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Addendum

Taxation Ruling

Income tax: Division 35 – non-commercial business losses

This Addendum amends Taxation Ruling TR 2001/14 to include additional examples which provide further guidance on the concept of *business activities 'of a similar kind'.

Taxation Ruling TR 2001/14 is amended as follows:

1. Paragraph 130

After the paragraph insert:

Example 2A – Retail activities of a similar interrelated kind

130A Theo sells fresh fish from a refrigerated truck and trailer at farmers and regional markets in the southern area of a city each weekend. Initial sales are slow and the marketplace is dominated by larger established retailers but Theo believes there is a niche market. To expand his options he conducts similar activities in the northern area markets of the same city, in partnership with his brother George. Theo and George are employed four days a week in their eldest brother's food distribution business.

130B For the northern area operations Theo borrows money to acquire another refrigerated truck and purchases a trailer which incorporates cooking facilities. He establishes a new supply source with a fisherman and George uses the trailer to give cooking demonstrations. With the new northern area activities and George's cooking demonstrations he is establishing regular customers. The northern area operation performed better than the southern area activities. Theo made a loss for the whole year due to the interest paid on loans and the low sales in the southern area. Taken together the northern and southern area activities will satisfy the assessable income test in Division 35, but individually neither will satisfy any of the Division 35 tests for the year. The rate of growth for the northern area activities indicates that this side of the operations should pass the Assessable income test in the next year.

130C Given the use of different assets and the financial separation of the retail activities (that is, one is conducted as a sole trader, and the other in partnership, for which separate accounts are kept), it is considered that the two operations constitute *business activities in their own right. The further question then arises, as to whether or not they are of a similar kind. If they are then Theo can group them together under subsection 35-10(3) and the grouped activity will satisfy the assessable income test. This is a question of fact and no single issue is determinative. Applying the factors described in paragraph 51 of this Ruling to the facts of Theo's case produces the following comparison:

Factor	Southern area operation	Northern area operation
Location	From refrigerated truck at various markets and major events within the southern area	From trailer attached to truck at various markets and major events within the northern area
Assets used	Truck and trailer	Truck and trailer with cooking facilities
Goods/services produced	Sale of fresh fish	Sale of fresh fish and cooking demonstrations
Market conditions	Dependent on day's catch and passing trade	Dependent on day's catch and passing trade
Commercial links	Currently unprofitable, owned by Theo, inspired northern area activity	Profitable and controlled by Theo and George as partners
Other characteristics	Niche retail market operation	Parallel retail activity with different supplier and added customer attraction

130D An overall comparison shows significant similarities between the two activities such as the use of similar assets, the same targeted market and similar market conditions. There is a limited degree of interdependency between the activities and the locations for the two activities are different, though the process of attending the different locations is the same. Whilst there are some minor differences between the activities the strength of the similarities between the two activities are such that they can be regarded as being of a similar kind for the purposes of Division 35.

Example 2B – Separate *business activities not ‘of a similar kind’

130E Roman runs an organic chicken stall at weekend farmers markets in a similar manner to Theo in Example 2A. Like Theo he is encountering price sensitive buyer resistance to his premium grade product and has started a support operation to earn extra money. Roman sets up a take away shop adjoining his house in a small country town which is open four nights a week. The shop specialises in BBQ organic chickens but most sales are of non-organic pizzas and fish and chips. The shop is not highly successful. An older established shop in the town has a loyal clientele and is significantly cheaper than Roman’s shop. The tourist trade from nearby attractions that Roman has targeted is not as high as expected. Roman maintains his regular employment for three days per week as a counsellor at the nearby youth correctional facility whilst he strives to develop his belief in organic food into a viable *business.

