The Henry Report and the Taxation of Work Related Expenses: Principles versus Practice

Simon James
Associate professor of economics, University of Exeter, and fellow of the Chartered Institute of Taxation

Ian Wallschutzky
Former associate professor in Taxation, University of Newcastle, Australia

Clinton Alley
Research associate, University of Waikato Management School and senior academic staff member, WINTEC, Hamilton, New Zealand

Address for correspondence: srjames@ex.ac.uk
Abstract
The Henry Report on the future of the Australian tax system examined many areas of relevance to tax systems in general. One was the tax treatment of employment expenses. The Henry Report recommended that a new test should be introduced to narrow the definition of deductible employment expenses and that this test might be similar to the approach taken in the UK. In the light of the basic principles of the issue, this paper examines the reasons for the recommendation and the extensive experience of the UK arrangements. The situation in New Zealand is also examined as another approach. Finally a possible solution is suggested.

Key words: Henry Report, Taxation, Work related expenses

Introduction
In an extensive review of the Australian tax system the Henry Report examined a number of issues relevant to all tax systems including the UK arrangements. This provides a good opportunity to look again at some of the aspects discussed in the Report and one issue in particular is the tax treatment of work related expenses (WRE). This potentially affects all taxpayers in employment and the Henry Report (2010, p.57) recommended that with respect to such expenses there 'should be a tighter nexus between the deductibility of the expense and its role in producing income'. The Report (2010, p. 57) stated:

A new test that more strictly defines deductible expenses incurred in producing income should be introduced. This test could be similar to the approach taken in the United Kingdom, where a tax deduction for WREs is only available if the employee is obliged to incur and pay the expense as holder of the employment, and if the expense is incurred wholly, exclusively and necessarily in the performance of the duties of the employment. A tighter nexus should be consistent with the fringe benefit tax arrangements, to eliminate opportunities for arbitrage.

The UK arrangements regarding employees’ work expenses are very restrictive to the extent that most are simply not deductible. However, an income tax system which does not normally permit individuals to deduct work related expenses is rather like a system that taxes businesses on gross rather than net income. It may be that work expenses in general are smaller and, for most individuals, less important than are business costs to businesses, but there are potentially significant disadvantages in moving away from a tax system based on first principles in important areas.

The UK rule for the deductions for work related expenses is very narrow and is almost exactly as indicated in the Henry Report. It is currently laid down in the Income Tax (Earnings and Pensions) Act 2003 s 336(1) which specifies that the general rule for a deduction from earnings is allowable for an amount if:

(a) the employee is obliged to incur and pay it as holder of the employment, and

(b) the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

Although there have been some modifications over the years, the basic position has survived for a very long time – it continued from the Taxes Act 1988 s 198(1) which, in turn, came from the Taxes Act 1970 s. 189(1) and originally from the Income Tax Act 1853 s. 51. Ini-
tially few taxpayers were affected but in the many years these arrangements have applied to large numbers of taxpayers they have been subject to a great deal of criticism. For example, the Royal Commission on the Taxation of Profits and Income (1955, para. 129) stated that there ‘can be no part of the income tax code which has been so regularly the subject of unfavourable notice’. They have also been a source of rich and extensive judicial comment relating to the difference in treatment of employee expenses and those of the self-employed. One colourful example was supplied by Lord Justice Harman as follows:

Now it is notorious – and, indeed, a long standing injustice, that the scale of the taxpayer’s allowances under Schedule E are on an altogether more niggardly and restricted scale than under Schedule D. Indeed, it has been said that the pleasure of life depends nowadays upon the Schedule under which a man lives.  

There may, of course, be advantages as well as disadvantages in restricting the extent to which work expenses may be deducted and different countries have taken different positions on this issue. The Henry Report itself presents an international comparison which shows that work related expenses are generally deductible in Australia and Denmark, they are allowed on a narrow basis in Ireland, the Netherlands, Switzerland and the UK, limited in Canada and the USA and generally not deductible at all in New Zealand and Spain (Henry Report, 2010, Pt. 2, vol. 1, Box A1-2. p. 54).

The purpose of this paper is to re-examine this issue. Section 2 considers basic principles with respect to the deductibility of such expenses and section 3 describes the Henry Report’s views regarding the reform of the taxation of work related expenses and the circumstances which led to its proposals. Section 4 discusses the UK experience with its arrangements over a long period. Section 5 briefly examines the New Zealand situation since work related expenses ceased to be deductible in 1988 and Section 6 offers a conclusion.

