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# The Implications of Fletcher v FCT

## **Abstract**

The main business deductions provision - s51 - continue to provoke plenty of reported litigation. The tests for deductibility imposed by the courts overlap and their application is difficult to predict. Fletcher v FCT adds complexity. Ms Khoo argues for a straightforward interpretation of this important provision.

## **Keywords**

income taxation, Australia, fletcher v FCT

## THE IMPLICATIONS OF FLETCHER V FCT



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*The main business deductions provision – s 51 – continues to provoke plenty of reported litigation. The tests for deductibility imposed by the courts overlap and their application is difficult to predict. Fletcher v FCT adds complexity. Ms Khoo argues for a straightforward interpretation of this important provision.*

### Introduction

Einstein surprised few when he concluded that “the hardest thing in the world to understand is income tax”. He may well have been referring to the Australian Income Tax Assessment Act or to what some of our courts have done to it.

Section 51(1) of the Income Tax Assessment Act 1936 (ITAA) is relatively simple in concept and drafting. It allows deductions for outgoings and losses incurred in gaining or producing assessable income. However, the section has generated more litigation than any other section in the Act. The tests imposed and applied by the tribunals and courts have been uncertain and confusing.

Section 51(1) allows for deductions for losses and outgoings under two positive limbs:

- All losses and outgoings to the extent to which they are incurred in gaining or producing assessable income.
- All losses and outgoings necessarily incurred in carrying on a business for the purpose of gaining or producing such income.

Regrettably, there are at least five different tests which have been used by the courts in interpreting s 51(1). They are:

- the essential nature or character test;
- the “incidental and relevant” test;
- the condition of employment test;
- the purpose test; and
- the form test.

The recent High Court decision in *Fletcher v FCT*<sup>1</sup> demonstrates the complexity that has arisen as a result of the various approaches by the courts when applying s 51. *Fletcher's* case involved a partnership investment plan

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<sup>1</sup> 91 ATC 4950.

by which the taxpayers claimed deductions under s 51 for outgoings of interest. It is sufficient, for the purposes of this article, to consider only the purpose and form tests. These tests have been the subject of heavy debate in the courts and academia.

### The “purpose” test of deductibility

*Ronpibon Tin NL v FCT*<sup>2</sup> introduced the oft-applied but not very helpful “incidental and relevant” test: “For expenditure to form an allowable deduction as an outgoing incurred in gaining or producing assessable income it must be incidental and relevant to that end.”<sup>3</sup> This suggests that there needs to be a nexus or connection with the production of assessable income. To determine if there is such a nexus or connection, it is suggested that one still has to look at the purpose, intention or object of the transaction which incurred the outgoing.<sup>4</sup> Hence, even under the “incidental and relevant” test, purpose plays an important role in determining if the expenditure is incidental and relevant to gaining or producing assessable income.

The place of the taxpayer's purpose in all of this has become a vexed issue. Although the word “purpose” appears in the second positive limb of s 51(1), it is there concerned with the carrying on of a business. The purpose of carrying on the business must be for the production of assessable income. Unfortunately, the section does not also refer to the purpose of any loss or outgoing or the purpose of the taxpayer.<sup>5</sup>

A distinction can be drawn between subjective and objective purposes. The subjective purpose of the taxpayer means the object which the taxpayer intends to achieve by incurring the expenditure.<sup>6</sup> The objective purpose means the object which the incurring of the expenditure is apt to achieve.<sup>7</sup> The objective purpose of a transaction may be inferred from the surrounding circumstances, whereas the subjective purpose can be proved by the circumstances and also by direct evidence.<sup>8</sup>

In *Magna Alloys*, Brennan J commented on the relevance of purpose:

Though purpose is not the test of deductibility nor even a conception relevant to a loss involuntarily incurred, in cases where a connection between an outgoing and the taxpayer's undertaking or business is affected by the voluntary act of the taxpayer, the purpose of incurring that expenditure may constitute an element of its essential character, stamping it as expenditure of a business or income-earning kind.<sup>9</sup>

2 (1949) 8 ATD 431; (1949) 78 CLR 47.

3 Ibid at 435-436; 56-57.

4 See Corkery JF, “Section 51(1) – The Rock of ‘Purpose’ Amid Storms of ‘Form’ and Waves of Inconsistency”, Proceedings of the Taxation Convention on the Taxation of Investments, South Australian Division of the Taxation Institute of Australia, April, 1984, p 16.

