


TR 2014/7A1 - Addendum - Income tax: foreign currency hedging transactions - applying the foreign income tax offset limit under section 770-75 of the Income Tax Assessment Act 1997 and determining the source of foreign currency hedging gains

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Addendum

Taxation Ruling

Income tax: foreign currency hedging transactions – applying the foreign income tax offset limit under section 770-75 of the *Income Tax Assessment Act 1997* and determining the source of foreign currency hedging gains

This Addendum is a public ruling for the purposes of the *Taxation Administration Act 1953*. It amends Taxation Ruling TR 2014/7 to state the Commissioner's view regarding the source of foreign currency hedging transactions gains for the purposes of Division 770 of the *Income Tax Assessment Act 1997*.

TR 2014/7 is amended as follows:

1. Paragraphs 2 and 3

Omit the paragraphs; substitute:

2. This Ruling deals with:

- when gains from foreign currency hedging transactions will be from a source other than an Australian source for the purposes of subparagraph 770-75(4)(a)(ii)
- when losses from foreign currency hedging transactions will be reasonably related to income that is covered by paragraph 770-75(4)(a) (disregarded income) for the purposes of subparagraph 770-75(4)(b)(ii).

3. This Ruling does not deal with the source of any other income.

2. Paragraph 13

Omit the paragraph; substitute:

Source of foreign currency hedging gains

13. While the source of income will always depend on the particular facts and circumstances, for the transactions the subject of this Ruling, the place where each foreign currency hedging contract is formed is the most important element in determining the source of any resulting foreign currency hedging gain.

3. Paragraphs 62 and 63

Omit the paragraphs; substitute:

62. With the exception of paragraph 13, this Ruling applies to years of income commencing on or after 1 July 2014.

63. Paragraph 13 of this Ruling applies to years of income commencing on or after 1 July 2015. This Ruling was issued in different form in December 2014. Those parts of the original Ruling addressing source applied from income years commencing 1 July 2014 and the parts of this Ruling addressing source apply from 1 July 2015.

4. Paragraphs 95 to 101

Omit the paragraphs; substitute:

Source of foreign currency hedging gains

95. Assessable income from a source other than an Australian source, upon which the taxpayer has not (or is not taken to have) paid foreign tax, is disregarded pursuant to subparagraph 770-75(4)(a)(ii).¹⁵

96. Determining the source of an item of income:

- is a matter of fact to be determined having regard to the facts and circumstances of each case and the relative weight to be given to those facts and circumstances¹⁶

¹⁵ Assessable income upon which the taxpayer has (or is taken to have) paid foreign tax, is disregarded pursuant to subparagraph 770-75(4)(a)(i).

¹⁶ *Nathan v. Federal Commissioner of Taxation* (1918) 25 CLR 183; [1918] HCA 45. Because source is always a practical matter of fact, different factors may be relevant in determining source where a contractual gain arises in a different context than in relation to the transactions the subject of this Ruling.

- looks to the element or elements in the transaction which contribute to the derivation of the income and the relative importance of each, viewed through an eye focussed on practical business affairs.¹⁷

97. Importantly, the focus is not on 'why' the gain is being made but on 'where'.¹⁸

98. In cases where the operations are characterised by entering into transactions, there are cases in which the place of formation of the contract has been given significant weight.¹⁹ There are other cases where the place of formation of the contract was considered to be only one contributory factor or given little significance.²⁰ The difference lies in determining what it is that generates the profit.²¹

99. In a hedging transaction of a type described in this Ruling, while the source of income will always depend on the particular facts and circumstances, the activity which is, as a practical matter of fact, most important in producing the gain, is the entering into and conclusion of the contract itself. Matters preliminary to the contract, such as entering into the Master ISDA, decisions as to how to best manage the foreign currency risk and the instructions on the management of that risk are, then, part of the reason *why* the transaction was entered into.²²

100. As a consequence, the place where each foreign currency hedging contract is formed is the most important element in determining the source of any resulting foreign currency hedging gain.

¹⁷ *Re Thorpe Nominees Pty Ltd v. Federal Commissioner of Taxation* 88 ATC 4886; (1988) 19 ATR 1834 and *Deputy Commissioner of Taxation v. Kirk* [1900] AC 588.

¹⁸ *Commissioner of Taxation (Western Australia) v. D & W Murray Ltd* (1929) 42 CLR 332; [1929] HCA 21 at CLR 346.

¹⁹ *Premier Automatic Ticket Issuers Ltd. v. Federal Commissioner of Taxation* (1933) 50 CLR 268; *Tariff Reinsurances Ltd. v. Commissioner of Taxes (Vict.)* (1938) 59 CLR 194; *Spotless Services Limited v. Federal Commissioner of Taxation* 93 ATC 4397; (1993) 25 ATR 344.

²⁰ *Re Thorpe Nominees Pty Ltd v. Federal Commissioner of Taxation* 88 ATC 4886; (1988) 19 ATR 1834, *Malayan Shipping Co. Ltd v. Federal Commissioner of Taxation* (1946) 71 CLR 156; (1946) 3 ATR 258; (1946) 8 ATD 75, *Cliff's International Inc v. Federal Commissioner of Taxation* 85 ATC 4374; (1985) 16 ATR 601.

