Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates, 2 June – 4 June 2009

Question: bet 137

Topic: Tax Deductions on Non-Commercial Business Activities

Hansard Page: Written

Senator Bushby asked:

Budget 09-10 changes to stop people claiming tax deductions on non-commercial business activities against other forms of income.

1. Can the ATO confirm that the government is intending to save $700m through this change over the next four years? If so, how have these figures been calculated?
2. Do the changes mean that anyone earning above $250,000 will not be allowed to offset losses from any type of business that makes a loss?
3. If the losses are carried forward to be offset in a year in which the business makes a profit, what impact will this have on the many small businesses that incur potential early losses typical of most start-up businesses?
4. How does this proposal fit in line with laws introduced in 1997 to set out when businesses could claim their losses? The rules were based on three tests: the business had property valued at more than $500,000, annual income was over $40,000 or equipment expenses were more than $100,000
5. Will the proposed rules affect just hobby businesses or any business that made a loss?
6. Are these rules designed to catch a particular type of taxpayer?
7. Taxpayers will still be able to apply to the Commissioner of Taxation for relief from the rules if there are exceptional circumstances. What type of circumstances would warrant exception from the rules?

Answer:

1. Treasury can confirm that the measure will have an ongoing gain to revenue which is estimated to be $700 million over the forward estimates period. These estimates have been calculated by Treasury (in consultation with the ATO) using Treasury's personal income tax microsimulation model. This model is based on confidentialised sample unit record tax return data provided by the ATO and contains information about non-commercial business losses claimed by each taxpayer.
2. No. Taxpayers with an adjusted taxable income over $250,000 who want to apply non-commercial business losses against other income may apply to the Commissioner and seek relief from the rules where they can demonstrate, on an objective basis, that the businesses activity will produce assessable income

greater than available deductions in a given year. That is, the business activity will become commercial.

If the taxpayer cannot demonstrate that the business activity will produce assessable income greater than available deductions, and there are no exceptional circumstances, the Commissioner cannot allow the individual to apply excess deductions against other income. The excess deductions are quarantined to the non-commercial business activity and may be carried forward and applied against assessable income from that business activity in future years.

3. Under the existing rules, taxpayers who carry on business activities which involve a lead time between the incurring of expenses and the production of assessable income, can – regardless of their adjusted taxable income – apply to the Commissioner for relief from the non-commercial losses rules.
   The changes proposed in the 2009-10 Budget do not affect these rules.

4. The non-commercial loss rules were introduced in response to the findings of the 1999 Review of Business Taxation. The Review noted at page 296 of its report that:

> There is a significant revenue leakage from unprofitable activities carried out by individual taxpayers, either acting alone or in partnership with another individual. …Many of these activities are no more than hobbies and/or lifestyle choices but even those that have business like characteristics (according to existing law) are often unlikely to ever make a profit and do not have a significant commercial purpose or character. They continue in a net loss position year after year, offsetting so-called business losses against other income, notably salary and wages. On average they make little or no contribution to the revenue raising task but gain a significant tax advantage.

Four tests were introduced which needed to be met for non-commercial business losses to be offset against a taxpayer's income from other sources. These tests were:

- the assessable income test – the assessable income generated from the activity must be at least $20,000;
- the profits tests – the activity must have produced a profit in three of the last five income years, including the current income year;
- the real property test – the reduced cost base value of real property or interests in real property used on a continuing basis to carry out the activity is at least $500,000; and
- the other assets test – the reduced cost base of any other assets used on a continuing basis to carry on the activity is at least $100,000.

Since 2000, the assessable income, real property, and other property thresholds have not been indexed.

The changes proposed in the 2009-10 Budget further improve the integrity of the tax system by requiring taxpayers with an adjusted taxable income of over $250,000 – who are more able to devote sufficient resources to meet one of the four tests – from applying excess losses from business activities that are little more than hobbies and lifestyle choices against their other income. The proposed changes build on the existing non-commercial losses rules.

5. The proposed rules will not affect any businesses. The proposed rules will affect any individual (not a business) that has an adjusted taxable income over $250,000, by preventing them from applying deductions from a business that – based on an objective expectation – will not produce assessable income greater than available deductions in a given income year within a timeframe that is considered commercial for the industry concerned.

6. The current non-commercial losses rules are not designed to effect taxpayers that carry on commercial businesses, and the purpose of the non-commercial losses rules will not change following the introduction of the proposed changes. The proposed changes build on the existing rules which can be discriminatory because high income earners are more able to satisfy the existing four tests than other taxpayers despite their activities not being commercial in nature.

7. All taxpayers can now apply to the Commissioner for relief from the rules where there are exceptional circumstances, and this will not change following the introduction of the proposed changes. The nature of exceptional circumstances is such that they cannot be identified prior to their occurrence with any certainty. However, the current legislation identifies circumstances such as drought, flood, bushfire and other natural disasters as examples of potentially exceptional circumstances. The Commissioner will continue to provide relief to all taxpayers in exceptional circumstances consistent with his previous practice in this area.