TR 2013/D1 - Fringe benefits tax: otherwise deductible rules and Division 35 of the Income Tax Assessment Act 1997

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Draft Taxation Ruling

Fringe benefits tax: otherwise deductible rules and Division 35 of the *Income Tax Assessment Act 1997*

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What this Ruling is about

1. This draft Ruling sets out the Commissioner's views on whether a 'once-only deduction' arises in calculating the taxable value of an 'external expense payment fringe benefit' under section 24 of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA)[1] where the expenditure associated with that fringe benefit would be subject to the loss deferral rule in subsection 35-10(2) of Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997). Division 35 of the ITAA 1997 is concerned with the deferral of losses from non-commercial business activities.

2. The views expressed in this draft Ruling also generally apply to other provisions of the FBTAA expressing the same ideas as section 24,[2] which is used in this draft Ruling to illustrate those ideas. Together, these provisions are referred to in this draft Ruling as the 'otherwise deductible rules'.

[1] All legislative references in this draft Ruling are to the FBTAA unless otherwise indicated.

[2] The other provisions in the FBTAA which provide an 'otherwise deductible rule' expressing the same ideas as section 24 are: section 19 (loan fringe benefits); section 34 (airline transport fringe benefits); section 37 (board fringe benefits); section 44 (property fringe benefits); section 52 (residual fringe benefits).

3. Specifically, this draft Ruling considers:

- whether the terms 'deduction' and 'allowable' in both the definition of 'once-only deduction' in subsection 136(1) and in section 24 refer to a deduction allowable under a specific provision or to a deduction taken into account in calculating taxable income under section 4-15 of the ITAA 1997; and
- whether expenditure – which, had it been incurred by the recipient of an external expense payment fringe benefit and not reimbursed,[3] would have been affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 – can ever give rise to a 'once-only deduction' (as defined in subsection 136(1)).

Class of entities/scheme

4. This draft Ruling applies to employers who provide an external expense payment fringe benefit, within section 20, to their employee, where the employee's expenditure[4] associated with that fringe benefit would be subject to the loss deferral rule in subsection 35-10(2) of the ITAA 1997 were it not for the excepted provisions[5] and section 51AH of the *Income Tax Assessment Act 1936* (ITAA 1936).

Ruling

Do the terms 'deduction' and 'allowable' in the definition of 'once-only deduction' in subsection 136(1) and section 24 refer to a deduction allowable under a specific provision, or a deduction taken into account under section 4-15 of the ITAA 1997?

5. For the taxable value of an external expense payment fringe benefit provided to an employee to be reduced under the otherwise deductible rule in section 24, certain requirements must be satisfied. One requirement is that a 'once-only deduction' would have 'been allowable' (or would, but for the excepted provisions have 'been allowable') to the employee in respect of their expenditure.

[3] The term 'reimbursed' is used in this draft Ruling to cover both the making of a payment in discharge of an employee's obligation within paragraph (a), and a reimbursement within paragraph (b), of section 20.

[4] The term 'employee's expenditure' is used in this draft Ruling to cover both relevant payments and obligations of the employee.

[5] The term 'excepted provisions' is used in this draft Ruling to refer to those provisions which are ignored in applying section 24, namely section 82A of the ITAA 1936 and Divisions 28 and 900 of the ITAA 1997.

6. For a 'once-only deduction' to arise under subsection 136(1) 'in relation to expenditure', two conditions must be satisfied:

- the **first condition**: requires there is a deduction in a year of income in respect of a percentage of that expenditure; and
- the **second condition**: requires that in respect of any percentage of that same expenditure, no other deduction is allowable in any other year of income.

7. In both this definition of a once only deduction and in section 24 (and other equivalent, otherwise deductible rules), the terms 'deduction' and 'allowable' refer to amounts which qualify as deductions under section 4-15 of the ITAA 1997 in the calculation of the employee's taxable income.

Whether expenditure hypothetically affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 can ever give rise to a 'once-only deduction' (as defined in subsection 136(1)), for the purposes of the relevant otherwise deductible rules?