²¹ *Federal Commissioner of Taxation v. United Aircraft Corporations* (1943) 68 CLR 525; [1943] HCA 50; (1943) 7 ATD 318 at CLR 538; ATD 324. See also Gibbs J in *Esquire Nominees Ltd v. Federal Commissioner of Taxation* (1972) 129 CLR 177; 72 ATC 4076; (1972) 3 ATR 105 at CLR 192; ATC 4086; ATR 116.

²² See for example *Commissioner of Inland Revenue v. Hang Seng Bank Ltd* [1991] AC 306, *Commissioner of Income Tax, Bombay Presidency and Aden v. Chunilal B. Mehta of Bombay* (1938) LR 65 Ind App 332, *Commissioner of Inland Revenue v. N V Phillips' Gloeilampenfabrieken* [1955] NZLR 868.

101. Absent express or implied terms to the contrary, a contract is formed where the communication of the acceptance is received.²³

5. Paragraphs 184 to 188

Omit the paragraphs; substitute:

Source of foreign currency hedging gains

184. Some taxpayers are of the view that the source of a gain in the given transaction is Australia where the relevant decision making is occurring in Australia and that place of contract is not important. Therefore, if all the decisions regarding the timing, size and nature of the trade are undertaken in Australia, the alternative view would conclude the source of the gain will be Australia. Under this approach, source is viewed as being where decisions are made and weight is not placed on the formal steps leading to the formation of the contract.

185. However, as discussed at paragraph 99 of this Ruling, focussing on the decisions being made is to focus more on 'why' the foreign currency hedging gain is being made and the activity involved in this, than on 'where' the foreign currency hedging gain is made and the activity involved in this aspect. Thus, the Commissioner does not accept this alternative view.

186. It has also been suggested that the appropriate contract to be looking to in determining source is the Master ISDA and not to the individual contracts themselves. This is on the basis that the Master ISDA, in setting out the terms and conditions upon which each individual contract is then executed, is the source of the income.

187. This is not accepted as an appropriate view of the function of the Master ISDA. Gillard J in *Powercor Australia v. Pacific Power* [1999] VSC 110, cited with approval the following description of the Master ISDA:

...the master agreement sets out the rules of the game which the parties are to play, as those rules are understood by the market place, whereas each transaction is a separate playing of that game.⁵¹

188. Therefore, as explained in paragraph 99 of this Ruling, what gives rise to the income is not the Master ISDA itself but each transaction, each contract, entered into under the Master ISDA.

²³ *Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd* (1957) 98 CLR 93, 111. For telephone, see *Sydbank Soenderjylland A/S v Bannerton Holdings Pty Ltd* (1996) 68 FCR 539. For fax, see *Schib Packaging Srl v Emrich Industries Pty Ltd* [2005] VSCA 236.

⁵¹ [1999] VSC 110 at [319].

6. Detailed contents list

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7. Subject references

Omit the subject references.

8. Legislative references

Omit:

- ITAA 1997 Div 770

Insert:

- ITAA 1997 Div 770
- ITAA 1997 770-75(4)(a)(ii)

9. Case references

Insert:

- Cliff's International Inc v. Federal Commissioner of Taxation 85 ATC 4374; (1985) 16 ATR 601
- Commissioner of Income Tax, Bombay Presidency and Aden v. Chunilal B. Mehta of Bombay (1938) LR 65 Ind App 332
- Commissioner of Inland Revenue v. Hang Seng Bank Ltd [1991] AC 306
- Commissioner of Inland Revenue v. N V Phillips' Gloeilampenfabrieken [1955] NZLR 868
- Commissioner of Taxation (Western Australia) v. D & W Murray Ltd (1929) 42 CLR 332; [1929] HCA 21
- Deputy Commissioner of Taxation v. Kirk [1900] AC 588
- Esquire Nominees Ltd v. Federal Commissioner of Taxation (1972) 129 CLR 177; 72 ATC 4076; (1972) 3 ATR 105
- Federal Commissioner of Taxation v. United Aircraft Corporations (1943) 68 CLR 525; [1943] HCA 50; (1943) 7 ATD 318
- Malayan Shipping Co. Ltd v. Federal Commissioner of Taxation (1946) 71 CLR 156; (1946) 3 AITR 258; (1946) 8 ATD 75
- Nathan v. Federal Commissioner of Taxation (1918) 25 CLR 183; [1918] HCA 45
- Powercor Australia v. Pacific Power [1999] VSC 110
- Premier Automatic Ticket Issuers Ltd. v. Federal Commissioner of Taxation (1933) 50 CLR 268
- Re Thorpe Nominees Pty Ltd v. Federal Commissioner of Taxation 88 ATC 4886; (1988) 19 ATR 1834
- Schib Packaging Srl v Emrich Industries Pty Ltd [2005] VSCA 236
- Spotless Services Limited v. Federal Commissioner of Taxation 93 ATC 4397; (1993) 25 ATR 344

- Sydbank Soenderjylland A/S v Bannerton Holdings Pty Ltd (1996) 68 FCR 539
- Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd (1957) 98 CLR 93, 111
- Tariff Reinsurances Ltd. v. Commissioner of Taxes (Vict.) (1938) 59 CLR 194

This Addendum applies on and from 1 July 2015.

Commissioner of Taxation

16 March 2016

ATO references

NO: 1-7RPRRS5

ISSN: 2205-6122

ATOlaw topic: International issues ~ Foreign income tax offset.

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