
Allowable deductions

Section 8-1 of the ITAA97 allows the taxpayer to deduct from assessable income any loss or outgoing to the extent that:

- a) It is incurred in gaining or producing the taxpayer's assessable income; or
- b) It is necessarily incurred in carrying on a business for the purpose of gaining or producing the taxpayer's assessable income.

But in neither case are losses or outgoings a general deduction where they are:

- Of a capital or of a capital nature; or
- Of a private or domestic nature; or
- Incurred in relation to gaining or producing the taxpayer's exempt income or non-assessable non-exempt income; or
- Prevented from being a deduction by a provision of the Act.

Occupational clothing:

Expenditure on clothing and its maintenance is generally treated as expenditure of a private nature and not deductible. However, case law has allowed a deduction where:

- The clothing is 'necessary and peculiar' to the taxpayer's occupation.
- The clothing is conventional in nature, but because of the occupation of the taxpayer, extra expense is incurred in relation to the clothing. In this situation, the taxpayer is entitled to claim a deduction for the additional expense which is over and above 'normal' expenditure.

Prepaid expenditure:

For small business taxpayers that have elected to enter the simplified tax system (STS) and individuals incurring non-business expenditure, the 13-month rule that applied pre-July 2001 has been replaced by a 12-month rule. The 12-month rule allows an immediate deduction for prepayments where:

- The payment is incurred for a period of service not exceeding 12 months; and
- The period of service ends in the next income year.

Interest

Interest, being of a revenue nature in itself, is clearly deductible if incurred in gaining or producing assessable income. It is important to distinguish between the purpose for which money is borrowed, and the security given for it. In *FC of T v. Munro (1926)*, the taxpayer borrowed money secured on income-producing property to acquire some shares in a company for himself and his two sons, and made an interest free advance to the company. It was held that there was no nexus between the loan and the production of assessable income, the deduction was denied. Equally, in another case, where the taxpayer borrowed money at 12.5 percent and on-lent it to his wife at 1 percent, it was held that the interest on the borrowed money was deductible only to the extent of the interest earned, as the balance was not incurred for the purpose of producing assessable income.