

# International Tax Developments: Impact on Global Financial Centres

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23 September 2020

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# Today's agenda

- 1 Introduction
- 2 International Developments
- 3 Taxation System in Labuan





# International developments



# Base Erosion Profit Shifting (“BEPS”)

## 1. Digital business

- Action 1 – Address the challenges of the digital economy

## 2. Coherence actions

*Removing gaps, black holes*

- Action 2 – Hybrids
- Action 3 – CFCs
- Action 4 – Interest deductions
- Action 5 – Harmful tax practices

## 3. Substance actions

*Aligning taxing rights with value - adding activity*

- Action 6 – Prevent treaty abuse
- Action 7 – Permanent establishment
- Actions 8, 9 & 10 – Transfer pricing

## 4. Transparency actions

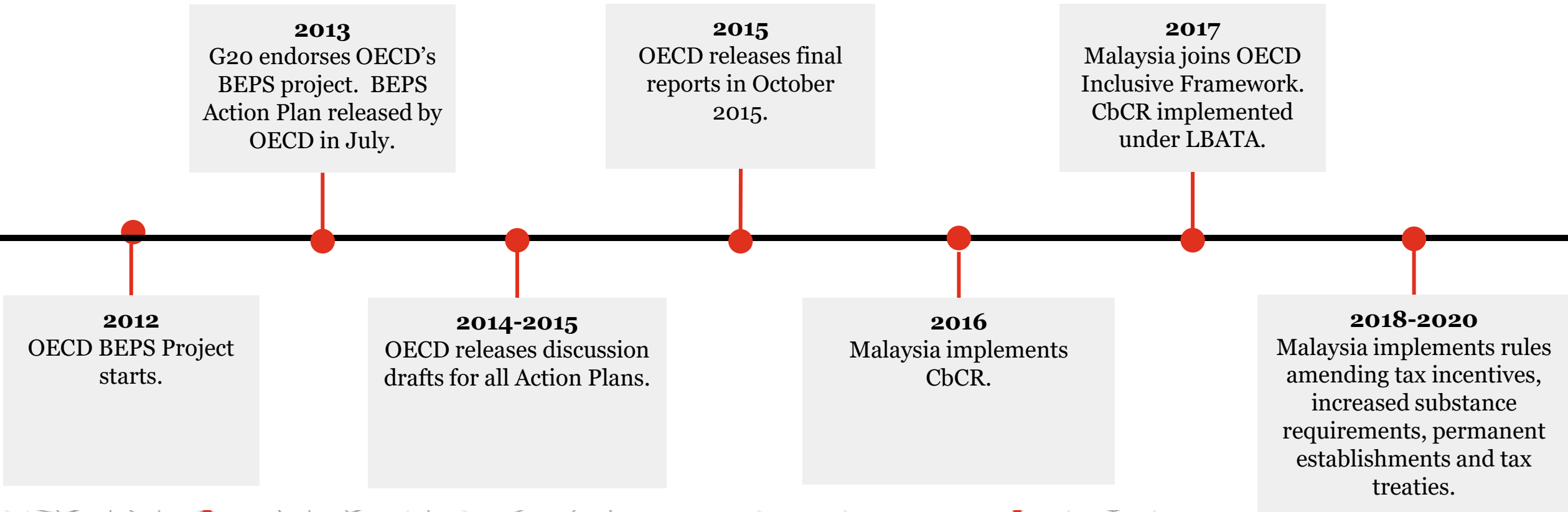
*Significant additional disclosure*

- Action 11 – Data on BEPS
- Action 12 – “Tax scheme” disclosure
- Action 13 – Transfer pricing disclosure