130F Given the physical separation of the retail activities and their different focus it is considered that the two operations constitute *business activities in their own right. The further question then arises, as to whether or not they are of a similar kind. If they are then Roman can group them together under subsection 35-10(3) and the grouped activity will satisfy the Assessable income test. This is a question of fact and no single issue is determinative. Applying the factors described in paragraph 51 of this Ruling to the facts of Roman’s case produces the following comparison:

Factor	Fresh chicken retail	Take away food
Location	From a refrigerated van at markets	From a shop in a small country town
Assets used	Van	Cooking equipment, building, local produce
Goods/services produced	Sale of organic chickens	Cooked food of mostly non-organic variety
Market conditions	Income derived from sale of organic poultry at produce market – dependent on market for organic produce	Income derived from take away sale of cooked non-organic items – dependent on price sensitive local and passing tourist trade

Commercial links	Occasional and limited use of organic chicken in shop	Limited as sales in take away shop are wider than just organic chicken
Other characteristics	Currently unprofitable but supports other activity in minor way	Marginally profitable with some stock from fresh chicken retail activity utilised

130G An overall comparison of the two activities shows some commonality exists between them as both are retail oriented and involved in the provision of food however there are significant differences between the activities. They are carried on in different locations, are aimed at different markets, utilise different assets to produce their sales and have limited interdependency. In summary, one is a specialist operation aimed at a discerning market and the other a general retail operation with specialist intentions. The general impression gained from this analysis of the two activities is that they are not of a 'similar kind' for the purposes of Division 35 and consequently they cannot be grouped together.

130H Therefore under Division 35 Roman will have to attribute the otherwise allowable deductions between the two activities to determine the profit or loss from each activity. As separate activities neither satisfies any of the four tests and the loss deferral rule will therefore apply separately to losses from both activities (assuming that the Exception does not apply, and there is no exercise of the Commissioner's discretion).

Example 2C – Separate *business activities not 'of a similar kind'

130I Juan and Piotr operate a mixed farm on the edge of a rural town where Piotr is employed as a solicitor. On this farm they are raising a herd of deer and last year established a mushroom and asparagus operation. The Commissioner's discretion in Division 35 has been exercised for this activity, so that losses from it have not been deferred. To further diversify their income base this year Juan has established a bed and breakfast operation in a leased homestead on the edge of a nearby town. The lease is for an initial 12 months and a minor refurbishment of the living and sleeping quarters has been undertaken.

130J The 12 month lease is nearing expiry and although the activity has been neither profitable nor able to meet a Division 35 test, by itself, Juan can see a profitable future for the venture based on current trends. Juan has incurred some losses from this venture and wishes to be able to group this activity with the farm activity to more easily satisfy the relevant tests in Division 35 and therefore offset these losses against his other income.

130K Assuming the bed and breakfast activity is considered to be a *business activity then given the physical separation of the activities and their different focus it is considered that the two operations would constitute *business activities in their own right. The further question then arises, as to whether or not they are of a similar kind. If they are then Juan can group them together under subsection 35-10(3) and the grouped activity will satisfy the Assessable income test. This is a question of fact and no single issue is determinative. Applying the factors described in paragraph 51 to the facts of Juan's case produces the following comparison:

Factor	Farm based activities	Bed and breakfast
Location	On rural land owned by Juan and Piotr	From a rented building near a country town
Assets used	Land, sheds, farming equipment, fertiliser	Rented building, personal cooking and hosting skills
Goods/services produced	Growth and sale of deer, asparagus and mushrooms	Accommodation and choice of breakfast
Market conditions	Governed by domestic consumption of venison, mushrooms and asparagus	Governed by domestic and some international market for tourism
Commercial links	No discernible links other than provision of some produce to the bed and breakfast	No links bar same owners and use of some farm produce
Other characteristics	Sales of produce	Provision of tourist facility

130L The overall comparison of the two activities shows very little interdependency exists between them, other than the provision of some produce from the farm based activity to the bed and breakfast activity. In further contrast they are carried on in different locations, are aimed at different markets, utilise different assets to produce their sales and have limited commercial links. The overall impression gained is that they are separate and discrete *business activities with one a *primary production activity and the other a tourist focussed service activity. The two activities would not be regarded as being of a 'similar kind' for the purposes of Division 35.

130M Juan will have to attribute the otherwise allowable deductions between the two activities to determine the profit or loss from each activity. As Juan's bed and breakfast activity is treated separately from his other activities and does not pass any test in this year, the loss deferral rule will apply to this activity, (assuming that the Exception does not apply and that there is no exercise of the Commissioner's discretion).

