The treatment of certain gains and losses on Foreign Currencies for corporation tax purposes

Part 04-05-01

This document should be read in conjunction with Section 79, 79A, 79B and 79C Taxes Consolidation Act (TCA) 1997

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Introduction

Non-Euro currencies are assets, for the purposes of capital gains tax, meaning that realised foreign exchange gains or losses are usually within the scope of capital gains tax. However, section 79, 79A, 79B and 79C TCA 1997 set out certain circumstances where foreign exchange movements are brought within the corporation tax regime.

- Section 79 provides for the tax treatment for exchange gains and losses arising from the conversion of foreign currency denominated trade receivables, payables, current accounts, cash balances and their associated hedging contracts (refer to section 1 below).

- Section 79A provides for the matching of foreign currency exchange gains and losses on certain assets and liabilities of companies for Capital Gains Tax purposes (refer to section 2 below).

- Section 79B enables a company with a foreign currency asset to match the asset for tax purposes with redeemable share capital denominated in the same currency (refer to section 3 below).

- Section 79C simplifies the calculation of tax liabilities for holding companies, by allowing a holding company to calculate any currency gain or loss on a disposal of foreign currency in a bank account using the corporation tax rules rather than capital gains tax rules (refer to section 4 below).

1 Trade Receivables, Payables, Cash Balances and Current Accounts [section 79]

1.1 Trade Receivables, Payables, Cash Balances and Current Accounts

Section 79(2) applies to exchange gains and losses whether realised or unrealised which:

- are attributable to any “relevant monetary item” of a company,
- result directly from a change in the rate of exchange, and
- are properly debited and credited, as the case may be, to the profit and loss account of the company on the basis of generally accepted accounting principles.

A **“relevant monetary item”** as defined in section 79(1)(a) means:

- Trade receivables of a company. For the purpose of this section, it is accepted that trade receivables include any amount owed to a business by its customers. For the purpose of this section, companies should use the trade receivables amount shown on the balance sheet in their audited financial statements.
- Non-euro currency held in trading bank accounts. A trading bank account is the company’s main current account. It is the account into which receipts from customers are lodged and from which expenses of the trade are paid. It is accepted that some small amounts that would not qualify as a trade deduction (such as parting tickets) may be paid out of this account without the account losing its status as a ‘trading bank account’ for the purpose of this section. Where lodgements from customers exceed expenses, Revenue expect large surplus amounts to be transferred to a separate account to avoid this account taking on any characteristics of an investment or savings account and thus no longer qualifying as a ‘trading bank account’.
- Money held by a company for its trade (being cash in hand).
- Money payable by a company for its trade (being ordinary creditors and long-term loans of the company).

The effect of the section is to allow relief for exchange losses on borrowings to the extent that they are booked in the company’s profit and loss account. Conversely exchange gains on these borrowings will be taxed. The treatment applies irrespective of whether the gain or loss is realised. This could mean that a company will have to account for tax on unrealised profits. This approach is balanced however in that unrealised losses will be dealt with on the same basis.

The definition of monetary items includes a "purpose of trade" test. It is important to understand that the section applies only to trading companies in respect of assets and liabilities, trading bank accounts and moneys held for the purposes of a trade. For example, it does not apply where a loan drawn down in a foreign currency is used to acquire an overseas investment (but see section 3 and section 4 below for the tax treatment in such cases). It is for the company to show that this test is satisfied.

1.2 Hedging Contracts

Section 79(2) also applies to exchange gains and losses whether realised or unrealised which:

- are attributable to any "relevant contract" of a company,
- result directly from a change in the rate of exchange, and
- are properly debited and credited, as the case may be, to the profit and loss account of the company on the basis of generally accepted accounting principles.

A **"relevant contract",** in relation to a company, is a contract or instrument designed to protect "relevant monetary items" from losses due to foreign exchange variations: a hedging transaction.

This subsection provides symmetry of treatment between monetary items and their associated hedges[1].

The instruments most likely to be encountered in practice are currency swaps or forward purchases. Section 79(2) provides that gains or losses credited or debited to a company's profit and loss account, which are attributable to these contracts, are to be dealt with in the same way as gains or losses on "relevant monetary items". This means that they will be brought into account in computing trading income.

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1.4 Exchange rate risk on tax liabilities

Section 79(4) provides that exchange rate gains and losses on "relevant tax contracts" are, subject to certain conditions, to be ignored for capital gains tax purposes.

[1] Under section 79(1)(b), the treatment of a contract as a relevant contract is not to change the tax treatment of that contract for any purpose of the Tax Acts.

