

## Table of Contents

<b>Topic 1 - Tax System and Tax Policy .....</b>	<b>5</b>
<b>2.1 Income tax base, tax unit and tax rates .....</b>	<b>7</b>
<b>Alternative Tax Bases.....</b>	<b>7</b>
<b>Income tax law framework .....</b>	<b>9</b>
Income Tax rates 1986 - Schedule 7 (subsection 12(1)) - .....	10
Basic income tax calculation.....	10
Approach to interpreting tax law .....	10
Styles of tax law drafting.....	10
Styles of tax law interpretation.....	11
<b>2.2 Elements of ordinary income .....</b>	<b>11</b>
<b>Income Tax Assessment Act 1997.....</b>	<b>11</b>
<b>Textbook [2.10 – 2.100] – Australian Tax law concept of income .....</b>	<b>12</b>
What is Income? (Section [2.10]) .....	12
Different Uses of "Income" (Section [2.10]) .....	13
Ordinary Income: The Role of Courts (Section [2.20]).....	13
Influence of Trust Law on Income (Section [2.30]).....	13
Judicial vs. Legislative Approaches to Income (Section [2.65]) .....	15
<b>(a) Realisation, or: Income as a Flow .....</b>	<b>16</b>
Textbook - [2.110]-[2.140], [5.350], [6.320]-[6.360] including: Dixon .....	16
Anstis (2010) 241 CLR 443Links to an external site.; [2010] HCA 40 (and see later) .....	20
<b>(b) Ordinary income must be received and owned beneficially.....</b>	<b>21</b>
<b>Chapter 2</b> [2.150]-[2.215] including Federal Coke, Constable; note Countess of Bective, Zobory. ....	21
FCT v McNeil (2007) (focus on para 20) .....	26
<b>(c) Valuation: Ordinary income is money or money's worth.....</b>	<b>26</b>
<b>Chapter 2</b> , [2.220]-[2.270] including Cooke & Sherden, Abbott v Philbin.....	26
<b>Chapter 4</b> , [4.180]-[4.200] Payne v FCT 96 ATC 4407 (and see later) .....	29
<b>(d) Apportionment .....</b>	<b>30</b>
Chapter 2 [2.280]-[2.300] including McLaurin.....	30
<b>(e) Exempt and Non-assessable Non-Exempt income.....</b>	<b>31</b>
Chapter 2 [2.330], [2.420].....	31
<b>2.3 Putting it together: Method for inclusions in the tax base .....</b>	<b>32</b>
<b>Chapter 2 [2.390]-[2.470].....</b>	<b>32</b>
Step 1 – Is the Amount Ordinary Income? (s 6-5 ITAA 1997) .....	32
Step 2 – Is the Amount Statutory Income? .....	33
Step 3 – Is the Amount Exempt or Non-Assessable? .....	33
Step 4 – Reconciling Ordinary and Statutory Income .....	33
Step 5 – Does the Amount Trigger Fringe Benefits Tax (FBT)? .....	33
Step 6 – Reconciling FBT and Income Tax .....	33
Step 7 – Is There a Capital Gain? .....	34
Step 8 – Reconciling CGT and Other Income Provisions .....	34

<b>3.1 Income from services (work, or labour)</b>	<b>34</b>
<b>(a) The nexus required: ordinary or statutory income from services</b>	<b>34</b>
ITAA97 Provisions	34
Chapter 4, [4.10]-[4.210] including Hayes, Scott, Dixon, Harris, Smith, Holmes, Payne	35
Gifts and Other Benefits	36
Stewart, M (2022) Tax and Government in the 21st Chapter 5, pp 113-133	44
Tax Ruling TR 1999/17	45
<b>(b) Fringe benefits</b>	<b>46</b>
ITAA 1936 - SECT 23L	46
Chapter 4, [4.220]- [4.380], [4.530]	46
<b>(c) Restrictive covenants, service contracts, profit shares and compensation</b>	<b>50</b>
Chapter 4, [4.710]-[4.770] including Brent, Scott, Phillips; [4.820]-[4.860] including Higgs v Olivier, Woite, note Hepples.	50
Chapter 6, [6.10]-[6.20] Phillips, [6.60]-[6.70] Slaven, [6.100]-[6.110] Smith	53
Blank v C of T [2016] HCA 42	55
CR 2016/86 – Income Tax: Payments under the SA Stolen Generations Reparations Scheme	56
<b>3.2 Jurisdiction to tax: ‘residence’</b>	<b>57</b>
ITAA36: s 6(1) ‘resident or resident of Australia’	57
International Tax Agreements Act 1986: s 4.	57
Chapter 16 [16.10]-[16.30], [16.120]-[16.130], [16.225]-[16.230]	57
Australia-Iceland Tax Treaty (2022) (Articles 1.1, 2, 4.1, 4.2)	58
Tax Ruling TR 2023/1 Income tax: residency tests for individuals	59
<b>4.1 Income from property (investments)</b>	<b>60</b>
<b>(a) Introduction to income from property and capital gains tax</b>	<b>60</b>
ITAA97: s 6-5, 6-10, Part 3-1, Div 100 (all sections), s 102-5, s 118-20	60
Chapter 3 [3.05]-[3.45]	61
<b>(b) Income from the use of property: interest, annuities, rent, royalties</b>	<b>63</b>
ITAA97: s 6-5, 6-10, 6-25, 15-20	63
ITAA36: s 27H(1), 262	63
[3.410]-[3.470] Lomax v Peter Dixon (not including statutory regimes for securities);	64
[3.500]-[3.510], [3.590], [3.620]-[3.715] including Murray v ICI, note McCauley; Stanton; Aktiebolaget Volvo	66
<b>(c) Dividends and franking credits</b>	<b>71</b>
ITAA97: s 6-5, 6-10, 6-25, 67-25(1), s 200-5 to 200-20, 200-35, 200-40, 207-20	71
ITAA36: s 6(1) definition of ‘dividend’, s 44(1)(a)(i)	72
Chapter 14 [14.20], [14.60]-[14.80], [14.120]-[14.130], [14.490]	72
<b>4.2 Income from business</b>	<b>74</b>
<b>Legislation</b>	<b>74</b>
ITAA97: s 6-5, 6-10, 6-25, 15-10, 15-15, 15-30, 20-10, 20-15, 20-20, 20-25, 104-35	74
ITAA36: s 21, 21A	75
<b>(a) Is there a business or isolated profit-making venture?</b>	<b>75</b>
[5.10]-[5.240] Martin, Ferguson, TR 97/11, Stone, Fairway Estates, Whitfords Beach; note Greig	75
Taxation Ruling TR 2005/1, Income tax: Carrying on business as a professional artist	88

