MHC & ASSOCIATES, DFK
CERTIFIED PUBLIC ACCOUNTANTS

AROUND US
VOL.2
ISSUE 10
OCTOBER 2002

# TAXABILITY OF INTEREST-FREE/SUBSIDISED LOANS

**Perquisite of Employment and Administrative Concession**

Where an employer provides interest-free/subsidised loans to an employee, the employee derives a benefit from such loans. The benefit so derived is considered a perquisite of employment and thus taxable. However, as an administrative concession by the Inland Revenue Authority of Singapore ("IRAS"), where loans are made to an employee who does not have substantial shares or control or influence over the company, the benefit of such loans will not be brought to tax.

**Interest-free/Subsidised Loans to Directors**

The definition of an "employee" under Section 2 of the Singapore Income Tax Act includes "a director of the company". Any interest-free/subsidised loans extended to a director would also constitute a perquisite of employment. As a director is generally regarded as having control or influence over the company, the benefit derived by him will not fall within the scope of IRAS's administrative concession.

The taxable benefit derived by employees and directors must be reported in the employee's Form IR8A (Return of Employees' Remuneration) accordingly. It is our understanding that the IRAS compute the value of interest benefit using the prime interest rate of banks.

**Recent Developments on Directors/Shareholders Interest-free Loans**

IRAS's legal basis of taxing the benefit of interest-free/subsidised loans was reaffirmed by the High Court in July 2001. The tax case between *Ng Yew Keng and Ng Yew Hwee vs Comptroller of Income Tax* involved two directors who were also shareholders of a family-owned company. Interest-free loans were extended to them by the company. The appellants argued that the loans were shareholders' loans but the High Court reaffirmed IRAS's tax treatment that the interest benefits were taxable as gains from employment. Furthermore, in this case, the use of prime interest rate of banks as a reasonable basis to compute the benefit derived by the directors was also established.

The following points were recently clarified by IRAS in their letter dated 2 July 2002 to the Institute of Certified Public Accountants ("ICPAS"):

a. Interest-free loans to shareholders who are not directors or employees of a company would not be regarded as perquisites of employment and therefore not taxable.
b. Whether the loans made to the shareholders who are also directors or employees of the company are shareholders' loans instead of directors' loans is to be determined based on facts of each case.
c. IRAS would generally be prepared to accept that the loans which are given to directors who are also shareholders be treated as loans to them in their capacity as shareholders if all the following elements are present in the loan arrangement:
    i. There are bona-fide (other than tax) reasons for the loan arrangement;
    ii. The loans are not remuneration or benefits to the directors, disguised in the form of loans to shareholders or is not intended as a means for a company to pay dividends or return excess capital to its shareholders (there must be an existence of a genuine intent for a creditor/debtor relationship with a reasonable expectation of repayment of the loans);
    iii. The loans are extended to all shareholders (including shareholders who are not directors) under similar terms and loan quantum; and
    iv. The availability of documentary evidence to support that the loans are made to the recipients in the capacity of shareholders and not directors of the company.

**IRAS's Audit Programme**

We also make reference to the article in the Straits Times on 16 August 2002. IRAS 's audit programme is still ongoing for cases involving interest-free or subsidised interest rate loans with the view to bring to tax the interest benefit of such loans provided to directors.

**Voluntary Disclosure and Concessionary Penalties**

IRAS will raise retrospective assessments for the six back years of assessment, i.e. from the year of Assessment 1996 for such benefits. In the Straits Times article on 16 August 2002, IRAS also encourages directors to come forward voluntarily by 30 October 2002 to declare such benefit received, if any. Following representations by the business community, the deadline has been extended to 30 November 2002. For voluntary disclosure, IRAS has indicated that they will be imposing concessionary penalties at 5% per year for each back year of assessment, instead of original 10% as well as allowing directors to settle the additional taxes by 12 instalments.

**Conclusion**

Due to the recent debate on the issue of whether the loans extended to the shareholders and directors are in their capacity as shareholders of the company, a review of the loan arrangements should be performed. Going forward, various alternative ways to mitigate the tax impact can be considered.

You may wish to seek professional advice from your tax consultants concerning your tax position in relation to the above issue.