

When is a business not an active asset?

TINGARI VILLAGE NORTH PTY LTD V COMMISSIONER OF TAXATION.



Tingari Village North Pty Ltd v Commissioner of Taxation [2010] AATA 233 is an Administrative Appeals Tribunal decision which examines whether the sale of a residential park could take advantage of the small business (Div 152) CGT concessions. In particular it considers the 50% discount, the retirement concession and whether a particular liability could be included in reducing the net value of the CGT asset for the purposes of the \$5,000,000 threshold.

FACTS

What is a “Residential Park”?

Tingari Village North Pty Ltd (**Tingari Village**) conducted a residential park (the **Park**) near Terrigal, New South Wales. The Park consisted of 77 mobile home sites, a community hall with a kitchen, toilet, games room and library. In November 2005, at the time of sale, 76 of the sites were occupied by mobile homes.

The Park was regulated by the *Residential Parks Act 1998* (**Residential Park Act**) NSW and the Residential Park Regulations 1999 made under that Act.

The AAT found that a residential park is land on which the park owner conducts a business of accommodating moveable homes, which were self contained dwellings containing various rooms and facilities.

The structures were manufactured offsite before being transported and installed on steel bearers on a designated site in the Park.

By s 85A Residential Parks Act a moveable dwelling on a residential site is not for any purpose to be regarded as a fixture, and the dwelling owner is entitled to sell it separately from the site (s 80) which belongs to the park owner.

The moveable homes were located along sealed roads, and were plumbed and connected to mains electricity.

Sale of the Park

In November 2005, Tingari Village sold the Park making a considerable capital profit which in absence of concessions was taxable. By claiming the small business 50% reduction concession and the retirement concession for the year ended 30 June 2006, Tingari Village disclosed a net capital gain of \$70,646.

The Commissioner was not persuaded that Tingari Village was entitled to small business CGT relief and so on 18 February 2005 issued an amended assessment which increased the net capital gain from \$70,646 to \$2,141,292 and increased taxable income from a loss to \$2,009,881 for the year ended 30 June 2006.

Subsequently, the Commissioner issued a further assessment which included a shortfall penalty of 50% on the basis that the shortfall had resulted from recklessness.

LEGISLATION

The provisions in issue were found in Div 152 ITAA 1997. The Tribunal commenced its analysis with s 152-1:

“This Subdivision sets out some basic conditions for relief. If the basic conditions are satisfied, then a small business entity may be able to reduce its capital gains using the small business concessions in this Division.

The 3 major basic conditions are:

- (a) a limit of \$5,000,000 on the net value of assets that the business and related entities own;
- (b) the CGT asset must be an active asset;

- (c) if the asset is a share or interest in a trust, there must be a controlling individual just before the CGT event, and the entity claiming the concession must be a CGT concession stakeholder in the company or trust.”

The Tribunal then considered s 152-10:

“(1) A capital gain (except a capital gain from CGT event K7) you make may be reduced or disregarded under this Division if the following basic conditions are satisfied for the gain:

- (a) a CGT event happens in relation to a CGT asset of yours in an income year;
- (b) the event would (apart from this Division) have resulted in the gain;
- (c) you satisfy the maximum net asset value test (see section 152-15);
- (d) the CGT asset satisfies the active asset test (see section 152- 35).”

The Tribunal found that paras (a) and (b) were satisfied. The dispute related to the maximum net asset value test and active asset test.

The maximum net assets value test was dealt with by s 152-15:

“You satisfy the maximum net asset value test if, just before the CGT event,

- (a) the sum of the following amounts does not exceed \$5,000,000:
 - (i) the net value of the CGT assets of yours;
 - (ii) the net value of the CGT assets of any entities connected with you;
 - (iii) the net value of the CGT assets of any small business CGT affiliates of yours or entities connected with your small business CGT affiliates (not counting any assets already counted under sub-paragraph (ii)).
- ...”

The Tribunal found no need to consider the meaning of the expression “entities

connected with you” because the parties agreed which entities were connected.

The Tribunal found that by s 152-20 the net value of the CGT exempt assets of an entity:

“is the amount (if any) by which the sum of the market value of those assets exceeds the sum of the liabilities of the entity that are related to the assets.”

The rules for working out the net value of CGT assets are set out in ss 152-20(2), (3) and (4) as follows:

- “(2) In working out the **net value of the CGT assets of** an entity:
- (a) disregard shares, units or other interests (except debt) in another entity that is connected with the first-mentioned entity or with a small business CGT affiliate of the first-mentioned entity; and
 - (b) if the entity is an individual, disregard:
 - (i) assets being used solely for the personal use and enjoyment of the entity, or the entity’s small business CGT affiliate; and
 - (ii) a dwelling of the individual, or an ownership interest in such a dwelling, if the individual uses the dwelling to produce assessable income to any extent but does not satisfy paragraph 118-190(1)(c) (about deductibility of interest); and
 - (iii) a right to, or to any part of, any allowance, annuity or capital amount payable out of a *superannuation fund or an *approved deposit fund; and
 - (iv) a right to, or to any part of, an asset of a superannuation fund or of an approved deposit fund; and
 - (v) a policy of insurance on the life of an individual.
- (3) Subsection (4) applies in working out the **net value of the CGT assets** of an entity that is:
- (a) your small business CGT affiliate; or
 - (b) connected with your small business CGT affiliate.
- (4) Disregard assets of that entity that are not used, or held ready for use, in the carrying on of a business (whether alone or jointly with others) by:
- (a) you; or
 - (b) an entity connected with you (unless the connection with you is only because of your small business CGT affiliate).”

