

IRAS CIRCULAR

TAX DEDUCTION FOR BORROWING COSTS OTHER THAN INTEREST EXPENSES



**INLAND REVENUE
AUTHORITY
OF SINGAPORE**

Published by
Inland Revenue Authority of Singapore

Published on 21 Jun 2007

© 2007 IRAS Singapore. All Rights Reserved.

No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying and recording without the written permission of the copyright holder, application for which should be addressed to the publisher. Such written permission must also be obtained before any part of this publication is stored in a retrieval system of any nature.

IRAS CIRCULAR

TAX DEDUCTION FOR BORROWING COSTS OTHER THAN INTEREST EXPENSES

INTRODUCTION

1. On 15 February 2007, the Second Minister for Finance announced in his Budget Statement 2007 that a tax deduction would be given for borrowing costs (other than interest expenses) which are incurred as a substitute for interest expense or to reduce interest costs.
2. The tax deduction is granted to align the tax treatment of interest expenses with such other borrowing costs and to reduce business costs.
3. This circular provides the scope of the tax deduction for the other borrowing costs and details of such costs that will be granted tax deduction.

EXISTING TAX TREATMENT

4. Under section 14(1)(a), interest expenses incurred on capital employed in acquiring income chargeable with tax is allowable against the income earned. This provision is applicable where the borrowing is used to finance a capital asset and the asset is employed in acquiring taxable income. The interest expenses incurred in respect of the borrowing applied to acquire the income would be deductible against the taxable income earned. Since this provision is only applicable to interest expenses, the other borrowing costs (for example guarantee fees, bank option fees) incurred in relation to the borrowing are not deductible as the borrowing is on capital account and the related borrowing costs would then be capital in nature.

NEW TAX TREATMENT

5. Increasingly, the costs of borrowing are no longer confined to interest expenses alone. There have been representations from businesses that there are other borrowing costs incurred to secure lower interest rates on borrowings to finance capital expenditure that produce taxable income. Without incurring such other borrowing costs, the business enterprise has to pay a higher interest expense, which would then

qualify for tax deduction under section 14(1)(a). Where the other borrowing costs are payable as a substitute for interest expense or to reduce interest costs, businesses have represented that these should be accorded the same tax treatment as interest expense.

6. Second Minister for Finance has therefore decided to allow a tax deduction for borrowing costs (other than interest expenses), which are **incurred as a substitute for interest expense or to reduce interest costs**, with effect from the Year of Assessment 2008. With this change in tax treatment, the other borrowing costs of this nature, which are currently not granted tax deduction under Section 14(1)(a), will be made allowable under the said section.
7. To provide certainty on the scope of this tax change and to ensure that the policy intention (as explained in paragraphs 5 and 6) is met, the other borrowing costs that will be granted tax deduction under section 14(1)(a) are listed in the Annex. The Income Tax Act will be amended to effect this tax change. The list of deductible other borrowing costs (hereinafter referred to as “qualifying borrowing costs”) will be prescribed by Regulations.
8. This tax change takes effect from the Year of Assessment 2008.

BORROWING COSTS INCURRED FOR REFINANCING BORROWINGS

9. The administrative concession for interest expenses incurred by taxpayers on loans to re-finance earlier loans as given in our e-Tax Guide (Administrative Concession for Interest Incurred By Taxpayers on Loans to Re-Finance Earlier Loans or Borrowings) of 17 Apr 1995 will also apply to the qualifying borrowing costs which are incurred on such loans. The conditions for deduction of the qualifying borrowing costs will follow those stated in that Guide.

DISCOUNT/ PREMIUM ON DEBT SECURITIES

10. For discount on bonds/notes or premium on redemption of bonds/notes, the deduction will be given at the point when the premium or discount is incurred by the issuer. For example, where a 10-year bond is issued for \$100 par value and provides for a premium on redemption of \$2 to be paid at the end of the 10-year period, the deduction of the qualifying premium of \$2 will only be given at the time when the bond is redeemed and the premium of \$2 is actually incurred by the issuer. Similarly, if an 8-year bond with a par value of \$100 is issued at a discounted price of \$97, the discount of \$3 can only be allowed at the end of the 8-year period when the bond matures and the issuer incurs outlay to redeem the full face value of the bond from the bondholders.

