LHAG INSIGHTS

TAX, CUSTOMS & TRADE

30 JULY 2026

IRB'S INTRA-GROUP LOAN GUIDELINES: RECOGNITION OF EQUITY FUNDING

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On 30 July 2026, the Inland Revenue Board of Malaysia ("**IRB**") published the Malaysia Transfer Pricing Guidelines - Controlled Financial Transactions: Intra-Group Loans ("**Guidelines**").

The Guidelines supplement Chapter 9 of the Malaysia Transfer Pricing Guidelines 2024 ("**MTPG 2024**") and set out the Director General of Inland Revenue ("**DGIR**")'s position on the application of section 140A of the Income Tax Act 1967 ("**ITA**") and the Income Tax (Transfer Pricing) Rules 2023 ("**TP Rules**") to intra-group loans.

[1] WA-25-13-01/2026

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A. Debt or Equity

Recognition of equity and accurate delineation

The Guidelines state that funding presented as a loan may, in substance, constitute equity. Taxpayers must therefore determine whether the funding constitutes a genuine loan or an equity contribution before establishing an arm's length interest rate.

The Guidelines define a "purported loan" as an arrangement labelled as a loan between associated persons but which may not possess the characteristics of debt that independent persons would expect. The debt-equity balance of an entity within a multinational enterprise ("**MNE**") group may differ from that of an independent entity in comparable circumstances. This may affect the borrower's interest expense and taxable profits in Malaysia.[1]

The Guidelines require the controlled financial transaction to be accurately delineated by reference to its economically relevant characteristics. The analysis must consider:

1. the economic substance of the transaction;
2. the commercial or financial relations between the parties;
3. the contractual terms and actual conduct;
4. the allocation and control of risks;
5. each party's financial capacity; and
6. the functions performed, assets used and risks assumed.

The Guidelines state that the label assigned to the transaction is not determinative. Each arrangement must be examined on its own merits. Where an arrangement differs from one that independent persons acting in a commercially rational manner would have adopted, the DGIR may disregard or recharacterise it to reflect its actual nature.[2]

[1] Guidelines, paragraphs 1.8 to 1.12.
[2] Guidelines, paragraphs 1.3 to 1.7 and 1.17 to 1.19.

Debt-versus-equity characteristics

Paragraphs 1.13 to 1.15 set out the general characteristics and detailed criteria for distinguishing debt from equity. These may be consolidated as follows:

Criterion	Debt Indicators	Equity Indicators
Legal obligation to repay	Fixed and enforceable obligation to repay principal and interest	No obligation to repay, or repayment depends on profits or management discretion
Maturity	Repayment on a specified date or on demand	No fixed maturity; perpetual or redeemable at the issuer's discretion
Expected return	Predetermined interest independent of the borrower's profitability	Return depends on profits or dividends
Ranking on liquidation or dissolution	Creditor claim ranking ahead of equity holders	Residual claim after creditors have been paid
Participation in management or control	No participation in the borrower's management	Voting rights or influence over management
Right to enforce repayment	Repayment enforceable through legal proceedings	Limited legal recourse based on a residual claim
Accounting treatment	Recorded as a liability	Recorded as equity
Tax treatment	Treated as an interest-bearing loan	Treated as a capital contribution
Intention of the parties	Intention to create a debtor-creditor relationship	Intention to create an ownership interest

The Guidelines state that no single characteristic or criterion is sufficient to determine the classification. The transaction must be assessed as a whole, together with all relevant facts and circumstances.

The Guidelines further state that a fixed repayment schedule, stated interest rate and formal loan agreement do not, by themselves, establish that the arrangement is debt for transfer pricing purposes.[3]

Consistent with paragraph 10.12 of Chapter X of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 ("**OECD Guidelines**"), other relevant evidence may include:

1. the existence of security and financial or operational covenants;
2. the expected source of principal and interest payments;
3. the borrower's ability to obtain third-party financing;
4. the purpose and use of the funds;
5. the borrower's repayment conduct;
6. any repeated extensions of the repayment date; and
7. whether the agreement is consistent with the parties' accounting treatment and actual conduct.

Potential recharacterisation as equity

The Guidelines state that the DGIR may recharacterise a purported loan as an equity contribution where it does not possess the characteristics of a genuine loan. Such recharacterisation may result in:

1. the disallowance of interest deductions;
2. additional tax liabilities; and
3. transfer pricing surcharges.

Example 1 concerns a foreign associated company providing an unsecured loan to a Malaysian company without covenants or restrictions on the use of the funds. The absence of these lender protections results in a high interest rate. The DGIR may question the economic substance of the arrangement where an independent lender would have required security or covenants, or where the borrower's financial position and credit risk indicate that no independent lender would have provided the financing on those terms.

[3] Guidelines, paragraphs 1.13 to 1.18

The DGIR may disregard the structure under subsection 140A(3A) where:

1. the economic substance of the transaction differs from its form; or
2. the form and substance are the same, but the arrangement, viewed in totality, differs from what independent persons acting in a commercially rational manner would have adopted, and the structure impedes the DGIR from determining an appropriate arm's length interest rate.

