TR 94/22 - Income tax: implications of the Edwards case for the deductibility of expenditure on conventional clothing by employees

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Taxation Ruling

Income tax: implications of the ***Edwards case*** for the deductibility of expenditure on conventional clothing by employees

other Rulings on this topic

IT 2409; TD 93/101; TD 93/109; TD 93/111; TD 93/154; TD 93/232

contents para

What this Ruling is about 1

Ruling 4

Date of effect 11

Explanations 12

Conventional clothing 12

Apportionment 22

Examples 25

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]

What this Ruling is about

1. This Ruling sets out our views on the effect of the Full Court of the Federal Court of Australia decision in *FC of T v. Edwards* 94 ATC 4255; 28 ATR 87. The matter was an appeal from the decision of Gummow J of the Federal Court reported at 93 ATC 5162*;* (1993) 27 ATR 293 which was an appeal from the Administrative Appeals Tribunal (AAT) decision reported as Case 31/93 93 ATC 359*;* AAT Case 8858 (1993) 26 ATR 1181. This case involved the deductibility under subsection 51(1) of the *Income Tax Assessment Act 1936* (the Act) of expenditure on clothing of a type suitable for wear outside work referred to in this Ruling as conventional clothing. Conventional clothing can be described as ordinary clothing of a type usually worn by men and women regardless of their occupation.

2. This Ruling does not cover the deductibility of expenditure on uniforms, protective clothing, or occupation specific clothing. These matters will be the subject of another Ruling.

3. This Ruling withdraws Taxation Ruling IT 297 and Taxation Determination TD 93/110 because the underlying rationale of that Ruling and that Determination reflects inappropriate tests of deductibility.

Cross references of provisions

3A. This Ruling considers the implications of the *Edwards case*, a case that explains the application of subsection 51(1) of the Act. Subsection 51(1) expresses the same ideas as section 8-1 of the *Income Tax Assessment Act 1997*.

Ruling

4. The decision of the Full Federal Court in the *Edwards case* is not authority for the deductibility of all expenditure on clothing acquired and worn at work.

5. We accept that the proper construction of subsection 51(1) does not result in any universal proposition that conventional clothing can never attract deductibility under the Act. Each case must be approached by the application of the subsection properly construed to its particular facts.

6. The analysis on the facts starts with ascertaining what are the income earning activities and then determining whether a sufficient nexus exists between those activities and the expenditure. Outgoings will be deductible in whole or in part where there is a clear connection between the expenditure and the actual derivation of income. It is not sufficient that the expenditure on clothing is a prerequisite to the derivation of assessable income. It must contribute to the derivation of that income.

7. It is our view, that in most cases expenditure on conventional clothing will not be deductible.

8. For expenditure by an employee to be deductible under the first limb of subsection 51(1) of the Act, the High Court of Australia has indicated that the expenditure must have the essential character of an outgoing incurred in gaining assessable income or, in other words, of an income producing expense (*Lunney v. FC of T* (1958) 100 CLR 478 at 497-498). There must be a nexus between the outgoing and the assessable income so that the outgoing is incidental and relevant to the gaining of the assessable income (*Ronpibon Tin N.L. v. FC of T* (1949) 78 CLR 47). Consequently, it is necessary to determine the connection between the particular outgoing and the operations by which the taxpayer more directly gains or produces his or her assessable income (*Charles Moore & Co (WA) Pty Ltd v. FC of T* (1956) 95 CLR 344 at 353, *FC of T v. Cooper* 91 ATC 4396 at 4403; (1991) 21 ATR 1616 at 1624; *Roads and Traffic Authority of NSW v. FC of T* 93 ATC 4508 at 4520; (1993) 26 ATR 76 at 91). Whether such a connection exists is a question of fact to be determined by reference to all the facts of the particular case. In most cases a

sufficient connection will not exist between expenditure on conventional clothing and the derivation of assessable income by an employee taxpayer.

9. Nothing in the Full Federal Court's decision in the *Edwards case* changes the principles set out in paragraph 8. In fact the Court specifically stated that the decision does not establish a principle that clothing acquired for and worn at work will generally be deductible. The decision in the *Edwards case* is simply an example of a situation where, on the particular facts of the case, such a sufficient connection did exist. If an employee taxpayer incurs clothing expenditure in a directly similar way to Ms Edwards, a deduction is allowable for a proportion of the expenditure.

