

## ADDITIONAL MEANS FOR LABUAN OFFSHORE COMPANIES TO UTILISE THE MALAYSIAN TAX TREATIES

In his 2008 Budget speech, YAB DATO' SERI ABDULLAH BIN HJ AHMAD BADAWI PRIME MINISTER AND MINISTER OF FINANCE announced that:

"In the light of greater global competition, we need to ensure that Labuan remains competitive as an international offshore financial centre. Given that investors in Labuan undertake a wide range of financial services, a flexible tax regime is necessary. In this regard, the Government proposes that Labuan offshore companies be given the option to be taxed under the Income Tax Act 1967, in addition to the existing options."

In order to put the above into effect, the Section 3B of the Income Tax Act 1967 (ITA) has been amended to read as follows:

*"Notwithstanding section 3, tax shall not be charged under this Act on income in respect of an offshore business activity carried on by an offshore company other than an offshore company (in this Act referred to as "chargeable offshore company"), which has made an election under section 3a of the Labuan Offshore Business Activity Tax Act 1990"*

And a new Section 3A has been inserted in the Labuan Offshore Business Activity Tax Act 1990 (LOBATA) to read as follows:

- 3A. (1) *Notwithstanding any other provision of this Act, an offshore company carrying on an offshore business activity may make an irrevocable election in the prescribed form that any profit of the offshore company for any basis period for a year of assessment and subsequent basis period to be charged to tax in accordance with the Income Tax Act 1967 in respect of that offshore business activity.*
- (2) *The election referred to in subsection (1) shall be made and furnished to the Director General three months after the beginning of the basis period for a year of assessment:*

*Provided that for the basis period ending on a day in the year of assessment 2008, the election under this section may be made and furnished before 1 August 2008."*

The amendments would mean that the Labuan Offshore Company ("LOC") can elect to either:

1. Pay tax under the LOBATA at 3% of net audited profit or RM20,000 for offshore trading activities (offshore non-trading activities are tax exempt); or
2. Pay tax under the ITA at the prevailing tax rate (26% for year of assessment 2008) and be governed by ALL the provisions of the ITA and hence be able to

access fully ALL the Double Tax Treaties that Malaysia has signed with its 60 treaty partners.

The benefits of allowing the LOC to be taxed under ITA are:

1. Since all the income of the LOC is foreign sourced, this income when remitted to Labuan/Malaysia will be exempted from Malaysian Income Tax because of Paragraph 28 of Schedule 6 of the ITA. Schedule 6 of the ITA lists out all the **INCOME WHICH IS TAX EXEMPT.**

Paragraph 28 states that:

*“28. (1) Without prejudice to the provisions of section 130, income of any person, other than a resident company carrying on the business of banking, insurance or sea or air transport, for the basis year for a year of assessment derived from sources outside Malaysia and received in Malaysia.*

*(2) Paragraphs 5 and 6 of Schedule 7A shall apply mutatis mutandis to the amount of income derived and received by a resident company exempted under subparagraph (1).”*

Paragraph 28 ensures that not only the income of LOC are tax exempt, it also exempt the shareholders of the LOC from paying any income tax when they receive dividends from the LOC (provided by Para 6 & 7 of Schedule 7A).

Hence when a person set up a LOC and elects to be taxed under ITA, he would be able to maximize his return on investment.

2. Although at present a LOC should be able to derive Double Tax Agreements (DTA) benefits, 10 out of the 60 treaty partners have denied treaty benefits to LOC. They have excluded LOC which carry on “offshore business activities” from the treaty benefits.

Therefore, in order to ensure certainty in the application of DTA, a new section is introduced in LOBATA to ensure that LOCs which are taxed under ITA are having access to the full benefits of ALL the DTAs that Malaysia has signed with other countries.

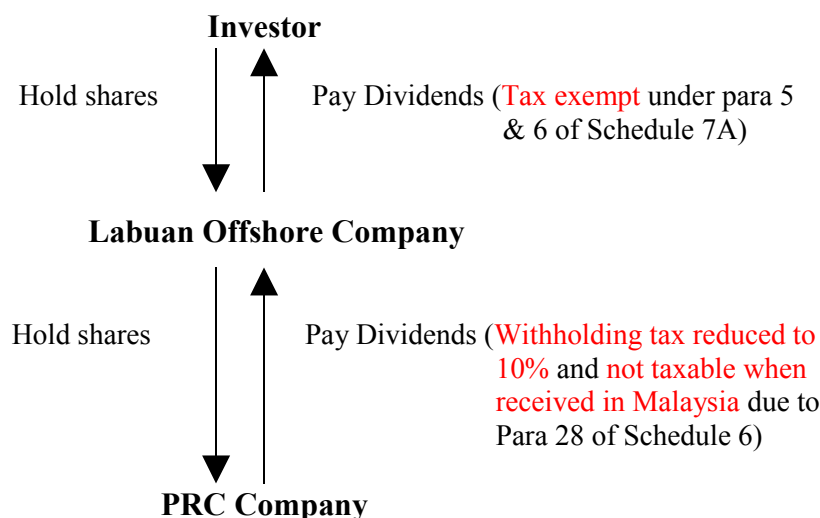
Under the DTA a person having income in one country but resident in the other country would be able to avoid paying double tax on the income he derives from one country but remitted to the other country.

The DTA also provides for the reduction of withholding tax on dividend, interest, royalties, rent and fees on technical services received. The reduction is usually from 20% to 10%, a saving of 10% on the amount paid.

An illustration of the above is as follows:

A LOC is set up to invest in the shares of a company in People’s Republic of China (PRC). The dividend received by the LOC would be subjected to 10% withholding tax in PRC instead of 20% because of the application of the provisions of DTA. This would mean that the LOC would be able to receive 90% of the dividend paid in PRC when received in Malaysia and this 90% is tax exempt in Malaysia because of Para 28 of

Schedule 6. Hence, the shareholder of the LOC would be able to receive this 90% as dividend without having to pay further tax because of Para 5 & 6 of Schedule 7A. There is no further tax on the dividend besides the 10% withholding tax in PRC.



However, a LOC electing to be taxed under ITA also has its drawbacks. They are:

1. The more stringent provisions of ITA would be applicable to these LOCs. Hence the LOCs are subjected to current year of assessment of income tax and would have to estimate its income a year in advance and start making advance tax payments based on these estimates. They will also be subjected to tax audit and tax investigations. All these are not applicable under LOBATA.
2. Under the DTA, there are also provisions for exchange of information between the treaty partners. Therefore, the element of confidentiality which the offshore jurisdictions are accustomed to would be eliminated.

## Conclusion

The amendment is definitely a great step forward in enhancing the competitiveness of Labuan as an IOFC. There are not many IOFCs in the world which have such a wide DTA network as Malaysia and hence Labuan. Allowing the LOCs to make use of all of Malaysian DTAs would definitely attract more investors, who are eager to obtain maximum returns for their investments, to use Labuan as their preferred offshore jurisdiction.

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