



Commissioner's discretion

When and how to apply for a Commissioner's discretion to offset a business loss against income from other sources.

Last updated 2 May 2018

If you're an individual in business, as either a sole trader or in partnership, and your business makes a loss, you may be able to offset the loss against your other income such as salary and wages. To be eligible, you must meet the income requirement and pass one of the four tests. If you are not eligible, you can apply for a Commissioner's discretion.

See also:

- *TR 2007/6 Income tax: non-commercial business losses – Commissioner's discretion*
- *TR 2001/14 Income tax: Division 35 – non-commercial business losses*
- *TR 2001/14A – Addendum Income tax: Division 35 – non-commercial business losses*
- *TR 2001/14A2 – Addendum Income tax: Division 35 – non-commercial business losses*

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Applying

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When to apply

You can apply for a Commissioner's discretion if you:

- have special circumstances outside your control
- meet the income requirement and the nature of the business activity means you will not pass a test, however, you expect your

business activity will meet one of the tests or make a tax profit within the commercially viable period for your industry

- do not meet the income requirement, because of the nature of the business activity for the most recent income year where your business activity has not made or will not make a tax profit and there is an objective expectation your business activity will make a tax profit within the commercially viable period for your industry.

Changes to the operation of the non-commercial loss rules apply for the 2009–10 and later income years. There is now a Commissioner's discretion for individuals who do not meet the income requirement but whose business activity is commercially viable.

If you are applying for the discretion on the grounds of special circumstances, you should apply as soon as possible after those circumstances have occurred. However, we will accept applications within the normal amendment period for that income year.

If you are applying for the discretion on the grounds of lead time, you should apply for the first year you have excess deductions you wish to offset against other income. To ensure you have provided all the necessary information for us to consider your application for the Commissioner's discretion, you must complete and answer all questions in the application.

If you later realise you could have applied for the Commissioner's discretion, you may do so and, if granted, request an amendment of the relevant income tax assessment within the normal amendment period.

See also:

- **Non-commercial losses** for the income requirement and four tests

How to apply

You must apply for the discretion using **Private ruling form (non-commercial losses)** and provide relevant information, including evidence from independent sources (where available) that objectively establishes that you meet the conditions for the Commissioner's discretion. You will also need to complete the **Non-commercial losses: evidentiary checklist** as part of your application.

We will notify you of the decision in writing.

Duration

The duration of a Commissioner's discretion will be decided on a case-by-case basis. The Commissioner may decide that the discretion can apply to future years as well, but it depends on the particular circumstances of each request. We consider factors such as special circumstances, the nature of the business and lead times when determining the length of the discretion.

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Special circumstances

Special circumstances in which you can apply for the Commissioner's discretion to allow you to claim your loss.

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If your business activity has been affected by special circumstances outside your control, you can apply for the exercise of the Commissioner's discretion to allow you to claim your loss in that income year if those special circumstances have prevented you passing one of the four tests or from making a tax profit.

Special circumstances are sufficiently different to the circumstances that occur in the normal course of conducting a business activity.

Special circumstances include natural disasters such as drought, flood, bushfire, cyclones, hailstorms and tsunamis.

Other events that may be included as special circumstances, depending on the facts, are:

- oil spills
- chemical spray drifts
- explosions
- disturbances to energy supplies
- government restrictions
- illnesses affecting key personnel.

For the other events, you must show that the special circumstances were outside your control.

Income requirement met

If you meet the income requirement, there are two main factors we consider to decide if it is appropriate for the exercise of the discretion for an income year:

- your business activity is affected by special circumstances such that it is unable to satisfy any of the tests
- the special circumstances affecting your business activity are outside your control.

Example 1

Mark operates a clothing store specialising in the sale and hire of costumes. During the 2015–16 income year, a fire destroyed all of his stock. Mark's business was insured, but due to the specialised nature of the apparel he was unable to resume normal operations for three months. As a result, Mark's business activity had assessable income of less than \$20,000 and resulted in a loss that he wants to offset against his other income.

