



PCG 2022/D2 (Finalised) - Non-commercial business losses - Commissioner's discretion regarding flood, bushfire or COVID-19

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 There is a Compendium for this document: **PCG 2022/1EC** .
This document has been finalised by PCG 2022/1.



Status: **draft only – for comment**

Draft Practical Compliance Guideline

Non-commercial business losses – Commissioner's discretion regarding flood, bushfire or COVID-19

❗ Relying on this draft Guideline

This Practical Compliance Guideline is a draft for consultation purposes only. When the final Guideline issues, it will have the following preamble:

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this draft Guideline is about

1. Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997) prevents an individual's losses¹ from non-commercial business activities being offset against the individual's other assessable income in the year the loss is incurred.²
2. All legislative references in this draft Guideline³ are to the ITAA 1997.

¹ 'Losses' means the amount by which the allowable deductions attributable to a business activity exceed the assessable income from that activity (section 35-10 of the ITAA 1997).

² The individual's losses can be incurred either alone or in partnership (section 35-10). The operation of the Division is modified for those losses incurred in partnership (section 35-25).

³ All further references to 'this Guideline' refer to the Guideline as it will read when finalised. Note that this Guideline will not take effect until finalised.

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3. Division 35 operates in relation to the business activities carried on by a business, rather than the business itself. A business may be made up of more than one business activity.

4. Broadly, a loss from each business activity that an individual (alone or in partnership) carries on in a year is deferred to be offset against future income from the same business activity, unless:

- the individual meets the income requirement⁴ and the business activity satisfies one of the four stipulated tests⁵
- the individual has a business activity that is eligible for an exception⁶, or
- the Commissioner exercises the discretion in subsection 35-55 for the business activity for one or more income years.⁷

5. The discretion can be exercised in relation to a business activity for one or more income years if the Commissioner is satisfied that it would be unreasonable, by reference to the circumstances specified, to defer the losses.

6. One of the circumstances in which the discretion may be exercised is where the business activity was or will be affected by special circumstances outside the control of the operators of the business activity, including drought, flood, bushfire or some other natural disaster.⁸

7. This discretion is for situations where the business activity was or will be affected by special circumstances that caused it to fail to satisfy one of the four tests or make a profit in the relevant year.⁹

8. Special circumstances outside of the control of the operator of the business activity are those which are sufficiently different to distinguish them from the circumstances that occur in the normal course of conducting a business activity. Ordinary economic, weather or market fluctuations, which are expected to occur on a regular or recurrent basis and could reasonably be predicted to affect the business activity, will not normally be considered special circumstances.¹⁰

9. Ordinarily, special circumstances are those which have materially affected the business activity, causing it to not satisfy any of the four tests.¹¹ In addition to drought, flood and bushfire, examples of special circumstances (depending on the facts) may include government restrictions, explosions and disturbances to energy supplies.

⁴ The income requirement (subsection 35-10(2E)) is met when, in a given income year, the sum of the individual's taxable income (disregarding any assessable first home super saver released amounts), reportable fringe benefits, reportable superannuation contributions and total net investment losses is less than \$250,000.

⁵ The assessable income test (section 35-30), the profits test (section 35-35), the real property test (section 35-40) or the other assets test (section 35-45).

⁶ Concerning certain performing arts and primary production businesses. See subsection 35-10(4)).

⁷ If a loss is not deferred, the individual cannot apply the loss carry back tax offset as this is not available to individuals. See paragraph 160-5(b) and section 160-25.

⁸ As outlined in paragraph 35-55(1)(a).

⁹ In the context of the note to paragraph 35-55(1)(a) and consistent with the aim of the discretion, it is the Commissioner's view that the provision will apply in situations where the business activity would have satisfied one of the four tests if the special circumstances had not occurred. See paragraphs 59 to 66B, and 105 to 108, of Taxation Ruling TR 2007/6 *Income tax: non-commercial losses: Commissioner's discretion*.

¹⁰ As outlined in Paragraph 13 of TR 2007/6.

¹¹ Paragraph 13 of TR 2007/6. Note, for those individuals who do not satisfy the income requirement, the special circumstances must have caused the business to not make a tax profit in the relevant year(s) – see paragraph 13A of TR 2007/6.

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10. In recent years, special circumstances such as flood, bushfire and COVID-19 impacts may have caused the non-commercial loss rules to apply to a taxpayer's business. If this happens, and a taxpayer does not meet one of the other requirements for the loss to be offset against their other income, the taxpayer will need to seek the Commissioner's discretion to allow them to do so.

11. This Guideline outlines a safe harbour that, provided you satisfy the relevant conditions, allows you to manage your tax affairs as if the Commissioner had exercised the discretion in paragraph 35-55(1)(a). It does not prevent you from applying for an exercise of the discretion in the usual way if your circumstances do not fall within the terms of the safe harbour.

12. This Guideline does not apply to the Commissioner's discretions in:

- paragraphs 35-55(1)(b) or (c) – the 'lead time' limbs, or
- subsection 35-55(2) – the blackhole expenditure limb.

Date of effect

13. When we finalise this Guideline, we intend that it apply for the 2019–20, 2020–21 and 2021–22 income years.

Safe harbour – compliance approach

14. If your circumstances satisfy the conditions listed in paragraph 16 of this Guideline, you can manage your tax affairs as if we had exercised the discretion. There is no need to apply for the discretion to be exercised.

