



Tax Insights

Eichmann decision lifts the bar on active asset test

Snapshot

A recent decision of the Federal Court addressed the question of whether an asset (a block of land) was sufficiently connected to business operations so as to qualify as an active asset. The decision of Derrington J in [Commissioner v Eichmann](#) was handed down in December 2019 in favour of the Commissioner.

The relevant question was whether the land was used in the course of carrying on a business. The approach adopted by the Court has posed the active asset test as an extremely onerous one requiring that the asset and its use have a "direct functional relevance to the carrying on of the normal day-to-day activities of the business".

The matter arose in the context of the small business concessions in Division 152 of the Income Tax Assessment Act 1997 (ITAA 97), but the same issue is also relevant to the CGT participation exemption in Subdivision 768-G, ITAA 97.

Taxpayers who have in the past treated assets as relevantly active should revisit those conclusions in light of the decision. Further, regard needs to be had to this decision in respect of impending transactions where the active asset test arises.

The taxpayer lodged an Application for Extension of time application on 13 February 2020, which indicates that the taxpayer wishes to appeal, but failed to do so within the stipulated time period. At this time, it is not known whether an appeal will be heard.

Background and facts

In December 2016, the taxpayer sought a private ruling from the Commissioner in relation to the “active asset” question. In March 2017 the Commissioner ruled unfavourably. The taxpayer objected to the private ruling decision and the Commissioner affirmed the position under the ruling.

In February 2019, the AAT held in favour of the taxpayer concluding that “the decision under review is set aside and substituted with a decision that the land is an ‘active asset’ for the purposes of section 152-40(1) ITAA”. The Commissioner appealed against the AAT decision.

The relevant facts before the Court were based on those contained in the ruling request. In broad terms, the facts were that the taxpayers disposed of a block of land and argued that the land was relevantly an active asset, in connection with a business of building, bricklaying and paving. The land had two sheds as well as a fence and security gate. The usage of the land involved the following:

- The sheds were used for storage of work tools, equipment and materials used in the business
- The open space on the property was used to store material that did not need to be stored under cover, including bricks, blocks, pavers, mixers, wheelbarrows, drums, scaffolding and iron
- Work vehicles and trailers were parked on the property
- Tools and items were collected on at least a daily basis
- Some preparatory work was done at the property, although the property was mainly for storage with the building, bricklaying and paving done on site.

Submissions

The Commissioner submitted that in order for an asset to satisfy the active asset test, its use must be an integral part of the relevant business, and part of the process by which the business was carried on.

The Commissioner variously referred to the asset’s use as needing to be “integral to the business operations”, “integral to the carrying on of the business” or “integral to the process or processes by which the business was carried on”. The Commissioner also submitted that the test requires that there be a “direct connection” or relationship between the asset and the carrying on [of] the taxpayer’s business.

The Commissioner submitted that it was not sufficient that an asset be used:

- In connection with the carrying on of business;
- In relation to the business; or
- As part of the business.

The taxpayer argued that the Commissioner’s submissions effectively sought to read into the definition the additional requirement that the use of the asset was integral to the carrying on of the business, and such an interpretation was unwarranted.

Judgement

The Court addressed the question of whether the asset was used in the course of carrying on a business by way of asking two subsidiary questions:

- Firstly, was there a relevant use that could be attributed to the land; and:
- Second, was that use in the course of carrying on the building, bricklaying and paving business.

The Commissioner pointed to a previous AAT decision, involving substantially similar facts, where approximately 90% of the land was vacant and only 10% of the land was used in connection with a business. In other words, a threshold issue was, whether have regard to all the relevant facts, a particular use could be attributed to the land. This was influenced by a policy view that it would be an inappropriate outcome to obtain a tax concession on the whole of the gain, where only a small part of the use of the asset was relevantly active

Derrington J accepted that principle and held that “it needs to be established that the whole, or predominantly the whole, of the asset” has been used in the course of carrying on the business. Despite the challenges of the limited facts contained in the private ruling request, the Court held that the land had met the “wholly or predominantly” test.

The next question was whether the land met the test of being so used "in the course of carrying on a business".

The Court held that this test requires "more than that the asset is used by an entity which is carrying on a business", and "the mere fact that there is a temporal connection between the carrying on of the business and the asset's use is insufficient". At the other end of the spectrum, it is not a requirement of the test that the use of the asset must be "essential or fundamental to the business processes".

The judgement outlined a number of descriptions in order for an asset to be relevantly taken used in the course of carrying on the business, such as requiring:

- "a direct relationship between the use to which the asset is put and the carrying on of the business"; and
- That the asset "must be used in the ordinary and common flow of the business transactions"; and
- A "direct functional relevance to the carrying on of the normal day-to-day activities of the business which are directed to the gaining or production of assessable income"; and
- That "the use must be a constituent part or component of the day to day business activities"
- Activities which are in the course of carrying on the business are "those directed to the securing and performing" the construction, bricklaying and paving services.

The Court noted that the property was used for the storage of materials and "storage itself was not an activity in the ordinary course of [the business]". Rather, such use was "preparatory to the undertaking of activities in the ordinary course of business".

The Court held that the asset was not relevantly used in the course of carrying on a business, and was not therefore an active asset.

Next steps

When applying the active asset test, the various tests outlined by the Court will require an extensive analysis as to the relevant facts regarding the asset, the use of the asset, the scope of the business, and the key steps in the business operations.

Whilst the case dealt with land, the principles should be equally relevant to other assets. Taxpayers who have treated assets as relevantly active should revisit those conclusions in light of the decision. It may be appropriate to gather and document additional facts to test and support the positions adopted.

Further, in respect of impending transactions where the active asset test arises, taxpayers would be advised to ensure that the approach to the analysis is well informed by the position adopted by Derrington J.

In the meantime, taxpayers should monitor the status of the appeal process.

Contacts



Peter Radlovacki
Partner
Tel: +61 2 8260 4243
pradlovacki@deloitte.com.au



Manu Sriskantharajah
Partner
Tel: +61 3 9671 7310
msriskantharajah@deloitte.com.au



Jonathan Schneider
Partner
Tel: +61 8 9365 7315
joschneider@deloitte.com.au



David Watkins
Partner
Tel: +61 2 9322 7251
dwatkins@deloitte.com.au



Spyros Kotsopoulos
Partner
Tel: +61 2 9322 3593
skotsopoulos@deloitte.com.au



Marc Worley
Partner
Tel: +61 8 9365 7807
maworley@deloitte.com.au



Jacques Van Rhyn
Partner
Tel: +61 7 3308 7226
jvanrhyn@deloitte.com.au



Richard Bridgart
Partner
Tel: +61 3 9671 6046
rbridgart@deloitte.com.au

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is, by means of this publication, rendering professional advice or services.

Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 244,000 professionals, all committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 7,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit Deloitte's web site at www.deloitte.com.au.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

© 2020 Deloitte Touche Tohmatsu.