


TD 2005/D49 - Income tax: foreign currency gains and losses: where an amount of exempt income is paid directly into a foreign currency denominated bank account, will subsection 775-35(1) of the Income Tax Assessment Act 1997 operate to disregard any forex realisation loss made on withdrawal of that amount?

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This document has been finalised by TD 2006/16.



Draft Taxation Determination

Income tax: foreign currency gains and losses: where an amount of exempt income is paid directly into a foreign currency denominated bank account, will subsection 775-35(1) of the *Income Tax Assessment Act 1997* operate to disregard any forex realisation loss made on withdrawal of that 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. No.
2. A forex realisation loss will not be disregarded under subsection 775-35(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) simply because the loss is made on the withdrawal of exempt income previously deposited into a foreign currency denominated bank account.

Explanation

3. A bank account (with a credit balance) is a single chose in action, representing the account holder's right to be repaid the balance standing to the credit of their account.¹ For foreign currency denominated accounts, this right is a right to receive foreign currency.

¹ *Joachimson v. Swiss Bank Corporation* [1921] 3 KB 110; [1921] All ER 92; (*Joachimson*); *Hart (Inspector of Taxes) v. Sangster* [1957] 1 Ch 329; [1957] 2 All ER 208; *Alcom v. Republic of Colombia* [1984] AC 580; [1984] 2 All ER 6 (*Alcom*).

4. The net amount standing to the credit of such a bank account from time to time reflects all of the amounts deposited into and withdrawn from the account, including any exempt income deposited. However, the actual funds represented by that amount are beneficially owned by the bank and not the account holder.² All the account holder has is a chose in action, being the right to receive the balance standing to the credit of their account, generally payable on demand.³

5. When an amount is withdrawn from such a foreign currency denominated bank account, part of the account holder's right to receive foreign currency ceases and forex realisation event 2 happens (pursuant to subsection 775-45(1) of the ITAA 1997). A forex realisation gain or a forex realisation loss may arise when forex realisation event 2 happens.

6. Subsection 775-35(1) of the ITAA 1997 provides that a forex realisation loss made as a result of forex realisation event 2 will be disregarded 'to the extent that it is made in gaining or producing exempt income'.

7. The relationship between a loss and the gaining or producing of both assessable and exempt income has been extensively considered in the context of section 8-1 of the ITAA 1997 (and section 51(1) of the *Income Tax Assessment Act 1936*). A long line of court decisions has made clear that there must be some connection between a loss and the activities directed at gaining or producing the taxpayer's income.⁴ It is considered that these decisions provide guidance when interpreting subsection 775-35(1) of the ITAA 1997 as both that section and section 8-1 of the ITAA 1997 are concerned with finding a sufficient connection between a loss and the earning of income. In *Charles Moore & Co (W.A.) v. FC of T* the High Court said '[w]hat matters is their [the loss or outgoing] connection with the operations which more directly gain or produce the assessable income'.⁵

8. The mere payment of exempt income into a bank account does not provide a sufficient connection between the gaining or producing of that amount and a forex realisation loss made as a consequence of the subsequent withdrawal of some, or all, of the amount. It would only be in the most unusual of circumstances that an amount of exempt income had not been gained or produced by the taxpayer, in the sense of having been earned or derived by that taxpayer, prior to its withdrawal from the bank account. That is, the loss is made after the exempt income has been gained or produced, rather than as part of the process by which the income was gained or produced.

9. Likewise, the making of such a forex realisation loss was not the result of a liability that came into existence as a direct consequence of the method by which the exempt income was gained or produced. Consequently, the reasoning set out in paragraphs 3 and 4 of Taxation Ruling No. IT 2084 which deals with the deductibility of financial institutions duty imposed upon bank accounts is not relevant in these circumstances.

² *Foley v. Hill and Ors* (1848) 2 HL Cas 28; [1843-60] All ER Rep 16; (1848) 9 ER 1002, *Joachimson, and Re Metway Bank Ltd* [1991] 1 Qd R 120.

