DEVIL’S IN THE DETAIL: NON-COMMERCIAL BUSINESS LOSSES

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I INTRODUCTION

When the theme for the 2008 Australasian Tax Teachers’ Conference was announced (The Devil’s in the Detail), the author immediately thought of the non-commercial losses provisions. These provisions are contained in Division 35 of the Income Tax Assessment Act 1997 (Cth) (‘ITAA 1997’) and restrict individuals from offsetting losses from non-commercial activities against other income. Division 35 was introduced following the Review of Business Taxation Report, A Tax System Redesigned (‘Ralph Report’). The Ralph Report stated that the primary rationale for this reform was to improve the integrity of the taxation system by restricting loss deductions for hobby style taxpayers. The Report asserted:

Many of these activities are no more than hobbies and/or lifestyle choices but even those that have business like characteristics (according to existing law) are often unlikely to ever make a profit and do not have a significant commercial purpose or character. They continue in a net loss position year after year, offsetting so-called business losses against other income, notably salary and wages. On average they make little or no contribution to the revenue-raising task but gain a significant tax advantage.

The Ralph Report stressed that the consequent leakage of revenue that stemmed from individuals being able to offset losses from such unprofitable non-commercial business activities against other sources of income undermined the integrity of the tax system.

Following on from the Ralph Report recommendations, Division 35 introduces a framework for determining whether losses from a business activity can be offset against other sources of income. Echoing the Ralph Report, s 35-5(1) provides that the object of Division 35 ‘is to improve the integrity of the taxation system by preventing losses from non-commercial activities that are carried on as businesses by individuals (alone or in partnership) being offset against other assessable income.’ The concept underlying Division 35 is, therefore, at first glance very simple – preventing losses from non-commercial activities being offset against other sources of income. The devil, however, is in the detail. Division 35 is highly complex. These complexities permeate every aspect of the legislation, in particular:

- the operation of the loss deferral rule;
- the four threshold tests that prima facie determine the applicability of the loss deferral rule;
- the need to identify and separate a particular business activity;
- the grouping principles;

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2 Ralph Report ibid 295-296.
3 Ralph Report ibid 296. See also Explanatory Memorandum, A New Business Tax System (Integrity and Other Measures) Bill 1999 [1.7]-[1.9]; Taxation Ruling TR 2001/14 [8] and [38].
4 Ralph Report ibid. See also Explanatory Memorandum ibid, Taxation Ruling TR 2001/14 ibid.
• its application to partnerships; and
• the exercise of the Commissioner’s discretion where one of the four threshold tests are not met.

This complexity is reflected in the number and size of the taxation rulings and interpretative decisions that attempt to deal with these principles. Ultimately it is concluded that a simple concept has been masticated by detail.

At other times the devil’s in the lack of detail. A number of the above tests/exceptions are based on the application of undefined terms. Moreover, despite the Ralph Report highlighting the problems with the existing law pertaining to the definition of a business, the legislation also fails to define a ‘business’ or a ‘business activity.’ This again has led to numerous and voluminous rulings and interpretative decisions and the current trickle of cases will undoubtedly increase with time.

Effectively, Division 35 adds another layer of complexity to the existing jurisprudence pertaining to the notion of a ‘business’ which the Ralph Report recognised is a highly uncertain and resource intensive part of taxation law. It is ultimately contended that it would have been preferable for the legislature to have introduced a statutory definition of income that focuses on the common indicia of these hobby style activities identified in the Ralph Report; namely they are ‘unlikely to ever make a profit and do not have a significant commercial purpose or character.’ A statutory definition of business that requires (i) a reasonable prospect of making a profit and (ii) a profit making intent would have addressed the policy concerns expressed in the Ralph Report and simplified the complexity of the notion of ‘business’.

II LOSS DEFERRAL RULE

Division 35 introduces a loss deferral rule, effected through s 35-10(2), that is operative from the 2000-2001 income year. Basically, the s 35-10(2) loss deferral rule provides:

an individual taxpayer;

• who is carrying on a business;
• is prevented from offsetting losses;
• from a particular business activity;
• against the taxpayer’s assessable income from other sources for that income year.

At first glance the operation of the loss deferral appears straightforward. Any loss from the non-commercial business activity is treated as if it was not incurred by the

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5 ibid.
6 ibid.
7 ibid.
8 Explanatory Memorandum ibid [1.3]. See also Taxation Ruling TR 2001/14 ibid [4] and [6].
9 An ‘individual’ means a natural person. See Taxation Ruling TR 2001/14 ibid [33].
10 Division 35 applies to ‘individual taxpayers’, whether acting alone or in partnership: s 35-10(1). See the discussion below as to the application of Division 35 to partnerships.
11 Division 35 is not intended to apply to activities that do not constitute a business, for example, the receipt of income from passive investments: s 35-5(2). As discussed below, the notion of a business is not, however, defined in the legislation.
12 As discussed below, the legislation is not always confined to one single business activity. At times business activities may be grouped: s 35-10(3).
13 As discussed below, the term ‘business activity’ is not defined in ITAA 1997 otherwise that in its unhelpful definition of ‘business’ in s 995-1 ITAA 1997.
individual in that income year, but may be carried forward as a loss: s 35-10(2). Thus losses from a business activity that have been deferred under s 35-10(2) are prima facie quarantined and can only be offset against any profits of the relevant business activity in a future income year: s 35-10(2)(b).\textsuperscript{14}

The carry forward loss may in turn be offset against other income of the individual carrying on the relevant business activity in an income year in which the business activity meets at least one of the four threshold tests, discussed below: s 35-10(1)(a). Alternatively, they may be offset where the Commissioner exercises his/her discretion, discussed below, or the primary production or the professional arts business exceptions apply.

However, this prima facie simple loss deferral rule becomes more complex. What if the income earned from the business activity that now, for example, meets one of the four threshold tests is not sufficient to absorb the carry forward loss? Once one of triggers for allowing the loss offset has been met, any deferred loss from an earlier income year will not again be deferred under Division 35. Accordingly, all losses, including the deferred losses, attributable to an individual’s business activity will be able to be offset against any assessable income of that individual. In effect, the deferred losses are no longer quarantined. Where an individual’s other income is insufficient to absorb all of the losses relating to the business activity, any remaining Division 35 losses will become normal carry forward tax losses. These losses will be treated in the same way as any other carry forward loss under Division 36.\textsuperscript{15} Thus, in effect, once the threshold tests or exceptions apply, the deferred losses are no longer quarantined to the particular business activity.\textsuperscript{16}

What if the business activity does not meet one of the criteria for loss offsetting, but nevertheless makes a profit in a subsequent year of income? In an income year that a business activity has a profit but does not pass, for example, one of the four threshold tests, losses deferred from prior years may be offset to the extent of this profit. Thus the deferred loss is reduced to the extent of that profit. The balance then becomes the Division 35 loss for that income year and is in turn deferred under s 35–10(2).

