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Income Tax Treatment of Foreign Exchange
Gains or Losses for Businesses
(Third Edition)



Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses

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Table of Contents

	Page
1. Aim	1
2. At a glance	1
3. Glossary	2
4. Tax treatment of foreign exchange differences	3
5. Accounting versus tax treatment	4
6. To accept accounting treatment for revenue foreign exchange differences	5
7. To regard the designated bank account maintained for receiving trade receipts and paying revenue expenses as revenue in nature	7
8. Contact Information	10
9. Update and amendments	11
Annex A – Example to illustrate the accounting and tax treatments of foreign exchange differences arising from foreign currencies transactions	13
Annex B – Examples of the application of the de-minimis limit for the designated bank account treatment	15

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 losses¹.
- 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:

Nature of foreign exchange differences	Tax treatment	Effective date of tax treatment
Capital foreign exchange differences	Not taxable or deductible	Not applicable
Revenue foreign exchange differences	All exchange differences recognised in the profit and loss account are taxable or deductible, regardless of whether they are realised or unrealised.	<p><u>Banks</u> Treatment applied automatically since 2 Nov 1993</p> <p><u>Non-banks</u> Treatment applied automatically since the Year of Assessment (YA) 2004, unless option (irrevocable) was made in the YA 2004 by the business for its unrealised exchange differences not to be treated as gain or loss for tax purposes.</p> <p>From 12 Nov 2018, the option previously made may be revoked from an effective YA by election to the Comptroller of Income Tax ("CIT") for approval.</p>
Translation foreign exchange differences	Not taxable or deductible	Not applicable

- 2.2. Please refer to the paragraphs below for further details.

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.

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. Revaluation

Revaluation 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. Capital versus revenue nature

4.1.1 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.

4.1.2 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. 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.

4.2 Realised versus unrealised gains or losses

4.2.1 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.

4.2.2 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.

4.2.3 However, the 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. Such foreign exchange differences 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 A.

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. Such foreign exchange differences are deemed to be realised in the following year and taxable or deductible accordingly. Please refer to the example in the Annex A.

4.3 Translation foreign exchange differences

4.3.1 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.

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 and accounting 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 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.

6. To accept accounting treatment for revenue foreign exchange differences

6.1 Taking into consideration the feedback from businesses on the tax treatment of foreign exchange differences, the CIT accepts, for tax purposes, the accounting treatment adopted by businesses for revenue exchange differences. This means that businesses do not need to distinguish between realised and unrealised revenue foreign exchange differences. All revenue foreign exchange differences will be taxable or deductible in the year that they are charged to the profit and loss account. This tax treatment is effective as follows:

Banks

It applies automatically to banks since 2 Nov 1993.

Non-Banks

It applies automatically to businesses other than banks since YA 2004, unless such businesses had opted out of the tax treatment when submitting the YA 2004 income tax return.

6.2 The above tax treatment for revenue foreign exchange differences has been legislated under Section 34AB of the Income Tax Act. Also, from 12 Nov 2018, businesses that had previously opted out of the tax treatment in YA 2004², could now make an irrevocable election to the CIT to adopt the tax treatment. The election should be made when the business files its income tax return.³ Upon approval by the CIT, such businesses will be allowed to adopt the tax treatment from the year of assessment in which the election was made, and every subsequent year of assessment. In the first year of assessment in which the election was made, any prior years' unrealised revenue exchange differences which were not taxable or deductible previously, would be regarded as realised in the basis period relating to that assessment.

6.3 Businesses that had opted out of the tax treatment in the YA 2004 and would like to continue with the option must follow the tax treatment of foreign exchange 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 the CIT in paragraphs 4.2.3(a) and 4.2.3(b).

² The opt-out made in the YA 2004 was previously irrevocable.

³ For businesses that file the Form C, such election should be made in their income tax computations. Businesses that file the Form C-S can write in separately to CIT to make the election when filing their income tax returns.

6.4 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 (i.e. either physical conversion or deemed realised in paragraph 4.23)	Yes
	Unrealised	Yes (unless the business had opted out of the treatment as per paragraph 6.3)
Translation	Not relevant	No

7. 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 revalue the year-end balances of these accounts in their functional currency. From the tax perspective, such foreign exchange differences are regarded as capital in nature and therefore, not taxable or deductible⁴. 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 revaluation 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 receipts⁵ and paying revenue expenses⁶ in a particular foreign currency ("designated revenue purpose"). The designated bank account is not used for any other purposes such as (but not limited to):

- a. Purchase of capital items (e.g. fixed assets);
- b. Used for investment purposes (e.g. share purchase, placement of fixed deposit);
- c. Transfer of funds to/from Group cash pooling account; or
- d. Transfer of funds to another non-designated bank account of the business.

