

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Deadline for comment: **8 August 2022**

Please quote reference: **PUB00360**

Notes: This item was largely prepared in 2020 before the COVID-19 pandemic resulted in the cessation of overseas travel. It was decided to delay the publication of this draft partly because taxpayers were not going to be travelling overseas and partly so that the tax community, who might otherwise have submitted on this item, could focus on other priorities.

Send feedback to Public.Consultation@ird.govt.nz

QUESTIONS WE'VE BEEN ASKED

Deductibility of overseas expenses

Issued: XX XXXX 2022

Publication number QB XX/XX

This item considers whether income tax deductions can be claimed for overseas travel costs (other than meal costs). It also covers how to apportion costs when only part of the total amount incurred is deductible.

Key provisions

Income Tax Act 2007 – ss DA 1, DA 2

REPLACES: Policy Statement "Overseas travel expense claims" published in *Tax Information Bulletin* Vol 7, No 2 (August 1995): 13.

Question

Can income tax deductions be claimed for overseas travel costs (other than meal costs)?

Answer

Income tax deductions can be claimed for overseas travel costs (other than meal costs) but only to the extent that they have a connection with deriving assessable income or carrying on a business.

Income tax deductions cannot be claimed for any part of the costs that are of a private or domestic nature, of a capital nature, or incurred in deriving exempt income or income from employment.

If the costs need to be apportioned between deductible and non-deductible amounts, then this must be done on a basis that is reasonable in the circumstances.

Key terms

General permission a rule in s DA 1 that allows a deduction for costs incurred.

General limitations rules in s DA 2 that deny a deduction for costs incurred.

Explanation

Scope of this QWBA

1. This Question We've Been Asked (QWBA) discusses the deductibility of overseas travel costs (other than meal costs).
2. It also covers how to apportion costs when:
 - only part of the total amount incurred is deductible under the general permission (s DA 1), or
 - a deduction for part of the amount is denied under a general limitation (s DA 2).
3. This QWBA updates and replaces the policy statement "Overseas travel expense claims".¹ That policy statement stated that when travel relates to a group tour or

¹ *Tax Information Bulletin* Vol 7, No 2 (August 1995): 13.

conference, tour organisers may apply to Inland Revenue for prior approval of expense claims. This is no longer the case. Unless a taxpayer applies for a binding ruling under part 5A of the Tax Administration Act 1994, current Inland Revenue policy is that no prior approval is available because of the different circumstances of each taxpayer.

4. This QWBA does not consider the following two issues:
 - Whether a companion's travel costs may be deducted by a taxpayer who takes a business trip. This issue is considered in [QB 13/05: Income tax – Deductibility of a companion's travel expenses](#).²
 - The deductibility of meal costs. This issue is considered in [IS 21/06: Income tax and GST – Treatment of meal expenses](#).³
5. This QWBA addresses the deductibility of **overseas** travel costs only. Although the statutory tests for deductibility apply in the same way to domestic travel costs, more specific provisions may apply to domestic travel costs.
6. For examples on how the law applies, see below from [32].

Deductibility

7. A taxpayer's overseas travel costs will be deductible if they satisfy the requirements of the general permission. The general permission is satisfied where costs⁴ are incurred by the taxpayer and a sufficient nexus or connection exists between the advantage gained or sought to be gained by the costs and:
 - deriving assessable income, or
 - carrying on of a business for the purpose of deriving assessable income.
8. To determine whether a sufficient nexus exists, the nature of the costs and their relevance to the taxpayer's income earning process or business must be considered.⁵
9. Even if the costs satisfy the requirements of the general permission, a deduction will not be allowed if one of the general limitations applies. The relevant general limitations are the:
 - private limitation

² *Tax Information Bulletin* Vol 26, No 1 (February 2014): 40.

³ *Tax Information Bulletin* Vol 33, No 7 (August 2021): 30.

⁴ These rules also apply to losses (eg, depreciation losses), but this QWBA generally refers to costs for ease of reading.

⁵ See, for example, *CIR v Banks* (1978) 3 NZTC 61,236 (CA).

- capital limitation
 - exempt income limitation employment limitation.
10. To decide whether a general limitation applies to a cost it is necessary to consider the cost from the perspective of the person who incurred it. This involves determining what the person intended to achieve from a practical, business point of view. In doing this, trivial or minor advantages are effectively ignored.⁶
 11. The general permission and general limitations contemplate apportionment; that is, part of the costs may be deductible, and part may not.
 12. Special rules apply to prepaid travel and accommodation costs over \$14,000.
 13. The general limitations, apportionment, and the special rules applying to prepaid costs are discussed further below. This discussion is followed by examples.

