

# ***TR 2002/D9 - Income tax: boat hire arrangements***

 This cover sheet is provided for information only. It does not form part of *TR 2002/D9 - Income tax: boat hire arrangements*

This document has been finalised by TR 2003/4.



## Draft Taxation Ruling

### Income tax: boat hire arrangements

---

Contents	Para
What this Ruling is about	1
Date of effect	6
Ruling	7
Explanations	32
Examples	80
Detailed contents list	100
Your comments	101
Appendix	page 27

#### *Preamble*

*Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office. DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.*

#### **What this Ruling is about**

---

1. This Ruling considers the operation of sections 26-50<sup>1</sup> and 40-25<sup>2</sup> of the *Income Tax Assessment Act 1997* ('ITAA 1997'),<sup>3</sup> specifically:

- when the taxpayer's activity amounts to the carrying on of a \*business<sup>4</sup> in relation to a boat for the purposes of subsection 26-50(5);<sup>5</sup>
- the operation of the anti-avoidance rule in subsection 26-50(7);
- when deductions are not denied or reduced for a boat under subsection 26-50(5) and subsections 40-25(3) and (4); and

---

<sup>1</sup> Prior to 1 July 1997 deductions for a boat were denied under section 51AB of the *Income Tax Assessment Act 1936* ('ITAA 1936').

<sup>2</sup> Prior to 1 July 1997 deductions for depreciation of a boat that was a 'leisure facility', were denied under subsection 54(3) of the ITAA 1936, subject to subsections 54(3A) and (4) of the ITAA 1936. From 1 July 1997 subsections 42-45(3) and 42-170(2) and (3) of the ITAA 1997 have substantially the same operation, in relation to boats acquired before 1 July 2001.

<sup>3</sup> The Appendix to this draft Ruling sets out the provisions of section 26-50.

<sup>4</sup> An asterisk before a term in this Ruling denotes that the term is defined in the *Income Tax Assessment Act 1997* ('ITAA 1997'). Terms that are defined in the ITAA 1997, and identified with an asterisk in the Act, are similarly identified in this Ruling.

<sup>5</sup> This Ruling does not address the issue of when a taxpayer's activity is an enterprise for the purposes of the entitlement to an Australian Business Number ('ABN'). However, it should be noted that an activity without a reasonable expectation of profit or gain is not an enterprise within the meaning of section 38 of the *A New Tax System (Australian Business Number) Act 1999*. Greater detail may be found in Miscellaneous Taxation Ruling MT 2000/1 'The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number ('ABN').'

# TR 2002/D9

- apportionment of expenses between \*business and non-business use where a \*business is being carried on in relation to the boat.

2. This Ruling applies only to boat hire activities. The Ruling deals with specific provisions of the ITAA 1997 that relate to deductions for expenses incurred in relation to the ownership or use of boats. It is not to be construed more widely. In particular, this Ruling does not deal with the application of the tax law to other 'negatively geared' activities, for example, rental properties.

## **Class of person/arrangement**

3. This Ruling applies to a taxpayer who owns a boat and:
- (a) enters into an arrangement to provide the boat to a charter operator,<sup>6</sup> or another party, for the charter operator or that other party to hire, lease or charter to others and has:
    - no effective control over the activities of the charter company; or
    - little effective control over the boat; or
  - (b) directly provides the boat for hire, lease or charter including through an agent.

(Refer to diagrams below)

---

<sup>6</sup> The terms and words used in relation to agreements between parties mentioned in the Ruling are not intended to reflect the meanings given in, or have implications under, Admiralty or Maritime Law.

**(a) Boat provided to charter operator**

**Boat Provided Directly to Hirer**

4. The boat hire, lease or charter activities of the boat owner are referred to for the rest of this Ruling as the 'boat hire activities'.

5. The figures in the table below demonstrate the outcomes, for taxation purposes, that are sought by taxpayers who enter into a boat hire arrangement. This example is broadly representative of a number of cases that have been seen, and relates to a boat valued at \$350,000 at the time of acquisition. Depreciation deductions are calculated at the 30% rate applicable to taxpayers entitled to use the Simplified Tax System.<sup>7</sup> Note particularly that in this example:

- the particular arrangement is for a limited term (though this is not always the case); and
- the projected expenses far exceed the projected income.

<sup>7</sup> The calculation of depreciation shown in this table is on the basis that the taxpayer does carry on a business in relation to their boat and is entitled to use the Simplified Tax System in relation to that business activity. It is not intended by the use of these figures in this table to suggest that these tests are met in this case, but merely to show the outcomes that are sought by taxpayers who enter into boat hire arrangements.

<b>Year</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>Charter Income</b>	50,000	50,000	50,000	50,000	50,000
<b>Management Fees</b>	25,000	25,000	25,000	25,000	25,000
<b>Operating Expenses</b>	18,000	18,000	18,000	18,000	18,000
<b>Interest</b>	18,750	18,750	18,750	18,750	18,750
<b>Depreciation</b>	105,000	73,500	51,450	36,015	25,210
<b>Total Expenses</b>	166,750	135,250	113,200	97,765	86,960
<b>Loss</b>	-116,750	-85,250	-63,200	-47,765	-36,960
<b>Cumulative income</b>	50,000	100,000	150,000	200,000	250,000
<b>Cumulative loss</b>	-116,750	-202,000	-265,200	-312,965	-349,925

## **Date of effect**

6. This Ruling applies to income 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 21 and 22 of Taxation Ruling TR 92/20).

## **Ruling**

### **General indicators of a \*business as applied to boat hire arrangements**

7. Determining whether a taxpayer's boat hire activities amount to the carrying on of a \*business involves considering the general indicators of when a business exists. These general indicators, and how they apply in relation to boat hire arrangements, are set out in the following paragraphs. **No single indicator is determinative. The determination is to be based on the 'large or general impression gained'** (*Martin v. FC of T* (1953) 90 CLR 470 at 474; 5 AITR 548 at 551).

### ***Significant commercial purpose or character***

8. In the context of a boat charter arrangement, where the cumulative expenses exceed or are reasonably expected to exceed the cumulative income of the activity for the overall period of the

arrangement, the activity lacks a significant commercial purpose or character.