The loss deferral rule is also modified for an income year if the taxpayer derived exempt income: s 35-15(1). In that case, a loss that would otherwise be carried forward to a future income year under s 35-10(2)(b) is first reduced by the amount of any net exempt income of the individual taxpayer that is not applied for that income year pursuant to ss 36-10 and 36-15. This reduction is made before the individual taxpayer applies the s 35–10(2)(b) amount against assessable income from the business activity: s 35–15(2).\textsuperscript{17}

The loss deferral loss deferral rule is further complicated where there is a cessation of a business activity. First, as noted above, the loss deferral rule applies if the allowable deductions of the non-commercial business activity exceed the assessable income of that business activity for that income year. While the deductible amounts attributed to the business activity include all those amounts that are deductible under Income Tax Assessment Act 1936 (Cth) (‘ITAA 1936’) and ITAA 1997, not just s 8-1 ITAA 1997,\textsuperscript{18} Taxation Ruling TR 2001/14 [57] states that the provisions do not apply to amounts that are incurred after a business activity has ceased. This comment in the ruling relates to those long tail liabilities that continue to be deductible under s 8-1

\textsuperscript{14}Explanatory Memorandum, above n 3 [1.25]-[1.26].
\textsuperscript{15}See also Explanatory Memorandum ibid [1.27]-[1.28].
\textsuperscript{16}See also Explanatory Memorandum ibid [1.22].
\textsuperscript{17}See further Taxation Ruling TR 2001/14 above n 3 [31], [114]-[115], [171] and [172].
\textsuperscript{18}See also Taxation Ruling TR 2001/14 ibid [12].
ITAA 1997 even though they have ‘crystallised’ and become incurred after the cessation of a business within the reasoning in Placer Pacific Management Pty Ltd v FCT.\textsuperscript{19}

Second, the loss deferral rule operates differently where the non-commercial business activity ceases. As noted above, usually, under the loss deferral rule the loss is attributable to the next income year. However, if the business activity ceases, while the loss is carried forward, it only becomes deductible in the income year if, and when, the business activity is next conducted.\textsuperscript{20} If the business activity is not recommenced, the cessation of the business means that any unused deferred losses are effectively forfeited.\textsuperscript{21} The loss deferral rule operates in a similar manner if a business activity is incorporated. If the taxpayer incorporates his/her business, the losses are again forfeited, as the new company cannot use any unused deferred losses. Similarly, a loss that would otherwise have been carried forward under the loss deferral rule cannot be deducted in either the current or a later income year where the taxpayer becomes bankrupt: s 36-20.\textsuperscript{22}

Thus the pivotal loss deferral rule underlying Division 35 is not as simple as it appears at first glance. The devil’s in the detail.

III THRESHOLD TESTS

As noted above, the Ralph Report was concerned with the revenue leakage stemming from activities that are ‘no more than hobbies and/or lifestyle choices.’\textsuperscript{23} Echoing the Ralph Report’s recommendations,\textsuperscript{24} the legislative response underlying Division 35’s framework for deciding what activities would be subject to the loss deferral rule was the introduction of four alternative tests:

- assessable income test;
- profits test;
- real property test; and
- other assets test.

While such tests clearly focus on the profitability and size of the business activity, indicative of the hobby v business dichotomy,\textsuperscript{25} they have been subject to considerable criticism.\textsuperscript{26} They favour large-scale activities that may nevertheless

\textsuperscript{19} (1995) 95 ATC 4459.
\textsuperscript{20} See also Explanatory Memorandum above n 3 [1.21].
\textsuperscript{21} See also Taxation Ruling 2001/14 above n 3 [54] and [131]-[132].
\textsuperscript{22} See also ibid [32], [116]-[117] and [173].
\textsuperscript{23} Ralph Report above n 1, 296. See also Explanatory Memorandum, above n 3 [1.7]-[1.9]; Taxation Ruling TR 2001/14 ibid [8] and [38].
\textsuperscript{24} Ralph Report ibid 294-300.
constitute lifestyle choices and discriminate against small legitimate business. The tests are easily manipulated by especially the wealthy who can, for example, ensure that their hobby farm meets the real property or other assets tests. The assessable income and profits tests can also be manipulated through deferring or accelerating income or expenditure, including trading stock. More importantly in the context of this paper, while at first glance these tests seem decisively simple, they have proven to be otherwise. While this is particularly so when applied to partnerships, as discussed later in the paper, even the basic operation of the tests is uncertain and complicated. Once again the devil’s in the detail.

**A Assessable Income Test**

The loss deferral rule does not apply to a business activity if in the subject income year the assessable income from the business activity is at least $20,000: s 35-30(a). Even the notion of what is the taxpayer’s ‘assessable income’ is complicated under Division 35. This is indicative from the number of relevant interpretative decisions. These provide that the assessable income includes any trading stock brought to account under s 70-35(2): ATO Interpretative Decision ID 2003/279. Similarly, balancing adjustments under s 40-285(1) are included in the assessable income: ATO Interpretative Decision ID 2003/288. Interest from a business account is also included: ATO Interpretative Decision ID 2003/332. Funds repaid from a farm management deposit have been considered assessable income for this purpose: ATO Interpretative Decision ID 2004/112. A Landcare grant has also been considered assessable income: ATO Interpretative Decision ID 2004/262.

The application of the assessable income test is complicated where the taxpayer started, or stopped, carrying on the business activity during the subject income year. Under s 35-30(b) the test is satisfied where a reasonable estimate of the assessable income had the taxpayer carried on the activity throughout the year is at least $20,000. Requiring an ‘estimation’ is of course fraught with uncertainty. How is this estimation to be made? The legislation is silent on the matter. An estimation on a pro rata basis would appear at first glance to be the logical approach where, as here, the business activity is conducted for only part of the year. However, the Explanatory Memorandum suggests that an estimate, rather than a pro-rating, is appropriate where seasonal variations need to be taken into account in determining the assessable income for the income year.

