

TECHNICAL

Direct Taxation

DEDUCTION OF INTEREST EXPENSE AND RECOGNITION OF INTEREST INCOME FOR LOAN TRANSACTIONS BETWEEN RELATED PERSONS – PUBLIC RULING NO. 9/2015

The PR was reported in our [e-CTIM TECH-DT 87/2015](#) dated 21 December 2015 and explains, in relation to a loan transaction between related persons:

- a) when deduction for interest expense is allowed against a business source;
- b) the recognition of interest income.

Important Definitions

Among the important terms defined are the following:

Term	Meaning
relative	A parent, a child (including a stepchild and a child adopted in accordance with any law), a brother, a sister, an uncle, an aunt, a nephew, a niece, a cousin, an ancestor or a lineal descendant.
Related persons	In subsection 29(3) of the ITA means – <ol style="list-style-type: none"> (i) between persons one of whom has control over the other; (ii) between individuals who are relatives of each other * or (iii) between persons both of whom are controlled by some other person. <p><i>*Note – effective for YA 2015 and subsequent years of assessment.</i></p>
person	Includes a company, a body of persons, a limited liability partnership, and a corporation sole.

Tax Treatment of Interest Expense and Income

Para No.	Summary
4	Tax Treatment of Interest Expense
4.1	<p><u>Interest expense due and payable</u></p> <ul style="list-style-type: none"> Interest expense incurred and payable on borrowed monies is only deductible in ascertaining adjusted income from the business when the interest is due to be paid. [S33(4)] (Examples 1 – 3) When making a claim, a taxpayer is required to inform the relevant IRBM branch by letter, accompanied by revised tax computations in respect of interest payable for each affected YA. IRBM will amend the relevant assessments to allow the claim after confirmation and review of the amended assessments.
4.2	<p><u>Loan agreement prior to YA 2014</u></p> <ul style="list-style-type: none"> S33(4) is applicable to loan agreements signed before and after YA 2014. For agreements that are effective prior to YA 2014, but the date on which interest is due to be paid has not yet passed, then from YA 2014, interest deduction will only be allowed on the date interest is due to be paid. Deductions of interest incurred

Para No.	Summary
	which have been allowed prior to YA 2014 will be maintained. (Example 4)
4.3	<p><u>No payment is made on the date interest is due to be paid</u></p> <ul style="list-style-type: none"> If no interest payment is made on the date interest is due to be paid, a deduction for interest expense can be claimed and allowed under S33(1)(a) as the liability for interest payment has arisen on the due date. (Example 5)
4.4	<p><u>Payment is made before date interest is due to be paid</u></p> <ul style="list-style-type: none"> If payment is made before the interest due date, then interest deduction is allowed in the YA the interest is paid. (Example 6)
4.5	<p><u>Interest restriction under subsection 33(2) of the ITA</u></p> <ul style="list-style-type: none"> Interest restriction under S33(2) (when a loan is not used wholly for the purpose of a business) is fully explained in PR No. 2/2011. (Example 7)
5	Recognition of Interest Income
5.1	<p><u>Basis period to which gross income in respect of interest is related</u></p> <ul style="list-style-type: none"> Under S27 of the ITA, interest is taxable when received although the income relates to an earlier period.
5.2	<p><u>Basis period to which income obtainable on demand is related</u></p> <ul style="list-style-type: none"> Notwithstanding S27, interest may be deemed received in the absence of any payment received under certain circumstances. S29 (an anti-avoidance provision) provides that – <ul style="list-style-type: none"> (i) For <u>loan transactions between unrelated persons</u>, interest income of the lender is taxed in accordance with the provisions of S27 when interest is received or obtainable on demand by the lender. [S29(1)] (ii) For <u>loan transactions between related persons</u> (w.e.f YA 2014) interest income of the lender is deemed to be received (deemed obtainable on demand) by the lender on the date the interest income is due to be paid by the borrower, whether or not the interest is received. [S29(3)] (Example 8)

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5.3	<p><u><i>Basis period to which gross income in respect of interest is related.</i></u></p> <p>This paragraph explains the application of S27(2), provisos (b) and (c).</p> <ul style="list-style-type: none">• Proviso (b) – where part of an overlapping period in respect of which interest income is receivable elapsed more than 4 years before the day on which the receipt of the gross income first became known to the DGIR, that interest income is deemed to have accrued evenly over the overlapping period which has not elapsed.• Proviso (c) – where the whole of the overlapping period in respect of which gross interest income is receivable elapsed more than 4 years before the day on which the receipt of that gross income first become known to the DGIR, that gross income is treated as gross income for the basis period for the YA which began 4 years before the beginning of the YA which includes the day on which the receipt of the gross income first became known to the DGIR. <p>Please refer to the diagrams under this paragraph in the PR as well as the following examples:</p> <table><tr><th><i>Example (No.)</i></th><th><i>Loan transaction between :</i></th><th><i>Applicable provision</i></th></tr><tr><td>9(a)</td><td>related persons</td><td>proviso (b) of S27(2)</td></tr><tr><td>9(b)</td><td>unrelated persons</td><td>proviso (c) of S27(2)</td></tr><tr><td>10</td><td>related persons</td><td>proviso (b) of S27(2)</td></tr></table>	<i>Example (No.)</i>	<i>Loan transaction between :</i>	<i>Applicable provision</i>	9(a)	related persons	proviso (b) of S27(2)	9(b)	unrelated persons	proviso (c) of S27(2)	10	related persons	proviso (b) of S27(2)
<i>Example (No.)</i>	<i>Loan transaction between :</i>	<i>Applicable provision</i>											
9(a)	related persons	proviso (b) of S27(2)											
9(b)	unrelated persons	proviso (c) of S27(2)											
10	related persons	proviso (b) of S27(2)											
6	<p>Summary</p> <p>Example 11 illustrates the tax treatment for the recognition of interest income (for the lender) and deduction of interest expense (for the borrower) on loan transactions between related persons.</p> <p>The table under paragraph 6.2 summarizes the application of S27, S29(3), S33(1)(a) and S33(4) of the ITA.</p>												

Members may view the PR at the [Institute website](#) and the [LHDNM website](#).

You may write to the Institute at technical@ctim.org.my or secretariat@ctim.org.my in respect of any suggestions, concern or comments you may have on the [PR](#) so that we may raise them to the LHDNM.

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