, George was drawn into a legal battle over 'Wytelaidee' in 1990 as a result of mistaken identity. He was unable to spend any time on the property and sold all stock, plant and equipment to finance the legal battle. The olive trees were left untended and grew wild. The olives were left to rot. No income was derived from the property from 1991. George always intended to return to 'Wytelaidee' after the legal battle which ended in 1995 and to recommence operations. Was George carrying on a business of primary production for the years 1991 to 1995?

59. No, for the years 1991 to 1995 George was not carrying on a business of primary production. As the property was left untended for

the period and stock and equipment was sold there was no activity being carried on thus there was a lack of:

- any size or scale of activity;
- an intention to make a profit;
- repetition or regularity of activity;
- a significant commercial purpose.

60. If George had made arrangements for the olives to be picked, processed and sold he may have been able to claim that he continued to carry on a business of olive production and sale.

(Note: refer to paragraph 27.)

Example 9 - repetition and regularity

61. John, a commercial lawyer, owned 500 apricot trees on a weekend retreat property located 250 km from his home in Brisbane. The trees had been in commercial production when he bought the property. John knew at the outset that he could, with proper management, run the enterprise at a profit. However, due to his employment, he was busy in the city and was unable to attend to the trees on a regular basis. Thus, he did not spray the trees for pests, irrigate or prune them. He decided that he could not be bothered hiring someone to look after the trees. He picked what he could in the hope of making some return but due to the lack of care the apricots were not of a suitable quality for the commercial market. They were rejected by a wholesaler he approached after he had picked a small quantity of the fruit. He left what fruit he had picked with an honesty box on the side of the road and estimated that he got $50. Was John carrying on a business of apricot growing?

62. No, John would not be considered to be in a business of apricot growing, despite the impression given by the size and scale of his activity. Further:

- there was no repetition and regularity of activities that would produce a commercial quantity and quality of fruit for sale;
- there was no clear evidence that he intended to make a profit from this activity;
- the way he conducted it means that it was extremely unlikely that he would ever cover his costs;
- he did not adopt methods used by commercial orchardists;

- there was a general lack of system and organisation about his apricot growing activity.

(Note: refer to paragraph 27.)

Is the activity of the same kind and carried on in a manner that is characteristic of the industry?

63. An activity is more likely to be a business when it is carried on in a manner similar to that in which other participants in the same industry carry on their activities. Lord Clyde in *IR Commissioners v. Livingston* at TC 542 said that:

> '...the test, which must be used to determine whether a venture ... is, or is not, "in the nature of trade", is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.'

64. In considering this indicator the following factors might be compared with the characteristics of others engaged in the same type of business:

- the volume of sales. If there is a small number of sales it is less likely that a business is being carried on. The volume of sales should also be capable of producing a profit at some time. However, allowance will be made for droughts, fires and other uncontrollable events which may effect the volume of sales. We also accept that in the early stages of an activity, sales may be low;
- what types of customers the taxpayer sells his/her product to - as wholesalers, or direct to retailers, the public at large, or friends or relatives, and the manner in which this marketing takes place;
- what sort of expenses are incurred by the taxpayer;
- the amount invested in capital items;
- previous experience of the taxpayer. Where a taxpayer does not have any knowledge or experience he/she may be expected to have sought advice from experts. However, it is recognised that a taxpayer may be a pioneer in his/her industry. He/she may have conducted research into the activity and decided that the traditional approach is wrong and to try to conduct the activity with a view to profit in a new way but businesslike way;
- the activity should also be compared with that of a keen amateur. The sales of a keen amateur may only be a way

of obtaining 'new' funds to continue with the personal interest.

65. The aspects mentioned in the above paragraph would be compared to the same aspects of how others in the industry conduct their business of primary production. The activity should also be compared to that of the activity of a keen amateur. If a taxpayer:

- has no knowledge or experience of the primary production activity that he/she intends to enter into; and
- does not seek advice or conduct research; and
- starts the activity;

then he/she may have difficulty in proving that he/she is carrying on a business of primary production. This will be especially so when the above points add to a general impression that there is no profit motive behind the activity and there is very little likelihood that the activity will ever be profitable.

