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TRANSFER PRICING FLASH

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Malaysia Transfer Pricing Guidelines – Controlled Financial Transactions: Intra-Group Loans

The *Malaysia Transfer Pricing Guidelines – Controlled Financial Transactions: Intra-Group Loans* [“MFTIL”] has recently been issued by the Inland Revenue Board [“IRB”] on 30th July 2026. The MFTIL has been anticipated since the release of the Malaysia Transfer Pricing Guidelines 2024 ["MTPG 2024"], which flagged in Chapter 9 (Intra-Group Financial Transactions) that separate guidance would be issued given the complexity of pricing intra-group financial transactions. The MFTIL is to be read together with the Income Tax Act 1967 [“ITA 1967”], the Income Tax (Transfer Pricing) Rules 2023 [“TP Rules 2023”] and the MTPG 2024.

What are the key highlights of the MFTIL?

1. **Objective and Scope**
   The MFTIL provides comprehensive guidance to determine whether an intra-group loan is consistent with the arm's length principle as required under the ITA 1967, the TP Rules 2023 and the MTPG 2024.

2. **Beyond Interest Rates: The Importance of Loan Characterisation in Transfer Pricing Analysis**
   The IRB emphasises that assessing the arm’s length nature of the interest rate alone is insufficient. Taxpayers are required to first evaluate whether the purported loan arrangement should be recognised as a debt or whether it should instead be characterised as another type of financial support, such as an equity contribution. Taxpayers are expected to identify and incorporate in their transfer pricing documentation [“TPD”] the following aspects as they are crucial for transfer pricing analysis:-

   a. Accurate Delineation of Financial Transactions
   - Substance over form
   - Risk control and capacity
   - Functional analysis

   b. Is a “Purported Loan” Really a Loan?
   Even where a financing arrangement is labelled and documented as a loan, its economic substance may indicate that it is, in fact, a contribution to equity capital. Before an arm's length interest rate can be established, taxpayers must first test whether a “purported loan” exhibits the characteristics of debt or equity, having regard to the combination of all relevant facts and circumstances.

c. Key Criteria: Distinguishing between Debt and Equity

Criteria	Debt	Equity
Legal Obligation to Repay	Fixed and enforceable	No obligation; depends on profits / discretion
Maturity Date	Fixed, on demand or scheduled	No fixed maturity; perpetual / redeemable
Return	Predetermined interest	Depends on profits / dividends
Ranking upon Liquidation	Ranks as creditor	Ranks after debt obligations
Right to Enforce	Enforceable in courts	Limited; depends on residual claim

If the Director General of Inland Revenue ["DGIR"] has reason to believe a "purported loan" does not possess the characteristics of a debt instrument, it may be recharacterised as an equity contribution under Subsection 140A(3A) of the ITA 1967 where: (a) the economic substance of the transaction differs from its form, or (b) the arrangement, viewed in totality, differs from what independent persons behaving in a commercially rational manner would have adopted.

Where the DGIR accepts the financing structure as loan but not the interest rate, the rate will be substituted with an arm's length interest rate. Alternatively, recharacterisation of a debt to equity by the DGIR results in the disallowance of interest deductions. Both scenarios give rise to additional tax and surcharges.

3. **Creditworthiness Matters: The Starting Point for Pricing Intra-Group Loans**
A borrower's credit profile is one of the primary factors in determining an arm's length interest rate. The MFTIL recognises that this can be assessed by reference to rating agencies such as RAM Ratings, Moody's and Standard & Poor's, while Credit Tip-Off Service (CTOS) and Central Credit Reference Information System (CCRIS) are more relevant for Small and Medium-sized Enterprises (SMEs).

Importantly, the transfer pricing analysis should distinguish between three different levels of credit rating and document:-

(a) the credit rating of the Multinational Enterprise ["MNE"] group as a whole;
(b) the borrower's own stand-alone credit rating; and
(c) the rating attaching to the specific debt instrument.

It is stressed in the MFTIL that clear and comprehensive credit rating evaluation of the intra-group loan arrangements should be documented in taxpayers' contemporaneous TPDs.

4. **Treatment of Director Loans**
Where a company provides a loan or an advance from its internal funds to a director to which Section 140B of the ITA 1967 applies, the provisions of Section 140A of the ITA 1967 will not be applicable. Instead, the company shall compute the deemed interest income governed by Section 140B of the ITA 1967 and the interest will be regarded as arm's length.

In contrast, where a director provides a loan or an advance to the company, the interest rate should be determined on an arm's length basis pursuant to Section 140A of the ITA 1967, with any interest income derived being subject to tax under Section 4(c) of the ITA 1967.

5. **Determining the Arm's Length Interest Rate:**
Simplified Approach Introduced Together with Eligibility Criteria to Fulfil
The MFTIL reiterates that the arm's length interest rate should be determined using the most appropriate transfer pricing method based on the facts and circumstances of the financing arrangement. While the Comparable Uncontrolled Price ["CUP"] method remains the preferred approach, alternative methods may be applied where reliable comparables are unavailable.

