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Published in:
International Journal of Critical Accounting

DOI:
[10.1504/IJCA.2016.081623](https://doi.org/10.1504/IJCA.2016.081623)

Published: 06/01/2017

Document Version
Peer reviewed version

[Link to publication on the UWS Academic Portal](#)

Citation for published version (APA):

James, K. (2017). The Australian Taxation Office perspective on work-related travel expense deductions for academics. *International Journal of Critical Accounting*, 8(5-6), 345-362.
<https://doi.org/10.1504/IJCA.2016.081623>

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THE AUSTRALIAN TAXATION OFFICE PERSPECTIVE ON WORK-RELATED TRAVEL EXPENSE DEDUCTIONS FOR ACADEMICS

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Abstract

This paper includes a case study of my own experiences as a personal taxpayer being audited by the Australian Taxation Office (ATO) as well as a legal analysis of Australian tax cases relating to the deductibility of travel-related expenses. The personal case study explains Australia's tax system of Pay As You Go (PAYE) income tax deductions followed by annual tax return submissions (using an honesty-based system) plus occasional subsequent tax audits if deductible expenses claimed in tax returns are deemed excessive. The case describes how the ATO initiated and handled my tax audit in 2013-15 and the arguments put forward by the ATO officers as to why my research-related tax deductions should be disallowed. The next part of the paper reviews the tax law cases in Australia's past which have either allowed or disallowed work-related travel expense deductions. This discussion concludes with the *Payne* case of 1999-2001. Judges have now polarized themselves into two discrete camps, those for deductibility looking at the composite income-earning activities of the taxpayer (viewed in a holistic way) with those against deductibility arguing that travel between two unrelated places of employment or business is equivalent to travel between home and work.

Keywords: *Australian taxation; Australian taxation law; Deductibility; High Court; Payne case; Section 51(1); Taxation law; Travel-related expenses.*

Introduction

This paper discusses the audit launched by the Australian Taxation Office (hereafter ATO) into work-related deductions claimed by the author (an associate professor at that time) in his submitted tax return for the 2012-13 financial (tax) year. This audit was launched in the second half of 2013 and dragged on throughout 2014 until the author had conversations with a tax officer from the ATO's Perth office during the southern summer of 2014-15. All work-related deductions (primarily for research-related travel but also some for books) were disallowed by the ATO and the author had to play AUD11,000 in Australian dollars which included AUD9,000 of disallowed tax deductions (at the effective tax rate) plus AUD2,000 of penalty for being careless in the preparation of his tax return. The *effective* tax paid back was double the nominal amounts because the author was earning Fiji dollars in Fiji in 2014-15 and the exchange rate was around 1 Fiji dollar to 0.57 Australian dollars. Pursuing alleged tax debts when a person leaves the country to work in a Third World country with a weak currency creates equity issues which the ATO does not wish to acknowledge due to its ingrained Australian-centric perspective with its deeply embedded notions of "us" and "them". As far as the ATO was concerned, I was their fish and, to mix oceanic metaphors, the world or at least the South Pacific was their oyster. My conclusion in this paper is that the ATO does not understand the nature of an academic's job. The organization does not understand that money spent on research trips is an integral part of the job rather than being only a capital expense designed to boost one's qualifications and employability (although research publications do serve that purpose as well). This lack of understanding was demonstrated by the Perth tax officer's arguments plus his inappropriate comparison of a university academic with a primary school teacher (who is not required to do research as part of her / his job description). If the ATO refuses to allow deductions for work-related expenses for academics then a simple Pay As You Go tax system (such as Fiji's) which does not recognize any deductions at all but which has a lower tax rate scale is preferable to the more expensive Australian system.

Case Study

This case explores the ATO's official viewpoint towards work-related deductions claimed by university academics (primarily for research-related travel and books used for research activities). I argue that the ATO's interpretation of Section 51(1) of the *Income Tax*

Assessment Act 1936 (as amended) is problematic and emerges from a misunderstanding on its part of the nature of an academic's job. Section 51(1) reads as follows:

“All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such 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 ...” [cited in Stewart, 2001, p. 498].

The end result of the ATO's interpretation of Section 51(1) is that while *in theory* academics can claim work-related deductions *in practice* these will or may all be disallowed in the event of a tax audit. My conclusion in this paper is that academics should not claim work-related deductions for research activities unless they are willing to pay the money back to the ATO. There is no likelihood or guarantee that *any* work-related deductions for research activities will be allowed due to the ATO's misunderstanding of the nature of an academic's work. ATO officials have shown their unwillingness to listen to strong logical arguments which contradict the ATO's primary goal of revenue-generation.

Australia has an allegedly “honesty-based” system where individuals claim in their tax returns deductions and rebates as well as declare any assessable income which is not their primary salary income (from which tax is deducted each pay-day and forwarded to the ATO as part of the PAYG system). The way the system is set up means that when deducting tax through PAYG most individual taxpayers receive a small refund every year after their tax return is processed. Traditionally this refund has been around AUD2,000-3,000. However, if you claim more work-related or other deductions you get a larger tax refund since, at this point in the process, it is an honesty-based system. If you just lose your job, for example, it might be tempting to claim many deductions relating to your last job to gain a larger tax refund to see yourself through the difficult times.

Tax audits, according to a long-serving tax auditor (in personal conversation with the author), are launched on an annual basis with each year having a unique theme. For example, people in one occupation may be audited in one year and those in another occupation in the next. The focus will usually be on work-related expenses when the annual theme is a particular occupational category. Then no other items will be checked unless they “jump out” at the auditor from off the pages of the tax return. In my case the audit began approximately six months after the end of the financial year to which the audit related. Letters were forwarded from my Australian address to Fiji in my case so the ATO did not seem to be using the most advanced technology at this point. Australian Immigration had record that I had left

Australia for Fiji with my family on 7 May 2013 and it was aware that I had ticked the box on the departure card that I would be away for three years. Also, throughout my audit, the Fijian tax authorities were never contacted and so effectively the ATO was acting like a rogue agent on foreign soil with imperialistic attitudes. The fact that I was earning Fiji dollars and would have to pay them back Australian dollars (which were twice as expensive) was not something that ATO officers saw as problematic or as creating an ethical issue.

