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## Deductions Arising From Illegal Activities

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# Deductions Arising From Illegal Activities

## **Abstract**

The income tax legislation taxes income 'from all sources'. On its plain wording, the ITAA is not concerned with how that income is earned or generated. Should we tax illegal gains, such as the profits of crime or the gains of illegality? Equally, assuming the ill-gotten gains are taxable, should the costs of those crimes and illegalities be deductible? To use the words of Hely J in *C of T v La Rosa*, the subject of this article, can we have '[t]he paid assassin ... deduct[ing] the cost of his bullets and depreciat[ing] the cost of his gun'? Based on a strict interpretation of the tax law, the answer is yes.

## **Keywords**

income tax legislation, tax law, ethics, illegal activities

## DEDUCTIONS ARISING FROM ILLEGAL ACTIVITIES

by Siska Lund\*

The income tax legislation taxes income 'from all sources'. On its plain wording, the ITAA is not concerned with how that income is earned or generated. Should we tax illegal gains, such as the profits of crime or the gains of illegality? Equally, assuming the ill-gotten gains are taxable, should the costs of those crimes and illegalities be deductible? To use the words of Hely J in *C of T v La Rosa*, the subject of this article, can we have '[t]he paid assassin ... deduct[ing] the cost of his bullets and depreciat[ing] the cost of his gun'? Based on a strict interpretation of the tax law, the answer is yes.

### Introduction

Is there a difference between what is legal and what is ethical? Should our views about morality influence our interpretations of taxation law; and vice versa?

Such questions are raised by *Commissioner of Taxation v La Rosa*.<sup>1</sup> The decision was an appeal and cross-appeal from the Federal Court of Australia (of Nicholson J) in *Commissioner of Taxation v La Rosa*.<sup>2</sup> That case was an appeal from the Administrative Appeals Tribunal (the 'AAT').<sup>3</sup>

*La Rosa's* case is the first to consider the deductibility of losses incurred in carrying on a drug dealing business under what is now s 8-1 of the 1997 Act, but was then s 51(1) of the *Income Tax Assessment Act 1936* ('ITAA 1936'). The Full Federal Court (Carr, Merkel and Hely JJ) dismissed the appeal by the Commissioner against the allowance of a deduction in respect of money stolen from the taxpayer. This article argues that the Court made a sound decision in light of the uncertainty involved in applying a public policy test and the proper interpretation of the ITAA. However, Parliament may have valid reasons for making legislative changes to disallow the deduction of

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1 [2003] FCAFC 125 (5 June 2003).

2 (2002) 50 ATR 450.

3 [2000] AATA 625.

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some or all losses incurred in carrying on a drug dealing business. The possibility of legislative reform is also discussed.

## Deductions under the ITAA

### 1 Business deductions

The income tax laws have been designed to broadly ensure that taxpayers are only taxed on their 'net position'.<sup>4</sup> This means that a taxpayer's taxable income for an income year is determined by subtracting deductions from assessable income.<sup>5</sup>

Section 6-5 *ITAA 1997* (formerly s 25(1) *ITAA 1936*) states that assessable income includes gross income 'derived directly or indirectly from all sources'. The *ITAA* does not differentiate as potentially assessable income between income that is derived from legal or illegal activities.<sup>6</sup> Therefore, the fact that a receipt is illegal, immoral or ultra vires does not prevent it being characterised as ordinary.<sup>7</sup>

The *ITAA* contains a 'general deduction' provision in s 8-1 *ITAA 1997*. In *La Rosa's* case, the issue was whether losses incurred in carrying on a drug dealing business were deductible under s 51(1) *ITAA 1936*. This subsection allows a deduction for losses or outgoings incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for that purpose.

### 2 Limitations on deductibility

The *ITAA* specifies what deductions are allowable against assessable income. As a general principle it is for Parliament, rather than the Courts, to determine whether a

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4 RH Woellner, S Barkoczy et al, *Australian Taxation Law* (13th ed, CCH Australia Limited, 2003), 670.

