

CMT301 Taxation 1

Topic 6 General Deductions

Objectives

To understand how to apply elements of s 8-1 general deductions:

- Words and phrases of the POSITIVE LIMBS
 - incurred
 - any loss or outgoing
 - to the extent that
 - in gaining or producing
 - your assessable income
 - necessarily incurred (2nd limb)
 - carrying on a business (2nd limb)
 - for the purpose of
 - Sufficient connection
- Words and phrases of the NEGATIVE LIMBS

1. Introduction

Referring back to the equation used to calculate taxable income:
s 4-15 (Taxable income = Assessable income – deductions).

We can see that deductions form the other part of the income tax equation.

There are two types of deductions general deductions and specific deductions. This topic focuses on general deductions. The general deductions provision s 8-1 ITAA 1997 is one of the primary provisions (most used) of the ITAA. Section 8-1 consists of positive and negative limbs as follows:

2. The Legislation, s 8-1

Positive Limbs:

Section 8-1(1), You can deduct any loss or outgoing that:

- a is incurred in gaining or producing your assessable income
- b is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.

Negative Limbs:

Section 8-1 (2), Exclusions to the extent:

- a loss or outgoing of capital or of a capital nature, or
- b loss or outgoing of a private or domestic nature, or
- c incurred in relation to gaining or producing your exempt income; or non-assessable non-exempt income
- d a provision of this Act prevents you deducting it.

3. Words and phrases analysis

3.1 The positive limbs

Relationship between the first and second positive limbs

The first and second positive limbs are not mutually exclusive, as they are linked by the conjunction ‘or’. Thus they are alternatives. The first positive limb is available to all taxpayers, while the second limb is only available to business taxpayers. In *Ronpibon Tin NL v FCT; Tong Kah Compound NL v FCT* (1949) 78 CLR 47, a leading High Court case on s 8-1, viewed both limbs as covering similar ground. However, some commentators consider that the second limb has a wider operation.

Online Activity 1: Read *Ronpibon Tin NL v FCT; Tong Kah Compound NL v FCT* (1949) 78 CLR 47

A. ‘any loss or outgoing’

The meaning of ‘any loss or outgoing’ was examined in *Amalgamated Zinc (De Bavay’s) Ltd v FCT* (1935) 54 CLR 295 where (in respect of the 1922 Act) Latham CJ said at 303: ‘losses and outgoings ... be read as meaning that the outgoings must be an expenditure which has an effect in gaining or producing income’. Also, in *FCT v Ilbery* (1981) 12 ATR 563, Toohey J at 569 stated “‘outgoings’... it suggests something paid out, something that has left the hands of the taxpayer’.

B. ‘incurred’

Timing of an expense is an important issue since it governs the tax year when a deduction can be claimed. Thus, this is a very important matter for tax planning.

The timing of deductions is generally governed by when an expense is ‘incurred’ under ITAA 1997 s 8-1 (formerly ITAA 1936 subs 51(1)). From 1 July 2001-30 June 2005, however, small business taxpayers could elect to join the STS and adopt a cash basis for accounting for deductions. Since these rules are grandfathered, former STS businesses can still use the cash basis for deductions.

‘Incurred’ is not defined in the ITAA, however, the courts have consistently declined to give any exhaustive meaning of ‘incurred’ as seen by the cases below:

New Zealand Flax Investments Ltd v FCT (1938) 61 CLR 179

FCT v James Flood Pty Ltd (1953) 10 ATD 240

Nilsen Development Laboratories Pty Ltd v FCT 81 ATC 4031

RACV Insurance Pty Ltd v FCT 74 ATC 4169

Commercial Union Assurance Co of Australia Ltd v FCT 77 ATC 4186

FCT v Citylink Melbourne Ltd (2008) 228 CLR 1; 62 ATR 648

Online Activity 2: Read *New Zealand Flax Investments Ltd v FCT* (1938) 61 CLR 179
FCT v James Flood Pty Ltd (1953) 10 ATD 240

- ***Principles ‘incurred’***

The principles from the above cases can be categorised into the following two types:

- 1. Where a taxpayer makes payment for an outgoing during the income year***

An outgoing is incurred when a taxpayer outlays money for a good, service or other type of supply. The taxpayer has definitively committed or has completely subjected itself by making payment, thus the outgoing is incurred: *FCT v James Flood Pty Ltd*. **Example:** Jackie runs a horse-breeding business and pays \$100 for straw for the stables. The \$100 is incurred by payment.

