

You and the Taxman

What to consider in financing arrangements of commodity trading companies?

Mind the tax costs associated with financing arrangements to avoid erosion of commercial benefits.

In today's global environment, companies are grappling with unprecedented uncertainty. Macroeconomic challenges such as supply chain disruptions, price volatility and rising operating costs have compressed profit margins.

To navigate this turbulent landscape, companies must broaden their trading focus in pursuit of better margins.

Financing arrangements are essential for commodity trading companies to access funds for capital structure optimisation and liquidity management.

The common financing structures used in the commodity supply chain include:

- Trade finance: Short-term credit is obtained for either purchase or sale of commodity, such as letter of credits (LC).
- Structured commodity financing: Lending is secured against underlying commodities, such as repurchase agreements (REPO).
- Receivable financing: Accounts receivables being sold to third parties at a discount, such as receivables factoring.

Syndicated credit facilities may also be undertaken to meet companies' huge funding requirements.

Companies must be aware of the tax implications that are associated with these financing arrangements, so that they will not be surprised by any adverse tax costs.

This article highlights the key tax considerations.

Nature and characterisation of the arrangement

Determining the nature of the financing arrangement is the first step to understanding the tax considerations. This determination is not necessarily a straightforward exercise for certain arrangements.

Take receivables factoring for instance. This arrangement typically involves the risks and rewards associated with the receivables being substantially transferred or retained from one party to another. Whether a factoring arrangement is considered as a sale of receivables or a financing arrangement requires an evaluation of such risks and rewards in totality.

There is no specific rules and regulations on determining whether a factoring arrangement may constitute a sale of receivable or otherwise in the Income Tax Act (ITA). We will generally look to case laws for guidance. One key principle cited in determining whether a factoring arrangement is a sale of accounts receivables (a true sale) or an extension of credit with accounts receivable as collateral (a loan) is that:

“..... the most important single factor when determining whether a transaction is a true sale is the buyer’s right to recourse against the seller. One of the core attributes of owning a receivable is the risk that it will not be paid. If the buyer ‘sells’ the receivable, but retains the risk of non-payment, it is more likely that the transaction will be recharacterised as a loan. ”

The accounting for factoring arrangements can be complex, including an analysis of the facts and circumstances to determine whether the underlying receivables may be de-recognised in accordance with the Singapore Financial Reporting Standards (FRS). An alignment to the accounting treatment will generally lend support to the position taken from a Singapore corporate income tax perspective.

A prepayment offtake may also be construed as a financing arrangement. In a prepayment arrangement, a trader pays a producer a lump sum prepayment amount in return for the commitment to supply a pre-agreed volume of product to the trader. This prepayment can be seen as a source of lower cost of financing for the producer. The producer may then pass some of the cost savings to the trader. This can take the form of a reduction to the sales price on the products to be sold to the trader.

Proper contemporaneous documentation is important to ensure that the nature of such savings is appropriately and consistently reflected as a reduction to the sales prices. The drawdown of the prepayment as and when the trader takes delivery of the products should be monitored and tracked against the prepayment sum, to further support the prepayment as that of buy-sell transactions.

Relevant tax considerations

The following tax considerations may be relevant if the arrangement is determined to be a financing arrangement.

1. Deduction on the financing costs

There is no thin capitalisation rule in Singapore.

Under the ITA, interest expense is tax deductible if it is payable on capital employed in acquiring income. For interest paid on borrowed money used for income-producing and non-income producing assets, the interest expense attributable to the latter will be disallowed. For cases where companies cannot identify and track the use of an interest-bearing financing arrangement to specific assets (whether income or non-income producing), the Inland Revenue Authority of Singapore (IRAS) requires companies to use the Total Assets Method (TAM) and allocate that portion of interest attributable to the non-income producing assets to be disallowed for tax deduction purpose.

Companies typically undertake trade financing specifically for their trading operations. Where the financing can be directly traced to the underlying commodity trading transactions, tax deduction can be claimed on the full cost, so long as companies maintain the contemporaneous robust documentation.

