Week 5: Assessable income Part 2 - Income from carrying on a business

Identification of a business

Significance of establishing if a business context exists

- It is first important to determine the signification of establishing whether an activity or transaction constitutes a business because:
    - Determines the eligibility for accessibility of receipts and deductibility of expenses
    - Proceeds from certain quasi-business activity will not be treated as income
        - Income or expenses generated from hobbies for example are non assessable and non-deductable
    - Feasibility studies and pilot projects
        - Receipts are usually non-assessable and expenses non-deductable however section 40-880 allows for certain black hole expenses such as environmental assessments, pre-incorporation contracts and expenditure incurred to set up a business to be deductable over a 5 year period

Common law test for determining whether a business exists

1. System and organisation
    - Was activity is carried on in a similar manner to that of the ordinary trade
    - Was activity organised and carried on in a businesslike manner and systematically - records are kept
        - **Ferguson vs. FCT:** Navy officer wanted to set up a cattle ranch and leased 5 cows- he engaged with a vet to use the sperm of bulls in order to fertilise the cows to produce calves of which he would be the owner of- in leasing the cows he incurred a number of expenses and claimed them as deductable – court found that transactions constituted a business since he kept detailed records of receipts and payments
        - **Crees:** Where expenses are high and sales are low then activities will less likely be classified as a business – in this case the court determined that orchard selling was not a business since activities where poorly run – sales were low and expenses were high and no adequate records were kept
    - If an activity is a primarily enjoyable a higher level of system and organisation is needed to prove that it constitutes a business
2. Size and scale of activities
    - The larger the scale of the activity the more likely it is to be a business however business may still be small
3. Sustained, regular and frequent transactions
        - **Case N50:** Retired accountant set up a consulting practice from his home – when determining whether his activities constituted that of a business the court looked the degree of activity of the business and decided that he was not activating as a business since there was a lack of demand for his services

- However one-off transactions may also constitute a business
    - **Rutledge vs. IRC:** Rutledge bought 1 million rolls of toilet paper and sold them in a single transaction – court determined this to be a business transaction and the 1m was assessable income

4. Profit motive
    - TR 97/11 the motive for profit is an important indicator of carrying on a business
        - **Daff vs. FCT:** There must be a reasonable prospect for profit the fact that venture fails does not prevent it from qualifying as a business
        - **Ferguson vs. FCT:** Immediate profit is not necessary and irrelevant
        - **Brajkovich vs. FCT:** Taxpayer had a strong profit motive however was not found to be a business because in that case, the element of sport, excitement and amusement was the main attraction for the taxpayer and it could not be said that a business was being carried on and was not conducted in a systematic and organised way
5. Commercial character of transaction
    - is the person willing to trade on an open market i.e. do they advertise or market to the public
6. Characteristics or qualities of property dealt in
    - If goods are inherently unsuitable for domestic purpose then they are more likely to be considered a business
        - Rutledge vs. IRC
7. Taxpayer has the required knowledge and skill
8. Other Issues
    - Illegal transactions can constitute a business
    - A business can exist where a person converts his/her talents into a business
        - **Stone vs. FCT**: In cases where a person converts his or her talents into a business amounts will be assessable as income when the individual commences commercially exploiting their personal attributes for money -- Although profit making was not her primary purpose, the taxpayer was aware that sporting success would bring financial reward, and her acceptance of sponsorship indicated that she had turned her talent to account for money