



TR 96/19 - Income tax: chemists: Pharmaceutical Benefits Scheme income

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Taxation Ruling

Income tax: chemists: Pharmaceutical Benefits Scheme income

*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

Class of person/arrangement

1. This Ruling applies to a taxpayer who is an 'approved supplier' and derives income under the Pharmaceutical Benefits Scheme (PBS), which is administered under the *National Health Act 1953* (NHA). The Ruling applies where income from the supply of PBS products that constitute trading stock is returned on an accruals basis.

Ruling

2. A taxpayer who is entitled to payment under the PBS is assessable on the amount when it is derived. Regardless of whether the amount of the payment under the PBS is assessable under subsection 25(1) or paragraph 26(g) of the *Income Tax Assessment Act 1936* (the ITAA), the payment is included in assessable income in the year it is derived. With respect to when amounts payable under the PBS are derived, it is necessary to determine the time at which a recoverable debt is created. It is considered that a pharmacist accounting for income on an accruals basis derives PBS income at the time a product is dispensed to the customer.

Date of effect

3. 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

Operation of the Pharmaceutical Benefits Scheme (PBS)

4. The following is a broad summary of the PBS:

- The PBS scheme operates under the NHA and it is administered by the Health Insurance Commission (HIC).
- Under the PBS, an approved supplier who supplies prescribed pharmaceutical benefits on the National Health List to eligible persons is entitled to payment of a predetermined scheduled amount.
- The HIC makes PBS payments to approved suppliers who present an account for pharmaceutical benefits supplied.
- Under the scheme, payments are made in accordance with a scheduled amount reflecting a cost reimbursement for the product supplied less the amount the supplier is entitled to charge the customer, plus a dispensing fee and a mark up. An example of a PBS payment is:
 - an approved pharmacist supplies an eligible consumer with a pharmaceutical product on the National Health List. The product costs the pharmacist \$16.00. The consumer pays \$2.60 on receipt of the product.
 - on the next scheduled billing date after dispensing the product, the pharmacist makes a claim to the HIC for payment of the amount of \$18.75, being the difference between \$16.00 and \$2.60, plus a \$3.75 dispensing fee and \$1.60 mark up. The amount which the pharmacist is entitled to claim can be ascertained at the time of dispensing.
- Usually 20 days after the pharmacist makes a claim the HIC pays (by electronic transfer) the pharmacist.

5. A taxpayer who returns particular income on an accruals basis derives that income once there is a recoverable debt in respect of the income; that is, once there is a presently existing right to demand payment. The term 'recoverable debt' is used to describe the point of time at which the taxpayer is entitled to an ascertainable income amount on performance of the agreed task (as distinct from the time when legal recovery may be commenced) (see *Henderson v. FC of T* (1970) 119 CLR 612; 70 ATC 4016; (1970) 1 ATR 596; *Henderson v. FC of T* 69 ATC 4049; (1969) 1 ATR 133); *Barratt v. FC of T* 92 ATC 4275; (1992) 23 ATR 339 (*Barratt's case*)). Whether there is, in law, a recoverable debt is a question to be determined by reference to the contractual agreements which give rise to the entitlement to payment, the general law and any relevant statutory provisions.

6. In respect of payments made under the PBS, the relevant law is the NHA. The entitlement of an approved pharmacist to payment of a benefit is provided for by subsection 99(2) of the NHA which provides that:

'An approved pharmacist or approved medical practitioner who has supplied a pharmaceutical benefit is, subject to section 99AAA and to the conditions determined under section 98C and applicable at the time of supply, entitled to be paid by the Commonwealth.'

7. Under subsection 99(2) of the NHA, an approved pharmacist who has supplied a pharmaceutical benefit becomes entitled immediately to be paid an amount equal to the scheduled fee for the benefit less any amount the pharmacist is entitled to charge the customer for the benefit under the NHA. Therefore, in our view a recoverable debt comes into existence at the time of dispensing.

8. Subsection 99(2) is subject to section 99AAA of the NHA. Subsection 99AAA(2) of the NHA provides that:

'(2) An approved supplier who wants to receive payment from the Commonwealth in relation to the supply of a pharmaceutical benefit must make a claim for payment to the Secretary in accordance with the rules made by the Minister under paragraph (8)(a).'

9. We do not consider that the requirement under subsection 99AAA(2) that an approved supplier must make a claim for payment is a condition precedent that must be satisfied before a recoverable debt comes into existence: cf *FC of T v. Australian Gas Light Co & Anor* 83 ATC 4800; (1983) 15 ATR 105 (*Australian Gas Light case*). In our view, that requirement is no more than an impediment to enforcement (see *Barratt's case*) and cannot be regarded as a

contingency which defers derivation of the amount (see comments in **Alternative Views** considered later in this Ruling).

10. Also, it is our view that a PBS payment is primarily for the disposal of trading stock. When referring to trading stock, Menzies J in *J Rowe and Son Pty Ltd v. FC of T* (1971) 124 CLR 421; 71 ATC 4157; (1971) 2 ATR 497 stated at CLR 448, ATC 4158, ATR 499:

'In a system of annual accounting, ordinary business considerations would indicate that what becomes owing to a company for trading stock sold during a year should, in some way, be brought into account to balance the reduction of trading stock which the transaction effects. Any other method of accounting would lead to a misrepresentation of the trader's financial position.'

and at CLR 450, ATC 4160, ATR 500:

'...income from the sale of stock is derived when the stock is sold and a debt is created. It need not be payable in the year of income.'

