REVENUE MEMORANDUM CIRCULAR NO. 12-2024 issued on January 22, 2024 clarifies the treatment of foreign currency transactions for financial reporting and internal revenue tax purposes.

The Table below shows the differences between the foreign exchange (forex) gains/losses recognized in the financial statements prepared under the Philippine Financial Reporting Standards (PFRS)/Philippine Accounting Standards (PAS) and the forex gains/losses as income or allowable deduction for Income Tax purposes.

PARTICULARS	PFRS	Current Tax Treatment
1. Initial measurement of foreign currency transactions	All foreign currency transactions are recorded in the entity's functional currency using the spot rate of exchange at transaction date.	Foreign currency transactions are translated into Philippine Peso using the prevailing interbank reference rate on the date of transaction. This is the basis of the reportable transactions for taxes other than Income Tax (e.g., VAT, GRT, OPT, Excise, DST, etc.)
2. Unrealized gain or loss on remeasurement of monetary assets and liabilities denominated in foreign currency	Recognized in profit or loss.	Results to a temporary difference for which deferred tax accounting should be applied to reconcile accounting net income to taxable net income.
3. Unrealized gain or loss on remeasurement of non-monetary items carried at fair value currency transaction	Recognized in profit or loss or OCI depending on the treatment of the changes in the fair value of the item itself.	Not considered in the determination of the taxable income.
4. Realized gain or loss on settlement of a foreign currency transaction	Recognized in profit or loss.	Forex gains/losses arising from closed and completed transactions are considered as taxable income or deductible expense for Income Tax purposes.

PAS 21 requires an entity to determine its functional currency taking into account the primary economic environment in which an entity operates. Once the entity has determined its functional currency, all other currencies are treated as foreign currencies.

A foreign currency transaction is recorded initially using the rate of exchange on the date of the transaction. The use of average rate is permitted as long as they are a reasonable approximation of the actual. (PAS 21.21-22)

Foreign currency monetary amounts are reported using the closing rate. Any unrealized gain or loss arising from the translation of monetary assets and liabilities at the end of the reporting period is generally recognized in profit or loss.

Non-monetary items carried at historical costs are measured using the historical exchange rate at the date of the transaction. This means that they are not remeasured at reporting date.

Non-monetary items that are carried at fair value are translated using the exchange rates at the date the fair value is measured. Any unrealized gain or loss arising from the translation is recognized in the same way the change in fair value is recognized in the financial statements. For example, when the change in the fair value of a non-monetary item is recognized in OCI, then unrealized gain or loss arising from the translation shall also be recognized in OCI.

When monetary items are settled, the difference between the carrying amount of the monetary asset or liability and the consideration received/paid is recognized immediately in profit or loss.

Foreign currency transactions shall be converted into functional currency using the exchange rate at the time an asset, liability, income and expense are recognized and measured/remeasured (i.e., the date of transaction, reporting date, settlement date).

The exchange rate to be used at initial recognition of foreign currency denominated transactions shall be the spot rate on the date of transaction. Since the forex spot rates change from time to time within a particular day depending on the market trading activities, different forex spot rates are being published every trading day (e.g., open, close, high, low, weighted average, etc.) as a reference rate to be adopted for proper valuation reflecting the true income of foreign currency denominated transactions.

The taxpayer has the preference to adopt which spot rate to be used (e.g., open, close, high, low; weighted average, etc.) in the beginning of the taxable year as long as the spot rates adopted must be used consistently both in recording for financial accounting purposes and reporting for tax purposes for at least one taxable year.

The exchange rate to be used in converting foreign currency denominated transactions incurred on dates where there are no published forex rates available (e.g., weekends, holidays, etc.) shall be the latest closing spot rate available on the business date immediately preceding the date of transaction.

