

SWPD and Commissioner of Taxation -

Decision impact statement

SWPD and Commissioner of Taxation

Court citation(s):	[2020] AATA 555
Venue:	Administrative Appeals Tribunal
Venue reference no:	2018/3729
AAT member name(s):	A G Melick AO SC, Deputy President L Rieper, Member
Decision date:	18 March 2020
Appeals on foot:	No
Decision outcome:	Unfavourable to the Commissioner

Impacted advice

 The ATO has reviewed the impact of this decision on related advice and guidance products.

Précis

This Decision Impact Statement outlines the ATO's response to this case which concerns whether the taxpayer (referred to by the Tribunal as the Applicant) was carrying on a 'forestry' business in the 2015–16 income year for the purposes of the small business capital gains tax concessions in Subdivision 152-A of the *Income Tax Assessment Act 1997* (ITAA 1997), and whether the sale of the property on which the trees were planted satisfied the active asset test.

Brief summary of facts

The taxpayer purchased real property in 1992 for \$180,000, from a known forestry operator who had in the past selectively logged the native forest on the property. The taxpayer saw the purchase as a good business opportunity and gave evidence that he had done calculations prior to the purchase, although he no longer had the calculations.

The taxpayer had heard about the property through an employee at a hotel he owned and, having little knowledge of the forestry industry at the time, spoke to a number of people about the opportunity, including two forestry people who were patrons of his bar. The property, being 343.95 hectares, contained predominantly native forest regeneration and a small five-hectare plantation forest. The property had a well-developed road system and was close to a mill. The taxpayer borrowed 70% of the purchase price from the National Australia Bank.

At the time of purchase, the Tribunal found at [20] that the taxpayer planned to:

... sit on the property and wait as it was too big to weed or water and did not need daily or weekly attention, although it did need maintenance works to the boundary and roads.

The taxpayer gave evidence that no other use could be made of the land as it had no access to water, sewerage or power although the Tribunal observed at [48] that there was no evidence before it that the taxpayer '... ever made enquiries as to the value of the land itself or the prospects of capital growth'.

During the period of ownership, no harvesting activities took place on the property. The activities engaged in by the taxpayer, or at his direction, included:

- maintaining roads and fences on the property
- repairing rain damaged and blocked culverts
- clearing fallen logs
- weed eradication (at the direction of local Council), and
- establishing a replacement access road (due to the previous road being in the wrong place).

The Tribunal found at [52] that the taxpayer also '... attended various industry seminars'.

As to how the taxpayer was to have known when the trees were ready for harvesting, the Tribunal observed at [52] that the taxpayer's evidence was that '... he had been told that trees would be viable to harvest when it became hard for him to put his arms around them'. The Tribunal also found that the parties' experts had agreed this '... was a reasonable, although far from precise, measure'.

The taxpayer sold the property in April 2016 for \$2.75 million. At the time of the sale, no harvesting of the trees planted on the property had taken place – the Tribunal found at [51] that the evidence was that '... the trees were still many years from being a commercial crop'. The Tribunal also found at [23] that the '... trees did not grow as initially anticipated by the Applicant', a drought having commenced in 1996 and continued to 2004, and the water table having dropped. The Tribunal heard evidence at [53] that the taxpayer's initial prediction of when '... the trees would be ready to harvest' (20 years from purchase) was 'overly optimistic' given the low quality of the soil, but the taxpayer's prediction had been based on advice which the taxpayer had received and could not be criticised for accepting.

Overall, the Tribunal found at [26] that the taxpayer was a witness of truth with a good recollection of relevant matters, and at [27] there was some corroboration for the taxpayer's evidence. The Tribunal accepted at [58] the taxpayer's evidence of what took place.

Issues decided by the Tribunal

Was the taxpayer a 'CGT small business entity' within the terms of subparagraph 152-10(1)(c)(i) of the ITAA 1997?

To be entitled to reduce the capital gain made on the sale of the property under the CGT small business conditions, one of the conditions that had to be satisfied was that the taxpayer was a CGT small business entity for the 2015–16 income year. This in turn required the taxpayer to be a 'small business entity', the definition of which includes the requirement that the taxpayer carried on a business in the relevant year. The primary issue for determination therefore was whether the taxpayer was carrying on a forestry business over the relevant time. This is a question of fact and degree.

The *indicia* identified by the High Court in *Spriggs v Commissioner of Taxation* [2009] HCA 22 (*Spriggs*) relevant to the existence of a business were central to the Tribunal's consideration of this issue. The Tribunal considered and weighed up the *indicia* and accepted that on balance, the taxpayer was carrying on a forestry business.

