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# Question 1:

Tax implications are one of the most complex regimes to understand in the modern world and since its inception, implications has been changing almost every financial year. The way an expense is treated with regard to tax differs when it comes to the nature of that particular expense. Capital expense and revenue expense being the two broad and major categories of expenses, the present situation involves a question of tax deductibility depending on the nature of expense.

## Brief Facts:

In the present factual situation, a person named John has applied and got approved the permission and license to run a casino in Melbourne. In the process John has been approved the casino building for a period of 90 years where he paid $180 million for acquiring the valid license to run the casino from appropriate authority and has paid $80 million as prepaid rent for the first 10 years. He also negotiated to pay $400,000 rent per year for the remaining 80 years of the leased building. Now the most important issue that arise here is with regard to the prepaid rent that he has paid for the period of first 10 years. Therefore all the taxation and deduction implication has to be determined with regard to the prepaid rent of first 10 years.

## Issues:

The main question of law which has to be answered here in whether that amount of prepaid rent for the first 10 years will be treated as a capital expense or a revenue expense because the nature of expense will help John to determine whether he can claim deduction in tax for those 10 years. The Income Tax Assessment Act 1997 and 1936 are the main legislations governing taxation in the territory of Australia, therefore careful determination of the questions of law will be done with regard to the taxation legislations in force in Australia. The first basic issue that arises in this situation is to determine whether, the prepaid rent as an expense is of capital or revenue expense. In addition to this, there is another underlying issue, as to whether such expense is deductible under the Income Tax Assessment Act 1997 and 1936 because of the fact of deductibility will depend on the nature of expense as said earlier.

## Law:

For determination of the above-mentioned issues, lets discuss what capital expense and revenue expense means in general. Capital expenses are those expenditures that are incurred by organisations for acquisition or maintenance of fixed tangible assets like plant, building, machinery or even intangible assets like patent or licenses. It is an expense which is also incurred for increasing the scope of existing long term operations. This means that those fixed assets will have lifespan of more than one accounting year. Thus it can deduced that, decisions regarding capital expenses are of critical nature which has significant impact on the financial heath of a company. On the other hand, revenue expense means the expenses that are incurred by an organisation during the normal operation of a business whose benefit will be received with one financial or accounting year. Revenue expenses also generate short term revenue and some basic examples of revenue expenses are rent expenses, salary expenses, utility expenses, insurance expenses and even certain manufacturing expenses (Hall & Hamon, 1996,p.34).

In case, an expense is considered of capital nature whose utility does not diminish within one accounting year does not usually qualify for deduction under Income Tax Assessment Act 1997 and 1936. Regardless of the nature of expense, the Income Tax Assessment Act, allows for some general deduction under section 8-1 of the Act. Section 8-1 allows write-off for any expense that has happened while earning an taxable income for the financial year. That income is also considered necessary for running the operation of business. However, the same section of the legislation does not allow deduction in case the expense is considered a loss of capital or it is an expense incurred for private or domestic purpose.Apart from general write-off contained in section 8-1 of Income Tax Assessment Act 1997, there are provisions that deals with specific deductions under section 8-5(1) which allows tax deduction from the taxable income for the amount which is allowed by specific division of the legislation.

Again under section 25-10 of Income Tax Assessment Act 1997, deduction is allowed for expenses which is not considered of capital expense and is used to gain benefits within one accounting year. Landmark case that has approved of this law can be seen in the case of [[1]](#endnote-0)[[2]](#footnote-0)*W. Thomas & Co. Pyt Ltd v. Federal Commissioner of Taxation*, where the decision was given under TR 97/23 as to expenses of repairs or short term cost is considered of revenue nature and can be claimed allowance in the same. Therefore it can be deduced that, expenses that are considered of revenue nature can be claimed deduction on. In addition to this, the Income Tax Assessment act 1997 under section 25-20 allows for deduction for costs undergone in preparation, registration or stamping a leased property which will be used to generate income in future. Deduction is also allowed when a taxpayer incurs loss in profit making operation (Edrey & Dotan, 2019).

Therefore, the Income Tax Assessment Act 1997, assesses income under section 6 of the act and then follows the same with general and specific deduction under section 8 of the act. Now it has to be noted that, section 8 allowing deduction has two positive limbs as reported by the Australian Taxation Office which helps a person paying tax to subtract a loss or expense from their taxable income where, such expense or loss is imposed while earning the taxable income of the taxpayer and when it is essentially incurred during the operation of such income producing purpose. The first positive limb is applicable to most taxpayer those who generate assessable income. This was affirmed in the case of [[3]](#footnote-1)*Federal Commissioner of Taxation v. Green*, where positive limb of deduction was allowed regardless of the fact that loss or gain was incurred or not. The secondary positive limb is applicable to situation where the person paying tax runs a venture for the purpose of earning an income which is taxable. This regulation was affirmed in the case of [[4]](#footnote-2)*Federal Commissioner of Taxation v. Snowden & Willson Pty Ltd*.

