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IRAS e-Tax Guide

Income Tax: Tax Deduction for Borrowing Costs Other Than Interest Expenses (Fifth 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 1947 (“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 1**.

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) of the ITA. 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) of the ITA, 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 has been prescribed in the Regulations since YA 2008.
- 4.2 To keep pace with business developments, the list of deductible borrowing costs in the Regulations was expanded with effect from YA 2014 to include amendment fees, front-end fees and back-end fees. Sections 5 and 6 below provide more detailed information on two specific borrowing costs – front-end fees and discounts/premiums on debt securities.

- 4.3 The tax treatment for interest expenses incurred by taxpayers on loans to re-finance earlier loans or borrowings¹ 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.

5 Front-end fees

- 5.1 For front-end fees to qualify for deduction, they must be equivalent to interest that would otherwise have been payable under the loan agreement. Fees paid for other products or services provided by the lender (e.g. underwriting and arranger fees) are not prescribed borrowing costs under the Regulations and are not deductible.
- 5.2 In practice, IRAS understands that lenders often charge borrowers for loans based on an “all-in” pricing concept, where the borrowing costs would include these components: (i) a benchmark/reference rate (e.g. Singapore Overnight Rate Average (“SORA”)); (ii) interest margin; and (iii) front-end fee. The interest margin and front-end fee are collectively known as the “all-in margin”. Taxpayers have represented to IRAS that these two components are fully interchangeable and determined based on negotiation. Taxpayers are thus of the view that the full amount of front-end fee is equivalent to interest otherwise payable and should be allowed deduction.
- 5.3 Based on IRAS’ consultation with banks, interest margin and the front-end fee are generally interchangeable for bilateral and club loans. For syndicated loans however, the front-end fee may include a service component. IRAS understands that lenders typically do not provide their clients with a breakdown of the front-end fee between interest and service components due to commercial sensitivities and thus, taxpayers may face difficulties identifying the quantum of front-end fees that could qualify for deduction.
- 5.4 To ease compliance, IRAS is prepared to allow deduction on front-end fees incurred for the different types of loans based on the paragraphs set out below.

¹ For details on interest incurred on loans to re-finance earlier loans or borrowings, please refer to IRAS’ website at www.iras.gov.sg (Home > Taxes > Corporate Income Tax > Income & Deductions for Companies > Business Expenses > Tax Treatment of Business Expenses (G-L) > Interest Incurred on Loans to Re-finance Prior Loans or Borrowings).

5.5 Bilateral loans

5.5.1 Bilateral loans are provided by a single lender, which deals directly with the borrower to set up the loan. Typically, the lender would provide the loan on a take and hold basis, with no intention to sell down² to other participating lenders. Hence, no coordination, arrangement or underwriting services is provided by the lender.

5.5.2 Since front-end fees under bilateral loans are generally not for the provision of services and are interchangeable with the interest margin, IRAS is prepared to treat the full amount of front-end fees as equivalent to interest and hence deductible, subject to the following conditions³ being met:

- i. The taxpayer must have made a draw-down on the loan facility by the end of the basis period in which the front-end fee was incurred. Where the loan agreement is signed within 3 months from the financial year-end, the taxpayer will have until the end of the next financial year to make a draw-down on the loan. Please refer to Annex 2 for an example of the application of the draw-down condition.
- ii. The front-end fee was incurred in the basis period for the YA in which the tax deduction was claimed (i.e. deduction is granted on an incurred and not amortised basis).
- iii. The loan agreement and other loan documentation must not indicate any intention by the lender to sell down the loan or include provision of underwriting services.
- iv. The deductible amount of front-end fee should not include any fees for services (e.g. facility agent fee, security agent fee, coordination fee, etc.). Such services, where chargeable, are not tax-deductible.

