TD 2004/D80 - Income tax: consolidation: capital gains and losses: does a capital gain arise under CGT event C2 when the amount received in payment of a foreign currency denominated trade receivable exceeds its tax cost setting amount?

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Draft Taxation Determination

Income tax: consolidation: capital gains and losses: does a capital gain arise under CGT event C2 when the amount received in payment of a foreign currency denominated trade receivable exceeds its tax cost setting amount?

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. An amount received on payment of a foreign currency denominated trade receivable (an FCTR) in excess of its tax cost setting amount which is derived by a joining entity pre-consolidation but received post-consolidation is a capital gain under CGT event C2 to the head company to the extent that the excess is not attributable to a change in currency exchange rates. This is the case notwithstanding that the joining entity will have included the whole amount of the receivable in its assessable income for the income tax year prior to the joining time.

Explanation

2. A trade receivable denominated in foreign currency is a reset cost base asset because such assets do not meet the definition of retained cost base asset in subsection 705-25(5) of the *Income Tax Assessment Act 1997* (ITAA 1997). The relevant part of the definition of retained cost base asset specifies that a retained cost base asset is limited to a right to receive a specified amount of Australian currency. Reset cost base assets are defined in section 705-35 of the ITAA 1997 to be all assets other than retained cost base assets or excluded assets.

3. Where an FCTR becomes an asset of the head company at the joining time, subsection 701-10(4) of the ITAA 1997 provides that the FCTR will have its tax cost set at its tax cost setting amount. The tax cost setting amount can be less than the face value of

the trade receivable. As a result, and assuming no currency exchange impact, when the debtor pays the FCTR the amount received may exceed its tax cost setting amount.[1]

4. A foreign currency trade receivable is a CGT asset as defined in section 108-5 of the ITAA 1997. Under subsection 701-55(5) of the ITAA 1997 its cost base and reduced cost base are adjusted to equal the asset's tax cost setting amount. Where the cost base (set at the tax cost setting amount) is less than the amount received from the debtor when the FCTR is discharged (generally, the face value of the trade receivable), a capital gain to the extent of that excess arises under CGT event C2 in section 104-25 of the ITAA 1997 to the head company.

5. Section 118-20 of the ITAA 1997 would apply to reduce that capital gain if, because of the CGT event, another provision of the tax law includes an amount in the head company's assessable income or exempt income for any income year.

6. The amount received in excess of the tax cost setting amount of a trade receivable that is not attributable to a currency exchange rate effect is not received as an ordinary incident of carrying on business. Rather, the excess amount arises as an incident of the statutory allocation process under the consolidation regime. It does not constitute income under ordinary concepts.

7. Nor is the excess considered to be statutory income. Payment of the FCTR is not an amount received upon the disposal or redemption of a traditional security for the purposes of section 26BB of the *Income Tax Assessment Act 1936*.

8. As no amount is included in assessable or exempt income as ordinary or statutory income of the head company due to the payment of the trade receivable in the circumstances described above, section 118-20 does not apply and the capital gain arising on the happening of CGT event C2 is not reduced.

9. This Draft Taxation Determination does not deal with the question of foreign currency gains or losses that may arise where some or all of the gain or loss is attributable to a currency exchange rate effect. To the extent that foreign currency gains or losses do arise on discharge of an FCTR, the provisions of Division 775 of the ITAA 1997 would need to be considered.

Example

10. The following example assumes no foreign currency exchange gain or loss tax consequences.

- At time 1, company B derives ordinary income of $100 by selling trading stock to entity Z on credit for $US80 (which translates to $A100).
- At time 2, B joins a consolidated group that is headed by company A. As a result of applying the ACA method, the trade receivable obtains a tax cost setting amount of $A85 for the head company. There are no currency fluctuations between time 1 and time 2.
- At time 3, Z pays $US80 to company B in settlement of its trade debt, which translates to $A100. Under the consolidation provisions, company A is taken to receive that $A100 payment.

[1] An overriding assumption in this Determination is that the transitional measures covered in Division 701 of the *Income Tax (Transitional Provisions) Act 1997* which allow the retention of the existing tax values for the assets of a chosen transitional entity have not been adopted.

11. In the above example, the amount received on payment of the FCTR ($A100) exceeds its tax cost setting amount (being the cost base of the FCTR) of $A85. None of the excess is attributable to a currency exchange rate effect. Accordingly, head company A makes a capital gain of $15 under CGT event C2.

Date of Effect

12. 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

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

Due date: **14 January 2005**

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Commissioner of Taxation
8 December 2004

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/20

Subject references:

- capital gains and losses
- consolidation
- foreign currency trade receivables
- foreign exchange gains and losses
- trade receivables

Legislative references:

- ITAA 1936 26BB
- ITAA 1997 104-25
- ITAA 1997 108-5
- ITAA 1997 118-20
- ITAA 1997 701-10(4)
- ITAA 1997 701-55(5)
- ITAA 1997 705-25(5)
- ITAA 1997 705-35
- ITAA 1997 Div 775
- IT(TP)A 1997 Div 701
- TAA 1953 Pt IVAAA

ATO references

NO: 2004/13399
ISSN: 1038-8982