



## Tax & Management Tools For Small Business

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### Tax News and Updates March 2023

#### Importance of correctly classifying a person as an employee or contractor

An issue that often arises is the question of whether an individual is an employee of a business or a contractor to the business.

In many cases it is clear that an individual is an employee because that is how they have been engaged. But also, prevalent in the small business community is the situation where individuals provide services to a business and the business does not want to consider them as employees. Frequently, these people are referred to as contractors.

#### The right decision is important

Determining whether an individual is an employee, or a contractor is far more than a nice intellectual discussion. This decision can have very costly implications if the wrong decision is made. Deciding that a person is not an employee can mean:

- Not deducting tax from payments, which is required by law.
- Underpaying the person in relation to industrial awards.
- Not paying superannuation contributions that should be made.
- Not covering the person for accidents on the job.
- Underpaid worker's compensation premiums.
- Underpaid pay-roll tax.
- Other issues.

If the wrong decision is made by a business in relation to say, more than one employee, over a number of years, when the ATO and other government departments find out, the business can be up for a huge amount to pay. This will include penalties and non-deductibility for some of the amounts. This can be enough to cripple a business and finish it off.

#### The High Court speaks

In 2022, The High Court handed down two decisions about this issue. These cases changed an important way in which these decisions had been made in the past.

The High Court threw out what is known as the “multifactorial” approach to making the decision as to whether an individual is an employee or a contractor. This is where everything that happens in the relationship between the individual and the business hiring them is taken into account when making the decision.

The High Court replaced this approach with a stricter approach that focuses only on the rights between the parties that are set out in the contract between the parties. This has been recognised as an important change in relation to this issue. It means that carefully worded contracts can make it clearer that an individual is not an employee, if that is what you want.

### **ATO rulings**

The ATO has recognised that it has to update some of its rulings and public information due to this change made by the High Court. In December 2022, the ATO release a draft tax ruling that discussed this change. Also released was a draft “Practical Compliance Guideline” (PCG). This sets out the situations where the ATO will chase up arrangements and where they will leave them alone.

Of note in the PCG is that the ATO will not say a business is safe from investigation unless the business pays an individual as an employee or has taken advice from a tax agent or lawyer on a particular engagement arrangement with an individual. The need to take advice is a tough stipulation, but that is the current approach of the ATO.

The tax ruling and the PCG will be finalised later in the year, but we don’t know when.

So, it is important that your business correctly classifies those individuals you engage to undertake work for you because getting it wrong can be very costly. cost you. Also, in a situation where you do not consider an individual to be an employee, it is best to take professional advice.

### **ATO finalises guidance on WFH deductions**

The ATO has now finalised its position on the methods that are available to claim work from home (‘WFH’) deductions.

Consistent with the previous announcement, taxpayers can from 1 July 2022 work out their WFH claim by using either:

- the existing ‘actual costs’ method; or
- the revised ‘fixed rate method’ which allows claims at the rate of 67 cents per hour.

### **Actual costs method**

To use the actual method means you keep all of the invoices/receipts in relation to running your home. You calculate your tax deduction as a portion of the total of the expenses, often based on floor area. Under this method, you must have a part of your house set aside exclusively for your work. This method has not changed.

## Revised fixed rate method of 67 cents per hour

The new 67 cents per hour rate (previously 80 cents per hour was claimed by most taxpayers up to 30 June 2022) has just been finalised by the ATO and applies from 1 July 2022. Under this revised fixed rate method, you multiply the number of hours worked at home by 67 cents. This method covers the cost of:

- Energy expenses (electricity and gas); and
- Internet expenses; and
- Mobile and home phone expenses; and
- Stationery and computer consumables.

You do not need to set aside a part of your house exclusively for work to use this method. Also, more than one person in the house can use this method.

When using the 67 cents per hour method, you separately claim depreciation on the work-related portion of assets such as office furniture and technology (e.g. computers) as well as repairs to office equipment.

The 67 cents per hour method can also be used by individuals that operate some or all of their business from home.

## Important - records you must keep

If you want to use the new 67 cents per hour method, from 1 March 2023, you are required to keep actual records of the hours you work at home.