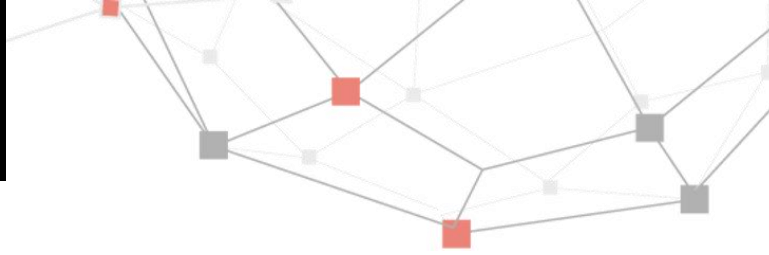
## 5. Other

- Action 14 – Dispute resolution
- Action 15 – Multilateral instrument

# BEPS Timeline



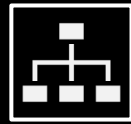
# Inclusive Framework Minimum Standards



## Implementing CbCR

Transparency measure to assist tax authorities assess high-level transfer pricing and other BEPS related risks. Annual report to be filed by MNCs using a standard template.

1



## Prevention of treaty abuse

Looks at the issue of treaty shopping and has come up with new treaty provisions to prevent the issue, including the use of a Multilateral Instrument to modify existing treaties.

3



## Countering harmful tax practices

Review of preferential tax regimes which are potentially harmful to the tax base of other countries. Measures include review of preferential tax regimes, exchange of information and substance requirements.

2



## Enhancing dispute resolution mechanism

Introducing measures to improve resolution of tax-related disputes between countries.

4



# Implementing CbCR



CbCR Rules implemented in December 2016

CbCR Rules for Labuan implemented in December 2017

Takes effect from 1 January 2017

Impacts MNEs with >RM3 billion in group consolidated revenue

Annual filing

Non-compliance penalties



# Countering Harmful Tax Practices



**Forum for Harmful Tax Practices (FHTP) will review tax incentives to ensure that profits are attributable to where the underlying economic activity and value creation (i.e. “substantial activity”) takes place. Additionally, the ring-fencing of preferential tax regimes is prohibited.**

**Malaysia enacted a number of legislative changes (i.e. enabling laws) by the due date of 31 December 2018.**

## Substantial activity

- **Employees:** There should be an adequate number of employees with the relevant skill-set in the country.
- **Investment outlay:** There should be an adequate level of investment or annual business expenditure.
- **Income from IP exploitation:** The “nexus” approach if used whereby the research and development (R&D) must be incurred and carried out in the country to qualify for an incentive.

## Ring-fencing

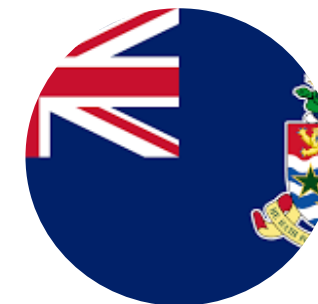
- **What is ring-fencing?:** This occurs when the preferential regime excludes resident taxpayers and/or prevent taxpayers enjoying the incentive from dealing with the domestic market.
- **Labuan Business Activity Tax Act:** The previous prohibition in transacting with domestic Malaysian entities or in MYR was considered “ring-fencing”. This has been amended.

# Countering Harmful Tax Practices

Substance requirements have been widely adopted by a number of financial centres such as Hong Kong, Bermuda, BVI, etc. and are generally in-line with the global requirements.



*Employees*  
*Level of investment*  
*Annual business spend*  
*Core business activity*  
*Decision making*  
*Documentation*  
*Physical office*



# Prevention of Treaty Abuse



**Multilateral Instrument (MLI) concluded in November 2016.**  
**Adoption of the MLI will allow jurisdictions to amend bilateral tax treaties.**

**Malaysia signed the MLI in January 2018 and ratified it in July 2020.**  
**73 tax treaties entered into by Malaysia will be covered.**

## Minimum standards

- **Purpose of agreement:** Include statement that treaty is not meant for tax evasion or avoidance.
- **Preventing treaty abuse:** Include general anti-abuse provision, i.e. Principal Purpose Test.
- **Mutual Agreement Procedure (MAP):** Update MAP in treaties to allow taxpayers to appeal to competent authorities in either country, establish a 3-year timeline for MAP applications, etc.

