

YOUR KNOWLEDGE



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Note: The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained.

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How good is ChatGPT at tax?

Not being paranoid or anything but we were curious about the skills of the latest innovation to take the world by storm, ChatGPT, and its ability to work with the Australian tax system.

Let's start by saying that we were impressed. Not so much by ChatGPT's ability to work with the complexities of the tax system, but for its tone and approach. The outcome from our testing, including the example below, is that you might end up with some general comments that are reasonably accurate, but you're unlikely to get an answer that can be relied on. And with most technical commentary tied up in personal advice rather than on the web where ChatGPT can explore it, it is unlikely that we will get there any time soon.

Here are the results of our test question and our commentary (ChatGPT's response is in italics).

Question: How much capital gains tax does an Australian resident pay on an investment property with a worked example.

ChatGPT: *An Australian resident pays capital gains tax (CGT) on the profit made from selling an investment property. The CGT is calculated by subtracting the cost of the property (purchase price plus any costs associated with acquiring and owning the property) from the sale price.*

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How good is ChatGPT at tax? Continued

For example, let's say an Australian resident purchased an investment property for \$500,000 and spent \$50,000 on costs associated with acquiring and owning the property (such as legal fees, stamp duty, and repairs). The total cost of the property is \$550,000.

The accountant: Let's stop there and take stock. There are some tricks and traps that need to be considered when working out an asset's cost base.

While repair costs in some cases can form part of a property's cost base, this is not always the case. The situation is often different where the asset being sold is an investment property that has been rented to tenants. When a landlord repairs damage that occurs while the property is rented to a tenant, this will often be deductible to the landlord at the time the repair costs are incurred. Because deductions are available for these repair costs, they should not also be included in the property's cost base.

There are also other adjustments that need to be considered. In the context of investment properties, it will often be necessary to make adjustments to the cost base to take into account capital works deductions. Landlords can often claim capital works deductions when an investment property is used to derive assessable rental income. The property's cost base should then be reduced by capital works deductions that have been or could be claimed by the landlord (although there is an exception to this if the property was acquired before 13 May 1997 and the cost of improvements was incurred by 30 June 1999).

The longer the period of ownership, the more likely that capital works deductions and repair costs can end up being quite significant and have a material impact on the capital gain calculation.

ChatGPT: *After several years, the resident decides to sell the property for \$700,000. The profit made from the sale is \$700,000 - \$550,000 = \$150,000.*

The CGT rate in Australia is currently at 45% and the resident will pay 45% of the \$150,000 profit, which is \$67,500.

The accountant: Let's take a closer look at that calculation. There is no CGT rate of 45% that applies specifically to capital gains. Net capital gains form part of an individual taxpayer's assessable income. This figure is then used to calculate the individual's taxable income for the relevant income year. If there is a positive taxable income figure, then we apply the individual's marginal tax rates.

One way of explaining this is that a higher taxable income normally results in a higher tax bracket and a higher rate of tax. In other words, the tax rate that applies to an individual's net capital gains is impacted by the individual's other income or losses (if any).

Also, while the highest marginal tax rate for individuals is currently 45 per cents for each dollar of taxable income above \$180,000, Australian residents are also normally subject to the Medicare levy of 2%. This should be considered and factored in.

ChatGPT: *It's worth noting that there are certain exemptions and reductions that can be applied to the CGT calculation, such as the main residence exemption and the small business CGT concessions.*

The accountant: If only tax was that simple! There are certain exemptions and reductions that can apply to capital gains. While the answer mentions the main residence exemption and the small business CGT concessions, these concessions do not normally apply to the sale of an investment property.

For the main residence exemption (or partial main residence exemption) to be available, one of the key conditions is that property would need to have been established and used as the individual's main residence. The exemption is unlikely to be available if the property has been used solely as an investment property to derive assessable rental income, although if the property was inherited then the position could be different.

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Full throttle in 2023

In a volatile market, keeping to a strategy, or let's face it creating one, can be tough.

