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Updates to the Guidelines on the Establishment and Operations of Labuan Leasing Business

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Introduction

The Guidelines on the Establishment and Operations of Labuan Leasing Business which were published on 1 August 2013, have recently been updated and the revised Guidelines ("**Revised Guidelines**") were published by the Labuan Financial Services Authority ("**Labuan FSA**") on 29 December 2017. The Revised Guidelines (with certain exceptions, to be discussed below) became effective on 1 January 2018.

Overview of the Key Changes

Substance Requirement

The main amendment introduced in the Revised Guidelines is the new substance requirement, which requires Labuan leasing companies to establish substantial activities and perform strategic functions in Labuan ("**Substance Requirement**"). Factors considered in determining compliance with the Substance Requirement, include, but are not limited to:

(a) Physical presence: There is a requirement for the Labuan leasing company to maintain an operational office in Labuan, which must be appropriately furnished with office equipment to be used for business purposes only.

(b) Key leasing activities: The core income generating activities such as the identification and acquisition of assets to be leased, negotiation of leasing terms, solicitation of lessees, management of leased assets and financing of the acquisition of assets are expected to be carried out from the Labuan office.

(c) Employment: The Labuan leasing company is required to employ an adequate number of full-time employees with the necessary qualifications, skills or experiences in the relevant fields related to the leasing business.

(d) Annual business spending: The Labuan leasing company is expected to incur business spending in Malaysia (including Labuan) in undertaking the Labuan leasing business.

Unlike all the other requirements of the Revised Guidelines, the Substance Requirement will come into force on 1 January 2019, providing for a one-year grace period for Labuan leasing companies to comply with this requirement.

Other Requirements

The other more pertinent changes introduced under the Revised Guidelines include, amongst others:

(a) Licensing Fees

Annual licence fee of MYR 60,000 and subsequent approved leasing transaction fee of MYR 20,000 are now also payable for leases with non-residents. Under the 2013 guidelines, such fees were only payable for leases with Malaysian residents.

(b) Sufficiency of Capital

Labuan leasing companies are now required to have sufficient and positive capital or working funds which commensurate with their Labuan leasing business based on factors including the volume of the business, the value of the assets leased and the relevant leasing arrangements. Labuan FSA may also require a Labuan leasing company to inject additional capital into its company.

(c) Requirement for Labuan FSA's Prior Approval

(i) Labuan FSA's prior approval is now required for the establishment of an office outside Labuan or for the acquisition of any subsidiaries.

(ii) Any change in lessee and leased asset for the leasing business would also require Labuan FSA's prior approval.

(iii) Prior approval is now only required for a change of shareholding in a Labuan leasing company which exceeds 10%.

(d) Adequate Internal Policies and Controls

Labuan leasing companies will now also need to establish an adequate set of internal policies and controls for its operations, compliance, corporate governance and risk management. The policies and controls are to be regularly reviewed to ensure that they stay appropriate, relevant and prudent.

Comments

According to the speech of the Governor of the Central Bank of Malaysia at the Labuan Industry Annual Dinner late last year, the Malaysian government is reviewing the Labuan tax framework to, amongst other reasons, ensure its alignment with international tax practices. This follows Malaysia's announcement of its intention to participate in the Inclusive Framework on Base Erosion Profit Shifting (BEPS) Action Plan as a BEPS Associate in January 2017. As a BEPS Associate within the Inclusive Framework, Malaysia has committed to the implementation of four minimum standards, which include countering harmful tax practices. As Labuan has previously been identified by the Organisation for Economic Co-operation and Development ("**OECD**") as practicing harmful tax practices, the changes made in the Revised Guidelines (particularly the

Substance Requirement) are largely consistent with Malaysia's commitments on the OECD front.

The Substance Requirement appears onerous and Labuan leasing companies may be required to restructure their business in order to maintain their business in Labuan. This may also impact the attractiveness of Labuan as an investment destination for companies looking to set up and operate a leasing business.

As Labuan leasing companies are typically set up to enjoy tax benefits, including withholding tax exemption on lease payment to non-residents, lower income tax rates as well as stamp duty exemption on lease agreements, it would be crucial for Labuan leasing companies to take time to understand the requirements under the Revised Guidelines and consider whether they have the ability to comply with the requirements and the necessary measures to be taken to ensure compliance. Failure to comply with the conditions of the leasing licence can result in adverse consequences, including the revocation of the leasing licence, imposition of penalties and severe tax implications.

Click here to access a copy of the Revised Guidelines.

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