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Do You Buy Or Sell Goods Or Services Overseas?

Globalisation has and continues to open up endless opportunities for local businesses to access foreign markets. With the advent of the internet, more and more businesses are buying and selling goods and services all over the world. With this in mind, we thought it was timely to look at the tax implications that arise for Australian businesses undertaking cross border transactions. In particular, this article provides a summary of the foreign exchange tax rules and then applies these rules to some common transactions.

For the purpose of this article and the examples, it is assumed the taxpayer is an Australian resident and does not have a permanent establishment in the relevant foreign jurisdiction.

The Law

Where a transaction is invoiced in a foreign currency, the Australian tax regime generally requires translation of that amount back to Australian currency and the calculation of a foreign exchange gain or loss. This is essentially a two step process.

Translation rule

The first step is to convert the transaction back to an Australian dollar equivalent. This ensures Australian tax is levied on a common unit of currency. These rules provide the timing for conversion, which varies depending on the type of transaction (e.g. sale, purchase etc).

Foreign exchange gain or loss rules

(foreign exchange rules) – The second step is to record a foreign exchange gain or loss for movements in foreign exchange rates, generally between the date of conversion in step one and the date funds change hands. That is, it records an amount for tax purposes for the movement in the exchange rate between the date of the transaction and the date receipt or payment physically occurs.

To demonstrate these rules in an easy to understand way, suppose you make a sale in a foreign currency on day 1 and collect the cash on day 30. Translation rules require you to convert the amount to Australian dollars on day

1 to include in assessable income. A foreign exchange gain or loss is recorded on day 30 as the difference between what you actually receive on day 30 and the Australian dollar equivalent of what you were entitled to on day 1.

It should be noted these rules will not apply to every sale or purchase with an overseas customer or supplier. It will depend on the arrangement with that customer or supplier. The following table shows when these rules will apply to some common arrangements:

Transaction	Apply translation rules?	Apply foreign exchange rules?
Foreign sale/purchase - in Australian dollars and to be settled in Australian dollars	No	No
Foreign sale/purchase - in foreign currency and to be settled in foreign currency	Yes	Yes
Foreign sale/purchase - in foreign currency but will settle by paying an Australian dollar equivalent	Yes	Yes

Where a transaction is not denominated in a foreign currency, the translation rules will not apply. Similarly, where a transaction is entered in to and settled in Australian currency, the foreign exchange rules will not apply because there can be no exchange rate movement.

Examples

Sale of Goods

John sells computer hardware to a customer in the US. The customer agrees to pay \$1,000 US for the hardware. The sale takes place on 1 June 2009 and the cash changes hands on 30 June 2009. The payment is deposited in to John's bank account on 30 June 2009 and converted to Australian dollars immediately. The relevant exchange rates are:

Date	US	Exchange rate	Australian
1/6/09	\$1,000	\$1 US = \$0.80 AUD	\$1,250
30/6/09	\$1,000	\$1 US = \$0.75 AUD	\$1,333

For tax purposes, the \$1,000 US is translated at the earlier of when the amount is received or when it is included in assessable income. The sale is included in assessable income on 1 June 2009 and translated to Australian dollars on that date. John includes \$1,250 in assessable income on 1 June 2009.

The difference between what is received on 30 June 2009 and what has already been included in assessable income will represent an assessable foreign exchange gain (\$83). The foreign exchange gain is included in assessable income when the cash is received. A foreign exchange gain arises because John receives more cash when he is paid than when the transaction was entered in to.

Although the income from the sale of the hardware and the foreign exchange gain are included in assessable income at different times, the total amount included in assessable income is equal to the actual cash received.

Purchase of Services

John has a dispute with a customer in the UK and engages a UK lawyer to act on his behalf. John receives an invoice for legal fees of 10,000 pounds on 30 September 2009. John pays the Australian dollar equivalent of 10,000 pounds on 31 December 2009. The relevant exchange rates are:

Date	GBP	Exchange rate	Australian
30/9/09	10,000 pounds	1 GBP = \$0.40 AUD	\$25,000
31/12/09	10,000 pounds	1 GBP = \$0.35 AUD	\$28,570

For tax purposes, the 10,000 pounds are translated at the earlier of when the amount is paid and when it becomes deductible. The legal fees will be deductible when invoiced so this will be the date of translation. John includes \$25,000 as a deduction on 30 September 2009.

The difference between what is paid on 31 December 2009 and what has already been included as a deduction will represent a deductible foreign exchange loss (\$3,570). The foreign exchange loss is included as a deduction when the cash is paid. A foreign exchange loss arises because the amount required in Australian dollars to settle the transaction has increased from when the transaction occurred (i.e. John needs to pay an extra \$3,570 Australian because of movements in the exchange rate).

Although the deduction for legal services and the foreign exchange loss become deductible at different times, the total amount claimed as a deduction is equal to the actual cash paid.

The foreign exchange rules are particularly complex. Specific rules apply to the acquisition and disposal of depreciating assets and capital gains tax assets. There are also special rules which apply to foreign bank accounts which broadly seek to simplify the foreign exchange rules where there are high volumes of transactions. There are also a number of elections available which can change the amount and timing of a foreign exchange gain or loss. However, the purpose of this article is to raise awareness of these rules, rather than provide a detailed technical explanation.

Contact Us

For further information or clarification about the issues contained in this newsletter, please contact your William Buck advisor.

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