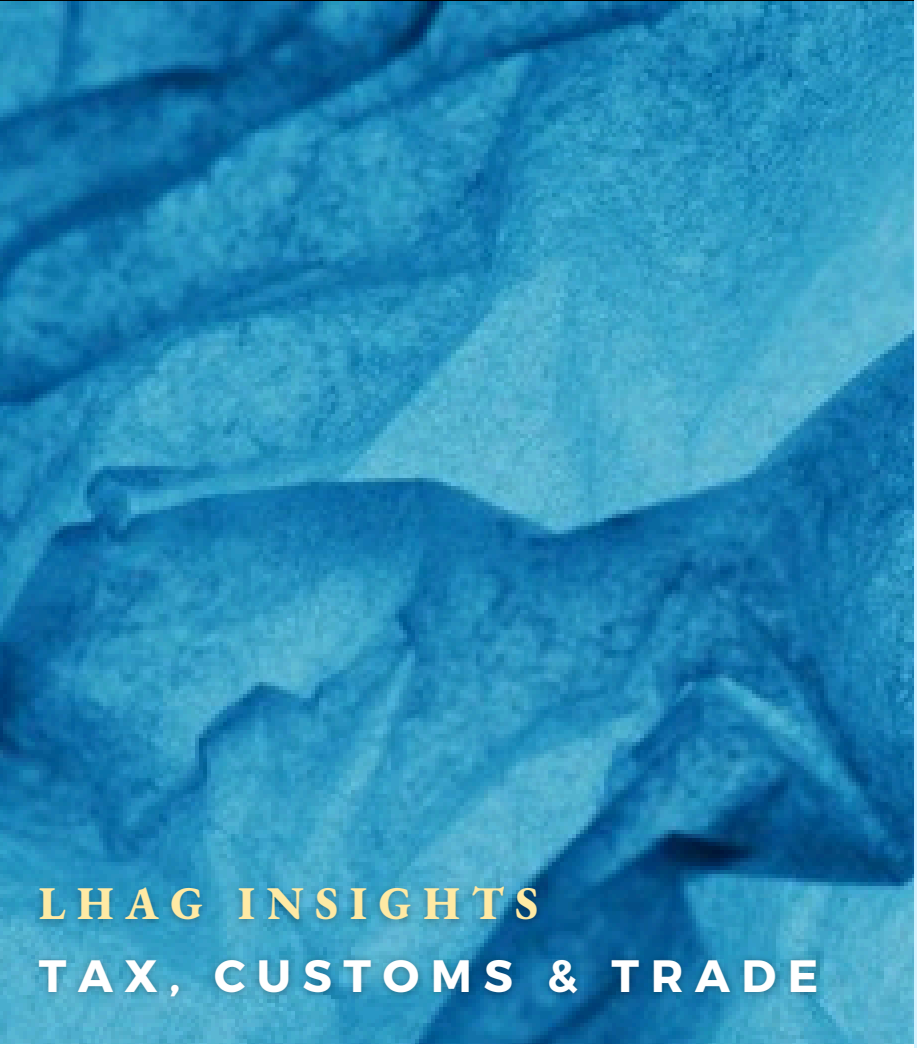


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INTRA-GROUP FINANCING UNDER SCRUTINY: HIGH COURT TREATS THE IRB'S POWER TO IMPOSE DEEMED INTEREST AS AN IMPORTANT QUESTION OF LAW

by Jason Tan Jia Xin and Jesslyn Teo Yi En

Many Malaysian groups finance their operations internally. A holding company may channel capital raised from the market to its subsidiaries or related companies may make interest-free advances to each other and record the amounts in running intercompany accounts. Much of this funding is interest-free, and the balances often roll forward in the accounts for years.

In tax audits, the Inland Revenue Board ("**IRB**") has taken a different view of these arrangements. It treats interest-free funding and intercompany balances as loans, imputes interest and taxes the company on interest that it did not charge.

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This approach raises a basic question: ***can the IRB treat interest-free funding and carried-forward balances as interest-bearing loans?*** Several taxpayers have taken that question to court by way of judicial review. Recently, the Kuala Lumpur High Court ("**High Court**") granted leave for judicial review in several such disputes, including ***TWL Holdings Berhad v Ketua Pengarah Hasil Dalam Negeri*** ("**TWL**") and ***Naza Corporation Holdings Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*** ("**NCH**"). In TWL, the High Court held that the challenge raises "an important question of law" suitable for determination by the court, relying on ***Metacorp Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*** **[2011] 5 MLJ 447** ("**Metacorp**").

