TD 94/88 - 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?

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. Division 3B allows income tax deductions for currency exchange losses of a capital nature and treats as assessable income currency exchange gains of a capital nature 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.

2. If a currency 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 currency 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.

3. The ownership of ordinary shares makes a shareholder a member of the company. Whilst each member has a contractual relationship with the company by virtue of the Memorandum and Articles of Association of the company, a currency exchange gain or a currency exchange loss cannot arise under that contract in the sense required by the terms of Division 3B.

4. For a currency exchange gain or a currency exchange loss to arise in the required sense the gain or loss must be attributable to a currency exchange rate fluctuation. When a share in a non-resident company denominated in a foreign currency is sold, or the company is wound up, any gain or loss in respect of the disposal is not attributable to a currency exchange rate fluctuation. The gain or loss is attributable to a change in the market value of the shares or a deficiency in shareholder funds as the case may be.

5. A currency exchange gain or loss may arise, however, in respect of a currency exchange rate fluctuation under a contract to acquire or dispose of shares denominated in a foreign currency in a non-resident company.

6. We accept that a currency exchange gain or loss can also arise in respect of a change, in Australian dollar terms, that may occur between the time an entitlement to an amount of money denominated in a foreign currency arises upon the winding up of a company and the time the amount is actually paid if the difference results from a currency exchange fluctuation during that period.

Note

7. Division 775 of the *Income Tax Assessment Act 1997* (ITAA 1997) was introduced by *The New Business Tax System (Taxation of Financial Arrangements) Act (No.1) 2003* (the Act) on 17 December 2003 and contains measures that relate to the recognition and treatment of foreign currency gains and losses. These provisions apply from the 'applicable commencement date' as defined in section 775-155 of the ITAA 1997– for most taxpayers, this was 1 July 2003.

8. Under the Act, Division 3B was repealed, but continues to apply in the following limited situations:

- in relation to an eligible contract entered into before the applicable commencement date; and
- for the purposes of working out the assessable income or allowable deductions of an Authorised Deposit-taking Institution (ADI) or a non-ADI financial institution (within the meaning of the ITAA 1997).

9. This Taxation Determination continues to apply only in those limited situations described above in paragraph 8.

Note: The Addendum to this Determination that issued on 27 October 2004 applies on and from the 'applicable commencement date', as defined in section 775-155 of the ITAA 1997.

Commissioner of Taxation
24/11/94

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Related Determinations:

Related Rulings:

Subject Ref: foreign exchange gains; foreign exchange losses; shares

Legislative Ref: ITAA Pt III Div 3B; ITAA 1997 Div 775; ITAA 1997 775-155; The New Business Tax System (Taxation of Financial Arrangements) Act (No.1) 2003

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