



Circular No 1/2025
Date: 26 February 2025

To: All members of the Association of Labuan Trust Companies, Malaysia (“ALTC”)

SUCCESSFUL RESOLUTION OF JUDICIAL REVIEW APPLICATIONS CHALLENGING THE DECISIONS OF THE DIRECTOR GENERAL OF INLAND REVENUE AND MINISTER OF FINANCE REGARDING THE SUBSTANCE REGULATIONS

We are pleased to inform that the judicial review applications initiated by Messrs. Shearn Delamore & Co. (“**Shearn**”) on behalf of the ALTC and more than 170 Labuan entities (“**the Applicants**”) from 2021 onwards (“**JR Cases**”) to challenge the legality and validity of the decisions (“**the Impugned Decisions**”) of the Director General of Inland Revenue (“**DGIR**”) and the Minister of Finance (“**MOF**”) concerning the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 [P.U.(A) 392/2018] and the Labuan Business Activity Tax (Requirements for Labuan Business Activity) 2018 (Amendment) Regulations 2020 [P.U.(A) 375/2020], as well as, and Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2021 [P.U.(A) 423/2021], have been successfully concluded in favour of the Applicants.

This circular outlines the salient developments in the JR Cases and their implications for the Applicants and other affected Labuan entities.

1. FIRST JUDICIAL REVIEW (“1st JR”)

A. Background of the 1st JR:

As members may be aware, **the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 [P.U.(A) 392/2018]** (“**2018 Regulations**”), which was gazetted on 31 December 2018 and purportedly effective from 1 January 2019, purported to list **21** categories of “*Labuan business activities*” that were subject to the corresponding “Substance Requirements”, i.e. a minimum requisite number of full-time employees in Labuan and annual operating expenditure in Labuan.

In 2020, ALTC was informed that an additional category of activities would be inserted into the 2018 Regulations namely, “**Code 23**” i.e. “**Other trading activity – Labuan entity that carries out administrative, accounting and legal services including backroom processing, payroll services, talent management, agency services, insolvency related services and management services**” (“**Code 23**”¹).

¹ “Code 23” is the new “Item 20” of the First Schedule to the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2021 [P.U.(A) 423/2021].



Thereafter, the **Labuan Business Activity Tax (Requirements for Labuan Business Activity) 2018 (Amendment) Regulations 2020 [P.U.(A) 375/2020]** (“**2020 Regulations**”) were gazetted by MOF on 24 December 2020. The 2020 Regulations purported to amend the 2018 Regulations retrospectively with effect from 1 January 2019 and also purported to retrospectively introduce two new categories of Labuan business activities under “*Item 21*” and “*Item 22*” that were not previously subject to any “Substance Requirements”.

However, as members would be aware, “**Code 23**” was not included in the 2018 Regulations or the 2020 Regulations. Thereafter, the DGIR had, vide a letter dated 5 February 2021 (“**DGIR’s Letter**”), taken the position that Labuan entities and activities that are not listed in the Schedule to the 2018 Regulations and the 2020 Regulations (“**Non-Listed Activities**”) would be defaulted to and be subjected to tax under the Income Tax Act 1967 (“**ITA**”) at the rate of 24%.

Subsequently, the MOF agreed with the DGIR, and vide their letter dated 1 April 2021 (“**MOF’s Letter**”), wrote to the ALTC stating that Non-Listed Activities would automatically be taxed under the ITA instead of the Labuan Business Activity Tax Act 1990 (“**LBATA**”).

Thereafter, many Labuan entities that were affected by the DGIR’s Letter and the MOF’s Letter, participated in the 1st JR.

In this regard, for the purpose of the court proceedings, the Applicants whose business activities fell under “Code 23” were grouped into one category as “**Category A**” while the Applicants who did not fall under “Code 23” and instead carried on business activities which were never included in the 2018 Regulations and the 2020 Regulations, were grouped into another category as “**Category B**”.

B. High Court Decision (13 June 2022)

On 13 June 2022, the learned High Court Judge ruled in favour of the Applicants and quashed both the IRB’s Letter and the MOF’s Letter, among others in the 1st JR (“**High Court Decision**”). The brief grounds/orders of the High Court Decision and its ramifications are set out below:

- a. the 2018 Regulations and the 2020 Regulations were held to be invalid;
- b. as both these regulations were invalid, there were no “Substance Requirements” applicable to the Applicants prior to the issuance of the new substance regulations, namely, the **Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2021 [P.U.(A) 423/2021]** (“**2021 Regulations**”) which were only gazetted on 22 November 2021;
- c. even then, the High Court held that the 2021 Regulations could not have any retrospective effect all the way back to 1 January 2019 as that would take away the



Applicants' vested rights. As such, the 2021 Regulations could only apply prospectively, i.e. from 22 November 2021;

- d. as a result, prior to the 2021 Regulations, no substance requirements were prescribed for the Applicants and for that period, they continued to be taxed under LBATA, not the ITA; and
- e. as the MOF's Letter and DGIR's Letter also stated that Non-Listed Activities were to be taxed under the ITA, the quashing of these letters meant that the Non-Listed Activities were also entitled to be taxed under LBATA according to the High Court Decision.

