TR 93/25 - Income tax: assessability of proceeds from illegal activities, treatment of amounts recovered and deductibility of fines and penalties.

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An updated version of this ruling has been issued as a draft for public comment until 25 February 2022.

This document has changed over time. This is a consolidated version of the ruling which was published on *12 August 1993*

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Taxation Ruling

Income tax: assessability of proceeds from illegal activities, treatment of amounts recovered and deductibility of fines and penalties.

*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part . Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

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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 under subsection 25(1) of the *Income Tax Assessment Act 1936* (ITAA).

2. In this Ruling illegal activities means any activities not permitted by law such as those related to drug dealing, insider trading, misappropriation, prostitution, SP bookmaking etc.

3. This Ruling also considers the treatment of amounts that are recovered or repaid and any fines or penalties that are imposed for the offence.

4. This Ruling does not consider the application of the capital gains tax provisions.

Ruling

5. What is normally accepted as income is determined according to the ordinary usages and concepts of mankind. Receipts from a systematic activity where the elements of a business are present 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 ITAA and *Taxation Administration Act 1953*(TAA).

Date of effect

8. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

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 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. Other cases where the proceeds from illegal transactions were considered to be assessable income include *Minister of Finance (Canada) v. Smith* [1927] AC 193 which involved proceeds from bootlegging liquor in Ontario, *Lindsay v. IRC*(1932) 18 TC 43 where the proceeds in question had been derived from smuggling rye whiskey out of Scotland for sale in the USA and *Southern (HM Inspector of Taxes) v. A.B.* (1933) 18 TC 59, considering the proceed of illegal bookmaking operations.

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

Treatment of Amounts Recovered or Repaid

13. Subsection 51(1) ITAA 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 repayment or restitution is imposed on the offender as a means of retribution and is not incurred by the offender in earning the proceeds. Such payments represent a repayment of income as opposed to an outgoing incurred in deriving that income.

14. 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.

15. 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 subsection 170(3) ITAA 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 TAA.

Fines and Penalties

16. Generally, fines and penalties are not deductible under subsection 51(1) ITAA (*Madad Pty Ltd v. FCT* 84 ATC 4739) and they are specifically excluded from being deductible pursuant to subsection 51(4) ITAA.

17. Amounts ordered by the Courts under the *Proceeds of Crime Act 1987 (Cth)* or the *Crimes (Confiscation of Profits) Act 1989 (Qld)* (or a similar State enactment) fall within paragraph 51(4)(b) ITAA which states that a deduction is not allowable for:

> "(b) an amount ordered by a court, upon the conviction of a person for an offence against a law of the Commonwealth, a State, a Territory or a foreign country, to be paid by the person."

Examples

Example 1

18. Mr A. Baba was found, pursuant to an audit, to have earnt $20,000 during the year ended 30 June 1991 from the misappropriation of company funds. This amount is assessable income and therefore his return was amended to increase his income for that year from the amount declared of $25,000 to $45,000.

19. Ali was subsequently indicted with the offence of misappropriation and on 1 February 1992 (ie. during the year ended 30 June 1992) he was convicted and pursuant to a Court restitution order an amount of $20,000 was repaid to the company.

20. The $20,000 is not allowable as a deduction for the year ended 30 June 1992; however this amount will be excluded from his assessable income for the year ended 30 June 1991, thus reducing his assessable income for that year back to $25,000.

Example 2

21. In addition to being ordered to repay the $20,000, Ali is also fined $2,000. The $2,000 is not allowable as a deduction, nor is it excluded from his assessable income for the year ended 30 June 1991.

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subject references
- amendment and objection provisions
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- fines and penalties
- illegal activities
- isolated transactions

legislative references
- ITAA 25(1); 51(1); 51(4); 170(3)
- TAA Part IVC
- Crimes (Confiscation of Profits) Act

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
- Southern (HM Inspector of Taxes) -v- A.B. (1933) 18 TC 59