TD 2006/30 - 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?

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?

This Ruling provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

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

Example

2. *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.*[2] *The bond is subsequently disposed of on 15 July 2005 for its face value (that is US$40,000). Payment is also received on 15 July. 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.*

3. *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).*

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[1] The consequences of choosing to use item 12 are not considered in this Determination.
[2] Hypothetical, not actual, exchange rates are used in this example.

4. *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).*

5. *Applying the translation rules in subsections 960-50(4) and 960-50(6) of the ITAA 1997, a difference of A$12,500 arises.*[3]

Date of effect

6 This Determination applies to years commencing both before and after its date of issue, but it will only apply to transactions that occur on or after the applicable commencement date for section 960-50 of the ITAA 1997. Under section 960-55 of the ITAA 1997 the applicable commencement date for section 960-50 for most taxpayers is the first day of the 2003-2004 income year, or, if that date is earlier than 1 July 2003, the first day of the 2004-2005 income year. 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.

Commissioner of Taxation
26 April 2006

[3] It is then necessary to determine how much of this difference is subject to subsection 26BB(2) of the ITAA 1936 or the provisions of Division 775 of the ITAA 1997.

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Explanation

7 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.[4] The provisions of Division 775 of the ITAA 1997 may also apply to a gain or loss made on the disposal or redemption of a traditional security denominated in a foreign currency. This Determination does not deal with the issue of how much, if any, of a gain or loss made on disposal or redemption is subject to the operation of subsection 26BB(2) or subsection 70B(2) of the ITAA 1936, or the provisions of Division 775 of the ITAA 1997. This Determination is instead concerned with explaining the two step calculation process required by section 960-50 of the ITAA 1997.

8 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.

9 There are two items in the table in subsection 960-50(6) of the ITAA 1997 that could potentially 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.

10 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) of the ITAA 1997. 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.

[4] However, there may be circumstances where sections 26BB and 70B of the ITAA 1936 do not apply. For example, both sections contain express exclusions (see subsections 26BB(3) to (5) and subsections 70B(2A) to (4) of the ITAA 1936).

11 The Explanatory Memorandum to the Bill[5] that introduced subsection 960-50(4) of the ITAA 1997 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)].*

12 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.

13 Again there are two items in the table in subsection 960-50(6) of the ITAA 1997 that could potentially apply to the loss made upon disposal or redemption of a traditional security; item 8 and item 11. However, it is considered that it is not appropriate to apply the rules in item 8. As can be seen from the wording of the relevant translation rules, that item is concerned with a situation where some, or all, of a payment is itself deductible. That is not the situation where a traditional security is disposed of or redeemed. In such a situation it is the difference between the amounts received and the payments made in respect of the security that gives rise to the gain or loss, rather than any individual receipt or payment. Additionally, as was the case with item 7, the use of the rules in item 8 to determine the timing of the translation in respect of a loss on the disposal or redemption of a traditional security would be inconsistent with the intended operation of subsection 960-50(4) of the ITAA 1997.

14 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 into Australian dollars on the date the taxpayer receives payment for the traditional security).

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

References

Previous draft:

TD 2005/D38

Subject references:

- foreign currency translation
- forex realisation event
- traditional security

Legislative references:

- TAA 1953
- 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 Div 775
- ITAA 1997 960-50
- ITAA 1997 960-50(1)
- ITAA 1997 960-50(4)
- ITAA 1997 960-50(6)
- ITAA 1997 960-55

Other references:

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

ATO references

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