As for credit facilities, while the main purpose is to support the trading operations, companies may sometimes draw down the facilities for other

purposes, such as on-lending to related entities for interest-bearing loans, or to undertake equity investments. Since funds can be commingled for various purposes, the IRAS expects companies to adopt the TAM and attribute the interest to the various assets.

Increasingly, commodity trading companies may undertake equity investments. The value of these investment can be huge. Further, these investments may be non-income producing (not paying dividend) or the dividend may be tax exempt in Singapore. As a result, companies find themselves having a large portion of interest disallowed or with no deduction value because a large portion of the interest is allocated to equity investments.

Apart from interest, companies may have to incur other types of borrowing costs, such as participation fees and commitment fees for their credit facilities.

The ITA provides deduction on prescribed borrowing costs in the same manner as interest expense. Fundamentally, the borrowing costs must be incurred as a substitute for interest expense or to reduce interest cost. Other conditions must be met for prescribed borrowing costs listed in the IRAS e-guide, *Income Tax: Tax Deduction for Borrowing Costs Other Than Interest Expenses (Fourth Edition)*, issued on 30 October 2023.

Companies must understand the various borrowing costs that they have to incur under these credit facilities, so as to avoid unexpected situations where the costs do not fall within the prescribed list. Where practicable, companies may take into consideration, the tax treatment of the various borrowing costs in their credit facility negotiation with the agent banks.

2. Withholding tax (WHT) considerations

Singapore WHT will apply to any interest, commission, fee or any other payment to a non-resident in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness. The terms “any other payment” made “in connection with any loan or indebtedness” are generally widely interpreted.

The WHT obligation lies with the payer and there are penalties for failure to withhold as well as late WHT payments to the IRAS.

Often, companies may fail to withhold tax due to the lack of full understanding of the nature of the complex financing arrangements. Within the organisation, communication protocols must be in place to ensure adequate communication between the relevant team involved in securing the financing arrangements and the team responsible for accounting for the WHT, such as the tax or finance team.

Furthermore, the nature of the payments may not be discernible. Singapore WHT does not apply if a particular payment to the non-resident is solely for services and such services are rendered outside Singapore.

Another WHT consideration is the contracting party, i.e., whether the lending is contracted directly with the non-resident financial institution or its Singapore branch. If it is the latter, Singapore WHT does not apply due to specific domestic tax exemption for payments to Singapore branches of non-resident banks. Where commercially justifiable, companies may then arrange for the lending to be undertaken with the Singapore branch instead. Commercially, this may not be possible, perhaps due to the credit relationship residing only with the non-resident lender.

Other considerations

Companies may undertake structured financing arrangements and derive financing income or service fee income to support their affiliated entities. Singapore tax incentives such as the Global Trader Programme and the Finance Treasury Centre incentive, allow qualifying income derived from qualifying activities to be taxed at the applicable concessionary tax rates. Companies can explore such tax incentives as appropriate and holistically in light of the implementation of the Global Anti-Base Erosion (GloBE) Rules.

Singapore tax resident companies may claim foreign tax credits on the foreign taxes suffered on the income that they receive from overseas borrowers under these financing arrangements, including treaty jurisdictions. Double tax relief (DTR) is only available if the taxes are withheld in accordance with treaty provisions. Where taxes are inappropriately applied in the foreign jurisdictions, DTR may not be available to the Singapore tax resident companies.

Conclusion

Financing arrangements are vital for commodity trading companies in broadening their trading margins. It is essential that companies are aware of the potential tax consequences associated with these arrangements, so that the commercial benefits are not eroded by unexpected tax costs.

This article was published in May 2025.

Toh Shu Hui
Partner, Tax Services,
Ernst & Young Solutions LLP
shu-hui.toh@sg.ey.com

Rebecca Hong
Associate Director,
Tax Services, EY Corporate
Advisors Pte. Ltd.
rebecca.hong@sg.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

All in to shape the future with confidence.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

© 2025 EY Corporate Advisors Pte. Ltd.
All Rights Reserved.

APAC no. 12003971
ED None

UEN 201911025K

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com