## Optional Provisions

- **Transparent entities:** Cover the instances when treaty benefits will be granted to fiscally transparent entities.
- **Avoidance of PE:** Includes provisions to prevent the artificial avoidance of PEs via the use of commissionaire arrangements, or, fragmentation, as well on the definition of person closely related to the enterprise.
- **Corresponding adjustment:** Provides for a corresponding adjustment to be made by a country to the profits of a resident entity to mitigate double taxation.

# Taxation System in Labuan



# Taxation System in Labuan



## General Tax Regime

- Labuan Business Activity Tax Act, 1990 (“LBATA”)
- “Labuan business activities” 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*



## Labuan Business Activities

- "Labuan trading activity" includes banking, insurance, trading, management, licensing, shipping operations or any other activity which is not a Labuan non-trading activity
- "Labuan non-trading activity" means an activity 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



# Taxation System in Labuan



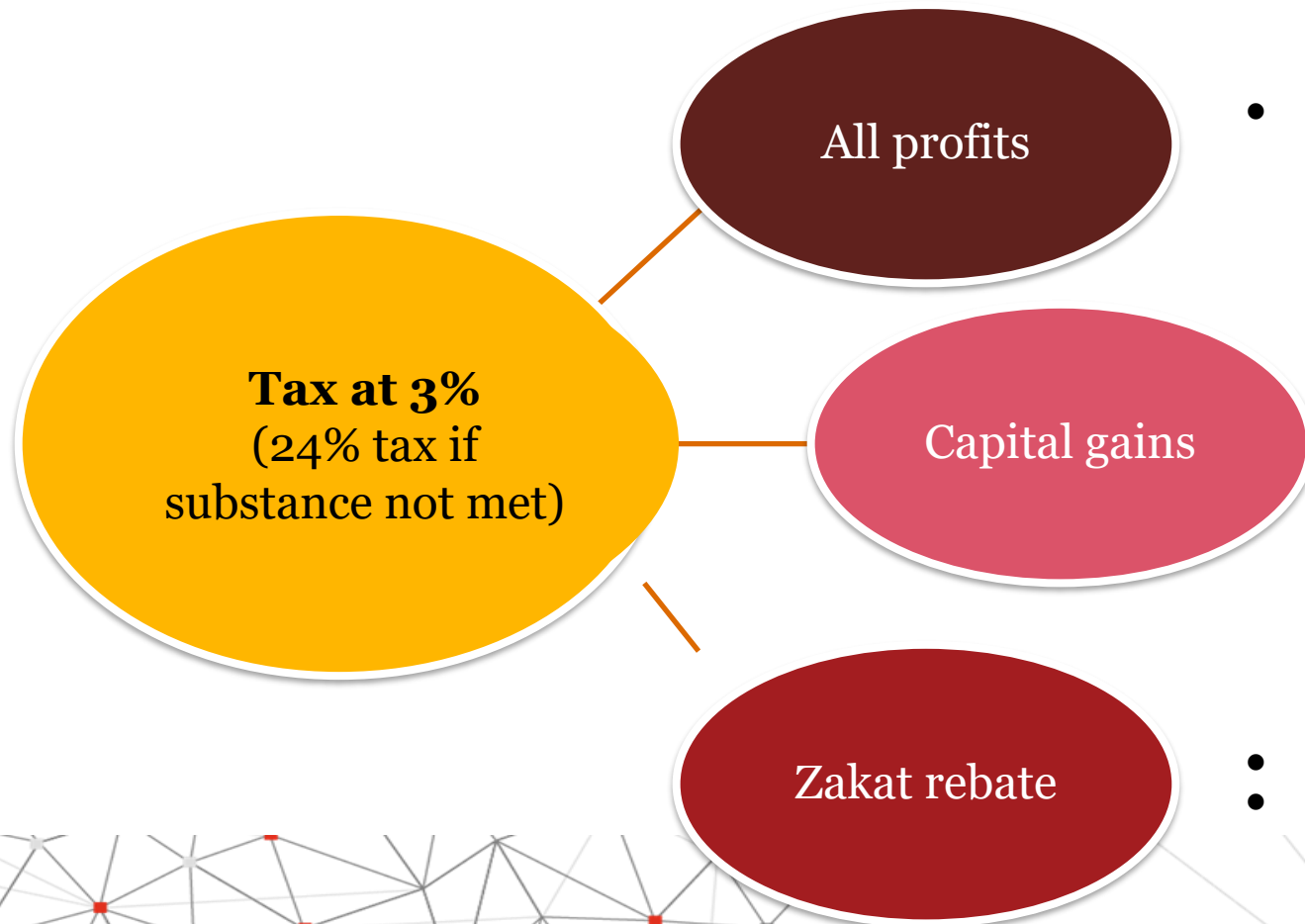
Type of business activity	Tax treatment
<b>Labuan Non-Trading</b> Includes holding of investments in securities, stock, shares, loans, deposits and immovable properties by a Labuan entity on its own behalf.	Not subject to tax*
<b>Labuan Trading</b> Leasing, banking, insurance, trading, management, licensing or any other activity which is not a Labuan non-trading activity.	3% of net profits per audited accounts*
<b>Undertakes both Labuan Trading and Labuan Non-Trading</b> Deemed to be Labuan trading activity	
<b>Non-Labuan business activities</b>	Taxed under domestic tax act at prevailing tax rate (currently at 24%)



