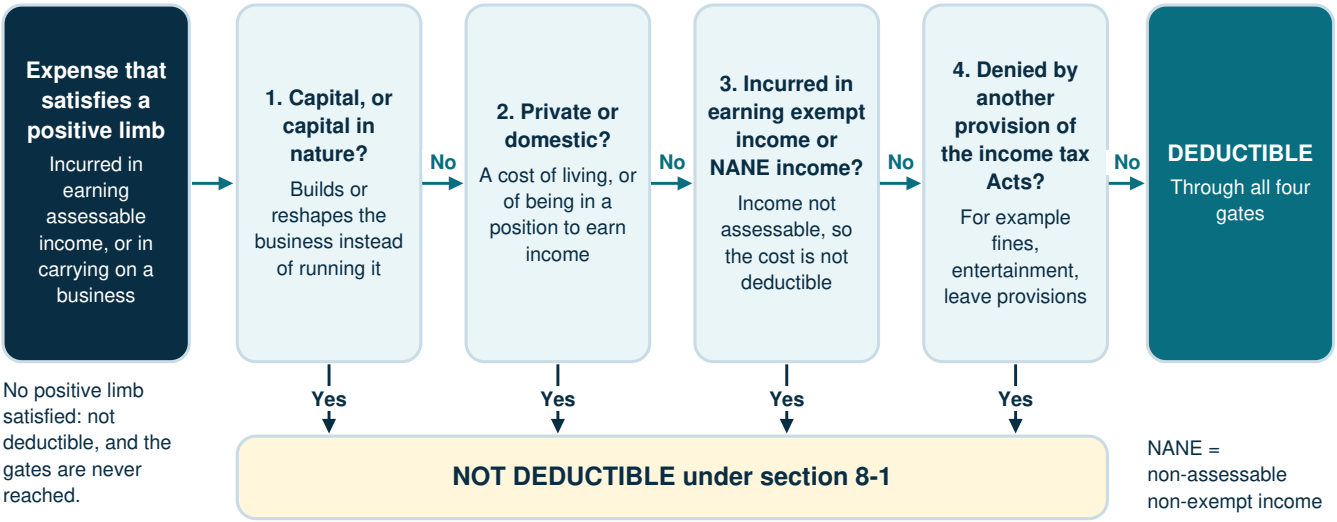
The Negative Limbs and Denied Deductions

MODULE 2 | 2.10.1 | STUDENT COMPANION

The negative limbs in section 8-1(2) are tested only after a positive limb is satisfied. They remove capital costs, private or domestic costs, the costs of earning exempt or NANE income, and anything another provision denies. Entertainment is denied unless it is a fringe benefit or an exception applies, and a payment to a relative is deductible only up to a reasonable amount.

The four gates

Four gates: the negative limbs of section 8-1(2)



Gate 1 - capital

No definition in the Act. The courts decide. Early pointers: a payment made once and for all (Vallambrosa Rubber), or one that brings an enduring benefit (British Insulated and Helsby Cables v Atherton).

Leading test: Sun Newspapers. Does the outlay go to the structure of the business (capital) or to the process of operating it (revenue)? Weigh the character of the advantage sought and how lasting it is; how it will be used or enjoyed; and the means of obtaining it (lump sum or periodic).

- Instalments can still be capital: AusNet Transmission (buying a business); Sharpcan (a gaming licence).
- Wages are capital when the employees are building a capital asset.
- Losses on large-scale share dealings made with a profit-making purpose were deductible: Greig v FCT.

Gate 2 - private or domestic

Expense	Position
Childcare	Not deductible: a cost of being able to work (Lodge)
Home to work travel	Not deductible. Fly-in fly-out: only travel after duties begin (John Holland)
Clothing	Conventional: no. Protective, high-visibility, a specific uniform or occupation-specific: yes. Non-compulsory uniform: only if registered with AusIndustry (s 34-10)
Home office	Costs of using the room: yes. Mortgage interest and rates: no (Handley), unless that part of the home is a separate place of business
Self-education	For a new job or activity: no. To keep up to date or win promotion in the current job: yes (TR 98/9) - course and seminar fees, student union fees, materials, textbooks, and travel from home or from work to the place of education and back. Childcare while studying stays private (Lodge); HELP repayments are denied (s 26-20)

Gate 3 - exempt or NANE income

If the income is not assessable, the cost of earning it is not deductible.

