

Taxation of Labuan Foundations

What is a Labuan Foundation?

A foundation is a body corporate, traditionally viewed as being somewhere between a trust and a company. The Labuan Foundation Act, 2010 permits for the establishment, regulation and dissolution of foundations in Labuan.

A foundation can be created for beneficiaries or purposes or both. Where created for purposes, the purposes can be charitable, non-charitable or a mixture of both. A foundation might be created, for example, for benefiting a particular person or class of persons, for carrying out a specific purpose or holding a particular asset.

Foundations can be used as an alternative to a trust in many situations, and can also be used in combination with trusts.

A foundation has separate legal personality. This means that the foundation itself exists in the same way that a person or company exists. Therefore a foundation can hold assets and take Court proceedings in its own name in the same way that a company may. This will have obvious benefits for any third parties wishing to contract with a foundation since that third party will easily be able to ascertain the existence and status of the foundation and be comfortable that it has full power to deal with its own assets. In this respect a foundation differs from a trust where it is the trustees of the trust who own assets and enter into contracts.

A foundation's powers will be exercised by its council, which is similar to a company's board of directors.

The taxation of a Labuan Foundation registered under the Labuan Foundation Act, 2010 ("Lafa") can be subject to either the Labuan Business Activity Tax Act 1990 ("LBATA") or the Income Tax Act, 1967 ("ITA") or both, depending on the type and place of assets it holds and also on the business activity it carries on. The tax treatment of holding of investments in Malaysian securities, stock, shares, loans, deposits in a Labuan foundation is quite different from the tax treatment of holding of investments in the same Malaysian items by other Labuan entities. This basically is because under the Lafa Section 6(b)(2) mandated that the income from holding of such Malaysian assets are to be taxed under ITA.

1. Labuan foundation holding Malaysian Property

1.1 Under Section 2 – Interpretation of the Labuan Foundation Act, 2010:

"Malaysia" means the territories of the Federation of Malaysia, the territorial waters of Malaysia and the sea-bed and sub-soil of the territorial waters, and includes any area extending beyond the limits of the territorial waters of Malaysia, and the sea-bed and subsoil of any such area, which has been or may hereafter be designated under the laws of Malaysia and in accordance with international law as an area over which

Malaysia has sovereign rights for the purposes of exploring and exploiting the natural resources, whether living or non-living;

“Malaysian property” means any property which is situated in Malaysia;

“property” includes—

- (a) *assets of every kind, whether corporeal or incorporeal, movable or immovable, tangible or intangible, however acquired; and*
- (b) *legal documents or instruments in any form, including electronic or digital, evidencing title to or interest in, such assets as described in paragraph (a), including bank cheques, money orders, shares, securities, bonds, bank drafts and letters of credit;*

1.2 Hence if a Labuan Foundation has investment in Malaysian shares, securities, bonds, loans, deposits and property whether movable and immovable, tangible or intangible situated on Malaysian soils and in Malaysian seas, the income derived from the investments therefrom would be subject to ITA because of:

(a) **Section 3 of the ITA which states that:**

Subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia.
and

(b) **Section 6 (b) of LAFA which provides that:**

- (1) *The beneficiaries of a Labuan foundation may be a resident or a non-resident.*
- (2) *Where the property of a Labuan foundation include Malaysian property, the Income Tax Act 1967 [Act 53] shall be applicable to any income derived therefrom.*
- (3) *The income derived from any property which is not Malaysian property is subject to the Labuan Business Activity Tax Act 1990.*

1.3 The overriding provision is Section 3 of the ITA if the income of any person is accruing in or derived from Malaysia. Section 6(b)(2) of LAFA merely reinforced the fundamental principle of taxation in Malaysia which is based on territorial basis and thus subjecting such income under ITA.

1.4 Section 50(1) of LAFA states that:

“A Labuan foundation duly registered under this Act is a body corporate and may sue and be sued in its corporate name.”

1.5 Section 2 of ITA describes company as:

[“company” means a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia and a business trust;]

1.6 Therefore although there is no mention of foundation in the ITA, a Labuan foundation would be treated as a company under ITA. All provisions which are applicable to a company under the ITA shall also be applicable to a Labuan foundation.

2. Labuan foundation holding non-Malaysian Property

2.1 A Labuan foundation which only holds properties (*other than holding of investments in securities, stock, shares, loans, deposits*) which are situated outside of Malaysia its income shall be subject tax under ITA. Typically such assets are immovable properties like land and buildings and movable properties like plant, machinery and equipment.

2.2 Such income from the holding of properties situated outside of Malaysia (in foreign countries) is exempt from tax if not remitted to Malaysia.

2.3 The Labuan Foundation will have to file tax returns under ITA and since its income is from foreign source will be tax-exempt unless such income is remitted to Malaysia.