\* Subject to substance requirements

# Taxation System in Labuan

## Labuan Business Activity Tax Act 1990



- Net profits per audited accounts

- Capital gains are reflected as part of net profits
- Subject to tax at 3%
- Real Property Gains Tax would similarly apply to chargeable gains on the disposal of real property situated in Malaysia

- Rebate to be granted for any *zakat* paid for a year of assessment
- Excess *zakat* paid not refundable



### Stamp duty exemption

- Labuan companies are exempted from stamp duty on all instruments which are made in connection with Labuan business activities.
- The sale of shares in Labuan companies and the Memorandum and Articles of Association of a Labuan company are also exempted from stamp duty.

### Personal tax exemption

- **Director fees** received by a non-Malaysian citizen exempted
- 50% exemption of **employment income** received by non-Malaysian citizen in a managerial capacity with a Labuan entity
- 50% exemption of **gross housing allowance and gross Labuan Territory allowance** received by a Malaysian citizen employed by a Labuan entity

### Indirect tax exemption

- Labuan has been categorised as Designated Area and is not subject to sales and service tax.
- Services from the designated area to other places in Malaysia (or vice versa) or services imported into the designated area will be subject to service tax.

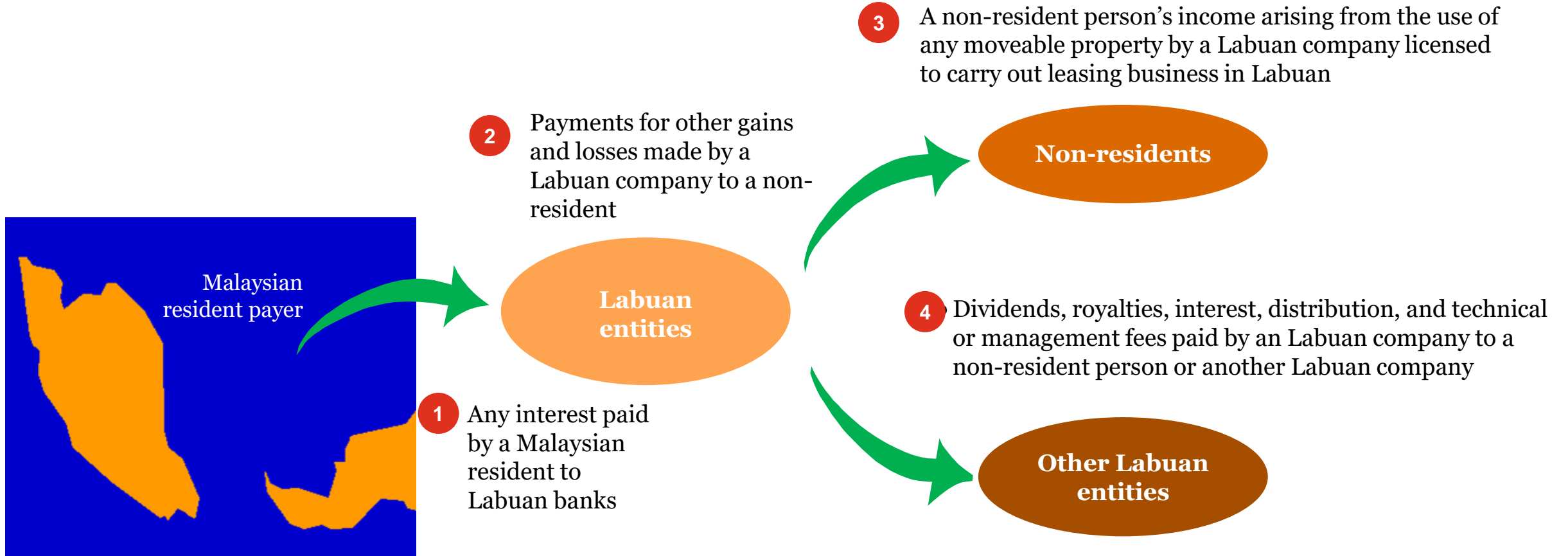


# Taxation System in Labuan

## Withholding Taxes



Withholding tax exemptions exists so that generally, payments from a Labuan company should not attract Malaysian withholding tax.



# Taxation System in Labuan

Labuan International Commodity Trading Company (LITC) under Global Incentives for Trading (GIFT) Programme