5 Section 4-15(1) *ITAA 1997*.

6 The Commissioner has expressed his views on the assessability of proceeds from illegal activities in Taxation Ruling TR 93/25.

7 *Partridge v Mallandaine* [1898] AC 758 ('business' of burglary); *Minister of Finance (Canada) v Smith* [1927] AC 193 (profits arising from illicit liquor trade); *Lindsay Woodward and Hiscox v IR Commrs* (1932) 18 TC 43 (whisky smuggler); *No 275 v Minister of National Revenue* (1955) 13 Can Tax ABC 279 (prostitution); *England v Webb* [1898] AC 758 (ultra vires activities of company); *Taxation Review Authority No 17* (1980) 4 TRNZ 173 (drug trafficking).

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loss or outgoing otherwise falling within s 51(1) should not be deductible on public policy grounds or otherwise.<sup>8</sup>

Section 26-5 *ITAA 1997* (formerly s 51(4) *ITAA 1936*) provides that a taxpayer is not entitled to deduct certain fines and penalties. The policy behind the enactment of this provision seems to be that a 'penalty' is imposed as a punishment and that a person should not indirectly benefit from paying a penalty by gaining a tax deduction.<sup>9</sup> In *Herald and Weekly Times Ltd v FC of T*<sup>10</sup> their Honours stated that, 'a penalty is imposed as a punishment of the offender considered as a responsible person owing obedience to the law. Its nature severs it from the expenses of trading. It is inflicted on the offender as a personal deterrent, and it is not incurred by him in his character of trader.'

Provisions disallowing deductions for bribes made to public officials have recently been introduced into the *ITAA* for the 1999/2000 and subsequent income years.<sup>11</sup> There are obvious policy reasons behind the introduction of these provisions. The measures to prevent an income tax deduction arising from bribes were recommended by the OECD Council on Bribery in International Transactions to counter corruption of public officials in foreign countries and to maintain competitive neutrality between member countries.<sup>12</sup>

### La Rosa's Case

#### 1 A drug deal and a loss

The taxpayer was involved in drug dealing. In 1996 he was sentenced to more than 12 years in prison, after pleading guilty to charges relating to the importation and possession of heroin.<sup>13</sup> Money, personal property and real property valued at \$264,610 were also confiscated from the taxpayer under the *Proceeds of Crimes Act 1987*.

Following the taxpayer's criminal convictions, his financial affairs came to the Commissioner's attention – he had not lodged income tax returns for the seven years

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8 Above n 1, para 56.

9 RH Woellner, S Barkoczy et al, *Australian Taxation Law* (13th ed, 2003), 721.

10 (1932) 48 CLR 113, 120.

11 Sections 26-52, 26-53.

12 Taxation Laws Amendments Bill (No. 8) 1999 (Bills Digest 51 1999-2000), <<http://wipi.aph.gov.au>> viewed 30 October 2003.

13 *La Rosa v The Queen* (1999) 105 A Crim R 362, 363.

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of income ended 30 June 1990 to 30 June 1996 inclusive. Accordingly, the Commissioner issued default notices of assessment on the taxpayer pursuant to s 167 *ITAA 1936*. Included in the assessable income of the taxpayer was \$220,000 that was accumulated from drug dealings and had been buried in the taxpayer's backyard and later dug up for an intended drug deal in May 1995. The \$220,000 was subsequently stolen from the taxpayer during that intended drug purchase.

The taxpayer lodged objections to these income tax assessments on the basis that they overstated his income for those income years. The Commissioner disallowed the taxpayer's objection, so the taxpayer appealed to the AAT.

## 2 AAT decision

In considering the assessability of the income derived from illegal business activities, the AAT adopted the views of the Commissioner in Taxation Ruling TR 93/25. In that Ruling, the Commissioner considered that, inter alia, receipts from a systematic activity where the elements of a business are present are income, irrespective of whether the activities are legal or illegal.<sup>14</sup> On this basis, the AAT found that the Commissioner had correctly included the \$220,000 in the assessable income of the taxpayer under s 25(1) *ITAA 1936* because the taxpayer was carrying on a drug dealing business.

