TD 2006/D24 - Income tax: capital gains: can the clause 'the relevant business ceased to be carried on' in subparagraph 152-35(a)(ii) of the Income Tax Assessment Act 1997 be satisfied in the case of a taxpayer who sold the business to another?

This document has been finalised by TD 2006/64.

Draft Taxation Determination

Income tax: capital gains: can the clause 'the relevant business ceased to be carried on' in subparagraph 152-35(a)(ii) of the *Income Tax Assessment Act 1997* be satisfied in the case of a taxpayer who sold the business to another?

This publication provides you with the following level of protection:

Ruling

1. Yes. The reference to 'the relevant business ceased to be carried on' in subparagraph 152-35(a)(ii) of the *Income Tax Assessment Act 1997* (ITAA 1997) is not limited to a business that ends, in the sense that no one continues to carry it on, and includes a reference to a business that has ceased to be carried on by a taxpayer because the taxpayer has sold that business.

Example 1

2. *Jane carried on a business from premises she owned. In June 2003 she sold the business but retained ownership of the premises. In December 2003 Jane sold the premises and made a capital gain. As Jane sold the premises within 12 months of selling the business and the premises were an active asset just before the sale of the business, subparagraph 152-35(a)(ii) of the ITAA 1997 is satisfied and the premises can satisfy the active asset test if the other aspects of the test are also satisfied.*

Example 2

3. *Laura, a sole trader, carried on business from premises she owned. The premises had been used only for business purposes. Due to expansion of the business, Laura vacated the premises and moved into larger premises across the street. Shortly after moving, Laura entered into a contract to sell the original premises.*

4. *In this case, immediately before their sale, the premises were not used, or held ready for use, in Laura's business as she had moved to other premises. Accordingly, the premises were not an active asset 'just before' the CGT event (subparagraph 152-35(a)(i) of the ITAA 1997),and therefore do not satisfy the active asset test.*

Example 3

5. *Jordan is the controlling individual of Aus Co, an Australian resident company. Aus Co's business is sold in winding-up the company. Six months later the shares in Aus Co are cancelled and Jordan makes a capital gain on the cancellation. Just before the sale of the company's business, the market value of the active assets of the company was at least 80% of the market value of all the assets of the company.*

6. *For the purpose of determining whether a share in a company that has ceased to carry on a business satisfies the active asset test, the 'relevant business' referred to in subparagraph 152-35(a)(ii) of the ITAA 1997 is the business previously carried on by the company.*

7. *As Aus Co's business ceased within 12 months of the CGT event happening to the shares, the relevant test time for the purpose of paragraph 152-35(a) of the ITAA 1997 is just before the cessation of the business because that pre-dates the CGT event. As Aus Co satisfied the ' 80% test' (paragraph 152-40(3)(b) of the ITAA 1997) at that time, the shares held by Jordan were active assets just before the cessation of the business and paragraph 152-35(a) of the ITAA 1997 is therefore satisfied.*

Example 4

8. *Arthur carried on a business for many years from premises he owned. In 2002 he died and the business ceased at that time. Six months later, the legal personal representative (LPR) of Arthur's estate sold the premises and made a capital gain.*

9. *In this situation, the premises were not an active asset of the LPR just before the sale because the LPR did not continue to carry on the deceased's business. Subparagraph 152-35(a)(i) of the ITAA 1997 is therefore not satisfied. As well, the premises were not an active asset of the LPR just before the business ceased because at that time they were not an asset of the LPR at all (being still owned by Arthur). Subparagraph 152-35(a)(ii) of the ITAA 1997 is therefore also not satisfied.*

10. *Accordingly, the premises do not satisfy the active asset test in relation to the capital gain made by the LPR on the sale of the premises.*

Example 5

11. *Company A carried on business from premises it acquired in 1987. On 1 July 2000, Company A sold the business and leased the premises to Company B. Company A and Company B had a common 'controller' such that they were both connected entities under paragraph 152-30(1)(b) of the ITAA 1997.*

12. *On 1 July 2002, the common controller sold their shares in Company B. As a result, Company A and Company B were no longer connected with each other as there was no common controller. Company B continued to carry on its business and use the premises. On 1 June 2003, Company A sold the premises and made a capital gain. Company A needs to determine whether it qualifies for the small business CGT concessions in Division 152 of the ITAA 1997.*

13. *The premises were an active asset of Company A between 1987 and 1 July 2000 as they were used by Company A in the course of carrying on a business (paragraph 152-40(1)(a) of the ITAA 1997). The premises continued to be an active asset of Company A between 1 July 2000 and 1 July 2002 as they were used in the business of a connected entity (subparagraph 152-40(1)(c)(ii) of the ITAA 1997). However, the premises ceased to be an active asset from 1 July 2002 until their sale on 1 June 2003 because, although the business carried on by Company B continued, Company B stopped being connected with Company A as a result of the common controller selling their shares in Company B.*