<b>(b) The scope and course of the business; ordinary and extraordinary receipts.....</b>	<b>89</b>
[5.250]-[5.320] Federal Coke, Squatting Investment, GP International Pipecoaters; [5.350]-[5.410] Myer Emporium, note Westfield, Ruling TR 92/3; .....	89
[5.600]-[5.680] Rolls Royce v Jeffrey, Kwikspan Purlin, Montgomery; .....	94
<b>(c) Restrictive covenants for a business; compensation .....</b>	<b>97</b>
Chapter 5 [5.420]-[5.460] including Dickenson, MIM Holdings; .....	97
Chapter 6 [6.30]-[6.40] Sydney Refractive Surgery Centre (see CGT later) .....	99
<b>5.1 Introduction to CGT.....</b>	<b>100</b>
<b>Steps/Approach to learning CGT?.....</b>	<b>100</b>
ITAA97: s 100-5 to 100-55.....	100
<b>5.2 Step 1 - Is there a CGT Event and a CGT Asset?.....</b>	<b>101</b>
Chapter 3 [3.50]-[3.150] including Determination TD 2014/26, note Sharpcan, Ruling TR 94/30, Orica; [3.160]-[3.260] including Sara Lee, Orica, Hepples. ....	105
Taxation Determination TD 2014/26.....	105
FCT v Sharpcan Pty Ltd.....	106
Ruling TR 94/30.....	106
Orica.....	107
<b>[3.160]-[3.260] .....</b>	<b>109</b>
Sara Lee .....	109
Hepples .....	110
<b>Compensation Payments - Chapter 6: [6.190]-[6.200] including TR 95/35 explaining CGT event C1 and C2.....</b>	<b>110</b>
Tax Ruling TR 95/35: Detailed Explanation .....	111
<b>5.3 Calculating the capital gain or loss .....</b>	<b>112</b>
<b>(a) Capital proceeds and cost base.....</b>	<b>112</b>
<b>(b) CGT discount .....</b>	<b>112</b>
ITAA97: Div 110 s 110-25, 110-35, 110-45(1), (1B), (3), (4),.....	112
Div 112 s 112-20; Div 116 s 116-20(1), 116-30, 116-45 .....	112
Div 115: s 115-5, 115-20, 115-15, 115-25, 115-30 item 4, 115-40, 115-100, 115-105.....	112
Chapter 12, [12.610]-[12.690].....	113
<b>5.4 Does an exemption or deferral (rollover) apply?.....</b>	<b>113</b>
ITAA97: Divs 108-B and 108-C; .....	113
Div 118 s 118-5, 118-10, 118-20, 118-24, 118-25, 118-37, 118-77 .....	114
Subdiv 118-B, focus on: s 118-105, 118-110, 118-115, 118-145, 118-190, 118-195 .....	114
Chapter 3: [3.270]-[3.300].....	114
Chapter 6: [6.40] .....	114
Sydney Refractive Surgery Centre .....	114
<b>[6.190]-[6.200] .....</b>	<b>115</b>
Ruling TR 95/35.....	116
<b>(b) Rollovers; inheritance on death .....</b>	<b>117</b>
ITAA97: Div 128 s 128-10, s128-15, 128-20, 115-30(1) item 4.....	117

