

MT 1999/D1 - The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number ('ABN')

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Draft Miscellaneous Taxation Ruling

The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number ('ABN')

Contents	Para
What this Ruling is about	1
Date of effect	4
Ruling	5
Explanations and examples	27
Detailed contents list	124
Your comments	125

Preamble

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

What this Ruling is about

1. This Ruling provides assistance in determining the entitlement to an Australian Business Number ('ABN') for entities other than Corporations Law companies and government entities.

2. The Ruling sets out our views on the meaning of certain key words and phrases used in the *A New Tax System (Australian Business Number) Act 1999* ('ABNA') to define:

- an entity (section 37 of the ABNA); and
- an enterprise (section 38 of the ABNA).

3. Included within the meaning of enterprise under paragraphs 38(1)(d), (e) and (f) of the ABNA are all of the activities done by:

- the trustees of funds covered by, or by authorities or institutions covered by, Subdivision 30-B of the *Income Tax Assessment Act 1997* ('ITAA 1997') and to which deductible gifts can be made;
- charitable institutions and the trustees of charitable funds; and
- religious institutions.

This Ruling does not consider the meaning of these types of entities.

Date of effect

4. This Ruling, when finalised, will apply from the date of commencement of the ABNA, being 8 July 1999.

MT 1999/D1

Ruling

5. The ABN is a single, unique business identifier to be used for all dealings with the Commonwealth Government. It is also available to State, Territory and local government regulatory bodies. Identification for taxation law purposes is only one of the objects of an ABN.

6. Corporations Law companies are automatically entitled to an ABN under subsection 8(2) of the ABNA. Other entities are required under subsection 8(1) of the ABNA to be carrying on an enterprise in Australia to be entitled to an ABN. (The Government has recently introduced legislation to amend subsection 8(1) to allow an entity which makes supplies that are connected with Australia to obtain an ABN. The implications of the proposed amendment are not considered in this Ruling.) Government entities are deemed to be carrying on an enterprise in Australia under section 5 of the ABNA.

Entities entitled to an ABN if they carry on an enterprise in Australia (section 37 of the ABNA)

7. Entities, other than Corporations Law companies and government entities, must fall into one of the types of entity listed in section 37 of the ABNA to be entitled to an ABN. They are:

- (a) an individual;
- (b) a body corporate;
- (c) a corporation sole;
- (d) a body politic;
- (e) a partnership;
- (f) any other unincorporated association or body of persons;
- (g) a trust; or
- (h) a superannuation fund.

8. An entity carrying on more than one enterprise is only entitled to one ABN. It is the entity and not the enterprise that is entitled to an ABN.

9. The term entity is widely defined and includes all kinds of legal person. In its own capacity an entity is entitled to only one ABN. However, in addition to acting on its own behalf, the entity may act as trustee for one or more trusts. If that is the case, the entity is acting in each capacity separately and may be entitled to an ABN for each capacity.

10. For example, a private company, XYZ Pty Ltd, runs a small family hardware store and is also the trustee for a family trust that operates as a plumbing contractor. The company, being a Corporations Law company, is entitled to an ABN in its own business capacity. It is also entitled to an ABN in its capacity as trustee of the family trust that is carrying on an enterprise. However, even if the company ceases to be trustee, the ABN would continue to be used by any new trustee.

11. Entity is a key concept in determining entitlement to an ABN, and the **Explanations and examples** part of this Ruling provides further guidance in this regard.

Enterprise (section 38 of the ABNA)

12. Section 38 of the ABNA includes certain activities in 'enterprise' and excludes other activities. Enterprise activities also include activities in the course of commencement or termination of the enterprise, under section 41 of the ABNA.

13. Section 38 enterprise activities are an activity, or a series of activities, done:

- in the form of a business;
- in the form of an adventure or concern in the nature of trade;
- on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property;
- by the trustee of a fund that is covered by, or by an authority or institution that is covered by, Subdivision 30-B of the ITAA 1997 and to which deductible gifts can be made;
- by a charitable institution or by a trustee of a charitable fund
- by a religious institution; or
- by the Commonwealth, a State or a Territory, or by a body corporate, or corporation sole, established for a public purpose by or under a law of the Commonwealth, a State or a Territory.

14. The following activities are excluded from the section 38 meaning of enterprise:

- activities done as an employee or other PAYE earner (unless it is done in supplying services as the holder of an office that the employee or PAYE earner has accepted in the course of, or in connection with, an

MT 1999/D1

activity, or series of activities, of the kind mentioned in the activities included in an enterprise);

- activities done as a private recreational pursuit or hobby;
- activities done by an individual (other than a trustee of a charitable fund) or a partnership (all the members of which are individuals) without a reasonable expectation of profit or gain; and
- activities done as a member of a local governing body established by or under a law of a State or Territory (other than an eligible local governing body within the meaning of section 221A of the *Income Tax Assessment Act 1936* ('ITAA 1936')).

'Activity, or series of activities'

15. For an entity to be entitled to an ABN, it is only necessary to identify one enterprise. Where an entity carries on a number of activities, it is only necessary that one of those activities constitutes an enterprise in order for the entity to be entitled to an ABN.

'Business'

16. An enterprise includes a business.

17. The definition of business in section 41 of the ABNA is the same as the definition of 'business' in subsection 6(1) of the ITAA 1936.

18. To determine whether an activity, or series of activities, amounts to a business, the activity needs to be considered against the indicators of a business established by case law.

'An adventure or concern in the nature of trade'

19. The concept of 'an adventure or concern in the nature of trade' has arisen in the context of United Kingdom revenue law. There is no definition of 'an adventure or concern in the nature of trade' in the ABNA. Trade commonly means operations of a commercial character where goods or services are provided to customers for reward.

20. An adventure or concern in the nature of trade includes a commercial activity that does not amount to a business. Isolated transactions fall into this category. However, the sale of the family home, car and other private assets are not, in the absence of other factors, adventures or concerns in the nature of trade. The fact that the

asset is sold at a profit does not, of itself, result in the activity being commercial in nature.

'In the form of'

21. The use of the phrase 'in the form of' in paragraphs 38(1)(a) and (b) of the ABNA indicates that, as well as activities that constitute a business or an adventure or concern in the nature of trade, an enterprise also includes an activity or activities that is or are in the form of a business or in the form of an adventure or concern in the nature of trade. This includes an activity or series of activities that, if it or they had been done for profit, would satisfy the ordinary concept test of 'business' or 'adventure or concern in the nature of trade'.

On a regular or continuous basis, in the form of a lease, licence or other grant of interest in property

22. An activity is 'regular' if it is repeated at reasonable intervals and 'continuous' if there is no significant cessation or interruption to the activity. Whether an activity is repeated over time on a regular basis is a question of fact and degree.

The Commonwealth, a State or Territory, or a body corporate, or corporation sole established for a public purpose under a law of the Commonwealth, a State or a Territory

23. Any activity or series of activities carried on by the Crown in the right of the Commonwealth, a State or a Territory amounts to an enterprise. Where either a body corporate or a corporation sole, established for a public purpose, carries on an activity, or series of activities, they are carrying on an enterprise. If they were not established for a public purpose, they may still be carrying on an enterprise by satisfying one of the other criteria.

