IRAS e-Tax Guide

Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses

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Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses

1 Aim

1.1 This e-Tax Guide provides details on the tax treatment of foreign exchange gains or losses for businesses (banks and businesses other than banks). This e-Tax Guide consolidates the two e-Tax guides issued previously on the income tax treatment of foreign exchange gains or losses[1].

1.2 It would be relevant to businesses which have foreign exchange gains or losses.

2 At a glance

2.1 The tax treatment of foreign exchange differences is summarised in the table as follows:

<table>
<tr><th rowspan="2"></th><th colspan="3">Nature of foreign exchange differences</th></tr>
<tr><th>Revenue</th><th>Capital</th><th>Translation</th></tr>
<tr><td rowspan="2">Description</td><td>Foreign exchange differences arising from revenue transactions</td><td>Foreign exchange differences arising from capital transactions</td><td rowspan="2">Foreign exchange differences arising from translating financial statements prepared in the functional currency of the business to another currency for presentation purposes</td></tr>
<tr><td colspan="2">Whether a transaction is capital or revenue in nature depends on the facts and circumstances of each case</td></tr>
<tr><td>Tax treatment</td><td>All exchange differences recognised in the profit and loss account are taxable or deductible even if there is no physical conversion of the foreign currencies</td><td>Not taxable or deductible</td><td>Not taxable or deductible</td></tr>
</table>

[1] This e-Tax Guide is a consolidation of two previous e-Tax guides on:
a. “Treatment of foreign exchange gains or losses for banks” published on 2 Nov 1993; and
b. “Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses” published on 28 Nov 2003.

	Nature of foreign exchange differences		
	Revenue	**Capital**	**Translation**
Condition for tax treatment	The accounting treatment is consistently applied to both the foreign exchange gains and losses	Not applicable	Not applicable
Effective date of tax treatment	Banks Granted automatically since 2 Nov 1993 Non-banks Granted automatically since the Year of Assessment 2004 unless opted-out	Not applicable	Not applicable

2.2 Please refer to the paragraphs below for further details.

3 Glossary

3.1 Capital foreign exchange differences

These are foreign exchange differences arising from capital transactions. The foreign exchange differences are capital in nature.

3.2 Foreign exchange differences

Foreign exchange gains or losses are collectively referred to as foreign exchange differences.

3.3 Functional currency

Functional currency is the currency of the primary economic environment in which the entity operates. Another term for functional currency is measurement currency.

3.4 Revenue foreign exchange differences

These are foreign exchange differences arising from revenue transactions. The foreign exchange differences are revenue in nature.

3.5 Translation

Translation refers to the conversion of an amount in foreign currency to a business' functional currency.

3.6 Translation foreign exchange differences

These are foreign exchange differences arising from translating the financial statements prepared in the functional currency of the business to another currency for presentation purpose.

4 Tax treatment of foreign exchange differences

4.1 Foreign exchange differences can arise from capital or revenue transactions. Whether a transaction is capital or revenue in nature is dependent on the facts and circumstances of each case.

4.2 For income tax purposes, foreign exchange differences arising from capital transactions ("capital foreign exchange differences") are capital in nature. They are, therefore, not taxable as income or deductible as an expense (referred to as "taxable or deductible"). On the other hand, foreign exchange differences arising from revenue transactions ("revenue foreign exchange differences") are revenue in nature. They are, therefore, taxable or deductible.

4.3 It is a well established principle of taxation that gains or losses are recognised for tax purposes only when they are realised. Thus, revenue foreign exchange differences are taxable or deductible only when they are realised.

4.4 Foreign exchange differences are considered as realised when the foreign currencies are physically converted into or exchanged for the functional currencies of the businesses, or vice versa.

4.5 However, for administrative ease, the Comptroller of Income Tax ("CIT") regards revenue foreign exchange differences arising under these two situations as realised even if there is no physical conversion or exchange of the foreign currencies:

a. Sales/purchases settled in the same accounting period

The sales or purchases of the business transacted in foreign currencies (i.e. currencies other than the functional currency) are settled (i.e. payment received or made) in the same accounting period. However, the exchange rates at the time of the transactions and at the time of settlement of the transactions may be different. As a result, foreign exchange differences are charged to the profit and loss account. For administrative ease, they are regarded as realised when the transactions which give rise to them are settled. They are taxable or deductible in the same accounting year. Please refer to the example in the Annex.

b. Sales/purchases not settled in the same accounting period

The sales or purchases of the business transacted in foreign currencies are not settled in the same accounting period in which the transactions arose. However, the exchange rates at the end of the accounting period may be different from those at the transaction date or that applied at the end of the previous accounting year-end. As a result, foreign exchange differences arising from translating the monetary items (e.g. debtors and creditors) denominated in foreign currencies into the functional currency of the business are charged to the profit and loss account. For administrative ease, they are deemed to be realised in the following year and taxable or deductible accordingly. Please refer to the example in the Annex.

