

# ***TD 2012/2 - Income tax: when is the shortfall interest charge incurred for the purposes of paragraph 25-5(1)(c) of the Income Tax Assessment Act 1997?***

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 There is a Compendium for this document: **TD 2012/2EC** .



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# Taxation Determination

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Income tax: when is the shortfall interest charge incurred for the purposes of paragraph 25-5(1)(c) of the *Income Tax Assessment Act 1997*?

**❶ This publication provides you with the following level of protection:**

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.

## Ruling

1. Shortfall interest charge (SIC) is incurred for the purposes of paragraph 25-5(1)(c) of the *Income Tax Assessment Act 1997* (ITAA 1997)<sup>1</sup> in the year of income the Commissioner gives a taxpayer a notice of amended assessment. This is the case even if the SIC liability is notified separately from the notice of amended assessment, or if the SIC is unpaid at the end of that year of income (for example, because the due date for payment of the SIC falls in the next year of income).

2. For years of income preceding the application of SIC, we take the same view of when the general interest charge (GIC) is incurred by a taxpayer who is liable to pay GIC because an additional amount of tax is payable under an amended assessment.

## Example 1

3. *Little Co Pty Ltd* self assessed its taxable income for the 2006-07 year of income which resulted in tax payable of \$300,000. The income tax liability under this deemed assessment was due and payable on 1 December 2007.

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<sup>1</sup> All legislative references are to the ITAA 1997 unless otherwise indicated.

4. On 1 October 2009, the Commissioner gave Little Co Pty Ltd a notice of amended assessment increasing its tax payable for the 2006-07 year of income by \$200,000. Little Co Pty Ltd is liable to pay SIC on the additional income tax payable (the shortfall amount) for each day in the period 1 December 2007 to 30 September 2009. The total SIC calculated for the period is incurred by Little Co Pty Ltd, and therefore deductible, in the 2009-10 year of income. For example, Little Co Pty Ltd cannot deduct in the 2008-09 year of income the SIC liability for the period 1 July 2008 to 30 June 2009.

**Example 2**

5. Sally was given a notice of assessment for the 2007-08 year of income with a due and payable date of 21 November 2008. On 15 June 2009 the Commissioner gave Sally a notice of amended assessment which increased her income tax liability for the 2007-08 year of income. Sally also received a notice of her liability to pay SIC on the shortfall amount. The SIC liability was calculated for each day in the period 21 November 2008 to 14 June 2009 and had a due and payable date in July 2009. Sally incurred the SIC liability in the 2008-09 year of income. She is entitled to deduct the total SIC liability in the 2008-09 year of income, notwithstanding that it is payable, and paid in the next year.

**Example 3**

6. On 15 May 2011 the Commissioner gave Manu Co Pty Ltd a notice of amended assessment for the 2004-05 year of income. The amendment was a result of applying the transfer pricing provisions in Division 13 of the Income Tax Assessment Act 1936 (ITAA 1936), therefore the standard period for amendment (either two or four years as appropriate) did not apply.

7. Manu Co Pty Ltd is a 30 June balancer and is liable to SIC on the shortfall amount for each day in the period 1 December 2005 to 14 May 2011. The total SIC liability is incurred in the 2010-11 year of income and is therefore deductible in that year.

**Date of effect**

8. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will 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 this Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

## Appendix 1 – Explanation

**① This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.**

9. Paragraph 25-5(1)(c) allows taxpayers a deduction for expenditure they incur to the extent it is for the SIC or the GIC.

10. The word 'incur' in subsection 25-5(1) has the same meaning as in the context of the general deduction provisions in section 8-1.

11. Taxation Ruling TR 97/7 explains the meaning of 'incurred' for the purposes of section 8-1. It sets out general rules, settled by case law, that assist in most cases in determining whether and when a loss or outgoing has been incurred. The key principles include:

- Incurred does not equate to having been paid.<sup>2</sup>
- The taxpayer must be definitively committed in the year of income.<sup>3</sup> That is, it must be a presently existing liability to pay a pecuniary sum.<sup>4</sup>
- It is not a presently existing liability if it is contingent.<sup>5</sup>
- Incurred does not include amounts which are merely 'impending, threatened, or expected'.<sup>6</sup>

12. Whether there is a presently existing pecuniary liability in a year of income requires consideration of the facts of each case, having careful regard to the source of the liability.<sup>7</sup>

13. The source of a taxpayer's liability to pay SIC is found in Division 280 of Schedule 1 to the *Taxation Administration Act 1953* (TAA). A liability for SIC arises on an additional amount of income tax,<sup>8</sup> petroleum resource rent tax (PRRT)<sup>9</sup> or excess contributions tax<sup>10</sup> that a taxpayer is liable to pay because the Commissioner amends their relevant tax assessment for a year of income.