³ *Joachimson; Alcom*.

⁴ *Ronpibon Tin N.L. and Tongkah Compound N.L. v. FC of T* (1948-1949) 78 CLR 47 at 56-57; [1949] ALR 785 at 789-790; (1949) 8 ATD 431 at 435-436, and *Lunney v. FC of T* (1958) 100 CLR 478; [1958] ALR 225; (1958) 11 ATD 404.

⁵ *Charles Moore & Co (W.A.) v. FC of T* (1956) 95 CLR 344 at 351; [1957] ALR 68 at 70; (1956) 11 ATD 147 at 149. See also *FC of T v. Smith* (1981) 147 CLR 578 at 585-586; (1981) 34 ALR 16 at 20; 81 ATC 4114 at 4117; (1981) 11 ATR 538 at 542.

Example

10. John receives a United Kingdom (UK) War Disablement Pension that is exempt income under section 53-10 of the ITAA 1997. John's pension is paid directly into a UK Pounds Sterling denominated bank account. However, due to adverse currency exchange movements, John makes a forex realisation loss upon withdrawing an amount from this account.

11. Despite the depositing of amounts of exempt income into his account, John's forex realisation loss was not itself made in gaining or producing exempt income. Accordingly, John's forex realisation loss is not disregarded under subsection 775-35(1) of the ITAA 1997. However, this does not necessarily mean that the loss will be an allowable deduction (see for example subsections 775-30(2) and 775-165(2) of the ITAA 1997).

Note 1

12. For similar reasons, a forex realisation gain will not be exempt under section 775-20 of the ITAA 1997 simply because the gain is made on the withdrawal of exempt income previously deposited into a foreign currency denominated bank account. Only a forex realisation gain that, had it have been a forex realisation loss, would have itself been made in gaining or producing exempt income would be exempt under this section.

Note 2

13. A forex realisation gain or loss that arose under forex realisation event 1 on disposal of an amount of foreign currency (cash) that had been received as exempt income would also not necessarily be respectively exempt under section 775-20 of the ITAA 1997 or disregarded under subsection 775-35(1) of the ITAA 1997.

Date of effect

14. 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

15. 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

19 October 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; IT 2084

Subject references:

- disposal of foreign currency
- exempt income
- foreign exchange gains and losses
- forex realisation event
- forex realisation gain

Legislative references:

- TAA 1953 Pt IVA
- ITAA 1936 51(1)
- ITAA 1997 8-1
- ITAA 1997 53-10
- ITAA 1997 775-20
- ITAA 1997 775-30(2)
- ITAA 1997 775-35(1)
- ITAA 1997 775-45(1)

- ITAA 1997 775-165(2)

Case references:

- Alcom v. Republic of Colombia [1984] AC 580; [1984] 2 All ER 6
- Charles Moore & Co (W.A.) v. FC of T (1956) 95 CLR 344; [1957] ALR 68; (1956) 11 ATD 147
- FC of T v. Smith (1981) 147 CLR 578; (1981) 34 ALR 16; 81 ATC 4114; (1981) 11 ATR 538
- Foley v. Hill and Ors (1848) 2 HL Cas 28; [1843-60] All ER Rep 16
- Hart (Inspector of Taxes) v. Sangster [1957] 1 Ch 329; [1957] 2 All ER 208
- Joachimson v. Swiss Bank Corporation [1921] 3 KB 110; [1921] All ER 92
- Lunney v. FC of T (1958) 100 CLR 478; [1958] ALR 225; (1958) 11 ATD 404
- Re Metway Bank Ltd [1991] 1 Qd R 120
- Ronpibon Tin N.L. and Tongkah Compound N.L. v. FC of T (1948-1949) 78 CLR 47; [1949] ALR 785; (1949) 8 ATD 431

ATO references

NO: 2005/9963

ISSN: 1038-8982

ATOlaw topic: Income Tax ~ Foreign exchange gains and losses