

TRANSFORMING BUSINESS WITH NEW LEGISLATION

Labuan International Business and Financial Centre

Even as change has been force-fed on many governments and jurisdictions in the aftermath of the economic slowdown, Labuan International Business and Financial Centre has been independently implementing changes on a stage-by-stage basis.

The latest move was the passage and finally the enactment on 11 February 2010 of 4 new laws with 4 others radically amended to transform the business scene in the jurisdiction.

Labuan IBFC, relatively unknown compared to the Caymans or British Virgin Islands, is however, regarded by those who do know it as a safe, and attractive jurisdiction robustly regulated by the newly re-named Labuan Financial Services Authority (Labuan FSA, previously Labuan Offshore Financial Services Authority or LOFSA). Labuan ranks alongside other domiciles on the OECD 'white list' of locations that have signed exchange of tax information agreements with at least 12 of its treaty partners.

The jurisdiction is already home to more than 7,400 companies; 60 banks; 150 insurance entities; 23 Trust companies and scores of service providers including lawyers, accountants, tax consultants, audit and secretarial staff.

Labuan's strategic location in the heart of South East Asia, off the north west coast of Sabah, Malaysia, has many benefits especially with the current 'flight to quality' plus the continuing economic boom in China and India encourage investments to flow eastwards.

Changes in the way the jurisdiction operates began in January 2008 when it re-named and re-positioned itself as Labuan IBFC in keeping with its goal to be the premier IBFC in the Asia Pacific region. In line with this objective, Labuan identified five key areas of focus, namely, holding companies, Islamic finance, insurance including captive insurance, private wealth management and fund management. A dedicated unit to market and promote Labuan was set up, followed since then by the legislative changes.

The laws in force comprise the new Labuan Islamic Financial Services and Securities Act 2010; Labuan Financial Services and Securities Act 2010; Labuan Foundations Act 2010; Labuan Limited Partnerships and Limited Liability Partnerships Act 2010 while the four amended Acts are the Labuan Companies Act 1990; Labuan Business Activity Tax Act 1990; Labuan Financial Services Authority Act 1996 and Labuan Trusts Act 1996.

Labuan Islamic Financial Services and Securities Act

Since Labuan took on the mantle of 'first mover' in Islamic finance starting with the establishment of the first Islamic bank in 1998, it has been steadily enhancing its reputation in this specialist and fast growing area. This decade has seen it issue a stream of financing, from the first global sukuk in 2002 to one of the largest aircraft financing transactions using an Ijara leasing structure and the latest USD1.5 billion Islamic bonds by Petroliaam Nasional (Petronas), Malaysia's national petroleum company.

The ground-breaking Labuan Islamic Financial Securities and Services Act 2009 (LIFSSA) is probably the first of its kind in the world, an 'omnibus' piece of legislation that clarifies and streamlines all the rules and guidelines issued over the years on Islamic finance.

In addition, LIFSSA addresses Shariah compliance in trusts and foundations as well as the establishment of the Shariah Supervisory Council. Labuan has been at the forefront in the drive towards internationally recognized and accepted Shariah standards, setting the example with its own Shariah Supervisory Council that comprises globally acclaimed Islamic scholars.

Labuan Trusts Act and Labuan Foundations Act

Amendments to the Labuan Trusts Act 1996 (LTA) and the introduction of the Foundations Act 2010 (LFA) are expected to give Labuan IBFC an edge as a modern offshore centre for wealth planning. This is fortuitous as industry experts forecast that Asia's share of the rich community is poised to grow annually by 12 to 15 per cent until 2013, making the region the largest source of high net worth investors, after the U.S.A.

The Labuan Trusts Act (LTA) has taken the best from the best, drawing features as well as improving upon those from jurisdictions such as the British Virgin Islands, the Cayman Islands, Guernsey, Jersey, Dubai and Mauritius.

One of the most attractive features in the LTA is the Labuan Special Trust which is modeled after the British Virgin Islands 'VISTA' Trust. A central provision of the Labuan Special Trust is that it can be used to hold shares in a Labuan Holding Company, which in turn may own assets such as cash, real estate, art securities, businesses, insurance policies etc.

These shares, which are 'on trust to retain', may be held indefinitely. Interestingly, as the management of the company is the responsibility of the directors only, there is a distinct separation between the custodian role of trustees and their fiduciary role of investment which is handled by the company directors. This provision meets the contemporary needs of High Net Worth Individuals or families who recognise that members of the next, younger and better educated generation may wish to attempt more sophisticated investment options; yet by separating the roles indicated above, the founders of wealth (the older generation) can still keep the original legacy intact. This feature is one of the most sought after in Trust Law.

