TR 93/D19 - Income tax: tax shortfall penalties: calculation of a tax shortfall and allocation of additional tax

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This document has been finalised by TR 94/3.

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Draft Taxation Ruling

Income tax: tax shortfall penalties: calculation of a tax shortfall and allocation of additional tax

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.

DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

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What this Ruling is about

1. This Ruling outlines the general basis on which additional tax should be calculated under sections 226G, 226H, 226J, 226K, 226L and 226M (the shortfall sections) of the *Income Tax Assessment Act* 1936 (ITAA).

Ruling

- 2. Additional tax under the shortfall sections is calculated in respect of a tax shortfall or part of a tax shortfall. While a tax shortfall is broadly the gross difference between the tax properly payable by a taxpayer and the tax that would have been payable by the taxpayer if it were assessed on the basis of the taxpayer's return, a tax shortfall will frequently need to be split into its component parts to determine the correct application of the shortfall sections.
- 3. The examples below illustrate the calculations to be followed in applying shortfall sections. The examples recognise that in the course of an audit a tax officer may detect a number of items that require adjustment, some of which may warrant penalty, some of which may not. In addition, there may be adjustments made in a taxpayer's favour which may or may not relate to the debit adjustments made. Further, the adjustments may be to income, deductions, rebates, foreign tax credits or offsets of franking deficit tax.
- 4. The basic rule is that if there is not a tax shortfall for a year then additional tax cannot be imposed. For example, if a taxpayer has omitted an amount of income, but the tax related to that matter is more than offset by an adjustment in the taxpayer's favour (whether or not

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related to the omitted income), no additional tax would be payable. Accordingly, the examples below only cover situations where, after the various adjustments to the taxpayer's assessment, there is a tax shortfall. Although all of the examples assume that the taxpayer was taxable to start with, the same principles for calculating penalty would apply where a taxpayer had originally returned a loss, provided there was in fact a tax shortfall after all adjustments had been made.

5. The examples below are assumed to be in respect of assessments for the 1992-93 year of income for a resident individual taxpayer. The principles illustrated apply equally to the calculation of penalty under the shortfall sections for other kinds of taxpayers.

Date of effect

6. This Ruling (that is, the final Taxation Ruling based on this Draft Taxation Ruling) sets out the current practice of the Australian Taxation Office and is not concerned with a change in interpretation. Consequently, it applies from the date on which the shortfall sections commenced to operate.

Examples

7. The examples below are based around combinations of the following income/rebate/credit adjustments:

TAXABLE INCOME AS RETURNED / ASSESSED	(TIAR/A)	35,000
INCOME MISSTATEMENT NO. 1 (caused by recklessness - penalty 50%)	(IM NO.1)	1,000
INCOME MISSTATEMENT NO. 2 (caused by lack of reasonable care - penalty 25%)	(IM NO.2)	2,000
INCOME MISSTATEMENT NO. 3 (not culpable - no penalty)	(IM NO.3)	500
INCOME MISSTATEMENT NO. 4 (OVERSTATEMENT OF INCOME UNRELATED TO OTHER MISSTATEMENTS)	(UIM)	(300)
REBATE/CREDIT MISSTATEMENT NO. 1 (caused by recklessness - penalty 50%)	(R/C NO.1)	500
REBATE/CREDIT MISSTATEMENT NO. 2 (caused by lack of reasonable care - penalty 25%)	(R/C NO.2)	1,000
REBATE/CREDIT MISSTATEMENT NO. 3	(UR/C)	(400)

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(UNDERSTATED REBATE/CREDIT UNRELATED TO OTHER REBATE/CREDIT MISSTATEMENTS)

NOTES:

- "income misstatements" may be either understated income amounts or overstated deductions, or a combination of both;
- "credits" for penalty purposes are foreign tax credits under Divisions 18, 18A and 18B of Part III of the ITAA, and offsets of franking deficit tax;
- for the purpose of calculating tax shortfalls in the following examples, 1992-93 resident individual rates of tax have been used;
- for the purpose of calculating interest in the following examples, the tax is assumed to have been avoided for a period of one year, and the rate of interest for the purpose of section 170AA of the ITAA is assumed to be 9.6% for that whole year.