Individuals or partnerships of individuals without a reasonable expectation of profit or gain

24. The test requires that, in the circumstances, the individual or partners carrying out the activity, or series of activities, is or are considered to have a reasonable expectation of profit or gain. A reasonable expectation requires more than a possibility.

25. The reasonable expectation of profit or gain test is not limited to specific years and may cover a number of periods. Some activities do not make profits or gains in the short term. However, the period to be covered by the test must be relevant to the nature of the activity undertaken.

MT 1999/D1

Private rulings

26. An entity cannot obtain a private ruling under Part IVAAA of the *Taxation Administration Act 1953* ('TAA') on whether they are carrying on an enterprise. The ABNA is not an income tax law as defined for the purposes of section 14ZAAA of the TAA. However, the ATO provides general advice.

Explanations and examples

Entities entitled to an ABN if they carry on an enterprise in Australia (section 37 of the ABNA)

Individual

27. This term is defined in section 41 of the ABNA to mean 'a natural person'.

Body corporate

28. The *Butterworths Australian Legal Dictionary* includes in the definition of 'body corporate':

'Body corporate An artificial legal entity having separate legal personality. It includes bodies created by common law (such as a corporation sole and corporation aggregate), by statute (such as the Australian Securities Commission) and by registration pursuant to statute (such as a company, building society, credit union, trade union, and incorporated association).'

29. If a body is not established under an Act of Parliament, or under a statutory procedure of registration, such as the Corporations Law or an Incorporation Act, then it generally is not a body corporate. The body should be further examined to see whether it falls into one of the other categories of 'entity'. If it is not a profit making body, it is likely to be an unincorporated association.

30. A body corporate is, thus, a body of persons that is legally recognised as having its own identity, one separate from the individuals who compose it. Corporations have perpetual succession. They have the power to act, hold property, enter into legal contracts, sue and be sued in their own name, just as a natural person can.

31. The idea of a 'body corporate' is broad and includes trading and non-trading, profit and non-profit making organisations. The question of whether or not a body is a body corporate, however, is one of fact. That is, a body corporate must be formalised under statute, in

order for it to take on its own legal identity. Corporations Law companies are the most obvious example.

32. There are other types of body corporate. Statutory bodies, which are often indirect arms of government, are established under their own Acts of the Commonwealth or a State Parliament. The Acts to establish these corporations have sections that specifically state that they are established as a body corporate.

33. These government agencies are extremely varied in their form and activities. Most city or shire councils are bodies corporate, established by a State or Territory Local Government Act (e.g., *Local Government Act 1993* (Qld)). In some cases, they are established under an Act in their own right, such as the Brisbane City Council (*City of Brisbane Act 1924* (Qld)).

34. Other bodies with less or no government control or involvement are also established as bodies corporate under their own Acts of Parliament. The governing bodies of various religious institutions (e.g., the Glebe Administration Board of the Church of England in New South Wales) are also established in this way (*Anglican Church of Australia (Bodies Corporate) Act 1938* (NSW)). This Act also confers the right of the Board to establish other bodies corporate under this Act by ordinance. The term would also include bodies corporate established under other general Acts, e.g., for the purposes of the strata titling of land.

35. Each State has an Associations Incorporation Act that allows various kinds of non-profit bodies to become bodies corporate (e.g., *Associations Incorporation Act 1984* (NSW)). These bodies must have a certain number of members (usually five or more), a committee structure and a set of rules about how the organisation is to be run. Bodies incorporated under these acts are normally community, cultural, educational or charitable type organisations.

Corporation sole

36. A corporation sole is a corporation consisting of one natural person only and that person's successors to a particular position. It constitutes an artificial legal person who can sue and be sued in the title of the position and in whom title to property can be vested.

37. The main difference between a corporation sole and a body corporate, is that a corporation sole is not a 'body' of persons. Instead, a corporation sole is an office that is held by a single person. In this case, it is the office that is the 'legal person'. The office continues to exist as a legal entity in its own right, regardless of who holds it, or even if it is vacant, from time to time. The idea of a corporation sole originally applied to offices in the Church, which is

MT 1999/D1

why the classic example of a 'corporation sole' is a bishop, but other types of corporations sole exist, such as a Minister of the Crown.

38. Corporations sole have all the other characteristics of a corporation, that is;

- perpetual succession;
- the right to hold property;
- the right to enter into contracts; and
- the right to sue and be sued under its own name.

39. Corporations sole must be established either by Act of Parliament or by statutory procedure. See, for example, the Acts in various states constituting the Public Trustee as a corporation sole (e.g., *Public Trustee Act 1913* (NSW), section 7).

Body politic

40. Simply put, 'body politic' means a body of persons under a system of government. In Australia, the term is used in legislation to mean the Crown in right of the Commonwealth, or a State or Territory. Examples of this use can be seen in the Acts that constituted the ACT, the Northern Territory and Norfolk Island. All of these Acts state that the Territory has been established as a body politic under the Crown (e.g., section 7 of *The Norfolk Island Act 1979* or section 5 of the *Northern Territory (Self Government) Act 1978*): see also High Court Rules 1952, Order 1, Rule 51.

41. Government departments are not bodies politic in their own right. Instead, they are part of the larger body politic of the Commonwealth or State or Territory.

42. Bodies such as municipal councils have already been discussed above; they are bodies corporate, rather than bodies politic.

43. The term 'body politic' is not restricted to Australia in any way, and can also mean a foreign nation and its government.

Partnership

44. This term has the meaning of the same term in section 995-1 of the ITAA 1997. That section defines a partnership to mean 'an association of persons carrying on business as partners or in receipt of ordinary income or statutory income jointly, but does not include a company'.

Any other unincorporated association or body of persons

45. An unincorporated association or body of persons is any association or grouping of persons with a common aim, which does not otherwise constitute an entity for the purposes of section 37 of the ABNA.

46. The use of the word 'other' indicates that if an association or body of persons satisfies any of the other parts of the definition of entity, it would not be considered to be an entity under this part. Paragraph 37(1)(f) of ABNA covers anything that can be called a 'body' or an 'association', which has not been established as an entity under other parts of subsection 37(1).

47. For persons to be considered to be an association or body, they must have come together for some common purpose. Apart from this limitation, the phrase is not considered to impose any limitation on the class of association or body that may constitute an entity for the purposes of the ABNA.

48. An unincorporated association or body is not a legal 'person'. Unlike a body corporate it has no separate legal identity. It consists of the aggregate of its members at the moment and does not have perpetual succession. Because it is not a legal 'person', it does not have the right to hold property, or to take or be subjected to legal proceedings in its own name. Rather, the individual members are individually liable for the actions of the body as a whole.

49. The nature of an association is usefully discussed for present purposes by Fletcher in *'The Law of Partnership in Australia and New Zealand'*, seventh edition, 1996 at pages 3 and 4. The relevant extract is reproduced below:

'Associations of persons may be divided into two main groups: associations formed with the principal object of providing a benefit to the community as a whole and those whose main purpose is to benefit their constituent members. In the first group are found not only the organs of community government but also associations of private individuals whose aim is to supply certain of the essential needs of the community. In the second group are those associations which, even if they do cater for the needs of the general public, are principally concerned with the benefit of their own members.