The downside of not taking time out for your strategy is that there is a tendency to keep a short-term focus at an operational level to try and pick quick wins to generate financial returns. Sometimes in the process, this short-term focus undermines longer term value and returns.

Here are our 'must dos':

Know what your position is.

A business health check is an analysis of the current state of your business. It is an analytical review of its operation with view to providing a broad overview of operating performance and identifying potential issues. Understanding your position will reveal your risks and capacity to develop.

Know what to look for.

Once you know your position, the next question is what are the measures that are going to give you the best insight into business performance. In a volatile market, this information will give you what you need to make informed decisions at any one point in time.

Be prepared to make quick decisions.

If you know your position and have the data you need, be prepared to make quick decisions and take the first mover advantage. If you have the two elements above, you have your radar for identifying opportunities and mitigating risk. Most businesses are simply a replication of what they see. While the

pandemic and market instability is difficult, we have also seen a wave of innovation as people adapt to find solutions.

Don't bank on a single opportunity.

If COVID has taught us anything it is that things change, and we need to adapt and change with the circumstances. While one single opportunity might make all the difference, an overreliance on one product, service, or methodology of delivering those products and services, exposes you to risk.

Understand your end game.

What are you aiming for? Family empire? Fast growth and sale? Sustainable growth and sale as a retirement plan? Public listing? Even if you plan on simply running and growing your business for decades to come, that is a decision. Your end game and your progress towards that end game impacts your structure, focus, and decision making.

Document your strategy.

Document your strategy - knowing it in your head is not enough. This does not have to be an onerous *War & Peace* approach. It is understanding what you are aiming for, and breaking that down into measurable objectives, then into measurable outcomes and timeframes (preferably actionable against rolling 90 day plans). This approach also makes management meetings a lot more meaningful.

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Is ‘downsizing’ worth it?

From 1 January 2023, those 55 and over can make a ‘downsizer’ contribution to superannuation.

Downsizer contributions are an excellent way to get money into superannuation quickly. And now that the age limit has reduced to 55 from 60, more people have an opportunity to use this strategy if it suits their needs.

What’s a ‘downsizer’ contribution?

If you are aged 55 years or older, you can contribute \$300,000 from the proceeds of the sale of your home to your superannuation fund.

Downsizer contributions are excluded from the existing age test, work test, and the transfer balance threshold (but are limited by your transfer balance cap).

For couples, both members of a couple can take advantage of the concession for the same home. That is, if you and your spouse meet the other criteria, both of you can contribute up to \$300,000 (\$600,000 per couple). This is the case even if one of you did not have an ownership interest in the property that was sold (assuming they meet the other criteria).

Sale proceeds contributed to superannuation under this measure count towards the Age Pension assets test. Because a downsizer contribution can only be

made once in a lifetime, it is important to ensure that this is the right option for you.

Let’s look at the eligibility criteria:

- You are 55 years or older (from 1 January 2023) at the time of making the contribution.
- The home was owned by you or your spouse for 10 years or more prior to the sale – the ownership period is generally calculated from the date of settlement of purchase to the date of settlement of sale.
- The home is in Australia and is not a caravan, houseboat, or other mobile home.
- The proceeds (capital gain or loss) from the sale of the home are either exempt or partially exempt from capital gains tax (CGT) under the main residence exemption or would be entitled to such an exemption if the home was a post-CGT asset rather than a pre-CGT asset (acquired before 20 September 1985). Check with us if you are uncertain.
- You provide your super fund with the Downsizer contribution into super form (NAT 75073) either **before or at the time of making the downsizer contribution**.
- The downsizer contribution is made within **90 days of receiving the proceeds of sale**, which is usually at the date of settlement.
- You have not previously made a downsizer contribution to super from the sale of another home or from the part sale of your home.

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The ATO's final position on risky trust distributions

The ATO has released its final position on how it will apply some integrity rules dealing with trust distributions - changing the goal posts for trusts distributing to adult children, corporate beneficiaries, and entities with losses. As a result, many family groups will pay higher taxes because of the ATO's more aggressive approach.