Now it has to be inferred that, both the affirmative limbs under general deduction legislations are not always separate and sometimes overlaps depending on the factual situation. An example where only the second positive limb of deduction applies can be seen in the case of [[5]](#footnote-3)*Charles Moore & Co Pty Ltd v. Federal Commissioner of Taxation*, famously known as the Charles Moore’s case. In this case, a departmental store was allowed tax write-off on the theft of past day’s earning. The court held that, each days earning was an essential part of the business operation of the person who is supposed to pay tax and therefore the loss was deductible. For this reason section 25-45 of Income Tax Assessment Act 1997 allows for deduction for certain types of losses by theft making it a specific deduction rather than a general deduction under section 8 of the Act (Zimmerman 2001,p.388-397).

As Kieran (2016, p.345-362) reported that, in general terms, outgoing means all types of expenses that are incurred by a person who is supposed to pay tax whereas, loss as a general term means a situation where no involuntary payments were made. However, it has to be further noted that, the application of the first limb or second limb will depend on the factual situations of cases[[6]](#footnote-4). In relation to this, it also has to be noted that, both the positive limbs of deduction is allowed to the extent of the purpose of the taxpayer. This means, that the degree of deduction will depend on how many features of positive or negative limbs are satisfied by the taxpayer. At the point when the proper strategy for allotment is presented, the variety is frequently closed amongst the activity of allotting an active which is brought about in obtaining a single service which is used to suffice numerous goals such as fees paid to directors where the business venture earns taxable income, and the procedure of allocating an active that is caused procuring services that can be partitioned into varied parts that are at last used for various goals like exchanging stock which is gained in mass, yet which is eventually used for various purposes[[7]](#footnote-5).

A deduction is possibly permitted under the purview of first positive limb if there is reasonable enough connection between the costs and the activities that the person paying tax undertakes to earn its taxable income. While the association that is needed to fulfil the obligation has been acknowledged to be very wide, some relation are simply too remote to even consider satisfying it. In such manner, its good to take note of, just for the fact a cost has been imposed all together with the intention of earning does not naturally imply that it was incurred in the creation of non exempt income. It is not essential that the spending has a connection with earning while in the time of spending in that it produces taxable financial gain in the identical time period in which the spending is incurred. Both the above-mentioned positive limbs requires the cost or outgoing being imposed on the person paying tax at some particular time of the financial year in order to be considered that expense or loss as deductible[[8]](#footnote-6) (Markham & Martin 2014, p.45).

Another Landmark case that can be related in this context is the [[9]](#footnote-7)Sharpcan’s Case, where the decision was taken with regard to categorising expenses as capital and revenue. In this case, section 40-880 of Income Tax Assessment Act was brought into action to relate the scope of ‘black-hole expenditure’ when certain expenses are considered to preserve the value of goodwill. The case decided that certain ordinary and non-ordinary expenses of a business is considered as revenue expense because of which deduction can be claimed. Though this case related to expenses regarding license but is a prime example of revenue expenses being eligible for deduction. In addition to this another landmark case in this relation can be seen as the [[10]](#footnote-8)Federal Commissioner of Taxation v. Star City Pty Ltd, where prepaid rent was allowed for deduction considering the same as of revenue nature as prepaid rent is paid with the objective of deriving or producing income every year and not for acquiring any asset (Young & Markham 2020).

## Application:

With the application of all the above-mentioned discussion to the present factual situation it can be said that, John has prepaid an amount of $80 million for the purpose of rent for 10 years and has also agreed to pay a rent of $400,000 for the remaining 80 years of lease for the casino building. The prepaid rent here can be considered revenue expense because of the fact that, John will be earning or producing income for the next 10 years with the operation of the casino which has been affirmed by the case of *Star City Pty Ltd v. FCT*, where court allowed prepaid rent for deduction. Even though general deductions under section 8 is applicable, the purview of specific deductions are also applicable as this situation involves specific positive limb. Prepaid rent for the next 10 years will be earning income for the casino owned by John and the expense of paying prepaid rent incurred by John has been done for the purpose of generating income. Thus, the prepaid rent paid by John is a revenue expense and he can claim deduction in the same for each year.

## Conclusion:

From all the above made discussion, it can be concluded by saying that the prepaid rent is a revenue expense in the given factual situation. In come sense, even though the prepaid rent might look of capital nature as it was used to run the business and acquire the casino building for 10 years but that very fact that for the next 10 years John will be earning and producing assessable income from the rented casino makes it eligible to be called a revenue expense on which deduction can be claimed every year.

# Question 2:

There are several kinds of expenses for which tax deductions can be claimed in the Australia taxation regime. Thus, deduction can also be claimed for certain travel expenses that are made by taxpayers. Though it has some limitations and criteria but travel expense that are directly related to business or employment are completely deductible.

