SUBMISSION

BOARD OF TAXATION

POST-IMPLEMENTATION REVIEW OF NON-COMMERCIAL LOSSES LEGISLATION

The Board of Taxation has undertaken a post-implementation review of the non-commercial loss provisions in Division 35 of the Income Tax Assessment Act 1997.

Summary

It is the interpretation by the Commissioner of Taxation (Commissioner) which is of concern, as it is the opinion of the writer of this submission that the Commissioner has taken a narrow view of exactly what is a commercial operation and appears to ignore taxpayer circumstances and reasonable commercial activity during a business start-up phase. I believe that greater transparency and an even-handed application of the Commissioner's discretion can only take place if there is a review of the terms surrounding business start-up lead times, and a greater consideration given to defining the concept of carrying on a business for the purposes of this Section of the Act.

Contention

It is my contention that the discretion available to the Commissioner in paragraph 35-55 (1)(b) of the Income Tax Assessment Act 1997 (ITAA 1997) is not being exercised in a fair and equitable manner.

I base my contention upon one first-hand example and consideration of a recent Federal Court of Australia case, Commissioner of Taxation ***V*** Eskandari (2004) FCA 8.

Actual Client Case Example

The example referred to is a client who is an Auditory Verbal Therapist. A taxpayer who is a trained teacher of the deaf, with specialist qualifications as a Certified Auditory Verbal Therapist.

In January 2001, the taxpayer, a teacher with 22 years of teaching experience in full-time employment, decided to establish a private practice to pursue a specific and specialist path of their profession.

The taxpayer provides educational and support services in the form of individual auditory verbal therapy sessions for families and their hearing impaired infants or children. The activity represents a specialist service which will require time to develop, because the type of services provided are relatively unknown in the community. Also, the services are not yet supported by medical health funds, which would see a greater attraction by the wider community at a faster rate than that currently enjoyed when the health funds acknowledge this service as a valid, properly based service in this area.

The request for the Commissioner to exercise his discretion was rejected, on the grounds that the business activity was commenced on a scale considered too small. The Commissioner

further argues that the activity carried out by the taxpayer is of a type that is able to produce assessable income soon after its' commencement, yet has not done so.

It is my opinion that such an approach assumes that the market place is ready and willing to take on such services in a wholesale manner. Such an approach denies commercial reality and the ability for any new venture, the opportunity to grow. Using such an assumption, the Commissioner will clearly only accept primary production pursuits as a business activity with an "acceptable" lead time with commercial purpose.

Given the specialist qualification of the person in this case, it is not appropriate to consider the taxpayer as a hobbyist or a person choosing a different lifestyle. This was a seriously considered career move by a professional, who has been punished for not having enough clients in a new field of "medical" activity.

This does not seem a fair application of the taxation law. This case in an example of a professional entering into a business activity with a long lead time. I am certain that the taxpayer is "planting" many leads and "watering" the community with awareness and education of the new technical breakthrough which can be offered to medically disadvantaged people. What is uncertain is when the "crop will be picked" in sufficient numbers to provide a level of assessable income to satisfy either the Commissioner or the legislative criteria.

The taxpayer estimated that the $20000 turnover threshold will not be attained until around 2006. There is little doubt that the taxpayer wishes to make a profit, and they should not be penalised because they decide not to, or cannot afford, a major advertising and educational awareness program which could incur costs in the tens of thousands of dollars just to reach a turnover threshold in the first year of starting out.

For a fair and transparent approach to this legislation, the assistance offered to "small primary producers who find it necessary to support themselves through moderate amounts of off-farm income, while genuinely, at the same time, seeking to pursue their farm activities on a commercial basis" (Extract from the House of Representatives Second Reader's speech for New Business Tax System (Integrity Measures) Bill 2000) should be extended to other types of taxpayers in the community. It is not a fair system where (it appears that) only primary producers can be singled out for activities of a commercial nature at the time of start up.

Whilst it is not stated in the information surrounding the introduction of the legislation on non-commercial losses, there was a contention in the mid 1990's from the Commissioner that many of the multi-level marketing activities carried on by taxpayers were not of a commercial nature. In fact, an Income Tax Ruling (now referred to as an Administrative Position) was issued and directed to multi-level marketing activities, and in particular Amway distributors. That ruling set down certain criteria to assist taxpayers who were involved in network marketing activities, to determine whether they were or were not carrying on a business. There is a long history of cases pondering the issue of "carrying on business". I most likely concur with the Commissioner in relation to the non-commercial viability of many small multi-level marketing operators whose activities do not grow in size or volume from year to year.

However, a small multi-level marketing and sales operator is a very different type of taxpayer to the professionally qualified and well experienced person, from the likes of my client as described in the submission.

Federal Court of Australia Case
Commissioner of Taxation *V* Eskandari (2004) FCA 8

In this case, a decision by the Administrative Appeals Tribunal (AAT) was set aside. The AAT supported the Commissioner's decision under S35-55 of the Act where the Commissioner had issued a private ruling in which he refused to exercise his discretion in S35-55 (1) (b) in favour of the taxpayer.

The Court, in setting aside the AAT decision, has considered the merits of the taxpayer's lead time between commencing activity and the production of assessable income.

I believe the issues raised in this case support my contention that there is a need for greater transparency and simplification in this discretionary area so as to give greater certainty in cases of genuine start-up commercial activities carried out by taxpayers.

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Date

Background

This submission is written by Mr Ron Metcalf, FCPA, Principal of Metcalf Spahn, a Certified Practising Accounting (CPA) firm. The firm offers a range of taxation, accounting and auditing services and has a particular interest in the fairness of and the interpretation of Income Tax Legislation as it applies to its' clients.

THE BOARD OF TAXATION CONFIDENTIALITY DECLARATION

DECLARATION IN RELATION TO THE USE OF CONFIDENTIAL SUBMISSIONS FOR INDIVIDUALS

1. RONALD WAYNE METCALF ('the respondent') has made a submission ('the submission') to the Commonwealth (represented by the Board of Taxation) concerning the post-implementation review of the non-commercial losses legislation ('the Review').

2. The submission will be used by the Board of Taxation to assist in formulating its views and recommendations on the Review.

3. The submission contains information ('confidential information'), specified in the space provided below, the improper use or disclosure of which would damage the respondent's interests.

   The confidential parts of the submission are:

   There are none.

4. The respondent agrees to provide the submission to the Board of Taxation, notwithstanding the inclusion of the confidential information, subject to the following conditions:

   4.1 Unless the respondent otherwise agrees, the submission will only be made available to:

   4.1.1 the members of the Board of Taxation;

   4.1.2 the Board's Secretariat and the Board's consultants engaged for the purposes of the Consultation; and

   4.1.3 the Department of the Treasury and Treasury Ministers and their advisers.

   4.2 The Board of Taxation may make a report, which may be released publicly, which may acknowledge that the respondent has made a submission. The report will not disclose any of the content of the submission to the extent it is confidential.

4.3 The submission will not be released publicly on the Board's website to the extent that it is confidential.

5. The respondent recognises, and acknowledges, that the Board of Taxation is subject to the *Freedom of Information Act 1982*, and to requests by Parliament for the production of documents. However, the respondent understands and expects that the confidential information in the submission would be exempt from such release on the grounds that it was provided in confidence, and contains information that is, by its nature, confidential.

Signed by: Ronald Wayne Metcalf

Signature: _____

Date: 27 February 2004