REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

March 16, 2006

REVENUE REGULATIONS NO. 6 - 2006

SUBJECT : Regulating the Use of Functional Currency Other than the Philippine Peso in Financial Statements that will be Submitted and in the Books of Accounts that will be Maintained for Internal Revenue Tax Purposes.

TO : All Internal Revenue Officers, Employees and Others Concerned

SECTION. 1. Scope. – Pursuant to Section 244, in relation to Section 6 (H), of the National Internal Revenue Code (NIRC) of 1997, these Regulations are hereby promulgated to prescribe the guidelines and procedures in adopting the use of functional currency other than the Philippine peso in financial statements that will be submitted and books of accounts that will be maintained for internal revenue tax purposes.

SEC. 2. Definitions. For purposes of these Regulations, the term:

Functional Currency is the currency of the primary economic environment in which the reporting entity operates; that is the currency of the environment in which an entity primarily generates and expends cash.

Foreign Currency is a currency which is other than the functional currency of the qualified entity. For purposes of these Regulations, the Philippine peso or other currencies will be considered as foreign currency if it is not the functional currency of the qualified entity.

SEC. 3. Authority to Use Functional Currency. A tax-filer, corporate or otherwise, does not have a free choice as to the functional currency to be used. It cannot arbitrarily choose to use a certain currency as its functional currency in its financial statements and books of accounts for tax purposes. The company's determination of its functional currency shall be made in accordance with the guidelines provided under Section 4 below.

The use of functional currency other than the Philippine peso for financial recording and reporting purposes does not mean, however, the use of such functional currency for tax return purposes. This holds true even if the use of functional currency other than the Philippine peso becomes a requirement/is permitted under the Philippine-adopted Generally Accepted Accounting Principles, or is mandated by the SEC or other competent body.

SEC. 4. Determination of the Functional Currency. In determining its functional currency, the tax-filer should consider the following factors:

(a) The currency that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled);

(b) The currency of the country whose competitive forces and regulations mainly determine the sales price of its goods and services;

(c) The currency that mainly influences labor, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled);

(d) The currency in which funds from financing activities are generated;

(e) The currency in which receipts from operating activities are usually retained.

In cases when the above indicators are mixed and the functional currency is not obvious, the reporting entity can use its judgment as to which is the dominant currency to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and circumstances. A company's functional currency reflects the underlying transactions, events and circumstances that are relevant to it. Accordingly, once determined, the functional currency should not be changed unless there is a substantial change in those underlying transactions, events and circumstances.

The taxpayer may use the currency that qualifies as its functional currency based on the above guidelines. Functional currency shall not be limited to the US Dollar but shall include the Japanese Yen, Euro Dollar and other major foreign currencies, the adoption thereof being subject to SEC notification for corporations and to the procedural requirements for individuals, as mentioned in Section 5 below.

SEC. 5. Notification Requirements- A corporate tax-filer electing to use as functional currency for financial reporting purposes a currency other than the Philippine peso must submit to the Revenue District Office (RDO) or Large Taxpayers District Office(LTDO) or Large Taxpayers Service (LTS), whichever is the BIR office that has jurisdiction over the taxpayer, a copy of the duly received notification sent to the SEC (as provided in SEC Memorandum Circular 1 series of 2006) for the use of such functional currency within 30 days from the filing of the notification to the SEC, but may be subject to extension on meritorious grounds. Such copy of the SEC notification duly stamped received by the BIR must also be attached to the income tax return upon filing of said return.

In the case of an individual electing to adopt functional currency in financial reporting, an application/notification under oath must be filed with the RDO/LTDO/LTS, whichever is the BIR office that has jurisdiction over the taxpayer, within 30 days after the taxable year in which the use of functional currency takes effect. Such application/notification shall contain justification that the individual taxpayer has complied with the guidelines in Section 4 above.

The information on functional currency shall form part of the taxpayer's registration database.

SEC. 6. Change in Functional Currency- In the case of a corporation whose functional currency changes from one currency to another, the taxpayer must submit to the BIR a copy of such SEC duly received notification to change the functional currency (as provided in SEC Memorandum Circular 1 series of 2006) within 30 days from the filing of such notification with the SEC.

In the case of an individual, a revised application/notification under oath shall be filed with the RDO/LTDO/LTS within 30 days after the taxable year in which the change of functional currency takes effect.

As a rule, a taxpayer shall not be allowed to change its functional currency in the middle of the year, or adopt one for a period less than one year. However, in certain exceptional cases like in the case of business combinations such as mergers or consolidations, change in functional currency to cover a period of less than one full year may be permitted.