Next, the AAT considered whether the taxpayer should be entitled to a deduction under s 51(1) *ITAA 1936* for the \$220,000 that was stolen from the taxpayer during the intended drug purchase. The AAT relied on *Charles Moore & Co (WA) Pty Ltd v Federal Commissioner of Taxation*.<sup>15</sup> There, deductibility was allowed in respect of a sum of money stolen at pistol point whilst being taken from the taxpayer's retail store to the nearby bank for depositing.

In *La Rosa's* case, the AAT characterised the \$220,000 loss as one incurred in the course of gaining or producing assessable income. It was lost during a robbery connected with a drug purchase operation directly connected with the taxpayer's illicit drug dealing business. The occasion of the loss was the theft of money intended to be applied in connection with the purchase of trading stock for the taxpayer's business as a dealer in drugs. It did not matter that the drug dealing business was illegal. Therefore, the \$220,000 was allowed as a deduction during the year ended 30 June 1995.

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<sup>14</sup> Above n 1, para 5.

<sup>15</sup> (1956) 95 CLR 344.

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**3 Federal Court, at first instance**

The Commissioner appealed the AAT's decision to allow the taxpayer to deduct the stolen funds.

At first instance, Nicholson J dismissed the Commissioner's ground of appeal that deductions pursuant to s 51(1) *ITAA 1936* should only be available for legitimate business activities:<sup>16</sup>

To adopt the use of legitimacy would seem to introduce a measure of subjectivism which would give rise to uncertainty in the application in the law. More fundamentally, the contentions for it do not disclose any foundation either in case law or in the wording of the *ITAA* upon which such a concept could be approached. In my view, it is essential to adhere to application of the words of the *ITAA* in s 51(1).

The Commissioner also submitted that the stolen funds were not deductible on public policy grounds. The Commissioner submitted that the policy of the law is not served by allowing a deduction to the taxpayer for a payment or loss of funds in acquiring or attempting to acquire a substantial supply of prohibited drugs through a drug dealing. In particular, the Commissioner took the view that the Victorian Supreme Court's decision in *Mayne Nickless Ltd v Federal Commissioner of Taxation*<sup>17</sup> stood for the principle that the courts will not allow a person to benefit from their own wrongdoing.

Nicholson J accepted that s 51(1) *ITAA 1936* may be limited by public policy considerations. However, His Honour distinguished *Mayne Nickless* and held that none of the authorities relied on by the Commissioner supported the more general proposition that expenditure (other than fines and penalties) which has the requisite nexus with the business operations should nonetheless not be deductible because those operations are unlawful and involve breaches of the criminal law.

Nicholson J thus adopted a literal approach and held that the public policy argument for the Commissioner could not succeed.

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<sup>16</sup> Above n 1, para 59.

<sup>17</sup> [1984] VR 863.

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**4 Full Federal Court appeal**

The Commissioner appealed the decision of Nicholson J to the Full Federal Court and contended that the deductions should not have been allowed. Again, the Commissioner's main submission was that the taxpayer's loss arose from conducting illegal business activities and thus, allowing a deduction for such a loss would be contrary to public policy.

Hely J gave the leading judgment of the Full Court of the Federal Court. Carr J and Merkel J concurred.