5 *FCT v Ilbery* 81 ATC 4661 per Toohey J at 4665; *FCT v Creer* 86 ATC 4318 per Wilcox J at 4326; *Magna Alloys & Research Pty Ltd v FCT* 80 ATC 4542 per Brennan J at 4545.

6 *Magna Alloys & Research Pty Ltd v FCT*, ibid at 4544.

7 Ibid.

8 Ibid.

9 Ibid at 4547.

... purpose is relevant to describe an element of connection between expenditure and a taxpayer's undertaking or business in cases where a taxpayer incurs expenditure or agrees to incur expenditure without any antecedent obligation to do so or where the occasion of the expenditure ... is not manifestly to be found in whatever is productive of assessable income or in whatever would be expected to produce assessable income, or in the carrying on of a business.<sup>10</sup>

In *Ure v FCT*,<sup>11</sup> the taxpayer had borrowed moneys at commercial rates of interest and on-lent them at 1% interest to either his wife or to a family company. The taxpayer returned, as assessable income, the 1% interest received by him. He sought to deduct from his assessable income the whole of the interest on the borrowed moneys paid by him.

On the question of purpose the court in *Ure* stated:<sup>12</sup>

- It is difficult to determine what weight is to be given to indirect objects which a taxpayer had in mind in incurring the outgoing.
- Ordinarily, where the immediate object achieved by the outgoing is the production of assessable income which is commensurate with the amount of the outgoing, indirect objects or motives of a personal or domestic character will plainly not prevent the characterisation of the outgoing as having been incurred in earning assessable income.
- However, in some cases, the immediate object or effect of an outgoing will not suffice either to explain or to characterise it.
- In such cases, indirect objects or motives can be of decisive importance.

The court went on to find that, on *Ure's* facts, the less direct objects and advantages which the taxpayer sought to achieve were important in characterising the outgoing. The indirect objectives were not of an income-earning character. They involved the provision of accommodation for the taxpayer and his family, financial benefit to the taxpayer's wife and a family trust and a reduction in the taxpayer's personal liability to pay income tax.

The decision in *Fletcher v FCT*,<sup>13</sup> as will be illustrated later in this note, is consistent with the approach of the Federal Court in *Ure*.

The taxpayer's subjective motives can be important in characterisation of the outgoing. Although the taxpayer may have the intention of producing assessable income, that alone is not the whole picture. The indirect intentions of the taxpayer must then be taken into account. This is often the case when the production of assessable income is not commensurate with the level of outgoing.

*FCT v Ilbery*<sup>14</sup> involved the taxpayer borrowing \$20,000, which he used to purchase an income-producing property. Immediately after receiving the \$20,000, the taxpayer exercised an option under the loan agreement to make

<sup>10</sup> Ibid at 4548.

<sup>11</sup> 81 ATC 4100.

<sup>12</sup> Ibid per Deane and Sheppard JJ at 4110.

<sup>13</sup> 91 ATC 4950.

<sup>14</sup> 91 ATC 4661.

(1993) 3 Revenue L J

a payment of \$14,000, representing pre-payment of interest at 14% pa for five years. The taxpayer then claimed in his income tax returns a deduction under s 51(1) for the \$14,000 pre-paid interest.

The Federal Court found that the pre-payment of interest was not an allowable deduction under s 51(1). The purpose of the taxpayer in incurring the outgoing was of paramount importance. The court found that he had an intention of securing a tax advantage and no other purpose. The taxpayer did not require the loan of \$20,000 in order to produce income.

The pre-payment was also made at a time when no relevant income-producing activity had begun. In short, it was not an outgoing incurred in producing assessable income, the formula required by s 51(1).

Toohey J referred to Brennan J's statement in *Magna Alloys* that purpose may constitute an essential element in stamping an outgoing as expenditure of a business or income-earning kind.<sup>15</sup> His Honour stated that, conversely, purpose may stamp an outgoing as one having no relevant connection with the gaining or producing of assessable income.<sup>16</sup>

*Fletcher* is also consistent with the decision in *Ilbery*. The High Court in the former found that, if the taxpayers had the purpose of discontinuing the investment plan before it ran its full course, then, in as far as outgoings of interest exceeded assessable income, those outgoings of interest will not be deductible, as they will not have been incurred in gaining or producing assessable income.

### The "form" test or "legal rights" test of deductibility

Under the largely discredited "form" test, if the legal effect of the taxpayer's action was to produce assessable income then any purpose which the taxpayer may have had apart from the production of assessable income was irrelevant.

