

TR 2001/14A7 - Addendum - Income tax: Division 35 - non-commercial losses

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Addendum

Taxation Ruling

Income tax: Division 35 - non-commercial losses

This Addendum is a public ruling for the purposes of the *Taxation Administration Act 1953*. It amends Taxation Ruling TR 2001/14 to clarify the meaning of 'cars, motorcycles and similar vehicles' for the purposes of the Other assets test, the revocation of a reasonable estimate for the purposes of the Assessable income test, partnership assets for the purposes of Real property test, the consequences of a change in ownership for the purposes of the Profits test and the consequences of a Farm Management Deposit withdrawal for the Assessable income test and the loss deferral rule.

TR 2001/14 is amended as follows:

1. Paragraph 1B

After the paragraph; insert:

Interpretation

1C. Unless otherwise stated, all legislative references in this Ruling are to the ITAA 1997.

2. Paragraph 30

(a) Omit footnote 4A; substitute:

^{4A} The operation of the Commissioner's discretion is considered in detail in Taxation Ruling TR 2007/6 *Income tax: non-commercial business losses: Commissioner's discretion*.

(b) Omit 'TR 2006/7'; substitute 'TR 2007/6'.

3. Paragraph 62

After the paragraph; insert:

62A. Where a taxpayer lodges a tax return on the basis of a correctly made reasonable estimate of the assessable income the business activity would have earned for the income year for the purposes of section 35-30, there is nothing contained in the ITAA 1997 that allows a taxpayer to later revoke that reasonable estimate (see **Example 3A** at paragraphs 132A to 132E of this Ruling).

4. Paragraph 63

After the paragraph; insert:

63A. As section 35-35 examines the results and not the ownership of the business activity, a change of ownership in a particular year will not prevent profits from a business activity, made under a previous owner, from being taken into account for the purpose of the Profits test. Consequently, profits from a business activity, made under a previous owner can be taken into account, provided the change in the ownership or the terms and conditions of a sale of the business do not result in a loss of continuity of identity of the business activity (see **Example 6A** at paragraphs 137A to 137D of this Ruling).

Partnership assets for the purposes of the Real property test

63B. For the purpose of applying the Real property test in section 35-40 where a person carries on a business activity as a partner, the values of assets owned or leased by another partner of the partnership that are not partnership assets but are used in carrying on the activity in that year must be ignored (paragraph 35-25(d)).

63C. Where one party provides property for the partnership business and it can be concluded that the property is a partnership asset and that it is used in carrying on the partnership business activity, paragraph 35-25(d) does not exclude the value of the asset from being used by the partner who does not have legal title to the property in determining, for their purposes, whether the Real Property test in section 35-40 is met.

63D. A 'partnership asset' is not defined for the purposes of the ITAA 1997. Whether an asset is a partnership asset is ultimately a question of fact and depends on the agreement of the parties and their acts and intentions (see *Harvey v. Harvey* (1970) 120 CLR 529; *O'Brien v. Komesaroff* (1982) 150 CLR 310; *Kelly v. Kelly* (1990) 92 ALR 74; 64 ALJR 234). For example, where one partner provides property for the partnership business without express agreement, although there had been no formal conveyance of the property, a practice of charging rent for the property would indicate that the premises remains the separate property of that partner (see *Robinson v. Ashton* (1875) LR 20 Eq 25) (see **Example 6B** at paragraphs 137E to 137H of this Ruling).

5. Paragraph 64

After the paragraph; insert:

What is the meaning of 'any adjacent land used in association with the *dwelling' for the Real property test

64A. Paragraph 35-40(4)(a) specifically excludes from the assets that can be counted for the purposes of the Real property test a dwelling, and any adjacent land used in association with that dwelling, that is used mainly for private purposes. The word 'adjacent' was defined in *Murray Goulburn Co-operative Co Ltd v. FCT* 99 ATC 4455; (1999) 42 ATR 34 as 'lying near, close, or contiguous; adjoining; neighbouring'.