- 2. Where a taxpayer has not made payment for an outgoing during the income year***

- ***Taxpayer is definitively committed or is completely subjected to the debt***

A debt is incurred if the taxpayer has definitively committed or has completely subjected itself to the liability per *FCT v James Flood Pty Ltd*.

Example: in June of the income year, Jackie fills up her car with \$340 of petrol. She runs a monthly account at the petrol station and pays the account on 31 July of the next income year. The \$340 is incurred since Jackie has definitively committed or has completely subjected herself to the liability.

- ***Taxpayer has a presently existing pecuniary liability***

An outgoing is generally incurred when a taxpayer owes a debt for which the taxpayer has a presently existing pecuniary⁸ liability. A presently existing pecuniary liability must be determined by reference to terms of the contract or arrangement under which the liability arises: see *New Zealand Flax Investments*; *Nilsen Development Laboratories*; *FCT v James Flood Pty Ltd*.

- ***The debt must not be merely contingent, pending, threatened or expected***

A liability to pay that is contingent, pending, threatened or expected for an outlay that is certain in a future income year will not be incurred: *Nilsen Development Laboratories*. However (as noted above), if there is a presently existing liability for a future year expense the amount will be incurred.

Example: in June of the current income year, Jackie’s old car begins to struggle to tow the horse float. She will have to pay for a new engine on her car in July of the next income year, and this will cost \$5000. This is merely an expected or threatened outlay and thus has not been incurred.

- ***Estimated liabilities may be incurred***

For certain taxpayers (for example, insurance companies), an outgoing that is a pecuniary liability in the year of income and that is able to be reasonably estimated, is incurred: See: *RACV Insurance Pty Ltd*; *Commercial Union Assurance Co of Australia Ltd*.

- ***Prepaid expenses***

Generally a prepaid expense is deductible under s 8-1 in the year incurred unless it is of a capital nature and incurred at a point too soon before the income producing activity; or where a specific prepayment limitation provision applies. See *FCT v Brand* 95 ATC 4633

However, in *AAT Case 10,297* (1995) 31 ATR 1058, a 25-year lease prepayment was held to be on capital account.

- ***Expenses referable to future years***

The general principle is that expenses are deductible when they are incurred, although, the exception in *Coles Myer Finance Ltd v FCT* applies to certain discounts incurred with bills of exchange. This principle allows deductions to be apportioned on a straight-line basis over the term of the instrument: that is, the court applied the matching principle of commercial accounting. See *Coles Myer Finance Ltd v FCT* (1993) 25 ATR 95

The ATO has limited the application of the matching principle to similar financing arrangements, thus it does not apply it to prepaid expenses such as rent, insurance, interest etc.

- ***Expenses referable to an earlier year***

Expenses referable to earlier years of income may be deductible, depending upon the connection between the expenses and the former income, as seen in the following cases:

Online Activity 3: Read *Amalgamated Zinc (De Bavay's) Ltd v FCT* (1935) 54 CLR 295; *Peyton v FCT* (1963) 13 ATD 133; *Queensland Meat Export Co Ltd v FCT* (1939) 5 ATD 176

Long tail liabilities (outgoings in respect of liabilities that crystallise well after the business activities that gave rise to them) are deductible:

- ***Prepaid expense restrictions***

Different regimes restrict deductions for prepaid expenses and these regimes apply to: small business and non-business taxpayers; large and medium business; and for tax shelter prepayments under ITAA 1936 ss 82KL-82KZO.

C. 'in gaining or producing'

The meaning of these words was considered in *Amalgamated Zinc (de Bavay's) Ltd v FCT* (1935) 54 CLR 295, where Dixon J said 'in gaining or producing' is to be read as in the course of gaining or producing and this 'looks rather to the scope of the operations or activities and the relevance thereto of the expenditure than to the purpose in itself.'

