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Recent Labuan Tax Changes

Recent changes to the Labuan tax laws have seen new regulations introduced to enhance the reputation and credibility of the tax regime in Labuan. The changes are welcomed as Malaysia seeks to implement the minimum standards under the Base Erosion and Profit Shifting (BEPS) Action Plan which sets out strategies and standards for best practices in tax. This alert sets out a quick summary of the main changes thus far.

Amendments under the Finance Act 2018

The Labuan Business Activity Tax Act 1990 (“LBATA”) was amended via the Finance Act 2018, which came into force on 27 December 2018. Key changes under the LBATA are as follows:

- The definition of “Labuan business activity” was amended to remove Malaysian ringgit restrictions or restrictions on dealing with Malaysian residents.
- New economic substance requirements for Labuan entities were introduced. Section 2B(1)(b) of the LBATA requires Labuan entities, for the purpose of the Labuan business activity, to have (i) an adequate number of full time employees in Labuan, and (ii) an adequate amount of annual operating expenditure in Labuan.
- Income derived from royalty or other income derived from an intellectual property right shall not enjoy LBATA tax, and is now subject to tax under the Malaysian Income Tax Act 1967.
- Labuan entities carrying on a Labuan trading activity no longer have the option to elect to pay tax of RM20,000. This means that all Labuan entities that carry on a Labuan trading activity and comply with the relevant economic substance requirements shall be subject to tax at the rate of 3% on its chargeable profits.
- A Labuan entity that does not carry on a Labuan business activity, or in carrying on a Labuan business activity, does not have the adequate number of full time employees in Labuan, or adequate amount of annual operating expenditure in Labuan, will be subject to tax under the Malaysian Income Tax Act 1967.
- A Labuan entity continues to be able to make an irrevocable election to pay tax under the Malaysian Income Tax Act 1967.

Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018

On 1 January 2019, the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 (“2018 Regulations”) came into operation. The 2018 Regulations specify the (i) minimum number of full time employees required in Labuan and (ii) minimum amount of annual operating expenditure required in Labuan for each type of Labuan entity.

There are 21 types of Labuan entities listed, most of which are licensed entities and would already have to comply with some form of substance requirements under their respective industry guidelines. What is of note is that the substance requirements are now imposed on insurance and insurance-related licensees (which previously relied on appointing a Labuan insurance manager or Labuan underwriting manager to comply with substance requirements), and holding companies. Holding companies are now subject to a minimum number of 2 full time employees and an annual operating expenditure in Labuan of RM50,000.



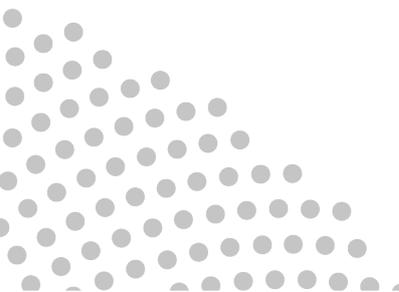
Since then, there have been various pronouncements by the Labuan Financial Services Authority (“LFSA”) to address areas of concern from the industry players. LFSA has stated that these pronouncements are subject to release of gazetted regulations but it is useful to see what they are:

- Revised list of substance requirements on certain Labuan entities including Labuan banks, investment banks, insurers, insurance brokers, leasing companies and holding companies. Significantly, the substance requirements on holding companies are reduced as follows:
- for Labuan holding companies that undertake other than pure equity holding activities, they require a minimum of 1 full time employee and minimum annual operating expenditure of RM20,000 in Labuan; and
- for Labuan holding companies that undertake pure equity holding activities, they are not required to have any full time employees in Labuan, but will need to comply with management and control requirements, and have a minimum annual expenditure of RM20,000 in Labuan.
- Revised reduced rates of non-deductibility rules on interest payments and lease rental payments.
- Imposition of substance requirement rules (minimum of 2 full time employees and minimum annual operating expenditure of RM50,000) on Labuan entities that carry out administrative, accounting and legal services including backroom processing, payroll services, talent management, agency services, insolvency related services and management services.

Labuan Business Activity Tax (Amendment) Act 2020

On 10 February 2020, the Labuan Business Activity Tax (Amendment) Act 2020 (the “Amendment Act”) came into force. A key change under the Amendment Act is to put into effect the pronouncement made by LFSA earlier that any Labuan entity carrying on a Labuan business activity but fails to comply with the relevant substance requirements for a basis period for a year of assessment is subject to tax under the LBATA **at the rate of 24% of its chargeable profits** for that year of assessment, and not subject to tax under the Malaysian Income Tax Act 1967.

The other amendments under the Amendment Act relate to detailed and increased powers of the Director General of Inland Revenue (“DG”) in dealing with tax matters under the LBATA, including:

- Where the DG believes that any transaction has the direct or indirect effect of altering the incidence of tax payable, relieving any person from liability or evading or avoiding liability, the DG may disregard or vary the transaction and make adjustments as he thinks fit, including the computation or re-computation of the chargeable profit, or the imposition of liability to tax.
 - In determining the chargeable profit of a person, the DG may substitute the price for the acquisition or supply of property or services in respect of transactions that the person has entered into, to reflect an arm’s length price for the transaction.
 - In order to ascertain whether a person is chargeable to tax, the DG has the power to call for the books, accounts and returns of the person in order to obtain the full information.
 - For the purposes of the LBATA, the DG has full and free access to all lands, buildings and places and to all books, documents, objects, articles, materials and things and may search such lands etc. and inspect, copy or make extracts from such books etc.
 - Every person who is required to furnish a return of his profits for a year of assessment shall keep and retain in safe custody sufficient documents for a period of seven years from the end of that year of assessment.
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As the Labuan International Finance and Business Centre enters its 30th year of operation this year, it continues to introduce necessary changes to its laws and regulations to remain both reputable and competitive. These latest changes reflect the balance that needs to be struck from this perspective. Businesses would do well to look at whether their existing structures are in compliance with the new requirements.

If you have any questions or require any additional information, please contact **Chua Wei Min**, Director ZICO Insights Law LLC.

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