Private limitation

14. The private limitation denies a deduction for costs to the extent to which they are of a private or domestic nature.
15. Costs are of a private nature if they are costs of living as an individual member of society, such as costs for food, clothing, or protective shelter. Costs are of a domestic nature if they relate to the individual household or family unit.
16. Certain kinds of costs have some relationship with deriving income because they are necessary prerequisites, or incidental or relevant to deriving income (for example, travel to a place of work and childcare costs). Despite this, because of the private limitation, such costs are not deductible.
17. It is noted that the private limitation does not apply to companies since they are not natural persons who have need of food, clothing, or protective shelter. Where a company incurs costs on a shareholder or an employee that is of a private or domestic nature for the shareholder or employee, then more specific provisions may apply to the company. Such costs may be:
 - deductible wages and salary subject to PAYE
 - deductible fringe benefits subject to fringe benefit tax
 - non-deductible dividends that may be subject to the imputation credit rules.

⁶ *Cox v CIR* (1992) 14 NZTC 9,164 (HC) at 9,176.

18. Also, where a company incurs costs on a shareholder or an employee that is of a private or domestic nature, the amounts involved may be assessable income of the shareholder or employee if they are wages, salary, a dividend or income under ordinary concepts.

Capital limitation

19. The capital limitation denies a deduction for costs to the extent to which they are of a capital nature.
20. When considering whether the capital limitation applies, the courts have identified various factors that may be relevant.⁷ These factors include:
- the need or occasion that called for the costs
 - whether the costs were of a once-and-for-all nature, producing assets or advantages that were an enduring benefit
 - whether the costs were expended on the business structure of the taxpayer or whether they were part of the process by which income was earned
 - whether the costs were made from fixed or circulating capital
 - how the costs would be treated under ordinary principles of commercial accounting.
21. If the capital limitation applies to deny a deduction, then the costs may have produced depreciable property and a depreciation deduction may be available instead.

Exempt income limitation

22. The exempt income limitation denies a deduction for costs to the extent to which they are incurred in deriving exempt income.
23. Exempt income includes income derived by a person who is a transitional resident if the income is foreign-sourced and is neither employment income nor income from the supply of services.

⁷ See, for example, *Trustpower Ltd v CIR* [2016] NZSC 91, (2016) 27 NZTC 22-061.

Employment limitation

24. The employment limitation denies a deduction for costs to the extent to which they are incurred in deriving income from employment.
25. This means that if a taxpayer is an employee and incurs overseas travel costs to derive employment income, then no deduction is available to the taxpayer.
26. If an employer incurs the costs of their employee's overseas travel, then a deduction may be available to the employer. However, as noted when considering the private limitation, more specific provisions may apply to costs incurred by the employer.

Prepayments

27. Costs are usually deductible in the income year they are incurred. However, where costs are prepaid, deductions may be spread over multiple income years. This applies to advance bookings for travel and accommodation over \$14,000, or to bookings that are for more than six months after a taxpayer's balance date.⁸
28. The deduction is spread by effectively offsetting the initial deduction for the prepayment by treating part of the prepayment (the "unexpired portion") as income.⁹ Then in the following income year a deduction will be allowed for the unexpired portion of the costs.¹⁰ This is repeated, if necessary, until the prepayment has been fully allocated to the income years in which the advantage of the costs has been enjoyed.

Apportionment

29. The use of the phrase "to the extent to which" in the general permission and the general limitations means that apportionment is required in relevant situations.
30. Where two advantages are sought and a general limitation applies to one advantage, then it will be necessary to apportion the costs between the two. The method of apportionment must be reasonable in the circumstances. For example, for overseas travel costs, a reasonable method of apportionment (accepted by the Taxation Review

⁸ Determination E12: Persons excused from complying with section EA 3 of the Income Tax Act 2007 (Inland Revenue, Wellington, March 2009).

⁹ Under s EA 3 (Prepayments).

¹⁰ Under s DB 50 (Adjustment for prepayments).

Authority (TRA)) is an apportionment based on the number of days spent on business as a fraction of the total number of days spent on travel.