I was first asked to supply documentary evidence to support all of the claims. Because of moving house and then moving country I did not have all of these records. Documents must be kept for five years (Queensland Government, 2016) which is a burdensome requirement for a person frequently changing addresses or even just moving houses in cramped inner-city style accommodation with limited storage facilities. A person might serve these five years in (say) three different countries and would be expected to load all evidentiary documents from the first two countries (if both had tax rules like Australia's) and bring them to the third country which is in my view an unreasonable burden. The ATO's rules have in mind a more traditional society (say Australia in the 1960s or 1970s) where people rarely moved from one country to another.

I was able to locate bank statements kept by my wife and invoices relating to travel expenses and books so I sent these back to the original tax audit officer based in Albury, New South Wales. Then my case was assigned to someone else and a letter of about four pages was sent back to me explaining why all of my claimed work-related deductions were not allowed. The ATO during a tax audit seems to want to bet on two horses in the race simultaneously. It claims that the evidence is missing / not acceptable and also tries to attack claimed deductions on conceptual and legal grounds based on tax law. It is this second area where mistakes are easily made because the ATO's principal objective is revenue raising rather than writing unbiased and well-researched legal articles. In other words, it has already chosen its side.

The letter from the ATO explained the ATO officer's view that no deductions were allowed because my employer had not instructed me to go on these trips. As I outlined in my objection letter and later when I was in telephone conversation with the Perth-based officer, academic employment simply does not work like that. Bosses in academia do not tell their junior staff what topics to research and do not tell them when and where to go for research trips. The ATO officer was simply assuming or pretending that an academic job was like a corporate job where you go a trip (for example, a marketing trip) because the boss tells you to go for one. The officer writing the letter quoted the general deduction provision of Section

51(1) of the *Income Tax Assessment Act* 1936 (as amended) before disallowing the deductions but I think the interpretation was wrong and confused. I complained officially about the competence of this tax officer. Eventually I told the ATO that I was visiting Perth for holidays from 1 January to 1 February 2015 and we agreed that the case would be handled from the Perth office during my one month's stay there.

The Perth-based officer and I had some telephone conversations and he, unsurprisingly, and his superior there agreed with the ATO's prior interpretation of the case. Wary, perhaps because I had made a complaint about the earlier officer, he was a model of political correctness, politeness, understanding, and tolerance. I was reminded of Marcuse's (1964) observation that in modern western capitalist societies we can blame no-one because everyone is smiling, polite, and innocent; it is only the system rather than individuals which imposes power in a brutal manner. There is nobody at an organization that we can reasonably get angry with (everybody is accountable to someone higher up the chain) and we leave more frustrated and powerless than ever. We almost long for an old-fashioned shouting match but the ATO is far too careful to allow such a thing to happen these days.

I should mention here that all but AUD2,000 of my work related deductions were for a period of time (six months) in the middle of the financial year under audit when I was unemployed. I was probably a little cheeky and disingenuous to claim deductions for a time period when I was not working. My reasoning was that: (a) I was still doing research based on long-term ongoing projects and these were not dependent upon me being employed (especially for existing as opposed to new projects where my contacts knew me as an individual); (b) I was invited as a guest-speaker in December 2012 to an accounting conference in Malang, East Java, Indonesia (this invitation was made when I was still employed and only my accommodation not airfares were to be covered); and (c) these research projects and research expenses would benefit me in my future job(s) once my unemployment period ended. Taken together I felt that these arguments were moderately strong to strong and I do not perceive that I was cheating the ATO by making obviously ridiculous claims for deductions. My view was that these claims could go either way and I was willing to give these claims up voluntarily in the interests of an agreed settlement where my other claims would be allowed. I even cited (semi-ironically) Stephen R. Covey's book *7 Habits of Highly Effective People* (Covey, 1989) which says that we should try to bring about "win-win situations" and not "win-lose". This Covey reference was lost on the ATO officer who was not trained to think that way by the ATO which, as a First World government

agency, is convinced that it must win all the time (and this has become part of the stock of received wisdom at the ATO).

The Perth-based ATO officer listened to my various arguments (to be discussed shortly) and my Covey citation. He then said he would talk to his boss and call me back the next day. At the end of this telephone conversation I was quietly hopeful that I might be allowed the AUD2,000 of deductions which were incurred during the six months of the audit period when I was employed. As mentioned, I was willing to voluntarily and cheerfully give up the other claims (which were incurred during my unemployment period) in the interests of a satisfactory settlement. When the ATO officer called back the next day his voice was as smooth as milk chocolate but within 20 seconds he had delivered the unfortunate news that all of my claims would be disallowed. I should have known that my hopes were futile in the face of the ATO's relentless desire, drummed in to all of its officers, to rake in as much taxpayer money as possible (especially from small personal taxpayers rather than huge companies which continue their tax evasion and tax avoidance unabated).

It was during this last phone call, when the final verdict on my case was delivered by the man whose voice was made for radio, that the betting-on-two-horses syndrome became clearly apparent again. The officer was explaining to me that conceptually and legally none of my claims were valid and then he drew a rabbit out of the hat mid-conversation by saying that the expenses of a research trip to Adelaide and Perth for research did not have evidentiary support. I am not convinced about this lack of evidentiary support but a win-win situation is not a concept compatible with the deeply embedded worldview of a trained ATO officer so I ceased arguing my case (until this article). The fact that six days of my Adelaide-Perth research trip were spent in my home city of Perth was probably an extra factor used by the ATO to decide that my expense was of a "capital, private or domestic nature" (Section 51(1)). Lastly I was given another ATO extension number where I could call up and arrange for a delayed payment plan (and this officer was only too willing to oblige). After negotiating and agreeing to a delayed payment plan my case was officially over, which was a real "win-lose outcome" in the best traditions of the ATO. Now I proceed to a discussion of the conceptual and legal issues.

