TR 93/25DC1 - Income tax: assessability of proceeds from illegal activities, treatment of amounts recovered and deductibility of fines and penalties

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This document has been finalised by TR 93/25A1.

Taxation Ruling

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

Contents

~~contents~~ Ppara

What this Ruling is about 1
Ruling 5
Date of effect 8
Explanations 9
Examples 18

This is a draft consolidation outlining proposed changes to TR 93/25 to take into account developments in the law since it was issued. It confirms that income from illegal activities that is gained by an entity directly in pursuit of its own income producing activities is assessable. It also sets out the treatment of amounts forfeited, recovered from or repaid.

The following preamble will apply to this Ruling once the Addendum is finalised:

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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

~~*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.*~~

What this Ruling is about

1. This Ruling considers whether the proceeds of certain illegal activities will be treated as assessable income under ~~sub~~section ~~25(1)~~6-5 of the *Income Tax Assessment Act ~~1936~~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 ~~SP~~illegal 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 associated offence.

4. This Ruling does not consider the application of the capital gains ~~tax~~ 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 ~~must~~ depends on the circumstances of each case.

7. [Omitted.]~~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 75~~21~~ and ~~-22~~76 of Taxation Ruling TR ~~92/20~~2006/10 *Public Rulings*).

Explanations

Assessability of p~~P~~roceeds from i~~I~~llegal a~~A~~ctivities

9. The tests as to whether an amount is assessable income under ~~sub~~section ~~25(1)~~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:

> [1]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.[1]

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 *Income tax: whether profits on isolated transactions are income* provides guidance in determining whether profits from isolated transactions are assessable under ~~sub~~section 6-5 of the ~~25(1)~~ ITAA 1997.

Treatment of a~~A~~mounts f~~F~~orfeited, r~~R~~ecovered from or r~~R~~epaid

13. The deductibility of amounts earned from illegal activities that are subsequently ~~repaid, or~~ forfeited, ~~or~~ recovered from or repaid ~~deductibility for these amounts tax implications of this~~ depends on the circumstances of the case.~~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.~~

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. ~~—i~~It does not suffice for deductibility that the illegally-~~-~~earned income was assessable when derived.

15. It wa~~i~~s recognised by ~~that at least in one case~~ the Federal Court in ~~(~~*Zobory, P.A. v ~~FC~~Commissioner of Taxation of the Commonwealth of Australia* [1995] FCA ~~1226)~~ 269~~(Zobory)~~ ~~held~~ that a taxpayer who had misappropriated funds that were~~and~~ then invested ~~them~~ at interest, ~~and~~ who held both the misappropriated funds and income derived from those funds~~it~~ on constructive trusts, and who ultimately repaid the misappropriated funds and ~~paid over the~~ interest to the victim of

the fraud, was not liable 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 income 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 must subsequently ordered to repay those amounts and the other requirements of the section (including non-deductibility of the repayment) are satisfied.[1] In such cases the assessment for the year in which the amounts were returned as assessable income can be amended in recognition of the change in statutory treatment from assessable income to non-assessable non-exempt income (see section 170(10AA) of the ITAA 1936). 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. 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.

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[1] In regards to amendment periods, see table item 22 in the table in the table in subsection 170(10AA) of the *Income Tax Assessment Act 1936.*

[2] See alsoRefer Law Administration Practice Statement PS LA 2011/10 *Waiver of tax-related liabilities in proceeds of crime mattersconcerning the waiver of tax related liabilities in proceeds of crime mattersin regards to the application of Division 342 of Schedule 1 to the TAA in regards to matters concerning proceeds of cime.*

Fines and p~~P~~enalties

16. Generally, fines and penalties are not deductible under ~~sub~~section ~~8-1 51(1)~~of the ITAA 1997 (*Commissioner of Taxation v Madad Pty Ltd ~~v. FCT~~* [1984] FCA 311~~84 ATC 4739~~) and they are specifically excluded from being deductible pursuant to ~~sub~~section 26-5 of the~~51(4)~~ ITAA 1997.

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."~~[Omitted.]

Examples

Example 1

18. ~~*Mr A. Baba*~~*Alex was found, pursuant to an audit, to have earnt $20,000 from the misappropriation of company funds during the year ended 30 June 2020~~*1991 from the misappropriation of company funds. This amount is assessable income and therefore ~~his~~Alex's income tax return was amended to increase ~~his~~ income for that year from the amount declared of ~~$25,000 to~~ $45,000.*

19. [Omitted.]~~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. [Omitted.]~~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. *Following on from Example 1, Alex~~In addition to being ordered to repay the $20,000, Ali~~ is also ~~also~~ fined $2,000. The $2,000 is not ~~allowable as a deduction~~deductible as it is a fine or penalty that is excluded from being deductible pursuant to section 26-5 of the ITAA 1997~~, nor is it excluded from his assessable income for the year ended 30 June 1991~~.*

Commissioner of Taxation

12 August 1993

Appendix – Your comments

22. You are invited to comment on this draft Ruling, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

23. A compendium of comments is prepared when finalising this Ruling and an edited version (names and identifying information removed) is published to the Legal database on ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Draft update published: 17 December 2021

Contact officer details have been removed following publication of the final guideline.~~Due date: 25 February 20221~~

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~~*subject references*~~

~~- *amendment and objection provisions*~~

~~- *business tests*~~

~~- *fines and penalties*~~

~~- *illegal activities*~~

~~- *isolated transactions*~~

legislative references
- ITAA 1997 6-5; 8-1; 26-5; 59-30~~ITAA 25(1); 51(1); 51(4); 170(3)~~

~~-~~ TAA 1953 Sch1 Div 342~~ TAA Part IVC~~
- ~~Crimes (Confiscation of Profits) Act~~

case references
- Commissioner of Taxation v Madad Pty Ltd [1984] FCA 311; (1984) 4 FCR 420; 55 ALR 379; ~~v. FCT~~ 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, P.A. v ~~F~~Commissioner of Taxation of the Commonwealth of Australia [1995] FCA 269; 129 ALR 484; 95 ATC 4251; 30 ATR 412; 64 FCR 86~~1226~~

other references
- Law Administration Practice Statement PS LA 2011/10

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