Mark's other income for the 2015–16 income year was \$35,000, and Mark met the income requirement for that income year. However, Mark's business activity did not satisfy any of the tests set out in Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997) in the 2015–16 income year. To claim a deduction for

the loss, he needed to ask the Commissioner to exercise discretion for that income year.

Mark is able to show that his business activity satisfied the assessable income test in the 2014–15 year and his trading before the fire indicated that he was likely to satisfy this test in the 2015–16 year, if it were not for the fire.

The Commissioner accepts that the business activity would have satisfied the assessable income test if the fire had not occurred. The Commissioner will exercise discretion for the 2015–16 income year as the fire is considered to be a special circumstance outside Mark's control. Mark will be able to offset the loss from his business activity against his other income.

If your business activity would not have satisfied a test even if the special circumstances had not occurred, it is unlikely that the Commissioner would exercise the discretion, and so you would defer your losses.

Income requirement not met

For most individuals who do not satisfy the income requirement it is expected that the business activity will meet one of the four objective tests.

Access to the special circumstances discretion is not limited to those individuals who satisfy the income requirement. Individuals who do not meet the income requirement, but can demonstrate their business is commercial and has been affected by special circumstances, may also apply for the Commissioner's discretion to allow the losses to be claimed in that income year.

For a business activity to be regarded as commercial, at least one of the four objective tests provided in the non-commercial loss rules must be satisfied. If you do not satisfy the income requirement, the factors you must satisfy in deciding whether to apply for the Commissioner's discretion for an income year are all of the following:

- your business activity is affected by special circumstances such that it is unable to produce a tax profit
- your business activity either satisfies at least one of the tests, or is affected by special circumstances such that it is unable to satisfy

any of the tests

- the special circumstances affecting your business activity are outside your control.

Example 2

Alister carries on a business of breeding cattle for sale, and has done so for the past 20 years. In prior years this business activity has been very profitable. However, in the 2015–16 income year it was affected by drought, which caused Alister to spend much more than anticipated on fertilizer and seed to maintain the condition of his pastures. The drought also affected the average sale price per head Alister could obtain for his cattle. A large loss was made from the business for the 2015–16 income year.

Alister has other income of \$300,000, so he did not meet the income requirement for the 2015–16 income year. Alister's business activity satisfied both the assessable income and profits test for this year. For Alister to claim a deduction for the loss, he needs to ask the Commissioner to exercise his discretion for that income year.

Alister's application shows that special circumstances outside his control – the drought – caused his business activity to make the loss; without those circumstances, a profit would have been made.

The Commissioner accepts the business activity is 'commercial' based on the strong past profitable performance and the fact that the business continues to satisfy the assessable income test and the profits test. The Commissioner concludes that it is unreasonable in these circumstances for the loss to be deferred, and uses the special circumstances discretion. Alister will be able to offset the loss from his business activity against his other income.

If your business activity would have made a loss even if it had not been affected by special circumstances, it is unlikely that it would be considered unreasonable for the loss deferral rules to apply and the Commissioner is unlikely to exercise the discretion.

Example 3

Using Alister's case in Example 2, if his business had not made a profit in recent times and was not reasonably expected to make a profit in the future, the Commissioner would not exercise the special circumstance discretion. Even though Alister's business satisfied the real property test or the other assets test and was affected by drought, it was not because of the drought that Alister would not make a profit. This means it would not in itself, indicate that it was unreasonable for losses from the business to be deferred.

The discretion can be exercised in income years after the one in which the special circumstances occurred if the effects of those special circumstances continue to prevent your business activity from satisfying any of the tests in those later income years. However, there may be situations where the special circumstances, because of their continued existence, become the ordinary or usual situation. It would not be appropriate to exercise the discretion once this occurs.

Tax profit

A tax profit is where the amount of assessable income from the activity for a year is greater than the sum of the deductions attributable to the business activity for that year.

Outside your control

The special circumstances affecting your business activity must be outside your control.

If you fail for no adequate reason to adopt certain practices commonly used in your industry to prevent or reduce the effects of certain circumstances, such as pests or diseases, this may point to the circumstances not being outside your control.

