

TECHNICAL

Direct Taxation

PUBLIC RULING NO. 8/2015 – LOANS OR ADVANCES TO DIRECTOR BY A COMPANY

The above Public Ruling ([PR](#)) was issued on 30 November 2015 (refer to our [e-CTIM TECH-DT 87/2015](#) dated 21 December 2015). The PR explains the tax treatment relating to –

- (a) a company that provides loans or advances to a director of the company without interest, or at a rate which is lower than the arm's length rate; and
- (b) interest income deemed received by the company from such loans/ advance.

Definitions

Among the terms defined (paragraph 3) are the following:

Word	Meaning
interest	The return or compensation for the use or retention by a person of a sum of money belonging to or owed to another.
director	The director of a company as defined under subsection 75A(2) of the ITA.
company	Means a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia and a business trust.

Tax treatment of loans or advances to directors

The tax treatment is explained in paragraph 4 and summarized below:

Paragraph No.	Subject matter/ Summary
4.1	<p><i>Tax treatment</i></p> <ul style="list-style-type: none"> • A company that provides loans or advances to its directors without interest, or at a rate which is lower than the arm's length rate is deemed to receive interest income from such loans/ advances for the basis period for a year of assessment (YA) under S4(c) of the Income Tax Act 1967 (ITA). (<i>All provisions cited hereafter refers to sections from the ITA, unless otherwise stated.</i>) • If such loans/ advances are funded fully from internal funds, S140B is applicable, and the company is deemed to have gross income from an interest source as stated above. • If the loans/ advances are financed from external funds or third party sources, S140B is not applicable.
4.2	<p><i>Sources of funds</i></p>

	<ul style="list-style-type: none"> Internal funds are surplus funds that may arise from the injection of capital, retained earnings and company reserves. <i>Examples 1, 2 and 3</i> illustrate situations where S140B is applicable. External funds refer to financial resources acquired by a company through loans from third parties (e.g. banks or related companies) specifically used to finance loans/ advances to directors. Minutes of meetings of Board of Directors (BOD) may be referred to, to show BOD's decision/resolution to obtain such external funding. <i>Examples 4 and 5</i> illustrate situations where S140B is not applicable. Where funding for loans/ advances to directors are from "mixed funds" (financed from internal and external funds) the interest income is computed only on the portion related to the amount of internal funds. The company must prove that some/ all of the loans or advances are from external funds and hence not subject to S140B. (<i>Example 6</i>) If the loan from external fund is used partly for a business purpose and partly for investment purposes, interest restriction under S33(2) is applicable (refer PR No. 2/2011.) (<i>Example 7</i>)
4.3	<p><i>Directors who are also employees of a company</i></p> <ul style="list-style-type: none"> If external funds are used to provide loans/advances to directors who are also employees of the company, the interest cost of funding the loan facility constitutes a perquisite to the director, which is income chargeable under S13(1)(a). (Refer PR 2/2013.)
4.4	<p><i>Loans/ advances to directors via a partnership</i></p> <ul style="list-style-type: none"> If a company makes loans/ advances to a partnership in which the partners are also directors of the lending company, the loans/ advances are subject to S140B. A partnership is not a legal entity and legal responsibility for the partnership lies with each of the partners. A loan given to a partnership is deemed to be given to the directors. S140B applies only to the partner who is also a director of the company. (<i>Example 8</i>) Total loans to directors are based on the percentage of capital contribution by each partner. (<i>Examples 9 and 10</i>)

Computation of interest income

The method of computing the amount of interest income deemed received is explained in paragraph 5 (summarized below):

Paragraph No.	Subject matter/ Summary
5.1	<p><i>Application of formula in S140B(2)</i></p> <ul style="list-style-type: none"> Interest income deemed received under S140B is computed monthly using the following formula: $\frac{1}{12} \times A \times B$

	<p>12</p> <p>where –</p> <p>A = the total amount of loans/ advances outstanding at the end of the calendar month*;</p> <p>B = ALR of commercial banks published by BNM on interest free loan or advances at the end of the calendar month or other reference lending rate as may be prescribed by the DGIR if no ALR published.</p> <p>* Refers to the balance of loans or advances after deducting repayment of loans and advances and adding any new loans or advances made during that month.</p>
5.2	<p><i>Effective date of S140B</i></p> <ul style="list-style-type: none"> S140B is effective from YA 2014 and subsequent years. Interest income is computed on loans/ advances outstanding at the end of each calendar month, including any existing balance on loans/ advances made before YA 2014. (<i>Examples 11 & 12</i>)
5.3	<p><i>Rate of interest</i></p> <ul style="list-style-type: none"> If the loan/ advance to a director is given <i>interest-free</i>, the amount of interest deemed received by the company is computed based on the prescribed formula with ALR published by BNM in the basis year in which the loan/ advance is given. The following examples are given: <ul style="list-style-type: none"> <i>Example 13 & 14</i> (no repayment is made by director); <i>Example 15</i> (repayment made by director). If <i>interest is charged</i> on the loan/ advance to a director, it is necessary to compare the two total amounts of interest which are calculated based on the following rates: <ul style="list-style-type: none"> Interest rate charged by the company; and Formula found in S140B(2) <p>The higher of the above 2 amounts calculated as indicated above is taken as interest income of the company In the basis period for the YA.</p> <p>(a) If the amount of interest charged by the company is more than the amount computed using the formula in S140B(2), then the amount due and payable by the director is taken as interest income of the company chargeable under S4(c). S140B does not apply in such cases. (<i>Example 16</i>)</p> <p>(b) If interest charged by the company amounts to less than the total calculated using the formula in S140B(2), the amount charged is disregarded. S140B(2) applies and the latter amount is deemed to be interest income of the company assessable under S4(c). (<i>Example 17</i>)</p>
6	<ul style="list-style-type: none"> If loans/ advances to directors are given by a dormant company, the company is deemed to have commenced operations [under S 21A(8)]. S140B is applicable to loans/ advances to directors and interest income is deemed received by the company and assessed under S4(c). (<i>Example 18</i>)

Other provisions relating to loans/ advances to directors (paragraph 7)

Paragraph No.	Subject matter/ Summary
7.1	If loans to directors are financed by internal funds, S29(3) [<i>Person deemed entitled to receipt of interest on demand</i>] shall not apply even though the loans/ advances involved related parties as defined in that section because S140B is a special provision to compute interest income deemed to be received by a company from loans/ advances made to its directors.
7.2	If loans/ advances are given to directors who are also shareholders according to S75A(2) , the provisions of S140A(2) [<i>Transaction with associated person</i>] is not applicable because the benefits received by directors from the loans/ advances have been taxed on the company under S140B. The company need not provide documentation for the purpose of S140A(2) . (<i>Example 20</i>)
7.3	The introduction of S140B does not preclude or restrict the business and transactions of a lender as provided under the Moneylender's Act 1951 .

Members may read the PR in full at the websites of the [Institute](#) and the [LHDNM](#).

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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