Dixon CJ in *Cecil Bros Pty Ltd v FCT*<sup>17</sup> noted that, once it was held that the payments to an interposed company between Cecil Bros and their wholesalers was for the purchase of stock in trade, there could be no ground for excluding any part of it from the allowable deductions despite a mark-up of about 10%.<sup>18</sup>

*Europa Oil (No 2)*<sup>19</sup> is the classic example of the application of the "form" test. The court looked at the legal effect as distinct from the economic consequences of contracts that were set up.

The whole deduction was allowed, as opposed to the decision in *Europa Oil (No 1)*. The contracts in *Europa Oil (No 2)* did not confer on Europa Oil a legal enforceable right to delivery of the goods or some other act which when performed would confer a benefit in money or money's worth.<sup>20</sup> The

15 *Magna Alloys & Research Pty Ltd v FCT* 80 ATC 4542 at 4547, referred to in *FCT v Ilbery* 81 ATC 4661 per Toohey J at 4667.

16 *Ilbery*, ibid at 4667.

17 (1964) 111 CLR 430.

18 Ibid per Dixon CJ at 438. See also *FCT v Phillips* 78 ATC 4361.

19 *Europa Oil (NZ) Ltd (No 2) v Commr of IR (NZ)* 76 ATC 6001.

20 Ibid at 6007.

deductions were allowed in full, as they were legally gained in the production of assessable income.<sup>21</sup>

A variation of the form test is found in *Walker v FCT*<sup>22</sup> The taxpayer entered into partnerships for the purpose of carrying on a business of cattle breeders and pastoralists. The investment was a severely negative one for some time. The outgoings were deductible under both limbs of s 51(1).

Lusher J stated that *Ure's* case was really a question of apportionment of outgoings between two objects, one being the gaining of assessable income and the other being one not directed to the gaining of assessable income. His Honour stated that the ultimate question turned on the subject matter to which the expenditure was directed rather than on purpose. He found that *once the expenditure matches an appropriate business subject matter, the fact that the taxpayer had some purpose in mind in obtaining tax deductions or benefits is irrelevant* where that additional purpose is not directed to some subject matter of expenditure.<sup>23</sup> (Writer's emphasis). Hence, he found that *Ure's* case was not contrary to his findings.

*Walker's* case was appealed to the Full Federal Court.<sup>24</sup> The Commissioner submitted, in the Federal Court, that the sole or predominant purpose of each of the partnerships entered into was to achieve tax advantages and that it was intended that the partnerships would be dissolved as soon as the tax advantages had been achieved.<sup>25</sup> Hence it follows that no genuine business activity was intended. This argument is similar to that offered in *Fletcher's* case.

Fisher J chose to accept Lusher J's findings that each of the partnerships was carrying on business activities for the purpose of gaining assessable income.<sup>26</sup> There was no preordained "dissolution" of the partnerships. However, Fisher J stated that he might attach significance to a dissolution if the major partners had wholly terminated the partnership inter se and ceased carrying on activities altogether.

In *Fletcher's* case, one will see that the crucial factor in the High Court's decision was a question of fact as to whether there was a plan to discontinue the partnership and the investment plan before it could run its full course.

Lusher J's findings of fact were crucial. Even though the Commissioner's submissions that the partnerships were not intended to continue beyond the initial stage of acquiring a limited number of progeny were strong, there was no ground shown which warranted interference with Lusher J's findings of fact.

21 See *FCT v South Australian Battery Makers Pty Ltd* 78 ATC 4412, which purported to follow *Europa Oil (No 2)*.

22 83 ATC 4168.

23 Ibid at 4199.

24 *FCT v Walker* 84 ATC 4553.

25 Ibid at 4560.

26 Ibid at 4562.

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## The facts of Fletcher v FCT

The taxpayers were partners in the business of subdividing and selling land. They entered a complex annuity investment scheme in 1982 which involved the purchase of an annuity by the partnership for \$2.02m. The taxpayers only paid across \$50,000 of the \$2.02m. Of this, only \$20,000 was available for actual investment.

\$2m of the investment and the interest payable thereon was in the form of a "round robin" of bills of exchange. This meant that the bills ended up in the hands of the original drawee so that no money actually passed under them. The only money which did pass by the end of the taxation year, 1982, was the \$50,000 paid by the taxpayers.

The investment plan spanned a period of 15 years. Under the scheme, there would be substantial tax deductions available to the partnership in the first five years, small deductions in the second five years and very large taxable receipts over the final five years.

