TR 93/D2 - Income tax: assessability of proceeds from illegal activities and treatment of amounts recovered.

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Australian Taxation Office

Draft Taxation Ruling

Income tax: assessability of proceeds from illegal activities and treatment of amounts recovered.

other Rulings on this topic

IT 2623; TD 92/D140

contents	para
What this Ruling is about	**1**
Ruling	**5**
Date of effect	**8**
Explanations	**9**

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What this Ruling is about

1. This Ruling considers whether the proceeds of certain illegal activities will be treated as assessable income.

2. In this Ruling illegal activities means any activities not permitted by law such as drug dealing, prostitution, insider trading, SP bookmaking etc. It does not include activities such as bank robberies where the recipients of the money do not obtain legal title to it.

3. The Ruling also considers the treatment of amounts that are recovered or repaid.

4. The Ruling does not consider the application of the CGT provisions.

Ruling

5. What is normally accepted as income is determined according to the ordinary usages and concepts of mankind. Receipts from regular activities are income irrespective of whether the activities are legal or illegal.

6. In the case of an isolated transaction the assessability of the proceeds must depend on the circumstances of each case.

7. Where an amount included as income is recovered or repaid this amount may be excluded from the assessable income of the year in which the proceeds were derived, subject to the objection and amendment provisions of the *Income Tax Assessment Act 1936* (ITAA) and *Taxation Administration Act 1953*.

Date of effect

8. This Ruling has both a past and future application (see Taxation Ruling TR 92/20). However, it does not have a past application for a taxpayer who has agreed to a settlement of a dispute to the extent that the Ruling is less favourable than the settlement terms. To the extent that the Ruling is more favourable, it does not have a past application for the taxation years the subject of the settlement.

Explanations

The Assessability of Proceeds from Illegal Activities

9. The tests as to whether an amount is assessable income under subsection 25(1) ITAA are the same for amounts received from both legal and illegal activities. Where a taxpayer systematically engages in an illegal activity and the elements of a business are present such as repetition, regularity, view to a profit and organisation, the proceeds from the activity have an income character.

10. In the English case *Partridge v. Mallandaine* (1886) 2 TC 179 the question of dealing in stolen goods was considered and Denman J stated:

> 'In my opinion if a man were to make a systematic business of receiving stolen goods, and to do nothing else, and he thereby systematically carried on a business and made a profit of £2000 per year, the Income Tax Commissioners would be quite right in assessing him if it were in fact his vocation.'

11. Two other English cases where the proceeds from illegal transactions were considered to be assessable income are *Lindsay v. IRC* (1932) 18 TC 43 where the proceeds in question had been derived from smuggling and *Minister of Finance (Canada) v. Smith* [1927] AC 193 which involved proceeds from bootlegging liquor.

12. Taxation Ruling TR 92/3 provides guidance in determining whether profits from isolated transactions are income and therefore assessable under subsection 25(1).

Treatment of Amounts Recovered or Repaid

13. Subsection 51(1) allows a deduction for losses or outgoings incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for that purpose. Amounts obtained from an illegal activity that are subsequently repaid or recovered for whatever reason will not be an allowable deduction because such amounts are not incurred in any way for the purpose of obtaining the illegal proceeds. Generally they are imposed on the offender as a means of retribution and are not incurred by the offender in earning the proceeds.

14. Any fines or penalties imposed on an offender are also not deductible under subsection 51(1) for the same reasons as amounts recovered or repaid are not deductible. Furthermore fines and penalties are specifically excluded from being deductible pursuant to subsection 51(4). (Refer TD 92/D140).

15. In circumstances where amounts are recovered or repaid a strict application of the law may lead to the unfair situation where the Commissioner is seeking tax in respect of amounts that have been repaid. The general approach has been to use the objection and amendment provisions in the law, subject to the statutory time limits in those provisions, to exclude the amount repaid from the assessable income of the year in which the proceeds from the illegal activity were taxed. (See for example Taxation Ruling IT 2623).

16. Where the repayment has been made, the taxpayer's assessments may be amended to exclude from assessable income the amount repaid. This is subject to the qualification that amended assessments can only be made under sub-section 170(3) where an application is made by a taxpayer within 4 years from the date upon which the tax became due and payable under the assessment. Taxpayers should also be aware of the objection provisions of Part IVC of the Taxation Administration Act.

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- business tests
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- isolated transactions

legislative references
- ITAA 25(1); 51(1); 51(4); 170(3)
- TAA Part IVC

case references
- Partridge v. Mallandaine (1886) 2 TC 179
- Lindsay v. IRC (1932) 18 TC 43
- Minister of Finance (Canada) v. Smith [1927] AC 193