5.6 Club loans

5.6.1 Club loans are provided by a small group of lenders to a borrower. Unlike syndicated loans, no or minimal arrangement or coordination is required as the borrower deals directly with the lenders to set up the club loan. The lenders would enter the arrangement on a take and hold basis, and would not need to look for other lenders to participate in the loan.

5.6.2 Similar to bilateral loans, front-end fees paid for club loans are generally not for the provision of services, and are interchangeable with the interest margin. Hence, IRAS is prepared to treat the full amount of front-end fees as equivalent to interest and hence deductible, subject to the conditions in paragraph 5.5.2.

² This refers to selling down of loans during the process of loan signing and not in the secondary market after loan signing. Provisions permitting the transfer of loans to the secondary market after loan signing are not regarded as sell-down.

³ The conditions will apply to both term loans and revolving credit facilities.

5.7 Syndicated loans

5.7.1 A syndicated loan is provided by a group of lenders (a syndicate) to one or more borrower(s). One or more lenders would act as arranger(s) and obtain a mandate letter from the borrower(s) to allow the arranger(s) to invite other lenders to participate in the provision of the loan. An arranger may not have the intention to lend the full loan quantum to the borrower, and would look for participating lenders to contribute capital in order to meet the borrower's desired loan quantum, or sell down the loan to other lenders. There are two ways in which the arranger could provide the syndicated loan:

- If the arranger underwrites the loan, it would be required to make up the difference if the sell down phase is not successful (i.e. the borrower's desired loan quantum is only partially subscribed to by other lenders).
- If the arranger does not underwrite the loan (i.e. "best efforts" loan), it would not be obligated to provide the full desired quantum, and the borrower would only be able to borrow the amount that is subscribed.

5.7.2 In syndicated loans, the arranger(s) may not charge a separate fee for the provision of loan arrangement and/or underwriting services⁴. Instead, the front-end fee paid by borrowers to the arranger(s) covers both the provision of the loan/ credit facility and the provision of services. In other words, the front-end fee includes a component that is equivalent to interest otherwise payable (interchangeable with interest margin during loan negotiation with borrowers in arriving at the agreed all-in margin) and a component for services. However, the breakdown between the different components may not be known to the taxpayer (as the borrower).

5.7.3 Separately, based on IRAS' consultation with banks, arranger(s) would pay a participation fee to participating lenders to encourage them to subscribe to the syndicated loan, in addition to the agreed interest margin. In most instances, these participating lenders only contribute funds for the loan and do not provide any additional services. The arranger would retain the fee difference between the front-end fees received from the borrower and the participation fees paid to the participating lenders.

5.7.4 As the participation fee generally represents payment for the provision of credit without any accompanying services, IRAS is prepared to use the participation fee as a proxy for the amount of front-end fees equivalent to interest otherwise payable for syndicated loans, in the absence of a clear and explicit breakdown of the front-end fee between interest and service components.

⁴ Loan arrangement refers to arranger getting lenders together to finance the loan. Loan underwriting refers to the arranger assuming the risk of underwriting the loan and is closely connected to work performed to sell down the loan to other lenders.

- 5.7.5 IRAS understands that participation fee is decided between the lenders and typically not made known to the borrower. To reduce compliance effort for taxpayers, IRAS will allow deduction on 55% of the front-end fees payable for syndicated loans. This percentage is determined based on data on front-end fees and participation fees that IRAS has collated from banks following consultation with the Association of Banks in Singapore. Taxpayers must continue to meet the conditions at paragraph 5.5.2(i), (ii) and (iv) in order to claim deduction on front-end fees for syndicated loans.
- 5.8 The above tax treatment of front-end fees takes effect from YA 2023. Over time, IRAS will monitor developments in the banking industry's practices and assess whether 55% remains appropriate for syndicated loans.

6 Discount/ premium on debt securities

- 6.1 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.
- 6.2 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.⁵ Hence, taxpayers will have to make the necessary adjustments in their tax computations when submitting their tax returns to IRAS.