In *Ronpibon Tin NL v FCT; Tongkah Compound NL v FCT* (1949) 4 AITR 236 at 245 the High Court observed:

In brief substance, to come within the initial part of the subsection it is both necessary that the occasion of the loss or outgoing should be found in whatever is productive of

the assessable income or, if none be produced, would be expected to produce assessable income.

The majority of the High Court in *FCT v Day* [2008] HCA 53 appears to have employed a broad scope for deductions under s 8-1. That is, what is in the course of income production may be widened. Expenses that are not the result of the day-to-day business activities or work may have sufficient nexus to the production of assessable income. As discussed below, in *Day*, legal expenses incurred by a public servant in defending improper conduct charges in respect of his private life were deductible. The High Court found that the words in the course of in s 8-1(1)(a) ITAA 1997 did not require a direct nexus between an expenditure and the activity which produced the assessable income. An indirect nexus was sufficient as long as it was not too remote.

Online Activity 4: Read *FCT v Day* [2008] HCA 53

D. 'your assessable income'

No deduction is allowable for expenditure incurred by one taxpayer to generate income for another taxpayer. See *FCT v Munro* (1926) 38 CLR 153

Example: An employee of Big Pty Ltd pays phone expenses for his business work Phone and forgets to claim reimbursement. The phone expenses are not deductible to Big Pty Ltd.

E. 'to the extent that' (apportionment)

It is clear that s 8-1(1) contemplates apportionment. In *Ronpibon Tin*, the High Court found that management expenses must be apportioned in determining deductions: See *Ronpibon Tin NL v FCT; Tong Kah Compound NL v FCT* (1949) 78 CLR 47

In *Ronpibon Tin*, Latham CJ, Rich, Dixon, McTiernan, and Webb JJ stated:

For expenditure to form an allowable deduction as an outgoing incurred in gaining or producing the assessable income it must be incidental and relevant to that end ... (56 57) The question of fact is therefore to make a fair apportionment to each object of the companies actual expenditure where items are not in themselves referable to one object or the other (at 60).

Online Activity 5: Read *Ure v FCT* 81 ATC 4100

F. Sufficient connection of losses and outgoings and assessable income

The central issue in s 8-1 usually involves whether there is sufficient connection between the loss or outgoing and the production of assessable income. The courts have attempted to paraphrase the words of the positive limbs to determine the degree of connection required, although you must be careful in applying such tests without due regard to the words of s 8-1.

Tests adopted by the courts are:

- ***Incidental and relevant test***

The loss or outgoing must be ‘incidental and relevant’ to income-producing activities, as seen in *Ronpibon Tin* where the court held that an expense will only be deductible if it is incidental and relevant to gaining or producing assessable income. While this phrase incidental and relevant is often repeated in case law it raises the question what is ‘incidental and relevant’? Thus, this test appears to be of little assistance to determining whether there is sufficient connection.

- ***Essential character test***

The ‘essential character’ of the loss or outgoing must be of a work or business nature, as demonstrated in *Lunney v FCT*.

See *Lunney v FCT*; *Hayley v FCT* (1958) 100 CLR 478

Once again, the words ‘essential character’ are often cited in case law which then raises the question, what is ‘essential character’? Thus, this ‘How long is a piece of string?’ type test is arguably of little assistance to determining whether there is sufficient connection.

- ***The perceived connection test***

FCT v Hatchett 71 ATC 4184 asserted that there must be a perceived connection between the outgoing and the assessable income. However, a taxpayer and the Commissioner may well perceive this connection somewhat differently. What precisely is a ‘perceived connection’?

- ***Legal rights view***

Traditionally, Australian courts have enforced a taxpayer’s legal rights,¹ that is, a taxpayer is entitled to a deduction if the expense is incurred (form), rather than focus on the substance of the transaction (that is, expenses are commercially realistic or reasonable).

See: *Cecil Bros Pty Ltd v FCT* (1964) 111 CLR 430

FCT v South Australian Battery Makers Pty Ltd (1978) 140 CLR 645

FCT v Phillips (1978) 8 ATR 783; 78 ATC 4361

- ***The purpose test***

Whilst ‘purpose’ only appears in the second positive limb, the courts’ interpretation has implied a role for purpose in both positive limbs. This test looks at the substance (rather than the form) of the transaction to see if there is sufficient connection between the expense and the income, *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 and *Magna Alloys* are leading cases.

