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# Let's chat

Taxation of Tradies - A Case Study Series for Junior Accountants - The Business Lifecycle of Dan the Carpenter - As a Sole Trader (April 2024)

With:

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*Information provided is general in nature; precise application depends on specific circumstances*



# Overview

- ABN and GST registration
- Tax recording keeping requirements
- Tax cash flow management considerations
- BAS completion guidance
- Superannuation as a sole trader
- Engaging employees and subcontractors
- PSI rules
- Asset protection discussion
  
- See paper for legislative references



# ABN registration

- Introduced 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'*
- Does not necessarily mean there is a new legal entity established
- Sole trader ABN links the ABN to the individual
- ABN available where sole trader:
  - carrying on an enterprise in Australia **or**
  - in the course or furtherance of carrying on an enterprise, the sole trader make supplies that are connected with the indirect tax zone



# ABN registration

- Likely that Dan will be carrying on an enterprise
- Definition of enterprise taken from GST Act
- 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'.
- Following are factored in making such determination: whether the activity or series of activities are done:
  - “in the form of a business; or
  - in the form of an adventure or concern in the nature of trade; or
  - on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property; or...”



# ABN registration

- TR 97/11 includes following factors to be considered:
  - *“a significant commercial activity;*
  - *a purpose and intention of the taxpayer to engage in commercial activity;*
  - *an intention to make a profit from the activity;*
  - *the activity is or will be profitable;*
  - *the recurrent or regular nature of the activity;*
  - *the activity is carried on in a similar manner to that of other businesses in the same or similar trade;*
  - *activity is systematic, organised and carried on in a businesslike manner and records are kept;*
  - *the activities are of a reasonable size and scale;*
  - *a business plan exists;*
  - *commercial sales of product; and*
  - *the entity has relevant knowledge or skill.”*



# GST registration

- Sole trader required to register for GST where they are carrying on an enterprise and their GST turnover meets the registration turnover threshold
  - enterprise takes on the meaning as discussed above;
  - GST turnover means current GST turnover or projected GST turnover; and
  - 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).
- Sole trader may voluntarily register for GST if they don't meet the \$75,000



# GST registration

- Ensure register for GST prior to activities undertaken to reduce issues
- Once registered, ensure sole trader charges the necessary GST on the relevant invoice and prepares such invoices pursuant to the requirements (considered further below)
- GST returns (via the BAS) must be lodged with the ATO:
  - Quarterly – where turnover above \$75,000 and below \$20 million
  - Annual – where turnover below \$75,000



# GST registration

- BAS dates:
  - 28 July for the previous quarter ending 30 June;
  - 28 October for the previous quarter ending 30 September;
  - 28 February for the previous quarter ending 31 December; and
  - 28 April for the previous quarter ending 31 March.





# Accounting of transactions

- Income tax purposes:
  - Income recognise when derived
- GST purposes:
  - Choice between accounting on a cash basis or accrual basis
  - Cash basis available where entity is a small business entity
  - Cash basis enables GST on taxable supply payable in tax period in which payment received and input tax credits claimable in tax period in which creditable acquisitions incurred and paid
  - Accrual basis also possible if wanting to align with income tax



# Record keeping - deductions

- Generally, written evidence must be obtained from the supplier and retained for 5 years and produced within (approximately) 28 days of a request being made by the Commissioner
- Some exemptions apply:
  - Work expense – No written evidence or record required if claiming \$300 or less
  - Laundry expense – No written evidence or record required if claiming \$150 or less
  - Where an expense is \$10 or less with the total of such expenses not exceeding \$200, a record of expense will suffice over a document from a supplier
  - Where phone expenses being claimed are less than \$50, a detailed breakdown is not required and a per call deduction may apply



# Record keeping - deductions

- Written evidence must contain the following from the supplier of the expense:
  - the name or business name of the supplier; and
  - the amount of the expense, expressed in the currency in which it was incurred; and
  - the nature of the goods or services; and
  - the day the expense was incurred; and
  - the day it is made out,
- Two potential exceptions:
  - 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;
  - 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.