So, for the tax year ending 30 June 2023, you need to keep:

- A record which is representative of the total number of hours worked from home during the period from 1 July 2022 to 28 February 2023; and
- A record of the total number of actual hours you worked from home for the period 1 March 2023 to 30 June 2023. **An estimate of the hours in this period will not be accepted by the ATO. You must keep a daily record of the hours worked.**

Also, if you want to use the new 67 cents per hour method, you must keep at least one monthly or quarterly bill or other invoice to show that you actually incur expenses for energy, internet, phone, stationery and computer consumables. These records are not used to calculate your deduction. You retain the records to prove that you incur the expense. The ATO may ask you to produce these records.

## What is the best structure for owning an investment property?

The answer is going to depend on a range of factors, but there are some general rules you can apply.

If the property is likely to be ‘**negatively geared**’ (i.e. it is going to make a loss to start with), then the owner should be someone who earns other income against which this loss can be offset, i.e. the **highest income earner**. If you are a couple, then ideally the property is owned by the partner earning the highest income.

On the other hand, if the property is '**positively geared**' (i.e. the income generated by the property exceeds its costs), then ideally the owner is someone who is on a low marginal rate of tax, i.e. the **lowest income earner**. This is because the rental income will then be subject to lower rates of tax. If the property is owned by a high income earner, the additional rental income is subject to higher rates of tax.

For asset protection purposes, property should not be held in the name of a high risk professional such as a doctor or lawyer.

A **company** may be a suitable structure in certain situations to hold an investment property, but often is not the preferred structure as the 50% capital gains tax discount does not apply assets owned by a company.

Another option is to hold the property in a **discretionary family trust**. When a property is held in a discretionary trust you get to choose who receives the net income each year. So one year you can distribute the rental income to person A, and the next year to person B. If person A is working and person B is at home, then all of the net income would be directed to person B who will be paying tax at a lower rate. If things change down the track, and person B starts to earn more income than person A, you would then direct the net income to person A.

However, there are some downsides and tax complexities when holding property in a family trust:

- First, it may be **harder to get a loan** to buy a property in a discretionary trust. You need to discuss this with your bank or mortgage broker. That said, most banks these days understand and can accommodate a discretionary trust as the borrower.
- You also need to be careful if the property is going to be negatively geared for a period of time. If the property is in a trust and makes a net loss (taking into account all possible tax deductions, including depreciation and capital allowances) then **the loss is 'locked' in the trust and can only be offset** against future income (assuming *a family trust election has been made in the year the loss is incurred*).
- Another thing to consider is the impost of **land tax** – some states (including NSW) impose a higher level of land tax on properties held in a discretionary trust.
- The ATO has recently issued new guidance on income distributions made to beneficiaries where the income is not paid to the beneficiaries, but instead is either retained in the trust or the funds are used by or gifted to other persons (usually the controllers of the trust).

## Five Steps to go digital in 2023

The ATO has been providing more digital options for small business tax, super and employer obligations and has highlighted the following five steps that small businesses can take to start their digital journey in 2023:

**Step** **one**  
Register for the ATO's 'online services' to check due dates, lodge activity statements and keep track of super online.

**Step** **two**  
Sole traders can try out the ATO App, which assists in recording business income, recording and managing car trips and other expenses on the go and keeping track of deductions.

This information can then be sent to a tax professional at tax time.

**Step three**  
Make all ATO payments electronically.

**Step four**  
Find out about eInvoicing and Single Touch Payroll, as well as software solutions that will help with business activities such as record keeping and budgets and forecasting.

### **Step five**

Check and upgrade online security needs.

Click [here](#) for further information.

### **Point of sale systems on ATO radar**

The ATO has reaffirmed its commitment to tackling the use of electronic sales suppression tools ('ESSTs') after recent raids across Australia.

These tools are used to manipulate sales records, so a business can under-report its income and avoid paying the correct amount of tax.

ESSTs enable businesses to ring up sales before removing them from their tax records. Producing, supplying, using, or even just possessing an ESST is illegal and severe penalties can apply.

ESSTs can come in a variety of forms, including:

- an external device connected to a point of sale ('POS') system;
- software installed into a POS system;
- a feature or modification built into a POS system; or
- a service provided by a third party.

The ATO's website has also been updated to help businesses understand if their POS systems have been affected. Click [here](#) for further information.

[Click here to access the Australianbiz website](#)

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