Online Activity 6: Read *Magna Alloys & Research Pty Ltd v FCT* (1980) 11 ATR 276; 80 ATC 4542

In accordance with *Ure* (where a taxpayer's indirect objects or motives were relevant to characterise the nature of the expense), in *Fletcher and Spassked*, the courts have taken a harder line on tax avoidance and adopted a purposive approach to s 8-1. See *Fletcher v FCT* (1991) 173 CLR 1

It is commonly possible to characterise an outgoing as being wholly of the kind referred to in the first limb of s 51(1) without any need to refer to the taxpayer's subjective thought processes. That is ordinarily so in a case where the outgoing gives rise to the receipt of a larger amount of assessable income. In such a case, the characterisation of the particular outgoing as wholly of a kind referred to in s 51(1) will ordinarily not be affected by considerations of the taxpayers' subjective motivation. If, for example, a particular item of assessable income can be earned by making a lesser outgoing in one of two possible ways, one of which is a loss or outgoing of the kind described in s 51(1) and the other of which is not, it will ordinarily be irrelevant that the taxpayer's choice of the method which was tax deductible was motivated by taxation considerations or that the non-deductible outgoing would have been less than the deductible one. In such a case, the objective relationship between the outgoing actually made and the greater amount of assessable income actually earned suffices, without more, to characterise the whole outgoing as one which was incurred in gaining or producing assessable income. If the outgoing can properly be wholly so characterised, it is not for the court or the Commissioner to say, how much a taxpayer ought to spend in obtaining his income, but only how much he has spent: see eg, *Ronpibon Tin*, supra, at (CLR) 60; *Cecil Bros Pty Ltd v FCT* (1964) 111 CLR 430 at 434; 8 AITR 523; 9 AITR 246.

The position may, however, well be different in a case where no relevant assessable income can be identified or where the relevant assessable income is less than the amount of the outgoing. Even in a case where some assessable income is derived as a result of the outgoing, the disproportion between the detriment of the outgoing and the benefit of the income may give rise to a need to resolve the problem of characterisation of the outgoing for the purposes of the subsection by a weighing of the various aspects of the whole set of circumstances, including direct and indirect objects and advantages which the taxpayer sought in making the outgoing: see eg, *Robert G Nall Ltd v FCT* (1937) 57 CLR 695 at 699-700, 706, 708-9, 712-13; 1 AITR 169. Where that is so, it is a 'commonsense' or 'practical' weighing of all the factors which must provide the ultimate answer: see eg, *BP Australia Ltd v FCT* [1966] AC 224 at 264; 112 CLR 386; 9 AITR 615; *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 at 648; 3 AITR 436; *FCT v Foxwood (Tolga) Pty Ltd* (1981) 147 CLR 278 at 285, 293; 11 ATR 859; 35 ALR 1. If, upon consideration of all those factors, it appears that, notwithstanding the disproportion between outgoing and income, the whole outgoing is properly to be characterised as genuinely and not colourably incurred in gaining or producing assessable income, the entire outgoing will fall within the first limb of s 51(1) unless it is either somehow excluded by the exception of 'outgoings of capital, or of a capital, private or domestic nature' or incurred in relation to the gaining or production of exempt income. If, however, that consideration reveals that the disproportion between outgoing and relevant assessable income is essentially to be explained by reference to the independent pursuit of some other objective and that part only of the outgoing can be characterised by reference to the actual or expected production of assessable income, apportionment of the outgoing

between the pursuit of assessable income and the pursuit of that other objective will be necessary.

See *Spassked Pty Ltd v FCT* [2003] FCAFC 282; (2003) 52 ATR 337; 2003 ATC 4184

Spassked and *Fletcher* provide authority that if expenses are less than income then there is no need to consider a taxpayer's purpose; otherwise purpose will need to be considered. Also, *Charles Moore & Co (WA) Pty Ltd v FCT* (1956) 95 CLR 344 provides authority that a taxpayer's purpose is irrelevant if expenses are involuntary (this case involved the deductibility of losses incurred from the theft of takings — finding that the stolen takings were deductible).

