TD 98/D12 - Income tax: does subsection 160K(5) apply to determine the attributable income of a controlled foreign company ('CFC') in relation to gains and losses of a capital nature, where Part IIIA of the Income Tax Assessment Act 1936 ('the Act'), as modified, applies to that disposal?

This document has been finalised by TD 1999/37.

Australian Taxation Office

Draft Taxation Determination

Income tax: does subsection 160K(5) apply to determine the attributable income of a controlled foreign company ('CFC') in relation to gains and losses of a capital nature, where Part IIIA of the *Income Tax Assessment Act 1936* ('the Act'), as modified, applies to that disposal?

1. Yes. Where a CFC acquires, and later disposes of, a tainted asset, the CFC is required to determine its attributable income in relation to the calculation of the gain or loss for the purposes of Part IIIA, as modified by Part X, by using the currency conversion rules set out in subsection 160K(5) of the Act.

2. Subsection 160K(5) provides that expenditure in a foreign currency is to be converted to Australian currency at the time it is incurred. Similarly, the consideration received is to be converted at the time of disposal.

3. Section 383 sets out the basic assumptions made in calculating a CFC's attributable income. The section assumes the CFC is an Australian resident taxpayer to whom the Act applies. Subdivisions B to E of Division 7 of Part X further modify the application of the Act in relation to CFCs.

4. Subdivision C of Division 7 of Part X sets out modifications relating to Australian capital gains tax. Where a CFC has disposed of a tainted asset that falls within the provisions of Part IIIA, the gain or loss is determined by following the rules set out in Part IIIA, as modified by Subdivision C. Subsection 160K(5) has not been modified in any way by this subdivision and is the relevant provision for determining the currency conversion rules in calculating the capital gains or losses of a CFC.

5. Where subsection 160K(5) states:

> '… would, but for this subsection be an amount in the currency of a foreign country, the amount so taken into account is the equivalent amount in Australian currency …'

it expresses a requirement that where an asset of the CFC is purchased or disposed of in a currency other than the Australian currency (i.e., a currency of a foreign country), the CFC must convert the amount to the Australian currency equivalent when the costs are incurred or at the time of the disposal of the asset, as the case may be. Accordingly, in the same manner as any Australian resident who purchases or disposes of any asset in a currency other than Australian currency, a CFC is required to convert the amount to the Australian currency equivalent.

6. TD 92/108 will be withdrawn on finalisation of this draft Taxation Determination.

Example 1

7. A CFC resident in Hong Kong acquires shares for HK$100 on 1 January 1997, which converts to A$20 on that date, and then sells them on 30 June 1997 for HK$100, which converts to A$30 on that date. Details are:

	HK$	***A$***
Shares acquired 1 January 1997	*100*	*20*
Shares sold 30 June 1997	*100*	*30.*

8. Assuming that the CFC fails the active income test, an attributable capital gain arises in relation to a 'disposal of a tainted asset'.

Example 2

9. A CFC resident in Hong Kong acquires shares for HK$100 on 1 January 1997, which converts to A$20 on that date, and then sells them on 30 June 1997 for HK$110, which converts to A$20 on that date. Details are:

	HK$	***A$***
Shares acquired 1 January 1997	*100*	*20*
Shares sold 30 June 1997	*110*	*20.*

10. In this example, no attributable capital gain or loss arises in relation to the disposal of the tainted asset, even though the CFC has made a gain in its local currency.

Your comments

11. If you wish to comment on this draft Determination, please send your comments by 18 September 1998 to:

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Commissioner of Taxation
19 August 1998

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