"Carrying on Business – Need for a definition?"

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Abstract

Cases concerning the meaning of ‘carrying on business’ for the purposes of the Income Tax Assessment Act 1936 and 1997 date back to the introduction of the Federal Income Tax System yet its meaning is still the subject of contentious litigation today. Is there a case to mount for defining ‘carrying on business’ for the purposes of the Income Tax Assessment Act?

This paper looks at that question.

The meaning of ‘business’ is also an issue for the purposes of the GST legislation as the definition of enterprise for GST purposes includes a ‘business’ and we fall back to the income tax cases concerning the meaning of ‘business’ that is not absolute or clear.

Currently the question as to whether an activity constitutes ‘carrying on business’ is determined by the application of a number of factors that have evolved from case law yet no particular factor is determinative. The recent decision of the High Court of Australia in Federal Commissioner of Taxation v Stone 2005 HCA 21 demonstrates the current approach to establishing the existence of a ‘business’ lacks certainty, a fundamental requirement of a good tax system. This paper looks at what options are available and the extent to which the recently introduced non-commercial loss provisions in Division 35 of the Income Tax Assessment Act 1997 have dealt with the uncertainty associated with the meaning of ‘carrying on business’.
Whether a taxpayer is carrying on business has important implications under the Income Tax Assessment Acts, Double Tax Agreements and the GST provisions yet no comprehensive definition of what it means to *carry on business* appears in the legislation. A conclusion as to whether a business is being carried on has ramifications throughout the Tax Acts and GST provisions.

The Australian Courts have grappled with what it means to *carry on a business* in applying legislation in Australia and have at times struggled to come up with a user-friendly interpretation. Certainly the nature of business is something that we would expect to change and so a strict definition is not appropriate. We have seen the courts in Australia highlight various factors that indicate that a business is being carried on and emphasised that not one factor is determinative and the importance of each will depend on the particular facts\(^1\). We have also seen that such an approach to the meaning of *carrying on business* has resulted in a significant amount of litigation and rulings issued by the Australian Taxation Office as well as taxpayer uncertainty\(^2\).

Business is defined in Section 995 of the Income Tax Assessment Act (ITAA) 1997 and Section 6(1) of ITAA 1936 to include (but not limited to) “any profession, trade, employment, vocation or calling, but does not include an occupation as an employee”. This definition does not deal with the general meaning of what it is to *carry on a business*. 
The first part of this paper looks at Australian legislation, focusing on the taxation provisions, to highlight the importance of the phrase to *carrying on business*. The second part looks at the factors that are relevant to a determination that a taxpayer is *carrying on business* and recent developments. Based on an analysis of the factors relevant to a determination that a taxpayer is *carrying on business* and the implications of the non-commercial loss provisions in Division 35 of the ITAA 1997 other alternatives are put forward.

**Importance of the concept “to carry on business”**

**Section 6-5 ITAA 97**

A determination as to whether a taxpayer is *carrying on business* arises on an application of Section 6-5 of the ITAA 97. Section 6-5 requires a taxpayer to include in assessable income “income according to ordinary concepts which is called ordinary income”. Income according to ordinary concepts has been interpreted by the courts to include the ordinary receipts of *carrying on business* and as a result whether an amount is assessable income may depend on whether the taxpayer is *carrying on a business*, if so what is the business, when did it begin and when may it end?

Section 6-5(2) requires that only ordinary income that a taxpayer derived during the year be assessed in that particular year. The ITAA’s do not include a definition of derived for the purposes of Section 6-5(2) but cases have established a set of rules that determine when income is derived, depending on the type of income and the application of those
rules is generally referred to as tax accounting. In relation to income from personal exertion a cash basis of recognition of income is considered appropriate but in relation to business or trading income an accruals basis is to be used. A number of cases dealing with professional taxpayers such as accountants and pathologists have demonstrated that in establishing whether a cash or accruals basis of recognising income is appropriate you need to determine whether the taxpayer’s activities are essentially the provision of personal services or whether they go so far to constitute the carrying on of a business of providing professional services and accordingly the derivation of business income. In answering this we look at a range of factors that the courts have highlighted as indicative of a business and need to apply those factors to the taxpayer’s scenario. We can see from case history that such an analysis is difficult and uncertain.

**Section 8-1(1)(b) ITAA 97**

Section 8-1(1)(b) of ITAA97 requires an evaluation as to whether a business is being carried on as it allows a taxpayer a general deduction from assessable income any loss or outgoing to the extent that…..

“ it is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income”.

When we look at the many cases considering the meaning of carrying on business for the purposes of Section 8-1(1)(b) we can see that the application and interpretation of this
section has resulted in significant litigation in which litigants disagree as to whether the taxpayer is *carrying on a business*, when a business commenced and whether the business has ceased.  

**Division 28 ITAA 97**

Under Division 28 of the ITAA 1997 “*business kilometres*” are defined to include kilometres not in relation to *carrying on a business* but “travelled in the course of (a) producing your assessable income: or (b) your travel between workplaces” (Section 28-25(3)). Accordingly although referred to as *business* kilometres there is no requirement that the taxpayer be *carrying on business* to fall within the definition. Arguably the use of the term *business* kilometres is confusing.

**Section 26-50 ITAA 97**

If you are carrying on a “*business* of providing leisure facilities for payment or of selling leisure facilities” you will not be denied a deduction for the cost of the leisure facility per Section 26-50(3) (a) and (b)(1). Similarly costs in relation to boats held as part of trading stock of a *business* or used in the course of a *business* fall outside Section 26-50(5) and will be deductible subject to the requirements of Section 8-1. When then is a taxpayer *carrying on a business* in relation to leisure facilities and boats? We saw in the case of **Phippen v Commissioner of Taxation (2005) AATA 952** that the taxpayer was unsuccessful in arguing that they were *carrying on a business* in partnership, trading as
Sailaway Yacht Charters, and as result could not claim any business deductions in connection with the boat based on exceptions to Section 26-50.

**Division 32 ITAA 97**

Entertainment costs in relation to a seminar are potentially deductible despite Section 32-5 based on the exception in Section 32-35 for seminars. If the seminar is however a *business* meeting then the exception in Section 32-35 will not apply. A seminar is a *business* meeting as defined in Section 35-65(3) “if its main purpose is for individuals who are (or will be) associated with the *carrying on of a particular business* to give or receive information, or discuss matters, relating to the *business*. If *no business is carried on then no* business meeting and potentially Section 32-35 could still apply.

**Division 35 ITAA 97**

A relatively new Division in the ITAA 1997, Division 35 was introduced by the Federal Government to improve the integrity of the tax system by deferring losses in relation to “non-commercial activities”. Division 35 will only apply to individuals who alone or in partnership *carry on a business*. So before it can be established that a taxpayer should be concerned about the application of Division 35 the taxpayer must be *carrying on a business*.
The recent Post Implementation Review by the Board of Taxation looking at the Quality and Effectiveness of the Non-Commercial Losses Provisions in Division 35 noted at paragraph 1.20 that “the issue of whether a business is being carried on is not addressed by Division 35 and this is regarded as contributing to uncertainty”\textsuperscript{8}.

