IT 2613 - Income tax: changed basis of accounting for expenditure

TAXATION RULING NO. IT 2613

INCOME TAX: CHANGED BASIS OF ACCOUNTING FOR EXPENDITURE

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I 1012362	CHANGED BASIS OF ACCOUNTING FOR EXPENDITURE DEDUCTIONS	51(1)

OTHER RULINGS ON THIS TOPIC: IT 333

PREAMBLE

This Office was recently asked to consider the case of a taxpayer who had been claiming deductions under section 51 of the Income Tax Assessment Act 1936 (the Act) on an incorrect basis and who wished to change to the correct basis. In past years, the taxpayer had incorrectly been claiming deductions based on the accounting principle of matching costs against revenue rather than when the expense had been incurred in terms of subsection 51(1) of the Act. As a result, certain expenses had not been deducted for income tax purposes in the year in which they were incurred but rather in the following year when the liability was discharged.

2. The issue which arose for consideration was whether in the year of changeover to the correct basis of accounting the taxpayer could deduct not only the expenditure incurred in that year of income but also expenditure which was incurred but unclaimed in a prior year of income.

3. The taxpayer sought to rely on Taxation Ruling No. IT 333. It provides that, where a taxpayer is required to change from deducting expenditure on spare parts and consumable stores from a usage basis to an incurred basis, the opening balance of undeducted expenditure incurred in a prior year could continue to be deducted on a usage basis in the year of change and succeeding years until the balance is exhausted.

RULING

4. As was stated in RACV Insurance Pty Ltd v. FCT 74 ATC 4169 at 4176; (1974) 4 ATR 610 at 618:

> "The Income Tax Assessment Act in imposing liability to income tax adopts the basic method of imposing taxation in respect of annual periods of time. This necessarily involves assigning to a period of a year both income and losses or

liabilities."

5. A loss or outgoing to be deductible under subsection 51(1) of the Act must be incurred in the year of income in which it is claimed (F.C. of T. v. Raymor (N.S.W.) Pty Ltd 90 ATC 4461 at 4466; FCT v. James Flood Pty Ltd (1953) 88 CLR 492 at 506-507). A loss or outgoing is incurred in the year in which there is a presently existing liability to discharge an obligation which is due (Nilsen Development Laboratories Pty Ltd and Ors v FCT 81 ATC 4031 per Barwick C.J. at 4035; (1981) 11 ATR 505 at 509; FCT v. Australian Guarantee Corp Ltd 84 ATC 4642 per Beaumont J. at 4658, (1984) 15 ATR 982 at 1002). As Dixon J. said in Armco (Australia) Pty Ltd v. FCT (1947-48) 76 CLR 584 at 618:

> "The comparison made between the beginning and end of an accounting period means that stock in trade and purchases are taken into account not by reference to what is actually paid for them, but according to the value assigned to the one and the liability incurred in acquiring the other. That is done, of course, entirely independently of the period within which the actual disbursement of money is made to discharge the liability."(emphasis added).

6. In the light of those authorities it is considered that where a taxpayer should have, but failed to, claim a deduction in a previous year of income that deduction cannot be claimed in the financial year when the liability is discharged because the loss or outgoing is not incurred in the latter year. Therefore, where a taxpayer changes to the correct basis for claiming deductions (i.e., the incurred basis), only the expenditure which is calculated in accordance with the correct basis may be deducted in the changeover year. In other words, the deductions must be claimed in the event of such a change in the proper year of income regardless of the basis adopted in previous years of income.

7. The approach outlined above is in accordance with the approach adopted by the High Court of Australia in respect of the derivation of income (Country Magazine Pty Ltd v. FCT (1968) 117 CLR 162; 15 ATD 86; 10 AITR 573; Henderson v. F.C. of T. (1970) 119 CLR 612; 70 ATC 4016; 1 ATR 596).

8. In the Country Magazine case, Kitto J said (CLR p.166; ATD p.89; AITR p.576):

> "....the taxpayer cannot turn what is assessable income of one year into assessable income of a different year by including it in the wrong year's return ... The [Income Tax Assessment] Act obliges the Commissioner to assess tax in respect of all income which the taxpayer in fact derived in each year, and it gives him no discretion to leave any such income out of the assessment on the ground that the taxpayer mistakenly included that income in his return of the previous year and was taxed accordingly. If there is any remedy for the mistake it must be by means of an amendment of the previous year's assessment."

9. In Henderson's Case (supra), partnership income was returned on a cash receipts basis in the 1964 income year. In the 1965 year, the income was returned on an earnings basis with the result that an amount representing outstanding fees at the end of the 1964 year was not included as income. The High Court held that this amount could not be included in the 1965 assessment. At CLR p.647; ATC p.4018; ATR p.599 Barwick C.J. said:

> "... assessable income when ascertained must be expressed in a figure. There cannot in fact be alternative figures for such assessable income."

The Chief Justice went on to say (CLR p.650; ATC p.4020; ATR p.601):

> "... the assessment of the appellant for income tax for the year ended 30 June 1964 was erroneous and could have been rectified by the respondent by an amended assessment within three years of its making ... The fact that that course may now be impossible by reason of the lapse of time affords no reason, in my opinion, for any departure from the annual basis on which the income of the tax year in question is to be computed."

10. While the principle emerging from these cases was expressed in the context of cases involving the derivation of income, it is considered to apply equally to the incurring of losses or outgoings for the purposes of section 51 of the Act.

11. The appropriate remedy to correct the situation where a deductible outgoing was incurred but unclaimed in a prior year is by way of amendment of the assessment of the previous year (Henderson, supra; Country Magazine, supra). Where a taxpayer so requests, assessments will be amended within the limits authorised under the Act.

12. The views outlined in Taxation Ruling IT 333 are limited to expenditure on spare parts and consumable stores. In that Ruling, the particular nature of spare parts and consumable stores and their average life were material considerations.

COMMISSIONER OF TAXATION
20 September 1990