⁴ The general tax position where foreign exchange differences arising from the revaluation of year-end balances of bank accounts are regarded as capital in nature does not apply to banks and insurance businesses:

Banks

Cash is regarded as stock-in-trade for banks. Hence, foreign exchange differences arising from the revaluation of year-end bank balances of banks will generally be treated as revenue in nature.

Insurance businesses

The nature of insurance businesses is to underwrite risks. Insurance businesses collect premiums from their customers and the accumulated premiums or cash from customers are invested in stocks, properties and other assets to generate income to support the policy liabilities and provide returns to the policy holders. In this regard, foreign exchange differences arising from the revaluation of year-end balances of bank accounts for insurance businesses are generally regarded as arising in the course of trade and treated as revenue in nature unless proven otherwise. Where an insurance business is able to prove to the CIT that its bank accounts are used principally for capital transactions (i.e. capital receipts and capital expenditures), the CIT would be prepared to treat the bank accounts to be on capital account. Accordingly, foreign exchange differences arising from the revaluation of year-end bank balances of such bank accounts will be treated as capital in nature.

⁵ Sales on revenue account, whether of goods or services, or trade debtors are collectively known as trade receipts.

⁶ Purchases on revenue account, whether goods or services, or trade creditors or operating expenses are collectively known as revenue expenses.

- 7.3 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 revaluation of the year-end balance of the designated bank account into the businesses' functional currency will be taxable or deductible.
- 7.4 Businesses have given feedback that to qualify for the existing designated bank account treatment, they would need to maintain at least two different bank accounts in the same currency (one solely for revenue purposes and one for other transactions) even though most of their transactions in that currency is revenue in nature. This gives rise to additional administrative burden as well as increase in business and compliance costs in order to enjoy the designated bank account treatment.
- 7.5 Arising from businesses' feedback, CIT has reviewed the condition for the designated bank account. With effect from YA 2020, CIT is prepared to allow businesses to treat foreign exchange differences arising from the revaluation of designated bank account as revenue in nature even if the said designated bank account is not maintained solely for revenue purpose. This is provided that the number and value of capital transactions within the designated bank account do not exceed the following de-minimis limit:
- a. Total number of capital transactions: not more than 12 transactions a year ; and
 - b. Total value of capital transactions: not more than S\$500,000 a year.

For the purpose of computing the total number and value of capital transactions, the inflow and outflow of funds are to be added together. Please see Annex B for examples on the application of the de-minimis limit.

7.6 Non-applicability of the de-minimis limit

- 7.6.1 Businesses that can maintain the designated bank account solely for revenue purposes as set out in paragraph 7.2 above need not adopt the de-minimis limit. However, in the event that the designated bank account has not been used solely for designated revenue purpose, businesses can adopt the de-minimis limit and rely on it to avail themselves of the designated bank account treatment. This is provided that the total number and value of capital transactions are within the de-minimis limit.
- 7.6.2 Businesses that do not wish to track the nature of the transactions within their foreign currency bank accounts can continue to treat the exchange differences arising from the revaluation of their foreign currency bank accounts as capital in nature.
- 7.6.3 The de-minimis limit will apply on a prospective basis. A business whose designated bank account was not maintained solely for revenue purposes prior to YA 2020 will not be allowed to adopt the de-minimis limit for the prior YAs regardless of whether those assessments have been finalized, are currently under objection or currently under review. However, the business may apply to adopt the de-minimis limit with effect from YA 2020 if it is able to meet the de-minimis limit prospectively.

7.7 The table below summarises the tax treatment of foreign exchange differences arising from the revaluation of bank account with effect from YA 2020:

Nature of bank account	Tax treatment of foreign exchange differences arising from the revaluation of foreign currency bank account	
	Prior to YA 2020	With effect from YA 2020
Maintained solely for designated revenue purposes (paragraph 7.2)	Revenue (i.e. taxable / deductible)	Revenue (i.e. taxable / deductible)
Maintained not solely for designated revenue purposes (paragraph 7.5)	Capital (i.e. not taxable / not deductible)	Revenue (i.e. taxable / deductible) if the de-minimis limit is met. Otherwise, capital (i.e. not taxable / not deductible)
Maintained for mixed usage / does not wish to adopt the de-minimis limit treatment (paragraph 7.6.2)	Capital (i.e. not taxable, / not deductible)	Capital (i.e. not taxable, / not deductible)

7.8 The designated bank account treatment will cease to apply from the year of assessment when:

- a. the designated bank account is not maintained solely for revenue purposes and the total number or value of capital transactions exceed the de-minimis limit; or
- b. the designated bank account is not maintained solely for revenue purposes and the business chooses not to adopt the de-minimis limit.

