Deloitte.
Private

Briefing document
Foreign exchange

Introduction
Where there are significant movements in the value of sterling compared to foreign currencies, these affect the calculation of foreign income and the value of assets in sterling terms, which in turn can affect UK tax liabilities. This note is intended to clarify how foreign exchange is dealt with in calculating capital gains and taxable income for individuals and trusts. It also covers how the rules affect non-UK domiciled individuals who are taxed on the remittance basis.

The law does not provide for a particular exchange rate basis to be used for tax purposes. HMRC publish certain year end spot rates and various average exchange rates at http://deloi.tt/forex, which are based on London closing rates. These rates are not mandatory and are of limited application, however, so taxpayers generally need to use alternative rates from reputable sources. The basis chosen should be used consistently to ensure a just and reasonable result.

Capital gains
For capital gains tax purposes, the base cost of an asset acquired using foreign currency is determined by converting the price into sterling at the spot rate on the date of acquisition. Similarly, proceeds are determined by converting into sterling at the spot rate on the date of disposal. This means that an asset can be sold for no economic gain in the foreign currency, but foreign exchange movements could give rise to a capital gain or loss. For instance, if an individual purchases an asset for $100,000 when the exchange rate was $1.80:£1 and sells it for $100,000 when the exchange rate is $1.35:£1, the cost and proceeds are expressed as £55,555 and £74,074, respectively. Although there is no gain in dollar terms, there is a capital gain of £18,519 in sterling terms. As proceeds are converted on the disposal date, any movements in exchange rates between the disposal date and an actual conversion into sterling do not affect the calculation of the gain on the asset sold. If the currency moves further before being converted into sterling, this may of itself give rise to a gain, but gains or losses on actual currency or foreign currency bank accounts are normally exempt (see below).

Foreign currency itself (i.e. non-sterling cash) is a chargeable asset for capital gains tax, so gains and losses can arise. There is an exemption for foreign currency that has been acquired for personal expenditure abroad, however, which includes expenditure on the provision or maintenance of a non-UK home. In practice, gains and losses on cash are therefore rare.

Foreign currency bank accounts
Prior to 6 April 2012, deposits in foreign currency bank accounts were normally chargeable assets for capital gains purposes. If the foreign currency had appreciated against sterling between deposit and withdrawal, capital gains therefore arose. These deposits are now exempt assets, so neither capital gains nor losses arise on withdrawals on or after 6 April 2012.

It is important to note that this exemption is limited to foreign currency bank accounts and does not affect the treatment of gains and losses on other currency-related assets, such as options and futures.

Income tax

Generally, income denominated in a foreign currency should be converted to sterling based on the spot rate for the date of receipt. There are exceptions to this, however.

For regular income receipts and deductible expenses that arise evenly over time (e.g. in respect of a business conducted in a foreign currency), it is acceptable to use an average exchange rate (monthly, annual or some other basis) provided the result is reasonable. In years where there are some very sharp fluctuations, the annual average might not be appropriate in some cases.

Offshore funds

Some offshore collective investment schemes are cash based and can be denominated in foreign currency (e.g. liquidity funds), but the units are treated in a similar way to shares and do not fall within the foreign currency bank account exemption. If the underlying foreign currency appreciates in value between acquisition and redemption, gains can therefore arise.

Gains on certain non-UK collective investment schemes ('non-reporting funds') are subject to income tax rather than capital gains tax. These are known as 'offshore income gains'. Offshore income gains are calculated using capital gains principles. Like capital gains, offshore income gains can arise in sterling terms on foreign currency-denominated units even if there is no gain in foreign currency terms.

Non-UK domiciled individuals

Special rules apply to non-UK domiciled individuals who have opted to be taxed on the remittance basis. Income that is taxed on the remittance basis is converted into sterling on the date of remittance rather than the date of receipt. If foreign denominated income has grown in value between receipt and remittance, the taxable income therefore grows accordingly.

Non-UK domiciled individuals are taxed on the remittance basis automatically where unremitted foreign income and gains for the year are £2,000 or less. In determining whether this limit is breached, foreign denominated income is converted based on the spot rate on 5 April at the end of the relevant tax year.

In contrast to foreign-denominated income, the calculation of a capital gain that is taxed on the remittance basis is not directly affected by the exchange rate on the date of remittance. The gain is calculated based on the normal principles set out above. The calculation of the remittance itself may be be affected, however. Following on from the example above, and assuming the proceeds are in an offshore account that does not contain any income or other gains, a remittance of $20,000 to the UK at a time when the exchange rate is $1.25:£1 would give rise to a taxable gain of £16,000 (the remaining £2,519 of gain would remain in the offshore account).

Find out more…

This note reflects the law in force as at 6 April 2020. Please be aware that it does not cover all aspects of this subject. To find out more about any aspect of the above, please discuss with your usual Deloitte contact. If you do not have a usual contact, please contact Patricia Mock (pmock@deloitte.co.uk).

For further information visit our website at www.deloitte.co.uk.