
Taxation of Tradies - A Case Study Series for Junior Accountants - The Business Lifecycle of Dan the Carpenter - As a Sole Trader

April 2024

**Darius Hii, Director, CTA
Chat Legal Pty Ltd**



Chat Legal Pty Ltd
ABN 64 621 391 553
letschat@chatlegal.com.au
PO Box 74, Underwood, QLD 4119
<https://chatlegal.com.au>



Taxation of Tradies - A Case Study Series for Junior Accountants - The Business Lifecycle of Dan the Carpenter - As a Sole Trader

1 Overview

- 1.1 Dan the carpenter has finished his apprenticeship and stayed on with his employer for a number of years learning the ropes.
- 1.2 Now he feels like the time is right to go out on his own.
- 1.3 He has decided a sole trader structure will suit him for now and has come to you for advice to ensure he stays on top of his tax obligations.
- 1.4 This paper covers suggested discussion points for accountants to have with Dan, including:
 - (a) Australian Business Number (**ABN**) and Goods and Services Tax (**GST**) registration requirements.
 - (b) Tax record keeping requirements, including:
 - (i) accounting for cash transactions;
 - (ii) how substantiation of vehicle claims depends on the type of vehicle;
 - (iii) apportionment methods for expenses that include private use.
 - (c) Tax cash flow management, including factoring in:
 - (i) the tax deferred "holiday" in the first year of business;
 - (ii) the lump sum catch up at tax return assessment time;
 - (iii) workings of the quarterly pay as you go (**PAYG**) tax instalment system;
 - (iv) GST budgeting.
 - (d) Business Activity Statement (**BAS**) completion guidance.
 - (e) Superannuation as a sole trader and obligations to enable tax deductible treatment.
 - (f) Requirements if considering engaging:
 - (i) casual labour or an apprentice; and
 - (ii) subcontractors.
 - (g) Impact that the personal services income (**PSI**) rules can have on sole traders, including:
 - (i) how the components of an invoice between labour and materials can determine PSI status; and
 - (ii) how to self assess that you are a personal services business.
 - (h) The asset protection discussion.
- 1.5 The above will be covered from a broad perspective in a manner to enable junior accountants to explain the key issues in a way that non-tax technical persons would understand. The paper will only seek to breakdown the PSI rules in technical detail given the importance of ensuring the personal services businesses rules operate (where necessary).
- 1.6 The author recommends readers to consider crafting a discussion checklist to assist them in covering the myriad of tax and compliance issues applicable to sole traders.



2 ABN and GST registration requirements

- 2.1 The first item to check off the sole trader checklist is the need for the sole trader to:
- (a) obtain an ABN; and
 - (b) determine whether they are required to be registered for GST.

ABN registration

- 2.2 *A New Tax System (Australian Business Number) Act 1999 (Cth) (ABN Act)* was legislated to 'make it easier for businesses to conduct their dealings with the Australian Government...so that they can identify themselves reliably (a) in all their dealings with the Australian Government; and (b) for all other Commonwealth purposes'.¹
- 2.3 The ABN Act also resulted in the reduction of various registration and reporting requirements arising from State, Territory and local government regulatory bodies.
- 2.4 To be entitled to an ABN, the sole trader must:
- (a) be carrying on an enterprise in Australia; or
 - (b) in the course or furtherance of carrying on an enterprise, the sole trader make supplies that are connected with the indirect tax zone (not considered in this paper).²
- 2.5 Whilst it is likely that a sole trader is carrying on an enterprise, Miscellaneous Taxation Ruling (MT) 2006/1 provides ATO guidance on what it means to for an 'carrying on an enterprise for the purposes of entitlement to an Australian Business Number'.
- 2.6 In determining whether activities undertaken by a sole trader can be considered as actually carrying on an enterprise, an analysis of the term 'enterprise' from the *A New Tax System (Goods and Services Tax) Act 1999 (Cth) (GST Act)* is required in determining whether the activity or series of activities are done:
- (a) *"in the form of a business; or*
 - (b) *in the form of an adventure or concern in the nature of trade; or*
 - (c) *on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property; or..."*³
- 2.7 Whether activities of a sole trader are 'in the form of a business' will be based on consideration of the various main indicators of carrying on a business. Taxation Ruling (TR) 97/11 provides further discussion in relation to some of the following indicators:
- (a) *"a significant commercial activity;*
 - (b) *a purpose and intention of the taxpayer to engage in commercial activity;*
 - (c) *an intention to make a profit from the activity;*
 - (d) *the activity is or will be profitable;*
 - (e) *the recurrent or regular nature of the activity;*

¹ Section 3 ABN Act

² Section 8 ABN Act

³ Paragraph 150 MT 2006/1



- (f) *the activity is carried on in a similar manner to that of other businesses in the same or similar trade;*
- (g) *activity is systematic, organised and carried on in a businesslike manner and records are kept;*
- (h) *the activities are of a reasonable size and scale;*
- (i) *a business plan exists;*
- (j) *commercial sales of product; and*
- (k) *the entity has relevant knowledge or skill.”*

2.8 It should be noted that there is no single test that is determinative on whether a business is being carried on and it will depend on the particular facts of the circumstances.⁴

2.9 In the case of sole traders who seek to ‘go out on their own’ – their actions are likely to be considered as carrying on an enterprise.

2.10 Where a sole trader is entitled to an ABN, steps can be taken to register for an ABN pursuant to the requirements of the relevant Registrar. As of the date of this paper, ABNs can be applied via the following website: <https://www.abr.gov.au/>.

GST registration

2.11 A sole trader is required to be registered for GST if they are carrying on an enterprise and their GST turnover meets the registration turnover threshold⁵ where:

- (a) enterprise takes on the meaning as discussed above;
- (b) GST turnover means current GST turnover or projected GST turnover;⁶ and
- (c) the registration turnover threshold is defined to be \$75,000 for all entities other than not-for-profit organisations (noting taxi drivers have different rules applicable to them).⁷

2.12 GST turnover is calculated on the total value of all of the supplies an entity has made (or expects to make) in the 12-month period ending in a particular month (in the case of current GST turnover),⁸ or the total value of all of the supplies the entity expects to make in the next 12 months, starting in a particular month (in the case of projected GST turnover).⁹ It should also be noted that:

- (a) there are a number of supplies excluded from turnover such as supplies that are:
 - (i) input-taxed;
 - (ii) not made for consideration;
 - (iii) not connected with Australia; and
 - (iv) not made in connection with the enterprise; and¹⁰

⁴ Paragraph 179 MT 2006/1

⁵ Section 23-5 GST Act

⁶ Section 188-10 GST Act

⁷ Section 23-15 GST Act and section 23-15.01 *A New Tax System (Goods and Services Tax) Regulations 2019 (Cth) (GST Regulations)*