14. The SIC liability exists for each day in the period that the tax was understated. This would generally be from the day the tax under the original assessment was due (or would have been due if there had been any tax payable) to the day before the Commissioner gave the taxpayer a notice of amended assessment.<sup>11</sup>

<sup>2</sup> *W Nevill & Company Ltd v. Federal Commissioner of Taxation* (1937) 56 CLR 290; [1937] HCA 9, *Nilsen Development Laboratories Pty Ltd & Ors v. Federal Commissioner of Taxation* (1981) 144 CLR 616, *Federal Commissioner of Taxation v. James Flood Pty Ltd* (1953) 88 CLR 492, *Emu Bay Railway Company Ltd v. Federal Commissioner of Taxation* (1944) 71 CLR 596; [1944] HCA 28.

<sup>3</sup> *Federal Commissioner of Taxation v. James Flood Pty Ltd* (1953) 88 CLR 492.

<sup>4</sup> *Nilsen Development Laboratories Pty Ltd & Ors v. Federal Commissioner of Taxation* (1981) 144 CLR 616.

<sup>5</sup> *Federal Commissioner of Taxation v. James Flood Pty Ltd* (1953) 88 CLR 492.

<sup>6</sup> *New Zealand Flax Investments Ltd v. Federal Commissioner of Taxation* (1938) 61 CLR 179.

<sup>7</sup> *Nilsen Development Laboratories Pty Ltd & Ors v. Federal Commissioner of Taxation* (1981) 144 CLR 616, *Federal Commissioner of Taxation v. James Flood Pty Ltd* (1953) 88 CLR 492.

<sup>8</sup> Subsection 280-100(1) of Schedule 1 to the TAA.

<sup>9</sup> Subsection 280-102(1) of Schedule 1 to the TAA.

<sup>10</sup> Subsection 280-102A(1) of Schedule 1 to the TAA.

<sup>11</sup> Subsections 280-100(2), 280-102(2) and 280-102A(2) of Schedule 1 to the TAA.

15. The Commissioner must give a notice stating the amount of SIC the taxpayer is liable to pay.<sup>12</sup> This notice can be combined with another notice – such as the notice of amended assessment that gives rise to the SIC liability. The total SIC payable by a taxpayer is due and payable 21 days after the day on which the Commissioner gives the taxpayer a notice of their SIC liability.<sup>13</sup>

16. The language of the relevant provisions in Division 280 of Schedule 1 to the TAA makes clear that a liability to SIC is contingent on an amended assessment being made and that the taxpayer must be liable to pay an additional amount of tax. The note to section 5-10 of the ITAA 1997 (which forms part of the Act) also provides support for the view that the SIC is only imposed if the Commissioner amends an assessment and it results in an increase of tax payable.

17. The service of a notice of (amended) assessment is the essential final step in making the assessment (see *Batagol v. Commissioner of Taxation* (1963) 109 CLR 243 and *Commissioner of Taxation v. Prestige Motors Pty Ltd* (1994) 181 CLR 1; [1994] HCA 39).

18. Although the SIC is calculated retrospectively for each day in the SIC liability period, the earliest time at which the SIC liability crystallises into a presently existing liability is when all of the steps necessary for its imposition have occurred – namely the making of an amended assessment by the Commissioner with an increased amount of tax payable. At this time a taxpayer becomes ‘definitively committed’ and therefore incurs the liability to SIC. Until those steps are completed, any liability to pay the SIC is at most ‘impending or threatened’.

19. This means that, where the SIC liability period spans more than one year of income, the SIC is not deductible in each of the years to which the liability relates. On the last day of each of those earlier years of income, the SIC is at most ‘impending or threatened’.

20. It also means that the SIC is incurred when the taxpayer is issued with the notice of amended assessment, even if they are not notified of the amount of SIC payable until a later date or if the SIC is unpaid at the end of that year of income.<sup>14</sup>

21. Further, the liability to SIC will remain a ‘presently existing obligation’ notwithstanding the Commissioner’s discretion to remit all or a part of that amount under section 280-160 of Schedule 1 to the TAA. The amount of any SIC remitted, whether in the same year the assessment is amended, or a later year, is assessable to the taxpayer in the year of income the remission is made (see subsection 20-25(2A) of the ITAA 1997).

### ***Income years preceding the application of SIC***

22. The SIC applies to amendments of assessments of income tax for the 2004-05 and later years of income; of PRRT for the 2006-07 and later years of income; and of excess contributions tax for the 2007-08 and later years of income.

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<sup>12</sup> Section 280-110 of Schedule 1 to the TAA.

<sup>13</sup> Section 5-10 of the ITAA 1997 and subsection 82(3) of the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRTAA).

<sup>14</sup> Note that small business entities that are eligible to continue to use the STS accounting method are taken to have incurred the SIC liability when it is paid. See section 328-120 of the *Income Tax (Transitional Provisions) Act 1997* for the conditions that must be met by taxpayers wishing to use this approach.

23. For years of income preceding the application of SIC, a taxpayer who is issued with an amended assessment increasing the amount of income tax or PRRT payable for the relevant year is liable to pay the GIC on the unpaid tax.<sup>15</sup> As with the SIC, the GIC is calculated retrospectively from the due date for payment of the original assessment.