Overall, though, the purpose test is very important (for voluntary expenses) given that it is widely applied and since it complies with sound tax policy principles for deductible expenses.

G. Necessarily incurred

The initial question is, does the word 'necessarily' restrict the operation of the second limb? There must be sufficient connection between the loss or outgoing and the production of assessable income, but the word 'necessarily' does not really limit the operation of the second limb as found in *Ronpibon Tin NL v FCT* (1949) 8 ATD 431 at 435. The word 'necessarily' no doubt limits the operation of the alternative, but probably it is intended to mean no more than clearly appropriate or adapted for. The word necessarily has not narrowed the operation of the second limb, it only looks to commercial necessity.

See: *Magna Alloys & Research Pty Ltd v FCT* (1980) 11 ATR 276; 80 ATC 4542
FCT v Snowden & Willson Pty Ltd (1958) 99 CLR 431; 11 ATD 463
WD & H O Wills (Australia) Pty Ltd v FCT (1996) 65 FCR 298; 96 ATC 4223

H. 'carrying on a business'

The second limb mandates that a taxpayer must be carrying on a business. The question of whether a business is being carried on is discussed in topic.

No symmetry between deriving income and incurring a deduction

An important aspect of s 8-1 is that it provides no symmetry between deriving income and incurring a deduction. In other words, a receipt could be income in the hands of a payee regardless of whether it is a capital expense of the payer. See *FCT v Rowe* (1997) 35 ATR 432 at 446; *GP International Pipecoaters Pty Ltd v FCT* (1990) 21 ATR 1 at 6.

3.2 Words and phrases analysis step 2: the negative limbs of s 8-1

Subsection 8-1(2) excludes expenses to the extent:

1. loss or outgoing of capital or of a capital nature; or
2. loss or outgoing of a private or domestic nature; or
3. incurred in relation to gaining or producing your exempt income; or
4. a provision of this Act prevents you deducting it.

1. Capital or capital nature

Expenses of capital or of a capital nature are not deductible, as opposed to expenses of a revenue nature. The courts, though, have had substantial difficulties in determining what constitutes capital (similar to the s 6-5 ordinary income-capital distinction) but have formulated the following guidelines.

In *Sun Newspapers*, the leading Australian test the Business entity test was formulated.

Sun Newspapers Ltd v FCT (1938) 61 CLR 337

Facts: The taxpayer paid a lump sum in instalments over a three-year period to a competitor, in consideration for the competitor not being associated with the production of a daily paper within 300 miles of Sydney.

High Court held: The lump sum was not deductible, capital in nature. Dixon J provided three tests (at 363):

- a the character of the advantage sought, and in this its lasting qualities may play a part
- b the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and
- c the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.

Online Activity 7: Read *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337

Other cases involving the capital-revenue distinction are listed below.

The High Court has confirmed the approach adopted in the *Sun Newspapers* numerous times, including in: *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634; *FCT v South Australian Battery Makers Pty Ltd* 78 ATC 4412; *FCT v Snowden & Willson Pty Ltd* (1958) 99 CLR 431; *John Fairfax & Sons Pty Ltd v FCT* (1959) 101 CLR 30; *Broken Hill Theatres Pty Ltd v FCT* (1952) 85 CLR 423; *Charles Moore & Co (WA) Pty Ltd v FCT* (1956) 95 CLR 344.

2. Private or domestic nature

It would seem to be a rare situation where an expense of a private or domestic nature would satisfy the requirements of the positive limbs. Nevertheless, the courts have held that private living expenses are not deductible under s 8-1(2)(b). Other private expenses include:

- ◆ child-minding expenses
- ◆ home to work travel
- ◆ home office
- ◆ interest on private use loans
- ◆ clothing
- ◆ cosmetics and personal grooming

3. Incurred in gaining exempt income

It would seem difficult to find an expense that would satisfy the positive limbs if it is incurred in gaining exempt income, so s 8-1(2)(c) has little application.

4. Deduction limitations

Paragraph 8-1(2)(d) denies a deduction where a provision in the ITAA prevents a deduction. These limiting provisions are considered in topic 7.