Moreover, the legislation does not identify relevant factors in making such an estimation. This has in turn required supplementary guidance through a public ruling. Taxation Ruling TR 2001/14 [62] states that in making a reasonable estimate, relevant factors include: 

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27 See also Douglas, ibid 390; Kenny ibid.
28 See also Kenny ibid.
29 See also Cooper, above n 26,163.
30 Note under the first test it is the assessable income, rather than taxable income, that is the focus.
31 Explanatory Memorandum, above n 3, [1.31]. See Peterson v FCT (1960) 106 CLR 395 as an example of a seasonal partnership.
• the cyclical nature of the particular business activity that may result in variations in the pattern of receipts;
• any orders received and/or forward contracts entered into;
• the amount that could have been derived for a full income year based on a pro rata calculation of the assessable income already derived for the part of the year. The amount derived for the part of the year must be typical of the income derived in a full year;
• the type of business activity undertaken, considering the nature and type of income receipts of similar activities typical of the industry; and
• current size and investment in the activity.

Despite the undoubted uncertainty underlying any consequent estimation of income, *ATO Interpretative Decision ID 2003/630* states that this estimation is irrevocable.

**B Profits Test**

The loss deferral rule does not apply to a business activity for an income year, if, for each of at least three of the past five income years, (including the current year in which the loss has arisen), that business activity has produced taxable income: s 35-35(1). Once again, while seemingly simple, there are a number of complications incorporated into this threshold test. First, how does the test work when the business activity has been operating for less than five years? *Taxation Ruling TR 2001/14* [62] provides that it is not necessary that the business activity be carried on for five years. It suffices if, for example, a profit is made in three out of four years.\(^{32}\)

Second, to complicate matters more it has been suggested in *ATO Interpretative Decision ID 2003/407* that it is not necessary that the taxpayer conducted the business activity during the years in which the qualifying profits were made. This interpretative decision suggests that where there is continuity in the business activity, the profits made by the prior owner may be taken into account for this purpose. In *ATO Interpretative Decision ID 2003/407* the taxpayer purchased a primary production business from a family trust. Despite the change in ownership, that the family trust had made a profit in the four previous income years enabled s 35-35(1) to be satisfied.

Third, as to the reference to ‘taxable income’, s 35-35(1) provides that this is the amount where the sum of the deductions attributable to the activity for the year is less than the amount of assessable income from the activity in that year. However, in order to ensure that only those amounts that actually arise in a particular year are taken into account, the rule excludes any deferred losses that are deemed to be attributable to the activity for a particular income year by s 35-10(2)(b).\(^{33}\)

**C Real Property Test**

Under the third threshold test, the loss deferral rule does not apply to a business activity for an income year if the total value of real property used in carrying on the business activity in that year is at least $500,000: s 35-40(1). Once again this sounds decisively simple. However, there a number of complications incorporated into the legislation. First, the legislation allows the taxpayer to choose whether to use the value of the real property itself or the value of the interest in the real property.\(^{34}\) Thus a lessee, for example, can choose to use the value of the interest or the value of the underlying property.

\(^{32}\) See further *Taxation Ruling TR 2001/14*, above n 3 [93] and [137].

\(^{33}\) Explanatory Memorandum, above n 3, [1.34].

\(^{34}\) *Taxation Ruling TR 2001/14*, above n 3 [53].
Second, how is the value of the real property to be determined? The legislation allows the use of the market value or the reduced cost base.\textsuperscript{35} The market value of the real property or interest may be used where the market value exceeds the reduced cost base: s 35-40(2).

Third, when is the value of real property determined? Generally the reduced cost base or market value is calculated as at the end of the income year: s 35-40(3)(a). However, once again there is a different rule in the case of a cessation of a business. Where the individual taxpayer ceased carrying on the business activity during the year the valuation date is:

- when the individual stopped the business activity: s 35-40(3)(b)(i); or
- if the individual disposed of the asset before this point but in the course of ceasing the business activity, at the time the individual disposed of the asset: s 35-40(3)(b)(ii).

Fourth, certain assets are excluded from the real property test. Specifically, a dwelling\textsuperscript{36} and any adjacent land used in association with the dwelling, that is used mainly for private purposes (s 35-40(4)(a)) and fixtures owned by the taxpayer as a tenant (s 35-40(4)(b)) are excluded. These exclusions are in turn the subject of a number of rulings and interpretative decisions.\textsuperscript{37}

The reference to fixtures in s 35-40(4)(b) highlights a fifth complication, namely the potential overlap of the real property test and the other assets test. An asset that is fixed to land takes on the quality of the real property and thus potentially could be used under either or both tests. This in turn has required the introduction of reconciliation rules. \textit{Taxation Ruling TR 2001/14} [26] and [27] recognises that the value of some leased assets and depreciating assets can be taken into account under either the real property test or the other assets test, but states that they cannot be used for both. In regard to leased property the ruling states that the ‘general scheme is that an individual with an interest in real property comprised of fixtures owned by them as a tenant, takes the fixtures into account under the other assets test, and not under the Real property test (paragraph 35-40(4)(b)).’\textsuperscript{38} In regard to depreciating assets, the ruling states ‘the general scheme in this case is that where such an asset is part of the real property taken into account for the purposes of the Real property test, then it is not also counted for the Other assets test (paragraph 35-45(4)(a)).’\textsuperscript{39}

Returning to the general operation of the real property test, a sixth complication arises in cases that require apportioning. Section 35-50 provides that if the real property is used during the income year only partly in carrying on the business activity, only that part of the reduced cost base, market value or other value that is attributable to the use of the asset in carrying on the business activity is to be taken into account.

Finally, the real property must be used on a continuing basis in carrying on the business activity: s 35-40(1). ‘Continuing’ is not, however, defined in Division 35. Again this has required subsequent clarification through a public ruling. \textit{Taxation Ruling TR 2001/14} [65] provides the term ‘continuing’ takes on its ordinary meaning. However, as the ruling is primarily concerned with the other assets test, discussed below, it really provides no useful guidance.

\textsuperscript{35} ‘Reduced cost base’ has the same meaning as for capital gains tax under Subdiv 110-B of Chap 3 ITAA 1997: s 995-1 ITAA 1997. See also \textit{Taxation Ruling TR 2001/14} ibid [18].

\textsuperscript{36} ‘Dwelling’ has the same meaning as for the capital gains tax under s 118-115: s 995-1 ITAA 1997.

\textsuperscript{37} See, for example, \textit{Taxation Ruling TR 2001/14}, above n 3; \textit{ATO Interpretative Decision ID 2004/510}; \textit{ATO Interpretative Decision ID 2004/644}.

\textsuperscript{38} \textit{Taxation Ruling TR 2001/14} ibid [26].

