TD 93/D223 - Income tax: does Division 3B of Part III of the Income Tax Assessment Act 1936 (Division 3B) apply to ordinary shares denominated in foreign currency?

This document has been finalised by TD 94/88.

Draft Taxation Determinations (TDs) represent the preliminary, though considered, views of the ATO. Draft TDs may not be relied on; only final TDs are authoritative statements of the ATO.

Draft Taxation Determination

Income tax: does Division 3B of Part III of the *Income Tax Assessment Act 1936* (Division 3B) apply to ordinary shares denominated in foreign currency?

1. No. The ownership of ordinary shares does not give the shareholder a foreign exchange rate exposure in the terms contemplated by Division 3B. It is not a contract to which Division 3B applies.

2. Division 3B allows income tax deductions for foreign exchange losses of a capital nature and treats as assessable income corresponding foreign exchange gains realised after 18 February 1986 under contracts entered into after that date. The losses are deductible and gains are assessable to the extent to which they relate to the production of assessable income or to the carrying on of a business for that purpose.

3. The general principles concerning the realisation of foreign exchange gains and losses are stated in Taxation Ruling TR93/8. If a foreign exchange gain or loss arises from a liability in a foreign currency, the taxpayer realises the gain or loss when the liability is discharged by actual or constructive payment. Conversely, if a foreign exchange gain or loss arises from a right to receive foreign currency, the taxpayer realises the gain or loss on the actual or constructive receipt.

4. The ownership of ordinary shares makes the shareholder a member of the company. Each member of the company has a contractual relationship with the company by virtue of the Memorandum and Articles of Association of the company: *Corporations Law 1990*, subsection 180(1).

5. However, there is generally no provision in the Memorandum or Articles for ordinary shareholders to pay or receive specified amounts in either Australian or a foreign currency on a specified day or days. As such, the Memorandum and Articles do not of themselves give rise to an exchange rate exposure to which Division 3B applies.

6. Consequently, ownership of ordinary shares does not constitute a contract to which Division 3B applies. Accordingly, any gain or loss on disposal of shares or on a return of capital would generally be determined under the capital gains provisions of Part IIIA of the *Income Tax Assessment Act 1936* (Part IIIA). This approach is consistent with the Treasurer's Press Release of 18 February 1986 which said that:

> "where an asset such as ... shares is sold overseas by an Australian taxpayer, exchange rate gains or losses ... will be taken into account under the CGT arrangements."

Example:

An Australian resident, R, was issued ordinary shares in USA Corporation (a foreign company) on 31 December 1987 for US$10,000 (equivalent to AUS$13,870, assuming that the exchange rate was 0.721 at that date). Subsequently, USA Corporation went into voluntary liquidation and on 31 December 1990 made a distribution of shareholders funds which included paid up capital. R received a return of paid up capital of US$10,000 (converted to AUS$12,945, assuming that the exchange rate was 0.7725 at that date). The loss of AUS$925 is not deductible under Division 3B. However, the provisions of Part IIIA would apply in determining the amount and timing of a deduction for the capital loss incurred.

Commissioner of Taxation
2/9/93

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