Recently the High Court in *FC of T v Anstis* 2010 ATC 20-221 (French CJ, Gummow, Kiefel and Bell JJ) commented on the meaning of general deduction provision s 8-1 ITAA 1997 as follows:

25. The essential provision concerning deductions is s 8-1 of the 1997 Act, which provides in relevant part as follows:

"(1) You can deduct from your assessable income any loss or outgoing to the extent that:

(a) it is incurred in gaining or producing your assessable income;

...

(2) However, you cannot deduct a loss or outgoing under this section to the extent that:

...

(b) it is a loss or outgoing of a private or domestic nature".

26. The deduction for depreciation of the computer properly fell to be determined not under s 8-1 but under s 40-25 of the 1997 Act. The Commissioner did not argue before the Tribunal or the primary judge that it was the different test in s 40-25 that applied. The Full Court refused to entertain the Commissioner's argument regarding s 40-25[32] and the matter was not raised in this Court.

27. As for the remainder of the expenses, the test to be applied to deductions under s 8-1(1)(a) is not materially different from its predecessors, and regard may be had to the decided cases concerning the latter[33]. The preposition "in" found in the phrase "in gaining or producing" has long been understood as meaning "in the course of" gaining or producing[34]. In *Ronpibon Tin NL v Federal Commissioner of Taxation*[35], when dealing with s 51(1) of the 1936 Act, this Court held that for a loss or outgoing to be deductible it is:

"both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income".

28. The circumstances giving rise to the present appeal are, as Ryan J noted[36], quite different from the authorities[37] dealing with "self-education expenses". In those cases the taxpayer carried on a business, or was already in employment, to which the studies related. The prospect of the future employment of the respondent as a teacher was not the basis on which her education expenses have been held to be deductible. Rather, the question is whether the occasion of her expenses was productive of her

"passive income"[38], in the form of youth allowance, and assessable on the basis of the reasoning in Dixon and Keily.

29. It may be said that the income was assessable not by reason of any personal exertion or exploitation of property on the part of the respondent. However, contrary to the submission by the Commissioner, that does not inexorably lead to a conclusion that there may be no deductions of any kind allowed under s 8-1 of the 1997 Act. The notion of "gaining or producing" income within the meaning of s 8-1(1)(a) is wider than those activities which may be said to earn income. According to its ordinary meaning, to "gain" means not only to "earn or obtain (a living)" but to "obtain, secure or acquire" or to "receive"[39]. Similarly, the ordinary meaning of the verb "produce" is to "bring (a thing) into existence"[40] and is not limited to bringing something into existence by mental or physical labour.

30. Essential to the inquiry of deductibility is the identification of that which is productive of the assessable income[41]. To put it another way, one must ask how the assessable income was (or was expected to be) gained or produced. Contrary to what the Full Court said, the respondent was not "paid to undertake [study]"[42] and that was not required to be so for the deductions to be allowable. Rather, as Ryan J said[43], the assessable youth allowance income received by the respondent was gained or produced by her entitlement to that payment consequent on the determination by the Secretary that she qualified for the payment. That statutory right to payment[44] would be retained by her, without reduction, non-payment, suspension or cancellation, so long as she maintained her qualification for the payment by satisfying the activity test by undertaking full-time study so defined.

31. The reason or motive of the respondent for incurring those education expenses, which could be characterised, for example, as obtaining a qualification to undertake future employment as a teacher, is not determinative of the question whether they were incurred in gaining or producing income[45]. The occasion of the outgoings was to be found in what the respondent did to gain or produce, by establishing and retaining her entitlement to, the receipts provided by the terms of the social security legislation.

Were the deductions of a private nature?

32. Against the prospect that the outgoings were deductible under s 8-1(1)(a), the Commissioner relied on an alternative ground of appeal that the outgoings were nonetheless of a "private" nature and so were not deductible by reason of s 8-1(2)(b). This ground was not raised in the Federal Court but, in the absence of any further evidence the taxpayer might have led affecting this question of law, the grant of special leave in this Court encompassed that ground.

