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OECD WHITE LISTS MALAYSIA AFTER LABUAN LAWS ARE AMENDED

By Peter Searle, Managing Director of EC Trust (Labuan) Bhd.

On 18 February, 2010, Malaysia was "white listed' by the Organisation for Economic Cooperation and Development (OECD). The reclassification of Malaysia (including Labuan) as “white listed”, means Malaysia is a category 1 jurisdiction which has "substantially implemented the internationally agreed tax standard".

In many ways, Malaysia’s “white listing” by the OECD was relatively straightforward, as Malaysia has one of the widest double tax treaty networks in the world, having Double Taxation Agreements (“DTAs”), with over 70 countries, and in particular, with British Commonwealth, Arab, European, Middle East, and Asia countries.

Malaysia's recent Protocols to more than 12 of its DTAs, together with the enactment of new legislation on 11 February, 2010, updates, revises and strengthens Labuan’s capabilities as an International Financial Centre, at the same time as enabling it to comply with OECD disclosure requirements.

This paper reviews some of the major features of the new legislation, which provides for foundations, companies limited by guarantee, protected cell companies, limited liability partnerships, “no par value shares” of companies, abolition of the rule against perpetuities for trusts, as well as information sharing provisions in accordance with the internationally agreed tax standard.

Malaysia well and truly took the opportunity afforded by the OECD, to substantially rewrite its entire legislative regime for the Federal Territory of Labuan.

MALAYSIA’S ENGLISH COMMON LAW BACKGROUND

Malaysia is a Federation of States which were all formerly British colonies prior to the formation of Malaya in 1957, and of Malaysia in 1963. Most of Malaysia’s laws are much the same as other British Commonwealth countries or States thereof.

Malaysia only abolished appeals to the Privy Council in 1985 (Australia did so in 1974). British Commonwealth lawyers and businessmen have no difficulty understanding the common law of Malaysia, since it is practically identical to the common law of England. In all Malaysian States, English is either the official language, or one of two official languages, together with the national language of Bahasa Malaysia.

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English is the official language for the High Court in Sabah and Sarawak, which has jurisdiction over the Federal Territory of Labuan, and the proceedings there are conducted in English. Thus, Court cases involving Labuan companies, are conducted in the High Court of Sabah and Sarawak, in English, under basically the same Court Rules as the High Court in England.

Even if there is an appeal to the Court of Appeal and/or to the Federal Court of Malaysia, the language of the Court is still English, because the proceeding originated in the High Court of Sabah and Sarawak. This may seem a small matter, but is very comforting to expatriates who are familiar with English and whose worst nightmare would be to conduct a Court case in Spanish, Mandarin or Swahili. Having said that, Court cases involving Labuan companies are a rarity, and the real comfort is in being able to understand, and act on, the legislation, with reasonable certainty.

THE TAXATION OF LABUAN COMPANIES AND TRUSTS

The Labuan Business Activity Tax Act ("LBATA") retains and extends the favourable taxation regime for Labuan companies and trusts.
All Labuan non-trading activities carried on with non-residents in a currency other than Malaysian, remain tax free (Malaysian residents are defined to be Malaysian citizens or permanent residents of Malaysia).
The maximum taxation rate on Labuan trading activities carried on with non-residents in a currency other than Malaysian, remains at 3% of audited net profits or a maximum of RM20,000 (about 4,000 pounds sterling), at the election of the Labuan company.
Labuan companies are now entitled to carry on shipping operations, and Labuan's favourable taxation regime on trading activities is extended to shipping operations carried out in Labuan or outside Malaysia.
Labuan companies remain free of withholding taxes and stamp duty in Malaysia, and are not subject to indirect taxes in Malaysia.

MALAYSIA'S NEW LAWS CONCERNING LABUAN ENTITIES

The amending legislation now enacted has, in fact, been eight years in the drafting. Labuan's previous legislative regime was enacted in 1990 and was only the subject of minor amendments until 2010. The last edition of the Labuan legislation was published in 2005 in one volume of only 570 pages comprising all nine Acts, Regulations and Forms. LBATA formed only 12 of those pages. We have been told not to expect substantial legislative amendments after these ones, for at least ten years. Thus, we have certainty, predictability, stability and the rule of law, in Labuan, Malaysia.

