

# ***TR 2002/D10 - Income tax: Non-commercial losses - application of subsections 35-10(2) and 35-10(4) to business activities carried on in partnership***

 This cover sheet is provided for information only. It does not form part of *TR 2002/D10 - Income tax: Non-commercial losses - application of subsections 35-10(2) and 35-10(4) to business activities carried on in partnership*

This document has been finalised by TR 2003/3.



## **Draft Taxation Ruling**

### **Income tax: Non-commercial losses – application of subsections 35-10(2) and 35-10(4) to business activities carried on in partnership**

| Contents                         | Paragraphs |
|----------------------------------|------------|
| <b>What this Ruling is about</b> | <b>1</b>   |
| <b>Ruling</b>                    | <b>3</b>   |
| <b>Date of effect</b>            | <b>12</b>  |
| <b>Explanations</b>              | <b>13</b>  |
| <b>Alternative views</b>         | <b>42</b>  |
| <b>Examples</b>                  | <b>49</b>  |
| <b>Detailed contents list</b>    | <b>66</b>  |
| <b>Your comments</b>             | <b>67</b>  |

#### ***Preamble***

*Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office. DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.*

#### **What this Ruling is about**

1. This ruling considers the operation of Division 35 of the *Income Tax Assessment Act 1997* ('ITAA 1997') and Division 5 of Part III of the *Income Tax Assessment Act 1936* ('ITAA 1936'), where an individual carries on business activities in partnership with others.
2. This ruling specifically considers the following issues:
  - the application of the loss deferral rule in subsection 35-10(2) of the ITAA 1997 to business activities carried on in partnership; and
  - the calculation of the amount of 'assessable income' for the purposes of paragraph 35-10(4)(b) of the ITAA 1997, regarding the Exception from the loss deferral rule for a \*primary production business<sup>1</sup> or a \*professional arts business, where the assessable income from other sources is less than \$40,000.

<sup>1</sup> An asterisk before a term in this Ruling denotes that the term is defined in the *Income Tax Assessment Act 1997* (ITAA 1997). Terms that are defined in the ITAA 1997, and identified with an asterisk in that Act, are similarly identified in this Ruling.

## Ruling

---

### **Subsection 35-10(2) and multiple business activities carried on in partnership**

3. An issue arises in relation to subsection 35-10(2) where an individual taxpayer carries on more than one business activity in partnership with others. This issue concerns whether the amount of any assessable income, and of the otherwise allowable deductions, to be identified under this subsection, are those that arise under section 92 of the ITAA 1936, or whether a 'look-through' approach applies.

4. The object of Division 35 is to apply certain rules, where appropriate, to each separate business activity carried on by an individual taxpayer, whether alone, or in partnership with others (see subsections 35-5(1) and 35-10(1)).

Note: paragraphs 36 to 48 and 83 to 85 of Taxation Ruling TR 2001/14 deal with the issue of identifying separate business activities.

5. In accordance with the object of Division 35, where an individual taxpayer carries on multiple business activities in partnership, subsection 35-10(2) applies by identifying their share of the assessable income (if any) from, and their share of the otherwise allowable deductions attributable to, the carrying on of each separate business activity (see **Examples 1(a)** and **(b)**).

6. In a case of this type, for the individual taxpayer, any excess of their share of otherwise allowable deductions over their share of any assessable income, for each separate business activity, will be subject to the requirements of Division 35, and may be deferred under subsection 35-10(2) to the next year the activity in question is carried on.

7. The correct application, in other words, of subsection 35-10(2) to situations such as those in Examples 1(a) and (b), is not one that simply looks at the result for the partnership as a whole. Therefore, subsection 30-10(2) should not be applied to such cases simply by using the amount of assessable income, or of the allowable deduction, the individual partner would calculate otherwise under section 92 of the ITAA 1936.

### **Subsection 35-10(4), where the 'other source' is in a partnership**

8. A further issue arises concerning the operation of subsection 35-10(4), where one of the potential 'other sources' of assessable income, is in a partnership.

9. Subsection 35-10(4) operates to stop the loss deferral rule in subsection 35-10(2) applying where the business activity carried on by

the individual taxpayer is either a \*primary production business or a \*professional arts business (as defined) and ‘*your assessable income ... from other sources that do not relate to that activity*’ is less than \$40,000 (paragraph 35-10(4)(b)).

