IT 2360 - Income Tax : substituted accounting periods

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TAXATION RULING NO.IT 2360

INCOME TAX : SUBSTITUTED ACCOUNTING PERIODS

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1210261	SUBSTITUTED ACCOUNTING PERIODS	18(1)

PREAMBLE Sub-section 18(1) of the Income Tax Assessment Act provides that any person may, with the leave of the Commissioner, adopt an accounting period being the 12 months ending on some date other than 30 June. The accounting period so adopted shall continue in succeeding years unless, with the further leave of the Commissioner, some other date is adopted.

2. The purpose of this Ruling is to set out guidelines to be followed in dealing with applications for leave under sub-section 18(1). In part it has been brought about by the need to counter manipulation and exploitation of substituted accounting periods in a number of cases.

3. The measures announced by the Treasurer in the 1986-87 Budget Speech to amend the income tax law to advance the due dates for payment of quarterly instalments and assessments by some companies whose accounting periods for income tax purposes end on a date earlier than 30 June are quite independent of the matters referred to in this Ruling. The proposed amendments are directed to the payment of income tax liabilities. This Ruling deals with the practical operation of sub-section 18(1).

RULING General Considerations

4. Although the power expressed in sub-section 18(1) is seemingly unrestricted it is patently clear that there are limitations imposed upon the exercise of it. In Giris Pty. Ltd. v. FCT 69 ATC 4015 : 1 ATR 3, Windeyer J. made the following observations about the limitations placed upon the Commissioner in the exercise of the discretion given in section 99A. They apply with equal force to sub-section 18(1):-

> "....he is to be guided and controlled by the policy and purpose of the enactment, so far as that is manifest in it. That would exclude from his consideration any matter which it would be unlawful for him to take as a criterion, such as the State of residence of a trustee or of the beneficiaries of a trust. It would also, I think, exclude all merely fanciful and prejudiced tests which were hypothetically

suggested in argument, such as vocation, religion, colour of skin or hair."

5. Bearing in mind that the Commissioner has the responsibility for the general administration of the Act and must report annually to the Parliament on the workings of the Act there are, at least, four underlying matters of policy or purpose which have been borne in mind in the formulation of this Ruling:-

1. There is a basic initial presumption that an annual accounting period ending on 30 June is appropriate, at least in the generality of cases.

2. As far as it permits the income tax law must be administered to operate fairly over the whole range of taxpayers so that no one taxpayer is advantaged or disadvantaged in relation to other taxpayers.

3. The need to collect income tax revenues by 30 June in each year.

4. The responsibility to ensure that the affairs of the Australian Taxation Office are conducted in an efficient and business-like manner.

6. The generality of the power expressed in sub-section 18(1) raises other considerations. If leave is granted in terms of the sub-section, is it absolute, i.e., does it subsist for all times? Furthermore, is it open to impose conditions upon the granting of leave?

7. Insofar as the concept of absoluteness is concerned practical commonsense requires that leave granted to adopt an accounting period other than 30 June should subsist for only so long as the circumstances which gave rise to leave being granted also subsist. Thus, leave granted to a company in a group to balance on the same date as other companies in the group will operate only while the company remains in the group or continues to be active. In either of the events that the company is taken over by another group of companies or ceases to be active the leave granted is to be treated as no longer operative.

8. In future, therefore, it will be a condition of any grant of leave to adopt an accounting period other than 30 June that the leave will exist only for so long as the reasons for leave being granted continue to exist. The applicant taxpayer should be required to undertake to inform the relevant branch of the Australian Taxation Office of any material change to the circumstances in which leave was granted. A decision whether or not the leave granted will continue to apply will be made in the light of the altered circumstances. The same approach should be followed where leave has been granted prior to the issue of this Ruling and, subsequent to the issue of the Ruling, the reasons for leave having been granted in any case cease to exist, i.e. the taxpayer should inform the Australian Taxation Office of the change in circumstances and make fresh application for leave

under sub-section 18(1).

9. For many years it has been the practice to require adjustments to be made in the year of changeover to the new accounting period. The primary object of the adjustments is to ensure that the taxpayer pays an appropriate amount of tax in the changeover year. For example, where a taxpayer is granted leave to adopt an accounting period ending 30 April in lieu of the subsequent 30 June, an adjustment is required in the changeover year so that the taxpayer pays tax on approximately the same amount of income that he would have derived if he had an accounting period ending 30 June. The practice of requiring appropriate adjustments in the year of changeover is considered to be implicit in the power granted by sub-section 18(1) and will continue. It is not affected by the proposals to amend the income tax law to advance the due dates for payment of quarterly instalments and assessments referred to in paragraph 3.

