

Non-Commercial Losses Explained

July 2018

Any losses you incur as a sole trader or partnership in business are called "Non-commercial Losses".

If the tests are passed, individual taxpayers can benefit from these losses by offsetting them against other income such as salary and wages, providing an effective way to minimise their taxable income.

Business vs Hobby

One key thing to remember is that not all income producing activities meet the definition of a business for tax purposes. It is important to distinguish between a business and a hobby as losses incurred from engaging with the latter are disregarded.

You generally operate as a business if you:

- Engage with profit making undertaking
- Repeat similar types of activities
- Demonstrate consistency of business size and scale with other businesses in the industry
- Carry out an activity that is planned and organised

Income Test and Objective must be passed

Before you can offset your non-commercial losses, you must:

1. Pass the income test

- The income requirement is passed if the individual has an adjusted taxable income of less than \$250,000. This is calculated as the sum of taxable income (excluding business losses), reportable fringe benefits, reportable superannuation contributions, total net investment losses and any child support that you pay.

2. Pass one of the 4 objective tests

- Your business earned an assessable income of \$20,000 and above
- Your business produced a tax profit in at least 3 of the last 5 years including the current year
- Your business used a real property with a value of \$500,000 and above to carry out the business. A real property includes land, structures such as buildings fixed to the land, interests in the property such as lease of the property. (Note: Any asset or dwelling and adjacent land used for private purposes and short-term basis are excluded from the test.)

- Your business used other assets with a value of \$100,000 and above. These assets include items of plant and equipment, trading stock, assets leased to another entity, trademarks, patents, copyrights and similar rights. (Note: Cars, motorcycles and similar vehicles are excluded from the test)

Exemptions from the tests

If you are an individual engaged with a primary production activity or professional arts business you are exempted from the income and objective tests so long as your other income is less than \$40,000.

Failing the tests

If you failed the above tests, you will not be able to offset your losses against your other income. As a result, your losses will be deferred to future years until you can satisfy the tests.

Request for Commissioner Discretion

You may request the commissioner to exercise their discretion to allow for your losses to be applied if you failed the tests. This is relevant in situations where your losses are attributable to uncontrollable factors namely natural disasters, drought or flooding.

In addition, the commissioner may grant your request if you can successfully demonstrate that your business activity will make a tax profit and satisfy one of the 4 objective tests within a period suitable to your industry.

If you would like to discuss your own situation to determine whether you can offset a loss from your business against your other income, please contact a Nexia Advisor.

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