Chapter 3 [3.310], [3.350]-[3.380] .....	117
<b>5.5 Net capital gain or loss; reconciliation with other rules .....</b>	<b>118</b>
ITAA97: s 6-10, 102-5, 118-20, 118-24, 118-25 .....	118
Chapter 12.700 .....	119
<b>6.1 - Section 8-1 'general deductions' .....</b>	<b>120</b>
<b>(a) Nexus requirement and negative limbs .....</b>	<b>120</b>
Introduction to Deductions .....	120
Structure of s 8-1 .....	120
ITAA97: s 8-1, 26-19, 26-20 .....	122
Chapter 7, [7.10], [7.60]-[7.190] including .....	122
[7.230]-[7.390] including .....	127
FCT v Anstis (2010) 241 CLR 443.; [2010] HCA 40 .....	134
Tax Ruling TR 2024/3 Income tax: deductibility of self-education expenses incurred by an individual ..	135
ATO website: Tax Gaps (overview) .....	136
ABC: 'No more work-related expenses, time for a standard deduction says tax watchdog. ....	137
<b>(b) Apportionment .....</b>	<b>138</b>
Ronpibon Tin .....	138
<b>6.2 Personal, private or domestic expenditure .....</b>	<b>139</b>
ITAA97: s 8-1(2)(b), 25-100, 26-30, 26-35, 26-40 (and note s 51-50). ....	139
Chapter 8 [8.10]-[8.210] including .....	139
Lunney – Travel to and from work .....	139
Martin - childcare .....	140
Hatchett – Education related expenses .....	141
Finn – Travel Expenses .....	141
Handley – Home office expenses .....	142
Forsyth – Home Office .....	143
Cooper – Food Drink and entertainment .....	144
<b>7.1 Deductions specifically included or prohibited .....</b>	<b>144</b>
Pre-recorded lecture notes .....	144
Chapter 10 [10.10]-[10.100] including .....	145
Western Suburbs Cinemas .....	145
W Thomas .....	146
TR 2023/3 Income tax: expenses associated with holding vacant land .....	147
TR 2021/1 Income tax: when are deductions allowed for employees' transport expenses? .....	148
<b>7.2 Method of accounting .....</b>	<b>150</b>
Chapter 11 [11.100]-[11.170] .....	150
Carden's case .....	150
Henderson .....	151
Firstenberg .....	151
Ruling TR 98/1 .....	152
<b>7.3 Accounting for income .....</b>	<b>153</b>
Chapter 11 [11.190]-[11.220] (cash basis) .....	153
Brent; .....	153

Henderson .....	154
Arthur Murray. ....	155
<b>7.4 Accounting for deductions.....</b>	<b>156</b>
<b>(a) ‘Incurred’ and recognising deductions .....</b>	<b>156</b>
ITAA97: s 8-1, s 26-10 .....	156
Ruling TR 97/7.....	156
Henderson .....	156
James Flood .....	156
Nilsen Development Laboratories .....	157
<b>8.1 Prohibition on deduction of capital expenditure .....</b>	<b>158</b>
<b>Pre-recorded lecture notes .....</b>	<b>158</b>
<b>ITAA97: s 8-1(2) .....</b>	<b>161</b>
<b>Chapter 9 [9.10]-[9.280] including.....</b>	<b>161</b>
AusNet; .....	161
Sun Newspapers; .....	163
Broken Hill Theatres.....	164
BP Australia.....	164
Sharpcan; [9.170] .....	164
Steele;.....	166
Egerton-Warburton; .....	166
Colonial Mutual Life Assurance; .....	166
Cliffs International .....	166
<b>8.2 Capital allowances .....</b>	<b>168</b>
<b>Chapter 10 [10.110]-[10.270] including.....</b>	<b>168</b>
Wangaratta Woollen Mills .....	168
Ruling TR 2004/16 .....	169
Sharpcan.....	170
<b>9.1 Introduction to taxation of partnerships and trusts .....</b>	<b>170</b>
<b>Chapter 13 [13.50]-[13.110] (partnerships); [13.280]-[13.320], [13.430] (trusts); .....</b>	<b>170</b>
Partnerships.....	170
Trusts.....	172
<b>Chapter 14 [14.10]-[14.75] (companies) .....</b>	<b>174</b>

## Topic 1 - Tax System and Tax Policy

### 1. Introduction to Taxation

#### What is a Tax?

A tax is a **compulsory financial charge** imposed by the government on individuals, businesses, or other entities to fund public services and infrastructure.

#### Key Characteristics of a Tax:

- **Compulsory:** Payment is mandatory under the law.
- **Imposed by Government:** Only the government (federal, state, or local) can impose taxes.
- **No Direct Benefit:** Unlike fees or charges, taxpayers do not receive a direct service in exchange for their payment.
- **Main Purpose – Revenue Generation:** Taxes fund government programs, public goods, and services.

#### Legal Definitions:

- Deferred to historical precedent, stating that any change in principle should come from the **legislature**, not the courts.

#### **McTiernan J (dissenting):**

- Found in favour of deductibility (not reproduced in full here).

