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Your claim for a business tax loss can be denied

Business owners are naturally keen to be able to absorb a business loss as a tax deduction, but it also pays to not stray too far from the generally accepted rules regarding tax losses — there are circumstances where the ATO is legitimately able to deny such claims.

The ATO has the discretion to disallow the deduction of a tax loss if, during the relevant income year, the business attempting to make such a claim earned assessable income (or realised a capital gain) that *would not have been derived* had the loss been unavailable as a deduction (our emphasis).

The tax law has measures in place to ensure such deductions are limited to those businesses that are legitimately eligible — such as the continuity of ownership and the same business tests — but there is also the measure above, which the ATO calls an "integrity" safeguard, that may result in a denial of a claim for losses that business owners should keep in mind.

There is some balance to the rules in that the Commissioner of Taxation is "prevented" from disallowing the deduction should "continuing shareholders" stand to benefit from the relevant income. However there is still a fair amount of discretion left to the Commissioner in how the business loss rules are applied.

Remember also that different business structures have different rules around loss claims.

Individuals can generally carry forward a tax loss indefinitely, but must claim a tax loss at the first opportunity. You cannot choose to hold on to losses to offset them against future income if they can be offset against the current year's income.

If you are a sole trader you may also be able to offset the business losses carried forward against other income under the "non-commercial business loss" rules (ask this office if you think this might apply).

If a partnership makes a tax loss, each partner has a proportionate share of the loss and treats it like a loss from any business activity (including applying the non-commercial loss rules).

If you operate your business as a trust and you incur a tax loss, you cannot distribute the loss to the trust's beneficiaries.

Losses must be quarantined in a trust to be carried forward by the trust indefinitely until offset against future net income. It is possible to use those losses as deductions against income in the trust in future income years if the trust satisfies certain tests relating to ownership or control of the trust.

Companies can carry forward a tax loss indefinitely, and use it when they choose, provided they satisfy the above mentioned continuity and same-business tests.

As far as the ATO exercising the discretion to disallow, and of course circumstances of the business or businesses involved will have an influence, a business can mitigate the risk that the ATO will exercise this discretion to disallow a tax loss deduction by making sure that either (or preferably both) of the following contentions are supported:

- that the business would have derived the income or realised the capital gain regardless of the tax loss being available
- that continuing shareholders will benefit from the above in a fair and reasonable manner with regard to their rights and interests.