

**FREQUENTLY-ASKED QUESTIONS
NEW LABUAN BUSINESS ACTIVITY TAX
(SUBSTANTIAL ACTIVITY REQUIREMENTS) 2019**

A. GENERAL

1. Are the following entities subjected to the *Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018*?

a) Managed Trust Companies?

Only Labuan entities that are listed in the *Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 (Substance Regulations)* are subjected to the substantial activity requirements stipulated under the said regulations.

b) Captives e.g. Protected Cell Companies (PCCs)?

Labuan FSA will provide clarification, in due course, on how substantial activity requirements apply to a captive setup including PCCs.

c) Investment Holding Companies?

The *Substance Regulations* is applicable to an Investment Holding Company if it fulfils the definition of a Holding Company (HC) in Labuan Companies Act 1990 (LCA). A HC is defined under section 3 of the LCA as a corporation which has subsidiaries (i.e. owning more than 50% of the subsidiaries' shared capital) and has control over these subsidiaries as depicted below:

- the HC controls the board of directors of its subsidiaries; and
- it owns more than 50% of the voting rights in the other company (which can be considered a subsidiary).

d) Islamic windows?

An Islamic Window of a Labuan financial institution shall not be regarded separately from the entity, hence, substantial activity requirements would only apply on the entity itself.

e) Labuan entities with income solely derived from Intellectual Property (IP)?

Effective 1 January 2019, any income derived from IP rights under Section 4(3) of LBATA is subject to be taxed under the Income Tax Act 1967 (ITA).

f) Dormant companies?

A Labuan entity which has no business income is not subjected to the *Substance Regulations*.

2. In view of the changes in the definition of Labuan business activity, what is the status of a Labuan entity that was taxed under ITA due to previous restriction for dealing in Ringgit and with residents?

With effective from 1 January 2019, Labuan entity may file their tax under LBATA.

3. For Labuan entities that have made an irrevocable election to be taxed under ITA:

a) Can they now file under LBATA?

No, the election is irrevocable and cannot be reversed.

b) Do they need to fulfil with substantial activity requirements under the *Substance Regulations*?

No, because the Labuan entities are not taxed under LBATA.

4. For newly incorporated/registered entities:

a) Do they need to meet the substantial activity requirements upon commencing their businesses?

Yes, in order to enjoy LBATA's tax incentives.

b) Can the minimum annual expenditure be pro-rated?

As it is annual operating expenditure requirement, the requirement should correspondently be pro-rated from the date of the commencement of business.

5. What is the requirement of an operational office in Labuan?

Under the new regulations, Labuan entities are expected to have a physical office for the full-time employees.

6. Can Labuan entities pool and share their office space?

It is expected that Labuan entities would have dedicated physical office e.g. dedicated entrance, office signage etc. In respect of related companies within a Group, physical office may be shared.

7. Can co-located and marketing office in KL be considered an operational office in Labuan?

Pursuant to the *Substance Regulations*, the scoped-in Labuan entities would need to have an operational office in Labuan to enjoy the LBATA's preferential tax treatment.

8. What are the consequences of not complying with the minimum substantial activity requirements?

The Labuan entity would not be eligible to enjoy the LBATA tax preferential treatment e.g. tax rate of 3%. Consequently, it will be taxed under the ITA.

B. EMPLOYMENT

9. What is the definition of full time employee?

Full time employee means that the employee is employed by the Labuan entity to serve the entity in Labuan. This can be evidenced by, but not limited to, the employment contract, organisational chart of the Labuan office and etc.

10. Does substantial activity requirement prescribe minimum qualifying criteria for employees that are engaged by a Labuan entity e.g. qualification, minimum salary, citizenship?

No, under the *Substance Regulations*, there is no qualifying requirements on employees that are engaged by Labuan entities.

C. ANNUAL OPERATING EXPENDITURE

11. What are the expenses that qualify as part of the annual operating expenditure in Labuan?

These are expenses incurred by Labuan entities in Labuan island (e.g. invoices and receipts issued in Labuan). This includes defraying payments, professional and statutory fees e.g. salaries, lease rental, service providers' fees, licence fees to Labuan FSA etc.

12. A Labuan entity has a manpower arrangement with its Head Quarter (HQ) in Kuala Lumpur:

a) Scenario 1: Its employees are in Labuan and under HQ's payroll. The salary expenses were subsequently reimbursed by the Labuan entity. Does the Labuan entity fulfil the minimum requirements on (i) employees and (ii) annual operating expenditure?

The arrangement satisfies the substantial activity requirements on employees and local spending in Labuan subject to meeting the minimum requirements under the new regulations.

- b) **Scenario 2**: Its employees are in Labuan and under HQ's payroll. The salary expenses are absorbed entirely by the HQ. Does the Labuan entity fulfil the minimum requirements on (i) employees and (ii) annual operating expenditure?

The Labuan entity only satisfies the employee requirement. However, the salary is not incurred by the Labuan entity in Labuan, hence not accounted as part of annual operating expenditure in Labuan.

D. MISCELLANEOUS

13. **Are reinsurance premiums subjected to the non-deductibility treatment under Section 39 of the ITA?**

No, general reinsurance premiums paid by licensed Malaysian insurers to Labuan entities are 100% tax deductible pursuant to Section 60(7) of ITA. Hence, the treatment of non-deductibility under Section 39(1)(r) of ITA is not applicable on the said premiums. For further details, enquiries can be directed to the Inland Revenue Board of Malaysia (IRB).

14. **With the removal of restrictions on resident dealings and Ringgit, are Labuan entities allowed to undertake business with residents in Malaysia freely?**

Yes in respect of tax requirements under the LBATA.

15. **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?**

The 3% tax rate takes effect on 1 January 2019 in relation to the tax filing for Year Assessment 2020. The election of RM20,000 or 3% tax is still available for income earned prior to 1 January 2019.

16. What is the tax treatment if a Labuan entity that does not have a basis period for a year of assessment?

The Director General (DG) of IRB may direct the basis period for such situation pursuant to the amended Section 8 of LBATA. For further details, enquiries can be directed to the IRB.

Labuan Financial Services Authority

25 January 2019

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