\textsuperscript{39} Ibid [27].
D Other Assets Test

The final threshold test, the other assets test, provides that the loss deferral rule does not apply to a business activity for an income year if the total value of assets (excluding real property assets) used in the business activity in that year, is at least $100,000: s 35-45(1). Again this sounds straightforward. However, the application of the threshold test requires a valuation methodology that is applicable to a variety of possible assets. In turn, the table in s 35-45(2) sets out a number of rules that are required to accommodate the various assets that might be included in the other assets test and in turn how to determine their value. Some of the valuation rules appear to be reasonably obvious. For depreciation assets, the written down value of the asset under Division 40 ITAA 1997 is included. However, as Kenny notes, as s 35-45(2) refers to the written down value under s 40-40 ITAA 1997, depreciating assets under other parts of the Act, such as Division 328, are excluded. For trading stock, the value is its value under s 70-45(1) ITAA 1997. For trademarks, patents, copyrights and similar rights, the value is their reduced cost base. This matter becomes more complicated in the case of leased items. Where a taxpayer leases an asset from another entity, the value of the asset is the sum of the amounts of the future lease payments for the asset to which the taxpayer is irrevocably committed, less an appropriate amount to reflect any interest component for those lease payments. Thus the value of the underlying leased asset is not used for the purpose of s 35-45.

The other assets test also shares the same complications as the real property test, detailed above. Thus under s 34-45(3), the other assets test is subject to the same timing rule as the real property rule and is also subject to the above discussed complications when a business ceases. Similarly, apportionment may be required under s 35-50 where the asset is only partially used in the business activity.

Again, the asset must also be used on a continuing basis in the carrying on of the business activity: s 35-45(1). As noted above, ‘continuing’ is not defined in Division 35. Taxation Ruling TR 2001/14 [66] states if an asset is ‘used on a short-term basis for a specific task or a one-off activity’ there will be no continuous use. Similarly, intermittent hiring of property is said not to meet the required degree of usage. Taxation Ruling TR 2001/14 [65] quotes FCT v Stewart[63] to the effect that to be used on a continuing basis there must be more than ‘transient or insubstantial use.’ It is stated in Taxation Ruling TR 2001/14 [66] that this does not mean that an item of machinery used in an ongoing business, but which is only used during certain periods is not used on a continuing basis. The example given is a harvester that is used only during harvest time. Clearly this legislative prerequisite is going to require a case-by-case examination of a taxpayer’s circumstances to determine if usage is sufficiently continuous.

IV IDENTIFYING SEPARATE BUSINESS ACTIVITIES

As noted above, generally Division 35 is concerned with the profits and losses etc of each particular business activity. This in turn requires separating within an overall enterprise any distinct business activities. This is clearly a difficult process that

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40 Cars, motor cycles and similar vehicles are also excluded under s 35-45(4).
41 Kenny, above n 26.
42 Taxation Ruling TR 2001/14, above n 3 [64].
44 See also Explanatory Memorandum, above n 3, [1.17].
involves trying to identify if activities are stand alone businesses that are separate from other business activities that are grouped under a broader umbrella of activity. In turn, the need to separate business activities will also require the difficult process of apportioning profits and expenses between various business activities when applying, for example, the above discussed four threshold tests.  

As the Explanatory Memorandum acknowledged, identifying if activities are in fact separate will require difficult questions of fact and degree. Yet no guidance is provided in the legislation and this has again required clarification through a public ruling. To this end Taxation Ruling 2001/14 [37] states that an activity that forms part of a taxpayer’s overall business will not be treated as a separate business activity for Division 35 purposes unless it is ‘capable of standing alone as an autonomous commercial undertaking.’ Taxation Ruling 2001/14 [41] states that it is also necessary that the separate business activities are ‘capable in their own right of producing assessable income and having attributed to them amounts that would otherwise be deductible.’ Taxation Ruling 2001/14 [43] further states:

[T]o be identified as a separate business activity for Division 35, within the statutory scheme referred to, the activity (or set of activities) will need to exhibit the following:

(i) it produces a loss, in the sense that looked at as a separate activity there is clearly assessable income produced, or intended to be produced, from it, and otherwise allowable deductions attributable to carrying it on in excess of that income (otherwise Division 35 has no relevance);

(ii) its conduct is not motivated by factors connected with supporting in any commercial way the carrying on of the individual’s other business activities; and

(iii) it shows signs in its own right that it is unlikely to ever be profitable.

The application of these factors is clearly going to be complex and uncertain. The ATO’s Non-commercial losses: similar business activities - fact sheet regards the following activities as similar:

- grazing sheep and grazing cattle;
- growing grapes and growing olives;
- manufacturing shirts and manufacturing jeans.

Activities that are said to be dissimilar:

- manufacturing and farming;
- repairing cars and making furniture.

Ultimately, Taxation Ruling 2001/14 [41] states that whether the business activities are so discrete in character and conducted in such a manner so that they are considered to be separate and distinct business activities for Division 35 purposes is a ‘question of fact and overall impression, like the question whether they are carrying on a business.’ Thus the ruling recognises that Division 35 has added another layer to an already complex question ‘whether the taxpayer is carrying on a business,’ discussed below.

V GROUPING ACTIVITIES

While generally Division 35 is concerned with the profits and losses etc of a particular business activity, this is further complicated because at times the

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45 Douglas, above n 26, 389.
46 See also Explanatory Memorandum, above n 3, [1.18]-[1.19].
47 See also Douglas, above n 26, 389; Cooper, above n 26, 162.
49 Ibid.
50 See also Explanatory Memorandum, above n 3, [1.17].
legislation allows business activities to be grouped under s 35-10(3). Grouping can be advantageous to a taxpayer. First, it allows the overall enterprise, comprised of grouped activities, to be adjudged in terms of size and profitability under the four threshold tests, thereby possibly excluding the operation of the loss deferral rule.\(^5\)

Second, it may be advantageous in terms of identifying the ‘next income year in which the activity is carried on’ under s 35-10(2). As noted above, deferred losses can be offset against future income. The grouping rules may bring forward the next qualifying financial year in which the deferred loss can be offset against income. The activity that makes the profit in the later year of income need not be the same activity as that which made the non-commercial loss if they are grouped because they are of a similar kind.\(^2\) Thus, as a consequence of the grouping effect of s 35-10(3), that future income can stem from a grouped activity.

Third, grouping will also be advantageous where a business activity ceases. The taxpayer will continue to be able to offset the loss in the future as long as the taxpayer carries on a business activity of a similar kind.\(^5\) As discussed above, without continuing a similar business activity the deferred loss would otherwise effectively be forfeited.