#### **Key Quotes**

"To say that expenditure on fares is a prerequisite to the earning of a taxpayer's income is not to say that such expenditure is incurred in or in the course of gaining or producing his income." (Williams, Kitto and Taylor JJ)

"It is not for the court... to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent." (per curiam)

"If the whole subject is to be ripped up now it is for the legislature and not the court to do it." (Dixon CJ)

#### **Subsequent Development / Commentary**

- **Lunney** has been consistently applied to deny deductions for **ordinary commuting**.
- It left **open questions** about travel between **two places of work**, travel involving **carrying tools**, and travel by **independent contractors**.
- Later cases and ATO rulings have created exceptions and **refined distinctions**, leading to a more **nuanced** body of doctrine in this area.

### *Martin - childcare*

#### **Facts**

- The taxpayer, a working mother, claimed a deduction for child care expenses paid to kindergartens while she was at work.
- Her claim was rejected by the Board of Review and the Supreme Court of NSW, and she appealed to the Full Federal Court.

#### **Issue**

Was the taxpayer entitled to deduct kindergarten (child care) expenses under s 51(1) as being incurred in gaining or producing assessable income?

#### **Ruling**

**Held:** No deduction allowed. The expenses were **not incurred in the course of gaining assessable income**, but were **private in nature**.

#### **Reasoning**

- The Court reaffirmed the reasoning in **Lunney v FCT** and **Ronpibon Tin NL v FCT**, emphasising the need to look at the **essential character** of the expense.
- Although child care was a **prerequisite** for the taxpayer's ability to work, this did **not make the expense incidental or relevant** to the performance of her duties.
- The Court distinguished between:
  - **Expenses incurred to enable the taxpayer to earn income** (preliminary expenses, generally non-deductible); and
  - **Expenses incurred in the course of actually earning income** (potentially deductible).
- The childcare expenses were found to be **private and domestic** in nature, similar to other **living expenses**.

#### **Key Quotes**

"The expenditure was not incurred in, or in the course of, performing the work for which she was engaged to perform."

"There was nothing about the expenditure which was relevant or incidental to the work."

"Such a consideration is not of itself sufficient to attract the operation of s 51(1)."

### *Hatchett – Education related expenses*

#### **Facts**

- Hatchett was a teacher employed by the WA Education Department.
- He incurred:
  1. **\$89 for thesis submissions** to obtain a **Teacher's Higher Certificate (THC)**, which enabled progression to a higher salary scale.
  2. **\$71 in university fees** for subjects in the Faculty of Arts. A portion of this was refunded by his employer.
- The THC directly entitled him to a salary increase for doing the same work; the university study did not result in promotion or immediate assessable income.

#### **Issue**

Were the THC expenses and the university fees deductible under **s 51(1)** as outgoings incurred in gaining or producing assessable income?

#### **Held**

- **THC expenses were deductible.**
- **University fees were not deductible.**

#### **Reasoning – Menzies J**

##### **1. Teacher's Higher Certificate**

- There was a **clear and direct connection** between the expenditure and Hatchett's ability to **earn more assessable income** in the immediate future.
- Even though the certificate was obtained after the tax year ended, the **purpose** of the expense was to **increase employment income**, and this satisfied the nexus test under s 51(1).
- The expense was **not capital in nature**, nor private.
- Menzies J confirmed that **expenditure incurred in anticipation of future income is still deductible.**

##### **2. University Fees**

- The **connection to assessable income was weak and speculative.**
- Hatchett had **no concrete outcome** (e.g., promotion, qualification) from the study.
- The court emphasised that encouragement from an employer **does not make an expense deductible.**
- Education aimed at **general improvement** (as opposed to a specific income benefit) is typically **private in nature.**
- The **likelihood** of promotion is not sufficient without a clear nexus to income production.

### *Finn – Travel Expenses*

#### **Facts**

- Mr Finn was a **senior architect** employed by the Public Works Department of WA.
- He took **combined long service and recreation leave** to travel through Europe to **study architecture** and modern building design.
- Before departure, his **employer requested** that he also travel to **South America** to report on architecture there.
- The **WA Government funded** his return travel between England and South America.
- He took **hundreds of photos**, collected architectural material, met with experts, and made **written records** for professional use.
- He claimed a deduction under s 51(1) for **travel-related expenses**, net of the government contribution.

#### **Issues**

1. Were the travel expenses deductible under s 51(1) as incurred in gaining or producing assessable income?
2. Were the expenses of a **capital, private, or domestic** nature?

## Held

**Deductible** – The travel expenses were **incurred in gaining or producing assessable income** and were **not capital, private, or domestic** in nature.

## Reasoning

### 1. Employment Nexus Satisfied

- The travel was undertaken:
  - During Finn's employment,
  - With employer encouragement and partial financial support,
  - For the **explicit purpose of developing professional skills** relevant to his government architectural work.
- Although the travel occurred during leave, it was treated by the department as **beneficial to Finn's duties** and directly **relevant to his role**.
- The High Court emphasised that:
  - Improving professional skills,
  - Complying with employer requests,
  - And enhancing performance in the existing role= creates a **strong link to assessable income**.

### 2. Not a Capital Outlay

- The Court **rejected the argument** that the expenditure was capital:
  - Knowledge is **not an enduring asset** like plant or machinery.
  - Professional development is part of the **ordinary course** of a skilled employee's work.
  - Unlike fixed assets, **knowledge fades** and must be **renewed and maintained**.