10. Subject to the qualification stated below, where the ‘other sources’ of the taxpayer’s assessable income are only the income producing activities carried on in partnership with others, the assessable income of those partners who are individuals, is calculated for the purposes of subsection 35-10(4) as their interest in the net income of the partnership, i.e., the amount included in their assessable income under subsection 92(1) of the ITAA 1936 (see **Example 2(a)**).

11. This is not the case however, where both the primary production business (or the professional arts business), which is the ‘loss making activity’ for the purposes of Division 35, and the activities producing assessable income not related to that activity, which are the ‘other sources’ for the purposes of subsection 35-10(4), are all carried on in the same partnership. In such a case the ‘*assessable income ... from other sources*’ under that subsection is calculated by disregarding any assessable income from, and allowable deductions attributable to, the loss making activity (see **Example 2(b)**).

## **Date of effect**

---

12. This ruling applies to assessments to which Division 35 of the ITAA 1997 may apply, i.e., to assessments for the income year ended 30 June 2001 (or equivalent substituted accounting period) and subsequent years.

## **Explanations**

---

### **Object of Division 35**

13. As noted in paragraph 4, it is clear from the scheme of Division 35 that its rules are intended to operate in respect of each separate business activity conducted by an individual, irrespective of whether the activity is carried on by them alone, or in partnership.

### **Division 5 of Part III of the *Income Tax Assessment Act 1936***

14. Division 5 of Part III of the ITAA 1936 sets out the ordinary rules for the treatment of income and allowable deductions where a partnership is concerned. Section 90 of the ITAA 1936 defines the ‘*net income*’ of the partnership broadly as all the assessable income

# TR 2002/D10

less all the allowable deductions of the partnership, calculated as if it were a resident taxpayer. Similarly, the '*net loss*' of a partnership is defined as the excess of all the allowable deductions over all the assessable income of the partnership, calculated as if it were a resident taxpayer.

15. Subsection 92(1) of the ITAA 1936 then includes in the assessable income of each partner their interest in the net income of the partnership. Where a partnership loss has been incurred, subsection 92(2) of the ITAA 1936 provides that there is as an allowable deduction to each partner for their interest in the net loss of the partnership.

16. The effect of these provisions is that a partner will have either an amount included in their assessable income or an allowable deduction in respect of their share of the overall result of the operations of a partnership.

## **Subsection 35-10(2) of the *Income Tax Assessment Act 1997***

17. The rule in subsection 35-10(2) applies to the excess of an individual taxpayer's allowable deductions over their assessable income from each business activity. One interpretation of the interaction of subsection 35-10(2) with section 92 of the ITAA 1936 is that the subsection only applies to each individual partner's interest in the net amount assessable to them under subsection 92(1) of the ITAA 1936, or their interest in the net amount deductible under subsection 92(2), as the case may be.

18. This approach would result in the rule in subsection 35-10(2) being potentially ineffective where multiple business activities are carried on in the one partnership. This is because under this analysis, the loss deferral rule in Division 35 could operate only on the net profit or loss from all activities of the partnership, and not on the net results of each separate business activity.

19. Section 35-5 however, states that the intention of Division 35 is to prevent losses from non-commercial activities carried on by individuals, whether alone or in partnership, from being offset against their other income. Further, subsection 35-10(2) refers to '*... your assessable income from the business activity ... or your share of it ...*'. Generally, the only time a taxpayer would have a share of assessable income from a business activity is where that activity is carried on by the individual in partnership with others. The use of the words '*or your share of it*' indicates strongly that the rule in this subsection was always intended to apply to the individual's interest in the operations of each separate business activity carried on in partnership.

***Purposive approach to statutory interpretation***

20. The courts have on many occasions considered the use of a purposive approach to statutory interpretation, saying that statutory provisions should be interpreted in a way that promotes the objects of the provision.