C. Appeals to the Court of Appeal

Thereafter, both the DGIR and MOF filed their respective appeals to the Court of Appeal against the High Court Decision ("**the Appeals**").

However, the Applicants applied to the Court of Appeal to strike out the Appeals and on 12 May 2023 and 26 September 2024, the MOF's Appeal and the DGIR's Appeal respectively were struck out by the Court of Appeal.

With that, the 1st JR was concluded in the Applicants' favour and the High Court Decision stands.

2. SECOND JUDICIAL REVIEW ("2nd JR")

A. Background of the 2nd JR:

After the 2021 Regulations were issued, the Applicants under Category A (i.e. "Code 23"/ "Item 20" entities) filed another judicial review application, i.e. the 2nd JR, to argue that the "Substance Requirements" imposed by the 2021 Regulations could only apply after 2021 due to issues of actual and practical impossibility in complying with the same.

B. Settlement (10 December 2024)

Thereafter, a binding Consent Order was recorded before the High Court on 10 December 2024 ("**the Consent Order**"), confirming that the Applicants falling under Category A need only comply with the "Substance Requirements" imposed under the 2021 Regulations from such Applicant's first complete annual period or full 12-month financial/accounting period commencing on or after 23 November 2021.

With the recording of the Consent Order, we are pleased to announce that the 2nd JR has also been successfully concluded in the Applicants' favour.



3. IMPLICATIONS OF THE OUTCOMES OF THE 1st JR AND 2nd JR

Applicants	1 st JR	2 nd JR
Category A	<ul style="list-style-type: none"> No “Substance Requirements” prior to the gazette of the 2021 Regulations Only need to carry on a "<i>Labuan trading activity</i>" to qualify for 3% tax rate under Section 4(1) of LBATA. 	<ul style="list-style-type: none"> Must comply with the “Substance Requirements” as imposed under the 2021 Regulations with effect from such Applicant’s first complete annual period or full 12-month financial or accounting period commencing on or after 23 November 2021.
Category B	<ul style="list-style-type: none"> No “Substance Requirements” Only need to carry on a "<i>Labuan trading activity</i>" to qualify for 3% tax rate under Section 4(1) of LBATA. 	[<i>N/A as the Applicants under Category B did not take part in the 2nd JR.</i>]

In short, moving forward, the Applicants under Category A are required to comply with the “Substance Requirements” as imposed under the 2021 Regulations from such Applicant’s first complete annual period or full 12-month financial or accounting period commencing on or after 23 November 2021 in order to qualify for 3% tax rate under Section 4(1) of LBATA while the Applicants under Category B only have to carry on a "*Labuan trading activity*" to qualify for 3% tax rate under Section 4(1) of LBATA without the need to comply with any “Substance Requirements”.

4. IMPLICATIONS FOR NON-PARTICIPATING LABUAN ENTITIES

Subject to the fulfilment of certain conditions, the Labuan entities that did not participate in the 1st JR or the 2nd JR but wish to challenge the DGIR's/MOF’s decision(s) on the abovementioned issues may still do so.

For instance, if you are not named as an Applicant in the above 1st JR or 2nd JR but the Revenue sends you a letter or raises an assessment to insist that the unlawful Substance Regulations apply to you for years of assessment prior to 2021, then you have three (3) months within which to file an application to seek leave to apply for judicial review.



Similarly, if the Revenue refuses to accept your tax returns or other tax filing under LBATA and insists that you file under the ITA even though you carried on a Labuan business activity, you may still be able to file an application to seek leave to apply for judicial review within three (3) months of any such adverse decisions.

All such applications for leave to apply for judicial review will be heard before the High Court. From there, there is a right of appeal to the Court of Appeal and from there, a right to apply for leave to appeal to the Federal Court.

In addition, all disputed assessments issued by the Revenue also need to be appealed against via notices of appeal (Forms Q) within 30 days. Any such disputes that remain unresolved may be appealed to the Special Commissioners of Income Tax (“SCIT”) with rights of appeal to the High Court and from there, to the Court of Appeal.

Further, if you have mistakenly complied and overpaid more tax than you should have for year of assessment 2021 or prior years of assessment, you may be able to apply to the DGIR for relief on account of such error or mistake. The application must be made within five (5) years after the end of the year of assessment within which the assessment was made. Any disputes on the application for relief may be referred to the SCIT with rights of appeal to the High Court and from there, to the Court of Appeal.

Finally, any dispute arising with the Revenue or any administrative authority may be disputed within certain strict timelines and members should seek legal advice if they are aggrieved by any assessment or decision in this regard.

***Note:** This circular was prepared by Mr. Anand Raj and Ms. Irene Yong from Shearn as a follow up to the briefing session held in Labuan on 18 December 2024 and to summarise the key developments to-date. In order to keep this circular concise and readable, this circular only contains a summary of the selected issues and is not nor is it intended to be an exhaustive document on this subject. This circular is not a substitute for a tax law review or advice nor does this circular constitute legal advice on any general or specific transactions, arrangements, documents or business practices. This circular will not be updated for any changes, modifications or amendments in law, legislation, rules, regulations or any other subordinate legislation unless specifically requested and instructed by ALTC.*

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