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EXAMPLE A:

INCOME INCREASE

TAXABLE INCOME AS RETURNED / ASSESSED			(TIAR/A)	35,000
INCOME MISSTATEMENT NO. 1 (penalty 50%)			(IM NO.1)	1,000
INCOME MIS	STATEMENT N	NO. 2 (penalty 25%)	(IM NO.2)	2,000
INCOME MIS	STATEMENT N	NO. 3 (no penalty 0%)	(IM NO.3)	500
	STATEMENT N O OVERSTATE		(UIM)	(300)
TIAR/A			35,000	
Less UIM			300	
Plus	IM NO.1 IM NO.2 IM NO.3	1,000 2,000 500	34,700	
Net Debit Adju			3,500	
Amended Taxable Income (ATI)		38,200		

Tax Shortfall

Tax on ATI	38,200	9,886
Less Tax on TIAR/A	35,000	8,494
Plus Adjusted Medica	re Levy	40
Tax Shortfall		1 432

Allocation of Tax Shortfall to Income Misstatements

IM NO.1	IM NO.2	IM NO.3
<u>1,000</u> x 1,432	<u>2,000</u> x 1,432	<u>500</u> x 1,432
3,500	3,500	3,500
= 409.14	= 818.28	=204.57

Penalties

IM NO.1	IM NO.2	IM NO.3
50% flat	25%flat	no penalty
409.14 x 50%	818.28 x 25%	
= 204.57	= 204.57	

Total Penalties = 204.57 + 204.57 = \$409.14

Interest

 $1432 \times 9.6\% = $137.47 \text{ (deductible)}$

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EXAMPLE B:

REBATE/CREDIT REDUCTION

TAXABLE INCO	OME AS RET	TURNED / ASS	SESSED	(TIAR/A)	35,000
REBATE/CRED	IT MISSTAT	EMENT NO.	(penalty 50%)	(R/C NO.1)	500
REBATE/CRED	IT MISSTAT	EMENT MO.	2 (penalty 25%)	(R/C NO.2)	1,000
REBATE/CREDIT MISSTATEMENT NO. 3 (UR/C) (400) (UNRELATED UNDERSTATED REBATE)				(400)	
TIAR/A				35,000	
Amended Taxabl	le Income (AT	T)		35,000	
Tax Shortfall					
Tax on ATI Less	35,000	8,494			
Tax on TIAR/A	35,000	<u>8,494</u>		0	
Plus R/C No.1		500		O	
R/C No.2		<u>1,000</u>	1,500		
Less UR/C			400		
				1,100	
Tax Shortfall				1,100	

Allocation of Tax Shortfall to Rebate/Credit Misstatements

R/C NO.1	R/C NO.2
<u>500</u> x 1,100	<u>1,000</u> x 1,100
1,500	1,500
= 366.66	= 733.33

Penalties

R/C NO.1	R/C NO.2
50% flat	25%flat
366.66 x 50%	733.33 x 25%
= 183.33	= 183.33

Total Penalties = 183.33 + 183.33 = \$366.66

Interest

 $1,100 \times 9.6\% = $105.60 \text{ (deductible)}$

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EXAMPLE C

INCOME INCREASE, REBATE/CREDIT INCREASE

TAXABLE INCOME AS RETURNED / ASSESSED			(TIAR/A)	35,000
INCOME MISSTATEMENT NO. 1 (penalty 50%)			(IM NO.1)	1,000
INCOME MISS	TATEMENT N	IO. 2 (penalty 25%)	(IM NO.2)	2,000
INCOME MISS	TATEMENT N	IO. 3 (no penalty)	(IM NO.3)	500
INCOME MISS (UNRELATED			(UIM)	(300)
REBATE/CRED (UNRELATED	UNDERSTATI		(UR/C)	(400)
TIAR/A Less UIM			35,000 300	
Plus	IM NO.1 IM NO.2 IM NO.3	1,000 2,000 500	34,700	
Net debit adjustr	ment		3,500	
Amended Taxab	le Income (ATI	(I)	38,200	
Tax Shortfall				
Tax on ATI Less	38,200	9,886		
Tax on TIAR/A	35,000	<u>8,494</u>	1,392	
Plus Adjusted Medica Less	are Levy		40	
Unrelated Rebate	e (UR/C)		(400)	
Tax Shortfall			1,032	

Allocation of Tax Shortfall to Income Misstatements

IM NO.1	IM NO.2	IM NO.3
<u>1,000</u> x 1,032	2,000 x 1,032	<u>500</u> x 1,032
3,500	3,500	3,500
= 294.85	= 589.71	= 147.42