***Activities of the kind carried on in a similar manner to those of ordinary trade***

9. This indicator will not be satisfied where the boat owner's hire activities amount to no more than merely leasing their boat to a charter operator, who uses that boat in carrying on the business of a charter operator (see paragraphs 56 to 65 below). The taxpayer is not carrying on a business in respect of their boat.

***Organised, systematic, business-like manner***

10. The boat hire activities conducted by the taxpayer should be carried out in a systematic and organised manner. This usually involves matters such as advertising for customers in a consistent and systematic manner, maintaining profitable activities, discontinuing unprofitable activities, and keeping appropriate business records.

***Repetition and regularity***

11. To amount to the carrying on of a business, the taxpayer's activities in relation to the boat should display both repetition and regularity. However, even an activity in which a boat is merely leased to a boat charter operator may exhibit characteristics of regularity and repetition. This indicator therefore rarely distinguishes a boat hire activity that amounts to a business from one that involves no more than the mere lease of a boat.

***Prospect of profit***

12. As noted in relation to significant commercial purpose or character, where the cumulative expenses exceed, or are reasonably expected to exceed, the cumulative income of the activity for the overall period of the arrangement, the taxpayer will not be able to demonstrate that there is a reasonable expectation of making a profit. The taxpayer must be able to show they have an intention to make a profit. The tax savings made by offsetting the losses from the charter activity against other income are not profits from the boat charter activity.

***The size and scale of the activity***

13. To satisfy this indicator the taxpayer's boat charter activity should be of a sufficient scale to provide the taxpayer with a

reasonable expectation of making a profit from the activity. This will not be the case if the activity is merely the lease of a boat that has been acquired largely for eventual personal pleasure or an arrangement entered for tax benefits.

### ***Mere lease of a boat***

14. If a boat is merely provided by the taxpayer to another party who provides the boat for lease, hire or charter to third parties, the taxpayer is not carrying on a \*business in relation to that boat.

15. Payment to the taxpayer made in the form of a percentage of the charter income from the boat held and used by a charter operator or other party, does not in itself result in the taxpayer carrying on a business in common with the charter operator or other party.

16. Thus, if in substance the boat charter arrangement entered into by the taxpayer is more correctly characterised as a mere lease without sufficient of the hallmarks of a business, it is considered that the taxpayer is not carrying on a \*business in relation to that boat.

### **Boat provided to charter operator**

17. Whether the taxpayer has control over, or input into, the business of the charter operator, or other party, is not determinative. What will be determinative of whether the taxpayer is carrying on a \*business will be the application of the general indicators of \*business and the other factors discussed in this ruling.

18. Specifically, where the taxpayer owns a boat and:

- provides the boat to a charter operator or another party for hire, lease or charter, to other parties; and
- has little control over, or input into, the business activity of the charter operator or other party to whom the boat is provided; and/or
- has no effective control over the boat; and/or
- the arrangement amounts to no more than a mere lease of the boat by the taxpayer to a charter company or third party; and/or
- has no reasonable expectation of making a profit from the activity,

the taxpayer does not carry on a \*business in relation to that use of the boat.

**Boat provided directly to hirer**

19. Where a taxpayer owns a boat and provides it directly to the hirer for charter, lease or hire, the taxpayer will be considered to carry on a \*business in relation to the boat only if the general indicators of a \*business, and the other factors discussed in this ruling, point to the taxpayer carrying on a \*business.

**Otherwise allowable deductions denied by sections 26-50 & 40-25**

20. Section 26-50 and subsections 40-25(3) and (4) operate to deny or reduce deductions in relation to a boat that are otherwise available under the taxation law, unless a \*business is being carried on in relation to the boat by the taxpayer claiming the deductions. The availability of GST input tax credits also depends on whether a deduction is denied by section 26-50.<sup>8</sup>

21. Section 26-50 will not deny a \*deduction to a taxpayer if, at all times in the income year, the taxpayer:

- holds the boat as trading stock for sale; or
- uses the boat mainly for letting it on hire; or
- uses the boat mainly for transporting the public or goods for payment

in the ordinary course of **a business carried on by the taxpayer.**  
(Refer paragraphs 26-50(5) (a), (b) and (c).)

22. Deductions are also not denied under 26-50 where the use of the boat is essential to the efficient conduct of another business carried on by the taxpayer. (Refer paragraph 26-50(5)(d).)

23. Subsections 40-25(3) and (4) also deny a \*deduction for a decline in value of a depreciating asset that is a boat if these tests for deductions under section 26-50 are not satisfied.

***Additional requirements of section 26-50 and section 40-25***

*'mainly' held or used*

24. Paragraph 26-50(5)(b) provides that one of the exceptions where subsection 26-50(1) will not apply, and hence will not stop the taxpayer being able to claim a \*deduction for their boat, is where they:

‘use the boat (or hold it) mainly for letting it on hire in the ordinary course of a \*business that [they] carry on:...’

---

<sup>8</sup> See paragraph 69-5(3)(e) of the *A New Tax System (Goods and Services Tax) Act 1999* which provides that no input tax credit is available when a \*deduction is denied under section 26-50 of the ITAA 1997.

That is, the taxpayer must be able to satisfy the requirement that the boat be held **'mainly'** for the stated purpose if a \*deduction is to be allowed.

25. If the boat is not held **'mainly'** for use as mentioned in paragraph 26-50(5)(b), deductions for the decline in value of that boat are also denied under subsection 40-25(4).

26. Even if a taxpayer carries on a \*business, where a taxpayer uses, or holds, their boat for personal use more often than for letting or hiring it in the ordinary course of their \*business, they will fail to satisfy this exception.

#### **'essential to the efficient conduct of a \*business'**

27. Paragraph 26-50(5)(d) provides that one of the exceptions where subsection 26-50(1) will not apply, and hence not prevent the taxpayer being able to claim \*deductions for their boat, is where they

'use the boat for a purpose that is essential to the efficient conduct of a \*business that [they] carry on...'