The s 35-10(3) grouping principle necessitates some determinative factor as to what activities are grouped. Under s 35-10(3) separate and distinct business activities may be grouped where they are of a similar kind. A grouped activity does not have to be ‘of the same kind’, just ‘of a similar kind’.\(^4\)

This begs the question what is sufficiently ‘similar’? This is clearly an amorphous notion that has again necessitated the ‘intervention’ of a public ruling. *Taxation Ruling 2001/14* [50] states as relevant factors:

- the location(s) where they are carried on;
- the type(s) of goods and/or services provided;
- the market(s) conditions in which those goods and/or services are traded;
- the type(s) of assets employed in each; and
- any other features affecting the manner in which they are conducted.

The application of the similar kind test will also depend on how broadly or narrowly each of the business activities is construed. The broader in nature the distinct business activities, the more likely they will have the same or similar characteristics.\(^5\) As the existing jurisprudence regarding the notion ‘normal proceeds’\(^6\) of a business under s 6-5 *ITAA 1997* indicates, there is great uncertainty as to when a court will broadly\(^5\) or

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51 See also *Taxation Ruling 2001/14*, above n 3, [53] and [119]-[122].
52 See also ibid [49], [91] and [130]-[131].
53 See also ibid [54].
54 See also ibid [49] and [85].
55 See also ibid [52]. See further ibid [51]-[53], [85]-[87] and [119]-[129].
56 *Californian Copper Syndicate (Limited and Reduced) v Harris* (1904) 5 TC 159, 165-166; *Australasian Catholic Assurance Co Ltd v FCT* (1959) 100 CLR 502, 509; *FCT v Merv Brown Pty Ltd* (1985) 85 ATC 4080, 4086.
narrowly construe a business. The breadth of the business activities and determining whether they are similar is clearly going to be an uncertain question of fact and degree, determined on a case-by-case basis.

VI PARTNERSHIPS

As noted above, the application of Division 35 is particularly complicated in the context of partnerships. Division 35 applies in relation to ‘individual taxpayers’, whether acting alone or in partnership: s 35-10(1). The consequent complications stem from two core features of Division 35’s application to partnerships. First, as stated in Taxation Ruling TR 2003/3, for the purposes s 35-10(2) it is not the partnership as a whole that is examined, but rather the individual partner’s interests in each business activity. Thus, as discussed below, the application of Division 35 involves more than a consideration of the net partnership income under s 90 ITAA 1936.

Second, the application of Division 35 becomes complex when the individual carries on multiple business activities in a partnership. As a consequence of the need to separate and isolate various business activities, discussed above, the application of Division 35 also involves more than a consideration of an individual partner’s interest in partnership income under s 92 ITAA 1936. The complexities involved as a consequence of these principles is highlighted below in the application of the four threshold tests and the primary production and professional arts business exceptions to partnerships.

A Assessable Income Test

The application of the assessable income test to a partnership is overly complex. The assessable income is that part of the assessable income from the business activity for the year that is attributable to the interest of a partner who is an individual in the partnership net income or partnership loss for the year: s 35-25(b). Under s 35-25(a) the taxpayer may include that part of the partnership’s assessable income attributable to other partners who are individuals, including the taxpayer’s own share. In addition to the amount identified under s 35-25(b) any part of the assessable income from the business activity for the year that is derived from the activity by the individual taxpayer otherwise than as a member of the partnership is included in the assessable income: s 35-25(b).

B Profits Test


Taxation Ruling TR 2003/3, above n 3 [5], [13] and [19].

See also ibid [6] and [19].

Ibid [5].

Explanatory Memorandum above n 3, [1.32].
The application of the profits test is also complicated in the context of partnerships. The profits test is satisfied if for each of at least three of the past five income years, (including the current year) the sum of the individual partner’s deductions attributable to the activity (including his or her share of the partnership deductions) is less than the sum of the individual partner’s assessable income (including his or her share of the partnership’s assessable income) from the activity for that year: s 35-35(2).\(^{63}\) Indicative of the complexity of this rule in the example provided in *Taxation Ruling TR 2001/14*:

Bob and Brendan are partners in a general law partnership which carries on a publishing business and they each receive a $2,000 distribution from it. Bob has no other attributable expenses and the result for him is a profit from the business activity for the income year. … Brendan took out a loan to fund his contribution to the partnership on which he pays interest of $5,000 during the year. Brendan's $5,000 interest expense is attributable to his interest in the partnership net income. Brendan's deductions that are attributable to the activity ($5,000) exceed the income he has derived from it ($2,000). Brendan has a loss for the income year from the activity. If this pattern of income and attributable expenses were to continue for a further two years (years 2 and 3), with the partnership distributing losses to Bob and Brendan in years 4 and 5, Bob would pass the Profits test in years 4 and 5, as when testing for each of those years he would have profits from the activity in three out of the past five years (ie, years 1 to 3); whereas Brendan would not pass the Profits test in any of the five years, as even in the years in which he received a distribution of partnership income, his attributable expenses meant that overall he did not make a tax profit from that activity in any year.

Thus the example highlights the complexities that stem from focusing on individual partners, rather than the partnership as a whole. Here we have a single business, but two different outcomes for the two partners.

### C Real Property and Other Assets Tests

Applying the real property test to partnerships is also complicated. When calculating the reduced cost bases of real property or interests in such, the following amounts only are included:

- any part of the reduced cost bases or other values of assets of the partnership used in carrying on the activity in that year that is attributable to the partner’s interest in those assets: s 35-25(c); and
- any part of the reduced cost bases or other values of assets owned or leased by the individual taxpayer that are not partnership assets but are used in carrying on the activity in that year: s 35-25(d).

The interests in companies and trusts are ignored.\(^{64}\) Similarly, when calculating the value of other assets, only the following amounts are included:

- any part of the reduced cost bases or other values of assets of the partnership used in carrying on the activity in that year that is attributable to the partner’s interest in those assets: s 35-45(4)(c); and
- any part of the reduced cost bases or other values of assets owned or leased by the individual taxpayer that are not partnership assets but are used in carrying on the activity in that year: s 35-45(4)(d).

Again, the interests in companies and trusts are ignored.\(^{65}\)

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\(^{63}\) See also *Taxation Ruling TR 2001/14*, above n 3, [29].

\(^{64}\) Ibid [28].

\(^{65}\) Ibid [28] and [143].
**Primary Production and Professional Arts Business Exceptions**

As the application of the primary production business exception, noted above, is particularly complicated in regard to partnerships and it is primarily addressed in this context. Under s 35-10(4), the loss deferral rule does not apply to a business activity for an income year if:

- the business activity is a primary production business; and
- the taxpayer’s assessable income for that year (except any net capital gain) from other sources that do not relate to that activity is less than $40,000.