If the loan is not recognised, the funding may be recharacterised as equity and the interest disallowed. If the loan is recognised but its pricing is not arm's length, the DGIR may substitute the contractual rate with an arm's length rate.

Consistency with the OECD Guidelines

The recognition in paragraphs 1.8 to 1.19 that funding presented as a loan may, in substance, constitute equity is consistent with paragraphs 10.4 to 10.13 of the OECD Guidelines.

Both the Guidelines and the OECD Guidelines recognise that:

1. the balance of debt and equity funding within an MNE group may differ from the funding structure that would exist if the entity were independent;
2. the enquiry extends to whether a prima facie loan should be regarded as debt or another form of funding, including a contribution to equity, before determining the interest rate applicable to any debt;
3. the description assigned to an advance does not constrain its transfer pricing characterisation;
4. accurate delineation must precede pricing; and
5. the analysis may consider multiple characteristics of the instrument, the borrower and the parties' conduct.

Paragraph 10.13 of the OECD Guidelines further considers an advance that exceeds the amount the borrower can service based on its financial projections. The amount recognised as debt is limited to the maximum amount that an independent lender would have advanced and an independent borrower would have borrowed. The remaining amount is not regarded as a loan for the purpose of determining arm's length interest. That said, the Guidelines do not expressly address partial debt recognition. It remains to be seen whether the DGIR will adopt this approach.

B. Intra-Group Loans

The Guidelines state that, once funding has been recognised as debt, the commercial and financial relations between the lender and borrower must be examined from both perspectives.

From the lender's perspective, the Guidelines require consideration of:

1. the borrower's business;
2. the purpose and structure of the loan;
3. the amount and duration of the financing;
4. historical and forecast cash flows;
5. balance-sheet strength and existing indebtedness;
6. the expected source of repayment;
7. security and financial or operational covenants;
8. economic conditions; and
9. alternative uses of the lender's funds.

The Guidelines explain that, where a parent lends to a subsidiary, the parent's existing ownership and control may reduce the significance of formal security. The absence of contractual security should therefore be assessed in light of the parent's control over the borrower and the availability of the borrower's assets as collateral.[4]

From the borrower's perspective, the Guidelines state that an independent borrower would seek to minimise its overall financing costs while obtaining funding suited to its short-term and long-term requirements. The borrower would consider:

1. alternative sources of finance;
2. assets available as security;
3. interest-rate and foreign-exchange risks;
4. projected repayment capacity;
5. business performance;
6. future capital-raising capacity; and
7. whether the terms could be renegotiated if economic conditions change.

[4] Guidelines, paragraphs 2.2 to 2.7.

The terms of the controlled loan must therefore be tested against the options realistically available to both parties.[5]

The Guidelines identify the borrower's creditworthiness as a primary factor in determining the interest rate. The assessment may refer to recognised rating agencies, including RAM Ratings, Moody's and Standard & Poor's, and to CTOS or the Central Credit Reference Information System for Small and Medium-sized Enterprises.

The analysis should distinguish between:

1. the MNE group's credit rating;
2. the borrower's stand-alone credit rating; and
3. the rating of the specific debt instrument.

The Guidelines require consideration of both the borrower and the instrument:

Borrower characteristics	Instrument characteristics
Financial strength and profitability	Currency
Cash-flow stability	Maturity
Repayment history	Repayment terms
Existing debt and liquidity	Seniority or subordination
Exposure to market and currency risks	Security, guarantees and covenants

Where both an issuer rating and an issue-specific rating are available, the Guidelines state that the issue rating may be more appropriate if the relevant instrument is sufficiently comparable. The credit-rating methodology, assumptions, adjustments and market data should be documented in the contemporaneous transfer pricing documentation ("**CTPD**").[6]

[5] Guidelines, paragraphs 2.8 to 2.10.
[6] Guidelines, paragraphs 2.11 to 2.26.

The Guidelines state that group membership may improve the borrower's creditworthiness where an independent lender would expect the group to provide support. The extent of implicit support depends on:

1. the entity's strategic importance;
2. its operational integration with the group;
3. legal or regulatory obligations;
4. use of the group's name;
5. reputational risks;
6. potential negative effects on the MNE group as a whole; and
7. the group's history of providing support.

A strategically important entity may warrant a rating closer to the group rating, while an entity with limited group significance may require a predominantly stand-alone assessment. The Guidelines state that the incidental benefit of implicit group support does not, by itself, require a separate payment or transfer pricing adjustment.[7]

C. Determining the Arm's Length Interest Rate

The Guidelines state that the arm's length interest rate must be determined after the transaction has been accurately delineated and accepted as debt. The comparability analysis must consider the contractual terms; functions, assets and risks; the purpose, amount and duration of the loan; currency and foreign-exchange risk; the borrower's creditworthiness; security, guarantees and covenants; seniority; fixed or floating interest; economic conditions; and business strategies. The Guidelines identify the following pricing approaches:

Pricing Approach	Guidelines' Position
Comparable Uncontrolled Price Method	May use third-party loans, bond issuances, deposits, commercial paper, convertible debentures or independent loans obtained by the taxpayer or another group member, subject to comparability adjustments. An MNE group's average external borrowing rate is generally unsuitable.

