TR 92/4 - Income tax: whether losses on isolated transactions are deductible

Australian Taxation Office

Taxation Ruling
Income tax: whether losses on isolated transactions are deductible

other Rulings on this topic
TR 92/3

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part . Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

contents para

What this Ruling is about

1. This Ruling provides guidance in determining whether losses on isolated transactions are deductible under subsection 51(1) of the *Income Tax Assessment Act 1936*. In this Ruling, the term 'isolated transactions' refers to:

(a) those transactions outside the ordinary course of business of a taxpayer carrying on a business; and

(b) those transactions entered into by non-business taxpayers.

2. The Ruling does not consider the application of the capital gains and capital losses provisions (Part IIIA) or section 52.

3. This Ruling should be read with Taxation Ruling TR 92/3 which deals with whether profits from isolated transactions are income and therefore assessable under subsection 25(1).

Ruling

4. A loss from an isolated transaction is generally deductible under subsection 51(1) if:

(a) in entering into the transaction the taxpayer intended or expected to derive a profit which would have been assessable income; and

(b) the transaction was entered into, and the loss was made, in the course of carrying on a business or in carrying out a business operation or commercial transaction.

Date of effect

5. This Ruling sets out the current practice of the Australian Taxation Office and is not concerned with a change in interpretation. Consequently, it applies (subject to any limitations imposed by statute) for years of income commencing both before and after the date on which it is issued.

Explanations

6. Subsection 51(1) provides that: 'all losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income'.

7. For a loss to be incurred in gaining or producing the assessable income 'it is both sufficient and necessary that the occasion of the loss ... be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income' (*Ronpibon Tin N.L. and Tongkah Compound N.L. v. FC of T* (1949) 78 CLR 47 at 57; *Fletcher & Ors v. FC of T* 91 ATC 4950 at 4957; (1991) 22 ATR 613 at 622).

8. If an isolated transaction results in a loss, that transaction has not produced, and will not produce, a profit which is income. Nevertheless, that loss may fall within the first limb of subsection 51(1) if, in entering that transaction, the taxpayer intended or expected to derive a profit which would have been assessable income.

9. The second positive limb of subsection 51(1) covers almost all of the ground occupied by the first limb (*Ronpibon Tin* 78 CLR at 56). If a taxpayer which carries on a business enters into an isolated transaction, that transaction is only on revenue account if the intention or purpose of profit-making exists in relation to the transaction in question (*FC of T v. Spedley Securities Limited* 88 ATC 4126 at 4130; 19 ATR 938 at 942). It follows that for losses on isolated transactions incurred by taxpayers carrying on a business, the second limb has no wider operation than the first.

10. If an isolated transaction was expected to produce a profit which would be exempt income, a loss incurred in that transaction is not

incurred in gaining or producing assessable income and is not deductible under subsection 51(1).

11. If an isolated transaction was expected to produce a capital profit, a loss incurred in that transaction is not deductible under subsection 51(1). Such a loss is expressly excluded from deduction as being a loss of capital or of a capital nature, regardless of whether the transaction also produced, or was expected to produce, income.

12. If an isolated transaction or operation which is essentially private or domestic in character produces a profit, that profit is not income. A loss on such a transaction is expressly excluded from deduction as being a loss of a private or domestic nature.

13. The above reasoning leads to the conclusion that a loss from an isolated transaction is generally deductible under subsection 51(1) if the taxpayer expected the transaction to produce a profit which would have been income assessable under subsection 25(1).

14. We consider that a profit from an isolated transaction is generally income when both of the following elements are present (*FC of T v. The Myer Emporium Ltd* (1987) 163 CLR 199 at 213; 87 ATC 4363 at 4369; 18 ATR 693 at 699-700):

(a) the intention or purpose of the taxpayer in entering into the transaction was to make a profit or gain; and

(b) the transaction was entered into, and the profit was made, in the course of carrying on a business or in carrying out a business operation or commercial transaction.