64B. The meaning of the term *dwelling in this context is the same as for capital gains tax purposes. While the meaning of that term is set out in the CGT provisions (see section 118-115) this does not mean that section 118-120 has application when applying paragraph 35-40(4)(a). Section 118-120 provides an exemption from CGT consequences where a CGT event happens to land adjacent to a dwelling to the extent that the land is used primarily for private or domestic purposes in association with the dwelling. The maximum area of land covered by the exemption is 2 hectares. However, this exemption is only relevant for the purposes of the 'main residence' exemption under Subdivision 118-B. It does not apply to section 35-40.

64C. As Division 35 makes no mention of a limitation on the area of adjacent land, any area of adjacent land used in association with a dwelling that is used mainly for private purposes will be excluded from the assets that can be counted for the purposes of the real property test (see **Example 6C** at paragraphs 137I to 137K of this Ruling).

What are '*cars, motorcycles and similar vehicles' for the Other assets test?

64D. Whether a vehicle falls within the category '*cars, motorcycles and similar vehicles' depends on the nature of the vehicle. The term 'cars' is defined in section 995-1 as a motor vehicle designed to carry a load of less than one tonne and fewer than nine passengers. It does not include motor cycles or similar vehicles.

64E. The term 'motor vehicle' is then defined in section 995-1 to mean 'any motor-powered road vehicle (including a four-wheel drive vehicle)'.

64F. Therefore, to determine whether a particular vehicle comes within the definition of 'cars' it must be determined whether it:

- is a motor-powered road vehicle (including a four-wheel drive vehicle)
- is designed to carry a load of less than one tonne
- is designed to carry less than nine passengers.

64G. The legislation does not define the meaning of the term 'motorcycle' and so takes on its ordinary meaning.

64H. The Macquarie Dictionary^{9A} defines 'motorcycle' as:

n. a motor vehicle resembling a bicycle, for one or two riders, sometimes with a sidecar attached.

64I. For a vehicle to be 'similar' to a car or motorcycle it does not have to be identical. An item is not required to exhibit all the features of the original to be considered similar (*Galcif Pty Ltd v. Dudley's Corner Pty Ltd* (1995) 6 BPR 14,134; *Goodfellow v. FC of T 77* ATC 4086; (1977) 7 ATR 265) (see **Example 7A** and **Example 7B** at paragraphs 140A to 140R of this Ruling).

6. Paragraph 90

After the paragraph; insert:

90A. When determining if the Exception applies it is necessary to ascertain whether the individual's assessable income from sources that do not relate to the *primary production business activity or *professional arts business activity is less than \$40,000. Consequently this also means that if the individual derives assessable income from other sources that **do** relate to that business activity, it will **not** be taken into account in determining if the \$40,000 threshold is met.

90B. Whether the source of assessable income relates to a business activity is a matter of overall impression. It requires an association or connection between the two but the required extent of that association or connection will depend on the purpose and context of the provision in question (see *Tooheys Ltd v. Commissioner of Stamp Duties (NSW)* (1961) 105 CLR 602, *Secretary, Department of Foreign Affairs and Trade v. Boswell* (1992) 36 FCR 367).

90C. The purpose and context of subsection 35-10(4) do not suggest that any indirect or less than substantial connection between the two will be sufficient. Rather, they point to the relationship between the business activity and the source of the other income needing to be more than a remote one.

^{9A} *The Macquarie Dictionary*, 2001 rev. 3rd edn The Macquarie Library Pty Ltd, NSW.

90D. In the case of *Spriggs v. Federal Commissioner of Taxation*, *Riddell v. Federal Commissioner of Taxation* (2009) 239 CLR 1; 2009 ATC 20-109; (2009) 72 ATR 148 (*Spriggs*), the High Court found that each taxpayer, who was a professional sportsman, carried on a business of commercially exploiting his sporting prowess and reputation for profit and that employment with a club was part of that business.