21. Support for adopting an interpretation of subsection 35-10(2) conforming with the intent outlined above can be found in the High Court decision in *Cooper Brookes (Wollongong) Pty Ltd v. FC of T* (1981) 147 CLR 297; 81 ATC 4292; (1981) 11 ATR 949, and the subsequent line of authority<sup>2</sup> in Australia in which narrow literal interpretations have been avoided in favour of purposive ones that allow the recognised legislative intent to operate.

22. The purposive approach is founded on the notion that the intent of the Legislature is to be ascertained from, amongst other things, the context of the provision in question. In *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384; (1997) 141 ALR 618 Brennan CJ, Dawson, Toohey and Gummow JJ, said at CLR 408; ALR 635:

‘... the modern approach to statutory interpretation (a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses ‘context’ in its widest sense to include such things as the existing state of the law and the mischief which, by legitimate means such as those just mentioned, one may discern the statute was intended to remedy.’

23. The mischief intended to be remedied by Division 35, specifically in relation to ‘non-commercial losses’ arising from carrying on separate and distinct business activities in partnership with others, will not be fully and appropriately addressed unless a comprehensive ‘look-through’ approach to the individual partner’s position is adopted.

***Support from section 15AA***

24. Section 15AA of the *Acts Interpretation Act 1901* provides statutory authority for favouring an interpretation of a provision that promotes the purpose or object of the legislation to one that would not. For the reasons stated above, construing subsection 35-10(2) as requiring a look-through approach where partnerships are concerned, promotes the object of Division 35. Under subsection 35-5(1) this

---

<sup>2</sup> see e.g., *Brooks v. FC of T* [2000] FCA 721; (2000) 173 ALR 235; (2000) ATC 4362; (2000) ATR 312; *FC of T v. Orica (formerly ICI Aus Ltd)* (1998) 194 CLR 500; 98 ATC 4494; (1998) 39 ATR 66; *Collins v. AMP Superannuation Ltd* (1997) 147 ALR 243; (1997) 75 FCR 565.

# TR 2002/D10

object involves applying the Division to individuals making non-commercial losses from carrying on business activities, either 'alone or in partnership'. This object would be defeated if an interpretation of subsection 35-10(2) were adopted whereby individuals could shelter a non-commercial business loss in a partnership in which they also carried on a profitable activity.

25. Section 35-5 clearly states the intended purpose of Division 35, which is to prevent losses from non-commercial activities carried on by individuals, whether or not in partnership with others, from being offset against their other income. Further, subsection 35-10(2) refers to '*... your assessable income (if any) from the business activity, or your share of it, ...*'. This reference to a taxpayer's share of the assessable income, when read in the context of the stated objects of the Division, must therefore be interpreted as referring to the individual partner's share of the assessable income referable to the business activity which is carried on in the partnership.

26. To interpret the words, '*your assessable income*' in subsection 35-10(2) as referring only to the share of net income included in the assessable income of the partner under subsection 92(1) of the ITAA 1936, potentially shielding the losses from non-commercial activities against profits from other activities carried on in the same partnership, would defeat, rather than promote the objects of the Division.

27. Further, It would be an absurd result to read the phrase in subsection 35-10(2), '*or your share of it*', as only applying to the assessable income from the business activity, and not also to the preceding words in the provision '*...amounts attributable to the \*business activity for that income year that you could otherwise deduct under this Act...*'. This is because the subsection is concerned with identifying both the assessable income from, and the otherwise allowable deductions attributable to, that activity. It is therefore reasonable to conclude that the Legislature could not have intended such an operation and that the alternative interpretation is to be preferred.

28. It might be argued that if this outcome had been intended by the Legislature, the law should have been expressed by the insertion of additional words, so that subsection 35-10(2) would read:

If amounts attributable to the 'business activity for that income year that you could otherwise deduct under this Act, *or your share of them*, for that year exceed your assessable income (if any) from the business activity for that year, or your share of it, this Act applies to you as if the excess:

- (a) were not incurred in that income year, and

- (b) were an amount attributable to the activity that you could deduct from assessable income from the activity for the next income year in which the activity is carried on.’