Section 100A

The tax legislation contains an integrity rule, section 100A, which is aimed at situations where income of a trust is appointed in favour of a beneficiary, but the economic benefit of the distribution is provided to another individual or entity. For section 100A to apply, there needs to be a 'reimbursement agreement' in place at or before the time the income is appointed to the beneficiary. Distributions to minor beneficiaries and other beneficiaries who are under a legal disability are not impacted by these rules.

If trust distributions are caught by section 100A, this generally results in the trustee being taxed on the income at penalty rates rather than the beneficiary being taxed at their own marginal tax rates.

While section 100A has been around since 1979, until recently there has been relatively little guidance on how the ATO approaches section 100A. This is no longer the case and the ATO's recent guidance indicates that a number of scenarios involving trust distributions could be at risk.

For section 100A to apply:

- The present entitlement (a person or an entity is or becomes entitled to income from the trust) must relate to a reimbursement agreement.
- The agreement must provide for a benefit to be provided to a person other than the beneficiary who is presently entitled to the trust income; and

- A purpose of one or more of the parties to the agreement must be that a person would be liable to pay less income tax for a year of income.

High risk areas

Until recently many people have relied on the exclusions to section 100A which prevent the rules applying when the distribution is to a beneficiary who is under a legal disability (e.g., a minor) or where the arrangement is part of an ordinary family or commercial dealing (the 'ordinary dealing' exception). It is the ordinary dealing exception that is currently in the spotlight.

For example, let's assume that a university student who is over 18 and has no other sources of income is made presently entitled to \$100,000 of trust income. The student agrees to pay the funds (less tax they need to pay to the ATO) to their parents to reimburse them for costs that were incurred when the student was a minor. This situation is likely to be considered high risk if the student is on a lower marginal tax rate than the parents because the parents are receiving the real benefit of the income.

The ATO is also concerned with scenarios involving circular distributions. For example, this could occur when a trust distributes income to a company that is owned by the trust. The company then pays dividends back to the trust, which distributes some or all of the dividends back to the company. And so on. The ATO views these arrangements as high risk from a section 100A perspective.

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SMSF reporting changes from 1 July 2023

If you have an SMSF with a total balance of less than \$1 million, from 1 July 2023 you will need to report quarterly to the ATO instead of annually. Previously, SMSFs with a balance under \$1m reported annually at the same time as lodging the SMSF annual return.

Is 'downsizing' worth it continued

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Do I have to buy another smaller home?

The name 'downsizer' is a bit of a misnomer. To access this measure you do not have to buy another home once you have sold your existing home, and you are not required to buy a smaller home - you could buy a larger and more expensive one.

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The ATO's final position on risky trust distributions continued

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Where to from here?

If you have a discretionary trust, it will be important to ensure that all trust distribution arrangements are reviewed in light of the ATO's guidance to determine the level of risk associated with the arrangements. It is also vital to ensure that appropriate documentation is in place to demonstrate how funds relating to trust distributions are being used or applied for the benefit of the beneficiaries.

The ATO's new approach applies to entitlements before and after the publication of the new guidance but for entitlements arising before 1 July 2022, the ATO will not generally pursue these if they are either low risk under the new guidance, or if they comply with the ATO's previous guidance on trust reimbursement agreements.

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How good is ChatGPT at tax? Continued

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Also, the small business CGT concessions would not normally apply to the sale of an investment property. This is because the concessions can only apply if the asset passes an active asset test, which requires the property to have been used in qualifying business activities for a minimum period of time.

Assets used in a business carried on by the owner or certain related parties can often be treated as active assets for the purpose of these concessions, but there is a specific exception for assets used mainly to derive rent from unrelated parties.

If the property has been solely used to derive rent (even if used in a rental business) from unrelated parties, the property is likely to fail the active asset test and the small business CGT concessions shouldn't be available.