8. For an employee's expenditure in respect of an external expense payment fringe benefit to give rise to a 'once-only deduction' both the first and second conditions in the definition of this term, as set out in paragraph 6, must be met. For these purposes, this expenditure has a hypothetical quality, as under section 24, an assumption required to be made is that the employer has not reimbursed the employee in relation to it.[6]

9. To determine whether the first condition is met in the case where the expenditure is hypothetically affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 requires consideration of the effect of that subsection.

Operation of loss deferral rule

10. Where the rule in subsection 35-10(2) of the ITAA 1997 applies for a particular income year to a business activity, and the amounts attributable to that business activity for that year which could otherwise be deducted exceed the assessable income from the business activity for that year, paragraph 35-10(2)(a) of the ITAA 1997 treats the amount of the excess as though it 'were not incurred in that income year'. The result is that only an amount equal to the amount of income from the business activity is able to be taken into account as a deduction under section 4-15 of the ITAA 1997.

[6] The employee's actual position is that they cannot deduct the expenditure which has been reimbursed, because of section 51AH of the ITAA 1936. The assumption in section 24 that there has been no reimbursement means that the application of Division 35 of the ITAA 1997 to the expenditure is a hypothetical one.

11. In other words, in the circumstances set out in paragraph 10, all of the amounts which could otherwise be deducted are affected by subsection 35-10(2) of the ITAA 1997.

12. There is no rule which applies to determine how much (if any) of each amount that would otherwise be deductible is left remaining as a deduction, once the loss deferral rule in subsection 35-10(2) of the ITAA 1997 has applied to it. Moreover, the loss deferral rule does not provide any basis for selectively choosing which, if any, of these amounts are to be left remaining as such a deduction.

13. Instead, the loss deferral rule blends all of the otherwise deductible amounts attributable to the business activity in a way where they lose their identity and connection with the expenditure on which their initial deductibility (for example, under section 8-1 of the ITAA 1997), was based.

Once-only deductions

14. Whatever the full breadth of the expression, 'in respect of', in the definition of 'once-only deduction' in subsection 136(1), the loss of identity and connection with an expenditure which is (or would be on the assumptions required by section 24 and excluding the excepted provisions) otherwise deductible were it not for the loss deferral rule in subsection 35-10(2) of the ITAA 1997, means that it cannot be concluded that any deduction ultimately taken into account under section 4-15 of the ITAA 1997, after subsection 35-10(2) has operated, has a sufficient nexus with the expenditure in question.

15. Moreover, the lack of a sufficient nexus is also demonstrated by the fact that there is no way to calculate how much of any specific deduction(s), before subsection 35-10(2) of the ITAA 1997 has operated, remain after the subsection has applied.

16. The expenditure therefore does not satisfy the first condition in the definition of 'once-only deduction', as it cannot be said that there is any deduction 'in respect of' a percentage of the relevant expenditure.

17. As set out in paragraph 6, the definition of 'once-only deduction' requires that both the first and second conditions be satisfied.

18. Expenditure (including an employee's expenditure in respect of an external expense payment fringe benefit) that is hypothetically affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 can therefore never satisfy the first condition, and hence, never give rise to a 'once-only deduction', for the purposes of section 24.

Date of effect

19. When the final Ruling is issued, it is currently proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

20. In view of the fact that some private rulings expressing contrary views to those in this draft Ruling have been made, submissions are sought on whether the final Ruling should apply only from a certain date, and, if so, what that date should be.

Commissioner of Taxation
27 March 2013

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Liability to fringe benefits tax, expense payment fringe benefits and the general operation of the otherwise deductible rule in section 24

21. An employer is liable to fringe benefits tax under section 66 on their 'fringe benefits taxable amount'. In the usual case, and in general terms, this amount is the sum of individual fringe benefits amounts calculated under Divisions 2 to 13 of Part III of the FBTAA. Central to this calculation is working out the taxable value of each fringe benefit provided in respect of an employee's employment by the employer. Division 5 provides for working out the taxable values of expense payment fringe benefits.

22. 'Expense payment benefits'[7] are benefits referred to in section 20. Section 20 relevantly provides that a benefit is provided to an employee by an employer where the employer either:

(a) makes a payment in discharge, in whole or in part, of an obligation of the employee to pay an amount to a third person in respect of expenditure incurred by the employee; or

(b) reimburses[8] the employee, in whole or in part, in respect of an amount of expenditure.

