IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

M.88/84

No Special Consideration

1437

(1984) 8 TRNZ 225,
(1984) 6 NZTC 61,864

IN THE MATTER of Section 43 of the Inland Revenue Department Act 1974 as amended

BETWEEN THE COMMISSIONER OF INLAND REVENUE

APPELLANT

AND JOE FRIDAY HAENGA of Wellington, Shunter

RESPONDENT

Hearing 12 November 1984

Counsel R M Elliott for appellant
J R Wilson for respondent

Judgment 19 November 1984

P. 9. I think the word is "temporally"

JUDGMENT OF DAVISON C.J.

The respondent is a shunter who was employed by the New Zealand Railways during the tax year ended 31 March 1982. He was required by law (Government Railways Act 1949 s 120B(3)) as a condition of his employment to be a contributor to the Welfare Fund in accordance with the rules of the Government Railways Welfare Society. The respondent was a member of such Society. Its functions as set out in the rules are:

" 2.(1) It shall be the function of the society to provide welfare relief, assistance, and benefits for its members and their dependents.

(2) Without limiting the generality of the provision of subsection (1) of this section, the society may from time to time:

(a) Grant to any of its members, who by reason of sickness are absent from duty without pay or on reduced pay, such financial assistance as it thinks fit.

(b) Assist any member or former member of the society in financial difficulties which it considers to have been brought about by misfortune.

(c) Assist financially the dependents of a deceased member or deceased former member of the society.

(d) Assist financially any member of the society on the death of his spouse or any child of his family.

(e) Provide comforts (either financial or otherwise) to any member or former member of the society during any sickness suffered by him.

(f) Assist financially any member or former member of the society who may be required to obtain special medical or surgical treatment for himself or his spouse or any child of his family, either in New Zealand or elsewhere.

(g) Assist financially a member who, as a result of illness or injury to his spouse, is required to employ domestic or nursing help in his home.

(h) Establish, maintain, and manage accommodation suitable for holiday or convalescent purposes of its members and their dependents. "

Annual contributions to the fund in accordance with Rules 8, 11 and 12 are payable in 13 instalments, 4 weekly in advance by way of deduction from wages or salary.

The respondent in the relevant tax year claimed a deduction of $46.80 for his contribution to the Society as an employment related expense. The appellant disallowed the deduction. At the request of the respondent, the appellant stated a case to the Taxation Review Authority.

The Authority decided that the appellant had incorrectly disallowed the deduction and allowed the respondent's appeal. The appellant now appeals to this Court by way of case stated on points of law against the Authority's decision.

Four questions are stated in the case. The first three are as set out below. Counsel are agreed that the fourth question is not required to be answered.

1. Having regard to the foregoing provisions of the Income Tax Act 1976 and in particular to Clause 8 of the Fourth Schedule to the said Act, the Taxation Review Authority held

that the expenditure was incurred for the purposes of the respondent's employment and that there was a sufficient nexus between the payment made by the respondent to the Society and the respondent's employment within the holding of Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472. Was the Taxation Review Authority correct in so holding?

2. The Taxation Review Authority rejected a submission on behalf of the appellant that on a construction of the Rules of the Society, the expenditure must be regarded as a payment made after the relevant income had been earned, and that the character of expenditure was therefore private or domestic, at least in part. Was the Taxation Review Authority correct in rejecting the said submission?

3. Was there any evidence before the Taxation Review Authority which could reasonably support the finding that the total expenditure was for the purposes of the respondent's employment?

THE STATUTORY PROVISIONS

The statutory provisions with which this appeal is concerned are found in the Income Tax Act 1976.

" s 104. In calculating the assessable income of any taxpayer, any expenditure or loss to the extent to which it -

(a) Is incurred in gaining or producing the assessable income for any income year; or

(b) ...

may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred. "

" s 105. (2) For the purposes of section 104 of this Act and notwithstanding the proviso to section 106(1)(d) of this Act, every taxpayer who in any income year derives assessable income which consists of income from employment shall be deemed to have incurred an amount of expenditure or loss in gaining or producing that income from employment equal to the greater of -

(a) ...

