

Deductions:

Division 8 ITAA97:

- Individuals can reduce their income from certain outgoings
- 2 categories
 - o **1) General Deductions s 8.1**
 - o **2) Specific Deductions s 8.5**
 - In addition to general deductions, items can be added to reduce our income if specific sections of the legislation allows for it

1) General Deductions

General Rule: If you have expenditure losses from producing assessable income then you can deduct it **s 8-1(1) ITAA97**

- Section 8-1(1) ITAA97 provides that a taxpayer can deduct from their assessable income, a loss or outgoing to the extent that it is (positive limbs):
 - o Incurred in gaining or producing assessable income; or
 - o Necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income
 - These are the “positive limbs” of s8-1
- Section 8-1(2) provides that a loss or outgoing that satisfies the positive limbs of s8-1 may however **not be deductible** to the extent that it is (negative limbs):
 - o capital in nature
 - o for private or domestic use
 - o incurred in gaining exempt or non-assessable non-exempt income; or
 - o prevented from being deductible by a specific provision of the income tax legislation

CASE: Charlies Moore & CO Pty ltd v FCT (1956)

- Here an employee was carrying daily earnings was robbed on the way to the bank
- Held:
 - o The loss was held to be deductible
 - o **The tax payer doesn't have to show that a specific outgoing expenditure is productive for assessable income**
 - o It is sufficient that the expenditure or loss is incurred in the cost of running your business – therefore a loss/non profit would be enough

TEST: There must be a sufficient nexus or connection between the expense and the production of assessable income; there are two aspects to the nexus test:

- How directly does the expense relate to the generation of assessable income – if the link between the expense and the production of assessable income is too remote, it will not be deductible.
- Temporal nexus – the connection between the expense and assessable income may be broken if the expense is incurred a significant period before, or much later than, the generation of assessable income to which it relates.

Clear Nexus:

CASE: FCT v Total Holdings (Australia)

- A loan was taken out – the parent company was able to **claim deductions for interests expenses** – the parent company didn't use the money itself but instead for the corporate group of its subsidiaries

CASE: W Nevill & Co v FCT

- Company was undergoing a restructure, having 2 managing directors and was considered by the board that the **business could be run more efficiently if the business was run by 1 director**
- One of **the directors was sacked** and his **payout** was held to be **deductible**

CASE: FCT v Day

- Customs officer (Federal Govt) was charged for **misuse of his position, work vehicle**, improper attempt to conceal absences – this was under the Public Services Act which he was subject to
- **Incurred legal expenses in defending himself** in court
- Issue: Could he get a deduction to all these expenses?
- Held:
 - o He was exposed to liability under these offences because of his work as a federal govt employee – therefore **deductible**
 - o Clear cut case

CASE: FCT v Snowden

- **Building construction company was accused of negligent work** of their business
- The building construction company **incurred legal expenses to answer these charges and marketing costs to better their reputation** in the market place again
- Held:
 - o There was a connection between what they were accused of and their job
 - o **Deductible**

CASE: Herald and Weekly times Ltd v FCT

- Incurred legal expenses and a damages payment
- An allegation for **defamation**
- Held:
 - o This damage to their reputation was **deductible**

Temporal Nexus:

Capital costs associated with starting a business can be deducted

CASE: Steele v DCT

- An area of land was bought with the intention to build a motel on the land
- The motel in the end was abandoned
- Issue: Was the interest expenses that Steele had incurred from their loan deductible?

