

ADMINISTRATIVE CONCESSION FOR INTEREST INCURRED BY TAXPAYERS ON LOANS TO RE-FINANCE EARLIER LOANS OR BORROWINGS

INTRODUCTION

1. When ascertaining the income which is taxable for any Year of Assessment (YA), a person can claim deduction for expenses:
 - (a) which are incurred wholly and exclusively in producing the income;
 - (b) which are incurred in the basis period for the YA; and
 - (c) whose deduction is not otherwise prohibited by the Singapore Income Tax Act (SITA).
2. An expense commonly claimed by taxpayers is interest paid or payable. The deductibility of interest expense is presently governed by section 14(1)(a) of the SITA. Briefly, for the Comptroller to allow a taxpayer's claim for deduction of interest expense, he must be satisfied that:
 - (a) the general conditions in paragraph 1 above have been met; and
 - (b) the interest was payable on capital employed in acquiring the income.
3. Currently, there are many taxpayers who have financed their acquisition of income-producing assets with loans or borrowings. Some of them may, for various reasons, subsequently re-finance the earlier loans or borrowings. For the purpose of this Practice Note, re-financing refers to the situation where a taxpayer takes out a new loan and uses the whole of that proceeds to repay an existing loan.
4. Based on a strict interpretation of the provisions in section 14(1)(a), the interest incurred on a loan taken up to re-finance an earlier loan or borrowing is not deductible for tax purposes as the subsequent loan is taken up to repay an existing one and the interest incurred is therefore not payable on capital employed in acquiring the income. Accordingly, the Comptroller can disallow all claims for deduction of interest incurred on loans taken up to re-finance earlier loans or borrowings.
5. IRAS however recognises that the above tax treatment may not reflect the commercial realities in some cases. For example, a taxpayer may re-finance an earlier loan to reduce his overall cost of financing as the interest rate on the new loan may be much lower than that charged by the lender on the original loan. In such cases, the taxpayer may be unduly penalised if his claim for deduction of the interest incurred on the new loan is disallowed.

6. The purpose of this Practice Note is to spell out some of the circumstances under which the Comptroller would allow a deduction of the interest incurred on loans taken up to re-finance earlier loans or borrowings.

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7. As an administrative concession, IRAS has decided that claims for deduction of interest incurred on loans taken up to re-finance earlier loans or borrowings may be allowed if the taxpayer can prove to the satisfaction of the Comptroller that the re-financing is effected for genuine commercial reasons. Some of the reasons which may be acceptable to the Comptroller include:
 - (a) the re-financing arrangement is effected so as to achieve an overall reduction in cost of finance (eg. due to better credit terms such as lower interest rates);
 - (b) the re-financing arrangement is necessary due to the taxpayer's financial position (eg. he may be in financial difficulties and need to restructure the loan in the interim).
8. Some examples of situations where the above concessionary tax treatment may be applied are:
 - (a) the taxpayer re-finances a higher interest-bearing loan with a lower interest-bearing one;
 - (b) the taxpayer re-finances an interest-free loan with an interest-bearing one because the period of the interest-free loan has expired;
 - (c) the taxpayer re-finances a lower interest-bearing loan with a higher interest-bearing one because the period of the lower interest-bearing loan has expired.
9. The Comptroller's decision will depend on the specific circumstances of each case. The onus of proof that the re-financing arrangement is effected for genuine commercial reasons rests solely with the taxpayer concerned.
10. The above concessionary tax treatment, however, does not in any way preclude the Comptroller from:
 - (a) disallowing taxpayer's claims for deduction of interest incurred on a subsequent loan against the income derived from an asset purchased with the original loan where the proceeds from the subsequent loan are used to finance another asset (eg. the first asset is pledged as security to raise the funds to purchase the second asset);
 - (b) disallowing interest incurred in respect of non-income producing assets.

11. Taxpayers may apply to the Comptroller for this concession to be granted with immediate effect. However, assessments which have been finalised prior to the issuance of this Practice Note where a strict interpretation has been applied shall not be re-opened unless valid objections have been lodged by the taxpayer concerned.