

From: Peter O'Brien [pobrien@hogglawson.com.au]
Sent: Friday, 20 February 2004 5:51 PM
To: postimplementationreviewncl@taxboard.gov.au
Subject: Non Commercial Losses Legislation Review

Dear Sir,

I wish to place before the review committee what I consider to be an error in the drafting of the legislation which places unintended hardship on taxpayers who seek to rely on the special circumstances discretion available to the Commissioner.

The Taxation Office interpretation of the discretion available under the non commercial losses legislation is that as the legislation applies to losses incurred from the year ended 30 June, 2001, only special circumstances that effect the years from 30 June, 2001 onwards will be taken into account.

There are 4 tests that can be applied to determine if the loss can be immediately deductible. Three of these tests relate solely to activities that occur in the loss year ie

- 1) Assessable income of more than \$20,000, or
- 2) Real property used in the business of more than \$500,000, or
- 3) Other assets used in the business activity of more than \$100,000.

The fourth test requires a taxable income to be derived from the business activity in at least three out of the last five years (including the current year). This is the only test that requires the results of the business activity in years prior to the commencement of the legislation to be taken into account in determining if the test is passed or not.

Notwithstanding this requirement to 'look back' prior to the introduction of the legislation the Taxation Office has taken the view that the special circumstances discretion will either only be considered when the special circumstances occur in years from 30 June, 2001 onwards or the special circumstances that occur in years prior to 30 June, 2001 have an effect on the loss arising in the current year. In other words the special circumstances must impact on a year after the introduction of the legislation.

The problem appears to be in the drafting of the legislation in that the section dealing with the special circumstances discretion refers back to the section dealing with the deferral of losses and does not refer back to the sections dealing with the four tests. As the deferral of losses section only applies from 30 June, 2001 onwards their position is that the special circumstances discretion can also only apply to years from 30 June, 2001 onwards.

The unintended consequence of this drafting is best explained from a real situation in which a client has found herself:

Mrs X conducts a business of lecturing under the general title of "English Lecture Series". The content of these lectures can vary considerably as there can be components of old English, Latin, Old French, and old Norse languages depending on the particular topic she has chosen for a particular set of lectures. Her area of expertise is a specialist area, that of Early English (Old English or Anglo Saxon, and Middle English).

She has conducted such a business since approximately 1985. Prior to this time she was employed by a University to conduct lectures of a similar nature.

She normally conducts 3 courses during each financial year. They are usually arranged for the months of June/July, September/October and March. These courses are conducted over a 4 week period and are held on a Wednesday. It takes approximately 6 weeks preparation time prior to each lecture. The lectures are held between 10.00am and 12.00pm and the content of the morning's session is then repeated at a lecture held on the same day between 7.00pm and 9.00pm for people unable to make the morning lecture. The lectures are held at rented premises and Mrs X incurs the cost of advertising upcoming lectures to attract clients.

Her trading results from this business for the last 5 years are set out below:

1998 (4,520) loss
1999 824 profit

2000 (393) loss
2001 457 profit
2002 (13,005) loss

The loss in 2002 is primarily caused by conference fees paid in relation to a business related conference titled '10th Conference of the International Society of Anglo-Saxonists'. Mrs X has all the necessary documentation to support the claim for these conference costs and they are clearly related to her business activities.

She has derived a profit in 2 out of the last 5 years. The minor loss in the 2000 year was caused by special circumstances occurring which resulted in her being in a position to offer only 1 course in that financial year which occurred in March, 2000. This caused her gross income in 2000 to decline by 79% compared to her 1999 gross income. Her 2001 gross income increased by 208% compared to the 2000 year.

The spouse of Mrs X, Professor Emeritus Y, suffers from dementia and is in a nursing home. Mrs X attends the nursing home at lunchtime to feed her husband and spends a number of hours each night feeding him, talking and reading to him. This information is provided as general background.

The special circumstances consist of the following:

The Professor was hospitalised in early March 1999 and returned to hospital two more times between March and July 1999 following complications from the initial treatment. Mrs X is committed to caring for her husband and the stress caused by these hospitalisations and the attitude of the Doctor attending the third hospitalisation was sufficient to prevent Mrs X producing more than one series of lectures in the 2000 financial year. On the third hospitalisation Mrs X had to fight for adequate medical treatment to be given to her husband as the attending doctor (a locum) and the Professor's children by a former marriage all opposed her wishes, which, nevertheless, prevailed

Once returned to the Nursing Home, the Professor's care plan had to be adjusted and, during the ensuing months, both Mrs X and the nursing staff had to adopt new procedures with regard to wheel chair transport, dietary and feeding arrangements. This new regime required careful monitoring on the part of both staff and Mrs X as the principal carer. Mrs X spent increased time in both attendance and supervision to ensure the success of the adaption to the new care plan.. This has weighed heavily on the mind of Mrs X and she suffered from exhaustion as each day was a struggle to attend to the requirements of the new care plan. These special circumstances were a direct cause of her being unable to prepare and conduct a lecture series until March 00. We note these circumstances were special in that they were one off and have not been repeated.

It is our submission that if it were not for the special circumstances occurring that the assessable income derived in the 2000 year would have been increased, due to the holding of 2 additional lecture series, to such an extent that the business would have generated a net profit as it did in the previous year and the subsequent year, thereby satisfying the 3 out of 5 year net profit test. The example quoted in Taxation Ruling 2001/14 at Example 12 A can be distinguished from Mrs X as in that example the taxpayer who became ill had not generated profits in the business in prior years.

We submit that the intention of the legislation was to allow the Commissioner to exercise his discretion to not apply the deferral of losses rule when special circumstances occurred in a year prior to 30 June, 2001 which resulted in the 3 out of 5 year profit rule being failed in 2002.

When the test requires you to 'look back' prior to the introduction of the legislation it is ridiculous to argue that special circumstances that occurred in 2000 cannot be the subject of the Commissioners discretion because it didn't occur in 2002 or it didn't have an effect on the loss incurred in 2002 – the special circumstances in 2000 which caused the small loss directly resulted in the taxpayer failing to satisfy the profits test in the 2002 loss year.

We have obtained permission from the Taxpayer involved to provide her personal details if this is required to properly consider this submission. She is unable to afford the costs of an appeal against the adverse Private Binding Ruling decision which issued to her in the January, 2004. She is also unable to afford our costs in this matter so our time is being supplied gratis due to the obvious inequity of the situation.

Please do not hesitate to contact this office if you require further information. Your comments on this matter would be appreciated.

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Celebrating 50 Years

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