

# client alert | explanatory memorandum

November 2021

## CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 22 October 2021.

## ATO scrutinising gifts or loans from overseas

The ATO has recently issued an alert warning taxpayers against disguising undeclared foreign income as gifts or loans from related overseas entities, including family and friends. It says it has continued to encounter situations where Australian resident taxpayers have derived amounts of income or capital gains offshore that are assessable, but the taxpayers have failed to declare the amounts in their income tax returns.

Individuals who are Australian residents for tax purposes should remember that their worldwide income, as well as certain profits derived by offshore entities they control, is assessable income for Australian tax purposes.

The ATO will now be looking closely at arrangements where taxpayers are aware of their residency status and the tax implications that flow from it, but attempt to avoid or evade tax of their foreign assessable income by concealing the character of the funds upon repatriation to Australia by disguising the amounts as either gifts or loans from a related overseas entity.

Whether or not a gift or loan is genuine depends upon the following criteria being satisfied:

- the characterisation of the transaction as a gift or loan is supported by appropriate documentation;
- the behaviour of the parties is consistent with that characterisation; and
- the monies provided are sourced from funds genuinely independent of the gift or loan receiver.

If family or friends who reside overseas have provided a genuine gift to an individual or their business, it is prudent for them to keep supporting documents such as:

- any declarations the donor has made in their country of residence about the nature of the amounts transferred;
- an executed contemporaneous deed of gift prepared by the donor;
- formal identification of the donor (eg a copy of their photo identification from their passport or identity card);
- a copy of the donor's bank statements showing the gift and donor's wealth before they made the gift; and
- financial records reflecting the donor's transfer.

Gifts also include inheritances. Where an inheritance is received, a certified copy of the donor's will or a distribution statement for the estate should be a part of the recordkeeping.

In relation to genuine loans from overseas entities made to help start up a business or to acquire income-producing assets, supporting documents may include the following:

- a properly documented loan agreement that details parties to the loan, date, amount, interest rate, frequency of repayments and terms of the loan;
- correspondence relating to the loan, such as pre-contractual negotiation communications or variations made post-agreement);
- documents in relation to security or guarantees provided;
- arrangements governing the drawdown and transmission of funds;
- financial records showing advance of funds and subsequent repayments, including interest and principal payments over the loan term;
- financial and accounting records showing how the loan amounts were used; and
- documents showing the payment of withholding tax.

If there is any uncertainty about whether particular amounts are genuine gifts or loans, the ATO has said it will form a view based on all the available evidence – therefore, keeping contemporaneous and complete

records is strongly recommended. The ATO notes that a deed of gift or a statutory declaration (provided either by the donor or the receiver) may not be accepted as conclusive evidence.

## **New data matching program: government payments**

A new data matching program designed to identify and address non-compliance with tax and super obligations is under way in relation to government payments for the 2018–2019 to 2022–2023 income years. In essence, it covers most services that the Commonwealth Government pays third-party program providers to deliver.

Specifically, data will be obtained from the following agencies in relation to these programs that they deliver:

- Comcare – services provided under the *Safety Rehabilitation and Compensation Act 1988*;
- Department of Education, Skills and Employment – VET FEE-HELP scheme, VET student loans program, child care subsidy, employment services;
- Department of Health – aged care subsidy, hearing services program, Commonwealth home support program;
- National Disability Insurance Agency – National Disability Insurance Scheme (NDIS);
- National Indigenous Australian Agency – Indigenous Advancement Strategy;
- Department of Home Affairs – youth transition support services, national community hubs, humanitarian settlement program, Australian cultural orientation program, adult migrant English program, free translating service, and settlement engagement and transition support program;
- Department of Veterans' Affairs – health treatment program; and
- clean energy regulator – large-scale renewable energy target and small-scale renewable energy scheme.

The wide-ranging nature of this program is designed to identify and address non-compliance with tax and super obligations by service providers receiving government payments or helping deliver the specified programs. The data collected will enhance the information the ATO currently receives from government entities through the taxable payments annual report (TPAR).

This means that contractors, subcontractors and consultants in any type of business structure (sole trader, company, partnership or trust) that receive payments from government under any of these programs may be subject to extra scrutiny.