15. Our views on the above elements are set out in detail in TR 92/3 and apply equally in considering whether a loss on an isolated transaction is deductible.

16. Consequently, a loss from an isolated transaction is generally deductible under subsection 51(1) if:

(a) in entering into the transaction the taxpayer intended or expected to derive a profit which would have been assessable income; and

(b) the transaction was entered into, and the loss was made, in the course of carrying on a business or in carrying out a business operation or commercial transaction.

17. As emphasised in TR 92/3, whether a profit on an isolated transaction is income depends very much on the circumstances of the particular case. The same is true in determining whether a loss incurred on an isolated transaction is deductible under subsection 51(1).

18. There may be rare cases where a taxpayer enters into a transaction intending or expecting to make an assessable profit and a non-assessable profit (e.g. a profit which would be exempt income). If such a transaction results in a loss, it is necessary to determine the extent to which that loss was incurred in attempting to gain an assessable profit. That may require the apportionment of the loss between the object of gaining an assessable profit and the object of gaining a non-assessable profit (*Fletcher* 91 ATC at ATC 4957-4958, 22 ATR at 622-623; *Ronpibon Tin* 78 CLR at 59).

Examples

19. As the deductibility of a loss on an isolated transaction depends so much on the circumstances of the particular case, the answers given in the following examples are not determinative of our views on cases with similar, but different, facts.

20. TR 92/3 contains examples which illustrate when a profit on an isolated transaction is assessable income. In general terms, if those examples in which taxpayers made assessable profits had resulted in losses rather than profits, those losses would be deductible under subsection 51(1). However, if those examples in which taxpayers made profits which were not income had resulted in losses, those losses would not be deductible under subsection 51(1).

Example 1

21. Boomgate Ltd, which carried on a business of operating car parks, acquired a number of commercial premises near a vacant site. Boomgate neither owned, nor had a lease of, the vacant site. Boomgate had earlier made representations to the local council that the vacant site should be zoned as a car park and advised the council that it wanted to operate a car park on the site. The local council rezoned the vacant site as a child care centre. Boomgate sold the commercial premises at a substantial loss soon after the rezoning. Boomgate had no prior dealings in land, except in renting car parks, and bought the premises with the purpose of reselling them at a profit.

22. The loss incurred by Boomgate is an allowable deduction under subsection 51(1), even though the transactions were outside the ordinary course of the taxpayer's business. If Boomgate had made a profit in reselling the properties, that profit would have been income and assessable under subsection 25(1). A significant purpose of Boomgate in acquiring the premises was to make a profit by their sale and those premises were acquired in the course of the taxpayer's business.

Example 2

23. In 1987 Mr Lyon bought 20,000 shares at $1 each in a large public company from an arm's length seller. Mr Lyon was not carrying on a business of trading in shares . He principally bought the shares to derive dividend income although a significant purpose was to benefit from an increase in the value of the shares. In 1992 Mr Lyon sold the 20,000 shares at $0.80 each.

24. Mr Lyon's loss is a capital loss and not deductible under subsection 51(1). If the sale of shares had returned a profit, that profit would not have been income because the transaction was merely an investment, not a business operation or commercial transaction.

Commissioner of Taxation

30 July 1992

ISSN 0813 - 3662

ATO references
NO 92/5371-8
BO

Previously released in draft form as EDR 76

Price $0.50

FOI index detail
reference number
I 1013325

subject references
- isolated transactions
- losses
  - deductions

legislative references
- ITAA 51(1)

case references
Fletcher & Ors v. FC of T 91 ATC 4950; (1991) 22 ATR 613
FC of T v. The Myer Emporium Ltd (1987) 163 CLR 199; 87 ATC 4363; 18 ATR 693
Ronpibon Tin N.L. and Tongkah Compound N.L. v. FC of T (1949) 78 CLR 47
FC of T v. Spedley Securities Limited 88 ATC 4126; 19 ATR 938