⁸ Section 188-15 GST Act

⁹ Section 188-25 GST Act

¹⁰ Sections 188-15 and 188-25 GST Act



- (b) the calculation of GST turnover is also relevant in determining other various GST compliance requirements such as the tax period turnover threshold, cash accounting turnover threshold and electronic lodgment turnover threshold.
- 2.13 Where a sole trader does not meet the necessary turnover, provided they carry on an enterprise, they may still choose to register for GST.¹¹ If choosing to do so, the sole trader is required to remain registered for a period of 12 months.
- 2.14 When registering for GST, the sole trader must apply in the form approved by the Commissioner and such registration can be completed at the following website (as of the date of this document): <https://business.gov.au/>
- 2.15 It is noted:
- (a) a sole trader only needs a single registration for GST, even if the entity carries on more than one enterprise;
 - (b) is possible to register for GST prior to the commencement of the enterprise provide the Commissioner can be satisfied that the enterprise will start;¹²
 - (c) the starting date of registration will be the date the application is lodged;¹³
 - (d) there is a penalty for failing to apply for registration when required to do so;
 - (e) a registration can be cancelled in the approved form where an enterprise ceases or if the turnover falls below the \$75,000 threshold.¹⁴
- 2.16 Whilst it is outside the scope of this paper to provide a detailed summary of the GST obligations imposed on an entity, the following should be noted in relation to the consequences of being GST registered:
- (a) a sole trader must charge 10% GST on the price of goods and services that constitute a taxable supply and a sole trader may also claim the GST paid on creditable acquisitions made in the course of its enterprise;¹⁵
 - (b) a GST return must be lodged with the ATO to report GST received, and claim GST paid, and the frequency of such lodgments will depend on whether the sole trader is required to lodge a business activity statement (**BAS**) monthly, quarterly or annually (which is dependent on turnover);¹⁶
 - (c) when lodging, the BAS may be sent physically or electronically to the ATO, noting the BAS will disclose the net amount of GST for each relevant tax period resulting in either GST payable by the sole trader (where GST in taxable supplies exceed input tax credits claimable) or input tax credits available for the sole trader.¹⁷
- 2.17 The frequency in which a sole trader is required to lodge a BAS and GST return in a tax period will depend on a sole trader's turnover (as previously defined above). Broadly:

¹¹ Section 23-10 GST Act

¹² Section 25-5(1)(b) GST Act

¹³ Section 25-10 GST Act

¹⁴ Section 25-50 GST Act

¹⁵ Section 7-1 GST Act

¹⁶ Section 31-5 GST Act

¹⁷ Divisions 33 and 35 GST Act



- (a) annual tax periods are only available if the sole trader has registered voluntarily – that is the sole trader has a GST turnover less than the registration turnover threshold (\$75,000); otherwise
- (b) quarterly tax periods are required (provided the sole trader has a turnover of less than \$20 million, in which case monthly tax periods are required).

2.18 Where quarterly tax periods apply, the BAS will be due by the following dates:

- (a) 28 July for the previous quarter ending 30 June;
- (b) 28 October for the previous quarter ending 30 September;
- (c) 28 February for the previous quarter ending 31 December; and
- (d) 28 April for the previous quarter ending 31 March.¹⁸

¹⁸ Section 31-8 GST Act



3 Tax record keeping requirements

Accounting of cash transactions

- 3.1 Whilst ordinary income is recognized as to when it is derived,¹⁹ accounting on a cash basis for GST purposes is possible where:
- (a) the entity is a small business entity (but not because of the actual aggregated turnover test)
 - (b) the entity is not carrying on a business and its GST turnover is less than \$2m (ie the cash accounting turnover threshold) the entity accounts for income tax on a receipts basis, or
 - (c) the Commissioner has determined in writing that a cash basis is appropriate (such as for liquidators and receivers).²⁰
- 3.2 Where accounting on a cash basis, GST on a taxable supply is attributed to the tax period in which the payment is received.
- 3.3 Similarly, under the cash basis, input tax credits are accounted for in the tax period in which such expense is incurred and paid.
- 3.4 Whilst an accruals basis is the default accounting method, it may be preferable for sole traders to elect to account on a cash basis for cashflow management and consistency with the receipt of income.
- 3.5 As discussed further below, steps should be taken to ensure appropriate cash flow issues are managed regardless of whether sole trader accounts on a cash or accruals basis.

General record keeping requirements for claiming deductions

- 3.6 Whilst the analysis of what expenses may be deductible is outside the scope of this paper, it is crucial to ensure proper recording keeping requirements are met in order to substantiate on such claims.
- 3.7 Division 900 *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) contains detailed provisions expanding on the substantiation requirements for such claims of deductibility.
- 3.8 Specifically, in relation to substantiating work expenses, subdivision 900-B ITAA 1997 notes the following.
- (a) Deductions as a work expense must be substantiated with written evidence.²¹
 - (b) Travel records are required when claiming expenses for travel where a sole trader is away from their ordinary residence for 6 or more nights in a row.²²
 - (c) Evidence is not required to be lodged with a sole trader's income tax return, but they must be retained for 5 years²³ in case the Commissioner requests for it to be produced.²⁴ Where the Commissioner requests for records to be produced, 28 days or more notice must be given.

¹⁹ Section 6-5(2) ITAA 1997

²⁰ Section 29-40 GST Act

²¹ Section 900-15 ITAA 1997

²² Section 900-20 ITAA 1997

²³ The 5 years starts the later of the due day for lodging or the date the return is lodged. It is noted that this period may be extended if in a dispute with the Commissioner.

²⁴ Section 900-25 ITAA 1997



- (d) Where all of the work expenses excluding travel allowance expenses and meal allowance expenses intended to be deducted is \$300 or less, no written evidence or records are required to be kept.²⁵
- (e) Laundry expenses of up to \$150 can be claimed without obtaining written evidence (regardless if the total work expenses is more than \$300).²⁶
- (f) Written evidence may not be required for certain:
 - (i) travel allowance expenses up to an amount considered reasonable by the Commissioner for accommodation, food/drink and other losses or outgoings incidental to travel;²⁷ and
 - (ii) overtime meal allowances.²⁸

Taxation Determination 2020/5 provides guidance on what the reasonable travel and overtime meal allowance expense amounts are for the 2020/2021 financial year. Thought should be had to review the appropriate ATO guidance at the relevant time for future financial years.

- (g) Where an expense is small (\$10 or less) and the total of all such expenses do not exceed \$200, a record of the expense will suffice rather than obtaining a document from a supplier.²⁹
- (h) It should be noted that the ATO has accepted that where no more than \$50 in phone, data and interest expenses (in total) are being sought, an apportionment is not required and rather set deductions can be made on a per call/text message basis.³⁰ Deductions of greater than \$50 require records to be kept and a calculation of the work-related component.

