INLAND REVENUE
AUTHORITY
OF SINGAPORE

IRAS e-Tax Guide

Income Tax: Tax Deduction for Borrowing Costs Other Than Interest Expenses (Third Edition)

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1 Aim

1.1 This e-Tax guide provides the scope of tax deduction for borrowing costs (other than interest expenses) which are incurred as a substitute for interest expense or to reduce interest costs and details of such borrowing costs that will be granted tax deduction.

2 At a glance

2.1 With effect from the Year of Assessment ("YA") 2008, borrowing costs (other than interest expenses), which are **incurred as a substitute for interest expense or to reduce interest costs**, are granted tax deduction. This tax treatment is provided under section 14(1)(a)(ii) of the Income Tax Act ("ITA").

2.2 To provide certainty on the scope of deductible borrowing costs (other than interest expenses) and to ensure that the policy intent in paragraph 2.1 is met, the list of deductible borrowing costs (hereinafter referred to as "qualifying borrowing costs") has been prescribed under the Income Tax (Deductible Borrowing Costs) Regulations 2008 (hereinafter referred to as the "Regulations").

2.3 A list of the qualifying borrowing costs is also available in the **Annex**.

3 Background

3.1 Prior to YA 2008, only interest expenses incurred on capital employed in acquiring income chargeable with tax is allowable against the income earned. Where a 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. As section 14(1)(a) of the ITA was previously 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. This is because the borrowing is on capital account and the related borrowing costs would then be capital in nature.

3.2 Increasingly, the costs of borrowing are no longer confined to interest expenses alone. There were 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.

3.3 To align the tax treatment of interest expenses with such other borrowing costs and to reduce business costs, tax deduction on borrowing costs (other than interest expenses) was allowed with effect from YA 2008.

4 Tax treatment of borrowing costs other than interest expenses

4.1 To qualify for tax deduction under section 14(1)(a)(ii), the borrowing costs (other than interest expenses) must be **incurred as a substitute for interest expense or to reduce interest costs.** A list of deductible borrowing costs is prescribed in the Regulations. This takes effect from YA 2008.

4.2 To keep pace with business developments, the list of deductible borrowing costs in the Regulations is expanded to include:

New items of qualifying borrowing costs	Effective YA
Amendment fees, front-end fees and back-end fees	2014

4.3 The tax treatment for interest expenses incurred by taxpayers on loans to re-finance earlier loans or borrowings[1] will also apply to the qualifying borrowing costs which are incurred on such loans. The conditions for deduction of interest expense incurred on refinancing will similarly apply to the deduction of qualifying borrowing costs.

[1] For details on interest incurred on loans to re-finance earlier loans or borrowings, please refer to IRAS website.

4.4 For front-end fees to qualify for deduction, they must be equivalent to interest which would otherwise have been payable under the loan agreement. In addition, there must also be a draw-down of the loan (money borrowed) during the basis period of the claim for deduction. Such deductions should be claimed on an incurred basis and not on an amortised basis. Fees paid for other products or services provided by the lender or any other persons (e.g. underwriting and arranger fees, participation fees) are not prescribed borrowing costs under the Regulations and are not deductible.

4.5 Taxpayers claiming deductions for front-end fees should maintain contemporaneous documentation (e.g. the facility agreement, fee letters, correspondences, draft term sheets) to support such claims for deduction. The documents should show clearly:

(a) the intention during loan negotiations as to what the front-end fee was paid for; and

(b) how the quantum of the front end fee had been determined.

Where any services were provided by the lender, the nature of the services and the quantum of fees payable for all such services should be clearly documented and provided for.

4.6 Failure to state the nature of the front-end fee clearly in the documents may jeopardise a taxpayer's claim on deduction. For example, where the Facility Agreement provides that a lead bank is appointed as an arranger and an underwriter of a syndicated loan, but there is no separate fee charged for such services, the Comptroller of Income Tax may take the view that the front-end fee was paid for such services, whether in whole or in part. If so, the front-end fee would fall outside the scope of the prescribed borrowing costs.

5 Discount/ premium on debt securities

5.1 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.

5.2 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 or FRS 109 over the tenure of the bonds/notes issued for a capital purpose will not be allowable for tax purposes.[2] Hence, taxpayers will have to make the necessary adjustments in their tax computations when submitting their tax returns to IRAS.

