



Jason Tan Jia Xin  
Partner

**Tax, Customs & Trade**

E: [tjx@lh-ag.com](mailto:tjx@lh-ag.com)

HP: 012 370 7037



Chris Toh Pei Roo  
Partner

**Tax, Customs & Trade**

E: [tpr@lh-ag.com](mailto:tpr@lh-ag.com)

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### Intercompany Financing & Borrowings in Tax Audits by the IRB: A Looming and Real Threat

Widespread tax audits conducted by the Inland Revenue Board (“**IRB**”) on companies lately are causing jitters among CFOs and tax managers. The ongoing “**Operasi Mega Corp**” has set off alarm bells on thorny issues such as transfer pricing, withholding tax, retrospective clawback of tax incentives, and the deductibility of expenses.

In terms of transfer pricing, glaring intercompany loans and amounts owing from related companies that are sitting in financial statements are being looked at, with the threat of IRB slapping taxpayers with imputed interest income and penalties looming large. The IRB’s approach often disregards the fact that such transactions are genuinely intended by companies as equity contributions rather than loans.

#### **Urgent Action**

Companies must immediately:

- **Dig** up all historical intercompany balances, loans, and advances
- **Characterise** these transactions by obtaining legal and tax advice
- Use legal documents, such as **Agreements** and internal corporate documents, to justify the non-charging of interest
- Prepare transfer pricing **Documentation**

**Head Office**

Level 6, Menara 1 Dutamas  
Solaris Dutamas  
No. 1, Jalan Dutamas 1  
50480 Kuala Lumpur  
Malaysia  
Tel: +603 6208 5888  
Fax: +603 6201 0122

**Johor Office**

Suite 21.01  
21st Floor, Public Bank Tower  
No.19, Jalan Wong Ah Fook  
80000 Johor Bahru, Johor  
Tel: +607 278 3833  
Fax: +607 278 2833

**Penang Office**

51-12-E, Menara BHL Bank,  
Jalan Sultan Ahmad Shah,  
10050  
Penang  
Tel: +604 299 9668  
Fax: +604 299 9628

**Email**

[enquiry@lh-ag.com](mailto:enquiry@lh-ag.com)

**Website**

[www.lh-ag.com](http://www.lh-ag.com)

**Legal Position – Interest or No Interest**

A plethora of Commonwealth and foreign case laws have ruled that equity-like advances or loans are not considered debt in nature and, therefore, the charging of interest is unnecessary. The courts have also ruled that the features<sup>1</sup> of an intercompany transaction should be examined holistically before determining and characterising whether it is equity-like or even quasi-equity.

In fact, the Commentary to the OECD Model Tax Convention also sets out the possibility that a prima facie loan may have characteristics of a contribution to equity. Therefore, it is premature to assume that all your intercompany financing or loans must be interest-bearing.

Legal agreements and transfer pricing documentation are therefore vital to support and evidence such characterisation. All these documents and arguments are required to be submitted to the IRB during the audit.

Jason Tan and Chris Toh are Tax Partners of LHAG with heavy specialisation in transfer pricing. They have been advising companies on complex intragroup financing structures, structuring intragroup legal agreements, and formulating effective strategies.

If you have any queries, please contact Partners, [Jason Tan Jia Xin](mailto:tjx@lh-ag.com) ([tjx@lh-ag.com](mailto:tjx@lh-ag.com)) and [Chris Toh Pei Roo](mailto:tpr@lh-ag.com) ([tpr@lh-ag.com](mailto:tpr@lh-ag.com)).

<sup>1</sup> In many cases, courts will examine at least 10 to 12 features of a transaction before determining its true characterisation. These transactions are largely documented in the form of contracts and agreements.