3.9 Similar retention of evidence requirements are present for car expenses (discussed further below).³¹

Written evidence required

3.10 Section 900-E ITAA 1997 confirms what constitutes sufficient written evidence.

3.11 Although no time limit is required to obtain written evidence of the expense, written evidence is required to be entitled to a deduction. Where written evidence is not available at the time of lodgment, provided there is good reason to expect the written evidence within a reasonable time, the relevant expense may be deducted without having the evidence at the relevant time.³²

3.12 Any written evidence must contain the following from the supplier of the expense:³³

- (a) the name or business name of the supplier; and
- (b) the amount of the expense, expressed in the currency in which it was incurred; and

²⁵ Section 900-35 ITAA 1997

²⁶ Section 900-40 ITAA 1997

²⁷ Sections 900-50 and 900-55 ITAA 1997

²⁸ Section 900-60 ITAA 1997

²⁹ Section 900-125 ITAA 1997

³⁰ \$0.25 for work calls made on a landline; \$0.75 for work calls made from a mobile; and \$0.1 for text messages sent from a mobile

³¹ Section 900-75 ITAA 1997

³² Section 900-110 ITAA 1997

³³ Section 900-115 ITAA 1997



- (c) the nature of the goods or services; and
- (d) the day the expense was incurred; and
- (e) the day it is made out,

with only two potential exceptions being:

- (f) if the document does not show the day the expense was incurred, a bank statement or other reasonable, independent evidence that shows when it was paid may be relied on in its place;
- (g) if the document the supplier provides does not specify the nature of the goods or services, the sole trader may write the missing details themselves prior to lodgment.

3.13 Crucially, such a document must be in English unless the expense incurred outside of Australia.³⁴

3.14 Similar requirements must be provided where evidencing a depreciating asset expense.

Travel record

3.15 Where expenses are being claimed associated to travel, a travel record is required.

3.16 In such circumstances, the following must be recorded in a diary or similar document:³⁵

- (a) nature of the activity;
- (b) the day and approximate time when it began;
- (c) how long it lasted;
- (d) where you engaged in it.

3.17 Crucial is evidencing the income-producing activity to determine the relevant claims which were incurred for income-producing purposes. Failing to provide such record will result in such activity in being unable to be taken into account.³⁶

A failure to substantiate

3.18 It is at the Commissioner's discretion to review any failure to substantiate.³⁷ TR 97/24 and Law Administration Public Statement 2005/7 and 2001/25 provides the Commissioner's view of such exercise of discretion.

3.19 Where documents have been lost or destroyed, then a complete copy will suffice. Failing such a copy, if the Commissioner is satisfied that reasonable precautions were taken, then a substitute document may be remade.³⁸

Record keeping in relation to vehicle expense claims

3.20 Deductions may be available for expenses related to motor vehicles such as:

- (a) petrol;
- (b) oil repairs;
- (c) servicing;

³⁴ Section 900-115(4) ITAA 1997

³⁵ Section 900-150 ITAA 1997

³⁶ Section 900-155 ITAA 1997

³⁷ Section 900-195 ITAA 1997

³⁸ Section 900-205 ITAA 1997



- (d) new tires;
- (e) lease charges;
- (f) interest on a car loan; and
- (g) car washes and polishes.

- 3.21 Such deductions may fall within the meaning of 'car expense' under section 28-13 ITAA 1997³⁹ in addition with the decline in value of a car, and may be deductible under section 28-12 ITAA 1997.
- 3.22 In seeking to claim such expenses, special substantiation rules apply under sections 28-1 to 28-185 ITAA 1997, where the sole trader owns the car.
- 3.23 Two methods are available in claiming motor vehicle expense deductions – the logbook method and the cents per kilometre method. Either method may be chosen.⁴⁰
- 3.24 Substantiation rules must be met in order for such expenses to be deductible, and unlike other deductions, there is no substantiation-free threshold for motor vehicle expenses.

Cents per kilometre method

- 3.25 The cents per kilometre method calculates the motor vehicle deduction based on the following formula:⁴¹

$$\begin{aligned} & \text{Number of business kilometres travelled by the car in the income year} \\ & \quad * \text{rates of cents kilometre determined under subsection 128} \\ & \quad - 25(4) \text{ for the car for the income year} \end{aligned}$$

- 3.26 The current rate of cents kilometre is 78 cents for the 2022/2023 financial year and 85 cents for the 2023/2024 financial year.
- 3.27 Business kilometres are considered kilometres the car travelled in the course of producing the sole trader's assessable income or travel between workplaces.
- 3.28 The maximum business kilometres available for deduction is 5,000. Where the car travelled more than 5,000 business kilometres, the deduction only allows a maximum claim on the first 5,000 kilometres.⁴²
- 3.29 Importantly, car expenses are not required to be substantiated using the cents per kilometre method.⁴³

Logbook method

- 3.30 The logbook method multiplies the amount of each car expense by a percentage equal to the car's business use.
- 3.31 Business use relates to kilometers the car travelled in the course of a sole trader producing assessable income or travel between workplaces.⁴⁴
- 3.32 It requires a logbook to be kept at least 12 continuous weeks in the first year, and then every 5 years thereafter.

³⁹ Meaning any losses or outgoings to do with a car, or to do with operating a car (such as fuel, oil, servicing and interest)

⁴⁰ Section 28-15 ITAA 1997

⁴¹ Section 28-25 ITAA 1997

⁴² Section 28-25(2) ITAA 1997

⁴³ Section 28-35 ITAA 1997

⁴⁴ Section 128-90(4) ITAA 1997



- 3.33 The logbook must include:⁴⁵
- (a) the date the trip began and ended;
 - (b) odometer readings at the start and end of the trip;
 - (c) kilometres travelled on the journey; and
 - (d) the purpose of the trip.
- 3.34 Further, such logbook should include:⁴⁶
- (a) when the logbook period begins and ends;
 - (b) the car's odometer readings at the start and the end of the period;
 - (c) the total number of kilometres that the car travelled during the period;
 - (d) the number of kilometres that the car travelled, in the course of producing assessable income, on journeys recorded in the logbook; and
 - (e) a percentage of kilometres used for producing assessable income over total kilometres.
- 3.35 Steps are also required to ensure the following details are retained with the records:⁴⁷
- (a) the car's make, model and registration number (if any);
 - (b) if the car has an internal combustion engine—its engine capacity expressed in cubic centimetres.
- 3.36 Such entry should be made contemporaneously⁴⁸ as incomplete records may be deemed unreliable and rejected. Records must also be in English.
- 3.37 Once completed, a reasonable estimate can be determined and a new logbook will not be required:⁴⁹
- (a) for the next four income years in a row;
 - (b) unless:
 - (i) the Commissioner sends a notice;
 - (ii) the sole trader acquires an additional car which they wish to use the logbook method for; or
 - (iii) circumstances of use significantly change.
- 3.38 In addition to retaining a logbook and other records detailing odometer records, written evidence must be obtained and retained as to the car expense under the substantiation rules (as will be outlined further below).⁵⁰
- Methods only required for 'car'***
- 3.39 The above methods to calculate the available motor vehicle expenses relate to a specific definition for car.

⁴⁵ Section 28-125 ITAA 1997

⁴⁶ Section 28-125(3) ITAA 1997

⁴⁷ Section 28-140 ITAA 1997

⁴⁸ Section 28-125 ITAA 1997

⁴⁹ Section 128-115 ITAA 1997

⁵⁰ Division 900 ITAA 1997



- 3.40 Section 995-1 ITAA 1997 defines a 'car' to mean a motor vehicle (except a motor cycle or similar vehicle) designed to carry a load of less than 1 tonne **and** fewer than 9 passengers.
- 3.41 Where a sole trader wishes to claim work-related expenses in relation to a vehicle designed to carry a load of more than 1 tonne (e.g. a ute) or 9 or more passengers, they are not required to make a claim under the above methods, but can rather claim a deduction under general principles.
- 3.42 That is, they must incur a loss or outgoing in gaining or producing their assessable income; and then take steps to apportion between the private use as a non-deductible percentage of the claim.
- 3.43 While no logbook is formally required to assist with substantiating, retaining one may assist with calculating the necessary percentage related to producing assessable income.

