IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

M.44/84

1330

IN THE MATTER of the Income Tax Act 1976

BETWEEN THE COMMISSIONER OF INLAND REVENUE
Appellant

A N D DONALD LINDSAY MATHIESON of Wellington, Professor of Law and Barrister
Respondent

Hearing 7 September 1984

Counsel P J H Jenkin for appellant
J Prebble for respondent

Judgment 23 October 1984

JUDGMENT OF DAVISON C.J.

THE CASE

This case, stated by the Taxation Review Authority pursuant to s 43 of the Inland Revenue Department Act 1974, raises two questions for decision. They relate to a deduction of $119.85 for accommodation expenses claimed by the respondent from his taxable income for the year ended 31 March 1980 and allowed as such by the Authority.

The questions are:

(1) Was the relevant expenditure properly allowed as a deduction as being expenditure incurred in gaining or producing the assessable income of the respondent from Victoria University, Wellington, for the income year ending the 31st March 1980.

(2) Whether the relevant expenditure could be regarded as of a private and domestic nature and so was prohibited as an allowable deduction by Section 106(1)(j) of the Income Tax Act 1976.

THE FACTS

1. The respondent was a Professor of Law at Victoria University and also carried on practice as a Barrister.

2. The respondent was on research and study leave from Victoria University from mid-January 1980 to mid-May 1980. He spent that leave at Oxford University, incurring expenses of travelling to and from London, and accommodation expenses in Oxford. The respondent was accompanied by his wife for the period that he was overseas on leave.

3. Whilst overseas the respondent incurred the following expenses:

Travel expenses	$1944.00
Accommodation expenses made up of rent, electricity and telephone	605.85
	$2549.85

Towards these expenses he received from his employer, Victoria University, a grant of $2430.00. This left a shortfall of $119.85 which was treated as relating entirely to accommodation expenses.

4. The respondent claimed to deduct the sum of $119.85 in calculating his assessable income for the year ended 31 March 1980.

5. It was part of the conditions of the employment of the respondent that he periodically, if not continuously, carry out research and that such research conform to those conditions of his employment. A failure to carry out research would prejudice the respondent's University prospects and would technically place him in breach of his employment contract.

6. During the whole of his period of study leave in England the respondent devoted his attention towards writing a short book on a jurisprudential question in which he had a particular interest. He was also engaged in other activities to a lesser degree but he did not attend any refresher course or attend any course or conference or research project for the purpose of enabling him to keep up-to-date with, or to develop his capacity to perform his existing duties in connection with his occupation. In fact, by 1980 the respondent's teaching interest had moved entirely away from jurisprudence which was the area in which he was pursuing a research interest.

7. During the period of leave the respondent was effecting research in accordance with his employment at the University, but in the sense that he was creating new frontiers of jurisprudence rather than endeavouring to keep up with developments or develop the capacity to perform his duties at the University.

8. The Authority on the 26th day of January 1983 held that the relevant expenditure incurred by the respondent was clearly a condition of the respondent's employment, and that as it was not expenditure of a private or domestic nature in terms of Section 106(1)(j) of the Income Tax Act 1976 the expenditure was incurred by the respondent in the gaining or producing of his assessable income from the University. Accordingly the particular expenditure was deductible.

9. Against that decision the Commission has appealed.

THE STATUTE

The provisions of the Income Tax Act 1976 relevant to this matter are as follows:

"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) Is necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year -

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 -

(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.... "

"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 FINDINGS

The following passages from the decision of the Authority set forth his conclusions on the various issues:

" I find that on the facts of this case O was effecting research in accordance with the terms and conditions of his employment at the University. He was creating new frontiers of jurisprudence rather than endeavouring to keep up with developments or develop his capacity to perform his duties in terms of Clause 5(b)."

" I appreciate the argument that it was not necessarily a condition that O take study leave to effect research. However, the terms of employment provide for the availability of study leave and having arranged to take this O was obliged to undertake the work for which leave was approved. He was also obliged to meet the expenses thereby incurred over and above the grant he received from the University. It is clear from the terms of employment that a staff member must undertake research appropriate to his type of employment and I see no reason for this being limited to New Zealand. In any case, O needed to obtain material from a University library in England as that material was not available in New Zealand. "

" I agree that the very fact that expenditure is incurred in the income producing process must mean that it is not a private or domestic expenditure. "

" In this situation where a taxpayer obtained leave to effect research pursuant to his Conditions of Appointment it would not seem to me to be equitable to maintain that expenditure properly related thereto is not for the purposes of and as a condition of his employment. "

APPELLANT'S CASE

The appellant's case is based on two main submissions. They are:

1. The balance of accommodation expenses amounting to $119.85 are not deductible in the calculation of assessable income because they were not incurred by the taxpayer for the purpose of and as a condition of (the underlining is mine) his employment: s.105(2)(b) and cl.8 4th Schedule.