4.6 Apart from foreign exchange differences arising from capital or revenue transactions, foreign exchange differences may also arise from translating the financial statements prepared in the functional currency (e.g. US$) of the business to another currency (e.g. S$) for presentation purpose ("translation foreign exchange differences"). These are merely notional gains or losses and are therefore not taxable or deductible for tax purposes.

4.7 The table below summarises the tax treatment of foreign exchange differences mentioned in the paragraphs above:

Nature of foreign exchange differences	Realised or unrealised?	Taxable or deductible?
Capital	Not relevant	No
Revenue	Realised	Yes
	Unrealised	No, unless regarded as realised by CIT in paragraphs 4.5(a) and 4.5(b) above
Translation	Not relevant	No

5 Accounting versus tax treatment

5.1 For accounting purposes, the profit and loss account does not separately reflect capital, revenue or translation exchange differences and whether they are realised or unrealised.

5.2 In view of the different treatment of foreign exchange differences for tax purposes, businesses need to keep track of their foreign currency transactions which are revenue in nature. This is so that they can determine if the foreign currencies have been physically converted into the functional currencies before treating the revenue foreign exchange differences as realised for income tax purposes.

5.3 The CIT recognises that the tracking of the foreign currency transactions requires additional efforts and for some businesses, the transactions involved may be voluminous. Businesses have represented that they face difficulties in distinguishing between realised and unrealised revenue foreign exchange differences. Taking into consideration the feedback from businesses on the tax treatment of foreign exchange differences, the CIT has put in place two concessionary tax treatments for revenue foreign exchange differences.

6 Administrative concession – To accept accounting treatment for revenue foreign exchange differences

6.1 The CIT accepts, for tax purposes, the accounting treatment adopted by businesses for revenue foreign exchange differences. This means that businesses will no longer need to distinguish between realised and unrealised revenue foreign exchange differences. All revenue foreign exchange differences will be taxable or deductible in the year they are charged to the profit and loss account.

6.2 <u>Scope of the administrative concession</u>

The concession only applies:

a. to revenue foreign exchange differences. Capital and translation foreign exchange differences remain not taxable or deductible; and

b. when the same accounting treatment is consistently applied to both revenue foreign exchange gains and revenue foreign exchange losses.

6.3 <u>Effective dates of the administrative concession</u>

a. <u>Banks</u>

The concession applies to banks with effect from 2 Nov 1993.

b. <u>Businesses other than banks</u>

The concession applies automatically to all businesses other than banks with effect from the Year of Assessment 2004.

If any businesses other than banks have opted out of the concession when submitting the income tax return for the Year of Assessment 2004, their decision is irrevocable[2]. These businesses must follow the tax treatment of foreign exchange

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[2] Businesses other than banks were given the option to opt out of the administrative concession when it was introduced in 2003 ("Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses" published on 28 Nov 2003").

differences as explained in paragraph 4. This means that revenue foreign exchange differences are not taxable or deductible until they are realised or regarded as realised by CIT in paragraphs 4.5(a) and 4.5(b).

6.4 In the first assessment year that the concession is effective, any prior years unrealised revenue exchange differences which were not taxable or deductible previously, would have been regarded as realised in that assessment year.

7 Administrative concession – To regard the designated bank account maintained for receiving trade receipts and paying revenue expenses as revenue in nature

7.1 Some businesses maintain foreign currency bank accounts for the purposes of their business operations. Foreign exchange differences may arise when businesses translate the year-end balances of these accounts into their functional currency. From the tax perspective, such foreign exchange differences are regarded as capital in nature and therefore, not taxable or deductible. The reasons being:

a. Generally, the funds in bank accounts constitute the capital assets of the businesses; and

b. The bank accounts hold the cash proceeds of the businesses (e.g. sales or investments) and provide the means for payment (e.g. purchases of stocks or assets). The foreign exchange differences arising from any revenue transactions would have been recognised for tax purposes when they are settled. Hence, the foreign exchange differences arising from the translation of the year-end balances of the foreign currency bank accounts into the businesses' functional currency represent the cost of holding the foreign currencies to meet both capital and revenue requirements of the businesses.