The taxpayer must be able to satisfy the requirement that the boat be more than an 'aid' or 'advantage' to the conduct of the business: *Re Sinclair and FC of T* [2000] AATA 1168; 2001 ATC 2092; (2000) 47 ATR 1001.

28. This test is stringent. The requirement will not be satisfied if use of the boat is merely convenient, an aid or economical. The boat must be essential to the efficient conduct of the \*business.

29. If the boat is not held for use as mentioned in paragraph 26-50(5)(d), deductions for the decline in value of that boat are also denied under subsection 40-25(4).

#### **Schemes to avoid section 26-50**

30. Even if a boat is being used, or is held, in a way that satisfies subsection 26-50(5), so that deductions are not denied under that provision, that use (or holding) may be because of a \*scheme. If the Commissioner forms the opinion that this scheme would not have been entered into or carried out if section 26-50 had not been enacted, then the boat is taken by subsection 26-50(7) not to have been used in the way that satisfies subsection 26-50(5).

#### **Apportionment of expenses**

31. Where a boat is held or used in a manner that satisfies subsection 26-50(5), expenses related to a boat must be apportioned to reflect the business and non-business use of the boat. In particular,

expenses that are related to a taxpayer's personal use of a boat are not allowable under section 8-1.

## **Explanations**

---

### **General indicators of a \*business as applied to boat hire activities**

32. Broadly, in order for a taxpayer's activities to amount to the carrying on of a \*business it is necessary that the activity amount to a commercial enterprise and involve notions of repetition and continuity of activities (see, for example, *Hope v. The Council of the City of Bathurst* (1980) 144 CLR 1 at 8-9; 80 ATC 4386 at 4390; (1980) 12 ATR 231 at 236, and *State Superannuation Board (NSW) v. FC of T* 88 ATC 4382 at 4389-4390; (1988) 19 ATR 1264 at 1273-1274).

33. In *Ferguson v. FC of T* 79 ATC 4261 at 4271; (1979) 9 ATR 873 at 884, Fisher J said:

'It is necessary to give consideration to the essential nature of the activity, and the question whether it has the characterisation of a business is primarily a matter of general impression and degree.'

34. The general indicators of when a \*business is being carried on as interpreted by the courts are identified and discussed in Taxation Ruling TR 97/11. That Ruling is directed to determining whether a \*business of primary production is being carried on. However, the principles discussed in that Ruling also apply to determining whether other forms of activity amount to carrying on a \*business.

35. The general indicators of a \*business, and how they apply in relation to boat hire arrangements, are discussed in the following paragraphs. **No single indicator is determinative. The determination is to be based on the overall general impression gained.** In *Martin v. FC of T* (1953) 90 CLR 470 at 474) 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.'

### ***Significant commercial purpose or character***

36. This indicator often overlaps with aspects of the other indicators. The taxpayer's activity should be carried out on a scale, and in such a way as to show:

- the activity is being operated for commercial reasons and in a commercially viable manner; and
- the taxpayer's activity is capable of producing an overall profit over the term of the activity; and
- the activity is not attractive to the taxpayer solely on the basis that a sizeable tax deduction may be available.

37. The phrase 'significant commercial purpose or character' is referred to by Walsh J in *Thomas v. FC of T* 72 ATC 4094; (1972) 3 ATR 165. 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. Walsh J said at ATC 4099; ATR 171 that, among other factors, he was influenced by the scale of the activity, which, while small, was:

'expected upon reasonable grounds that [the] produce [from the trees] would have a ready market and yield ... a financial return which would be of a significant amount, with a relatively small outlay of time and money and that this return would continue for a very long time.'

38. In the context of a boat hire arrangement, where the cumulative expenses exceed, or are reasonably expected to exceed, the cumulative income of the activity for the overall period of the arrangement, the activity lacks a significant commercial purpose or character.

***Activities of the kind carried on in a similar manner to those of ordinary trade***

39. The boat hire activities conducted by, or on behalf of, the taxpayer should be based around business methods and procedures of a type ordinarily used in boat hire activities that would commonly be said to be businesses.

40. It is the activities of the taxpayer, and not of some other person (for example, a charter operator), that are to be examined to determine whether the exception in subsection 26-50(5) is satisfied. (The nature of the exception is explained at paragraphs 20-23 above.)

41. For an activity in relation to a boat to be accepted as carried out by a manager or agent on behalf of the taxpayer, it must be demonstrated that the business is that of the taxpayer, not that of the manager or agent. Thus, it would be expected that all contracts with third parties would be entered into as agent for the taxpayer, and that the agent is acting in the taxpayer's interests, and not in the interests of their own boat charter business.

42. However, this indicator will not be satisfied if the arrangement is that the taxpayer merely lets their boat to a charter operator for the carrying on of the business of the charter operator. Moreover, if additional features have been included in the agreement to change the legal relationships from that of letting the boat to the charter operator, to letting the boat to the hirer through the charter operator as a manager, the anti-avoidance provisions in subsection 26-50(7) may be invoked.<sup>9</sup> Therefore, where a taxpayer appoints a manager or agent to operate the charter activity, the contract or agreement will be examined to determine not only the form of the arrangement but also the substance of the arrangement. The substance of the arrangement should be that the taxpayer is carrying on a business in respect of their boat for it to be held that their hire activity satisfies subsection 26-50(5).

***Organised, systematic, business-like manner***

43. The boat hire activities conducted by the taxpayer should be carried out in a systematic and organised manner.

44. In the New Zealand case of *Case M36* (1990) 12 NZTC 2,224 Bathgate DJ considered whether a yacht charter business was being carried on by the taxpayer. Bathgate DJ, when determining that the taxpayer did not carry the activity on in a business-like manner, considered the following:

- the taxpayer's actions in purchasing the yacht and committing himself to fairly significant loan expenditure and interest payments prior to making definite arrangements for chartering the yacht;
- the taxpayer's haphazard approach to the venture as reflected in a small amount of income received from the activity; and
- the taxpayer's concern that the yacht be available to him for personal use during the peak charter season.

