

**CFL1**

# **Administration of Offshore Centres**

**7 OCTOBER 2003**

1. Time allowed : Three (3) hours
2. Total number of questions : Five (5) questions
3. Number of questions to be answered : All five (5) questions [20 marks each]
4. Begin each answer to a new question on a fresh page.
5. Answer **all** questions in **English**.

## ANSWER ALL FIVE (5) QUESTIONS

1. (a) Define "offshore financial centres". [2]
- (b) State **five** reasons why individuals or corporations choose to carry out their business transactions from offshore centres. [10]
- (c) Describe the functions of the Labuan Offshore Financial Services Authority. 8]  
(Total:20 marks)
2. (a) List any **five** business restrictions which are imposed on Labuan offshore companies. [10]
- (b) State any **five** tax incentives granted for conducting offshore business activities in the Labuan International Offshore Financial Centre. [10]  
(Total:20 marks)
3. (a) What is the role of trust companies in Labuan? [6]
- (b) List **five** advantages of the Labuan International Financial Exchange (LFX). [10]
- (c) Briefly describe the channel used for carrying out the operations of LFX. [4]  
(Total:20 marks)
4. (a) List **four** criteria required by Bank Negara Malaysia in approving foreign currency credit facilities (exceeding the equivalent of RM5million) to residents. [8]
- (b) Briefly describe **five** financial services offered by the Labuan offshore banks. [10]
- (c) Define "Labuan Interbank Offered Rates". [2]  
(Total:20 marks)
5. (a) Define "money laundering". [5]
- (b) List **five** examples of transactions which can be regarded as "suspicious" under money laundering activities. [5]
- (c) Define "tax avoidance" and "tax evasion". [10]  
(Total:20 marks)

- END OF QUESTION PAPER -

## **OUTLINE ANSWERS**

### **Question 1**

Candidates answered parts (b) and (c) of the question poorly.

1. (a) Offshore financial centres are defined as geographical locations where non- residents conduct business due to the jurisdiction being free from the restrictions of domestic reserve requirements and monetary controls as well as low tax rates for businesses.
- (b) Choose any five of the following:
- Tax reduction or avoidance
  - Tax planning or deferment of taxes from business profits
  - Maintaining privacy and confidentiality of business transactions
  - Lower costs of conducting business in the offshore centres
  - Avoidance of currency restrictions
  - Minimum government controls
  - Capital availability
  - Little import restrictions for personal effects
- (c) The functions of the Labuan Offshore Financial Services Authority are:
- To administer, enforce, review and give effect to the provisions stated in the Labuan Offshore Acts and any other law relating to offshore financial services in Labuan.
  - To ensure offshore financial transactions are conducted according to the laws provided and in line with established norms of good and honourable conduct as well as preserve and maintain the good repute of Labuan International Offshore Financial Centre (IOFC).
  - To carry out research and commission studies on offshore financial services in Labuan.
  - Make recommendations for creating and improving any facility to enhance the Labuan's attractiveness as an (IOFC).
  - To foster high standards and promote offshore financial services in Labuan by co-operating and working with offshore financial institutions and professional and industry associations.
  - To advise the Minister of Finance generally on matters relating to offshore financial services in Labuan.
  - To license or register persons/companies carrying on offshore financial services in Labuan.
  - To regulate and supervise the conduct of offshore financial services in Labuan.

### Question 2

Candidates' performed poorly in the areas examined. They were unable to provide the restrictions imposed on Labuan offshore companies. Most candidates were also unable to state the tax incentives granted for conducting business in the Labuan IOFC.

2. (a) Business restrictions which are imposed on Labuan offshore companies (Choose any five of the following):
- Banking business unless permitted under the Offshore Banking Act 1990.
  - Insurance or reinsurance business unless permitted under the Offshore Insurance Act 1990.
  - Business with a resident of Malaysia except as permitted by the Labuan offshore legislation or Labuan Offshore Financial Services Authority.
  - Transacting in the Malaysian currency except for defraying administrative and statutory expenses as permitted under the Labuan offshore legislation.
  - Shipping operations in Malaysia.
  - Business of a trust company.
  - A resident investing in an offshore company may not use the offshore company to invest in a domestic company.
- (b) Tax incentives (Choose any five of the following):
- 3% of net profits from audited accounts or RM20,000 upon election by the offshore company.
  - No stamp duty is payable on instruments executed by an offshore company in relation to an offshore business activity.
  - Royalties, interest and technical or management fees paid by an offshore company to a non-resident or another offshore company are exempt from income tax and not subject to withholding tax. However, no exemption is available in respect of interest which accrues to a place of business of a non-resident licensed to carry on a business under the Banking and Financial Institutions Act 1989, Islamic Banking Act 1983, Takaful Act 1984 or Insurance Act 1996 in Malaysia.
  - No sales tax, surtax, import duties, excise duties and export duties.
  - Road tax in Labuan has been reduced to 50% since 1 January 1997.
  - No inheritance, death or estate duty is levied.
  - Exemption from tax, effective year of assessment 1998, of up to 50% of allowances and facilities enjoyed by Malaysian residents in their employment in Labuan.

