



Market Briefing

Revised Labuan Tax Framework

17 January 2019

Agenda

- I. Developments driving the Labuan Tax Review**
- II. The Revised Labuan Tax Framework**
- III. Labuan Substantial Requirement is Reasonable vis-a-vis Other Jurisdictions**
- IV. Labuan IBFC still Business-Conducive & Attractive**
- V. Monitoring & Enforcement on Substance Compliance**
- IV. Frequently-Asked-Questions (FAQs)**

New International Tax Standards drive for Labuan Tax Framework to be comprehensively reviewed

Malaysia's commitment to FHTP requirements ...

OECD's BEPS 15 action plans (2013)

Action 5: Forum on Harmful Tax Practices (FHTP)

⇒ ensure tax regime across countries are **equitable, transparent and substantive**

Key assessment for Labuan IBFC:

1. Ring-fencing elements
2. Absence of substantial activities
3. Lack of transparency

EU's code of conduct for business taxation (2017)

Guidance for determining substance when considering whether a tax measure is **harmful or 'fair'**

Tax criteria:

1. Tax transparency
2. Fair taxation
3. Substantial requirements
4. **BEPS measures**

If Labuan IBFC does not comply, with Malaysia's commitment, regime may be...

- i. "Black-listed" by the OECD
- ii. "Black-listed" by EU's Code of Conduct Group
- iii. Abolished and Labuan Financial businesses will be scoped under the Income Tax Act 1965 (ITA)

Labuan's regime....

❶ **Rated as "Not Harmful"** at the recent FHTP meeting on 9-11 January 2019

❷ **Rated as "Largely Compliant"** by Global Forum on Tax Transparency and Exchange Information

...lower or no tax scrutiny from other countries on Labuan cross-border businesses

Labuan Tax Review were jointly undertaken with Ministry of Finance and key agencies over the last 5 years

Tax review to enhance Labuan IBFC's competitiveness...

2014 - 2016

- ➊ Initiated Labuan Tax Review Project
 - ⇒ Task force lead by MOF
 - ⇒ Participated by LFSA, BNM, LHDN, SC & LC
- ➋ Technical review of Labuan Tax Framework by PWC
 - ⇒ Proposed enhancements while retaining minimal corporate tax rate
- ➌ Labuan Business Repositioning Study of Labuan to complement the tax review initiatives

Pressure from FHTP Assessments...

2017

- ➊ Malaysia joined OECD's inclusive Frameworks on BEPS
- ➋ Labuan "matured" markets to be subjected to domestic tax rate
- ➌ Leasing & financial business regimes were reviewed by FHTP and subsequently amended

2018 - 2019

- ➊ LBATA revisions announced in the Budget 2019
- ➋ New LBATA requirements were gazetted
- ➌ OECD satisfied with Labuan tax changes
- ➍ Labuan IBFC rated as "Not Harmful" and "Largely Compliant"

Revised Labuan Tax Framework effective 1 January 2019

	Prior 2019	New
A. Corporate Income Tax		
1. Tax election on RM20,000	3% or RM20k	Removed RM20k
2. Taxation rate		3% of audited net profit
B. Dealing Restrictions		
1. Dealing with resident	Not allowed unless permitted	Permitted
2. Transaction in RM		
C. Expense Deductibility by Resident Counterparty		
1. Interest payments	100% Allowable	33% non-deductible
2. Lease rentals		33% non-deductible
3. General reinsurance premiums		100% allowable
4. Other type of expenses		97% non-deductible
D. Withholding Tax	Exempted	Exempted
E. Stamp Duty	Exempted	Exempted
F. Substantial Requirements in Labuan		
1. Employees	Generally not specified	Required
2. Operating expenditure		Required

Labuan Substantial Requirement is Reasonable vis-a-vis Other Jurisdictions'

Jurisdiction assessed by OECD	Minimum employment	Minimum annual local business spending (RM)
Labuan	2 – 4	50,000 – 180,000; 3 mil
Malaysia		
• <i>Inward Reinsurance</i>	10	4 mil
• <i>Inward Retakaful</i>	5	4 mil
• <i>Principal Hub</i>	3 – 60 with min. salary reqs.	3 mil – 13 mil
• <i>MSC</i>	20 – 50 with min. salary reqs.	1 mil – 10 mil
• <i>East Coast Economic Region</i>	4 – 100	1 mil – 200 mil
Singapore*	3 – 10	600,000 – 45 mil
Hong Kong*	Aircraft leasing functions and management must be performed in the country	
Other IFCs**	Adequate number	

*Aviation leasing regimes

**Jersey, Guernsey, Isle of Man, Bermuda, BVI, Cayman Island, Barbados

1. Labuan IBFC substantial requirement is **reasonable to others** assessed by OECD's FHTP and EU's Code of Conduct Groups
2. **OECD monitors closely** jurisdictions' implementation especially on substantial requirements
 - ⇒ Lesser scrutiny for those with explicit quantitative requirements
3. Labuan's substantial requirements provides **definitive floor and certainty** to facilitate market's compliance.