10. If the connection described at paragraph 8 does exist, it may be necessary to apportion the claim for deduction. A reasonable estimate of work use relative to private use of the clothing should be applied.

Date of effect

11. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Conventional clothing

12. In the *Edwards case* the taxpayer was the personal secretary to the wife of a former Queensland Governor. Although there was no express condition of employment that any particular clothing be worn, the taxpayer was expected to dress in a manner compatible with the Governor's wife. The taxpayer well understood that she would not have been employed if she did not dress in accordance with the dress standards and requirements for each particular occasion at which she attended on the Governor's wife.

13. The taxpayer was previously employed as an executive secretary and as a consequence her existing wardrobe was of the requisite quality. The new employment resulted in a need to increase the quantity and to include hats, gloves and formal evening wear. Additional clothing was necessitated by employment activities taking her outside Brisbane in circumstances where laundry facilities were not readily available. Consequently a supply of immediately wearable

fresh clothing was required. The taxpayer very seldom had opportunity to wear her formal wardrobe for private purposes. When off-duty, she wore casual clothing such as jeans and T-shirts. In the course of her new employment it was normal that she change attire several times during the course of a day.

14. The first limb of subsection 51(1) provides that:

> 'All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income ... shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income.'

15. In *Fletcher & Ors v. FC of T* 91 ATC 4950; (1991) 22 ATR 613 the Full High Court of Australia affirmed that whether an outgoing is incurred in gaining or producing assessable income under the first limb of subsection 51(1) is a question of characterisation of the expenditure. The Courts have pointed out on many occasions that an outgoing will not properly be characterised as an income-producing outgoing unless it is 'incidental and relevant to that end' (i.e. incidental and relevant to the derivation of income).

16. In *FC of T v. Cooper* 91 ATC 4396 at 4401-4402**;** (1991) 21 ATR 1616 at 1622, Lockhart J stated:

> 'The question whether the additional expenditure of the taxpayer is deductible under s 51(1) cannot be answered simply by a process of reasoning that, because expenditure of this kind is prerequisite to the earning of the taxpayer's assessable income (in the sense that it is necessary if assessable income is to be derived), it must be incidental and relevant to the derivation of income. It does not follow that such expenditure is incurred in or in the course of gaining or producing the income. The deductibility of the expenditure depends upon determining the essential character of the expenditure itself and not upon the fact that, unless it is incurred, the taxpayer will not be able to engage in the activity from which his income is derived.'

17. In the *Edwards case* the AAT and the Federal Court identified the following circumstances as relevant to their decision that the expenditure on additional clothing was of the requisite character:

- The essential activities by which the employee gained her income involved attending on the Governor's wife as her personal secretary.
- The clothing was necessary to properly attend on the Governor's wife at official functions and engagements.

- The employee was required to change her clothing sometimes two or three times a day in the course of performing her income-producing activities.
- The employee was expected to dress in a manner compatible with the Governor's wife. She well understood that she was expected to dress in accordance with an appropriate standard for each occasion.
- In her employment, the employee had need of an extensive wardrobe of high quality clothes.
- Additional changes of clothing did not serve a private purpose.
- The employee lived in and her employment was a seven-days-a- week occupation. She did not have a lot of private time.
- The infrequent use of the formal wardrobe for private purposes. The employee very seldom had occasion to wear her private clothing, which tended to be casual in nature, such as jeans and tracksuits.
- Engagements away from the employee's home base in circumstances where laundry facilities were not promptly available required a supply of fresh changes of clothing.
- The exposure to the public eye was in a different way from her previous work life in private enterprise.

18. Gummow J gave the following summary of the findings of the AAT (93 ATC 5167; 27 ATR at 298):

> 'In the present case, the AAT held (paras. 19,25) that with the use of her wardrobe after personal requirements of modesty, decency and warmth were met by her first set of clothes of the day, there was a direct nexus between the expenditure of the taxpayer on her wardrobe and her income producing activities.'