Example 10 - activity of same kind and carried on in a manner characteristic of industry

66. Geoff and Heather purchased a small property in the Adelaide Hills after returning from a holiday in Japan where they had noticed not only the sale price but also the remarkable size and flavour of the apples. They had determined that the land was suitable for apple trees. Both spent a considerable amount of time researching, talking to experts and collecting technical literature on apples for the Japanese market. They determined from discussion with wholesalers that if their apples were of superior quality they would have a ready market and would be able to make a substantial profit from the sale of their apples. They both changed their employment from full-time to part-time so that at all times one of them was on the property. They selected and planted varieties for the Japanese market based on their research and planted one hundred trees. They carefully sprayed and pruned the trees and protected the growing fruit from the elements. From their research they ensured they would meet stringent overseas market rules regarding spraying and quality, etc. They distinguished their product by individually wrapping them and putting 'quality one' labels on them. Heather devised a unique irrigation system which they installed. They made losses for four years in a row. In the fifth year, although making significant sales, their production was still insufficient to generate a profit. However, based on current market conditions and anticipated production levels, they were confident that in future years they would make a profit. Were Geoff and Heather carrying on a business of apple production?

67. Yes, because despite the size and scale of operation and the fact that the activity was not carried on in a similar manner to that of the ordinary trade of apple growing:

- there was an apparent significant commercial purpose or character to their activity;
- there was a clear intention to make a profit and their research had shown that the activity would be profitable;
- despite lacking previous experience of apple production they have conducted specific research into the methods required to succeed in servicing a specialty market;
- there was repetition and regularity of the activity given the amount of time they spent attending to the trees;
- there was an intention to engage in business and a plan for its successful and profitable operation;
- unlike Peter in Example 6 (paragraph 51), Geoff and Heather are able to show that they are pioneering new methods or servicing specialty markets.

(Note: refer to paragraph 27.)

Organisation in a businesslike manner and the use of system

68. In *Newton v. Pyke* the court suggested that business should be conducted systematically. A business is characteristically carried on in a systematic and organised manner rather than on an *ad hoc* basis. It is often necessary to look at whether an activity is being carried on in a manner that conforms with ordinary commercial principles, to determine whether that activity amounts to the carrying on of a business.

69. In *Ferguson* the Full Federal Court was influenced by the systematic and organised nature of the taxpayer's activities. Fisher J said at FLR 324-325; ATC 4271; ATR 884:

> '...the venture as a whole had a commercial flavour, was conducted systematically and, ... in a business-like manner. It could not be said that there was anything haphazard or disorganised in the way in which he carried out the activity.'

In *JR Walker* Ryan J was satisfied, at ATC 4182; ATR 335, that the taxpayer was in the business of goat breeding as he had 'organised his activities in a business-like way through the keeping of books of account'.

70. The weight that is attached to this indicator will depend on the facts of the situation and a taxpayer may still carry on a business of primary production despite having poor organisational skills.

Example 11 - organisation in a businesslike manner and the use of system

71. Rob had a passion for Topiary plants. He had 500 plants which he had potted and tended on his modest property. There was no local market for the plants. The nearest major city was Melbourne but it was too expensive for him to transport the plants to the city on a regular basis to sell them. He tried unsuccessfully to sell the plants, on irregular occasions, at the Melbourne markets. Rob had no credit facilities and only accepted cash. Was Rob carrying on a business of primary production?

72. No, Rob was not carrying on a business of Topiary plant production because:

- there did not appear to be an element of commerciality;
- he had not conducted research into the activity, potential markets, or the profitability of the activity;
- there were restrictions on his markets;
- he placed restrictions on his ability to sell the plants by his inability to cater for anything other than cash;
- he had no plan or system in place to make the activity succeed;
- his purpose for engaging in the activity was his passion for the plants.

(Note: Refer to paragraph 27.)

73. However, in some cases it will be essential that specific records are kept, especially breeding records for a stud farm. Other matters that may be considered are:

- whether a systematic approach is taken to record keeping;
- the amounts of inputs, costs, seasonal and other conditions affecting production;
- how growing and market conditions are monitored.

74. For taxation purposes, certain records are required to be kept where a business is being carried on. The keeping of records which monitor the flow of cash, stock and production will assist in showing that a business is being carried on. (See also Taxation Ruling TR 96/7 and the record keeping provisions of section 262A of the Act.)