Interestingly, the answer didn't refer to the general CGT discount or indexation, which are the most likely concessions that would apply to a situation like this.

If the seller is an Australian resident (and not a temporary resident) during the period they owned the property and has owned the property for more than 12 months, the 50% CGT general discount would often be available to reduce the capital gain.

If the property was acquired before 21 September 1999, indexation of the cost base could be available instead. It would be necessary to compare both options to see which provides the more favourable result.

ChatGPT: *It is advisable to consult with a tax professional to determine the specific tax implications of selling an investment property.*

The accountant: Yes, indeed it is. Thank you ChatGPT.

Claiming deductions for working from home expenses

Prior to 1 July 2022, to calculate a deduction for expenses incurred as a result of working from home, taxpayers have the choice of using one of the following methods:

The Shortcut Method – allowed 80c per hour for each hour a taxpayer worked from home to calculate all their additional running expenses, such as electricity, gas, internet, mobile and home telephone expenses, all depreciation, stationery, computer consumables etc.

The Fixed Rate Method – allowed 52c per hour for each hour a taxpayer worked from home to calculate their electricity and gas expenses, office cleaning and depreciation of furniture and furnishings. In addition, a separate deduction for work related internet, mobile and home telephone, stationery and computer consumables and depreciation of computers, laptops and similar devices could be claimed.

Actual Expenses – that is, calculating the actual expenses incurred as a result of working from home.

From 1 July 2022, taxpayers can continue to claim their actual expenses or, alternatively, they can use the revised fixed rate method of 67c per hour for each hour they work from home. The rate per hour calculates the total of your deductible expenses for energy, internet, mobile and/or home telephone and stationery and computer consumables for the income year. This means you cannot claim an additional separate deduction for any of these expenses. For example, if you use your mobile when working from home and when you work from somewhere other than your home, your total deduction for the mobile phone expenses will be covered by the hourly rate of 67c per hour. However, the actual decline in value deduction for the depreciating assets used while working from home can be claimed separately, providing the requirements of Section 8-1 and Divisions 40 and 900 or Section 262A of the ITAA 1936 are satisfied.

We have provided an example adapted from the draft Practical Compliance Guideline (PCG) 2022/D4 to outline this.

The criteria for using the revised Fixed Rate Method consists of three parts:

1. You must actually be working from home on or after 1 July 2022. Minimal tasks such as occasionally checking emails or taking telephone calls while at home will not qualify.
2. You must incur the additional running expenses which are deductible under section 8-1 as a result of working from home. In circumstances where a third party (for example, an employer) reimburses you for your additional running expenses or is incurring the additional running expenses on your behalf, will not satisfy this criteria.
3. You must keep and retain relevant records in respect of the time you spend working from home and for the additional running expenses, such as invoices or bills in the name of the home owner. Where invoices or bills are in the name of one member of the household but the cost is shared, each member of the household who contributes to the payment of that expense will be taken to have incurred it. You must have records that show the total number of hours you worked from home during the income year and at least one invoice, bill or credit card statement for each of the additional running expenses you have incurred during the income year.

For the 2022-2023 income year, you need to keep:

- A record which is representative of the total number of hours worked from home during the period 1 July 2022 to 28 February 2023, and
- A detailed record of the total number of hours you worked from home for the period 1 March 2023 to 30 June 2023
- For energy, mobile and/or home telephone and internet expenses, you must keep one monthly or quarterly bill.
- For stationery and computer consumables you must keep the receipt for the item purchased.

For the 2023-24 and later income years, you must keep detailed records for the entire income year of the number of hours you worked from home during that income year. An estimate will not be accepted. A record of your hours for the income year can be in the form of: timesheets, rosters and a diary/log or similar document.

To assist keeping detailed records of hours working from home we have created a simple log for the period 1 March 2023 to 30 June 2023 which can be downloaded via our website: [daily log sheet](#).

