

## *UITF abstract 19*

### *Tax on gains and losses on foreign currency borrowings that hedge an investment in a foreign enterprise*

#### **Background**

- 1 Where certain conditions are met, SSAP 20 'Foreign currency translation' permits certain gains and losses on foreign currency borrowings that have been used to finance or provide a hedge against equity investments in foreign enterprises to be reported as reserve movements. As a result of the subsequent introduction of FRS 3 'Reporting Financial Performance' these gains and losses are now reported in the statement of total recognised gains and losses.
- 2 Until recently, neither the retranslation of the net investment in a foreign enterprise nor the gain or loss on foreign borrowings had any consequences for tax. Owing to recent changes in UK tax legislation this is no longer always the case and in some circumstances, for example where a matching election is not made for tax purposes, the gain or loss on retranslation of the borrowings is taxable.

#### **The issues**

- 3 The UITF considered how any tax effect of gains and losses on exchange differences on borrowings that are reported in the statement of total recognised gains and losses should be recognised. It concluded that such tax effects should also be reported in the statement of total recognised gains and losses.
- 4 The UITF considered the restrictions of SSAP 20 on the gains and losses that are dealt with in the statement of total recognised gains and losses. It concluded that the restriction that the gains and losses should not exceed the exchange differences on the equity investments (in individual accounts) or net investments in foreign enterprises (in consolidated accounts) should be applied after taking account of any tax charge or credit relating to the gain or loss on the borrowings. It noted that SSAP 20 also requires that the borrowings whose exchange gains and losses are dealt with in the statement of total recognised gains and losses should not exceed the amount of cash that the equity investment or net investment is expected to be able to generate, whether from profits or otherwise. The UITF believed that it would be consistent with its view on the restrictions on gains and losses that this test should also be performed on a net-of-tax basis.

- 5 SSAP 20 also requires that the amount of exchange gains and losses on borrowings that are taken to the statement of total recognised gains and losses should be reported. The UITF concluded that it was necessary to disclose the amount of the related tax.

### **Application to smaller entities**

- 6 Reporting entities applying the Financial Reporting Standard for Smaller Entities currently applicable are exempt from this Abstract.

### **UITF Consensus**

- 7 The UITF reached a consensus that where exchange differences on foreign currency borrowings that have been used to finance, or provide a hedge against, equity investments in foreign enterprises are taken to reserves and reported in the statement of total recognised gains and losses, in accordance with paragraphs 51, 57 and 58 of SSAP 20 and paragraph 27 of FRS 3, tax charges or credits that are directly and solely attributable to such exchange differences should also be taken to reserves and reported in that statement.
- 8 The restriction on the amount of the gains or losses arising on the borrowings that are dealt with in the statement of total recognised gains and losses set out in paragraphs 51(a) and 57(b) of SSAP 20 should be applied after taking account of any tax charge or credit directly and solely attributable to the borrowings. Similarly, the comparison with the total amount of cash that the investments are expected to be able to generate and the exposure created by the borrowings (paragraphs 51(b) and 57(c) of SSAP 20) should be considered in after-tax terms.
- 9 The amount of tax charges and credits accounted for as described in paragraph 7 above should be disclosed, in addition to the gross amount of the exchange differences.

### **Date from which effective**

- 10 The accounting treatment required by this consensus should be adopted in financial statements relating to accounting periods ending on or after 23 March 1998, but earlier adoption is encouraged.

### **References**

- SSAP 20 'Foreign currency translation' paragraphs 51, 57, 58 and 60.  
FRS 3 'Reporting Financial Performance' paragraph 27.

**EDITORIAL NOTE: NOT PART OF THE ABSTRACT**

**Date of publication and subsequent amendments**

UITF Abstract 19 was issued on 20 February 1998.

There have been no subsequent amendments.

**END OF EDITORIAL NOTE**