11. In view of the above, any “interest expense” (representing the non-cash discount/premium calculated using the effective interest method) which is charged to the profit and loss account in accordance with FRS 39 over the tenure of the bonds/notes issued for a capital purpose will not be allowable for tax purposes¹. Hence, taxpayers will have to make the necessary adjustments in their tax computations when submitting their tax returns to IRAS.

ADJUSTMENT FOR AMOUNTS OF QUALIFYING BORROWING COSTS WHICH ARE NOT DEDUCTIBLE

12. Presently, for interest expenses claimed under section 14(1)(a), adjustments are made to disallow any portion of interest expenses that is not deductible (for example interest expense attributable to pre-commencement of business period or interest expense attributable to non-income producing assets). Similarly, tax adjustments to disallow the portion of qualifying borrowing costs attributable to the pre-commencement of business period, pre-YA 2008 period and/or non-income producing assets will also have to be made.
13. In the case of discount/premium on debt securities, the amount of discount/premium attributable to the pre-commencement of business period and/or pre-YA 2008 period will be computed on a straight-line basis, unless a more satisfactory method of apportionment exists. For instance, if a 5-year bond is issued on 1 Jan 2004 at a discount of \$10 for \$90 and matures on 31 Dec 2008 (at \$100), the issuer will be given a tax deduction on the discount in YA 2009 (assuming his accounting year ends on 31 Dec), and the amount deductible in YA 2009 is computed as follows:

Total discount	= \$10
Portion before YA 2008 (i.e. YA 2005 to 2007)	= 3 yrs / 5 yrs X \$10 = \$6
Amount to be allowed	= \$10 - \$6 = \$4

ADMINISTRATIVE PROCEDURE

14. To enjoy the deduction of the qualifying borrowing costs, taxpayers need to claim the qualifying borrowing costs in their tax returns and provide brief details of how the borrowing costs claimed have been incurred as a substitute for interest expense or to reduce interest cost. There is no need to submit supporting documents together with their returns.

¹ Based on the current section 34A(2)(e), the FRS 39 treatment will not be accepted for interest deductions under section 14(1)(a). Similar amendments to section 34A will also be made to achieve the same effect for the qualifying borrowing costs.

However, they should maintain sufficient supporting documents for the purpose of submission to the Comptroller of Income Tax if called upon to do so as part of IRAS' audit or verification process.

ENQUIRIES

15. For any general enquiries or clarification on this Circular, please call:
 - a) 1800-3568622 (Corporate);or
 - b) 1800-3568300 (Individual).

Inland Revenue Authority of Singapore

List of deductible borrowing costs

	Items	Brief description
1	Guarantee fees	Fees paid to a guarantor so that the borrower can enjoy preferential interest rates and reduce his interest costs
2	Bank option fees	Fees paid to the lender to keep the interest rate on borrowing at a fixed level or within a specified range
3	Discounts ² on notes or bonds	Discount suffered by the issuer of notes or bonds with zero or below market interest rate (please refer to paragraphs 10, 11 and 13 of the circular for the timing of deduction of such discounts)
4	Premiums ² on redemption of notes or bonds	Premium paid upon redemption by issuer of notes or bonds with zero or below market interest rate (please refer to paragraphs 10, 11 and 13 of the circular for the timing of deduction of such premiums)
5	Prepayment fees/ early redemption fees	Fees paid to the lender upon the early redemption of borrowing and the fees represent compulsory adjustments to the interest obligation of the borrower
6	Extension fees	Fees paid to the lender to extend the repayment date of the borrowing and the fees represent compensation to the lender for the time value of the money borrowed for the extended period
7	Increased costs	These refer to any upward interest rate adjustments when certain event occurs as specified in the loan agreement
8	Interest rate cap premiums	These are upfront payments made to cap the interest rate at a certain level
9	Interest rate swap payments	These are payments made to protect the borrower against interest rate fluctuations
10	Conversion fees	Fees paid to lender to convert the interest rate charged from a prime based rate to a lower swap rate
11	Cancellation fees	Fees paid to lender when the loan or any part of it is cancelled and the fees represent adjustments of the interest return to the lender

² The deduction of the discount/premium on convertible debt securities that is attributable to the debt component will be covered in the revised IRAS Circular on "Income Tax Implications Arising from the Adoption of FRS 39 – Financial Instruments: Recognition & Measurement" that is to be released soon.