23. Where the expense payment benefit is provided in respect of the employment of the employee and qualifies as an 'external expense payment fringe benefit', section 23 provides that the taxable value is the amount of the relevant payment[9] or reimbursement.

24. However, the amount worked out under section 23 may be reduced under section 24 which is headed, 'Reduction of taxable value – *otherwise deductible* rule'.[10]

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[7] As defined in subsection 136(1).

[8] The meaning of 'reimburses' in section 20 was considered by the Federal Court in *The Roads and Traffic Authority of New South Wales v. FC of T* (1993) 43 FCR 223; 93 ATC 4508; (1993) 26 ATR 76 (*Roads and Traffic Authority*). Although not needing to decide the point, at FCR 228; ATC 4512; ATR 82, Hill J thought the payment amounting to the reimbursement would need to be referable to the actual expenditure said to have been reimbursed, 'that is to say there would need to be some correspondence between the payment and the expenditure incurred, even if the reimbursement were to be but part reimbursement'.

[9] Reduced, in a case to which paragraph 20(a) applies, by the amount of the recipients contribution.

[10] The operation of the 'otherwise deductible rule' is limited to benefits provided to employees. (That is, it does not apply to benefits provided to associates of employees.) Refer paragraph 24(1)(a) and also Taxation Determination TD 93/90.

25. The broad effect of section 24 with which this draft Ruling is concerned, depends on the hypothesis[11] that the relevant employee did not have their expenditure reimbursed. The actual position for the employee is that because their expenditure has been reimbursed, section 51AH of the ITAA 1936 applies to deny actual deductibility of the expenditure to them.

26. This hypothetical or notional unreimbursed expenditure is called 'gross expenditure' in section 24.

27. Section 24 then asks whether this gross expenditure is a 'once-only deduction', which;

> … would, or would if not for section 82A of the *Income Tax Assessment Act 1936*, and Divisions 28 and 900 of the *Income Tax Assessment Act 1997*, have been allowable to the [employee] under either of those Acts in respect of the gross expenditure …

28. Where there is no 'recipients portion' as defined in the FBTAA (which will broadly be the case where the full amount of the expenditure is reimbursed), the taxable value of the expense payment fringe benefit is reduced under subsection 24(1) by the amount of the 'once-only deduction', referred to also in the subsection as 'the gross deduction'.[12]

Meaning of 'once-only deduction' – two conditions

29. The term 'once-only deduction'[13] is defined in subsection 136(1) as:

> … in relation to expenditure, means a deduction in a year of income in respect of a percentage of the expenditure where no deduction is allowable in respect of a percentage of the expenditure in any other year of income

30. The definition has two conditions both of which must be satisfied:

- the **first condition**: requires there is a deduction in a year of income in respect of a percentage of the [employee's hypothetical or notional unreimbursed] expenditure, and
- the **second condition**: requires that in respect of any percentage of that same expenditure, no other deduction is allowable in any other year of income.

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[11] In *Roads and Traffic Authority*, Hill J, when dealing with another otherwise deductible rule in section 52, referred at FCR 241; ATC 4522-4523; ATR 93, to it requiring an 'assumption' that the recipient had incurred and paid 'unreimbursed expenditure'.

[12] Note that the taxable value under subsection 24(1) is reduced by an amount referred to as 'the notional deduction', but in cases where there is no 'recipients portion', this 'notional deduction' will also equal the 'gross deduction'.

[13] In Taxation Determination TD 93/46 examples given of deductions which are not a 'once-only deduction' are deductions spread over more than one year, such as depreciation on equipment with a life of more than one year or borrowing expenses for a loan lasting more than one year.

Deferral of non-commercial losses – Division 35 of the ITAA 1997[14]

31. In broad terms, Division 35 of the ITAA 1997 operates to prevent the losses of certain business activities of a taxpayer from being deducted against other assessable income of that taxpayer unless certain exceptions apply. For those business activities to which it applies, subsection 35-10(2) of the ITAA 1997 relevantly provides:

> If the amounts attributable to the *business activity for that income year that you could otherwise deduct under this Act for that year exceed your assessable income (if any) from the business activity, or your share of it, this Act applies to you as if the excess:
>
> (a) were not incurred in that income year, and
>
> (b) were an amount attributable to the activity that you can deduct from assessable income from the activity for the next income year in which the activity is carried on.