- Held:
 - o You could get a deduction
 - o The motel business was hard to justify the outcome
 - o **The HCA looked at the case in the sense she had bought the land – the most significant asset that is dedicated for this activity - she has in a way started the business when the land was bought**

a) Parts of the business that the person is no-longer operating

CASE: AGC (Advances) Ltd v FCT

- The taxpayer was allowed a deduction for **bad debts expense** even though the bad debts related to a business segment that it no-longer operated/had terminated
- Held:
 - o This was a **deduction**

CASE: Placer Pacific Management Pty Ltd v FCT

- Taxpayer was settling a negligence claim for a faulty conveyor belt and someone had suffered the injury
- Held:
 - o It was a deduction even though years before the business was sold

b) You cannot get a deduction for a capital expense vs expenditure that is more short term on the revenue account

Elements for a general deduction provision s 8.1 – **NEGATIVE LIMB 1**

- Cases have outlined a number of tests to be able to distinguish revenue expenditure from capital expenditure
- **Distinction:** Expenses related to **business processes** (revenue expense) and expenses related to a **business structure** (capital expense)

CASE: **Sun Newspaper case** [BUSINESS ENTITY TEST] (leading precedent)

- The sun newspaper published newspapers in Sydney
- They entered into a transaction with one of their competitors for the purpose of shutting down their competitor for a period
- It did achieve the result of eliminating a source of competition permanently
- The taxpayer made a large payment of 86,000 pounds to their rival for agreeing not to produce one of their papers for **a 3 year period** and in relation to another paper of the competitor the taxpayer actually bought the competitors interest in that newspaper
- Held:
 - o Non-deductible capital expenditure
 - o The taxpayer could strengthen their position in the market place for the future by effectively shutting down its competitor
 - o **TEST:** Distinction between capital and revenue expenditure
 - 1) Character of the advantage sought
 - Consider whether the expense results in a lasting or temporary benefit?
 - Temporary benefit = revenue; enduring benefit = capital

- 2) Manner in which the benefit is to be used
 - Similar to the first factor, is the benefit enjoyed in a short-term sense, though used recurrently or is it relied upon in a constant way?
- 3) Means adopted to obtain the benefit
 - Did the taxpayer acquire the benefit through recurrent payments or a one-off payment? One-off = capital expense
- **If it is a business-related capital expenditure it can be deducted over a 5 year period – s40-880 ITAA97**

Example:

- Pizza oven for a pizza business = is capital and meets all elements
- Electricity cost for the pizza business = is revenue expense and meets all elements but in an opposite sense

CASE: *Vallambrosa Rubber Co Ltd v Farmer* (1910) [**ONCE AND FOR ALL TEST**]

- Taxpayer owned a rubber estate in Malaysia where they claimed expenses of maintenance of maintaining the premises eg: Weeding
- Held:
 - TEST: Capital expenditure is going to be spent once and for all, and income expenditure is a thing that will occur every year
 - This expenditure was being incurred every year for weeding and pest control
 - This was maintenance rather than a one off expense – was deductible

CASE: *British Insulated & Helsby Cables Ltd v Atherton* [**ENDURING BENEFIT TEST**]

- Employer spent a lot of money to establish a pension fund for the benefit of employees
- A 1 off expense is more of a capital nature
- Held:
 - TEST: Where expenditure is made with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade = capital expenditure
 - Here the employer had created an asset of lasting value
 - Was clearly capital and not revenue

CASE: *BP Australia v FCT* (1965) (Exclusivity payment)

- The petrol station will only sell that particular manufacturers petrol
- BP did this and paid service stations a lump sum to sell its petrol exclusively for a period of 5 years
- Issue: Was the lump sum payment capital or revenue in nature?
- Held:
 - Boarder line case
 - Was held to be revenue and therefore deductible

CASE: *Strick v Regent Oil Co Ltd* (Exclusivity payment)

- Service station was obligated to only sell the petrol of a specific manufacture
- The time period with some service stations was 10-20 years

- Held:
 - o Was capital in nature and therefore not deductible because of the long time of the contract

CASE: FCT v Star City Pty Ltd (Casino) (Substance rather than form decisive)

- The casino got a 99 year lease from the NSW govt and made an upfront payment for the casino license and paid a \$120 million for prepaid rent for 10 years
- Held:
 - o Was a capital expense
 - o The payment is for a benefit that is enjoyed over a very long period of time

