


TD 93/D103 - Income tax: foreign exchange gains and losses of a capital nature - in what circumstances is a loan 'wholly or partly rolled over' under section 82W of the Income Tax Assessment Act 1936 ?

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Draft Taxation Determination

Income tax: foreign exchange gains and losses of a capital nature - in what circumstances is a loan 'wholly or partly rolled over' under section 82W of the *Income Tax Assessment Act 1936*?

1. For the purposes of 82W, a loan is wholly or partly rolled over if it is renewed, in whole or part, by repaying the maturing loan and replacing it with a new loan.
2. Division 3B of Part III applies only to foreign exchange gains and losses of a capital nature. The Division applies to foreign exchange gains made, or foreign exchange losses incurred, under certain contracts entered into on or after 19 February 1986 (see definition of 'eligible contract' in subsection 82V(1)). The effect of section 82W is that the Division also applies to foreign exchange gains or losses under pre-19 February 1986 contracts where particular events occur after that date.
3. If, on or after 19 February 1986 and under a contract entered into by a taxpayer before that date, a loan made to the taxpayer is wholly or partly rolled over (except pursuant to a contractual obligation that was binding on the taxpayer before 19 February 1986), the loan resulting from the roll-over is deemed to be made to the taxpayer under a contract entered into by a taxpayer at the time of the roll-over (paragraphs 82W(1)(b) and 82W(1)(e)). Paragraphs 82W(2)(b) and 82W(2)(e) are corresponding provisions in relation to the roll-over of a loan made by a taxpayer before 19 February 1986.
4. The terms 'rolled over' and 'roll-over' are not defined in Division 3B. The Macquarie Dictionary (Second Edition), Macquarie University, 1991 defines 'roll-over provision' as 'an agreement made between a borrower and lender in which each agrees to renew a loan, when it matures, at a rate of interest based on the ruling rate of interest at the time'. This definition is of limited assistance because it does not explain how the renewal of a loan may occur under a roll-over. Commercial dictionaries provide greater assistance as to the meaning of 'roll-over', perhaps because the term is widely used in banking and finance.
5. Alan Gilpin, Dictionary of Economics and Financial Markets (Fifth Edition), Butterworths, 1986, defines 'roll-over' as 'renewing credit i.e. to roll-over debts by borrowing to pay them'. S.P. Valentine, 'International Dictionary of the Securities Industry', Macmillan, 1985 gives the following more expansive definition: 'Rollover is ... the practice of extending a period of credit by technical repayment followed by a further loan of the same amount for a further period. The terms of the loan may not be precisely the same, however. The lender might well take the opportunity to increase the rate of interest on the loan.' We consider that these definitions accurately describe the meaning of roll-over in section 82W.
6. Some commercial dictionaries say that 'roll-over' includes the extension of a loan. We consider that in paragraphs (b) and (e) of subsections 82W(1) and 82W(2), 'roll-over' does not include the extension of the period of a loan - paragraphs (c) and (f) of those subsections expressly address the situation where the period of the loan is extended.

7. Bills of exchange and promissory notes are not loans (*Chow Yoong Hong v. Choong Fah Rubber Manufactory* [1962] AC 209 at 215-217; *Willingale (Inspector of Taxes) v. International Commercial Bank Ltd* [1978] AC 834). Therefore, the roll-over of a bill or a note (see Taxation Ruling TR 93/8 at paragraph 66) is not the roll-over of a loan for the purposes of section 82W. Similarly, if a loan is repaid and replaced by a bill of exchange, the loan is not rolled over.

Example 1

On 1 July 1985 Fabulous Finance Ltd and Mr William Gully entered into a foreign currency loan contract. The main terms of the contract were: a period of 5 years, Fabulous was to advance \$US100,000 on 1 July 1985, interest was payable every 6 months in arrears, the borrower could repay the loan at the time interest was due, the interest rate was set each 6 months by reference to current bill rates. Mr Gully used the funds to purchase a rental property. Mr Gully repaid the loan on 1 July 1990.

The loan was not rolled-over every 6 months. There was simply one loan with term of 5 years. Mere adjustments in the interest rate in accordance with terms of the contract do not amount to roll-over. The loan contract is not an eligible contract and, therefore, Division 3B does not apply to any realised exchange gain or loss in relation to the loan.

Example 2

On 2 January 1986 Piggybank Ltd and Bacon Pty Ltd entered into a foreign currency loan facility contract. Bacon, which carried on the business of a piggery, used the funds to construct new sties. The main terms of the contract were: Piggybank to advance amounts totalling up to \$US100,000 to Bacon, the period of the contract was 5 years, the term of loans under the facility was 6 months, interest was payable at the maturity of a loan and interest rates were set at the start of each loan by reference to certain bill rates. Furthermore, if Bacon notified Piggybank that Bacon wanted to renew an advance, Piggybank was required to advance the same amount when Bacon repaid the outstanding advance.

On 3 January 1986 Piggybank advanced \$US100,000 to Bacon. On 1 July 1986 Bacon notified Piggybank that it wanted to renew the advance outstanding. On 3 July 1986 Bacon repaid the original loan and Piggybank again advanced \$US 100,000 to Bacon. These payments were made by a set-off.

The loan was rolled over on 3 July 1986. The loan was renewed by repayment of the original loan and making a new loan. Furthermore, the roll-over occurred under a contract entered into before 19 February 1986 but not pursuant to an obligation binding on Bacon before 19 February 1986. Paragraph 82W(1)(e) deems the loan resulting from the roll-over to have been made under a contract entered into on 3 July 1986. Consequently, Division 3B applies to any realised foreign exchange gain or loss arising under the loan resulting from the roll-over.

Commissioner of Taxation

29/4/93

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