15. If you choose to use this safe harbour and are subsequently selected for an ATO compliance check, we may seek to confirm that you satisfy the relevant safe harbour conditions.

Safe harbour – conditions

16. You qualify for the safe harbour if you satisfy all of criteria (a) to (f) below in an income year and you made a tax profit from your business activity in the immediately preceding income year¹²:

- (a) you satisfy the income requirement in subsection 35-10(2E)
- (b) you made a loss from your business activity
- (c) your business activity was affected by one or more of the following events
 - (i) flood (including where you received ATO flood support)
 - (ii) bushfire (including where you qualified for an ATO bushfire lodgment and payment deferral), or
 - (iii) a government-imposed lockdown, business closure and/or restriction due to COVID-19

¹² 'Tax profit' refers to the business activity producing assessable income for an income year that is greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and (2C)). See paragraph 16 of TR 2007/6.

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- (d) the event meant that
 - (i) you were not able to carry on your business activity, or unable to carry it on to the same scale as you usually carry on your business activity, or
 - (ii) some or all of your customers were not able to access your business activity, or access it in the same way as they usually did
- (e) you have not applied for a private ruling requesting the Commissioner exercise the 'special circumstances' discretion in relation to your business activity in the relevant income year
- (f) you have evidence to support that you are eligible for the safe harbour.

Examples

17. The following examples illustrate how the safe harbour can apply in various situations.

Example 1 – bushfire – eligible to use the safe harbour

18. *Beth has operated an established beekeeping business. At the commencement of the 2019–20 income year, the business maintained 100 hives that provided pollination services to agricultural enterprises and produced honey for sale. The business had generated small tax profits in recent years, including in the 2018–19 income year.*

19. *In December 2019, the business activity was impacted by bushfire resulting in a loss of approximately half the hives. In previous years, the average loss of hives was approximately 5% per year.*

20. *Beth's other income remained stable and she met the income requirement in the 2019–20 income year.*

21. *Beth's beekeeping business returned a loss in the 2019–20 income year.*

22. *Beth maintains evidence of the loss of hives to demonstrate the impact of the bushfire on her business activity.*

23. *In this case, Beth is eligible to use the safe harbour.*

Example 2 – flood – not eligible to use the safe harbour

24. *Steve runs a coffee roasting business from the garage of his home. Steve has not made a profit in recent years, including in the 2019–20 income year. Steve meets the income requirement in the 2020–21 income year.*

25. *In the 2020–21 income year, the town where Steve lives was inundated with flood water and Steve closed his business for three months to undertake repairs to his garage where the business activity was conducted.*

26. *Even though the flood, which would be considered to be a special circumstance, impacted Steve's business activity, Steve did not make a tax profit in the income year before the event. In this case, Steve is not eligible to apply the safe harbour. However, Steve can apply for the exercise of the discretion in the usual way.*

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Example 3 – COVID-19 – eligible to use the safe harbour

27. Mary operates a food truck. Mary meets the income requirement in the 2019–20 income year. The business generated a tax profit in the 2018–19 income year. A government-imposed lockdown in response to COVID-19 meant that Mary could not operate her business from March to June 2020.

28. In the 2019–20 income year, the business made a loss. Mary maintains evidence of the lockdown's impact on her business.

29. In this case, Mary is eligible to use the safe harbour.

Example 4 – COVID-19 – income requirement – not eligible to use the safe harbour

30. David operates a successful boutique clothing design and manufacture business, which supplies several independent retail stores across Australia. In recent income years the business has made tax profits.

31. During a number of months in the 2020–21 income year, a series of government-imposed COVID-19 restrictions limited David's ability to manufacture and supply clothes to his customers. David's business activity made a loss in that year.

32. David's other taxable income and net investment losses were greater than the income requirement of \$250,000.

33. In this case, while David's business activity was affected by special circumstances outside his control and the business made a loss, David is not eligible to apply the safe harbour because he did not meet the income requirement. However, David can apply for the exercise of the discretion in the usual way.

Example 5 – COVID-19 – able to carry on the business activity – not eligible to use the safe harbour

34. Bert conducts a share trading business activity, which has made a tax profit in the last income year. The share trading business activity is for his own benefit.

35. In the 2020–21 income year, the values of Bert's holdings fluctuated and he made a loss from his share trading activity. The area where Bert lived was subject to extended periods in government-imposed lockdown due to COVID-19, but this did not prevent Bert from conducting his share-trading business activity as normal. Bert meets the income requirement in the 2020–21 income year.

36. Bert was able to continue his share trading business activity as normal despite COVID-19 and therefore is not eligible to apply the safe harbour.

Commissioner of Taxation

11 May 2022

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Your comments

37. You are invited to comment on this draft Guideline. Please forward your comments to the contact officer by the due date.

38. A compendium of comments is prepared when finalising this Guideline and an edited version (names and identifying information removed) may be published to the Legal database on ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **21 June 2022**

Contact officer details have been removed following publication of the final guideline.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2007/6

Legislative references:

- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(2C)
- ITAA 1997 35-10(2E)
- ITAA 1997 35-25

- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 35-55(1)(c)
- ITAA 1997 35-55(2)
- ITAA 1997 160-5(b)
- ITAA 1997 160-25

ATO references

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subsection 35-10(2E)
Income tax ~~ Tax losses ~~ Non-commercial losses ~~ Other assets test
Income tax ~~ Tax losses ~~ Non-commercial losses ~~ Profits test
Income tax ~~ Tax losses ~~ Non-commercial losses ~~ Real property test

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