INLAND REVENUE
AUTHORITY
OF SINGAPORE

IRAS e-Tax Guide

Income Tax
Total Asset Method for Interest Adjustment
(Second Edition)

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1 Aim

1.1 This e-Tax Guide sets out the application of the total asset method ("TAM") of attributing common interest expenses to income producing and non-income producing assets.

1.2 The Guide applies to any taxpayer who claims deduction of interest expense and borrowing costs, incurred on loans or borrowings, under section 14(1)(a) of the Income Tax Act 1947 ("ITA").

2 At a glance

2.1 Under section 14(1)(a) of the ITA, interest expense and borrowing costs incurred on loans or borrowings specifically taken up to finance income-producing assets are deductible against the income produced. If the asset does not produce income, the interest expense and borrowing costs are not tax deductible.

2.2 If a taxpayer wishes to claim deduction on interest expense or borrowing costs but cannot identify and track the use of an interest-bearing loan to specific assets financed by the loan and not all the assets are income-producing, the TAM as described under paragraph 5 of this e-Tax Guide is the default method to be applied to attribute the common interest expense to the assets. Essentially, the formula in the TAM attributes an amount of common interest expense incurred to each asset in the total asset base as at the financial year end, other than the assets financed by specific interest-bearing loans. Interest expense attributed to income producing assets is deductible against the income produced while the amount attributed to non-income producing assets is not deductible.

2.3 This e-Tax Guide provides the rationale for using the TAM, explains its underlying assumption and states how the TAM should be applied. Taxpayers who use the TAM should align their methodology with the guidance in this e-Tax Guide from 16 Dec 2016.

3 Glossary

3.1 <u>Borrowing costs</u>

Borrowing costs refer to the qualifying borrowing costs prescribed under the Income Tax (Deductible Borrowing Costs) Regulations 2008. The list can also be found in the IRAS e-Tax Guide "Income Tax: Tax Deduction for Borrowing Costs other than Interest Expenses".

3.2 Interest expense

Interest expense for the purpose of TAM refers to interest incurred on interest-bearing loans. It comprises specific and common interest expenses.

Specific interest expense refers to interest expense arising from loans or borrowings taken to fund specific assets. These assets include Right-Of-Use ("ROU") assets treated as sale agreements for tax purposes for which a lessee is eligible to claim deduction on interest expense against the income produced from the ROU assets (including assets under hire purchase arrangements).

Common interest expense refers to interest expense other than those arising from loans taken to fund specific assets.

However, the interest expenses exclude:

- Non-deductible interest expense[1]
- Interest expense on ROU asset regarded as an operating lease or a finance lease not treated as a sale agreement for tax purposes as the lessee is allowed a tax deduction on the contractual lease payments[2].

3.3 Interest-bearing loans

These refer to any form of financing, for example, bank overdrafts, loans, bonds and notes where interest is charged.

3.4 Income producing assets

Income producing assets are assets which produced income in the relevant Year of Assessment ("YA"). Examples of assets include investments in shares, properties, loans and assets used for business purposes such as factory, plant and equipment.

For investments in shares, a block[3] of shares that has yielded dividends in a particular YA may be considered to be income-producing assets for subsequent YAs even if no dividends are received in the subsequent YAs.

[1] An example of non-deductible interest expense is interest expense incurred on loan taken to finance the payment of dividends - see FAQ 10.7.

[2] Please refer to IRAS e-Tax Guide "Tax Treatment Arising from Adoption of Financial Reporting Standard 116 or Singapore Financial Reporting Standard (International) 16 – Leases" for more details.

[3] Please refer to IRAS website on "Concessionary Group Treatment for Dividend Income" at http://www.iras.gov.sg under Home > Taxes > Corporate Income Tax > Specific Industries > Investment Holding Companies for more information on how such investment would be considered income producing.

3.5 Non-income producing assets

Non-income producing assets are assets which do not produce any income in the relevant YA. They include properties acquired for long-term investment which are vacant, investments in shares which have not yielded dividends since acquisition and loans where no interest is charged for the use of funds.

4 Background

4.1 For interest expense and borrowing costs to be deductible under section 14(1)(a) of the ITA, the Comptroller of Income Tax ("CIT") must be satisfied that the interest is incurred for assets employed in acquiring income, failing which the interest expense is not deductible. This means that for interest expense on an interest-bearing loan to be deductible under section 14(1)(a), there must be a direct link between the use of the loans and the income produced[4]. To demonstrate that linkage, taxpayers have to identify and track how the interest-bearing loans are applied in order to claim deduction of the interest expense incurred on those loans.