The law relating to the first group will be either constitutional or administrative law or the law governing charitable trusts ...

The second, or private benefit, type of association can be subdivided into two further classes, namely those having a primary object of providing a social or cultural benefit for their members, such as sports clubs and literary societies, and those with a primary purpose of providing pecuniary benefits for

MT 1999/D1

their members. It is with this last kind of association, which may be loosely described as a business association, that the law of partnership is concerned ...

In common law jurisdictions, associations of persons, formed with a view to reproducing a financial gain for the benefit of their members, have, for over a century, been formed as either unincorporated business associations or as trading corporations. Partnerships are the pre-eminent representatives of the first category. Not all unincorporated business associations are partnerships ...'

Business associations

50. Statements in the authorities that support the business association component of Fletcher's analysis are as follows: in *Smith v. Anderson* (1880) 15 Ch D 247; [1874-1880] All ER Rep 1121, James LJ said at 1127:

'It is very difficult to my mind to understand what the difference is between a company and an association. My intellect is not capable of comprehending the difference. The word "association" in effect, though it is now commonly used, is, speaking etymologically, an inaccurate word.

"Association" does not describe the thing formed; but, properly and etymologically, describes the act of associating together, from which act of associating there is formed a company or partnership, or a body of what counsel for the plaintiff called *socii*.'

In the *Caledonian Employees' Benevolent Society Case* (1928) SC 633 at 635, the Lord President referring to the *Companies (Consolidation) Act 1908*, said:

'It is not, I think, open to doubt that the fundamental and essential characteristic of the whole class of bodies described in the Act as companies, associations, and partnerships, is that they are bodies constituted by some species of contract of society, and founded on the contractual obligations thus undertaken by the members, or *socii*, *inter se* ... ***No doubt the word "association" is by itself capable of including a wide variety of much more loosely and irregularly constituted bodies of persons ...***' (emphasis added).

Not for profit associations

51. Generally, unincorporated not for profit associations have a membership and a committee; a system of rules; and an understanding between the members of their rights, privileges and responsibilities.

Members are free to join or leave the association at will and the membership may be expected to change over time (see *Conservative and Unionist Central Office v. Burrell (Inspector of Taxes)* [1980] 3 All ER 42 per Vinelott J; *Conservative and Unionist Central Office v. Burrell (Inspector of Taxes)* [1982] 2 All ER 1 at 4 per Lawton LJ, and *Smith v. Anderson* per James LJ).

52. There are many types of group that may fit this description. Groups such as special interest clubs or societies and community groups provide good examples of not for profit associations.

Body of persons

53. If there is doubt whether a group of legal persons meets the ‘association’ description, it can still be regarded as an ‘entity’ if it is an unincorporated ‘body of persons’. This is a broad term that can cover all types of groups of people. It would, however, generally be expected that an unincorporated body would not be carried on for profit-making purposes.

Superannuation fund

54. This term has the meaning of the same term in section 10 of the *Superannuation Industry (Supervision) Act 1993*.

Government entity

55. This term is defined in section 41 of the ABNA.

Other relevant entity definitions

Company

56. This term is defined in section 41 of the ABNA to mean:

- (a) ‘a body corporate; or
- (b) any other unincorporated association or body of persons; but does not include a partnership’.

Corporations Law company

57. This term is defined in section 41 of the ABNA to mean ‘a body registered as a company under the Corporations Law’. Such companies have an Australian Companies Number (‘CAN’).

MT 1999/D1

Enterprise (section 38 of ABNA)

‘Activity, or series of activities’

58. An enterprise may comprise one activity or a series of activities. To determine whether or not an entity is carrying on an enterprise, the relevant activities, or series of activities, of the entity need to be identified.

59. The ABNA does not define an ‘activity, or series of activities’. In the absence of a statutory definition, an ‘activity’ is essentially an act or series of acts that an entity chooses to do. Entities can undertake a wide range of activities with varying degrees of interrelationship. The meaning of an ‘activity, or series of activities’ for an entity can range from a single transaction to groups of related activities or to the entire operations of the entity.

60. As an entity may carry on more than one activity, some of which may not constitute an enterprise, the relevant ‘activity, or series of activities’ may not comprise the entire operations of the entity. It is, therefore, necessary to determine to what extent the overall operations of the entity are broken down into relevant activities in order to determine the existence of an enterprise.

61. Where there are a number of separate activities, the entity may be carrying on more than one enterprise. From a practical point of view it is not necessary to identify every enterprise in an entity. It is only necessary to establish that there is one enterprise for the entity to be entitled to an ABN.

Example 1: an activity that is an enterprise

Doctor Jones is medical practitioner who runs his own practice as sole practitioner. He also has a primary production activity that is a hobby that he conducts as an individual.

Doctor Jones is entitled to an ABN in respect of the medical practice that is an enterprise.

The hobby activity, which is a separate and distinct activity from the practice, is not an enterprise.

Example 2: more than one enterprise carried on by an entity in its own right

A partnership, DEF, owns and runs two hotels, a restaurant and a wholesale liquor outlet, all of which operate in different locations.

The partnership applies for and is granted an ABN.

DEF carries out four series of activities, each of which constitutes an enterprise, but is still only entitled to one ABN. These are carried on in its own capacity.

Example 3: activities or series of activities

A football club has 200 members, most of whom play for the club.

Membership fees amount to \$10,000 per annum. The club attempts to cover its expenditure by running a bar at its clubhouse and this has an annual turnover of \$30,000 with a net profit of just over \$8,000.

The bar is staffed on a voluntary basis and, in addition to beer, wine and spirits, sells some finger food.

The club maintains records of its income and expenditure.

The club is entitled to an ABN on the basis that it is:

- an unincorporated association of persons; and
- carrying on an enterprise - an activity in the form of a business - the bar.

As part of its operations, the club is carrying out a series of activities that would include the fielding of sporting teams and other member related activities. Some of these activities would be considered to be in the form of a business; the others would not. For example, the bar trade would, by itself, comprise an enterprise being carried on by the club.

'Business': a business, as defined, is an enterprise

62. Paragraph 38(1)(a) of the ABNA includes in the definition of 'enterprise' any activity, or series of activities, done in the form of a business. Therefore, a business is carrying on an enterprise. What constitutes an activity, or series of activities, in the form of a business is discussed later.

Definition

63. 'Business' is defined in section 41 of the ABNA:
'business' includes any profession, trade, employment, vocation or calling but does not include occupation as an employee'.

The definition is same as the definition of 'business' in subsection 6(1) of the ITAA 1936.

64. The ITAA 1936 meaning of business is considered in Taxation Ruling TR 97/11. Although TR 97/11 deals with carrying on a

MT 1999/D1

primary production business, the principles discussed in that Ruling apply to any business. As this Ruling does not add to the discussion in TR 97/11 on carrying on a business, TR 97/11 can be referred to for a fuller discussion on whether a particular activity constitutes the carrying on of a business.

65. TR 97/11, in paragraph 12, makes the point that ‘whilst each case might turn on its own particular facts, the determination of the question is generally the result of a process of weighing all the relevant indicators’. There is no single test of whether a business is being carried on.