### 3. Personal Motivation Not Fatal

- Although personal and professional motives co-existed (e.g. general interest in architecture), the **dominant purpose** was work-related.
- The **purpose of professional advancement** (with implications for promotion and higher pay) was central and sufficient.

## *Handley – Home office expenses*

## Facts

- Mr Handley, a **barrister**, maintained a **study in his private home**, in addition to his **city chambers**.
- He used the home study **20 hours per week** for approximately **45 weeks a year**, mostly at night and on weekends.
- The room was **not physically separate** from the rest of the house and was only occasionally used for non-work purposes.
- He claimed deductions for a **proportion of interest on the home mortgage, municipal and water rates, and insurance premiums**, arguing they related to his income-earning use of the study.
- The Commissioner disallowed these expenses under the **domestic/private exception** in s 51(1).

## Issue

Were the taxpayer's claimed expenses deductible under s 51(1), or were they private or domestic in nature and therefore excluded?

## Held

**Not deductible** – The expenses were of a **domestic nature** and not sufficiently connected with income production to qualify under s 51(1). No apportionment was warranted.

## Reasoning

### Wilson J (majority reasoning)

- The study, though used for professional purposes, remained **part of the home**.



- The **interest, rates, and insurance premiums** related to the entire property and would **not change** regardless of whether professional work occurred at home.
- These outgoings could not be **severed or apportioned** in the circumstances.
- The taxpayer's **decision to work at home** was one of **personal convenience**, not professional necessity.
- The court drew a **distinction** between:
  - A **home used as a place of business**, and
  - A **home in which some work is done**.
- The latter category does **not support deduction** of structural or ownership-related costs (like interest or insurance).

#### **Murphy J (concurring judgment, stricter approach)**

- All claimed expenses were **inherently domestic**.
- Even **exclusive use** of a room for legal study does **not transform it into a business space**.
- Murphy J argued that **convenience-based use** of a home study, even if productive, remains **domestic**.
- He warned that allowing such deductions would lead to **absurd claims** (e.g. for bedrooms or gardens used for contemplation).
- The test is not whether the **study aids income**, but whether the **nature of the expense** is private/domestic or income-generating.
- While some expenses (e.g. heating and cleaning) might be **apportioned**, interest and insurance remained entirely **private**.

### *Forsyth – Home Office*

#### **Facts**

- The taxpayer, **Forsyth**, was a **barrister** who entered into an agreement with trustees (likely related parties) under which he **rented part of his home**, including a study used for professional purposes.
- He sought to **deduct the rental payments** under s 51(1) as expenses incurred in gaining assessable income.
- The Commissioner disallowed the claim, arguing the expenses were of a **domestic nature** and thus excluded.

#### **Issue**

Was the **rental expense deductible**, or was it excluded as being of a **domestic nature**, despite being used partly for professional work?

#### **Held**

**Not deductible** – The rental payments were **domestic in nature** and therefore excluded under the second limb of s 51(1).

#### **Reasoning**

##### **Wilson J**

- Reaffirmed Menzies J's principle from *Hatchett* that if an expense is genuinely incurred in gaining assessable income, it is rarely also "private".
- But distinguished "**domestic**" from "**private**":

"It is certainly not true of outgoings of a capital nature... Nor... should it necessarily be true of outgoings of a domestic nature."

- Quoted dictionary meaning of "domestic":

"of or belonging to the home, house or household" (Shorter Oxford).

- Found that the **rental agreement**, despite covering a room used for professional purposes, was **fundamentally about the household**, and thus retained its **domestic character**.
- Therefore, even if part of the home was used for income-earning purposes, **the nature of the outgoing (rent) as domestic prevailed**.

## Cooper – Food Drink and entertainment

### Facts

- The taxpayer, **Mr Cooper**, was a **professional rugby league player**.
- His **coach**, Roy Masters, prescribed an **increased food and alcohol intake** (including at least one dozen cans of beer weekly) to help Cooper **maintain body weight** for professional performance.
- Cooper claimed a deduction for the cost of **additional food and drink** consumed as part of this regime.
- The Commissioner disallowed the deduction; the matter was appealed.

### Issue

Was the expenditure on food and drink **incurred in gaining or producing assessable income**, or was it **private in nature** and therefore **non-deductible**?

### Held

The expense was **not deductible**. The **essential character** of the expenditure remained **private**, despite its connection to employment.

### Reasoning

#### Hill J (majority)

- **General Principle:** Expenditure on **food and drink** is **ordinarily private** unless special circumstances alter its character.
- **Key Test:** Look to the **essential character** of the outgoing.
- The fact that Cooper was **instructed** to consume more food and drink **did not change the nature** of the expense.
- Compared to medication (which might be deductible), **food retains its inherently private character**.
- Therefore, even if consumption aids employment, it is **not enough to make it deductible** under s 51(1).

