

# Revenue Rulings

## Principal Place of Residence Exemption – Substantial Business Activity

*Land Tax Act 2005*

Revenue Ruling LTA.001 (version 2)

Ruling history	
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To	-

### Preamble

The principal place of residence (PPR) exemption provided by section 54(1)(a) of the *Land Tax Act 2005* (the Act) applies to land owned by a natural person that is used and occupied as the PPR of that person. Sections 54(1)(ab) and (b) of the Act extend the PPR exemption to land owned by:

- a person that is used and occupied as the PPR of a natural person who has a right to reside on that land; and
- trustees of certain trusts that is used and occupied as the PPR of a vested beneficiary in relation to the land.

However, where the PPR land is also used by any person to carry on a substantial business activity, section 62(1) of the Act provides that the PPR exemption applies only to the extent that the PPR land is used and occupied for residential purposes by the owner, a vested beneficiary in relation to the land or a natural person who has a right to reside on the land, as the case requires. If section 62(1) of the Act applies, the Commissioner of State Revenue (the Commissioner) must apportion the value of the PPR land between use and occupation for residential and business purposes in accordance with section 62(3) of the Act.

In determining whether the PPR land is also used by a person to carry on a substantial business activity, section 62(2) of the Act provides that the following factors must be taken into account:

- whether paid employees or contractors (other than employees or contractors who are relatives of, and who ordinarily reside with, the person who uses and occupies the land as his or her PPR) work on the land; and
- whether any part of the land is used or allocated solely for business purposes; and

- if part of the land is used or allocated (whether solely or partly) for business purposes, the proportion of the area of the land, or of the floor space of buildings on the land, that is so used or allocated; and
- the amount of income (if any), and the proportion of the person's total income, that is derived from business activities carried on on the land; and
- any other matters the Commissioner considers relevant.

The purpose of this Revenue Ruling is to explain the factors in section 62(2) of the Act which the Commissioner must take into account when determining whether the PPR land is also used by a person to carry on substantial business activity.

In this Ruling, a reference to a resident of a PPR land refers to the owner, a vested beneficiary in relation to the land or a natural person who has a right to reside on the land (as the case requires) who uses and occupies the land as his/her PPR.

### Ruling

In determining whether land is used by a person to carry on a substantial business activity, account must be taken of –

- Whether paid employees or contractors (other than employees or contractors who are relatives of, and who ordinarily reside with, the resident of the PPR land) work on the PPR land**

Where remunerated employees or contractors are engaged in the business activities carried on on the PPR land, the Commissioner will consider the number of employees or contractors engaged and the regularity with which they work. The greater the number of employees or contractors and the greater the regularity with

which they work, the more likely it is that the Commissioner will consider that the PPR land is being used to carry on a substantial business activity.

Employees or contractors who are related to the resident of the PPR land and who ordinarily reside with that resident are not taken into account. A relative includes a spouse or domestic partner, a child or grandchild, a parent or grandparent, a brother or sister, and a nephew or niece.

For example, if the resident of the PPR land conducts a consulting business on the PPR land and employs a full time secretary/bookkeeper, this would indicate that the PPR land is used to carry on a substantial business activity. However, if the secretary/bookkeeper is the child of the resident of the PPR land and ordinarily resides with that resident, that employee is not taken into account in determining whether a substantial business activity is carried on on the PPR land.

Furthermore, the Commissioner will generally take into account only those employees or contractors whose work on the PPR land is directly related to the principal business activities carried on on the PPR land.

For example, if the PPR land is used to carry on a bookkeeping business, the engagement of a gardener at the PPR land will not be taken into account in determining whether a substantial business activity is carried on on the PPR land. However, if the PPR land is used to carry on a Bed & Breakfast business, the engagement of a gardener will be taken into account as a gardener is considered to be directly related to the carrying on of a Bed & Breakfast business.

**b) Whether any part of the PPR land is used or allocated solely for business purposes**

Where part of the PPR land (including the floor space of any building(s) on the PPR land) is allocated solely for business purposes, the Commissioner will generally consider that the PPR land is being used to carry on a substantial business activity.

For example, if part of the building, such as the ground level floor of a two storey residence, is

used solely for a milk bar or cafe business, this will generally indicate that a substantial business activity is being carried on on the PPR land.

*Home Office*

A home office refers to the use of a space on the PPR land (such as a study or spare room) to carry out business related work, such as accounts or storage of business records.

Where the resident of the PPR land undertakes most of his/her work at his/her employer's business and uses a home office to complete work related to their employment from time to time, the Commissioner is unlikely to consider the use of a home office in such circumstances to be a use of the PPR land to carry on a substantial business activity.

Similarly, where the resident of the PPR land is self-employed but undertakes most of their work at other premises (such as at a client's property), the Commissioner is unlikely to consider the use of a home office in such circumstances to be a use of the PPR land to carry on a substantial business activity.

**c) If part of the PPR land is used or allocated (whether solely or partly) for business purposes, the proportion of the area of the land, or of the floor space of buildings on the PPR land, that is so used or allocated**

Where more than 30 per cent of the PPR land or 30 per cent of the area of a building on the PPR land is used (whether solely or partly) for business purposes, the Commissioner will generally consider that the PPR land is used to carry on a substantial business activity.