The scheme also provided for a mechanism whereby the adverse tax consequences of the final five years could be avoided. The partnership was not liable to repay any outstanding principal or pay interest in the event of default under the loan agreements at any time during the first 10 years. There was only recourse to the partnership's interest under the annuity agreement.

Under the circumstances, it would be advantageous to the taxpayer partners to ensure that the annuity and loan agreements did not run their full course.<sup>27</sup> The whole structure of the investment plan suggested that it would be terminated before the commencement of the final five years.

## The appeal

The taxpayers claimed in their 1981-82 to 1984-85 personal tax returns their respective shares of the partnership loss. The Commissioner disallowed the claims and the taxpayers objected.

The High Court appeal was from the Full Federal Court,<sup>28</sup> which dismissed the taxpayers' appeal from a decision of the Administrative Appeals Tribunal (AAT). The AAT had found that the outgoings of interest, which were the basis of the partnership's loss in each income year, were not deductible under s 51(1). The Federal Court agreed with the findings of the AAT in that the purpose of the scheme was not to gain or produce assessable income for the partners but to reduce their taxable income.

The appeal was allowed. The High Court found:

- (1) Where an outgoing gives rise to the receipt of a larger amount of assessable income, it is possible to characterise it as being wholly deductible under the first limb of s 51(1) without any need to refer to the taxpayer's motives.<sup>29</sup>

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<sup>27</sup> *Fletcher v FCT* 91 ATC 4950 at 4960.

<sup>28</sup> 90 ATC 4559.

<sup>29</sup> Above n 27 at 4957-4958.



This is basically the “form” test. The necessary nexus to “gaining or producing assessable income” exists without the need to resort to the taxpayer’s motivations. The fact that assessable income is greater than the outgoing incurred is sufficient to characterise the whole outgoing as one which was incurred in gaining or producing assessable income.<sup>30</sup> It does not matter that the taxpayer may have had a choice of incurring a lesser outgoing or that he or she may have had the choice of incurring a tax deductible outgoing under s 51(1) or a lesser non-deductible outgoing in producing the assessable income.

Once the outgoing is so characterised, the Commissioner cannot question how you carry on your business or whether the expenditure was necessary. If the outgoing can properly be characterised as having been incurred in gaining or producing assessable income, then “it is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent.”<sup>31</sup> This is the old *Toohey’s* principle.<sup>32</sup>

- (2) Where no relevant assessable income is derived as a result of the outgoing, or where the relevant assessable income is less than the amount of the outgoing, it is a commonsense or practical weighing of the various aspects of the whole set of circumstances, including direct and indirect objects and advantages which the taxpayer had in mind, which will determine whether the outgoing was incurred in gaining or producing assessable income.<sup>33</sup>

This is the “purpose” test. The court looks at both the objective and subjective intents of the taxpayer and determines what the whole object of the scheme was and what advantages were sought by the taxpayer in incurring those interest payments.

Often, the taxpayer’s subjective intent in incurring the outgoing may, depending on the circumstances of the particular case, constitute an element, and possibly the decisive element, in characterisation of either the whole or part of the outgoing for the purposes of s 51(1).<sup>34</sup> This view of the relevance of purpose has been discussed above in the *Magna Alloys’* case, *Ure’s* case and *Ilbery’s* case.

- (3) If, upon consideration of all the factors, it appears that the whole outgoing is properly characterised as genuinely and not colourably incurred, the entire outgoing will fall within the first limb of s 51(1), unless it is otherwise excluded by the exceptions under

30 Ibid at 4958.

31 Ibid at 4958 referring to *Ronpibon Tin NL* (1949) 8 ATD 431 and *Cecil Bros Pty Ltd v FCT* (1962) 12 ATD 449.

32 *Toohey’s Ltd v Commissioner of Taxation (NSW)* (1922) 22 SR (NSW) 432 per Ferguson J at 440.

33 91 ATC 4950 at 4958.

34 Ibid at 4957.

s 51(1). (Section 51(1) excludes 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.)

An outgoing would be "colourably" incurred if it was incurred not for the purpose of producing or gaining assessable income but for the sole purpose of reducing tax liability or some other benefit. In other words, there was no real income-producing activity or no carrying on of a business which related to the outgoings. The High Court held that the outgoings would be "colourably" incurred if the investment plan was pre-determined to not run its full course. In that event, the outgoings would not be wholly deductible.