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The new Malaysian Laws and Amendment Acts and the updated OECD progress report dated 25th March, 2010, can be found in full text here - http://www.ectrustco.com/documents/legislation.asp

Malaysia has enacted modern company concepts in the form of the Labuan Companies Act ("LCA") and the Labuan Financial Services and Securities Act ("LFSSA"). The new laws make it easier for Labuan companies –

to raise capital by issuing no par value shares;
to make offers or invitations to the public;
to operate as private funds without Labuan Financial Services Authority approval;
to restructure their capital;
to reduce their capital without Court approval;
to finance the aquisition of their own shares,
to purchase their own shares;
to issue fractions of shares;
to carry on business with Malaysian residents; and
to dissolve the company without Court approval or the appointment of a liquidator.

Key features of the amendments, from a planning or improvement point of view, are as follows –

NO PAR VALUE SHARES – CAPITAL RAISING MADE EASY

The old company law concepts contained in the former provisions concerning share premium accounts, the issue of shares at a discount, and a specified number of "authorized shares", have all been repealed. They are replaced by the modern concept of "no par value shares" (s.46 of the LCA). This means that the company no longer issues shares at "par value", and no longer issues shares at a premium or at a discount, as it would have previously.

Under the new laws, the Labuan company may issue shares at a new share price per share issue, having regard to the directors' own valuation of the net asset value of the company. Each new capital raising may simply be a new share issue at a price determined by the directors, probably based on prevailing net asset value and market forces at the time. As a consequence, the legislative restrictions on the use of share premium accounts and on the issue of shares at a discount, are no longer applicable and have been repealed.

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OFFERS OR INVITATIONS OF SECURITIES AND DEBENTURES

Capital raisings by way of offers or invitations of securities and debentures without the Authority's approval, are also less restrictive. The threshold number of persons to whom an offer of securities or debentures may be made without the Authority's approval, has been increased from twenty to fifty (s. 8(5) of the LFSSA).

If the first time investment of each initial debenture holder is RM250,000 or more (about 50,000 pounds sterling), there is no limit to the number of persons to whom the offer or invitation may be made, provided "they are in possession of sufficient information to be able to make a reasonable evaluation of the offer or invitation" (s. 8(5) of the LFSSA).

PRIVATE FUNDS NO LONGER REQUIRE APPROVAL

Private Funds are now allowed to carry on business without obtaining the approval from the Authority – they merely give notice in writing to the Authority setting out the details of the scope and nature of its business (s.28 of the LFSSA).

Private Funds must lodge an information memorandum or other offering document with the Authority through a licensed entity such as a trust company (s.29 of the LFSSA). The licensed entity needs to be satisfied that the information memorandum refers to a private fund as defined in the Act; and that there is no element of fraud involved in the establishment of the private fund.

The information memorandum is deemed to be a prospectus so far as it may contain false or misleading information (s.29 of the LFSSA).

COMPANIES LIMITED BY GUARANTEE AND UNLIMITED COMPANIES

The Labuan Companies Act now expressly provides that a Labuan company may be a company limited by shares; a company limited by guarantee; or an unlimited company (section 14). The Act had previously only expressly provided for companies limited by shares, and companies limited by guarantee were incorporated at the indulgence of the Labuan Authority waiving that requirement.

One advantage of a company limited by guarantee is that, not having any shareholders, it may not satisfy the requirements of controlled foreign corporation ("CFC") regimes which stipulate a specific shareholding threshold before the foreign company is defined as a CFC.

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FOUNDATIONS

The Labuan Foundations Act 2010 expressly allows for the formation and regulation of Foundations. Foundations are commonly used for charitable purposes. Labuan Foundations are incorporated, and may be formed for non-charitable purposes, and may not have beneficiaries. Such purpose Foundations may fall outside CFC tests which involve a shareholding threshold, and may fall outside Transferor Trust provisions, as there are no beneficiaries, which are usually a requirement for trust categorization.

LABUAN TRUSTS

The rule against perpetuities has been abolished so that Labuan trusts can continue indefinitely.

The Labuan Special Trust has been introduced along the lines of the VISTA trust in BVI, which absolves the trustee from any need to interfere in the affairs of a Labuan company in which the trust has shares.

Malaysian citizens can now be settlors or beneficiaries of Labuan trusts as long as the trust property is not in Malaysia. However, such a trust can own a Labuan company which does own property in Malaysia.

PROTECTED CELL COMPANIES AND CAPTIVE INSURANCE

The LCA now allows a Labuan company to be incorporated as a protected cell company, and allows an existing Labuan company to be converted into a protected cell company, provided it will operate for the sole purpose of –

(a) conducting Labuan insurance business or Labuan captive insurance business; or
(b) conducting the business of a mutual fund (s. 130N.).