Method	When It Applies?	Key Features / Requirements
CUP Method (Preferred Method)	Where reliable comparable market data is available	• External Comparables: Bond yields, third-party loans, commercial papers, etc. • Internal CUPs: Other independent loans of the taxpayers or their respective groups. • Appropriate adjustments should be made for differences in tenure, currency, security and other loan terms. • An MNE group's average external borrowing rate is generally not an acceptable internal CUP, as it does not reflect the characteristics of the specific loan or borrower.
Cost of Funds Method	Where reliable CUPs are unavailable	• Interest rate is derived from the lender's funding and servicing costs, plus a risk premium and an appropriate profit margin. • Where the lender merely performs an agency or pass-through role (eg: on-lending or Special Purpose Vehicle (SPV) / sukuk structures), pricing should reflect only the return appropriate to that agency function, not a full financing margin.

To ease the compliance burden, the MFTIL introduces a simplified method that allows eligible taxpayers to elect designated interest rates (available in the website of Bank Negara Malaysia) without performing a detailed comparability analysis, as follows:-

<table>
<tr><th>Simplified Method</th><th>Applicable Conditions</th><th>Additional Conditions</th></tr>
<tr><td>Deposit Rate</td><td rowspan="2">• The taxpayer is not in the business of borrowing and lending;
• Interest income of taxpayer is taxed under Section 4(c) of the ITA 1967; and
• Loan is denominated in Ringgit Malaysia.</td><td>• The taxpayer only engages in intra-group loan with associated person who is resident in Malaysia;
• Loan is funded from the taxpayer's own internal funds with proof of evidence; and
• Aggregate amount of intra-group loan in the year of assessment does not exceed RM50 million.</td></tr>
<tr><td>Average Lending Rate (ALR)</td><td>• Aggregate amount of cross-border intra-group loan in the year of assessment does not exceed RM50 million.</td></tr>
</table>

Where a taxpayer does not meet the all the above conditions, or chooses not to elect the simplified method, a full comparability analysis is required instead.

However, despite the pricing method adopted by taxpayers (including the simplified approach), the DGIR can exercise the power to replace a taxpayer's pricing method and to substitute or impute an arm's length rate if he disagrees with the taxpayer's pricing approach or its determination of arm's length interest rate.

Note: The simplified method <u>*cannot be used*</u> *when loan capital is borrowed from one entity and passed on from original borrower to an ultimate borrower.*

6. **Three-year Review for Benchmarking**
   For rates determined using methods other than the simplified method, taxpayers may review the rates once every three years, provided the underlying facts and circumstances remain unchanged.

7. **Key Takeaways for Taxpayers Engaging in Controlled Financing Transactions**

   (a) ***Delineate controlled transactions before pricing*** – Taxpayers should document in their TPDs the delineation process of their intercompany financial transactions, including the accurate characterisation of the transaction as debt or equity, having regard to a thorough analysis of the economically relevant characteristics of the transactions.

   (b) ***Substantiate the funding rationale*** – The commercial and economic rationale for the financing, including the borrower's debt-servicing capacity, should be supported by contemporaneous transfer pricing analysis and other relevant evidence.

   (c) ***Align contractual terms with actual conduct*** – Valid intercompany financing agreements, board approvals and the parties' actual conduct along with other underlying facts should be consistent with, and corroborate, the intended characterisation of the transaction.

   (d) ***Reassess reliance on group-wide benchmarks*** – Pricing derived from standardised treasury policies or group average borrowing costs should be revisited, as such standard or group approach may not withstand a comparability analysis for transfer pricing purposes.

   (e) ***Validate eligibility for pricing using simplified approach*** – Qualifying conditions should be substantiated on a continuing, rather than assumed basis, particularly where facts and circumstances evolve.

   (f) ***Uphold transfer pricing compliance*** – Supporting analyses and transfer pricing documentation should be maintained on a contemporaneous basis.

Given the IRB's heightened scrutiny on related party financing arrangements, taxpayers should ensure that intra-group financing transactions are supported by sound commercial rationale and robust documentation. Maintaining appropriate transfer pricing governance policy and regular reviews are critical to demonstrate compliance with the applicable transfer pricing requirements for both domestic and cross-border controlled transactions in order to mitigate potential tax exposures.

For more insights of the MFTIL, kindly refer to the link above.

Legend

CUP	=	Comparable Uncontrolled Price
DGIR	=	Director General of Inland Revenue
IRB	=	Inland Revenue Board
ITA 1967	=	Income Tax Act 1967
MFTIL	=	Malaysia Transfer Pricing Guidelines – Controlled Financial Transactions: Intra-Group Loans
MNE	=	Multinational Enterprise
MTPG 2024	=	Malaysian Transfer Pricing Guidelines 2024
TP Rules 2023	=	Income Tax (Transfer Pricing) Rules 2023
TPD	=	Transfer Pricing Documentation

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