Example 12 - organisation in a businesslike manner and the use of system

75. Leon owned a property of twenty hectares in Queensland, an hour's drive from his home. He bred race horses and had begun with six brood mares, a stallion and a colt which he had built into a modest sized herd. Over the years he had conducted extensive research into horse breeding activities and had collected much literature. Through his contacts with local and overseas breeders he developed a number of ideas for a successful and profitable breeding program. He had established that he could make a reasonable profit, had identified relevant markets and had a business plan. He had set up a computer system to monitor the breeding program, costs and the record keeping requirements of the Act. His activity was well organised and conducted in a systematic manner. Was Leon carrying on a business of primary production?

76. Yes, Leon was carrying on a business of primary production. Given the presence of the other indicators, the fact that he carried on his activity in an organised and systematic manner added weight to the conclusion that he was carrying on a business of horse breeding. See also the discussion in Taxation Ruling TR 93/26 at paragraph 9 dealing with issues relating to the horse industry.

(Note: refer to paragraph 27.)

Size or scale of the activity

77. The larger the scale of the activity the more likely it will be that the taxpayer is carrying on a business of primary production. However, this may not always be the case. The size or scale of the activity is not a determinative test, and a person may carry on a business though in a small way (*Thomas* at ATC 4099; ATR 171).

78. For example, the case of *JR Walker* involved five Angora goats, two of which died. Whilst the scale was small, the court held that a goat breeding business was being carried on because there was a profit making purpose and repetition and regularity in the taxpayer's activities. Research, based on authenticated sources, showed that a profit could be made from the significant capital allocated to breeding stock.

79. In *JR Walker*, Ryan J said at ATC 4182; ATR 334:

> '...the respondent's activities had the purpose of profit making. ... There was also repetition and regularity in his activities. ... The activities of the taxpayer were limited but ... he maintained communications with the expert and he tried to make himself

> informed about market conditions through membership of the Angora Breed Society and reading publications ... He organised his activities in a business-like way through the keeping of books of account ...'

80. The scale of the activities may be small but still result in more produce than is required for the taxpayer's own domestic needs. Where this is so, and there is an intent to profit from the activities and a reasonable expectation of being able to do so, these all point to a business being carried on despite the scale.

81. Similarly, in *Thomas* at ATC 4099; ATR 171 Walsh J in the High Court said:

> 'But a man may carry on a business although he does so in a small way. In my opinion the appellant's activities in growing the trees ought not to be found to have been carried on merely for recreation or as a hobby. I leave out of account the pine trees, the growing of which did not have, I think, a significant commercial purpose or character. But the appellant in planting the avocado pear trees and the macadamia nut trees set out to grow them on a scale that was much greater than was required to satisfy his own domestic needs and he expected upon reasonable grounds that their produce would have a ready market and would yield, if the trees became established, a financial return which would be of a significant amount, with relatively small outlay of time and money, and that this return would continue for a very long time.'

82. The smaller the scale of the activity the more important the other indicators become when deciding whether a taxpayer is carrying on a business of primary production.

Example 13 - size or scale of the activity

83. See Example 9 (John and his 500 apricot trees) at paragraph 61. In this example, despite the size/scale of activity by John, he was not carrying on a business of primary production.

(Note: refer to paragraph 27.)

Example 14 - size or scale of the activity

84. See Example 10 (Geoff and Heather and the Japanese apple market) at paragraph 66. In this example, Geoff and Heather carried on a business of very small scale apple production for the Japanese market.

(Note: refer to paragraph 27.)

Example 15 - size or scale of the activity

85. See Example 3 (Naida and her chickens) at paragraph 36. The small scale of her operations counted against there being a commercial purpose or character to the activities.

(Note: Refer to paragraph 27.)

Hobby or recreation

86. The pursuit of a hobby is not the carrying on of a business for taxation purposes. Money derived from the pursuit of a hobby is not regarded as income and therefore is not assessable. As was said in *Ferguson* at ATC 4265; ATR 877:

> '...if what he is doing is **more properly described as the pursuit of a hobby or recreation or an addiction to a sport,** he will not be held to be carrying on a business, even though his operations are fairly substantial.' (emphasis added)

Expenses incurred in relation to the hobby activity are not allowable deductions. However, we recognise that a hobby can sometimes turn into a business.

