



MALAYSIAN INSTITUTE
OF ACCOUNTANTS



MEMORANDUM ON ISSUES ARISING FROM LABUAN BUSINESS ACTIVITY TAX (AMENDMENT) BILL 2019 AND OTHER MATTER RELATED TO LABUAN BUSINESS ACTIVITY TAX ACT 1990

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ACTIVITY TAX (AMENDMENT) BILL 2019 AND OTHER MATTER
RELATED TO LABUAN BUSINESS ACTIVITY ACT 1990**

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MALAYSIAN INSTITUTE OF ACCOUNTANTS (MIA)

THE MALAYSIAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (MICPA)

A. LABUAN BUSINESS ACTIVITY TAX (AMENDMENT) BILL 2019

1. Amendment to Section 2B – effective Year of Assessment 2020 onwards

Insertion of new Section 2B(1A)

*“A Labuan entity carrying on a Labuan business activity which fails to comply with regulation made under Section 2B(1) for a basis period for a year of assessment shall be charged to tax at the rate of **twenty four per cent upon its chargeable profits** for that year of assessment”*

Section 2B(1) states the Labuan entities,

(a) shall be as specified in the Schedule; and

(b) shall, for the purpose of the Labuan business activity, have

(i) an adequate number of full-time employees in Labuan; and

(ii) an adequate amount of annual operating expenditure in Labuan,

as prescribed by the Minister by regulations made under this Act.

The Minister may, upon the recommendation of the Director General, by order published in the Gazette, amend the Schedule including for the purposes of declaring any other person as a Labuan entity.

Effective 1 January 2019 or YA 2020 onwards, P.U.(A) 392/2018 – Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 gazetted on 31 December 2018 specifies the substantive requirements (i.e. the minimum number of full time employees in Labuan and the minimum amount of annual operating expenditure in Labuan) for each Labuan business activity in a basis period for a year of assessment (YA). This has been supplemented by

Pronouncement 2-2019 from the Labuan Investment Committee as well as the Clarification thereto.

Comment:

- a) The new Section 2B(1A) of Labuan Business Activity Tax (Amendment) Bill 2019 reverses the provision where the understanding was that the provisions under the Income Tax Act 1967 (the ITA) shall apply if the Labuan entity fails to comply with the substance requirements as specified in the Regulations. This may have significant impact to those taxpayers who rely on the exemptions provided under the ITA.

Please clarify whether non-trading income such as dividend received by an investment holding company in Labuan from a foreign subsidiary:

- i) is exempted from tax under Schedule 6 of the ITA if it is taxed under the ITA or Section 9 under the Labuan Business Activity Tax Act 1990 (LBATA).
or
ii) would it be taxed at 24% under the LBATA.

IRBM's response:

The new amendment reverses the provision where the understanding was that the provisions under the Income Tax Act 1967 (the ITA) shall apply if the Labuan entity fails to comply with the substance requirements as specified in the Regulations as there were a lot of operational issues such as the difference in submission of income tax returns base on preceding year and current year and the compliance of instalments under CP204.

This amendment will ease the burden of Labuan entities to comply with all the provisions under ITA 1967.

Non-trading income that is listed in the P.U.(A)392/2018 covers only holding company which will also cover investment holding company which receives dividend income. If the holding company complies with the substance requirement under the Regulations, it will be charged under Section 9 of LBATA 1990. If the investment holding company do not fall under the definition of holding company as provided in the regulation, the income is taxable under ITA 1967 and any exemptions including those given under paragraph 28 Schedule 6 of ITA 1967 maybe applicable.

If the Labuan entity could not fulfil the substance requirement under the Regulations, the entity will now be taxed at 24% of the chargeable profits. IRBM takes note that the word chargeable profits only appear in section 4 of LBATA 1990 under trading activity but the new provision under section 2B mentions

Labuan entity carrying on a Labuan business activity which include trading and non-trading activity.
New definition of chargeable profit will be determined through practice note regarding this matter.

- b) A Labuan entity may elect to be taxed under the ITA but the deadline for submission of the election for YA 2020 would have lapsed (an election must be made within three months after the beginning of the basis period for a YA i.e. by 31 March 2019 if the year-end is 31 December).

A concession can be granted by the Inland Revenue Board of Malaysia (IRBM) to allow those taxpayers that may be impacted under (a) above to make an election to be taxed under ITA for YA 2020.

IRBM's response:

Under subsection 3A(2) of LBATA 1990, the DG has not been given the powers to give any extension period. Therefore, no extension can be given.

- c) We would like to propose that the amendments under Labuan Business Activity Tax (Amendment) Bill 2019 to be applied prospectively as follows:
- i) Proposals that are effective from 1 January 2019 – to change the effective date to 1 January 2021.
 - ii) Proposals that are effective from YA 2020 – to change the effective YA to YA 2022 onwards.