To standardize the forex rates to be used for tax purposes, the following rules are prescribed to govern the conversion of foreign currency denominated transactions to Philippine Peso:

a. The spot rate of exchange on the day of the transaction based on the Banker's Association of the Philippines (BAP) published rates, or
b. In the event that the forex rate as stated in item (a) is impractical or not feasible, the spot rate on the day of the transaction based on other available exchange rates (e.g., Bangko Sentral ng Pilipinas (BSP), Bloomberg, Reuters exchange rates, etc.) shall be used subject to the following conditions:
    i. A taxpayer electing to use forex rates other than BAP published rates must submit to the Revenue District Office (RDO) or Large Taxpayer District Office (LTDO) or Large Taxpayers Service (LTS), whichever has jurisdiction over the taxpayer, a notarized sworn statement stating the source of the forex rates to be used, the reason for using such forex rates other than BAP published rates

and a statement allowing the BIR to have an access on the day-to-day forex rates used during BIR audit (e.g., access to subscription with Bloomberg, etc.) for the taxable year, within 30 days prior to the start of the taxable year.

ii. The source of forex rates used in converting foreign currency denominated transactions, such as the URL/source where the forex rates are published or listed or a summary of the day-to-day exchange rates used for the taxable year must be available for presentation and submission, together with other supporting documents during BIR audit.

Election of forex rates are irrevocable and must be used consistently both in recording for financial accounting purposes and reporting for tax purposes for at least one taxable year.

The notarized sworn statement informing the concerned BIR offices of electing the use of forex rates other than BAP published rates shall be submitted. In case of subsequent change in forex rates used, a new notice shall be submitted to the concerned BIR office, which shall be applied from the start of the succeeding taxable year.

In case the taxpayer's accounting system is not capable of adopting the exact number of decimal places as of those in the forex published rates, the taxpayer may use the maximum number of decimal places as designed in their respective system subject to written notification to the BIR office whichever has jurisdiction over the taxpayer for the system limitation.

Given that BAP publishes USD/PhP spot rates only, taxpayers with foreign currency transactions other than USD are allowed to directly convert the foreign currency other than USD to PhP using the forex rates other than BAP published rates as stated in Q&A (4)(b) of the Circular following the conditions enumerated.

The taxpayer is allowed to use the BSP spot rates for foreign currency transaction other than USD subject to the following conditions:

a. The taxpayer shall summarize its foreign currency transactions other than USD with the following information:
    i. Date of transaction
    ii. Amount of foreign currency transactions other than USD
    iii. Nature of transaction
    iv. Forex rate used in converting to PhP; and
    v. PhP converted amount of the foreign currency transaction
b. The requirement on item (a) must be available for presentation and submission, together with the supporting documents on the said foreign currency transactions during BIR audit.

The taxpayer will still be required to prove the reliability of exchange rate used during a tax audit. Moreover, corresponding administrative penalties under Section 255 of the Tax Code, as amended, would be imposed for first and second offenses. Subsequent offenses shall be considered as willful failure, and thus not subject to compromise.

In the absence of any proof, the forex rates other than BAP published rates used by the taxpayer shall be disregarded during BIR audit. In case of foreign currency transactions denominated in USD, the same shall be converted using the BAP published rates, whereas for foreign currency transactions denominated in a currency other than USD, the BSP rates shall be used.

With the availability of wide range of forex between foreign currencies other than USD to PhP, the practice of converting first to USD the foreign currency other than the USD is now superseded by Q&A No. 4(b) and Q&A No. 6 of the Circular. Foreign currency transactions are converted into Philippine peso for tax purposes using the spot rate of exchange on the date of transaction.

A forex difference (i.e., gains/losses) results when there is a change in the exchange rate between the transaction date, balance sheet date and the date of settlement of any monetary items arising from a foreign currency transaction.

Unrealized forex gains/losses result from fluctuations in exchange rates upon remeasurement between the transaction date and the balance sheet date. It is only a potential gain/loss where there is no real flow of wealth yet generated from the remeasurement for accounting purposes.

Realized forex gains/losses results from changes in the exchange rates between the transaction date and the date of settlement. This represents the actual gains/losses incurred from a closed and completed foreign currency transactions.