2. That the balance of accommodation expenses amounting to $119.85 are of a private and domestic nature (the underlining is mine) and not permitted to be deducted in the calculation of assessable income: s 106(1)(j).

I now deal with those two submissions:

"PURPOSES AND CONDITION"

Section 104 of the Act permits a taxpayer in calculating his assessable income to deduct expenditure to the extent to which it is incurred in gaining or producing assessable income for any income year and by virtue of s 105(2)(b) he is entitled to make deductions to the extent of the limits provided of any of the kinds of expenditure provided for in the Fourth Schedule. In the present case the only relevant clause of that schedule is clause 8 which enables deduction of expenditure incurred by the taxpayer "for the purposes of and as a condition of his employment". (The emphasis is mine).

One must then turn to the facts to examine the respondent's employment. The case records:

1. That it was part of the respondent's conditions of employment that he periodically carry out research and that such research conform to those conditions of employment. A failure to carry out research would prejudice the respondent's University prospects and technically place him in breach of his employment contract.

2. That during his period of leave the respondent was effecting research in accordance with his employment at the University in the sense that he was creating new frontiers of jurisprudence rather than endeavouring to keep up with or develop the capacity to perform his duties at the University.

It could hardly be argued, as was in fact acknowledged by counsel for the appellant, that the expenditure claimed by the respondent for accommodation expenses was not expenditure "for the purposes of his employment". But that is not enough to make that expenditure tax deductible. It must also be incurred "as a condition of his employment". The Authority found that it was not necessarily a condition of the respondent's employment that he take study leave to effect research. The respondent could no doubt have carried out research in Wellington whilst at the University.

However, respondent's terms (conditions) of employment provide for the availability of study leave and the Authority held that having arranged to take such leave, the respondent was obliged to undertake the work for which leave was approved.

The appellant, however, challenges the notion that the respondent was obliged as a condition of his employment to travel to England and incur accommodation expenses. He may have been required, counsel said, as a condition of his being granted leave and paid a travel grant of $2430 to travel to England on such leave and of necessity to incur expenses of accommodation but such was not a condition of employment (because the requirement to carry out research could have been done in New Zealand) but rather was simply a condition of his being granted study leave.

Expressed in another way, the appellant accepted that the right of the respondent to obtain study leave is a condition of his employment in the sense that it is available to him but whether he exercises that right to study leave and where he elects to go is at his own option and he is not required to do so by his employer. Counsel for the appellant submitted that the essential prerequisite of deductibility of expenses under clause 8 as being incurred by a taxpayer as a condition of his employment is the element of obligation or requirement to incur such expenses.

Reference was made to the definition of the word "condition" in the Shorter Oxford English Dictionary:

> " 1. Something demanded or required as a prerequisite to the granting or performance of something else: a provision, a stipulation.
>
> 2. Law. In a legal instrument, a provision on which its legal force or effect is made to depend 1588.
>
> 3. Covenant, contract, treaty 1718. "

The Authority appears to have appreciated the distinction advanced by counsel for the appellant when he said in his decision:

> " I would not presently go so far as to say that if a practical requirement of a taxpayer's terms of employment causes him to spend money then that expenditure is deductible under Clause 8. That concept seems to me to abrogate from the stipulatory nature of the expenditure. If a taxpayer could deduct expenditure related to his employment which seemed to him should be made as a practical need in the course of his job, then such expenditure may not have been strictly required of the taxpayer. It may have been made by him as being helpful to the circumstances of his employment but the payment may not have been required or demanded by those circumstances. "

I agree with the submission made by counsel for the appellant and also with the view expressed by the Authority that in order to be tax deductible the expenditure must be made as a condition of the taxpayer's employment in the sense that it is required of him by his employer. Was that so in this case?