Indicators of a business

66. TR 97/11 discusses the main indicators of carrying on a business and provides examples for the indicators. The indicators are:

- a significant commercial activity;
- purpose and intention of the taxpayer in engaging in the activity;
- an intention to make a profit from the activity;
- the activity is or will be profitable;
- repetition and regularity of activity;
- activity is carried on in a similar manner to that of the ordinary trade;
- activity organised and carried on in a businesslike manner and systematically - records are kept;
- size and scale of the activity;
- not a hobby, recreation or sporting activity;
- a business plan exists;
- commercial sales of product; and
- taxpayer has knowledge or skill.

‘An adventure or concern in the nature of trade’

Enterprise includes activities done in the form of an adventure or concern in the nature of trade

67. Paragraph 38(1)(b) of the ABNA includes in the definition of ‘enterprise’ an activity, or a series of activities, done in the form of an adventure or concern in the nature of trade. As paragraph 38(1)(a) of the ABNA includes in ‘enterprise’ an activity, or a series of activities, done in the form of a business, paragraph 38(1)(b) covers commercial

activities of a trading nature that do not amount to activities in the form of a business.

68. There is no definition of ‘trade’ and ‘concern or adventure in the nature of trade’ in the ABNA.

69. The word trade is commonly used to denote operations of a commercial character by which the trader provides to customers, for reward, some kind of goods or services.

70. Generally, a business is a trade that is engaged in on a regular or continuous basis, while an adventure or concern in the nature of trade may be an occasional or one-off transaction that does not amount to a business. This is the view of Jacobs J in *AB v. FC of T* (1997) 37 ATR 225 at 242; 97 ATC 4945 at 4961:

‘See also the discussion in R W Parsons, *Income Taxation in Australia*, The Law Book Company Limited, Sydney, 1985, p 159-63 in which the learned author expresses the view that “an adventure in the nature of trade” is equivalent to an “isolated business venture” as opposed to a continuing business. I respectfully agree. I also accept that such a transaction must “exhibit features which give it the character of a business deal” (*McClelland v. FC of T* (1970) 120 CLR 487 at 495; (1970) 2 ATR 21 at 26; 70 ATC 4115 at 4120).’

71. An adventure or concern in the nature of trade is a concept used in United Kingdom taxation law. United Kingdom law proves a useful starting point when considering the meaning of adventure or concern in the nature of trade in the ABNA: see *FC of T v. The Myer Emporium Ltd* (1987) 163 CLR 199; (1987) 18 ATR 693; 87 ATC 4363; *FC of T v. Whitfords Beach Pty Ltd* (1982) 150 CLR 355; (1982) 12 ATR 692; 82 ATC 4031; *McClelland*; *AB v. FC of T*.

Trade v investment assets

72. United Kingdom cases categorise assets as either trading assets or investment assets. Assets purchased with the intention of holding them for a reasonable period of time, to be held as income producing assets or to be held for the pleasure or enjoyment of the person are more likely to be purchased for investment purposes rather than trading purposes: see *Johnston v. Heath* [1970] 3 All ER 915.

73. Examples of investment assets are rental properties, business plant and machinery, the family home, family cars and other private assets. The realisation of investment assets does not amount to trade. Certain types of assets, such as land and shares, can be purchased for either investment purposes or trading purposes. However, they cannot be held at the same time for both purposes. They must be one or the other: see *Simmons (as liquidator of Lionel Simmons Properties) v. IR*

MT 1999/D1

Comms [1980] 2 All ER 798. The character of an asset can, however, change from trade to investment or from investment to trade.

74. United Kingdom cases where it was found that there was an adventure or concern in the nature of trade include:

Edwards (Inspector of Taxes) & Anor v. Bairstow [1956] AC 14; 36 TC 207; [1955] 3 All ER 48

Bairstow and Harrison purchased a complete cotton spinning plant in 1946 with the object of selling it as quickly as possible at a profit. They had no intention of holding it by using it as an income producing asset and it was not purchased for their pleasure or enjoyment. It was eventually sold in five separate lots over a fifteen month period.

Johnston v Heath

Heath was offered non-income producing land that had planning permission but had not been developed because of drainage difficulties. He had insufficient funds to purchase the land and his intention was to resell the land as soon as possible after acquisition. The lack of funds was not an obstacle to the purchase, as Heath found a buyer for the land before he contracted to buy it from the original owner. The land was purchased and sold.

Wisdom v. Chamberlain [1969] 1 All ER 332; [1969] 1 WLR 275

Wisdom had assets worth between £150,000 and £200,000 and was concerned about a devaluation in sterling. His accountant considered that silver bullion would be a suitable hedge against devaluation. Silver bullion of £200,000 was eventually purchased using borrowed funds rather than realising existing assets. The devaluation did not occur and a profit of £48,000, after deducting interest of £7,000, was made on disposal of the silver bullion. There was a transaction entered into on a short term basis for the purpose of making a profit out of the purchase and sale of a commodity. If Wisdom had disposed of his existing investment assets to finance the purchase then the case may have been different. The purchase of the silver bullion may then have been an investment transaction rather than a trading transaction.

IR Commrs v. Fraser (1942) 24 TC 498

Fraser, a woodcutter, purchased in 1937 a large quantity of whisky in bond for £400 with the sole object of resale at a profit. He did not take delivery of the whisky, with the purchase and sales taking place through an agent. Fraser had no special knowledge of the whisky trade and had not previously traded in whisky. Lord Normand, at 502, said:

‘But the purchaser of a large quantity of a commodity like whisky, greatly in excess of what could be used by himself, his family and friends, a commodity which yields no pride of possession, which cannot be turned to account except by a process of realisation, I can scarcely consider to other than an adventurer in a transaction in the nature of trade; ... Most important of all, the actual dealings of the Respondent with the whisky were exactly of the kind that take place in ordinary trade.’

75. The above cases show that more than a mere realisation of an investment asset is required and that the character of the activity as a whole needs to be considered.

Commerciality

76. Whether or not there is a trade or an adventure in the nature of trade is a question of fact and degree: see *J P Harrison (Watford) Ltd v. Griffiths* (1960) 40 TC 281. In essence, an adventure or concern in the nature of trade should reflect significant commercial activity. It should have the characteristics of a business deal.

Example 4: an adventure in the nature of trade

James, a salaried systems analyst, works for a financial institution. During his leisure time he develops some unique software and licences the copyright in the software to a software house for \$250,000.

James is entitled to an ABN in respect of the development of the software on the basis that he is:

- an individual carrying out an activity that is an adventure or concern in the nature of trade.

He may not have had a commercial intention when he first started to develop the software but his intention changed at the time he decided to licence it and look for a prospective buyer.

MT 1999/D1

Example 5: an adventure in the nature of trade

Bill and Jane live on a 2.5 hectare lot that is becoming too much to maintain.

They decide to sell part of the land and apply to subdivide the lot in half. The survey and subdivision are approved. They retain the subdivided lot containing their house and the other is sold.

Bill and Jane are not entitled to an ABN in respect of the subdivision on the basis that:

- the activity is not in the form an adventure or concern in the nature of trade; and
- it is the mere realisation of a private asset.

