Non Commercial Loss

SENIOR ACCOUNTANT TRAINING



What is Non-Commercial Loss



A Loss which is incurred as a sole trader or in partnership.



From a business activity which is not related to **primary source of income**.



Can not offset this non-commercial loss against other income if that other income does not have a **significant commercial purpose or character**.



Can only defer the loss until a profit is made from business activity.

Some Examples of Non-Commercial Losses

- A small hobby farm that earns little income but has high running costs.
- A craft or art business that hasn't made consistent profits.
- A consulting venture that hasn't yet reached commercial scale.

Parameters for losses to be offset or deferred

- Must be in **business activity.**
- Carrying **more than one business activities** and they are similar in nature, can offset losses against income from other similar business.
- **Expected Activity**

  1/ loss making business is in primary/non-primary production or in professional arts

  2/ Assessable income from other sources(apart from what mentioned above) is less than $40,000(excluding any net capital gain)
- **Less than $250,000 requirement**

  1/ The total of your taxable income, reportable fringe benefits, reportable super contributions and total net investment losses **must less than $250,000 for you to be eligible to offset your losses in the current year.**

Requirement is $250,000 or below and not the other way around

- If and only if adjusted assessable income is less than $250,000, assesse has to proceed for four test.
- If adjusted assessable income is more than $250,000, then there is **no need to go** for four test. The assesse has to defer the non-commercial loss for future years.

Parameters for losses to be offset or deferred

- **Four Tests**(**APRO** Test)
  - 1/ **A**ssessable Income Test
  - 2/ **P**rofit Test
  - 3/ **R**eal Property Test
  - 4/ **O**ther Assets Test

- **Commissioner Discretion**

1/ special circumstances outside your control that have prevented you passing one of the four tests OR

2/ because of the nature of the business, there is a lead time before your business can pass one of the four tests or make a profit.



Assessable Income Test:

- ❑Assessable Income from business activity during FY must be **at least $20,000**
- ❑Assessable Income includes both ordinary income such as gross earnings of business activity as well as statutory income such as capital gain etc.
- ❑Part year trading- below 1 year in business
- ❑Making reasonable estimates and assessable income is greater than $20,000



Four Tests

Profit Test

- Business made tax profit in **3 out of past 5 years** (including current year)
- Business made tax profit for 3 years(not necessarily to be **consecutive**) it will pass profit test for next 2 years regardless of whether it makes a loss.
- Profit test is purely based on **financial position** of entity and not **on ownership**.
- Ownership can be changed but profit or loss can not

Example: Profits Test

Example: profits test

Nguyen buys an orange orchard from Steve as a going concern on 1 July 2017. At the end of the 2018 financial year, Nguyen's business has produced a $7,500 tax loss. The business records show that in the previous years, the orchard produced tax profits and losses:

- 2017 – $17,500 profit
- 2016 – $15,000 profit
- 2015 – $4,000 loss
- 2014 – $16,000 profit.

Nguyen needs to include the 2018 financial year when examining the profits test. In the period 2014 to 2018, 3 years have produced a tax profit. Nguyen meets the profits test.

Four Tests

Real Property Test

- **What it is**: Real Property includes 1/ Land 2/ Buildings fixed to the land & 3/ interest such as lease of that property
- **Valuation**: Real Property of at least $500,000 in value shall be used in business activity on a **continuing basis**.
- **Method for ascertainment of value**:

  1/ Reduced Cost Base

  2/ Market Value

- **Can not include value of an asset used:**

  1/ On a short-term basis

  2/ For a one-off task

  3/ through an agreement for intermittent use on an hourly, daily, weekly, monthly or other short-

  term basis.



Other Asset Test

- **What it includes**: 1/ Items of plant or equipment
  2/ Items of trading stock
  3/ assets leased from another entity
  4/ Trademark, patents, copyrights & similar rights

- **What it excludes:** 1/ Real Property Assets or interest in real property asset(already included in prev. test)
  2/ Cars, motorcycles & similar vehicles

- **Value:** Value of **Other Assets** used in business **on a continuing basis** is at least $100,000.

- Must use **same valuation method that is used for valuing income tax**.
  (Exception: Leased Asset Valuation)



Commissioner Discretion

Commissioner Discretion:

1/ special circumstances outside your control that have prevented you passing one of the four tests **OR**

2/ Because of the nature of the business, there is a lead time before your business can pass one of the four tests or make a profit.

Note: Commissioner discretion will only come into picture if the assesse does not pass **any one of above four tests.**

How to Offset Losses

- Subject to fulfillment of conditions listed above, current year losses plus losses from earlier years can be offset against other income in current year.
- No restrictions on whether loss can be offset against foreign or Australian components of income.



Example: How to defer your losses

Example: deferred losses

The accounts of Michael's plumbing business show the following amounts for an income year:

- assessable income $15,000
- deductions $20,000.

Michael also has $3,000 in net exempt income from other sources.

His deferred loss is $5,000 ($15,000 − $20,000).

The amount deferred to future years is reduced by the net exempt income amount to $2,000 ($5,000 − $3,000). Therefore, the amount that can be offset in future years against Michael's income from business activities is $2,000.

Example: How to offset your losses

Example: offsetting deferred losses

Martin has a full time job but also runs a mobile pie van at various sporting grounds on the weekend. His net figures are below.

Year	Assessable income (1)	Allowable deductions (2)	Net (1) – (2)	Deferred deduction from previous year	Deferred deduction for current year
1	$10,000	$11,000	($1,000)	$0	$1,000
2	$14,000	$15,500	($1,500)	$1,000	$2,500
3	$18,000	$17,000	$1,000	$2,500	$1,500
4	$20,000	$22,000	($2,000)	$1,500	$0

In the first year, Martin makes a loss of $1,000 but can't offset this against his other income because he doesn't meet any of the four tests.

In the second year, Martin makes a loss of $1,500. He can't offset this loss because none of the four tests are satisfied. He now has a $2,500 deferred loss to carry forward ($1,500 is added to the $1,000 loss from the first year).

In the third year, Martin makes a profit of $1,000. He can offset $1,000 against the deferred loss. Martin now has a deferred loss of $1,500 ($2,500 less $1,000).

The losses will continue to be deferred until either:

- Martin satisfies one of the four tests and meets the income requirement
- the Commissioner exercises his discretion to allow the loss.

In year four, Martin meets the income requirement as he has assessable income of $20,000. Martin can deduct the $1,500 deferred loss and the $2,000 loss for year 4 against his other income for that year.

Practical Application in XERO

- Need to show in P9- Business Loss Activity Details



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Business loss activity details

Activity	Legal Practice
Industry description and code	Solicitor 6931
Partnership or sole trader	Sole Trader
Type of Loss	Assessable income test
Product ruling year	
Product/Private ruling number	
Deferred non-commercial loss from a prior year	16,503
Net loss amount	222,579