TD 2005/D38 - Income tax: foreign exchange: when calculating the amount of any gain or loss on disposal or redemption of a traditional security denominated in a foreign currency should the amounts relevant to the calculation be translated (converted) into Australian dollars when each of the relevant events takes place?

This document has been finalised by TD 2006/30.

Draft Taxation Determination

Income tax: foreign exchange: when calculating the amount of any gain or loss on disposal or redemption of a traditional security denominated in a foreign currency should the amounts relevant to the calculation be translated (converted) into Australian dollars when each of the relevant events takes place?

Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. Yes, provided that item 12 of subsection 960-50(6) of the *Income Tax Assessment Act 1997* (ITAA 1997) does not apply.[1]

Explanation

2. Generally, a gain on the disposal or redemption of a traditional security is included in the taxpayer's assessable income under subsection 26BB(2) of the *Income Tax Assessment Act 1936* (ITAA 1936), and a loss is deductible to the taxpayer under subsection 70B(2) of the ITAA 1936.[2]

3. Subsection 960-50(1) of the ITAA 1997 requires an amount of foreign currency to be translated into Australian currency. Therefore, where a traditional security is denominated, acquired, and sold, in a foreign currency, the resulting gain or loss on the disposal or redemption must be determined in Australian dollars. The timing of the translation (conversion) of the relevant amount from the foreign currency into Australian currency is determined by applying the rules set out in the relevant item of the table in subsection 960-50(6) of the ITAA 1997.

[1] The consequences of choosing to use item 12 are not considered in this Determination.
[2] However, there may be circumstances where sections 26BB and 70B do not apply. For example, both sections contain express exclusions (see subsections 26BB(3) to (5) and subsections 70B(2A) to (4)).

4. There are two items in the table in subsection 960-50(6) of the ITAA 1997 that could apply to the gain made upon disposal or redemption of a traditional security. Item 7 applies to an amount of statutory income. It requires the translation to be made when the amount was required to be included in assessable income. Item 11 applies to amounts where no other item in the table applies. It requires translation at the time of the receipt or payment.

5. An application of the rules in item 7 would result in the amount of the gain being translated when the disposal or redemption occurs. That is, the amount translated would be the gain as calculated in the foreign currency, rather than first translating the individual elements of the gain (the cost and disposal price), and then calculating the gain. However, using the rules in item 7 to determine the timing of the translation in respect of a gain on the disposal or redemption of a traditional security would be inconsistent with subsection 960-50(4). Under that subsection, when translating an amount that is itself the result of another calculation, the taxpayer must first translate the elements in that calculation.

6. The Explanatory Memorandum to the Bill[3] that introduced subsection 960-50(4) makes it clear that when translating the amount of gain or loss made on the disposal or redemption of a traditional security each element is to be separately translated. Paragraph 3.20 of the Explanatory Memorandum states:

> In some cases an amount which is taken into account for tax purposes, for example an amount of income or a deduction is the sum or the result of 2 or more other amounts. An example is an amount included in assessable income under section 26BB of the ITAA 1936 or a deduction under section 70B of the ITAA 1936. Any amounts which are elements in the calculation of another amount are to be translated prior to calculating the other amount. *[Schedule 4, item 59, subsection 960-50(4)].*

7. Item 7 cannot apply to the loss on disposal or redemption of a traditional security as it only applies to statutory income. Item 11 is the only relevant item for such a loss. Therefore the treatment of the gain on the disposal or redemption of the traditional security using the rule in item 11 would be consistent with the treatment of a loss upon the disposal or redemption of such a security.

8. Thus, in calculating the gain or loss on the disposal or redemption of the traditional security, comparison must be made between the cost of acquisition of the traditional security (translated into Australian dollars on the date the taxpayer pays for the traditional security) and the proceeds received on disposal or redemption (translated on the date the taxpayer receives payment for the traditional security).

Example

9. *On 21 January 2005 an Australian resident taxpayer acquires and pays for a 10 year United States (US) Treasury bond with a face value of US$40,000. The exchange rate on this day is A$1.00 = US$0.80[4]. The bond is subsequently disposed of on 15 July 2005 for its face value (ie. US$40,000). The exchange rate on this day is A$1.00 = US$0.64. The US Treasury bond is a traditional security, and the acquisition and disposal is not a business transaction.*

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[3] New Business Tax System (Taxation of Financial Arrangements) Bill (No. 1) 2003

[4] Hypothetical, not actual, exchange rates are used in this example.

10. *Subsection 960-50(6), item 11, of the ITAA 1997 requires that the payment made for the traditional security be translated at the exchange rate prevailing at the time of payment, 21 January 2005. The cost is A$50,000 (US$40,000/0.80).*

11. *Item 11 also requires the amount received on disposal of the bond to be translated into Australian currency at the exchange rate prevailing at the time of receipt, 15 July 2005. The amount received is A$62,500 (US$40,000/0.64).*

12. *Applying the translation rules in subsections 960-50(4) and 960-50(6) of the ITAA 1997, a difference of A$12,500 arises.*

Date of Effect

13. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Your comments

14. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

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Commissioner of Taxation
12 October 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- foreign currency translation
- forex realisation event
- traditional security

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 26BB
- ITAA 1936 26BB(2)
- ITAA 1936 26BB(3)
- ITAA 1936 26BB(4)
- ITAA 1936 26BB(5)
- ITAA 1936 70B
- ITAA 1936 70B(2)
- ITAA 1936 70B(2A)
- ITAA 1936 70B(2B)
- ITAA 1936 70B(2C)
- ITAA 1936 70B(3)
- ITAA 1936 70B(4)
- ITAA 1997 960-50(1)
- ITAA 1997 960-50(4)
- ITAA 1997 960-50(6)
- New Business Tax System (Taxation of Financial Arrangements) Act (No. 1) 2003 Sch 4 item 59

Other references:

- Explanatory Memorandum to the New Business Tax System (Taxation of Financial Arrangements) Bill (No. 1) 2003

ATO references

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