90E. The High Court said that whether, in relation to any sporting artistic or professional activity, an individual is carrying on a business that includes employment activities as opposed to pursuing activities of unrelated income derivation depends on a 'wide survey and an exact scrutiny' of the individual's activities. It indicated that the contractual framework under which an individual carries out their income earning activities, and the synergy or connection between the various activities, would be relevant in deciding this (see **Example 4A** at paragraphs 133A to 133F of this Ruling).

7. Paragraph 92A

Omit the last sentence; substitute:

It was held at paragraph 31 that '[i]f the starting point or source of the assessable income must be the business activity ..., [then] the extent and nature of that business activity must be identified ... [to] determine whether or not particular income is 'from' it'.

8. Paragraph 92C

After the paragraph; insert:

92D. Farm Management Deposits¹⁵ (FMDs) are designed to allow primary producer taxpayers to carry over income from years of good cash flow and to draw down on that income in years when the cash flow is needed.¹⁶ It is also a requirement of FMDs that the taxpayer be carrying on a primary production business in Australia or the deposit must be repaid to the taxpayer.¹⁷

¹⁵ The term 'Farm Management Deposit' is defined in subsection 393-20(1).

¹⁶ Refer to section 393-1.

¹⁷ Refer to Item 11 of the table in section 393-35.

92E. In relation to the assessable income that arises as a result of the withdrawal of a FMD,¹⁸ the Commissioner accepts that where the FMD deposit was funded by the primary production business activity and the withdrawal occurs while that same business activity is conducted, the extent and nature of the business activity is such that the relationship between that assessable income and the conduct of the business means that the assessable income will be from the business activity for the purposes of Division 35 (see **Example 5A** at paragraphs 136A to 136D of this Ruling).

9. Paragraph 132

After the paragraph; insert:

Example 3A – Assessable income test – revoke ‘reasonable estimate’

132A. Laura resigned from her job and commenced a green grocer business activity in the new local shopping centre in June 2012. Laura made a loss from this activity in the 2011-12 income year. The assessable income from the business activity for the period 1 June to 30 June 2012 was \$6,000.

132B. Laura made a reasonable estimate of assessable income that would have been derived from the business activity had it been carried on throughout the 2011-12 income year by considering such factors as:

- (a) the amount that could have been derived for the full income year based on a pro rata calculation of the assessable income already derived for the month of June, that is, \$6,000
- (b) the cyclical nature of the taxpayer's business activity which may result in variations in the pattern of receipts
- (c) the type of business activity undertaken, considering the nature and type of income receipts of similar activities typical of the industry.

132C. Based on a pro rata calculation of \$6,000 per month for a full income year and given the nature of the business activity, Laura made a reasonable estimate of assessable income of approximately \$72,000 for the 2011-12 income year. On that basis Laura's business activity met the requirements of paragraph 35-30(b). Subsequently Laura lodged her 2011-12 income tax return for the year and included the income and deductions from the business activity.

¹⁸ Refer to section 393-10 for assessability on repayment of deposit.

132D. In the 2012-13 income year the green grocer business made assessable income in excess of \$200,000. Laura requested an amendment to her 2011-12 income tax assessment on the basis that the reasonable estimate should be revoked and that the Assessable income test should now be considered not to have been satisfied. The purpose of the amendment was to enable Laura to claim the loss previously claimed in the 2011-12 income year against assessable income in the 2012-13 income year.

132E. However, at the time Laura lodged her 2011-12 tax return the information it contained was correct and there is nothing contained in the ITAA 1997 that allows Laura to revoke the reasonable estimate made for the purposes of section 35-30. Consequently, Laura's amendment request was refused.

10. Paragraph 133

After the paragraph; insert:

Example 4A - *Professional Arts businesses Exception

133A. Eric is an individual who has carried on a 'professional arts business', as defined in subsection 35-10(5), for some years. Otherwise allowable deductions attributable to this *professional arts business activity exceeded assessable income from the activity for the income year.

