

Malaysia issues rules and regulations applicable to Labuan companies and transactions with Labuan companies

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Executive summary

On 31 December 2018, Malaysia issued rules and regulations which will impact Labuan¹ companies and any Malaysian resident transacting with Labuan companies.

This Alert summarizes the key aspects of the rules and regulations.

Detailed discussion

Requirements for employees and annual operating expenditure

The 2019 budget proposed that Labuan activities undertaken by Labuan companies will be subject to substantive conditions.² On 31 December 2018, Malaysia issued the regulations on the minimum number of full-time employees and amount of annual expenditure in Labuan, which are effective 1 January 2019.

Some of the minimum requirements for Labuan entities carrying on Labuan business activities are as follows:

Activity	Minimum number of full-time employees in Labuan	Minimum amount of annual operating expenditure in Labuan
Labuan insurer, Labuan reinsurer, Labuan takaful ³ operator or Labuan retakaful ⁴ operator	4	RM150,000 (US\$37,500)
Labuan International Commodity Trading Company	3	RM3,000,000 (US\$750,000)
Labuan bank, Labuan investment bank, Labuan Islamic bank and Labuan Islamic investment Bank	3	RM180,000 (US\$45,000)
Labuan trust company	3	RM120,000 (US\$30,000)
Labuan leasing company or Labuan Islamic leasing company	2	RM100,000 (US\$25,000)
Labuan fund manager	2	RM100,000 (US\$25,000)
Holding company	2	RM50,000 (US\$12,500)

The substance requirements for various other types of businesses were also listed in the regulations.

Labuan entities that do not meet the substance requirements would not be treated as carrying on a Labuan business activity and would be subject to tax under the *Income Tax Act 1967* (ITA) instead of being taxed under the *Labuan Business Activity Tax Act 1990* (LBATA). The tax rate under the ITA is generally 24% of taxable profits, as compared with 3% of audited profits under the LBATA.

At this stage, it is unclear whether any substance requirements will be imposed for Labuan entities carrying on activities other than those listed in the regulations.

Limitation of tax deductions on payments to Labuan companies

On 27 December 2018, as part of the *Finance Act 2018*, Malaysia enacted legislation whereby all payments made by Malaysian residents to Labuan companies would not be allowed as a tax deduction, subject to any rules that may be specified by the Minister of Finance.⁵

Subsequently on 31 December 2018, Malaysia issued the rules specifying that 33% of interest and lease rental payments and 97% of other payments made by Malaysian residents to Labuan companies will be disallowed as a tax deduction effective 1 January 2019.

Endnotes

1. Labuan, officially the Federal Territory of Labuan, is a federal territory of Malaysia.
2. See EY Global Tax Alert, [Malaysia releases 2019 Budget](#), dated 4 December 2018.
3. A type of Islamic insurance, a plan based on brotherhood, solidarity and mutual assistance to provide for mutual financial aid and assistance to the participants in need, by means of the participants mutually agreeing to contribute for that purpose.
4. The Islamic alternative to the reinsurance industry.
5. See EY Global Tax Alert, [Malaysia enacts 2019 Budget proposals](#), dated 3 January 2019.

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