


TD 2012/D12 - Income tax: can a consolidated special purpose financial report of a head company of a tax consolidated group satisfy clause 1.1 of Schedule 2 to the Income Tax Assessment Regulations 1997 where transactions within the same class are translated using inconsistent methodologies?

 This cover sheet is provided for information only. It does not form part of *TD 2012/D12 - Income tax: can a consolidated special purpose financial report of a head company of a tax consolidated group satisfy clause 1.1 of Schedule 2 to the Income Tax Assessment Regulations 1997 where transactions within the same class are translated using inconsistent methodologies?*

This document has been finalised by TD 2013/21.



Draft Taxation Determination

Income tax: can a consolidated special purpose financial report of a head company of a tax consolidated group satisfy clause 1.1 of Schedule 2 to the Income Tax Assessment Regulations 1997 where transactions within the same class are translated using inconsistent methodologies?

❶ This publication provides you with the following level of protection:

This publication is a draft for public 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 following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment 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 the time limits under the law allow it.

Ruling

1. No.

Example: Consolidated financial report prepared by a tax consolidated group

2. Gyro Pty Ltd is the head company of a tax consolidated group and is required to prepare a financial report under the Corporations Act 2001 (Corporations Act). It has two wholly owned subsidiaries (Spyro Pty Ltd and Tyro Pty Ltd) that are the only subsidiary members of the tax consolidated group. Both Spyro Pty Ltd and Tyro Pty Ltd prepare special purpose financial statements.

3. Spyro Pty Ltd translates each of its foreign currency purchases occurring in the current month at the spot rate at the time of the transaction. By contrast, Tyro Pty Ltd translates each of its foreign currency purchases occurring in the current month at the spot rate at the end of the previous month. Gyro Pty Ltd prepares special purpose financial statements that covers the affairs of the group and which combines the results produced by Spyro Pty Ltd and Tyro Pty Ltd.

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4. *The consolidated special purpose financial statement prepared by Gyro Pty Ltd does not satisfy all of the requirements of clause 1.1 of Schedule 2 to the Income Tax Assessment Regulations 1997 (the Regulations).*¹

Date of effect

5. 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 75 to 77 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

19 December 2012

¹ All legislative references are to Schedule 2 of the Regulations unless otherwise indicated.

Appendix 1 – Explanation

① *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.*

Special purpose financial statements

6. The Australian financial reporting framework broadly consists of two regimes. Entities that are required to prepare a financial report for the purposes of the Corporations Act must prepare either general purpose financial statements (GPFS)² or special purpose financial statements (SPFS).

7. In broad terms, the accounting standards each state that they apply, amongst other things, to GPFS,³ or financial statements that are, or held out, to be GPFS. This means that such financial statements comply with the International Financial Reporting Standards as adopted in Australia and any other reporting regime devised by the Australian Accounting Standards Board (AASB) for the preparation of GPFS.

8. Financial statements that do not follow all the accounting standards are generally prepared by non-reporting entities and are referred to as SPFS. These financial statements can apply a subset of the accounting standards as the accounting standards themselves⁴ prescribe limited mandatory application.

Special translation rules

9. Subdivision 960-C of the *Income Tax Assessment Act 1997* (ITAA 1997) requires an amount in foreign currency to be translated into an Australian dollar amount. It sets out the basic rules for identifying the exchange rate to be used for translation of foreign currency amounts into Australian dollar amounts, for certain income tax purposes.

10. The objects of Subdivision 960-C of the ITAA 1997 are set out in section 960-49 of the ITAA 1997. One of those objects is stated in paragraph 960-49(b):

- (b) to ensure that the rules for identifying the exchange rate for the translation of a foreign currency amount into Australian dollars:
 - (i) reflect an appropriate prevailing exchange rate; and
 - (ii) take into account, as appropriate, commercial practices for the translation of foreign currency amounts into Australian dollars.

11. The table in subsection 960-50(6) of the ITAA 1997 sets out special translation rules that specify the exchange rate to be used for particular amounts that are relevant to an entity's income tax liability. Items 1 to 11 of the table require amounts to be translated into Australian currency 'at the exchange rate applicable' at various times referred to in the item.

² General purpose financial statements consist of two Tiers of reporting requirements: Tier 1 (full International Financial Reporting Standards as adopted in Australia) and Tier 2 (Reduced Disclosure Requirements). See AASB 1053 *Application of Tiers of Australian Accounting Standards*.

³ There are some standards which contain other application criteria. For example, AASB 8 *Operating Segments* limits its application to for-profit entities and AASB 1004 *Contributions* limits its application to not-for-profit entities.

⁴ Non-reporting entities that are required to prepare financial statements under the Corporations Act are only compelled to apply a limited set of accounting standards (see paragraph 18 of this draft Determination), with the rest at the discretion of the entity.