The Labuan companies should be given time to plan to adopt the proposed amendments as the Labuan companies have currently based on the existing legislations.

For example, under new Section 2B(1A) of the Labuan Business Activity Tax (Amendment) Bill 2019, Labuan companies that do not meet the substantive requirements under LBATA will be subject to tax at 24%. Previously, the IRBM has confirmed that Labuan companies that do not meet the substantive requirements will be taxed under the ITA as stated under item no 2 – amendment of Section 2B of the LBATA of the Chartered Tax Institute of Malaysia's (CTIM) Memorandum on Issues

Arising from Recent Tax Legislation in relation to Labuan dated 18 January 2019.

Based on the above-mentioned reply from the IRBM, Labuan companies would have prepared budgets and tax estimates/ provisions based on the previous understanding. The Labuan companies with financial year ended other than November and December would have closed the accounting periods now. Hence, the proposed amendments would have retrospective impact to the said Labuan companies. Even for YA 2021, some Labuan companies may already be coming to the end of their financial year 2020 (e.g. January, February, March year-end companies) and such companies could already have received income / undertaken activities for YA2021. As such, even to defer the provisions to YA 2021 would not be sufficient to provide an equitable outcome

IRBM's response:

The Labuan entities have been given ample time to undertake necessary actions as the filing date of the returns is by 31st March 2020 therefore this proposal is not relevant.

Please confirm that the reply provided by the IRBM to item 2.1 (Page 9 of 13 of CTIM's Memorandum on Issues Arising from Recent Tax Legislation in relation to Labuan dated 18 January 2019) is still applicable.

IRBM's response:

IRBM's response to item 2.1 (Page 9 of 13 of CTIM's Memorandum on Issues Arising from Recent Tax Legislation in relation to Labuan dated 18 January 2019) is no more relevant following the LIC's pronouncement 2/2019, paragraph 2(ii) as follows :

Audit requirement for Labuan entities that are dormant, struck off, winding up or under liquidation (referred to as "relevant entities")

In paragraph 2(ii)(b) of Pronouncement 1-2019, it stated that relevant Labuan entities which are not deriving any source of income are not required to comply with the substantial activity requirements. In addition, such entities will also be exempted from audit requirement for the purpose of fulfilling Labuan Business Activity Tax Act 1990 (LBATA)'s requirements.

Therefore, these entities will remain in LBATA 1990.

- d) A Labuan entity carrying on a Labuan business activity which fails the substantive requirement will be taxed at 24% on its chargeable profits under new Section 2B(1A).

Pursuant to Section 2 of the LBATA, "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.

Based on the above, a Labuan entity which fails to meet the substantive requirement will be taxed at 24%.

However, a Labuan entity carrying on a Labuan non-trading activity that is relating to the holding of investments in securities, stock, shares, loans, deposits or any other properties situated in Labuan by a Labuan entity on its own behalf, shall not be charged to tax under Section 9 of the LBATA.

Will a Labuan entity carrying on a Labuan non-trading activity that does not meet the substantive requirement be subject to tax at 24%?

IRBM's response:

Yes. Please refer to answer in paragraph 1(a) above.

- e) What about a Labuan entity carrying on an activity which is not listed in the Substance Regulations? Can we confirm that such entity will be subject to tax under the ITA, and not subject to 24% tax under the LBATA?

IRBM's response:

Yes. Your understanding is correct.

- f) Please confirm that if a company does not meet the substance requirements in one YA (e.g. YA 2022) but meets the substance requirements for the whole of the basis period for the following YA (YA 2023), such company would be eligible for the preferential 0% / 3% tax rates under the LBATA for YA2023. In other words, please confirm that failing to meet the substance requirements in any one particular YA will not "taint" other YAs.

IRBM's response:

Yes. Your understanding is correct.

- g) The substance requirements are still being revised and we are nearly at the end of 2019. Many companies would like to do their best to comply with substance requirements but may not be certain on what specific substance requirements apply to them. Will any concessions / concession period for compliance be granted?

IRBM's response:

This issue requires policy's decision.

2. New Section 3B - effective YA 2020 onwards

“Residence -

For the purposes of the double taxation arrangements effected under Section 132 of the Income Tax Act 1967-

(a) a Labuan entity carrying on a business or businesses is resident in Malaysia for the basis year for a year of assessment if at any time during that basis year the management and control of its business or of any one of its businesses, as the case may be, are exercised in Malaysia; and

(b) any other Labuan entity is resident in Malaysia for the basis year for a year of assessment if at any time during that basis year the management and control of its affairs are exercised in Malaysia by its directors, partners, trustees or other controlling authority.”

Comment:

a) A new Section 3B is introduced to determine the residence status of a Labuan entity specifically for the purpose of double taxation arrangement (DTA) effected under Section 132 of the ITA.