Service provider identification details obtained under the program will vary depending on whether they are individuals or entities. For individuals and sole traders, basic details collected will include names (first and last), dates of birth, addresses (residential, postal, etc), ABNs, service types, email addresses and phone numbers. For entities, basic details collected will include service provider business names, addresses (business, postal, registered, etc), ABNs, ACNs, organisation or service types, contact names, email addresses and phone numbers.

Payment information obtained under the program will consist of service provider IDs, names of services, types of services (linked to programs), value of payments received for the relevant financial years, counts and types of claims, and withholding and re-credit amounts.

It is estimated that 36,000 service providers will be captured under this program each financial year; of that number, approximately 11,000 will be individuals and the rest will be companies, partnerships, trusts and government entities.

The ATO will be checking the registration obligations of third-party providers (ABNs, TFNs, GST and PAYG withholding) as well as lodgment obligations (outstanding income tax, BAS and FBT returns). It will also look at whether service providers have correctly reported income, comparing the data obtained against income records, and will check for any outstanding tax and super debts and assess the entity's ability to pay those debts.

Source: [www.ato.gov.au/General/Gen/Government-Payments-Program/](http://www.ato.gov.au/General/Gen/Government-Payments-Program/)  
[www.legislation.gov.au/Details/C2021G00763](http://www.legislation.gov.au/Details/C2021G00763)

## **Do you need a Director Identification Number?**

Directors of companies will soon have to enrol in the Director Identification Number regime. This requires current and future directors to apply for director identification numbers (DIN) which will be permanently linked to the individual, even if they are no longer a director. It is hoped the regime will make it easier to trace relationships across companies and reduce instances of phoenixing and other illegal activity. Most existing directors will have until 30 November 2022 to apply for the DIN through the ATO.

The Director Identification Number regime came into force late in 2020 as a tool for the Federal Government to reduce phoenixing and black economy activities. Broadly, the regime will require all directors to confirm

their identity with the ATO, at which time they will be issued a unique identifier. This identifier will then be permanently linked to the individual, even if they cease to be a director.

The Government has recently introduced an instrument that extends the time available for persons who are eligible officers immediately before the commencement of the obligations to apply for a DIN. Individuals that operate under the *Corporations Act 2001* and became a director on or before 31 October 2021 are required to apply for a DIN before the end of the transitional period, which is between 4 April 2021 and 30 November 2022.

Directors who operate under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* and became a director on or before 31 October 2021 will have even more time to apply for a DIN – until 30 November 2023 (with a transition period between 4 April 2021 and 30 November 2023). Any individuals who are appointed directors between 1 November 2021 and 4 April 2022 will have within 28 days of their appointment to apply for the DIN, and from 5 April 2022 individuals seeking to become directors will need to apply for a DIN before their appointment.

It is envisaged that the DIN will provide traceability of a director's relationships across companies, enabling better tracking of directors of failed companies and preventing the use of fictitious entities. It will also assist regulators to investigate a director's involvement in what may be repeated unlawful activity, including illegal phoenixing.

The Australian Securities and Investments Commission (ASIC) and external administrators will also benefit, saving time and money, as the DIN will make it simpler to track the corporate history of various directors and assist liquidators in improving the efficiency of the insolvency process. The DIN is also expected to protect individuals against the fraudulent use of stolen identities to set up companies, and is expected to improve overall data integrity and security.

To prevent abuse of the regime, any conduct that undermines the DIN requirement will be subject to civil and criminal penalties. This includes deliberately providing false identity information, intentionally providing a false DIN or intentionally applying for multiple DINs.

Directors will be able to use the new Australian Business Registry Services (ABRS) online services to register from 1 November 2021.

Sign-ins and director identity verification will be conducted using the myGovID app. This app requires a compatible smart device and will require an individual to enter personal details and verify at least two Australian identity documents (drivers licence, birth certificate, citizenship certificate, passport, etc) to obtain the "standard identity strength". The "strong identity strength" which is currently in testing phase will require the completion of an additional face verification check.

Source: [www.legislation.gov.au/Details/F2021L01391](http://www.legislation.gov.au/Details/F2021L01391)

[www.ato.gov.au/General/Gen/Modernising-Business-Registers/](http://www.ato.gov.au/General/Gen/Modernising-Business-Registers/)

[www.abrs.gov.au/director-identification-number/who-needs-apply-and-when](http://www.abrs.gov.au/director-identification-number/who-needs-apply-and-when)

## **COVID-19 relief for SMSFs extended**

Due to the ongoing economic impacts of COVID-19 on large parts of Australia, the ATO has announced the extension of various COVID-19 relief measures for trustees of self managed superannuation funds (SMSFs). The relief previously only applied to the 2019–2020 and 2020–2021 financial years, but will now also be available for the 2021–2022 financial year.