4.2 Taxpayers who are able to substantiate that the interest-bearing loan is taken to fund a specific asset and that asset is income producing, the interest expense incurred on that loan is deductible against the income. If the asset funded by that loan is non-income producing, the interest expense is not deductible. This is known as the direct identification method.

Example

Company X borrowed $2 million to purchase an office unit which is rented out for an annual rent of $60,000. Company X would be able to deduct the interest expense incurred on the $2 million loan against the rental income derived from the office unit.

Example

Company Y took a $50 million loan to acquire a factory as premises for the company's manufacturing activities. Since the factory is an asset employed in acquiring the company's income, the interest expense incurred on the $50 million loan is deductible against the income of the company.

[4] Andermatt Investments Pte Ltd v CIT [1995] 3 SLR

4.3 Where direct identification and tracking of the interest-bearing loan to the asset cannot be established, the interest expense would not be deductible under section 14(1)(a).

4.4 The CIT has been exercising his administrative discretion in allowing a portion of the common interest expense attributable to income producing assets, using the TAM[5] as a proxy method to ascertain the amount of common interest expense attributable to non-income producing assets, which is to be disallowed. Where applicable, the TAM is also used to determine the common interest expense attributable to assets which produced certain income streams such as exempt income or passive investment income and the computed interest expense is allowed against such income streams only.

5 Total Asset Method

5.1 The formula used in the TAM to determine the amount of interest expense to be disallowed is shown below:

$$\frac{\text{Cost}^{6}\text{ of non-income producing assets as at B/S date}}{\text{Cost}^{6}\text{ of total assets}^{7}\text{ as at B/S date}} \times \text{Common interest expense}$$

= Interest expense to be disallowed

B/S: Balance sheet as at the relevant financial year end

5.2 The TAM is a simple formula that seeks to reduce compliance costs for taxpayers. The underlying assumption of the TAM is that specific interest expense and common interest expense are incurred to finance the cost of total assets of a company as at the relevant financial year end regardless of whether the assets are income producing or not. To the extent that the cost of assets is not financed by specific interest-bearing loans, the common interest expense is attributable to the cost of these assets that are income producing and non-income producing proportionately. The cost of these assets is used as a proxy to pro-rate the common interest expense. Interest expense attributable to non-income producing assets is not deductible.

Example 1 in the Annex illustrates how the TAM is applied.

5 In JD v Comptroller of Income Tax [2005] 4 SLR(R) 705(HC) and [2006] 1 SLR(R) 484 (CA), the method adopted by Comptroller was endorsed as an administrative discretion that was legally tenable and reasonable.

6 Please refer to paragraph 8 on the value to use.

7 Total assets refer to all “current assets” and “non-current assets” as per balance sheet. Cost of total assets excludes cost of assets financed by specific interest-bearing loans, and cost of ROU assets.

5.3 Where the TAM is used, the underlying assumption of the TAM applies. Accordingly, the total interest expense for a specific asset may comprise:

a) interest expense incurred on a specific loan; and

b) common interest expense attributed to the cost of asset not financed by the specific loan.

Example 2 in the Annex illustrates how the TAM is applied where a taxpayer obtains an interest-bearing loan to partially fund a specific asset.

5.4 When the TAM is used to determine the common interest expense attributable to an asset which produced a certain income stream, the following formula applies:

$$\frac{\text{Cost}^{6}\text{ of the assets as at B/S date}}{\text{Cost}^{6}\text{ of total assets}^{7}\text{ as at B/S date}} \times \text{Common interest expense}$$

= Interest expense to be allowed against the specific income stream

B/S: Balance sheet as at the relevant financial year end

5.5 When the specific interest-bearing loan is fully repaid, the cost of asset financed by the loan should be included in the "Cost of Total Assets" (i.e. the denominator of the TAM formula) in subsequent YAs. This inclusion is in line with the application of the TAM where only the costs of assets financed by specific interest-bearing loans can be excluded from the TAM computation.

6 Loans to related parties

6.1 Where loans to related parties in Singapore[8] are made, the TAM may be used to ascertain the amount of interest expense to be disallowed.

7 Borrowing costs

7.1 The TAM can similarly be applied to ascertain the amount of qualifying borrowing costs attributable to non-income producing assets. The amount ascertained will not qualify for deduction.

[8] For more information on loans to related parties, please refer to the section "Related party financial transactions" in the IRAS e-Tax Guide "Transfer Pricing Guidelines".

8 Valuation of assets for TAM computation purposes

8.1 For assets that are not covered under FRS 109[9] ("non-financial assets"), the historical costs of these assets will be used in the TAM.