Similarly, if you acquired a poorly run but promising business activity, it would generally be considered within your control and would not, by itself, constitute special circumstances, even though the actions of the former operator may have been outside your control.

Economic or other market fluctuations that might reasonably be expected to affect a business activity are not unusual or out of the ordinary and, therefore, are not considered to be special circumstances. These fluctuations are expected to occur on a regular or recurrent basis when carrying on a business activity and affect all businesses within a particular industry. However, substantial, unexpected economic or market fluctuations of a scale not regularly encountered previously may qualify on a case-by-case basis.

Example 4

Oliver has a farming business which produced assessable income of \$25,000 from the sale of produce in the 2014–15 income year and satisfied the assessable income test. In the 2015–16 income year the market price of his produce dropped because of lower consumer demand; Oliver's farm income fell to \$18,000 and a loss resulted. The fall in market price was within the range of normal fluctuations for this industry. Oliver's business activity did not satisfy any of the tests and the exception for primary production business activities did not apply, as he received at least \$40,000 of non-farm income.

In this case, the Commissioner would not exercise the discretion for special circumstances as the reduction in market prices for produce from Oliver's farm is not a special circumstance but a normal business fluctuation. As a result, the loss from Oliver's farming business activity will be deferred.

Evidence

Evidence to support your application for the Commissioner's discretion due to special circumstances can include:

- evidence of the event (circumstances)
- why the effect of the event is regarded as special in relation to the ordinary operations of your business activity
- whether, and on what basis, the event can be regarded as unusual or out of the ordinary
- the basis on which your activity would have passed a test or made a tax profit but for the event occurring - that is, what happened

differently as a result of the event occurring

- whether the event was the main or only reason for your business activity failing a test or not making a tax profit
- how the event, including the effects of the event on your business activity, was outside your control
- whether your business activity has passed a test or made a tax profit in a previous year
- whether you expect the event to affect your business activity in the future, and if so, to what extent
- any other information or evidence you think should be taken into account in your application.

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Lead time

When you may apply for the Commissioner's discretion based on a lead time.

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Where you can demonstrate that your business activity is commercially viable but, because of its nature, there is a lead time between the commencement of the activity and the production of any assessable income, you may apply for the exercise of the Commissioner's discretion.

If you meet the income requirement

The Commissioner must be satisfied that both:

- the activity, because of its nature, has not satisfied, or will not satisfy, any of the four tests
- there is an objective expectation, based on independent evidence (where available) that, within a period that is commercially viable for the industry, the business activity will either
 - satisfy one of the four tests
 - make a tax profit.

Example 5

Tamsin acquired a still in September 2015, and the appropriate licences and authorisations to produce and distribute an alcoholic spirit. She commenced production of the base spirit in October 2015. Legislation states that the spirit must be aged in oak casks for at least two years before it can be bottled and sold.

Tamsin developed a business plan based on advice from her accountant and information from alcohol distributors. Tamsin's business plan indicates that she will be able to commence sales of her product in the 2017–18 income year. Tamsin will have losses from her activity that she wishes to deduct against her \$50,000 salary and wage income for the 2015–16 and 2016–17 income years. Her activity will be profitable in the 2017–18 income year.

As Tamsin's alcoholic beverage production and distribution activity is carried on as a business in the 2015–16 and 2016–17 income years, she will need to ask for the Commissioner to exercise discretion for these income years. Tamsin is able to present independent evidence that making a profit in the third year of operation is within the period that is commercially viable for the industry.

The Commissioner accepts that it is in the nature of the business activity that there will be a lead time before a profit can be expected or one of the tests satisfied. The Commissioner would exercise discretion in such a case for each of the 2015–16 and

2016–17 income years inclusive. Any losses made in these years would not be deferred.

If you do not meet the income requirement

The Commissioner must be satisfied that both:

- the activity, because of its nature, will not make a tax profit
- there is an objective expectation, based on independent evidence (where available) that, within a period that is commercially viable for the industry, the business activity will make a tax profit.