Counsel for the respondent submitted that that issue is a question of fact and that I am precluded from reviewing the decision of the Authority on a question of fact: see s 43(1) of the Inland Revenue Department Act 1974:

> "The determination of an Authority on any objection shall be subject to appeal to the Supreme Court in any case where, not being an objection referred to an Authority pursuant to section 73(12) of the Income Tax Act 1976 -

(a) The amount of tax or duty involved in the appeal to the High Court is $2,000 or more; or

(aa) The amount of credit of tax involved in the appeal to the High Court is $2,000 or more; or

(ab) The amount of loss involved in the appeal to the High Court is $4,000 or more; or

(b) The appeal relates to questions of law only, -

but shall be final and conclusive in all other cases. "

However, I prefer to regard the question not as one of fact but as one of law involving the construction of the Contract of Employment of the respondent by the University and the determination of whether or not the incurring of the accommodation expenses was as a result of a condition of the respondent's employment.

In order to arrive at an answer to that question and decide what the Contract of Employment means it is necessary to take the contract in several stages.

First: Respondent was required periodically, if not continuously, to carry out research and the failure to do so would technically place him in breach of his Contract of Employment. The requirement that respondent carry out such research was a condition of his employment. Where the respondent chose to carry out such research was, however, a matter for him. He was not required to go to England. It may have been preferable for him to do so but it was not required of him by his employer, either expressly or by implication. It was the respondent's choice to go to England and when he decided to go he was able in accordance with a further condition of his employment to apply for study leave.

Second: When the respondent applied for study leave he was not required by his employer to go to any particular place on his leave but was free to choose where he took his leave. Having decided, however, to go to England, he was entitled to apply for a travel grant and

the grant was approved on the basis of the work which the respondent stated he proposed to do, namely, to go to England to carry out research.

The respondent obtained the travel grant not because his employer required him to go to England, but because having elected of his own volition to go to England on study leave, his conditions of employment enabled him to obtain an allowance towards his expenses.

Third: The respondent's going to England and incurring accommodation expenses was not therefore as a result of any requirement or condition of his employment such as to enable his expenses to be tax deductible in accordance with s 105(2)(b) and cl.8 of the Fourth Schedule.

The learned Authority in reaching the conclusion that the respondent's claim for deduction of accommodation expenses did satisfy clause 8 has run together and confused the condition of respondent's employment that he carry out research, which was required of him by his employer, with something that was not a condition of his employment required of him by his employer, namely, the opportunity for or availability of study leave.

The difference between the two situations is simply that the employer required the respondent to do research; it did not require him to take study leave. But if he did take such leave and sought a grant then he had to spend the grant in accordance with his request.

In such circumstances, in my judgment, the provisions of the Act entitling respondent to deduction of the sum of $119.85 for accommodation expenses in the calculation of his assessable income have not been met.

"PRIVATE AND DOMESTIC" EXPENSES

Section 106(1)(j) provides that except as expressly provided in the Act, no deduction shall be made in calculating assessable income for -

> "Any expenditure or loss to the extent to which it is of a private or domestic nature. "

The respondent let his home in New Zealand and, accompanied by his wife, travelled to England where he took up accommodation near Oxford University where he was to spend time carrying out research. He remained there from January to mid-May 1980.

Before the Authority it was contended on behalf of appellant that the respondent had effectively transferred his "home" from New Zealand to the English flat for the short period he was there, relying upon the decision of this Court as to the meaning of "home" in Geothermal Energy NZ Ltd v CIR [1979] 2 NZLR 324. The Authority found on the facts that respondent did not transfer his home to the English flat and I must accept that finding for present purposes.

The general nature of the way in which a dwelling or accommodation is to be treated for taxation purposes was discussed at length in CIR v Banks [1978] 2 NZLR 472 where Richardson J. in delivering the judgment of the Court said in relation to s 112(1)(e) of the 1954 Act (now s 106(1)(e) of the present 1976) at p 479:

> "Apportionment of the rent of dwellings and other domestic premises is allowed and the extent of the deduction is relative to the use of the premises in the production of income. Of course, it does not follow that all expenses in relation to dwellings are deductible on the same basis. Rent has been singled out for special reference. It is not profitable to speculate on the reasons for that. But, to put it at its lowest, the treatment of rent in s 112(1)(e) is entirely consistent with the proposition that there is nothing inherent in the nature of a house to require the conclusion that expenses in relation to the house and the occupation of the house are essentially and exclusively private and domestic and are unrelated in character to the income earning process. "

And further at p 480:

> "But it is not sufficient that income related activities take place in the premises. A purely temporal connection between expenditure and income earning on the premises is sufficient.