8.2 For assets that are covered under FRS 109 tax treatment[10] ("financial assets"), by default, the value of the assets used in the TAM is the value reported on the balance sheet. However, taxpayers can elect to use historical costs of the assets by making an election in writing at the time of submitting their Income Tax Returns. They must be able to track the historical costs of all the assets separately and keep proper records on the cost of the assets. Once an election is made, it has to be applied consistently. At any time after the election, taxpayers can opt to use the value of the financial assets shown in the balance sheet under the FRS 109 valuation. Such a move to adopt the FRS 109 valuation is irrevocable once it is exercised.

8.3 For the purpose of TAM, taxpayers who are on the pre-FRS 39 tax treatment or on the FRS 39 tax treatment but have elected to use historical costs of assets, may continue to use historical costs of assets when they transit to FRS 109 tax treatment. This is provided they continue to track the historical costs of all the assets separately and keep proper records on the costs. These taxpayers may at any time exercise an irrevocable option to use the value of the financial assets shown in the balance sheet under the FRS 109 valuation.

9 Administrative procedures

9.1 Taxpayers have to provide their interest restriction computations in their tax computations. Supporting documents need not be submitted with their Income Tax Returns. However, taxpayers should maintain sufficient documentation for submission to the CIT if called upon to do so as part of the CIT's audit or verification process.

9.2 For cases where supporting documents are not kept or where abuse of the TAM is found, the CIT will make adjustments to disallow the interest expense. In addition, penalties may be imposed for any incorrect claim.

[9] FRS 109, which replaces FRS 39, applies to entities for annual periods beginning on or after 1 Jan 2018 (early application is permitted).

[10] Please refer to the e-Tax Guide "Income Tax Implications arising from the Adoption of FRS 109 - Financial Instruments".

10 Frequently asked questions

10.1 Can taxpayers continue to vary the application of the TAM if the variation was accepted by the CIT in the past years of assessment?

The CIT is prepared to continue allowing the agreed variation until:

(i) the relevant assets are disposed of; or

(ii) the relevant loans are repaid.

When either event (i) or event (ii) occurs, TAM as described under paragraph 5 of this e-Tax Guide is the default method to be applied.

10.2 If I can directly identify the use of a loan to finance an investment, can I opt to use TAM to attribute the interest expense to other assets?

No, the TAM should not be used to attribute the interest expense on a loan where direct identification of the use of the loan is possible.

10.3 Do I need to attribute interest expense and borrowing costs to investments which derive one-tier dividend or foreign sourced dividend using the TAM?

Yes, interest expense and qualifying borrowing costs have to be attributed to the cost of these investments and are to be deducted against the dividend income.

10.4 Can my company exclude from the TAM formula the cost of the non-income producing asset which existed before the company takes a loan?

No, the TAM is used where direct identification and tracking of interest-bearing loan to the asset is not feasible. It serves as a proxy to attribute common interest expense to income-producing assets and non-income producing assets. Therefore, once the TAM formula is adopted, there is no need to identify how an asset is funded. The cost of all assets, other than the amount financed by specific interest-bearing loans, have to be included in the denominator of the formula.

10.5 Can my company exclude from the TAM formula the cost of assets financed by non-interest bearing funds?

No, the TAM formula assumes that specific interest expense and common interest expense are incurred to finance total cost of assets of a company. Therefore, once the TAM formula is adopted, there is no need to exclude from the TAM formula the cost of assets financed by non-interest bearing funds.

10.6 Does my company have to make adjustment to the asset base for movements during the year such as movement arising from acquisition and sale of assets?

No, the TAM is a proxy formula which essentially relies on figures extracted from taxpayers' financial statements as at the end of the financial year.

10.7 Can interest expense incurred on a bank loan for payment of dividends to shareholders form part of the common interest expense for TAM?

No, as the dividend payment is a non-trade transaction, the interest expense on the bank loan is not deductible.

10.8 Can I include the exchange loss of $500 arising from interest expense of $10,000 incurred on a foreign currency loan as part of the total interest expense when applying TAM?

Yes, the total interest expense includes any foreign exchange differences arising from the interest expense incurred. Hence, the total amount of interest expense to be used when applying TAM is $10,500 (i.e. $10,000 + $500).

10.9 What are the costs to be excluded from the denominator of TAM formula?

In applying the TAM to common interest expense, the total asset base includes all current assets and non-current assets as reflected in the balance sheet.

However, cost of assets financed by specific interest-bearing loans (including assets under hire purchase arrangements), ROU assets treated as sale agreements for tax purposes and ROU assets where contractual lease payments incurred have been allowed as a tax deduction, are to be excluded from the denominator of TAM formula.

10.10 What are some examples of non-financial assets that are not covered under FRS 109 as mentioned in paragraph 8.1?

Examples of non-financial assets include:

- Investment property;
- Investment in associate / subsidiary / joint venture;
- Property, plant and equipment;
- Goodwill and other intangible assets.