A **“relevant tax contract”** is a contract entered into to hedge against exchange rate risk on a corporation tax liability which arises from a change in the rate of exchange between the functional currency and the Euro.

The conditions are as follows:

- the gain or loss must be attributable to a relevant tax contract entered into for the purpose of eliminating an exchange rate risk in relation to a corporation tax liability, and
- the gain or loss must result directly from exchange rate fluctuations,

A gain may only be ignored for capital gains tax purposes to the extent that it does not exceed the exchange rate loss on the corresponding tax liability.

A loss will only be ignored to the extent that it does not exceed the exchange rate gain on the corresponding tax liability.

2 Matching of investments in certain shares with foreign currency liabilities [section 79A]

Section 79A is designed to facilitate companies borrowing in the currency in which they intend to invest in another company. In order to avoid the possibility of being exposed to the risk of exchange gains or losses, section 79A TCA 1997 allows a company to elect to match certain shares and liabilities for capital gains tax purposes. If an election is made, any gain on the shares concerned is reduced by a loss on the matched liability. Similarly, if a loss arises on the shares, it will be reduced by a gain on the liability thereby removing the risk of exchange rate losses.

A **"foreign currency asset**" is an asset of a company which was acquired for an amount which consisted solely of a non-Euro currency. If only part of the consideration was so denominated, the asset will not be a "foreign currency asset". A "foreign currency asset" does not include an asset that is already taken into account as a "relevant monetary item" under section 79 TCA 1997.

A "**relevant foreign currency asset**" is, where a company has made the appropriate election, shares in a trading company (or a holding company of a trading company) provided that, immediately after acquiring the shares the investing company holds at least 25% of the share capital of the trading (or holding) company.

A **"foreign currency liability**" is

(a) a liability of a company that is denominated in a non-Euro currency other than a liability that is a "relevant monetary item" for the purposes of section 79 TCA 1997, or

(b) any amount subscribed for paid-up share capital, or contributed to the company, which is denominated in a non-Euro currency.

A company can elect, by giving notice in writing to the inspector, to have a specific relevant foreign currency asset matched with a specified corresponding foreign currency liability denominated in the same non-euro currency as the asset. Such an election must be made within 3 weeks of the acquisition of the asset.

Where a company disposes of a matched foreign currency asset, the foreign exchange losses or gains on the liability are to be offset against the foreign exchange gains or losses on the matched asset.

Where there is a foreign exchange loss on the discharge of the liability, the consideration received on the disposal of the asset is to be reduced by the amount of the loss. However, the reduction may not exceed the gain on the disposal of the asset.

Where there is a foreign exchange gain on the discharge of the liability, the consideration received on the disposal of the asset is to be increased by the amount

of the gain. However, the increase may not exceed the loss made on the disposal of the asset.

Where a company disposes of a matched foreign currency asset but does not discharge the foreign currency liability at the same time, the company is treated as having discharged the liability at the time it disposed of the asset. This will enable the appropriate matching relief to be applied.

Where a company elects to match a foreign currency asset with a foreign currency liability, which was incurred before the asset was acquired, the company will be deemed to have discharged the liability, and incurred a new liability, at the time the asset was acquired. This will enable the appropriate matching relief to be applied.

3 Matching of foreign currency assets with certain foreign currency share capital [section 79B]

Section 79B TCA 1997 enables a company with a foreign currency asset to elect to match the asset for tax purposes with redeemable share capital denominated in the same currency. In such cases, the gain or loss on the redemption of the share capital will be taken into account in calculating taxable trading income, thus cancelling the gain or loss on the disposal of the asset.

A **"foreign currency asset"** is an asset of a company which:

(a) was acquired for an amount which consisted solely of a currency other than the functional currency[2] of the company.

(b) any gain on the disposal of which will be taken into account in computing the company's trading income.

A **"relevant foreign currency liability"** is a liability of a company which is denominated in a currency other than the functional currency of the company, and which arises from redeemable paid-up share capital issued by the company. It does not include any liability which is a "relevant monetary item" for the purposes of section 79 TCA 1997.

A company can elect, by giving notice in writing to the inspector, to have a specified foreign currency asset denominated in currency other than the "functional currency" of the company matched with a specified corresponding foreign currency liability denominated in the same currency. Such an election must be made within 3 weeks of the acquisition of the asset.

A company that has matched a foreign currency asset with a foreign currency liability and which disposes of the asset but does not discharge the liability at the same time is treated as having discharged the liability at the time it disposed of the asset. This will enable the appropriate matching relief to be applied.