In a sense Division 35 incorporates additional tests to the requirement for a deduction under Section 8-1(1)(b) that a taxpayer carry on business where the activity is not profitable. The four tests of a commercial activity in Division 35 are based on turnover, profitability and assets invested with discretion in the Commissioner in the case of special circumstances. If any one of the four tests are met then a taxpayer is not subject to the limitations of Division 35 and arguably the tests incorporated in Division 35 reflect the factors the Federal Government consider demonstrate the existence of a commercial business and minimise the loss to revenue.

**Section 40-880 ITAA 97**

Section 40-880 provides a deduction for “business related costs” including expenditure to establish, convert, and defend your business structure, costs of raising equity, unsuccessful takeover, liquidation and ceasing business to the extent that the business was carried on for a taxable purpose. For Section 40-880 to apply the relevant costs must relate to a business. No business, no deduction under Section 40-880.

**Division 70 ITAA 97**
Under the ITAA 97 anything that constitutes trading stock is subject to Division 70. Division 70 sets out acceptable basis of valuation of trading stock amongst other things. It is essential that items of trading stock be determined and treated in accordance with Division 70. Trading stock is defined in Section 70-10 to include…

“(a) anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a business: and
(b) livestock”

Accordingly, unless it is an item of livestock, to establish that it constitutes trading stock it must be shown that the taxpayer produced, manufactured or acquired it in the ordinary course of a business. If no business exists the item will not be trading stock and not subject to Division 70.

**Division 152 ITAA 97**

Division 152 of the ITAA 1997 provides for relief from capital gains tax for small business. Entitled “Small Business Relief” the various concessions will be available to businesses that satisfy four basic conditions set out in Section 152-10(1). One of those conditions is that the CGT event happens in relation to an active asset and an active asset is defined in Section 152-40(1) as an asset you own and…. 

“(a) use it, or hold it ready for use, in the course of carrying on a business;
(b) it is an intangible asset that is inherently connected with a *business that you carry on*; or

(c) it is used, or held ready for use, in the course of *carrying on a business* by;

(i) your small business CGT affiliate

(ii) another entity that is connected with you”

The provisions do provide for shares in an interest in a trust to be an active asset where the active assets of the company or trust meet the requirements of Section 152-40(3).

Accordingly the various CGT concessions provided for in Division 152 are only available to assets used in a business. Again the importance of establishing that a business exists is demonstrated by these concessions.

In *FC of T v Murry 98 ATC 4585* the owners of a taxi licence argued that a 50 percent exemption applied based on an application of 160ZZR of ITAA 1936 (in some ways the precursor to Division 152 of ITAA 97) to a capital gain made on the sale of a taxi licence. The taxpayer argued that the sale of the taxi licence constituted the disposal of goodwill of a business but failed to establish that the disposal of a taxi licence alone constitutes the sale of a business of a taxpayer. A taxi licence alone is not a business.

Section 152-40(4) does list a number of CGT assets that cannot be active assets and includes essentially passive interests eg shares and interests in trusts not covered by Section 152-40(3), financial instruments and assets whose main use is to derive interest,
annuities, rent, royalties or foreign exchange. These passive interests may very well have been excluded without Section 152-40(4) as in many instances ownership alone of such assets would not constitute the *carrying on of a business* and as a consequence fall outside Division 152.

Perhaps in light of the uncertainty concerning the meaning of *carrying on business* the government wanted to ensure that Division 152 would not apply to passive ownership of assets.

**Division 165 ITAA 97**

Issues concerning the *defining of a business* arise with respect to the carry-forward loss provisions in Division 165 and specifically, the application of the same business test in Section 165-210. A company satisfies the same business test in Section 165-210(1) “if throughout the same business test period it carries on the same business as it carried on immediately before the test time.” Accordingly Section 165-210(2) states that if a company derives assessable income from a business of a kind that it did not carry on before the test time or a transaction of a kind that it had not entered into in the course of its business operations before test time then the same business test will not be satisfied.

As a result, although it is referred to as the same business test it is more than that as even if a company carries on the same business a transaction outside previous practice can mean that the test is not satisfied. The use of the term “same-business test” at Section 165-210(1) is perhaps misleading.
**Simplified Tax System “STS”**

Eligibility to become an STS taxpayer and obtain the tax concessions under the Simplified Tax System requires the taxpayer to “carry on a business in that year” per Section 328-365. Again we fall back to the courts interpretation of what it means to carry on business resulting in uncertainty on the application of the STS concessions.

**Partnerships**

The definition of a partnership in Section 995-1(1) and, the subsequent treatment of partnerships for tax purposes, can require a determination as to whether the partnership is carrying on a business.

A partnership is defined in Section 995-1(1) as ….

“(a) an association of persons (other than a company or a limited partnership) carrying on business as partners or in receipt of ordinary income or statutory income jointly; or

(b) a limited partnership”

Accordingly to determine whether a partnership for tax purposes exists (other than a limited partnership) it is necessary to establish either the carrying on of business as partners or joint receipt of income. The tax definition is more expansive that the State Partnership Acts and common law, which limits partnerships to those persons carrying
on business in common with a view to profit. Yet it is important to note that if a tax partnership is carrying on a business then the partners are relatively free to determine how they would like to distribute profits and losses to the partners. In contrast a tax partnership that is so purely on the basis of joint receipt of income must allocate profits and losses according to relative capital contributions. Again the issue as to what constitutes the carrying on of a business is relevant to the existence of a partnership and also if the partnership does not carry on business partners have no flexibility in allocating profits and losses.

**Resident Company**

In terms of international tax issues it is appropriate to start with the definition of a resident company in Section 6(1) of the ITAA 36.

“ resident or resident of Australia means
(b) a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia”.

Accordingly, if a company is not incorporated in Australia it may still be a resident if it carries on business in Australia. What does it mean to carry on business in Australia, specifically what are the factors that demonstrate that a business is carried on in a
particular jurisdiction? If no business is carried on in Australia the company cannot meet the requirements of the second statutory test of residence.

In TR2004/15 ‘Income Tax; Residence of Companies Not Incorporated in Australia-Carrying on business and Central Management and Control’ the ATO states its views on what it means to *carry on business* in Australia for the purposes of the definition of a resident company and notes that there are alternative views on the correct interpretation of a resident company for the purposes of Section 6(1)(b)^12.

**Permanent Establishment**

Whether a taxpayer has a permanent establishment in a particular country is based on the definition of a permanent establishment in Section 6(1) of the ITAA 36…..

“permanent establishment in relation to a person….means, a place at or through which the person *carries on any business* and, without limiting the generality of the foregoing includes:

(a) a place where the person is *carrying on business* through an agent…..”

Again what it means to *carry on business* is significant as it is relevant in a determination as to whether a permanent establishment exists. Also of note is that the definition of a
permanent establishment in the Double Tax Agreements (DTA’s) Australia has entered into, based on an UK Convention states that….

“….the term “permanent establishment” means a fixed place of business through which the business of the enterprise is wholly or partly carried on.”

The definition of permanent establishment per the UK Convention goes on to include and exclude certain scenarios but prima facie it means a fixed place of business. What is a business and where is it carried on for the purposes of the Double Tax Agreements?