24. The liability to pay GIC in these circumstances is also contingent on the taxpayer being issued with an amended assessment.<sup>16</sup> Accordingly, we take the same view of when GIC is incurred for the purposes of section 25-5 where it applies to understatements of tax for income years preceding the introduction of the SIC.

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<sup>15</sup> For income tax, see former section 170AA of the ITAA 1936 for the 1999-2000 year of income and former subsection 204(3) of the ITAA 1936 for the 2000-01 to 2003-04 years of income. For PRRT, see section 65 of the PRRTAA as it applied for 2005-06 and earlier years. Note GIC did not apply to amended assessments for excess contributions tax.

<sup>16</sup> Under former section 170AA of the ITAA 1936, a taxpayer is only liable to pay GIC if an amended assessment is made increasing their tax liability. For the 2000-01 to 2003-04 years of income, the wording in subsection 204(3) of the ITAA 1936 is more generic and makes no specific reference to an assessment (or amended assessment) being issued – a liability to pay GIC applies if an amount of tax is unpaid after the due date. However, as income tax is only ‘due and payable’ when an assessment is made, an amount of income tax due following an amended assessment is only unpaid when the process of amending the assessment is complete. In the case of PRRT, the position is clear as PRRT only became a full self assessment regime for years commencing from 1 July 2006, meaning before then, any amounts payable were solely dependent on an assessment by the Commissioner.

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## Appendix 2 – Alternative views

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**❶** *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.*

25. An alternative view is that the SIC is incurred at the end of each day in the SIC liability period. It has been suggested that the Full Federal Court decision in *Federal Commissioner of Taxation v. H* (2010) 188 FCR 440; [2010] FCAFC 128 (*H's case*) supports this position.

26. That case concerned the calculation of a company's 'distributable surplus' for the purposes of Division 7A of the ITAA 1936. The Court concluded that prior to an assessment being made the company had an obligation to pay income tax arising from the operation of the *Income Tax Act 1986* (ITA 1986). The present legal obligation came into existence on 30 June of the year of income in which the income was derived. At worst that obligation might be a contingent obligation (contingent on an assessment being made), but that does not disqualify it as a present legal obligation in the sense that it exists as at 30 June, though the obligation is to do something at a future date. On the making of an assessment, the present legal obligation arising from the ITA 1986 matures into an enforceable debt that becomes due and payable. The Court also agreed with the observations of the Administrative Appeals Tribunal that GIC is a present legal obligation on each day that tax which should have been paid remains unpaid.

27. However, *H's case* was concerned with the meaning of 'present legal obligation' for the purposes of section 109Y of the ITAA 1936. The Court's interpretation of the phrase 'present legal obligation' in the context of section 109Y of the ITAA 1936 is not relevant to the substantial body of jurisprudence on the meaning of 'incurred' in section 8-1 of the ITAA 1997, which is directly relevant to section 25-5 of the ITAA 1997.

28. For the reasons stated in the Explanation section of this Determination, a liability to pay the SIC is contingent on an amended assessment increasing the amount of tax payable – it does not arise from the operation of the ITA 1986 itself.

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## References

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*Previous draft:*

TD 2011/D11

*Related Rulings/Determinations:*

TR 97/7; TR 2006/10

*Subject references:*

- deductions & expenses incurred
- shortfall interest charge

*Legislative references:*

- ITAA 1936 Div 7A
- ITAA 1936 Div 13
- ITAA 1936 109Y
- ITAA 1936 170AA
- ITAA 1936 204(3)
- ITAA 1997 5-10
- ITAA 1997 8-1
- ITAA 1997 20-25(2A)
- ITAA 1997 25-5
- ITAA 1997 25-5(1)
- ITAA 1997 25-5(1)(c)
- TAA 1953 Sch 1 Div 280
- TAA 1953 Sch 1 280-100(1)
- TAA 1953 Sch 1 280-100(2)
- TAA 1953 Sch 1 280-102(1)
- TAA 1953 Sch 1 280-102(2)
- TAA 1953 Sch 1 280-102A(1)
- TAA 1953 Sch 1 280-102A(2)
- TAA 1953 Sch 1 280-110
- TAA 1953 Sch 1 280-160
- Income Tax (Transitional Provisions) Act 1997 328-120

- Income Tax Act 1986
- Petroleum Resource Rent Tax Assessment Act 1987 65
- Petroleum Resource Rent Tax Assessment Act 1987 82(3)

*Case references:*

- Batagol v. Commissioner of Taxation (1963) 109 CLR 243
- Commissioner of Taxation v. Prestige Motors Pty Ltd (1994) 181 CLR 1; [1994] HCA 39; 94 ATC 4570; (1994) 28 ATR 336
- Emu Bay Railway Company Ltd v. Federal Commissioner of Taxation (1944) 71 CLR 596; [1944] HCA 28
- Federal Commissioner of Taxation v. H (2010) 188 FCR 440; [2010] FCAFC 128; 2010 ATC 20-218
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