45. Where the boat hire activity is conducted in a business-like manner by or on behalf of the boat owner, including:

- the keeping of appropriate business records;
- arrangements for charter of the boat are not haphazard in their nature;
- personal availability or use of the boat by the taxpayer does not take priority over the availability of the boat and use of the boat for charter purposes,

---

<sup>9</sup> See the section on Anti-avoidance at paragraphs 30 and 75.

this indicator may be satisfied. However, this in itself will not be determinative of whether or not the boat hire activity amounts to the carrying on of a business.

### ***Repetition and regularity***

46. To amount to the carrying on of a business, it is expected that the taxpayer's activities in relation to the boat should display both repetition and regularity. It is expected that this indicator is present in boat hire arrangements. However, even an activity in which a boat is merely leased to a boat charter operator may exhibit characteristics of regularity and repetition. This indicator therefore rarely distinguishes a boat hire activity that amounts to a business from one that involves no more than the mere lease of a boat.

### ***Prospect of profit***

47. In the context of a boat hire arrangement where the cumulative expenses exceed, or are reasonably expected to exceed, the cumulative income of the activity for the overall period of the arrangement, this indicator would not be satisfied.

48. In order to demonstrate that a boat hire activity amounts to the carrying on of a \*business, a taxpayer needs to show that there is a reasonable expectation of making a profit. The taxpayer's hire activities should be conducted in a way that facilitates this outcome. This requires examining whether objectively there is a real prospect of making a profit in future years from undertaking the boat hire activities.

49. Mason J, in *Hope* CLR at 8-9; ATC at 4390; ATR at 236, 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.’

50. Stronger evidence of an intention to make a profit occurs when the taxpayer has conducted research into their proposed activity and consulted experts or received advice on the running of the activity and the profitability of it before setting up the business. This was the case in *FC of T v. JR Walker* 85 ATC 4179; (1985) 16 ATR 331.

51. The tax savings made by offsetting the losses from the charter activity against other income are not profits from the boat hire activity.

***The size and scale of the activity***

52. The taxpayer's activities should be of such a scale to make it commercially viable. The number of boats entered into an arrangement is not of itself determinative of whether a \*business is being carried on. Where the general indicators of a \*business are satisfied and a greater number of boats are involved, it is more likely that a taxpayer will be considered to be carrying on a \*business.

53. Where the scale of the activity is small other indicators take on greater weight when deciding whether a business is being carried on by the taxpayer. In *Thomas* the court was influenced by the fact that even though the activity was small, the scale of the activity was sufficient to provide the taxpayer with an expectation of a financial return which would be of a significant amount, with a relatively small outlay of time and money, and that this return would continue for a very long time.

54. In *Ferguson* ATC at 4265; ATR at 877, Bowen CJ and Franki J commented on the indicators in the following manner:

‘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 other addiction to a sport, he will not be held to be carrying on a business even though his operations are fairly substantial.’

55. To satisfy this indicator the taxpayer's boat hire activity should be of a sufficient scale to provide the taxpayer with a reasonable expectation of making a profit from the activity. If the activity is more properly characterised as a mere lease of a boat that has been acquired largely for eventual personal pleasure or an arrangement entered into for tax benefits, this factor will not be satisfied.

***Mere lease of a boat***

56. The taxpayer should be able to demonstrate an intention to derive \*assessable income from the hire, lease or charter of the boat in a \*business carried on by the taxpayer. The taxpayer should also be able to demonstrate that their involvement in the activity is greater than the lease of an asset to the charter operator or other party for use in their business.

57. Mere provision of a boat under a lease does not of itself indicate that the taxpayer is participating in the business of the person who uses the asset in the ordinary course of **their** business.

58. In *Case G10* (1974) 75 ATC 33; 19 CTBR (NS) *Case 103*, the taxpayer owned a block of holiday flats which they provided for short term rental. In determining that the taxpayer was self-employed for

the purposes of payment to a superannuation fund the Board of Review distinguished between mere rental income and a business. At ATC 38 the Board of Review said:

‘Here the elements of repetition and continuity of acts and transactions are for present purposes sufficient evidence of the existence of a business. The taxpayer was actively engaged personally from day to day in multifarious activities directed to the profitable operation of his income-producing holiday flats. His is not a case of a person who simply owns flats which bring him income vicariously through a letting agent. This taxpayer was personally gainfully employed in his occupation of managing his holiday flats for short term lettings.’

59. The decision in *Federal Commissioner of Taxation v. Murry* 98 ATC 4585; (1998) 39 ATR 129 provides a contrast with *Case G10*. In *Murry*, the High Court considered whether the sale of a taxi licence by the taxpayer amounted to the sale of a business. The taxpayer and her husband owned a single taxi and licence which they operated. At a later date they purchased a second licence and leased it to another taxi owner who operated a taxi activity using the vehicle and licence. When the second licence was sold, the taxpayer claimed that the sum from the sale was for the sale of goodwill. To determine whether the 50% reduction to the capital gain applied, the Court had to decide whether the sale of a taxi licence by the taxpayer amounted to the sale of a business.

60. The majority in *Murry* held that the taxpayer and her husband merely exploited the economic potential of a taxi licence by leasing it to a taxi operator. While a taxi business existed, it belonged to the operator. The licence was an asset that could be sold independently of the business activity of the owner/operator of the taxi.

61. Payment to the taxpayer made in the form of a percentage of the charter income from the boat held and used by a charter operator or other party does not in itself result in the taxpayer carrying on a business in common with the charter operator or other party (see *Taxiway Pty Ltd v. Commissioner of State Revenue* 95 ATC 4667; (1995) 31 ATR 362).

62. Further, in *Case 11/96* 96 ATC 199 at 203; (1996) 31 ATR 1309 at 1313, the taxpayer was providing a taxi and licence to his father for consideration and was also said not to be carrying on a business. The Tribunal said:

‘In the instant case there was no activity on the part of the applicant, apart from the acquisition and leasing of the taxi. Once the lease was established he played a passive role, receiving lease rent regularly but otherwise not engaged in the affairs of the taxi. If a business was being conducted, it was by the lessees. The applicant outlayed capital to acquire the

**TR 2002/D9**

taxi in the expectation of a return from its leasing. In this sense he was a passive investor taking no part in the business risk of operating the taxi.'