Apportionment methods

- 3.44 Losses or outgoings incurred that are private or domestic in nature are generally not deductible.
 - 3.45 However, where such expense incurred was partially used for producing assessable income, and is partially for private use, the claim can be apportioned.
 - 3.46 What percentage is considered appropriate for an apportionment will ultimately depend on the facts and the determination of the proportion of the claim related to deductible purposes.
 - 3.47 Where usage regarding the claim can be identified and itemised between deductible and non-deductible use, apportionment can be determined based on a reasonable analysis of the line items such as:
 - (a) number of work calls made as a percentage of total calls made from a phone;
 - (b) amount of time spent on work calls as a percentage of your total calls from a phone;
 - (c) amount of data downloaded for work purposes as a percentage of total downloads for a smart device.
- As may be appreciated, phone, data and internet expenses⁵¹ could be calculated using the above methodology (subject to the availability to analyse such data).
- 3.48 The most appropriate method (total calls or time of use) will ultimately depend on the facts, but such method must be reasonable and logical. Consider whether time spent on a computer for work over total time spent on a computer would be reasonable for determining internet expense claim where the internet may be used by other devices owned by other persons.
 - 3.49 Alternatively, where such claims cannot be broken down into identifiable components, a reasonable basis should be used in determining deductible use.
 - 3.50 Keeping a diary may be of assistance, and generally, provided it is kept for a continuous four-week period and subject to any contrary guidance, such use can be extrapolated for the remainder of the year (subject to adjustments for periods of time when the usage may be significantly different).
 - 3.51 In this regard, once an expense is determined to be deductible, it is not for the Commissioner to determine such apportionment simply due to the amount of the claim

⁵¹ Please note the substantiation rules provided further below



being greater than what would normally have been incurred by a prudent business person.⁵² Care, however, must be taken not to inflate payments under a scheme to create artificial deductions.

⁵² *Ronpibon Tin* (1949) 78 CLR 47



4 Tax cash flow management considerations

- 4.1 When shifting from income received as an employee to income received as a sole trader, care should be taken to ensure sole traders understand the cash flow issues that may arise.
- 4.2 Specifically, whereas income received during their employment may reflect a close estimate of the 'post-tax' money able to be spent, income derived as a sole trader will be the gross amount without having monies already set aside to pay one's various tax obligations.
- 4.3 Issues may therefore arise where the sole trader fails to ensure sufficient monies are available when tax is due.

Income tax budgeting

- 4.4 A cashflow specific issue that arises for sole traders in their first year of business is the fact that they may find themselves without having withheld any monies during the income year for tax or making instalment payments.
- 4.5 This will arise as they find themselves earning income without having any 'pay-as-you-go withholding obligations' due to them having no history of business income and being unable to pay a salary to themselves.
- 4.6 Accordingly, sole traders will only find out the amount of tax they are required to pay after the end of a financial year and potentially not until the following calendar year. That is, a sole trader may operate from 1 July 2023 to 30 June 2024; but not be liable to pay tax until April/May 2025.
- 4.7 This effectively results in a 'tax-deferred holiday' for the first year of business for the sole trader. A consequence of this 'deferral' is that a larger lump sum amount owed to tax will be presented to the sole trader as the sole trader is required to 'catch-up' on tax not paid for the first year of operation.
- 4.8 Subsequent to lodgment of the tax return, instalment activity statements will be issued for the sole trader in subsequent quarters to ensure tax is paid throughout the income year to reduce the larger lump sum owed following lodgment of a future tax return.
- 4.9 The amount of tax payable for each instalment activity statement will be based on the tax return lodged prior, and as a result, such amounts payable will differ on a year-to-year basis depending on the information provided from the most recent tax return.
- 4.10 This may also result in future discrepancies if a sole trader's income significantly increases or decreases.
- 4.11 Strategies should therefore be recommended to the sole trader to assist in budgeting with these issues and may include the creation of a second bank account for the business where the sole trader self-withholds amounts each month/quarter to reduce the impact of significant changes to the amount of tax owed.
- 4.12 This may reduce the likelihood of sole traders spending such income earned prior to the payment of their tax obligations. This is a particular issue to be managed due to sole traders treating their income earned as their own.

GST budgeting

- 4.13 As discussed above in the paper, sole traders may have the ability to determine:
 - (a) whether GST returns are filed quarterly or annually; and
 - (b) whether GST will be assessed on a cash or accruals basis.



- 4.14 In determining whether GST returns should be filed quarterly or annually, thought should be had in relation to the income tax cash flow issues discussed above, specifically the accumulating of GST liabilities over the course of a year.
- 4.15 In contrast, where GST returns are lodged quarterly, such frequent payments may assist in the cash flow management and tax obligations of the sole trader.
- 4.16 As to whether GST should be on a cash or accruals basis, accounting GST on a cash basis may allow for the sole trader to better manage cashflow as input tax credits and GST payable are only accounted once payment has been made.
- 4.17 That is, where clients may delay payments for an extended period of time, GST is not payable for a tax period until the sole trader has received the money.
- 4.18 In contrast, provided payments for business expenses are made within the tax period, input tax credits may be obtained for that tax period. That is, sole traders may choose to extend payment to the latest point in time of the tax period to ensure cash flow is managed whilst still being able to claim input tax credits within the relevant tax period.
- 4.19 Where GST is accounted on an accrual basis, discrepancies arise in relation to cash received and GST payable/input tax credits claimable.
- 4.20 This may result in a sole trader having cash flow problems where they have invoiced for work but did not receive payment of such an invoice. Alternatively, an advantage may arise where the sole trader incurs an expense despite not having yet made payment for the expense (in that an input tax credit is available for the tax period without having paying the cash).
- 4.21 Under the accrual basis, specific care must be taken as to the timing of issuing invoices and incurring expenses. Additional considerations for sole traders may also extend to ensuring appropriate payment terms and ensuring work may be separated into smaller amounts to reduce exposure to such discrepancies.
- 4.22 As with general income tax budgeting, sole traders should ensure monies are retained to cover any GST liabilities as and when they come due.



5 BAS completion guidance

- 5.1 As previous sections have outlined, many of a sole trader's tax obligations are recorded in the BAS. The BAS will generally require reporting and payment of tax in relation to GST law, PAYG instalment and PAYG withholding.
- 5.2 A sole trader's BAS can be accessed via their myGov or an accounting provider who has standard business reporting enabled software.
- 5.3 Although using appropriate software will arrange for completion of the BAS in a seamless manner, this section will seek to provide tips and suggestions.