# Apportionment

- Where expenses are partially private, apportionment required
- Examples of apportionment:
  - \$80 per month phone plan
  - Bill outlines phone calls and monthly data use
  - Identified 20% of calls made are work-related
  - \$16 per month claimed as a deduction and extrapolated for the remainder of the year
  - One month not included as leave was taken
- Other than bill, consider data usage information on smart devices



# Motor-vehicle claims

- Considered 'car expenses':
  - petrol;
  - repairs and servicing;
  - new tires;
  - interest on car loan;
  - car washes and polishes
- Own substantiation rules/methods:
  - Cents per kilometre
  - Logbook
- Only available where employee owns or hires/leases the car



# Cents per kilometre method

- Number of business kilometres travelled by the car in the income year \* rates of cents kilometre determined under subsection 128-25(4) ITAA 1997 for the car for the income year
- The current rate of cents kilometre is 78 cents as of the 2022/2023 financial year; 85 cents as of 2023/2024
- Business kilometres are considered kilometres the car travelled in the course of producing the employee's assessable income or travel between workplaces
- The maximum business kilometres available for deduction is 5,000 (i.e. \$3,900/\$4,250)
- No other substantiation required other than counting kilometres (although retaining a diary may assist in recalling travel)



# Logbook method

- Logbook made for 12 continuous weeks (which can then be applied for the remainder of the year and the next four thereafter unless exceptions apply)
- Stringent requirements in the logbook relating to details of the trip, odometer, kilometres travelled and information about the car – see paper for more information
- Note the rules surrounding travel expenses may assist in determining whether the trip related to producing income
- Consider buying a physical book or downloading an app
- Records must be in English

# Motor vehicle expense exceptions



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- Above methods only apply for a 'car'
- Legislation defines 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
- Motor vehicles that fall outside this definition may include a ute
- In claiming deductions, no formal logbook required and claims must be substantiated using reasonable methods
- A logbook may assist, however, in calculating the necessary percentage related to producing assessable income





# Tax cashflow considerations

- Consider Dan the employee:
  - PAYG taken out each 'paycheck' automatically
  - Superannuation paid when required
  - No GST to consider
- Consider Dan the sole trader:
  - No wages as business income is income of Dan – therefore, no PAYG withholding taken out
  - No required superannuation contributions as no wages for Dan
  - GST payable on provision of services and GST to claim on creditable acquisitions
- Dan the sole trader may seem like he has made more whilst overlooking the mounting tax obligations



# Tax cashflow considerations

- 1 July 2024 – Dan starts the new business
- 28 October 2024 to 28 August 2024 – Dan has made payments in relation to GST as required under the BAS
- 30 June 2025 – A great first year, Dan has moved his money around and spent a fair chunk
- 1 July 2025 – Dan starts the second year of the business with optimism as he found himself with more excess cash than when he was an employee
- 28 October 2025 onwards – Dan continues to stay on top of his BAS



# Tax cashflow considerations

- April 2026 – After seeing his accountant, Dan has been told that tax has to be paid on the income generated for the 2024/2025 financial year and to ‘keep money aside’ to pay the tax
  - As no tax has been set aside as Dan went, he is feeling the ‘second year crunch’ as he cannot use as much of what he has made on himself and his family
  - He’s had to take money out of the 2025/2026 income year to pay the tax for the 2024/2025 income year
- June 2026 – Dan finishes the second year, happy but hurting
- August 2026 – Dan receives his BAS statement and notices that in addition to GST being payable, he has to pay something called ‘PAYG instalment’ that worked out to be roughly  $\frac{1}{4}$  of the tax he had just paid in April 2026



# Tax cashflow strategies

- Keeping a second bank account to 'set monies aside'
- Where GST accounting on a cash basis, consider if the sole trader is able to defer payment of expenses until the end of the tax period (as input tax credits may still be available for the period, and the business retains as much cash as reasonably possible)



# Importance of the invoice

- Ensuring appropriate invoice documentation retained (also relevant in how invoices should be provided to suppliers):
  - the words 'tax invoice' stated prominently;
  - the seller's identity and the seller's ABN;
  - if the total price of the invoice is at least \$1,000 – the sole trader's identity or ABN;
  - what is supplied, including the quantity (if applicable) and the price of what is supplied;
  - the extent to which each supply to which the document relates is a taxable supply;
  - the date the document is issued;
  - the amount of GST (if any) payable in relation to each supply to which the document relates;
  - 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.



