TD 1999/D21 - Income tax: capital gains: does the redenomination of a financial arrangement to the Euro constitute:(a) the derivation of assessable income or the incurrence of an allowable deduction; (b) the realisation of a currency exchange gain or loss for the purposes of Division 3B of Part III of the Income Tax Assessment Act 1936; or (c) a CGT event?

Draft Taxation Determination

Income tax: capital gains: does the redenomination of a financial arrangement to the Euro constitute:

(a) the derivation of assessable income or the incurrence of an allowable deduction;
(b) the realisation of a currency exchange gain or loss for the purposes of Division 3B of Part III of the *Income Tax Assessment Act 1936*; or
(c) a CGT event?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office (ATO). DTDs may not be relied on; only final TDs are authoritative statements of the ATO.

1. No. The redenomination of a financial arrangement to the Euro does not result in any taxation consequences under (a), (b) or (c).

Background

2. The Euro has been introduced to replace the national currencies of 11 members of the European Monetary Union (EMU)[1]. Introduction is a two-stage process. The first stage began on 1 January 1999 with the ability, albeit not the compulsion, to denominate non-cash transactions in Euros. National currencies will remain in circulation. The second stage involves the introduction of Euro notes and coins, and the withdrawal of national currencies, from 1 January 2002.

3. A financial arrangement that extends beyond 1 January 1999, which is denominated in one of the currencies being phased-out, may be redenominated to the Euro (on a no compulsion, no prohibition basis). Where an arrangement extends beyond 1 January 2002 and is denominated in one of the affected national currencies, a reference to the national currency is to be read as the equivalent amount in Euros (compulsory redenomination).

[1] As at 1 January 1999, the members are Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

Redenomination

4. Redenomination of an arrangement involves two currencies: the affected national currency and the Euro. Redenomination is the replacement of one currency with another. It is the changing of:

> 'the unit in which the amount of outstanding debt is stated from a national currency unit to the euro unit . .'[2]

Redenomination may be either unilateral or mutual. It involves an agreement or requirement to satisfy rights and meet obligations under an existing arrangement in a replacement currency.

5. Types of financial arrangements affected by redenomination to the Euro include contractual arrangements, debt instruments, derivatives and equity holdings.

Assessable income and allowable deductions

6. Provided the effect of redenomination of a financial arrangement to Euros is solely to change the monetary measurement of the financial arrangement, it is a minor alteration and does not alter the substance of the arrangement. Redenomination, of itself, does not cause assessable income to be derived or an allowable deduction to be incurred.

Currency exchange gains and currency exchange losses

7. Foreign exchange gains and losses that are capital in nature fall within Division 3B of Part III of the *Income Tax Assessment Act 1936*. Division 3B uses the expressions 'currency exchange gain' and 'currency exchange loss' to describe such gains and losses. Currency exchange gains are made and currency exchange losses are incurred when they are realised (paragraph 82V(2)(b)). A redenomination of a financial arrangement to Euros does not constitute the realisation of a currency exchange gain or currency exchange loss.

Capital gains tax

8. The capital gains tax provisions apply if a CGT event occurs (section 102-20 of the *Income Tax Assessment Act 1997* (ITAA97)). A redenomination is merely a change in the relevant monetary measure of the financial arrangement. It does not of itself constitute a CGT event (section 104-5 of the ITAA97).

Example 1: unilateral redenomination

9. ABC Pty Ltd, an Australian resident company, borrows 1,000,000 deutschemarks on 1 July 1998 from DEF Inc., a resident company of Germany. The loan contract contains a general term allowing ABC Pty Ltd to change the denomination of the contractual currency. On 30 June 1999, ABC Pty Ltd invokes this clause so that it will now repay the balance of the principal of the loan and interest in Euros. ABC Pty Ltd's decision to redenominate and to repay in Euros does not discharge the loan. No assessable income is derived by the redenomination and no allowable deduction is incurred. No currency exchange gain or loss is made and no CGT event happens.

Example 2: mutual redenomination

10. UVW Pty Ltd, an Australian resident company, borrows 1,000,000 deutschemarks on 1 July 1998 from XYZ Inc., a resident company of Germany. There is no term in the loan contract allowing either party to change the denominated currency. On 30 June 1999, UVW Pty Ltd and XYZ Inc. agree that UVW Pty Ltd will repay the balance of the principal of the loan and interest in Euros. This agreement does not discharge the loan. No assessable income is derived by the

[2] Article 1 of the Draft Council Regulation (EC) 1997 in the Annex to Council Regulation (EC) No. 1103/97 of 17 June 1997, adopted under Article 235 of the European Union Treaty.

redenomination and no allowable deduction is incurred. No currency exchange gain or loss is made and no CGT event happens.

Your comments

11. If you wish to comment on this draft Determination, please send your comments promptly by 28 April 1999 to:

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Commissioner of Taxation
31 March 1999

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

Subject references:

capital gains; capital losses; CGT event; currency exchange gains; currency exchange losses; Euro; foreign exchange gains; foreign exchange losses; redenomination

Legislative references:

ITAA36 Pt III Div 3B; ITAA36 Pt III Div 3B sec 82; ITAA97 Pt 1-3 sec 6-5; ITAA97 Pt 1-3 sec 6-10; ITAA Pt 1-3 sec 8-1; ITAA97 Pt 1-4 sec 10-5; ITAA97 Pt 1-4 sec 12-5; ITAA97 Pt 3-1; ITAA97 Pt 3-1 sec 102-20; ITAA97 Pt 3-1 sec 104-5.

Case references:

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