Conceptual and Legal Issues

Introduction

The general deduction provision Section 51(1) in Australia's *Income Tax Assessment Act* 1936 (as amended) (hereafter ITAA) defines deductions as "[a]ll 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". The notion here is of an earnings process and the section is consistent with and relies upon the matching principle of traditional Historical Cost Accounting (right down the crucial capital-income distinction). In the case of the carrying on of a business an extra clause in Section 51(1) allows deductions for "[losses and outgoings] necessarily incurred ... for the purpose of gaining or producing such [assessable] income". It is interesting that the word "necessarily" only occurs in the clause relating to the carrying on of a business. Commentators have referred to the two positive provisions as "two positive limbs" (Stewart, 2001, p. 498) with the part involving carrying on a business as the "second positive limb" and the other as the "first positive limb" (Stewart, 2001, p. 498). The negative aspect of Section 51(1), which disallows deductions for losses and outgoings of a "capital, private or domestic nature" is referred to as the "negative limb" (Stewart, 2001, p. 498). Note that the courts have said that "necessarily incurred" does not mean that if the expense had not been paid the revenue would not have been earned. For example, without gardening expenses or security guard expenses a business taxpayer's hypothetical revenues might not have been at all different from the actual numbers. However, these still qualify as tax deductions because the test is whether there is a logical connection between expenses and revenues. Stewart (2001) confirms that prior cases reveal that the assessable income can be earned in a later year than the year in which the expense was incurred and that if there was no actual assessable income resulting this does not preclude deductibility. Stewart (2001, p. 499) further points out that:

"This [first positive limb] has been expressed as requiring that the expenditures be 'incidental and relevant' to the gaining or producing of assessable income. As stated by the High Court in its unanimous judgment in *Ronpibon Tin*: '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.' These established general principles apply to every question of deductibility of an expense under s 51(1)".

Under the ITAA a general deduction can still be disallowed by a specific deduction provision and, conversely, an expense allowed by a specific deduction provision might not be allowable under the general deduction provision.

The Lunney Case (1958)

As we have seen, under Section 51(1), an otherwise allowable expense is disallowed if it is of a “capital, private or domestic nature” (the “negative limb” of Section 51(1)). The classic example, long upheld by the courts (see the *Lunney* case of 1958¹ and also Taxation Ruling TR 95/19², issued 16 June 1995, para. 23, cited in Stewart, 2001, p. 503), is that travel from home to work is of a private nature and cannot be deducted under Section 51(1) (Stewart, 2001). In the *Lunney* case, Williams, Kitto, and Taylor JJ, in a joint judgement, stated as follows:

“Expenditure of this character is not by any process of reasoning a business expense; indeed, it possesses no attribute whatever capable of giving it the colour of a business expense. ... [A]t the most, it may be said to be a necessary consequence of living in one place and working in another. And even if it were possible — and we think it is not — to say that its essential purpose is to enable a taxpayer to derive his assessable income there would still be no warrant for saying, in the language of s 51, that it was ‘incurred in gaining or producing the assessable income’ or ‘necessarily incurred in carrying on a business for the purpose of gaining or producing such income’” [(1958) 100 CLR 501, cited in Stewart, 2001, p. 500].

However, generally speaking, considerable controversy remains attached to these three terms (capital, private, and domestic) and clearly the ATO (and the High Court [see Stewart (2001)]) would like to side-line as many otherwise allowable deductions as possible using one or more of these three categories.

It first appeared that the courts were willing to award deductions in cases of travelling to or from two places of business or between a place of business and a place of employment (Stewart, 2001). However, a problem does emerge when one of these two places is also the principal residence of the taxpayer (Stewart, 2001). First we had the decisions in the cases of *Finn*, *Green*, and *Garrett* all of which favoured the taxpayer. However, the majority High Court opinion in the *Payne* case, where travel deductions were disallowed, points to a stricter interpretation of Section 51(1) and it is unclear how far future judges might go in applying the reasoning used in *Payne* to cases where the facts were slightly different (Stewart, 2001). Furthermore, much confusion has been caused because the two judges’ dissenting opinion in the *Payne* case clearly followed the decisions and reasoning used earlier in cases *Green* and *Garrett*. First we will review cases *Finn*, *Green*, and *Garrett*, and then the *Payne* case.

¹ (1958) 100 CLR 478.

² According to Stewart (2001, p. 503), “new system Taxation Rulings such as TR 95/19 are binding on the Commissioner even if the law would produce a different result and so [they] may be relied upon by a taxpayer in a case such as *Payne*”.

The Finn Case (1961)

In the High Court case of *Federal Commissioner of Taxation versus Finn (1961)*³, we had the situation of a senior architect employed by the government of South Australia. In a case with facts very similar to my own case, Finn travelled abroad for eight months and he devoted himself to the study of architecture overseas. The High Court found that the travel was sufficiently “incidental and relevant” to the taxpayer’s employment. The travel was deductible because it was carried on essentially for educational purposes and it was directed towards the “acquisition of better knowledge of a skilled profession” (cited in Stewart, 2001, p. 500). The findings of this case *prima facie* suggest that the costs of research trips made by university academics should be deductible under Section 51(1). This case has been rarely mentioned in recent decisions.