Division 8 – **Negative Limb 2:**

- Expenses of a **private or domestic nature are not deductible under s8-1(2)(b).**

CASE: FCT v Cooper

- Professional rugby player was asked to eat more so he could improve
- This additional food was argued to be revenue
- Held:
 - o Too much of a private or domestic matter to it
 - o Wasn't sufficiently related to his job

Fines that are a matter of contract or institutions which are private entities that are not govt

Division 8 - **3rd and 4th Negative Limbs:**

- **No deduction is allowed in respect of exempt income or non-assessable exempt income:** s8-1(2)(c)
- Deduction denied under specific provision of tax law (s8-1(2)(d)), e.g.
 - o Penalties imposed under Australian or foreign law: s26-5 ITAA97
 - **Fines** in a private context are still deductible
 - S 26-5 only applies to penalties imposed by government
 - o Expenses related to 'rebutable benefits' (such as youth allowance): s26-19 ITAA97
 - o Payments made under the HECS-HELP scheme: s26-20 ITAA97
 - Payments made relating to your education because it is already subsidised by the government
 - o **Only reasonable amount (market value) deductible in relation to payments made to related entities:** s26-35 ITAA97
 - Only a reasonable amount is allowed as a deduction – this is determined by market value
 - Eg: Family members in a business is employed and the wages are above market value then the parent running the business can only claim the market value payment s 35
 - Payment above market value is treated like a gift
 - o While tax deductions are available for gifts made to certain public institutions and charities, there are exceptions and limits to be further discuss

- Expenditure relating to illegal activities: s26-54 ITAA97 (cf. common law under *FCT v La Rosa* (2003) 53 ATR 1).
 - The income is assessable but no deductions for expenditure – this is for public policy reasons
- **Reimbursed expenditure:** s51AH ITAA36
 - Payments reimburse by employers
 - If this is the case no deductions can be reimbursed
 - If only part is reimburse – then the other part would count as a tax deduction
- Membership fees relating to recreational clubs: s26-45 ITAA97
 - Is not a deduction

Entertainment Expenses:

Section 32-5 ITAA97 provides that **no deduction is allowed for entertainment expenses, but** there are a significant number of **exceptions**.

Entertainment defined as:

- Entertainment by way of food, drink, or recreation; or
- Accommodation or travel related to the provision of entertainment by way of food, drink or recreation: s32-10(1).
- You are taken to provide “entertainment” even if business discussions take place: s32-10(2).
- Exceptions are contained in subdivision 32-B:
 - The **main exception is entertainment by way of a fringe benefit**
 - These are benefits provided from employers to employees on top of their normal salary
 - Expenses incurred in providing food or drink in an in-house dining facility
 - If your business is for example a hospitality business

How much to claim from a deduction?

- Apportionment must occur where only part of the expenditure relates to producing assessable income. See: *Ronpibon Tin No Liability v FCT* (1949) 78 CLR 47 (taxpayer was not allowed a deduction for expenditure to the extent that it related to the production of exempt income).
- “Business judgment rule” – provided the expenditure is incurred in gaining assessable income, the Court will not query the amount/level of expenditure i.e. the efficiency of the taxpayer’s business is irrelevant for tax purposes: *Tweedle v FCT* (1942) 7 ATD 186; *Magna Alloys & Research Pty Ltd v FCT* (1980) 11 ATR 276.

Expenses that are incurred to get employment are too remote and merely put you in the position to earn assessable income

CASE: *FCT v Maddalena* (1971) (Expenses from gaining employment – No)

- An electrician and part time rugby player
- Travelling and expenses were had when deciding to change football clubs
- Held:
 - This expenditure was too remote

CASE: Spriggs v FCT; Riddell v FCT (2009) (Expenses from gaining employment - Yes)

- Management fees incurred by the taxpayer – both professional football player
- Held:
 - o They were running a business of themselves – being a sport person and also entering into endorsement contracts
 - o In the case you have professional sports person and they actually were very successful and perhaps might have even been famous
 - o Given they had significant advertising and promotional contracts – not only were they playing sport but were business people
 - o The business involved commerciality

