

QUESTION WE'VE BEEN ASKED QB 13/05

INCOME TAX – DEDUCTIBILITY OF A COMPANION'S TRAVEL EXPENSES

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Question We've Been Asked (QWBA) is about ss DA 1(1) and DA 2(2). It applies for the 2014 income year and subsequent income years.

During a review of the *Public Information Bulletin* and *Tax Information Bulletin* series published before 1996, parts of the items "Deduction for Wife's Expenses – Professional People Attending Overseas Conferences" *Public Information Bulletin* No 74, p 10 (June 1973) and "Overseas Travel Expense Claims" *Tax Information Bulletin* Vol 7, No 2 (August 1995) were identified as no longer reflecting the Commissioner's interpretation of the law as it relates to the deductibility of a companion's travel expenses. The Public Information Bulletin review has now been completed, see "Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013).

This QWBA updates and replaces the *Public Information Bulletin* item. This QWBA also updates and replaces the part of the *Tax Information Bulletin* item dealing with claims for a companion's or a family member's overseas travel expenses. The Commissioner considers that the other two parts of the *Tax Information Bulletin* item dealing with the information that a taxpayer should supply when asked by Inland Revenue to support a claim for overseas travel expenses and the apportionment of private expenses are still correct and relevant.

Question

1. In the course of carrying on a business, a taxpayer takes a business trip. A companion accompanies the taxpayer on that business trip. Can the taxpayer deduct the companion's travel expenses?

Answer

2. In most cases, the companion's travel expenses will not be deductible. If the companion is accompanying the taxpayer simply for companionship or to attend social functions, then this expenditure will not have a sufficient nexus with the taxpayer's business or income-earning activity.
3. However, a deduction may be permitted where the companion supports the taxpayer, to a reasonably substantial degree, in the business being undertaken. The companion does not need to be an expert in the affairs of the business, but they do need some knowledge of the business being undertaken or they must possess some special skill or expertise to be able to provide support in a material way. If these qualities are present, then the Commissioner considers a sufficient nexus will exist between the companion's travel expenses and the taxpayer's business or income-earning activity.
4. This answer applies to travel expenses incurred overseas and in New Zealand. Deductions for travel expenses incurred in New Zealand may be restricted by the entertainment rules (ss DD 1 – DD 11). Employers may also need to consider fringe benefit tax (FBT) if travel expenses confer a private benefit on their employees or associated persons of the employees. This QWBA does not consider the implications of the entertainment rules or the FBT rules on a companion's travel expenses.

Explanation

Deductibility

5. The travel expenses of a taxpayer's companion will be deductible if the expenses satisfy the requirements of s DA 1(1), known as the general permission, and s DA 2 does not deny their deduction. Section DA 1(1) is satisfied where a sufficient nexus or relationship exists between the expenses incurred and the deriving of the taxpayer's assessable income or the carrying on of a business by the taxpayer for the purpose of deriving assessable income. To determine whether there is a sufficient nexus, the character of the expenditure and its relevance to the taxpayer's business must be considered.
6. Some types of expenditure will not be deductible. Section DA 2(2) prohibits a deduction for expenditure of a private or domestic nature.
7. In *CIR v Haenga* [1986] 1 NZLR 119 (CA), Richardson J noted that certain kinds of expenditure have some relationship with the earning of income in that they are necessary prerequisites (eg, travel to a place of work and childcare costs). However, Richardson J, at 127 to 128, concluded that they are not deductible:

It is a matter of degree and so a question of fact to determine whether there is a "sufficient" nexus between the expenditure and what it provided or sought to provide on the one hand and the income earning process on the other so as to fall within the words of the section. That the inquiry involves a value judgment of sufficiency is implicit in the statutory scheme.

The legal answer is complicated where as here the asset or advantage in respect of which expenses are incurred may serve private and income earning purposes. Thus expenses of travelling between home and work and expenses of child care have conventionally been regarded by the Courts as a private matter, a form of consumption. In as much as they are a prerequisite to the earning of income it is arguable that they are incurred in the gaining of the assessable income. But depending on one's perspective a similar argument could even be advanced to justify deduction of outlays on such basic items as essential food, clothing and shelter which may be said to maintain and enhance the physical and psychological wellbeing of the individual, and in turn his or her ability to perform his employment. In one sense then any such expenditure has a relation to the purpose of earning income, even if it is described as an ordinary living expense. But it is not to be expected that the legislature ever contemplated such an erosion of the income tax base in respect of employment income; and with careful emphasis on the character of the expenditure incurred the Courts have denied the notion that an expense properly characterised as consumption is incidental and relevant to the derivation of income merely because it is necessary in that sense (*Lodge v Federal Commissioner of Taxation* (1972) 128 CLR 171, 175; *Lunney v Commissioner of Taxation* (1958) 100 CLR 478).

