GENERAL DEDUCTIONS

POSITIVE LIMBS OF DEDUCTIONS

1. Any loss or outgoing incurred in gain or producing assessable income
2. Any loss or outgoing incurred in a business in producing or gaining assessable income.

NEGATIVE LIMBS OF DEDUCTIONS

1. Expenditure of capital nature - e.g. purchasing building
2. Private or domestic nature
3. It is incurred in relation to gaining or producing the taxpayer's exempt income or non- assessable, non-exempt income
4. Legislation/fine of any nature

Loss or outgoing must be "incurred"

An expense may be incurred even if not yet paid. **Incurred** - does not mean paid, defrayed, discharged. An expense is incurred when the taxpayer is:
• committed, or
• completely subjected to the expense.
The expense must be more than impending, threatened or expected.
For example - a taxpayer uses electricity to run a factory. The taxpayer incurs an expense not when the electricity is used, but prior to payment when a bill is rendered by the electricity authority. It is only at that moment that the taxpayer is completely subjected to the expense. Until then the electrical authority cannot sue for the debt.

Charles Moore v FCT

- The taxpayer claimed a deduction for the days trading receipts stolen from an employee at gunpoint on the way to the bank, he was not insured.
- **Held** – deductible, banking is a necessary and integral part of business operations - The **loss** represented the kind of misfortune, which was a **natural or recognized incident of the operations** pursued by the taxpayer to earn its income.
- **Question** - what if the taxpayer leaves takings in a briefcase on a train, or in a car in the casino car park?

Herald and Weekly Times Ltd v FCT

- A newspaper paid amounts to settle a defamation action against it in respect of alleged libels published by it.
- **Held –** deductible, publishing a newspaper inevitably exposes a publisher to the possibility of being sued for libel. The expense of settling a defamation action was incurred as a **natural consequence** of the inclusion of the alleged defamatory material in the newspaper. The fact that the income produced by the publication

containing defamatory matter arose in an earlier income year is unimportant in the context of a continuing business

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PROVISIONS

- Provisions such as in respect of bad debts, etc, are not allowable deductions. Provisions are usually merely book entries in respect of anticipated or possible future loss contingencies. At the point of time of making the provision, it is not yet possible to say that a loss or outgoing has been "incurred," as the relevant "triggering" event has not yet occurred. **However,** insurance companies incur liabilities at the time that certain events occur (for example, motor accidents) **but which in fact the insurance company may not become aware of until some time later.**
- It has been necessary for such companies to make some estimate of such liability usually by reference to historical experience**.**

RACV Insurances P/L v FCT

- The taxpayer set aside amounts to cover unreported 3rd. party claims - These were estimates of the amount of claims arising out of accidents occurring before the end of the income year but not yet reported.
- **Held** – deductible. In this case the only question was the estimation of damages. The fact that the amount is estimated and that it may have to be adjusted in light of later events does not bar the deduction. Once the event had occurred (the accident) out of which absolute liability arose, section 8-1(1) applied, which was not dependent on notice of the claim.

IN GAINING OR PRODUCING ASSESSABLE INCOME

- Applies to assessable income in the past present and future
- It is assessable income and not taxable income that is important
- Deductibility does not rely on the result of the expenditure
- If a deduction does not generate assessable income it will still be deductible if it satisfies s 8-1.

TIMING ISSUES

- Loss or outgoing must be incurred in gaining or producing the assessable income. It is not necessary to match the loss or outgoing with the income earned in the same income year - at least where a continuing business is involved.
- Expense may be relevant to the income of:
  - An earlier income year; or
  - A later income year; or
  - Be relevant to the reduction of future expenses

TIMING- AMALGAMATED ZINC V FCT

- A mining company discontinued its business but remained liable to make annual worker's compensation payments. After it discontinued its business it derived its income solely from investments.
- **Held** - not deductible. **Complete cessation of income producing operations** out of which the necessity to make the outgoing arose - there was no longer a nexus between the outgoing and the earning of assessable income. The taxpayer continued to make worker's compensation payments as a result of its liability under the relevant legislation and not because they could produce income.

PLACER PACIFIC MANAGEMENT PTY LTD

- The taxpayer, a manufacturer of conveyor belts installed a conveyor belt for NWCC. In July 1981 it sold its business. In August 1981 NWCC sued the taxpayer claiming that the conveyor belt was defective. In 1989 the taxpayer settled the action by paying NWCC $325,000 and claimed the amount as a deduction in the year of income ending 1989.

- **Held** - deductible
- Provided that the cause of the business outgoing is found in the business operations directed towards the gaining or producing assessable income generally –
- the fact that the outgoing was incurred in a year later than the year in which the income was incurred; and
- the fact that in the meantime the business may have ceased will **not deny deductibility.**

EXPENSES TO PRODUCE FUTURE INCOME

- In a **continuing business**, it is **not the practice** to inquire into the **exact time** that it is hoped that expense will affect the production of assessable income. Expenditure upon raw materials, repairs to plant, advertising - designed to produce results in future year - deductible.
- Continuity requires that the expense should be attributable to the year against which it is actually defrayed.

APPLICATION OF S8-1 TO COMMONLY INCURRED EXPENSES

- Expenses incurred in gaining employment
- Relocation expenses
- Childcare expense
- Travel expenses
- Car expenses-
- Self-education expenses
- Home office expenses
- Clothing expenses
- Interest expenses
- Legal expenses

INCURRED

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- **For example -** a taxpayer uses electricity to run a factory. The taxpayer incurs an expense not when the electricity is used, but prior to payment when the electricity authority renders a bill. It is only at that moment that the taxpayer is completely subjected to the expense. Until then the electrical authority cannot sue for the debt.

Nilsen Development Laboratories P/L v FCT

- The taxpayer's employees were entitled to long service leave and holiday leave - some employees had completed the required service period. They were entitled to payment for long service leave pay and holiday pay - **"when"** they took leave - none had actually taken leave or been paid - the taxpayer claimed a deduction in respect of provisions in its accounts representing estimates of leave entitlements incurred at the end of the income year.
- **Held** - not deductible. Liability arises once the triggering event has occurred, at the point in time when the employee has:
- (1) served the required period and
- (2) upon the occurrence of an event, that is - going on leave, termination of employment, death, etc.
- Until then **- no presently existing liability** had been created. The commercial propriety of making provision for an accruing liability has little bearing on whether there is a loss or outgoing under section 8-1(1) (formerly s51(1))

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SPECIFIC AND NON SPECIFIC DEDUCTIONS

- 8-5(1) You can also deduct from your assessable income an amount that a provision of this Act (outside this Division) allows you to deduct.
- 8-5(2) Some provisions of this Act prevent you from deducting an amount that you could otherwise deduct, or limit the amount you can deduct.
- 8-5(3) An amount that you can deduct under a provision of this Act (outside this Division) is called a specific deduction.
- For a summary list of provisions about deductions, see section 12-5.

- S 8-10 - No double deductions - If 2 or more provisions of this Act allow you deductions in respect of the same amount (whether for the same income year or different income years), you can deduct only under the provision that is most appropriate.
- The Explanatory Memorandum states that when an expense is potentially deductible under s 8-1 – general deductions, or Division 25 – specific deductions, the preferred option is to claim a deduction under a specific provision.
- If do not satisfy the specific deduction provisions then need to consider application of general provision of s 8-1