(b) An amount equal to the smaller of -
(i) The aggregate of the amounts of the expenditure and losses (being expenditure and losses incurred by the taxpayer in gaining or producing that assessable income) of any of the kinds specified in the said Fourth Schedule to this Act, reduced by every amount received (whether before or after the incurring of that expenditure and those losses), by or on behalf of the taxpayer, in respect of or in relation to that expenditure and those losses.

(ii) ...

s 106. (1) Notwithstanding anything in section 104 of this Act, in calculating the assessable income derived by any person from any source, no deduction shall, except as expressly provided in this Act, be made in respect of any of the following sums or matters:

(j) Any expenditure or loss to the extent to which it is of a private or domestic nature.

Fourth Schedule: Items of expenditure or loss deductible in respect of income from employment:

8. Expenditure incurred by the taxpayer for the purposes of, and as a condition of, his employment, not being expenditure of any of the kinds referred to in any of the foregoing provisions of this Schedule. "

AUTHORITY'S DECISION

It was conceded by the appellant before the Authority (and is also conceded in this Court) that the respondent's contribution to the welfare fund of $46.80 was made "as a condition of his employment" as required

by clause 8 of the Fourth Schedule. The concession followed from the Government Railways Act 1949, s 120B(3)(ante).

The substantial issue before him was whether the expenditure was -

> "incurred in gaining or producing assessable income" - s.104(a)
> and was
> "incurred by the taxpayer for the purposes of ... his employment" - Cl.8 Fourth Schedule.

The Authority held that the expenditure satisfied those tests.

DECISION

I now deal with the three questions left in the case by looking first at the issues generally and later answering the specific questions.

In order that the expenditure of $46.80 may be deductible it must meet the criteria of being -

(a) Incurred in gaining or producing assessable income - s.104(a).

(b) Be incurred by taxpayer for the purposes of and as a condition of his employment - s.105.

(c) Not of a private or domestic nature - s.106(i)(j).

(a) Incurred in gaining assessable income

The test to be applied in deciding whether the expenditure was "incurred in gaining or producing assessable income" was spelt out by Richardson J. in Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472, 477:

> " The statutory requirement is that the expenditure be 'incurred in gaining or producing the assessable income'. That has to be judged as at the time that the taxpayer became definitively committed to the expenditure for which deduction is sought (Federal Commissioner of Taxation v Flood (1953) 88 CLR 492; King v Inland Revenue Commissioner (1973) 4 ATR 188). Where the expenditure

> involves an element of volition and is itself of a revenue rather than a capital character, consideration of the object or purpose of the expenditure may, in many instances, be determinative of deductibility. In other situations that will not be so. "

And further at p 478:

> " Putting it positively, Dixon J. said in Amalgamated Zinc (de Bavay's) Ltd v Federal Commissioner of Taxation (1935) 54 CLR 295, 309 and we respectfully agree:
> ' The expression 'in gaining or producing' has the force of 'in the course of gaining or producing' and looks rather to the scope of the operations or activities and the relevance thereto of the expenditure than to purpose in itself. '
> It then becomes a matter of degree, and so a question of fact, to determine whether there is a sufficient relationship between the expenditure and what it provided, or sought to provide, on the one hand, and the income earning process, on the other, to fall within the words of the section. The factual question is complicated where, as here, the asset or advantage, in respect of which expenses are incurred, may be and is used for both private and income earning purposes. "

That test which has been referred to as the nexus test requires that there be a temporal or chronological link between the expenditure and the employment so as to satisfy the requirement that the expenditure be made "in the course of gaining" the assessable income and also a sufficient relationship between the expenditure incurred and the income earning process.

The Authority in referring to this aspect of the case dealt with the chronological link in this way. He said:

> " In so far as under sections 104 and 105 the contributions must be 'incurred in gaining or producing the assessable income', I think it is specious to argue that the contributions to the Welfare Society were made after the income was earned, or for benefits which are obtained after the income has been earned. The evidence

> is quite clear that O incurred the commitment to make the contributions simultaneously with obtaining the employment which produces the income; and he became eligible for benefits upon commencement of employment.