Practical Considerations

10. It is expected that the circumstances in which leave is granted to adopt an accounting period other than 30 June will be rare. Furthermore it is expected that applications under sub-section 18(1) will be restricted to taxpayers carrying on business, particularly company taxpayers. It is difficult to imagine any circumstances in which leave under sub-section 18(1) should be granted to taxpayers deriving income by way of salary and wages, pensions, etc. and/or rents, dividends and interest.

11. A change in the accounting period of a business taxpayer should only be approved where there is a substantial business need for making the change. In this context a substantial business need does not mean savings in tax or the gaining of a competitive edge over other taxpayers. It means that there must be some factor or element peculiar to the particular business or class of business which makes a 30 June year wholly inappropriate or impractical as a measure for determining taxable income.

12. A substantial business need may exist where it is found that the taking of stock on hand at 30 June is a practical impossibility. The counting of live-stock on the vast cattle stations in the far north of Australia is an example. It is understood this is a process which can extend over several months and its timing is dependent upon the cattle season which extends from April to November. There may also be other isolated instances where, by the nature of a business, the income from the business activity is received up front before the incurring of the bulk of the expenditure and a 30 June year seriously distorts the calculation of taxable income.

13. Convenience of the taxpayer is not sufficient reason for a change in accounting period. Nor is it sufficient to say that a 30 June year does not permit a proper matching of income and expenditure. This is a claim which may be made in relation to businesses which are of a seasonal nature. It has not been established that any period ending other than 30 June generally

enables an accurate matching of income and expenditure. In any event it must be taken for granted that successive Governments have not been unaware of this feature - the fact that there has not been any amendment to the income tax law to deal with it is tacit recognition that it is not a matter of sufficient substance to warrant change of accounting period.

14. In April 1975 a circular issued to tax agents in which it was stated that applications for leave to adopt accounting periods ending on 31 March (or on some later date prior to 30 June) will generally be approved where the change is sought by the taxpayer concerned as a means of enabling his tax agent to spread his workload more evenly over the year. Since then, however, tax agents' lodgment arrangements have developed considerably and the spread of the workload may be achieved through an appropriate lodgment programme. As a general practice the April 1975 circular will no longer be followed and applications for leave to adopt accounting periods other than 30 June should be determined solely in accordance with this Ruling.

15. The granting of leave to adopt an accounting period other than 30 June may, of course, place some constraints upon the taxpayer and his accountants in relation to the lodgment of the return of income in order that an assessment may issue in time for tax to be collected by 30 June in each year. It is expected that the taxpayer and his accountants will take whatever action is necessary to ensure that the return of income is lodged within whatever extended time for lodgment may be allowed.

16. The more usual situation where leave may be granted is in a resident company group situation. It has been the practice for many years to grant leave to companies in a group to balance on the same date as the parent i.e. so that all companies in the one group share the same accounting period for income tax purposes. Many of the parent companies have been in existence prior to the introduction of Commonwealth income tax in 1915 and they have been permitted to lodge income tax returns on the same accounting period as they used prior to 1915. Some banks in existence prior to 1915, for example, have always lodged income tax returns on a 30 September year end. So have their subsidiaries. The practice has not been restricted to resident companies. Subsidiaries and branches of overseas companies are also permitted to lodge returns of income for the same year as the parent is required to lodge returns under the relevant income tax legislation or by the relevant income tax authorities. These long standing practices may continue to enable all companies in the group to balance on the same day.

Accounting Period - year in lieu

17. Where leave is granted to adopt an accounting period ending on any date between 1 July and 30 November the period adopted shall be in lieu of the income year ending on 30 June of the calendar year, i.e. on 30 June immediately preceding. Where leave is granted to adopt an accounting period ending on any other date, the period adopted shall normally be in lieu of the

year of income ending on 30 June next succeeding.

When application to be made

18. In the normal course of events it would be expected that it would be made in the first year in which the reasons for seeking leave manifest themselves, e.g. in the first year of business or in the year in which a company becomes a subsidiary of another company which has a balance date other than 30 June.

19. The lodgment of a return of income for a period ending on some date other than 30 June is not acceptable as an application for leave under sub-section 18(1). What is required is a formal application setting out the reasons for the requested accounting period.