Example 6

In the 2015–16 income year, Jack has a taxable income of \$200,000, reportable super contributions of \$50,000, and reportable fringe benefits of \$20,000. Jack also owns a vineyard that he purchased in August–2013. The vineyard is valued at \$750,000 and has excess deductions of \$50,000 in 2015–16.

Jack does not meet the income requirement because the sum of his taxable income, reportable fringe benefits, and reportable super contributions is \$270,000. The vineyard has not made a profit in the previous income years. Despite the fact that his business activity is being carried on with real assets worth more than \$500,000, he must now apply to the Commissioner if he wants to apply his losses against his other income.

Jack has obtained an independent assessment that the vineyard will make a tax profit (assessable income greater than deductions) within seven-years from when he started the business activity. The independent advice also includes evidence that the commercially viable period for the industry is at least seven-years. Jack applies to the Commissioner to exercise the discretion. The Commissioner decides that there is an objective expectation, based on the independent assessment and evidence, that the vineyard will produce assessable income greater than available deductions in a given year within a period that is considered commercially viable for the industry

concerned, and that Jack can apply the \$50,000 against his other assessable income in the 2015–16 income year.

Nature of the business

Irrespective of whether you meet the income requirement, you must provide objective evidence (where available) that the reason your activity has not yet met one of the four tests or produced assessable income greater than available deductions (tax profit) is because of the nature of the business, and not for some other reason that is peculiar to your particular business activity.

The phrase 'because of the nature of the business' refers to inherent characteristics of the type of business activity being conducted by you, which are common to any business activity of that type. These inherent characteristics must be the reason why your activity is unable to satisfy any of the tests or make a tax profit from the period your business activity first commences -to the end of the last income year in which that characteristic still affects the activity's ability to satisfy a test or produce a tax profit (an initial period). This initial period has to be within the commercially viable period for the industry.

A determination does not need to be made as to how long it will take your business activity to become commercially viable. Rather, it involves an enquiry into whether your business activity will satisfy a test or make a tax profit within a time frame in which other commercial businesses in the same industry would make a profit.

The period that is commercially viable will vary from industry to industry, according to factors such as anticipated income, expenses and seasonal variations.

Examples of such activities include forestry, viticulture and other horticultural activities.

The discretion is not available in cases where the failure to make a profit is for reasons other than the nature of the business activity, such as:

- starting out on a small scale
- building up a client base
- business choices made by you that are not consistent with the ordinary or accepted practice in the industry concerned (such as

hours of operation, location, climate or soil conditions, or the level of debt funding).

Example 7

Phillipa started a red fruit growing business in the 2012–13 income year. However, Phillipa planted a very small number of red fruit bushes despite the recommendation from the industry body, Red Fruit Growers United, that significantly more bushes should be planted for a commercial activity. Phillipa planned to retire in about 15 years and gradually increased the size of the orchard over the ten years before her retirement. Phillipa installed an irrigation system as recommended by the industry body, which cost \$150,000.

In the 2015–16 income year, Phillipa has a taxable income of \$220,000, and reportable super contributions of \$35,000.

She does not meet the income requirement because the sum of her taxable income and reportable super contributions is \$255,000.

Phillipa's business made losses in the 2013, 2014 and 2015 income years. The exception for the primary production business activities did not apply, as she had received more than \$40,000 of non-farm income in each year. Even though Phillipa carried on the business activity with other assets valued at more than \$100,000, Phillip must apply to the Commissioner if she wants to apply her losses in the 2010 and future income years against her other income.

Evidence from the industry body shows that any red fruit growing business would not be expected to make a tax profit before year five as there are inherent characteristics that prevent it from doing so until around the time of full yield.

Even though there are inherent characteristics in Phillipa's business activity that prevent her from making a tax profit in the 2016 year, there needs to be an objective expectation based on evidence from independent sources that within the commercially viable period Phillipa will make a tax profit, for the Commissioner's discretion to be exercised.