SEC. 7. Currency to be Used for Income Tax Purposes – The income tax returns (ITRs) of taxpayers which have adopted functional currency (other than Philippine peso) in their financial statements and books of accounts shall still be prepared in Philippine pesos. Thus, all entries in the ITR shall be in Philippine pesos.

For purposes of translating the functional currency income and expenses to Philippine Pesos, the translation shall be done on a monthly basis using the average exchange rate during the month (under the Philippine Dealing System or PDS). The total translated amounts per month shall be added to arrive at the income and expenses in Philippine pesos for the quarter/year, which shall be the basis in computing the taxpayer's income tax liability. The total figures in the ITR for the year should be reconciled with the total of the equivalent peso figures as converted from the functional currency figures in the subsidiary ledgers maintained to serve as the source of the figures reflected in tax returns other than income tax. The reconciliation of the figures shall be done at the end of the year and the reconciling items shall be reflected in the annual or final adjustment income tax return. Thus, after such reconciliation, the figures in the annual ITR should tally with the total annual figures in the other tax-type tax returns such as the tax returns for VAT, Percentage Tax, Withholding Tax, Documentary Stamp Tax, etc.

Tax credits applied against the income tax due (in Philippine pesos), if any, shall be equal to the actual amounts of such credits in Philippine pesos, as shown in the supporting documents (e.g. withholding tax certificates issued by the other party withholding agents, proof of advance payment of the tax and prior year's income tax return).

SEC. 8. Currency to be Used in the Filing of Tax Returns Other than Income Tax – All tax returns other than the ITR shall likewise be filed in Philippine peso currency using historical peso amounts or actual conversion/prevailing PDS rate on transaction day, whichever is applicable.

SEC. 9. Submission of Audited Financial Statements- Only the audited financial statements in the qualified functional currency shall be submitted to the BIR. For purposes of the annual income tax return, the taxpayer, however, shall submit together with the duly audited financial statements in qualified functional currency, a supplementary schedule showing the quarterly amounts of functional currency income and expenses with translation to Philippine pesos. In determining the quarterly amounts, the rules provided in Section 7 above shall apply.

SEC. 10. Books of Accounts to be Maintained – Taxpayers who qualified hereunder should maintain their books in functional currency (if other than the Philippine peso). However, said taxpayers shall also maintain subsidiary ledgers for transactions subject to the other taxes (i.e. aside from income tax), which will be recorded both in functional currency and in Philippine peso using the historical peso amounts or actual conversion/prevailing rate on transaction day, whichever is applicable. Said functional currency books/records must be registered with the BIR in accordance with existing rules on registration of books and may be subject to BIR audit in connection with the audit of tax liabilities.

SEC. 11. Preparing Financial Statements in Functional Currency

A qualified entity presenting functional currency (other than the Philippine Peso) financial statements should:

1. Restate its prior year financial statements as if the company had been booking its transactions in prior years using such functional currency;

2. Treat the transactions in the Philippine Peso and other currencies as foreign currency transactions for reporting purposes. For purposes of functional currency financial statements, Philippine Peso and currencies other than the functional currency are considered foreign currencies and transactions therein shall be accounted for under prevailing generally accepted accounting principles. Transactions in foreign currencies shall be converted and recorded in the books of accounts in equivalent functional currency amount using the conversion rate on the day of the transaction. The conversion rate used should always be mentioned in the books of accounts.

In the transition to functional currency reporting or in the translation of Philippine peso financial statements at the start of the initial year when functional currency is adopted, the qualified entity shall translate its Philippine peso balances to its functional currency financial statements as follows:

a. Functional currency amounts (for both balance sheet and income statement items, including capital accounts) should be specifically identified and carried over to the functional currency financial statements in their original functional currency amounts, i.e., not translated amounts. For example, assuming the determined functional currency is the U.S. dollars (USD), all accounts denominated in USD amounts should be carried over to the functional currency financial statement;

b. For foreign currency monetary assets and liabilities, translate using the closing spot exchange rate as of the balance sheet date;

c. Non-monetary foreign currency items that are measured in terms of historical cost in a foreign currency shall be *converted/*translated using the exchange rate at the date of transaction;

d. Non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date such fair value was determined. For example, property, plant and equipment denominated in foreign currency and carried at revalued amounts shall be translated into the functional currency using the exchange rate on revaluation date;

e. Non-monetary items for which the carrying amount is determined by comparing two or more amounts, such as inventories which are carried at lower of cost or net realizable value, or the carrying amount of an asset for which there is an indication of impairment and is therefore carried at net recoverable amount, the carrying amount is determined by comparing:

   i. The cost or carrying amount, as appropriate, translated at the exchange rate at the date that amount was determined (i.e., the rate at the date of the transaction for an item measured in terms of historical cost); and

   ii. The net realizable value or recoverable amount, as appropriate, translated at the exchange rate at the date that value was determined (i.e., the closing rate when the value was determined at the balance sheet date).