Hely J agreed that, 'there is a body of authority which justifies the proposition that the illegal nature of a receipt does not deny its taxability.'<sup>18</sup> His Honour stated that, 'where a taxpayer systematically engages in an illegal activity, and the elements of a business such as organisation, repetition, regularity and view to a profit are present, then the proceeds from that activity will be income according to ordinary concepts.'<sup>19</sup> His Honour acknowledged that, 'to hold otherwise would be to favour dishonest businesses over honest ones.'<sup>20</sup>

For the purposes of s 51(1) *ITAA 1936*, Hely J accepted that the AAT had made a correct characterisation of the \$220,000 loss. Hely J held that there was a sufficient nexus between the loss and the business operations of the taxpayer.<sup>21</sup> His Honour stated that 'the risk that losses of that type will be sustained was inherent in the activities under consideration.'<sup>22</sup>

Similarly, Carr J held that since 'income' had been interpreted literally, s 51(1) *ITAA 1936* also called for a literal interpretation and as such, the usual principles should be applied to allow the loss of \$220,000 as a deduction.<sup>23</sup> Adopting the literal approach to statutory interpretation, Carr J acknowledged that the criminality of the occasion of the outgoing must be irrelevant.<sup>24</sup>

The Commissioner argued that the policy of the law is not served by allowing a deduction to the taxpayer under s 51(1) *ITAA 1936*. If allowed, the deduction will be

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18 Above n 1, para 21.

19 Above n 1, para 23.

20 Above n 1, para 21.

21 Above n 1, para 27; *Commissioner of Taxation v Jones* (2002) 117 FCR 95, 98.

22 Above n 1, para 29.

23 Above n 1, para 6.

24 Above n 1, para 7.

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given for an outgoing or loss that is clearly and sharply prohibited by the declared criminal law.<sup>25</sup> However, the Court unanimously dismissed this submission on the ground that allowing for such a deduction does not frustrate the operation of the criminal law, nor will any sanction imposed by that law be diluted by the allowance of a deduction for business expenses or losses.<sup>26</sup> Their Honours distinguished this case from those involving fines and penalties imposed by Parliament or the courts and held that allowance of such a deduction does not amount to a condonation of the taxpayer's activities.

The Court held that the policy of the law does not disentitle the taxpayer to a deduction in relation to the \$220,000. In particular, Hely J stated:<sup>27</sup>

[T]he purpose of the ITAA is to tax taxable income, not to punish wrongdoing. The language of ss 17, 25, 48 and 51 is indifferent as to whether the income, loss or outgoing in question has its source in lawful or unlawful activity... There should not be a higher burden of taxation imposed on those whose business activities are unlawful than that imposed in relation to lawful business activities. Punishment of those who engage in unlawful activities is imposed by the criminal law, and not by laws in relation to income tax.

The Full Federal Court therefore rejected the taxpayer's public policy submission and allowed the deduction.

#### Was *La Rosa's* case wrongly decided?

The reasoning in the Full Federal Court decision in *La Rosa* is roundly defensible, in light of the uncertainty involved in applying a public policy test and the proper interpretation of the ITAA.

Interpretation of tax laws has produced two extreme views. The history of tax jurisprudence shows these two extreme views struggling in competition, as the pendulum swings now in favour of the taxpayer, now in favour of the Commissioner.<sup>28</sup> On the one hand, there is the 'golden rule' of Lord Wensleydale:<sup>29</sup>

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25 Above n 1, para 48.

26 Above n 1, per Carr J, para 8; per Hely J, para 58.

27 Above n 1, para 55; per Carr J, para 9.

28 William Barker, 'Statutory Interpretation, Comparative Law, and Economic Theory: Discovering the Ground of Income Taxation' (2003) 40 *San Diego Law Review* 821.

29 *Grey v Pearson* (1857) 10 ER 1216 at 1234 in Justice Graham Hill, 'A Judicial Perspective on Tax Law Reform' (1998) 72 (9) *The Australian Law Journal* 685, 687.

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[I]n construing wills and indeed statutes, and all written instruments, the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument...

At the other extreme is the purposive approach, where the court is directed to favour the construction of the legislation which gives effect to the legislative purpose.<sup>30</sup> This approach raises the issue of how the purpose is to be ascertained. Today, clear support for the purposive rule arises from s15AA and s15AB of the *Acts Interpretation Act 1901*.<sup>31</sup> Second Reading Speeches, statements of the relevant Minister at the time, and reports of Commissions can be relied upon as guides to what the legislation was designed to do.