133B. During the income year Eric was also employed as a lecturer in art at a tertiary institution. Eric's conditions of employment required him to undertake suitable research on an ongoing basis. This requirement could be met by the production and exhibition of works as a professional artist. Eric satisfied the research requirement by continuing to carry on a business as a professional artist. Eric's assessable income for the income year from employment as a lecturer in art was more than \$40,000 and he also satisfied the income requirement in subsection 35-10(2E) for the income year. He wishes to know if his professional arts business activity is exempted by subsection 35-10(4) from the loss deferral rules applying.

133C. Eric's employment, as a source of assessable income, is only indirectly and less than substantially related to their professional arts business:

- whilst the activities conducted by Eric as part of the professional arts business may be relevant for employment purposes, the employment is not relevant for the purposes of the professional arts business;
- different types of contract are used in the production of the assessable income from the two different sources, with different terms and conditions;

- different assets are used in producing the different types of assessable income;
- the nature of the income from the two sources is different (on the one hand, salary or wages are derived under a contract of service; on the other hand, business income from the sale of art is derived under contracts for the sale of goods); and
- the level of risk attaching to whether income will be derived from either source is different and unrelated.

133D. As a matter of overall impression, the assessable income from Eric's employment is from other sources not related to his professional arts business. Therefore Eric's professional arts business is not exempted from the loss deferral rule applying because his assessable income from sources not related to his professional arts business is greater than \$40,000.

133E. Eric's situation is distinguishable to that of the taxpayers in *Spriggs*. Unlike the arrangements in *Spriggs*, Eric's contract of employment is solely a contract of employment between the taxpayer and the tertiary institution. It is not a broader contract involving additional parties that provides for the carrying on of other income-producing activities as well as the employment activities. There is no necessary connection effecting a clear 'synergy' between the employment as an art lecturer and the conduct of the professional arts business.

133F. The amount of the employment income is therefore taken into account in determining whether the \$40,000 threshold in subsection 35-10(4) is exceeded.

11. Paragraph 136

After the paragraph; insert:

Example 5A – assessable income from the business activity - farm management deposits

136A. Anura carried on a primary production business activity within Australia for the whole of the 20014-15 income year.

136B. In the 2012-13 income year Anura made a valid farm management deposit (FMD) in accordance with Subdivision 393. The funds for this deposit were from the operation of the particular primary production business activity. In the 2014-15 income year Anura made the decision to have the FMD repaid and this resulted in an amount being included in Anura's assessable income for that income year by section 393-10.

136C. Anura wishes to know if the assessable income that arises as a result of the operation of section 393-10, because the FMD is repaid, is assessable income 'from' the business activity when:

- (a) applying the loss deferral rule in Division 35, in subsection 35-10(2); and/or
- (b) determining whether the Assessable income test in section 35-30 has been satisfied?

136D. On the facts of this particular case, the Commissioner accepts that the extent and nature of Anura's business activity is such that the relationship between the assessable income resulting from the FMD repayment and the conduct of the business means that the amount is assessable income 'from' the business activity for the 2014-15 income year. Therefore Anura can take this assessable income into account for the purposes of applying the loss deferral rule in subsection 35-10(2) or determining whether the Assessable income test in section 35-30 has been satisfied.

12. Paragraph 137

After the paragraph; insert:

Example 6A – Profits test – change in ownership

137A. Cathy purchased a primary production business from a family trust part way through the current income year.

137B. The family trust had made profits in the four previous income years, prior to the change of ownership, as the sum of the deductions attributable to the activity was less than the assessable income from it for each of those four previous income years.

137C. Although Cathy continued to carry on the business in the manner it was conducted by the family trust, she made a loss from the business activity for the current income year.

137D. However, as the change in ownership did not result in a loss of continuity of identity of the business activity, Cathy is able to take into account the profits made under the family trust for the purposes of the Profits test to determine whether the deferral of losses rules in section 35-10 applies in her circumstances.