12. The general rules are modified by the Regulations. Subregulation 960-50.01(1) of the Regulations modifies the table in subsection 960-50(6) of the ITAA 1997 by adding items 11A (exchange rate that is reasonable having regard to the circumstances) and 12.

13. Item 12 of the table provides that, as an alternative to the result mentioned in any of the items 1-11A, the amount may be translated into Australian currency using any of the rules set out in Schedule 2 to the Regulations. The rules that apply for item 12 are contained in Part 1, which allows the translation of foreign currency amounts into Australian currency or an applicable functional currency using the rates used in preparation of an audited financial report, daily rates or average rates.

14. Clause 1.1 allows an entity to translate amounts using the exchange rate in its financial report provided that the financial report meets certain requirements. Clause 1.1 provides:

For item 12 of the table in subsection 960-50(6) of the Act, as modified, if:

- (a) a financial report (within the meaning of the *Corporations Act 2001*) prepared by an entity:
 - (i) complies with the accounting standards under the *Corporations Act 2001*; and
 - (ii) translates amounts into Australian currency using particular exchange rates; and
 - (iii) has been audited in accordance with the *Corporations Act 2001*; and
- (b) the entity, or another entity, wishes to translate an amount into Australian currency in accordance with that item, using the exchange rate used in that financial report to translate a corresponding amount;

the entity mentioned in paragraph (b) must translate all amounts into Australian currency using the exchange rates that were used in that financial report to translate corresponding amounts.

Complies with the accounting standards

15. The first requirement for clause 1.1 to apply is that there is a 'financial report'. This takes its meaning from the Corporations Act and is defined (in section 9 of that Act) as 'an annual financial report or half year financial report prepared under Chapter 2M'.

16. Some reports prepared under Chapter 2M of the Corporations Act may be specifically directed to not have to comply with some or all of the accounting standards⁵ and still be a 'financial report'. However having a financial report is a necessary but not sufficient condition for the application of clause 1.1.

17. The financial report must be one that also 'complies with the accounting standards' as required by subparagraph 1.1(a)(i).

⁵ For example, see paragraph 293(3)(a) of the Corporations Act.

18. Having regard to the application provisions of the accounting standards themselves, a non-reporting entity that is required to prepare financial reports under Chapter 2M of the Corporations Act must comply with the following accounting standards:

- AASB 101 *Presentation of Financial Statements*
- AASB 107 *Statement of Cash Flows*
- AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*
- AASB 1031 *Materiality*
- AASB 1048 *Interpretation of Standards*, and
- AASB 1054 *Australian Additional Disclosures*.

19. Paragraph 13 of the AASB 108 specifically deals with the consistency in the selection and application of an entity's accounting policies. Paragraph 13 provides:

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an Australian Accounting Standard specifically requires or permits categorisation of items for which different policies may be appropriate. If an Australian Accounting Standard requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

20. An entity that applies one methodology to translate one set of foreign currency transactions and a different methodology to another set of transactions of the same kind in the preparation of its financial statements will not comply with AASB 108. Such a financial report does not comply with the accounting standards, for the purposes of subparagraph 1.1(a)(i).

21. In the case of a tax consolidated group, the effect of the single entity rule⁶ is that a head company and its subsidiary members is taken to be a single taxpayer. The subsidiary members of a group are taken to be part of one entity, being the head company and the transactions of the subsidiary members are taken to have been undertaken by the head company. Where that head company prepares a consolidated SPFS having regard to the transactions of its subsidiaries, and adopts different translation methodologies for the same class of transactions, then this financial report will similarly not satisfy the requirements of AASB 108, and cannot be said to comply with the accounting standards, for the purposes of subparagraph 1.1(a)(i).

⁶ Section 701-1 of the ITAA 1997.

Appendix 2 – Your comments

22. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

23. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- be published on the ATO website at www.ato.gov.au.

24. Please advise if you do not want your comments included in the edited version of the compendium.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- accounting standards
- foreign currency
- financial statements
- general purpose financial statements
- special purpose financial statements

Legislative references:

- ITAA 1997 701-1
- ITAA 1997 Subdiv 960-C
- ITAA 1997 960-49
- ITAA 1997 960-49(b)
- ITAA 1997 960-50(6)
- ITAR 1997 960-50.01(1)
- ITAR 1997 Sch 2

- ITAR 1997 Sch 2 Pt 1
- ITAR 1997 Sch 2 1.1(a)(i)
- Corporations Act 2001
- Corporations Act 2001 9
- Corporations Act 2001 Ch 2M
- Corporations Act 2001 293(3)(a)

Other references

- AASB 8 Operating Segments
- AASB 101 Presentation of Financial Statements
- AASB 107 Statement of Cash Flows
- AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors
- AASB 1004 Contributions
- AASB 1031 Materiality
- AASB 1048 Interpretation of Standards
- AASB 1053 Application of Tiers of Australian Accounting Standards
- AASB 1054 Australian Additional Disclosures

ATO references

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