If a permanent establishment exists that has implications for both domestic legislation and the DTA’s. For example if an Australian resident carries on business through an overseas permanent establishment then the net income for tax purposes can be worked out using the overseas currency and the net amount converted to Australian dollars per Section 960-60. If no permanent establishment exists in the overseas jurisdiction then Section 960-50(6) requires ordinary income to be converted at the exchange rate prevailing at the time of derivation. In addition other provisions of the ITAA’s are affected by the existence or non-existence of a permanent establishment including sections dealing with the application of withholding tax.

**Business Profits and DTA’s**
If you look at how the taxing rights are divided between the countries that are parties to a DTA or tax treaty we see taxing rights vary based on the type of income derived. For example the UK Convention with Australia deals separately with income from real property, business profits, shipping and air transport, dividends, interest, royalties, alienation of property, income from employment, fringe benefits, entertainers and sportspersons, pensions and annuities, government service, students and other income.

When are profits “business profits” that are derived from the *carrying on of a business* and subject to Article 7 of the UK Convention? If not business profits then another article will apply which may allocate the taxing rights differently. If it is determined that the profits are business profits then Article 7 of the UK Agreement states that Australia can only tax business profits of a UK taxpayer to the extent the UK taxpayer has a permanent establishment in Australia.

**Class of Foreign Sourced Income**

Although the government announced in the 2005 Federal Budget that the requirement to separate foreign source income into single classes will be removed\(^4\), prior to those changes if foreign income was *business income* it fell into ‘all other assessable income’ per Section 160AFD(8) but if the activity did not go so far as to constitute a business and the income was interest, dividends, rent or royalties it would fall under a different class in Section 160AFD(8) such as interest, modified passive or offshore banking income.
Record Keeping

Section 262A requires “a person carrying on a business” to keep records that record and explain all transactions and other acts engaged in by the person that are relevant for any purpose of this Act.”

Superannuation

A superannuation fund is defined in Section 6(1) of the ITAA 36 as…

“(a) a scheme for the payment of superannuation benefits on retirement or death; or
(b) a superannuation fund within the definition of “superannuation fund” in Section 10 of the Superannuation Industry (Supervision) Act 1993”

A superannuation fund is a trust fund and is bound by the ordinary principles of trust law. It is a principle of trust law that a trustee cannot carry on a business unless expressly authorised to do so by the trust instrument or by statute\textsuperscript{15}.

As a superannuation fund is required to have as its sole purpose the provision of benefits to members on retirement death of a member generally they are prohibited from undertaking speculative activities or carrying on an active business. However, the activities of a superannuation fund in holding shares and other investments and from time to time realising them may, in some cases, amount to the carrying on of a business\textsuperscript{16}. 
A superannuation fund that does not carry on a business, either of investing for the purpose of producing income (in which the buying and selling of shares is a part) or of dealing or trading in shares, must rely on the first limb of subsection 8-1(1) to claim income tax deductions. Whereas a superannuation fund that carries on a business may rely on the second limb of subsection 8-1(1).

Section 21A ITAA 36

Section 21A of the ITAA 36 deems non-cash business benefits to be convertible to cash. Non-cash business benefits are defined in Section 21A(5) as …..

“property or services provided after 31 August 1988:

(a) wholly or partly in respect of a business relationship; or

(b) wholly or partly for or in relation directly or indirectly to a business relationship”.

To establish whether Section 21A applies then a taxpayer must determine whether the benefit arose from a business relationship. What are the characteristics of a business relationship? Must one or all parties to the relationship be carrying on a business?  

Section 152 and 153 ITAA 1936
Division 16 of the ITAA 36 deals with averaging of incomes and Section 152 and 153 applies a different treatment in calculating average income when a taxpayer carries on business and has no taxable income in a particular year. If a taxpayer is carrying on business then the year in which no taxable income was derived can be included as an average year but if no business is carried on and no assessable income is received then that year is not counted as an average year.

**Goods and Services Tax**

One of the concerns highlighted on the introduction of A New Tax System (Goods and Services Tax) Act 1999 (GST Act) was that the interpretation of the term “business” was important in a determination as to whether there was a taxable supply and subject to the 10% GST.

In establishing that a taxable supply has occurred Section 9-5 of the GST Act requires that the supply, for consideration, be by an enterprise, registered or required to be registered and that it be connected with Australia.

The definition of an enterprise is in Section 9-20 of the GST Act and includes activities in the form of a business. Section 9-20 does include more than just business activities but to a large part requires an analysis as to whether a business is being carried on. We are then forced to refer back to income tax case law and its interpretation of the meaning of carrying on business to establish whether a particular activity or activities satisfies one of the requirements to be a taxable supply.
Section 9-20(1) of the GST provisions define an enterprise as…

“…..an activity, or series of activities, done:

(a) in the form of a business; or

(b) in the form of an adventure or concern in the nature of trade; or

(c) on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property; or

(d) 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 Income Tax Assessment Act 1997 and to which deductible gifts can be made; or

(da) by a trustee of a complying superannuation fund or, if there is no trustee of the fund, by a person who manages the fund; or

(e) by a charitable institution or by a trustee of a charitable fund; or

(f) by a religious institution; or

(g) 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.

(2) However, enterprise does not include an activity, or series of activities, done:

a) by a person as an employee or in connection with earning withholding payments covered by subsection (4) (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)); or

Note:

Acts done as mentioned in paragraph (a) will still form part of the activities of the enterprise to which the person provides work or services.

(b) as a private recreational pursuit or hobby; or
c) by an individual (other than a trustee of a charitable fund), or a partnership (all or most of the members of which are individuals), without a reasonable expectation of profit or gain; or

d) 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)"

We can see that carrying on an enterprise for the purposes of the GST Act is broader than carrying on a business.

Section 9-20 excludes hobbies and recreational pursuits from the definition of enterprise but the need for this exclusion is questionable as much of the case law concerning whether a business is carried on has involved a distinction between business and a hobby and arguably if an activity constitutes a hobby it would not be an enterprise under any of the positive limbs of Section 9-20.

Hobbies or recreational pursuits need to be distinguished from the carrying on of a business to establish whether there is a taxable supply for GST purposes. Uncertainty concerning the meaning of “carrying on business” suggests that the litigation that has arisen with respect to Section 8-1(1)(b) and Section 6-5 relating to the carrying on business will be relevant to an application of the GST provisions.

Similarly the exclusion of employees from the definition of enterprise requires a consideration as to whether a taxpayer’s relationship is one of employment as apposed to a business relationship as a contractor, a distinction that has been the subject of much previous litigation18.
Interestingly, Section 9-20(1)(b) includes in the definition of enterprise an activity “in the form of an adventure or concern in the nature of trade” and arguably would include a commercial activity that does not amount to a business for example isolated transactions and profit making schemes.

Further if a registered entity acquires goods or services in carrying on an enterprise, it can claim a credit for the GST in the cost of acquisition. Are the goods acquired in \textit{carrying on business} or were they acquired in pursuit of a hobby or employment relationship? The interpretation of business and the \textit{carrying on of a business} is again important from a GST perspective. Is there a sale of a going concern for the purposes of Section 38-325 of the GST Act and GST free? The answer to this question requires analysis of the activities to determine the existence of a continuing business.

