

## Client Alert

April 2020

### COVID-19 and Labuan Companies – Potential Change to Tax Residency Status

For further information, please contact:

**Adeline Wong**  
Partner  
+603 2298 7880  
[adeline.wong@wongpartners.com](mailto:adeline.wong@wongpartners.com)

**Istee Cheah**  
Senior Associate  
+603 2298 7864  
[istee.cheah@wongpartners.com](mailto:istee.cheah@wongpartners.com)

On 16 March 2020, the Malaysian Prime Minister announced a Restriction of Movement Order ("**RMO**"), which prohibits Malaysian citizens from travelling out of Malaysia and foreign visitors from entering Malaysia. The border controls were scheduled to last for two weeks, starting from 18 March 2020 to 31 March 2020. Subsequently, the Prime Minister, in his special address on 25 March 2020, declared that the RMO be extended to 14 April 2020. On 10 April 2020, the Prime Minister had announced a further extension of the RMO until 28 April 2020.

In the present circumstances, there is some degree of uncertainty as to whether the border controls may be extended, or reintroduced if the outbreak is contained in Malaysia but then worsens. In addition, foreign directors of Labuan companies may be unable to travel to Malaysia for other reasons (e.g., international travel restrictions or if multinational enterprises ("**MNEs**") suspend international travel for their employees/directors due to safety concerns). This may give rise to potential tax complications, including changes to corporate tax residency statuses.

In this alert, we will take a look at concerns about maintaining the Malaysian tax residency status of Labuan companies during the COVID-19 pandemic.

#### Malaysian tax residency status

The Malaysian Income Tax Act ("**ITA**") provides that:

- (a)** a company carrying on a business is resident in Malaysia for the basis year for a year of assessment if at any time during that basis year the management and control of its business or of any one of its businesses, as the case may be, are exercised in Malaysia; and
- (b)** any other company is resident in Malaysia for the basis year for a YA if at any time during that basis year the management and control of its affairs are exercised in Malaysia by its directors or other controlling authority.

Further, under the Labuan Business Activity Tax Act, a Labuan company that also intends to establish or continue establishing Malaysian tax residency for purposes of claiming reliefs under the relevant double tax agreements will need to ensure that at any time during that basis period, the management and control of its business or of any one of its businesses, as the case may be, are exercised in Malaysia.





The ITA provides that if it has been established between the Director General of Inland Revenue and the company, that the company was resident in Malaysia for the basis year or any year of assessment ("YA"), it shall be presumed that the company is resident in Malaysia for every subsequent YA until the contrary is proved.

Under normal circumstances, the Inland Revenue Board ("**IRB**") will accept that the tax residency test has been satisfied only if a company conducts its board meetings in Malaysia. It is also noteworthy that the IRB will not issue a certificate of residency if board meetings are held virtually instead of physically in Malaysia.

Consequently, there are concerns that if a Labuan company's board meetings are not held in Malaysia because its directors cannot travel to Malaysia, this will mean that the management and control of the company has not been exercised in Malaysia, resulting in the company losing its Malaysian tax residency status. Companies may need to appoint more local directors in order to reduce the risk of disruptions to their tax residency status, or find other ways to mitigate this risk.

Malaysia has introduced a number of emergency measures to help businesses and individuals weather the COVID-19 crisis. It is hoped that the IRB will also make concessions in this area if a Labuan company is already a tax resident of Malaysia, and the change in the locations of board meetings are due only to the COVID-19 pandemic.

Another issue is whether there may be a risk of a Labuan company being considered to have a tax residency status in another jurisdiction if directors attend a board meeting from that other jurisdiction. For example, in Australia, there have been concerns that if directors of a foreign company have to attend board meetings from Australia, this will result in the company being treated as an Australian tax resident. The Australian Taxation Office has indicated that this may not be an issue if the only reason for directors attending board meetings in Australia is due to the impacts of COVID-19, and there are no other changes to the circumstances of the company.

[www.wongpartners.com](http://www.wongpartners.com)

Wong & Partners  
Level 21  
The Gardens South Tower  
Mid Valley City  
Lingkaran Syed Putra  
59200 Kuala Lumpur



### **What this means for taxpayers**

During these times of uncertainty, MNEs need to review the board composition of their Labuan entities to determine whether it would still be possible to conduct board meetings physically in Malaysia. MNEs will also need to review where directors are currently based, and determine their locations when board meetings are conducted in order to determine whether there may be a risk of the Labuan company being considered to have a tax residency in another jurisdiction.

Also, it would be advisable for MNEs to consider options to mitigate their tax residency risk, and this may include changing board compositions, speaking with local tax authorities, assessing alternatives for making board decisions and their impact, and preparing new documentation. In more extreme situations, MNEs may need to reconsider their strategies, and undertake some group restructuring.