33. In *John v Federal Commissioner of Taxation*[46], Mason CJ, Wilson, Dawson, Toohey and Gaudron JJ accepted that on then existing authority a loss or outgoing could be incurred in gaining or producing assessable income and yet not be deductible by reason of its domestic nature. Their Honours went on to consider losses or outgoings of a private nature and said[47]:

"In *Federal Commissioner of Taxation v Hatchett*[48] Menzies J commented that '[i]t must be a rare case where an outgoing incurred in gaining assessable income is also an outgoing of a private nature'. His Honour's statement was accepted by Wilson J, with whom Mason J agreed, in [*Federal Commissioner of Taxation v Forsyth*][49]. This view bears a close similarity to the view expressed in *Ronpibon Tin*[50] in relation to a loss or outgoing incurred in gaining or producing exempt income. However, in the case of a loss or outgoing incurred in gaining or producing exempt income, it is that characteristic which takes it outside the description of a loss or outgoing incurred in gaining or producing assessable income, whilst the view expressed in *Hatchett*[51] is that the fact that an outgoing falls within the description of a loss or outgoing incurred in gaining or producing assessable income serves (other than in a rare case) to stamp the loss or outgoing as one not bearing the character of a loss or outgoing of a private nature.

We do not see any necessary antipathy between a loss or outgoing incurred in gaining or producing assessable income and a loss or outgoing of a private nature."

Their Honours then applied the test of "essential character" as adopted in *Handley v Federal Commissioner of Taxation*[52] and *Forsyth*.

34. The question presented for resolution on this appeal is unusual because the outgoings incurred in study undertaken by the respondent were not deductible by reason of that study bearing some relation to an existing business or existing employment on her part. Those outgoings were deductible by reason of their being incurred in the course of her retention of a statutory right to payment. The authorities of *Federal Commissioner of Taxation v Hatchett*[53] and *Commissioner of Taxation v Finn*[54] are thus of limited assistance in the instant case; those taxpayers were in employment, and the outcome for each decision in this Court turned on the question of whether the outgoings were incurred in gaining or producing income.

35. The terms "private" and "domestic" in s 8-1(2)(b) would seem difficult in their application to an entity other than a natural person. It is also difficult to apply them where, unlike the situation in *Commissioner of Taxation v Cooper*[55], there is no available dichotomy between an essentially "private" expense and an essentially "working or business" expense.

36. In *Cooper*, Lockhart J and Hill J held that expenditure by a footballer, in accordance with an instruction by his coach, on amounts of food and drink he consumed in addition to his normal meals were not incurred in gaining or producing income, and were in any event of a private nature[56]. Hill J explained that[57]:

"the essential character of expenditure on food and drink will ordinarily be private rather than having the character of a working or business expense. However, the occasion of the outgoing may operate to give to expenditure on food and drink the essential character of a working expense in cases such as those illustrated of work-related entertainment or expenditure incurred while away from home."

37. Hill J, in considering the positive limb of s 51(1) of the 1936 Act, referred in *Cooper* to the English Court of Appeal decision in *Norman v Golder (Inspector of Taxes)*[58]. There, Lord Greene MR said that medical expenses, food and clothes were "laid out in part for the advantage and benefit of the taxpayer as a living human being" and so were not "wholly and exclusively laid out or expended for the purposes of the trade, profession, employment, or vocation" under the then applicable rule concerning deductions. The Master of the Rolls held further that medical expenses could not be deducted as they were expenses for a domestic or private purpose in contrast to being for the purpose of a trade or profession. However, that may be difficult to reconcile with his Lordship's earlier statement that medical expenses were laid out in part for the benefit of a taxpayer as a human being, which implies mixed purposes of expenditure. There is no such dichotomy of purposes under the 1997 Act, as is particularly apparent in this case, and *Norman v Golder* must be read accordingly.

38. The Commissioner contended that the respondent's expenditure was private in nature as it was an attempt by her to better herself as an individual; it was an investment in "human capital". However, in *Finn*, Windeyer J observed[59]:

"Outgoings incurred for the genuine purpose of acquiring or maintaining knowledge and skill in a vocation do not become an outgoing 'of a private nature' simply because the taxpayer got pleasure and satisfaction in increasing his knowledge and attainments."

Footnotes¹

¹ [32] (2009) 180 FCR 288 at 294-295 [24]-[25].

[33] *Spriggs v Federal Commissioner of Taxation* (2009) 239 CLR 1 at 17 [53].