Gate 4 - denied by another provision

Gate four: deductions denied by a specific provision

Wrongdoing

- Penalties for breaching a law - **s 26-5**
- Bribes to public officials - **ss 26-52, 26-53**
- Spending on illegal activities, after a conviction for an indictable offence - **s 26-54**

Personal

- Maintaining a spouse, or a child under 16 **- s 26-40**
- Recreational club memberships - **s 26-45 (FB)**
- Leisure facilities - **s 26-50 (FB)**
- Travel costs of a relative on a business trip - **s 26-30 (FB)**
- Gifts to political parties and candidates **- s 26-22**

Protecting the system

- Wages paid without the required PAYG withholding - **s 26-105**
- Provisions for annual and long service leave: deduct when the leave is paid **- s 26-10**
- GST in a price, to the extent of an input tax credit - **s 27-5**
- Costs of holding vacant land (some exceptions) - **s 26-102**
- Travel to a residential rental property (some exceptions) - **s 26-31**

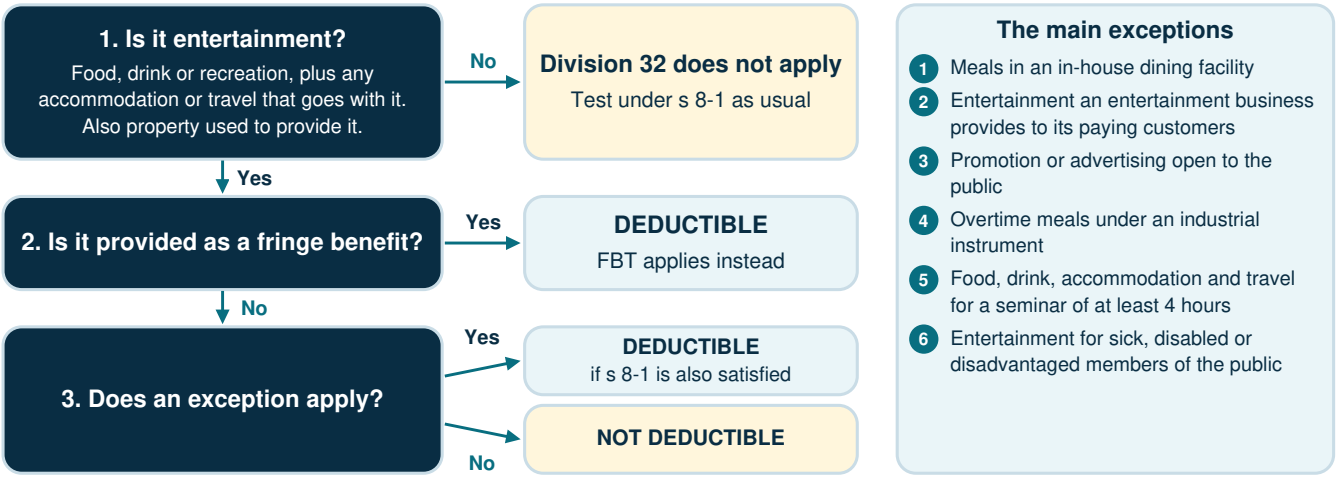
(FB) = the denial gives way when the cost is provided as a fringe benefit. FBT applies instead.

Also denied. HELP debt repayments (s 26-20, unless paid by an employer subject to FBT); costs of earning a rebatable benefit such as Youth Allowance (s 26-19); wages to seasonal workers without PAYG withholding (s 26-25A); excess superannuation contributions charge and tax (ss 26-74, 26-75).

Exceptions to remember. Section 26-5 does not catch a GST Act penalty under Subdivision 162-D. A relative's travel is deductible if the relative has a genuine and substantial business reason to be there. Vacant land costs stay deductible where the land is used in a business, and rental travel where letting residential property is itself a business.

Entertainment (Division 32)

Entertainment: three questions



Example. Fernhollow Creamery: client dinner $1,200 - denied. Public tasting $800 and lunch at a six-hour staff seminar $600 - deductible. Deductible: $1,400 of $2,600.