The Green Case (1950)

In *Federal Commissioner of Taxation versus Green (1950)*⁴, the taxpayer derived revenue including director’s fees from seven companies; rent from five buildings; dividends; and interest. The taxpayer was based in Brisbane and received part of the deductions he claimed for travel to Townsville and Cairns to supervise, inspect, and manage the rental properties. The travel was undertaken annually according to factual evidence presented to the court. In a brief High Court judgement, Latham CJ expressed his clear agreement with Philp J of the Supreme Court of Queensland that the travel was deductible. The following reasoning was given:

“[H]is Honour held that it was reasonably necessary to inspect and supervise from time to time the properties from which rents were derived. The evidence supported these findings. The expenditure, a deduction of which is claimed, was incurred in relation to the management of the income-producing enterprises of the taxpayer. If this is so it is immaterial that there might be a difficulty in holding that the taxpayer was carrying on in a continuous manner an identifiable business of some particular description” [(1950) 81 CLR 319, cited in Stewart, 2001, p. 501].

Another important point made by Latham CJ here, which clarified some confusion, was that Section 51(1) applied to outgoings and losses incurred in deriving any assessable income and

³ [1961] HCA 61; (1961) 106 CLR 60 (*Finn*).

⁴ [1950] HCA 20; (1950) 81 CLR 313 (*Green*).

not just to outgoings and losses incurred in deriving assessable income received from carrying on a business (Stewart, 2001). This statement appears to conflate the two positive limbs of Section 51(1) into just one limb expressed in two different forms.

The Garrett Case (1982)

In the *Garrett versus Federal Commissioner of Taxation* (1982)⁵ case the taxpayer was a medical practitioner and also a farmer and grazier who lived in rural New South Wales. The taxpayer treated patients in his home town, in Sydney, and in other country towns (Stewart, 2001). For farming and medical consultation purposes, he travelled via private aircraft between his property and the places where he conducted his medical consultations (Stewart, 2001). In the New South Wales Supreme Court Lusher J ruled that the claimed AUD23,300 was deductible because the demand for the doctor's services in various places and the distances he had to travel made his use of the private aircraft reasonable (Stewart, 2001). In his judgement Lusher J is cited as making the following comment:

“I find as a fact that the expenditure was incurred in travel between the different places [of] business for the purpose of gaining and producing income, further that the expenditure was ‘outgoings’ incurred in gaining and producing his assessable income. The essential character of the expenditure was that it was a part of the operations by which he earned his income, and was essential to the performance of them, there being no other practical or reasonable way of transporting himself and his vaccines” [(1982) 58 FLR 1018 (*Garrett*)], cited in Stewart, 2001, p. 501].

Lusher J here interprets Section 51(1) in a holistic way in the sense that he connects the expenses as a whole with the assessable income earned as a whole and also takes into account the physical or logistical aspects of the taxpayer's income-earning activities. By contrast some later judges think differently and often refer to trips between places of employment or places of business as *pre-requisites* for the earning of assessable income rather than as actions productive of that income. This is especially so when the two businesses or two places of employment (the departure and arrival points for the travel) are unconnected (for example, a country deer farm and a Sydney-based pilot's job as in *Payne*).

Re the Income Tax Acts (1903)

⁵ (1982) 58 FLR 101 (*Garrett*).

In this case⁶ the taxpayer was a grazier who lived on one property X in rural Victoria which he owned and managed. He also had two other rural properties (used for dairying activities) and he was a director of several Melbourne-based companies from which he received fee income. He had an office at property X where he did administrative and clerical work in relation to his businesses. The taxpayer claimed a deduction for travel between X and the other rural properties and between X and Melbourne to offset against his director's fees income. The Victorian Supreme Court (Holroyd, A'Beckett, and Hodges JJ) upheld the deduction of all the travel expenses. It was unanimously agreed that the travel between X and the other rural properties was deductible because "necessary and expended solely for the purpose of carrying on the trade of the taxpayer in each place" (Stewart, 2001, p. 502).

By contrast, there were different judicial opinions expressed about the deductibility of the Melbourne trips. Holroyd J argued for deductibility because he believed that director's fees were part of the taxpayer's income and that the expenses were incurred to enable him to earn those fees. A'Beckett J also supported deductibility because the expenses were for travel between two places of business where income was earned. That he lived at property X was not held to be a relevant factor. Thirdly, Hodges J expressed doubts about the deductibility because he had "a feeling and a view that it is rather getting from his residence to the income-earning place". However, rather magnanimously, he did not formally dissent from the majority opinion of the other two judges. Although the taxpayer was a clear winner in this early case, the fact that one judge disagreed with deductibility of the Melbourne trip expenses and the other two judges used different reasoning to reach a more favourable conclusion arguably did not bode well for the future. Room had been provided for future decisions to be based along the lines of the reasoning of Hodges J. Mr Payne, perhaps from a position of excessive self-confidence, relied for his case upon the decisions in *Green* (1950) and *Garrett* (1982).

Payne case (Administrative Appeals Tribunal)

In the *Payne* case, the taxpayer was seeking deductions for travel between his deer farm in rural New South Wales (which was also his residence) and Sydney where his pilot job was based. An interesting issue is raised here because the two places of business are clearly unrelated. It may also be significant that one was a place of employment for the taxpayer

⁶ [1904] VicLawRp 40; (1903) 29 VLR 298. The case concerned the application of the then-applicable Victorian income tax law, which had a quite different structure from the *Income Tax Assessment Act 1936* (Cth).

rather than a place of business. This might be seen to distinguish *Payne*, in some people's eyes, from the two cases, *Green* and *Garrett*, relied upon by the taxpayer. It might be argued that, for at least some of the trips, the travel from the deer farm to Sydney was the equivalent of travelling from home to work and hence not deductible. Such a decision would be consistent with the minority view expressed by Hodges J in *Re the Income Tax Acts* (1903).