29. In the High Court case of *Newcastle City Council v. GIO General Ltd* (1997) 191 CLR 85; (1997) 149 ALR 623 McHugh J discussed the circumstances in which a court can interpret the words of a provision as if additional words were contained in that provision. At CLR 113; ALR 643 he stated:

‘As a result, on rare occasions a court may be justified in treating a provision as containing additional words if those additional words will give effect to the legislative purpose. In *Jones v. Wrotham Park Estates* [(1980) AC 74], Lord Diplock said that three conditions must be met before a court can read words into legislation. First, the court must know the mischief with which the statute was dealing. Secondly, the court must be satisfied that by inadvertence Parliament had overlooked an eventuality which must be dealt with if the purpose of the legislation is to be achieved. Thirdly, the court must be able to state with certainty what words Parliament would have used to overcome the omission if its attention had been drawn to the effect.’

30. Section 35-5 clearly spells out the mischief that Division 35 is dealing with, and it is clear that the intended operation of subsection 35-10(2) is to defer, where appropriate, the losses incurred by an individual referable to each separate business activity they carry on. Where the individual carries on a business activity in partnership with others, it is also clear that this subsection was intended to defer the taxpayer’s share of the losses from that business activity. This is not achieved for the situations in question unless the subsection is interpreted as if it contained the words, ‘*or your share of them*’, as set out in paragraph 28 above.

31. Failure to read the subsection as if it contained the words ‘*or your share of them*’ in reference to the deductions creates an incongruous result. To interpret the subsection as applying to the taxpayer’s share of the assessable income, but not to the taxpayer’s share of the allowable deductions, would result in inconsistencies between the application of the subsection to business activities carried on as a sole trader, and its application to those carried on in a partnership, and would be counter to the stated objectives of the Division. Such an interpretation could not have been intended by Parliament. It is clear therefore that the omission of the words ‘*or your share of them*’, to ensure that the subsection examines an individual’s share of both the allowable deductions and the assessable



income in relation to activities carried on in partnership, is therefore only explicable as inadvertence by Parliament.

32. The three conditions stated by Lord Diplock are satisfied. The mischief with which the statute is dealing is clearly known, the omission appears to be due to inadvertence or an oversight by Parliament, and it is possible to state with certainty the words which would be used by Parliament to overcome this omission. Further, a construction which treats subsection 35-10(2) as containing these words, promotes the objects of both this subsection and Division 35 overall.

### **Subsection 35-10(4) of the *Income Tax Assessment Act 1997***

33. Subsection 35-10(4) operates to prevent the loss deferral rule in Division 35 applying to a 'loss' from a business activity ('the loss making activity'), that is either a \*primary production business or a \*professional arts business, where the assessable income (excluding any net capital gain), of the individual taxpayer carrying on that activity, from '*other sources that do not relate to that business activity*' is less than \$40,000.

34. For the subsection to apply therefore, it must be possible to quantify the amount of the assessable income from these 'other [unrelated] sources'. In many cases this should not involve any particular problems. For example, take the case of an individual taxpayer carrying on a loss making primary production business, who also derives employment income, which is from a completely unrelated source. Calculation of the assessable income of this taxpayer that is from this unrelated source, for the purposes of subsection 35-10(4), logically occurs by disregarding any assessable income from, or allowable deductions attributable to, the loss making activity.

### ***Subsection 35-10(4) and partnership situations***

35. The application of subsection 35-10(4) where the source of the unrelated income is an income producing activity carried on in partnership with others, may give rise to some difficulties. As noted in paragraphs 14 to 16 of this Ruling, special rules in

Division 5 of Part III of the ITAA 1936 apply in calculating the amount that a partner includes in their assessable income. These rules involve the calculation of either the 'net income' of the partnership, or the 'partnership loss', under section 90 of the ITAA 1936, before calculating the amount the partner includes as their assessable income (being their interest in the net income), or claims as an allowable deduction (being their interest in the partnership loss), under section 92 of the ITAA 1936.

36. Under these rules there is a calculation of what is the assessable income of the partnership, calculated as if the partnership were a resident taxpayer (section 90). However, unlike the position with subsection 35-10(2) (as explained above), there are no words in subsection 35-10(4) that suggest it is appropriate to look through the calculation of the assessable income of the partnership to identify a particular partner's share of that assessable income, when calculating for the purposes of subsection 35-10(4), the partner's assessable income from an unrelated source. Further, it does not follow from the object of Division 35, as stated in section 35-5, that such a look through approach should be adopted.