\textbf{Australian Business Number}

Whether an activity requires an Australian Business Number (ABN) is not purely based on whether that activity constitutes a business but whether it meets the requirements of Section 8 of the A New Tax System (Australian Business Number) Act 1999 (ABNA).

Section 8 of the ABNA requires all companies registered under the Corporations law: government entities; other entities carrying on an enterprise in Australia; and other entities required to be registered for the GST, to obtain an ABN.
The definition of enterprise for the purposes of ABN registration is set out in Section 38 of the ABNA and mirrors the definition of enterprise in Section 9-20 of the GST Act. The question as to whether an ABN number is required will in many cases require an analysis of whether a business is carried on or are the activities merely a hobby or the subject of an employment relationship.\textsuperscript{19}

**Trade Practices Act**

The meaning of carrying on business has been the subject of judicial interpretation in application of the Trade Practices Act (TPA). Conduct in trade or commerce that is misleading or deceptive or likely to mislead or deceive is prohibited by Section 52 of the TPA. Government authorities are subject to the TPA only if they carrying on business and Justice Finn in *The Village Building Company v Canberra International Airport Pty Limited and Airservices Australia (2004) FCA 133* considered the authorities concerning what it meant to carry on business in a decision as to whether Airservices Australia was subject to Section 52 of the TPA.

**Corporations Law**

Many provisions of the Corporations Act rely on a person or body carrying on business. The application of the term is particularly relevant to the licensing and approval provisions of the Corporations Law and Division 3 of Part 1.2 provide interpretation of the term. The meaning of the term “carrying on business” has also been subject to judicial determination for the purposes of laws dealing with corporations in *Edgelow v MacElwee (1918) 1 KB 205* and *Hyde v Sullivan (1956) 56 SR (NSW) 113*. 
As has been highlighted in the paper so far the meaning of to be ‘carrying on business’ is significant in the application of the Income tax Assessment Acts, GST, Australian Business Number Act, Trade Practices Act and also the Corporations Law.

**Indicia of Business**

A number of ‘indicia of business’ have evolved from case decisions, not all concerning the application of one Section but rather have developed from a number of cases concerning different sections of the ITAA 1997 and 1936. Many of the indicia however do come from decisions concerning Section 8-1(1)(b) and Section 6-5. These decisions have highlighted that not one indicia is determinative but rather whether a business is being carried on depends on the facts of each case and in some instances one factor may be more significant than another. This seems to be where the uncertainty arises as no definitive test exists and taxpayers who identify that they need to establish whether their activities constitute a business are at times unsure.

As noted earlier the definition of business in Section 995 of the ITAA 97 is of little practical assistance and the courts have often used dictionary definitions as in *Bivona Pty Ltd (1989) 20 ATR 282* where Justice Burchett referred to a decision on the meaning of business in applying the New Zealand income tax provisions…

“ In common usage “business” has long had a wide and flexible meaning. In the sense in which it is used in legislation imposing a charge to tax in respect of revenue earning
activities The Oxford English Dictionary definitions “a pursuit or occupation demanding
time and attention; a serious employment as distinct from a pastime….; trade;
commercial transactions or engagements” and Webster’s Third New International
Dictionary definitions “a usually commercial or mercantile activity customarily engaged
in as a means of livelihood and typically involving some independence of judgement and
power of decision…a commercial or industrial enterprise” reflect the underlying notion”

What we can say about the test as to whether a business is carried on and any
determination as to the existence of a business is that:

- It is both subjective and objective.
- It involves an analysis of the nature of the activities.
- It involves an analysis of the extent of the activities.
- It involves an analysis of the purpose of the activities.

Specifically the elements that have been considered by the courts as relevant in a
determination of the carrying on of a business include:

1. Profit motive as evidenced by a taxpayers conduct Bradjkovich v FCT (1989) 20
   ATR 1570
2. Commercial viability and prospect of profit Ferguson v FCT (1979) 9 ATR 873

Factors 1 and 2 are arguably the two essential tests and other factors listed below
serve as evidence of Factors 1 and 2
3. Repetition and regularity. These factors have long been held to be key elements of a business and point to a profit intention *Hyde v Sullivan (1955) 73 WN (NSW)*

4. Organisation of activities in a commercial or businesslike way, that is with system and organization *Ferguson v FCT (1979) 9 ATR 873*

5. Size, scale and permanency of activities. Arguably the larger the scale of activities the more likely a business is carried on however reference is made to *FCT v JR Walker (1985) 16 ATR 331* in which one angora goat was held to be a business because of the demonstrated profit making purpose and repetition and regularity

6. Amount of capital employed

7. Not a hobby, recreation or sporting activity

8. Significant commercial purpose demonstrated by a business plan, expert advice, nature of the transactions involved and similar to other businesses in the same industry

9. Inherent characteristics of the taxpayer. The fact of incorporation raises a presumption of an intention to carry on business where no such presumption applies to individuals *Lewis Emanuel & Son Ltd v White (1965) 42 TC 369* and *FCT v Total Holdings (Australia) Pty Ltd (1979) 9 ATR 885*. Similarly use of a trust may raise a presumption of business activity *Fanmac Ltd v FCT (1991) 21 ATR 413*

10. Intention of the taxpayer to carry on business is not enough but rather the extent of actual activity *Inglis v FCT (1979) 10 ATR 493 at 496-7*
11. Taxpayer employed full time or conducts another business *Ferguson v FCT (1979) 9 ATR 873* and *Bradjkovich v FCT (1989) 20 ATR 1570*

An overriding issue then is whether a taxpayer can be *carrying on business* where there is accepted a profit motive exists but no reasonable prospect of making a profit in the immediate future or at all. In *Ferguson* Bowen CJ and Franki J stated at 876 that... ”an immediate purpose of profit-making in a particular income year does not appear to be essential”.

In a situation where no profit is demonstrated the taxpayer needs to show that the other indicators of business are present in sufficient strength to overcome the view that the activity is inherently unprofitable and does not constitute a business.

The Commissioner’s view expressed in “TR 97/11 Business of Primary Production” is that “it is important that the taxpayer show how the activity can make a profit” and existence of such things as research into the activity, expert consultation or advice on the activities potential profitability would all be relevant.

Of particular interest are the comments of Justice Dowsett in *Hart v Federal Commissioner of Taxation (2002) FCA 1559* in relation to a taxpayer whose activities were held to be business-like but not in connection with a business for the purpose of Section 8-1(1)(b). Justice Dowsett referred to the losses in relation to aviation activities of the taxpayer and noted...
“…the continuing disparity between income and outgoings is difficult to reconcile with an intention to carry on a business. Although one may incur losses in conducting a business in the hope of subsequent profit, hope usually gives way to reality, at least where money is concerned” 22

Justice Dowsett held that the taxpayers in Hart23 were not carrying on a business in relation to air show activities but rather the activities constituted a hobby of the investors in the taxpayer entity. Of concern was the fact that Justice Dowsett also held that the Commissioner’s determination of a shortfall penalty based on finding of recklessness for the purposes of Section 226H would apply. The taxpayer was reckless as it was considered that the taxpayer had ignored recurrent losses that demonstrated the activities were not motivated by a desire to carry on business but an interest in aviation.