Travel expenses

8. The deductibility of a companion's travel expenses was the subject of two New Zealand tax cases: *Case 16* (1964) 2 NZTBR 119 and *Case K75* (1988) 10 NZTC 602. These cases illustrate how the nexus requirement works in practice.
9. *Case 16* and *Case K75* both concern the deductibility of a companion's overseas travel expenses. In the Commissioner's opinion, the same reasoning would apply to travel expenses incurred within New Zealand. It is the character of the expenses that is important, not whether they were incurred in New Zealand or overseas. (However, deductions for some travel expenses incurred in New Zealand may be restricted under the entertainment rules (ss DD 1–DD 11).)
10. In *Case 16* the taxpayer company carried on business as a wholesale wine and spirits merchant. A was a shareholder and the managing director of the taxpayer. A's wife B was also a shareholder and director, but not an employee. Because of B's personal standing and business interests in Great Britain, she was able to materially assist the company to obtain a whiskey distributorship. However, in 1958 restrictions were placed on import licences, which resulted in poor sales for the taxpayer. The Great Britain whiskey distributor became dissatisfied. To try to preserve the distributorship, A and B visited the distributor. A confirmed that B's presence was essential to the visit. She was present at every meeting, took

part in every business discussion and assisted in making decisions. The company sought a deduction for the travel expenditure. The Commissioner allowed a deduction for A's travel expenses, but not for B's.

11. The Taxation Board of Review (the board) held that B's travel expenses had a sufficient nexus with the assessable income of the business, so were deductible. The board found that B actively and competently carried out the duties of a director. Her standing within the licensed trade in Great Britain was of particular value to the company. B was not an employee of the company, but her intimate knowledge of the business meant she was able to contribute in a material way to the business being undertaken on the trip.
12. *Case K75* concerned the deductibility of travel expenditure incurred by a group of executives' wives. The executives had undertaken several business trips accompanied by their wives. The trips involved attending various local and international conferences and seminars. The purpose of the trips was networking and information gathering (to keep up to date with new developments in the publishing world). The wives assisted their husbands with these tasks by meeting and assessing the integrity and competence of the delegates, hosting dinners for delegates and participating in discussions about the business.
13. The company sought a deduction for the wives' travel expenses. The Commissioner refused to allow a deduction on the grounds that the travel expenses lacked sufficient nexus.
14. Judge Barber held that the expenditure was deductible. However, he considered that such expenditure would not easily satisfy the nexus test. He stated at 612:

I record that I commenced this exercise from the point of view that it must be quite difficult for an objector to prove a sufficiently strong link, on the balance of probabilities, between travel expenditure for wives and an income earning process. ... wives would not usually have a sufficient knowledge or interest in the business of their husband's employer to warrant deductibility by the employer of a wife's travel expenses when accompanying her husband.
15. Judge Barber considered, at 612, that a sufficient nexus would exist where:

... the wife is travelling with the employee-executive husband to provide him with support, to a reasonably substantial degree, in undertaking the business of the employer; or, in other words, if the wife is adding in a reasonably substantial manner to the contribution which the husband would otherwise make to the business of the employer ...
16. In finding that this test was satisfied, Judge Barber noted that the wives were able to recall names of business contacts, they "ate, drank and talked" the business of the company, and they had a wide knowledge of their husbands' goals and the issues facing the company. Judge Barber considered that the expenditure benefited the company, observing with regards to one wife in particular, at 611:

True, Mrs G might not be an "expert" in the affairs of the Company; but I am satisfied that her presence overseas accompanying Mr G, was of substantial benefit to the Company, and similarly with regard to the other two wives.
17. Judge Barber noted that deductibility is not available where the presence of the wife has no connection with the business activities undertaken by the employee husband. A deduction is not allowed if the companion is travelling as part of a "junctet or joy-ride" (at 613).
18. In the Commissioner's opinion, for a companion to provide support to a "reasonably substantial degree, in undertaking the business of the employer" the companion (whether a spouse or otherwise) must have some knowledge of the business or some special skill or expertise to provide this support in a material way. Simply being supportive is not enough; that support must relate to the business being undertaken for a sufficient nexus to exist.