The first place to appeal a Commissioner of Taxation's ruling in Australia is the Administrative Appeals Tribunal (hereafter Tribunal). When faced with the situation where his claims for deductions were disallowed, Mr Payne, as taxpayer, then appealed to the Tribunal. J Block, Senior Member, presided over the Tribunal and he decided the case in the Commissioner's favour. The Tribunal broke the deductibility issue up into two questions (Stewart, 2001): Firstly, are expenses incurred in travel between two places of unrelated income derivation incurred "in gaining or producing assessable income"? Secondly, if yes, what, if any, bearing does the existence of the taxpayer's residence at one of those places have on the matter?⁷

The Tribunal's decision was that the expenditure was incurred in travelling between two unrelated places of business and hence the travel was a *pre-requisite* to earning income in either place and not deductible. As mentioned, this was held to be conceptually similar to travel between home and work (of course the opposing opinion can also be argued for) where the *Lunney* verdict applies. Because the first question was answered in the negative then the second question about taxpayer's residence did not need to be addressed.

The Tribunal argued that *Green* did not apply because in that case *the travel itself was part of the income-earning operation* of managing rental properties in the north of the state of Queensland from a base in Brisbane in south-east Queensland. *Garrett* was distinguished from the present case for the same reason. The Tribunal said that the travel was simply to put him (Mr Payne) in a position where he could carry on two separate and unrelated income-earning activities. The Tribunal also noted that *Re the Income Tax Acts* had been overturned by *Lunney* although this is a strange comment as the facts in those two cases were somewhat different. In Stewart's (2001) words, "The travel must be a part of the very operation by which income is earned or, put another way, the occupation must by its very nature require travel".⁸ Does interview-based academic research fall into this category? The present author would answer in the affirmative because if the research topic relates to a Sydney context (for example, Sydney trade-union strategy in the construction industry) a researcher from outside

⁷ *Payne (AAT)* [1997] AATA 163; (1997) 46 ALD 718, 728.

⁸ *Payne (AAT)* [1997] AATA 163; (1997) 46 ALD 718, 738.

Sydney must travel there to do interviews. A less clear-cut situation might be travelling to a place where one or two key interviewees live. This might occur, for example, if the research context was Sydney but the person or people had since moved on from there for personal or family reasons. Some might also wonder whether new technology could be used for an interview; if that was possible then the travel could be avoided totally. This could be done for one or two isolated interviews but not where observation and an understanding of local contextual factors are important.

Payne case (Federal Court – Foster J)

Dissatisfied with the Tribunal's decision, Mr Payne exercised his right under Section 44 of the *Administrative Appeals Tribunal Act 1975* (Cth) to appeal to the Federal Court. His case was initially presided over there by Foster J. The taxpayer believed that the Tribunal had erred in law and he continued to maintain that his claims were deductible under Section 51(1) of *ITAA* based on the precedents set in *Green* and *Garrett*.

Foster J agreed that the Tribunal had made an error in law and he put the case up for further consideration by the Full Federal Court. He said that *Lunney* did not serve as a basis for assessing claims of deductibility of travel between two places of business but instead he restricted its operation to simple travel between home and work only. He claimed that the Tribunal's attempt to develop a comprehensive theory for work-related travel deductibility was dangerous and ignored the fact that tax law precedes on a case by case basis.⁹

Foster J argued that what is crucial is whether the expense was productive in producing the "composite income". He argued that there was an error of law made at the Tribunal because it failed to take into account the relationship between the totality of his earnings and his overall earnings process. Stewart (2001, p. 506) notes that Foster J added into his statement a "somewhat strained analysis" which attempted to theorize links between Mr Payne's Sydney-based pilot job and his deer farm.

Payne case (Full Federal Court)

The Commissioner chose to appeal to the Full Court of the Federal Court. Sackville and Hely JJ agreed with Foster J, although their reasoning was slightly different, and they returned the

⁹ *Payne (FC)* (1998) 39 ATR 375.

case to the Tribunal to be dealt with according to law (thus to correct the original error of law made at that level previously).

First of all, Sackville and Hely JJ agreed that the travel expenses were incurred either *before* or *after* the income-earning activities at either place. In other words, the expenses were not incurred in the course of either income-earning activity. However, they then went on to say that assessable income need not be from one particular place of business but it means the assessable income which the relevant outgoing would be expected to produce.¹⁰ According to Sackville and Hely JJ, the crucial question:

“...involves an examination of the scope of the operations undertaken by the taxpayer ... and the relevance of the expenditure to those operations. The expenditure must be incidental and relevant to the derivation of assessable income from those operations and, in addition, its essential character must be that of a business expense. The relevance of the expenditure should be determined having regard to the overall income producing activities of the taxpayer, and not by reference to individual sources of income”.

By now it seems that two rival schools of judicial thought have emerged, and it is hard to see how the two contrasting viewpoints can be reconciled. Either commentators see the earning of the “composite income” across all income-earning activities as most important or they perceive that any or all of the expenses are simply *pre-requisites* to earning income at any one place of business or employment (and hence not deductible). Sackville and Hely JJ’s point about it must be an expense of a “business character” is interesting and might seem too subjective but accountants around the world make similar decisions every month. Here we see how some might get fooled by the topic of an academic’s research project rather than the method and purpose. For example, some might, even subconsciously, perceive that expenses for research into music or sport or tourism related-topics have less of the character of a business expense (because they are too much fun!) than expenses for research on more mundane topics such as local government or internal auditing. However, clearly this perspective would be wrong.

Given this deadlock or stalemate between two competing views, Sackville and Hely JJ tried their best to clarify when they said that travel between two places of employment or business is travel *on* work not travel *to* work.¹¹ Some might be left scratching their heads at this comment as it might appear to be overloading the meaning that should be attached to either or both of the prepositions mentioned. Clearly the key question is whether

¹⁰ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 445.

¹¹ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 446.

commentators look at the income-earning activities of the taxpayer as a composite whole or whether they add the activities up one by one, put mental fences around them, and focus on their separateness.