37. Therefore, whilst the rules in Division 5 of the ITAA 1936 were not specifically designed to quantify a partner's assessable income from a 'source', but rather their assessable income in relation to the partnership as a whole, it is considered, subject to the qualification expressed below, that these rules will generally apply when determining whether subsection 35-10(4) operates in relation to a relevant partner, to prevent the loss deferral rule in subsection 35-10(2) applying.

38. Thus, in the case where the loss making activity is conducted separately from the activities carried on in partnership (i.e., outside of the partnership), and those partnership activities constitute all the other sources of unrelated assessable income, the amount of a relevant partner's assessable income 'from other sources' unrelated to the loss making activity will be their interest in the net income of the partnership, calculated under subsection 92(1) of the ITAA 1936 (see **Example 2(a)**).

39. If, however, there is more than one source of unrelated assessable income, e.g., salary and wages, interest, dividends or an interest in more than one unrelated partnership (calculated as above under subsection 92(1) of the ITAA 1936), the assessable income from sources that are unrelated to the loss making activity is the total assessable income from all such unrelated sources.

*Operation of subsection 35-10(4) where both the loss making activity and sources of other income are carried on in the same partnership*

40. A qualification to the approach described above exists where the loss making activity and the source(s) of unrelated assessable income are both carried on in the same partnership. Application of the above approach, using sections 90 and 92 to determine the amount of the assessable income, for the purposes of subsection 35-10(4), from 'other [unrelated] sources', would mean in such a case that this amount would always be understated, through taking into account the 'loss' from the loss making activity, and therefore, would not be a true

and proper reflection of the actual assessable income from these other sources.

41. It is considered that the proper interaction of sections 90 and 92 of the ITAA 1936, with subsection 35-10(4) of the ITAA 1997, in such a case, requires that the 'loss' from the loss making activity (i.e., any assessable income from, and allowable deductions attributable to, that activity), be disregarded. In other words, the amount of the relevant partner's assessable income from the 'other sources' in question, for the purposes of subsection 35-10(4), is calculated by excluding from the calculation under section 90, any assessable income from, and allowable deductions attributable to, the loss making activity (see **Example 2(b)**).

## **Alternative views**

---

### **Subsection 35-10(2) and multiple business activities carried on in partnership**

42. Subsection 92(1) of the ITAA 1936 provides that a partner's share of the net income of a partnership is to be included as assessable income. Subsection 92(2) of the ITAA 1936 provides that a partner's share of the net loss from a partnership will be an allowable deduction.

43. Where a taxpayer carries on two business activities in the same partnership, which has an overall profit, and one activity produces a profit, and the other produces a loss, subsection 92(1) of the ITAA 1936 requires that each partner include in their assessable income only their share of the net income of the partnership.

44. It could be argued therefore, that for the individual partner, with no deductions in their own right, there is no excess of allowable deductions over assessable income in respect of the activities carried on in the partnership, because only their share of the overall net income of the partnership is included in their assessable income.

45. In such a case therefore, there is no 'excess' to which subsection 35-10(2) could apply.

46. For the reasons given above, adopting the above approach to the interpretation of subsections 35-10(2) is not considered to promote the object of Division 35, and is therefore not preferred.

### **Subsection 35-10(4), where the 'other source' is in a partnership**

47. There is an alternative view to the one expressed above in respect of subsection 35-10(4). This is, consistent with the preferred

approach for subsection 35-10(2), that the words 'or your share of it' should also be read into subsection 35-10(4)

48. It does not follow however, from either the plain words of subsection 35-10(4) or the object of Division 35, that this approach should be adopted. Therefore, this view is not preferred.

## **Examples**

### **Example 1(a): multiple business activities where a test passed**

49. Jane and Andrew are equal partners in a partnership which carries on two business activities, a computer software consulting business and a small horse stud. For the year ended 30 June 2001 the income and expenses for the two activities are:

|                       | <u>Computer Software</u> | <u>Horse Stud</u> |
|-----------------------|--------------------------|-------------------|
| Assessable Income:    | \$210,000                | \$24,000          |
| Allowable Deductions: | \$60,000                 | \$51,000          |
| Profit/Loss:          | \$150,000                | \$(27,000) loss   |

50. The net income of the partnership therefore is \$123,000, and \$61,500 each is assessable potentially under section 92 of the ITAA 1936 to Andrew and Jane.

