

Technical Update

June 2022



Supporting Documents for Interest on Loan Between Related Parties

(Instruction 10979. GDT dated 25 May 2022)

The General Department of Taxation (GDT) has recently issued Instruction no. 10979 GDT dated 25 May 2022 which further deals with the rules on loans between related parties. We summarize the key changes as follows:

Description	As per new Instruction 10979	As per previous regulations
Interest rate	<ul style="list-style-type: none"> — Related parties can follow the <u>interest rate as per their loan agreement and shall be exempted from the “arm’s- length” principle.</u> — The interest rate shall <u>not exceed the market interest</u> (i.e., the annual average rate from at least 5 major banks, issued by the GDT) at the time of borrowing. 	<ul style="list-style-type: none"> — The interest on loan between related parties shall be based on the “arm’s-length” principle (<i>Prakas 986, dated 10 October 2017; and Instruction 11946, dated 21 August 2018</i>)
Supporting documents	<p>Instruction 10979 provides further clarification on the previous documentary requirements provided under Instruction No. 4909:</p> <ul style="list-style-type: none"> — Loan agreement which clearly states the length and repayment terms ; — Business plan or current and forecasted financial statements together with the documents on the purpose of borrowing and the explanation; and — Board of Director’s resolution (for the enterprises which are not single-private limited companies). 	<ul style="list-style-type: none"> — The enterprise shall maintain the required supporting documents for loans between related parties as follows (<i>Instruction No. 4909, dated 18 March 2019</i>): — Loan agreement with clear terms of borrowing; — Business plan in relation to the loan; — Documents to explain the basis of interest rate; and — Board of Director’s resolution (for the enterprises which are not single-private limited companies)
Cash Advance	<ul style="list-style-type: none"> — Cash advance between related parties with lifespan of less than 1 year from the date of receipt of the cash advance until the settlement date shall <u>not be considered as loan transaction and shall be exempted from “arm’s length principle”.</u> 	<ul style="list-style-type: none"> — No previous guidelines were provided on cash advance between related parties, but in practice, cash advances were treated as loan transactions.

The previous Instruction 4909, on the “Supporting Documents of Interest Rate between Related Parties” shall be abrogated to be consistent with this new Instruction.

Our comments

- The changes introduced under Instruction 10979 can ease the burden on taxpayers to provide sufficient documentation for the interest rate applied on the related party loans, which shall be exempted from the “arms-length” principle especially the removal of the documents to explain the basis of the interest rate. However, if the taxpayer is not able to provide the required documentation under this new Instruction 10979, it appears that the GDT may still reassess and deem the reasonable market interest rate.
- The GDT also limits the interest rate on related party loans to the annual market interest rate issued by the GDT. It could be inferred that the GDT may disallow portion of the interest expense on related party loans which exceeds the market interest rate.
- The inclusion of cash advance clause above can make the business’s operation more flexible in obtaining of financing when shortfall of the working capital.
- Impacted taxpayers should further consult with their tax advisors on how this new Instruction would impact their existing related party loan transactions.

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

Contact us

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