⁵ Based on the current sections 34A(2)(e) and 34AA(3)(e) of the ITA, the FRS 39 treatment and FRS 109 treatment respectively will not be accepted for interest deductions under section 14(1)(a) of the ITA. Similarly, where section 14(1)(a) of the ITA applies to discount or premium on bonds/notes, sections 34A(2)(i) and 34AA(3)(k) of the ITA 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 Adjustment for amounts of qualifying borrowing costs which are not deductible

7.1 For interest expenses claimed under section 14(1)(a)(i) of the ITA, 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 assets⁶). 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.

7.2 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 a company that commenced its business of making investment on 1 Jan 2015 issued an 8-year bond prior to its business commencement on 1 Jan 2014 at a discount of \$10 for \$90 (the bond matured on 31 Dec 2021 at \$100) the issuer will be given a tax deduction on the discount in YA 2022 (assuming his accounting year ends on 31 Dec), and the amount deductible in YA 2022 is computed as follows:

Total discount	=	\$10
Portion before YA 2016 (i.e. YA 2015)	=	1 yr / 8 yrs X \$10 = \$1.25
Amount to be allowed	=	\$10 - \$1.25 = \$8.75

⁶ Please refer to the e-Tax Guide “Total Asset Method for Interest Adjustment”.

8 Administrative Procedure

8.1 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.

8.2 Front-end fees

8.2.1 Taxpayers claiming deduction on front-end fees should declare in their tax computations the type of loan that the front-end fees relate to and confirm that the relevant conditions as stated in paragraph 5.5.2 are met. IRAS may request supporting documentary evidence to verify the type of loan and that the relevant conditions have been met.

Club loans

8.2.2 For club loans, taxpayers should be prepared to furnish documentary evidence (e.g. mandate letter and term sheet) to substantiate their claim that their loan arrangements are indeed club loans and not syndicated loans. A club loan can be differentiated from a syndicated loan based on the terms and conditions contained within the mandate letter. A syndication mandate letter will usually contain the following:

- Underwriting commitments (and sometimes also final hold amount) by each of the mandated arrangers;
- Bookrunner and/or underwriter roles in addition to the mandated arranger role;
- Clear market clause to facilitate syndication; and
- Other syndication related matters from time to time (e.g. material adverse situation, syndication assistances from borrower etc.)

8.2.3 The mandate letter of a club loan will normally not contain these items. Where the loan documentations such as the mandate letter and term sheet include terms and clauses indicating syndication, arrangement, sell-down intention, underwriting, the loan will be regarded as a syndicated loan. Examples of such terms include but not limited to bookrunner(s), underwriting, structuring, arranging, skim fees⁷.

⁷ Skim fees generally refer to the underwriting, structuring and arrangement fees paid to Mandated Lead Arrangers ("MLA") less the participation fees paid to syndication lenders (excluding the MLA).

Syndicated loans

- 8.2.4 Taxpayers claiming deduction on 55% of the front-end fees incurred on syndicated loans should indicate this clearly in their tax computations and confirm that the relevant conditions in paragraph 5.5.2 are met.
- 8.2.5 If taxpayers wish to claim deduction in excess of the 55% for their syndicated loans, they should be prepared to support their claim with documentary evidence (e.g. facility agreement, fee letters, correspondences, mandate letter, term sheet etc.). The documentary evidence should clearly show the intention for the front-end fee payment and prove that the amount of front-end fee claimed is equivalent to interest that would otherwise have been payable.
- 8.2.6 If taxpayers are unable to furnish documents that show an explicit breakdown of the front-end fee into interest and service components, IRAS will also accept documentary evidence showing the amount of participation fees paid to participating lenders, specifically:
- Participation fee schedule provided to participating lenders from the lead arranger, and information on the amount of loan subscribed by each participating lender as well as the fees paid to each of them; and
 - Confirmation in writing from the lead arranger that the said participating lenders did not provide any services besides the provision of the loan.