63. The words of the Tribunal in *Case 11/96* have equal application to the situation where a boat owner makes their boat available to the operator of a boat charter business. That is, adapting the words of the Tribunal, it can be said in relation to a boat provided to a boat charter operator involving no other input to the boat operation by the boat owner: 'there [is] no activity on the part of the taxpayer, apart from the acquisition and leasing of the [boat]. Once the lease [is] established he play[s] a passive role, receiving lease rent regularly but otherwise not engag[ing] in the affairs of the [boat]. If a business [is] being conducted then it [is] by the lessees. The taxpayer [outlays] capital to acquire the [boat] in the expectation of a return from its leasing. In this sense he [is] a passive investor taking no part in the business risk of operating the [boat].'

64. In many cases seen by the Commissioner, the following features have been evident, giving rise to a view that the true character of the arrangement under which the boat is provided by the boat owner to the charter operator is a lease agreement:

- the owner loses effective control of the boat;
- the charter contract for use of the boat by the public is in the name of the charter operator;
- the charter operator retains a right to all charter income until after the completion of the charter when typically the owner receives only a percentage of the net amount;
- the owner does not have any right to non-refundable deposits paid to the boat charter operator by prospective hirers;
- the charter operator has a discretionary power to redirect charters from the owner's boat to another boat even when the owner's boat would be available for charter;
- the charter operator acts in their own interest, sometimes to the detriment of the boat owner; and
  - insurances in relation to the use of the boat by the hirer are entered into by the charter operator.

65. Thus, if the boat hire arrangement entered into by the taxpayer is more correctly characterised as a lease agreement, it is considered that the taxpayer is not carrying on a \*business in relation to the boat.

**Otherwise allowable deductions denied by sections 26-50 & 40-25**

66. Section 8-1 provides that losses and outgoings are deductible to the extent to which they are incurred in earning \*assessable income or carrying on a \*business for that purpose.

67. Deductions in relation to boats are denied under section 26-50 for losses or outgoings incurred in:

- acquiring and retaining ownership of or rights to use a boat; or
- using, maintaining or repairing a boat; or
- relation to an obligation associated with ownership or rights to use the boat,

unless the boat is used mainly for the carrying on of a \*business of letting or hire, or transport for payment, in the ordinary course of the taxpayer's business, or the use of the boat is essential to the efficient conduct of a \*business carried on by the taxpayer. That is, section 26-50 applies to deny deductions for the boat unless the taxpayer's activity (and not, for example, the activity of the charter operator who allocates the boat for the use of a customer) amounts to the carrying on of a \*business in relation to the boat.

68. Subsections 40-25(3) and (4) also deny deductions for a decline in value of a depreciating asset that is a boat if the tests for deductions under section 26-50 are not satisfied. That is, no \*deduction is available for the decline in value unless the boat is used mainly for the carrying on of a \*business of letting or hire, or transport for payment, in the ordinary course of the taxpayer's business, or the use of the boat is essential to the efficient conduct of a \*business carried on by the taxpayer.

***Additional requirements of section 26-50 and section 40-25***

*'essential to the efficient conduct of a \*business'*

69. Paragraph 26-50(5)(d) provides that one of the exceptions where subsection 26-50(1) will not apply, and hence not prevent the taxpayer being able to claim \*deductions for their boat, is where they;

'use the boat for a purpose that is essential to the efficient conduct of a \*business that [they] carry on...'

The taxpayer must be able to satisfy the requirement that the boat be more than an 'aid' or 'advantage' to the conduct of the business.

70. In *Sinclair* ATR at 1005; ATC at 2096 the taxpayer used his boat to demonstrate navigational aids. After examining the evidence

**TR 2002/D9**

provided, K L Beddoe (Senior Member) concluded that the boat was an aid and provided advantages but it was not considered 'essential to the efficient conduct of the business'.

71. In *Case 6/2001 AATA 965*; 2001 ATC 142 at 148; (2001) 48 ATR 1176 at 1185 the taxpayer owned a catamaran. The taxpayer's husband carried on an accounting business and leased part of the boat as an office. The taxpayer provided secretarial services from the boat. In disallowing deductions claimed for expenses associated with the maintenance of a boat, and interest and loan expenses, Mr K L Beddoe (Senior Member) said 'convenience and economy may suggest efficiency but they do not suggest essentiality.'

72. In *Case R63 84 ATC 457*; *Case 117 (1984) 27 CTBR (NS) 934* the taxpayer was a company carrying on the business of an advertising agency. The taxpayer claimed deductions for costs associated with a motor cruiser. The taxpayer claimed it used the boat for entertaining clients and potential clients. The deductions were disallowed by the Commissioner. When agreeing that the claims were not allowable Mr PM Roach (Member) indicated that the requirement in question meant that the conduct of the taxpayer's business required for its efficient conduct using a boat of the type in question. The use of the boat was not essential to the efficient conduct of the business if the business could be conducted efficiently without the use of such a boat.

73. This test is stringent. The requirement will not be satisfied if use of the boat is merely convenient, an aid or economical. The boat must be essential to the efficient conduct of the \*business.

74. If the boat is not held for use as mentioned in paragraph 26-50(5)(d), deductions for the decline in value of that boat are also reduced under subsection 40-25(4).

**Schemes to avoid section 26-50**

75. Subsection 26-50(7) is an anti-avoidance provision which states:

'(7) A \*leisure facility or boat is taken not to be used (or held) as described in subsection (3) or (5) if:

- (a) apart from this subsection, the leisure facility or boat would be used (or held) in that way because of a \*scheme; and
- (b) in the Commissioner's opinion, the scheme would not have been entered into or carried out if this section had not been enacted.'

76. Where it appears that the main reason a boat hire arrangement was entered into in a particular manner was to avoid the operation of section 26-50, consideration will be given to the application of the anti-avoidance provision contained in subsection 26-50(7).