Appropriate invoices retained

- 5.4 It is important for the sole trader to retain appropriate tax invoices when completing the BAS.
- 5.5 Tax invoices are important because they record creditable acquisitions made by a sole trader. Until the sole trader holds a tax invoice, they may not claim any input tax credits relating to a purchase.
- 5.6 Upon request, suppliers must issue a tax invoice for all taxable supplies with a GST-exclusive value of \$75 or more within 28 days of the request.⁵³
- 5.7 To claim GST credits on purchases of less than \$75 for which a tax invoice has not been issued, purchasers are required to keep receipts or other evidence of the purchase.⁵⁴
- 5.8 Tax invoices must include the following:⁵⁵
 - (a) the words 'tax invoice' stated prominently;
 - (b) the seller's identity and the seller's ABN;
 - (c) if the total price of the invoice is at least \$1,000 – the sole trader's identity or ABN;
 - (d) what is supplied, including the quantity (if applicable) and the price of what is supplied;
 - (e) the extent to which each supply to which the document relates is a taxable supply;
 - (f) the date the document is issued;
 - (g) the amount of GST (if any) payable in relation to each supply to which the document relates;
 - (h) if the document was issued by the sole trader and GST is payable in relation to any supply - that the GST is payable by the seller.
- 5.9 Additional information regarding tax invoices for GST purposes can be found in Goods and Services Tax Ruling (**GSTR 2013/1**), and the following may be of particular relevance for Dan the Carpenter:
 - (a) Paragraph 22 - A builder's registration number or licence number is insufficient in itself to identify the supplier, or where applicable the recipient.
 - (b) Paragraph 42 - A document issued by the supplier that does not meet all of the tax invoice requirements may be treated by the recipient as a tax invoice if:

⁵³ Section 29-70(2) GST Act

⁵⁴ Section 29-80 GST Act and Regulation 29.80.01 GST Regulations

⁵⁵ Section 29-70 GST Act



- (i) it would be a tax invoice but for the missing information; and
 - (ii) all of that missing information can be clearly ascertained from other documents given to the recipient by the supplier.
- (c) Paragraph 58 - A supplier is not required to issue a tax invoice and a recipient can claim an input tax credit without a tax invoice if the value of the taxable supply is \$75 or less. For the purposes of the low-value threshold for tax invoices in subsection 29-80(1), where multiple taxable supplies are made in a single transaction, the threshold should be applied to the aggregate value of those taxable supplies.
- 5.10 Steps should be taken by the sole trader to ensure appropriate documentation are retained and easily accessible in the event of audit.

General comments regarding the BAS

- 5.11 The BAS must be lodged when a taxpayer is registered or required to be registered for GST and regardless of whether GST is payable.
- 5.12 Where the net amount of GST collected (due to supplies/invoices from the sole trader) exceeds input tax credits from acquisitions, GST will be payable by the sole trader. In the alternative, where input tax credits exceed any GST collected, a refund may be payable by the ATO or offset against any other tax liabilities owed by the sole trader to the ATO.
- 5.13 Where completing the BAS without assistance from external software, the ATO has provided a GST bookkeeping guide found (as of the date of this paper) at the following website: <https://www.ato.gov.au/businesses-and-organisations/preparing-lodging-and-paying/business-activity-statements-bas/goods-and-services-tax-gst/simpler-bas-gst-bookkeeping-guide>.
- 5.14 As mentioned above, once the ATO has calculated tax payable in a sole trader's most recent tax return, PAYG instalments will be payable under future BAS.
- 5.15 The ATO will automatically calculate such PAYG instalment amount, and the sole trader is not required to calculate such amount.
- 5.16 If, however, the sole trader believes the pre-calculated amount amounts to a significant departure from the anticipated tax payable for the income year, the sole trader may vary it completing the appropriate reason and being mindful of the potential for general interest charge to apply.
- 5.17 Where the sole trader also employs other persons, PAYG withholding may be required in relation to wages paid and other amounts (such as amounts to contractors who do not provide the sole trader with an ABN – see additional brief comments below).
- 5.18 In contrast to PAYG instalments that are automatically calculated and pre-printed, the following should be noted for sole traders regarding the BAS labels:

W1 Total salary, wages and other payments

- (a) At this label the taxpayer will show the amounts of:
- (i) gross wages, salaries and allowances and leave loading provided to its employees; and
 - (ii) directors' fees.



All payments must be shown at this label even if no withholdings was made from the payments – for example, an employee receives less than the tax-free threshold. Superannuation payments are not included at this item.

W2 Amounts withheld from payments shown at W1

- (b) At this label the taxpayer should show the actual amounts withheld from the wages at W1 above. For most taxpayers this will be the only withholding and this amount can then be entered at W5 and then the summary at 4 on the back page of the BAS.

W4 Amounts withheld where no ABN is quoted

- (c) This label should be completed if the taxpayer has withheld 49% of the invoice amount where no ABN has been quoted.

W3 Other Amounts withheld

- (d) This label is for recording amounts withheld from interest and dividends or trust distributions to investors who have not quoted a TFN.

W5 Total Amounts withheld This is the total of W2, W3 and W4.

- (e) This amount is then transferred to the summary of the BAS.



- 6 Superannuation as a sole trader and obligations to enable tax deductibility**
- 6.1 Employers are obligated to make superannuation contributions on behalf of employees.
- 6.2 In the case of sole traders, however, there is no 'employer' of the sole trader as the sole trader works for themselves.
- 6.3 There is no minimum requirement for a sole trader to contribute to their superannuation, and without steps being taken, the sole trader may find themselves in a position with little to no monies in their superannuation.
- 6.4 Sole traders are therefore required to take active steps in making contributions to their superannuation fund, if they wish to do so.
- 6.5 In this regard, a member of a superannuation fund can claim an income tax deduction for contributions made to their superannuation fund provided certain conditions are met.⁵⁶
- 6.6 Most relevant to sole traders, appropriate notice must be provided to the sole trader's superannuation fund provider whether by using the relevant superannuation fund's own form or completing the appropriate ATO form (<https://www.ato.gov.au/forms-and-instructions/superannuation-personal-contributions-notice-of-intent-to-claim-or-vary-a-deduction>).
- 6.7 In addition, payment must be made and received by the superannuation fund prior to 30 June of the relevant financial year.
- 6.8 Sole traders should therefore be recommended to arrange for such documentation to be prepared and amounts paid by the middle of June to ensure sufficient time for the funds to transfer.

⁵⁶ Section 290-170 ITAA 1997



7 Requirements if considering engaging casual labour and subcontractors

- 7.1 Whilst outside the scope of this paper to discuss the differences in engaging employees and subcontractors from an employment law perspective, this section will seek to provide a broad overview of such differences legally and from a tax obligation perspective.
- 7.2 That said, specific to Dan the Carpenter, thought may be had in relation to considering the following 'Guide to taking on an apprentice' prepared by the Fair Work Ombudsman: <https://www.fairwork.gov.au/sites/default/files/migration/712/guide-to-taking-on-an-apprentice.pdf>.
- 7.3 Whether a sole trader wishes to engage an employee (being a casual or apprentice) or a subcontractor will be dependent on the circumstances the sole trader finds themselves in at the relevant point in time.
- 7.4 Where flexible work is preferred, then engaging a casual employee or subcontractor may be more suitable than taking on an apprentice (as apprentices are usually engaged on a fixed full-time or part-time basis). This enables the sole trader to budget for additional assistance on a job by job basis rather than taking on a commitment to employ a person for a particular period of time regardless of any workflow.
- 7.5 In addition, where the sole trader does not have the capacity to adequately train or assess the required skills of employees, appropriately qualified subcontractors may enable better management of a sole trader's time as less supervision is required. Further, subcontractors are usually required to rectify and defects at their own cost, which is the general expectation given the level of skill and experience a subcontractor has over employees. Appropriate legal documentation should be prepared to ensure this obligation on such subcontractors.
- 7.6 In contrast, offering apprenticeships can prove to be a worthy investment in the future of the business or next generation of workers. Where an apprentice is employed and their skills developed over the course of the engagement, synergies and processes may develop to enable the sole trader's business to grow.
- 7.7 Further, the lower monetary cost of engaging an apprentice (as they are on fixed term contracts as opposed to casual contracts) and the availability for subsidies may offset the added time-spent mentoring and training such apprentice.