6 Adjustment for amounts of qualifying borrowing costs which are not deductible

6.1 For interest expenses claimed under section 14(1)(a)(i), 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.

6.2 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 an 8-year bond was issued on 1 Jan 2006 at a discount of $10 for $90 and matured on 31 Dec 2013 (at $100), the issuer will be given a tax deduction on the discount in YA 2014 (assuming his accounting year ends on 31 Dec), and the amount deductible in YA 2014 is computed as follows:

Total discount	=	$10
Portion before YA 2008 (i.e. YA 2007)	=	1 yr / 8 yrs X $10 = $1.25
Amount to be allowed	=	$10 - $1.25 = $8.75

[2] Based on the current sections 34A(2)(e) and 34AA(3)(e), the FRS 39 treatment and FRS 109 treatment respectively will not be accepted for interest deductions under section 14(1)(a). Similarly, where section 14(1)(a) applies to discount or premium on bonds/ notes, sections 34A(2)(i) and 34AA(3)(k) provide for the time when such discount or premium that are qualifying borrowing costs is deemed incurred and the amount to be allowed a deduction.

7 Administrative procedure

7.1 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. Generally, taxpayers should maintain contemporaneous documentation to support their claims for the deduction of qualifying borrowing costs. There is no need to submit supporting documents together with their returns. 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.

8 Contact Information

For any general enquiries or clarification on this e-Tax Guide, please call:

(a) 1800-3568622 (Corporate); or

(b) 1800-3568300 (Individual).

Inland Revenue Authority of Singapore

9 Updates and Amendments

	Date of amendment	Amendments made
1	18 Aug 2014	The e-Tax Guide is updated to expand the list of deductible borrowing costs to allow deduction of (i) amendment fees (ii) front-end fees and (iii) back-end fees as qualifying borrowing costs with effect from the YA 2014.
2	15 Jan 2019	The e-Tax Guide has been updated to provide greater clarity on how deduction for front-end fees should be claimed (Paragraphs 4.3 to 4.6). Paragraph 4.3 has been updated as the administrative concession has been removed and replaced with the tax treatment for interest expense incurred on loans to re-finance earlier loans or borrowings. Paragraphs 4.4 to 4.6 have been added to provide details on the documents that taxpayers should maintain in order to support their claim for such deductions. Footnotes 2 and 3 have been updated with references to the new provisions and e-Tax Guide relating to FRS 109.

Annex: List of Deductible Borrowing Costs

	Items	Brief description
1	Guarantee fees	Fees payable to a guarantor to enable the borrower to enjoy preferential interest rates and reduce his interest costs
2	Bank option fees	Fees payable to the lender to keep the interest rate on borrowing at a fixed level or within a specified range
3	Discounts[3] on notes or bonds	Discount suffered by the issuer of notes or bonds with zero or below market interest rate
4	Premiums[3] on redemption of notes or bonds	Premium payable upon maturity or early redemption by issuer of notes or bonds with zero or below market interest rate
5	Prepayment fees/ early redemption fees	Fees payable 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 payable 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	Upward interest rate adjustments when certain event occurs as specified in the loan agreement
8	Interest rate cap premiums	Upfront payments made to cap the interest rate at a certain level
9	Interest rate swap payments	Payments made to protect the borrower against interest rate fluctuations

[3] For the deduction of the discount/premium on convertible debt securities that is attributable to the debt component, please refer to the e-Tax Guides “Income Tax Implications Arising from the Adoption of FRS 39 – Financial Instruments: Recognition & Measurement” and “Income Tax: Income Tax Treatment Arising from Adoption of FRS 109 – Financial Instruments” that are available on IRAS’ website.

	Items	Brief description
10	Conversion fees	Fees payable to lender to convert the interest rate charged from a prime based rate to a lower swap rate (definition prior to YA 2014)
	Conversion fees/ amendment fees	Fees payable to lender to convert the interest rate specified in the loan agreement that is applicable at the point of the conversion to a lower interest rate (with effect from YA 2014)
11	Cancellation fees	Fees payable to lender when the loan or any part of it is cancelled and the fees represent adjustments of the interest return to the lender
12	Front-end fees/ back-end fees	Fees payable to the lender either at the beginning or at the end of the term of borrowing and the fees are equivalent to the interest that the borrower would otherwise be required to pay to the lender under the loan agreement (with effect from YA 2014)