— Opinion

ATO targets 'gifts' from overseas

Taxpayers are on notice that unless they are meticulous in documenting perfectly legal arrangements, they may find their windfall treated as assessable income.

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As Richard Nixon once said, "people react to fear, not love". It's a fitting aphorism for the latest alert from the Australian Tax Office (TA 2021/2): Disguising undeclared foreign income as gifts or loans from related overseas entities, which continues the ATO's long-running war on undisclosed offshore income.

The focus of the alert is on the creative strategies being employed by taxpayers to evade their tax obligations, including by concealing foreign assessable income under the guise of receiving a gift or loan from a foreign entity.

The ATO is undertaking reviews and audits of this category of tax evader, based on rich data now available to it from a variety of sources that include: information exchanges afforded through double tax agreements, AUSTRAC data on movements of funds, and data extracted under the Common Reporting Standard and the US Foreign Account Tax Compliance Act.

The alert directly confirms that taxpayers who have not derived any foreign income and have received a genuine gift or loan from a family member overseas should not be concerned. But, in the same breath, the ATO qualifies that exclusion by stating that "a genuine gift is one where, among other things, the gift or loan is supported by appropriate documentation". This is where the alert becomes problematic.

Before expanding on some of the ATO's somewhat impractical expectations, let's back pedal to consider the commissioner's increasingly well-resourced focus on international tax evasion.

Casting our mind back to March 2014, we had Project Do It, whereby the ATO undertook a high-profile amnesty that allowed Australian taxpayers to voluntarily disclose (undeclared) offshore income in return for a range of administrative concessions on the period-of-review, penalties and shortfall interest.

Since Project DO IT, concessions have been few and far between, and the commissioner has been engaged in a co-ordinated, global assault on tax evasion, including tax havens. But let's not mince words here, the ATO has been justified in acting against individuals who cheat the tax system and the result speaks for itself.

Global crackdown

At a domestic level, the ATO-led Serious Financial Crimes Taskforce has recovered $510 million arising from serious financial crime activities, including offshore tax evasion.

The ATO has also embraced the global effort through partnerships with the Joint Chiefs of Global Tax Enforcement (J5), the OECD and the Joint International Taskforce on Shared Intelligence and Collaboration. These partnerships have, in recent years, resulted in over 2500 exchanges of information which has raised additional tax liabilities of $1 billion.

Among the other tools at the ATO's disposal, are its various information exchange powers and its network of international treaties and information exchange agreements. The first data exchange took place under the Common Reporting Standard, culminating in the ATO's announcement in August 2019, that it was in possession of data relating to 1.6 million offshore accounts holding over $100 billion.

And of course, we can't forget the opportunistic data leaks that were the Panama Papers and Paradise Papers, unveiling the tax secrets of the "super rich" and encouraging the introduction of the tax whistleblower regime.

So, as a backdrop to last week's alert, the commissioner already has eyes and ears on the ground across the globe that arms him nicely to identify, at a granular level, any and all funds that have been transferred into Australia from offshore.

This brings us back to the kind of documentation now required to demonstrate that the money deposited into your bank account last week was a gift from your long-lost aunt in Switzerland.

Documentary proof

The alert offers some commentary on what the ATO considers to be "appropriate documentation", which varies depending on the size of the gift and the nature of the relationship between the parties.

Larger gifts, or in circumstances of "atypical relationships", a contemporaneous Deed of Gift would be required, along with evidence of the gift-giver's capacity to make the gift.

For a genuine loan, the ATO expects that there would be a "properly documented" loan agreement, and that principal and interest are repaid over time.

The ATO is often content to throw on taxpayers the burden of proving (to the ATO's satisfaction) that an amount transferred is a "genuine gift" or a "genuine loan", failing which the amount is simply treated as ordinary income. If the transfer of funds from overseas gives rise to a genuine suspicion that tax on foreign gains has been evaded, then that conduct ought to be investigated to ensure that any under-reported gains are brought to tax.

However, the legal necessity of the documentation expected by the ATO (and the requirement for ongoing interest and principal to be repayable on a loan) is debatable, and we would hope that the ATO will keep in mind the distinction between prudent record keeping and the requirements of the law. Notwithstanding that the law does not technically require a gift or loan to be documented or implemented in the manner set out by the ATO – and nor is the average wealthy foreign aunt likely to consider or welcome the prospect – it would be judicious for taxpayers to take the ATO's advice to heart.

Taxpayers should consider themselves on notice that unless they are meticulous in documenting perfectly legal arrangements, they may well find the windfall from auntie treated as assessable income.

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