



# LOANS TO DIRECTORS MADE IN THE PAST: CAN SECTION 140B OF THE INCOME TAX ACT 1967 REACH BACK IN TIME?

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## **LOANS TO DIRECTORS MADE IN THE PAST: CAN SECTION 140B OF THE INCOME TAX ACT 1967 REACH BACK IN TIME?**

The article examines whether past financial arrangements are subject to the subsequent enactment of provisions in the Income Tax Act 1967 (“**ITA 1967**”), and reconciling the broader principles of statutory interpretation, Public Rulings and the presumption against retrospectivity.

The recent decision of the Special Commissioners of Income Tax (“**SCIT**”) in **RFSB v. Director General of Inland Revenue** affirmed the presumption against retrospectivity. Our Partner, Tania Kat-Lin Edward, acted for and succeeded on behalf of RFSB in this appeal before the SCIT. We are grateful to RFSB for the opportunity to represent it before the SCIT.

### **Background: RFSB v. DGIR**

The Taxpayer here is a company incorporated in Malaysia which had ceased its business operations and has been dormant since 2007. In 2008, the Taxpayer advanced several loans to its directors totaling RM4,091,272.00 (“**Loans**”), which continued to be reflected as outstanding director’s loan balances in the Taxpayer’s

accounts for subsequent years of assessment.

In or around 2014, **Section 140B of the ITA 1967** came into effect, which deems a company to have gross income consisting of interest on a loan / advance in the basis period where the company makes the loan / advance to a director out of the internal funds of the company.

At the beginning of 2017, DGIR began its intervention with a document request limited to YA 2017 as part of a tax audit exercise, with which the Taxpayer duly complied. However, in 2021, the scope of DGIR’s enquiry was expanded to cover YA 2015 to YA 2019 on the basis that deemed interest income under **Section 140B of the ITA 1967** applied to the Loans.

### **The Impugned Assessments: What Did DGIR Seek to Tax?**

On this footing, DGIR issued additional assessments for YA 2015 to YA 2019, imputing interest income using the statutory formula prescribed in Section 140B(2) of the ITA 1967 (“**Impugned Assessments**”). In addition to the tax assessed, DGIR imposed penalties amounting to 45% of the alleged undercharged tax pursuant to Section 113(2) of the ITA 1967, on the basis

that the Taxpayer had filed incorrect returns by omitting the deemed interest income (“**Penalties**”).

DGIR’s case was not merely that Section 140B(2) of the ITA 1967 applied prospectively from YA 2014, but that it could operate on the Loans that remained outstanding after the provision came into effect. This approach raised a fundamental question: **whether Parliament intended for Section 140B of the ITA 1967 to attach new tax consequences to transactions completed long before the provision existed.**

### **The Taxpayer’s Appeal before the SCIT**

Aggrieved by the Impugned Assessments and Penalties, the Taxpayer filed an appeal to the SCIT.

In determining the validity of the Impugned Assessments and Penalties, the SCIT was required to address a threshold question: **whether Section 140B of the ITA 1967, which came into effect in 2014, could operate retrospectively.** This question was central because the Loans giving rise to the deemed interest had been advanced

long before the enactment of Section 140B of the ITA 1967.

The Taxpayer contended that it is trite that legislation should not apply retrospectively in a manner that impairs an existing right or obligation, unless a contrary intention appears<sup>1</sup>. In this regard, an express indication in the provision is a prerequisite for any retrospective effect.

Further, the Taxpayer argued that the presumption against retrospective application is deeply enshrined in Article 7(1) of the Federal Constitution, which strikes at retrospective penal laws, and that any conflict between the offending statute and the Federal Constitution would thereby void the former<sup>2</sup>.

The SCIT considered the parties’ submissions and agreed that the determination of deemed interest income for YA 2015 to YA 2019 under Section 140B of the ITA 1967 in respect of loans advanced in 2019 entailed a retrospective application of the provision. Section 140B of the ITA 1967 introduces a new and substantive tax liability by deeming interest income to arise, and as such, is incapable of retrospective application in the absence

<sup>1</sup> National Land Finance Co-Operative Society Ltd v. Director General of Inland Revenue [1993] 4 CLJ 339 (SC), at pp. 344b-344f.

<sup>2</sup> Multi-Purpose Holdings Bhd v. Ketua Pengarah Hasil Dalam Negeri [2006] 2 MLJ 498 (CA), at [17]-[18].

of clear and express legislative language to that effect.

## Can Public Rulings Rewrite the Statute?

It bears emphasis that paragraph 5.2 of the Public Ruling No. 8/2015 provides that the determination of interest under Section 140B of the ITA 1967 would apply to existing balance on loans or advances made before YA 2014.

In response, the Taxpayer relied on Seiwa Podoyo Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [2023] 7 MLJ 214 (HC), submitting that Public Rulings are merely guidelines to assist the public, including the taxpayers and officers of DGIR, on the DGIR's interpretation of the ITA 1967. The Public Rulings and guidelines issued by DGIR are ultimately *"not binding and have no force of law or legal authority"*<sup>3</sup>.

Therefore, interpretations advanced by DGIR through Public Rulings or similar guidelines are not binding and cannot override the provisions of the ITA 1967. Where the ITA 1967 does not expressly provide for a particular outcome, that outcome cannot be introduced by way of

DGIR's interpretation through its Public Rulings or similar guidelines.

## Penalties

DGIR contended that the imposition of penalties was justified under its discretion pursuant to Section 113(2) of the ITA 1967, on the footing that the Impugned Assessments were valid.

In this regard, the Taxpayer argued that the Penalties were entirely unjustified. Section 140B of the ITA 1967 could not be applied retrospectively, and in the absence of any underlying tax liability, the imposition of penalties cannot stand. In the absence of a valid assessment, the penalties necessarily fell away. Further, the alleged "incorrect returns" arose from both parties' innocent differing interpretations of Section 140B of the ITA 1967, rather than any act of concealment, disobedience, or tax evasion on the part of the Taxpayer.

It bears emphasis that DGIR's discretion under Section 113(2) of the ITA 1967 is not unfettered and must be exercised reasonably, for a proper purpose, and in accordance with law.

<sup>3</sup> at [35]; see also Multi-Purpose Holdings Bhd v. Ketua Pengarah Hasil Dalam Negeri [2006] 2 MLJ 498 (CA) at [13].

## **Practical and Legal Implications for Taxpayers**

The decision carries important implications for taxpayers, particularly companies with loans or advances made to their directors before the introduction of Section 140B of the ITA 1967. It reinforces the presumption against retrospective taxation, particularly where a provision creates a new substantive tax liability. From a commercial perspective, the decision provides reassurance to companies with legacy director loans that predate YA 2014, reducing the risk of unexpected historical tax exposure.

## **Conclusion**

**RFSB v. DGIR** stands as a reaffirmation of the fundamental principle that taxing statutes must be construed prospectively, unless Parliament has clearly and expressly provided otherwise. Section 140B of the ITA 1967, which introduced a new deeming charge on loans or advances made to the company's directors, could not be applied to transactions completed years before its enactment, nor could penalties be sustained on the back of such an impermissible application.

This decision is a much-welcomed affirmation of the rule against

retrospectivity, providing clarity that taxing statutes do not operate to superimpose tax liabilities on arrangements entered into with the legitimate expectation that no such liability would arise.

***This article was written by our General Civil and Commercial Litigation and Commercial Arbitration Team, Sudharsanan Thillainathan and Tania Kat-Lin Edward, with the assistance of How Xue Ying. It contains general information only. It does not constitute legal advice or an expression of legal opinion and should not be relied upon as such.***