Furthermore, for Sackville and Hely JJ, the phrase “*in the course of* gaining and producing assessable income” (my italics) should be interpreted broadly and widely so as to include travel prior to arriving at a particular place of employment or business. As they write:

“Where travel is between places from which income is derived, for the purpose of deriving income from activities conducted at those sources, there is the contemporaneity between expenditure and income earning activity which is implicit in the notion of ‘in the course of’ gaining or producing assessable income. Moreover, the expenditure has a substantial business character. If the purpose of the travel is exclusively to go from one income producing activity to another, it is difficult to see how the essential character of the expenditure is other than a business or working expense”.¹²

Sackville and Hely JJ also made it clear that a close organizational connection between the two income-earning activities need not be established.¹³ Furthermore, the “substantial business character” of the expenditure does not change just because the taxpayer travels between two seemingly unrelated places of business or employment. It appears that Sackville and Hely JJ have now been able to produce a coherent worldview or theory in support of their position. However, those on the other side of the fence are unlikely to change their views because it seems that the respective positions have already hardened. The case was returned to the Tribunal on the basis of the argument that travel between a place of business and an unconnected place of employment could be allowable deductions under Section 51(1).¹⁴

Payne case (Full Federal Court: Dissent of Hill J)

In his dissenting opinion, Hill J stated that the law on the tax deductibility of travel expenses had stood for a long time and that changes could only be made by the High Court or the legislature (i.e. federal parliament).¹⁵ Hill J summarized the extant case law as producing the following propositions:

1. Travel from home to work is not deductible; it is a condition precedent to work.
2. Travel from work to home is not deductible; it is subsequent to work.

¹² *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 446-7.

¹³ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 446-7, contrary to the view of Foster J.

¹⁴ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 451.

¹⁵ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 436.

3. Travel on work from one place of employment to another in the same job, or from one place of business to another for the purpose of one business, is deductible.

This is an ingenious summary as Hill J only dared to include in this list the uncontroversial areas, preferring to keep silent about the decisions in *Green* and *Garrett* and indeed the views of his own esteemed Full Federal Court colleagues who were very clear in holding that travel may be deductible for travel between *unconnected* places of employment or business. Controversially, Hill J then concluded from his three points above that travel between two unconnected places of employment, two unconnected places of employment or between a place of employment and an unconnected place of business are not deductible.¹⁶ A basketball fan might respond to this by saying that if you only put certain players on the court then that must influence the result that you get.

Hill J concluded that where there is no connection between the expense and either income-producing activity and where the expense is not a working expense of either activity then it was not “incurred in the course of gaining or producing assessable income” (and hence not deductible).¹⁷ Hill J believed that *Payne* was an example of such a case. Clearly Hill J’s view must mean a narrow interpretation of the somewhat ambiguous phrase “in the course of” as opposed to the broader interpretation of the phrase favoured by his colleagues Sackville and Hely JJ. In the view of Hill J the travel expenditure was simply a *condition precedent* for his work as a pilot and hence not deductible.¹⁸ We can see here evidence of a widely-held view that most if not all employment jobs (as opposed to businesses) have a clear boundary, a clear starting point, and a clear ending point (both time-wise and in terms of geography). If a job is based in Sydney then the job is not carried out outside of Sydney or until the taxpayer reaches her / his Sydney office (which is ironic given that in *Payne* we are talking about a pilot’s job). Also note that “[not] a working expense of either activity” is probably a different and narrower test than the earlier “business character” test which was ignored.

Payne case (High Court: Majority decision)

The High Court decision was extremely disappointing for Mr Payne as the majority this time supported the dissenting opinion of Hill J in the Full Federal Court and elected to seriously limit the type and range of work-related travel expenses which could be deductible. Mr Payne

¹⁶ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 437.

¹⁷ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 436.

¹⁸ *Payne (FFC)* [1999] FCA 320; (1999) 90 FCR 436.

might have remembered the bleak line from a Bruce Springsteen song: “there is just a meanness in this world”. By contrast, the two High Court dissenters upheld the prior arguments in *Green* and *Garrett* and the Full Federal Court majority. They believed that a broader range of work-related travel expenses could qualify for deductibility.

Gleeson CJ, Kirby and Hayne JJ first referenced the majority decision of the Full Federal Court before later going on to disagree with it:

“Accepting, as one must that ‘the assessable income’ referred to in s 51(1) is a broad concept, it may well follow, as the majority of the Full Court said, that ‘[t]he relevance of the expenditure should be determined having regard to the overall income producing activities of the taxpayer, and not by reference to individual sources of income’. That is not to say, however, that the kind of connection that s 51(1) requires between outgoing and income is other than the connection described as ‘incurred in gaining or producing the assessable income’. The question is whether the outgoing was incurred *in the course of* gaining or producing actual or expected income. That is, is the occasion of the outgoing found in whatever is productive of actual or expected income?”¹⁹

The *Lunney* case was put forward as creating the precedent whereby travel expenses for travel between home and place of employment or business were not deductible.²⁰ The joint judgement in *Lunney* was cited as alleged proof for the proposition that expenditure which is a mere “prerequisite” to the earning of a taxpayer’s income (home-to-work travel expenses being the classic case) is not incurred in or *in the course of* gaining or producing her or his income: However, note that the phrase “in the course of” is an *amplification* of the statutory text of Section 51(1) and the words don’t actually appear in the text itself.

Then we got the following somewhat useless judicial statement (what does “more immediate” mean exactly?) which failed to clarify anything but did let people know that the majority opinion was leading up to a decision which would not be pleasing to Mr Payne:

“That is, the majority in *Lunney* held that a taxpayer does not demonstrate that the first limb of s 51(1) is satisfied by demonstrating only that there is some causal connection between the expenditure and derivation of the income. What must be shown is a closer and more immediate connection”.²¹

This “closer and more immediate” principle (but where did that phrase come from and what authority did it have?) was then “applied” to the *Payne* case facts (prejudicially of course for Mr Payne because the majority opinion had already decided that “in the course of” deserved a narrow interpretation). The following conclusion was then reached: “[w]hen, as here, the

¹⁹ *Payne* [2001] HCA 3; (2001) 177 ALR 273 (emphasis in original, citation omitted).