CASE: Fullerton v FCT (1991) (Relocation expenses - No)

- Taxpayer had to move for work purposes otherwise he was going to lose his job
- Held:
 - o This expenditure was too remote as it put the taxpayer into the position of generating an income

CASE: Lodge v FCT (Child care payments – No)

- It is considered to be too much of a private or domestic nature
- Is too remote to be assessable income

Travel expenses:

CASE: Lunney v FCT; Hayley FCT (Travel Expenses to work – Generally no)

- General rule of travelling between home and work is not classified as a deduction
- Most people have to incur this expense – there is a definite work character attached but also a private and domestic matter
- Is not a deduction

CASE: FCT v Collings (1976) (Travel Expenses when working from home – Yes)

- Started working from home
- The taxpayer was fully available to her employer at any time and sometimes she travelled to her employees office to resolve queries when it couldn't be resolved whilst she was at home
- Held:
 - o Was a deduction
 - o **'Could be called anytime to work' – She was travelling on work NOT to work**

CASE: Fullerton v FCT (Travel Expenses – Exception – rare alternate work)

- Going to the clients sight sometimes for a month or more
- The taxpayer, a forester, had to move for work purposes, or otherwise faced retrenchment.
- Relocation expenditure is treated as incurred in order to put the taxpayer into the position of being able to earn assessable income.
- Held:
 - o Deductible expense

CASE: FCT v Wiener (Travel Expenses fundamental to job – Exception)

- Travelling is a fundamental part of your job
- Relief teacher and had to travel to a lot of different schools each week – 4 schools a week
- Held:
 - o Allowed a deduction for all her travel expenses
 - o Included travel between schools, travelling from home to her first place of work and from the school to travelling home at the end of the day

CASE: FCT v Vogt (1975) (Travel Expenses – Exception)

- Taxpayer a professional musician who was required to carry a large instrument between home and work. The transportation of the bulky items between home and work.
- Held:
 - o Where taxpayer is required to carry bulky items to perform their employment, a deduction allowed for travel expenses incurred in transporting items:

CASE: FCT v Payne (Travel Expenses between jobs – Exception)

- You had a taxpayer who was a Qantas pilot and also had a deer farming business he was running at his house
- Wanted to claim a deduction between the airport and his house
- Held:
 - o Was held to not be a deduction
 - o HOWEVER s 25-100 ITAA was later added after this case which says a deduction is had for travel between two unrelated places of work. The provision does not apply where one of the workplaces is also the taxpayer's residence.

Self-education:

- **TEST:** If it is related to your work or assists in getting a promotion or a higher income (TR 98/9)
- **TEST:** If it enables you to do your job better even if it doesn't mean you subsequently earn more money (FCT v Studdert)
 - o It will be deductible income

CASE: FCT v Hatchett (1971) (probably outdated case)

- Had a school teacher who incurred expenses for an Arts Degree and the Teachers High School certificate
- Held:
 - o Only the certificate would allow him to get a promotion
 - o The Arts degree wasn't included as it wouldn't directly lead to promotion
 - o **Could be argued however that this case is out-dated** as these days teachers need degrees

CASE: FCT v Studdert (1991) (Self education – Yes)

- Taxpayer tried to claim flying lessons as a deduction – the taxpayer was a flight engineer
- Held:
 - o Was deductible
 - o The taxpayer was a flight engineer and the more you know about how a plane works – the better you can perform as a flight engineer
 - o Expert evidence was received on this point of decision
 - o **You still can get self education expense even though you may not be able to get promoted** – as you may already be at the top of your profession

CASE: FCT v Anstis [2010] (**OLD LAW** - Legislation has changed the case)