Labuan IBFC still business-conducive & attractive...

1. Continue to be **taxed at 3%**, still low compared to other neighbouring centres
2. Existing **tax exemptions preserved**:
 - **No withholding tax** (lease rentals, dividends, interest, royalties, technical and management fees)
 - No stamp duty
 - 50% tax exemption on foreign staff in managerial position
 - No tax on foreign director fee
 - Labuan allowance
 - Housing allowance
3. Non-deductibility on resident payments will only be computed at year-end compared to withholding tax which are paid upfront on each transaction(s).
4. Only **Labuan entities listed in the Regulation** are required to comply with the substance requirement
5. **Certificate of tax residence for DTA benefits** will continue to be issued by IRB

Labuan IBFC still business-conducive & attractive...

6. Labuan Island's **duty free status** remains
7. More **cost-efficient** in Labuan
8. **Liberalise dealings with Residents and in RM** by Labuan entities
 - ⇒ In compliance with domestic laws e.g. FEA rules, local licensing
9. **Higher certainty on taxation compliance**
10. **Increased DTA-recognition of Labuan** by other competent tax authorities with the recent OECD's FHTP assessment as "Not Harmful" and rated as "**Largely Compliant**" by the OECD's Global Forum on Tax Transparency and Exchange Information
 - ⇒ Will boost Labuan's business
 - ⇒ Greater business prominence of Labuan IBFC

Substance Compliance will be monitored & enforced

1. Establishment of Labuan Investment Committee

- i. Chaired by Labuan FSA
- ii. Members are representatives from MOF and LHDN (or other Ministries/agencies where relevant)
- iii. Roles & functions :
 - Review and recommend policies on substantial requirements
 - Facilitate growth for Labuan businesses
 - Make recommendations to Minister of Finance on Labuan tax regime

2. Monitoring & enforcement by Labuan FSA

Substance compliance will be monitored via:

- Readiness checks on Labuan entities' premises
- On-site supervision of Labuan entities



Frequently Asked Questions... *General*

1. Are the following entities subjected to the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 (Substance Regulation)?
 - a) Managed trust company?
 - b) Protected cell company?
 - c) Investment holding company?
 - d) Islamic window?
 - e) Labuan entity with solely Intellectual Property (IP) income?
 - f) Dormant company?

2. For Labuan companies that have elected ITA (s3A of LBATA):
 - a) Due to Ringgit and resident dealings in the past, should they close the income tax file under ITA and file Labuan tax return moving forward?
 - b) Do they need to comply with substance requirement?

Frequently Asked Questions... *General*

3. For newly incorporated/registered entities:
 - a) Do they need to meet the substance requirements upon commencing their businesses?
 - b) Can the minimum local spending be pro-rated?
4. What is the requirement of an operational office in Labuan?
5. Can Labuan entities pool and share their office space?
6. Can co-located and marketing office in KL be considered an operational office in Labuan?
7. What are the consequences of not complying with the minimum substantial requirements?

Frequently Asked Questions... *Employment & Annual Operating Expenditure*

8. What is the definition of full time employee?
9. Is there any criteria set for the employee in Labuan office e.g. qualification, minimum salary, resident or non-resident?
10. What are the expenses that qualify as part of the annual operating expenditure in Labuan?
11. A LE has a manpower arrangement with its HQ in KL :
 - a) Scenario 1: Its employees in Labuan are under HQ's payroll and the salary expenses were subsequently reimbursed by the LE.
 - b) Scenario 2: Its employees in Labuan are under HQ's payroll and the salary expenses are absorbed entirely by the HQ.

In the above scenarios, does the LE fulfil the minimum requirement on
(i) Employees (ii) Annual operating expenditure?

Frequently Asked Questions... *Miscellaneous*

12. Are reinsurance premiums subjected to the non-deductibility treatment under Section 39 of the ITA?
13. With the removal of restrictions on resident dealings and RM, are LE allowed to undertake business with residents in Malaysia freely?
14. When is the effective date of the new requirements of LBATA e.g. removal of RM20,000 option and 3% tax on audited net profit?
15. What is the tax treatment if a Labuan entity does not have a basis period for a year of assessment?
16. Why is income from IP rights taxed under ITA?

Facilitating Compliance to the New Tax Regimes

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2. **Frequently-Asked-Questions** will be made available on Labuan FSA's website.

THANK YOU

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