

Sticking to the facts: can a home garage satisfy the business premises test?

COMMISSIONER OF TAXATION V DIXON CONSULTING PTY LIMITED [2006] FCA 1748



INTRODUCTION

On 15 December 2006, the Federal Court of Australia (“the Court”) handed down its finding in the case of *Commissioner of Taxation v Dixon Consulting Pty Limited* [2006] FCA 1748 (“*Dixon Consulting*”) which considered the definition of premises as it related to the business premises test, being one of the four personal services business tests under the Personal Services Income regime in the *Income Tax Assessment Act 1997* (“ITAA97”). The Court held, overturning the decision of the Administrative Appeals Tribunal (“Tribunal”) that the company failed to satisfy the business premises test as the test had been incorrectly applied to the facts. Although the decision in *Dixon Consulting* appears to endanger the use of premises situated on private property for the purposes of a personal services business, the Court commented that the Company could have satisfied the business premises test had the Tribunal applied the test correctly.

FACTS

Dixon was a director and the sole shareholder of Dixon Consulting Pty Ltd (“Company”). The other director of the Company was Dixon’s wife. The Company derived its income from personal services provided to it by Dixon, who was a business analyst.

Dixon and his wife owned and lived on a property at Dural. The property had only two buildings on it – a house, which Dixon and his wife used as their private residence and a two-storey garage. Dixon and his wife kept two vehicles on the ground floor of the garage and the upper level of the garage was used as an office.

Dixon ran the Company out of the office located above the garage and, during the relevant year, the office was used exclusively by the Company. The office itself could be accessed by an external flight of stairs and was clearly signposted on the side of the garage below. There were no plumbing or toilet facilities in or attached to the garage, but such facilities could be accessed in the house. The Company’s mail was delivered to the mailbox at the entrance to the Dural property together with Dixon’s private mail. Parking was available for clients adjacent to the garage.

Although three cars could be parked in the ground floor of the garage, the Dixons only kept two vehicles there. Both vehicles were registered in the name of the Company; a Holden sedan was used by Dixon’s wife mainly for private purposes and a Toyota land cruiser was used by Dixon for company purposes. All vehicle expenses and fringe benefits tax relating to the personal use of the vehicles was paid by the Company. The residual space in the garage was used both by the Dixon family and the Company as a store.

PROCEDURAL HISTORY

On 16 June 2004 the Company applied for a personal services business determination from the Commissioner of Taxation (“Commissioner”). In the application, the Company was named as the personal services entity and the relevant business premises was the Dural property. Dixon explained in the application that the business premises were physically separate:

“Premises exist in loft [office] over separate garage. 15 metres between edge of house to steps to office. No adjoining roof or walkway. No accommodation (bedroom) or kitchen. Separate phone line”.

From this application, the Commissioner accepted that the Company had exclusive use of the office but, he refused to make the determination on the ground that the Company did not satisfy the requirement that the business premises be “physically separate from premises that Mr Dixon and his family used for private purposes”.

The Company lodged an objection to this decision, which was disallowed by the Commissioner, and then applied to the Tribunal for a review of the objection. The Tribunal set aside the Commissioner’s objection decision and determined that the business premises test in s 87-30(1) ITAA97 was satisfied and referred the matter back to the Commissioner for further consideration. The Commissioner then appealed to this Court, which is the subject of the present case.

RELEVANT LEGISLATION

Personal services income can only be derived by a personal services entity that is conducting a personal services business. Personal services income is governed by Part 2-42 of the ITAA97, which seeks to attribute the income of a personal services entity to the individual who performed the personal services.

For a personal services entity to be conducting a personal services business, it must satisfy one of the four personal services business tests outlined in s87-15(2) ITAA97. The relevant test in this case was the “business premises test” described as follows:

Section 87-30 The business premises test for a personal services business

- (1) An individual or a personal services entity meets the business premises test in an income year if, at all times during the income year, the individual or entity maintains and uses business premises:
 - (a) at which the individual or entity mainly conducts activities from which personal services income is gained or produced; and
 - (b) of which the individual or entity has exclusive use (emphasis added); and
 - (c) that are physically separate (emphasis added) from any premises (emphasis added) that the individual or entity, or any associate of the individual or entity, uses for private purposes; and
 - (d) that are physically separate from the premises of the entity to which the individual or entity provides services and from the premises of any associate of the entity to which the individual or entity provides services.
- (2) The individual or entity need not maintain and use the same business premises throughout the income year.