The historical costs of these assets are to be used in applying the TAM.

11 Contact information

11.1 If you have any enquiries or need clarification on this e-Tax Guide, please call:

(a) 1800-3568622 (Corporate)

(b) 1800-3568300 (Individual)

Inland Revenue Authority of Singapore

12 Updates and amendments

	Date of amendment	Amendments made
1	28 Feb 2023	• Update paragraph 2.2 and FAQ 10.1 to clarify that TAM as described under paragraph 5 is the default method to be applied. • Update paragraph 2.3 on the effective date of aligning the methodology for TAM. • Update paragraph 3.2 to clarify that: o Specific interest expense includes interest expense arising from ROU assets treated as sale agreements for tax purposes (including assets under hire purchase agreements). o Interest expense for the purpose of TAM excludes non-deductible interest expense and interest expense on ROU asset regarded as an operating lease or a finance lease not treated as a sale agreement for tax purposes. Footnotes 1 and 2 are added. • Update footnote 6 in paragraphs 5.1 and 5.4 to clarify the value of the cost of assets to be used for the purpose of TAM. • Update footnote 7 in paragraphs 5.1 and 5.4 to clarify the meaning of total assets and cost of total assets. • Update paragraph 8, add footnote 9 and update footnote 10 for consequential changes

		arising from the adoption of FRS 109 tax treatment. • Add new FAQ 10.8 to clarify that interest expense includes foreign exchange differences on interest incurred for the purpose of TAM. • Add new FAQ 10.9 to clarify the costs to be excluded from the denominator of TAM formula. • Add new FAQ 10.10 to provide more examples of non-financial assets that are not covered under FRS 109 as mentioned in paragraph 8.1.

Annex

Example 1
Common interest expense attributable to all assets (i.e. no specific loan)

Company X's accounting year end is 31 Dec. In May 20X1, Company X bought an investment property for $3,000,000 and gave an interest-free loan of $1,000,000 to a related party.

Company X's assets and bank borrowings as at 31 Dec are as follows:

	$		Interest expense $	
Loan to related party (interest-free)	1,000,000	(A)		
Investment property (income-producing)	3,000,000	(B)		
Other assets (trade)	6,000,000			
Total assets	10,000,000	(C)		
Bank loan 1	2,000,000		40,000	
Bank loan 2	4,000,000		80,000	
			120,000	(D)

The TAM is applied to compute the amount of common interest expense attributable to the investment property and interest-free loan to a related party.

	Interest expense $	
<u>Interest-free loan to a related party</u> *A / C x D* *(1,000,000 / 10,000,000 x 120,000)*	12,000	Not deductible as the asset is non-income producing
<u>Investment property</u> B / C x D *(3,000,000 / 10,000,000 x 120,000)*	36,000	Deductible against rental income
Interest deductible against trade income *(120,000 – 12,000 – 36,000)*	72,000	

<u>Example 2</u>

Company with an asset partially funded by a specific loan and partially funded by a common loan

Company Y's accounting year end is 31 Dec. In Jul 20X1, Company Y acquired a property for $4,000,000 out of which $3,000,000 was financed by bank loan 1. The balance of $1,000,000 is financed by the Company's working capital.

Company Y's assets and bank borrowings as at 31 Dec are as follows:

	$		Interest expense $	
Investment property	4,000,000	(A)		
Loan to related party (interest-free)	1,000,000	(B)		
Investment in shares (income-producing)	2,000,000	(C)		
Other assets (trade)	3,000,000			
Total assets	10,000,000	(D)		
Specific bank loan 1 (obtained in Jul 20X1)	3,000,000	(E)	60,000	(F)
Common bank loan 2 (obtained in Aug 20X1)	1,500,000		30,000	(G)
			90,000	

The TAM is applied to compute the amount of common interest expense attributable to the respective assets.

	Interest expense $	
<u>Investment property</u>		
Interest expense (direct identification)	60,000	
Common interest expense	4,286	
(A-E) / (D-E) x G	64,286	Deductible against rental income if the property is rented out
(4,000,000-3,000,000) / (10,000,000-3,000,000*) x 30,000*		
<u>Loan to related party (interest-free)</u>		
Common interest expense	4,286	Not deductible as the asset is non-income producing
B/(D-E) x G		
1,000,000 / (10,000,000 - 3,000,000) x 30,000*		
<u>Investment in shares</u>		
Common interest expense	8,571	Deductible against dividend income
C/(D-E) x G		
2,000,000 / (10,000,000 – 3,000,000) x 30,000*		

*Portion of the cost of the property financed by specific bank loan 1.