Example 2D – Separate *business activities which are 'of a similar kind'

130N Christan is a journalist employed as a columnist by a newspaper group. He wants to establish himself as a writer in the visual entertainment field. He was commissioned by a former colleague to write some scripts for a popular soap opera. These scripts are his only 'sales' to date. Christan is also a poet and has achieved reasonable sales from a self published book. He has also earned some fees from poetry recitals and some royalties from an earlier book of poems.

130O Christan has written a draft movie script which has been reviewed by a prominent producer and a famous director who have each expressed an interest in buying the rights to it as a possible movie. The offer is conditional on Christan updating certain aspects of the script, which requires him to incur expenses in conducting new research. Since this positive but conditional interest was expressed to Christan, he has put his latest poetry collection on hold, scaled back the frequency of his newspaper column and has committed himself, almost full time, to completing the script from his home office.

130P Christan would like the Commissioner's discretion exercised in order to offset the expenses he is incurring, in updating the movie script, against his salary income derived from writing the newspaper column. To do this Christan needs the scriptwriting activity to be considered a *business activity and for it to be able to satisfy one of the tests contained in Division 35. Christan has yet to satisfy any of the Division 35 tests from either his scriptwriting or poetry activities. To prevent the expenses being deferred, the separate activities need to be considered as activities of a similar kind and therefore able to be grouped together for Division 35 purposes.

130Q Based on Taxation Ruling TR 2005/1 Income tax: carrying on a business as a professional artist, the poetry based activity has achieved sufficient longevity, purpose, peer recognition and profit making intention to be accepted as a *business activity. Despite the developing nature of the scriptwriting activity there is also sufficient profit making intention, repetition and time devoted to the activity to indicate that, for the purposes of this example, this is a *business activity. Applying the factors and reasoning described in paragraphs 40 to 46 of this Ruling to Christan's circumstances leads to some doubt about whether the scriptwriting is a separate *business activity from that of the poetry writing. It seems evident however, that the scriptwriting is not an ancillary activity to the poetry based activity.

130R If the poetry and the scriptwriting are separate *business activities in their own right, the further question then arises, as to whether or not they are of a similar kind. If they are then Christan can group them together under subsection 35-10(3) and the grouped activity will satisfy the Assessable income test. This is a question of fact and no single issue is determinative. Applying the factors described in paragraph 51 of this Ruling to the facts of Christan's case produces the following comparison:

Factor	Poetry	Scriptwriting
Location	From Christan's home office	From Christan's home office
Assets used	Computer, ergonomic chair and table	Computer, ergonomic chair and table
Goods/services produced	Poetry – written material	TV and film scripts – written material
Market conditions	Governed by market for specialist poetry	Governed by market for popular visual entertainment

Commercial links	Produced from Christan's imagination with limited commerciality and a limited specialist literary audience	Produced from Christan's imagination with potential for mass audience appeal and commercial success
Other characteristics	Income *derived from sale of self published written material	Income *derived from producing written material for visual entertainment industry

130S An overall comparison indicates there are both many similarities and differences between these two activities. The activities are aimed at vastly different markets with the scriptwriting activity having potentially mass market appeal whilst the poetry based activity has limited market appeal and is almost characterised as a labour of love for Christan. There is limited, if any, crossover between the activities such that Christan's reputation as a poet counts for little amongst his scriptwriting peers.

130T Counteracting this initial impression of a lack of similarity are the facts that both 'goods' are written works which are produced from Christan's imagination and experiences. They are the product of his skill and written inventiveness, in addition to which they share the same production location in Christan's home office. They utilise the same skills and assets in their production and, although aimed at different markets, they share the same fundamental means of deriving income – namely they are written works which are sold by Christan to interested parties. On that basis the overall impression is that if these are separate *business activities then they are of a similar kind and therefore may be grouped for the purposes of Division 35.

2. Detailed contents list

Insert:

Example 2A – Retail activities of a similar interrelated kind	130A
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Example 2D – Separate *business activities
which are 'of a similar kind'

130N

3. Related Rulings/Determinations

Insert:

TR 2005/1

This Addendum applies before and after its date of issue.

Commissioner of Taxation

11 July 2007

ATO references

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