f. For foreign currency income and expense items recognized in the reporting period, for each period presented (i.e., including comparatives), translation should be based on exchange rates at the dates of the transactions. For practical reasons, a rate that approximates the actual exchange rates at the dates of the transactions, for example, an average rate for the period, may be used to translate foreign currency income and expense items;

g. For capital accounts, the exchange rates on the dates the Philippine Peso contributions were made shall be used to translate into the functional currency financial statements. In cases where capital is allowed to be contributed in currency other than Philippine Peso, such original amount shall be carried over to the functional currency financial statements if the contributions were made in the entity’s functional currency. If the contributions were made in currency other than the entity’s functional currency, then the exchange rates on the dates contributions were made shall be used to translate such amount into functional currency financial statements;

h. Any exchange differences resulting from the first-time presentation of functional currency financial statements shall be charged or credited to retained earnings;

i. Comparative financial statements are required to be filed; and

j. All references to exchange rates refer to the PDS rates.

SEC. 12. Treatment of Gain or Loss on Sale of Investment under Functional Currency. – An investor which invests in functional currency (other than Philippine peso) securities can compute its gain or loss from the sale of said investment using the functional currency.

For example, if Company A invests in a US dollar bond at US$100,000 when the US$:P rate was US$1:40 and sells the same investment at US$102,000 when the US$:P rate was US$1:50, the computation of the capital gain shall be as follows:

	USD	**Pesos**
Selling price	102,000	5,100,000
Cost	100,000	4,000,000
Taxable Gain	2,000	

In the above illustration, the taxable gain that should be reported is only $ 2,000. Thus, in reporting for tax purposes of the $ 2,000 gain in equivalent or converted Philippine peso denomination, the equivalent peso denomination is the peso equivalent of 2,000 U.S. dollars using the conversion rate on the date of the consummation of the transaction.

The above rule shall also apply to non-resident stockholders of an investee company where such investee company in the Philippines uses a functional currency other than the Philippine peso for its financial statements.

However, if an investor makes an investment in Philippine peso, then it shall compute the gain or loss from sale of said investment using the Philippine peso cost and Philippine peso selling price.

SEC. 13. Availment of NOLCO and Excess MCIT - The Net Operating Loss Carry-over (NOLCO) and excess Minimum Corporate Income Tax (MCIT) can still be carried forward in the income tax computation of the taxpayer that has switched to a functional currency other than the Philippine peso, subject to the three-year life limitation and other rules governing NOLCO and MCIT. However, in all cases, the NOLCO and MCIT that shall be applied in subsequent year/s shall be determined using the historical peso amounts shown in the income tax return/s for the previous year(s) or years where they originate or emanate.

SEC. 14. Payment of Taxes in Functional Currency – Taxpayers filing tax returns in the Philippine peso may pay the tax in functional currency computed using the functional currency buying rate of the collecting bank vis-à-vis the Philippine peso at the time of payment. The collecting bank shall, however, report to the BIR said collection in peso as converted/translated.

Despite the permission to pay in functional currency, all figures in the tax returns shall always be in peso.

SEC. 15. Separability Clause - If any part or provision of these Regulations shall be held to be unconstitutional or invalid, other provisions hereof which are not affected thereby shall continue to be in full force and effect.

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SEC. 16. Repealing Clause - The provisions of revenue memorandum circulars, orders, rulings and other issuances inconsistent herewith are hereby amended, modified or repealed accordingly.

SEC. 17. Transitory Provision – Taxpayers adopting functional currency financial statements (other than Philippine peso) for the taxable year ending December 31, 2005 shall be covered by these Regulations with respect to their annual income tax return for 2005. Said taxpayers shall attach to their tax return a copy of the SEC notification/approval, in the case of corporations, or the notification to BIR under oath, in the case of individuals, of their qualification to use functional currency (other than Philippine peso). The same rules shall apply to taxpayers which were previously qualified to use functional currency financial statements (other than Philippine peso) under the previous SEC rules (SEC Memorandum Circular 14 series of 2003).

SEC. 18. Effectivity Clause – These Regulations shall take effect after fifteen (15) days following publication in a newspaper of general circulation.

(Original Signed)
MARGARITO B. TEVES
Secretary of Finance

Recommending Approval:

(Original Signed)
JOSE MARIO C. BUÑAG
Commissioner of Internal Revenue