### **SMSF residency test**

To be a complying super fund and receive tax concessions, SMSFs must be an "Australian super fund" at all times during the year. This requires, among other things, for the central management and control of the SMSF (ie individual trustees, or directors of a corporate trustee) to ordinarily be in Australia. Under the relief, a fund will still meet this requirement even if its central management and control is temporarily outside of Australia for up to two years.

Obviously, with the Australian borders pretty much closed during the entirety of the pandemic, and many other countries imposing travel bans, some individual trustees or directors of a corporate trustee may be stranded in another country over the two-year limit through no fault of their own. In these situations, provided there are no other changes in the SMSF or in the circumstances of the individual trustee (or directors of the corporate trustee) affecting other residency conditions, the ATO has indicated it will not apply compliance resources to determine whether a fund meets the residency test.

### **Rental relief**

If an SMSF or a related party has continued to provide rental relief based on the current market conditions, whether it be a rental reduction, waiver or deferral to a tenant, the ATO will provide relief in the form of not taking any compliance action against the fund. However, this is predicated on the rental relief being offered on commercial terms, and there being proper documentation with regards to the arrangement.

The ATO notes that not taking compliance action is only an interim measure. In due course it will be making a formal determination, similar to the one made in 2020, to ensure that rental deferrals offered by SMSFs or related parties to their tenants does not cause a loan or an investment to be an in-house asset in the current and future financial years.

### **Loan repayment relief**

For loan repayment relief provided by an SMSF to a related or unrelated party due to the financial impacts of COVID-19, where the relief is offered on commercial terms and the changes to the loan agreement are properly documented, the ATO will provide relief on similar terms as the interim rental relief – that is, it will not take any compliance action against the fund. This will also apply to limited recourse borrowing arrangements (LRBAs).

### **In-house assets**

Where an SMSF exceeds the 5% in-house asset threshold at 30 June 2021 due to the financial impacts of COVID-19, trustees must still prepare a written plan to reduce the market value of the fund's in-house assets to below 5% by 30 June 2022. However, the ATO has said it will not take any compliance action where the plan has not been executed by the due date (30 June 2022) as a result of the market not having recovered, or in some cases the plan may be unnecessary owing to the recovery of the market.

### **PAYG variations**

The ATO has also confirmed that its penalty and interest relief for excessive PAYG variations applies to SMSFs that continue to be impacted by COVID-19 during 2021–2022. The ATO will not apply penalties or interest for excessive variations of PAYG instalments during the 2021–2022 income year, provided that the taxpayer has taken reasonable care to estimate their end-of-year tax.

This ATO concession for penalties and interest applies to 30 June ordinary balancers for the 2021–2022 income year and entities that have been granted a substituted accounting period (SAP). For an entity with a SAP, any variation must relate to instalments made during the 2021–2022 income year.

A PAYG instalment variation requires a reasonable and genuine attempt to determine the liability. When considering if a genuine attempt has been made, the ATO takes into account what a reasonable person would have done in the taxpayer's circumstances.

The ATO notes that PAYG variations do not carry over into the new income year. Therefore, if a taxpayer made variations in the 2020–2021 income year, they may need to vary again in 2021–2022. The varied amount or rate then applies for all of the taxpayer's remaining instalments for the income year, or until they make another variation.

The ATO encourages PAYG instalment payers to review their tax position regularly and vary the PAYG instalments as their situation changes. Taxpayers who realise they have made a mistake working out their PAYG instalment can correct it by lodging a revised activity statement or varying a subsequent instalment.

If a taxpayer is unable to pay an instalment amount, the ATO requires them to still lodge an instalment notice and discuss a payment arrangement with the ATO so that they don't have a debt at the end of the year.

### **Audits**

The ATO has also extended to 2021–2022 its existing COVID-19 relief in the Addendum to the Auditor/actuary contravention report (ACR). The ACR relief for 2021–2022 will apply for:

- rental relief (including rental reductions, waivers and deferrals);
- loan repayment relief (including for LRBAs); and
- in-house assets.