Travelling with a companion because of ill-health

19. "Overseas travel expense claims" *Tax Information Bulletin* Vol 7, No 2 (August 1995) outlined situations where a taxpayer may be able to claim a companion's travel expenses. One situation is where a taxpayer travelling on business must be accompanied because of ill-health.
20. The Commissioner no longer considers that a companion's travel expenses would be deductible where the companion is travelling with the taxpayer because of ill-health. In such cases there is likely to be an insufficient nexus with the taxpayer's business or income-earning activity and the expenses would likely be of a private or domestic nature. The companion might arguably be providing the taxpayer with support to a reasonably substantial degree, but that support relates to the taxpayer's personal circumstances and not to the business being undertaken.
21. Expenses relating to a health condition are generally not deductible as business expenses. This is the position taken by the New Zealand courts in the following cases: *Case E87* (1982) 5 NZTC 59,455, *Case F69* (1983) 6 NZTC 59,904, *Case F133* (1984) 6 NZTC 60,210, *Case F117* (1984) 6 NZTC 60,125, *Case F158* (1984) 6 NZTC 60,354 and *Haenga*. (See also "Self-employed person's medical costs not deductible" *Tax Information Bulletin* Vol 7, No 1, (July 1995).) In *Case F158* a taxpayer claimed a deduction for the cost of private medical treatment. The taxpayer underwent private treatment so that he was able to more quickly resume his professional work. In denying the deduction, Judge Barber noted:

In a number of cases over the past year I have covered the view that, generally, expenditure required to remedy diseases or disabilities of the human body is expenditure of a private type – even though a reason for the expenditure is to enable the taxpayer to better earn income or resume the earning of income by remedying his health.

...

However, not only is such expenditure not incurred in the course of gaining or producing income, in terms of sec 104 of the Act because it is incurred prior to the income earning process in order to enable the taxpayer to resume that process; but also, quite apart from the legal authorities, common sense tells us that such expenditure for surgery on parts of the human body cannot be regarded as business expenditure because it has the character or nature of private expenditure and hence is not deductible under our law by virtue of sec 106(1)(j) of the Act. The expenditure is not an overhead or functioning cost of O's legal practice; it is a health maintenance cost for O as a human being.

Examples

22. The following examples explain the application of the law. In both examples, the purpose of the trip is business. If a business trip also contains a private element such as a holiday, then it may be necessary to apportion some of the costs associated with the trip. See "Overseas Travel Expense Claims" *Tax Information Bulletin* Vol 7, No 2 (August 1995) for information about apportioning travel expenses.
23. Some of the travel expenses discussed below may also be a fringe benefit and be subject to fringe benefit tax (FBT). These examples do not consider FBT.

Example 1: Spouse accompanying husband to overseas conference

24. Andrew is a barrister. He attends an international law conference in Japan. The purpose of the conference is to discuss new developments in the law and to network with prospective clients and colleagues. The conference is directly relevant to Andrew's practice.
25. The organisation presenting the conference expects that attendees will bring their partners. Andrew's wife Mary accompanies him. She meets with the other

attendees' partners and accompanies Andrew to dinners and cocktail functions held as part of the conference.

An overseas organisation expects Andrew to be accompanied – are Mary's travel expenses deductible?

26. Mary's travel expenses need to have a nexus with Andrew's business or income-earning activity. In the Commissioner's opinion, it is unlikely that there will be a sufficient nexus simply because an organisation expects that attendees will bring their partners. The onus will be on the taxpayer to show that this expectation has created a sufficient nexus.
27. If all Mary did was attend dinners and cocktail functions and provide companionship to Andrew, then her travel expenses would not be deductible because there would be an insufficient nexus with Andrew's business or income-earning activity. *Case K75* confirms that travel expenses will not be deductible if the person is travelling as a mere companion.

Would it make a difference if Andrew was also presenting a paper at the conference, the leader of a delegation or the only accredited delegate?