32. In this draft Ruling the deferral of the excess of attributable, otherwise deductible amounts over any assessable income from the business activity is referred to as the operation of the 'loss deferral rule'.

33. In cases to which this draft Ruling applies:

- the employee expenditure in respect of an external expense payment fringe benefit would, under the hypothesis required by section 24, be an amount attributable to a business activity carried on by the employee that the employee could otherwise deduct (or would have been able to were it not for the excepted provisions), for the purposes of subsection 35-10(2) of the ITAA 1997, and
- the status of the employee and their business activity is such that the conditions for the loss deferral rule in subsection 35-10(2) of the ITAA 1997 to apply (set out in subsection 35-10(1) of the ITAA 1997) are all met.

[14] Taxation Ruling TR 2001/14 *Income tax: Division 35 – non-commercial business losses* considers the operation of Division 35 of the ITAA 1997.

Do the terms 'deduction' and 'allowable' in the definition of 'once-only deduction' in subsection 136(1) and section 24 refer to a deduction allowable under a specific provision, or a deduction taken into account under section 4-15 of the ITAA 1997?

34. In cases to which this draft Ruling applies the employee's expenditure is hypothetically deductible under a specific provision, such as section 8-1 of the ITAA 1997. However, where subsection 35-10(2) of the ITAA 1997 would apply to this deduction, there may be no, or only some lesser amount, recognised as a different deduction, when calculating the employee's taxable income under section 4-15 of the ITAA 1997.[15]

35. One view is that in such a case it is the amount to which section 8-1 of the ITAA 1997 applies, which answers the description of the 'deduction' the definition of 'once-only deduction' refers to, which 'would have been allowable' for the purposes of paragraph 24(1)(b).

36. This view is not preferred.

37. Neither section 8-1 nor section 4-15 of the ITAA 1997 use the term 'allowable', in contrast to their respective counterparts in the ITAA 1936, subsection 51(1) and section 48. Nevertheless, sections 8-1 and 4-15 express the same ideas as were in subsection 51(1) and section 48, and it is still common to speak of the deductions to which both section 8-1 and section 4-15 refer as 'allowable deductions'.[16]

38. The meaning of a deduction being hypothetically 'allowable' in the context of section 24 can therefore extend to the amount of the deduction 'allowable', in the sense of being taken into account in the calculation of taxable income under section 4-15 of the ITAA 1997. The preferred meaning is one which recognizes this context and the purpose of section 24.

[15] Subsection 4-15(1) provides that taxable income is the difference between a taxpayer's 'Assessable income' and their 'Deductions'. The Method Statement in this subsection says: 'To find out what you can deduct, see Division 8.' Subsection 995-1(1) of the ITAA 1997 defines a 'deduction' as 'an amount that you can deduct.'

[16] See, for example, *Re Andrew Lamparelli and Commissioner of Taxation* [2005] AATA 414 at paragraph 15; *Frisch v. FC of T* [2008] AATA 462 at paragraph 13, Annexure A; 2008 ATC 10-031 at paragraph 13, Annexure A; (2008) 72 ATR 551 at 570.

39. This purpose, was considered by Ryan J in *National Australia Bank Ltd v. FC of T.*[17] At FCR 272; ATC 4930; ATR 522, his Honour considered the operation of a similar otherwise deductible rule in section 19 (for the taxation of loan fringe benefits) and stated in relation to the purpose of that rule:

> This approach to the application of s 19 is consonant with the legislative purpose which I discern in the relevant parts of the Act read as a whole which is to subject to tax the value of a benefit except to the extent that such value, had it been received and used by the recipient in the form of money, would have been allowable to him or her as a deduction for income tax purposes.

40. A narrower meaning of 'deduction' in the definition of 'once-only deduction' and of 'allowable' in section 24, would defeat this purpose, as it would enable the taxable value of a fringe benefit to be reduced merely because hypothetical expenditure was an allowable deduction under a specific provision, even though some other provision might operate on the expenditure to mean ultimately that some lesser, or no, amount was a 'deduction' for the purposes of section 4-15 of the ITAA 1997.