In light of the uncertainty concerning what constitutes the carrying on of a business it is significant that the courts are prepared to apply a shortfall penalty based on recklessness. The taxpayer in Hart24 appealed to the full Federal Court but lost on the basis that the full Federal Court did not consider the decision of the judge at first instance was inappropriate.

The issue concerning the requirement to make a profit is addressed, from a revenue loss perspective, by the Non-commercial loss provisions in Division 35 of the ITAA 1997 with respect to individuals and individuals in partnership. If Division 35 applies, business
may be carried on and deductions available under Section 8-1, but any losses from a particular business activity must be deferred and only offset against income derived from that business in the future.

The number of court cases and rulings issued by the Tax office concerning various aspects of activities that constitute carrying on a business are indicative of the lack of certainty with respect to the meaning of “to carry on business”. Other issues that the courts have had to grapple with for the purposes of the ITAA concerns what are ordinary receipts of a business and in that sense defining what the business is, the point at which a business commences and when it ceases which requires an analysis of the characteristics of the activity.

Many cases concerning the carrying on of a business look at the distinction between business and hobby\(^{25}\). There is also a line of cases which look at whether the transaction or transactions were capital or revenue in nature in which the courts have looked at whether the activities of the taxpayer went so far as to constitute the carrying on of a business and assessed as ordinary income under Section 6-5\(^{26}\).

**Non-Commercial Loss Provisions – Division 35**

Perhaps the introduction of Non-Commercial Loss provisions in Division 35 of the ITAA 1997 and the inclusion of four tests of a “commercial business” is an attempt at providing a more definitive test as to the existence of a “commercial business” in relation to
activities that produce a loss but Division 35 only applies to individuals and individuals in partnership and are really an attempt at reducing tax revenue loss.

Arguably the problem could be better addressed in a comprehensive and workable concept of \textit{carrying on business}.

There are competing objectives at work here in that the existence of a business in some instances will ensure assessability or the application of GST to a transaction but at the same time provides for a deduction under the second limb of Section 8-1(1) that would not otherwise be available. Looking at the reforms in Division 35 the government is concerned with revenue leakage and deductions under Section 8-1 rather than any other inefficiency caused by the difficulty in coming up with a workable definition of \textit{carrying on business}.

The determination as to the carrying on of a business causes uncertainty, increased costs of professional advice, at times costly litigation and significant use of Tax Office resources in issuing rulings both public and private and as a consequence does not sit well with an efficient tax system. These concerns were raised in the Ralph Review of Business Taxation\textsuperscript{27}…..

“The law in relation to carrying on a business is very difficult and resource intensive to administer and must be done on a case-by-case basis. The need to apply the existing law
on that basis does not permit the efficient and effective use of resources and creates uncertainty\(^{28}\).”

The Ralph Report recommended a solution to the law in relation to carrying on business that would be to better deal with the losses arising from non-commercial activities and the Federal government introduced into the ITAA Division 35. Division 35 does not address the issue as to what constitutes a business for the purposes of the ITAA’s and the difficulties and complexities in relation to carrying on business remain.

The Federal Government’s response to the Ralph recommendations in “A Tax System Redesigned (AGPS, Canberra, 1999) Treasury Press release No. 058 at Attachment A noted that ….

“…The existing law, using the concept of ‘carrying on business’, attempts to minimise the revenue leakage associated with non-commercial activities but has generally been unsuccessful. There is significant revenue leakage from unprofitable activities carried out by individual taxpayers claiming deductions for so called business like characteristics (according to the law), but are often unlikely ever to make a profit and do not have any particular commercial purpose. The current law is complex and resource intensive to administer. The measure seeks to simplify current law, remove uncertainty and prevent significant leakage of revenue from deductions from non-commercial activities “\(^{29}\)
Arguably though the changes in Division 35 have not dealt with the uncertainty and complexity just revenue leakage. For Division 35 to apply a taxpayer must be carrying on business so that question needs to be answered before Division 35 applies.

The Post Implementation Review of the Non-commercial Loss provisions highlighted that the identification of the existence of a business was not addressed by Division 35 and that was regarded as contributing to uncertainty. Also the report prepared by BDO Kendalls who were engaged by the Board of Taxation to provide an evaluation of Division 35 noted that some uncertainty remains in the area of “the determination of whether a business is being carried on”.

The Board of Taxation’s review of the quality and effectiveness of the non-commercial loss provisions found that the…

“… intent of the legislation was delivered in a manner that was easily understood without any substantive unintended consequences or significant compliance burdens on the community.”

However as the income tax concept of what constitutes carrying on business is not addressed in Division 35 and in fact that determination needs to be made before Division 35 applies, the Board of Taxation review does not evaluate the issues associated with that determination.
Interestingly if a taxpayer owns just enough rental properties not to be a business, however many that is, then Division 35 will not apply to limit the deduction in relation to losses whereas if a taxpayer owns so many that that are considered to be in the business of renting out properties then the limitations in Division 35 apply. We can apply a similar analysis to share trading, land developers and other activities.

Division 35 defers a deduction for losses with respect to a particular business activity to be offset against income of that type in the future unless a taxpayer’s business meets one of the four exceptions or the Commissioner exercises the discretion under Section 35-55 based on the special circumstances of the taxpayer. Note that the limitations in Division 35 do not apply to a primary production business or professional arts business if the income from other sources is less than $40,000 (Section 35-10(4))

The four exceptions in Division 35 relate to businesses where:

1. Assessable income generated from the business activity is at least $20,000.
   Section 35-30.
2. Taxable income has been produced in 3 of the last 5 years. Section 35-35
3. The value of real property used in carrying on the business is at least $500,000.
   Section 35-40
4. The value of assets other than real property is at least $100,000. Section 35-45.
   Note that cars, motorcycles and similar vehicles are specifically excluded from the test
Division 35 in a sense works as a test of ‘carrying on business’ with respect to individuals by limiting the offset of losses where the business does not meet one of the four tests and the Commissioner is not convinced of any special circumstances.

Perhaps rather than the introduction of Division 35 the government could have amended the tax legislation so that for a taxpayer to be carrying on business it must meet certain profitability or asset tests. As the courts have been prepared to hold that activities constitute a business despite the fact that no profit or very little profit is realised then a requirement of a reasonable expectation of profit could be added. What is a reasonable expectation and how that is evidenced could be stated and in fact may have some commercial advantages where taxpayers are forced to address business viability at the outset. Perhaps a business plan or evidence of expert advice would be required.

The Commissioner has highlighted in his discussion of the discretion in Division 35 that any special circumstances would require the activity to show that there is an expectation it will pass a profit test or produce a profit within a reasonable time. Arguably however if a taxpayer’s activities could not meet this test it would not be a business in the first place, deductions would not be available under Section 8-1 and we would not have to consider Division 35.
It has also been argued that business is not something that can be defined as the activities by which a taxpayer profits or earns a living are diverse and ever changing. As Dr Gerber noted in *AAT Case 5770 (1990) 21 ATR 3291 at* 3293, business “is not defined and indefinable. It will not cause litmus paper to change colour”.