The question of the proper approach to the construction of tax statutes arose early in the jurisprudence of the High Court in *Heward v The King*,<sup>32</sup> a death duty case. Griffith CJ and Barton J were of the view that it was for the Crown to express in clear and unambiguous language any charge which it sought to impose upon a subject.<sup>33</sup> Subsequent cases show that this approach was popular until the 1970s when the purposive approach found favour.

In adopting a literal approach to s 51(1) *ITAA 1936*, the Court in *La Rosa* acknowledged that all ordinary and necessary business expenses are presumed to be deductible, regardless of the legal or illegal nature of the business. This approach to interpreting the *ITAA* is consistent with the approach used in the recent High Court decision in *FC of T v Ryan*.<sup>34</sup> Here, the majority held that the construction of the Act for which the Commissioner contended strained the words of s 170(3) beyond any reasonable degree of elasticity that they might be said to have.<sup>35</sup>

On a general level, using public policy to interpret the *ITAA* would introduce uncertainty where the wording of the *ITAA* itself is not ambiguous. Given that the *ITAA* is based on a self-assessment system, it would be an onerous task for taxpayers to have to guess which is the correct interpretation, deriving that from an often

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30 Above n 9, 49.

31 Justice Graham Hill, 'A Judicial Perspective on Tax Law Reform' (1998) 72 (9) *The Australian Law Journal* 685, 687.

32 (1906) 3 CLR 117.

33 Above n 31, 688.

34 (2000) 201 CLR 109.

35 *Ibid* 126.

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indeterminate purpose. If legislation is expressed with obscurity the courts should not be bound to endeavour to give it a construction it does not bear on its face.<sup>36</sup> That was the reason why Hely J ultimately found for the taxpayer. In His Honour's view, if taxable income is derived from unlawful activities, or from lawful activities pursued in an unlawful manner, fines, penalties and forfeitures imposed by the criminal law are not to be taken into account in the computation of taxable income.<sup>37</sup> His Honour found nothing to support the implication into the *ITAA* of an unexpressed qualification that a deduction otherwise authorised by s 51(1) will be denied if allowance of the deduction would frustrate federal or state policies proscribing particular types of conduct, however sharply defined.<sup>38</sup>

The Court in *La Rosa* applied the most appropriate rule of interpretation in tax matters. Few laws have the force that income taxation has to reach into our private lives and alter our behaviour and even our life choices. Therefore, it is best that these rules be as straightforward as possible. Parliament has the responsibility of drafting legislation which is clear and unambiguous and achieves what it sets out to achieve. If it fails to do so, it is not for the court to re-write the law.

The decision in *La Rosa* does not preclude disallowing the deduction of losses incurred in carrying on an illegal business; it just leaves the decision to the legislature.

#### **Should parliament change the law?**

After the decision in *La Rosa*, almost all losses incurred in carrying on an illegal business would be deductible. Essentially, *La Rosa's* case sets a precedent for law-breakers to receive tax deductions. Carr J<sup>39</sup> noted that this result may be an anomaly to which Parliament should give attention.

#### **A Public policy reasons for changing the law**

The primary public policy reason for disallowing the deduction of some or all losses incurred in carrying on an illegal business is to ensure that criminals do not find refuge in the *ITAA* by obtaining tax benefits related to their illegal activities. Hely J stated that the policy of the law in proscribing 'drug dealing' may not be supported

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36 Above n 31, 689.

37 Above n 1, para 57.

38 Above n 1, para 59.

39 Above n 1, para 10.

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by allowing a deduction for, eg the cost of acquiring trading stock in the form of prohibited drugs so as to enable the business of drug dealing to be maintained.<sup>40</sup> However, his Honour also stated that there is an element of unreality in the expectation that persons would be deterred from engaging in an unlawful business if they were not permitted a deduction for its expenses.<sup>41</sup>

In the US, s 280E of the *Internal Revenue Code of 1986* denies credits and deductions 'for any amount paid or incurred during the taxable year in carrying on any trade or business [that]... consists of trafficking in controlled substances...' There, the Senate expressly set forth the following justification for adding s 280E to the Code in 1982:<sup>42</sup>

To allow drug dealers the benefit of business expense deductions at the same time that the U.S. and its citizens are losing billions of dollars per year to such persons is not compelled by the fact that such deductions are allowed to other, legal, enterprises. Such deductions must be disallowed on public policy grounds.

