FEDERAL COMMISSIONER OF TAXATION v. FAICHNEY[1]

Income Tax—Deductions—Expenses of residence—Research Scientist using room as study—Income Tax Assessment Act, section 51.

The taxpayer in *Federal Commissioner of Taxation v. Faichney*[2] was a research scientist who, because of the nature of his employment, found it necessary to do a considerable amount of work at home. When he built his house he included a fourth bedroom which he set up as a study and which was used almost exclusively by him. An appreciable part of the use was for activities connected with his work. The taxpayer claimed the right to deduct a proportion of the interest payable under a mortgage of his home, attributable to his study, a proportion of the electricity expenses attributable thereto, and depreciation on carpet, curtains and bookshelves in the study. Mason J. held that no deduction in respect of the interest could be allowed, but a deduction in respect of lighting, heating and depreciation of furniture was allowable. In reaching this decision Mason J. relied heavily on a judgment of Walsh J. in *Thomas v. Federal Commissioner of Taxation.*[3]

Until these two cases were decided, it was generally assumed that a taxpayer who used part of his home as a study in order to derive assessable income, could deduct the proportion of rent or interest paid, which was related to the study, as an outgoing incurred in gaining or producing assessable income under section 51(1) of the Income Tax Assessment Act 1936-1972. This view was adopted by a number of Board of Review cases.

Section 51(1) provides that:

> [a]ll 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, or are incurred in relation to the gaining or production of exempt income.

The question in these cases is basically one of apportionment. Does the section contemplate apportionment? If so, does the section allow apportionment where one room is set aside exclusively for business purposes? Does it allow apportionment where a room is used partly for business purposes and partly for domestic purposes? In answer to the first question, clearly section 51(1) in using the words 'except to the extent' contemplates apportionment between business and private expenses. This much was decided in *Ronpibon Tin N.L. v. Federal Commissioner of Taxation.*[4]

As to the other questions, in principle it would seem only just that if a taxpayer incurs expense in setting up a separate room as a study, he should be able to deduct such expenses as outgoings incurred in gaining or producing assessable income where in fact the study is used for such purposes. The

[1] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.
[2] *Ibid.*
[3] (1972) 46 A.L.J.R. 397.
[4] (1949) 78 C.L.R. 47, 59.

fact that the study might also be used for other purposes should in fact make no difference. Surely, if a taxpayer builds a study attached to his business premises, any interest paid under a mortgage raised for the purpose of building that study is deductible. And if the taxpayer periodically uses that study for private cocktail parties, unconnected with the gaining of assessable income, does that mean he loses his deduction? It seems arguable that where the private or domestic use is fairly frequent the Act contemplates apportionment. Similarly apportionment should be allowed where the study is attached to the taxpayer's home rather than his place of business.

It seems to be established that a business man who lives in premises above his place of business is able to apportion his expenses.[5] There seems no valid reason for not allowing the same right to a professional man who does some of his work in a study at home.

The result of *Thomas v. Federal Commissioner of Taxation*[6] and *Federal Commissioner of Taxation v. Faichney*[7] is that apportionment is not allowed when a particular room is set aside as a study and used exclusively for the purpose of gaining or producing assessable income or when the room is used partly for such purposes and partly for private or domestic purposes.

In *Thomas'* case[8] the taxpayer, a barrister, had added three rooms to his home. One of these rooms he used as a study. He sought a deduction for a proportion of the interest payable under a loan raised for the purpose of making the extensions. Walsh J. refused to allow the deduction on the grounds that:

> the house should not be regarded in the circumstances of this case as including part of the business premises of the appellant and the loan should not be regarded as having been raised for the purpose of providing him with business premises. Payment of the interest in so far as it was an outgoing connected with the cost of extensions to the house was, in my opinion an outgoing 'of a capital, private or dometic nature' within the meaning of s. 51(1) of the Act. In my opinion it did not lose that character merely because the appellant, like most professional men, did some of his work at home or because he used one of the added rooms for that purpose. The appellant did not spend money in erecting premises suitable only for use as business premises. He added rooms to his house.[9]

On its own this decision would have been subject to criticism and could have been distinguished by Mason J. in *Faichney's* case.[10]

Walsh J. appears to suggest that deductions under section 51(1) can be made in respect of outgoings for business premises only when the premises are suitable solely for business purposes. This would suggest that the Act does not allow apportionment. Yet, as I have already pointed out, the Act clearly contemplates at least some apportionment by the use of the words 'except to the extent'.[11]

Furthermore, the argument that the taxpayer incurred expense in making additions to his house and that therefore the expenses were consequent on

[5] Mannix and Harris, *Australian Income Tax Guide* (19th edn. 19) 83.
[6] (1972) 46 A.L.J.R. 397.
[7] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.
[8] (1972) 46 A.L.J.R. 397.
[9] *Ibid.* 399.
[10] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.
[11] *Ronpibon Tin N.L. v. Federal Commissioner of Taxation* (1949) 78 C.L.R. 47, 59.

ownership and not in the course of gaining his income is an unsatisfactory argument as it places too narrow an interpretation on section 51(1) and would exclude all but the barest necessities from the ambit of that section.[12]

Mason J. in *Faichney's* case[13] took a similar view to that of Walsh J. in refusing to concede that a study in the home can be anything but a part of the home:

> [t]o my mind, a study in a taxpayer's home, no matter how great the extent of its dedication in point of use to the pursuit of those activities from which the taxpayer earns his income is part of that home. Expenditure incurred in the erection of the study or in its renovation is as much an outgoing of a capital, private or domestic nature as an expenditure on any other part of the home. The view which I have expressed is, I think, in accord with the decision of Walsh J. in *Thomas v. Federal Commissioner of Taxation*.[14]

Mason J. then went on to quote the passage from *Thomas'* case[15] extracted above.