Perhaps a broad definition of what it means to *carry on business* in combination with Division 35 or similar provisions would deal with the government’s concerns relating to loss activities and yet provide a workable set of criteria for taxpayers to use in establishing whether their activities constitute a business. Alternatively the second limb of Section 8-1(1) could be rewritten to address the revenue leakage yet steer away from using the concept of business in providing deductions.

As highlighted by Di Phelan in her paper “A Prognosis for the “hobby loss” post-Ralph” in discussing the Division 35 non-commercial loss reforms…” it appears that the difficulties that have been faced by the Commissioner of Taxation in the area of distinguishing “business” from “hobby” are far from over”.

Di Phelan refers to overseas models in jurisdictions where the revenue authorities struggle with the business/hobby distinction and the potential loss to revenue and highlights that the model adopted in Division 35 is unlike the US, Canadian, English and New Zealand models that the Australian Treasury advised were used in the development of Division 35.36
What does appear from Di Phelan’s analysis is that a reasonable expectation of profit and or actual profitability requirements as in Section 183 US Internal Revenue Code would better meet the objectives of a good tax system being equity, efficiency and simplicity.\(^{37}\)

**Federal Commissioner of Taxation v Stone 2005 ATC 4234 - Carrying on business - Entering into commercial contracts**

*Stone’s case*\(^{38}\) was brought as a test case by the Commissioner of Taxation and looked at the meaning of the term to “carrying on business” with respect to a professional sportsperson. Whether a business exists required “a wide survey and exact scrutiny of the taxpayers activities”\(^{39}\) and was called for by virtue of the fact that the courts had interpreted Section 6-5 as including in ordinary assessable income all ordinary receipts of carrying on a business.

As a result, although the term business does not appear in Section 6-5, the High Court decision in *Stone* considered the application of Section 6-5 and specifically whether Stone was carrying on a business as a professional sportsperson and what were ordinary receipts of such a business if there is one.

The taxpayer in *Stone* was a Senior Constable in the Queensland Police Service and had competed in women’s javelin events since before 1995 and the appeal to the High Court by the Commissioner of Taxation concerned the year ended 30 June 1999.

During the 1999 year Stone received
• prize money,
• grants from the Australian Olympic Committee (AOC) and the Queensland Academy of Sport (QAS),
• fees for some appearances she made and
• payments in cash and kind from her sponsors.

The Commissioner argued that all four types of receipts were ordinary assessable income for the purposes of Section 6-5.

The taxpayer conceded that the sponsorship benefits were assessable as ordinary income but disputed the assessability of the other receipts. Justice Hill at first instance in the Federal Court held that some but not all the other receipts are assessable specifically excluding from assessability the QAS grant[^40].

The taxpayer appealed to the full Federal Court and the appeal was allowed in part with the full Federal Court holding that neither the prizes nor any of the grants were assessable but that the appearance monies were assessable along with sponsors payments in cash and kind.[^41] Much of the full Federal Court decision focused on whether and to what extent the taxpayer conducted a business and the full Federal Court concluded that the taxpayer’s athletic sporting activities did not constitute business activity nor did she turn her talent to account for reward and accordingly the prizes and grants were not assessable……
“The evidence indicates that Ms Stone is a career police women, who had achieved considerable success in an athletic sporting activity for which she had been rewarded. She has not been engaged in a business activity to exploit her sporting prowess or to turn her talent to account in money”.42

A few things the Federal Court said about the characteristics of a business:

- The quantum of prize money cannot determine its character as income.
- The fact that the taxpayer sought out sponsorships and that they were paid on a regular basis was not indicative of a business activity.
- Activities must be systematic and as Stone’s appearances were not systematic they were not part of the carrying on of a business. The fact that she was in full time employment as a police women weighed against a characterisation of her activities as constituting a business. You can carry on a business as well as other activities but in a situation where someone is in full time employment the evidence points against a business activity.
- It was concluded that as she trained and competed outside working hours then her primary purpose was likely to be the enjoyment of competition and the pleasure in winning and not the motive of profit making which is a significant factor in establishing the carrying on of a business.
The High court in considering the appeal by the Commissioner and cross appeal by Stone with respect to appearance monies, noted that in determining whether the various amounts are income the fundamental question is whether the amounts constitute income according to ordinary concepts for the purposes of Section 6-5.

The High Court judges note that categories of ordinary income originally developed under Section 25(1) of the ITAA 36, includes ordinary receipts of *carrying on business* and that approach has been applied in interpreting Section 6-5 of the ITAA 97 but strictly speaking the real question is whether the receipt is income in accordance with the ordinary concepts and usages of mankind. In a joint decision by Gleeson CJ, Gummow, Hayne and Heydon JJ it is emphasised that …..

“Asking whether a person was carrying on a business may therefore be useful and necessary. But the inquiry about “business” must not be permitted to distract attention from the question presented by both the ITAA 1936 and the ITAA 1997……As S6-5 of the ITAA 1997 makes plain, that requires consideration of whether the receipt in question is income in accordance with “the ordinary concepts and usages of mankind”

Whilst the High Court identified the key question being whether the amounts were in the nature of ordinary income they went on to conclude that taken as a whole the athletic activities of the taxpayer during the 1998-99 year constituted the conduct of a business, “the business of deriving financial reward from competing and winning in
the athletics arena”. Consequently, prize money, sponsorship payments, grants and appearance monies were all ordinary receipts of that business.

The factors the High Court judges considered relevant were that;

- She incurred significant expenses in competing at the highest level.
- She sought sponsorship to cover her expenses. This factor was considered the most significant by the High Court as it demonstrated that the athlete in this case had turned her athletic talent to account for money.
- She accepted grants imposing commercial restrictions as a consequence.
- It did not matter that she did not seek to maximise her receipts but her pursuit of excellence would in the long-term result in further prizes, grants and more sponsorship deals.
- No significance placed on the fact that sponsorships and other payments were not sought in a systematic way
- A primary motive to make a profit was not necessary for a conclusion that a business was being carried on.  

The commercial agreements with three sponsors, totalling $12,419 for the 1999 year is the crucial factor in the High Court’s conclusion that Stone was carrying on a business.

There was some question as to the extent to which the sponsors were solicited by the taxpayer and in fact it was confirmed that the agreement with Multiplex was unsolicited.
What is apparent from the decision of the High Court is that the level of sponsorship and
the extent to which it was sought was not relevant. What was relevant was the fact the
taxpayer did seek and obtain sponsors not the size or the amount of time devoted.46

Perhaps we can say post Stone that entering into commercial contracts will indicate that a
taxpayer is carrying on business. Although Stone was a test case it is unclear whether it
has provided a clear decision on the relevant factors that demonstrate the existence of a
business or its applicability is limited to the particular facts.

Interestingly the taxpayer had accepted early in the litigation process that the sponsorship
money should be treated as assessable and perhaps the courts may have decided
differently if the taxpayer had not agreed to that treatment. Perhaps by accepting that the
sponsorship monies were assessable it indicated to the judiciary that the taxpayer had
turned her talent to profit.