Example 6: an adventure in the nature of trade

Bill inherits a farm from his parents. He decides not to retain it and hires a surveyor to survey the 500 hectare property to establish how many 15 hectare lots it can be subdivided into. Having received approval for the subdivision from the local council, he proceeds to hire an engineer and, in turn, a contractor to build access roads for the lots and to install services such electricity sewerage and water. The lots are then sold at auction.

Bill is entitled to an ABN on the basis that:

- the activities are in the form of an adventure or concern in the nature of trade;
- they have a commercial flavour because of the way in which they have been undertaken.

'In the form of'

77. There is no judicial guidance in Australian or United Kingdom case law concerning the phrase 'in the form of'. The ordinary meaning of the phrase, however, is considered to support a view that 'in the form of', in conjunction with 'business' or 'adventure or concern in the nature of trade', includes an activity or series of activities that, if it or they had been done for profit, would satisfy the ordinary concept test of 'business' or 'adventure or concern in the nature of trade'.

78. This interpretation would bring within the scope of the subsection, activities that the Courts have held to be something less than either a 'business' or 'an adventure or concern in the nature of trade' but which, nevertheless, is taken by a particular statute or regulation to be a 'business' or 'an adventure or concern in the nature

of trade'. For example, the *Bank Account Debits Tax Administration Act 1982* (Cth) treats certain organisations that are not for ordinary concepts purposes a business (due to an incapacity to profit) as if they were a business.

79. Superannuation funds are an example of an entity that, in some circumstances, have been held not to be a business, for ordinary concept purposes, because of an incapacity to profit. In *State Superannuation Board (NSW) v. Federal Commissioner of Taxation* (1988) 82 ALR 63; (1988) 19 ATR 1264; 88 ATC 4382, Sheppard J said in the context of that case at 82 ALR 74; 19 ATR 1275; 88 ATC 4391:

‘All this activity plainly involved the applicant engaging in a regular and systematic course of conduct. What was, however, absent from its activities was the conduct of a commercial enterprise in which that expression is understood in ordinary language. The applicant was an organ of government. Although it invested moneys and received interest and dividends and also surpluses on sale of investments, it was not intended to make a profit. ...

However large a trust may be, it does not necessarily follow that the trustee administering it is carrying on a business. In most cases he will not be unless there are amongst the assets of the trust, specific assets which themselves may be described as businesses. If the question were whether the applicant was carrying on a business, using that expression in the sense indicated by the dictionaries and the authorities to which reference has been made, I would have reached the conclusion that the question should be answered in the negative.’

80. His Honour then went on to conclude that, although the NSW State Superannuation Board was not a business for ordinary concepts purposes, it did satisfy a test of an activity ‘in the nature of a business (whether or not for profit)’.

81. The incapacity to profit would be the most common reason why an activity or series of activities, with all the appearances of a ‘business’ or an ‘adventure or concern in the nature of trade’, would fail the ordinary concept tests.

Superannuation funds

82. The activities of superannuation funds that are not a business for ordinary concept purposes, are considered ‘in the form of a business’ within the meaning of paragraph 38(1)(a) of the ABNA.

MT 1999/D1

Mutual organisations

83. Organisations or associations whose receipts consist entirely of mutual receipts have been held not to be ‘an adventure or concern in the nature of trade’ but rather activities that may be, in a sense, a trading activity. In this context, there is an unwillingness to profit because the objective or outcome is not profits, but rather a desire to cover expenditure and to return any surplus directly or indirectly, sooner or later, to the members (*Fletcher v. Income Tax Commr* (1971) 3 All ER 1185). This type of activity is ‘in the form of an adventure or concern in the nature of trade’ for paragraph 38(1)(b) of the ABNA.

84. The activities of these organisations may amount to activities in the form of a business rather than activities in the form of an adventure or concern in the nature of trade.

Non profit clubs and associations

85. Non-profit clubs and associations are similar to mutual organisations in that their activities may, in a sense, involve trading activities (e.g., bar facilities of a sporting club) but there is an unwillingness to profit because the objective or outcome is not to derive profits (in the ordinary sense) but merely to cover expenditure and apply any surplus directly or indirectly, sooner or later, to the benefit of the membership as a whole.

86. A non-profit club or association might, therefore, have activities that, in a sense, may be categorised as either a ‘business’ or an ‘adventure or concern in the nature of trade’ but, due to the unwillingness to profit, are not. Accordingly, the activities of a non-profit club or association are ‘in the form of a business’ or ‘in the form of an adventure or concern in the nature of trade’ for subsection 38(1) of the ABNA.

On a regular or continuous basis, in the form of, a lease, licence or other grant of interest in property

Lease, licence or other grant of interest in property as an enterprise

87. Paragraph 38(1)(c) of the ABNA includes in the definition of an ‘enterprise’ an activity, or a series of activities, done on a regular or continuous basis, in the form of a lease, licences or other grant of interest in property is an enterprise.

88. This Ruling does not consider the meaning of ‘lease’, ‘licence’ or ‘other grant of an interest in property’.

Regular or continuous basis

89. To be an enterprise the lease, licence or other grant of property activity must be done on a regular or continuous basis.

90. In New Zealand, subsection 6(1) of the *Goods and Services Act 1985* includes ‘continuously or regularly’ in the definition of the term ‘taxable activity’. In the leading authority, the Court of Appeal case of *Newman v. CIR* (1995) 17 NZTC 12,097, the Court held that it is the activity of sale that has to be carried on continuously, rather than the various sequential steps or components that comprise the activity.

91. As for the regularity of activity, there must be repetition of the activity at reasonably proximate, but not necessarily fixed, intervals.

In the form of a lease, licence or other grant of interest in a property

92. In paragraphs 38(1)(a) and (b) of the ABNA the use of ‘in the form of’ brings into the definition of ‘enterprise’ activities that do not amount to a business or to a concern or adventure in the nature of trade. Something less than a business, for example, can be an enterprise as defined.

93. In paragraph 38(1)(c) the term ‘a lease, licence or other grant of interest in a property’ is normally broadly defined. To that extent the term ‘in the form of’ is not considered to broaden the term further than that broadest meaning.

Example 7: regular or continuous basis

Brian and Joan have a holiday home at a well-known beach side destination.

They use the holiday home extensively for family purposes but, on occasions, they let it out for a limited period of time to cover costs such as rates and taxes and ongoing maintenance costs. The extent of the leasing is never more than a few weeks, spread over the year on an ad hoc basis.

Brian and Joan are not entitled to an ABN on the basis that the leasing of the holiday home is not on a regular or continuous basis.

The activity would also not qualify as an enterprise on the basis that there is no profit making intention.

Example 8: regular or continuous basis

Greg runs a sheep growing property that has been quite profitable until the last two years, during which there has been a severe drought.

MT 1999/D1

There are two old cottages on the property, one of which Greg's wife, Jill, repainted and refurnished with spare furniture from the property's main house.

She placed a sign on the main road advertising this for short term lease to tourists. The cottage is also used regularly by their friends and relatives at no charge but the cottage is leased out for a fee on average about 20 weeks of the year.

Jill is entitled to an ABN in respect of the lease on the basis that it is regular and continuous.

