TD 2006/D5 - Income tax: where there is a disposal of foreign currency or a right to receive foreign currency and forex realisation event 1 happens, is the amount attributable to a currency exchange rate effect determined by subtracting the non-forex component of the capital gain (or loss) from the overall capital gain (or loss)?

Draft Taxation Determination

Income tax: where there is a disposal of foreign currency or a right to receive foreign currency and forex realisation event 1 happens, is the amount attributable to a currency exchange rate effect determined by subtracting the non-forex component of the capital gain (or loss) from the overall capital gain (or loss)?

This Ruling provides you with the following level of protection:

This publication is a draft for industry and professional comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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. You can rely on this publication (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you under-pay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the under-payment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided we are not prevented from doing so by a time limit imposed by the law.

Ruling

1. Yes. The non-forex component of the capital gain (or loss) is the foreign currency amount received on disposal less the foreign currency cost of acquisition, translated into Australian currency using the exchange rate applicable at the time of the disposal.

Example 1

2. *An entity acquires the right to receive foreign currency for US$100 when the exchange rate is A$1.00 = US$0.80. The entity disposes of the right six months later when its value is US$110. The exchange rate at the time of disposal is A$1.00 = US$0.60.*

3. *Assume that this particular right to receive foreign currency is not a 'traditional security' for the purposes of sections 26BB and 70B of the Income Tax Assessment Act 1936 (ITAA 1936).*

4. *FRE 1 happens when the entity disposes of the right to receive foreign currency (paragraphs 775-40(1)(b) and 775-40(3)(b) of the ITAA 1997).*

Overall capital gain

5. *The capital gain from the disposal of the right is determined by translating each receipt or payment (element) at the exchange rate applicable at the time of each transaction or event (subsection 960-50(6) item 5 of the ITAA 1997).*

capital gain = US$110/0.60 less US$100/0.80
= A$183.33 - A$125
= A$58.33

Non-forex component of the capital gain

6. *The non-forex component of the capital gain is calculated by determining the US currency value of the net gain from the disposal and translating this amount into Australian currency at the exchange rate applicable at the time of disposal.*

Non-forex component of the capital gain = (US$110 - US$100)/0.60
= A$16.67

Amount attributable to a currency exchange rate effect

7. *The forex realisation gain is the amount of the capital gain which is attributable to a currency exchange rate effect. The amount is calculated by taking the overall capital gain less the non-forex component of the capital gain.*

Forex realisation gain = A$58.33 less A$16.67
= A$41.66

8. *The amount of the capital gain which is attributable to a currency exchange rate effect is A$41.66 and is included in the entity's assessable income under subsection 775-15(1) of the ITAA 1997.*

9. *The non-forex component of the capital gain amount is subject to the capital gains tax provisions in the ITAA 1997.*

Example 2

10. *An entity acquires a right to receive foreign currency for US$100 when the exchange rate is A$1.00 = US$0.60. The entity disposes of the right six months later when its value is US$90. The exchange rate at the time of disposal is A$1.00 = US$0.80.*

11. *Assume that this particular right to receive foreign currency is not a 'traditional security' for the purposes of sections 26BB and 70B of the ITAA 1936.*

12. *FRE 1 happens when the entity disposes of the right to receive foreign currency (paragraphs 775-40(1)(b) and 775-40(3)(b) of the ITAA 1997).*

Overall capital loss

13. *The capital loss from the disposal of the right is determined by translating each receipt or payment (element) at the exchange rate applicable at the time of each transaction or event (subsection 960-50(6) item 5 of the ITAA 1997).*

Overall capital loss = US$90/0.80 less US$100/0.60
= A$112.50 – A$166.67
= A$54.17 loss

Non-forex component of the capital loss

14. *The non-forex component of the capital loss is calculated by determining the US currency value of the net gain from the disposal of the right and translating this amount into Australian currency at the exchange rate applicable at the time of disposal.*

Non-forex component of the capital loss = (US$90 – US$100)/0.80
= A$12.50 loss

Amount attributable to a currency exchange rate effect

15. *The forex realisation loss is the amount of the capital loss which is attributable to a currency exchange rate effect. This amount is calculated by taking the overall capital loss less the non-forex component of the capital loss.*

Forex realisation loss = A$54.17(loss) less A$12.50 (loss)
= A$41.67 loss

16. *The amount of the capital loss attributable to a currency exchange rate effect is A$41.67 and is an allowable deduction to the entity under subsection 775-30(1) of the ITAA 1997.*

17. *The non-forex component of the capital loss is subject to the capital gains tax provisions in the ITAA 1997.*

Date of effect

18. 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).

Commissioner of Taxation
18 January 2005

Appendix 1 – Explanation

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

Explanation

19. Forex realisation event 1 (FRE 1) is CGT event A1 which happens when an entity disposes of foreign currency, or a right, or part of a right to receive foreign currency (subsection 775-40(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)).

20. Where FRE 1 happens, the entity makes a forex realisation gain if there is a capital gain from the event and some or all of that capital gain is attributable to a currency exchange rate effect. The amount of the forex realisation gain is that part of the capital gain (if any) which is attributable to a currency exchange rate effect (subsection 775-40(4) of the ITAA 1997).

21. An entity will make a forex realisation loss from FRE 1 where there is a capital loss from the event and some or all of that capital loss is attributable to a currency exchange rate effect (subsection 775-40(6) of the ITAA 1997).

22. The amount attributable to a currency exchange rate effect can be determined by the following formula:

> Amount attributable to a currency exchange rate effect = overall capital gain (or capital loss) *less* the non-forex component of the capital gain (or loss)
>
> where:
>
> Non-forex component of the capital gain (or loss) = foreign currency amount received on disposal *less* foreign currency cost of acquisition, translated to Australian currency using the exchange rate at the time of disposal of the right

23. This method of calculating the non-forex component of the capital gain or loss using the exchange rate at the time of disposal ensures greater consistency with the policy of recognising forex realisation gains or losses on realisation. The purpose of the core forex realisation framework in Division 775 of the ITAA 1997 is to ensure that economic gains or losses arising from currency exchange rate effects are brought to account for income tax purposes when realised. Any economic gain or loss not arising from the currency exchange rate effects arises only on realisation of the asset, that is, when the entity disposes of the foreign currency or right to receive foreign currency. The non-forex component of the capital gain (or loss) should therefore be calculated using the exchange rate at the time of disposal.

Appendix 3 – Your comments

24. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date:	**17 February 2006**
Contact officer:	**Troy Herrmann**
E-mail address:	**Troy.Herrmann@ato.gov.au**
Telephone:	**(08) 9268 5531**
Facsimile:	**(08) 9268 5250**
Address:	**45 Francis Street** **Northbridge WA 6003**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- currency exchange rate
- foreign currency translation
- foreign exchange gains and losses
- forex realisation event

Legislative references:

- ITAA 1936 26BB
- ITAA 1936 70B
- ITAA 1997 Div 775
- ITAA 1997 775-15(1)
- ITAA 1997 775-40(1)
- ITAA 1997 775-40(1)(b)
- ITAA 1997 775-40(3)(b)
- ITAA 1997 775-40(4)
- ITAA 1997 775-40(6)
- ITAA 1997 960-50(6)

ATO references

NO: 2005/16364
ISSN: 1038-8982
ATOlaw topic: Income Tax ~~ Foreign exchange gains and losses