“The expenditure in question fails to be deductible because its essential character remains private.” (p 1638)

#### Wilcox J (dissenting in result)

- Acknowledged the **difficulty in applying the “essential character” test**.
- Emphasised the **importance of the occasion of the expenditure**.
- For example, meals incurred **while travelling for business** are deductible, not because food ceases to be private, but because the **occasion makes them work-related**.
- Suggested that the **description of the facts selected to define the expense's character** can determine the outcome.

“The difference between the two characterisations is that the latter takes account of the occasion of the expenditure.” (p 1625)

## 7.1 Deductions specifically included or prohibited

### Pre-recorded lecture notes

#### Prohibited Deductions: Division 26 & Division 32

- **Division 26** lists amounts that are non-deductible, even if incurred in business.
  - Examples: bribes, penalties, travel for relatives, private family expenses.
- **Division 32** denies deductions for entertainment expenses (e.g., business lunches), even if arguably work-related.
  - **Exception:** Some on-premises employee entertainment may be deductible (e.g., meals in law firm kitchens).
- **Rationale:** Enforcement difficulties with private vs business expenses led to outright prohibition.

#### 2. Specific Deductions (s 8-5 and Division 25)

- **s 8-5** allows deductions under specific provisions (cross-referenced throughout ITAA97).
  - Examples:
    - **Repairs** (s 25-10)
      - *Western suburbs cinema* – the deduction for hypothetical repairs was denied as the actual repair was a capital improvement.
        - Kitto J's - "If a total expenditure is of a capital nature, so is every part of it."
      - *W Thomas* - Repairs are deductible only if they relate to wear and tear from the taxpayer's own use in earning assessable income.
        - If a building is purchased in a defective or unfit condition, and repairs are needed before it can be used for income-producing purposes, those repairs are part of the capital cost of acquisition
    - **Gifts to DGRs** (Div 30)
    - **Borrowing expenses** (s 25-25, separate from interest, e.g., loan application fees)
    - **Bad debts** (s 25-35)
- **No Double Deductions:** s 8-10 prevents claiming the same expense under multiple sections.

### 3. Tax Accounting: Income and Deduction Timing

- **Income:** Must be allocated to correct income year when derived.
  - **Cash basis:** Recognise income when received (e.g., Brent case).
  - **Accrual basis:** Recognise when entitled, even if unpaid (e.g., Henderson case).
- **Deductions:** Recognised when "incurred" (not necessarily paid).
  - Even individuals can deduct incurred expenses if liability is certain (e.g., rent or subscriptions).
  - Courts ask: Has the taxpayer been definitively "subjected to the expense"?
  - **James Flood case:** Annual leave not "incurred" until taken (contingent liability).
  - **Citylink:** Deduction must also be properly referable to the income year.

### 4. Income Received in Advance

- **Arthur Murray case:** Prepaid dance lessons only recognised as income when services delivered.
  - Commercial/accounting practice is persuasive, but not decisive in determining tax treatment.

### 5. Tax Losses (Division 36)

- **s 36-10:** Tax loss = Total deductions (excluding earlier losses) – assessable income.
  - Must reduce by any **exempt income** (but not by **non-assessable non-exempt income**).
  - **Carried forward indefinitely** on a nominal basis (no indexation).
- **Strategy:** Prefer using losses ASAP due to time value and inflation.
- **Capital Losses:** Only deductible against capital gains; quarantined.
- **No Offset Against Exempt Income:** Reduces value of the loss.

### 6. Hobby/Non-Commercial Losses (Division 35)

- Applies to individuals with losses from non-commercial business activities.
- **Effect:** Loss is quarantined — can only be used against future income from same activity.
- **Not applicable to:** Rental property losses (e.g., negative gearing is unaffected).
- **Conditions:** Rule applies if income < \$250,000 and business activity doesn't meet certain thresholds (e.g., profits test, real property > \$500k).
- **Policy Goal:** Prevent tax avoidance via "hobby" deductions against unrelated high income.

## Chapter 10 [10.10]-[10.100] including

### *Western Suburbs Cinemas*

#### Facts

- The taxpayer owned the **Melba Theatre**, which required repairs to its **ceiling**, identified as dangerous.

- The **original repair material (Celotex)** was unavailable; repairs using **Fibro** were possible but deemed unsatisfactory and costly.
- Instead of repairing, the company **replaced the entire ceiling** with a **new and better fibro ceiling** at a cost of **£3000**.
- The taxpayer **claimed a deduction of £603**, the estimated cost of the hypothetical repair (had it been done), not the actual cost of replacement.

#### Procedural History

- The **Board of Review allowed** the deduction of £603.
- The **Commissioner appealed** to the High Court, arguing the expenditure was capital in nature and no deduction was allowable.

#### Issues

1. Can a **hypothetical repair cost** be deducted instead of the actual expenditure?
2. Was the replacement of the ceiling a **repair or a capital improvement**?
3. Can capital expenditure be **apportioned** to identify a deductible component?

