

8 March 2004

Board of Taxation

Post-Implementation Review of the Non-Commercial Loss Provisions

The National Association of Forest Industries welcomes the opportunity to participate in the post-implementation review of the Non-Commercial Loss Provisions. For a long-term industry where there may be lengthy periods between the time of investment and the receipt of income, such as forestry, it is essential to have a legislated approach that does not distort the decisions of investors towards those activities with a much shorter investment horizon.

Important features of the Non-Commercial Losses Provisions

A series of tests are contained in sections 30 to 45 in Division 35 of *the Income Tax Assessment Act 1997*, which determine whether losses from particular activities can be deducted against other forms of income in the year they arise. For many individuals investing in forestry projects, there are substantial difficulties associated with passing each of these tests. For example, with the profit test (s.35), it is highly unlikely that investors will attain a profit in 3 out of 5 years when it takes a minimum of 8 years to receive a return from forestry projects.

As a result, it is essential the forestry business activities can account for the 'losses' in the years of expenditure. In order to off set those losses against other forms of income, forestry investors must obtain the Commissioner's discretion (as outlined in s.35-55 of the Act).

While the original legislation attempted to provide a clear and workable approach to cover the rules that would help separate the losses from commercial and non-commercial activities, a lack of consultation meant that these 'integrity measures' actually impeded investment in certain business activities. Only through a number of rounds of consultation, was it possible to provide a workable solution for s.35-55(1)b, which recognised the specific requirements of business activities such as forestry and outlined how the Commissioner's discretion could be exercised effectively.

The main problem with the original wording of s.55 was that the Commissioner's discretion could not be applied to a business activity once it produced assessable income that was greater than the deductions attributed to it in any one year. In other words, after the first time it made a profit. For forestry projects which involve multiple commercial thinning operations prior to the final (clearfelling) harvest, this would have meant that after the first time that a project made a profit, all costs would have to be carried forward until the next point in time when the activity made a profit. This matter was addressed by amending legislation in 2002.

Responses to the evaluation criteria

The compliance and administration costs associated with this legislation have been minimised by the release of Tax Ruling TR 2001/14 (Income Tax: Division 35 – non commercial business losses) and the addendum after the taxation legislation was amended in 2002. This ruling provides clear examples of how the legislation will be interpreted and applied by the Australian Taxation Office. The legislation itself can now accommodate long-term activities such as plantation forestry.

Many individual taxpayers participate in plantation forestry projects through the purchase of prescribed interests offered by the managed investment companies. By obtaining the Commissioner's discretion for investors at the same time as the companies obtain product rulings for each of their projects, the costs of taxpayer compliance with Division 35 has been greatly reduced.

While the legislation is, unintentionally, open to a considerable degree of interpretation, it is to the taxpayers benefit that TR 2001/14 clarifies and simplifies how the legislation will be applied. The only area where there is some uncertainty is in s.35-55(1)b where to obtain the Commissioner's discretion 'there is an objective expectation, based on evidence from independent sources (if available) that within a period that is commercially viable for the industry concerned...'. This raises three matters in this text which need some clarification – what is an objective expectation, what are the independent sources and how is a period that determines commercially viable to be determined?

Although there were a number of inadvertent consequences originally associated with Division 35, they have been generally removed through legislated amendments and Tax Ruling TR 2001/14, which more adequately reflect taxpayer circumstances and commercial practices. It was these improvements which provided taxpayers with a greater degree of certainty over the treatment of business activities that suffered commercial losses in the early years of the projects.

Conclusion

The Non-Commercial Loss Provisions are consistent with other tax legislation applying to forestry business activities. Apart from still needing to provide the additional sources of clarification associated with s.35-55(1)b, as outlined above, it is reasonable to state that the current legislation, tax ruling and product ruling processes, all reflect normal commercial practices while providing industry with certainty, clarity and relatively low compliance costs.