





The Labuan Tax framework

Labuan is an island in the South China Sea off the coast of the state of Sabah in East Malaysia. It is also known as an offshore financial centre, offering international financial and business services.

Although Labuan is a federal territory within Malaysia, there are preferential tax treatments for companies conducting Labuan business activities, such as low fixed tax rate of 3%, withholding tax exemption on payments to non-residents, tax exemption on fees paid to non-citizen directors and so on.

In addition, Labuan companies are not restricted by regulations relating to foreign exchange control and foreign ownership. For Chinese companies that have their sights set on overseas expansion, Labuan may play a meaningful role in their expansion strategies. We are pleased to provide you further information about the Labuan Tax framework.

Overview of the Labuan Tax framework

1.	Where is Labuan?	Labuan is 18km off the coast of Sabah, East Malaysia and 171 kilometers from Kota Kinabalu (capital city of Sabah). It is a federal territory of Malaysia with an estimated population of 100,000.																						
2.	What is a Labuan entity?	Labuan entities are entities listed in the Schedule (Section 2B) of the Labuan Business Activity Tax Act 1990 (see list below) that also meet the specified substantive requirements. The substance requirements include minimum number of employees and minimum amount of annual operating expenditure in Labuan for carrying on Labuan business activity.																						
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3.	What defines a Labuan business activity?	<p>Labuan business activity means a Labuan trading or a Labuan non-trading activity carried on in, from or through Labuan, excluding any activity which is an offence under any written law.</p> <p>Labuan entities as listed in the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 ("the Regulations") are required to comply with the minimum requirements in respect of number of full time employees in Labuan and amount of operating expenditure in Labuan.</p> <p>Entities which are not listed in the Regulations or do not meet the minimum requirements as specified in the Regulations will not be regarded carrying on Labuan business activity and will be subject to tax under the Malaysian Income Tax Act 1967.</p> <p>The authorities may revise the Regulations from time to time.</p>																						

4.	Labuan trading and non-trading activities	<p>Labuan trading activities</p> <ul style="list-style-type: none"> • Banking • Insurance • Trading • Management • Licensing • Shipping operations <p>Or any other activity which is not a Labuan non-trading activity.</p>	<p>Labuan non-trading activities</p> <p>An activity relating to the holding of investments in securities, stock, loans, deposits or any other properties situated in Labuan by a Labuan entity on its own behalf.</p>
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Taxation System in Labuan																
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2.	Does Labuan have any tax treaties?	<p>Generally, Labuan companies can access most of Malaysia's network of more than 70 Double Tax Agreements (DTAs). However, Labuan has been specifically excluded from DTAs with Australia, Chile, Germany, India, Indonesia, Japan, Luxembourg, Netherlands, South Africa, Spain, Sweden, the Republic of Seychelles and the United Kingdom.</p>														
3.	Resident who transacts with Labuan company	<p>The following payments made by a resident to a Labuan company are not allowed for deduction under the Malaysian Income Tax Act 1967:</p> <ol style="list-style-type: none"> 1. Interest payment – 33% not allowable 2. Lease rental – 33% not allowable 3. Other payment – 97% not allowable 														

4. **Individuals** Individual residents in Labuan, with income accruing in or derived from Malaysia are subject to tax. Foreign sourced income received in Malaysia by resident individuals are tax-exempt. The rate of tax ranges from 0% to 28% for resident individuals and a flat rate of 28% for non-resident individuals.

The following tax exemptions are available to certain individuals up to YA 2020:

Taxpayers	Tax exemptions
Any person rendering qualifying professional services (legal, accounting, financial or secretarial services) in Labuan to a Labuan entity	65% of the statutory income derived from such provision of qualifying professional services.
Non-citizen individuals employed in a managerial capacity with a Labuan entity in Labuan, co-located office or marketing office of a Labuan entity in other parts of Malaysia.	50% of gross income from such employment.
Non-citizen individuals acting in their capacity as a director of a Labuan entity.	Directors' fee received.
Citizen of Malaysia who received housing allowance and Labuan Territory allowance from exercising an employment in Labuan with a Labuan entity.	50% of gross housing allowance and gross Labuan Territory allowance received.

5. **Capital Gains** For Labuan entities carrying on Labuan trading activity and both Labuan trading and non-trading activities, the gains would be reflected as part of the net profits and subject to 3% tax.

6. **Withholding Taxes** Royalties, interest, technical or management fees and other gains or profits under Section 4(f) of the Income Tax Act 1967 paid by a Labuan company to a non-resident person or another Labuan company subject to tax under LBATA are exempted from income tax and thus not subject to withholding tax.

7. Indirect Taxes	Service Tax	Sales Tax
	<p>Generally, service tax is charged at the rate of 6% on prescribed taxable services provided in Malaysia and any taxable imported services. The prescribed taxable services are listed in the Service Tax Regulations 2018. The service tax is a non-creditable tax and any tax paid is a cost to the recipient of the service.</p> <p>Some examples of services that are within the scope of service tax include Group and Corporate insurance policies, individual insurance policies excluding life and medical, broking and underwriting services, consultancy and accountancy services, management services and information technology services.</p> <p>However, Labuan has been given a concessional service tax treatment as a designated area. Currently the islands of Langkawi and Tioman are also designated areas, with Pangkor proposed to be added.</p> <p>Services provided within or between designated areas will not be subject to service tax. However, services from the designated area to other places in Malaysia (and vice versa) or services imported into the designed area will be subject to service tax.</p>	<p>Generally, sales tax is charged at the rate of 5%, 10% or a specific prescribed rate for goods manufactured in Malaysia or imported into Malaysia. Sales Tax is a non-creditable tax and any sales tax paid is a cost to the business.</p> <p>However, Labuan has been given a concessional sales tax treatment as a designated area. Currently the islands of Langkawi and Tioman are also designated areas, with Pangkor proposed to be added.</p> <p>Goods (other than petroleum) manufactured in the designated area are not subject to sales tax. Further, no sales tax shall be levied on goods imported into the designated area (from overseas or from other places in Malaysia), transported between designated areas, and transported from the designated area to the Special Areas (which represent specifically designated customs zones which are afforded concessional treatment for sales tax and customs duties).</p>
8. Stamp Duty	<p>The following instruments are exempted from stamp duty:</p> <ul style="list-style-type: none"> • all instruments which are executed by a Labuan entity in connection with a Labuan business; • all Memorandum and Articles of Association, statute, charter, rules, by-laws, partnership agreement or other instrument, under or by which a Labuan entity is established and the scope of that entity's function, business, powers and duties are set out, whether contained in one or more documents; and • all instruments of transfer of shares in a Labuan entity. 	

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