In such cases, the percentage of deductible front-end fee should be calculated as follows:

$$[B + (B/C \times D)] / A$$

Where:

A = Total amount of front-end fee paid by the taxpayer

B = Amount of participation fee paid to Pure Lenders⁸

C = Amount of loan subscribed by Pure Lenders

D = Amount of loan quantum subscribed by all arranger(s) (Note 2)

Note 1: C and D should add up to the total loan quantum provided to the taxpayer.

Note 2: Arrangers refer to lenders which performed arranging or underwriting services in conjunction with the provision of funds for the syndicated loan.

Taxpayers that wish to claim front-end fee in excess of the 55% should show their workings in their tax computations.

⁸ Pure Lenders refer to lenders that only contributed funds for the loan and did not provide any services. If a lender has contributed funds for the loan and provided arrangement/ co-arrangement / underwriting services, it would not be regarded as a Pure Lender.

9 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

10 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	<p>Paragraph 4.2 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.</p> <p>Footnotes 5 and 9 have been updated with references to the new provisions and e-Tax Guide relating to FRS 109.</p>
3	30 Oct 2023	<p>“Income Tax Act” in Paragraph 2.1 has been amended to “Income Tax Act 1947”.</p> <p>Editorial changes made to Paragraphs 4.1 and 4.2.</p> <p>Paragraph 5 is added to clarify the tax treatment of front-end fees.</p> <p>Footnote 6 is added to paragraph 7.1.</p> <p>Paragraph 7.2 has been updated to provide an example involving a more recent year (i.e. YA 2022).</p> <p>Paragraph 8.2 has been added to provide the administrative procedures for claiming deduction on front-end fees for different types of loans.</p> <p>Item 3 of Annex 1 has been updated to add “upon maturity or early redemption” to align wording to those used in the Income Tax (Deductible Borrowing Costs) Regulations 2008.</p> <p>Items 10 and 12 of Annex 1 have been updated to remove the definition of conversion fees prior to YA 2014 and “with effect from YA 2014” as YA 2014 is already time-barred.</p> <p>Annex 2 is added to provide an example of the application of draw-down condition for front-end fee deduction.</p>

Annex 1: 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 ⁹ on notes or bonds	Discount suffered upon maturity or early redemption by the issuer of notes or bonds with zero or below market interest rate
4	Premiums ⁹ 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

⁹ 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/ 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
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

Annex 2: Application of draw-down condition for front-end fee deduction

Scenario 1: Loan agreement is signed prior to the last 3 months of the financial year
<p>The draw-down condition is met only if the taxpayer has made a draw-down within the same basis period in which the front-end fee was incurred.</p> <p>For example, if the taxpayer has a December financial year-end, and signs a loan agreement in April 2022, the taxpayer must have made a draw-down before 31 Dec 2022 in order to claim deduction on front-end fee incurred between 1 Jan 2022 and 31 Dec 2022 in its YA 2023 return.</p>
Scenario 2: Loan agreement is signed within 3 months from the financial year-end
<p>The taxpayer has until the end of the next financial year to make a draw-down on the loan.</p> <p>For example, if the taxpayer has a December financial year-end and signs a loan agreement in October 2022, the taxpayer would have met the draw-down condition as long as it makes a draw-down before 31 Dec 2023:</p> <ul style="list-style-type: none">• If the taxpayer makes a draw-down in March 2023, before filing its YA 2023 tax return, it may claim tax deduction on front-end fee incurred between 1 Jan 2022 and 31 Dec 2022 in its YA 2023 return.• If however, the taxpayer only makes a draw-down in Dec 2023, after filing its YA 2023 tax return, it should not claim deduction on the front-end fees in its YA 2023 return as the draw-down condition has not been met at that point in time. Instead, it should submit a revised tax computation for YA 2023 following the draw-down if it wishes to claim deduction on the front-end fee.