



## NEW LFSA GUIDELINES

On 1 January 2018, the Labuan Financial Services Authority (LFSA) issued *Guidelines on the Establishment and Operations of Labuan Leasing Business* (the Guidelines). The Guidelines seek to clarify the requirements for Labuan companies carrying out leasing business in Labuan International Business and Financial Centre.

In particular, the Guidelines set out new thresholds to evidence the “substance” of Labuan leasing companies. The requirements include:

- maintaining an operational office in Labuan;
- carrying out “core income generating activities” from its office in Labuan; and
- employing full-time staff with relevant qualifications and experience in the leasing business.

This is a significant departure from the status quo.

In the current climate of increased scrutiny of cross-border tax structures, the Guidelines have been widely perceived as a way for the Malaysian authorities to combat Labuan leasing companies being used as conduits for tax avoidance.

#### **Existing arrangements to be grandfathered**

Since issuing the Guidelines, the Malaysian authorities have informally clarified that the Guidelines will not apply to leasing companies that have received prior LFSA approval. Existing leasing licences will remain valid and will not be revoked. However, future LFSA leasing licences will only be granted if Labuan leasing companies are in compliance with the Guidelines.

#### **Impact on the aircraft leasing industry**

Labuan, a “mid-shore” jurisdiction in Malaysia, is a popular leasing jurisdiction in the aviation sector for leasing to Malaysian-registered operators due to its low corporate tax rate and eligibility under the Malaysia

double taxation agreement. It is common to structure aircraft finance transactions via double taxation treaties to avoid withholding tax on rent or debt payments. In Labuan, this is done by using a lease-in-lease-out structure with a Labuan leasing company as the intermediate lessor.

In June 2017, the OECD’s Multilateral Convention to Implement Tax Treaty Related Measures was internationally endorsed with the objective of preventing base erosion and profit shifting (BEPS), including cross-border tax avoidance and manipulation. One of the specific aims of the OECD and the EU is to prevent the granting of treaty benefits in inappropriate circumstances. The LFSA’s issuance of the Guidelines is an example of a tax favourable jurisdiction, as a result, applying greater scrutiny to the beneficiaries of its tax treaty.

In an aircraft leasing transaction, the lessee is typically responsible for withholding tax payable where the tax arises as a result of change in law. This is based on the industry understanding that it would usually be the lessee’s jurisdiction effecting such change in law. However, it is becoming more common for lessors to take responsibility for withholding tax which arises as a result of the lessor’s status and eligibility for tax treaty benefits. This question of lessor substance in the context of tax liability means that the Guidelines are particularly pertinent for international lessors.

#### **LFSA to issue clarification on “substance”**

We understand that the LFSA will be issuing a clarification in respect of the new “substance” requirements for Labuan leasing companies. We anticipate that this clarification will

provide a clearer indication as to how the aircraft leasing industry will be affected by the Guidelines, and in what ways the sector will need to change and evolve.

For further information, please contact:



**DAVID BROTHERTON**

Partner, Singapore

**T** +65 6411 5360

**E** david.brotherton@hfw.com



**LING LUI**

Partner, Singapore

**T** +65 6411 5201

**E** ling.lui@hfw.com



**RHIAN CLAYTON-PAYNE**

Associate, Singapore

**T** +65 6411 5372

**E** rhian.clayton-payne@hfw.com

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