Alternative views

11. Alternative views put to this Office are that amounts received under the PBS are not assessable until either (a) the supplier makes a claim, or (b) the claim has been approved. These views are based on section 99AAA creating a condition precedent to the coming into existence of a recoverable debt.

12. With respect to (a), it is arguable that the legislative requirement to make a claim, imposed by section 99AAA, is a further step that a pharmacist is obliged to take before becoming entitled to payment. That a statute can create a condition precedent to the existence of a recoverable debt is supported by the decision in the *Australian Gas Light* case. However, we consider section 99AAA merely provides a special billing procedure which imposes an impediment to the recovery of the debt rather than a condition precedent to its existence. That a statutory provision can create an impediment to recovery but not delay derivation is supported by the decision in *Barratt's* case. That case considered the effect, on the timing of derivation of income by a partnership of medical practitioners, of subsection 35(2) of the *Medical Practitioners Act 1938 (NSW)* and of the *Health Insurance Act 1973 (HIA)*: see ATC 4281, ATR 345.

13. In *Barratt's* case it was held that the relevant statutes created an impediment to the recovery of the debt and not a condition precedent to its existence. It is our view that the effect of the statutes discussed

in *Barratt's* case, including the 'bulk billing' procedures, has the same effect as the procedures prescribed by section 99AAA of the NHA in relation to payments under the PBS. While it may be arguable that income is derived at the time of submitting a claim, we prefer the view expressed in paragraph 2 of this Ruling.

14. With respect to (b), we do not accept the view that the income is not derived until the PBS claim has been approved. The approval process does not constitute a step the claimant taxpayer is obliged to take before becoming entitled to payment.

15. A further view has been put that amounts payable under the PBS are assessable under paragraph 26(g) of the ITAA to the exclusion of subsection 25(1) of the ITAA because paragraph 26(g) is the more specific provision, and that such amounts are not derived for the purposes of paragraph 26(g) until they are actually received. We do not agree with either of those propositions.

16. Firstly, in our view, it is unnecessary to consider whether an amount is assessable as a subsidy or bounty under paragraph 26(g) if it is assessable under subsection 25(1) as income in ordinary concepts. As Hill J said in *First Provincial Building Society Limited v. FC of T* 95 ATC 4145 at 4150; (1995) 30 ATR 207 at 213:

'Ordinarily, a subsidy or bounty received by a taxpayer in relation to its business activities would constitute income in ordinary concepts.'

17. His Honour's approach is consistent with that taken by the High Court in *FC of T v. Whitfords Beach Pty Ltd* 82 ATC 4031; (1982) 12 ATR 692 and he specifically adopts the view expressed in that case by Mason J in relation to the question of whether paragraph 26(a) should be applied to cases that fall within its terms, to the exclusion of subsection 25(1). In particular, Mason J said at ATC 4046; ATR 709:

'... it was no part of the purpose of s 26(a) to limit the operation of s 25(1). Indeed, in large measure its object was to ensure that the revenue did not suffer in the event that s 25(1) received a more restricted application than it was then thought to have. I am still inclined to think that this is the preferable view and that, accordingly, the second limb of s 26(a) applies only to "profits not attributable to gross income that has already been captured by s 25"...'.

18. Similarly, in our view, it was not the purpose of paragraph 26(g) to limit the operation of subsection 25(1), but, rather, to include as assessable income amounts that might not otherwise be 'captured by' subsection 25(1).

19. Secondly, we do not consider that the use of the word 'received' in paragraph 26(g) means actual receipt. The word 'received' is not

used in a narrow or technical sense and has a similar meaning to derived: see paragraphs 20 to 23 of Taxation Ruling IT 2669.

20. Amounts payable to pharmacists under the PBS are received on a regular and recurrent basis in the ordinary course of business. Accordingly, those amounts are income according to ordinary concepts and are assessable income under subsection 25(1) when derived: that is, in the year in which the product is dispensed.

Example

21. On 28 June 1994, a pharmacist dispenses a product listed on the National Health List. The customer pays \$15.00 and the pharmacist is entitled to claim \$17.00 under the PBS. The \$17.00 is claimed on 6 July 1994 and received on 20 July 1994.

22. In the above example, the amount of \$32.00 (\$15.00 plus \$17.00) is assessable in the year ended 30 June 1994.

Commissioner of Taxation

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- accruals basis of accounting
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- cash basis of accounting
- pharmacists
- subsidies

legislative references

- ITAA 25(1)
- ITAA 26(g)
- Health Insurance Act 1973

- National Health Act 1953
- Medical Practitioners Act 1938 (NSW)

case references

- Barratt & Ors v. FC of T 2 ATC 4275; (1992) 23 ATR 339
- First Provincial Building Society Limited v. FC of T 95 ATC 4145; (1995) 30 ATR 207
- FC of T v. Australian Gas Light Co & Anor 83 ATC 4800; (1983) 15 ATR 105
- FC of T v. Whitfords Beach Pty Ltd 82 ATC 4031; (1982) 12 ATR 692
- Henderson v. FC of T 69 ATC 4049; (1969) 1 ATR 133
- Henderson v. FC of T (1970) 119 CLR 612; 70 ATC 4016; (1970) 1 ATR 596
- J Rowe and Son Pty Ltd v. FC of T (1971) 124 CLR 421; 71 ATC 4157; (1971) 2 ATR 497