Tax and legal obligations

- 7.8 As previously mentioned, the engagement of an employee results in PAYG withholding applying in the retention of that employee's wages and salary.
- 7.9 Under tax law, all records that explain PAYG withholding transactions must be retained for a period of five years. Records must be in English or in a format that can be converted into English.
- 7.10 Records to be retained includes:
- (a) payment and wage records;
 - (b) voluntary agreements;
 - (c) tax file number declarations;
 - (d) withholding declarations;
 - (e) copies of payment summaries and payment summary statements, or electronic annual report; and



- (f) employment termination payment records (or eligible termination payment records).
- 7.11 These added obligations should be weighed in determining the status of a person engaged by a sole trader as it imposes additional administrative requirements.
- 7.12 Further, separate to tax law obligations, are the obligations under the National Employment Standards that are minimum standards applying to the employment of all national system employees irrespective of industry, occupation or income, and commenced operation on 1 January 2010.
- 7.13 Employment law requires that that an employer must not contravene a provision of the National Employment Standards and doing so may result in penalties applying.
- 7.14 The National Employment Standards includes superannuation, mandated leave (parental, annual, sick and carer's, family and domestic violence, community service and long service leave) as well as minimum termination notices. Many of the standards may not apply to casual employees but care should be noted in that casual employees may have the right to become a permanent employee in particular circumstances.
- 7.15 In contrast to the above obligations, engaging a subcontractor may only require the sole trader to:
- (a) withhold contractor payments where the subcontractor fails to provide their ABN in the provision of the work; and
 - (b) pay superannuation where a subcontractor works under a contract that is wholly or principally for the labour of the person noting SGR 2005/1 provides guidance on when such a contract applies.⁵⁷
- 7.16 Where the contractor engaged is a sole trader, care should be taken to ensure appropriate legal documentation are prepared to properly reflect the contractor relationship. Where it may be inferred that the contractor is an employee, then PAYG withholding obligations would apply regardless of the issuing of an ABN or not. TR 2023/4 notes "[a] *contract will be a sham if it is not a legitimate record of the intended legal relationship between 2 parties, but instead is 'a mere piece of machinery' serving some other purpose (often to act as a façade and deliberately obscure the true legal relationship for third parties)*"⁵⁸ TR 2023/4 outlines the ATO's position on when an individual is considered an employee for the purposes of PAYG withholding obligations.

⁵⁷ Section 15A(3) *Superannuation Industry (Supervision) Act 1993* (Cth)

⁵⁸ Paragraph 35 TR 2023/4



8 Impact that the PSI rules can have on sole traders

Personal services income

- 8.1 The personal services income provisions (**PSI provisions**)⁵⁹ operate to:
- (a) deny various deductions against personal services income;⁶⁰ and
 - (b) attribute any 'personal services income' (that is income derived as a reward for one's personal efforts or skills)⁶¹ from an entity to the individual performing the work.⁶²
- 8.2 Although the PSI provisions relating to attribution of income will be of no relevance given that all income of a sole trader is attributed to that sole trader, the PSI provisions may apply to deny the sole trader from claiming certain deductions.
- 8.3 Specifically, if the PSI provisions apply, the following deductions may not be claimed by the sole trader:
- (a) amounts incurred in the course of producing income if the income is not payable to the sole trader as an employee and the sole trader would not be able to deduct such amount as an employee – that is, the only deductions able to be claimed would be those that an employee is eligible to claim;⁶³
 - (b) amounts of rent, mortgage interest, rates or land tax in relation to the sole trader's residence to the extent it relates to the gaining of personal services income;⁶⁴
 - (c) payments made to an associate or their superannuation fund to the extent the payment relates to gaining personal services income other than where the associate performs work that forms part of the sole trader's principal work (in effect, this provision denies the claiming of amounts paid to an associate for administrative services);⁶⁵
- 8.4 An exception applies to the above where the sole trader is conducting a personal services business.⁶⁶
- 8.5 Given the importance for a sole trader to be eligible to claim deductions on such income generated it is important to ensure that either:
- (a) the sole trader conducts a personal services business (discussed further below); or
 - (b) income produced by the sole trader does not meet the meaning of PSI (as the deductions are only denied with respect to the gaining of personal services income).
- 8.6 PSI for a sole trader means such income as a reward for a sole trader's personal efforts or skills,⁶⁷ but does not include such income associated with materials or products. Therefore, where the circumstance of such sole trader is that they can show the income is predominantly a result of the sale of goods, such income may not be considered PSI.

⁵⁹ Divisions 84 to 86 ITAA 1997

⁶⁰ Division 85 ITAA 1997

⁶¹ Section 84-5 ITAA 1997

⁶² Division 86 ITAA 1997

⁶³ Section 85-10 ITAA 1997

⁶⁴ Section 85-15 ITAA 1997

⁶⁵ Sections 85-20 and 85-25 ITAA 1997

⁶⁶ Section 85-30 ITAA 1997

⁶⁷ Section 84-5 ITAA 1997



- (a) Consider Example 1 at paragraph 163 of TR 2022/3: *“Andre is a plumber who operates as a sole trader...He charges \$25 for materials and \$225 for his labour. The total of the invoice is \$250. This income is Andre's PSI as it is mainly a reward for his personal efforts and skills.”*
- (b) This should be contrasted with Example 5 at paragraph 170 of TR 2022/3: *“Grace is a carpenter who operates a partnership with her spouse, Chris. Grace designs and constructs bespoke furniture and sells it through the partnership via the internet and at trade fairs. The payments made to the partnership are for the sale of the furniture rather than Grace's personal efforts or skills. The income derived by the partnership is not PSI.”*

8.7 As the apportionment of income means such income is PSI, steps must be taken to confirm whether the sole trader is a personal services business.