The Issue in Principle

‘Income tax, if I may be pardoned for saying so, is a tax on income’ stated Lord Macnaghten. In fact, the definition of income is not necessarily a simple matter and a start can be made with the Nobel prizewinner Sir John Hicks. His view was that income was the amount a person could spend without reducing their net wealth (Hicks 1946, p. 172):

The purpose of income calculations in practical affairs is to give people an indication of the amount which they can consume without impoverishing themselves. Following out this idea, it would seem that we ought to define a man’s income as the maximum value which he can consume during a week, and still expect to be as well off at the end of the week as he was at the beginning.

Hicks considered this to be the central meaning of income and it is an entirely logical definition. However it is unworkable in practice since there can be no objective way of determining either what a taxpayer might expect, never mind whether or not such an expectation is reasonable. Hicks went on to consider six approximations, three of which were ex post but even these present formidable difficulties in estimation. Indeed the whole topic of what constitutes income is a fascinating one and some of the many ramifications are described and analysed by Parker, Harcourt and Whittington (1988).

A similar and also well quoted approach is based on the Haig–Simons definition of income. Haig (1921, p. 7) defined income as ‘the money value of the net accretion of one’s economic power between two points of time’. Henry Simons (1938, p. 50) expressed his own version of
this as follows:

*Personal income may be defined as the algebraic sum of (a) the market value of rights exercised in consumption and (b) the change in the value of the store of property rights between the beginning and end of the period in question. In other words, it is merely the result obtained by adding consumption during the period to “wealth” at the end of the period and then subtracting “wealth” at the beginning.*

This, of course, has a number of similarities with Hicks’ central meaning of income. As before, there would be difficulties in operating such a definition in practice but mainly in relation to capital gains and losses, which are not the focus of this paper. Considering employment income in isolation, income could be defined as the maximum amount an individual could consume over a period without affecting his or her net wealth, which may be considered to stay constant for this purpose. Therefore income should be seen as the money received after deducting the costs of obtaining it.

In terms of economic analysis, not allowing taxpayers to deduct work related expenses would discourage people from working in areas where expenses were high and it would be certainly be perceived as unfair as the UK experience described below indicates. Some groups of taxpayers incur substantial expenses – for example in Australia employed doctors are required to be insured for professional negligence, the costs of which are considerable – and to deny them a deduction would be grossly unfair. Other taxpayers may work for small businesses who cannot afford to pay for essential tools and other expenses and perhaps the smaller the business the less its likely capacity to contribute.

Of course, administrative, compliance and other concerns should also be considered in the design of an operational income tax system (James & Edwards, 2007, pp. 105-126) as will be made clear below. However, in principle at least, work related expenses should be deductible and, to the extent they are not, individuals with such expenses would be taxed on a sum greater than their income.

**The Henry Report on Work Related Expenses**

The Australian tax system, in its present form, is in line with the principles outlined above and allows the costs incurred in earning income to be deducted. The Henry Report (2010, p. 53) states that there ‘are important equity reasons for maintaining this approach; that is, it is fair to recognise that people with the same level of income may incur different costs in earning that income.’

However the Report took the view that, compared with other countries, Australia was relatively generous in the extent to which work related expenses were allowable. Such expenses also add complexity to the personal income tax system and result in high compliance costs being imposed on taxpayers. Furthermore the number and scope of the claims limit the scope for automating the preparation of tax returns by pre-filling.

The first proposal in this context was in fact Recommendation 11 namely that (Henry Report, 2010, p. 57):

*A standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation.*
However Recommendation 12, to tighten the extent to which work expenses were allowable, may have been the result of the steady increase in the amount claimed and that a significant proportion may not have conformed to the law. As the Report noted, work related expenses claims account for about 42 per cent of the value of all deductions claimed by individuals, or around A$14 billion in 2006–07. Furthermore, generally (Henry Report, 2010, p. 53), 'the claimable amount is not capped, and the total claimed has grown substantially over time.'

Indeed it has. As Table 1 shows, work related deductions claimed in Australia has grown from A$7,763 million in the tax year 1999–2000 to a total of A$16,362 million in 2008–2009. Using ATO statistics the authors calculated that the claims per taxpayer rose from A$1,192 to A$2,039 over this period. It is not altogether clear why there has been such an increase. One factor might be that employees in recent years may have been required to pay more for expenses essential to their work but there are several possibilities.

