


Decision impact statement

Eichmann v Commissioner of Taxation

Court citation(s):	[2020] FCAFC 155
Venue:	Full Federal Court
Venue reference no:	QUD 43 of 2020
Judge name(s):	McKerracher, Steward and Stewart JJ
Judgment date:	18 September 2020
Appeals on foot:	The Commissioner did not seek leave to appeal to the High Court
Decision outcome:	Unfavourable to the Commissioner

Impacted advice

 The ATO will review 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 involved a challenge to an unfavourable private ruling issued by the Commissioner on whether the active asset test in Division 152 of the *Income Tax Assessment Act 1997*¹ was satisfied on the scheme disclosed in the ruling. The active asset test is one of the basic conditions that must be met by small business entities to access the CGT small business concessions.

Brief summary of facts

The material facts of the scheme in relation to which the Commissioner made the private ruling can be summarised as follows:

The taxpayer and his spouse were the shareholders and directors of a trustee company and were also the beneficiaries of a discretionary trust. The trust carried on a business of building, bricklaying and paving that was established before 1987. The taxpayer and his spouse owned a second property adjacent to their main residence. The main residence and the second property were both acquired in 1997. The second property was sold in the 2016–17 income year for \$935,000. That property had two sheds, and a block wall and gate to secure the property.

The property was used in the following ways:

- The two sheds were used to store work tools, equipment and other materials.
- The open space was used to store materials that did not need to be stored under cover, including bricks, blocks, pavers, mixers, wheelbarrows, drums, scaffolding and iron.

¹ All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1997*.

- Parking of work vehicles and trailers.

Tools and other items were collected from the property daily and, in some cases, the property would be visited a number of times a day depending on specific job requirements.

The aggregated turnover of the trust was less than \$2 million in the 2016–17 income year.

Issues decided by the Court

Whether:

- the applicable test for an ‘active asset’ as defined in paragraph 152-40(1)(a) was correctly identified by the primary judge
- the property was used ‘in the course of carrying on a business’ being carried on by the trust, being an entity connected with the taxpayers, and
- the property was an active asset based upon the scheme specified in the private ruling.

For the purposes of Division 152, an ‘active asset’ is defined as an asset that is owned and used, or held ready for use, in the course of carrying on a business.

At first instance², on appeal from a decision of the Administrative Appeals Tribunal in favour of the taxpayer, Derrington J referred to the Commissioner’s submission at [57] that on a proper construction of subsection 152-40(1):

... the words ‘is used or held ready for use, in the course of carrying on a business’ ... [referred to] ... a use which is integral to the process or processes by which the business is carried on

Derrington J observed at [58] that:

... it is difficult to identify from the authorities relied upon that any requirement exists that the use of the asset is “integral” to the business processes, in the sense of being critical or fundamental to the business processes.

His Honour explained at [61] that:

... for an asset to be used “in” the course of carrying on a business it is necessary for the use to have a direct functional relevance to the carrying on of the normal day-to-day activities of the business which are directed to the gaining or production of assessable income.

In that sense, the use must be a constituent part or component of the day-to-day business activities and may in that way be described as ‘integral’ to the ‘carrying on’ of the business.

Derrington J concluded that the Commissioner had correctly ruled that the property was not an active asset.

The Full Federal Court decided that Derrington J did not correctly identify the applicable test. However, the Full Federal Court also concluded that, even if his Honour’s articulation of the test had been correct, the Commissioner had, on the facts described in the ruling, incorrectly ruled that the property was not an active

² *Commissioner of Taxation v Eichmann* [2019] FCA 2155

asset. The Full Federal Court rejected a direct functional relevance approach holding that³:

... s. 152-40(1)(a) does not require the use of the relevant asset to take place within the day to day or normal course of the carrying on of a business. Nor does the provision require a relationship of direct functional relevance between the use of an asset and the carrying on of a business. Such narrowing qualifications to the statutory test are not supported by the language of the provision ...

Further, the Full Federal Court rejected the proposition that the asset was required to be used in the course of carrying on the activities of a business directed at gaining or producing assessable income.

ATO view of decision

The active asset test

The conclusion of whether an asset is an active asset is intrinsically fact-dependent. As recognised by the Full Federal Court, whether an asset has been used in the course of 'carrying on', the relevant business demands '... inquiries [that] involve issues of fact and degree'.⁴

While the Full Federal Court has made clear that '... the legislature has not used language which might confine these inquiries'⁵, it remains the case that the asset must be '... used at some point in the carrying on of an identified business'. The Commissioner will continue to closely examine matters such as the way in which an asset has been employed in the business and the extent to which the asset has been so employed in considering whether the asset meets the active asset test.

The importance of the defined facts in a private ruling

A challenge to a private ruling proceeds within the confines of the scheme specified in the ruling. The importance of this point is underscored by the Eichmann litigation in that, both at first instance and on appeal, the Courts identified deficiencies in the description of the scheme which in turn made the task of deliberating on the Commissioner's views on the application of the law to those facts more difficult. The Full Federal Court observed that⁶:

As is sometimes the case with private binding rulings, ruled facts can, with the benefit of hindsight, be found not to be as fulsome as might be desired to decide the question of law before the Court. That is not meant as a criticism of the Commissioner's staff. They cannot be expected to predict all of the legal arguments that might subsequently be made in relation to the facts they identify in a ruling. But it does suggest that the rulings system contained in Div. 359 of Sch. 1 to the *Taxation Administration Act 1953* ... will not always be an apt mechanism to address disputes concerning facts, and even issues of characterisation of those facts.

In ruling on whether the active asset test is met in a particular case, the Commissioner will take care to ensure the description of the scheme is, so as far as possible, sufficiently detailed as to reveal all the facts relevant to the statutory enquiry.

³ *Eichmann v Commissioner of Taxation* [2020] FCAFC 155 (*Eichmann FFC*), at [46].

⁴ *Eichmann FFC*, at [41].

⁵ In *Eichmann FFC*, the Full Federal Court observed at [41] that the legislature could have referred, but did not do so, to the day-to-day course of the business or used the words 'direct' or 'integral' to qualify the words 'in'.

⁶ *Eichmann FFC*, at [9].

Implications for impacted advice or guidance

The ATO will review the impact of this decision on related advice and guidance products.

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 officer.

Date issued:	29 July 2021
Due date:	27 August 2021
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Legislative references

Income Tax Assessment Act 1997
Div 152
152-40(1)
152-40(1)(a)

Case references

Commissioner of Taxation v Eichmann [2019] FCA 2155; 2019 ATC 20-728

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