41. The preferred view therefore is that a deduction which would be 'allowable' for the purposes of an otherwise deductible rule, like section 24, is one which would be recognised under section 4-15 of the ITAA 1997.

Whether expenditure hypothetically affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 can ever give rise to a 'once-only deduction' (as defined in subsection 136(1)), for the purposes of the relevant otherwise deductible rules?

42. The question above concerns both the first and second conditions in the definition of 'once-only deduction'. An example of where the second condition applies to deny the existence of a 'once-only deduction' is where a deduction arises *in respect of* some part of the hypothetical, unreimbursed expenditure in one income year, but there is some further deduction arising *in respect of* the same expenditure, for some other income year.[18]

43. Whether the second condition is relevant however, for the purposes of this draft Ruling, depends on there being a deduction which satisfies the first condition. If no part of the expenditure in question produces a deduction which satisfies the first condition then there is no need to consider the second condition in order to decide that the expenditure will not give rise to any 'once-only deduction'.

44. As explained in paragraph 30, the first condition requires that there is a deduction in a year of income 'in respect of' a percentage of the employee's notional unreimbursed expenditure.

[17] (1993) 46 FCR 252; 93 ATC 4914; (1993) 26 ATR 503.
[18] Refer also paragraphs 29 and 30.

Meaning of 'in respect of'

45. The authorities concerning the meaning of the words 'in respect of', establish, for example, the following propositions:

- the words take their meaning from their context, and it is that context which determines the matters to which they extend: *Workers' Compensation Board (Qld) v. Technical Products Pty Ltd*[19] per Deane, Dawson and Toohey JJ at CLR 653-4 and ALR 267; *FC of T v. Scully*[20] per Gaudron ACJ, McHugh, Gummow and Callinan JJ at paragraph 39;
- the fact that the words ordinarily have a wide scope does not mean that they are satisfied by any connection at all between the two subject matters, regardless of the statutory context or the objectives of the particular legislation: *Nintendo Co Ltd v. Centronic Systems Pty Ltd;*[21]
- in the context of the definition of 'fringe benefit' in the FBTAA the words 'in respect of' require a link between the provision of the relevant benefit and the employment of the relevant employee, and that link must be sufficient or material – a 'mere causal link' between the two will not be sufficient: *J&G Knowles & Associates Pty Ltd v. FC of T;*[22] *FC of T v. Indooroopilly Children Services (Qld) Pty Ltd.*[23]

46. The authorities also demonstrate that there are some subject matters which are simply too far removed, when regard is had to the particular context and legislative purpose in question, to be regarded as being in respect of each other.

47. One example is found in *Construction Industry Long Service Leave Board v. Irving*[24] (*Irving*). There the Full Federal Court considered whether unpaid statutory levies qualified as debts due 'in respect of' long service leave, for the purposes of paragraph 556(1)(g) of the former *Corporations Law*.

[19] (1988) 165 CLR 642; 81 ALR 260.
[20] (2000) 201 CLR 148; [2000] HCA 6; 2000 ATC 4111; (2000) 43 ATR 718.
[21] (1994) 181 CLR 134 at 145-8.
[22] (2000) 96 FCR 402 at 410; 2000 ATC 4151 at 4158; (2000) 44 ATR 22 at 30.
[23] (2007) 158 FCR 325 at 343; 2007 ATC 236 at 4252; (2007) 65 ATR 369 at 386.
[24] (1997) 74 FCR 587.

48. The Court noted at paragraphs 595-6 that these levies were payable regardless of whether the workers in question were entitled to any long service leave payments, and regardless of whether, ultimately, any of these workers might qualify for such payments in the future. The Court also noted that payment of the levies did not relieve the worker's employer from having to make payments to the worker who became entitled to take long service leave. At paragraph 596 the Court said:

> The remoteness of the connection between the levy payable by a particular employer and the entitlement of a worker to receive a payment from the Board is further demonstrated by the nature of the Fund. In E&L Constructions at 157, **Zelling J described the LSL Fund established under the 1975 Act as a 'blended fund'. Similarly, the Fund created by the Long Service Act consists not only of levies paid by the employers, but other components, including interest on investments and fines and penalties**. [emphasis added]

49. The Court concluded at paragraph 597:

> … we do not think that any amounts of unpaid levy can be described as 'in respect of [long service leave]', within the meaning of s 556(1)(g)(iv). As we have explained, the levy is neither imposed on an employer by reason of, nor calculated by reference to, any obligation on that employer to make payments to construction workers entitled to long service leave. Neither the levy nor the Fund of which it forms part is directed exclusively to discharging the Board's obligation to make payments to construction workers entitled to long service leave.