Regarding the possibilities that not all claims are lawful, the Report examined the situation in Canada (Henry Report, 2010, p. 55):

In Canada, a country with a similar tax system and administrative arrangements to Australia, it is estimated that 10 to 15 per cent of WRE claims each year are invalid. If over-claims in Australia are of a similar order, this would equate to an over-claim of between $1.4 and $2.1 billion in 2006–07.

However, it is a separate question as to whether the best solution to the situation is to adopt something similar to the UK arrangements and it is to these that we now turn.

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>A$m</th>
<th>A$ per taxpayer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999–2000</td>
<td>7,763</td>
<td>1,192</td>
</tr>
<tr>
<td>2000–2001</td>
<td>8,753</td>
<td>1,309</td>
</tr>
<tr>
<td>2001–2002</td>
<td>9,630</td>
<td>1,464</td>
</tr>
<tr>
<td>2002–2003</td>
<td>10,207</td>
<td>1,517</td>
</tr>
<tr>
<td>2003–2004</td>
<td>11,101</td>
<td>1,595</td>
</tr>
<tr>
<td>2004–2005</td>
<td>11,930</td>
<td>1,662</td>
</tr>
<tr>
<td>2005–2006</td>
<td>13,067</td>
<td>1,765</td>
</tr>
<tr>
<td>2006–2007</td>
<td>14,166</td>
<td>1,861</td>
</tr>
<tr>
<td>2007–2008</td>
<td>16,098</td>
<td>1,952</td>
</tr>
<tr>
<td>2008–2009</td>
<td>16,362</td>
<td>2,039</td>
</tr>
</tbody>
</table>

Table 1. Work Related Deductions Claimed in Australia
Source: Australian Taxation Office Taxation Statistics
Personal Statistics (Chapter 2) in each of the years 1999/2000 to 2008/2009. The figures in the right hand column were calculated by the authors.

The UK Experience
Although the restrictive UK provisions have existed for many years, taxpayers still have difficulty accepting them and continue to fight for earnings related deductions - normally
without success.
One such recent case that attracted considerable media attention and comment was that of the BBC newsreader who appealed against her claim for professional clothing being disallowed. It was argued on her behalf that should she wear the same clothes frequently while reading the news on television she would lose her job. It was claimed she would be willing to read the news naked but the BBC required her to wear clothes. The Tribunal had no difficulty in rejecting her appeal on plenty of grounds of the sort described below.

Historically, Schedule E with its restrictive work related expenses did not apply to most employees (the E in Schedule E was not, as many supposed, short for employees) but came about as a result of a series of events. The original income tax introduced in 1799 to pay for the war against Napoleon was not divided into schedules. This was a refinement introduced in 1803 and under that arrangement Schedule E applied only to holders of public offices, such as Members of Parliament, and certain others paid from public revenues. The only deduction permitted was for expenses ‘wholly exclusively and necessarily’ incurred in the performance of the duties of the employment – a provision that was, and still is, strictly applied. Other employment income was originally assessed under Schedule D where the criterion was, and still is, the less rigid ‘wholly and exclusively.’

This arrangement continued into the twentieth century until the 1920 Royal Commission on the Income Tax (1920, Cmd. 615) recommended that employment income should be transferred to Schedule E because it was thought that public and private employees should have the same basis of assessment. The change actually came about because a House of Lords decision in the case of Great Western Railway v. Bater made it extremely difficult to decide who had a public office and who an employment of profit. In the 1920s the income tax was much less extensive in its coverage of the population at that time and did not include lower paid workers. Such a change therefore aroused less public hostility than it might have done if it has been applied to a large number of taxpayers at the same time.

Furthermore, judicial opinion has made clear how restrictive these provisions are. For example, Macnaughton J stressed that ‘the deductions that can be made from remuneration received in respect of an office of profit are strictly limited by Rule 9.’ Vaisey J. stated more specifically:

I would observe that the provisions of that Rule are notoriously rigid, narrow and restricted in their operation. In order to satisfy the terms of the Rule it must be shewn that the expenditure incurred was not only necessarily but wholly and exclusively incurred in the performance of the relevant official duties. And it is certainly not enough merely to assert that a particular payment satisfies the requirement of the Rule, without specifying the detailed facts upon which the finding is based. An expenditure may be “necessary” for the holder of an office without being necessary to him in the performance of the duties of that office; it may be necessary in the performance of those duties without being exclusively referable to those duties; it may perhaps be both necessary and exclusively referable to those duties, but still not wholly so referable. The words are indeed stringent and exacting; compliance with each and every one of them is obligatory if the benefit of the Rule is to be claimed successfully. They are, to my mind, deceptive words in the sense that when examined they are found to come to nearly nothing at all.