87. Often it will be the case that there is a hobby when:

- it is evident that the taxpayer does not intend to make a profit from the activity;
- losses are incurred because the activity is motivated by personal pleasure and not to make a profit and there is no plan in place to show how a profit can be made;
- the transaction is isolated and there is no repetition or regularity of sales;
- any activity is not carried on in the same manner as a normal, ordinary business activity;
- there is no system to allow a profit to be produced in the conduct of the activity;
- the activity is carried on a small scale;
- there is an intention by the taxpayer to carry on a hobby, a recreation or a sport rather than a business;
- any produce is sold to friends and relatives and not to the public at large.

Example 16 - hobby or recreation

88. Norm was a keen gardener. His two favourite vegetables were broccoli and pumpkin. He enjoyed growing these in his garden and exhibiting the larger specimens at vegetable shows for which he often won prizes. He had been doing this for the last twenty years. Norm always kept up with the latest advances in growing techniques of broccoli and pumpkin. He had always been keen to talk to other growers of the vegetables and had subscribed to the relevant magazines. He also stayed in regular contact with the Department of Primary Industries to keep up with the latest information about vegetable growing. Norm had no business plan. He kept no records of his expenses. His only intention was to grow the biggest and best broccoli and pumpkin. To this end he often experimented with different growing techniques. Usually he gave away his broccoli and pumpkin to relatives and friends. However, he found that in the last 12 months people approached him at the shows to purchase his prize winning specimens. He has been happy to sell these. Was Norm carrying on a business of primary production?

89. No, Norm would not be regarded as carrying on a business. Rather his activities amounted to a hobby for the following reasons:

- the size and scale of his activity was small, as it was in his back yard;
- he had no plan or intention to make a profit and his activities were motivated by his passion for growing broccoli and pumpkins;
- his produce was usually given away to friends and family rather than sold to the general public;
- records were not kept and the activity was not carried on in the same manner as that of the ordinary business activity of commercial pumpkin and broccoli growers.

90. As a result of being approached at shows, Norm realised that there was a potential market for his produce and that he could turn his hobby into a business. He developed a profit making intention. He worked out the economics of his activities and calculated that by using extra land he would make a profit. He rented a block of land on which he grew broccoli and pumpkins on a larger scale. He kept detailed records of his activities and established his markets mostly as a result of approaches by people to him. Was Norm carrying on a business of primary production?

91. Yes, Norm would be regarded as carrying on a business of primary production. When the nature of the activity changed being a hobby to a business. At this time, in addition to his experience and skill in the activity:

- the activity had a profit making purpose;
- he expanded the size of the activity;
- he kept detailed records;
- he established markets.

(Note: refer to paragraph 27.)

Example 17 - hobby or recreation

92. Richard was a musician and singer in a rock band. Richard was also interested in dressage. Richard owned a substantial land holding on which he bred horses to obtain better mounts for his dressage competitions. He trained his own horses. He belonged to the local club and usually sold any unwanted and untrained offspring through his club and the local newspaper. The sale prices were well below the expenses associated with maintaining the horses. He conducted research into breeding and training techniques and tried to keep up-to-date with the latest information. He kept detailed records of breeding and all expenses associated with the horses. When the horses became too old to compete he put them out to pasture, as he could not bear to part with his old companions. Was Richard carrying on a business of horse breeding?

93. No, Richard was not carrying on a business of horse breeding despite the keeping of records, the organisation, the repetition and regularity of activity and the research conducted, because:

- the activity was primarily motivated by his desire to compete and any returns were merely incidental to this purpose;
- no profit was made from the activity;
- there was no intention to carry on a business or to make a profit: the keeping of records, the research and the sales made were all associated with Richard's dressage activities;
- there was no significant commercial purpose or character to the activity.

(Note: refer to paragraph 27.)

Application of all the indicators

Example 18 - Application of all the indicators

94. George and Desi grew tired of living in the suburbs. They moved, with their two young children, to a 20 hectare property about

50 kilometres away from the capital city where they were living. As part of their rural lifestyle they wanted to use their new property for primary production activities.

95. In July 1993 they planted oats, Japanese millet, phalaris and clover. The land was fertilised in expectation that they would be able to graze some beef cattle on it, fatten and sell them. They noted that a number of the larger properties in the area were used for this purpose.

96. They were not sure when they would be able to purchase these cattle due to a shortage of funds. It was not until May 1994 that 10 cattle were purchased. No plan of any sort was drawn up to see whether the grazing of beef cattle on their land would be profitable. George and Desi spoke to a number of their neighbours about what was the maximum number of cattle that their land could carry, but they received conflicting advice. Most of the advice suggested however that they did not have enough land to make the venture profitable. George and Desi had no clear idea of what all their costs would be for such an activity.