In such cases, the exchange differences arising from revaluing the bank account would not be regarded as revenue in nature and hence, not taxable or deductible from that year of assessment onwards. This treatment applies even if the said bank account is used solely for revenue purposes or meets the de-minimis limit in subsequent years.

7.9 Administrative procedure

(i) *Solely for designated revenue purposes*

Businesses that maintain the bank accounts solely for designated revenue purposes and wish to claim the revenue tax treatment for designated bank accounts would need to:

- a. have in place proper controls to ensure that the designated bank account is used solely for receiving trade receipts and paying revenue expenses;
- b. provide supporting documents (e.g. bank statements showing the movement of the funds) to substantiate that the bank account is solely used for the designated revenue purpose, upon IRAS' request; and
- c. provide details of the claim in the tax computation submitted which should include the account number of the designated bank account, foreign currency in which it was maintained, and confirmation that the account was being used for the designated revenue purpose.

(ii) *Adoption of de-minimis limit*

Businesses that file Form C⁷ and adopt the de-minimis limit treatment to claim the revenue tax treatment for designated bank accounts would need to:

- a. have in place proper controls to identify the nature of the transactions in the bank account;
- b. provide supporting documents (e.g. bank statements showing the movement of the funds) to substantiate the nature of transactions in the bank account, upon IRAS' request; and
- c. indicate the adoption of the de-minimis limit and provide the following information in their income tax computation to substantiate that the de-minimis limit is met:
 - Total number of capital transactions in the bank account during the basis period; and
 - Total value of capital transactions in the bank account during the basis period.

7.10 Notwithstanding the application of the de-minimis limit, CIT reserves the right to examine the transactions within the bank account. In the event that the total number and / or value of capital transactions upon review exceed the de-minimis limit, the designated bank account tax treatment will not apply.

8 Contact information

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

⁷ Businesses that file Form C-S need not submit the information at the time of filing their income tax return. However, they should ensure that such information is readily available for submission to IRAS upon request.

9 Updates and amendments

	Date of amendment	Amendments made
1	29 Jun 2012	<p>Previously, once businesses other than banks have opted out of the tax treatment 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*.</p> <p>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)).</p> <p>* Paragraph 12 of the e-Tax guide, Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses, published on 28 Nov 2003</p>
2	14 Mar 2019	<p>Clarifications on designated bank account:</p> <p>(a) Update paragraph 6 on the introduction of Section 34AB of the ITA which provides for the legislative basis to accept the accounting treatment adopted by businesses for revenue foreign exchange differences.</p> <p>(b) Specify the exclusion from the default capital tax treatment for bank accounts (refer to paragraphs 7.2 and 7.3).</p> <p>(c) Clarify when a bank account will not be regarded as a designated bank account (refer to paragraph 7.4)</p> <p>(d) Clarify the administrative requirements for businesses which wish to claim the revenue tax treatment for designated bank accounts.</p>

	Date of amendment	Amendments made
3	17 Aug 2020	<p>(a) Insert paragraphs 7.4 and 7.5 for the introduction of de-minimis limit to allow businesses to treat foreign exchange differences on foreign currency bank accounts as revenue in nature when capital transactions are within the limit.</p> <p>(b) Insert paragraphs 7.6 on the non-applicability of the de-minimis limit.</p> <p>(c) Summarise the tax treatment of foreign exchange differences arising from the revaluation of foreign currency bank accounts in paragraph 7.7 with effect from YA 2020</p> <p>(d) Insert paragraph 7.8 on the circumstances giving rise to the cessation of the designated bank account treatment.</p> <p>(e) Insert paragraph 7.9 for the administrative procedures for businesses that adopt the de-minimis limit.</p> <p>(f) Include examples in Annex B on the application of the de-minimis limit.</p>

Annex A – 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 2019, 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.