His Honour proceeded to distinguish the study of a professional man in his home from the expenditure incurred by a doctor in erecting a house which contained his surgery or in renovating a house containing such a surgery on the ground that a surgery is not part of a doctor's home but is his place of business. The distinction seems a very fine one. In fact it would be more in keeping with section 51(1) not to draw one at all. If the doctor had a surgery separate from his home, but also worked from certain rooms in his home set aside for such purpose would those rooms be classed as separate from the home or would they be more like the professional man's study and therefore part of the home? It would seem that a doctor who had two surgeries, one in his home and one apart from his home could claim deductions under section 51(1) in respect of both of them whereas a professional man who carried on part of his work from business premises and part from his study at home could not.

Furthermore, it is submitted that, for the purpose of section 51(1) one should not be concerned with whether the rooms form part of the taxpayer's home, but with whether they are used for the purpose of gaining assessable income.[16] In many cases business premises and private premises are combined as one. In the case of a storekeeper who owns a shop with attached living premises, does he own a shop with attached living premises or does he own a home with attached business premises? Surely, the real question is whether part of those premises are used for the purpose of gaining assessable income. What of the young solicitor who starts off his practice in the front room of his home? Is he therefore denied a deduction under section 51(1)? It seems unlikely that Mason J. would go so far as to say that section 51(1) denies a deduction where a man's sole business premises form part of his home. Yet, if section 51(1) is concerned with whether the rooms form part of the taxpayer's home rather than whether they are used for the purpose of gaining or producing assessable income the logical extension of the decision in *Faichney's* case[17] is to deny a deduction to a person who conducts his

[12] Furthermore, it appears this argument is inconsistent with the view of several members of the Full High Court in *Moffat v. Webb* (1913) 16 C.L.R. 120; See Moore, [1972] *Australian Tax Review* 279, 281.
[13] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.
[14] *Ibid.* 37 and 4249 respectively.
[15] (1972) 46 A.L.J.R. 397.
[16] Spry [1973] *Australian Tax Review* 64, 66.
[17] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.

business from his home on the ground that his business premises form part of his home. Or perhaps, in such a case Mason J. would create another exception like the case of a doctor and his surgery.

Mason J. could have distinguished *Thomas'* case[18] and come to a conclusion which, if not completely satisfactory would nevertheless have been preferable to the one he reached. It is possible to distinguish *Thomas'* case[19] on the basis that in that case it was not clear whether the taxpayer had set aside the study solely for professional purposes, that is whether he used the room either exclusively or primarily and predominantly for professional purposes. In *Faichney's* case[20] it was clear that the room was used primarily for professional purposes. A better result would have been to refuse to follow *Thomas'* case,[21] but if Mason J. did not wish to overrule the earlier case he could have confined it to its facts thereby allowing apportionment under section 51(1) only when the study was used exclusively for business purposes and not allowing apportionment where the room was used partly for business purposes and partly for private and domestic purposes. Although not the best result this would have been better than the result actually reached in *Faichney's* case.[22]

Mason J. held that expenditure on lighting and heating was deductible under section 51(1) and that depreciation was allowable under section 54 not only on the desk and bookshelves, but also on the carpet and curtains in the study. It seems surprising that these latter two items should be deductible under section 54 in light of the attitude of Mason J. with respect to the interest apportioned to the study since surely curtains and carpets are as much a part of the home as the four walls comprising the study.[23] One would expect that since he allowed apportionment in respect of these items he would have allowed apportionment in respect of the interest as well.[24]

It seems that in order to clarify the position of a professional man who uses a study within his home for the purpose of gaining or producing assessable income we must await a decision of the Full High Court. It is to be hoped that this decision when it comes will reverse the trend established by *Thomas'* case[25] and *Faichney's* case.[26]

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[18] (1972) 46 A.L.J.R. 397.
[19] *Ibid.*
[20] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.
[21] (1972) 46 A.L.J.R. 397.
[22] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.
[23] It appears that the absence in s. 54 of the exception in s. 51(1) as to private or domestic expenditure is of no real significance as no question of the deductibility of such expenditure would arise even in the absence of an express exception; Spry [1973] *Australian Tax Review* 64, 66.
[24] In *Caffrey v. Federal Commissioner of Taxation* [1973] A.T.C. 4144, a recent decision of Wickham J. in the Supreme Court of Western Australia, the fact situation was very similar to that in *Faichney's* case. His Honour held that the taxpayer could claim a deduction under s. 51(1) for a proportion of the rent paid for his home. He did not consider that *Faichney's* case or *Thomas'* case laid down any new legal rule relating to the construction of s. 51. He considered that even if the statement of Mason J. that rent paid for the taxpayer's home is of a private and domestic nature were not *obiter* it could not be regarded as a legal proposition that rent paid for the taxpayer's dwelling can never be to any extent incurred in gaining or producing assessable income within the meaning of s. 51(1) by adding another exception or provision to it.
[25] (1972) 46 A.L.J.R. 397.
[26] (1973) 47 A.L.J.R. 35; [1972] A.T.C. 4245.