

Corporate tax reform: lending to related parties (1/35/17)

We continue to inform you on the new Corporate Income Tax (CIT) Act.

What's the new deal?

Section 11 of the Act states that from 1 January 2018 lending to related parties will be treated as a profit distribution subject to a 20% CIT. This rule has been adopted as an anti-avoidance measure to prevent taxpayers who want to pay a dividend from making a loan instead, which is essentially a hidden dividend.

Is all lending to related parties treated as a profit distribution?

There are eight cases where such lending will not be treated as a profit distribution. These exclusions fall into two groups according to criteria relating to –

1. the lender;
2. the loan.

Exclusions: lender criteria

The profit distribution net will not catch a loan that –

- a) a shareholder makes to a taxpayer;
- b) a taxpayer makes to his foreign permanent establishment; or
- c) an agriculture/forestry cooperative society makes to its members (for business purposes).

Exclusions: loan criteria

Lending to related parties will not be treated as a profit distribution also if –

- a) the loan made by the taxpayer does not exceed a loan taken from an unrelated party;
- b) no retained earnings appear on the taxpayer's balance sheet at the beginning of the financial year;¹
- c) the loan made by the taxpayer does not exceed his authorised share capital at the beginning of the financial year less any loans not repaid, with the exception of a) above and d) and e) below;
- d) the loan is made for up to 12 months; or
- e) the loan is made by a taxpayer with social entity status.

Steps to take when repaying a loan charged to CIT earlier

When repaying a loan that was included in the taxable base for a past tax period, any repaid amount of the loan can be deducted from the taxable base for the current tax period.

We'll soon be looking at practical examples to show you how these exemptions apply to lending to related parties.

¹There are certain transition rules for retained earnings as at 31 December 2017.