The GIFT programme is a framework of incentives for traders undertaking trading of physical products and related derivatives by using Malaysia as their international trading base to undertake international commodity trading business via Labuan IBFC.

The specified trading of physical products and related derivatives are as follows:

- Petroleum and petroleum-related products including liquefied natural gas;
- Minerals;
- Agriculture products;
- Refined raw materials;
- Chemicals;
- Base minerals; and
- Coal

**3%** on chargeable profits as reflected in the audited accounts

## Substance Requirements

*2 full time employees*

*Minimum opex of RM3 million in Malaysia (including minimum of RM100k in Labuan)*

## Criteria

*Minimum annual turnover of USD50 million*

*Minimum annual business spending of RM3 million payable to Malaysian residents; and*

*To employ at least 3 professional traders*



# Taxation System in Labuan

## Substance Requirement



### Labuan substance requirements



Adequate number of full time employees in Labuan



Adequate amount of annual operating expenditure in Labuan

For example:-

- **Labuan Fund Manager- 2 employees and expenditure of RM100,000**
- **Holding company - 1 employee and RM20,000 expenditure**



# Taxation System in Labuan

## Tax Filing



A Labuan entity must file the relevant forms, which normally consist of:

- a return of its profits (Form LE 1)
- AND
- a statutory declaration (Form LE4) for Labuan trading activities;
- OR
- a statutory declaration (Form LE5) for Labuan non-trading activities

for the year of assessment within a period of 3 months (or any extended period as may be allowed by the Director General) from the commencement of a year of assessment, in the prescribed forms to the Director General.