ISSUES BEFORE THE TRIBUNAL

The Tribunal was asked to consider whether the business premises test was satisfied so that the Company would qualify as a personal services business. It was common ground that s87-30(1)(a) and (d) ITAA97 were satisfied. This left the Tribunal to consider the remaining requirements of the test:

1. Section 87-30(1)(b) ITAA97: Whether the Company had exclusive use of the premises, being the whole of the garage.
2. Section 87-30(1)(c) ITAA97: Whether the house and garage were physically separate, based on the Company's later contention that the business premises consisted of the garage as a whole.

Initially the Company submitted that the relevant business premises was only the office above the ground floor of the garage, which could be accessed by external stairs and was clearly signposted, and that this was "physically separate" from premises used for private purposes. However, during the course of the hearing, the Company altered its submission so that the relevant "business premises" consisted of the garage as a whole.

The Commissioner submitted that the Tribunal needed to consider whether "the premises used and maintained by [the Company were] physically separate from all parts of the property which comprise premises used by the Dixon family for residential purposes".

Initially the Commissioner argued, for the purposes of s 87-30(1)(c), the office being the relevant business premises was not physically separate from the premises the Dixon family used for private purposes.

However, as a result of the Company altering its submission to the garage as a whole, the Commissioner withdrew its agreement that the Company had exclusive use of the business premises for the purposes of s 87-30(1)(b) and argued that the Company was now in breach of this subsection.

TRIBUNAL'S DECISION

Exclusive use of the garage

The Tribunal found that the Company had satisfied the requirements contained in s 87-30(1)(b) even though the garage was **mainly** used by the Company. There was limited joint occupancy of the ground floor of the garage between the Company and the Dixon family and there was no evidence before the Tribunal that the Company had been granted exclusive rights to use any part of the Dural property to the exclusion of the Dixon family.

The Tribunal reasoned that the joint occupancy of the ground floor of the garage and the use of the vehicles by the Dixon family was justifiable as their use of Company property.

Physical separation

The Tribunal found that the garage as a whole was physically separate from the house for the purposes of s 87-30(1)(c) ITAA97 even though both structures were on the Dural property. The Tribunal pointed to the physical appearance of the garage by virtue of the signage and that the two buildings were found to be largely functional independent of one another.

ISSUES BEFORE THE COURT

The Commissioner asked the Court to consider:

1. Whether the Tribunal had misinterpreted the requirement for "exclusive use" in s 87-30(1)(b) in

its conclusion that the Company had exclusive use of the garage notwithstanding some private use by the Dixon family. The Commissioner submitted that the Tribunal wrongly considered the payment of fringe benefit tax as indicating the Company had exclusive use of the garage. Furthermore, the Tribunal failed to take into account that the ground floor of the garage was used by Dixon for private purposes.

2. Whether the Tribunal erred in its construction of the term "premises".

Exclusive use of the garage

The Court considered that "exclusive use" could be interpreted in two ways, either way resulting in the Company having exclusive use of the garage. The first option was that the Company was the only "person" that used the garage. A finding in this regard was a question of fact that could have only been found by the Tribunal. In this regard the Tribunal had found that the family used the garage to "a limited extent", which, because it was not "so slight that it should be disregarded" was inconsistent with exclusive use. The second option was that the Company had a legal right to the exclusive use of the garage whether or not it enforced that right. The Court reasoned that there was no evidence before it on which to make a decision in relation to the second option.

As a result of the above, the Court considered that the Tribunal had confused the requirements of s 87-30(1)(a), which required the Company to mainly conduct the activities from which personal services income was derived at the relevant business premises, with the requirements of s 87-30(1)(b), which required the Company to have exclusive use of the business premises.