The IRB has itself now set out how intra-group loans should be analysed. On 30 July 2026, it published the *Malaysia Transfer Pricing Guidelines – Controlled Financial Transactions: Intra-Group Loans* ("**Guidelines**"). Under the Guidelines, the IRB needs to decide whether funding is debt or equity before it imposes any interest. Read our previous alert on the Guidelines here.

A. Are You at Risk?

Businesses should review their position if any of the following applies:

1. A holding company has channelled capital, whether raised from the market or from its own funds, to its subsidiaries without charging interest;
2. Related companies pay expenses for each other and record the amounts in their intercompany balances; or
3. Have intra-group loans that carry interest below market rates.

In each case, the IRB may treat the funding as a loan, impute interest at a rate it selects, and tax the lender on that interest.

Section 140A of the Income Tax Act 1967 ("**ITA**") requires transactions between associated persons to be priced at arm's length. Where the IRB believes a price is not at arm's length, it may substitute an arm's length price. Rule 12 of the Income Tax (Transfer Pricing) Rules 2012 and 2023 ("**TP Rules**") applies these rules to financial assistance between associated persons.

With effect from 1 January 2021, the IRB may also impose a surcharge of up to 5% of the amount by which a taxpayer's income is increased or its deductions or losses are reduced, as a result of a transfer pricing adjustment.

B. The Question for the Courts

The disputes now before the courts turn on one question, namely whether the IRB can impose interest that the parties did not agree, charge or receive. That question arises in two settings.

Interest-free funding. A holding company often funds its subsidiaries without charging interest. The IRB treats this funding as a loan and imposes interest at a rate it chooses. Taxpayers argue this skips a step. Before any interest can be imposed, the IRB must first decide whether the funding is a loan at all or whether it is in substance equity. The IRB's own Guidelines support this approach. They state that calling an arrangement a "loan" does not decide what it is.[1] Funding that looks like a loan may in substance be a contribution to equity capital.[2] The Guidelines also state that it is "essential to conduct a test to determine whether the purported loan constitutes debt or equity before the arm's length interest can be established".[3] Funding that is in substance equity does not carry interest, and Section 140A does not supply it.

Balances carried forward. Related companies often keep running accounts with each other, and the balance is carried forward from year to year. The IRB treats the closing balance each year as a new loan. Taxpayers are of the view that a balance carried forward is simply the result of past entries. It is a state of affairs and not a transaction. This matters because Section 140A(2) only applies where a person, in the basis period for a year of assessment, "enters into a transaction" with an associated person. If the IRB cannot point to a transaction entered into in the basis period for the year being assessed, Section 140A does not apply because there is nothing to price. The Guidelines also do not deal with this situation expressly. They focus on "purported loans", meaning arrangements labelled or presented as loans,[4] not on balances carried forward from earlier years.

[1] Guidelines, paragraph 1.7
[2] Guidelines, paragraphs 1.9 and 1.10
[3] Guidelines, paragraph 1.12
[4] Guidelines, paragraph 1.10

C. What the Courts Have Said So Far

Interest-Free Funding: TWL

TWL is a public listed investment holding company. It raised capital from the market through rights issues, private placements and redeemable convertible notes, and channelled the funds interest-free to its property development subsidiaries. The IRB treated the funding as loans and imposed deemed interest for the years of assessment ("**YAs**") 2017 to 2019 and 2021 to 2023, applying the lending rates charged by licensed banks to their customers. TWL's transfer pricing reports prepared by an independent tax consultant concluded that the funding was equity in nature.

On 20 October 2026, the High Court granted leave for judicial review and a stay of the assessments. The Attorney General argued that TWL must first appeal to the Special Commissioners of Income Tax ("**SCIT**") because the dispute involved facts. The High Court disagreed. It held that "*there is no dispute over a question of fact but a question of law, whether the Respondent had exceeded its jurisdiction*", and that the application "*raises an important question of law which are suitable for determination by this Court and the only avenue is by way of judicial review application*". On this point, the Court relied on **Metacorp**, where Rohana Yusuf J (as Her Ladyship then was) held as follows.

