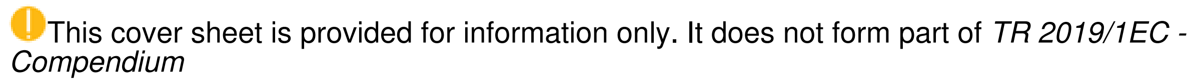
TR 2019/1EC - Compendium



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Public advice and guidance compendium – TR 2019/1

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2017/D7 *Income tax: when does a company carry on a business within the meaning of section 23AA of the Income Tax Rates Act 1986?*

This compendium of comments has been edited to maintain the anonymity of entities that have commented.

Summary of issues raised and responses

Issue No.	Issue raised	ATO response / Action taken
1	What is the purpose of the Ruling considering the draft legislation? Will it ever be published as a final?	Yes, the Ruling has been finalised in relation to section 23 of the *Income Tax Rates Act 1986* (ITRA 1986) as it applied to the 2015–16 and 2016–17 income years and section 328-110 of the *Income Tax Assessment Act 1997* (ITAA 1997) for which it also has ongoing relevance. Section 23AA of the ITRA 1986 was selected as, at the time the draft Ruling was authored and released, it was the legislative provision in respect of which guidance was sought and had ongoing application at the time. The principles and concepts can be applied more broadly in cases where the legislative context of the provision does not mean the phrase (or variants of it) are used in a different way or have a different meaning. However caution must be applied as different provisions may use or require the phrase 'carrying on a business' to have a different meaning. For example it may be used in the general sense where the nature of the business carried on does not matter, or may be used in a context where the provision turns on the nature and scope of the particular business carried on. (See issue 9 of this Compendium.) The words used in a particular provision may also be used in a subtly different way. For example, in relation to the definition of 'company residency' in subsection 6(1) of the ITAA 1936 the phrase used is 'carries on business in Australia', not 'carries on a business in Australia'. This requirement will be

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		satisfied provided the company carries on a business, and in doing so carries on part or all of that business in Australia. It does not require that the entirety of the business be carried on in Australia. Similarly provisions may be worded in such a way as to require the concept be given a different meaning.
2	Why did you choose section 23AA of the ITRA 1986? Can we apply these principles more broadly, for example, to the small business concessions?	Refer to the answer to question 1.
3	Why does the draft Ruling reference the ‘carrying on a business’ definition in section 23AA of the ITRA 1986 and not in the ‘small business entity’ definition which is relevant for the 2016–17 income year?	Refer to the answer to question 1.
4	The draft Ruling does not apply for the 2015–16 or 2016-17 financial years as it is restricted to ‘base rate entities’ applying section 23AA of the ITRA 1986, which only applies from 1 July 2017.	Refer to the answer to question 1.
5	Why did you choose section 23AA of the *Income Tax Assessment Act 1936* (ITAA 1936)? If the legislation is passed will you reference section 328-110 of the ITAA 1997 instead?	Refer to the answer to question 1.
6	What will happen to the draft Ruling if the legislation is passed? What will the ATO do and do we have any comments on this? The draft Ruling makes no mention that the lower corporate tax rate applies to base rate entities with no more than 80% passive income from the 2017–18 income year (as per the	Refer to the answer to question 1.

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	ATO's commentary and the media release from Minister O'Dwyer).	
7	The Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017 was introduced to the House of Representatives. If enacted, the current definition of 'base rate entity' in section 23AA of the ITRA 1986 will be repealed. The corollary of this is that there will no longer be a need to determine whether an entity 'carries on a business'. Consequently, the draft Ruling will only be relevant for the 2016 and 2017 income years. Given the current status of the law, limiting the draft Ruling by inserting at the end of paragraph 1 the words to the following effect, may be beneficial: 'as that section applied for the 2016 and 2017 income years'.	Refer to the answer to question 1.
8	The draft Ruling does not stipulate from which years it applies. Paragraph 75 simply states 'When the final Ruling is issued, it is proposed to apply both before and after its date of issue.' It should be more clearly expressed.	The final Ruling applies for income years both before and after its date of issue. This includes the 2015–16 and 2016–17 income years.
9	Is there a difference between 'a business' and 'a relevant business'?	Yes. There are two categories of legislative provisions and cases where the question of whether a company carries on a business arises. The first comprises those that are concerned with whether a company carries on a business in a general sense (irrespective of what the actual business is). The second category comprises those where the relevant question is whether a company 'carries on a particular business'.[1] These cases and provisions turn on the scope or nature of the business that is carried on by an entity. Further