Example 6B – Real property test – partnership asset

137E. The Darryl and Peter Partnership operate a business activity.

137F. Darryl has sole legal title to the land that is used exclusively in carrying on the partnership business activity. He does not charge the partnership rent for use of the land.

137G. In this case, as Darryl is using the land exclusively for the partnership business and is not charging the partnership rent for the use of the land it would be reasonable to conclude that Darryl is treating the property as a partnership asset.

137H. As it can be concluded that the property is a partnership asset, and that it is used in carrying on the partnership business activity, paragraph 35-25(d) does not exclude the value of the asset from being used by Peter, ie. the partner who does not have legal title to the land, for the purposes of the Real property test to determine whether the deferral of losses rules in section 35-10 applies in his circumstances.

Example 6C – Land adjacent to dwelling for the purposes of the Real property test

137I. Anura carries on a business activity of mixed farming on 20 hectares of land which she owns. She uses one hectare for private purposes comprising her private dwelling, tennis court, swimming pool and gardens. Anura uses the other 19 hectares on a continuing basis solely for the mixed farming business activity.

137J. While the total area of land is 20 hectares, as Anura's dwelling and adjacent land used solely for private purposes in association with that dwelling is one hectare, the one hectare of land cannot be counted for the Real property test.

137K. However, the apportionment rule in section 35-50 will apply in relation to the remaining 19 hectares of land that is used for the purpose of carrying on the business activity.

13. Paragraph 140

After the paragraph; insert:

Example 7A - motorcycles and similar vehicles for the purposes of the Other assets test

140A. Julie conducts a business activity of beef cattle grazing. She currently owns an Ag-Bike which is used when she checks on the cattle. While the Ag-Bike is useful for this purpose she is considering purchasing an All-terrain vehicle (ATV), a four wheel motorcycle, for the extra stability that is provided by having four wheels and would like to know if both machines are able to be counted for the Other assets test in section 35-45.

140B. Ag-Bikes are motorcycles with special heavy duty features to make them suitable for farm use. Some Ag-Bikes can also be registered for on-road use. Ag-Bikes are considered to be motor cycles within the ordinary meaning of that term and therefore come within the category of '*cars, motorcycles and similar vehicles'.

140C. ATVs are commonly referred to as three-wheeled and four-wheeled motorcycles. This is because they share a number of features similar to two-wheeled motorcycles such as:

- ATVs have similar engines, transmissions and brakes to two-wheeled motorcycles
- ATVs are designed and manufactured by two-wheeled motorcycle manufacturers
- ATVs are sold by motorcycle dealers.

140D. It is therefore considered that ATVs fall within the category 'cars, motorcycles and similar vehicles' in paragraph 35-45(4)(b).

140E. Accordingly, Julie is not able to include the value of the Ag-Bike and ATV for the purposes of the Other assets test in section 35-45.

Example 7B - cars and similar vehicles for the Other assets test

140F. Ashley conducted a business activity of building rally cars for sale during the 2014 income year. The vehicles are individually built to suit customer requirements or constructed and held in stock. The vehicle is based on a sedan passenger car platform. In the car's standard passenger sedan form, the vehicle satisfies the definition of the term 'car'.

140G. To build a rally car, a passenger car is modified by having the rear seat removed, which means that the vehicle can only accommodate two passengers including the driver. The vehicle's passenger protection is also enhanced (roll cage etc) and engine modifications are carried out to improve the vehicle's performance. These rally vehicles are generally only driven on public roads that are closed to the public.

140H. Ashley had one of these rally cars in stock at the end of the 2014 income year.

140I. The rally car is an item of trading stock¹⁹ whose value can be included for the Other assets test unless specifically excluded by subsection 35-45(4). Subsection 35-45(4) specifically excludes '*cars, motor cycles and similar vehicles' from being counted for the test.

¹⁹ The term 'trading stock' is defined in subsection 70-10(1).