*Note: Since year of assessment is defined to be calendar year, this will mean that filing deadline is 31 March each year. Extension of time is granted till end of October for YA 2020.*



# Taxation System in Labuan

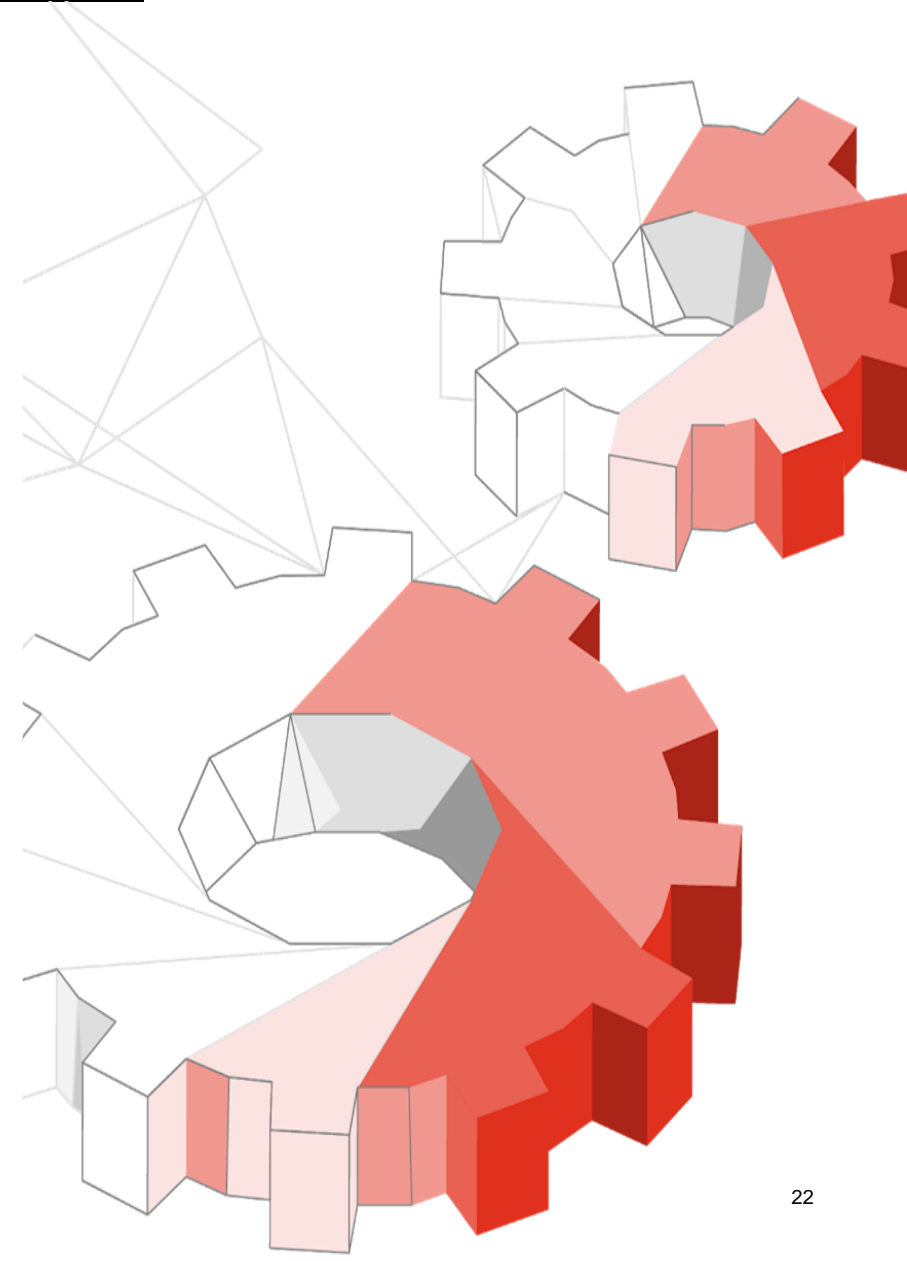
## Tax Residency

### Certificate of tax residency

- The current practice of the tax authorities in Labuan is to grant tax residency certificates for a period of 1 year, specific to the country which has requested for the tax residence confirmation of the Labuan Company
- Currently, the criteria to meet the condition that "management and control is exercised in Malaysia" is as follows:
  - Board of directors meeting held in Malaysia
  - The decisions made in the meeting has to show that "control" is being exercised; (i.e. policy making decisions)
  - Bank account in Labuan
- "Resident" is defined as "... (b) in relation to any other person, a person who has **established a place of business, and is operating, in Malaysia**"