- The taxpayer was a university student for a teaching degree
- Her assessable income included youth allowance
- She claimed as a deduction computer depreciation, textbooks and stationary to reduce her youth allowance assessable income - \$950
- She argued that to satisfactory progress towards completing a tertiary degree she needed all these things
- Held:
 - o It was allowed as a deduction because there was connection with the assessable income
 - o Youth allowance you get if you're undertaking study and you must then incur additional expenses such as textbooks to complete this degree

Travel expenses related to self-education:

CASE: FCT v Finn [**Highest Authority**]

- Architecture travelled for 1 year and his employer partially paid for it
 - o The employer re-inburst him for the part in which he travelled in South America
- He took extensive notes and had lots of information for where there was **objective evidence for what he learnt from these architecture trends overseas**

Held:

- Was a deduction
- The trip was supported by his employer **although not fully compensated**
- He had extensive evidence that the taxpayer collated overseas

CASE: Peter Lenten v FCT

- Taxpayer was a high school teacher
- Going on a self identification trip
- He did attend lectures and museums
- He didn't have the evidence of direct support by his employer before he embarked on his trip

Held:

- A 75% deduction was had for his trip
- The primary purpose of this trip was to perform better in his job (History Teacher)

Non-deductibility of self-education expenses:

- 1) HECS s 26-30
- 2) S 82A

Apportionment rule re-self education expenses (CASE: TR 98/9):

- 1) If the main purpose of trip is self-education but there is an incidental private recreational purpose as well – then you can still claim the full account of:
 - a. Accommodation
 - b. Airfares
- 2) If you have a trip which is mainly recreational and some (eg 1 day) business
 - a. Then you can claim the expenses of this conference for that 1 day
- 3) Go on a trip for a 5 day conference followed by a 7 day holiday
 - a. Even though more days are on holiday – you can legitimately regard this as 2 EQUAL purposes – allowing to deduct 50% of the airfare
 - b. It doesn't matter whether they are spending more than half their time for a private purpose – still 50% deduction
- 4) Accommodation and Meals (as part of a travel expense)
 - a. Where a taxpayer is away from home overnight in connection with a self-education activity, accommodation and meals expenses incurred are deductible under section 8-1. (Examples include an overseas study tour or sabbatical, a work-related conference or seminar or attending an educational institution.)
 - b. **They are part of the necessary cost of participating in the tour or attending the conference, the seminar or the educational institution.** We do not consider such expenditure to be of a private nature because its occasion is the taxpayer's travel away from home on income-producing activities.

Deductibility of common types of expenditure – Home Office

- A person could have a home office which is a general place of business – Eg: an accountant who allocates 1 room in their house to see clients
- Home office = place of business
 - o Can claim a portion of both running expenses (Eg: electricity, depreciation) AND
 - o Occupancy expenses (Eg: Rent, interest on a mortgage, insurance, rates)

CASE: TR 93/30 (Identifying a place of business – Factors)

- o 1) Whether the area is clearly identifiable as a place of business?
- o 2) Whether the area is not readily useable for a private or domestic purpose?
- o 3) Whether area exclusively or almost exclusively used to carry on a business
- o 4) Whether the area is used regularly for visits from clients or customers
- o 5) Look to CASE Swinford for additional element to consider
- o NOTE: You shouldn't be able to site/see their house/living areas or family

CASE: Swinford v FCT (additional element)

- The absence of alternate places to conduct income producing activities
- Self employed script writer who used a room in his apartment to write as well as meet television station staff

CASE: FCT v Faichney (1972) (what is claimable if not a 'place of business')

- Lawyer was trying to claim on interest on their mortgage and insurance because they had a home study

Held:

- Where the **home office is for convenience only** (e.g. home study): **ONLY a portion of running expenses are deductible**
- A deduction could not be had for any deduction of occupancy expenses
- Only a portion of running expenses were deductible, not occupancy expenses as it was not a 'place of business' (not a genuine home office).