14. *As the premises were not an active asset just before their sale subparagraph 152-35(a)(i) of the ITAA 1997 is not satisfied. Further, there was no sale or cessation of Company B's business. A sale of shares in a company that carries on the relevant business is not a cessation of the relevant business. However, it is possible to consider the business previously carried on by Company A as being the relevant business. On this basis, we consider the earlier sale of the business by Company A on 1 July 2000 to be a cessation of the relevant business.*

15. *As this cessation occurred more than 12 months before the CGT event (that is, the sale of the premises on 1 June 2003), an extension of time would need to be granted by the Commissioner before this part of the active asset test could be satisfied.*

Date of effect

16. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

Commissioner of Taxation
14 June 2006

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Explanation

17. For the small business concessions in Division 152 of the ITAA 1997 to apply to reduce or disregard a capital gain, the relevant CGT asset must satisfy the active asset test in section 152-35 of the ITAA 1997.

18. To satisfy the active asset test the CGT asset must, among other things, be an active asset of the taxpayer just before the earlier of the CGT event resulting in the capital gain and, if the relevant business ceased in the 12 months before the CGT event or any longer period the Commissioner allows, the cessation of that business (paragraph 152-35(a) of the ITAA 1997).

19. The words 'just before the earlier of the CGT event and …..the cessation of the business' in paragraph 152-35(a) of the ITAA 1997 refer to *immediately* before that time.

20. A CGT asset is an active asset (subject to certain exclusions) at a given time if, at that time, you own it and:

- it is used (or held ready for use) in the course of carrying on a business by you, a small business CGT affiliate of yours or an entity connected with you; or
- it is an intangible asset that is inherently connected with a business you carry on (subsection 152-40(1) of the ITAA 1997).

21. If an asset is an active asset because it is used in the business of a connected entity, the relevant business, as referred to in subparagraph 152-35(a)(ii) of the ITAA 1997, is the business carried on by the connected entity. Similarly, if a share in a company or an interest in a trust is an active asset because the company or trust satisfies the '80% test' in paragraph 152-40(3)(b) of the ITAA 1997, the relevant business is the business carried on (or previously carried on) by the company or trust.

22. A cessation of the relevant business, as referred to in subparagraph 152-35(a)(ii) of the ITAA 1997, clearly includes situations where a business carried on by a taxpayer entirely stops, such as where the taxpayer ceases trading, closes down or otherwise liquidates the business.

23. The question arises as to whether a cessation also includes a sale of the business. In such a case, the business ceases to be carried on by the taxpayer but continues to be carried on by the purchaser of the business.

24. Having regard to the broad intent of the provision and the limited operation the provision would otherwise have, the Tax Office considers the reference to 'the relevant business ceased to be carried on' in subparagraph 152-35(a)(ii) of the ITAA 1997 is not limited to a business that ends, in the sense that no one continues to carry it on, and includes a reference to a business that has ceased to be carried on by a taxpayer because the taxpayer has sold that business. A CGT asset may therefore satisfy paragraph 152-35(a) of the ITAA 1997 if it ceases to be an active asset because the business it was used in is sold before the sale of the asset.

25. However, if a CGT asset ceases to be an active asset of a taxpayer because the entity whose business it is used in ceases to be connected with the taxpayer, there is no cessation or sale of the 'relevant business' under subparagraph 152-35(a)(ii) of the ITAA 1997. As the CGT asset has ceased to be an active asset, subparagraph 152-35(a)(i) of the ITAA 1997 will also not be satisfied on a later sale of the asset and therefore the active asset test will not be satisfied.

26. The active asset test also requires the CGT asset to be an active asset for at least half of a particular period (paragraph 152-35(b) of the ITAA 1997).

Note

27. As noted in the Treasurer's Press Release No. 38 of 2006 (9 May 2006), the Board of Taxation's report on its Post-Implementation Review of the small business CGT concessions contains a number of legislative recommendations. This Draft Taxation Determination may be affected by the legislative change relating to Recommendation 7.1 of the Board's report.

Appendix 2 – Your comments

28. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date: **11 August 2006**

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References

Previous draft:

Not previously issued as a draft

Subject references:

- active asset
- active asset test
- basic conditions for relief
- capital gains
- capital gains tax
- cessation
- CGT assets
- CGT small business relief
- controlling individual
- small business relief
- time of CGT event

Legislative references:

- ITAA 1997 Div 152
- ITAA 1997 152-30(1)(b)
- ITAA 1997 152-35
- ITAA 1997 152-35(a)
- ITAA 1997 152-35(a)(i)
- ITAA 1997 152-35(a)(ii)
- ITAA 1997 152-35(b)
- ITAA 1997 152-40(1)
- ITAA 1997 152-40(1)(a)
- ITAA 1997 152-40(1)(c)(ii)
- ITAA 1997 152-40(3)(b)

Other references

- Treasurer's Press Release No. 38 of 2006

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ATO references

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