51. Subsection 35-10(2) requires that the assessable income and deductions for each business activity be examined separately for each individual. For the computer software business activity, each individual's share of the assessable income from the activity is \$105,000 and their share of deductions attributable to this activity is \$30,000. As no overall loss arises, subsection 35-10(2) does not operate to defer any amount.

52. For the horse stud however, each partner's share of the assessable income is \$12,000 and their share of deductions attributable to this activity is \$25,500, i.e., an overall loss for each partner from this activity of \$13,500 arises. This loss would be deferred under subsection 35-10(2) if it were not for the assessable income test in section 35-30.

53. In this example, both the partners are individuals and therefore the total assessable income from the business activity is taken into account for the purposes of the assessable income test. The total assessable income from the horse stud activity is \$24,000 and therefore the assessable income test is passed, and the loss from this activity does not have to be deferred by either Andrew or Jane.

**TR 2002/D10****Example 1(b): multiple business activities where no test passed**

54. For this example assume that the businesses are the same as in the previous example, but instead of two equal partners, Jane and Andrew, the businesses are conducted in partnership with three equal partners, Jane, Andrew and a private company, JA Investments Pty Ltd.

55. Again each partner will not have allowable deductions in excess of their assessable income in respect of the computer software business. In respect of the horse stud business activity however, each partner will have assessable income of \$8,000 and deductions attributable to it of \$17,000. Consequently, Jane and Andrew will have an excess which subsection 35-10(2) may defer. (Note: Division 35 only applies to individuals and hence the loss deferral rule does not apply to JA Investments Pty Ltd.)

56. In this example, two of the partners are individuals and one partner is a company. Section 35-25 requires the interests of any non-individual partners to be ignored when applying the assessable income test. As a result, only \$16,000 of the assessable income from the horse stud activity is taken into account for the assessable income test, and therefore it is not passed. As the Assessable income test is not passed, the rule in subsection 35-10(2) will operate to defer the losses of Jane and Andrew in respect of the horse stud activity in this example. Assuming no other test in Division 35 is met, the exception in subsection 35-10(4) does not apply, and no exercise of the discretion under section 35-55 will occur.

**Example 2(a): subsection 35-10(4) and partnerships**

57. Susan operates a cattle grazing business which has for the 2000-01 income year, the following income and expenses:

|                      |                 |
|----------------------|-----------------|
| Assessable Income    | \$10,000        |
| Allowable Deductions | \$35,000        |
| Profit / Loss        | \$(25,000) loss |

58. In addition, she operates a camping supplies store in equal partnership with Chester. The following income and expenses result from this business for the income year in question:

|                           |           |
|---------------------------|-----------|
| Assessable Income         | \$100,000 |
| Allowable Deductions      | \$30,000  |
| Net income of partnership | \$70,000  |

59. Clearly for Susan, the allowable deductions in respect of the cattle grazing business activity exceed the assessable income from it. Consequently subsection 35-10(2) may operate to defer the excess of the \$25,000 allowable deductions to the next year in which this activity is carried on.

60. 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. In this example, Susan's assessable income from sources which do not relate to the cattle grazing activity is the \$35,000, being her 50% interest in the net income of the partnership, which is included in her assessable income under subsection 92(1) of the ITAA 1936. As this does not exceed the \$40,000 limit in paragraph 35-10(4)(b), Susan satisfies the requirements of the Exception and does not have to defer the loss from her cattle grazing activity.

**Example 2(b): subsection 35-10(4) where loss making activity and sources of other income in same partnership**

61. 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:

|                           | Camping Store | Cattle Grazing  |
|---------------------------|---------------|-----------------|
| Assessable Income:        | \$100,000     | \$10,000        |
| Allowable Deductions      | \$35,000      | \$47,000        |
| Profit / Loss             | \$65,000      | \$(37,000) loss |
| Net income of partnership |               | \$28,000        |

62. 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 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.

63. 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.

**TR 2002/D10**

64. 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.