A Protected Cell Company ("PCC") has the following features –

it's name includes Protected Cell Company or "PCC";
each cell shall have its own distinct name or designation;
cell assets comprise the assets of the PCC held within or on behalf of the protected cell of the company;
cell assets held for each separate cell are kept separate from cell assets held for other cells; and
the PCC maintains separate records for cell assets and for each separate cell.

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The rights of creditors of a PCC are limited to the assets of the relevant cell assets. No party shall use any cell assets attributable to any cell of the PCC to satisfy a liability not attributable to that cell (s 130W of the LCA).

The definition of "Labuan captive insurance business" means Labuan insurance business where the insured is a "related corporation or associate corporation". Section 101(2) provides that where 15% or more of the voting shares of a corporation are held by another corporation, the first corporation is deemed to be an "associate corporation". Thus, captive insurance companies are now able to be utilized in many more corporate circumstances than had previously been the case.

These amendments should ensure a healthy future for Labuan's rapidly expanding captive insurance industry.

LABUAN INSURANCE BROKERS AND FINANCIAL PLANNERS

Historically, insurance brokers had been permitted to carry on a de facto financial planning business but the limits of one and the distinction with the other has always been vague, both in Labuan and in most other jurisdictions. This has led to uncertainty both in the law and its application, which has never been a good thing in any jurisdiction which professes to operate by the rule of Law.

Labuan's new laws deal directly with this age old problem by deciding the issue emphatically in favour of licensed insurance brokers being financial planners. Thus, the new definition of insurance broker has been extended to expressly include a person who is licensed to –
"analyse the financial circumstances of another person and provides a p[lan to meet that other person's financial needs and objectives…."

INFORMATION SHARING

In conformity with the new OECD Model Article 26, which is operative in more than 12 of Malaysia's DTAs pursuant to recent Protocols to those DTAs, (Article 28 in the case of the Malaysia/UK DTA), sub-section 22(1) of LBATA has been amended to empower the Director General to
"require any person to furnish such information as may be required by him or for compliance with any double taxation arrangements entered into by the Government of Malaysia."

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We are unaware of any Malaysian DTA which **requires** the Director General or the Government of Malaysia to call for or obtain information **for compliance** with the DTA. Malaysia's DTA partners may **request** for information. To date, the Malaysian authorities have indicated that they will not permit fishing expeditions.

New sub-section 22A(1) of LBATA provides that section 20, (which states that information *"shall be treated as confidential and shall not be communicated or disclosed to any person except for the purpose of this Act"),*

"*shall not prevent –*
(a) the disclosure of information in respect of double taxation agreements to a duly authorised servant or agent of the Government with whom arrangements have been made where such information is required to be disclosed under such arrangements; and
(b) the disclosure of information upon a request from a tax authority of any Government of any territory outside Malaysia."

We are unaware of any Malaysian DTA or Protocol which **requires** any servant or agent of the Government of Malaysia to disclose information under such arrangements.

Thus, in Malaysia, as in most other jurisdictions which have complied with the internationally agreed tax standard, the issue becomes one of Government policy concerning the treatment of requests for information from treaty partners.

To date, the Malaysian authorities have not issued Guidelines concerning the type of request under which information may be disclosed. Malaysian Government policy has always been to ensure information sharing powers were not used for fishing expeditions, and that there was a *prima facie* case made out by the Government making the request. It is unlikely that the Malaysian authorities will permit automatic information sharing, as is common among many EU countries. To the contrary, the Malaysian authorities are more likely to adopt more stringent requirements upon the tax authority making the request, such as those which Singapore has enacted.

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PETER SEARLE is a Trust Officer and Barrister who has been a tax and trust law specialist for over 30 years. He completed an Honours degree in Law, including International Law, at the Australian National University in 1979 and was admitted as a Solicitor and Barrister in the Supreme Court of Victoria in 1982.

He completed a Masters of Law in Taxation at Monash University in 1985. In 1986 Peter was called to the Victorian Bar and for the next sixteen years was an Australian barrister appearing in taxation, commercial, equity, bankruptcy, insurance and criminal law cases in the High Court of Australia, the Federal Court of Australia and the State Supreme Courts.

Peter is a prolific writer and speaker at numerous international conferences. Peter moved to the Federal Territory of Labuan, Malaysia in 2002, where he is Managing Director and Trust Officer of EC Trust (Labuan) Bhd (www.ectrustco.com)

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