Example as adapted from draft PCG 2022/D4

Piruntha is employed as software engineer. In November 2022, Piruntha's employer decides to give their employees some flexibility by allowing them to work from home. However, each employee must work from the office at least 3 days per week. Piruntha decides to take advantage of this arrangement and work at the office 3 days per week and from home 2 days per week. To work from home, Piruntha sets up a room in her home as an office.

On 1 December 2022, Piruntha purchases a laptop for \$1,499, a desk for \$250 and an office chair for \$299. She also purchases some stationery to use while she is working from home. On 6 December 2022, Piruntha commences working from home. When working from home, she uses the lights in her home office, as well as her laptop, her personal internet connection and her personal mobile phone (which she also uses when she is working at her employer's office and for private purposes).

Up until the end of February 2023, Piruntha uses her air conditioning to cool her home office and from around April 2023 until 30 June 2023, she uses her gas heating to warm the room.

Piruntha keeps a record of the time she spends working from home during the 2022–23 income year, which shows she worked a total of 560 hours at home. For a representative 4-week period, Piruntha keeps records which show that she uses her laptop, desk and office chair for around 5 hours per week while she is gaming and internet shopping and around 20 hours per week for work purposes.

Piruntha also keeps one quarterly invoice for her electricity and gas expenses, one monthly internet bill and one monthly mobile phone bill for the period 6 December 2022 to 30 June 2023. She also keeps the receipt for the stationery she purchased on 1 December 2022.

At the end of the 2022–23 income year, Piruntha determines that she meets all the criteria set out in paragraph 18 of PCG 2022/D4 because she:

- Is working from home to carry out her employment duties
- Has incurred additional running expenses as a result of working from home, and
- Has retained the relevant records.

As such, she decides to calculate her additional running expenses using the revised fixed-rate method.

First, Piruntha multiplies the total number of hours she worked from home by the hourly rate. Her calculation is:

$$560 \text{ hours} \times 67\text{c per hour} = \$375.20.$$

This is Piruntha's deduction for her electricity, gas, mobile phone, internet and stationery expenses.

As the desk and office chair Piruntha purchased cost less than \$300, she can claim the full purchase price of them in the 2022–23 income year. However, she must reduce her deduction for her private use of those items.[35] Piruntha works out her private and work-related use of her depreciating assets as follows:

$$\begin{aligned}\text{Time spent using assets for work} &= 20 \text{ hours per week} \\ \text{Time spent using the assets for private purposes} &= 5 \text{ hours per week} \\ \text{Total hours assets used per week} &= 25 \text{ hours} \\ 5 \text{ hours per week} \div 25 \text{ hours per week} &= 20\% \text{ private use} \\ 20 \text{ hours per week} \div 25 \text{ hours per week} &= 80\% \text{ work-related use.}\end{aligned}$$

The decline in value deduction (related to her work-related use) for the desk and chair is:

$$\begin{aligned}\$250 \times 80\% &= \$200 \\ \$299 \times 80\% &= \$239.20\end{aligned}$$

To calculate the decline in value of her laptop, Piruntha uses the depreciation and capital allowances tool on the ATO's website and chooses to use the diminishing value method. The tool calculates the decline in value of the laptop as:

<i>Income year</i>	<i>Opening adjustable value</i>	<i>Decline in value (using diminishing value method)</i>	<i>Taxable use</i>	<i>Deductible decline in value</i>	<i>Adjustable value at end of year</i>
2022-23	\$1,499	\$870.65	80%	\$696.52	\$628.35

To work out the total amount of her deduction for the additional running expenses she incurred as a result of working from home during the 2022-23 income year, Piruntha adds the amount calculated using the hourly rate to the work-related decline in value of her laptop, desk and chair. This is calculated as:

$$\$375.20 + \$200 + \$239.20 + \$696.52 = \$1,510.$$

When she lodges her 2022-23 tax return, Piruntha includes a deduction of \$1,510 for her working from home expenses at the other work-related expenses question.

Even though Piruntha also uses her personal mobile phone for work when she is in the office, she cannot claim any additional deduction for this work-related use of her phone in her 2022-23 income tax return.

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