50. The Court also construed the provision in question as requiring the debts falling within it to be, relevantly, 'in respect of long service leave and in respect of nothing else' (at paragraph 597). That requirement was not satisfied in *Irving*, even if it could be said, contrary to the Court's view, that the levies there were 'in respect of' long service leave. The Court considered that these levies were also 'in respect of the other unrelated purposes to which the Board is also empowered to apply the Fund' (at paragraph 597).

The effect of subsection 35-10(2) of the ITAA 1997 on the first condition for a 'once-only deduction'

51. The first condition for a 'once-only deduction' requires there to be 'in relation to' some specific expenditure, 'a deduction in a year of income in respect of a percentage of the expenditure'. Whether this condition is met for expenditure affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 requires an examination of how the subsection works.

52. Where subsection 35-10(2) of the ITAA 1997 applies, all of the otherwise allowable deductions attributable to a particular business activity are added together. The total of these deductions is then compared to the total of all of the amounts of assessable income from that activity in order to calculate any 'excess' of these deductions over that income. This excess is sometimes referred to as the 'non-commercial loss'. Paragraph 35-10(2)(a) then says the excess is to be treated, in applying the ITAA 1997, as if it 'were not incurred' in the income year in question.

53. The result is that the excess deductions are not taken into account in calculating the taxable income of the relevant taxpayer under section 4-15 of the ITAA 1997 for that year.

54. Moreover, there is no rule which applies to specify how much of any of the individual items of expenditure underpinning the affected deductions might relate to the 'non-excess', that is, relate to the total of the deductions which **are** able to be taken into account under section 4-15 for the relevant year.

55. The loss deferral rule in subsection 35-10(2) blends all of the otherwise deductible amounts attributable to the business activity together in a way where they lose their identity and connection with the expenditure on which their initial deductibility was based. The operation of the rule is analogous to that of former section 80 of the ITAA 1936 concerning the composition of a carried forward loss, considered by the High Court in *Ravenshoe Tin Dredging Ltd v. FC of T.*[25] Like former section 80, subsection 35-10(2) creates a special deduction arising from the operation of the ITAA 1997, which is not itself made up of 'actual expenditures' (refer Barwick CJ at CLR 91).

56. The absence of any specific provision or rule governing the composition of the non-excess, coupled with the loss of identify between the relevant expenditures and the amount of the deductions ultimately recognised under section 4-15 of the ITAA 1997 means there is no sufficient or material link between the two.

57. Therefore, the first condition for there to be a 'once-only deduction' will not be satisfied for expenditure affected by subsection 35-10(2) of the ITAA 1997. This expenditure will therefore not give rise to any 'once-only deduction'.

58. As set out in paragraph 30, the definition of 'once-only deduction' requires that both the first and second conditions be satisfied.

59. Therefore, expenditure hypothetically affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 can never satisfy the first condition and never give rise to a 'once-only deduction' for the purposes of section 24.

[25] (1966) 116 CLR 81.

Conclusion

60. The preferred view is that expenditure hypothetically affected by the loss deferral rule in subsection 35-10(2) of the ITAA 1997 will never give rise to any 'once-only deduction', and accordingly, cannot be taken into account in calculating any reduction in taxable value under section 24.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.

Alternative view of the meaning of 'deduction' and 'allowable' in the definition of 'once-only deduction', and in section 24

61. An alternative view of the meaning of 'deduction' and 'allowable' in the definition of 'once-only deduction' in subsection 136(1) and section 24, is that they refer to any amount which would be a deduction under any specific provision, such as section 8-1 of the ITAA 1997, irrespective of whether some other provision would operate to effectively reduce or deny that deduction being taken into account under section 4-15 of the ITAA 1997, in calculating a relevant employee's taxable income.

62. This view takes a literal interpretation to both subsection 136(1) and section 24, and ignores the scheme of the ITAA 1997 concerning the significance of when deductions take effect under section 4-15 of the ITAA 1997.