77. In order that the Commissioner not form the relevant opinion under subsection 26-50(7), the taxpayer must be able to demonstrate that the boat hire arrangement was entered into as a business for purposes other than to circumvent the operation of section 26-50. In forming this opinion, the Commissioner will take into account any evidence of:

- non-arm's length dealing;
- collusion;
- collateral advantages; or
- other elements of artificiality that point to a contrivance directed towards a particular tax outcome,

that might be obtained from arrangements that are entered into.

### **Apportionment of expenses**

78. Losses and outgoings are not deductible under section 8-1 to the extent they are capital or private in nature, or are incurred in relation to earning exempt income. Accordingly, in appropriate circumstances, the section allows for an apportionment between the deductible and non-deductible components of a loss or outgoing: *Ronpibon Tin NL v. FCT* (1949) 4 AITR 236; 78 CLR 47; *Ure v. FCT* (1981) 11 ATR 484; 81 ATC 4100.

79. Where a boat is held or used in a manner that satisfies subsection 26-50(5), expenses related to the boat must be apportioned between \*business and personal use. Expenses related to a taxpayer's personal use of a boat are not allowable under section 8-1.

### **Examples**

80. The following Examples illustrate the principles outlined in the Ruling. It is not possible in these Examples to identify all possible arrangements a taxpayer may enter into with respect to a boat. The Examples have been designed to highlight the factors that indicate when a \*business of leasing a boat or boats is being carried on. Although a particular type of boat is used in each Example, the principles illustrated apply equally to all types of boat (for example, house boats, cruisers, yachts, motor boats, catamarans and other water vessels). In the interests of readability, the amount of information

contained in the Examples is also necessarily less than the amount of information that the Commissioner would ordinarily seek to consider fully the question at issue.

**Example 1: arrangement with charter company**

81. Lionel took out a loan and purchased a yacht for \$450,000. Lionel then entered into a 5 year agreement which had an option for a 6<sup>th</sup> year with a third party, Tiggersail Charter Operators, who added Lionel's yacht to their fleet of boats available for charter.

82. Tiggersail entered into contracts with the general public to provide clients with a boat from the Tiggersail Fleet. Tiggersail had the right to allocate any boat from the fleet to any particular charter contract. Lionel had no effective control over Tiggersail's charter business.

83. While not expressly provided for in the written agreement, Tiggersail has verbally agreed with Lionel that the boat will be available for his personal use at certain times during the peak charter season.

84. On the 14<sup>th</sup> day of each month Lionel received a statement from Tiggersail setting out his percentage of the net charter income and a report notifying him when the yacht had been chartered and any repairs that had been organised for his boat for the previous month. The activity had no realistic expectation of a profit as the decline in value of the boat alone will exceed the projected annual income from the charter activity. During the life of the agreement Lionel's yacht related expenses exceeded income derived from the activity to the extent that the activity was not profitable.

85. Lionel is not carrying on a boat hire business, or any other business, and the income from the activity was therefore not income received in the course of carrying on a business.

86. The indicators outlined below point to the conclusion that the activity was not a business.

- The activity demonstrated a lack of a clear intention to make a profit based on reasonable grounds (refer paragraphs 12, 47-51 above);
- The activity was in the nature of asset leasing. Lionel entered an agreement for a fixed period with the Charter Company. Lionel had no control over the income the yacht earned. The Charter Company controlled who charters the boat for what amount and when (refer paragraphs 14-16, 56-65 above);

- Lionel's activity was of a small scale (refer paragraphs 13, 52-55 above);
- There is no reasonable expectation of making a profit from the activity (refer paragraph 8, 36-38 above);
- The mode of payment for use of the yacht by the Charter Company, on a share of the charter income basis, did not of itself result in Lionel carrying on a business in common with the Charter Company (refer paragraphs 15, 61 above);
- The payments that Lionel received are, however, income that is assessable under section 6-5. Deductions related to the yacht are denied under section 26-50 and subsections 40-25(3) and (4), as Lionel is not carrying on a business of leasing the yacht.

**Example 2: managed activity**

87. Samantha took out a loan and purchased a houseboat for \$250,000 in September 1994. Samantha registered the business name 'Caring River Cruising' in January 1995. Samantha entered into an agreement with Tony to act as a booking agent for her charter activity. Tony received a fixed monthly fee and a percentage of each charter payment. All charter income was paid directly into Samantha's bank account. Tony organised cleaning, refuelling and advertising for Caring River Cruising. At the end of each month Tony provided Samantha with a report including the bookings for that month and notified her of any possible repairs or maintenance the boat needed. Tony did not have the authority to redirect the charter booking to another boat unless Samantha authorised him to do so.

88. Samantha took the houseboat for personal holidays and use on those weekends when it was not booked for charter. In 2000/2001 this happened on 28 days. While the boat was advertised as available for charter all year, the total number of days the boat was chartered was 25.

89. Income received from the activity in 2000/2001 was \$20,950. Boat related expenses included interest on the loan and the decline in value, mooring fees, repairs and maintenance, fuel and Tony's fees and percentage as booking agent was \$41,450. The level of income and expenditure was typical of all years that Samantha owned the boat. She had no business plan and no intention of increasing the amount of time spent on the activity. At no foreseeable point will the activity make a profit.

**TR 2002/D9**

90. Samantha was not carrying on a charter boat business, or any other business in relation to the boat, and the income from the activity is not income from carrying on a business.

The activity:

- lacked commercial character (refer paragraphs 8, 36-38 above);
- did not demonstrate a clear intention to make a profit based on reasonable grounds (refer paragraphs 12, 47-51 above);
- was not conducted in a business-like manner (refer paragraphs 9, 10, 39-45 above).

91. Even if the activity amounted to the carrying on of a business, it is considered that Samantha used or held the boat ‘mainly’ for private and domestic reasons and did not use or hold the boat ‘mainly’ for business purposes, as required by paragraph 26-50(5)(b) (refer paragraphs 24-26 above).

92. The income from the activity is, however, assessable under section 6-5. Deductions related to the houseboat are denied under section 26-50 and subsections 40-25(3) and (4), as Samantha is not carrying on a business of leasing the houseboat.