> *"The applicant here had demonstrated illegality and unlawful treatment, thus it would be wrong to insist that it exhaust its statutory right of appeal, even if it is available. In fact, a complaint that raises a question of law as in the present case, would preferably be referred to the court, being a more appropriate forum."*

The High Court also observed that the IRB "*does not have the power to dictate that the Applicant should have charged interest as if it were a licensed bank*". It also reaffirmed that tax cannot be imposed without clear words, and that any ambiguity in a taxing provision must be resolved in favour of the taxpayer.[5] The Court stayed the assessments, accepting that an immediate demand for the tax could trigger a ***"domino effect"*** on the group's financing and ongoing projects. The grounds of judgment can be viewed here.

[5] **Merimen Online Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2025] 1 MLJ 743; National Land Finance Co-operative Society Ltd v Director General of Inland Revenue [1994] 1 MLJ 99**

Balances Carried Forward: NCH

NCH is an intermediate holding company of the Naza Group. Its accounts recorded year-end balances "due from" and "due to" related companies. These balances were the cumulative result of running accounts carried forward from year to year. They are interest-free with no repayment date. Where NCH lent money on defined terms, it documented those loans separately and charged interest.

The IRB treated the running balances as loans and imposed deemed interest for YAs 2019 to 2023 at a uniform rate, being a rate NCH charged on its documented loans. The assessments, which included penalties and surcharges, were issued on 30 July 2026, the same day the IRB published the Guidelines.

NCH contends that the IRB did not identify any specific transaction entered into in the years assessed, and that a balance carried forward is not a transaction that Section 140A can price. A year-end balance is simply the running total of entries recorded in earlier years. It does not reflect a new advance, agreement or payment made in the year assessed. Section 140A(2) applies only where a person, in the basis period for a year of assessment, "enters into a transaction" with an associated person. The IRB must therefore identify a transaction entered into in the basis period for each year assessed before it can substitute an arm's length price. Treating the same balance as a fresh loan each year would tax a state of affairs rather than a transaction. NCH also contends that the IRB rejected its transfer pricing reports without any analysis of its own, and did not apply the debt-or-equity test in the Guidelines. On 29 October 2026, the High Court granted NCH leave for judicial review.

D. Getting Audit-Ready

Businesses should not wait for an audit to find out how the IRB views their intra-group funding. To reduce the risk of a deemed-interest assessment, we recommend the following steps:

1. **Review intra-group balances**
   Identify interest-free advances, current accounts and long-standing balances. Separate genuine loans from shareholder funding and running accounts. Pay particular attention to large balances that have been carried forward for several years.

2. **Document the debt-or-equity analysis**

   Apply the debt-or-equity criteria in the Guidelines[6] and record the analysis in the transfer pricing documentation. Contemporaneous documents should be prepared before the IRB raises queries.

3. **Engage in writing during the audit**

   Where the IRB proposes deemed interest, ask it to identify the transaction, the period in which it was entered into, and the basis for the interest rate.

4. **Request corresponding adjustments**

   Where interest is imputed to the lender, request the offsetting adjustment for the borrower.

5. **Act promptly on any assessment**

   An application for judicial review must be filed within three months of the decision, and an appeal to the SCIT within 30 days of the notice of assessment. Consider both routes at the outset.

E. Our Thoughts

The leave decisions do not decide the merits. They do, however, send a clear signal that the High Court regards the limits of the IRB's power to impose deemed interest as a question of law for the courts, not a matter to be left only to the SCIT.

In our view, Section 140A is a pricing provision. It allows the IRB to correct the price of a transaction that exists. It does not allow the IRB to impose interest on funding that is in substance equity, or to treat a balance in the accounts as a new loan each year. Where funding is properly characterised as equity, there is no interest to price, and the IRB's own Guidelines now say as much.[7]

The substantive hearings will settle where the line falls. Until then, groups with interest-free advances or long-standing intercompany balances should review their position now, before an audit begins.

TWL was represented by **Dato' Nitin Nadkarni** and **Jesslyn Teo Yi En**. NCH was represented by **Dato' Nitin Nadkarni**, **Jason Tan** and **Jay Fong Jia Sheng**.

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[7] Guidelines, paragraphs 1.8 to 1.12