

This Determination, 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 Determination is a public ruling and how it is binding on the Commissioner. Unless otherwise stated, this Determination applies to years commencing both before and after its date of issue. However, this Determination 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 Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Taxation Determination

Income tax: for a balance day adjustment to be deductible under subsection 51(1) of the *Income Tax Assessment Act 1936*, is it sufficient for it to be a contingent liability?

1. No. A deduction is not allowable for a balance day adjustment in respect of a contingent liability.
2. In the context of this Determination:
 - (a) a balance day adjustment refers to an adjustment made in the accounts of a taxpayer returning income on an accruals basis; and
 - (b) a contingent liability is a loss that has not crystallised nor 'come home' to the taxpayer at balance date. It is no more than impending, threatened or expected at the end of the financial year.
3. No deduction is allowable under subsection 51(1) unless the expense has been 'incurred' prior to the end of the financial year.
4. The meaning of 'incurred' is discussed in *FC of T v. James Flood Pty Ltd* (1953) 88 CLR 492; 10 ATD 240. In *Flood's* case, the High Court decided that 'a liability will be a loss or outgoing incurred within the meaning of subsection 51(1) even though it remains unpaid, provided that the taxpayer has completely subjected itself to the liability'.
5. In *Nilsen Development Laboratories Pty Ltd & Ors v. FC of T*, (1981) 144 CLR 616; 81 ATC 4031; 11 ATR 505; 55 ALJR 97, Barwick CJ refers to previous decisions in *New Zealand Flax Investments Ltd v. FC of T* (1938) 61 CLR 179; 12 ALJ 313; and *Emu Bay Railway Co. Ltd v. FC of T* (1944) 71 CLR 596. His Honour goes on to say:

'That part of Sir Owen Dixon's statement in *New Zealand Flax Investments Ltd v. FC of T* which presently needs emphasis is that the word "incurred" in section 51(1) "does not include a loss or outgoing which is no more than pending, threatened or expected" and I would for myself add "no matter how certain it is in the year of income that that loss or expenditure will occur in the future".'
6. Court decisions in *Commonwealth Aluminium Corp. Ltd v. FC of T* (1977) 32 FLR 210; 7 ATR 376; 77ATC 4151; *FC of T v. Lau*, 84 ATC 4929; (1984) 16 ATR 55; and *Ogilvy and Mather Pty Ltd v. FC of T*, 90 ATC 4836; (1990) 95 ALR 663; 21ATR 841 confirm this view.

7. This Determination replaces Taxation Determination TD 93/91, which is now withdrawn.

Examples:

1. *A taxpayer engages a solicitor to provide legal advice. He expects to receive a bill for legal expenses after the end of the financial year. He estimates that the legal fees payable will be in the order of \$20,000. At the end of the financial year he accrues legal expenses of \$20,000 in his accounts. No legal services were provided during the financial year.*

No deduction is allowable for the estimated legal fees payable in the year of income.

2. *A taxpayer derives assessable income from the hire of machinery. One of his machines breaks down during the financial year. He estimates the cost of repairs based on quotations obtained at \$10,000. He accrues an expense for this amount in his accounts at the end of the financial year although no work is performed on repairing the machine during the financial year.*

No deduction is allowable for the accrued amount.

3. *A taxpayer engages a plumber to repair a broken water pipe in his factory. The parties orally agree that the taxpayer will pay after the plumber has presented a bill at the end of the job. The plumber completes the work during the financial year but does not bill the taxpayer until after the end of the financial year. The taxpayer estimates that the cost of the repair will be \$1,000. He accrues this amount as an expense at the end of the financial year.*

No deduction would be allowable for the expense accrual in the year of income. Until the bill is presented there is no presently existing liability on the part of the taxpayer.

Commissioner of Taxation

30/9/93

FOI INDEX DETAIL: Reference No.

I 1216206

Previously issued as final TD 93/91

Related Determinations:

Related Rulings: IT 2625

Subject Ref: deductions; balance day adjustments; contingent liabilities; accrued expenses.

Legislative Ref: ITAA 51(1)

Case Ref: FC of T v. James Flood Pty Ltd (1953) 88 CLR 492; 10 ATD 240; Commonwealth Aluminium Corp. Ltd v. FC of T (1977) 32 FLR 210; 7 ATR 376; 77ATC 4151; Nilsen Development Laboratories Pty Ltd & Ors v FC of T (1981) 144 CLR 616; 81 ATC 4031; 11 ATR 505; 55 ALJR 97; FC of T v. Lau 84 ATC 4929; (1984) 16 ATR 55; Ogilvy and Mather Pty Ltd v. FC of T 90 ATC 4836; (1990) 95 ALR 663; 21ATR 841; New Zealand Flax Investments Ltd v. FC of T (1938) 61 CLR 179; 12 ALJ 313; Emu Bay Railway Co. Ltd v. FC of T (1944) 71 CLR 596.

ATO Ref: PNR T95 Pt 6

ISSN 1038 - 8982