Personal services business tests

- 8.8 In order to be considered a ‘personal services business’, the sole trader only needs to meet one of four following tests.
- 8.9 The relevant tests include:
- (a) the results test – where it can be shown that the income was for the production of a result among other requirements;
 - (b) the unrelated client test – where it can be shown that the income was derived from unrelated clients and as a product of the sole trader making offers or invitations to the public at large;
 - (c) the employment test – where it can be shown that a portion of the income generated by a business structure is through the use of persons ‘employed’ or engaged with a business structure (not related to the key business owner/associated persons); or
 - (d) the business premises test – where it can be shown that a business structure runs the business through a separate business premises.
- 8.10 It is not required to meet more than one of above four tests to be considered a personal services business.
- 8.11 While only one of the tests needs be satisfied, it may be preferable in the long term for the sole trader to meet more tests (i.e. to reduce the likelihood of a future restructuring of the business falling within the general ‘anti-avoidance’ arguments).
- 8.12 The PSI provisions are tested on an income year by income year basis. As such, so long one of the tests are satisfied in an income year (it can be a different test each year), the sole trader will be considered a personal services business.
- 8.13 If none of the tests are able to be satisfied, then steps can be taken to obtain a personal services business determination from the ATO.
- 8.14 TR 2022/3 provides a comprehensive summary of the ATO’s position in relation to the application of the PSI provisions and is recommended reading for a summarised position. Notwithstanding TR 2022/3, each test is considered below.



Results test

- 8.15 The results test requires that in an income year, a sole trader derives at least 75% of its PSI as follows:
- (a) it is income for producing a result (**first limb**);
 - (b) the sole trader is required to supply its own tools of trade to perform the work (**second limb**); and
 - (c) the sole trader is liable for the cost of rectifying any defects (**third limb**).
- 8.16 All three limbs must be satisfied to qualify for the results test.
- 8.17 In determining whether any of above requirements have been met in any particular case, regard must be had to any “custom or practice” (when work is performed by persons who are not employees) in relation to the matters to which the particular criterion relates. That is, what is standard practice for a business the sole trader’s circumstance to be required to supply its own tools of trade to perform their work.
- 8.18 In relation to the first limb:
- (a) although the question on what is ‘income for producing a result’ has been subject to considerable case law, the crux of this limb is whether the sole trader is being paid on the basis of achieving a result;
 - (b) in particular:

[64] The words “producing a result” require something more than obtaining a payment reward for providing ongoing personal skills and efforts to enable another party...to produce a contracted for result to their clients. Consistent with the recognized indicia of the independent contractor, the words “for producing a result” require that the personal services income of the individual...was paid to him as the contract quid pro quo for producing a result and was not paid until and unless the result was produced.⁶⁸
 - (c) there is case law to suggest that invoicing on an hourly basis can satisfy the results test, specifically:

[24] We note that in the context of s 87-13(3)(a) it is not how your fee is calculated, but what you are paid for, that is important. It is possible for a person who is contracted to produce a result to choose to charge hourly rates as the means of remuneration, without altering the fact that payment is made for producing a result. In saying this, we are mindful of the comment of Allsop J in IRG at [43] that the method of payment may be important – but there is nothing in what his Honour said to suggest that a fee based on time spent will necessarily exclude the possibility of being paid “for producing a result.”⁶⁹
 - (d) importantly, the question is ‘What is the income for? And answer to that question will depend on the income-earner’s responsibilities to its clients; or put another way, what does he have to do to satisfy the obligations he has under agreement with the client, and to justify payment?’.⁷⁰ Having clear ‘milestones’ agreed prior to the commencement of the work will assist in evidencing such arrangements.

⁶⁸ Paragraph 64 *Skiba v FCT* [2007] AATA 1705

⁶⁹ *Taneja v FCT* [2009] AATA 87

⁷⁰ *Ibid* at [25]



- 8.19 In relation to the second limb, the sole trader must provide the necessary equipment and tools to complete the required work. In considering what equipment and tools are required to be supplied, consideration must be made as to the equipment and tools commonly used by others understanding the same line of work. That is, the sole trader must provide the necessary equipment and tools themselves - they cannot be given the tools and equipment.
- 8.20 Regarding the third limb, it can be sufficient that there is a contractual liability to meet the cost of defective work. This is only possible if there is in fact a risk of liability for the sole trader. In particular, the sole trader will need to show that they are required to rectify defects at their own cost (not at the cost of the client). Appropriately drafted agreements may assist to evidence such satisfaction of the third limb.
- 8.21 TR 2022/3 provides additional commentary on what it means to satisfy each of the requirements. Specifically:
- (a) Regarding 'the income is for producing a result':
 - (i) "In contracts that are for producing a result, **payment is usually made for a negotiated contract price to achieve a specified outcome... payment is made when the contractually specified results have been fulfilled. A contract price for achieving a specified result may be calculated by reference to an estimated number of hours applied to an hourly rate...** What needs to be considered is whether the contract price is for achieving a specified result and not merely payment for the hours worked." – paragraph 84.
 - (ii) "**The essence of the contract must be to achieve a result and not to do work.** The fact that a sole trader or PSE is required to complete identifiable tasks is not the same as achieving a contractually specified result if those tasks merely form part of the work being paid for on an ongoing basis." – paragraph 85.
 - (iii) "The condition will not be satisfied merely because the contract states that the contract is for producing a result. Consideration should be given to the substance of the arrangement between the sole trader or PSE and the service acquirer and what the sole trader or the PSE is actually being paid for." – paragraph 86.
 - (b) Regarding the supply of plant and equipment – "To satisfy the second condition, the sole trader or PSE must supply any plant and equipment or tools of trade needed to do the work that produces the result and which a service acquirer would expect the sole trader or PSE to provide or which the sole trader or PSE is contractually required to provide" – paragraph 87.
 - (c) Regarding liability to rectify defects:
 - (i) "To satisfy the third condition, the sole trader or PSE is, or would be, liable for the cost of rectifying any defects in the work. There is no requirement that they actually perform the work which rectifies the defect, so long as they are liable for the cost of rectifying any defect in the work performed." – paragraph 90.
 - (ii) It is noted that professional indemnity insurance is an indicator to suggest that the entity is liable for rectification but will not be determinative on this issue (see paragraph 93). Rather, it is crucial that the entity bears the cost of rectification of defects where required.



- 8.22 TR 2022/3 also considered various examples on whether the results test is satisfied (paragraph 195 to 209) and distinguishes between a consultant of which '*[p]ayment is made upon submission of a fortnightly invoice which includes a time sheet certified by a government department officer*' (paragraph 201) compared to those circumstances where:
- (a) "The contract specifies a fixed amount by way of payment" and "Instalments of the contract price are payable upon achievement of specified milestones." – paragraph 198;
 - (b) "The contract price is based on installation of the duct work in accordance with those plans and any changes are subject to the variation clauses in the contract." – paragraph 205; and
 - (c) "John is paid a set amount at the end of the contract, once the report has been finalised and presented." – paragraph 208.
- 8.23 In evidencing that the above limbs are met, any contracts entered into by the sole trader should be reflective of the above requirements.

80% test

- 8.24 Where the results test is not met, the sole trader may still be considered a personal services business provided any one of the remaining three tests are met.
- 8.25 In this regard, addition to the following requirements that must be met for each respective test, the sole trader must also meet the 80% test component.
- 8.26 In particular, if more than 80% of the sole trader's PSI comes only from one client, then this test will not be satisfied and the remaining three tests cannot be met.⁷¹
- 8.27 Therefore, the sole trader is required to have 80% of its PSI coming from more than one client if the following alternative tests are to be satisfied.
- 8.28 If during an income year, the sole trader does not have 80% of its PSI coming from more than one client, then none of the following three tests cannot be satisfied.