# Importance of the invoice

- Provided within 28 days of request – GST-exclusive value of \$75 or more within 28 days of the request
- No tax invoice required but purchaser required to keep receipt – GST-exclusive value less than \$75
- Where no invoice from supplier, 'RCTI' (recipient created tax invoice) invoice may be created
- Important for Dan - A builder's registration number or licence number is insufficient in itself to identify the supplier, or where applicable the recipient (paragraph 22 GSTR 2013/1)



# BAS completion tips

- Recommending external software for sole trader (Xero/MYOB/Quickbooks)
- Software coded to prepopulate based on bookkeeping data
- Sole trader otherwise required to keep a spreadsheet
- Following link for bookkeeping assistance:  
<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>
  - Guidance on classifying sales and purchase for GST
  - Clarifying most GST transactions
  - Where to include data on BAS



# BAS completion tips

## Simpler BAS

Simpler BAS is the default reporting method for small businesses with a GST turnover of less than \$10 million. This means:

- you don't need to complete a GST calculation worksheet
- if you lodge a paper activity statement or annual GST return, the sections where information is not needed can be left blank.

## What to report

On your monthly or quarterly activity statement, or your annual GST return, you must report the following GST information:

- G1 Total sales
- 1A GST on sales
- 1B GST on purchases.

**Watch:**







# BAS completion tips

## Taxable sales

Taxable sales are sales where GST is payable.

When completing your BAS you must report taxable sales and the GST in their price at:

- G1 Total sales
- 1A GST on sales.

On your BAS you disclose either the GST-inclusive or the GST-exclusive total sales figure at G1. You must indicate your choice.

Table 1 below contains a list of taxable sales and their descriptions. You can use this information to assist in identifying your taxable sales.

**Table 1: Taxable sales**

Transaction	Transaction description	GST tax code	Completing your BAS
Goods and services	Sales of goods and services in the course of your business or enterprise (ie trading stock).	GST	G1 Total sales 1A GST on sales



# BAS completion tips

## Purchases with GST in the price

You can only [claim GST credits](#) for GST included in the price of purchases that you buy or import for your GST-registered business, and that relate to taxable sales or GST-free sales.

To claim GST credits, when completing your BAS you must report the GST included in the price of your purchases at **1B GST on purchases**.

You do not report your total purchases.

Table 4 below contains a list of purchases with GST in the price and their descriptions. You can use this information to assist in identifying your purchases with GST in the price.

**Table 4: Purchases with GST in the price**

Transaction	Transaction description	GST tax code	Completing your BAS
Goods and services	<p>You can generally claim a credit for GST included in the price of any goods and services you buy or import for your GST registered business. Examples include:</p> <ul style="list-style-type: none"><li>• capital purchases such as motor vehicles, plant and equipment -- check to ensure capital purchases are allocated to the appropriate capital account</li><li>• inventory purchases (ie trading stock)</li><li>• normal running expenses such as leases, equipment rentals, stationery and repairs.</li></ul>	GST	1B GST on purchases



# BAS completion tips

- PAYG Instalments and PAYG Withholding may also be included depending on the sole trader's circumstances
- PAYG Instalments may be varied if pre-calculated amount considered different from anticipated tax to be paid



# Superannuation

- Sole traders may not automatically make contributions to superannuation
- A discussion regarding this is warranted
- No automatic contribution as no 'employer'
- Notice must be provided to superannuation fund and relevant fund/ATO has appropriate forms to be completed
- **Contribution must be received before 30 June**
- Sole traders should leave a buffer before 30 June in case of hold up on the transfer



# Employees and subcontractors

- Employees
  - Apprentice – full or part-time contracts
  - Casual
- Subcontractors
- TR 2023/4 provides ATO guidance on who is considered an employee for PAYG withholding requirements
- Notwithstanding the ATO position, note the general employment law position may differ
- Legal documentation may be crucial in ensuring certainty
- Employment wise – employees governed by various awards, National Employment Standards and Fair Work provisions
- Subcontractors are less regulated provided they are legitimate business operations