In dealing with the sufficient relationship he said:

> " It seems to me that O incurred the commitment for Welfare Society contributions at least as much to get the wages income as to obtain welfare benefits. While the point was not canvassed by counsel it seems to me that one should not assume that a Railways employee necessarily wishes to join the Society. He may be of such independent means that he does not need the Society's benefits. He may not have regard for the personnel on the Board of the Society. He may much prefer to make contributions to another form of Welfare Society of the medi-care type. However, unless O paid the contributions to the Society for the year in question, he could not obtain the income by way of employment which he received that year. I find that there is a sufficient nexus between O's contributions to the Society and his income earning process. In my view there is the necessary relationship between that expenditure and the carrying out of O's income related activities. "

And further:

> " Accordingly, I consider that the expenditure is germane, necessary and peculiar to his particular work activity. In short the overall purpose of the expenditure is consistency of work performance. This aspect coupled with the compulsory element leads me to find both a sufficient nexus between expenditure and income earning process and lack of private nature to the expenditure. "

And further:

> " Accordingly, despite Hannan's case I have found as indicated above a sufficient nexus and work related purpose to the expenditure on contributions to the Railways Welfare Fund Society. "

Mr Elliott for the appellant submitted that the Authority failed to come to grips with both the chronology and sufficient relationship elements of the nexus test and that neither element was properly considered and applied.

Referring to the chronology element, Mr Elliott submitted that the expenditure of $46.80 represented a payment made after the taxpayer's income had been earned and was not made in the course of gaining the income as required by Banks (ante). In support of this submission he relied upon Hannan v Commissioner of Taxes (1923) 23 S.A.S.R.434. That case concerned compulsory contributions made by an officer to the Public Service Superannuation Fund. Murray C.J. said at p 438:

> " A loss, outgoing or expense actually incurred by a taxpayer in the production of his income seems to me to be a loss sustained or a payment made or incurred in the course of the actual process of producing the income, and not a loss sustained or a payment to be made out of the income after it has been produced. "

The Authority accepted the principle of Hannan's case but appears not to have dealt with it in relation to the chronology test to which it applies. He elected not to follow it by applying the "purpose" test found in clause 8. He said:

> " One could not take issue with the principle enunciated by Murray C.J. particularly when related to the facts of Hannan's case. In the case before me I am concerned with the purpose of the expenditure in terms of clause 8 and whether there is sufficient nexus in terms of Banks' case with regard to sections 104 and 105 of the Act between the expenditure and the income earning process. Hannan's case was concerned with compulsory contributions to a retirement fund. O is involved in compulsory contributions to a welfare society aimed at preserving his fitness for work.
> Accordingly, despite Hannan's case I have found as indicated above a sufficient nexus and work related purpose to the expenditure on contributions to the Railways Welfare Fund Society. "

However, he had in his decision said in referring to the chronology test in the passage earlier referred to in this judgment that "the evidence is quite clear that O (the respondent) incurred the commitment to make the contributions simultaneously with obtaining the employment which produces the income". That finding followed from the undisputed facts as extracted from the rules to the effect that the annual contribution of $46.80 to the Welfare Society was made by dividing the year into 13 four weekly periods and requiring the member to pay such contributions in 13 instalments payable in advance at the beginning of each four weekly period. The Authority found the contributions to be made simultaneously with obtaining employment but strictly speaking they were made in advance of the member actually carrying out the work involved in his employment.

The Authority did therefore consider the chronology test and relate it to the evidence in the case although when dealing with Hannan's case and distinguishing it he did so by referring to the purpose for which the taxpayer incurred the expenditure and not by referring to matters directly related to the chronology test. However, reading the decision as a whole it is apparent that the Authority applied the chronology element of the test correctly and there was ample evidence to support his factual finding that the expenditure as made satisfied that element. It was in effect incurred, at least ~~temporaly~~ temporarily?, in the course of gaining or producing the income.

In relation to the other element of the nexus test - the sufficient relationship - the Authority first considered the evidence before him. That evidence was to the effect that membership of the Welfare Society and the benefits which were available from the Society as referred to in Rule 2(2)(ante) were such as to provide support to a member in many situations where his ability to work could in the absence of such support be adversely affected. These benefits help to ensure better health and security for a worker and his family and thus the worker is better equipped to discharge his duties at work.