Deductibility of common expenditure – Clothing:

- **S 8-1**

- o Expenditure on **occupancy specific clothing, protective clothing and uniforms is deductible**
- o Eg: Barrister's robes, white dress worn by nurse
- o CASE: Morris v FCT
 - Occupants who required to work in the sun, claiming sun glasses, hats, sunscreen etc
- o CASE: Mansfield
 - Claimed cosmetics, shoes and moisturizer
 - The needs of the items were needed for her working conditions as when she flew on airplanes her body swelled – she had to buy shoes 1 size too big to account for her swelling
- Expenditure on, or related to, **conventional clothing is generally not deductible**
 - o Expensive clothes – not deductible
 - o CASE: u80 (1987)
 - At David Jones you had to wear black clothes
 - The taxpayer didn't wear these clothes outside work
 - o Held:
 - Not a tax deduction
- Circumstances in which conventional clothing expenses may be deductible – **ABNORMAL level of expenditure on clothes**
 - o CASE: FCT v Edwards
 - There wasn't an element of choice here
 - An extraordinary amount was needed to be spent on clothes
 - She was travelling all the time with the governors wife – travelling interstate with limited washing places – her job required multiple changes of outfit for the day – And lots of evening wear
 - She worked for her employer 7 days a week – living at parliament
 - o Held:
 - Allowed a deduction

- The previous years before she got the job were analysed and how much she spent on clothes – all clothes were deductible

Deductibility of **Common Expenditures**:

1) Negative Gearing

- Interest on the loan > Rent/income from investments
- This is done in hope that the value of property increases over the long run

2) Legal expenses

- Related to employment, to defending yourself in a legal action etc
- CASE: Hallstroms Pty Ltd v FCT (outdated, strong dissent judgement)
 - Legal expenditure to block a competitor becoming more powerful in the market
 - The taxpayer blocked a patent application – the market was fridges
- Held:
 - It was a revenue account and therefore deductible
- CASE: Hill theatres v FCT (Authority)
 - Hill theatres was the only theatre in town and prevented others from entering the market – spent money on legal costs
- Held:
 - NOT a DEDUCTION
 - This was because the business was protecting themselves and therefore bettering themselves financially
 - Dixon and the majority said it was capital in nature

2) Specific Deductions:

a) **Repairs**:

S 25-10 ITAA:

- The taxpayer is entitled to a deduction for repairs to premises or depreciating assets, which are used for income producing purposes

If the property is used partly for a non-income producing purposes – then a partial deduction applies

A repair = Fixing something which is defective

- Doesn't mean renovating a property
- Doesn't mean making the value of the property go up by using better material

It is an improvement?

CASE: Thomas

- Flour miller who bought

CASE: FCT v Western Suburbs

- Cinema ceiling was replaced – the material was a different type of material
- The fibre material (new material) is a superior material

Held:

- Was a capital expenditure as it was an improvement on the property

CASE: Lindsay

- Ramp to a ship that was involved
- The ramp was considered a separate asset
- The new ramp was concrete, the old ramp was wooden

Held:

- Deduction denied where old ship ramp demolished and replaced

b) Bad debts:

- Taxpayer is allowed a deduction for the write-off of a bad debt where the amount was previously included in assessable income s 25-35 ITAA97
- Only the amount written off after action has been taken to recover the amount through debt collectors or legal action s 25-35 ITAA97

c) Tax loss:

- For a particular income year, the taxpayers deductions are greater than their assessable income
 - o A taxpayer is entitled to a deduction for prior year tax losses under Div 36
- Individuals taxpayer are then required to apply their prior year losses against assessable income

d) Gifts (to charities and public institutions)

- Div 30
 - o Allows taxpayers a deduction where gifts of money and property are made to certain charities, public institutions (e.g. public hospitals and public universities), and other eligible entities.
- **The institution has to be endorsed as a deductible gift recipient by the Commissioner, or is specifically mentioned in Div 30.**
- CASE: FCT v McPhail
 - o Taxpayer made a gift to a school (his son's)
 - o The school was a deductible recipient as he received a benefit which was a deduction in school fees
- Businesses cannot get any deductions for donating political gifts and donations
 - o S 26-22