20. In recent times a number of applications for leave under sub-section 18(1) have been made some years after the reasons for seeking leave have been in existence. This immediately raises the question whether the circumstances are such as to warrant leave being granted. More significantly the applications have been made in years in which there has been a loss for income tax purposes or there has been a substantial reduction in income. This has the result that any adjustment which might otherwise be required as a condition of granting leave is entirely removed in the case of a loss or substantially lessened where there has been a reduction of income. In fairness to taxpayers generally an application for leave should not be approved in any year in which there is a loss for income tax purposes other than the first year in which the reasons for the application existed. Nor should an application under sub-section 18(1) be approved in any year where the taxable income is significantly less than that of preceding years.

21. The income of the year of application will be significantly less than that of preceding years if it is:-

less than 75% of the taxable income of the preceding year where there is only one preceding year;

less than 75% of the larger of the taxable incomes of the two preceding years where there are only two preceding years;

less than 75% of the largest of the taxable incomes of the preceding three years where there are three or more preceding years.

Adjustments

22. Where leave to adopt an accounting period other than 30 June is granted it will be necessary to determine the extent to which any adjustments are necessary. This matter is dealt with and examples of adjustments given in Canberra Income Tax Circular Memorandum No. 550 and reference should be made to it. Where a taxpayer does not assent to the adjustments considered

necessary leave should not be granted.

23. As has been stated earlier adjustments may be required to ensure that an appropriate amount of tax is paid in the year of changeover. If, for example, leave is granted to a company to adopt an accounting period ending 31 March in lieu of the subsequent 30 June fairness to taxpayers generally requires that, in the year of changeover, the company should not be given a taxation advantage.

24. Adjustments will normally be required to take into account income derived between the end of the accounting period and 30 June. If, in the situation referred to in the preceding paragraph, the company had been incorporated on 1 January the adjustment would generally be achieved by adding to the taxable income for the three months period ending 31 March an amount equal to that taxable income, i.e. it would be assumed that the taxable income for the period 1 January to 30 June would have been double the taxable income for the period 1 January to 31 March. The amount to be added will depend upon the date of commencement of the business.

25. If a business has been in existence for some years a strict application of the income tax law would seem to require that the first assessment for the new accounting period ending 31 March should be based on the taxable income for the period of 12 months to 31 March, notwithstanding that the income and losses and outgoings of the first three months of the period would have been taken into account in determining the taxable income for the year ended the preceding 30 June. The taxpayer would not normally suffer any detriment because he will be taxed on the income of a full year in the same way as if an accounting period ending 30 June had been retained.

26. As an alternative to levying tax in the changeover year on the taxable income for the 12 months to 31 March an appropriate adjustment may be achieved by adding to the taxable income of the 9 months period from 1 July to 31 March an amount equal to the greater of:-

(a) one-third of that taxable income;

(b) one-fourth of the taxable income of the preceding year ended 30 June.

27. An application for leave to adopt an accounting period in lieu of the subsequent 30 June made in the first year of a business will require scrutiny to ensure that the trading results for the proposed accounting period fairly reflect the full range of business activities which the taxpayer proposes to undertake. Trading operations of a newly constituted business enterprise may take some time to develop to the full. In the early stages profits may be small and losses may even be incurred. To obtain a proper picture it may be necessary to have regard to projected or actual trading results for the period ending 30 June subsequent and to take the trading results into account in determining the extent of any adjustments

necessary.

28. It may be, for example, that, in the case of a business commencing on 1 January with an accounting period ending 31 March, examination of the trading results will require a greater adjustment than that referred to in paragraph 24, i.e. the taxable income for the period ending 30 June may be more than double the taxable income for the accounting period ending 31 March. In other cases, the adjustment required following examination of the post 31 March trading results may convert a loss into a taxable income. If, in another situation, a taxable income is returned for the accounting period ending 31 March and there is a loss in the period to 30 June, no adjustment to the taxable income will be necessary. Similarly, there would not be any need for adjustment where losses occurred in both periods.

29. Paragraphs 23-28 deal with adjustments required where leave is granted to adopt an accounting period in lieu of 30 June subsequent. Where, on the other hand, leave is granted to adopt an accounting period later than 30 June but prior to 30 November in lieu of the preceding 30 June it will be sufficient if income tax is paid in respect of the taxable income derived up to the end of the new accounting period. If, in the case of an existing business, an accounting period ending 30 September is granted in lieu of the preceding 30 June, all that is necessary is that a return should be lodged for the period up to 30 September, e.g. from 1.7.86 to 30.9.87.

30. The possibility of reversal of adjustments is also dealt with in Canberra Income Tax Circular Memorandum No. 550. It is recognised that cases will arise where a taxpayer who has adopted an accounting period ending on a date other than 30 June ceases to derive income. This position will most frequently arise in connection with the liquidation of a company. Where a company which balances on a date other than 30 June goes into liquidation, therefore, it will be necessary to examine its past assessments to ascertain whether any income derived by it since leave was granted or the date of commencing to derive income, whichever is the later, has escaped tax or, alternatively, whether any of the income has been subjected to double taxation by reason of a previous adjustment upon the change of accounting period.