63. For the reasons set out at paragraphs 5 to 7 and 34 to 41, it is not preferred.

Alternative view of whether expenditure can be traced through subsection 35-10(2) of the ITAA 1997, in deciding whether the first condition for a 'once-only deduction' is met

64. There is an alternative view that in deciding whether the first condition for a 'once-only deduction' is met, it is permissible to trace the expenditure in question (being that which has been paid or reimbursed), in order to quantify the amount of the related deduction ultimately taken into account under section 4-15 of the ITAA 1997.

65. Under this view, even though there is no provision or rule which expressly applies to identify the composition of the deduction(s) remaining for the purposes of section 4-15 after subsection 35-10(2) of the ITAA 1997 has applied, a rateable apportionment rule is said to apply. Examples of the operation of such a rule can be found in *Resch v. FC of T (Resch)*[26] and *Commercial Banking Co of Sydney Ltd v. FC of T (Commercial Banking Co).*[27]

66. This view is not accepted. The facts and provisions relevantly considered in the *Resch* and *Commercial Banking Co* cases differ greatly from the facts to which this draft Ruling applies and how subsection 35-10(2) of the ITAA 1997 works. These cases provide no authority for importing any tracing rule or rule of rateable apportionment into the subsection.

[26] (1942) 66 CLR 198.
[27] (1950) 81 CLR 263.

67. If the view expressed in paragraph 66 be wrong (which is not accepted), a percentage (being a rateable amount) of each deduction – including an employee's expenditure in respect of an external expense payment fringe benefit on the hypothesis required by section 24 – would be said to be allowed under section 4-15 of the ITAA 1997 after the application of the loss deferral rule in subsection 35-10(2). Whilst this would be sufficient to satisfy the first condition for a 'once-only deduction' that a percentage of the expenditure be allowable, it would still be necessary to consider the second condition. As explained in paragraph 30, that condition is that no percentage of the relevant expense be allowed as a deduction in any other year.

68. If tracing is permissible for the purposes of deciding whether the first condition is met though, parity of reasoning indicates it also would apply in relation to the second condition. Both conditions require that the deductions referred to be 'in respect of' the same expenditure, and there are no indications that this expression is to have a different meaning in the first condition, when compared to that for the second condition. Moreover, the absence of any provision or rule of composition and the blending of a mix of different deductions applies to both paragraph 35-10(2)(a) of the ITAA 1997, in relation to the first condition, and to paragraph 35-10(2)(b) of the ITAA 1997, in relation to the second condition.

69. Accordingly, even under this alternative view, the possibility of some future deduction in another year under paragraph 35-10(2)(b) of the ITAA 1997 that is 'in respect of' the relevant expenditure cannot be ruled out. The loss deferral rule in subsection 35-10(2) of the ITAA 1997 operates to defer the deduction to a relevant time, not deny it altogether.

70. This means that even if the expenditure could be said to satisfy the first condition under this alternative view, it could not be concluded that the second condition would also be satisfied. The same result would occur, that is, that the expenditure could not be said to give rise to any 'once-only deduction'.

Variation of alternative view that tracing is permitted

71. A variation of the alternative view that tracing expenditure through the application of subsection 35-10(2) of the ITAA 1997 can properly occur, is that this is so in relation to the first condition set out in paragraph 30, but not the case in relation to the second condition.

72. The reasons provided under this alternative view as to why tracing should apply for the purposes of the first condition are those set out in paragraphs 64 and 65. Under this variation, however, the second condition is said to be met on the basis that any further statutory deduction arising under paragraph 35-10(2)(b) cannot be said to be 'in respect of' the expenditure in question.

73. No sufficient or material link between this expenditure and any further statutory deduction is said to exist, because the connection is too remote, having regard to:

- the uncertainty over whether at the time the expenditure is incurred any future deduction arising under paragraph 35-10(2)(b) of the ITAA 1997 will be allowable as a deduction under section 4-15 of the ITAA 1997, in some future year;[28] and
- the quite different nature and character of the statutory deduction, which may often be the result of an amalgamation of different expenditures.