#### Reasoning – Kitto J

- A **repair** is distinguished from a **replacement** that does more than restore the asset to its original state.
- The **ceiling replacement** was a **substantial and better improvement**, not a mere repair:
  - It was a **major structural element**.
  - The new ceiling had **advantages over the old** (e.g. longer life, reduced future repair costs).
- The **actual expenditure** is what matters for deductibility under s 25-10, not what *could have* been incurred.
- The taxpayer **cannot claim a notional cost** of repair when it **chose to undertake a capital improvement**.
- **Apportionment** is not available in this context unless the **actual work done contains separable elements** of repair and improvement, which it did not here.

*"If a total expenditure is of a capital nature, so is every part of it."*

- Past cases (e.g. *Rhodesia Railways*) were **distinguishable**, as those involved actual **repairs**, not replacements or hypothetical scenarios.

#### Held

- The **entire expenditure was capital in nature**.
- The taxpayer **could not deduct** even a portion of it under s 25-10.
- The **Commissioner's appeal allowed**; deduction disallowed.

### W Thomas

#### Facts

- The taxpayer **purchased a building** (the **Berry Building**) for business use.
- At the time of purchase, the building was **not in a usable state** for its intended income-producing purpose.
- The taxpayer incurred **£5,082 in repairs and repainting** to render the building fit for use.
- The **Commissioner disallowed** the deductions, arguing they were capital in nature.
- The taxpayer **appealed**, claiming the costs were deductible repairs.

#### Issue

Whether the **cost of initial repairs** made to a building acquired in an **unusable condition** could be **deducted as revenue expenditure**, or whether such costs are **capital outlays** forming part of the acquisition cost of the asset.

#### Reasoning – Windeyer J

- **Repairs** are deductible **only if they relate to wear and tear from the taxpayer's own use** in earning assessable income.
- If a building is purchased in a **defective or unfit condition**, and repairs are needed **before** it can be used for income-producing purposes, those repairs are part of the **capital cost of acquisition**:

“...the cost of putting it in order suitable for use is part of the cost of its acquisition, not a cost of its maintenance.”

- The judge drew support from **Cook Islands v AB Donald Ltd**, emphasising:
  - Maintenance preserves an asset in its **existing condition**.
  - **Restoration of pre-existing defects** at the time of purchase **improves the quality** of the asset.
  - Such costs are part of the **capital structure** of the business and are **not revenue charges**.
- It was **irrelevant** that:
  - The taxpayer was **unaware** of some defects at the time of purchase.
  - Repairs were done **progressively** after portions of the building were put to use.
  - Some defects may have worsened after initial use.
- Windeyer J reiterated **Kitto J's principle from Western Suburbs Cinemas**:

“If a total expenditure is of a capital nature, so is every part of it.”

- Although the court acknowledged that **some minor expenses (like painting)** could, in other contexts, be revenue in nature, the **totality of the expenditure** here was deemed **capital**.

---

#### Held

- The expenditure was **capital in nature**.
- The **entire £5,082** was **non-deductible**.
- The Commissioner's decision to disallow the deduction was **upheld**.

### *TR 2023/3 Income tax: expenses associated with holding vacant land*

#### Purpose of the Ruling

- Explains when deductions for costs related to holding vacant land are **denied** under s 26-102.
- Applies from **1 July 2019**, even if land was acquired earlier.
- Only applies where deductions would otherwise be available under s 8-1 or similar.

---

#### Key Rule in s 26-102(1)

- Deductions are **denied** for holding costs of **vacant land**, unless certain **exceptions** apply.

---

#### Exceptions to Denial of Deduction

You **can still deduct** holding costs if:

1. **Substantial and permanent structure** exists on the land that is:
  - **Independent** and **not incidental** to another (proposed) structure.
  - **In use or available for use** (e.g. legally occupiable, not unsafe).
2. The land is:
  - **Used or available for use in carrying on a business**, or
  - **Leased at arm's length to an entity** that uses it in a business.
3. The land is held by:
  - **Primary producers** leasing land for primary production.

- Certain **entities** excluded under s 26-102(5).

---

## Definitions and Applications

- **Vacant land:** No independent, substantial, and permanent structure in use.
- **Substantial and permanent:** Significant in size/value and fixed.
- **Independent purpose:** E.g., farm sheds may qualify, but a garage or fence on residential land usually does not.

---

## Special Considerations

- **Residential premises under construction/renovation:**
  - Are not treated as substantial/permanent unless:
    - Lawfully able to be occupied **and**
    - **Leased or available for lease** (s 26-102(4)).
- **Interest and borrowing costs:**
  - Denied if related to holding vacant land.
  - Still deductible if related to construction/renovation of property (TR 2004/4 applies).
- **Apportionment:**
  - If only **part of land** is used in business or has structures, costs must be **fairly apportioned**.

---

## Examples

- A **vacant block** with a shed and fencing for future rental: deductions denied.
- A **manager's house** on farmland: land not considered vacant; deductions allowed.
- Land leased to a **family farming business** at market rent: deductions allowed.
- Land subdivided: each title assessed separately.