> As Turner J. observed in considering the deductibility of losses under the earlier s 111 (Commissioner of Taxes v Webber [1956] NZLR 552, 559): '... it cannot be sufficient if the loss is incurred simply during the time when the income is being earned. There must be an inquiry into 'the degree of connection between the trade or business carried on and the cause of the liability for damages' '. So, too, in this class of case there must be an inquiry into the degree of connection between income related activities and the asset or advantage gained or sought to be gained by the expenditure. "

The Banks case was dealing with the claimed use of part of a house for business premises.

In the present case the claim is that the use of the whole of the premises (the flat) was for business purposes in the sense that it was necessary for the respondent to occupy that flat in the production of assessable income from his employment. The Authority held:

> "That the very fact that expenditure is incurred in the income producing process must mean that it is not a private or domestic expenditure. "

The problem of the businessman travelling away from home was discussed by Rowlatt J. in Nolder v Walters [1930] 15 T.C. 380 at 388 where he said:

> "I think it always has been agreed, that when you get a travelling office, so that travelling expenses are allowed, those travelling expenses do include the extra expense of living which is put upon a man by having to stay at hotels and inns, and such places, rather than stay at home. Of course his board and his lodging in a sense, eating and sleeping, are the necessities of a human being, whether he has an office, or whether he has not, and, therefore, of course, the cost of his food and lodging is not wholly and exclusively laid out in the performance of his duties, but the extra part of it is. The extra expense of it is, and that is the quite fair way in which the Revenue look at it. In this case,

> therefore, he would be entitled to charge something for the extra expense which he is put to by having to go and spend all the day, and often the night, away from home, because that is part of his duty; and then it comes to the question really of quantum. "

However, in Federal Commissioner of Taxation v Hatchett [1971] 125 C.L.R. 494 at 498 Menzies J. dealt with the application of the words "private nature" where he said:

> "My conclusion that the expenditure in gaining the Teacher's Higher Certificate was incurred in gaining assessable income in the circumstances carries with it the conclusion that the expenditure was not of a private nature. It must be a rare case where an outgoing incurred in gaining assessable income is also an outgoing of a private nature. In most cases the categories would seem to be exclusive. So, for instance, the payment of medical expenses is of a private nature and is not incurred in gaining assessable income, notwithstanding that sickness would prevent the earning of income. I am satisfied that the payments here in question, falling, as I decide, into the first category, do not fall within the second. "

The significance of that passage lies in the observation of Menzies J. :

> "It must be a rare case where an outgoing incurred in gaining assessable income is also an outgoing of a private nature. "

That view was adopted by the Authority as I have earlier indicated and was the basis of his conclusion that because the respondent was occupying the flat "for the purposes of his employment" then the accommodation expenses were not of a private or domestic nature.

However, it is very questionable whether respondent incurred the accommodation expenses in gaining assessable income which was the significant observation in Hatchett's case.

The expenses were incurred in taking leave for the purpose of engaging in research which respondent was carrying out in England of his own choice - no doubt for the good reason that the facilities for such research were more readily available there. He and his wife had to live somewhere. They had let their Wellington home during absence overseas and of necessity required domestic accommodation.

Mr Prebble referred me also to Randall v Minister of National Revenue (1967) 62 D.L.R. (2nd) 127 as another example of a case where accommodation expenses were allowed as tax deductible. The circumstances of that case were, however, substantially different from the present one. Whether accommodation expenses are of a private and domestic nature is a matter of fact for determination in each particular case. It is not enough merely that the expenses were incurred whilst away from home, but in addition it is necessary to establish that they were incurred in earning assessable income.

If the accommodation expenses are incurred for personal and domestic expenses, that is not enough. They must be related to the carrying out of the terms and conditions of the employment. It may be difficult in some cases to determine on which side of the line a particular decision should fall. I was referred by Mr Jenkin to several cases dealing with the question of employment related expenditure but they do not really help in resolving the present factual situation.

I have concluded that the respondent's accommodation expenses were in this case of a private and domestic nature and do not therefore qualify as tax deductible.

The answers to the two questions as posed in the case are therefore: (1) No
(2) Yes

Costs reserved.

Solicitors for the appellant: Crown Law Office (Wellington)