31. Because the onus of proof rests on the taxpayer, they will need to retain sufficient evidentiary documents to justify any deduction claimed, including evidence justifying the apportionment of costs. If the evidence is in a foreign language, then English translations must be retained by the taxpayer.

Case law examples

32. TRA cases on the deductibility of travel costs include *Case D55* (1980) 4 NZTC 60,830; *Case F152* (1984) 6 NZTC 60,324; *Case G5* (1985) 7 NZTC 1,011; *Case K32* (1988) 10 NZTC 286; *Case K48* (1988) 10 NZTC 397; and *Case L73* (1989) 11 NZTC 1,426.
33. Some of these cases concern now-repealed provisions (such as provisions allowing deductions for employment-related costs and export incentives). However, they are still useful because they also consider different factual situations where it was necessary to apportion costs between deductible and non-deductible amounts.

Case D55 – travel to manage overseas investments

34. In *Case D55*, the taxpayer had overseas investments that he fully managed. Because of exchange control laws, he had not been able to transfer these investments to New Zealand when he and his family had emigrated to New Zealand. The taxpayer travelled back to his home country on several occasions to actively manage his investments.
35. The TRA held that the taxpayer's costs on travel in the relevant years were incurred in the course of gaining or producing the taxpayer's income. Without the taxpayer's personal attendance, and the actions he saw fit to take while there, the taxpayer's income would have declined progressively. This was because his capital assets would have been eroded through misappropriation and his accountant's deliberate disregard of the taxpayer's instructions.

Case F152 – travel by an employed electrician and his wife to do contract work

36. In *Case F152*, the taxpayer was a qualified electrician employed by a large manufacturing company. In his spare time, the taxpayer carried out electrical contracting work for another company. This contracting work was done in partnership with his wife. The taxpayer spent four days in Australia with his wife visiting the factory that made the electrical units on which he was doing contract work.

37. The TRA held that the cost of the taxpayer's ticket was wholly incurred for business purposes. However, it held that the private limitation applied to the cost of the wife's tickets.

Case G5 – travel for both business and private reasons

38. In *Case G5*, the taxpayer travelled to Europe for 42 days. He spent 11 days visiting factories and a motor show and the remainder of his time (31 days) visiting his parents.
39. The TRA held that a deduction was allowed of 11/42 of the total travel costs. This was on the basis that the 11 days spent visiting the factories and the motor show had the required nexus to the derivation of the taxpayer's income.

Case K32 – travel to establish a new plant

40. In *Case K32*, the taxpayers were a manufacturing company and the company's shareholder–managing director. The company manufactured auto electronic devices that its managing director designed for the local market. Among other things, this case concerned the deductibility of overseas travel costs incurred by the company when the managing director travelled to two overseas markets. The purpose was to establish a manufacturing plant for some of the company's products.
41. The TRA held that the principal object of the overseas trips had been to establish new plants permanently where none had existed previously. Hence, the travel costs were of a capital nature for capital development. Therefore, the capital limitation applied to deny a deduction for the costs incurred.

Case K48 – travel for business and recreation by married taxpayers and their family

42. In *Case K48*, the taxpayers were a married couple who had been fully engaged in a family enterprise. Between 1973 and 1977, the taxpayers and some family members had travelled overseas on four occasions – in part for business and in part for recreational purposes. The Commissioner allowed deductions for only 5% of the overseas travel costs as being related to carrying on their business.
43. The TRA held that it was more important to focus on the nature of the costs in the context of the business and to be satisfied that a nexus of "obvious necessity" existed between the costs and the income-earning process. It held that the taxpayers' claim for overseas travel costs appeared to have been overstated. It also held that the Commissioner's allowance of only 5% of the costs seemed too abstract. What should

have been done was to assess the worth of each trip against the taxpayers' account of how the time was spent. Accordingly, the TRA held that deductions should be allowed for 40% of the taxpayers' costs for the 1973 trip, 5% for the 1974 trip, 15% for the 1976 trip, and 5% for the 1977 trip.

Case L73 – travel paid for by taxpayer company for employee who was also self-employed

44. In *Case L73*, the taxpayer was a company carrying on business as a milk vendor. Its main employee and shareholder was also a self-employed engineering contractor who maintained certain machines. The taxpayer paid for an overseas trip for the employee to learn about maintenance of the machines. Depending on the results of the trip, it was contemplated that the taxpayer might commence business maintaining or running the machines.
45. The TRA held that the costs were preparatory to the establishment of a new business venture by the taxpayer that had not previously been involved with the maintenance of machines. Therefore, the costs were of a capital nature and not deductible.

