

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.

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.

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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) |

(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 MISSTATEMENT NO. 2 (penalty 25%) | (IM NO.2) | 2,000 |
| INCOME MISSTATEMENT NO. 3 (no penalty 0%) | (IM NO.3) | 500 |
| INCOME MISSTATEMENT NO. 4 (UNRELATED OVERSTATEMENTS) | (UIM) | (300) |

| | | |
|------------------------------|---------|---------------|
| ----- | | |
| TIAR/A | | 35,000 |
| Less UIM | | <u>300</u> |
| | | 34,700 |
| Plus | IM NO.1 | 1,000 |
| | IM NO.2 | 2,000 |
| | IM NO.3 | <u>500</u> |
| Net Debit Adjustment | | 3,500 |
| Amended Taxable Income (ATI) | | <u>38,200</u> |

Tax Shortfall

| | | |
|------------------------|--------|--------------|
| Tax on ATI | 38,200 | 9,886 |
| Less | | |
| Tax on TIAR/A | 35,000 | 8,494 |
| Plus | | |
| Adjusted Medicare Levy | | 40 |
| Tax Shortfall | | <u>1,432</u> |

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 x 9.6% = \$137.47 (deductible)

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EXAMPLE B:**REBATE/CREDIT REDUCTION**

| | | |
|--|----------|--------|
| TAXABLE INCOME AS RETURNED / ASSESSED | (TIAR/A) | 35,000 |
| REBATE/CREDIT MISSTATEMENT NO. 1 (penalty 50%) (R/C NO.1) | | 500 |
| REBATE/CREDIT MISSTATEMENT MO. 2 (penalty 25%) (R/C NO.2) | | 1,000 |
| REBATE/CREDIT MISSTATEMENT NO. 3 (UNRELATED UNDERSTATED REBATE) | (UR/C) | (400) |
| <hr/> | | |
| TIAR/A | | 35,000 |
| Amended Taxable Income (ATI) | | 35,000 |

Tax Shortfall

| | | | |
|---------------|--------|--------------|--------------|
| Tax on ATI | 35,000 | 8,494 | |
| Less | | | |
| Tax on TIAR/A | 35,000 | <u>8,494</u> | |
| | | | 0 |
| Plus R/C No.1 | | 500 | |
| R/C No.2 | | <u>1,000</u> | |
| | | | 1,500 |
| Less UR/C | | <u>400</u> | |
| | | | 1,100 |
| Tax Shortfall | | | <u>1,100</u> |

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 x 9.6% = \$105.60 (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 MISSTATEMENT NO. 2 (penalty 25%) | (IM NO.2) | 2,000 |
| INCOME MISSTATEMENT NO. 3 (no penalty) | (IM NO.3) | 500 |
| INCOME MISSTATEMENT NO. 4 (UNRELATED OVERSTATEMENT) | (UIM) | (300) |
| REBATE/CREDIT MISSTATEMENT NO. 3 (UNRELATED UNDERSTATED REBATE) | (UR/C) | (400) |

| | |
|------------------------------|---------------|
| TIAR/A | 35,000 |
| Less UIM | 300 |
| | <u>34,700</u> |
| Plus | |
| IM NO.1 | 1,000 |
| IM NO.2 | 2,000 |
| IM NO.3 | 500 |
| | <u>3,500</u> |
| Net debit adjustment | 3,500 |
| Amended Taxable Income (ATI) | <u>38,200</u> |

Tax Shortfall

| | | |
|-------------------------|--------|--------------|
| Tax on ATI | 38,200 | 9,886 |
| Less | | |
| Tax on TIAR/A | 35,000 | <u>8,494</u> |
| | | 1,392 |
| Plus | | |
| Adjusted Medicare Levy | | 40 |
| Less | | |
| Unrelated Rebate (UR/C) | | (400) |
| Tax Shortfall | | <u>1,032</u> |

Allocation of Tax Shortfall to Income Misstatements

| | | |
|----------------------|----------------------|--------------------|
| IM NO.1 | IM NO.2 | IM NO.3 |
| <u>1,000</u> x 1,032 | <u>2,000</u> 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.1