7.2 Some businesses may, however, designate a specific foreign currency bank account ("designated bank account") solely for the purpose of receiving trade receipts[3] and paying revenue expenses[4] in a particular foreign currency. The designated bank account is not used for any other purposes. In such a case, the CIT is prepared to regard the designated bank account as revenue in nature. Hence, any foreign exchange differences arising from the translation of the year-end balance of the designated bank account into the businesses' functional currency will be taxable or deductible.

[3] Sales on revenue account, whether of goods or services, or trade debtors are collectively known as trade receipts.

[4] Purchases on revenue account, whether goods or services, or trade creditors or operating expenses are collectively known as revenue expenses.

7.3 Effective date of the administrative concession

The concession is effective from the Year of Assessment 2004.

7.4 Administrative procedure

Any business who wishes to enjoy the administrative concession under paragraph 7.2 would need to:

a. inform the CIT in writing that it maintains a designated bank account as mentioned in paragraph 7.2; and

b. provide documentary evidence to substantiate its claim in paragraph 7.4(a). An example of such documentary evidence is the bank statements of the designated bank account showing frequent movements in the funds that are due to trade receipts and payments for revenue expenses.

8 Contact information

8.1 If you have any enquiries or need clarification on this Guide, please call 1800-3568622.

9 Updates and amendments

	Date of amendment	Amendments made
1	29 Jun 2012	Previously, once businesses other than banks have opted out of the administrative concession to apply the accounting treatment for revenue foreign exchange differences, the revenue foreign exchange differences are only taxable or deductible for income tax purposes when they are realised*. The CIT is prepared to accept the revenue foreign exchange differences as taxable or deductible for income tax purposes when they are realised or regarded as realised by the CIT (refer to paragraph 6.3(b)). * Paragraph 12 of the e-Tax guide, Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses, published on 28 Nov 2003

Annex – Example to illustrate the accounting and tax treatments of foreign exchange differences arising from foreign currencies transactions

Scenario

For the accounting year ended 31 December 2002, ABC Pte Ltd conducted two US$ and one £ sales transactions. Its functional currency is S$. It maintains two bank accounts, one in S$ and another in US$. The accounting and tax treatment of the transactions are summarised in the table below.

	Date	Event	Accounting treatment	Tax treatment based on tax principle	Current tax treatment	Concessionary tax treatment
1	1 Aug 2002	Sale of goods to DEF Inc for US$100	DR Trade Debtor S$170 CR Sales S$170 Exchange Rate: S$1.7 : US$1	None	None	None
2	1 Sep 2002	Sale of goods to GHI Inc for US$200	DR Trade Debtor S$360 CR Sales S$360 Exchange Rate: S$1.8 : US$1	None	None	None
3	1 Oct 2002	Payment received from DEF Inc of US$100	DR US$ Bank S$190 CR Trade Debtor S$170 CR Forex gain (P&L) **S$ 20** Exchange Rate: S$1.9 : US$1	S$20 is not taxable as there is no physical conversion of US$ to S$.	S$20 is taxable as it was settled during the year.	S$20 is taxable based on the accounting treatment.
4	15 Oct 2002	Sale of goods to JKL Ltd for £300	DR Trade Debtor S$900 CR Sales S$900 Exchange Rate: S$3.0 : £$1	None	None	None
5	1 Dec 2002	Payment received from JKL Ltd of £300	DR S$ Bank S$840 DR Forex loss (P&L) **S$ 60** CR Trade Debtor S$900 Exchange Rate: S$2.8 : £1	S$60 is deductible as £300 has been physically converted into S$ when deposited into S$ bank account.	S$60 is deductible as it was settled during the year.	S$60 is deductible based on the accounting treatment.
6	31 Dec 2002	Year end translation of trade debtor (GHI Inc) balance of US$200 from US$ to S$	DR Trade Debtor S$ 40 CR Forex gain (P&L) **S$ 40** Exchange Rate: S$2.0 : US$1	S$40 is not taxable as there is no physical conversion of US$ to S$.	$40 is taxable in the following year as it is "deemed realised in the following year".	$40 is taxable based on the accounting treatment.
7	1 Feb 2003	Payment received from GHI Inc of US$200	DR US$ Bank S$320 DR Forex loss (P&L) **S$ 80** CR Trade Debtor S$400 Exchange Rate: S$1.6 : US$1	S$80 is not deductible as there is no physical conversion of US$ to S$	S$80 is deductible as it was settled during the year	S$80 is deductible based on the accounting treatment.

Legend : 1. Forex - Foreign exchange 2. Current tax treatment – the tax treatment explained in paragraph 4 of the e-Tax Guide.