Payments to related entities (s 26-35)

A related entity is a relative, or a partnership in which a relative is a partner.

- The payment must be deductible under another provision, normally s 8-1.
- The Commissioner may cut the deduction back to what is reasonable.

Example. $60,000 paid to a daughter for work worth $15,000: deduction $15,000; the other $45,000 is not deductible.

Key figures for 2024-25

Item	Figure
Seminar exception for entertainment	Seminar of at least 4 hours
Maintenance of a child denied (s 26-40)	Child under 16
Indictable offence (s 26-54)	Carries a prison term of one year or more

Practice questions

MODULE 2 | 2.10.1 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Which gate?

Xanthe Carrowmore is a sole trader who runs a bus charter business, Gullwing Coaches. She also serves part-time in the Army Reserve, and her Reserve pay is exempt income. For each outlay below, made in 2024-25, state whether it is deductible under section 8-1. If it is not, name the gate (negative limb) that stops it, or explain why it never reaches the gates.

Outlay	Amount
1. Purchase of a new 48-seat coach	$420,000
2. Diesel for the fleet	$96,000
3. First of five yearly instalments of $15,000 (total $75,000) paid to the port authority for a 20-year exclusive right to collect cruise passengers at the terminal	$15,000
4. Fine imposed by the transport regulator for breaching driver rest-hour laws	$6,600
5. Provision for annual leave that her drivers have earned but not yet taken	$18,000
6. Xanthe's own daily travel between her home and the depot	$2,300
7. Travel costs of attending Army Reserve training	$1,250
8. Her annual membership of a golf club, where she sometimes meets clients	$3,100

Question 2 - Food, drink and recreation

Ostrander Lifts Pty Ltd maintains lifts in office buildings. Its spending on food, drink and recreation for 2024-25 is listed below. Assume that every item would otherwise satisfy section 8-1, and that no item is provided as a fringe benefit unless the table says so. Decide whether each item is deductible, then total the deductible amount and the amount denied.

Item	Amount
1. Dinner and drinks at a restaurant for the building managers of its four largest customers	$5,400
2. Hire of a private room at the restaurant for that dinner	$900
3. Barbecue and soft drinks at a public open day at its new training centre, advertised to the whole community	$2,600
4. Lunch and refreshments for technicians attending a seven-hour safety seminar at a conference centre	$1,800
5. Restaurant lunch with wine for the sales staff after a three-hour product briefing	$700
6. Meals for technicians working overtime, to which they are entitled under their enterprise agreement	$2,250
7. Meals served to employees on working days in the company's in-house canteen	$7,500
8. Cricket tickets given to employees. They are provided as a fringe benefit and the company pays FBT on them	$4,000
9. Afternoon tea and a magician for the patients of a children's hospital ward	$1,300
10. Corporate box at a football final for its suppliers	$3,300

Question 3 - Home office and a family employee

Mireille Kovalenko is a conveyancer who works as a sole trader. Her office is in leased rooms in town, but two days a week she works from the study in her house. The study is an ordinary room of the home, and clients never visit it. Her figures for 2024-25 are below. PAYG withholding has been carried out correctly on both salaries.

Outlay	Amount
Mortgage interest on the house	$21,000
Council rates on the house	$2,400
Home insurance	$1,600
Electricity for the house: $3,000, of which her records show this much was used to run the study while she worked	$360
Decline in value of the desk, chair and shelving in the study, which are used only for work	$450
Salary to her receptionist, who is not related to her	$58,000
Salary to her brother, Malachy, a student who looks after the office computers one afternoon a week. An unrelated contractor would charge about $13,000 a year for the same work	$52,000
Fee for a two-day course on changes to property law	$1,500
Repayment of the HELP debt for her own degree	$4,200

Questions for Mireille

(a) Which of the home costs can Mireille deduct, and why? (b) How much of Malachy's salary is deductible? Explain the two steps. (c) Are the course fee and the HELP repayment deductible? (d) Calculate Mireille's total deductions from this list.

Worked answers

MODULE 2 | 2.10.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Which gate?