**Example 3: business**

93. Chloe and Roma purchased three power boats in 1999 which they moored on Pittwater. Roma and Chloe have a business independent of the boats which provides them with an average yearly income in excess of \$60,000 each.

94. Their business plan demonstrated an intention to establish a sightseeing charter business and further increase the number of boats to six in the next four years. The boat activity was advertised weekly in a number of national tourist magazines, newspapers, on a tourist website and various radio stations as guided tours including picnic lunches at scenic locations and sunset tours with a light supper.

95. Their freelance work enabled them to be available at all times to operate tours. They also employed three staff on a part-time basis in the activity. As their charter activity developed they intend to spend less time on the freelance work and more time on the power boat charter activity.

96. In 2000/2001 they built up the activity to several catered tours daily. The boat activity returned income of \$120,940 and incurred total expenses of \$90,230 for the period. Chloe’s and Roma’s business plan showed a realistic expectation of ongoing taxable profit in future financial years.

97. Chloe's and Roma's activity amounted to the carrying on of a business. The factors that indicated a business was being carried on were:

- the activity had a significant commercial purpose (refer paragraphs 8, 36-38, 12, 47 above);
- the repetition and regularity of the activity (refer paragraphs 11, 46 above);
- the business plan demonstrated a clear intention to make a profit as well as a prospect of profit from the activity (refer paragraphs 8, 12, 36, 39, 47 above);
- the activity was conducted in a business-like manner (refer paragraphs 10, 43-45 above);
- there was a reasonable expectation of making a profit from the activity (refer paragraphs 8, 36-38, 12, 47-51 above).

98. The income from this activity was assessable under section 6-5. Deductions related to the yacht **are not denied or reduced** under section 26-50 and subsections 40-25(3) and (4), as Chloe and Roma are carrying on a business in relation to the boats.

### **Corresponding provisions of the ITAA 1936 and the ITAA 1997**

99. The following table cross references the provisions of the ITAA 1997 referred to in this Ruling to the corresponding provisions of the ITAA 1997 and the ITAA 1936.

<b>Current Provisions</b>	<b>Old 1997 provisions</b>	<b>1936 provisions</b>
6-5(1),(2),(3)		25(1)
8-1		51(1)
26-50(1)		51AB(3)(b), (4)
26-50(2), (3)		51AB(1) (in part)
26-50(4), (6)		51AB(5), (6)
26-50(5)		51AB(1) (in part)
26-50(7)		51AB(2)
40-25(3) and(4)	42-45(3) and 42-170(2) and (3)	54(3)

**Detailed contents list**

100. Below is a detailed contents list for this draft Ruling:

	Paragraph
<b>What this Ruling is about</b>	<b>1</b>
Class of person/arrangement	3
<b>Date of effect</b>	<b>6</b>
<b>Ruling</b>	<b>7</b>
General indicators of a *business as applied to boat hire arrangements	7
<i>Significant commercial purpose or character</i>	8
<i>Activities of the kind carried on in a similar manner to those of ordinary trade</i>	9
<i>Organised, systematic, business-like manner</i>	10
<i>Repetition and regularity</i>	11
<i>Prospect of profit</i>	12
<i>The size and scale of the activity</i>	13
<i>Mere lease of a boat</i>	14
Boat provided to charter operator	17
Boat provided directly to hirer	19
Otherwise allowable deductions denied by sections 26-50 & 40-25	20
<i>Additional requirements of section 26-50 and section 40-25</i>	24
<i>'mainly' held or used</i>	24
<i>'essential to the efficient conduct of a *business'</i>	27
Schemes to avoid section 26-50	30
Apportionment of expenses	31
<b>Explanations</b>	<b>32</b>
General indicators of a *business as applied to boat hire activities	32
<i>Significant commercial purpose or character</i>	36
<i>Activities of the kind carried on in a similar manner to those of ordinary trade</i>	39
<i>Organised, systematic, business-like manner</i>	43

<i>Repetition and regularity</i>	46
<i>Prospect of profit</i>	47
<i>The size and scale of the activity</i>	52
<i>Mere lease of a boat</i>	56
Otherwise allowable deductions denied by sections 26-50 & 40-25	66
<i>Additional requirements of section 26-50 and section 40-25</i>	69
<i>'essential to the efficient conduct of a *business</i>	69
Schemes to avoid section 26-50	75
Apportionment of expenses	78
<b>Examples</b>	<b>80</b>
Example 1: arrangement with charter company	81
Example 2: managed activity	87
Example 3: business	93
Corresponding provisions of the ITAA 1936 and the ITAA 1997	99
<b>Detailed contents list</b>	<b>100</b>
<b>Your comments</b>	<b>101</b>
<b>Appendix</b>	<b>page 27</b>

## **Your comments**

---

101. If you wish to comment on this draft Ruling, please send your comments promptly by **18 October 2002** to:

**Contact Officer:** Rhonda Jenkins  
**E-Mail address:** rhonda.jenkins@ato.gov.au  
**Telephone:** (08) 8208 3839  
**Facsimile:** (08) 8208 3947  
**Address:** Australian Taxation Office  
 PO Box 200  
 ADELAIDE SA 5001

---

**Commissioner of Taxation**

4 September 2002

---

# TR 2002/D9

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

TR 92/20; TR 97/11; MT 2000/1

*Subject references:*

- allowable deductions
- anti-avoidance measures
- assessable income
- boat
- boat charter
- carrying on a business
- catamaran
- charter activity
- cruiser
- houseboat
- lease
- leisure craft
- leisure facilities
- negatively geared investment
- passive income
- rental
- tax avoidance
- water craft
- yacht
- yacht charter

