

Small business tax concessions - ATO finalises guidance on carrying on a business

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In brief

The Australian Taxation Office (ATO) has recently finalised its Ruling ([TR 2019/1](#)), which deals with when a company is 'carrying on a business' for the purposes of determining eligibility for a broad range of small business tax concessions.

Although this Ruling had its origins in a draft ruling which only applied in the context of eligibility for the reduced corporate tax rate, in a welcome move, the ATO has now extended the application of the guidance to the similar requirement expressed in the numerous tax concessions that apply more broadly for small business companies.

While there has been no significant change in the overall substance of the Ruling compared to its previous draft, other than its broader application, companies that have been unclear on whether they may have been carrying on a business for purposes of the relevant small business tax concessions such as the capital gains tax (CGT) concessions may now want to revisit their prior year treatment in light of the new guidance.

Simultaneously, the ATO also released a draft tax determination ([TD 2019/D4](#)) which addresses the question of whether a company whose only business activity is renting out an investment property is eligible to claim the CGT small business concessions in relation to the disposal of the property.

In detail

Background

For the 2015-16 and 2016-17 income years, a company was only eligible for a lower corporate tax rate if it was a 'small business entity' (SBE). This included a requirement that the company 'carry on a business' in the relevant year. To support those rules, in 2017, the ATO released Draft Taxation Ruling TR 2017/D7 to clarify when a company would be considered to be 'carrying on a business' for the purposes of accessing the lower rate.

This draft ruling was fairly short-lived since, for the 2017-18 income years onward, the 'carrying on a business' requirement is no longer specifically relevant for purposes of determining eligibility for the reduced corporate tax rate, as the 'small business entity' requirement was replaced with the concept of a 'base rate entity' (BRE). Although the definition of a BRE contains no specific business requirement, the inclusion of a threshold test with reference to income derived "... in the ordinary course of carrying on a business ..." means that the concept of a company carrying on a business continues to have a degree of relevance whenever determining eligibility for the reduced corporate tax rate.

The ATO has now extended the application of the Ruling so that it applies more broadly to the concept of ‘carrying on a business’ to qualify as a SBE, beyond access to the lower corporate tax rate. Accordingly, it impacts eligibility for a wide range of small business tax concessions such as accelerated asset depreciation deductions (including the recently introduced increase in the instant asset write-off threshold to AUD30,000), CGT small business concessions, simplified trading stock rules, immediate deductibility for certain start-up expenses, and certain Goods and Services Tax and Fringe Benefits Tax concessions.

When is a company carrying on a business?

The Ruling is concerned with whether a company carries on a business in a general sense, rather than whether it carries on any particular kind of business, and only applies for the purposes mentioned above.

In addition, it applies only to companies incorporated under the *Corporations Act 2001*, other than companies limited by guarantee or companies acting in their capacity as the trustee of a trust. Trusts and individuals are specifically carved out of the Ruling.

Carrying on a business

The Ruling highlights previous case law that found that the question of whether a company carries on a business in a general sense is a question of fact, having regard to the particular circumstances and activities of the company. It acknowledges that companies are typically formed for the purpose or prospect of making a profit, and therefore “... *any gainful use to which a company puts its assets will, on its face, amount to the carrying on of a business.*” However, this presumption can be rebutted where, based on the facts, the company has no aim or prospect of making a profit.

The following table summarises some of the examples that are included in the Ruling:

<i>Carrying on a business</i>	<i>Not carrying on a business</i>
An inactive company that previously carried on a trading business, but now only derives interest income and pays ASIC fees	A company with activities so small and limited in scope that it has no purpose or prospect of making a profit, either now or in the future. For example, a dormant company whose only income is interest on a small amount of cash in the bank that is never likely to exceed its annual ASIC company review fee
A company that invests cash to derive interest income whilst investigating the viability of carrying on a business activity in the future	A company whose activities are limited entirely to determining business feasibility
A company that is holding assets (for example, a single commercial property or boats leased to independent third parties) that generate ongoing returns, even where management of the assets is outsourced	A company that exists solely to hold or maintain assets (such as a boat or holiday home) for use of its shareholders
A share investment company deriving a profit from a portfolio of listed shares	A company whose only asset is a non-interest bearing debt owing following the winding up of its active business
A holding company that holds shares in subsidiary companies which are engaged in trading	A company that borrows funds to invest in subsidiaries in such a way that there is no intent or purpose of deriving a profit