s/n	Date	Event	Accounting treatment	Tax treatment based on strict tax principle	Tax treatment under section 34AB	Tax treatment under the opt-out option
1	1 Aug 2019	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 2019	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 2019	Payment received from DEF Inc of US\$100	DR US\$ Bank S\$190 CR Trade Debtor CR S\$170 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 based on accounting treatment.	S\$20 is taxable as it was settled during the year
4	15 Oct 2019	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 2019	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 based on accounting treatment	S\$60 is deductible as it was settled during the year

Legend: Forex - Foreign exchange

Annex A – Example to illustrate the accounting and tax treatments of foreign exchange differences arising from foreign currencies transactions (cont'd)

s/n	Date	Event	Accounting treatment	Tax treatment based on strict tax principle	Tax treatment under section 34AB	Tax treatment under the opt-out option
6	31 Dec 2019	Year-end revaluation 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\$.	S\$40 is taxable based on accounting treatment	S\$40 is taxable in the following year (i.e. year 2020) as it is “deemed realised in the following year”
7	1 Feb 2020	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 based on accounting treatment	S\$80 is deductible in the year 2020 as it was settled during that year

Legend: Forex - Foreign exchange

Annex B – Examples of the application of the de-minimis limit for the designated bank account treatment

s/n	Identify the capital transactions in the bank account for the year	De-minimis Limit			Tax treatment of the foreign exchange differences on revaluation of foreign currency bank account
		Number of capital transactions: not more than 12 transactions a year [A]	Total value of capital transactions: not more than S\$500,000 a year [B]	Whether both [A] and [B] met de-minimis limit	
1	Purchase of fixed assets (S\$96,000) under hire purchase arrangement for 12 instalments	Each repayment of principal amount is regarded as one capital transaction. Total number of capital transactions: 12	The monthly instalment is S\$8,000. Total value of capital transactions: S\$96,000 (S\$8,000 x 12).	Yes	Revenue in nature
2	Trade-in of current fixed asset for the purchase of a new fixed asset. The company also purchased a motor vehicle under hire purchase arrangement for 12 instalments.	Total number of capital transactions: 13, comprises i) 1 trade-in purchase and ii) 12 hire purchase transactions.	(i) Trade-in value: S\$200,000 (ii) Hire purchase payments is S\$10,000 per instalment. Total value of capital transactions: S\$320,000 (S\$200,000 + (S\$10,000 x 12))	No * <u>Note:</u> Number of capital transactions [A] exceeded 12 transactions during the year.	Capital in nature *
3	Disposal of fixed asset and the cash inflow is used to purchase a new fixed asset.	The (i) inflow of fund from the disposal of an existing fixed asset and (ii) withdrawal of the fund to purchase a new fixed asset are regarded as two separate capital transactions. Number of capital transactions: 2	(i) Sale proceeds from the disposal of fixed asset: S\$50,000. (ii) Purchase of new fixed asset: S\$420,000. Total value of capital transactions: S\$470,000 (S\$50,000 + S\$420,000).	Yes	Revenue in nature

Note: *Once the de-minimis limit is breached, the said bank account will no longer qualify for the designated bank account treatment.

Annex B – Examples on the application of the de-minimis limit on the capital transactions in the designated foreign currency bank account (cont'd)

s/n	Identify the capital transactions in the bank account for the year	De-minimis Limit			Tax treatment of the foreign exchange differences on revaluation of foreign currency bank account
		Number of capital transactions: not more than 12 transactions a year [A]	Total value of capital transactions: not more than S\$500,000 a year [B]	Whether both [A] and [B] met de-minimis limit	
4	Excess funds are used to i) repay shareholder loan, ii) make payment on behalf of a related party and iii) transfer to a fixed deposit account.	Each outflow of fund is regarded as a separate capital transaction. Number of capital transactions: 3	(i) Repay shareholder loan: S\$300,000 (ii) Payment made on behalf of a related party: S\$50,000 (iii) Transfer to a fixed deposit account.: S\$100,000 Total value of capital transactions: S\$450,000 (S\$300,000 + S\$50,000 + S\$100,000)	Yes	Revenue in nature
5	Payments from trade debtors are transferred out to invest in the leasehold property which would be used as factory to store goods.	The inflow of funds from trade debtors is revenue in nature. The outflow of funds to acquire the leasehold property of S\$850,000 is capital in nature. Number of capital transactions: 1	The outflow of funds to acquire the leasehold property of S\$850,000 is capital in nature. Total value of capital transactions: S\$850,000.	No * <u>Note:</u> Total value of capital transactions [B] exceeded S\$500,000 during the year.	Capital in nature *

Note: *Once the de-minimis limit is breached, the said bank account will no longer qualify for the designated bank account treatment.