Phillipa developed a business plan for her business activity based on the material she had from the industry body. As Phillipa had planted such a small number of bushes it was not likely that the business activity would make a tax profit until she retired in fifteen years and increased the number of red fruit bushes to a commercial number.

The evidence from industry experts shows that a red fruit growing business, conducted in a commercially viable manner, should be able to make a tax profit by the fifth year.

As there is no objective expectation that Phillipa's business activity will make a tax profit within a period that is commercially viable for the industry concerned, the Commissioner's discretion would not be exercised and the losses from Phillipa's business activity would be deferred.

Example 8

Andrew started a clock-repair business in the 2014–15 income year. He was new to the region and had yet to establish his clientele. Andrew had intended to operate his business full time, but as his funding was very limited he chose to continue his part-time employment to support himself and only worked on his business activity in his spare time. Andrew's premises are in the back of a small arcade and he only opens for business on weekends, while the other shops in the arcade are open every day of the week. The arcade is not in an area that attracts business on weekends. Andrew cannot afford advertising and has so few clients that he is unable to cover his expenses; he has made losses each year.

Andrew has a taxable income of \$90,000 in the 2015–16 income year. Therefore, he meets the income requirement.

Andrew's business has yet to satisfy one of the four tests. Other businesses of this type are able to satisfy a test in the first year of operation.

The inability of Andrew's business activity to satisfy any of the four tests or produce a tax profit is due to his personal business choices as to his hours of business, location and advertising – not because of any inherent characteristics that affect clock-

repair businesses. Accordingly, the Commissioner would not exercise the discretion.

The inherent characteristics may be present for an initial period from the time your business activity commences. After that initial period has elapsed, which can be several years, the inherent characteristics may cease to be the cause of those business activities being unable to satisfy any of the tests or produce a tax profit.

Objective evidence

For the Commissioner to exercise discretion for lead time, you must be able to demonstrate to the Commissioner that there is an objective expectation your business activity will meet one of the tests or produce a tax profit that is within a **period that is commercially viable for the particular industry in which you conduct** your business. The objective expectation must be based on evidence from appropriate independent sources, where available.

Sources of independent evidence can include an independent professional individual or organisation experienced in the relevant industry, such as:

- industry or regulatory bodies
- tertiary institutions
- industry specialists
- professional or trade associations
- government agencies
- other independent entities with a similar successful business activity
- business advisers
- financiers
- banks.

You must be able to show both the:

- average time for the industry concerned to reach the level of operations required to be commercially viable

- reasonable period of time your business activity will take to pass a test or make a tax profit given your particular circumstances (you must be able to show that this time is within the standard for the industry concerned and consider your business plan, resources available to you and any relevant environmental factors).

Evidence of the commercially viable period for a specific industry may include:

- evidence of what is typically considered to be the commercially viable period for your particular industry. For example, evidence about when any first commercial crop is expected, expected yields, the year the activity is expected to become profitable for the first time (not the year the industry expects the activity to recoup the expenditure to date) and when a typical start-up activity in the industry becomes financially self-sustaining
- evidence such as industry articles, statistics, analyses, and market forecasts that support the proposals or projections made in any business plan
- evidence on the suitability of your business activity to the location where it is undertaken, such as soil and climate conditions, markets for the products or services, and transport requirements
- scientific research or other papers on relevant industries
- evidence supporting the yield and price forecasts.

Product rulings

If you have invested in an arrangement with a product ruling, and the Commissioner's discretion has been exercised in that product ruling, the discretion applies for the life of the ruling.

See also:

- Non-commercial losses and product rulings

If you disagree with the Commissioner's decision

How to request a review if you disagree with the Commissioner's decision.

Last updated 14 October 2024

The Commissioner's exercise of discretion under the non-commercial losses rules (including a decision not to exercise discretion) is a matter leading up to or forming part of the making of an income tax assessment.

All decisions leading up to or forming part of the making of an income tax assessment are subject to a formal review process, including internal review and review by the Administrative Review Tribunal and Federal Court of Australia.

See also:

- [Dispute or object to an ATO decision](#)

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