- (4) If there is some other objective pursued in incurring the outgoing, but part of the outgoing can be characterised by reference to the actual or expected production of assessable income, then the outgoing will be apportioned between the pursuit of assessable income and the pursuit of that other objective.<sup>35</sup>

### Application to Fletcher's case

In *Fletcher's* case, the assessable income derived from the annuity in each of the tax years was less than one-eighth of the adjusted outgoings of interest in that year.

Where the outgoings of interest did not exceed assessable income actually derived under the annuity agreement or investment plan in a particular tax year, they were properly to be characterised as incurred in gaining or producing assessable income. To that extent they are deductible under s 51(1). However, where the outgoings are substantially more than the assessable income derived there arose the question of to what extent those outgoings are properly to be characterised as incurred in gaining or producing assessable income.

The answer lay in the overall factual context in which the outgoings were incurred.<sup>36</sup> This involved a consideration of the contents and implications of the contracts which were entered into by the partnership out of which the outgoings of interest became payable. The purpose which the partners and those who advised them or acted on their behalf had in incurring the outgoings formed part of that consideration.<sup>37</sup>

### Consideration of "purpose"

The High Court found that if the plan was to run its full course of 15 years, then the total expected income which the partnership would be expected to derive would exceed the total of the adjusted outgoings of interest. If, over the 15 years, assessable income derived would be more than the deductions now sought (in the 1981-1985 income years), they would be

<sup>35</sup> See *Ure v FCT* 81 ATC 4100; *Kowal v FCT* 84 ATC 4001.

<sup>36</sup> 91 ATC 4950 at 4959.

<sup>37</sup> *Ibid.*

allowed.<sup>38</sup> The reference to assessable income in s 51(1) is not a reference to income derived in the year in which the deductions are sought.

The fact that the assessable income earned was more than the outgoings of interest was sufficient, without more, to characterise the whole outgoing as one which was incurred in gaining or producing assessable income.<sup>39</sup> The adjusted outgoings of interest incurred in each of the tax years would be wholly deductible under s 51(1).<sup>40</sup>

Whether the excess of the partnership's adjusted outgoings over assessable income can be deducted under s 51(1) turns upon two alternative intentions. It was a question of whether the partners intended that those outgoings of interest were made pursuant to a 15 year plan that would run its full course or as payments made under a 15 year plan that was structured and expected to be terminated before the commencement of the 11th year.

If the intention of the taxpayers was to terminate the plan at the beginning of the 11th year, then to the extent that adjusted outgoings exceeded assessable income, those outgoings were not incurred for the purpose of gaining or producing assessable income but for the purpose of gaining a tax advantage. The 15 year investment plan was projected to produce large taxable receipts only in the final five years. If the plan were to be terminated at the beginning of the 11th year, then there would be no taxable receipts overall but very large deductions. This would leave the individual partners with a considerable tax advantage. There would have been no production of assessable income or any business in any sense to warrant those deductions.

This was entirely a question of fact to be decided by the tribunal or court.<sup>41</sup> The onus of proof would be on the taxpayers. The matter was remitted to the Administrative Appeals Tribunal to make the necessary findings of fact.

## Possible conclusions for the AAT

The AAT could have arrived at either of these two conclusions:

- If it found, on a commonsense assessment of all the evidence, that the contractual arrangements entered into by the partnership were intended and expected to run their full course, the adjusted outgoings of interest would be *prima facie* allowable as deductions under s 51(1).

This finding would be subjected to the tax avoidance provisions of Part IVA and s 82KL of the ITAA which were not in issue in the High Court.

- If it found that the contractual arrangements were intended and expected to be terminated before the final five years, then the adjusted outgoings of interest would not be deductible under s 51(1) to the extent that they exceeded the partnership's assessable income

<sup>38</sup> Ibid at 4957 and see *Walker v FCT* 83 ATC 4168 (Sup Ct NSW) at 4188.

<sup>39</sup> Ibid at 4958 and 4960.

<sup>40</sup> Ibid at 4960.

<sup>41</sup> Ibid at 4961.

in each of the tax years. This would really be an apportionment of the outgoings.

Following the High Court decision, the AAT has found that the taxpayers did not intend or expect the annuity partnership investment scheme to run its full course.<sup>42</sup> Therefore, the adjusted outgoings of interest payable under the scheme were not deductible to the extent that they exceeded the partnership's assessable income.

