


IT 2489 - Income tax : business income of minors

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TAXATION RULING NO. IT 2489

INCOME TAX : BUSINESS INCOME OF MINORS

F.O.I. EMBARGO: May be released

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I 1010736	UNEARNED INCOME OF MINORS BUSINESS INCOME INCOME OF CERTAIN CHILDREN	102AE 102AF(3)

PREAMBLE In broad terms by Division 6AA of Part III of the Income Tax Assessment Act and the Income Tax (Rates) Act, unmarried children under 18 who are not engaged in a full-time occupation (with certain other exceptions not presently relevant) are liable to pay tax on their 'unearned' income at higher than normal rates of tax.

2. All types of assessable income of affected minors are eligible for Division 6AA rates of tax unless the income falls within one of the categories of 'excepted assessable income' (subsection 102AE(2)).

3. One category of excepted assessable income is business income. 'Business income' for this purpose means income derived by a minor during a year of income from carrying on a business either alone or together with another person or persons (subsection 102AF(3)). The amount of business income to be treated as excepted assessable income is determined by subsection 102AE(5). In a situation where the minor (who was a minor on the first day of the year of income) carries on a business alone, this means so much of that business income as the Commissioner considers fair and reasonable having regard to:

- . the extent to which the minor had the real and effective conduct and control of, and participated in the operations and activities of the business;
- . the extent to which the minor had the real and effective control over the disposal of income he/she derived from the business;
- . the extent to which the capital of the business consisted of property contributed by the minor, being properly the income from which, in the Commissioner's opinion would be excepted assessable income of the minor; and

. any other matters as the Commissioner thinks fit.

4. On the introduction of Division 6AA in 1980, the explanatory memorandum to the legislation (Act No. 19 of 1980) stated that 'The broad intended effect of subsection 102AE(5) will be that income of a business that is carried on by a minor will be treated as excepted income if the minor (or minors) in reality owns and conducts the business. Canberra Income Tax Circular Memorandum 884 was issued contemporaneously and discussed the new provisions. Subsection 102AE(5) was seen as an anti-avoidance measure restricting the amount that may be treated as business income in paragraph 102AE(2) (a). The broad effect of subsection 102AE(5) is that if the business is carried on by the minor alone or in partnership with another minor (or minors), the whole of the income may be treated as excepted assessable income if in reality the minor finances, owns, conducts and gets the benefit from the business. To the extent that this is not so, the Commissioner may reduce the excepted business income to such amount as he considers fair and reasonable. CITCM 884 went on:

'220. If it is clear that in fact there is a business and that it is carried on by the taxpayer alone, or with others who are under 19 at the end of a year of income, and the income represents a reasonable return for their efforts and the amount of their own "excepted" capital, that income should be regarded as wholly excepted. For example, a part-time lawn-mowing business genuinely conducted by a minor and his friends with plant and transport paid for out of their own past wages and who keep the profits which appear reasonable for such a side line.

221. But care will be required to guard against attempts to divert income derived by parents to their children under the guise of the business income category. So that if a business conducted by a minor or minors has plant or other assets, capital or services provided to it on a non-arms length basis, the excepted income arising should be reduced by an amount that is attributable to the benefits enjoyed under those arrangements, calculated on an arms length basis e.g., by an allowance for rent of land, interest on capital, or remuneration for advice or services.'

5. The general question of the extent to which a minor meets the requirements in paragraph 102AE(5) (a) is one of fact to be determined in the circumstances of each case. As to the extent of real and effective control over business income, guidance can be obtained from the following extract from Public Information Bulletin No. 5 of April 1965, relating to a comparable provision in section 94 dealing with real and effective control and disposal of shares of partnership income:

'The question whether a partner 16 years of age or over at the end of the income year has the real control of his share of partnership income, or a part of it, is one of fact to be determined in the light of the circumstances of each particular case.

The law sets out that the question is to be considered in the light of any of three matters. They are:

- . the constitution of the partnership;
- . the control of the partnership;
- . the conduct of the operations in the partnership.

In very broad terms, it is considered that a partner lacks the real control if, by reason of any of the matters mentioned in the preceding paragraph, he must allow his share to be dealt with in a particular way so that he cannot, of his own will, deal with it in another way. If this situation affects only part of the share, he will, for the purposes of section 94, be considered to lack the real control of that part only.

A partner who is not debarred by the constitution of a partnership or its control or conduct from controlling or disposing of his share of partnership income may, of his own will, leave his share of income or a part of it, with the partnership. If no other considerations exist, such a partner would have the real control of his share of the partnership income. There are likely to be cases in which all partners adopt this practice without there being any requirement to do so, either in the constitution of the partnership or by reason of any pressure by another partner or other person. In such a case, it may be found, after consideration of all the relevant facts, that each partner had the real control of his share of the partnership income.

A provision in a partnership agreement providing for one partner a power to manage the partnership would not, in itself, mean that another partner lacked the real control of his share of partnership income. Other provisions of the agreement and the nature of the control of the partnership and the conduct of its operations would need to be considered.'