The rationale for this exemption is straightforward. As the Explanatory Memorandum states this is to assist ‘primary producers who find it necessary to support themselves through moderate amounts of farm income (particularly in periods of hardship), while genuinely, at the same time, seeking to pursue their farm activities on a commercial basis.’

Once again, however, the devil’s in the detail. Leaving aside the particular application to partnerships, the exception requires the complex task of identifying a primary production business. Thus, in addition to the complexities involved in identifying a business, discussed below, there is the need to identify that the relevant business is one of primary production.

Importantly in this context, again, the application of this exemption is complicated in the case of partnerships. Where the loss making business activity is conducted by the individual taxpayer outside a partnership and the other source of income is partnership income or the loss making business activity is conducted by the partnership but the other source of income is not partnership income, the operation of s 35-10(4) is relatively straightforward. However, in the context of partnerships conducting multiple business activities the application of the legislation is difficult. Where the loss making business activity and the other source of income are both within the activities of the same partnership, the legislative exemption effectively requires a separating of business activities within the partnership and in turn the identification of the income from any unrelated partnership business activities and that of the loss making primary production business activities.

In turn the calculation of partnership net income under s 90 ITAA 1936 and a partner’s interest in such under s 92 ITAA 1936 cannot simply be used to determine the application of s 35-10(4).

The complexity of the application of these principles is reflected in the example provided in *Taxation Ruling TR 2003/3 [59]-[63]*:

59. David and Mary operate a camping supplies store and a cattle grazing business together in a partnership. They share profits and losses equally. The following income and expenses result from these two separate business activities for the 2001-02 income year:

<table>
<thead>
<tr>
<th></th>
<th>Camping Store</th>
<th>Cattle Grazing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessable Income</td>
<td>$100,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Allowable Deductions</td>
<td>$35,000</td>
<td>$47,000</td>
</tr>
<tr>
<td>Profit / Loss</td>
<td>$65,000</td>
<td>$(37,000) loss</td>
</tr>
<tr>
<td>Net income of partnership</td>
<td>$28,000</td>
<td></td>
</tr>
</tbody>
</table>

60. As in Examples 1(a) and (b) above, subsection 35-10(2) applies by looking at each individual partner's share of the assessable income and the allowable deductions for each business activity carried on in the partnership. Consequently, there is no amount which can be

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66 Explanatory Memorandum, above n 3.
67 See also *Taxation Ruling TR 2003/3, above n 3 [39]*.
68 See also ibid [38]-[39].
deferred by subsection 35-10(2) in respect of the camping supplies store, but each partner may have to defer $18,500 (50% of ($37,000)) each in respect of the cattle grazing business activity.

61. Subsection 35-10(4) provides an Exception to the operation of subsection 35-10(2), where a primary production business activity is being carried on and the assessable income (excluding any net capital gain) from sources which do not relate to this activity is less than $40,000.

62. Whilst the net income of the partnership is $28,000, and each partner's interest in that net income is $14,000, the figure of $14,000 does not provide a true reflection, for the purposes of subsection 35-10(4), of what is their 'assessable income from other sources' that are unrelated to the loss making (cattle grazing) activity.

63. The proper calculation of the amount of assessable income from these other sources, in this case the camping store, is carried out by disregarding the assessable income from, and the allowable deductions attributable to, the loss making (cattle grazing) activity. This gives rise to each partner's share of the net income in respect of the camping store being $32,500 (50% of $65,000). This is below the $40,000 prescribed in paragraph 35-10(4)(b), and hence the Exception in subsection 35-10(4) does operate to prevent the loss deferral rule in subsection 35-10(2) applying.

The example says it all – the devil’s in the detail.
As noted above, a further exception to the loss deferral rule applies where the business activity is a professional arts business and the taxpayer’s assessable income for that income year (except any net capital gain) from other sources that do not relate to that activity is less than $40,000 for an income year: s 35-40(4). Leaving aside for the moment the uncertainty of the notion of a ‘business’, discussed below, and in turn the notion of a ‘professional arts business’, the application of this exception is most complicated in the case of partnerships. Again, where either the loss making business activity is conducted by the individual taxpayer outside the partnership and the other source of income is partnership income or the loss making business activity is conducted by the partnership but the other sources of income is not partnership income, the operation of s 35-10(4) is relatively straightforward. However, where the partnership conducts multiple business activities, the application of s 35-10(4) is more complex. Again, where the loss making business activity and the other source of income are both within the activities of the same partnership, this exemption requires the income from any unrelated partnership business activities and that of the loss making professional arts business activities to be separated. Again, it is not simply a matter of using the net partnership income under s 90 ITAA 1936 and the partner’s interest in such under s 92 ITAA 1936.

VII COMMISSIONER’S DISCRETION

69 Under s 35-10(5) a ‘professional arts business’ is a business that an individual carries on as (i) the author of a literary, dramatic, musical or artistic work; (ii) a performing artist; or (iii) a production associate. However, these terms are not defined in ITAA 1997. Rather, the expression ‘author’, for example, is stated to be a technical term derived from copyright law: s 35-10(5)(a) Note. However, the Copyright Act 1968 does not define who is an author of a musical work. See also Taxation Ruling TR 2001/14 ibid [89]. Thus we must turn to the common law definition of ‘author’ which, according to Taxation Ruling TR 2001/14 ibid [89], provides that the author is the person who has ‘originated it or brought it into existence and has not copied it from another.’ See further the discussion of such complexities in Taxation Ruling TR 2005/1. Note, ATO Interpretative Decision ID 2004/468 states that the manager or agent of a professional artist is not considered to be conducting a professional arts business.

70 Taxation Ruling TR 2003/3 [39].
As noted above, under s 35-55 the Commissioner has discretion in certain cases to allow a taxpayer to offset losses from the business activity even if the business activity does not satisfy any of the above four threshold tests in an income year. This discretion is primarily designed to ensure that the loss deferral rule does not adversely impact on taxpayers who have commenced carrying on a business activity that by its nature requires a number of years to produce assessable income: s 35-10(1)(a) Note. While the rationale for the provision is reasonably straightforward, again the devil’s in the detail. As discussed below, the incorporation of this discretion makes the operation of Division 35 highly complicated and uncertain.