Example 9: regular or continuous basis

Bill is a salaried motor vehicle mechanic who works full-time during the week.

Bill owns a fishing boat (inherited from his uncle) and, during the weekend and his holidays, Bill and his wife operate this vessel on charter for fishing trips. This venture is very profitable and is so successful that Bill is seriously considering giving up his full-time employment and concentrating solely on charter work.

Bill would be entitled to an ABN on the following basis:

- Bill is carrying on a series of activities, full-time employment and charter work;
- the charter work is considered to be an enterprise because of the nature of the activity and the manner in which it is being carried on; and
- the employment is excluded for the meaning of 'enterprise' under section 38(2)(a) of the ABNA.

The Commonwealth, a State or Territory, or a body corporate, or corporation sole established for a public purpose under a law of the Commonwealth, a State or a Territory

94. An activity or series of activities done by the Crown in the right of the Commonwealth, a State or a Territory is an enterprise. The 'public purpose' test is limited to bodies corporate or corporations sole established under a law of the Commonwealth, a State or Territory.

95. The term 'public purpose' is not defined in the ABNA. However, in the *Butterworths Australian Legal Dictionary* the term is defined as:

'Purposes relating to the public interest. The term "public purposes" is wider than "government purposes": *Australian*

Tape Manufacturers Association v. Commonwealth (1993) 176 CLR 480; 112 ALR 53 at 61. Accordingly, it is sufficient if the purpose is one which benefits a select group or groups in the public interest such as the relief of necessitous farmers (*Attorney-General (NSW) v. Homebush Flour Mills Ltd* (1937) 56 CLR 390), or the compensation of relevant copyright owners (*Australian Tape Manufacturers Association v. Commonwealth* (1993) 176 CLR 480 at 505; 112 ALR 53), rather than the public generally.’

96. Thus, the activities to be carried out by the entity must be designed to be of benefit to the public generally or to an identifiable section of the public.

97. From the wording of the paragraph, it is necessary that the corporate body or corporation sole must be established with the requisite purpose in mind. If the entity is established for the requisite purpose, any activity by the entity is sufficient to satisfy the paragraph.

Employee or PAYE earner

Meaning of employee or other PAYE earner

98. For a discussion on what is meant by an employee or other PAYE earner reference should be made to Taxation Ruling TR 1999/13. That Ruling discusses the meaning of the term ‘employee’ as it is used in Division 2 of Part VI of the ITAA 1936. Division 2 provides the legislative framework for the PAYE system. The definitions in Division 2 extend the scope of the PAYE system to cover payments made to persons other than employees within the ordinary meaning of that expression.

Employee or other PAYE earner activities

99. The activities of an employee or other PAYE earner are not an enterprise within the meaning of section 38 of the ABNA unless they are done in supplying services as the holder of an office that the employee or PAYE earner has accepted in the course of or in connection with an activity or series of activities of the kind mentioned in subsection 38(1) of the ABNA.

Proposed PAYG withholding system

100. As part of the A New Tax System (Pay As You Go) Bill 1999 it is proposed to replace the PAYE system with a new system, the Pay As You Go (PAYG) withholding system. The new system is also to

MT 1999/D1

also replace other withholding systems such as PPS. It is intended that PAYG will apply to payments made on or after 1 July 2000.

101. The replacement of PAYE with PAYG will require a change to paragraph 38(2)(a) of the ABNA. It is proposed to repeal the paragraph and replace it with:

‘by a person as an employee or in connection with earning withholding payments covered by subsection (3) (unless the activity or series is done in supplying services as the holder of an office that the person has accepted in the course of or in connection with an activity or series of activities of a kind mentioned in subsection (1))’.

102. The withholding payments covered by the proposed subsection 38(3) of the ABNA are:

- payment to an employee;
- payment to a company director;
- payment to an office holder; and
- payment under a labour hire arrangement, or specified by regulations.

Example 10: PAYE earner

John, an accountant, is a sole practitioner who acts as a director of a client company from which he is paid directors fees.

John is entitled to an ABN in respect of his accountancy practice and the director’s fees are received in respect of the activity that forms part of the practice.

The activity of the director’s duties is not an enterprise in its own right.

Private recreational pursuit or hobby

Background

103. Hobbies and recreation are discussed in paragraphs 86 to 93 of Taxation Ruling TR 97/11, which considers the meaning of ‘business of primary production’ in the ITAA 1936. They are discussed in TR 97/11 as an indicator of when a business is not being carried on. The pursuit of a hobby is not the carrying on of a business for taxation purposes. Examples and indicators of a hobby are also provided in TR 97/11.

104. As this Ruling does not add to or change the discussion in TR 97/11 on hobbies and carrying on a business, TR 97/11 can be

referred to for a fuller discussion on whether a particular activity constitutes the carrying on of a hobby.

105. There are no statutory definitions of ‘private recreational pursuit’ or ‘hobby’. They take their ordinary meaning. *The Macquarie Dictionary* defines hobby to be ‘a spare time activity or pastime, etc., pursued for pleasure or recreation’ and ‘recreation’ to have a number of meanings including ‘refreshment by means of some pastime, agreeable exercise’ and ‘a pastime, diversion, exercise, or other resource affording relaxation and enjoyment’.

106. The nature of a private recreational pursuit or hobby has been considered in a New Zealand case. In *Case N27 (1991) 13 NZTC 3229*, Bathgate DJ described a private recreational pursuit, at 3240, to be:

‘in essence, a private pastime of the sort carried on for the personal refreshment, pleasure or recreation of the person (or persons) concerned.’

Private recreational pursuit or hobby is not an enterprise

107. An activity, or activities, of a private recreational pursuit or hobby is not an enterprise within the meaning of section 38 of the ABNA.

Pursuit of a hobby is not carrying on a business

108. As stated in paragraph 86 of TR 97/11, a hobby is not a business for taxation purposes:

’86. The pursuit of a hobby is not the carrying on of a business for taxation purposes. Money derived from the pursuit of a hobby is not regarded as income and therefore is not assessable. As was said in *Ferguson* at ATC 4265; ATR 877:

“... if what he is doing is **more properly described as the pursuit of a hobby or recreation or an addiction to a sport**, he will not be held to be carrying on a business, ever though his operations are fairly substantial.” (emphasis added)

Expenses incurred in relation to the hobby activity are not allowable deductions. However, we recognise that a hobby can sometimes turn into a business.’

Indicators of private recreational pursuit or hobby

109. Whether an activity is a private recreational pursuit or hobby is a question of fact. Similar to the term ‘business’ there is no guidance

MT 1999/D1

for determining whether the nature, extent and manner of undertaking the activities amount to a private recreational pursuit or hobby. There are a number of indicators that are relevant to determining whether the activities amount to a private recreational pursuit or hobby. Paragraph 87 of TR 97/11 lists the following indicators:

- 'it is evident that the taxpayer does not intend to make a profit from the activity;
- losses are incurred because the activity is motivated by personal pleasure and not to make a profit and there is no plan in place to show how a profit can be made;
- the transaction is isolated and there is no repetition or regularity of sales;
- any activity is not carried on in the same manner as a normal, ordinary business activity;
- there is no system to allow a profit to be produced in the conduct of the activity;
- the activity is carried on a small scale;
- there is an intention by the taxpayer to carry on a hobby, a recreation or a sport rather than a business;
- any produce is sold to friends and relatives and not to the public at large.'