Parliament may feel that it is easier to legislate for non-deduction rather than for judges or legislatures to take into account tax consequences.<sup>43</sup> Another reason for disallowing deductions is a political one: to prevent public outrage at the fact that illegal businesses can write-off losses and/or expenses.<sup>44</sup> Even if the taxpayer carrying on the illegal business faces criminal consequences and is dealt with accordingly, the wider public may not understand this.

## **B Options for changing the law**

If Parliament decided that there were sufficient public policy reasons to call for a change in the law, it would then have to decide the method of implementing the change. Parliament could disallow the deduction of losses incurred in carrying on any illegal business, or only those losses incurred in carrying on an illicit drug

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40 Above n 1, para 54.

41 Ibid.

42 S Rep No. 97-494, at 309 (1982) in Carrie Keller, 'The Implications of IRC s 280E in Denying Ordinary and Necessary Business Expense Deductions to Drug Traffickers' (2003) 47 *St Louis University Law Journal* 157, 165.

43 Tamara Sibley, 'Breaking the Law and 'Writing it off': Should Fines and Penalties be Deductible Under the Income Tax Act?' (2002) 65 *Saskatchewan Law Review* 217, 236.

44 Matthew Shanahan, 'Deductions for Drug Dealers' (2003) 38(2) *Taxation in Australia* 63, 67.

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dealing business. Furthermore, Parliament can consider changing the *ITAA* itself, or the statute declaring the business activity illegal.<sup>45</sup>

An option is to exclude from deductibility those losses arising only out of specific businesses or easily identifiable classes of business such as those considered illegal under the Criminal Code. Parliament may feel the need to exclude deductions from extremely offensive business activities where there are strong political reasons for doing so. Sections 26-52 and 26-53 of the *ITAA 1977* (Cth) are examples of Parliament disallowing specific deductions on public policy grounds.

The United States' *Internal Revenue Code* disallows the deduction of drug dealing. The American position goes beyond the position reached in Australian case law. Following the US and incorporating a provision similar to s 280E is one option available to the legislature. To justify this, there would have to be strong policy reasons for violating the principles of neutrality and equality in the eyes of taxation law.<sup>46</sup>

Arguably, incorporating a s 280E provision into the *ITAA* may be justified if the section had a deterrent affect. However, amending the tax law to deny a tax deduction on the grounds the person who incurred it did so in the course of carrying on an illegal business, might be considered capricious.<sup>47</sup> Such an amendment would exist solely to act as a penal sanction and therefore offend a fundamental principle underpinning our tax system – that there should be no 'right or wrong' concept with income tax.<sup>48</sup> Furthermore, efforts to use the *ITAA* to deter the drug trade are likely to be ineffective – whether the taxpayer will be deterred varies according to what the taxpayer could gain by violating the law, which will be different for different individuals.<sup>49</sup>

The Australian Taxation Office (the 'ATO') is not a law enforcement agency in the sense of detecting, investigating and prosecuting illegal activities. Rather, the ATO is the government's prime revenue collection agency. The ATO does not perform a function relevant to the detection and control of criminal activity, except to the extent that it may from time to time act in concert with other agencies, such as the National Crime Authority or the Australian Federal Police.<sup>50</sup> As stated by Carr J in the Full

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45 Above n 43.

