2022

TRICOR
INSIGHTS

REGULATORY TAX UPDATES ON LABUAN

Opening

Further to Tricor Insights 9/2021, this issue provides an update on the recent key amendments to the Labuan tax legislation up to 31 December 2021. For the reader's ease of reference, a recap of the content of Tricor Insights 9/2021 is also outlined below.

On 22 November 2021, the Labuan Business Activity Tax (Requirements For Labuan Business Activity) Regulations 2021 was gazetted to replace the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 issued on 31 December 2018. Two main changes to the Regulations are discussed below.

Subsequently on 23 November 2021, the Income Tax (Exemption) (No.11) Order 2021 was issued to provide exemption from the application of Section 39(1)(r) of the Income Tax Act 1967 (ITA) which restricts the deductibility of payments made to Labuan entities.

The tax regime for Labuan International Commodity Trading Companies is governed under a separate gazette order i.e. the Business Activity Tax (Requirements for Labuan International Commodity Trading Company) Regulations 2021 which was published on 27 December 2021.

The proposed amendments to the Labuan Business Activity Tax Act 1990 ("LBATA") as announced in the Budget 2022 were enacted via the Finance Act 2021 on 31 December 2021. The key amendments are outlined below.

Labuan Business Activity Tax (Requirements For Labuan Business Activity) Regulations 2021 [P.U.(A) 423/2021] ["Substance Regulations 2021"]

1) Introduction of new Labuan business activities under Item 20 in the First Schedule of the Substance Regulations 2021

The Substance Regulations 2021 introduces an additional category of Labuan business activities via item 20 as set out in the First Schedule of the said Regulations. The Substance Regulations 2021 take effect retrospectively from 1 January 2019 except for Regulation 3 (as discussed below) which is deemed to be effective from 1 January 2021.

Item 20 essentially comprises "other trading" Labuan business activities, as announced previously by the Labuan FSA via its circular dated 21 January 2020. In connection with this, the Labuan FSA issued an FAQ dated 14 December 2021 providing details of the Labuan business activities under Item 20, as outlined in the table below.

Item 20, First Schedule	Details of Labuan business activities
Administrative services	• Employee management • Payroll management • Property management • Human resource management • Financial planning • Contract or subcontract management • Facilities management • Proposal management
Accounting services	Services pertaining to recording, analysing, summarising or classifying financial, commercial and business transactions and information of a person or business
Legal services	• Conveyancing services

	• Legal advisory services • Litigation or legal representation services in any proceedings before any court, tribunal or other authority • Legal dispute resolution services including alternative dispute resolution
Backroom processing services	• Settlement of receivables and payables • Records maintenance • Regulatory compliance • Information technology related services which are usually performed by administrative and support personnel who do not deal directly with clients
Payroll services	• Processing, calculation, payment and deduction of remuneration, benefits, tax and statutory payment • Issuance of payslip and tax statement
Talent management services	Provision of human resource services to attract, onboard, develop, motivate and retain employees
Agency services	Provision of specific services on behalf of another pursuant to an agency agreement
Insolvency related services	Provision of services related to administering company liquidations, winding up or personal bankruptcy
Management services excluding Labuan Company Management services	Services provided to organize and coordinate activities of a business and usually consists of organizing, supervising, monitoring, planning, controlling and directing business' resources such as people, finance and technology

Labuan entities carrying on Labuan business activities under Item 20 are required to meet substance requirements to be eligible for the preferential tax rate of 3% on net audited profits under the LBATA. The substance requirements are as follows:

- Incur a minimum annual operating expenditure in Labuan of RM50,000; and
- Employ at least two (2) full time employees in Labuan.

These substance requirements must be complied with throughout the basis period for a year of assessment. If this condition is not met, the Labuan entity will be subject to tax at 24% on net audited profits for that year.

2) Introduction of control and management conditions for Labuan entities carrying on pure equity holding activities

Labuan entities carrying on pure equity holding activities shall comply with the following substance requirements:

- Incur a minimum annual operating expenditure in Labuan of RM20,000; and
- Exercise control and management in Labuan

Regulation 3 of the Substance Regulations 2021 provides the conditions relating to "control and management in Labuan" as follows:

- At least one (1) board of directors meeting is convened in Labuan;
- The registered office of the Labuan entity shall be situated in Labuan;

- The secretary of the Labuan entity appointed under the Labuan Companies Act 1990 shall be resident in Labuan; and
- The accounting and business records including minutes of Board meetings shall be kept in Labuan

If the operational expenditure and control and management requirements are not met throughout the year, the Labuan entity will be subject to tax at 24% on net audited profits for that year.

Income Tax (Exemption) (No. 11) Order 2021 [P.U.(A) 425/2021]

With effect from 1 January 2019, Section 39(1)(r) of the ITA was enacted to restrict a deduction for payments made by resident taxpayers to Labuan entities as follows:

Types of payments	% not deductible
Interest payment	25%
Lease rental	25%
Other payments	97%

The above Exemption Order provides that payments made to Labuan entities under the following circumstances will **not be subject to the restriction** on deductibility of expenses, subject to meeting the general deductibility test in Section 33(1) of the ITA:

Payer	Payee	Effective period
Tax resident	Labuan company which has made an irrevocable election to be taxed under the ITA	1 January 2019 onwards
Tax resident	Labuan company undertaking a qualifying activity under the Global Incentives for Trading Programme (GIFT)	Years of assessment 2019 to 2025
Labuan tax resident **not** carrying on: • A Labuan business activity specified in the Schedule to the Substance Regulations 2021; or • A Labuan business activity under the LBATA	Labuan Company carrying on a Labuan business activity under Section 2B of the LBATA	Years of assessment 2019 to 2025

Labuan Business Activity Tax (Requirements for Labuan International Commodity Trading Company) Regulations 2021 [P.U.(A) 482/2021]

The Labuan Business Activity Tax (Requirements for Labuan International Commodity Trading Company) Regulations 2021 was issued to update the scope of qualifying activity and substance requirements for Labuan entities carrying on a qualifying activity under the Global Incentives for Trading programme.