19. It was found that the factors set out at paragraph 16 together established a sufficient connection between the expenditure on additional clothing and the activities by which the taxpayer earned her income. The establishment of the sufficient connection demonstrated that the essential character of the expenditure was the gaining or producing of assessable income. Her employment activities were to attend on the Governor's wife and the outgoings on the additional clothing were inextricably linked to the way in which she earned her income. The following passage from the decision of the AAT was cited with approval by both Gummow J at first instance (92 ATC at 5165; 27 ATR at 296) and by the Full Federal Court on appeal (94 ATC at 4258; 28 ATR at 90):

> 'I am satisfied on the evidence that the occasion of the outgoing operates to give it the essential character of a working expense. I am satisfied on the evidence that the expenditure on the additional clothing (including hats, gloves and black tie formal evening wear) is both incidental and relevant to the derivation of the taxpayer's income.[Emphasis supplied]'

20. We accept the Court's finding on the facts of the case. Taxpayers who incur expenses in a directly similar way to Ms Edwards will be allowed a proportion of the expenditure on conventional clothing. There will be few if any situations that are directly analogous to the *Edwards case*.

21. The decision of the Full Federal Court contains the following cautionary statement (94 ATC at 4259; 28 ATR at 91):

> 'It should be noted that the decision does not establish that the cost of all clothing acquired and worn at work will, because of that circumstance alone, become deductible as an outgoing incurred in deriving assessable income.'

Apportionment

22. In analysing subsection 51(1) in *Fletcher's case,* the Full High Court took the view that the words 'to the extent to which' in the subsection make it clear that apportionment of outgoings is contemplated in at least two circumstances (91 ATC at 4957; 22 ATR at 621):

> 'One kind consists in undivided items of expenditure in respect of things or services of which distinct and severable parts are devoted to gaining or producing assessable income and distinct and severable parts to some other cause. In such cases it may be possible to divide the expenditure in accordance with the applications which have been made of the things or services. The other kind of apportionable items consists in those involving a single outlay or charge which serves both objects indifferently.' (per Latham CJ; Rich, Dixon, McTiernan and Webb JJ in *Ronpibon Tin N.L. and Tongkah Compound N.L. v. FC of T* (1949) 78 CLR 47 at 59)

The Full High Court also stated in *Fletcher's case*, relying on *Ronpibon Tin*, that what represents the appropriate apportionment of such items of expenditure is essentially a question of fact in each case. There must be some fair and reasonable assessment of the extent to which the expenditure relates to assessable income.

23. In the *Edwards case* the taxpayer had an executive wardrobe of similar quality for at least two years before the year of income in which the deduction was claimed. In the making of an apportionment

the AAT took this and all the other particular facts into account. The AAT allowed the clothing expenditure in the year at issue less the average of the clothing expenditure for the previous two years.

24. The Full Federal Court in the *Edwards case* made the following statement in relation to apportionment (94 ATC at 4259; 28 ATR 91):

> 'The apportionment that was made, which is not the subject of challenge in this appeal, was of a kind contemplated by s 51(1) of the Act and was made on a commonsense or practical basis: reflecting the fact that the entirety of the additional expenditure could not be said to have been incurred in the production of the assessable income but that a proportion of it was so incurred.'

Examples

25. The following examples are illustrative of the application of paragraphs 6 and 8 of this Ruling to various factual situations.

26. Craig works as a sales assistant in an exclusive menswear store. His employer requires him to wear clothing from the labels available in the store.

What are Craig's income earning activities?

The activities by which Craig derives his income are primarily by selling menswear in the store.

Is there a sufficient connection between those activities and expenditure on clothing from the store?

No. Even if Craig's clothing expenditure is a prerequisite to the derivation of his income, there is no direct nexus between the clothing expenditure and his income-producing activities of selling clothes.

Is expenditure on the clothing deductible?

No. In the absence of a sufficient nexus, the clothing expenditure is not deductible.

27. Neil is a professional actor who buys clothing to wear on stage as a costume in a particular production.

What are Neil's income earning activities?

Neil derives his income by assuming characters and performing on stage.

Is there a sufficient connection between those activities and expenditure on clothing*?*

A direct nexus exists between Neil's expenditure on clothing and his income-producing activities as an actor, even though the clothing purchased to play a part may be conventional in nature. Neil's clothing expenditure is directly related to his performing his employment activities in the clothing to earn his income.

Is expenditure on the clothing deductible?