**d) The amount of income (if any), and the proportion of the person's total income, that is derived from business activities carried on on the PPR land**

Where more than \$30,000 (gross) income is derived from the business activity carried on on the PPR land for the most recently completed financial year (preceding the year of assessment), the Commissioner will generally consider that the PPR land is used to carry on a substantial business activity.

e) **Any other matters the Commissioner considers relevant**

In addition to those factors set out at paragraphs a) to d) above, the Commissioner must also take into account any other matters he considers relevant in determining whether a substantial business activity is carried on on the PPR land.

Other matters which the Commissioner may consider include:

- Whether any other person has been given a right to use or occupy any part of the PPR land or building for business purposes. For example, if the resident of the PPR land grants a lease or licence to another person to store records or other business related materials, this may indicate that a substantial business activity is being carried on on the PPR land.
- The extent and nature of the business activity carried on on the PPR land when compared with business activity conducted elsewhere.
- The extent and nature of income tax deductions claimed in respect of the business activity carried on on the PPR land.
- The level of involvement of the resident of the PPR land (or his/her family) in the business activities.
- Whether promotional or advertising materials in respect of the business activities refer to the PPR land.
- Whether a council permit is required or has been issued in respect of the business activities carried on on the PPR land.

The relevance and weight to be given to each of the factors in section 62(2) of the Act will depend on the circumstances of each case.

**Apportionment**

If the PPR land is used by any person to carry on a substantial business activity, section 62(1) of the Act provides that the PPR exemption applies only to the extent that the PPR land is used and occupied for residential purposes by the resident of the PPR land.

Section 62(3) of the Act provides that the Commissioner must apportion the value of the PPR land as between use and occupation for residential

purposes and use for business purposes, having regard to the proportion of the PPR land used for each purpose and the extent to which each proportion is so used. Section 62(4) of the Act further provides that the Commissioner may consult the Valuer-General in relation to an apportionment.

**Example 1**

Leigh is a self-employed web designer who works from his PPR. One room is exclusively set aside for his web designing activities, representing approximately 12 per cent of the floor space of the building on the PPR land. Leigh has obtained a council permit to conduct the business activities from his PPR. During the most recent financial year, Leigh's gross income was \$38,000.

The fact that Leigh's web designing business generated over \$30,000 indicates that Leigh is using the PPR land to carry on a substantial business activity. This is particularly so given that part of his PPR is used exclusively for the business, and the fact that the council has granted a permit in respect of the business activities. As section 62(1) of the Act applies in this case, Leigh is entitled to the PPR exemption only to the extent that the PPR land is used and occupied by Leigh for residential purposes.

**Example 2**

Phil works full-time in a music store, and supplements his income by giving music lessons from his PPR on a casual basis. One room (approximately 15% of the floor space of the building) is set aside for his music lessons. Phil derives approximately \$8,000 per annum from his business activities.

Although a room at Phil's PPR is set aside solely for his business, the area allocated to his business and the income derived is not significant. Furthermore, Phil is involved in the business on a casual basis only. Taken together, these factors indicate that Phil is not using his PPR to carry on a substantial business activity. As section 62(1) of the Act does not apply, Phil is entitled to a full PPR exemption in respect of the PPR land.

**Example 3**

Sam and Debbie own a Bed & Breakfast property in the Yarra Valley. The building on the PPR land consists of 6 bedrooms; Sam and Debbie occupy

two bedrooms for personal use and the remaining four bedrooms are made available to guests. The Bed & Breakfast business generated an income of \$120,000 last financial year and Debbie decided to hire a part-time gardener to assist with the upkeep of the lawns.

The business income in this case is well above \$30,000 and the proportion of the PPR residence allocated for business purposes is significant (more than 30%). Also, Debbie has employed a gardener. The combination of these factors indicates that the PPR land is being used to carry on a substantial business activity. Therefore, the PPR exemption applies only to the extent that the PPR land is used and occupied for residential purposes by Sam and Debbie.

#### **Example 4**

Sharon is employed by XYZ Pty Ltd as an accountant. Occasionally, Sharon works after hours from her home office which is located in a spare garage on the PPR land. Each year, Sharon claims a tax deduction in respect of her home office expenses. Sharon's son also uses the home office to check his emails and complete his homework.

Although Sharon claims tax deductions in respect of her home office, the extent of the use is not significant. Furthermore, the home office is used partly for private purposes by Sharon's son. Taken together, these factors indicate that Sharon is not using her PPR to carry on a substantial business activity. As section 62(1) of the Act does not apply, Sharon is entitled to a full PPR exemption in respect of the PPR land.

#### **Example 5**

Annette has lived in her PPR for many years. To supplement her income, Annette decides to lease part of the PPR land (approximately 25 per cent) to her nephew, who uses it to operate a veterinary clinic. Annette's nephew employs a full-time receptionist to help him at the clinic and distributes advertising material containing the address of the PPR land.

The fact that part of the PPR land is leased to another person for business purposes, combined with the employment of a full-time receptionist and the provision of the advertising material, indicates that Annette's PPR is being used to carry on a

substantial business activity. Therefore, the PPR exemption applies only to the extent that the PPR land is used and occupied for residential purposes by Annette.

#### **Partial exemption if separate residence is leased for residential purposes**

It should be noted that where the PPR land is not used to carry on a substantial business activity, consideration may still need to be given to section 62A of the Act. Section 62A of the Act provides that where the PPR land contains a separate residence that is leased for residential purposes, land tax is assessable on that part of the PPR land leased for residential purposes.

**Please note that rulings do not have the force of law. Each decision made by the State Revenue Office is made on the merits of each individual case having regard to any relevant ruling. All rulings must be read subject to Revenue Ruling GEN.001.**