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		guidance on the distinction is provided at paragraphs 15 and 16 of the final Ruling. [1] For example, whether amounts are assessable as ordinary income under section 6-5 of the ITAA 1997 (*London Australia Investment Co Ltd v FCT* [1997] HCA 50; *AGC (Investments) Ltd v FCT* 92 ATC 4239; (1992) 23 ATR 287; *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* [1990] HCA 25); whether outgoings or losses are deductible under section 8-1 of the ITAA 1997, and whether a company carries on the same business for the purpose of the same business test in Subdivision 165-E of the ITAA 1997 *Avondale Motors (Parts) Pty Ltd v FCT* [1971] HCA 17; *Commissioner of Taxation v R & D Holdings Pty Limited* [2007] FCAFC 107; *Re Kennedy Holdings and Property Management Pty Ltd v Federal Commissioner of Taxation* [1992] FCA 645; *Federal Commissioner of Taxation v Radnor Pty Ltd* [2007] FCAFC 107.
10	The draft Ruling should make the connection with the concept of carrying on a business to the definition of 'aggregated turnover' which is relevant to working out an entity's aggregated turnover and requires a consideration of whether amounts represent ordinary income that the entity derives in the income year 'in the ordinary course of carrying on a business' (under subsection 328 120(1) of the ITAA 1997).	Whether an amount is ordinary income derived in the course of carrying on a particular business for the purpose of the aggregated turnover rules is beyond the scope of this Ruling.
11	The draft Ruling should be expanded further to provide guidance on the issue of what it means to carry on a business for all relevant purposes of the tax law.	It is not practical to address the meaning of carrying on a business in every provision of the taxation acts, and all possible nuances that follow, without the final Ruling becoming impractical and difficult to use. This is beyond the scope of the Ruling. The final Ruling is restricted to the meaning of the phrases as

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		used in section 23 of the ITRA 1986, as it applied in the 2015–16 and 2016–17 income years, and section 328-110 of the ITAA 1997.
12	Paragraph 9 of the draft Ruling identifies two categories of cases where the courts have considered whether a company carries on a business. The draft Ruling is stated to be concerned with the 'first category' of whether a company carries on a business in a general sense. Although it is acknowledged that the 'second category' of cases do not address the broader question of carrying on a business more generally, it does assist to distinguish between 'carrying on a business' and other activities which, although they may result in taxable profit, are in the nature of isolated commercial transactions. In this respect, Example 8 in the draft Ruling, which addresses the question of whether the company carries on a business in a general sense, seeks to also deal with the types of transactions that turn on the scope or nature of the business carried on. If the draft Ruling is to address the second category of cases, such as in Example 8 of the draft Ruling, it would be useful to extrapolate the outcome so that it then considers whether the amounts represent ordinary income that the entity derives in the income year 'in the ordinary course of carrying on a business' (as required by subsection 328-120(1) of the ITAA 1997 in working out the company's aggregated turnover).	This is beyond the scope of this Ruling and no changes have been made to the final Ruling to deal with the second category of cases or questions that turn on whether a business or a particular business is carried on. The purpose of Example 8 (Example 7 of the final Ruling) is to highlight there are additional enquiries that must be made when addressing these questions. It is not intended to explain how to answer them.
13	The draft Ruling should not carve out companies	It is accepted that companies limited by guarantee may carry on a business.