Unrelated Clients Test

- 8.29 In order to satisfy this test, in addition to the 80% test the sole trader must demonstrate that in the relevant income year:
- (a) the sole trader produces income from providing services to two or more entities that are not associates; and
 - (b) the services are provided as a direct result of making offers or invitations (e.g. advertising) to the public at large or to a section of the public to provide the services.
- 8.30 In dealing with unrelated clients, the sole trader's clients cannot be associates of one and another.
- 8.31 In addition to having unrelated clients, it is necessary to consider whether the services provided are as a direct result of the sole trader advertising to the public at large or to a section of the public to provide such services.

⁷¹ Section 87-15(3) ITAA 1997



- 8.32 'Direct result' has been rules as a case it is a 'proximate cause of the payment'. Therefore, there must be a direct link between the sole trader advertising the relevant services to the public and as a result of that specific advertising, the sole trader is contacted to undertake the services, as advertised.
- 8.33 Generally, clients acquired through word-of-mouth referrals would not satisfy this test because the clients are obtained through private relationships and personal contacts rather than by making offers to the general public.
- 8.34 However, there is case law, which accepts that where a business offers highly specialised services such that a public offer of services could only be made to a 'limited number of players', then general advertising would be inappropriate. In that case, the taxpayer's key employee's regular personal contact with the relevant companies to assess their needs and the opportunity to provide the highly specialised services via word-of-mouth and personal recommendations from others in the industry constituted the 'making offers or invitations to provide services' to a section of the public. As a consequence, the taxpayer met the unrelated client test.
- 8.35 TR 2022/3 provides the following comments in relation to the services being a direct result of making offers or invitations to the public:
- (a) "To meet this condition, the offer or invitation must be the reason that the sole trader or PSE obtained the work from the client and there must be a direct causal effect between the offer or invitation and obtaining the work" – Paragraph 99
 - (b) Where labour-hire firms or similar intermediaries are involved, the condition may not be met (see paragraphs 101 and 102).
 - (c) "An offer or invitation is made to 'the public at large' where any interested member of the public is capable of accepting it. An offer or invitation to 'a section of the public' is made in situations where only a select group is chosen to whom the invitation is made. Making an offer or invitation to a section of the public could include offering to provide services to one entity in certain circumstances; for example, in relation to competitive tenders" – Paragraph 103.
 - (d) "A word-of-mouth referral is not generally considered to satisfy the requirements of the unrelated clients test. A word-of-mouth referral is when a sole trader or PSE is offered work because of a recommendation from a previous client or industry contact. However, offers made by word of mouth in a very specialised or niche industry where there are only a very small number of potential service acquirers may, in limited circumstances, meet this condition." – Paragraph 104.

Employment test

- 8.36 To satisfy the employment test, in addition to the 80% test the sole trader must show that it:
- (a) engaged one or more entities (other than associates of the sole trader that are not individuals) to perform the work; and
 - (b) the engaged entities together perform at least 20% of the sole trader's work for the year.⁷²

⁷² Section 87-25 ITAA 1997



8.37 This test is also satisfied if the sole trader has for at least half the relevant income year, one or more unrelated apprentices.⁷³

8.38 TR 2022/3 provides detail on how the '20%' value is calculated at paragraphs 118 to 124.

Business premises test

8.39 To satisfy the business premises test, in addition to the 80% test the sole trader must at all times during the relevant income year, maintain and use a business premises:

- (a) from which the sole trader mainly conducts activities from which PSI is gained;
- (b) which the sole trader has exclusive use;
- (c) that are physically separate from any premises that the sole trader or any associate of the sole trader uses for private purposes; and
- (d) are physically separate from the premises of the entity which the sole trader (and from the premises of any associate of you or the sole trader) are providing services to.⁷⁴

8.40 Unfortunately in the case of Dan the Carpenter, as he produces his PSI away from any business premises, he will not meet this test.

8.41 Regardless, more generally, please note a home office cannot satisfy the business premises test because it is not physically separate from the private residential parts of the home.

⁷³ Section 87-25(3) ITAA 1997

⁷⁴ Section 87-30 ITAA 1997



9 The asset protection discussion

- 9.1 Whilst generally a topic that discusses a sole trader's personal risks and liabilities may fall within the realm of legal advice, accountants should arm themselves with sufficient knowledge to bring up the topic with their clients for consideration.
- 9.2 Further steps can be taken by the sole trader to engage a lawyer to provide a more comprehensive discussion of the law as it applies to the sole trader following the initial discussion.
- 9.3 As a key principle, however, asset protection is the structuring of assets to segregate 'at-risk' assets away from other assets and ensuring 'high-risk' individuals hold as few assets as possible.
- 9.4 In the context of Dan the Carpenter, asset protection should be a discussion to be had from the initial meeting, as assets held by Dan may be exposed to risks in any defective workmanship he may have performed.
- 9.5 The use of trust or company structures may offer to add a layer of protection from immediate client dissatisfaction and the assets of the sole trader, however, the following additional principles should be noted in ensuring trust and company structures do not absolve individuals of any responsibility from the trust and company:
- (a) directors may be personally liable for breaches of corporations law for a company; and
 - (b) trustees may be personally liable for breaches to their trustee obligations for a trust.
- 9.6 In addition to the above general law propositions, existing tax provisions operate to cause directors of company to be personally liable for any unpaid amounts by a company relating to PAYG withholding, GST and super guarantee charge.
- 9.7 Further the *Bankruptcy Act 1966* (Cth) includes clawback provisions which looks to unwind or reverse under-market value transactions made from a 'high-risk' person (in circumstances where a sole trader may choose to gift monies to other persons).
- 9.8 Broadly:
- (a) if a transaction is made for less than market-value consideration, then that transaction can be unwound or reversed if the transferor is bankrupted within a four year period; however
 - (b) if a transaction is made with the main purpose of preventing property from being accessed by creditors, then such a transfer can always be unwound.
- 9.9 This ensures 'high-risk' persons cannot transfer assets out of their name shortly prior to becoming bankrupt.
- 9.10 In identifying the 'main purpose' for under-market value transactions, the following factors can be considered:
- (a) does the person have any creditors at the time of the transfer;
 - (b) is the person engaged in or proposing to engage in any hazardous activities; and
 - (c) is it the intention to protect the transferred assets from any future action.
- 9.11 Notwithstanding the above impediments in implementing any asset protection strategies with regards of tax obligations and creditors, trust and company structures may offer



additional benefits to sole traders, particularly where sole traders (as directors) act with due care and consideration and in compliance with corporations law.



10 Disclaimer

10.1 This paper covers legal and technical issues in a general way. It is not designed to express opinions on specific cases. It is intended for information purposes only and should not be regarded as legal advice. Further advice should be obtained before taking action on any issue dealt with in this paper.

11 Contact details

Author	Darius Hii, Director
Firm	Chat Legal Pty Ltd ABN 64 621 391 553
Direct line	0403 923 374
Email	darius@chatlegal.com.au