*Legislative references:*

- ITAA 1936 25(1)
- ITAA 1936 51(1)
- ITAA 1936 51AB
- ITAA 1936 51AB(1)
- ITAA 1936 51AB(2)
- ITAA 1936 51AB(3)(b)
- ITAA 1936 51AB(4)
- ITAA 1936 51AB(5)
- ITAA 1936 51AB(6)
- ITAA 1936 54(3)
- ITAA 1936 54(3A)
- ITAA 1936 54(4)
- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 6-5(2)
- ITAA 1997 6-5(3)
- ITAA 1997 8-1
- ITAA 1997 26-50
- ITAA 1997 26-50(1)
- ITAA 1997 26-50(2)
- ITAA 1997 26-50(3)
- ITAA 1997 26-50(4)
- ITAA 1997 26-50(5)
- ITAA 1997 26-50(5)(a)

- ITAA 1997 26-50(5)(b)
- ITAA 1997 26-50(5)(c)
- ITAA 1997 26-50(5)(d)
- ITAA 1997 26-50(6)
- ITAA 1997 26-50(7)
- ITAA 1997 40-25
- ITAA 1997 40-25(3)
- ITAA 1997 40-25(4)
- ITAA 1997 42-45(3)
- ITAA 1997 42-170(2)
- ITAA 1997 42-170(3)
- ANTS(GST) 99 69-5(3)(e)
- ANTS(ABN) 99 38

*Case references:*

- Case 11/96 96 ATC 199; (1996) 31 ATR 1309
- Case 6/2001 AATA 965; 2001 ATC 142, (2001) 48 ATR 1176
- Case R63 84 ATC 457; (1984) 27 CTBR (NS) Case 117 934
- Case G10 (1974) 75 ATC 33; 19 CTBR (NS) Case 103
- Case M36 (1990) 12 NZTC 2,224
- FC of T v. Murry 98 ATC 4585; (1998) 39 ATR 129
- Ferguson v. FC of T 79 ATC 4261; (1979) 9 ATR 873; (1979) 37 FLR 310
- FC of T v. JR Walker 85 ATC 4179; (1985) 16 ATR 331; (1985) 79 FLR 161
- Hope v. The Council of the City of Bathurst (1980) 144 CLR 1; 80 ATC 4386; (1980) 12 ATR 231
- Martin v. FC of T (1953) 90 CLR 470; (1953) 5 AITR 548; (1953) 10 ATD 226
- Ronpibon Tin NL v. FC of T (1949) 78 CLR 47; (1949) 4 AITR 236
- Re Sinclair and FC of T [2000] AATA 1168; 2001 ATC 2092; (2000) 47 ATR 1001
- State Superannuation Board (NSW) v. FC of T 88 ATC 4382; (1988) 19 ATR 1264; 82 ALR 63
- Taxiway Pty Ltd v. Commissioner of State Revenue (Vic) 95 ATC 4667; (1995) 31 ATR 362
- Thomas v. FC of T 72 ATC 4094; (1972) 3 ATR 165
- Ure v. FC of T 81 ATC 4100; (1981) 11 ATR 484

ATO references:

NO 2002/012408

# TR 2002/D9

---

FOI status: **draft only - for comment**

Page 27 of 30

---

ISSN: 1039-0731

## Appendix

---

### SECTION 26-50 Expenses for a leisure facility or boat

26-50(1) You cannot deduct under this Act a loss or outgoing to the extent you incur it:

- (a) to acquire ownership of a \*leisure facility or boat; or
- (b) to retain ownership of a \*leisure facility or boat; or
- (c) to acquire rights to use a \*leisure facility or boat; or
- (d) to retain rights to use a \*leisure facility or boat; or
- (e) to use, operate, maintain or repair a \*leisure facility or boat; or
- (f) in relation to any obligation associated with your ownership of a \*leisure facility or boat; or
- (g) in relation to any obligation associated with your rights to use a \*leisure facility or boat.

However, there are exceptions (see subsections (3), (4), (5), (6) and (8)).

#### *What is a leisure facility?*

26-50(2) A *leisure facility* is land, a building, or part of a building or other structure, that is used (or held for use) for holidays or \*recreation.

#### *Exception - leisure facilities*

26-50(3) Subsection (1) does not stop you deducting a loss or outgoing for a \*leisure facility if at all times in the income year:

- (a) you hold the leisure facility for sale in the ordinary course of your business of selling leisure facilities; or
- (b) you use the leisure facility (or hold it for use) mainly to provide it:
  - (i) in the ordinary course of your \*business of providing leisure facilities for payment; or

- (ii) to produce your assessable income in the nature of rents, lease premiums, licence fees or similar charges; or
- (iii) for your employees to use; or
- (iv) for the care of your employees' children.

In the case of a company, subparagraphs (b)(iii) and (iv) do not apply to employees who are \*members or directors of the company.

*Exception - part year use of leisure facilities*

26-50(4) If you use a \*leisure facility (or hold it) as described in subsection (3) at all times during *part* of the income year, then subsection (1) does not stop you deducting so much of the loss or outgoing as is reasonable in the circumstances.

*Exception - boats*

26-50(5) Subsection (1) does not stop you deducting a loss or outgoing for a boat if at all times in the income year you:

- (a) hold the boat as \*trading stock for sale in the ordinary course of a \*business that you carry on; or
- (b) use the boat (or hold it) mainly for letting it on hire in the ordinary course of a \*business that you carry on; or
- (c) use the boat (or hold it) mainly for transporting for payment in the ordinary course of a \*business that you carry on, the public or goods; or
- (d) use the boat for a purpose that is essential to the efficient conduct of a \*business that you carry on.

*Exception - part year use of boats*

26-50(6) If you use a boat (or hold it) as described in subsection (5) at all times during *part* of the income year, then subsection (1) does not stop you deducting so much of

# TR 2002/D9

the loss or outgoing as is reasonable in the circumstances.

*Anti-avoidance - when exceptions do not apply*

- 26-50(7) A \*leisure facility or boat is taken not to be used (or held) as described in subsection (3) or (5) if:
- (a) apart from this subsection, the leisure facility or boat would be used (or held) in that way because of a \*scheme; and
  - (b) in the Commissioner's opinion, the scheme would not have been entered into or carried out if this section had not been enacted.

*Exception when you provide a fringe benefit*

- 26-50(8) Subsection (1) does not stop you deducting expenditure you incur in \*providing a \*fringe benefit.