## Brief facts:

In the given factual situation, Alex Kingsford who is a mechanical engineer and an employee of ABC engineering in Melbourne resides at a property which is in Dandenong, Victoria. Alex also runs a home-based catering business which he operates from home. When he travels from his employment workshop to his home-based business he uses either car or uber service. While filing tax returns he claimed a substantial amount of travelling expense between his employment place and home-based business place as deduction.

## Issue:

The primary issue and question of law that has to be answered here is whether the travel expense of Alex between the ABC engineering workshop and his home-based food catering business qualifies for deduction from tax.

## Law:

Section 51(1) of the Income Tax Assessment Act 1936 deals with deductions of travel expense. It strictly says that, in order to claim deduction for travel expense the cost has to be directly related to the job or employment. The Australian Taxation Office has published several tax rulings in this regard. As reported by the Australian Taxation Office, travel expense being covered or being claimed as deduction has some implications of fringe benefit tax which is another regime different from general deductions. Therefore, close consideration of TR 2017/D6 on the tax deductibility of travel expenses needs to be done in order to answer the question of law that has arisen from the given factual situation. The tax ruling notified that, travel expense from home to work is broadly not deductible apart from some specific situations. When travel is made between two different work locations of the same employment and there is sufficient connection to employment income and the expense in incurred in producing taxable income affirmed in the case of [[11]](#footnote-9)*John Holland Group Pty Ltd v Commissioner of Taxation*.

The new draft ruling provides further explanation of this idea, including paragraph 61 which states it should be considered in the general setting of the factual situation of each case as bearing and control only is not enough to constitute the pertinent relation with employment. We note further that Example 9 indicates the employee in the example will be subject to his manager's course and control, where the entirety of their boss' workplace policies and procedures concern them while voyaging. Noticing these comments are given in the example instead of the body of the ruling which may restrict the dependence that can be put on this direction. That is, it might just be applied to similar situations to the example. The ruling does not give some other situations an employee would be considered to be under the course and control of the business. For example, a typical situation is the place a salaried employee consistently flies without anyone else from an air terminal close to home to their work location and they use computer for work while on the flight. Also, normally, in this case, the employee's employment agreement says they are subject to the business' workplace policies and procedures at whatever point working for the business. Would the employee be under the 'bearing and control of the business' in this case?

Situations like these are not addressed in the as of late released draft ruling, along these lines the utilization of this idea to regular situations is still questionable. Some grave example has been set out in the cases of [[12]](#footnote-10)*Lunney v Federal Commissioner of Taxation and Hayley v Federal Commissioner of Taxation.* The court clearly mentioned that travelling from home to work or business are not deductible and this has its foundation from the English common law set out by Authorities of UK. The judge suggested that expenses of this kind has no reasonable connection with the business expense and it has not attribute of considering as a part of producing assessable income. Finally the case of [[13]](#footnote-11)*Commissioner of Taxation v. Payne*, sets out the accepted major rule of travel expense (Stewart 2001, p.495).

## Application:

On application of the above principles on the given factual situation, it can be inferred that, Alex travelled from his employment workshop to home-based business. Now this home-based business was actually the place where he resides and legislations and precedents have been to strict to not include dwelling place for this purpose of travel expense being eligible for deduction. Therefore, as Alex Kingsford travelled to his home and was not in any way related to to his work or employment cannot be claim the same for deduction under Income Tax Assessment Act 1997 or 1936. From the facts itself it can be seen that even though business related expenses can claim deduction but Alex in this regard ran his business from his home itself and did not need to travel to some other location for the operation of his business or for any other related business purpose which makes him ineligible from claiming deduction for the travel expenses that he incurred while travelling from employment workshop to his home-based business. On top of that, as case laws goes, his travel expense was not related in producing assessable income, therefore no deduction can be claimed in this regard.

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## Conclusion:

From the above discussion it can be concluded that, due to the lack of any nexus between the expense incurred by Alex in travelling from workshop of employment and home-based business, he fails to claim any tax deduction in this regard. Taxation ruling published by the Australian Taxation Office does not support the cause of Alex in this situation. Various authorities has been strict in ruling for the reason that sufficient nexus between producing assessable income is an important factor that has to be considered here.

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3. FCT v Green (1950) 81 CLR 313 [↑](#footnote-ref-1)
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5. Charles Moore & Co (WA) Pty Ltd v FCT (1956) 11 ATD 147 [↑](#footnote-ref-3)
6. Maryborough Newspaper Co Ltd v FCT (1929) 43 CLR 450 [↑](#footnote-ref-4)
7. Ronpibon Tin NL v FCT (1949) 78 CLR 47 [↑](#footnote-ref-5)
8. New Zealand Flax Investments Ltd v FCT (1938) 61 CLR 179: [↑](#footnote-ref-6)
9. Commissioner of Taxation v Sharpcan Pty Ltd [2018] FCAFC 163 [↑](#footnote-ref-7)
10. [2009] FCAFC 19; 175 FCR 39; (2009) ATC ¶20–093; 72 ATR 431 [↑](#footnote-ref-8)
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