31. In some cases, e.g. where the accounting period ends subsequent to 30 June but is in lieu of the preceding 30 June, it will be found that the company has been assessed in respect of all income derived by it up to the close of its last accounting period prior to completion of the liquidation. The final assessment in such cases should be based, without adjustment, on income derived subsequent to the close of the last accounting period up to the date of ceasing to derive income.

32. On the other hand, cases will arise in which an adjustment has already been made to include in the company's assessments a notional amount in respect of taxable income derived between the close of its accounting period and the

30 June next succeeding. In such cases the taxable income of the period from the close of the last complete accounting period up to the date of ceasing to derive income will require adjustment in order to avoid double taxation. As a general rule the adjustment may be effected by deducting from the taxable income of the final period an amount equal to that which was added to the taxable income of the year when the previous adjustment was made. Where the rate of tax in the year of the previous adjustment differs substantially from that in the final year, however, a more equitable result might be achieved by allowing a credit of an amount of tax equivalent to the additional tax payable in consequence of the previous adjustment. In a number of cases it may be found that the taxable income or tax (as the case may be) assessed in respect of the final period will be less than the quantum of taxable income or tax represented by the previous adjustment. In such cases the necessary adjustment to be made to avoid any double taxation is to be confined to the final assessment which, in the circumstances, would become non-taxable. It is not considered that any justification exists for carrying back a credit of the excess amount of taxable income or tax to the immediately preceding assessment, as that assessment would have been correctly made on the taxable income derived by the company during the accounting period of twelve months substituted for the year of income ending on the relevant 30 June.

Partnerships

33. What has been said in this Ruling in relation to the granting of leave to adopt accounting periods other than 30 June in the case of individual and company taxpayers applies also in the cases of partnerships.

34. Where partners in a partnership have common accounting periods for income tax purposes the partnership should lodge returns of income for the same accounting period. The adjustments that are required in other cases should also be required in partnerships in appropriate cases. If, for example, partners and the partnership are granted leave to adopt an accounting period ending 31 March in lieu of the succeeding 30 June the same adjustments as specified in paragraphs 23-28 would be required.

35. A particular difficulty in considering applications for leave to adopt accounting periods other than 30 June arises in the case of partnerships. It arises in circumstances where two or more persons who do not share common income tax accounting periods enter into partnership. For example, three persons whose accounting periods may end on 31 March, 30 June and 30 September may enter into partnership. Whether the partnership accounting period ends on 30 June or one of the other dates, a number of questions arise:-

1. Does the accounting period of the partnership, say the year ending 30 June, represent an application by two of the partners for leave to alter their existing accounting periods?

2. In which year is each partner's share of the income to be assessed? Is it the partner's accounting period corresponding to the partnership accounting period or is it the year in which the share of the net income of the partnership is ascertained, i.e. in the case of the partner whose accounting period ends on 30 April, is the share of the net income of the partnership for the year ended 30 June taken back to the year ended 30 April preceding or is it reflected in the year ended 30 April succeeding?

36. The difficulties assumed considerable importance in the preparation of Taxation Ruling No. IT 2051 dealing with leveraged leases. As the Ruling indicates leveraged lease transactions are usually undertaken by partnerships. In most cases the partners are banks and financial institutions whose accounting periods other than 30 June have been approved for many years. The solution that was reached in leveraged lease partnerships may be applied generally, i.e.:

> Where the partners do not share common accounting periods a partnership accounting period which corresponds to that of the majority partner will generally be approved. It will be a condition of approval, however, that the partners whose accounting periods do not coincide with that of the partnership must include in returns of income for their accounting periods the appropriate share of the net income or loss of the partnership attributable to their accounting periods.

Trusts

37. It is not unusual for some business ventures to be structured as unit trusts rather than as partnerships. It is said that the unit trust structure provides greater flexibility. Essentially, however, the arrangements reflect the wishes of the participants to carry on the venture jointly. Applications by unit trusts of this nature for leave to adopt accounting periods other than 30 June should be dealt with in the same manner as partnerships.

38. Another trust situation which may give rise to application for leave to adopt accounting periods other than 30 June is the large investment or property trust which may have thousands of investor/beneficiaries. This matter is currently under consideration and will be the subject of a further Ruling.

COMMISSIONER OF TAXATION
12 September 1986