

DEEMED INTEREST INCOME FROM LOANS OR ADVANCES TO DIRECTORS

1 Existing Legislation

Section 133 of the Companies Act 1965 provides that a company (other than an exempt private company) is prohibited to make a loan to a director of the company or of a related company unless the said loan is made:

- to provide such a director with funds to meet expenditure incurred or to be incurred by him/her for the purposes of the company or for the purpose of enabling him/her to properly perform his/her duties as an officer of the company; or
- to provide such a director who is engaged in the full-time employment of the company or its holding company with funds to meet expenditure incurred or to be incurred by him/her in purchasing or otherwise acquiring a home; or
- to such a director who is engaged in the full-time employment of the company or its holding company, where the company has at general meeting approved of a scheme for the making loans to employees of the company, and the loan is in accordance with the scheme.

Loan or advances may be made by a company to its directors from its internal funds or from external borrowings. Where the loan or advances are made from the company's internal funds, it would generally be interest-free as there is no additional financing cost incurred by the company.

2 Proposed Legislation

It is proposed that with effect from the year of assessment 2014, a new Section 140B of Income Tax Act 1967 will deem that the company shall derive interest income from loans or advances granted to the company's directors from the company's internally generated funds.

A person is regarded as a director if:

- He directly (ie on his own) or indirectly (ie with his associates) owns or controls at least 20% of the ordinary share capital of the company.
- He occupies the position of director (by whatever name called), including any person who is concerned in the management of the company's business.

The interest income for the basis period for a year of assessment shall be the aggregate sum of monthly interest in the basis period. The sum of the monthly interest is determined in accordance with the following formula:

	$1/12 \times (A \times B)$
Definition	
A =	total amount of loan or advances outstanding at end of the calendar month
B =	average lending rate of commercial banks published by the Central Bank at the end of the calendar month

Where interest is charged by the company and the total interest charged and payable by the director is more than the aggregate sum of interest as determined based on the above formula, this provision of deemed interest shall not apply.

Where the interest charged by the company is less than the aggregate sum of the interest as determined based on the above formula, the actual interest charged shall be disregarded. The company shall be deemed to derive interest income based on the above formula.

3 Example Of Computation

- ABC Sdn Bhd gave an advance to a company director of RM100,000 on 1 January 2014.
- The company director holds 20% of the ordinary share capital of the Company.
- The advance is unsecured, interest free and has no fixed terms of repayment.
- The director made repayment of RM20,000 in June 2014 and fully settled the advance by 31 December 2014.
- The average lending rate is assumed to be 5% in 2014.

The deemed interest income to the company from loans or advances granted to the company's directors from the company's internally generated funds are computed as follows :

	Balance at Month-End RM	Commercial Interest Rate %	Deemed Interest RM
January 2014	100,000	5%	416.67
February 2014	100,000	5%	416.67
March 2014	100,000	5%	416.67
April 2014	100,000	5%	416.67
May 2014	100,000	5%	416.67
June 2014	80,000	5%	333.33
July 2014	80,000	5%	333.33
August 2014	80,000	5%	333.33
September 2014	80,000	5%	333.33
October 2014	80,000	5%	333.33
November 2014	80,000	5%	333.33
December 2014	-	5%	-
			4,083.33

ABC Sdn Bhd is deemed to have earned interest income of RM4,083.33 for the year 2014.

Conclusion

If a company director owes money to his company at month-end, interest income will be deemed to be charged at market rate (irrespective of whether interest is actually charged or not by the company) and this deemed interest income will be taxable to the company.

Variation to assumptions

If the company charges interest of 9% on the director advance, the total interest payable by the director is RM7,350.00 which is more than the deemed interest of RM4,083.33.

In this scenario, the interest income to be disclosed as earned in the tax return, is RM7,350.00.

If the company charges interest of 3% on the director advance, the total interest payable by the director is RM2,450.00 which is less than the deemed interest of RM4,083.33.

In this scenario, the interest income to be disclosed as earned in the tax return, is RM4,083.33.

DISCLAIMER :

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