---

## *TR 2021/1 Income tax: when are deductions allowed for employees' transport expenses?*

### Purpose of the Ruling

- Clarifies when transport expenses (e.g. car, train, taxi, flights) are **deductible** by employees.
- Explains **general principles**, **exceptions**, and **common scenarios** for deductibility.
- Also relevant to **fringe benefits tax (FBT)** under the "otherwise deductible" rule.
- Replaces previous ruling **TR 2017/D6**.

---

### General Rule

- **Travel between home and a regular place of work is not deductible.** It is considered **private in nature** and a **prerequisite** to earning income (as established in *Lunney*).
- **Transport between work locations** (excluding home) is generally **deductible**, if employment duties occasion the expense.

---

### When Transport Expenses Are Deductible

To be deductible under s 8-1, expenses must:

1. Be **incurred in gaining or producing assessable income**;
2. Not be **capital, private, or domestic**;
3. Not relate to **exempt or non-assessable income**;
4. Not be **excluded by another provision**.

---

### Key Factors Supporting Deductibility (per case law):

- Expense arises **out of employment duties**, not personal choice.
- Travel is **relevant to performing work duties**.
- Employer **requests** the travel.
- Travel occurs **during work hours** and under **employer's direction**.

---

### Common Scenarios

Scenario	Deductible?	Reasoning
Home → Regular work (e.g. office/store)	✗ Not deductible	Travel is private, prerequisite to earning income.
Between two work locations (not home)	✓ Deductible	Employment duties occasion the travel.
Home → Client site or alternative location	✓ Deductible	Alternative location, required by duties.
Home → distant work location (chosen living area)	✗ Not deductible	Expense is due to employee's personal choice of residence.
Home → distant work location (required by duties)	✓ Deductible	Duties require travel between locations (e.g., interstate offices).
Transit point → work site	✓ Possibly	Deductible only if employment duties explain travel from the transit point.
Working from home (by choice)	✗ Not deductible	Travel is private unless home is the only work base (e.g. no employer premises).
Transporting bulky work equipment	✓ Deductible	If transport is required and no secure storage is available at workplace.
Relocation for work	✗ Not deductible	Travel is preparatory to income production and private in nature.

---

### Special Cases

- **On-call or standby work:** Travel is deductible **only** if substantial work begins at home and is continued at the worksite.
- **Flexible/work-from-home arrangements:** Travel to the office still considered private unless home is the **sole work base**.
- **Multiple regular places of work:** Travel to any regular workplace from home is not deductible, even if there are multiple such places.

---

### Fringe Benefits Tax (FBT)

- The ruling also applies to determine whether **employer-paid transport** would have been "**otherwise deductible**" to the employee for FBT purposes.



## 7.2 Method of accounting

Chapter 11 [11.100]-[11.170]

*Carden's case*

### Facts

- Dr Carden, a sole-practice medical professional, had for years returned his income on a **cash receipts basis**.
- Upon his death, **unpaid fees** for services rendered were received by his **executor** and claimed as **non-taxable corpus** of the estate.
- The Commissioner argued Dr Carden's accounts should have used the **accrual (earnings) method**, so the unpaid amounts would be assessable in his final year of life.
- The issue: whether the cash basis adopted was legally valid and appropriate for assessing his **true taxable income** under the tax law.

### Procedural History

- The Commissioner assessed the estate on the basis that Dr Carden should have used an accrual method.
- The matter was appealed to the High Court for determination of the appropriate accounting method under tax law.

### Issues

1. Is the choice between cash and accrual accounting a legal or administrative question?
2. Is the **cash receipts basis** an appropriate method of accounting for a sole-practitioner professional?
3. How should the tax law interpret "income" where no specific legislative method is prescribed?

### Judgment

**Dixon J** (for the majority) held that:

- The **appropriate method of accounting** is a **question of law**, not merely one of administrative discretion.
- Where the **statute is silent**, the method must give a "**substantially correct reflex of the taxpayer's true income**".
- For a sole-practitioner professional like Dr Carden, who has **no stock-in-trade, no circulating capital**, and whose **fees were uncertain**, the **cash basis** was not only lawful but **more appropriate**.
- The **accrual system**, while widely accepted in business, is not always appropriate—especially for professions not involving trading stock or deferred earnings.
- Therefore, **Dr Carden's income was correctly assessed on the receipts basis**.

### Key Legal Principles

- **Accounting method appropriateness** must reflect **commercial reality** and is determined by the nature of the income source.
- "**True income**" should be assessed by reference to a method that gives a **realistic picture of gain**, considering the taxpayer's specific activities.
- A **cash basis** is generally more appropriate for **professional services income**, unless the profession operates on a business-like model with stock or credit operations.

### Significance

- **Carden's case** is the leading authority on **choosing between cash and accrual methods** for income tax purposes.
- Introduced the enduring "**true reflex**" test: the chosen method must give a substantially correct representation of income.
- Led to the ATO **administratively requiring professionals to use the cash basis** following the case.
- Later legislative changes (e.g. **s 101A ITAA 1936**) overturned the non-taxability of post-death income as corpus.

### Broader Implications

- Reinforces the importance of **commercial practice and the nature of the taxpayer's enterprise** in tax accounting.
- **Flexibility** in tax accounting methods is permitted, but must be **justified on the facts** of each case.