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SUBMISSION – The Board of Taxation

Post-implementation Review of the Quality and Effectiveness of the Non-commercial Losses Legislation

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1.0 Introduction

The purpose of this submission is to provide comments to the Board of Taxation "the Board" in its post-implementation review of Division 35 of the Income Tax Assessment Act 1997 ("ITAA 1997").

1.1 Aim

The aim of this submission is to provide the Board opinions on the quality and effectiveness of the non-commercial losses legislation in Division 35 of the Income Tax Assessment Act 1997

2.0 Specific Comments

The writer has identified the following concerns, which he believes the Board should be addressing in its post-implementation review. It must be noted this submission reflects the views of the writer only and may not correspond to the views held by Lowenstein Sharp on the subject matter.

2.1 Section 35-10(4) and (5) - $40,000 Exception

Section 35-10(4) provides an exception to the Div 35 rules. It applies where there is a primary production business or a professional arts business, in that the tests do not have application where the assessable income of the taxpayer from sources other than the above business activities are less than $40,000.

The concern lies in the effectiveness of the exception in assisting these business activities. The intention of the legislation was to assisting small primary producers or professional arts businesses (narrowly defined), who find it necessary to support themselves through moderate amounts of off-farm/non-arts income (particularly during periods of hardship), while genuinely, at the same time, seeking to pursue their farm/arts activities on a commercial basis.

However, s.35-10(4)(b) is legislated at a fixed amount of $40,000, and is not adjusted to account for inflation, ie the "rising costs of living" unlike some other areas of the taxation system, which are indexed or subjected to regular review and adjustment. Taking the focus from an arts perspective, the prosperity of a nation is not only measured by quantifiable wealth, but also measured by the richness and diversity of its art culture and its effects on the society and the nation, to its portrayal to other

nations. The threshold of $40,000 has the unintended consequences of a substantive nature, that of ignoring the rising costs of living, particularly that of home ownership and the associated inner suburban rental property costs, which are also areas where we are witnessing pockets of thriving and flourishing arts 'enclaves'. In legislating a fixed ceiling of $40,000 without recourse to regular review and adjustment is to subject the artists of our nation to be potentially both income and asset poor. Overtime, the severity of this unintended impact of the threshold will be more gravely felt by those whose measure of prosperity is not defined purely by material wealth or richness in commerical terms.

It is recommended that the Board must provide 'certainty' in its assistance to both the farming/arts business individuals and broaden the narrow definition of professional arts business. This is to achieve the intent as stated in the Second Reading Speech accompanying the New Business Tax System (Integrity Measures) Bill 2000, and by providing as a minimum, an adjustable threshold which takes into account the rising costs of living.

2.2 Section 35-55 - Commissioner's Discretion

Section 35-55 provides where there are special circumstances demonstrating it would be unreasonable to apply Div 35 rules, the Commissioner of Taxation has the discretion to recognise the losses in that year, such as natural disasters and the required lead time in the start-up of business.

However, having had experience in assisting taxpayers who wish to make use of the discretion, via the completion of the specified "s35-55 application for a private ruling". The amount of information, details and time involved in completion the applications properly often are enormously large when compared with the scale of the business activities in question. In my experience, taxpayers were found to baulk at, be disheartened and confused by the level of information/details required. Also, fees charged by tax advisers in providing assistance in completing the application form and satisfying the "evidential burden", eg independent evidence of a lead time were seen as unrealistically high when measured against the potential benefits that were being sought, and with no guarantee of the discretion being granted. With experiences first hand, I have witnessed individuals of start-up businesses, unable to overcome the costs, time, stress and confidence of completing the application and in furnishing the required 'detailed' information, later decided to withdraw/discontinue their private ruling applications. However, it is submitted a fair number of these business activities were genuine and were worthy of being reviewed had the taxpayers persisted with their applications.

It is recommended the Board must review the private ruling application form and streamline its size and content, with the aim of making it more simple, workable and manageable in terms of compliance. It should also re-assess/relax the onus of the taxpayer in providing independent industry evidence regarding commercial viability and lead time, where such information may be more easily gathered/sourced from within ATO or from the Australian Bureau of Statistics.

2.3 Section 35-45 – Other Assets Test

This section covers the "fourth" test in Div 35, which requires the taxpayer to have other assets worth at least $100,000 on a continuous basis for use in the business activity.

The concern with passing this test is that the $100,000 threshold is based on depreciable/leased assets. Not all business activities are characterised by the investment of assets in order to engage in them successfully. Therefore, this test and the related real property tests are biased towards the "assets-loaded" business activities. Further complicating this problem is that the other assets test is based on the assets "written down values". Potentially, a start-up business may have satisfied this test, but in future years, the written down values may render the test to be failed, ie beneath the $100,000 threshold.

Given the focus of this test is by measuring the assets being used on a continuous basis in carrying on the business activity (as opposed to their depreciable or potential sale values), it is recommended the test would be more fairly employed by having the value of the assets measured at their original acquisition costs and not their written down values. These original acquisition costs of the assets are maintained in calculating the threshold for this test as long as the earlier of either the effective life of the assets or the disposal of the assets. By adapting to this alternative method of measurement, it is submitted this better reflects the underlying intention of this test, ie the "use" of the assets.

3.0 CONTACT DETAILS

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