


TD 2005/D32 - Income tax: can an Australian incorporated subsidiary of a foreign group which records the results of its worldwide business in a foreign currency, choose to use that foreign currency as its 'applicable functional currency', where it prepares financial statements in Australian dollars for statutory reporting purposes?

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This document has been finalised by TD 2006/4.



Draft Taxation Determination

Income tax: can an Australian incorporated subsidiary of a foreign group which records the results of its worldwide business in a foreign currency, choose to use that foreign currency as its ‘applicable functional currency’, where it prepares financial statements in Australian dollars for statutory reporting purposes?

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 Australian incorporated subsidiary that prepares 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.

Explanation

2. The functional currency provisions, in Subdivision 960-D of the ITAA 1997, allow certain entities which keep their ‘accounts’ solely or predominantly in a particular foreign currency, to choose to work out their taxable income or tax loss 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’.

3. 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 a functional currency choice. Section 292 of the *Corporations Act 2001* provides that a financial report must be prepared for each financial year by:

- all disclosing entities incorporated or formed in Australia;
- all resident public companies;

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- all resident large proprietary companies;
- all registered schemes;
- small proprietary companies directed to prepare financial reports; and
- some small proprietary companies controlled by a foreign company.

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

5. Subsection 960-70(4) of the ITAA 1997 defines ‘accounts’ to mean:

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

6. Where a taxpayer which is an Australian incorporated subsidiary company, 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.

7. 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 company’s taxable income or tax loss.

8. 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 what those accounts consist of in terms of the unit of measurement used (see for example, *FC of T v. FH Faulding & Co Ltd* (1950) 83 CLR 594).

9. 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.

Date of Effect

10. 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

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

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Commissioner of Taxation
17 August 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- foreign currency transactions
- foreign currency translations

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 Pt 3-90
- ITAA 1997 700-1
- ITAA 1997 701-1

- ITAA 1997 Subdiv 960-D

- ITAA 1997 960-60

- ITAA 1997 960-60(1)

- ITAA 1997 960-70

- ITAA 1997 960-70(1)

- ITAA 1997 960-70(4)

- ITAA 1997 960-80

- Corporations Act 2001 292

Case references:

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

ATO references

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ATOlaw topic: Income Tax ~~ Assessable income ~~ foreign currency
Income Tax ~~ Foreign exchange gains and losses