The prerequisites for the Commissioner’s discretion are quite complicated. The Commissioner may exercise the discretion in regard to one or more income years, if he or she is satisfied that it would be unreasonable to apply the rule in three circumstances. First, the discretion may be exercised where the business activity was or will be affected by special circumstances outside the taxpayer’s control. The notion of ‘special circumstances’ is not, however, exhaustively defined in Division 35. Only an inclusionary definition in terms of drought, flood, bushfire or some other natural disaster is included in 35-55(1)(a). Once again this has led to the necessity of a public ruling clarifying the matter. Taxation Ruling TR 2001/14 [70] states that special circumstances will not be dependent upon the government declaring a natural disaster. Moreover, the ruling notes there is nothing in the legislation that specifically confines special circumstances to natural disasters. The ordinary meaning of the words is wide enough to include other circumstances of a special nature. To this end Taxation Ruling TR 2001/14 [71] lists further examples of ‘special circumstances’:

- a chemical spray drift;
- a gas plant explosion;
- a power plant shutdown;
- a water authority malfunction;
- government authority restriction imposed on land use; or
- other events such as the illness of the taxpayer or employee(s) which have significantly affected the ability of the operator to carry on the business activity.

The ruling states at [72] that while ordinary economic or market fluctuations that might reasonably be predicted will not constitute ‘special circumstances’, substantial and unexpected economic or market fluctuations might be so considered. Undoubtedly the vagueness of the notion of ‘special circumstances’ will lead to case-by-case litigation.

Moreover, the discretion involves proof of a causal connection. The special circumstances must be the reason for failing to meet one of the four threshold tests. Thus in Farnan v FCT the taxpayer unsuccessfully argued that the Commissioner should have exercised his discretion not to defer the loss from his driving instruction business. The special circumstance the taxpayer suggested that had impacted on his business was the closure of one of the high schools where he made business presentations. The Tribunal rejected the argument on the basis that there was no

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71 See also Explanatory Memorandum, above n 3 [1.53].
72 The discretion can be applied for each year that the special circumstances have hampered one of the four threshold tests being satisfied: Taxation Ruling TR 2001/14, above n 3, [73], [147]-[153] and [156]-[157].
73 See Secretary, Department of Employment, Education, Training and Youth Affairs v Barrett (1998) 82 FLR 524.
evidence that, but for the closure of the high school, the taxpayer would have met any of the threshold tests.

Second, the discretion may be exercised where the business activity has started to be carried on and because of its nature it has not yet satisfied one of the threshold tests: s 35-55(1)(b). Once again, the rationale for this discretion appears simple. It is designed to ensure that the loss deferral rule does not apply to taxpayers who have commenced carrying on business activities which by their very nature take a number of years to produce assessable income: s 35-55(1)(b) Note. For example, the legislation notes that a business activity involving the planting of hardwood trees for harvest would require many years before it could reasonably be expected to produce income: s 35-55(1)(b) Note. The Explanatory Memorandum notes as examples of activities that could fall into this category forestry, viticulture and certain horticultural activities. However, again the devil’s in the detail.

This discretion requires that (i) the business activity must be ‘carried on’ and (ii) it is the nature of the business that dictates that one of the four threshold tests has not been met. In regard to the first requirement, the taxpayer must have commenced carrying on the activity. Taxation Ruling TR 2001/14 [75] and [97] states that this will generally require that the individual has (i) made a decision to commence the business activity, (ii) acquired the minimum level of business assets needed to carry on the activity and (iii) actually commenced ‘business operations.’ A mere intention to commence a business will not suffice. Thus preliminary and preparatory activities will be excluded from the scope of the discretion. As the relevant case law dealing with this issue in the context of s 8-1 ITAA 1997 indicates, determining whether activities are preparatory or preliminary can be a complex question.

As to the second prerequisite, it must be the nature of the business activity that leads to a failure to meet one of the four threshold tests. This in turn requires considerable specificity as to the cause underlying the failure to satisfy the tests. First it must be the nature of the particular industry, rather than the taxpayer’s competency, that leads to the failure to derive, for example, the required assessable income. In FCT v Eskandari the court in turn emphasised that s 35-55 does not apply if the business has failed because the taxpayer is ‘incompetent or lazy.’ There must be something innate or inherent in the business activity itself that means there is lapse in commencement and the production of assessable income: s 35-55(1)(b) Note.

Second, in FCT v Eskandari the court asserted that s 35-55(1)(b)(i) requires that it must be the nature of the particular industry, rather than the nature of the taxpayer’s business, that causes the initial lack of income. In turn the court said this requires that the essential features that are common to business activities of the same kind or class as the taxpayer’s business are the cause for the failure to meet the four threshold tests. This approach led to the relevant taxpayer failing to make his case, the court reasoning that the taxpayer’s failure to satisfy the relevant test was based on the

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75 Explanatory Memorandum, above n 3, [1.50] – [1.51].
76 Taxation Ruling TR 2001/14, above n 3, [75] and [100].
79 Taxation Ruling TR 2001/14 above n 3, [76], [108]-[109], [154] and [168]. See also paragraph Explanatory Memorandum above n 3 [1.51]; Taxation Ruling TR 2001/14 above n 3 [77], [105]-[113], [154]-[155] and [165]-[170].
taxpayer’s particular fee structure, rather than an aspect of the nature of migration agencies in general.\(^82\) Again this is undoubtedly going to lead to further cases where it is uncertain whether it is the nature of the industry or the taxpayer’s conduct of the particular business activity that is the underlying cause of the failure to meet one of the threshold tests.

The third basis for the exercise of the discretion is where there is an objective expectation, based on evidence from independent sources, where available, that the business activity will either pass one of the four threshold tests or produce a profit within a period that is commercially viable for the industry concerned: s 35-55(1)(b)(ii). The rationale is obvious. Again it is intended to cover a business activity that has a lead time between the commencement of the business activity and the production of any assessable income. Planting of hardwood trees for harvest, where many years would pass before the activity could reasonably be expected to produce income, is provided as an example: s 35–55(1)(b)(ii) Note. Further, examples of such activities would be ‘forestry, viticulture and certain horticultural activities.’\(^83\)

The exercise of this discretion requires the taxpayer to take on the burden of proving that there is an objective expectation that the threshold tests will be met in time.\(^84\) In a given case, this may be quite a heavy burden of proof. While the Explanatory Memorandum states that the objective expectation must be based on information from industry bodies or scientific research,\(^85\) the reference in the legislation to ‘where available’ indicates that in many cases objective evidence from independent sources will not be available.\(^86\) As the court recognised in \textit{FCT v Eskandari}:

In some cases it may be a straightforward exercise to identify the industry in which the business activity takes place. Some industries are well-established and the basis for an ‘objective expectation’ can readily be based on a comparison between the taxpayer's business and other businesses within that industry, particularly where businesses or business associations within the industry produce material such as annual reports or industry papers. In other cases the business activity may exist in an industry that is difficult to identify because of the innovative nature of the business or the undeveloped nature of the industry. There may, because of the nature of the industry, be very little or no independent source material. In such circumstances it will, as an evidentiary matter, be more difficult for the taxpayer to discharge the burden imposed by s 14ZZK(b)(iii) of the \textit{Taxation Administration Act 1953} (Cth) and convince the Commissioner that the requirements for the exercise of its discretion have been met. It may be necessary to refer to the circumstances of the taxpayer. Forming an objective expectation in such cases requires an extrapolation from those circumstances taking into account the nature of the relevant business activity, the costs or losses incurred and an estimated duration for the start-up phase. Ultimately, however, this question, including the meaning of a ‘commercially viable period’, is one of fact that is for the Tribunal to decide, and only where the Tribunal's decision constitutes an error of law will it be reviewable by this Court.\(^87\)

As stated in \textit{FCT v Eskandari}, it is also necessary to prove that with that type of business activity, after meeting certain requirements, it will be a commercially viable

\(^{83}\) Explanatory Memorandum above n 3, [1.53].
\(^{85}\) Explanatory Memorandum above n 3, [1.50]. Independent sources would include ‘industry bodies or relevant professional associations, government agencies, or other taxpayers conducting successful comparable businesses’: \textit{Taxation Ruling TR 2001/14} above n 3, [81].
\(^{86}\) See also \textit{FCT v Eskandari} (2004) 2004 ATC 4042, 4051.
business, not that the taxpayer’s particular business will become commercially viable.  

Further, under s 35-55(2) the Commissioner must not exercise the discretion after the time that it would be reasonable to expect the activity to first produce a profit or to pass one of the four above discussed threshold tests.

Finally, the process involved in activating an exercise of discretion is also relatively complicated. A taxpayer must apply for a private ruling under s 359-10 Taxation Administration Act 1953 (Cth), supported by a completed, ATO Application for private ruling on the exercise of the Commissioner’s discretion for the Non-commercial business losses form.\(^{89}\) As Kenny notes, this is a lengthy form that requires detailed information about the business activity, supported by documentation.\(^{90}\)

### VIII BUSINESS ACTIVITY

As is already apparent from the above discussion, the devil in Division 35 is not always in the detail, but the lack thereof. This is particularly apparent in a core part of Division 35. As detailed above, Division 35 is not intended to apply to activities that do not constitute the carrying on a business, for example, the receipt of income from passive investments: s 35-5(2). To this end the focus of Division 35 is on businesses carried on by individuals as ‘business activities’: s 35-10. Thus as Taxation Ruling 2001/14 \([56]\) affirms, the relevant assessable income must be ‘derived directly from, and has a causal relationship with, the carrying on of that business activity for the income year in question.’\(^{91}\)

Despite the importance of the notion of ‘business’ and in turn ‘business activity’ these terms are not defined in Division 35. Moreover, the Act does not define the terms except through the general, unhelpful definition of ‘business’ in s 995-1 ITAA 1997. Section 995-1(1) ITAA 1997 defines ‘business’ as including ‘any profession, trade, employment, vocation or calling, but does not include occupation as an employee.’ As the definition is inclusionary, it provides little assistance in identifying a business.\(^{92}\) Its main use lies in excluding persons who derive income as employees in the sense of a master and servant relationship, rather than being self-employed.\(^{93}\)

The absence of a definition of ‘business activity’ in Division 35 is particularly peculiar given the Ralph Report noted:

> The law in relation to carrying on a business is very difficult and resource intensive to administer and must be done on a case-by-case basis. The need to apply the existing law on that basis does not permit the efficient and effective use of resources and creates uncertainty. A systemic solution that better deals with losses arising from such non-commercial activities is warranted.\(^{94}\)

The failure to define a business activity means that the application of Division 35 includes the difficult question what is a ‘business’. In turn this will mean the application of Division 35 necessitates a reversion to the existing plethora of cases

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90 Kenny above n 26.
91 See further Taxation Ruling 2001/14, above n 3, [91]-[92] and [134]-[136].
92 Ferguson v FCT (1979) 79 ATC 4261, 4264; Case X31 (1990) 90 ATC 296, 298.
93 Partridge v Mallandaine (1886) 2 TC 179, 180.
94 Ralph Report, above n 1, 296. See also Explanatory Memorandum, above n 3, [1.7]-[1.9]; Taxation Ruling TR 2001/14 above n 3 [8] and [38].
relevant to, *inter alia*, s 8-1 *ITA 1997*, as to what is a ‘business’ and thus necessitate a case-by-case determination of such. This is indicative from the Division 35 cases that are starting to trickle through the courts. For example, in *Kennedy v FCT* the Tribunal concluded that the taxpayer’s documentary film production activities were for pleasure, rather than a business, and thus Division 35 could not apply.95 Indicative of this confusion there are further public rulings on this aspect of Division 35, such as *Draft Taxation Ruling TR 2004/D14* as to when a business of a professional artist is being conducted.

Effectively, Division 35 adds another layer of complexity to the existing jurisprudence pertaining to the notion of a ‘business’ which the *Ralph Report* recognised is a highly uncertain and resource intensive part of taxation law.96 It is ultimately contended that it would have been preferable for the legislature to have introduced a statutory definition of income that focuses on the common indicia of these hobby style activities identified in the *Ralph Report*, quoted above; namely they are ‘unlikely to ever make a profit and do not have a significant commercial purpose or character’.97 Preferable to the complexity of Division 35 would have been a statutory definition of business that required (i) a reasonable prospect of making a profit and (ii) a profit making intent. This reform proposal would reflect the key judicial indicia of a business, namely the existence of a profit making intent.98 This statutory definition would, however, involve a legislative overruling of a line of jurisprudence that provides that it is not necessary for activities to constitute a business that there be a realistic potential for the activities to make a profit as long as the taxpayer intends to make a profit and diligently pursues that object.99 A statutory definition of business would have addressed the policy concerns expressed in the *Ralph Report* and simplified the notion of ‘business’.

**IX CONCLUSION**

Once again a simple concept has been masticated by detail. Perhaps what is worse is that Division 35 is riddled with a blend of too much and too little detail. Despite the *Ralph Report*’s recognition of the complexity of existing legal notions, such as ‘business’, this is not subject to legislative definition and many other key terms in Division 35 are not defined. Further revision of Division 35 is clearly needed. A statutory definition of business would alleviate much of the *Ralph Report* concerns for revenue leakage, while simplifying existing jurisprudence.

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96 *Ralph Report* above n 1, 296. See also Explanatory Memorandum, above n 3, [1.7]-[1.9]; *Taxation Ruling TR 2001/14* above n 3, [8] and [38].
97 *Ralph Report* ibid. See also Explanatory Memorandum ibid; *Taxation Ruling TR 2001/14* ibid.