

# International Tax News\*

Foreign functional currency

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## TAX CONSEQUENCES AS A RESULT OF USING A FOREIGN FUNCTIONAL CURRENCY IN THE STATUTORY ACCOUNTS

In a newly published interpretative statement issued by the Ministry of Finance dated 21 April 2009, the Ministry of Finance discusses several tax issues related to the use of a functional currency other than NOK as reporting currency in the statutory accounts. In our opinion, the statement does not clarify several important issues and the effects of the statement are therefore uncertain.

Norwegian companies must in principle prepare statutory accounts where measurements are made in NOK. A foreign currency may however be used if the company's business is mainly carried out in that foreign currency (functional currency). In such cases, the reporting currency for statutory accounts purposes is the same as the functional currency. When a foreign functional currency is used in the statutory accounts, also the day-to-day book-keeping may be registered in the same currency.

Nevertheless, taxable income must be calculated in NOK. For companies having a foreign currency as functional currency and is using this currency as reporting currency in the statutory accounts, the question is how the statutory accounts shall be converted into NOK for tax purposes. Specifically, the question is whether it is sufficient to convert the net taxable income or whether it is a requirement that all items in the statutory accounts must be converted into NOK?

The Ministry of Finance is of the opinion that each item in the statutory accounts has to be converted from the foreign currency into NOK. If an item in the accounts is a sum of several transactions, the Ministry of Finance states that only the sum (and not the underlying transactions) has to be converted into NOK.

Furthermore, balance sheet items which are not cash or monetary items shall be converted to historical exchange rate, whilst cash and monetary items shall be converted at the exchange rate at the end of the accounting period. Salary and

VAT shall as before follow the rules set forth in the Bookkeeping Regulation (Reg. 1 December 2004 no 1558, section 4-2). The conversion of other items in the income statement shall, as a main rule, be done at the average rate of exchange.

Due to the conversion from the functional currency into NOK, solely for tax return purposes, a conversion difference may occur if the converted income does not correspond with the changes in the company's capital during the income year. The question is whether such a difference is taxable or tax deductible. Based on the Ministry of Finance's statement, it appears that the Ministry of Finance is of the opinion that such differences are, as a main rule, taxable or tax deductible.

In our view, the statement from the Ministry of Finance does not fully address several important tax issues in relation to using a functional currency other than NOK as reporting currency in the statutory accounts.

Firstly, the statement does not address the principle definition of the term foreign currency in relation to foreign exchange gains/losses when using a different functional and reporting currency than NOK. While a foreign currency exchange gain/loss is as the main rule taxable/deductible, the question in this context is whether such gain/loss has occurred. The conversion difference does not arise due to transactions being carried out in a different currency than the functional and reporting currency; it only arises due to the conversion for tax reporting purposes.

Secondly, the Ministry's view on the taxation of conversion differences is also highly questionable. As taxation requires a legal basis, a general question should be whether there is a legal basis for taxing such a conversion difference. The approach should then be whether the conversion difference, for tax return purposes only, represents an economic benefit/liability for the taxpayer. This issue is not discussed in the statement.

Therefore, although the statement appears clear in its conclusions, there are several uncertainties of what the consequences of the statement are.

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