97. The first sale of 5 head was in March 1995. At that time Desi accepted a redundancy offer and applied herself full time to their cattle grazing activity. With the money from the pay-out she purchased 20 additional cattle on the advice of her neighbour (a cattle farmer for a number of years). At the same time she developed a plan based on expert advice from the Department of Primary Industries for maximising the carrying capacity of their land and achieving profitability. She travelled with neighbours and purchased 20 weaners, and she arranged for her and George to share costs with these neighbours in transporting their cattle to various markets for sale.

98. By June 1996, 35 cattle had been sold and 11 were on hand. Market conditions had been poor and the sale prices for all their cattle sold had not been much greater than the price which they paid for them. However, Desi calculated that they could cut their costs further and noted from the rural press that long term forecasts of beef prices were good. On the basis of improved prices and a doubling of the herd size, she calculated that their activities could produce a reasonable profit. With her redundancy money she calculated that they could buy an adjoining 20 hectares for this purpose.

99. Were George and Desi carrying on a business of cattle grazing? If so, when did this business commence?

100. This Example is meant to illustrate the importance of considering all the indicators of whether a business is being carried on and how the facts related to some of those indicators can materially change over time. In this particular case there was a marked change in the character of the cattle grazing activity after March 1995.

101. Before March 1995 George and Desi were not carrying on a business of primary production. The reasons are that there was:

- little evidence of any system or organisation about the activity;
- doubt as to whether there was an overall profit-making purpose;
- a strong suggestion that the activity, as it was being conducted at that time, was inherently unprofitable;
- little repetition or regularity about the activity, and the small scale of the activity.

102. After March 1995 there was a considerable change in the way that the cattle grazing activity is being carried on. In particular there was then:

- a clear focus on how to make a profit from the activity. This was demonstrated by the drawing up of a plan to make a profit based on expert advice, the search for the most profitable markets for the sale of the cattle and efforts to reduce the costs of obtaining and maintaining the cattle;
- an increase in repetition and regularity, particularly an increase in purchases and sales of cattle;
- more similarity between the activities of George and Desi and those of a person who would clearly be considered to be carrying on a business of cattle grazing;
- a greater sense of permanency, and scale of the activity as evidenced by the purchase of the neighbouring property, together with a greater capacity to make the operations profitable.

103. We consider that from March 1995 George and Desi were carrying on a business of cattle grazing.

(Note: refer to paragraph 27.)

Private rulings

104. We believe that a person cannot obtain a private ruling under Part IVAA of the *Taxation Administration Act 1953* ('TAA') on the question of whether they are carrying on a business (refer Taxation Determination TD 96/16). Likewise, a person cannot obtain a private ruling on the question of whether they are carrying on a business of primary production. The reason for this is that the question does not identify a specific 'tax law'. Under section 14ZAF of the TAA a

person can only apply for a ruling on how, in the Commissioner's opinion, a tax law will apply with respect to an 'arrangement' in regard to a 'year of income'.

105. A taxpayer cannot ask for a ruling on a finding of fact. A taxpayer can ask for a ruling on a question of tax law that depends for its operation on either:

- the carrying on of a business of primary production, for example section 156 of the Act; or
- the carrying on of a business, for example, under the second limb of subsection 51(1) of the Act.

106. The notice of private ruling we give will contain our answer only on how the tax law applies to the arrangement, for example, that a deduction of $x is allowable under section 70 of the Act. Normally, however, this notice will be accompanied by an 'Explanation'. In the Explanation we would describe our reasons for the answer contained in the notice of ruling. For example, an Explanation accompanying a notice of ruling about the application of section 70 to an arrangement would usually contain our reasons about whether the activities described in the application for private ruling amounted to the carrying on of a business of primary production. The person who applied for the ruling would know therefore what the Commissioner's views were on this point.

107. Under paragraph 14ZAN(h) of the TAA, if it has not already begun, the taxpayer's 'arrangement' must be seriously contemplated. In such cases, a taxpayer's application therefore needs to show:

- how he/she intends to carry out the arrangement;
- that he/she has the means to carry out the arrangement; or
- that he/she has or will soon take steps to obtain the means to carry out the arrangement.