# Employees and subcontractors

- Who is best for Dan in the time of need
  - Flexibility – Subcontractor or casual labour
  - Experience – Subcontractor and maybe casual labour
  - Responsible for own work - Subcontractor
  - Working relationship – Apprentice
  - Access to subsidies – Apprentice
  - More control – Apprentice and casual labour
- No right solution, but consideration for Dan as apprentices will require more 'hands on' in mentoring and ensuring employment obligations covered
- May also be more rewarding at the end of the day



# PSI

- PSI provisions:
  - Deny various deductions against PSI
  - Attributes PSI to an individual (not applicable for sole trader)
- Deductions denied:
  - only deductions able to be claimed would be those that an employee is eligible to claim
  - cannot claim 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
- Exception if sole trader conducts a personal services business (**PSB**)
- Remember – only relevant if sole trader generates PSI



# PSI

- PSI for a sole trader means such income as a reward for a sole trader's personal efforts or skills, but does not include such income associated with materials or products
- For Dan the Carpenter, consider how much of the work relates to personal income and how much may relate to materials:
  - 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.”
  - 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.”





# PSB

- Results Test – where it can be shown that the income was for the production of a result among other requirements
- 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
- 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
- Business premises test – where it can be shown that a business structure runs the business through a separate business premises
- Only one needs to be met, if none met then a PSB determination may be considered
- If relying on the unrelated client, employment or business premise test, an **80%** test must also be met



# Results test

- Requirements:
  - Income for producing a result
  - The sole trader is required to supply its own tools of trade to perform the work
  - The sole trader is liable for the cost of rectifying any defects
- Note:
  - Question is if sole trader being paid on the basis of achieve a result
  - “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.”
  - Consider appropriate documentation to evidence such agreements based on results achieved
  - Also crucial that there is a contractual liability to meet the cost of defective work



# Results test

- TR 2022/3
  - “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
  - “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
  - (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



# 80% test

- Test not met if 80% of the sole trader's PSI comes only from one client
- Important for sole transfer not to only receive work through a single 'head contractor'



# Unrelated clients test

- Requirements:
  - The sole trader produces income from providing services to two or more entities that are not associates; and
  - 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
- Note:
  - 'Direct result' has been ruled 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
  - Consider for sole trader to create necessary marketing leads



# Unrelated clients test

- TR 2022/3
  - “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
  - Where labour-hire firms or similar intermediaries are involved, the condition may not be met (see paragraphs 101 and 102).
  - “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.



# Employment test

- Requirements:
  - Engaged one or more entities (other than associates of the sole trader that are not individuals) to perform the work; and
  - The engaged entities together perform at least 20% of the sole trader's work for the year
- Met if sole trader has for at least half the income year, one or more unrelated apprentices - section 87-25(3) ITAA 1997



# Business premises test

- Requirements – sole trader must at all times during the relevant income year, maintain and use a business premises:
  - From which the sole trader mainly conducts activities from which PSI is gained;
  - Which the sole trader has exclusive use;
  - That are physically separate from any premises that the sole trader or any associate of the sole trader uses for private purposes; and
  - 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
- Unlikely for Dan to meet given PSI produced away from business premises





# Asset protection

- Risk:
  - Defective work
  - Employees
- Strategies:
  - Take out insurance
  - High-risk, low assets; Low-risk, high assets
  - Segregation of risk through structures (trusts and companies)
  - 'Gift and loan back' arrangements



# Asset protection

- Devil in the detail as structures do not absolve risk:
  - directors may be personally liable for breaches of corporations law for a company
  - trustees may be personally liable for breaches to their trustee obligations for a trust
  - directors personally liable for PAYG withholding, GST and super guarantee charge
- Clawback provisions – bankruptcy rules which unwinds/reverses under-market value transactions



# The next stage

- Not to say structures are not worthwhile
- Still offer advantages to enable the growth of the business
  - Introducing partners
  - Providing equity to employees
  - Enabling children to get into the business
  - Flat tax rates in the case of a company



# The checklist

- Much of what was discussed cannot be covered in a single client meeting
- May be spread out over an initial discussion and any tax planning conversations
- Having a checklist and procedure to ensure Dan is advised helps make sure issues are not missed in their journey
- Role may be more than just a numbers person, but also a 'making sure Dan can pay the tax when the tax is due' person (management tips, that is a business advisor)

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