Examples

Example 1 - Travel overseas for two purposes

Gertrude owns a transport business. In May this year she went to Europe to visit her parents on their 50th wedding anniversary and to negotiate contracts for her business. She was overseas for 42 days and spent 11 days on business.

Gertrude would have gone to visit her parents regardless of whether she went over for business. However, she needed to go overseas at some stage during the year for business. Before she left, Gertrude contacted her business contacts overseas and arranged to meet them.

Gertrude travelled overseas for two different purposes. A reasonable apportionment is to allow a deduction for 11/42 of the cost of the airfare, and the cost of 11 days of accommodation while on business.

Example 2 - Incidental purpose

Fred is the owner-operator of a hardware store. He was running short of stock, so he went to Australia to buy stock. While there, Fred took the opportunity to spend a day with his old friend Bert. Fred spent a total of three days in Australia, one day on holiday and two days on business.

In Fred's situation, the holiday aspect of the trip is a trivial or minor purpose to the main business purpose. Fred visited Bert only because he was there for business and took the opportunity to see him.

A reasonable apportionment would be to allow a deduction for the total cost of the airfare, and the cost of two days of accommodation for business.

Example 3 - Main purpose of travel

Oscar is a self-employed travel consultant. He planned a holiday to America. While he was overseas, he took the opportunity to promote his tourism business at some shopping malls.

In Oscar's situation, he decided to promote his business only once he had arrived in America. This means that when Oscar purchased the airline ticket, his only purpose was to go on holiday. Therefore, no deduction is allowed. However, the Commissioner would allow a deduction for the accommodation costs while Oscar was on business.

Example 4 - Cancellations

Deborah is self-employed. She had booked and paid for transport, accommodation and conference costs for a business-related conference in France. The conference is scheduled to take place before the end of the income year. Now she has heard that a pandemic has resulted in travel restrictions imposed by the New Zealand Government. She decides to cancel the bookings for the flights, accommodation and conference. She receives a refund for some of the costs incurred. But she still has \$1,200 of costs that could not be refunded. Can Deborah claim a deduction for these costs?

Despite not being able to enjoy the benefits of the costs, the costs were still incurred by Deborah in the course of carrying on a business for the purpose of deriving her assessable income. In this case, Deborah's entire trip was for the business-related

conference. This will satisfy the general permission and no general limitations will apply. Therefore, the \$1,200 of costs are deductible.

Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

References

Legislative References

Sections DA 1, DA 2, DB 50, EA 3 of the Income Tax Act 2007

Case References

Case D55 (1980) 4 NZTC 60,830.

Case F152 (1984) 6 NZTC 60,324.

Case G5 (1985) 7 NZTC 1,011.

Case K32 (1988) 10 NZTC 286.

Case K48 (1988) 10 NZTC 397.

Case L73 (1989) 11 NZTC 1,426.

CIR v Banks (1978) 3 NZTC 61,236 (CA).

Cox v CIR (1992) 14 NZTC 9,164 (HC) at 9,176.

Trustpower Ltd v CIR [2016] NZSC 91, (2016) 27 NZTC 22-061.

Other References

[Determination E12: Persons excused from complying with section EA 3 of the Income Tax Act 2007](#) (Inland Revenue, Wellington, March 2009) *Tax Information Bulletin* Vol 21, No 2 (April 2009): 13.

[IS 21/06: Income tax and GST – Treatment of meal expenses](#) *Tax Information Bulletin* Vol 33, No 7 (August 2021): 30.

Policy Statement "Overseas travel expense claims" *Tax Information Bulletin* Vol 7, No 2 (August 1995): 13.

[QB 13/05: Income tax – Deductibility of a companion's travel expenses](#) *Tax Information Bulletin* Vol 26, No 1 (February 2014): 40.

About this document

Questions We've Been Asked (QWBAs) are issued by the Tax Counsel Office. QWBAs answer specific tax questions we have been asked that may be of general interest to taxpayers. While they set out the Commissioner's considered views, QWBAs are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further [Status of Commissioner's advice \(December 2012\)](#). It is important to note that a general similarity between a taxpayer's circumstances and an example in a QWBA will not necessarily lead to the same tax result. Each case must be considered on its own facts.