A Labuan International Commodity Trading Company ("LITC") means a Labuan Company which:

- Is incorporated or registered under the Labuan Companies Act 1990;
- Is licensed under Section 92 of the Labuan Financial Services and Securities Act 2010;
- Maintains a registered office in Labuan but is allowed to establish its business operational office anywhere in Malaysia; and
- Undertakes a qualifying activity under the Global Incentives for Trading programme

In this context, “qualifying activity” means the trading of physical products and related derivative instruments in relation to:

- Petroleum and petroleum-related products including liquefied natural gas
- Minerals
- Agriculture products
- Refined raw materials
- Chemicals
- Base minerals
- **Coal**

in any currency other than Ringgit.

Regulation 3(1) of P.U.(A) 482/2021 (which is deemed to have come into operation on 1 January 2019 until 31 December 2020) states that a LITC shall comply with the following substance requirements:

- Incur a minimum annual operating expenditure of RM3,000,000; and
- Employ at least three (3) full-time employees

With effect from 1 January 2021, the substance requirements are as follows:

LITC that has not more than 5 related companies	LITC that has more than 5 related companies
• Employ at least three (3) full-time employees, with at least two (2) of them working in the Labuan operational office; and • Incur a minimum annual operating expenditure of RM3,000,000, with at least RM100,000 incurred in Labuan by each company.	• Employ an additional full-time employee in the Labuan operational office for every addition of up to 5 related companies in the group; and • Incur a minimum annual operating expenditure of RM3,000,000, with at least RM100,000 incurred in Labuan by each company.

Amendments to the LBATA

With effect from the year of assessment 2022, a Labuan entity carrying on a Labuan business activity which is a Labuan **non-trading** activity shall, within a period of 3 months (or any extended period as may be allowed by the Director General) from the commencement of a year of assessment, file a statutory declaration and **return of profits** in the prescribed forms to the Director General.

Therefore, a Labuan entity carrying on a non-trading entity (i.e. investment holding activity or pure equity holding activity) is required to submit the following documents to the Inland Revenue Board of Malaysia (“IRB”) annually before 31 March:

- Form LE1 – Return of Profits by a Labuan Entity; and
- Form LE5 – Statutory Declaration

The above documents are to be submitted together with the Audited Financial Statements. Hence, all affected Labuan entities are required to appoint an approved external auditor for the purpose of preparation of the Audited Financial Statements for the year of assessment 2022 (FYE 2021) and onwards.

Failure to comply with the filing requirement as outlined above will render the Labuan entity guilty of an offence and upon conviction, be liable to a fine of not exceeding RM1 million or to imprisonment for a term not exceeding 2 years or to both.

Further, with effect from the year of assessment 2022, where a Labuan entity carrying on a Labuan non-trading activity is chargeable to tax at 24% (for failure to comply with the substance requirements under the LBATA), the full amount of the tax is required to be paid to the IRB upon the filing of Forms LE1 and LE5 (i.e. by 31 March).

A new Section 16A of the LBATA has been introduced which took effect from 1 January 2022. This section provides that where any tax is due and payable by a Labuan company, a **resident director** of the company during the period in which that tax is liable to be paid by that company, shall be **jointly and severally liable for such tax**.

In this context, a “director” is a person who:

- Is occupying the position of director, by whatever name called, including any person who is concerned in the management of the company’s business; and
- Is, either on his own or with one or more associates, the owner of, or able directly or through the medium of other companies or by any other indirect means to control, not less than 20% of the ordinary share capital of the company

Tricor Taxand’s take

- After much lobbying by the various stakeholders, the “non-regulated” business activities as promoted by the LFSA have finally been listed in the legislation with the inclusion of Item 20 in the First Schedule of the Substance Regulations 2021. With this amendment, more Labuan entities would be eligible for the preferential tax rate of 3% under the LBATA, subject to meeting the substance requirements.
- Labuan entities that fall within Item 20 are now required to re-submit their tax returns under the LBATA for financial years 2019 and 2020 respectively, and the deadline for the submission is 21 January 2022.
- However, such Labuan entities can continue to be taxed under the ITA by making an irrevocable election pursuant to Section 3A of the LBATA. The election must be done by 15 January 2022.
- Labuan entities carrying on pure equity holding activities should ensure both operational expenditure and control and management requirements are met in order to enjoy the zero tax rate for the year.
- The exemption from the restriction on deductibility of payments made to Labuan entities provides a more equitable tax treatment to the payer who would otherwise have been greatly burdened by the restriction.
- However, the exemption from the restriction on deductibility does not cater to the scenario where the resident payer (including a Labuan resident entity) is subject to tax under the ITA whilst the payee is a Labuan entity that is subject to tax under the ITA by virtue of undertaking a non-Labuan business activity.
- Labuan entities carrying on Labuan non-trading activities are now required to submit both a statutory declaration and Form LE1 for each year of assessment, together with the Audited Financial Statement
- Resident directors of a Labuan company are now jointly and severally liable for any tax due and payable by the Labuan company and such amount is recoverable from the directors via civil proceedings.

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