[5] Guidelines, paragraphs 2.8 to 2.10.
[6] Guidelines, paragraphs 2.11 to 2.26.
[7] Guidelines, paragraphs 2.27 to 2.29.

Pricing Approach	Guidelines’ Position
Loan fees and charges	Arrangement fees, commitment fees and other loan-related charges must be considered in determining arm’s length pricing and treated in the same manner as other intra-group transactions. Third-party fees may reflect regulatory or capital costs that an intra-group lender does not incur.
Cost of funds method	May be used where reliable comparables are unavailable. The calculation may include funding and servicing costs, a risk premium and an appropriate profit margin, subject to market rates and the borrower’s realistically available alternatives. An intermediary performing only agency functions should receive a corresponding agency return.

The Guidelines also allow an eligible taxpayer to elect Bank Negara Malaysia (“**BNM**”)’s deposit rate or average lending rate (“**ALR**”) under the simplified method:

Deposit Rate	Deposit Rate
Taxpayer is not in the business of borrowing and lending	Taxpayer is not in the business of borrowing and lending
Interest income is taxable under paragraph 4(c) of the ITA	Interest income is taxable under paragraph 4(c) of the ITA
Loan is funded from internal funds	Loan is denominated in Ringgit Malaysia
Loan is denominated in Ringgit Malaysia	Aggregate cross-border intra-group loans do not exceed RM50 million for the year
Aggregate intra-group loans do not exceed RM50 million for the year	-
Associated borrower is resident in Malaysia	-

The Guidelines state that the simplified method is unavailable where capital is borrowed from one entity and passed to an ultimate borrower. If the conditions are not met, the taxpayer must undertake a comparability analysis. The DGIR may replace the selected method and substitute or impute an arm's length rate. A rate determined under a non-simplified method may be reviewed once every three years if the facts and circumstances remain unchanged.[8]

D. Documentation and Compliance Requirements

The Guidelines require taxpayers engaging in intra-group loans to maintain agreements, credit assessments and supporting evidence demonstrating compliance with the arm's length principle. The documentation should include:

1. the identities of the lender and borrower;
2. the financing date and amount;
3. the purpose and use of the funds;
4. the source of the funds;
5. the interest rate and interest-charging policy;
6. repayment terms;
7. security, guarantees and covenants;
8. the debt-capacity and credit-rating analyses;
9. the assessment of implicit group support;
10. the selected pricing method and comparables; and
11. evidence of periodic review of existing loan arrangements.

Taxpayers using the simplified method must retain evidence establishing each eligibility condition and the applicable BNM rate. Taxpayers exempt from CTPD must still comply with the arm's length principle and retain sufficient supporting documents.[9]

[8] Guidelines, paragraphs 3.3 to 3.30.

E. Immediate Actions

Companies should:

1. **Review all intra-group balances**

   Identify loans, advances, current accounts and long-standing amounts owing, and determine which arrangements require further debt-versus-equity analysis.

2. **Document debt capacity**

   Record the commercial purpose of the funding, prepare reasonable cash-flow forecasts and quantify the amount the borrower can reasonably service.

3. **Align the documents and actual conduct**

   Ensure that loan agreements, board papers, accounting treatment, repayments, interest payments and any extensions of maturity consistently reflect the intended characterisation.

4. **Validate the loan terms and pricing**

   Review the borrower's creditworthiness, implicit group support, security, covenants and other loan terms, and confirm that the selected pricing method and interest rate are appropriate.

5. **Maintain an audit-ready file**

   Retain the characterisation, credit and pricing analyses together with the supporting documents, and ensure that the CTPD can be furnished within 14 days of a written notice.

F. Our Comments

The Guidelines expressly recognise that funding presented as a loan may, in substance, constitute equity. This is consistent with Chapter X of the OECD Guidelines, which similarly recognises that a prima facie loan may constitute equity and requires the nature and amount of debt to be determined before the applicable interest rate is priced. Accordingly, where funding is accurately delineated as equity, no interest should be charged on such funding. A loan agreement, stated interest rate and fixed repayment date will not, by themselves, establish a genuine debt relationship where the borrower lacks the capacity to service the debt or the parties' conduct is inconsistent with the asserted debt relationship.

[8] Guidelines, paragraphs 3.3 to 3.30.
[9] Guidelines, paragraphs 4.1 to 4.4.

The Guidelines do not expressly address partial debt recognition, an issue addressed in paragraph 10.13 of the OECD Guidelines. Paragraph 10.13 contemplates that only the amount an independent lender would have advanced and an independent borrower would have accepted is recognised as debt, with the excess treated as non-debt funding. It remains to be seen whether the DGIR will apply this approach or recharacterise the entire arrangement where the facts do not support genuine debt.

Taxpayers should consult tax professionals, transfer pricing specialists and legal advisers when delineating an arrangement, particularly where its classification is not straightforward. An incorrect delineation may result in disallowed interest deductions, imputed interest income, transfer pricing surcharges and other consequential tax or legal exposures.

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