Other advantages under the Labuan Special Trust include: settlors having wide reserved powers that are reasonable but do not compromise the trust; protection of a trust against a foreign law claim; variety of trust types including one unique to Labuan, "the advancement of human rights and fundamental freedom"; duration of trusts includes 'in perpetuity'; and clear guidelines relating to beneficiaries and the information they will receive.

The Foundations Act will be an added incentive for the wealthy to set up in Labuan IBFC as these foundations will operate in a similar way to trusts and should appeal to individuals or families from Civil Law countries like Indonesia, Thailand, the Philippines and the Middle East.

In addition, making a Trust or a Foundation into an Islamic form is easily done as long as the structure is formed according to Shariah principles.

Other legislative high points

Under the new Labuan legislative framework, one amalgamates the previous individual Acts on banking, insurance, securities, trust companies etc. and is known as the Labuan Financial Services and Securities Act 2010 (LFSSA). This Act introduced new entities such as limited liability partnerships and protected cell companies while managed trust companies are also provided for.

Another new Act is the Limited Partnerships and Limited Liability Partnerships Act 2010 (LLPLPA) which identifies the types, roles and duties of partners including the permission for an LP to convert to an LLP. The introduction in Labuan of these commonly used partnerships by professionals enhances the jurisdiction's appeal.

One new product that should prove exciting is the inclusion of shipping operations as a Labuan business activity under the revised Labuan Business Activity Tax Act 1990 (LBATA) provided such operations are carried out in Labuan and outside of Malaysia. There is also provision for advance tax rulings which will be a boon for potential investors who seek certainty and clarity in their tax obligations.

As for the governing law, now amended as the Labuan Companies Act 1990 (LCA), Labuan companies are permitted to own controlling stakes in Malaysian companies; a Labuan company that deals with residents merely informs Labuan FSA about the transaction; no par value shares have been introduced together with provisions on the amalgamation of companies.

Recent liberalisation moves

In keeping with the Malaysian Government's move to liberalise the financial sector, Labuan Holding Companies were permitted from 1 June 2009 to set up a regional headquarters or management office in Kuala Lumpur, the nation's capital. As of 19 January 2010, this was extended to Labuan banks which were given the go-ahead to co-locate one or more offices anywhere in Malaysia but no retail banking activities are allowed.

This flexibility of locating in Kuala Lumpur (for Labuan Holding Companies) or other Malaysian cities (applicable to Labuan banks) combined with the lower costs of operation, which are about 40% cheaper than Singapore or Hong Kong, offer investors the best of both worlds.

Further liberalisation moves by the Malaysian Government for the insurance sector expected in 2011 will enhance and accelerate Labuan IBFC's growth.

Tax and the issue of substance

Legitimate businesses in Labuan IBFC enjoy a competitive edge as the jurisdiction is a low tax territory. The tax benefits are enshrined in the Labuan Business Activity Tax Act 1990 (LBATA) where offshore non-trading companies are not subject to tax; and companies conducting trading activities can opt yearly to pay 3% of net audited profit or a flat rate of MYR20,000 (approximately USD5,800 at USD1=MYR3.5). Alternatively, a Labuan company can make an irrevocable election to pay tax under the Malaysian Income Tax Act 1967 (ITA) at 25%, thereby gaining more secure access to all of Malaysia's 69 DTAs and enjoy exemption on foreign sourced income as well as capital gains.

Under the new world order of the OECD with its Exchange of Information standard, secrecy will not be tolerated while transparency and the need for 'substance' will be predominant. Labuan IBFC has always stuck by its principle that only real, legitimate businesses are welcome. This means that the investor has to abide by the following criteria of substance as seen from the Malaysian tax perspective:

- Effective place of management should be the country of residence. This means business activities such as management or commercial decisions are actually conducted in the jurisdiction, as are the main activities of the entity.
- Accounts should be maintained in the jurisdiction
- While the legal entity's registered office could be located in Labuan, it must not also be regarded as a tax resident in another country.
- All relevant requirements pertaining to submission of tax returns should be complied with when due.
- Shareholding needs to be adequate based on the functions performed, taking into account the assets used and the risks assumed.

For more information on Labuan IBFC, please visit www.LabuanIBFC.my