A corporate beneficiary of a discretionary trust that has a clear expectation of being made entitled to trust income and re-invests the income in the trust (see further below)	A company that is a potential beneficiary of a discretionary trust, with no active participation by the company (e.g. not investing money derived from the trust)
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Accordingly, a company may be carrying on a business even if its activities are limited, such as passively receiving returns on investments and distributing them to shareholders. If the company “...invests its assets in gainful activities that have both a purpose and prospect of profit, it will normally be carrying on a business in a general sense.”

Corporate beneficiaries

It is not uncommon for trust distributions left unpaid to corporate beneficiaries (commonly referred to as UPEs) to be the sole or main asset of a company, and whether such a company is carrying on a business will need to be carefully considered.

Typically, these UPEs may be ‘quarantined’ from earlier years without generating any profitable return to the company, converted into interest bearing loans, documented under specific tax compliant investment agreements or repaid in full within certain specified timeframes. Sometimes, interest bearing arrangements or repayments may not be put in place or made for almost two years after the end of the year in which the UPE arises. These delayed investment arrangements could be problematic for corporate beneficiaries trying to substantiate a position that a business has commenced to be carried on from the earlier year in which the present entitlement to trust income arose.

In this context, the ATO has replaced the specific examples provided in the previous draft ruling with a more general discussion on the topic, noting that a detailed analysis of all the possibilities associated with corporate beneficiaries is beyond the scope of the Ruling. This is a complex area that should be examined closely based on specific facts and circumstances.

CGT small business concessions - rental business

Released at the same time as TR 2019/1, draft tax determination TD 2019/D4 (the Draft Determination) indicates that a company whose only business activity is renting out an investment property is not eligible to claim the CGT small business concessions in relation to the disposal of the property, notwithstanding that it may carry on a business in the general sense as outlined in TR 2019/1.

The requirement to ‘carrying on a business’ is only one of a number of qualifying requirements to be able to access the CGT small business concessions. Importantly, the relevant asset needs to be an ‘active asset’ as defined, and broadly excluded from this definition is property whose main use is to derive rent. As such, the Draft Determination states highlights that the small business CGT concessions would not be available in respect of the investment property.

Carrying on a business for other purposes of the tax law

As noted above, TR 2019/1 only applies to bind the Commissioner of Taxation in relation to specific sections of the tax law, including the definition of SBE. With respect to other parts of the tax law that contain similar concepts, the ruling states that ‘*whether a company carries on a business in the way relevant for those provisions must be considered in light of their words, purpose and context. Consequently, care must be exercised in applying the reasoning and conclusions expressed in this Ruling when applying other provisions.*’

Accordingly, whether a company is carrying on a particular business or whether an amount is ordinary income derived in the course of carrying on a particular business for the purpose of determining a company's 'aggregated turnover' (relevant for a range of tax provisions including access to small business concessions) is beyond the scope of the Ruling.

The takeaway

Finalisation of the binding ruling on whether a company is 'carrying on a business' for the purposes of assessing eligibility for the lower corporate tax rate is welcome, as is the extended application to the small business tax concessions more broadly.

Taxpayer companies should take the time to review the final guidance and, particularly where there may have been some prior uncertainty of whether or not a business was being carried on, take any necessary corrective action.

With respect to the lower corporate tax rate for the 2015-16 and 2016-17 income years, the Commissioner has indicated in Practical Compliance Guideline [PCG 2018/8](#) that a facilitative approach will generally be adopted to compliance in relation to the application of the 'carrying on a business' test and compliance resources will not be specifically allocated to conduct reviews of whether corporate tax entities have applied the correct rate of tax or franked at the correct rate for those income years.

Importantly, there is no choice to opt in or out of a lower company tax rate. Application of the lower rate is based entirely on meeting the relevant eligibility criteria, so companies will need to carefully assess and document their eligibility on an annual basis.

Let's talk

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