50% flat

 $294.85 \times 50\%$ $= 147.42$

IM NO.2

25%flat

 $589.71 \times 25\%$ $= 147.42$

IM NO.3

no penalty

 $\text{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 MISSTATEMENT NO. 2 (penalty 25%) | (IM NO.2) | 2,000 |
| INCOME MISSTATEMENT NO. 3 (no penalty) | (IM NO.3) | 500 |
| INCOME MISSTATEMENT NO. 4 (UNRELATED OVERSTATEMENT) | (UIM) | (300) |
| REBATE/CREDIT MISSTATEMENT NO. 1 (penalty 50%) | (R/C NO.1) | 500 |
| REBATE/CREDIT MISSTATEMENT NO. 2 (penalty 25%) | (R/C NO.2) | 1,000 |
| REBATE/CREDIT MISSTATEMENT NO. 3 (UNRELATED UNDERSTATED REBATE) | (UR/C) | (400) |

| | |
|------------------------------|---------------|
| TIAR/A | 35,000 |
| Less UIM | 300 |
| | <u>34,700</u> |
| Plus | |
| IM NO.1 | 1,000 |
| IM NO.2 | 2,000 |
| IM NO.3 | 500 |
| | <u>3,500</u> |
| Net debit adjustment | |
| | <u>38,200</u> |
| Amended Taxable Income (ATI) | |

Tax Shortfall

| | | | |
|------------------------|--------------|--------------|--------------|
| Tax on ATI | 38,200 | 9,886 | |
| Less | | | |
| Tax on TIAR/A | 35,000 | <u>8,494</u> | |
| | | | 1,392 |
| Plus | | | |
| Adjusted Medicare Levy | | <u>40</u> | 1,432 |
| Plus | | | |
| R/C NO.1 | 500 | | |
| R/C NO. 2 | 1000 | | |
| UR/C | <u>(400)</u> | | |
| | | | 1,100 |
| Tax Shortfall | | | <u>2,532</u> |

Allocation of Tax Shortfall to Income and Rebate/Credit Misstatements

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IM NO.1
 $\frac{1,000}{3,500} \times 1,432$
 = 409.14

IM NO.2
 $\frac{2,000}{3,500} \times 1,432$
 = 818.28

IM NO.3
 $\frac{500}{3,500} \times 1,432$
 = 204.57

R/C NO.1
 $\frac{500}{1,500} \times 1,100$
 = 366.66

R/C NO.2
 $\frac{1,000}{1,500} \times 1,100$
 = 733.33

Penalties

IM NO.1
 50% flat
 $409.14 \times 50\%$
 = 204.57

IM NO.2
 25% flat
 $818.28 \times 25\%$
 = 204.57

IM NO.3
 no penalty

R/C NO.1
 50% flat
 $366.66 \times 50\%$
 = 183.33

R/C NO.2
 25% flat
 $733.33 \times 25\%$
 = 183.33

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

Interest

$2532 \times 9.6\% = \$243.07$ (deductible)

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EXAMPLE E**INCOME REDUCTION, REBATE/CREDIT REDUCTION**

| | | |
|--|------------|---------------|
| TAXABLE INCOME AS RETURNED / ASSESSED | (TIAR/A) | 35,000 |
| INCOME MISSTATEMENT NO. 4 (OVERSTATEMENT) | (UIM) | (300) |
| REBATE/CREDIT MISSTATEMENT NO. 1 (penalty 50%) | (R/C NO.1) | 500 |
| REBATE/CREDIT MISSTATEMENT NO. 2 (penalty 25%) | (R/C NO.2) | 1,000 |
| REBATE/CREDIT MISSTATEMENT NO. 3 (UNRELATED UNDERSTATED REBATE) | (UR/C) | (400) |
| <hr/> | | |
| TIAR/A | | 35,000 |
| Less UIM | | 300 |
| Amended Taxable Income (ATI) | | <u>34,700</u> |

Tax Shortfall

| | | | |
|--------------------|--------|--------------|--------------|
| Tax on ATI | 34,700 | 8,380 | |
| Less | | | |
| Tax on TIAR/A | 35,000 | <u>8,494</u> | |
| | | | (114) |
| Less Medicare Levy | | | (3.75) |
| Plus R/C No.1 | 500 | | |
| R/C No.2 | 1,000 | 1,500 | |
| Less UR/C | | <u>400</u> | |
| | | | <u>1,100</u> |
| Tax Shortfall | | | 982.25 |

Allocation of Tax Shortfall to Rebate/Credit Misstatements

| | |
|---------------------|-----------------------|
| R/C NO.1 | R/C NO.2 |
| <u>500</u> x 982.25 | <u>1,000</u> 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 x 9.6% = \$94.29 (deductible)

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*reference number**subject references*

- additional tax
- calculation
- self assessment
- tax shortfall

legislative references

- ITAA 170AA; ITAA 226G;
ITAA 226H; ITAA 226J;
ITAA 226K; ITAA 226L;
ITAA 226M