He then said:

> " It seems to me that O incurred the commitment for Welfare Society contributions at least as much to get the wages income as to obtain welfare benefits. While the point was not canvassed by counsel it seems to me that one should not assume that a Railways employee necessarily wishes to join the Society. He may be of such independent means that he does not need the Society's benefits. He may not have regard for the personnel on the Board of the Society. He may much prefer to make contributions to another form of Welfare Society of the medi-care type. However, unless O paid the contributions to the Society for the year in question, he could not obtain the income by way of employment which he received that year. I find that there is a sufficient nexus between O's contributions to the Society and his income earning process. In my view there is the necessary relationship between that expenditure and the carrying out of O's income related activities. "

The Authority reached that conclusion after having earlier referred to the sufficient relationship element as discussed in Commissioner of Inland Revenue v Banks (ante) and noted Mr Elliot's submissions before him to the effect that there was no sufficient nexus between the payment made to the Welfare Society and the respondent's employment; that membership of the Society was not necessary to enable the respondent to carry out his day to day duties of employment; and that the respondent's duties could be performed without incurring the outlay for the subscriptions to the Society and that the expenditure was not made in the course of nor was it relevant to actual employee activities.

In this Court Mr Elliott repeated his submission that there was no sufficient relationship between the payments of the contributions and the respondent's employment. He referred to Brown v Bullock [1961] 3 All ER 129. The Court was there concerned with the question of deductibility of subscriptions paid by a bank manager to acquire membership of a club for the purpose of fostering contacts and extending

hospitality. The manager was instructed to join the club but refusal to do so would not necessarily involve the loss of his position as bank manager. The Court held that the subscriptions were not tax deductible since they were not paid in performing his duties as bank manager but as something that in the opinion of the manager's employer it was desirable for him to do socially. The English statutory provision - Income Tax Act 1952 - required that to qualify for deduction, money must be expended "wholly, exclusively and necessarily in performance of [taxpayers] duties". Donovan L.J. at p 133 expressed the test to be applied in these words:

> " The test is not whether the employer imposes the expense, but whether the duties do, in the sense that, irrespective of what the employer may prescribe, the duties cannot be performed without incurring the particular outlay. "

Our legislation does not impose the stringent test required by the English statute but merely requires that there be established a sufficient relationship between the expenditure, on the one hand, and the income earning process on the other to fall within the words of s 104(a) as being expenditure "incurred in gaining or producing the assessable income".

I do not find <u>Brown v Bullock</u> (ante) to be of any real assistance in the present case.

Reference was also made by Mr Elliott to <u>Bell v Gribble</u> [1903] 1 KB 517 and <u>Strong v Woodfield</u> (1906) 5 Tax Cases 215 (H.L.). The decision in each of these cases depended upon statutes differing greatly from our own and I find them of no assistance at all.

The issue on this aspect of the present case is simply whether the payment by the respondent of the Welfare Society contribution was incurred in gaining or producing his assessable income in so far as there was a sufficient relationship between the expenditure and the income earning process as referred to in <u>Banks</u>.

Quite clearly the respondent would not have been able to work for Railways or earn any income from that source unless he made the payment as required by s 120B(3) of the Railways Act 1949. But his joining the Welfare Fund and paying the contribution merely gave him the opportunity or right to work for Railways at all. They in no way contributed to the performance of his duties as a railway employee. If the words used by Richardson J. in Banks mean that "the income earning process" refers to the actual work for which a person is employed then the respondent's contributions have no reference to such work and in no way affect such work and are outside the deductibility provisions of s 104(a). If, however, the words "income earning process" are given a wider meaning and include the ability to carry out the work then as the respondent would have had no ability to carry out his work had he not made the contributions, his contributions would fall within s 104(a).

It seems to me that it is the wider interpretation which is to be preferred. That appears to have been the interpretation adopted by the Authority and I am not prepared to say he was wrong.

(b) Purpose and Condition of Employment

Section 105 and clause 8 of the Fourth Schedule require that to be tax deductible, in addition to an expenditure being incurred in gaining or producing assessable income as required by s 104(a) it should also be incurred "for the purposes of and as a condition of [the taxpayer's] employment". The test is a dual test and both elements must be satisfied before expenditure can be deductible. It was acknowledged by Mr Elliott that the respondent's contributions to the welfare fund were made as a condition of his employment by reason of s 120B(3) of the Government Railways Act 1949.

