General Deductions.

- Taxable income (S4-15) = Assessable income (division 6) – Deductions (division 8)

Deductions:

- General Deductions (S8-1)
- Specific Deductions (S8-5)
- Restrictions on Deductions

General deductions:

- section 8-1
- ***Positive tests***- subsection 8-1(1)
    - You can deduct from your assessable income any loss or outgoing to the extent that:
        - It is incurred in gaining or producing your assessable income or;
        - It is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income
- ***Negative Tests*** – subsection 8-1(2)
    - However, you cannot deduct a loss or outgoing under this section to the extent that:
        - It is a loss or outgoing of capital or
        - It is a loss or outgoing of a private or domestic nature or
        - It is incurred in relation to gaining or producing your exempt income
        - Provision of this Act prevents you from deducting it;
- To obtain a deduction under section 8-1 (General Deductions) YOU MUST satisfy one of the two positive limbs and not come within any of the 4 negative limbs.

Examples which may be deductible:

- salary and wages
- bank charges
- rent, rates and land taxes on business premises
- interest on money borrowed
- insurance on business premises
- stationery, printing, postage
- light, power and telephone
- advertising
- travel
- self-education
- home office expenses
- special clothing
- certain tools of trade
- trade and technical journals

Determine sufficient connection between Loss/Outgoing and Positive Limbs:

- Incidental and Relevant Test
  - *W Neville & Co v FCT (1937)*
    - connection with income derivation
    - expenses incurred to reduce future expenses
    - Seeking deduction for paying out managing director
    - Commissioner against: no sufficient nexus, as it was incurred to reduce future expenses, not to derive income;
      - If expense related to assessable income, it was assessable income of different income years;
      - No deduction would be available in the income year to the extent the company had issued notes promising payments in months after end of income year
    - Decision:
      - HC concluded that expense would save future expenses but was also directly related to the derivation of assessable income by the company as it would increase the efficiency and improve operations of business
      - Expense was related to ongoing business processes, therefore not a capital outlay;
    - Relevance of the case:
      - Proposition that an outlay to reduce future expenses will satisfy positive limbs of s 8-1.
      - Section 25-50 would not be relevant as payments were not in respect of past employment;
      - Promissory notes: deferred payment obligations that are deductible in the year they are paid;
- Essential Character Test
  - *Charles Moore & Co (WA) P/L v FC of T (1956)*
    - Takings stolen on the way to the bank; taxpayer sought to deduct the loss being the cash stolen;
    - Commissioner argued: loss wasn't deductible as it was not incurred in the course of taxpayer's ordinary business operations;
    - Decision: FCT held that loss was deductible as it was incurred in producing assessable income and it was not loss of capital nature; Such financial transactions could be characterised as necessary part of carrying on the business;
    - Relevance: still authority for availability of ordinary S8-1 ITAA 1997 deduction for theft losses of money and was applied in FCT v La Rosa 2003.
  - Essential character test is considered to be the key test
  - Looks at the nature of the expense;
  - *FC of T v Cooper (1991)*
    - Full Federal Court denied deductions for expenses of food and beer as it was personal expense, was incurred to enable the taxpayer to be in

a position to be able to carry out his profession but was no incurred in the course of that activity.
    - Relevance: precedent that reinforces primary test often used by courts to distinguish private expenses from expenses incurred in gaining assessable income. Deductible expense should be incurred in the course of deriving assessable income.

  - *Fletcher v FCT (1991)*
    - Taxpayer engaged in tax avoidance scheme
    - Commissioner denied taxpayer a deduction for the interest expense arguing that there was no actual interest payment as there was simply offsetting of the annuity payments against the loan obligation. Also argued that parties intended arrangements to be collapsed, so taxpayer never intended to use interest expense to gain assessable income;
    - Decision: if the assessable income derived from an investment exceeds the deductible expenses incurred to derive that income, the outgoings can be treated as fully deductible under first limb. But in case where that's not the case, taxpayer's objectives must be weighed in incurring the expenses. In this case, if it can be concluded that taxpayer intended to collapse agreements before the assessable annuity income exceeded interest expenses, a deduction should only be allowed to the extent of the assessable income gained. Remitting matter to Administrative Appeals Tribunal (AAT) for finding of facts. Taxpayer's dominant purpose here was to minimise taxes, not to gain assessable income.
    - Relevance: *Fletcher* is an endorsement by HC of an application of s51 and by extension s8(1) that looks to taxpayer's purpose in incurring the expense;
- Purpose Test
  - Magna Alloys & Research P/L v FC of T (1980)
    - Facts: illegal promotion sales tactics, company pays legal expenses, sought deduction as business expenses; but primary purpose of directors was to benefit themselves by having the company pay the lawyers' fees and that legal expenses related to criminal activities should not be deductible (Commissioner's view);
    - Decision: this case- primary motive of the company's directors (to benefit themselves) did not determine whether company's expense had sufficient nexus with the derivation of assessable income. From the company's perspective, protecting company's directors protected company's standing and its ability to continue trading so it was in the company's interest to protect directors => sufficient nexus was established.
    - Relevance: this approach guides most deduction cases today apart from those involving tax minimisation techniques. Articulation of a **business judgment rule –** expense has a sufficient nexus with the derivation of assessable income to satisfy requirements of **s8-1 (1)(b)**

– if the persons responsible for carrying on the business view it as desirable or appropriate for the pursuit of the business. Pragmatic approach continues to be used.

- Condition of Employment
    - Burton v FCT (1979)