6. The Administrative Appeals Tribunal has recently considered two cases concerning the application of Division 6AA to business income purportedly derived by a minor. In view of the different result in each case reported as Case U58, 87 ATC 376; AAT Case 50 18 ATR 3312 and Case U67, 87 ATC 429; AAT Case 54, 18 ATR 3348, respectively, this ruling has been issued to highlight the approach taken by the Tribunal and the considerations it took into account when forming an opinion under subsection 102AE(5) as to the amount of business income to be treated as excepted assessable income under paragraph 102AE(2)(a).

FACTS

7. The first case handed down by Mr P.M. Roach (Senior Member) concerned a minor who, on 1 October 1980 was 10 years old and attended school full-time, purported to commence business as a retail trader.

8. The minor's father operated a pharmacy from premises owned by

the minor's mother. The minor traded in non-pharmaceutical items from the premises those items being of a kind commonly marketed from retail pharmacies. A business name was registered. As the minor was unable to be present during business hours, a manageress/shop assistant was employed to manage the shop. She purchased stock and employed staff. The minor assisted in the shop from time to time, when school and other activities permitted, pricing items, stocking shelves, etc. A trading bank account was opened in the minor's name (with her as the only signatory) although her parents provided an indemnity to the bank. She paid all business outgoings through this account.

9. The initial capital of the business was obtained by means of a bank loan of \$6,000, for which her parents again provided an indemnity to the bank, and a loan from the family company of \$32,500.

10. The Commissioner assessed the income derived from this source as 'eligible income' under the provisions of Division 6AA, and applied the prescribed rates of tax. The Tribunal was not persuaded that the minor had real and effective control over the disposal of the whole or portion of income derived from the business. The Tribunal accepted, however, that because of the minor's assistance in the conduct of the business, it would be fair and reasonable that a reward of the order of \$3.00 per week, \$6.00 per week, \$10.00 per week and \$15.00 per week for the years ended 30 June 1981, 1983, 1984 and 1985 be treated as excepted assessable income in terms of paragraph 102AE(2) (a).

11. The second decision was handed down on 11 March 1987 by Dr P. Gerber and Mr K.L. Beddoe (Senior Members) and related to a minor, who during the year ended 30 June 1980 was 11 years of age, a full-time student, and resided with his parents on a farming property. He purported to be carrying on a business as a primary producer.

12. The minor had attended cattle sales in 1977 when he was 8 years old and had selected a number of poddy calves. The purchases were funded by accumulated child endowment payments given to him by his mother. The calves were reared by the minor but allowed to run with the father's stock as they bore the minor's grandfather's brand and were eartagged with the minor's own initials. The original stock were also known by name.

13. Between 1977 and 1980 several calves were dropped and there were a number of sales. In 1980 a single sale of 9 cattle was made. Proceeds from the sale of the cattle, and some pigs and oats in the 1981 year, were banked in a building society account conducted by the minor's mother as trustee for the minor. The net income from the venture for the year ended 30 June 1980 was assessed as eligible income under the provisions of Division 6AA, at the prescribed rates of tax.

14. The Tribunal held that a business of fattening and selling poddy calves was carried on by the minor, although in a small way. Accordingly the income was assessable and Division 6AA applied. It was satisfied, however, that the whole of the income

derived during the year should be treated as business income and accordingly as excepted income under paragraph 102AE(2)(a).

15. In the first case, the most notable feature emerging from the Tribunal's reasons for decision was its approach in considering whether the minor had the real and effective conduct and control of the business (87 ATC at 380; 18 ATR at 3317):

'In my view, in order for the applicant to succeed in that, it would be necessary for her to establish that at all material times she in fact by a free exercise of judgment, made independently of the directions of any other person in accordance with whose wishes and instructions she was accustomed to act, made all material decisions which were effective decisions as to the affairs of the business and the application of its assets and its profits. It is not necessary that I should be able to identify the persons whose actions were effective to deny her real and effective control. I am not persuaded that she had such control.'

16. In the second case, the evidence of both the minor and his father was that the minor very often made his own decisions as to which cattle were to be sold; the father acted mostly as an advisor but not so as to usurp real and effective conduct and control of the business from the minor. The Tribunal was satisfied that the minor had the real and effective conduct and control of the business which was not diminished by his age (10/11 years) during the year of income. The Tribunal mentioned in its reasons that the minor had been engaged in the raising of calves and pigs for a number of years and had lodged returns disclosing taxable incomes for the years ended 30 June 1977, 1978 and 1979. Division 6AA applied for the first time in the year ended 30 June 1979. Proceeds from the sale of cattle were banked in a building society account in the name of the minor's mother as trustee for the applicant. The Tribunal was satisfied on the evidence, however, that the fact that the account was operated by the mother on behalf of her minor son did not sufficiently compromise the degree of control which is required to demonstrate that the minor had the real and effective control over the disposal of the income he derived from the business during the year of income. The Tribunal went on to consider the anti-avoidance provisions of subsections 102AE(6) and (7) but found neither to be applicable on the facts of this case.

RULING

17. The decision in each case is consistent with, and affords support for, official practice. The decisions were open to the Tribunal on the evidence that emerged during hearings. The Tribunal's decision in each case serves to underline the fact that the question of the extent to which a minor meets the requirements of sub-paragraphs 102AE(5)(a)(ii) to (iv) is one of fact to be determined in the light of the circumstances of each case.

COMMISSIONER OF TAXATION
21 July 1988