108. An application should contain 'sufficient information' to enable the Commissioner to give the ruling. Where insufficient information is provided the Commissioner may request the relevant information under section 14ZAM of the TAA. Where information has been requested and remains insufficient the Commissioner does not need to comply with the application under paragraph 14ZAN(i) of the TAA.

109. 'Sufficient information' will include information which covers the eight indicators, and any other matter which the taxpayer considers relevant. We would expect to see information about:

- purpose and intention - the reason that the taxpayer has entered into the activity; whether the taxpayer is employed in some other area;

- profit motive and profitability of the activity - e.g., the existence of a business plan; the results of research on viability; realistic sales forecasts; cost projections over the anticipated length of time before the activity is expected to become profitable; details of how capital is to be employed; the source and cost of funds; taxpayer's expertise in the activity;
- repetition and regularity of the activity - how much time is spent on the activity; a breakdown of the tasks that are performed on a regular basis; regularity of purchases and sales;
- activity of the same kind - including such things as descriptions of methods used in the activity with regard to cultivation, livestock raising, obtaining the relevant licences and complying with the relevant laws;
- organisation - how the activity is conducted; how and what records are kept; what advice is sought;
- the size and scale of the activity - e.g., the size of the land, details of any private residence on the land, details of improvements to the land such as fencing, sheds, clearing and fertilising of the land; details of equipment/plant purchase including depreciation schedules; the numbers of livestock involved; level of capital investment;
- whether the activity could be viewed as a hobby or recreation
- **significant commercial purpose - this will generally follow from all of the above**.

Business plan

110. We emphasise that whilst a business plan will help a taxpayer to establish that he/she is carrying on a business of primary production it is not compulsory. Nor will the existence of a business plan be conclusive evidence that the taxpayer's activity amounts to the carrying on of a business.

111. A business plan is particularly relevant to establishing that there is an intention to make a profit, that the activity will be profitable and that the activity has a significant commercial purpose, particularly where it is capable of authentication by reference to texts, publications by relevant authorities or organisations and local experience in the industry. A business plan may include many things. However, we recommend that the basic elements of the business plan should include the following:

- a description of the business;
- the markets to which the taxpayer proposes to sell and realistic estimates of quantity and volume of sales;
- income expected from the activity;
- the research that has been conducted by the taxpayer - e.g., who the taxpayer has spoken to, what literature he/she has collected; what previous knowledge he/she has;
- information about the property on which the taxpayer proposes to conduct the business - e.g., its size, distance from home, whether irrigated or not, whether soil and water tested, whether rainfall sufficient for the activity;
- information about expected expenses and capital outlays - e.g., cost of travel, electricity, gas and water, cost of plant and equipment and stock;
- information about how the taxpayer proposes to pay for the expenses and capital outlays - e.g., if the taxpayer takes out a loan what is the interest rate and how long will it take to repay.

Business plan example

112. *Business - Jeff's passionfruit*

2000 Passion fruit vines. To be planted beginning financial year 1996.

Markets

Sell primary/ A grade fruit to Brisbane markets - up to 10 trays in good weeks, seconds etc for pulping and fruit juice markets.

Research

Will speak with local fruit growers about pests etc, collected DPI information on types and spraying cycles. Passion Fruit Growers Association in Brisbane provided literature on the latest practices re growing passion fruits and which passion fruit varieties to grow given future markets. Obtained DPI copy of 'Passionfruit in Queensland'. Combined with my knowledge of farming from several years on a fruit tree farm I feel that I have the knowledge to undertake the activity successfully.

Property

10 Acre block, 20 km from my home in Mackay, will require additional watering given varying rainfall. Existing bore water quality and quantity tested and found sufficient for my crop size. Irrigation to be installed. Soil tested and found to be suitable.

Expected expenses / outlays

Travel to block 3 times a week after work and weekends as needed. Estimate travel expenses using my existing ute will be $3,500 a year - including delivery of produce. Estimate that about half of this will be deductible, when carrying bulky farm materials. Electricity will need to be connected for pump and shed lights with an estimated running cost of $500 per year. Other one-off expenses include:

Connection of electricity	$1,000
Purchase of vines @ $3.00 per vine	$6,000
Installation of irrigation	$1,000
Rent of tractor / post digger for trellises (from neighbour)	$500
Posts / wire / for trellises and to fix up property fencing	$1,500
Labour (brother will help on posts)	Free
Ride on mower / spray unit (2nd hand)	$3,500

I will take out a loan of $10,000 to cover the above expenses plus use my existing savings. Given my other income I should have the loan paid out in 5 years. The vines will last 5 years from the time of planting and then I will replace them.

