



Taxation Determination

Income tax: can an Australian resident entity which keeps its 'accounts' predominantly in a foreign currency, choose to use that foreign currency as its 'applicable functional currency', where the entity is required to prepare financial statements in Australian dollars for statutory reporting purposes?

📌 This Ruling provides you with the following level of protection:

This publication (excluding appendices) 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 under-paid 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. An Australian resident entity which is required to prepare financial statements in Australian dollars for statutory reporting purposes, can choose to use a foreign currency as its 'applicable functional currency', where that foreign currency is the sole or predominant foreign currency in which it kept its 'accounts' (as defined in subsection 960-70(4) of the *Income Tax Assessment Act 1997* (ITAA 1997)), at the time of making the choice.

Date of effect

2. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Appendix 1 – Explanation

❶ *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

3. The functional currency provisions, in Subdivision 960-D of the ITAA 1997, allow certain entities or parts of entities that keep their 'accounts' solely or predominantly in a particular foreign currency, to choose to work out their taxable income or tax loss¹ in that foreign currency – and then translate that net amount to Australian dollars for income tax purposes. This constant unit of foreign currency is called the 'applicable functional currency'.

4. Under item 1 of subsection 960-60(1) of Subdivision 960-D of the ITAA 1997, Australian residents that are required to prepare financial reports under section 292 of the *Corporations Act 2001*, are included in the list of entities eligible to make an 'applicable functional currency' choice.

5. Section 292 of the *Corporations Act 2001* provides that a financial report and directors' report must be prepared for each financial year by:

- all disclosing entities (incorporated or formed in Australia);²
- all public companies;
- all large proprietary companies;³ and
- all registered schemes.

6. Subsection 960-70(1) of the ITAA 1997 provides that the 'applicable functional currency' for entities that are required to prepare financial reports under section 292 of the *Corporations Act 2001*, is the sole or predominant foreign currency in which they kept their 'accounts' at the time when they made the 'applicable functional currency' choice.

7. Subsection 960-70(4) of the ITAA 1997 defines 'accounts' to mean:

- (a) ledgers; and
- (b) journals;
- (c) statements of financial performance; and
- (d) profit and loss accounts; and

¹ The functional currency provisions apply in relation to the calculation of certain annual net amounts of an eligible entity. Thus the functional currency provisions may also apply for the purpose of working out the total 'assessable OB income' and total 'allowable OB deductions' within the meaning in Division 9A of Part III of the *Income Tax Assessment Act 1936*; and the 'attributable income' of a controlled foreign corporation or a transferor trust, refer items 3 to 5 inclusive of subsection 960-60(1) of Subdivision 960-D of the ITAA 1997.

² See also subsection 285(2) of the *Corporations Act 2001*.

³ Subsection 292(2) of the *Corporations Act 2001* provides that a small proprietary company has to prepare a financial report and directors' report only if:

- (a) it is directed to do so under section 293 or 294; or
- (b) it was controlled by a foreign company for all or part of the year, and it is not consolidated for that period in financial statements for that year lodged with ASIC by:
 - (i) a registered foreign company; or
 - (ii) a company, registered scheme or disclosing entity.

- (e) balance-sheets; and
- (f) statements of financial position;

and includes statements, reports, and notes attached to, or intended to be read with, any of the foregoing.

8. Where a taxpayer which is an Australian resident entity, maintains its 'accounts' as defined in subsection 960-70(4) of the ITAA 1997 predominantly in a foreign currency, but from time to time translates a part of those 'accounts' (such as the Statement of Financial Performance or Statement of Financial Position) into Australian dollars for the purpose of complying with section 292 of the *Corporations Act 2001* or any other statutory reporting requirements – the creation of an Australian dollar document does not affect the fact that, taken as a whole, the taxpayer's 'accounts' are still predominantly kept in a foreign currency.

9. Therefore, such a taxpayer that is required to prepare some financial statements in Australian dollars for statutory reporting purposes, can choose to use the foreign currency in question as its 'applicable functional currency', to work out its taxable income or tax loss. Such a choice will apply to the calculation of all of the amounts included in the entity's taxable income or tax loss.

10. The test of whether or not a particular foreign currency is the predominant one in which an entity keeps its 'accounts' (as defined), is a quantitative one, as it involves an examination of those 'accounts' in terms of the unit of measurement used (see, for example, *FC of T v. FH Faulding & Co Ltd* (1950) 83 CLR 594).