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	limited by guarantee, as they can conduct business even if their stated objective is not to make distributions to their members.	However, the analysis will be different to that for limited and no liability companies based on their individual circumstances, and this is beyond the scope of this Ruling.
14	The expression 'overall impression' used in the draft Ruling is vague.	This is a reflection of the law as whether a company carries on a business is to be determined by an examination of the facts, and in light of the impression gained from the overall nature of the activities. The wording has been slightly modified in the final Ruling to be more precise.
15	In Example 7 of the draft Ruling, the ATO should have regard to the existing view in MT 2006/1 The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number and make sure there is consistency between the view contained in MT 2006/1 and this taxation ruling.	MT 2006/1 is being reviewed and updated to reflect the views in the final Ruling.
16	We recommend tax consolidated groups be addressed with comments that clarify in broad terms[2] that: • the entry history rule in section 701-5 of the ITAA 1997 operates in such a way that the activities of an entity during any period when it was not a member of a consolidated group are ignored when determining if the head company is carrying on a business • because each subsidiary member is taken to be a part of the head company, rather than a separate entity (under the single entity rule of subsection 701-1(1)	The operation of the entry history rule and single entity rule in the consolidations regime is beyond the scope of this Ruling. However, provided the question of whether the head company of a consolidated group is carrying on a business at a particular time is being considered for a head company core purpose, then the single entity rule in subsection 701 1(1)) of the ITAA 1997 and entry history rule in section 701 5 of the ITAA 1997 would apply and any current and past activities of the subsidiary that are relevant may be taken into account in determining whether the head company carries on a business at that time and for that head company core purpose.

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	of the ITAA 1997) the business of the head company must be ascertained by reference to all of the activities carried on by all of the group entities during a relevant period, provided that the entities were members of the consolidated group during that period, and • activities, undertakings and enterprises taking place within a consolidated group will be relevant for identifying a business of the head company. [2] For example, having regard to the principles expressed in TR 2007/2 *Income tax: application of the same business test to consolidated and MEC groups - principally, the interaction between section 165-210 and section 701-1* of the *Income Tax Assessment Act 1997.*	
17	Paragraph 3 of the draft Ruling states that it applies only to companies incorporated under the *Corporations Act 2001*, other than companies limited by guarantee, and specifically excludes '...companies in their capacity as trustee of a trust…'. For clarity, we recommend a specific acknowledgement that companies may act in more than one capacity (for example, as both trustee of a trust and carrying on other income producing activities in its own right) and that the ruling will apply to those companies that carry on a business in	Agreed. The final Ruling has been updated to reflect this.

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	addition to undertaking a trustee role.	
18	Example 5 of the draft Ruling should be amended to incorporate examples that better accord with general practice where a company receives a distribution from a discretionary trust, and the company deals with its unpaid present entitlement in various ways. We recommend the Commissioner incorporate an example where the company has converted the unpaid present entitlement (UPE) to a complying Division 7A loan, or the company maintains the UPE in a sub-trust arrangement in accordance with the Commissioner's sub-trust guidelines. In particular, include situations where the loans from the company are not secured.	This example has been removed and replaced by a more general discussion in paragraphs 51 and 52 of the final Ruling.
19	Example 6 of the draft Ruling should be expanded to include the situation where a company with significant capital assets (in this case, a company that owns charter boats) has outsourced the maintenance and management of its fleet to third party professional managers.	Example 6 (Example 5 in the final Ruling) has been amended to reflect both scenarios.
20	Although the draft Ruling makes reference to the need for an ongoing assessment of whether a company is carrying on a business having regard to changes in purpose of its activities (paragraphs 39 to 42 of the draft Ruling), we submit that it should be made clear that this is made by reference to any time in the income year that is being considered. It is expected that a company should only need to carry	This is beyond the scope of this Ruling, and no changes have been made to the final Ruling.