Were they made "for the purposes of" the respondent's employment?

In its ordinary dictionary meaning "purpose" is defined as: "the object which one has in view"; "the object for which anything is done or made or which exists": see Shorter English Oxford Dictionary.

The Authority in dealing with the element of "purpose" stated in his decision:

> " I find that the expenditure by O as his contributions to the Society was made 'for the purposes of' his employment in terms of Clause 8. It would be a curious situation if such payments which are conceded by R to be made as 'a condition of' such employment were not also made for the purposes of that employment. It seems to me that a payment may be made for the purposes of employment and yet not necessarily be made as a condition of that employment. However, I cannot conceive of a situation where a payment made as a condition of employment is not also for the purpose of that employment. "

Mr Elliott for the appellant in this Court submitted that the Authority failed to distinguish the two separate tests of "purpose" and "condition" contained in clause 8. He pointed to the passage in the decision where he said the Authority had in fact treated the tests as one where he stated in the passage (ante):

> " It would be a curious situation if such payments which are conceded by [appellant] to be made as a condition of such employment were not also made for the purposes of that employment. "

I think there can be little doubt that the Authority did in this case treat the test of purposes as being included in the test of condition. There are, however, the two separate tests, both of which must be satisfied.

The test of "purposes" must be approached by inquiring whether the object for which the expenditure was made was related to the employment in the sense that the payment contributed to the earning of assessable income. The test of "condition" must be approached by considering

whether the expenditure "is demanded or required as a pre-requisite to the granting or performance of something else": see Shorter English Oxford Dictionary. Or to express the matter in a somewhat different way, by considering whether the expenditure is required before the employment or some aspect of it can be carried out. In the present case there can be little doubt that the respondent's payment to the welfare fund was made as a condition of his employment. But was it also made for the purposes of that employment? Did it contribute to the earning of assessable income?

There are clearly cases where on the facts as established both tests are satisfied. Were it not so, clause 8 which requires the two tests would be ineffective to enable deductions to be made. The present is such a case. The payment of the welfare fund contributions was made as an express condition of the respondent's employment by virtue of the Government Railways Act. The payment was also made for the purposes of that employment in so far as the payment contributed to the earning by the respondent of assessable income.

Mr Elliott submitted that the expenditure was not for the purposes of the respondent's employment because such expenditure was not peculiar to or incidental to the occupation concerned. It was not enough, he said, that the employer stipulates membership of the Society. The respondent must go further and show that the expenditure was germane to his particular occupation. I do not agree with that submission.

The Authority in my view, although he appeared to treat the two tests contained in clause 8 as one, arrived at the correct result in this case. However, Mr Elliott submitted that the Authority had erred in law in finding that there was evidence which was capable of supporting his finding that the total of the respondent's expenditure was for the purposes of his employment: see Meadow Mushrooms Ltd v Paparua County Council (1980) 8 N.Z.T.P.A. 76.

He argued first that none of the expenditure was deductible but, alternatively, that if some of it was then there was no reasonable basis for apportioning the expenditure: Buckley & Young Ltd v Commissioner of Inland Revenue [1978] 2 NZLR 485.

The Authority found in his decision "that the total expenditure is for the purposes of the employment". In the course of submissions, Mr Elliott traversed the evidence given before the Authority. I do not need to refer to that evidence in detail as I am satisfied that there was evidence capable of reasonably supporting the Authority's findings of fact and in making the findings that he did the Authority did not err in law.

(c) Private or Domestic Nature

Section 106(1)(j) prevents deductions from assessable income being made for expenditure of a private or domestic nature. The Authority stated in his decision:

> " On the facts of this case I have found that the total expenditure is for the purposes of employment and it cannot be regarded as expenditure of a private or domestic nature."

That was a finding of fact made by the Authority and has not been challenged in these proceedings.

Answers to the Questions:

Question (1) YES

Question (2) YES

Question (3) YES

The respondent is entitled to costs which I fix at $750 and disbursements.

Solicitors for the appellant Crown Law Office (Wellington)

Solicitor for the respondent J R Wilson (Wellington)