3. Labuan foundation holding both Malaysian Property and non-Malaysian Property.

3.1 Under Section 2 – Interpretation of LBATA:

“Labuan” means the Federal Territory of Labuan;

“Labuan business activity” means a Labuan trading or a Labuan non-trading activity carried on in, from or through Labuan, excluding any activity which is an offence under any written law;

“Labuan trading activity” includes banking, insurance, trading, management, licensing, shipping operations or any other activity which is not a Labuan non-trading activity;

“Labuan non-trading activity” means an activity relating to the holding of investments in securities, stock, shares, loans, deposits or any other properties situated in Labuan by a Labuan entity on its own behalf;

3.2 Section 3 of LBATA

Labuan business activity chargeable to tax.

Subject to this Act, a Labuan entity carrying on a Labuan business activity shall be charged to tax in accordance with this Act for each year of assessment in respect of that Labuan business activity.

- 3.3. A Labuan Foundation established and registered under the LAFA is a Labuan entity under the Schedule of LBATA.
- 3.4 A Labuan Foundation which holds both Malaysian Property and non-Malaysian Property (*holding of investments in securities, stock, shares, loans, deposits*) will be subject to tax under ITA and LBATA.
- 3.5 Income of a Labuan Foundation from the *holding of investments in securities, stock, shares, loans, deposits* outside of Malaysia shall be considered as Labuan non-trading activity under LBATA, and exempt from tax if it complies with *Schedule 2 of the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2021* (“*Substance Regulations 2021*”) OR at 24% of its audited net profits if it fails to comply with Substance Regulations. [*Section 6(b)(3) of LAFA and Section 9 of LBATA*]
- 3.6 Income of a Labuan Foundation from holding of non-Malaysian immovable properties like land and buildings and movable properties like plant, machinery and equipment will be subject to ITA (out of the scope of Labuan business activity and not situated in Labuan) and is exempt from tax if not remitted to Malaysia.
- 3.7 If the Labuan Foundation receives income from its investment in Malaysian shares, securities, bonds, fixed deposits and property whether movable and immovable, tangible or intangible situated in Malaysian soils and seas, the income derived therefrom would be subject to ITA. [*Section 6(b)(2) of LAFA*]
- 3.8 The Labuan Foundation will have to submit tax returns for its income from properties outside of Malaysia under ITA, and its pure equity income (*purely dividend from holding of shares and interest income from funds placed in financial institution from funds received from dividend and gains from sale of shares*) and non-pure equity income (*holding of investments in securities, stock, loans, deposits*) from outside of Malaysia under LBATA.
- 3.7 The tax treatment of Labuan Foundation is different from other Labuan entities as far as investment in Malaysian shares, securities, bonds, fixed deposits are concerned. For Labuan Foundations because of Section 6(b)(2) and 6(b)(3) of LAFA, income from these investments are to be taxed under ITA. However, for other Labuan entities income from such investments shall be taxed under LBATA.

4. Summary

4.1 Tax regime for Labuan Foundations

Assets	Situated In Malaysia	Situated Outside Malaysia	Situated In Labuan	Applicable tax regime
Securities, stock, shares, loans, deposits	YES	-	-	ITA
	-	YES	-	LBATA (SR)
Any Other Property (Land & Building, Plant and Machinery and Equipment)	YES	-	-	ITA
	-	-	YES	LBATA (SR)
	-	YES	-	ITA

4.2 Tax regime for Other Labuan Entities

Assets	Situated In Malaysia	Situated Outside Malaysia	Situated In Labuan	Applicable tax regime
Securities, stock, shares, loans, deposits	YES	-	-	LBATA (SR)
	-	YES	-	LBATA (SR)
Any Other Property (Land & Building, Plant and Machinery and Equipment)	YES	-	-	ITA
	-	-	YES	LBATA (SR)
	-	YES	-	ITA

* SR = Comply Substance Regulations - Nil or 3% of audited net profits.

Non-compliance with SR – 24% of audited net profits.

4.3 For foreign income which are taxed under ITA, if they are remitted to Malaysia, then they are subject to ITA at the prevailing rate.

4.4 However, from 1.1.2022 to 31.12.2026 foreign income remitted to Malaysia which are exempt from ITA are as follows:

Taxpayer's Category	Types of Tax Exempt Income	Qualifying Conditions
<ul style="list-style-type: none"> ✓ Company ✓ LLP ✓ Individual partner in relation to a partnership business in Malaysia 	Dividends	<ul style="list-style-type: none"> (i) The dividend income has been subjected to tax in the country of origin; (ii) The highest tax rate (headline tax) in the country of origin is not less than 15%; and (iii) *Comply with the economic substance requirements.
Individual	All types of income other than partnership income.	The income has been subjected to tax in the country of origin.

