


TD 2006/16 - 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 always operate to disregard any forex realisation loss made on withdrawal of that amount?

 This cover sheet is provided for information only. It does not form part of *TD 2006/16 - 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 always operate to disregard any forex realisation loss made on withdrawal of that amount?*



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* always operate to disregard any forex realisation loss made on withdrawal of that amount?

1 This Ruling provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant 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. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

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) merely because the loss is made on the withdrawal of exempt income previously deposited into a foreign currency denominated bank account.

Example

3. 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.

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4. *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.¹*

Date of effect

5. This Determination applies to years commencing both before and after its date of issue. However, this Determination does 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.

Commissioner of Taxation

5 April 2006

¹ This Determination does not consider the possible operation of other provisions within the income tax law that might deny deductibility. For example subsections 775-30(2) and 775-165(2) of the ITAA 1997 may potentially apply.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Explanation

6. 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.² 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.³ 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.⁴

7. It is clear from paragraphs 2.285 and 2.286 of the Explanatory Memorandum to the New Business Tax System (Taxation of Financial Arrangements) Bill (No. 1) 2003 that the intended operation of the phrase 'right ... to receive foreign currency' is sufficiently wide so as to encompass the account holder's right to be repaid the credit balance of their foreign currency denominated bank account. Those paragraphs state:

2.285 First, a gain or loss can arise under forex realisation event 1 when an entity deposits foreign currency into the account. This represents the disposal of the foreign currency in consideration for a right to repayment or debt.

2.286 Second, a gain or loss can arise under forex realisation event 2 where an entity withdraws an amount from a foreign currency denominated bank account with a credit balance. This is because the entity's right against the bank, represented by the account balance, ends to the extent that a withdrawal is made.

8. Paragraph 2.286 of the Explanatory Memorandum also makes it clear that it was intended that forex realisation event 2 would occur when an amount was withdrawn from such a foreign currency denominated bank account. A forex realisation gain or a forex realisation loss may arise when forex realisation event 2 happens.

9. 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'.

² *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*).

³ *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.

⁴ *Joachimson*; *Alcom*.

10. 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 subsection 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.⁵ It is considered that these decisions provide guidance when interpreting subsection 775-35(1) of the ITAA 1997 as both that subsection and section 8-1 of the ITAA 1997 are concerned with finding a sufficient connection between a loss and the earning of income. For example 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'.⁶

11. 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.

12. 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.

Note 1

13. 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 been a forex realisation loss, would have itself been made in gaining or producing exempt income would be exempt under this section.

Note 2

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

⁵ *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.

⁶ *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.

Appendix 2 – Alternative views

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.*

Alternative views

15. During the comment period for this Ruling, an alternative view was put that when some, but not all, of the credit balance of a foreign currency denominated bank account is withdrawn, the rights the customer has against the bank do not 'cease' (in whole or in part) to exist, and consequently there is no forex realisation event 2. The Tax Office does not accept this view. The Tax Office view is set out at paragraphs 7 and 8 of this Ruling.

References

Previous draft:

TD 2005/D49

Related Rulings/Determinations:

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
- 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 775-165(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

Other references:

- Explanatory Memorandum to the New Business Tax System (Taxation of Financial Arrangements) Bill (No. 1) 2003

ATO references

NO: 2005/9963

ISSN: 1038-8982

ATOlaw topic: Income Tax ~~ Foreign exchange gains and losses