## Conclusion

The High Court in *Fletcher's* case has adopted a two tier approach to deductions under s 51(1). It has adopted an amalgam of both the "form" and the "purpose" tests of deductibility. This promises us yet more confusion.

The High Court found that, in so far as outgoings and losses do not exceed assessable income, the outgoings will almost always be wholly deductible and not affected by the motives of the taxpayer. The taxpayer is left with the choice of how much of the outgoings should be incurred in producing the assessable income.<sup>43</sup> The fact that the taxpayer may be motivated to incur more outgoings for taxation reasons is irrelevant. This is an application of the "form" test of deductibility. As long as the taxpayer gets it legally correct, on paper, the deductions will be allowed.

Previous cases which have adopted the "purpose" test found that purpose may be relevant where it is not so clear that the outgoing was incurred in the production of assessable income.<sup>44</sup> In *Fletcher*, the High Court found that "purpose" becomes relevant where there is no relevant assessable income or the outgoing is more than the assessable income. This gives one the impression that the "form" test should be used at least until outgoings equal assessable income before considerations of purpose come into play.

The result is an unnecessarily complex four-step approach to deductibility:

- Is the assessable income more than the losses and outgoings incurred? If yes, those losses and outgoings will be deductible under s 51(1). The taxpayer's motives are irrelevant.
- Is there no relevant assessable income or is the outgoing more than the assessable income? If so, then, to the extent that they do not exceed assessable income, the losses and outgoings should be deductible under s 51(1). They would necessarily have been incurred in the production of that assessable income. Beyond that, the court must weigh the various aspects of the whole set of circumstances, the taxpayer's purpose and subjective intentions and advantages sought, to determine if the excess was incurred in gaining or producing assessable income.

<sup>42</sup> *Fletcher v FCT* 92 ATC 2045.

<sup>43</sup> See discussion above of the "form" test and *Cecil Bros Pty Ltd v FCT* (1962) 12 ATD 449; *FCT v Phillips* 78 ATC 4361.

<sup>44</sup> See discussions of *Magna Alloys, Ure and Ilbery*.

- Where, after considering all the factors, the whole outgoing can be characterised as genuinely incurred, the entire outgoing will fall within the first limb of s 51(1) and be deductible, unless excluded by the exceptions in s 51(1).
- Can the disproportion between the outgoing and the relevant assessable income be explained by reference to some other purpose and only part of that outgoing was incurred in the actual gaining or producing of assessable income? If yes, an apportionment will be made.

It has been suggested that, no matter what test one applies, purpose will always necessarily have to be taken into account.<sup>45</sup> Even under the first situation laid down by the High Court in *Fletcher*, if outgoings are commercially unrealistic, the court will have to determine if the taxpayer has any other purpose in mind besides the production of assessable income.<sup>46</sup> If so, then not all outgoings will be deductible, even if assessable income produced is greater.

Purpose of expenditure should be the test for deductibility. It is the fairest and most reasonable approach and it accords with the aim of encouraging bona fide, productive business activity. A “form” or “legal rights” test would disadvantage other taxpayers who continue to pay income taxes. It will encourage taxpayers to create artificiality in their transactions as occurred in *Europa Oil (No 2)*. A “purpose” test will promote the actual production of assessable income.

The decision in *Fletcher's* case, whilst not inconsistent with the earlier cases, adds complexity to an already complex area of the law with its two-tier approach. Perhaps, as recommended by Corkery, it is time for legislators to decide once and for all which test should be introduced into s 51(1) itself.<sup>47</sup> By including the word “purpose” in the first limb of s 51(1), taxpayers, when challenged, will have to show an income-earning purpose for their outgoings before they are deductible.

Practically, however, the Commissioner will not have the resources to apply the purpose test in every instance. In most cases, the Commissioner will allow normal-looking deductions where there clearly is a business operating, even where deductions claimed for expenditure more than income produced. This often is the case at the start of new businesses. Only where the Commissioner has doubts will more intense scrutiny be carried out.

Rather than labour on with the various and overlapping current tests, we should dismiss all of them but one. The Commissioner should look at purpose in a broad sense to establish the necessary nexus between outgoings and income production. Such a test will make the work of taxpayers, tax advisers and the courts much simpler and there will be a consistent approach throughout.

<sup>45</sup> See Corkery, above n 4 at 23.

<sup>46</sup> See *FCT v Phillips* 78 ATC 4361 at 4371.

<sup>47</sup> Above n 4 at 23-24. Corkery's recommendation was made as far back as 1984.