[34] *Amalgamated Zinc (De Bavay's) Ltd v Federal Commissioner of Taxation* (1935) 54 CLR 295 at 303, 309; [1935] HCA 81; *Spriggs v Federal Commissioner of Taxation* (2009) 239 CLR 1 at 18 [55].

[35] (1949) 78 CLR 47 at 57; [1949] HCA 15.

[36](2009) 72 ATR 940 at 953 [59], 955 [63].

[37]*Federal Commissioner of Taxation v Finn* (1961) 106 CLR 60; [1961] HCA 61; *Federal Commissioner of Taxation v Hatchett* (1971) 125 CLR 494; [1971] HCA 47; *Federal Commissioner of Taxation v Smith* (1978) 19 ALR 493; *Federal Commissioner of Taxation v Lacelles-Smith* (1978) 8 ATR 524.

[38]See Parsons, *Income Taxation in Australia* (1985) at 469 [8.56].

[39]New Shorter Oxford English Dictionary, 4th ed (1993).

[40]New Shorter Oxford English Dictionary, 4th ed (1993).

[41]See *Federal Commissioner of Taxation v Day* (2008) 236 CLR 163 at 179 [31]; [2008] HCA 53.

[42](2009) 180 FCR 288 at 297 [40].

[43](2009) 72 ATR 940 at 952 [54]-[55].

[44]See *Pape v Federal Commissioner of Taxation* (2009) 238 CLR 1 at 31 [38], 65-66 [140], 155 [452]; [2009] HCA 23.

[45] *Federal Commissioner of Taxation v Day* (2008) 236 CLR 163 at 183-184 [39]; cf *Fletcher v Federal Commissioner of Taxation* (1991) 173 CLR 1 at 17; [1991] HCA 42.

Online Activity 8: Toby runs a hardware store

A. On 23 June he pays \$100 cash for stationery

B. In May he orders paint for the store which is delivered on 30 June with an invoice for \$2,876 to be paid within 14 days. Are these expenses incurred in the current tax year² per s 8-1?

Online Activity 9: A television presenter, Silvio, has to be presented impeccably and incurs great expense in relation to suits, hair colouring and cuts and make-up products.

Are these costs an allowable deduction under section 8-1 ITAA 1997?

Online Activity 10: Jade, a government employee was granted a transfer from Adelaide to Perth and made several trips to find and purchase a new home in Perth.

Can Jade claim these travel expenses under s8-1 ITAA 1997?

Online Activity 11: A self employed doctor is on call for twelve hour shifts at least ten times a month for accident and emergency duties and on call for 2 days per week for other duties.

Her partner looks after the children. When the taxpayer's partner is away she employs a carer. Is she entitled to a deduction for the carer under s8-1 ITAA 1997?

Online Activity 12: Ricardo operates an accounting business as a sole trader and sponsors yacht racing as it will benefit his business through the advertising. He pays \$15,000 for the costs of repairs, spare parts and safety clothing. The yacht and the clothing and caps worn by the sailors will carry his business name. Can Ricardo claim expenses sponsoring yacht under s8-1?

Online Activity 13: Duck Hollow winery acquires a water entitlement For \$1000,000 to use a specified amount of river water each year for an indefinite period. Is the \$100,000 an allowable deduction under section 8-1?

Online Activity 14: Australian Tax Chapter 4, Practice Problem 5; Chapter 9, Practice Problems 1-14

[46] (1989) 166 CLR 417 at 427; [1989] HCA 5.

[47] (1989) 166 CLR 417 at 431.

[48] (1971) 125 CLR 494 at 498.

[49] (1981) 148 CLR 203 at 216; [1981] HCA 15.

[50] (1949) 78 CLR 47.

[51](1971) 125 CLR 494.

[52](1981) 148 CLR 182; [1981] HCA 16.

[53](1971) 125 CLR 494.

[54](1961) 106 CLR 60.

[55](1991) 29 FCR 177.

[56](1991) 29 FCR 177 at 185, 201-202.

[57](1991) 29 FCR 177 at 201.

[58][1945] 1 All ER 352 at 354.

[59](1961) 106 CLR 60 at 70.

² Year ended 30 June 2013