140J. Whether a vehicle satisfies the definition of '*cars, motor cycles and similar vehicles' and is excluded, depends on the nature of the vehicle. That is, whether the vehicle in question satisfies the relevant definitions, or ordinary meanings of the relevant terms, as the case requires.

140K. The critical issue in this case is whether rally cars are '*cars, motor cycles and similar vehicles' for the purposes of paragraph 35-45(4)(b). The term 'cars' is defined in section 995-1. A 'car' is a motor vehicle designed to carry a load of less than one tonne and fewer than nine passengers. It does not include motor cycles or similar vehicles.

140L. The term 'motor vehicle' is then defined in section 995-1 to mean 'any motor-powered road vehicle', including a four-wheel drive vehicle.

140M. Therefore, to determine if a rally car comes within the definition of 'cars' it must be determined whether the rally car:

- is designed to carry a load of less than one tonne;
- is designed to carry less than nine passengers; and
- is a motor vehicle;
- or is a vehicle similar to 'cars'.

140N. When a vehicle is modified, the modifications will need to be significant, not easily reversed and fundamentally change the vehicle to remove it from the classification of 'cars, motor cycles and similar vehicles' for the purposes of section 35-45.

140O. Where a vehicle, that is a derivative of a car, has undergone significant modifications, it may be necessary to assess on a case by case basis, whether the vehicle is a 'similar vehicle' for the purpose of paragraph 35-45(4)(b). Each case would need to be determined on its individual facts, as not all modifications will affect the nature of the vehicle (Miscellaneous Taxation Ruling MT 2033).

140P. A car modified for rallying will remain a car or similar vehicle. This is because the modifications for the purpose of Division 35 will need to extend beyond changing the function of the vehicle, to altering the fundamental design of the vehicle.

140Q. Even though Ashley's rally car is only used on closed public roads and there have been some modifications to the vehicle, the nature or fundamental design of the vehicle has not changed. The rally car is:

- designed to carry a load of less than one tonne;

- designed to carry less than nine passengers; and
- is a motor vehicle;
- or is a vehicle similar to 'cars'.

140R. Ashley's rally car satisfies the definition of 'cars, motor cycles and similar vehicles' in paragraph 35-45(4)(b) and as a result, is an asset that cannot be counted for the other assets test.

14. Detailed contents list

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15. Related Rulings/Determination

Omit:

TR 92/1; TR 97/11; TR 97/16; TR 2000/17; TR 2007/6;
TR 2005/1

Substitute:

TR 92/1; TR 97/11; TR 97/16; TR 2000/17; TR 2003/3;
TR 2005/1; TR 2006/7; MT 2033

16. Legislative references

Insert:

- ITAA 1997 35-45(4)(b)
- ITAA 1997 70-10(1)
- ITAA 1997 118-120
- ITAA 1997 Subdiv 393
- ITAA 1997 393-1
- ITAA 1997 393-10
- ITAA 1997 393-20(1)
- ITAA 1997 393-35
- New Business Tax System (Capital allowances-Transitional and Consequential) Act 2001

17. Case references

Insert:

- Harvey v. Harvey (1970) 120 CLR 529
- Kelly v. Kelly (1990) 92 ALR 74; 64 ALJR 234
- Murray Goulburn Co-operative Co Ltd v FCT 99 ATC 4455; (1999) 42 ATR 34
- O'Brien v. Komesaroff (1982) 150 CLR 310
- Robinson v. Ashton (1875) LR 20 Eq 25
- Secretary, Department of Foreign Affairs and Trade v. Boswell (1992) 36 FCR 367
- Spriggs v. Federal Commissioner of Taxation, Riddell v. Federal Commissioner of Taxation (2009) 239 CLR 1; 2009 ATC 20-109; (2009) 72 ATR 148
- Tooheys Ltd v. Commissioner of Stamp Duties (NSW) (1961) 105 CLR 602

This Addendum applies on and both before and after its date of issue.

Commissioner of Taxation

17 December 2014

ATO references

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