### Question 3

Most candidates had difficulty answering parts (a) and (b) of the question.

3. (a) Role of trust companies:

To ensure that Labuan is not used as a centre for illicit or illegal activities that will tarnish the reputation of Labuan as an IOFC. Under the Offshore Companies Act 1990, every Labuan offshore company must employ the services of a trust company to lodge documents and discharge its statutory obligations. Trust companies play the role of ensuring that offshore companies and offshore trusts are in fact offshore and remain offshore.

(b) Advantages of the Labuan International Financial Exchange (LFX):

- Operations are kept simple with minimal bureaucracy for efficiency and effectiveness.
- Labuan shares almost the same time zone with other Asian financial centres such as Hong Kong, Singapore, Seoul, Taipei and Tokyo.
- The LFX's rules are flexible in order to cater to the listing of a multitude of financial instruments.
- LFX promotes extensive usage of multimedia and Internet facilities allowing accessibility through international network and communication systems.
- No capital gains tax, no contract note duties, no exit levies and minimal corporate tax.

(c) The operations of the Labuan International Financial Exchange (LFX) are carried out via the Internet. From application for a listing sponsor licence to training in financial instruments listed on the LFX. Operations are done web-based via the Internet (www.lfx.com.my).

### Question 4

Candidates generally gave unsatisfactory answers to all the topics examined in this question.

4. (a) The four criteria Bank Negara Malaysia requires in approving foreign currency credit facilities (exceeding the equivalent of RM5million) to residents are:

- Productive purposes which generate foreign exchange earnings for Malaysia.
- Productive purposes which save outflow of foreign exchange from Malaysia through the production of import substitution goods.
- Large infrastructure projects.
- Working capital preferably should be sourced locally in the form of Ringgit facilities.

(b) Give any five of the following:

- Foreign Exchange trading for non-residents and authorised banks.

Examples:

- Spot/forward purchases and sales of foreign currencies
- Currency /Interest Rate swaps
- Currency Investment account
- Margin trading of forex account
- Structured trade / foreign exchange trading

- Trade Financing Facilities for non-residents only.

Examples:

- Establishing, opening, advising, confirming and negotiating letters of credit.
- Bills discounting and acceptance
- Financing and refinancing of trade transactions account
- Bankers Acceptances

- Foreign Currency Credit Facilities.

Examples:

- Short and long term financing
- Project financing
- Indemnity / Guarantees
- Syndication / loan arrangement

- Foreign currency deposits from residents and non-residents.

- Other financial services

Examples:

- Capital restructuring
- Advisory services
- Project evaluation
- Feasibility studies

- Trust Services

- (c) Labuan Interbank Offered Rates (LABOR) is a US Dollar interest rate benchmark for pricing loan rates in Labuan IOFC and reflects the cost of US Dollar funds in Labuan IOFC.

**Question 5**

Some candidates confused the definitions of “tax evasion” and “tax avoidance”.

5. (a) Money laundering is an activity which intends to change the sources of illegally obtained money into what appear to be legitimate sources.
- (b) Choose any five of the following:
- Large cash deposits by an individual or a company whose business is not reflective of large cash takings.
  - Substantial increases in cash deposits by individuals or companies without any apparent reason.
  - Customers transferring large sums of money to and from overseas locations with instructions to make payments in cash.
  - Customers seeking to exchange large quantities of low denomination notes for large ones.
  - Unexplained electronic fund transfers by customers without passing through an account.
  - Substantial amount of funds from countries noted for producing, processing, and marketing drugs or terrorist organisations.
  - Request to borrow against assets of third parties where the assets’ origin is unknown or where the value is inconsistent with the borrower’s standing.

- (c) Tax avoidance is an exercise involving the structuring of a transaction within the legal framework of the law to minimise present or future tax liabilities. It is not illegal to undertake this form of tax planning strategy.

Tax evasion is an exercise to avoid tax obligations through illegal means. It is an unlawful act to intentionally avoid paying any taxes to the Inland Revenue Department.