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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Taxation Ruling

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

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Relying on this Ruling

This publication is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

*[**Note:** This is a consolidated version of this document. Refer to the Legal Database (www.ato.gov.au/Law) to check its currency and to view the details of all changes.]*

What this Ruling is about

1. This Ruling considers whether the proceeds of certain illegal activities will be treated as assessable income under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997).

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

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

4. This Ruling does not consider the application of the capital gains and losses 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 depends on the circumstances of each case.

7. [Omitted.]

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 75 and 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

Explanations

Assessability of Proceeds from Illegal Activities

9. The tests as to whether an amount is assessable income under section 6-5 of the ITAA 1997 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 proceeds of illegal bookmaking operations.

12. Taxation Ruling TR 92/3 provides guidance in determining whether profits from isolated transactions are assessable under section 6-5 of the ITAA 1997.

Treatment of Amounts Forfeited, Recovered from or Repaid

13. The deductibility of amounts earned from illegal activities that are subsequently forfeited, recovered from or repaid depends on the circumstances of the case.

14. There is no general principle that amounts forfeited, recovered from or repaid cannot be deductible. However, whether they are deductible in the particular case will turn on whether there is sufficient connection between the payments and income-earning activities to satisfy the requirements of section 8-1 of the ITAA 1997. In some cases, there will be insufficient connection to income-producing activities (or to the carrying on of a business for the purpose of producing assessable income) to justify a deduction. In each case, whether the repayment gives rise to a deduction under section 8-1 of the ITAA 1997 requires that careful consideration be given to the

occasion for that repayment. It does not suffice for deductibility that the illegally-earned income was assessable when derived.

15. It was recognised by the Federal Court in *Zobory v Commissioner of Taxation of the Commonwealth of Australia* [1995] FCA 269 that a taxpayer who had misappropriated funds that were then invested at interest, who held both the misappropriated funds and income derived from those funds on constructive trusts, and who ultimately repaid the misappropriated funds and interest to the victim of the fraud, was not personally liable to tax in respect of the interest. We do not accept, however, that there is a general income tax principle that income earned from illegal activities if repaid is then treated as never having been derived.

15A. Section 59-30 of the ITAA 1997 provides that an amount is neither assessable nor exempt income if you must repay it, you do repay it in a later income year, and you cannot deduct the repayment. In the context of amounts of an income character earned from illegal activity in a particular year, this provision will be engaged if the taxpayer is subsequently ordered to repay those amounts and the other requirements of the section (including non-deductibility of the repayment) are satisfied.[1] However, section 59-30 of the ITAA 1997 only applies to a 'repayment'. It does not apply to the loss or forfeiture of income or amounts that are recovered.[2] That is, it does not apply when the taxpayer is obliged to pay the income to a person other than the person from whom it was derived, or in cases of mere loss.

Fines and Penalties

16. Generally, fines and penalties are not deductible under section 8-1 of the ITAA 1997 (*Commissioner of Taxation v Madad Pty Ltd* [1984] FCA 311) and they are specifically excluded from being deductible pursuant to section 26-5 of the ITAA 1997.

17. [Omitted.]

Examples

Example 1

18. Alex was found, pursuant to an audit, to have earned $20,000 from the misappropriation of company funds during the 2020–21 income year. This amount is assessable income and therefore Alex's

[1] In regard to amendment periods, see table item 22 in subsection 170(10AA) of the *Income Tax Assessment Act 1936*.
[2] See also Law Administration Practice Statement PS LA 2011/10 *Waiver of tax-related liabilities in proceeds of crime matters*.

income tax assessment was amended to increase income for that year from the amount declared of $25,000 to $45,000.

19. [Omitted.]

20. [Omitted.]

Example 2

21. Following on from Example 1 of this Ruling, Alex is also fined $2,000, which is not allowable as a deduction as it is a fine or penalty that is excluded from being deductible pursuant to section 26-5 of the ITAA 1997.

Commissioner of Taxation

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legislative references
- ITAA 1936 170AA
- ITAA 1997 6-5; 8-1; 26-5; 59-30

case references
- -Madad Pty Ltd v Commissioner of Taxation [1984] FCA 311; (1984) 4 FCR 420; 55 ALR 379; 84 ATC 4739
- 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
- -Zobory-v-Commissioner of Taxation [1995] FCA 1226; (1995) 64 FCR 86; 95 ATC 4251; (1995) 30 ATR 412

other references
- TR 2006/10
- PS LA 2011/10

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