74. This view is not accepted, as it relies on being able to trace expenditure through the application of subsection 35-10(2) of the ITAA 1997, which is not considered to be permitted (refer to the reasons given in paragraph 66). And if it was so allowable (which is not accepted), it would also be allowable for the purpose of the second condition so that condition would not be satisfied (for the reasons given in paragraphs 68 to 70).

[28] Such a deduction might not be allowable because the business activity in question ceases to be carried on, or, if carried on, does not produce sufficient assessable income.

Appendix 3 – Your comments

75. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

76. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**8 May 2013**
Contact officer:	**Paul Voglis**
Email address:	**paul.voglis@ato.gov.au**
Telephone:	**(02) 9374 1494**
Facsimile:	**(02) 9374 1468**
Address:	**Australian Taxation Office** **12 Woniora Road** **HURSTVILLE NSW 2220**

Appendix 4 – Detailed contents list

77. The following is a detailed contents list for this Ruling:

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2001/14; TD 93/46; TD 93/90

Subject references:

- airline transport fringe benefits
- board fringe benefits
- deductions & expenses
- expense payment fringe benefits
- FBT expense payment
- FBT expense payment fringe benefit
- FBT otherwise deductible rule
- fringe benefits
- fringe benefits tax
- loan fringe benefits
- losses
- non commercial losses
- property fringe benefits
- reductions of taxable value
- residual fringe benefits

Legislative references:

- Corporations Law 556(1)(g)
- FBTAA 1986
- FBTAA 1986 19
- FBTAA 1986 20
- FBTAA 1986 20(a)
- FBTAA 1986 20(b)
- FBTAA 1986 23
- FBTAA 1986 24
- FBTAA 1986 24(1)
- FBTAA 1986 24(1)(a)
- FBTAA 1986 24(1)(b)
- FBTAA 1986 34
- FBTAA 1986 37
- FBTAA 1986 44
- FBTAA 1986 52
- FBTAA 1986 66
- FBTAA 1986 136(1)
- ITAA 1936
- ITAA 1936 48
- ITAA 1936 51(1)
- ITAA 1936 51AH
- ITAA 1936 80
- ITAA 1936 82A
- ITAA 1997
- ITAA 1997 4-15
- ITAA 1997 4-15(1)
- ITAA 1997 8-1
- ITAA 1997 Div 28
- ITAA 1997 Div 35
- ITAA 1997 35-10(1)
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(2)(a)
- ITAA 1997 35-10(2)(b)
- ITAA 1997 Div 900
- ITAA 1997 995-1(1)

Case references:

- Commercial Banking Co of Sydney Ltd v. Federal Commissioner of Taxation (1950) 81 CLR 263
- Construction Industry Long Service Leave Board v. Irving as Administrator of Bettaform Constructions (SA) Pty Ltd (1997) 74 FCR 587
- Federal Commissioner of Taxation v. Scully (2000) 201 CLR 148;.[2000] HCA 6; 2000 ATC 4111; (2000) 43 ATR 718
- Federal Commissioner of Taxation v.Indooroopilly Children Services (Qld) Pty Ltd (2007) 158 FCR 325; 2007 ATC 4236; (2007) 65 ATR 369
- Frisch v. FC of T [2008] AATA 462; 2008 ATC 10-031; (2008) 72 ATR 551
- J&G Knowles & Associates Pty Ltd v. Federal Commissioner of Taxation (2000) 96 FCR 402; 2000 ATC 4151; (2000) 44 ATR 22
- National Australia Bank Ltd v. Federal Commissioner of Taxation (1993) 46 FCR 252; 93 ATC 4914; (1993) 26 ATR 503
- Nintendo Co Ltd v. Centronic Systems Pty Ltd (1994) 181 CLR 134
- Ravenshoe Tin Dredging Ltd v. Federal Commissioner of Taxation (1966) 116 CLR 81
- Re Andrew Lamparelli and Commissioner of Taxation [2005] AATA 414

- Resch v. Federal Commissioner of Taxation (1942) 66 CLR 198
- The Roads and Traffic Authority of New South Wales v. Federal Commissioner of Taxation (1993) 43 FCR 223; 93 ATC 4508; (1993) 26 ATR 76
- The Workers' Compensation Board of Queensland v. Technical Products Pty Ltd (1988) 165 CLR 642; 81 ALR 260

ATO references

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