It is also clear that the arrangement has led to hardship. The situation is described in Lord Cairns’ classic statement that ‘If the person sought to be taxed comes within the letter of
the law he must be taxed however great the hardship may appear to the judicial mind to be... you simply adhere to the words of the statute.\textsuperscript{12} Although the courts are bound to follow the law the provisions have been the subject of frequent judicial comment regarding resulting hardship. For example Rowlatt J. was very clear:

This case raises a question of hardship. I may go further and say the position really is unreasonable, because the expenses which are not allowed to be deducted sometimes more than eat up the emoluments.\textsuperscript{13}

Lord Evershed M.R. pointed out the risks to the law in general:

I would point once again to the distinction between the two Schedules [D and E] which I regard as somewhat regrettable as something which tends to bring the law into disrepute.\textsuperscript{14}

The view of Lord Green M. R. is also particularly relevant.

Rule 9 of Schedule E... is a very narrow and strict rule and it is one which undoubtedly causes a considerable amount of hardship when applied to particular cases. Judges dealing with particular cases have said so again and again. Their suggestions and observations, however, have either fallen upon deaf ears or perhaps have not reached the ears which are relevant to an alteration of the law, that is to say the ears of the persons who through the legislature decide these matters for other people.\textsuperscript{15}

However the matter has certainly been raised in Parliament but not made any difference as illustrated by the following question in the House of Commons (Hansard, 1959, cols. 926-7):

Mr Kenneth Robinson... asked the Chancellor of the Exchequer why, under his regulations, when a psychiatrist undergoes a training analysis for the purpose of increasing his therapeutic skill, no part of the cost of such an analysis is allowed by the Inland Revenue authorities as a deduction from income for Income Tax purposes.

Mr Amory: If, as I assume, the hon. Member’s question relates to psychiatrists in salaried employment assessed under Schedule E, the costs of personal analysis is not regarded as satisfying the test laid down by law, which is that expenses are deductible only if incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

Mr Robinson: Is the Chancellor aware that the purpose of this analysis is solely to make a man a better doctor? Is he aware that many younger psychiatrists are spending as much as £500 a year – perhaps one-third of their gross salary – on these courses in the interests of their patients? Will he have discussions with his right hon. and learned friend the Minister of Health to see whether some steps can be taken towards remedying this gross injustice?

Mr Amory: I do not disagree with what the hon. Member has said about the importance of this training, but as he knows, the test in the case of employed persons under Schedule E is very strict, and these courses, deserving thought they are, do not seem to amount to an essential qualification for employment.

What did have an impact on one occasion was some industrial power and this allowed a group of employees to achieve a change in the law so that they were assessed as self-employed rather than employees. The divers and diving supervisors operating on the UK Continental Shelf were so transferred by the Finance Act 1978. The Inland Revenue (1979, Cmnd. 7473), as it then was, stated that this ‘exceptional treatment’ recognised the distinctive features of their work and (more to the point) ‘the possible damage to the economy and the
threat to safety standards in the North Sea had experienced divers left that area'. Employees without such a strong bargaining position have not been similarly favoured.

The UK income tax with respect to work related expenses is not consistent with the basic principles of the matter as outlined above. According to expert authority it is also unfair and associated with hardship. Possible reasons why it has survived continuously for nearly 150 years will be left until after an examination of the situation in New Zealand.

The New Zealand Approach

The New Zealand approach to work related expenses certainly does not follow the principles summarised in section 2. It is interesting that New Zealand has a much tighter base for income tax than in Australia and also, incidentally, there are far fewer exemptions for the New Zealand GST than there are for the Australian GST. As the Henry Report noted, only about 57 per cent of consumption is taxed in Australia compared with over 90 per cent in New Zealand. What is acceptable to New Zealand taxpayers in this respect seems unacceptable to Australian ones. UK taxpayers in the main accept very restricted work related expenses but probably because that arrangement is older than all living taxpayers. It is doubtful that they would accept a new similarly restrictive approach to some aspect of the tax system – for example the UK value added tax has a coverage which is nowhere near as wide as the broad based coverage of the GST in New Zealand (James & Alley, 2008, pp. 35-47).

For work related expenses, the approach in New Zealand has been to move away from allowing any such expenses to be deductible. From 1 April 1988 the range of employment related expenses formerly deductible under the Fourth Schedule New Zealand Income Tax Act 1976, including home office expenses, travel expenses, self-education expenses, books and periodicals, union subscriptions, club subscriptions, entertainment expenses, occupational clothing, tools and miscellaneous expenses required by employment, ceased to be deductible.