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	on a business for part of a year of income to satisfy the relevant business requirement. This aspect should be made clear in the final Ruling, including in the examples.	
21	The Ruling should also note that there may be situations where, although an active trading business may have ceased, the retention of residual business assets for profitable sale may constitute the carrying on of a new business where there are not insignificant ongoing activities with a purpose or prospect of profit.	The general principles relevant to this are discussed in paragraphs 55 to 57 of the final Ruling. A detailed analysis is beyond the scope of this Ruling.
22	The Ruling should address when a company will start and cease to carry on a business.	A detailed analysis of when a business commences is an issue that is beyond the scope of this Ruling. However, some additional high level guidance has been added to paragraphs 54 to 57 of the final Ruling. Consideration as to whether to provide further guidance on this issue will be considered as part of the normal processes for determining whether we provide guidance on a topic.
23	We recommend that Example 2 of the draft Ruling should be changed to include facts that at least recognise the continuum of a lifecycle leading up to the commencement of a business. Would the conclusion be different if, for example, soon after the company was established and before the end of the income year, in pursuance of a business plan, the company was solely undertaking activities relevant to locating suitable properties in a particular region for future acquisition and subdivision?	Refer to the answer to question 22.

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24	It is suggested that the Ruling consider in further detail the question of whether winding down a business can constitute the carrying on of a business.	A detailed analysis of when a business will cease is beyond the scope of this Ruling. However some additional high level guidance has been included at paragraphs 55 to 57 of the final Ruling. Consideration as to whether to provide further guidance on this issue will be considered as part of the normal processes for determining whether we provide guidance on a topic.
25	Example 1 of the draft Ruling potentially applies to an income year that pre-dates the application of section 23AA of the ITRA 1986, which reduces its relevance in the context in which the Ruling is issued. We recommend that the years be changed to 2018 and later.	Agreed. The income years in Example 1 of the final Ruling have been changed.
26	We suggest that the facts in Example 1 of the draft Ruling be amended to make it more commercial as it would be highly unusual for a company to have ceased trading operations with retained funds earning extremely little interest (an interest return of less than $100 a year on a $300,000 bank deposit appears very uncommercial) for a long period of time other than where the company is embarking on a process of liquidation. It may also be the case that there is a small amount of interest earned on the account in any particular year as it was invested to mature in later income years. This possibility should be made clear.	Agreed. Example 1 of the final Ruling has been amended and simplified.
27	The name of the company as R&D Co might be considered misleading as it gives an impression that the company is undertaking research and	Agreed. Name changed in Example 2 of the final Ruling.

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	development (R&D) activities which is more than the activity of investigating viability of carrying on a potential business in the future. We suggest that the company name be changed to avoid any misapprehension that R&D activities do not constitute the carrying on of a business.	
28	Example 5 of the draft Ruling: (a) It must be recognised that if the company is made presently entitled to a share of the trust's income at year end, at that time, the company may not be in a position to determine whether it will reinvest the UPE (either under a sub-trust investment arrangement or via a Division 7A complying loan agreement as per legislation and/or PS LA 2010/4 *Division 7A: trust entitlements*) or when the trust might actually pay the trust distribution to the company. That is, there is a time lag between the creation of the UPE and the documentation of a Division 7A loan/sub-trust investment agreement. It is recommended that this example and possible outcomes make clear the income years when it is considered that the company is or is not carrying on a business.	Example 5 of the draft Ruling has been removed and replaced by a more general discussion in paragraphs 51 and 52 of the final Ruling. A mere intent to carry on a business without any activity sufficient to support a conclusion a business has commenced, will mean a company is not carrying on a business. When a business commences will always turn on the facts, and a detailed analysis of this type is beyond the scope of this Ruling.
	(b) Under possibility A, where the UPE is not reinvested by FamCo, it would be useful	Example 5 of the draft Ruling has been removed and replaced by a more general discussion in paragraphs 51 and 52 of the final Ruling. Whether a

