



TD 94/65 - Income tax: property development: is a 'management reserve' taken into account in calculating notional taxable income under the estimated profits basis of returning income from a long term construction contract?

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 This document has changed over time. This is a consolidated version of the ruling which was published on *21 July 1994*

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: property development: is a 'management reserve' taken into account in calculating notional taxable income under the estimated profits basis of returning income from a long term construction contract?

1. No. Only actual costs that are identified as likely to be incurred over the period of the contract and which are properly deductible are taken into account in calculating notional taxable income. These costs are estimated relying upon the taxpayer's experience in the construction industry and using sound commercial or business principles. The estimations must be well documented and can vary from year to year.
2. Costs of materials and labour are examples of properly deductible costs. However, general claims for a 'management reserve' or for 'additional costs arising from wet weather, industrial disputes, etc.' are not sufficiently informative about the actual costs involved to be properly deductible.
3. It is not sufficient to make a general claim for unspecified costs likely to arise on the happening of some future event. The calculation of notional taxable income needs to be more exact. The likely effect those future events will have on actual deductible costs must be quantified.
4. Therefore, the likely cost increases arising from wet weather and industrial delays should be quantified and taken into account in estimating the total costs of materials and labour when calculating notional taxable income. The method of estimation must be well documented to allow for verification in the event of an audit.

Example

A company enters into a long term construction contract to install air conditioning in a shopping centre and includes a 'management reserve' equal to 10% of estimated costs when calculating its notional taxable income under the estimated profits basis. The 'management reserve' is based on the assumption that there will be additional costs to the contract that cannot be identified at the moment. The reserve is based on previous experience and estimates.

The 'management reserve' cannot be taken into account in calculating notional taxable income. A claim for 'management reserve' is not sufficiently informative to qualify as a properly deductible expense.

Commissioner of Taxation

21/7/94

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