Such a change was made much more palatable than it would otherwise have been by substantial reductions in income tax rates being made at the same time.

From 1 October 1988 the individual income tax rates reduced to:

<table>
<thead>
<tr>
<th>Income</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does not exceed $30,875</td>
<td>24%</td>
</tr>
<tr>
<td>Exceeds $30,875</td>
<td>33%</td>
</tr>
</tbody>
</table>

A low income earner rebate also applied.

Until 1 October 1988 the individual income tax rates were:

<table>
<thead>
<tr>
<th>Income</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does not exceed $9,500</td>
<td>15%</td>
</tr>
<tr>
<td>$9,501 - $30,875</td>
<td>30%</td>
</tr>
<tr>
<td>Exceeds $30,875</td>
<td>33%</td>
</tr>
</tbody>
</table>

However, interest and dividend payments made on or after 1 October 1989 became subject to a new resident withholding tax.
The removal of the deductibility of working related expenses to an extent even greater than in the UK has the benefit of greatly simplifying tax administration. Also, as in the UK, it has helped to remove the need for many taxpayers to complete a tax return. In New Zealand individuals are only required to file a tax return (IR3) if they have earned income other than salary, wages, interest, dividends, and/or taxable Maori authority distributions. This is a major difference between New Zealand and the present situation in Australia where the Australian Act, basically requires everyone lodge a return.

The situation regarding returns is different in Australia. When the Henry investigation was looking at the Australian tax system one of the original ideas was to better mesh the income tax and welfare systems. Not much was made of this in the final report. It is probably too difficult. But there is a point to be made that it is harder to integrate the two if individuals’ incomes are unknown. If people are lodging returns their taxable income is established. As this taxable income is available it is easier to implement reforms to the welfare system.

There are other reasons why the Australian system needs taxpayers to lodge their tax returns. Other things rely on them, for example:

1. Child support payments are based on the adjusted taxable income of a parent
2. Repayment of student higher education debts are based on an adjusted taxable income concept
3. Seniors Health care cards

There are direct disadvantages as well to limiting the number of taxpayers required to complete an annual return. As pointed out in an earlier publication of James & Alley (1999, p. 5), if taxpayers are not required to sign an annual declaration on a return to the effect that full disclosure has been made, it is possible that some of them will fail to do so.

Of course there is also the equity issue of the difference in treatment between those earning employment income and those earning business income. In New Zealand, individuals who earn their income from salaries and wages (employment income) are treated differently from individuals who have investment, rental or business income in regard to deductions (Alley, et al. 2010, p. 491).

Where income is from employment there is no deduction for expenditure or loss incurred in earning that income. However, this employment limitation has exceptions. Expenses incurred in the preparation of tax returns and loss of earnings or profits insurance premiums (provided the benefit from the insurance policy is taxable) are allowable deductions. A deduction is possible for expenses incurred in earning income that has had withholding tax deducted.

Where the individual’s income is from interest and dividends it is subject to resident withholding tax and a deduction is allowed for expenses relating to the production of that income. For example, where a loan has been taken out to purchase shares, the interest from the loan may be deducted from the dividend income received from these shares. Commission on interest or dividend income is deductible, but not bank fees, as they are a private expense. Additional expenses incurred in earning partnership income are deductible (for example, interest on capital borrowed to purchase a share in the partnership).

To claim these deductions in NZ an IR3 Individual tax return must be completed. Few if
any salary and wage earners with all income tax deducted at source by PAYE or resident withholding taxes would bother. This might again indicate that this is not an issue of great importance to many New Zealand taxpayers. In fact for many salary and wage earners in New Zealand it is a relief that they cannot claim a tax deduction as they no longer feel the need to prepare and file a tax return. For some the cost of preparing the information and of employing assistance to file the return would be greater than the tax advantage of the minimal deduction that could be claimed. There is also the feeling that the least communication with the Inland Revenue Department, the easier on the psychological outlook of the taxpayer.

Conclusion
As indicated in section 3 above, the Henry Report’s proposal to tighten the rules on work related expenses may have come about as a result of the substantial increase in claims and the possibility that some of them are not legitimate. However, some of the increase may be because, as economic conditions have changed, employees have to bear a larger share of the costs of their duties. The principles of the issue described in section 2 suggest they should be allowed to claim such expenses. A tax system that is well administered in this way may significantly contribute to tax morale and better compliance generally (James, 2012).