# QUESTIONS?





# Thank you







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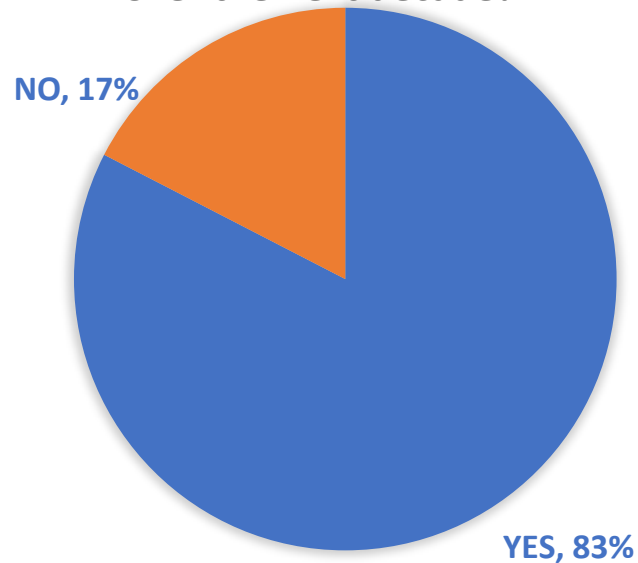
## POST WEBINAR REPORT



# International Tax Developments: Impact on Global Financial Centres

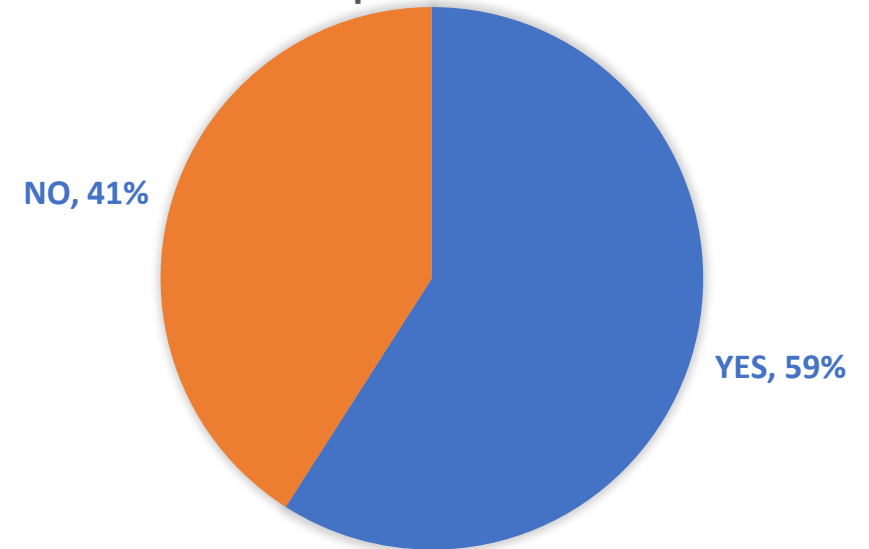
## POLLING RESULT

Do you believe that the global tax landscape will evolve into what is seen as a more equitable system over the next decade?



Note: Data collected based on 132 participants who participated in the polling

Do you think that Labuan IBFC's specified substance approach and cost efficiency will eventually enhance its competitiveness?



Note: Data collected based on 127 participants who participated in the polling