11. In this respect, no one component of those defined as making up these 'accounts' takes on any greater or lesser weight in reaching this conclusion, which is essentially one of fact and degree. For example, if an entity kept a dual ledger system and two sets of journals (that is in both a foreign currency and Australian currency), while its management accounts were kept in a foreign currency – we would accept that, on a quantitative basis, the entity kept its 'accounts' predominantly in a foreign currency.

12. This accords broadly with the meaning given in the Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990 (EM), to the phrase contained in former subsection 391(2) of Part X of the ITAA 1936, 'a single or predominant currency in which eligible amounts ... are expressed in the accounts ...'. Former section 391 of the ITAA 1936 provided special rules concerning converting amounts not expressed in Australian currency to Australian currency, in calculating the 'attributable income' of a controlled foreign corporation (CFC). The definition of 'accounts'⁴ in section 317 of Part X of the ITAA 1936, that applied for this purpose, closely resembles the definition of this term in subsection 960-70(4).

13. At page 297 of the EM it was stated:

Whether or not there is a predominant foreign currency is not to be determined by the volume or size of the transactions. Rather, the test will turn on whether or not there is a particular foreign currency used for the basic record keeping of the CFC.

14. The same approach is considered appropriate in determining whether there is an 'applicable functional currency' under subsection 960-70(1) (as modified to accommodate the fact that other entities (or parts thereof) besides CFCs are covered by Subdivision 960-D).

⁴ Section 317 of the ITAA 1936 defines 'accounts' to mean ledgers, journals, profit and loss accounts and balance sheets and includes statements, reports and notes attached to, or intended to be read with, any such records.

15. Note that an entity may be required under Australian law to keep its accounts in a currency *other* than Australian currency. This is governed currently by whether or not it is required to comply with the relevant Accounting Standard.⁵ At the time of issue of this Determination, the relevant Accounting Standard was AASB 121.⁶ It is accepted in relation to a year of income that, where an eligible entity within the meaning of subsection 960-60(1) of the ITAA 1997) is required under AASB 121 to keep its accounts so that entries are made in a non-Australian currency (referred to in AASB 121 as the ‘functional currency’⁷), then that currency will qualify as the entity’s ‘applicable functional currency’ for the purposes of subsection 960-70(1) of the ITAA 1997.⁸

⁵ Refer subsection 296(1) of the Corporations Act 2001 concerning complying with accounting standards, which provides that the financial report for a financial year must comply with the accounting standards.

⁶ AASB 121 is titled ‘The Effects of Changes in Foreign Exchange Rates’ and applies in respect of annual reporting periods beginning on or after 1 January 2005.

⁷ ‘Functional currency’ is defined in AASB 121 as: the currency of the primary economic environment in which the entity operates. Paragraph 17 of AASB 121 provides that each entity – whether a stand-alone entity, an entity with foreign operations or a foreign operation (such as a subsidiary or branch) – determines its functional currency in accordance with paragraphs 9-14 (of AASB 121). The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 20-37 and 50.

⁸ Note that AASB 121 requires foreign currency transactions to be recorded, on initial recognition, in the entity’s functional currency; and it also requires the entity to measure its results and financial position in that functional currency. [AASB 121 also requires an entity to select a presentation currency or currencies that may or may not be its functional currency. Further, AASB 121 requires an entity to translate its financial report to the presentation currency – if the entity’s presentation currency is different from its functional currency.]

References

Previous draft:

TD 2005/D32

Related Rulings/Determinations:

TR 92/20

Subject references:

- foreign currency transactions
- foreign currency translations

Legislative references:

- TAA 1953
- ITAA 1936 Pt X
- ITAA 1936 317
- ITAA 1936 391
- ITAA 1936 391(2)
- ITAA 1997 Subdiv 960-D
- ITAA 1997 960-60(1)

- ITAA 1997 960-70(1)
- ITAA 1997 960-70(4)
- ITAA 1936 Pt III Div 9A
- Corporations Act 2001 285(2)
- Corporations Act 2001 292
- Corporations Act 2001 292(2)
- Corporations Act 2001 293
- Corporations Act 2001 294
- Corporations Act 2001 296(1)

Case references:

- FC of T v. FH Faulding and Co Ltd (1950)
83 CLR 594

Other references:

- Explanatory Memorandum to the Taxation Laws
Amendment (Foreign Income) Bill 1990

ATO references

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