A company that elects to match a foreign currency asset with a foreign currency liability incurred earlier than when the asset was acquired is regarded as discharging that liability and incurring a new liability, at the time the asset was acquired. This will enable the appropriate matching relief to be applied.

[2] Refer to section 402(1)(a) for details on what functional currencies.

4 Exclusion of foreign bank accounts of certain holding companies [section 79C]

The purpose of section 79C TCA 1997 is to simplify the calculation of tax liabilities for holding companies, by allowing a holding company to calculate any currency gain or loss on a disposal of foreign currency in a bank account using the corporation tax rules rather than capital gains tax rules.

In order that there is no loss to the Exchequer, section 79C provides that the amount of any currency gain brought into charge is increased by an amount that will make the tax payable equate to the amount that would have been payable if capital gains tax rather than corporation tax applied.

4.1 The operation of the section

4.1.1 Relevant bank deposit [section 79C(1) and (2)]

Subsection (2) removes currency held in a 'relevant bank deposit' is not an asset for the purposes of Capital Gains Tax.

A "**relevant bank deposit**" is defined as a non-Euro denominated sum held by a "relevant holding company" in a bank.

Where a company has a number of "relevant bank deposits" this section will apply to the "net foreign exchange gain" or the "net foreign exchange loss". This is essentially the sum of all foreign exchange gains and losses on the disposal of amounts held in all relevant bank deposits. Disposal, in this context, will be the withdrawal or transfer out of an amount, or the change in currency of the account. That is, only realised gains and losses are taken into account.

Through the application of the definition of "net foreign exchange gain" and "net foreign exchange loss" a foreign currency bank account will not be of relevance to the calculation of tax under section 79C if any movements on it are taxable under Case I.

4.1.2 Relevant holding company [section 79C(1)]

A "**relevant holding company**" is defined as a company –

a) That has at least one wholly owned subsidiary where that subsidiary derives the greater part of its income from trading activities, or
b) which acquires or establishes, within one year of a net foreign exchange gain being credited to its accounts, a wholly owned subsidiary which derives the greater part of its income from trading activities.

That is, both companies which are currently holding companies, and which become holding companies within a year of a gain on a relevant bank account can avail of the treatment set out in section 79C.

The company's accounts must be prepared under Irish GAAP or IFRS[3].

4.1.3 Wholly owned subsidiary [section 9(1)(d)]

The definition of a "relevant holding company" refers to a company that has at least one "**wholly owned subsidiary**". This phrase, for the purposes of the Tax Acts, is to be interpreted in line with section 9(1)(d) TCA 1997 which requires that the subsidiary is 100% directly owned.

The legislation does not allow for the provisions of section 79C to apply to a holding company which indirectly holds trading subsidiaries.

4.2 Calculation of tax

4.2.1 Loss relief [section79C(5) and (6), and section 399]

Where a net foreign exchange loss arises in a year, loss relief will be available against future Case IV amounts under section 399[4].

Any unused capital loss carried forward from before the introduction of this section (which applies to accounting periods ending on or after 1 January 2012) may be converted and used as a section 399 loss. If it is more advantageous to the holding company, it may prefer to leave that capital loss as a capital loss, relievable under section 546.

4.2.2 Gains [section 79C(3)]

The amount of additional income, chargeable to tax under Case IV, in order to ensure no loss to the Exchequer, is calculated by way of a formula set out in section 79C(3) as follows:

$$\frac{A \times C}{B}$$

Where:

A is the net foreign exchange gain, as defined, which is shown in the profit and loss account or income statement of the holding company, less any relief for unused net foreign exchange losses brought forward under section 399.

B is the current rate of Corporation Tax on Case IV income (being the rate referred to in section 21A(3)(a)).

C is the current rate of Capital Gains Tax (being the rate referred to in section 28(3)). Should the CGT rate change during a company's accounting period the amount of the gain is to be apportioned on a time basis.

[3] There is a slight difference in the definition of the accounting standards which a relevant holding company can use to prepare its accounts for the purposes of Section 79C when compared to the accounting standards which are generally accepted for the purposes of the corporation tax acts (refer to section 4 TCA 1997). Relevant holding companies will not be excluded from section 79C where they prepare their accounts under accounting standards that fall within the section 4 definition.

[4] It is noted that section 79C refers to section 383, which is income tax Case IV loss relief rather than to section 399 which provides for corporation tax Case IV loss relief.

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