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	to comment on the spectrum of outcomes that can emerge in the second and later years having regard to the possible outcomes in Graph 1 of PSLA 2010/4.	business is carried on turns on what occurs in practice. This may not occur contemporaneously with the dates set out in Graph 1 of PS LA 2010/4. A detailed analysis of these possibilities is beyond the scope of this Ruling.
	(c) Possibility B refers to FamCo's UPE being loaned back to the Pail Family Trust under a written loan agreement on commercial terms, including the provision of security over trust assets. It would be helpful to expand this example to include other practical situations where there may be either a section 109N (ITAA 1936) complying Division 7A loan agreement or a complying sub-trust agreement in terms of one of the three investment options mentioned in paragraph 58 of PS LA 2010/4.	Example 5 of the draft Ruling has been removed and replaced by a more general discussion in paragraphs 51 and 52 of the final Ruling. A detailed analysis of all these possibilities is beyond the scope of this Ruling.
	(d) In respect of the above Division 7A scenarios, it would also be useful to confirm the position if the relevant loans were repaid in full by the relevant tax return lodgment dates such that no interest is paid (or due to be paid) on the loans in order to comply with the relevant tax provisions, assuming the recipient company subsequently employs the funds received with a clear purpose or prospect of profit.	Example 5 of the draft Ruling has been removed and replaced by a more general discussion in paragraphs 51 and 52 of the final Ruling. A detailed analysis of all these possibilities is beyond the scope of this Ruling.

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	(e) It would be useful if Possibility C also addressed the more likely scenario of where the trust distribution is invested by the company on interest bearing terms.	Example 5 of the draft Ruling has been removed and replaced by a more general discussion in paragraphs 51 and 52 of the final Ruling. A detailed analysis of all these possibilities is beyond the scope of this Ruling.
	(f) It is not uncommon for some corporate beneficiaries to have quarantined significant pre-16 December 2009 UPEs which, on their own, do not have a purpose or prospect of profit for the company. Provided the company is otherwise carrying on a business (based on guidance provided in the draft Ruling) it would be useful for the final Ruling to clarify if the existence of such UPEs alone, even if they are significantly larger in amount than the other profit generating assets of the company, is considered to alter the 'carry on a business' conclusion.	The mere ownership by a company of non-income producing assets which are greater in value than its income producing assets and activities would not of itself mean a company does not carry on a business. A detailed analysis of these variants and issues that may affect the conclusions in these scenarios is beyond the scope of this Ruling.
29	Example 7 of the draft Ruling is based on HoldCo owning all of the shares in SBE Co, which carries on a profitable trading business. Under Possibility B, HoldCo derives interest income on a loan to SBE Co. On the basis that HoldCo is carrying on a business under Possibility A (holding shares in SBE Co alone), we believe that Possibility B adds little value to the draft Ruling. We consider that an example which includes an interest free loan or making assets available on a rent-free basis would	Agreed in part. Revised Possibility B in Example 6 of the final Ruling) reflects this. The additional suggested examples referring to interest free loans or rent free provision of equipment are expressly covered in paragraph 58 of the final Ruling. The potential interactions between the principles relevant to when a company will carry on a business and the effect of the consolidations regime are beyond the scope of this Ruling.

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	be more beneficial. This example could be extrapolated to consider the position in the event that HoldCo were a tax consolidated group.	
30	The apparent elevation of the concept 'prospect of profit' is likely to mislead when there is no apparent judicial authority for its usage.	Whether a company's activities have a prospect of profit is expressly stated in the case law that set out the presumption that where a company aims to make, and has a prospect of profit, it is presumed that the company intends to, and does in fact, carry on a business.[3] This proposition has also been applied in other case law: see for example *Hart v Commissioner of Taxation* [2003] FCAFC 105; *Nelson v Commissioner of Taxation* [2014] FCAFC 163. The analysis of the indicia, in particular purpose of profit, has been revised in the final Ruling to include more analysis on this point. [3] *Inland Revenue Commissioners v Westleigh Estates Company Ltd* [1924] 1 KB 390.