46 Above n 4, 27, 35.

47 Peter Hill, 'Morality and Tax' (2003) 32 *Australian Tax Review* 69, 71.

48 Ibid.

49 Above n 43, 236.

50 Bernie Gallagher, 'Taxation and the Sex Industry',

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Federal Court in *La Rosa* '[drug dealers]' financial affairs are only likely to come to the Commissioner's attention following criminal proceedings and convictions.' Where the ATO chooses to participate with other law enforcement agencies, its participation is limited to pursuing relevant persons for tax purposes as taxpayers rather than criminals.<sup>51</sup>

Another option is to exclude as 'ordinary income' any income arising from illegal business. In *La Rosa's* case, Carr J was reluctant to apply a literal approach to the interpretation of the ITAA:<sup>52</sup>

I would, if it were open to me, take a different approach and, by applying a purposive interpretation to the word 'income', exclude the proceeds of sale of heroin and amphetamines and thereby remove the need to consider such matters as allowable deductions for dealers in hard drugs.

However, cases where the taxpayer successfully argued that illegality in the earning of profits or returns does preclude derivation of assessable income, are scarce. In the Irish case of *Hayes v Duggan*.<sup>53</sup> In that case the court relied on a dictum of Scrutton LJ in *RC v Von Glehn*:<sup>54</sup>

I am inclined to think, though I do not wish finally to decide it, that the Income Tax Acts are to be confined to lawful businesses, and to businesses carried on in a lawful manner.

Subsequently, Rowlatt J in *Mann v Nash*<sup>55</sup> refused to follow this reasoning, rejecting the decision of the Irish Supreme Court as mere rhetoric. In *MacFarlane v Commissioner of Taxation*<sup>56</sup> the Court acknowledged that there is a body of authority which justifies the proposition that the illegal nature of a receipt does not deny its taxability. Other cases support the principle that the tests as to whether an amount is assessable income under s 25(1) ITAA 1936 are the same for amounts received from

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<http://www.aic.gov.au/publications/proceedings/14/gallagher.pdf> viewed 24 October 2003 .

51 Ibid.

52 Above n 1, para 6.

53 [1929] IR 406.

54 [1920] 2 KB 553, 572.

55 (1932) 16 TC 523, 530.

56 (1986) 13 FCR 356, 380-381.

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legal and illegal activities.<sup>57</sup> This principle is not only logical because it complies with the general functioning of the ITAA and supports the original intent of the drafters of the ITAA, but it is also good social policy – to hold otherwise would be to favour dishonest business over honest ones.<sup>58</sup>

Accordingly, a purposive approach should not be adopted to interpret provisions of the ITAA. Regardless of moralities, ethics, social stigmas and so on, tax should be payable by the relevant person in the same way as any other taxpayer.

### Conclusion

The history of the enactment of the ITAA suggests that the enactors envisioned the Act as a way to collect revenue; and it was not intended to be interpreted in a way to regulate the manner in which people earned their income nor was it intended to be a way to prohibit certain types of activities.<sup>59</sup>

By interpreting the tax statute as an instrument simply to collect appropriate taxes, the Federal Court in *La Rosa* brought the law of the deductibility of such losses properly into line with the case law defining assessable income.

Parliament can, of course, amend the law on deductibility of losses incurred in carrying on an illegal business, or more specifically, in carrying on a drug dealing business. The policy reasons for disallowing deductions would have to warrant a violation of important principles underlying the ITAA: neutrality and equality.

An evaluation of the options available to Parliament if it decides to make amendments, does not reveal a particularly appealing choice. Ultimately, the most attractive option may be to leave the law as it is and to allow the deduction of all losses meeting the tests set out in the ITAA.<sup>60</sup> After all, the taxpayer in *La Rosa* has been jailed, his assets have been confiscated and he has been pursued for his tax debt.

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57 *Partridge v Mallandaine* (1886) 2 TC 179, 181; *Minister of Finance v Smith* [1927] AC 193; *Mann v Nash* [1932] 1 KB 752; *Lindsay v Commissioners of Inland Revenue* (1933) SLT 57; *Southern v AB* [1933] 1 KB 713.

58 Above n 9, 316.

59 Parliamentary Debates, *Hansard*, Vol 1xxvii, 5845ff.

60 Above n 44, 67.