As the term “business” is defined only in the ITA but not the LBATA, please clarify whether in applying the New Section 3B for the purposes of DTA under Section 132 of the ITA, the meaning of “business” as defined in the ITA should be adopted to determine whether a business is carried on by a Labuan entity in Malaysia, OR whether the term “business” in the New Section 3B should be taken to mean “Labuan business activity” as defined in Section 2 of the LBATA.

IRBM’s response:

The term business should mean as Labuan business activity as defined under section 2 LBATA 1990.

- b) The LBATA provides the definition for “basis period” instead of “basis year”. Under the LBATA, “basis period” and “year of assessment” are defined as follows:

“Basis period”, in relation to a year of assessment, means the accounting period or periods ending in the calendar year immediately preceding that year of assessment;

“year of assessment” means calendar year.

Will the words “year” underlined in the above-mentioned new Section 3B be “period”? There is no provision of basis year in the LBATA except for the ITA as follows:

Section 20 of the ITA, a basis year is the calendar year coinciding with a year of assessment shall constitute the basis year for that year of assessment.

IRBM’s response:

We take note of this comment. The word “year” is supposed to be “period”.

3. New Section 13A – come into operation on the coming into operation of the Labuan Business Activity Tax (Amendment) Act 2019

“Tax due and payable –

(1) Where an assessment is made under Section 6, the tax payable under the assessment shall, on the service of the notice of assessment under Section 6B, be due and payable on the person assessed at the place specified in that notice whether or not that person appeals against the assessment.

(2) Where any tax due and payable under subsection (1) has not been paid within thirty days after the service of the notice, so much of the tax as is unpaid upon the expiration of that period shall without any further notice being served be increased by a sum equal to ten per

cent of the tax so unpaid, and that sum shall be recoverable as if it were tax due and payable under this Act.”

Comment:

A new Section 13A is inserted to provide that a tax payable arising from an assessment made under Section 6 of the LBATA is due and payable when the notice of assessment is served on a person. If the tax is not paid within thirty days after the service of the notice, the tax unpaid will be increased by 10% and that sum shall be recoverable as tax due and payable under the LBATA.

From our interpretation of the new Section 13A, tax payable is due within 30 days from the date of service of the notice. However, an existing Section 11 of the LBATA also requires tax to be paid in full on filing of the statutory declaration and return of its profits for a YA under Section 5 of the LBATA. It appears that these two provisions are contradicting.

We wish to clarify if the words “*an assessment made under Section 6*” in the new Section 13A refer to “assessment / additional assessment raised by the IRBM where it appears to the IRBM that no or no sufficient assessment has been made on a person chargeable to tax for any YA.

IRBM’s response:

Section 11, LBATA 1990 is to address the assessments raised by the DG on returns filed in by Labuan entities under subsection 6(1) LBATA 1990.

The new section 13A is to address on the assessment or additional assessments raised under subsection 6(2), LBATA 1990 which the assessment or additional assessments is raised by the DG due to no or no sufficient assessment has been made to that person.

Therefore, there is no contradiction between both sections.

B. OTHER MATTER RELATED TO LABUAN BUSINESS ACTIVITY TAX ACT 1990

1. Labuan Investment Committee (LIC) Pronouncement 2-2019 dated 11 December 2019 – Item no 2(i)

The item no 2 (i) of LIC Pronouncement 2-2019 specifies revisions to the Labuan substantial activity requirements as follows:

The LIC had agreed to most of the industry’s proposals which included:

- (a) Moderating the substantial activity requirement relating to first party captives, (re)insurers/(re)takaful operators, insurance brokers, groups of leasing companies; and*
- (b) Expanding the list of Labuan entities that will be subjected to substantial activity requirements which include those entities that:*
 - Undertake pure equity holding. This will require them to comply with management and control requirement as well as the minimum OPEX; and*
 - Carry on non-pure equity holding. This which require them to comply with the minimum FTE as well as OPEX.*

Comment:

We would like to request for clarification/definition on the following:

- moderating the substantial activity requirements (i.e. what are the criteria, terms and conditions, etc).
- pure equity holding and the corresponding (i) “management and control”
- non-pure equity holding

IRBM’s response:

These amendments will be detailed out in the amendment of the Regulations.

2. Labuan Investment Committee (LIC) Pronouncement 2-2019 dated 11 December 2019 – Item no 2(ii)

Item No. 2(ii) of the pronouncement concerns Labuan entities that are dormant, struck off, in winding up or under liquidation which are not required to comply with the substantial activity requirements if they are not deriving any source of income. It states that such entities will also be exempted from audit requirement for the purpose of fulfilling LBATA's requirements.

Please advise what documents would be required for filing under the LBATA for such entities for a YA. The filing requirement for the YA 2019 consisted of the following:

- Form LE1
- Formal notification letter
- Audited accounts/financial statements (if audited accounts/financial statements are not prepared, then management accounts are acceptable).

IRBM's response:

The same type of documents submitted in YA 2019 shall be submitted for YA2020 onwards.