A hobby can become a business and an enterprise

110. A hobby can turn into an enterprise and also a business as the nature and extent of the activities change. The change would be reflected in changes to the indicators of private recreational pursuits and hobbies. For example, there may be an increase in the scale of the activities, the introduction of businesslike systems, an intention to make a profit and a move away from a private pastime.

Example 11: recreational pursuit or hobby

Linda is a public servant who spends some of her leisure time producing clay pots and other products. She has her own kiln in which she fires her creations and produces a saleable product. Linda has a stall at a weekend market at which she sells her clay products. These are popular and she is able to cover some of her costs and continue production.

Linda is not entitled to an ABN on the following basis that:

- the activity is a hobby; or

- it is an activity undertaken without expectation of profit or gain.

Individuals or partnerships without a reasonable expectation of profit or gain

Activities not an enterprise

111. An activity, or activities, of an individual (other than a trustee of a charitable fund) or a partnership (all the members of which are individuals) without a reasonable expectation of profit or gain is not an enterprise within the meaning of section 38 of the ABNA.

Individuals and partnerships

112. The words ‘individual’ and ‘partnership’ are defined in the ABNA. An ‘individual’ means a natural person and a ‘partnership’ takes the meaning given by section 995-1 of the ITAA 1997. That section defines a partnership to mean ‘an association of persons carrying on business as partners or in receipt of ordinary income or statutory income jointly, but does not include a company’.

Intention to make profit or gain

113. The intention to make a profit from an activity, or series of activities, is an indicator that suggests a business is being carried on. However, it may not be an indicator for an activity in the form of a business.

114. The reasonable expectation of a profit or gain is not limited to an expectation for the current year. Profits or gains are unlikely in the short term for some activities, such as tree farming, but expected over the long term. An immediate purpose of profit making is not essential. However, the period to be covered by the test must be relevant to the nature of the activity undertaken.

Reasonable expectation

115. The phrase ‘reasonable expectation’ has been considered in a number of cases. In *News Corporation Ltd v. National Companies and Securities Commission* (1984) 57 ALR 550; (1984) 5 FCR 88 at ALR 561; FCR 101, Woodward J said:

‘A reasonable expectation of an event requires more than a possibility, risk or chance of the event occurring.’

MT 1999/D1

116. In Part IVA of the ITAA 1936 cases, a reasonable expectation has also required more than a possibility: see also *FC of T v. Peabody* (1994) 181 CLR 359; (1994) 28 ATR 344; 94 ATC 4663.

117. Although the test is an objective test the intentions of the individual or individuals may be relevant. In *FC of T v Arklay* (1989) 85 ALR 368; (1989) 20 ATR 276; 89 ATC 4563 which was concerned with the meaning given to the expression ‘circumstances existed by reason of which it was reasonable to expect’ appearing in paragraph 82AAS (2)(a) of the ITAA 1936 the Full Bench of the Federal Court of Australia concluded ((1989) 85 ALR 372; (1989) 20 ATR 279; 89 ATC 4567):

‘We are of the opinion that the phrase with which we are concerned in the context of section 82AAS of the Act requires a determination whether or not circumstances exist by reason of which the decision-maker is able to expect on reasonable grounds that superannuation benefits would be provided as stipulated in the section. That test is an objective one. However, in applying the test the decision-maker, in considering the circumstances, should have regard to any relevant matters concerning the taxpayer personally. Put another way our understanding of the meaning of the expression is one which involves the application of an objective test, but, as one of the concomitant elements of that test, the subjective intentions of the taxpayer may be relevant’.

118. Nevertheless, a subjective profit intention is not sufficient. The test requires that, in the circumstances, the individual or partners carrying out the activity, or series of activities, is or are considered to have a reasonable expectation of profit or gain.

Example 12: no expectation of profit

John, a public servant, is made redundant in his employment and purchases half of his father in law’s farm (200 hectares), including some farm equipment, with the redundancy pay out. While the 200 hectares has consistently made profits, the 100 hectare lot is uneconomical in its own right and he and his father in law continue to farm both lots jointly, sharing in any profits. Prior to making the purchase, John had lived with his wife on her father’s property and helped him operate the farm on weekends and during holiday breaks. In order to prepare him for this, he completed a distance learning course at an agricultural college in farm management.

John and his father in law would be entitled to an ABN as a partnership on the basis that

- the activity would constitute an activity in the form of a business.

Because of the circumstances preceding and following the purchase of the property the activity would not be classified as one without a reasonable expectation of profit or gain.

Example 13: no expectation of profit

Frank is an architect who specialises in designing high rise office buildings and is an avid reader in ancient history.

He travels on holidays to the Middle East and, while there, decides to start researching a book on ancient housing in that region. Frank has no previous experience in writing. On his return he spends much of his leisure time writing the book and approaches a publisher to produce the book. The book is moderately successful and Frank receives some royalties.

Frank is not entitled to an ABN on the basis that:

- the book writing activity is classified as one undertaken without a reasonable expectation of a profit or gain.

The book is written as a one-off without any prior experience and is not associated with the professional qualifications of the individual, but rather, his leisure interest.

Members of local governing bodies

Activities of members of local governing bodies are not enterprises

119. The section 38 of the ABNA definition of ‘enterprise’ does not include an activity or series of activities done as a member of a local governing body established by or under a State law or Territory law (other than an eligible local governing body within the meaning of section 221A of the ITAA 1936).

Members of local governing bodies and the PAYE system

120. A ‘local governing body’ is usually a municipal or shire council. State or Territory law, such as the *Local Government Act 1993* (Qld) establishes most councils.

121. The members of local government councils, councillors, are not usually a part of the PAYE system. Section 221A of the ITAA 1936 defines the terms used in the sections dealing with the collection of PAYE for salary and wage earners. It states that payments made to the members of local government bodies are not salary and wages.

122. Sometimes, however, the work that council members do is their principal occupation and they prefer to have PAYE deductions made. When a local government body wants to be part of the PAYE

MT 1999/D1

system, it can pass a special resolution to become an ‘eligible local governing body’ for the purposes of Section 221A of the ITAA 1936. When this has been done, all the payments made to members of the eligible body are defined as salary and wages. This makes the members PAYE earners and brings their activities within the activities covered by paragraph 38(2)(a) of the ABNA.

Proposed PAYG withholding system

123. The proposed replacement of PAYE with PAYG will also require a change to paragraph 38(2)(d) of the ABNA. As part of the A New Tax System (Pay As You Go) Bill 1999 it is proposed to repeal the paragraph and replace it with:

‘as a member of a local governing body established by or under a State law or Territory law (except a local governing body to which subsection 12-45(3) in Schedule 1 to the *Taxation Administration Act 1953* applies)’.