In summary, based on the evidence before it, including expert evidence led by both parties, the Tribunal found:

- (a) at [37], a profit-making purpose existed. The Tribunal found at [30] that it is

... entirely plausible that an entrepreneur such as the Applicant would have purchased the property intending to make a profit without knowing a great deal about the industry and after only a few conversations with people in the industry.

Further, the Tribunal found at [34] that

... there is no evidence that he abandoned his profit-making intentions when it became apparent the trees would take much longer to grow to the size required for commercial harvesting.

- (b) at [44], the activities carried out were very much characteristic of a forestry business in its growth stage. The Tribunal observed that the forestry business was in the growth phase and that as such the significance to be attached to repetition and regularity as an *indicia* of carrying on a business was at [41] '... of considerably less importance in a forestry operation ...' of the type before the Tribunal. The Tribunal found at [42] that the taxpayer

... by his own hand or through contractors, carried out activities which were ancillary to the forestry business such as maintaining the roads and fences, removing noxious weeds and building an access road ... these activities were consistent with a forestry business ...

- (c) at [45–46], the transactions, while few, were of a commercial character having regard to a forestry business in the 'growth' phase where few transactions are to be expected and the absence of transactions is therefore not indicative of a lack of business, and

- (d) at [49], the activities were carried out by the taxpayer in a business-like manner putting to one side the deficiencies in the taxpayer's record keeping. While the taxpayer did not have a business plan or a budget, the Tribunal at [50] accepted the evidence of the taxpayer's accountant that it was not to be expected that the taxpayer would have these items '... and it would have been quite unusual if he had them'.

The Tribunal did not consider the lack of large-scale transactions or activity in this matter necessarily indicative of whether a business was being carried on. Instead, having regard to the consensus of both the taxpayer's and the Commissioner's experts on this issue, the Tribunal found at [45] that the low level of activity and transactions was consistent with a forestry business of this nature being in the 'growth' stage. The Tribunal also noted at [29] that '... [t]he forestry experts engaged by each party considered the property to be of a commercial size and to be carrying a crop of trees which would become commercial with time'.

While the Tribunal considered at [49] that the taxpayer's record keeping was 'solely lacking', and noted at [32] that both the taxpayer and his accountant acknowledged that the taxpayer was a 'poor record-keeper', the Tribunal also found at [32] that poor

record keeping ‘... does not of itself prove that the Applicant was not carrying on a business’.

Does the property satisfy the active asset test within the terms of paragraph 152-10(1)(d) of the ITAA 1997?

The Tribunal noted that the Commissioner did not agree that the condition in paragraph 152-10(1)(d) of the ITAA 1997 was satisfied. However, having concluded that the taxpayer had operated a business over the relevant period, the Tribunal found at [59] ‘... [i]t also follows that the property satisfied the active asset test’.

No further consideration or reasoning was provided for this conclusion.

ATO view of decision

CGT small business entity issue

The Commissioner considers that the Tribunal applied the correct legal test as outlined in *Spriggs* in determining whether the taxpayer was carrying on a business and that such a determination is factually specific and requires the consideration and balancing of various *indicia*, in combination and as a whole. In this case, after balancing the various *indicia* that it applied to the facts of this matter, the Tribunal accepted the taxpayer was carrying on a forestry business. The Commissioner accepts that this finding was open to the Tribunal on the facts as presented to it, albeit remains of the view that the facts of the case are extreme.

The ATO considers that there is nothing in this decision which casts any doubt on the proposition that, to be carrying on a business a taxpayer must satisfy the relevant test as outlined in *Spriggs* and do more than passively hold a CGT asset for a period of time. While acknowledging the result on the facts, the Commissioner does not consider it to establish any point of principle. The Commissioner will continue to carefully examine cases where it is asserted that the taxpayer is carrying on a business yet there is little evidence of relevant activities being carried on by the taxpayer. The absence of appropriate record keeping will also be a matter of concern for the Commissioner.

Active asset test issue

There was little analysis of this issue by the Tribunal beyond a conclusory statement. The ATO’s view as to when an asset is active, for the purposes of paragraph 152-10(1)(d) of the ITAA 1997, remains that an asset is active if you own it; and you use it or hold it ready for use in the course of carrying on a business, or if it is an intangible asset inherently connected with a business you are carrying on. This decision does not consider the active asset test and does not change the way we apply that test.

Implications for impacted advice or guidance

None.

Comments

We invite you to advise us if you feel this decision has consequences we have not identified. Please forward your comments to the contact officers.

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Due date:	21 August 2020	
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Legislative references

Income Tax Assessment Act 1997
Subdivision 152-A
152-10(a)(c)(i)
152-10(1)(d)

Case references

Spriggs v Commissioner of Taxation [2009] HCA 22; (2009) 239 CLR 1; 2009 ATC 20-109; 72 ATR 148; 256 ALR 596