TD 93/D212 - Income tax: Offshore Banking Units (OBU) - Can foreign currency denominated assets and receivables generated from OB activities be hedged into Australian dollars (AUD) and if so, would the AUD received from the forward sale constitute non-OB money?

This document has been finalised by TD 95/2.

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

Draft Taxation Determination

Income tax: Offshore Banking Units (OBU) - Can foreign currency denominated assets and receivables generated from OB activities be hedged into Australian dollars (AUD) and if so, would the AUD received from the forward sale constitute non-OB money?

1. Subsection 121D(8) of the *Income Tax Assessment Act 1936* allows an OBU to hedge interest rates and currency with non-residents (excluding Australian branches of non-residents), foreign branches of Australian residents and OBUs in order to manage exposure to risk from **borrowing or lending activities**. However, if the other party is a related person, any money payable under the contract must not be in AUD.

2. Any profits derived from the above hedge would be assessable OB income in accordance with subsection 121EE(2).

3. However, if an OBU hedges foreign currency denominated assets and receivables in respect of OB activities other than borrowing or lending, the hedge will not qualify as a hedging activity under subsection 121D(8). Nor will it qualify as a trading activity under subsection 121D(4) that would attract concessional tax treatment since the transaction would involve AUD.

4. Any profit derived from a hedge in respect of activities other than OB borrowing or lending would be assessable at normal company rates of tax (and any losses deductible at the full company rate).

5. Provided a hedge is at arm's length and timing differences do not influence the result, however, the hedge should not yield an assessable or deductible amount (see example).

6. The AUD received from the forward sale would not constitute non-OB money under section 121C because the AUD is merely a conversion of money derived from OB activities.

Example
As a result of trading activities, an OBU has a receivable of USD 1,000,000 and a payable of USD 900,000, both amounts due in 90 days time. Assuming the due and receivables/due and payable basis is used by the OBU for taxation purposes, the OBU will realise a net assessable amount of USD 100,000 in 90 days.

A receivable of USD 1,000,000 is internally hedged to the extent of USD 900,000 payable. However, the OBU wishes to hedge the net exposure of USD 100,000, and sells forward for AUD, at an agreed rate with delivery in 90 days.

In 90 days time, the OBU receives a net amount of USD 100,000 in AUD, at the agreed rate. Given the matched position of the net exposure and the hedge, there will be no profit or loss consequences for taxation purposes. However, if there is a mis-match in the timing of the receivables/payables and the hedge payment, it may be that the different timing results in recognising the income or losses.

Commissioner of Taxation
19/8/93

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