Approved SMSF auditors need to refer to the Addendum when determining whether a contravention arises because of the relief, when to report a contravention to the ATO via an ACR for the 2021–2022 financial year, and what evidence to obtain from the trustees to support the relief. In summary, SMSF auditors need to check that:

- rental relief is offered on commercial terms due to the financial impacts of COVID-19 (having regard to relevant state and territory COVID-19 support measures) and the arrangement is appropriately documented;
- loan repayment relief is offered on commercial terms due to the financial impacts of COVID-19 (having regard to the terms of relief offered by commercial lenders), and the changes to the loan agreement are properly documented;
- funds that exceeded the 5% in-house asset threshold at 30 June 2021 due to the financial impacts of COVID-19 have prepared a written plan to reduce the market value of the fund's in-house assets to below 5% by 30 June 2022.

The ATO has said that SMSF auditors need to use their professional judgment when determining whether relief is offered on commercial terms due to the financial effects of COVID-19. If there is insufficient appropriate evidence to support the relief, including that it is offered on commercial terms, SMSF auditors should report this via an ACR where the reporting criteria are met.

### ***Audit opinion modifications***

The existing ACR Addendum notes that auditors may still need to modify their opinion in Part B of the audit report where they identify any material breach of the provisions and regulations listed within the audit report, even if those breaches have arisen from the impacts of COVID-19 in circumstances where the ATO will not be taking compliance action against them. Even where a modification is not necessary, for example because the auditor forms an opinion that the contravention is not material, the auditor must still notify the trustee of these contraventions. This could be done in the management letter to the trustee.

The ATO also recommends that auditors add to the management letter that the ATO will not be taking any compliance action against these contraventions for the 2019–2020, 2020–2021 and 2021–2022 financial years. All other contraventions identified in the fund need to be reported to the trustee in the management letter and reported to the ATO in the ACR where the reporting criteria are met.

### ***Arm's length terms must be documented***

The ATO relief generally only applies where a landlord has “acted in good faith” and agreed that the tenant can defer payment of rent on arm's length terms during one or all of the 2019–2020, 2020–2021 and 2021–2022 income years in order to ease the financial hardship caused by COVID-19.

The National Cabinet Mandatory Code of Conduct (or any relevant state-based codes or legislation) may assist in assessing whether the rental deferral has been negotiated in good faith and on arm's length terms.

There must also be contemporaneous documentation reflecting the arm's length terms and that the lease remains enforceable. Any deferred amounts must also be repaid by the tenant as soon as practicable.

Source:

[www.pm.gov.au/sites/default/files/files/national-cabinet-mandatory-code-ofconduct-sme-commercial-leasing-principles.pdf](http://www.pm.gov.au/sites/default/files/files/national-cabinet-mandatory-code-ofconduct-sme-commercial-leasing-principles.pdf)

[www.service.nsw.gov.au/campaign/covid-19-help-businesses/covid-19-assistance-commercial-and-residential-landlords](http://www.service.nsw.gov.au/campaign/covid-19-help-businesses/covid-19-assistance-commercial-and-residential-landlords)

[www.vsvc.vic.gov.au/your-rights-and-responsibilities/retail-tenants-and-landlords/](http://www.vsvc.vic.gov.au/your-rights-and-responsibilities/retail-tenants-and-landlords/)

[www.ato.gov.au/Super/Sup/Varying-your-pay-as-you-go-instalments-due-to-COVID-19/](http://www.ato.gov.au/Super/Sup/Varying-your-pay-as-you-go-instalments-due-to-COVID-19/)

[www.ato.gov.au/Forms/Auditor-actuary-contravention-report-instructions/?anchor=AddendumAuditorContraventionReportingins#AddendumAuditorContraventionReportingins](http://www.ato.gov.au/Forms/Auditor-actuary-contravention-report-instructions/?anchor=AddendumAuditorContraventionReportingins#AddendumAuditorContraventionReportingins)

[www.ato.gov.au/Super/Sup/COVID-19-relief-in-ACR-Addendum-extended-to-2021-22-financial-year/](http://www.ato.gov.au/Super/Sup/COVID-19-relief-in-ACR-Addendum-extended-to-2021-22-financial-year/)

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