FACT SHEET

Non-Commercial Losses

What is a Non-Commercial Loss?

A non-commercial loss is basically any loss you incur, either as a sole trader or in partnership, in a business that is secondary to your main source of income. The term "business" generally encompasses any activity that results in the carrying on of an enterprise with the intent of making a profit. This includes any profession, trade, vocation or calling. Holding passive investments does not constitute a business therefore investment losses are excluded from the definition of non-commercial losses.

Specific legislation exists to limit the instances in which you can offset non-commercial losses against your primary source of income. These rules were introduced to limit the attractiveness of maintaining unprofitable businesses which provide lifestyle or other non-cash benefits as well as the tax advantage of the losses themselves.

When can a Non-Commercial Loss be deducted?

From 1 July 2009, you can only offset the loss generated by a non-commercial business activity against other sources of income if either:

- Your business activity is classified as primary production or professional arts and assessable income from other sources excluding capital gains is less than $40,000
- You meet the income test and one of the four non-commercial loss tests referred to in detail below
- The Commissioner has exercised his discretion to allow you to offset the loss, or
- The business loss is solely the result of claiming a deduction claimed under the small business and general business tax

As indicated above, you can offset your non-commercial business loss against other income provided your adjusted taxable income[1] is less than $250,000 and you meet one of the following four tests:

- Assessable income test: assessable income (including capital gains) in the year of the loss must be greater than $20,000. If the business activity either started or ceased during the year, you may make a reasonable estimate of what would have been the annualised assessable income for the purposes of this test
- Real property test: the total value of real property (or interests in real property) used on a continuing basis in conducting the business activity exceeds $500,000
- Profits test: the business activity must have yielded a profit in at least 3 of the last 5 years, up to and including the current year
- Other assets test: the total value of other assets used on a continuing basis in the business activity must be greater than $100,000. This excludes real property (already subjected to its own test) and motor vehicles but includes the likes of trading stock, plant and equipment and intangibles such as patents

If you do not satisfy any of the above tests, you may apply to the Commissioner requesting he exercise his discretion to allow you to offset your loss on the grounds that:

- Your business activity is affected by special circumstances, such as natural disaster
- Your business activity has recently commenced and there is a substantiated expectation that the activity will meet one of the four tests within a reasonable period relevant to the industry (e.g.: where there is a long lead-up)

1 Adjusted taxable income = taxable income + total business losses + total reportable fringe benefits + reportable superannuation contributions + total net investment losses

Enspira Financial Pty Ltd | ABN 29 611 163 083 | www.enspira.com.au | P: 1300 908 558 | E: info@enspira.com.au |

FACT SHEET

Non-Commercial Losses

What if I fail all of the Non-Commercial Loss tests?

If you fail all of the non-commercial loss tests, you must quarantine your business activity loss in the year it is incurred. That is, you cannot claim a deduction for the loss in the current year and the quarantined amount comes to be regarded as a deferred non-commercial loss. The losses are carried forward for the purposes of being available as a deduction against profits derived from your business activity in future years. There is no time limit for recouping deferred non-commercial losses.

Distinguishing a Business from a Hobby

In closing, it is worth mentioning a few points in relation to hobbies as the distinction between business and hobby can sometimes be blurred. If your activity is a hobby, it is not a business activity. Income earned and expenses incurred in relation to engaging in a hobby are ignored for tax purposes, as are losses incurred in engaging in a hobby. Factors that indicate you may be engaging in a hobby as distinct from a business activity include conducting the activity primarily for recreational enjoyment and having no reasonable expectation of profit or gain from the activity.

What Next?

If you operate a business that you rely on as a secondary source of income, contact your manager or partner at Enspira Financial to discuss how the non-commercial loss rules potentially impact you.

Enspira Financial Pty Ltd | ABN 29 611 163 083 | www.enspira.com.au | P: 1300 908 558 | E: info@enspira.com.au |