Yes. Because the connection between the income earning activities and the expenditure exists, Neil can claim a deduction. Whether apportionment is necessary depends on the particular facts.

This example does not establish a general principle that expenditure by actors on clothing is allowable. Claims by other actors would need to be determined on their own facts.

28. Jill is a police officer who is required as part of her law enforcement activities to wear clothing of a kind she doesn't normally wear that enables her to pose as a criminal. Jill wears other clothing to and from work.

What are Jill's income earning activities?

Jill earns her income as an undercover law enforcement officer who assumes characters to solve cases.

Is there a sufficient connection between those activities and expenditure on clothing?

Jill's expenditure on clothing worn in these activities, even though it may be conventional clothing, has a direct nexus with her income producing activities as a law enforcement officer. Jill's clothing expenditure is directly related to her performing her employment activities in the clothing to earn her income.

Is expenditure on the clothing deductible?

Yes. Because the connection between the income earning activities and the expenditure exists, Jill can claim a deduction. Whether apportionment is necessary depends on the particular facts.

This example does not establish a general principle that expenditure by police officers on clothing is allowable. Claims by other police officers would need to be determined on their own facts. In fact, it is our view that expenditure by plain clothes police officers, in most cases, will not be allowable.

29. John and Jane are parliamentarians who decide, as a result of the televising of parliamentary proceedings, to purchase a range of high quality garments to wear on these occasions.

What are John's and Jane's income earning activities?

As parliamentarians, John and Jane earn their income by performing a range of parliamentary duties. They do not earn their income by appearing on television.

Is there a sufficient connection between those activities and expenditure on clothing?

No. There is no direct nexus between the expenditure and the activities by which they earn their income.

Is expenditure on the clothing deductible?

Their expenditure is not deductible because there is no direct nexus between the expenditure and the parliamentary activities by which they derive their income.

30. Jim provides advice in a policy branch of a public service department. He wears trousers and a shirt to work, and keeps a suit handy in case he is needed to advise the Minister at Parliament House.

What are Jim's income earning activities?

Jim derives his income by giving advice on government policies to a wide range of people - Australian public, other departments, businesses, and sometimes, Ministers.

Is there a sufficient connection between those activities and expenditure on clothing?

No. There is no direct nexus between Jim's clothing expenditure and his income producing activities of providing advice on government policies.

Is expenditure on the clothing deductible?

No. In the absence of a sufficient nexus, the clothing expenditure is not deductible.

31. Gail is a television game show hostess who attends a studio every Tuesday to tape multiple episodes of the show for the week. Her employer does not provide her with clothing to wear on the show. She buys evening wear and formal wear to complement the sets and prize showcases.

What are Gail's income earning activities?

Gail's income earning activities are as a spokes model on the television show.

Is there a sufficient connection between those activities and expenditure on clothing?

Gail's expenditure on clothing worn in these activities which varies and complements the various prize showcases, and segments on the television show has a direct nexus with her income producing activities as spokes model on the game show. Gail's clothing expenditure is directly related and contributes to her performing her employment activities in the clothing to earn her income.

Is expenditure on the clothing deductible?

Yes. Because the connection between the income earning activities and the expenditure exists, Gail can claim a deduction. Whether apportionment is necessary depends on the particular facts.

This example does not establish a general principle that expenditure on clothing by people who appear on television, or models is allowable. Claims by other models and people who appear on television would need to be determined on their own facts.

Commissioner of Taxation

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- FC of T v. Edwards 94 ATC 4255; (1994) 28 ATR 87
- FC of T v. Edwards 93 ATC 5162; (1993) 27 ATR 293
- Case 31/93 93 ATC 359; AAT Case 8858 (1993) 26 ATR 1181
- Fletcher & Ors v FC of T 91 ATC 4950; (1991) 22 ATR 613
- FC of T v. Cooper 91 ATC 4396**;** (1991) 21 ATR 1616
- Ronpibon Tin N.L. and Tongkah Compound N.L. v. FC of T (1949) 78 CLR 47
- Lunney v. FC of T (1958) 100 CLR 478
- Charles Moore & Co (WA) Pty Ltd v. FC of T (1956) 95 CLR 344
- Roads and Traffic Authority of NSW v. FC of T 93 ATC 4508; (1993) 26 ATR 76