The Tribunal found that the CGT asset was the Park. It satisfies the active asset test if it was an **active asset** just

prior to the sale. The Tribunal found that an asset is an active asset if at the given time it is owned and used in the course of carrying on a business. The Commissioner accepted that broad definition, but contended that the Park was excluded because of s 152-40(4).¹ That section in part provides:

“... payments under residential tenancy agreement for the right to occupy a residential site in [the park] constitute rent ...”

“(4) However, the following CGT assets cannot be **active assets**:

- (a) – (d) ...
- (e) an asset whose main use in the course of carrying on the business mentioned in subsection (1) is to derive interest, an annuity, rent, royalties or foreign exchange gains unless:
 - (i) the asset is an intangible asset and has been substantially developed, altered or improved by you so that its market value has been substantially enhanced; or
 - (ii) its main use for deriving rent was only temporary.

Example: A company uses a house purely as an investment property and rents it out. The house is not an **active asset** because the company is not using the house in the course of carrying on a business. If, on the other hand, the company ran the house as a guest house the house would be an **active asset** because the company would be using it to carry on a business and not to derive rent.”

There was no suggestion that the exceptions in subparas (i) and (ii) are relevant

THE ISSUES

The first issue was simply stated: was the Park capable of being an active asset?

The second issue was the net value of the CGT assets of Tingari Village. Was it \$3,976,170 as claimed by Tingari Village or \$6,312,462 as claimed by the Commissioner?

The inclusion of several items on the balance sheet of Tingari Village was disputed. However, the Tribunal only considered one, whether a commercial bill of \$1.65 million was to be brought to account as a liability of JH Property an entity “connected with [Tingari Village]” within the meaning of Div 152.

WAS THE PARK AN ACTIVE ASSET?

By s 152-40(4)(a), an asset is not an active asset if its main use was to derive rent.

The Tribunal examined whether the Park was receiving rent.

The Tribunal found that rent was a payment by a tenant under contract to a landlord for the use of the landlord’s land. If exclusive possession was granted by the landlord, then a lease has been created, if not a mere licence has been granted.

The relevant requirement was in a form prescribed by Schedule 1 to the Residential Parks Regulations. The form of the agreement was considered by the Tribunal, and in conjunction with the Residential Parks Regulations, the Tribunal concluded “that payments under residential tenancy agreement for the right to occupy a residential site in [the park] constitute rent in terms of s 152-40(e) ITAA97”.²

The Tribunal reached the conclusion that the arrangements constituted a lease rather than a licence and hence receipts were characterised as rent by conducting an analysis of and applying real property legal principles to the terms and conditions, facts and circumstances surrounding the arrangements between Tingari Village and the residents of the Park.

The Tribunal noted³ that the Park contained facilities for use by the residents, notably a community hall in which Tingari Village provided food and drink for residents at its expense.

Tingari Village also had grass mown on access roads in the Park, gutters on community buildings cleaned, and rubbish collected.

The Tribunal found that none of these benefits were identified in the tenancy arrangements or at all as legally enforceable incidents of the right to occupy.

Thus the Tribunal found that the residential tenancy⁴ agreements gave a right to exclusive occupation of land for a fixed or renewable period in return for periodic payment of money. Because of the presence in s 152-40(e) ITAA97 of the exception in respect of rent, Tingari Village was not entitled to the concession contained in Div 152 ITAA97.

The Tribunal also considered private ruling No. 55228 issued by the Commissioner which considered that a mobile home park was an active asset.

The ruling was distinguished on the basis that the residents at that park did not have a right to exclusive possession, only a right to occupy.⁵

NET VALUE OF CGT ASSETS

Although concluding that the Park was not an active asset, the Tribunal also considered how to treat the \$1.65 million commercial bill.

The Tribunal analysed the commercial bill and the facts surrounding its creation.

The Tribunal found that a balance sheet view should be taken of the net asset position just before the CGT event. Tingari Village was not the primary debtor, merely a guarantor, no demand for payment had been made, and there was no reason to doubt the ability of the primary debtor to repay the commercial bill.

Second, the Tribunal found that s 152-20 ITAA97 requires⁶ that a relationship exist between the liabilities and assets of the entity in issue, not assets held by other connected entities.

The commercial bill was found to relate to assets held by other connected entities. Thus, Tingari Village could not deduct the \$1.65 million commercial bill from its assets for the purpose of bringing itself within the \$5,000,000 threshold.

Accordingly, on this additional ground, Tingari Village was not entitled to the Div 152 concessions.

SHORTFALL PENALTY

The Commissioner initially considered that Tingari Village had been reckless and applied a 50% penalty. By the time of the Tribunal hearing, the penalty had been reduced to 25%.

The Tribunal⁷ took the view that Tingari Village by its agent failed to take reasonable care in determining the extent of the net CGT assets.

The Tribunal acknowledged that the accountant was hampered by the large amount of work needed to acquire a picture of the affairs of Tingari Village, but found that as a matter of fact the accountant had failed to give adequate attention to the terms of the legislation⁸ and the factual matters made relevant by statute.

CONCLUSION

Tingari Village turned on whether the residential park was an active asset within the meaning of Div 152.

Ultimately a detailed analysis of real property law and the meaning of rent determined that this residential park was not an active asset. Given that there was probably very little difference between the way this residential park was conducted and that park referred to in private ruling 55228 was conducted, the taxpayer will feel aggrieved with the outcome.

As for the shortfall penalty, it seems odd that its imposition was determined by carelessness in matters which ultimately did not determine the outcome of the case.

However, the imposition of the penalty highlights the need for proper instructions and preparation prior to lodging a tax return.

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Reference notes

- 1 Para 19
- 2 Para 31
- 3 Para 42
- 4 Para 46
- 5 Para 47
- 6 Para 55
- 7 Para 61
- 8 Para 63