The "Realization" principle adopted under Revenue Regulations (RR) No. 02-40 provides that for purposes of taxation, only the realized gain or loss from foreign exchange transaction will be subject to Income Tax. Under this principle, income is recognized when: (i) the earning process is complete or virtually complete, and (ii) an exchange has taken place.

Unrealized gains or losses on forex fluctuations recognized in connection with the periodic remeasurement of assets and liabilities denominated in foreign currency to functional currency are not considered as income/loss for purposes of computing taxable income. Such differences are temporary and should be monitored for which deferred tax accounting should be applied. These temporary differences will reverse when the respective assets and liabilities are disposed of or settled. These temporary differences which give rise to deferred tax assets/liabilities are required to be disclosed in the Notes of Audited Financial Statements (AFS).

The taxpayers should separately record and report unrealized forex gains/losses from the realized forex gains/losses arising from foreign currency transactions. Only realized forex gains/losses, or those arising from closed and completed transactions, are considered as taxable income or deductible expense for Income Tax purposes. Realized forex gains/losses shall be substantiated with sufficient evidence that the same arose from a closed and completed transaction (e.g., schedule of foreign currency transactions resulting to forex gains/losses with reference to the bank statements on actual collection of receivables and payment of payables, etc.).

Moreover, automatic reversal of unrealized forex differences to realized forex gains/losses in the succeeding year not arising from closed and completed transactions are strictly prohibited for Income Tax purposes.

Difference in foreign exchange rates will give rise to actual gain/loss when certain events occur, such as, but not limited to the following:

- Exchange rate at the time of receipt of advance payments on contracts is different from the rate at the time income is earned and debited against advance payments;
- Exchange rate at the time of recording/recognizing accounts receivables is different from the rate at the time of actual collection of the account receivables;
- Exchange rate at the time advance payments are made to subcontractors is different from the rate at the time expenses on the sub-contract are incurred/recorded;
- Exchange rate at the time of recording/recognizing accounts payables is different from the rate at the time accounts payables are paid;

- Exchange rate at the time down payments for construction materials are made is different from the rage at the time of full-payment/settlement of the balance on the purchase price of the materials.

The practice of offsetting transactions of taxpayers and consequently the accounting and recording of the same and its related transactions in the books of the parties is strictly prohibited for taxation purposes.

The gross amounts of gain and loss must be presented in the Income Tax Return. However, for tax calculation purposes, forex loss is still allowed as a deduction following the rules on Income Tax deductibility.

Forex gains shall be presented as part of "Other Taxable Income" and be included in the computation of "Total Taxable Income" or "Gross Taxable Income" in the Income Tax Return. On the other hand, forex losses shall be presented as part of the "Ordinary Allowable Itemized Deductions" in the Income Tax Return.

Foreign currency transactions are converted into Philippine Peso using the prevailing spot rate on the date of transaction. This is the basis of the reportable transactions for taxes other than Income Tax (e.g., VAT, GRT, OPT, Excise, DST, etc.).

For VAT purposes, the reportable amount for sale of goods or properties shall be the gross selling price or the gross value in money as supported by a corresponding sales invoice; while for sale or exchange of services, including the use or lease of property, it shall be the gross receipts as supported by a corresponding official receipt.

For GRT and OPT, the reportable amount shall be the gross quarterly sales or receipts depending on the type of transaction subject to the said taxes.

For Excise, the reportable amount shall be the Excise Taxes imposed and based on weight or volume capacity or any other physical unit of measurement (Specific Tax) and imposed and based on selling price or other specified value of the goods (Ad Valorem Tax) generally before the removal/release of the excisable products.

For DST, the reportable amount shall be based on the value of the documents subject to stamp tax.

For Withholding Taxes, in general, the reportable amount shall be the value of the taxable income payment at the time it is paid or payable or when it is accrued or recorded as an expense or asset whichever comes first.

Illustrations and Accounting Entries are reflected in Annex "A" of the Circular, as guide for recording and reporting foreign currency transactions.