²⁰ *Payne* [2001] HCA 3; (2001) 177 ALR 274.

²¹ *Payne* [2001] HCA 3; (2001) 177 ALR 274.

travel is between two places of unrelated income derivation, the expense cannot be said to be incurred ‘in the course of’ deriving income from either activity’ ”.²² This dispute over the interpretation of the phrase “in the course of” (which does not even appear in the statutory text) appears to be at the heart of the disagreements which occurred in both the Full Federal and High Courts.

The High Court majority concluded as follows about the travel of Mr Payne:

“[It] occurred in the intervals between his two income-producing activities. The travel did not occur while the taxpayer was engaged in either activity. To adopt and adapt the language used in *Ronpibon*, neither the taxpayer’s employment as a pilot nor the conduct of his business farming deer occasioned the outgoings for travel expenses. These outgoings were occasioned by the need to be in a position where the taxpayer could set about the tasks by which assessable income would be derived. In this respect they were no different from expenses incurred in travelling from home to work”.²³

It seems that the diverse nature of the taxpayer’s two income-earning activities had a profound effect on the collective minds of Gleeson CJ, Kirby and Hayne JJ. They could not contemplate a worldview where the two activities and the income thereof were viewed as part of a “composite income”. As such, if we take this logic to its logical conclusion, no work could be conducted outside of (chronologically *before* or *after*) each place of business or employment and the case then became identical to travel between home and work. The majority opinion neatly sidestepped the prior decisions in *Green*, *Garrett*, and *Re the Income Tax Acts* by simply not referring to them at all (a tactic we hope that our undergraduates would not descend to) although the “misgivings” of Dixon CJ in *Lunney* were noted. The majority said that fault should be put at the feet of the legislation rather than in its interpretation, and went on to say that “the distinction has long been made and it is now too late for the Court to ‘rip it up’ and treat the section as allowing any and all deductions having some causal connection with the derivation of assessable income”.²⁴

Payne case (High Court: Dissent of Gaudron and Gummow JJ)

Naturally, in such an important and controversial area and one where a long history of judicial opinions have been favourable to the taxpayer, there was a dissenting opinion where Gaudron and Gummow JJ agreed with the majority decision in the Full Federal Court. However, as noted, the direction of the shift in judicial balance between the Full Federal and

²² *Payne* [2001] HCA 3; (2001) 177 ALR 274-5.

²³ *Payne* [2001] HCA 3; (2001) 177 ALR 275.

²⁴ *Payne* [2001] HCA 3; (2001) 177 ALR 275.

High Court cases was very unlucky for Mr Payne as a one majority supporting his claim in the Full Federal Court morphed into a one majority opposing him in the High Court. Gaudron and Gummow JJ were quick to warn about forcing a one-size-fits-all judicial principle or framework upon cases with diverse factual backgrounds:

“The temptation, or at least the tendency, to which this difficulty gives rise is the derivation of a ‘principle’ from similar facts in various cases. The ‘principle’ then is taken to govern the administration of the statute with respect to later cases said to fall within this artificially constructed category”.²⁵

Gaudron and Gummow JJ refused to accept that the proposition in *Lunney* was binding on any cases beyond the movement of the taxpayer between a sole place of work and the sole place of residence.²⁶

Discussion

In an academic’s work, our future promotion prospects and job opportunities are based, in large part (especially for jobs at senior lecturer level and above), on our past research performance which is measured principally by the number and quality of journal articles which we have published in peer-reviewed academic journals. Research-related travel costs might then appear to be capital in nature. However, if we fail to score enough research publications it is quite possible that we might be fired or our fixed-term contracts might not be renewed. Therefore, research is an integral part of the job description and we cannot avoid it except at considerable risk to our careers. This is obviously a different situation from a primary-school teacher who gets a higher-degree (probably studying outside of working hours) so as to improve her / his future job prospects. For the primary-school teacher research is not a part of the actual job. Furthermore, little interview-based research can be done without travel especially for academics like the author who was then based in a rural town (Toowoomba, Queensland, Australia, population 100,000). To quote the Administrative Appeals Tribunal, in *Payne*’s case, “the occupation must by its very nature require travel [to be a deductible expense]” (*Payne (AAT)* [1997] AATA 163; (1997) 46 ALD 718, 738, cited in Stewart, 2001, p. 505). Therefore, my research-related travel costs should have been deductible. An academic’s research-related travel creates expenses which are incurred for the clear purpose of gaining assessable income. We are not “just teachers” (except for the small

²⁵ *Payne* [2001] HCA 3; (2001) 177 ALR 270, 277.

²⁶ *Payne* [2001] HCA 3; (2001) 177 ALR 281.

minority of Australian academics on “teaching-only” contracts) and I believe the ATO does not fully understand this.

The contradiction, from the viewpoint of the ATO, is how academics can be expected to research but we are not instructed when and where to go for research trips, we are not told what topics to research, and often we get no university funding for research expenses (as research grants are hard to obtain). We operate like a principal contractor at a building site with our research projects being like sub-contractors which are organized by us. The ATO thinks we do research and get publications to boost our CV in the job-market and hence our research expenses are of a capital nature and disallowable (except under the specific “self-education expenses” provision). The Perth-based ATO officer I conversed with in January 2015 clearly thought in this way. He mentioned a case involving a primary-school teacher and was at a loss for words when I said a university academic’s job is completely different from a primary-school teacher’s job. A primary-school teacher is hired to teach only and research is not part of her / his job description and the same applies for a secondary-school teacher. Therefore, if a primary-school teacher completes higher-degree study to boost her / his future employment opportunities this expense is of a capital nature. By contrast, university academics are expected to do regular research as part of their job descriptions. Many of these researchers are not looking to change jobs but just hope to stay in their current jobs. In my opinion, then, the cost of research-related travel and book-purchase expenses should be allowable deductions for university academics. The test should be “was the primary purpose of the trip to do research or to have a holiday or to visit friends / relatives?” In the latter two cases, the expense is of a domestic or private nature and travel expenses are clearly not deductible.

