

NOTICE FOR LABUAN ENTITIES

FURTHER UPDATE ON ECONOMIC SUBSTANCE REQUIREMENTS FOR LABUAN ENTITIES

There was a townhall meeting organised by the industry's stakeholders in Labuan on Wednesday 4th March 2020. Representatives from the Ministry of Finance, Labuan FSA and Inland Revenue Board of Malaysia (IRB) sat together to provide further clarifications on the 'economic substance requirements' (ESR) matter, eagerly sought by the industry players.

Some important outcome from the recent pronouncements from Labuan FSA as well as from the townhall meeting are put together as follows –

A. Status of Trading Entities

1. Labuan entities that carry on trading business activities, for example general trading or consultancy services (activities that do not require licensing), which are not listed in the [Schedule](#)¹ (and its subsequent [amendments](#)²) –

- are not subject to the ESR regulations;
- and the LBATA tax regime does not apply;
- the entities will no longer benefit from the 3% tax rate;
- instead, they will be treated under the domestic Income Tax Act 1967 ("ITA") which carries tax up to 24%.

2. One category of business activities was recently added to the Schedule as per the [Notice](#)³ issued by the Labuan FSA. Labuan entities that carry on business activities of –

“administrative, accounting and legal services including backroom processing, payroll services, talent management, agency services, insolvency related services and management services”

will be entitled to the 3% tax rate under LBATA provided that they must satisfy the ESR of –

- (a) 2 full-time employees; and
- (b) meet the minimum of RM50K (approx. USD12,500) annual OPEX in Labuan.

3. Labuan entities which are dormant, struck-off, undergoing winding up or under liquidation, and provided that these entities are not deriving any income will be spared from the ESR regulations. Such entities will also be exempted from audit.
4. At this point of time, we are hopeful that there will be additional categories of trading entities to be included in the Schedule. Further industry consultation is ongoing with Labuan FSA with respect to this issue.

B. Actions Now Required for Trading Entities

1. Labuan entities which are listed in the Schedule are required to demonstrate that they comply with the ESR regulations by 31st December 2019. Labuan entities that fail to comply by the deadline will be taxed at 24% under LBATA.

Entities that fail to comply by the deadline may get to appeal to the IRB and review may be granted on a case to case basis.

2. Labuan entities that carry on activities mentioned in para. A.2. above will be required to meet the ESR immediately, if not done so.

¹ Labuan Business Activity Tax Act (Requirements for Labuan Business Activity) Regulations 2018 (P.U. (A) 392) – please scroll down for English version

² Clarification to Labuan LIC Pronouncement 2-2019 dated 20th December 2019

³ Addition to the Revised Substance Regulations

3. Please also be reminded that audit is mandatory for Labuan trading entities. Tax return for year of assessment 2020 submission's deadline is by 31st July 2020. Failure to submit the tax return in a timely manner will be dealt with compounds and penalties under LBATA.

C. Status of Non-Trading Entities (Pure and Non-Pure Equity Holding)

1. The ESR regulations for non-trading business activities are now certain.
2. For **pure equity holding** activities, it was further clarified that meeting the statutory obligations under the Labuan Companies Act 1990 such as having a resident secretary, registered office address, and books and records are kept in Labuan constitute "management and control" in Labuan. Thus, holding physical board and members' meetings in Labuan are now not necessary. The annual OPEX remains at RM20,000 (approx. USD5K).

D. Actions Now Required for All Non-Trading Entities

1. As previously [notified](#)⁴, all non-trading entities must now be able to demonstrate that they meet the ESR.
2. The tax return for year of assessment 2020 will include a declaration whether such entities satisfy with the ESR or not. Labuan non-trading entities who fail to comply with the ESR regulations at the time of declaration will be taxed at 24% under LBATA.

E. Recap of Timing for ESR Compliance for Labuan Entities Listed in the Schedule

1. All Labuan entities incorporated prior to 1st January 2019 are required to comply with the ESR regulations by 31st December 2019.
2. The ESR regulations apply immediately to Labuan entities incorporated on or after 1st January 2019.

F. Timing for Filings of Tax Return

Tax Filing under the LBATA for Labuan Entities Listed in the Schedule

1. Labuan entities will need to file their tax return by 31st July 2020 to evidence satisfaction with ESR regulations for year of assessment 2020.

Tax Filing under the ITA for Non-Listed Labuan Entities

2. Labuan entities which are not listed in the Schedule will not be subject under the ESR regulations and their tax obligations will be treated under the ITA regime.
3. We advise that a tax agent to be appointed as soon as possible to assist in the tax computation.

⁴ Notice Labuan Entities (Ref. HMRKLB00319) dated 24th December 2019

Further guidance to be issued by Labuan FSA

We expect further guidance will be issued by Labuan FSA, following which we will update you with more information and any new development.

Please note that this notice is intended to update you with the revised changes affecting all Labuan entities. It should not be used or relied upon as a substitute for advice or a basis for formulating your or your client's business decisions as to the tax and/or the economic substance requirements.

We urge that you contact us immediately to discuss further and formulate the next course of action for your or your client's Labuan entities.

Stay safe from the COVID-19!

Thank you.

Yours faithfully,

Sukor Ashak
Managing Director
HMR Konsultan (Labuan) Ltd.