Tax Question:
What is the difference between realized vs. unrealized gains and losses on foreign exchange?

Facts:
Foreign currency transactions need to be reported in Canadian dollars when they are recorded in the general ledger and on the T2 corporate tax return. The gains and losses that result from the exchange can be either realized which are taxable or unrealized which are not taxable.

Discussion:
When a foreign currency transaction is recorded on a particular date, it needs to be converted into Canadian dollars using the spot rate. For example, if you are entering a purchase order for $1,000 US dollars and the current spot rate of conversion is 1.35, the recorded transaction should be entered as $1,350 Canadian dollars.

At the Balance Sheet date, the account balances should be converted to Canadian dollars after adjusting for current exchange rate. For example, if your year end date is September 30, all account balances such as US bank account and Accounts Receivable in US dollars need to be converted at the September 30th exchange rate. The foreign exchange difference should be adjusted to the Income Statement to an account called “Unrealized Gain or Loss on Foreign Exchange”. As the foreign exchange of the account balance will fluctuate after the year end, it is considered unrealized. As a result, an adjustment is required on the Schedule 1 of the corporate tax return to ensure that the gain or loss on foreign exchange is not a taxable item (See FAQ 160—What is a Schedule 1).

During the year, there may be foreign exchange differences that occur on actual purchases and revenue or transactions that have been completed. These adjustments can be recorded to an account called “Realized Gain or Loss on Foreign Exchange” or you can adjust the individual transaction accounts which may be more difficult and time consuming to do. Please note that accounting software vary in how they deal with recording foreign exchange on these realized transactions.

Recommendation:
If you have any questions about realized vs. unrealized gains and losses on foreign exchange, please contact Gilmour Group Chartered Professional Accountants.