*Comply with the economic substance requirements

- (i) A **resident company**, resident LLP or resident individual in relation to a partnership business in Malaysia shall be regarded as having economic substance if it has:
 - (A) employ adequate number of employees with necessary qualifications to carry out the specified economic activities in Malaysia; and
 - (B) incur adequate amount of operating expenditure for carrying out the specified economic activities in Malaysia.
- (ii) As the mode of operation varies from industry to industry, it is neither feasible nor appropriate to specify any minimum thresholds for the

5. Distribution of Labuan Foundation to its Beneficiaries.

5.1 Under Section 2 of ITA:

["company" means a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia and a business trust.]

A Labuan Foundation is a body corporate (Section 50 of LAFA) established with a separate legal entity under the LAFA and hence falls under the definition of "company" under Section 2 of ITA. Therefore the distribution of its profits should be in accordance with the provisions of ITA applicable to a company.

- 5.2 Irrespective of whether a Labuan Foundation is taxed under LBATA or ITA on its income from investments in securities, stock, shares, loans, deposits or any other properties, the distribution to its beneficiaries by the Labuan Foundation shall not be subject to further tax in the hands of the beneficiaries.
- 5.3 No tax is deductible from the distribution of the Labuan Foundation under section 108 of the Income Tax Act 1967. The distribution from the Labuan Foundation is not taxable in the hands of the Beneficiary pursuant to Exemption Order PU(A) 95/2025 dated 13 February 2025:
- 5.4 Labuan Foundations are a less familiar concept than trusts. They are sometimes described as a hybrid of a trust and a company. A Labuan Foundation resembles a company in that it is a body corporate (albeit without shareholders) with separate legal personality that owns its own property like a company. A Labuan Foundation is governed by a council in accordance with its charter and regulations (its constitutional documents) in much the same way that a company is managed by its board of directors in accordance with its constitutional documents.
- 5.5 A Labuan Foundation also shares similarities with a trust. It has a founder who provides property to be held by the foundation in the same way that a trust has a settlor who provides property to be held subject to the terms of a trust. Also like a trust, a Labuan Foundation must have one or more objects which may be a purpose (charitable or non-charitable) and/or be for the benefit of one or more beneficiaries. Labuan Foundations have no beneficial owners and are therefore 'ownerless' structures (even where the foundation property is held for the benefit of beneficiaries).

5.6 The Distribution Letter of a Labuan Foundation would be as follows:

LETTER HEAD OF ABC (L) FOUNDATION

*TAN SRI DR. ABC
No. 23, Jalan Tijani, Tijani 1, Bukit Tunku,
50480, Federal Territory of Kuala Lumpur,
Malaysia*

Date: 6 May 2021

Dear Sir/Madam,

Distribution to the Initial Beneficiary

This is to confirm that a distribution amounting RM2,250,000.00 (equivalent to USD545,454.55) had been paid for the financial period ending 30 June 2021 to Tan Sir Dr. ABC (NRIC No.) as the Initial Beneficiary on 6 May 2021.

We hereby certify that no tax is deductible from the distribution of the ABC (L) Foundation under section 108 of the Income Tax Act 1967. The distribution from the ABC (L) Foundation is not taxable in the hands of the Initial Beneficiary pursuant to Exemption Order PU(A) 95/2025 dated 13 February 2025.

*Yours faithfully,
for and on behalf of
ABC (L) Foundation
Secretary*

6. Audited Financial Statements Required for a Labuan Foundation?

- 6.1 LAFSA does not prescribe that the accounts of a Labuan Foundation must be audited. The requirement for an audit is usually prescribed in its charter or articles of the foundation.
- 6.2 Section 77A(4) of ITA prescribed that:
- (4) *Where a company, limited liability partnership, trust body or co-operative society is required to prepare financial statements in accordance with any written law, the return furnished under this section shall be made based on such financial statements.*. [Subs. by Act A1576]
- 6.3 As the definition of “company” under ITA mean a body corporate, a Labuan Foundation is a body corporate as stated in Section 50 of LAFSA, hence would be construed as a “company”.
- 6.4 By reading Section 77A(4) of ITA, a Labuan Foundation which holds Malaysian properties may not have to have its accounts audited because under the LAFSA there is no audit requirement for a Labuan Foundation.
- 6.5 Even if the Labuan Foundation is holding investment of other properties (eg land and buildings) in Labuan or outside of Labuan and Malaysia, the income from these holdings will be charged to tax under ITA, and hence no audited accounts are required for submission of tax under ITA as provided for under Section 77A(4) of ITA.
- 6.6 As provided for under Section 6(b)(3) of LAFSA, if the Labuan Foundation’s assets consist of securities, stock, shares, loans, deposits outside of Malaysia then it is considered as carrying on a Labuan business activity which is a Labuan non-trading activity under LBATA, and hence not required to prepare audited accounts under Section 9 of LBATA:
- (1) *Notwithstanding section 3 the profit of, a Labuan entity carrying on a Labuan business activity which is a Labuan non-trading activity for the basis period for a year of assessment shall not be charged to tax under this Act for that year of assessment.*