Of course I can imagine that the ATO is very worried about abuse. However, much abuse will always go undetected under an honesty-based system. If the ATO wants to avoid abuse it should choose the path of Fiji which deducts tax from workers’ salary (at a lower tax rate) under PAYG but then allows no deductions. As it is, ATO is being hypocritical in the case of university academics by allowing them research-related deductions *in theory* but denying them all or nearly all such deductions *in practice*.

The ATO is probably very worried about a situation where university academics find “a friend in every city” or “a research project in every city” so that all travel to see those people (fellow academics) or to do research in another city yields allowable deductions. A person could visit Sydney (or wherever) for the real purpose of having a holiday but do a little bit of research while there or talk to another university academic about research just so as to claim a

deduction. There is no easy answer to this problem but the extreme approach adopted by the ATO represents a lazy and heartless attempt to avoid having to deal with the underlying issues. It has to be remembered that an academic claiming a deduction for a bona fide research trip will have to pay around 60% of the trip cost using her / his own money (at an effective marginal tax rate of 40%). The academic makes a greater sacrifice than the ATO does in absolute dollar terms and the ATO should respect this sacrifice. The academic pays 60% of the total cost while the ATO pays 40% of the total cost. Surely an academic using her / his own money to do research should be commended given that she / he could easily have spent the money on personal holidays or home extensions or a new car or anything else obviously of a private, domestic or capital nature (and not beneficial to society). Research often has social or public policy implications and it can also inform and improve the academic's teaching. Obviously an academic claiming deductions of 75% or more of her / his assessable income is probably being fraudulent. However, an academic earning AUD90,000 per year could possibly spend up to AUD40,000 per year on bona-fide research-related costs if she / he lives frugally the rest of the time.

Conclusion

This paper has included a case study of my own experiences as a personal taxpayer being audited by the ATO as well as a legal analysis of Australian tax cases relating to the deductibility of travel-related expenses. The personal case study explains Australia's tax system of Pay As You Go (PAYE) income tax deductions followed by annual tax return submissions (using an honesty-based system) plus occasional subsequent tax audits if deductible expenses claimed in tax returns are held to be excessive. The case describes how the ATO initiated and handled my tax audit in 2013-15 and the arguments put forward by the ATO officers as to why my research-related tax deductions should be disallowed. The next part of the paper reviews the tax law cases in Australia's past which have either allowed or disallowed work-related travel expense deductions. This discussion concludes with the *Payne* case of 1999-2001.

Judges have now polarized themselves into two discrete camps, those for deductibility looking at the composite income-earning activities of the taxpayer (viewed in a holistic way) with those against deductibility arguing that travel between two unrelated places of employment or business is equivalent to travel between home and work. The group against

deductibility has gradually gained more supporters to the extent that it became the majority opinion when the High Court discussed the *Payne* case whereas it was only a dissenting opinion in the Full Federal Court's hearing of *Payne*. The disparate worldviews that the two camps bring to their interpretation of Section 51(1) travel claims suggest that the two camps will be unable to merge or even to compromise. The majority High Court view held that faulty interpretations and ambiguous language should not be rectified by the High Court but must go back to the legislators. This position means that the High Court is condemned to swim forever in a sea of mediocrity and irrelevance. The position also ignores the fact that several earlier judicial opinions before *Payne* were strong and fairly consistent in their arguments for deductibility which means that the High Court is not always following precedence (which is the lofty standard which it committed itself to in *Payne*). These cases include *Re the Income Tax Acts*, *Finn*, *Garrett*, and *Green*. As to why the High Court majority in *Payne* felt that it must extend the *Lunney* principle of no deductibility for travel costs between home and work beyond that narrow factual situation requires further scrutiny as it is not at all self-evident or logically necessary. Furthermore, much emphasis was placed by the against-deductibility camp on the concept that expenses must be incurred "*in the course of gaining or producing assessable income*" (my italics) but the fact is that the three words in italics do not actually appear in the statutory text. Lastly, the against-deductibility camp ignore the very logical and commercially-minded "expenses must have a business character" test of *Sackville and Hely JJ* (Full Federal Court in *Payne* case) perhaps because this did not suit their pre-conceived and strongly-held views. Overall, I fear that revenue-raising rather than strong logical argument has cast an evil shadow over the entire affair. The courts have also expressed a fear about loss to revenue if a strict position on travel expense deductibility is not maintained (Stewart, 2001, p. 522)

The case, later generally ignored by judges in the against deductibility camp, which is perhaps closest to that of a university academic doing research is *Finn* (1961) which held that the expenses for a long (eight-month) trip overseas to study architecture paid for by a state government employed architect were deductible. The link here between expenses and income-earning activities is, in my opinion, slightly less strong than for research-related travel expenses incurred by academic employees. On balance, I am still of the view that research-related travel (made with a view to publishing in academic journals) should be tax deductible. It should not matter that the employee normally chooses her / his own research topics and where and when to go for research trips. These unusual contextual factors reflect the unique nature of an academic's job. Because current job security and future salaries are

largely based on prior publication records for senior lecturer positions and above my view is that research-related travel expenses paid for by the taxpayer from her / his personal funds should be (and in fact are) tax deductible under Australian taxation law. If the ATO refuses to allow deductions for work-related expenses for academics then a simple Pay As You Go tax system (such as Fiji's) which does not recognize any deductions at all but which has a lower tax rate scale is preferable to the more expensive Australian system.

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