65. The proper calculation of this 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.

**Detailed contents list**

66. Below is a detailed contents list for this draft Ruling:

|  | <b>Paragraph</b> |
|--|------------------|
| <b>What this Ruling is about</b>   | <b>1</b>         |
| <b>Ruling</b>  | <b>3</b>         |
| Subsection 35-10(2) and multiple business activities carried on in partnership   | 3                |
| <b>Date of effect</b>  | <b>12</b>        |
| <b>Explanations</b>  | <b>13</b>        |
| Object of Division 35  | 13               |
| Division 5 of Part III of the <i>Income Tax Assessment Act 1936</i>  | 14               |
| Subsection 35-10(2) of the <i>Income Tax Assessment Act 1997</i>   | 17               |
| <i>Purposive approach to statutory interpretation</i>  | 20               |
| <i>Support from section 15AA</i>   | 24               |
| Subsection 35-10(4) of the <i>Income Tax Assessment Act 1997</i>   | 33               |
| <i>Subsection 35-10(4) and partnership situations</i>  | 35               |
| <i>Operation of subsection 35-10(4) where both the loss making activity and sources of other income are carried on in the same partnership</i> | 40               |
| <b>Alternative views</b>   | <b>42</b>        |
| Subsection 35-10(2) and multiple business activities carried on in partnership   | 47               |

|  |           |
|--|-----------|
| Subsection 35-10(4), where the 'other source' is in a partnership  | 49        |
| <b>Examples</b>  | <b>49</b> |
| Example 1(a): multiple business activities where a test passed   | 49        |
| Example 1(b): multiple business activities where no test passed  | 54        |
| Example 2(a): subsection 35-10(4) and partnerships   | 57        |
| Example 2(b): subsection 35-10(4) where loss making activity and sources of other income in same partnership | 61        |
| <b>Detailed contents list</b>  | <b>66</b> |
| <b>Your comments</b>   | <b>67</b> |

## Your comments

---

67. If you wish to comment on this draft Ruling, please send your comments promptly by **18 October 2002** to

**Comments by Date:** 18 October 2002

**Contact Officer:** Peter Hawkins

**E-Mail address:** peter.hawkins.ato.gov.au

**Telephone:** (08) 8208 3885

**Facsimile:** (08) 8208 3947

**Address:** **Australian Taxation Office**  
PO Box 200  
Adelaide SA 5001

---

### Commissioner of Taxation

4 September 2002

---

*Previous draft:*

Not previously released in Draft form.

*Related Rulings/Determinations:*

TR 2001/14

*Subject references:*

- assessable income test
- deferred non-commercial loss
- loss deferral rule
- non-commercial loss
- partnerships
- primary production business and professional arts business exception

*Legislative references:*

- Acts Interpretation Act 1901 15AA
- ITAA 1997 Div 35
- ITAA 1997 35-5
- ITAA 1997 35-5(1)
- ITAA 1997 35-10(1)
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(4)
- ITAA 1997 35-10(4)(b)
- ITAA 1997 35-25
- ITAA 1997 35-30
- ITAA 1936 Div 5
- ITAA 1936 Div 5 Pt III



# TR 2002/D10

- ITAA 1936 90
- ITAA 1936 92
- ITAA 1936 92(1)
- ITAA 1936 92 (2)

*Case references:*

- Cooper Brookes (Wollongong) Pty Ltd v FC of T (1981) 147 CLR 297; 81 ATC 4292; (1981) 11 ATR 949
- CIC Insurance Ltd v. Bankstown Football Club Ltd (1997) 187 CLR 384; (1997) 141 ALR 618

- Brooks v. FC of T [2000] FCA 721; (2000) 173 ALR 235; 2000 ATC 4362; (2000) ATR 352
  - FC of T v. Orica (formerly ICI Aus Ltd) 98 ATC 4494; (1998) 39 ATR 66; (1998) 194 CLR 500
  - Collins v. AMP Superannuation Ltd (1997) 147 ALR 243; (1997) 75 FCR 565
  - Newcastle City Council v GIO General Ltd (1997) 149 ALR 623; (1997) 191 CLR 85
- 

*ATO references:*

NO: T2002/011895  
ISSN: 1039-0731