Detailed contents list

124. Below is a detailed contents list for this draft Miscellaneous Taxation Ruling:

	Paragraph
What this Ruling is about	1
Date of effect	4
Ruling	5
Entities entitled to an ABN if they carry on an enterprise in Australia (section 37 of the ABNA)	7
Enterprise (section 38 of the ABNA)	12
<i>‘Activity, or series of activities’</i>	<i>15</i>
<i>‘Business’</i>	<i>16</i>
<i>‘An adventure or concern in the nature of trade’</i>	<i>19</i>
<i>‘In the form of’</i>	<i>21</i>
<i>On a regular or continuous basis, in the form of a lease, licence or other grant of interest in property</i>	<i>22</i>
<i>The Commonwealth, a State or Territory, or a body corporate, or corporation sole established for a public purpose under a law of the Commonwealth, a State or a Territory</i>	<i>23</i>

<i>Individuals or partnerships of individuals without a reasonable expectation of profit or gain</i>	24
Private rulings	26
Explanations and examples	27
Entities entitled to an ABN if they carry on an enterprise in Australia (section 37 of the ABNA)	27
<i>Individual</i>	27
<i>Body corporate</i>	28
<i>Corporate sole</i>	36
<i>Body politic</i>	40
<i>Partnership</i>	44
<i>Any other unincorporated association or body of persons</i>	45
<i>Business associations</i>	50
<i>Not for profit associations</i>	51
<i>Body of persons</i>	53
<i>Superannuation fund</i>	54
<i>Government entity</i>	55
<i>Other relevant entity definitions</i>	56
<i>Company</i>	56
<i>Corporations Law company</i>	57
Enterprise (section 38 of ABNA)	58
<i>'Activity, or series of activities'</i>	58
<i>Example 1: an activity that is an enterprise</i>	61
<i>Example 2: more than one enterprise carried on by an entity in its own right</i>	61
<i>Example 3: activities or series of activities</i>	61
<i>'Business': a business, as defined, is an enterprise</i>	62
<i>Definition</i>	63
<i>Indicators of a business</i>	66
<i>'An adventure or concern in the nature of trade'</i>	67
<i>Enterprise includes activities done in the form of an adventure or concern in the nature of trade</i>	67
<i>Trade v investment assets</i>	72
<i>Commerciality</i>	76

MT 1999/D1

<i>Example 4: an adventure in the nature of trade</i>	76
<i>Example 5: an adventure in the nature of trade</i>	76
<i>Example 6: an adventure in the nature of trade</i>	76
<i>'In the form of'</i>	77
<i>Superannuation funds</i>	82
<i>Mutual organisations</i>	83
<i>Non profit clubs and associations</i>	85
<i>On a regular or continuous basis, in the form of, a lease, licence or other grant of interest in property</i>	87
<i>Lease, licence or other grant of interest in property as an enterprise</i>	87
<i>Regular or continuous basis</i>	89
<i>In the form of a lease, licence or other grant of interest in a property</i>	92
<i>Example 7: regular or continuous basis</i>	93
<i>Example 8: regular or continuous basis</i>	93
<i>Example 9: regular or continuous basis</i>	93
<i>The Commonwealth, a State or Territory, or a body corporate, or corporation sole established for a public purpose under a law of the Commonwealth, a State or a Territory</i>	94
<i>Employee or PAYE earner</i>	98
<i>Meaning of employee or other PAYE earner</i>	98
<i>Employee or other PAYE earner activities</i>	99
<i>Proposed PAYG withholding system</i>	100
<i>Example 10: PAYE earner</i>	102
<i>Private recreational pursuit or hobby</i>	103
<i>Background</i>	103
<i>Private recreational pursuit or hobby is not an enterprise</i>	107
<i>Pursuit of a hobby is not carrying on a business</i>	108
<i>Indicators of private recreational pursuit or hobby</i>	109
<i>A hobby can become a business and an enterprise</i>	110
<i>Example 11: recreational pursuit or hobby</i>	110

<i>Individuals or partnerships without a reasonable expectation of profit or gain</i>	111
<i>Activities not an enterprise</i>	111
<i>Individuals and partnerships</i>	112
<i>Intention to make profit or gain</i>	113
<i>Reasonable expectation</i>	115
<i>Example 12: no expectation of profit</i>	118
<i>Example 13: no expectation of profit</i>	118
Members of local governing bodies	119
<i>Activities of members of local governing bodies are not enterprises</i>	119
<i>Members of local governing bodies and the PAYE system</i>	120
<i>Proposed PAYG withholding system</i>	123
Your comments	125

Your comments

125. We invite you to comment on this draft Miscellaneous Taxation Ruling. We are allowing strictly four weeks for comments before we finalise this Ruling. If you want your comments to be considered, please provide them to us within this period.

Comments by Date:	26 November 1999
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Commissioner of Taxation
27 October 1999

Previous draft:

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Related Rulings/Determinations:

TR 97/11; TR 1999/13

Subject references:

- Australian Business Number
- activity or series of activities
- adventure or concern in the nature of trade
- body corporate

MT 1999/D1

- body of persons
- body politic
- business
- business association
- charitable institution
- corporation sole
- Corporations Law company
- eligible local governing body
- employee
- enterprise
- entity
- Government entity
- hobby
- indicators of a business
- indicators of a hobby
- individual
- in the form of
- isolated transactions
- investment assets
- lease, licence or other grant of interest in property
- local governing body
- mutual organisations
- non profit clubs and associations
- other unincorporated associations or body of persons
- partnership
- Pay As You Earn (PAYE)
- Pay As You Go (PAYG)
- PAYE earner
- PAYG withholding
- private assets
- private recreational pursuit or hobby
- public purpose
- reasonable expectation of profit or gain
- regular or continuous basis
- religious institution
- superannuation fund
- trade
- trust
- unincorporated association
- unique business identifier
- withholding payments

Legislative references:

- ANTS(ABN)A 5
- ANTS(ABN)A 8(1)
- ANTS(ABN)A 8(2)
- ANTS(ABN)A 37
- ANTS(ABN)A 37(1)(a)
- ANTS(ABN)A 37(1)(b)
- ANTS(ABN)A 37(1)(c)
- ANTS(ABN)A 37(1)(d)
- ANTS(ABN)A 37(1)(e)

- ANTS(ABN)A 37(1)(f)
- ANTS(ABN)A 37(1)(g)
- ANTS(ABN)A 37(1)(h)
- ANTS(ABN)A 38
- ANTS(ABN)A 38(1)
- ANTS(ABN)A 38(1)(a)
- ANTS(ABN)A 38(1)(b)
- ANTS(ABN)A 38(1)(c)
- ANTS(ABN)A 38(1)(d)
- ANTS(ABN)A 38(1)(e)
- ANTS(ABN)A 38(1)(f)
- ANTS(ABN)A 38(1)(g)
- ANTS(ABN)A 38(2)
- ANTS(ABN)A 38(2)(a)
- ANTS(ABN)A 38(2)(b)
- ANTS(ABN)A 38(2)(c)
- ANTS(ABN)A 38(2)(d)
- ANTS(ABN)A 41
- ITAA36 6(1)
- ITAA36 82AAS
- ITAA36 82AAS(2)(a)
- ITAA36 Pt IVA
- ITAA36 Div 2 Pt VI
- ITAA36 221A
- ITAA97 30-B
- ITAA97 995-1
- TAA 14ZAAA
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NO 99/14482-3

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