Penalties

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IM NO.3

no penalty

IM NO.1 IM NO.2 50% flat 25%flat 294.85 x 50% 589.71 x 25% = 147.42 = 147.42

Total Penalties = 147.42 + 147.42 = \$294.84

Interest

 $1,032 \times 9.6\% = $99.07 \text{ (deductible)}$

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EXAMPLE D

INCOME INCREASE, REBATE/CREDIT REDUCTION

TAXABLE INCOME AS RETURNED / ASSESSED				(TIAR/A)	35,000
INCOME MISSTATEMENT NO. 1 (penalty 50%)				(IM NO.1)	1,000
INCOME MISS	ΓATEMENT NO	0. 2 (penalt	ty 25%)	(IM NO.2)	2,000
INCOME MISS	ΓATEMENT NO). 3 (no pe	enalty)	(IM NO.3)	500
INCOME MISS? (UNRELATED O				(UIM)	(300)
REBATE/CRED	IT MISSTATEN	MENT NO.	. 1 (penalty 5	50%) (R/C NO.1)	500
REBATE/CRED	IT MISSTATEN	ИENT MO	2 (penalty	25%) (R/C NO.2)	1,000
REBATE/CRED (UNRELATED I				(UR/C)	(400)
TIAR/A Less UIM				35,000 300	
				24.700	
Plus	IM NO.1 IM NO.2 IM NO.3	1,000 2,000 500		34,700	
Net debit adjustn	nent			3,500	
Amended Taxabl	le Income (ATI)			38,200	
Tax Shortfall					
Tax on ATI Less	38,200	9,886			
Tax on TIAR/A	35,000	<u>8,494</u>	1392)	
Plus Adjusted Medica	ire Levy		40		
Plus R/C NO.1 R/C NO. 2 UR/C	500 1000 (400)			1,432	
3100	<u>(100)</u>			1,100	
Tax Shortfall				2,532	

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IM NO.1	IM NO.2	IM NO.3
<u>1,000</u> x 1,432	<u>2,000</u> x 1,432	<u>500</u> x 1,432
3,500	3,500	3,500
= 409.14	= 818.28	= 204.57

R/C NO.2
<u>1,000</u> x 1,100
1,500
= 733.33

Penalties

IM NO.1	IM NO.2	IM NO.3
50% flat	25%flat	no penalty
409.14 x 50%	818.28 x 25%	
= 204.57	= 204.57	

R/C NO.1	R/C NO.2
50% flat	25%flat
366.66 x 50%	733.33 x 25%
= 183.33	= 183.33

Total Penalties = 204.57 + 204.57 + 183.33 + 183.33 = \$775.80

Interest

 $2532 \times 9.6\% = $243.07 \text{ (deductible)}$

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EXAMPLE E

INCOME REDUCTION, REBATE/CREDIT REDUCTION

TAXABLE INCO	OME AS RE	ΓURNED / AS	SESSED	(TIAR/A)	35,000
INCOME MISST (OVERSTATEM		NO. 4		(UIM)	(300)
REBATE/CRED	IT MISSTAT	EMENT NO.	l (penalty 50%	%) (R/C NO.1)	500
REBATE/CRED	IT MISSTAT	EMENT MO.	2 (penalty 25°	%) (R/C NO.2)	1,000
REBATE/CRED (UNRELATED U				(UR/C)	(400)
TIAR/A Less UIM				35,000 300	
Amended Taxabl	e Income (A	Π)		34,700	
Tax Shortfall					
Tax on ATI Less	34,700	8,380			
Tax on TIAR/A	35,000	<u>8,494</u>		(114)	
Less Medicare L	evy			(114) (3.75)	
Plus R/C No.1 R/C No.2 Less UR/C		500 1,000	1,500 400		
Tax Shortfall			<u> 400</u>	1,100 982.25	

Allocation of Tax Shortfall to Rebate/Credit Misstatements

R/C NO.1	R/C NO.2
<u>500</u> x 982.25	1,000 x 982.25
1,500	1,500
= 327.41	= 654.83

Penalties

R/C NO.1	R/C NO.2
50% flat	25%flat
327.41 x 50%	654.83 x 25%
= 163.70	= 163.70

Total Penalties = 163.70 + 163.70 = \$327.40

Interest

 $982.25 \times 9.6\% = $94.29 \text{ (deductible)}$

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ATO references

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Price

subject references

additional tax

Not previously released to the public calculation self assessment

in draft form

\$1.10

tax shortfall

legislative references

ITAA 170AA; ITAA 226G;

ITAA 226H; ITAA 226J;

ITAA 226K; ITAA 226L;

ITAA 226M