In developing proposals for tax reform it is, of course, important to take account of all the relevant factors. It has been demonstrated that what might seem to be an obvious improvement in one area might not be an overall improvement at all if the effects on other aspects of the tax system are considered (James & Edwards, 2008, pp. 35-53). One particular example is the repeated call for simplification of the tax system. Restricting the deductibility of work related expenses certainly simplifies the tax system but there are sound reasons for a tax system to be sufficiently complex to match the complexity of modern economic life and the need to be fair. Simplification is something that can only be successfully achieved if the other important factors are taken into account (James & Wallschutzky, 1997, pp. 445-460).

In the case of work related expenses, the situation in the UK is very simple – they are not normally allowed. Furthermore, as described above, the UK provisions came about in a somewhat roundabout way and it would be hard to say that the results of the current arrangements were either anticipated or a result of deliberate policy. The UK arrangements are certainly considered to be unfair but it has been observed that there must be some advantage for them to have survived for so long relatively unscathed. As Vinlott J. put it:

S 189(l) reproduces provisions which have been part of the income tax legislation ever since it was reimposed as a permanent tax in 1853, and if it has survived the many criticisms which have been directed to it it must, I think, be because of the difficulties that are encountered in framing a provision that will avoid these harsh consequences in particular cases without opening the doors to unacceptable abuse.17

Indeed so - The Royal Commission (1955, paras. 129-143) examined the issue in some detail. It summarised the strong and widespread criticism of the UK rule and also noted that “nothing has ever been done to alter it” (Royal Commission, 1955, para. 132).

The Revenue were also anxious that the Commission would not propose any general rewording which would open the way for wider claims. In fact, the Royal Commission summarised the Revenue position very clearly (Royal Commission, 1955, para. 134):

Normally, indeed, it is the employer who pays for proper expenses, directly or by reim-
bursement and a claim that involves and employee's uncovered expenses is prima facie suspect. On the other hand, if the taxpayer were left free to decide for himself what expenses it was reasonable or proper to incur for the purpose of performing his duty, regardless of whether he was actually obliged to incur them in order to earn his salary, there would be no common measure to apply to the allowance of expenses and all sorts of claims would become admissible which it would be very difficult to scrutinise effectively in the course of administration.

The Commission did, however, take a view regarding the wording of the law. This might be particularly relevant to the Henry suggestion that the Australian test for work related expenses should be along the lines of the UK rule - expenses ‘incurred wholly, exclusively and necessarily in the performance of the duties of the employment’. It is relevant to note that the Royal Commission (1955, para. 133) stated:

In dealing with this difficult question it is essential to establish clearly what Rule 9 [as it then was] does require. Its reputation has suffered partly from its verbiage, and there has been a tendency to exaggerate the significance of certain words. The two determining phrases are “obliged...to expend” and “in the performance of the said duties”. “Necessarily obliged” means no more than “obliged”. “Wholly and exclusively” are the same words as those that occur in the Schedule D [self-employed] rule and, given the recognition of a right to apportion whatever is apportionable, they impose no unfair limitation. “Necessarily”, again adds no further force, once it has been laid down that the only allowable expenses are those which the holder of the office or employment is obliged to incur in the performance of the duties of his office or employment. Stripped of its verbiage, that is all that the rule requires.

The wording of the rule has been modified since 1955 but not in a way that meets the Royal Commission's point. Its recommendation therefore seems to be as relevant now as it was then: that the rule be reworded to ‘all expenses reasonably incurred for the appropriate performance of the duties of the office or employment’ (Royal Commission 1955, para. 140). This would be in line with the principle of taxing net rather than gross employment income and would move away from the long standing practice in the UK of disallowing many genuine work expenses.
The Henry Report and the Taxation of Work Related Expenses: Principles versus Practice

References
1. Australia’s future tax system, Report to the Treasurer, December 2009. The Henry Report was submitted on 23 December 2009 but not publicly released until 2 May 2010. It has two Parts: Part 1 is an Overview (216 pages); Part Two, which contains the Detailed Analysis, has two volumes – Volume 1 (377 pages) and Volume 2 (479 pages). Altogether, there are over 1,000 pages and 138 recommendations.

2. The old system of schedules dating back to 1803 disappeared in 2005 in the process of consolidation and re-writing the legislation but the very tight UK restrictions on employee claims for work expenses remain. Employees were assessed under Schedule E and the self-employed Schedule D.


10. As stated in Schedule E, Rule 9, ITA 1918.