Justice Kirby in a separate decision in Stone47 highlights his concern with the approach
taken to the interpretation of Section 6-5 in earlier decisions and that in the joint
judgement in this case. Justice Kirby notes that Section 6-5, and its predecessor Section
25(1) of the ITAA 1936, do not refer to the carrying on of a business as an item of
ordinary income and by approaching the issue in Stone’s case by analysing whether the
taxpayer is carrying on business we are moving away from the words of the legislation.
Although Justice Kirby goes on to agree with the joint reasons and applies past authority
accepted by the High Court he notes in his decision that…
“By imposing the notion of “business”, although the word does not appear in the ITAA 1997, there is a risk that the statute is glossed in a way disadvantageous to the taxpayer and unduly favourable to the Commissioner. If it were the will of the parliament to permit the imposition of the notion of “business” (and thus the aggregation of various receipts that thereupon take their colour, in part at least, from the unifying notion of a “business”), it is arguable that the parliament should make this plain by express enactment.” 48

The decision in Stone49 does demonstrate that the High Court was prepared to move away from the historical attributes of what constitutes the carrying on of a business and recognise the new industry of sport and professional athletes.50

Business Profits and Double Tax Agreements

What are “business profits” for the purposes of the Double Tax Agreements and when are profits subject to the business profits article eg Article 7 of the UK Convention? If it is determined that profits are business profits then Article 7 of the UK Agreement, for example, states that Australia can only tax business profits of a UK taxpayer to the extent they have a permanent establishment in Australia.

The courts in Australia have looked at whether an activity needs to constitute the carrying on of a business as interpreted under domestic law or does the approach to the interpretation of Double Tax Agreement mean that the meaning of business profits takes into account international interpretations as well.
In *Unisys Corporation v Federal Commissioner of Taxation (2002) NSWSC 1115* the Supreme Court of NSW considered whether royalties paid by Unisys Licensing Partnership (ULP), registered as a corporate limited partnership for the purposes of the ITAA 1936, to Unisys Corporation US were incurred by ULP *in carrying on business* in the USA through a permanent establishment and free of Australian withholding tax per Section 128(2B)(b). In considering the question the court looked at the meaning of *carrying on business* under the ITAA but determined that the courts in Australia may also have regard to the OECD Commentary on the Model Convention and to decisions in other jurisdictions in an attempt to achieve international uniformity. Accordingly, a wide definition of the term “business profits” including investment activities was considered appropriate. The court in *Unisys* referred to Paragraph 32 of the official Commentary on Article 7 of the 1992 OECD Model Convention in which it highlighted that a wide interpretation of business profits was required…

“Although it has not been found necessary in the convention to define the term “profits” it should nevertheless be understood that the term when used in this article and elsewhere in the Convention has a broad meaning including all income derived in carrying on an enterprise. Such a broad meaning corresponds to the use of the term made in the tax laws of most OECD Member countries.”

The court in *Unisys* referred to an earlier Australian decision in *Thiel v Federal Commissioner of taxation (1990) 171 CLR 338* in which an adventure in the nature of
trade was held to give rise to a business profit for the purposes of the business profits article in the DTA between Australia and Switzerland. In Thiel the taxpayer purchased 4 units in a trust for $50,000 and acquired a further 2 units in the expectation of considerable profit. Preparatory to a float 6 months later the taxpayer was allotted 600,000 shares in place of the units that he later sold in over 40 separate sales 3 to 4 months later for a total in excess of $550,000.

In the case of ULP the court determined that as the intellectual property agreement was entered into in the US with a US Corporation then there was an acquisition of valuable rights in the USA and their exploitation which did constitute the carrying on of a business in the USA, notwithstanding that the sub-licensee in Australia, Unisys Australia Ltd, was relied on to initiate payment and documentation. The court also held that ULP did not have a permanent establishment so although they derived business profits they had no permanent establishment in the US and as a result Section 128(2B)(b) did not apply and payments of royalties were subject to Australian withholding tax.

Decisions concerning the business profits article in the DTA’s indicate that the interpretations of the Australian provisions concerning carrying on business are relatively narrow and business today requires a much broader approach. Is the government hesitant to expand the concept because of the implications on deductions under Section 8-1? Certainly a broader concept of carrying on business would be more consistent with the use of the term enterprise for GST purposes and ABN registration.
The test of a resident company in Section 6(1)(b) of the ITAA 1936 states that a company not incorporated in Australia but that carries on business in Australia and has either its central management and control in Australia or its voting power controlled by Australian resident shareholders will be a resident of Australia for income tax purposes.

TR 2004/15 highlights the significance of the term to carry on business for the purposes of defining a resident company. Whatever it means to carry on business must be present in Australia to satisfy the second statutory test in Section 6(1)(b).

The ATO in TR 2004/15 considers that for the purposes of paragraph 6(1)(b), the concept of carrying on a business may be wider than its ordinary meaning and extends to undertakings of a business or a commercial character. For example, for the purposes of the second statutory test, a company may be carrying on business even if its only activity is the management of its investment assets.

Importantly the second statutory test suggests that all companies carry on business unless they are dormant and accordingly a broader interpretation is called for than applies for the purposes of Section 6-5 and Section 8-1 of the ITAA 1997.
Arguably this means that a company will be *carrying on business* for the purposes of Section 6(1)(b) even if its main activity is the management of its investment assets……

“This is because the purchase of property to rent out, whether or not after renovating it, and the proprietorship of that property, constitute an undertaking of a business or commercial kind”\(^56\)

TR2004/15 also refers to Williams J in *Malayan Shipping* and argues that there exists no general principle that if a company's central management and control is located in Australia then this means that the company is also *carrying on business* in Australia for the purposes of the second statutory test of a resident company. The approach of the ATO is that both the *carrying on of business* in Australia and the central management and control in Australia is required and at times they may not both be in the one location.

As the ATO states at paragraph 41…

“While it is clear that mere trading is not sufficient on its own to satisfy the second statutory test, and that central management and control can be relevant to determining where the *business is being carried on*, it is considered that major operational activities which are the essence of a company's income earning activities and which are carried out with a high degree of autonomy would be sufficient to constitute the *carrying on of business* in Australia where those activities occur in Australia”\(^57\)
Corporations Law

Carrying on business for the purposes of the Corporations Law has been the subject of case law and in *Edgelow v MacElwee (1918) 1 KB 205* the court held that the word “business” imports the notion of system, repetition and security, but that a more specific formula was not possible, as each case would involve a question of degree.

Also in *Hyde v Sullivan (1956) 56 SR (NSW) 113* the court said…

“Speaking generally, the phrase ‘to carry on business’ means to conduct some form of commercial enterprise systematically and regularly with a view to profit and implicit in this are the features of continuity and system”

The concept of carrying on business under the Corporations Law mirrors much of the decisions for the purposes of the Section 8-1(1)(b) and Section 6-5 ITAA 1997 requiring more than just a commercial transaction and such a restrictive approach may be a little outdated in light of the changes in the nature of business in 2006.

In *Orbit Travel Services v Travel Compensation Fund (1999) NSWCA 63* it was held for the purposes of the Corporations Law that “the mere fact that a foreign corporation invested its funds or held property in NSW was not sufficient to establish that they were carrying on business on the basis that what amounted to the carrying on business was a complex question of fact in which previous decisions, particularly those decided on other
legislation, were of little assistance. The expression had to be construed in its context in
this statute” 58

Importantly the Corporations Law does not require there to be a profit motive for a
person to be carrying on business as Section 18 of the Corporations law provides that a
reference to a person carrying on business includes a reference to a person carrying on
business other than for profit.