28. The role Andrew takes at the conference has no bearing on the deductibility of Mary's travel expenses. There must be a nexus between Mary's travel expenses and Andrew's business or income-earning activity. Mary is at the conference as a mere companion, so her travel expenses are not deductible.
29. It is also not significant that Andrew is a member of a profession. Deductibility is not related to a taxpayer's status as a professional; it is tied to the taxpayer's business.
30. Andrew could argue that Mary's travel expenses are deductible because he is presenting a paper at the conference to raise his business profile and he is expected to take a partner. In such circumstances Mary's travel expenses would be unlikely to have a sufficient nexus with Andrew's business. It is Mary's role and the contribution she makes, and the connection with Andrew's business that is important.

What if Andrew was the head of the international legal organisation running the conference and asked Mary to run the registration process and organise the various cocktail functions?

31. In this scenario, Mary's travel expenses may have a sufficient nexus with Andrew's business and be deductible. Mary is providing support to Andrew to a reasonably substantial degree with the business being undertaken. She is assisting with the conference and facilitating networking opportunities for the conference attendees, who would include potential clients for Andrew's business. This case is analogous to *Case K75*, where the executives' wives had a wide knowledge of what their husbands were trying to achieve and the wives understood and were concerned with furthering the company's business.

Would it make a difference if Andrew employed Mary full time as his bookkeeper?

32. Even if Mary were employed full time as Andrew's bookkeeper, her travel expenses are unlikely to be deductible. Employment status alone is not enough to create a sufficient nexus. Mary's job as a bookkeeper is an administrative one; she does not undertake legal work. The purpose of the conference is to discuss developments in the law and to network with clients and colleagues.

33. Mary may have knowledge of Andrew's business, but she is not providing support to Andrew to a reasonably substantial degree in the business being undertaken. She is attending the conference as Andrew's wife.

What if Mary is a lawyer employed by Andrew as a legal researcher and attended the conference seminars with him?

34. If Mary is a lawyer employed by Andrew as a legal researcher and attends the conference seminars with him, then her travel expenses are likely to be deductible. Her travel expenses will likely have a sufficient nexus with Andrew's business or income-earning activity. It is not Mary's job title that determines deductibility – it is the role that Mary performs in Andrew's business. Mary generates assessable income for Andrew's business by undertaking legal research that Andrew uses when providing legal services to his clients. The conference that Mary is attending is about developments in the law that relate directly to Andrew's area of practice. Mary's attendance will be likely to assist her in her work for Andrew.

Example 2: Niece accompanying aunt to overseas trade fair

35. Lucy owns a furniture-importing business. Once a year she travels to a furniture trade fair in Beijing, China. The trade fair is where she sees new designs, inspects items for quality, places orders and makes business contacts. Business is typically conducted in Mandarin. As Lucy cannot speak Mandarin she often hires an interpreter to help her conduct business. This year, Lucy decides to take her niece Alice. Alice speaks fluent Mandarin.

Are Alice's travel expenses deductible?

36. Alice's travel expenses are likely to have a sufficient nexus with Lucy's business or income-earning activity so would be deductible.
37. Alice is providing support to a reasonably substantial degree with the business being undertaken. Without Alice, Lucy cannot engage with her suppliers and place orders. Alice is not an expert in Lucy's business, but she does possess a special skill or expertise (speaking fluent Mandarin) and that special skill or expertise is used to provide support to Lucy in undertaking her business.

References

Subject references

Deductibility
Income tax
Travel expenses

Case F158 (1984) 6 NZTC 60,354
Case K75 (1988) 10 NZTC 602
CIR v Haenga [1986] 1 NZLR 119 (CA)

Legislative references

Income Tax Act 2007, s DA 1(1), s DA 2(2)

Case references

Case 16 (1964) 2 NZTBR 119
Case E87 (1982) 5 NZTC 59,455
Case F69 (1983) 6 NZTC 59,904
Case F117 (1984) 6 NZTC 60,125
Case F133 (1984) 6 NZTC 60,210

Other references

"Deduction for Wife's Expenses – Professional People Attending Overseas Conferences" *Public Information Bulletin* No 74, p 10 (June 1973)
"Overseas Travel Expense Claims" *Tax Information Bulletin* Vol 7, No 2 (August 1995)
"Self-employed person's medical costs not deductible" *Tax Information Bulletin* Vol 7, No 1 (July 1995)