The Court reasoned that the Tribunal's focus in relation to exclusive use had focused on the ownership of the vehicles garaged on the ground floor, and the fact that the Company had paid fringe benefit tax with respect to the private usage of those vehicles by Dixon and his wife. However, the Tribunal made no finding to the arrangements between Dixon and the Company concerning the use of the vehicles - on the one hand the vehicles could have been garaged on the ground floor because

the Company required it or, on the other hand, the vehicles could have been garaged there by the Dixons by reason of their ownership of the Dural property. Neither of these scenarios, without more (being an agreement between Dixon and the Company to use the garage), could lead to the conclusion that the Company had exclusive use of the garage.

Physical Separation

The Company had submitted to the Court that each of two buildings on the Dural property constituted different premises, and that each were physically separate from the other, without further consideration of the open space surrounding both buildings.

The Commissioner, however, contended that the Dural property constituted the premises, so that the two buildings were all part of those premises considering the open space surrounding the buildings, shared driveway and garden.

The Court saw no reason why “premises” should not have been interpreted in accordance with its dictionary meaning:

“a house or building with grounds etc belonging to it”

or

“a house or building, together with its land and outbuildings occupied by a business or considered in an official context”.

The Dural property is owned by Dixon and his wife under a single title. There was never any suggestion before the Court that a separate title existed for the garage, nor that the garage was not part of the Dural property. Leaving the garage aside, the Dixon family and the Company shared all other parts of the property, including the driveway, the mailbox, amenities and open space.

DECISION

The Court upheld the Commissioner’s appeal and remitted the matter back to the Tribunal for reconsideration. In doing so, the Court held that the Tribunal had made errors of law in relation to both the question of whether the Company had exclusive use of the garage and also whether there was the necessary distinction with regard to physical separation.

COMMENT AND CONCLUSION

The Company applied for a personal services business determination on the basis that it satisfied the business premises test under the Personal Services Income regime. The Company submitted that it operated the business from an office above the garage located on the family property. The argument made by the Company was complicated somewhat by their alteration of the relevant “business premises” during the course of the Tribunal hearing, from the office only to the garage as a whole. The Court reasoned that the Tribunal had made an error of law both in considering whether the Company had exclusive use of the business premises, and whether there was adequate physical separation between the business premises and the private residence. The Court held, overturning the decision of the Tribunal that the business premises test had been incorrectly applied to the facts and that, on the reasoning before it, the Company did not satisfy that test.

Although the decision in *Dixon Consulting* appears to endanger the use of premises situated on private property for the purposes of a personal services business, the Court commented that the Company could have satisfied the business premises test had the Tribunal applied the test correctly. The Court stated that it may have been possible for the Tribunal to find on the evidence before it, that “there are premises that are exclusively used by the Company that can be shown to be physically separate from the...house, open space and driveway that constitute the premises of the Dixon family”.

The *Dixon Consulting* decision serves as a timely reminder that a personal services business operated from the family property must make a clear distinction between any business and private activities as well as clearly identifying what space is to be used by the Company. There must be either strict adherence with this requirement or formal arrangements in place to show that such an agreement exists.

The approach taken in *Dixon Consulting* may be contrasted with Tax Ruling 93/30 which relates to allowable deduction for home office expenses. The Ruling states that deductions for home office expenses may be allowed where an area of the home is used for private study, or where an area of the home is used for a place of business.

A factor which is relevant to determining that an area is used for a place of business is that it is used exclusively or **almost** exclusively for carrying on a business, which is a much more relaxed approach than the *Dixon Consulting* decision on this issue.

Nevertheless, these two approaches should be considered as reasonably compatible as *Dixon Consulting* considers the application of the Personal Services Income regime at a more fundamental level whilst the Ruling only addresses allowable deductions.

As a result, unless the Commissioner publishes a tax ruling on what is acceptable to satisfy the business premises test specifically, personal services businesses and their advisors must scrutinise the details of their proposed structure to ensure that they will be able to satisfy the necessary components of business premises test.

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