Section 21 Corporations Law will automatically deem that a body corporate is carrying
on business in certain instances.

Trade Practices Act

A recent decision by Justice Finn of the Federal Court in The Village Building
Company Limited v Canberra International Airport Pty Ltd and Airservices
Australia 2004 FCA 133 looked at the meaning of carrying on business for the purposes
of the Trade Practices Act.

Conduct in trade or commerce which is misleading or deceptive or likely to mislead or
deceive is prohibited by Section 52 of the Trade Practices Act (TPA). In the Village
case59 one of the defendants, Airservices Australia, was a government authority and
government authorities are only subject to the TPA if they carrying on business.
Airservices Australia was under extensive legislative and ministerial control and its activities were required to be in accordance with government policy. Aircraft-noise data was collected in relation to each airport and made available on Airservice’s website without charge. Airservices argued and Justice Finn agreed that Airservice’s activities were done to enable them to carry out their statutory functions and did not constitute *carrying on business*. In making that decision Justice Finn reviewed the authorities in relation to what is meant by *carrying on business* and identified that:

- The type of activities carried on must be considered
- *Carrying on business* includes activities undertaken in a commercial enterprise as a going concern
- Normally there exists a profit motive but it was noted that Section 4 of the TPA states that the business need not be carried on for profit
- Repetition, system and regularity are characteristics of a business but on their own are not sufficient to establish that a business is carried on.
- Normally the activity would take place in a business context and that is unlikely where it involves essentially regulatory functions in the interests of the community or in performing a statutory duty.

The meaning of to *carry on business* for the purposes of the TPA is quite consistent with its meaning for the purposes of the ITAA’s but interestingly there is no requirement in the TPA that the activities be carried on for profit by virtue of Section 4 of the TPA.
**Conclusion**

A restrictive approach to the interpretation of *carrying on business* appears to be linked to the revenue loss associated with deductions under Section 8-1(1)(b) and also the interpretation of income according to ordinary concepts in Section 6-5 of the ITAA 1997 with reference to a notion of business income.

The approach to the interpretation of ordinary income in Section 6-5, where if it is concluded that the taxpayer is carrying on business all ordinary receipts of that business are ordinary income, has evolved from judicial decisions and something that the High Court struggled with in *Stones case* but felt powerless to move away from. For the purposes of establishing residency of a company for example the courts and the ATO are quite happy to determine that *carrying on business* includes an activity of a business or commercial kind.

Division 35 of the ITAA 1997 was introduced to limit the offset of losses arising from business activities of individuals but the problem with the concept of business income for the purposes of Section 6-5 have not been addressed. Perhaps a definition of *carrying on business* which is broad enough to include commercial transactions combined with a limitation in Section 8-1(1)(b) or in the form of Division 35 in relation to losses would provide certainty and consistency with usage of the term in other parts of the income tax and GST provisions as well as the corporations law and international agreements.

**Endnotes**

2 TR 97/11 Carrying on Business of Primary Production, TR 2005/1 Carrying on Business as a Professional Artist
3 Federal Commissioner of Taxation v Stone 2005 ATC 4234
4 Federal Commissioner of Taxation v Firstenberg 76 ATC 4141
5 Henderson v Federal Commissioner of Taxation 70 ATC 406
6 ibid 5, Barratt & Ors v Federal Commissioner of Taxation 92 ATC 4275
7 TR97/11 Carrying on Business of Primary Production in which the ATO summarises the relevant cases,
   Ltd v Federal Commissioner 97 ATC 4459, Federal Commissioner of Taxation v Brown 99 ATC 4600
8 Post Implementation Review of the Quality and Effectiveness of the Non-commercial losses Provisions in
   Division 35 of the ITAA 1997. Report to the Treasurer by the Board of Taxation June 2004
9 Federal Commissioner of taxation v Murry 98 ATC 4585 at paragraph 55
10 IT 2316
11 Federal Commissioner v McDonald 87 ATC 4541
12 Malayan Shipping Co Ltd v Federal Commissioner of Taxation (1946) 8 ATD 75
13 TR 2005/5 Permanent Establishment- What is a Place at or through which a person carries on business in
   the definition of a permanent establishment in Section 6(1) of the ITAA 1936, Theil v Federal
   Commissioner of Taxation (1990) 171 CLR 338
14 Federal Budget Paper May 2005
15 Kirkman v Booth (1848) 50 ER 821 at 824
16 TR 93/17, Federal Commissioner of Taxation v Radnor Pty Ltd 91 ATC 4689
17 Payne v Federal Commissioner of Taxation 96 ATC 4407
18 TR 2005/16 Income Tax: PAYG- Withholding from Payments to Employees Paragraphs 17-19, Vabu
   Pty Ltd v Federal Commissioner of Taxation 96 ATC 4898, World Book (Australia) Pty Ltd v Federal
   Commissioner of Taxation 92 ATC 4327
   the Purposes of Entitlement to an ABN” Paragraphs 59-63
20 Ferguson v FCT (1979) 9 ATR 873
21 ibid 7 paragraph 48
22 Hart v Federal Commissioner of Taxation (2002) FCA 1559 at paragraph 10
23 ibid 22
24 ibid 22
25 Phippen v Commissioner of Taxation (2005) AATA 952
26 Scottish Australian Mining Co Ltd v Federal Commissioner of Taxation (1950) 9 ATD 135, Whitfords
   Beach Pty Ltd v Federal Commissioner of Taxation 82 ATC 4087, Gutwenger v Commissioner of Taxation
   31 January 1995
28 ibid 27 at 296
29 A Tax System Redesigned (AGPS, Canberra, 1999) Treasury Press Release No 058 at Attachment A
Page 2
30 ibid 8 See 1.20 page 9 of review.
31 ibid 8 See 5.53 page 40 of review
32 ibid 8 Para 1.18 of review
33 TR 2001/4 Division 35 Non-Commercial Business Losses at Paragraphs 79-82
34 See TR 97/11 paragraph 17 and McInnes v Federal Commissioner of Taxation (1977) 7 ATR 373.
35 The Tax Specialist Vol 3 No 5 April 2000 Pages 266-275 at 266
36 ibid 35 pages 269-271
37 See Draft paper, reform of the Australian Taxation System (AGPS, Canberra, 1985)
38 Federal Commissioner of Taxation v Stone 2005 ATC 4234
39 ibid 38 at paragraph 19
41 Stone v Federal Commissioner of Taxation (2003) FCAFC 142
42 ibid 41 at paragraph 72
43 ibid 38 at paragraph 16
Unisys Corporation v Federal Commissioner of Taxation (2002) NSWSC 1115
ibid 51 at paragraph 46
ibid 51
ibid 55 at paragraph 33 and Pincus J in Lilydale Pastoral Co Pty Ltd v. FC of T (1987) 15 FCR 19
ibid 55
CCH Australian Corporations Commentary 26-330
The Village Building Company Limited v Canberra International Airport Pty Ltd and Airservices Australia 2004 FCA 133
“When is a government authority ‘carrying on business’? Warren Pengilley 66 Law Society Journal June 2004