IT 2645 - Income tax: relief from substantiation requirements

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OTHER RULINGS ON THIS TOPIC:

TITLE: INCOME TAX: RELIEF FROM SUBSTANTIATION REQUIREMENTS

NOTE: . Income Tax Rulings do not have the force of law.

. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Ruling.

PREAMBLE

This Ruling discusses the amendment made by the Taxation Laws Amendment Act (No.4) 1990 (Act No.4 of 1991) to the substantiation provisions of the income tax law in Subdivision F of Division 3 of Part III of the Income Tax Assessment Act 1936 (the Act).
The amendment received Royal Assent on 8 January 1991 and operates on and from that date. It introduced a new section 82KZAA to allow the substantiation provisions not to apply, as they may have in the past, to deny a deduction for an expense in certain cases where the strict requirements of those provisions have not been met.

2. The substantiation provisions make it a requirement for income tax purposes that certain documentary evidence be maintained to substantiate employment-related expense claims by employees, and car and travel expense claims by employees and self-employed persons. A deduction for the particular expenditure, otherwise allowable under general provisions of the Act, is precluded unless the specified evidence to satisfy the substantiation requirements is kept by, or on behalf of, the taxpayer. Consistent with the self-assessment

environment, a taxpayer, although required to declare that the evidence has been kept, is not required to furnish it with the income tax return but must supply it to the Commissioner when called on to do so.

3. The general rule (prior to the introduction of section 82KZAA) was that a deduction was not allowable, and was deemed never to have been allowable, for an expense if the taxpayer failed to retain the necessary evidence for the required period (or to produce it upon request).

4. Section 82KZAA was introduced by the Government, and unanimously endorsed by the Parliament, to meet widespread concerns in those forums and in the community generally over the operation of the substantiation requirements in particular individual cases. The specific concern was that, without in any way diminishing the basic operation of the general rule outlined above, the substantiation provisions should not be allowed to operate so harshly as to deny a deduction in exceptional individual circumstances where, on review of a taxpayer's claim, it is found that, having regard to all available documentary and other evidence, it would in all the circumstances be unreasonable for the provisions to have that outcome.

5. Against this background, subsection 82KZAA(1) sets out the criteria that must be satisfied if the substantiation sections (Subdivision F) are not to apply in relation to an expense.
The requirement remains that the Commissioner must be satisfied that the expense was incurred. This is consistent with the operation of the income tax law generally. Further, the Commissioner is directed to form an opinion that it would be unreasonable for the substantiation sections to apply.

6. In reaching his decision on these matters, the Commissioner is directed to have regard to:

(a) the nature and quality of evidence that the taxpayer has available to substantiate the claim; and

(b) special circumstances affecting the taxpayer, including (but not limited to):

(i) the extent to which the taxpayer attempted to comply with the substantiation sections;

(ii) whether the taxpayer's failure to comply with the sections was inadvertent or deliberate.

7. Also reflecting the concerns mentioned earlier, section 82KZAA applies only where a taxpayer's assessment is being reviewed.
In other words, it needs to be borne in mind that the onus that the substantiation provisions place on taxpayers as to the standard of documentary evidence required to support claims made in their returns has not been diminished in any way. While the law now provides relief in relation to the strict requirements of substantiation, this is available in very limited and exceptional circumstances only, and the obligation on taxpayers to maintain the statutory evidence necessary in respect of an expense as set down in the substantiation provisions has not been altered. Nor will the new measure result in deductions being available without satisfactory supporting evidence in cases to which it applies.

RULING

8. An officer reviewing a claim where the documentary evidence required by the substantiation provisions is incomplete, should consider the nature and quality of the evidence that is provided to support the taxpayer's assertion that the relevant expense was incurred. Also, the officer must consider the degree of completeness of the evidence that should have been kept to comply with the substantiation sections.

9. The point has been made that section 82KZAA applies only on a review of an assessment, and that taxpayers are still expected to meet the substantiation provisions. The section is premised on the basis that, by reason of self-assessment procedures, at the point of initial assessment a deduction claim will not be denied for want of substantiation, and the presumption is that the relieving effect of section 82KZAA will therefore be considered after a deduction, which does not meet strict substantiation standards, has been given through routine self-assessment processes.

10. Should there be an exceptional case in which a deduction claim is reviewed in the making of an initial assessment, and it is found that the claim may fail strict substantiation tests, then before the claim is disallowed on that basis, the possible application of section 82KZAA in a review of the assessment should be considered. If it appears that section 82KZAA would be likely to apply, and it is found necessary,

having regard to all relevant matters, to disallow the claim when making the initial assessment, the taxpayer should be given, with the notice of that assessment, an invitation to apply for an amendment in reliance on that section.

11. The degree of compliance with the substantiation sections will vary from case to case and each case should be considered on its own facts. However, it is consistent with the terms of the law that no relief would be available in respect of a claim for which there is no supporting documentation or factual material evidencing the expense. In other cases it is expected that a common sense approach in exercising the discretion will result in a deduction being allowed, where it is apparent from the evidence available that the expense has actually been incurred.

12. For example, failure to sign entries in a motor vehicle log book may not result in the relevant deduction being disallowed. The same outcome might be appropriate even in cases where a motor vehicle log book is not fully completed as to all details required, if the omissions are limited and the relevant details are manifestly obvious from the activities of the taxpayer, e.g.,
a surgeon who travels from his practice to hospital every day.

13. Similarly, where a taxpayer substantiates a large proportion of a claim, and the balance can be evidenced in some other way, relief may be available. As an illustration, a taxpayer may make a claim for telephone expenditure, but not have all relevant documentary evidence. The taxpayer still has the telephone connected and can produce a cheque butt and bank statement to verify the expense. It would be open to conclude that it would be unreasonable for the substantiation sections to apply in that case. Other acceptable evidence in such a case could be a subsequent account showing a credit for the previous payment of the telephone expenditure in question, or that there are no arrears in payment.

14. Other examples of alternative evidence which may be satisfactory include:

. entries on group certificates or statements of earnings showing, e.g., amounts of union dues or subscriptions to professional bodies; and

. credit card documents which, although not fully descriptive, contain sufficient information to clearly identify goods or services obtained, e.g., payment to a motor

vehicle registry of a recognised statutory amount for motor vehicle registration and insurance.

15. These few examples are not exceptions to the substantiation requirements. Nor in giving them is it intended to lay down any firm boundaries as to what is or is not acceptable for the new provisions. As stressed above, each case must be considered on its own merits, and a common sense approach applied that is consistent with the very clear intention of the Parliament in this matter.

COMMISSIONER OF TAXATION
5 July 1991

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