Outlay	Result
1. Coach, $420,000	Not deductible. Gate 1: it is a capital asset that will serve the business for years. (Deductions for its decline in value are a separate topic: capital allowances.)
2. Diesel, $96,000	Deductible. It is a cost of operating the business and passes all four gates.
3. Instalment for the exclusive right, $15,000	Not deductible. Gate 1. Apply the Sun Newspapers questions: the advantage is a 20-year exclusive right, which is lasting; it will be relied on throughout that time; and paying by instalments is only the method of payment. The right is part of the structure of the business, so every instalment is capital (compare Sharpcan).
4. Fine, $6,600	Not deductible. Gate 4: section 26-5 denies penalties imposed for breaching a law, even though the fine arose directly from running the business.
5. Leave provision, $18,000	Not deductible. Gate 4: section 26-10 denies a deduction for a provision for leave. The deduction arises when the leave is actually paid. (Equally correct: a provision is not a loss or outgoing that has been incurred, so no positive limb is satisfied.)
6. Home to depot travel, $2,300	Not deductible, and it never reaches the gates. Commuting is not a cost of earning her assessable income, so no positive limb is satisfied. It puts her in a position to earn income, the same reasoning as in Lodge.
7. Reserve training travel, $1,250	Not deductible. Gate 3: it is incurred in earning exempt income.
8. Golf club membership, $3,100	Not deductible. Gate 4: section 26-45 denies recreational club membership fees. The fringe benefit exception cannot apply, because Xanthe is the owner of the business and not an employee.
Total	**Total deductible under section 8-1: $96,000.**

Question 2 - Food, drink and recreation

Each item is the provision of food, drink or recreation, so it is entertainment and the general rule in section 32-5 denies a deduction unless the item is a fringe benefit or an exception applies.

Item	Result
1. Dinner for customers, $5,400	Denied. No exception covers entertaining selected clients.
2. Room hire, $900	Denied. Property used to provide entertainment is caught as well.
3. Public open-day barbecue, $2,600	Deductible. Promotion or advertising open to the public.
4. Seminar lunch, $1,800	Deductible. Food and drink for a seminar lasting at least four hours.
5. Lunch after the product briefing, $700	Denied. The briefing ran for only three hours, so the seminar exception does not apply.
6. Overtime meals, $2,250	Deductible. The employees are entitled to them under an industrial instrument.
7. In-house canteen meals, $7,500	Deductible. Meals in an in-house dining facility.

Item	Result
8. Cricket tickets, $4,000	Deductible. They are provided as a fringe benefit, so FBT applies instead of the denial.
9. Hospital ward party, $1,300	Deductible. Entertainment for sick members of the public.
10. Corporate box, $3,300	Denied. Recreation for suppliers, and no exception applies.

Deductible = $2,600 + $1,800 + $2,250 + $7,500 + $4,000 + $1,300 = **$19,450**.

Denied = $5,400 + $900 + $700 + $3,300 = **$10,300**.

Check: $19,450 + $10,300 = $29,750, the total spent.

Question 3 - Home office and a family employee

(a) Deductible: the $360 of electricity for the study and the $450 decline in value of the study furniture = **$810**. These are costs of using the room for work, which Handley accepted. Not deductible: mortgage interest $21,000, council rates $2,400 and home insurance $1,600. They are costs of owning the home, and the home remains private even though one room is used for work (Gate 2). The study is an ordinary room, not a separate place of business. The rest of the electricity ($3,000 - $360 = $2,640) is private too.

(b) $13,000. Step 1: the salary must be deductible under another provision. It is, because Malachy does real work for the business (section 8-1). Step 2: Malachy is a relative, so he is a related entity, and section 26-35 lets the Commissioner cut the deduction back to what is reasonable. $52,000 for work that would cost about $13,000 is excessive, so the deduction is limited to $13,000. The other $52,000 - $13,000 = $39,000 is not deductible.

(c) The course fee of $1,500 is deductible: it keeps Mireille up to date in the business she already carries on. The HELP repayment of $4,200 is not deductible: section 26-20 denies it (Gate 4), whatever the connection between the degree and her income.

(d) Mireille's total deductions

$810 + $58,000 + $13,000 + $1,500 = **$73,310**.

Item	Amount
Home office (electricity and study furniture)	$810
Receptionist's salary	$58,000
Malachy's salary, cut back to a reasonable amount	$13,000
Course fee	$1,500
Total deductions	**$73,310**