113. *Table of anticipated receipts and costs (in 1996 dollars)*

Year	1995/ 1996	1996/ 1997	1997/ 1998	1998/ 1999	1999/ 2000
Expected Sales					
A Grade (avg price)	0	2500	4000	4000	3000
Seconds (pulping)	2000	3000	5000	5500	6000
Gross Receipts	2000	5500	9000	9500	9000
Running Costs					
Accounting Fees	200	250	300	350	400
Bank Charges	50	50	50	50	50
Interest	1200	1000	800	600	300
Protective Clothing	50	50	50	50	50
Repairs and Maintenance/ fuel	300	500	500	500	500
Motor Vehicle	1750	1750	1750	1750	1750
Telephone	100	100	100	100	100
Sprays and Chemicals	250	250	250	250	250
Rates and Taxes	300	325	350	375	400
General Expenses	200	200	200	200	200
Total Costs	4400	4475	4350	4225	4000
Net Profit / Loss on trading before write-off and depreciation	(2400) Loss	1025 Profit	4650 Profit	5275 Profit	5000 Profit

114. *Depreciation and capital write-offs*

Depreciation on sprayer/ mower, fences/ improvements and trellises	960	960	960	960	960
Write-off of vines - Div 10F, starting 1 May 96	408[1]	2400[2]	2400[3]	792[4]	
Write-off electricity connection costs (10 years - section 70A)	100	100	100	100	100
Write-off irrigation expense (3 years - section 75B)	333	333	334	Nil	Nil
Total Write-off & Depreciation	1801	3793	3794	1852	1060
Net Profit / Loss on trading after write-off and depreciation	(4201) Loss	(2768) Loss	856 Profit	3423 Profit	3940 Profit

Jeff approached his accountant who gave him some additional information on capital and equipment write-offs and depreciation. He suggested using sections 70A and 75B to write off the electricity connection and irrigation expenses and Division 10F to write-off the capital value of the vines, although he noted that this would produce timing differences compared with an accounting write-off. However, using these rates of write-off would mean that the outcome would produce a correct tax result. Jeff noted as part of his business plan that:

> 'I have not yet seen published any Division 10F "safe harbour" write off rates issued by the Commissioner, so in my business plan calculation I will use a four year write off of the cost of the

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[1] Calculated from 1 May 1996: 62/365 days x $6,000 capital cost x 40% rate for plants with 4 year life from date first become income producing - see section 124ZZI of the ITAA.

[2] Full year write off of $6,000 capital cost @ 40% rate.

[3] Full year write off of $6,000 capital cost @ 40% rate.

[4] Write off of balance of the $6,000 over the 2 years and 183 days allowed for by section 124ZZI.

vines, commencing from when they become income producing, which I estimate to be 1 May 1996.'

115. **Note:** This business plan Example is an illustration only. It is not definitive on what deductions a taxpayer may claim or the calculation of profit.

Your comments

116. If you wish to comment on this Draft Ruling, please send your comments by: 7 March 1997

to:

Contact Officer:	Jennifer Ostler
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Detailed contents list

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subject references
- primary production
- whether carrying on a business of primary production

legislative references
- ITAA 6(1)
- TAA Part IVAA
- TAA 14ZAF
- TAA 14ZAM
- TAA 14ZAN(h)
- TAA 14ZAN(i)

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- FC of T v. JR Walker 85 ATC 4179; (1985) 16 ATR 331
- Ferguson v. FC of T (1979) 37 FLR 310; 79 ATC 4261; (1979) 9 ATR 873
- Goodman Fielder Wattie Ltd v. FC of T 91 ATC 4438; (1991) 22 ATR 26
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- Newton v. Pyke (1908) 25 TLR 127
- Smith v. Anderson (1880) 15 Ch D 247
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- The Commissioners of Inland Revenue v. Livingston and Others (1926) 11 TC 538
- Thomas v. FC of T 72 ATC 4094; (1972) 3 ATR 165
- Tweddle v. FC of T (1942) 7 ATD 186; (1942) 2 AITR 360
- Case H11 76 ATC 59; 20 CTBR (NS) Case 65
- Case K9 78 ATC 98; 22 CTBR (NS) Case 29
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