

CFL1

# Administration of Offshore Centres

12 APRIL 2005

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) State **four** primary objectives of setting up an International Offshore Financial Centre in Labuan. [8]
- (b) List **five** factors for individuals or corporations to consider offshore centres for their business operations and transactions. [5]
- (c) State **five** tax incentives for conducting offshore business activities at the International Offshore Financial Centre in Labuan. [5]
- (d) Define the terminology "offshore". [2]
- (Total:20 marks)
2. (a) State **five** functions of the Labuan Offshore Financial Services Authority. [10]
- (b) State **five** conditions a potential applicant must fulfil to obtain an offshore banking licence in Labuan. [10]
- (Total:20 marks)
3. (a) (i) What is the role of trust companies in Labuan? [4]
- (ii) List **five** categories (including the relevant sub-categories) of trust services offered by trust companies in Labuan. [13]
- (b) Define the terminology "resident" under the Offshore Companies Act 1990. [3]
- (Total:20 marks)
4. (a) A resident applying for credit facilities in foreign currency exceeding the equivalent of RM5million from a Labuan offshore bank requires the approval of Bank Negara Malaysia (BNM).  
State **four** criteria for approval of the credit facilities by BNM. [10]
- (b) What are **five** advantages of the Labuan International Financial Exchange? [10]
- (Total:20 marks)
5. (a) (i) Describe **three** stages of money laundering. [6]
- (ii) Define "suspicious transactions" under money laundering activities and list **three** examples of such transactions. [5]
- (b) Briefly describe the "Know Your Customer" policy. [4]
- (c) Define "tax avoidance". [5]
- (Total:20 marks)

- END OF QUESTION PAPER -

## **OUTLINE ANSWERS**

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

### **Question 1**

- There are no examiner's comments for this question.

1. (a) The primary objectives of setting up an International Offshore Financial Centre in Labuan:
- To complement the onshore financial system centred in Kuala Lumpur.
  - To strengthen the contribution of the financial sector towards the Gross National Product of Malaysia.
  - To enhance the attractiveness of Malaysia as an investment centre.
  - To promote the economic development of Labuan and its vicinity.
- (b) Give any five of the following factors for using offshore centres:
- High taxes in the country of residence
  - Inheritance provisions in the country of residence
  - Overseas employment contracts
  - Anonymity and secrecy
  - Political considerations
  - Re-routing expert sales
  - Depositing surplus funds
  - Accumulation of income prior to emigration on retirement
  - Geographical expansion
- (c) Give any five of the following tax incentives
- 3% of net profits from audited accounts or RM200,000 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 an offshore company pays to a non-resident or another offshore company are exempt from income tax and are not subject to withholding tax. However, no exemption is available in respect of interest that accrues to a place of business of a non-resident licensed to carry on a business under the BAFIA 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.
- (d) Offshore refers to a jurisdiction that is free from the restrictions of domestic reserve requirements and monetary controls as well as low tax rates for individuals and businesses.

## Question 2

- Candidates could not state the functions of the Labuan Offshore Financial Services Authority. They were also unable to state the licensing requirements.

2. (a) Give any five of the following functions of the Labuan Offshore Financial Services Authority:
- To administer, enforce, carry out and give effect to the provisions of the Labuan International Offshore Financial Centre legislations.
  - To carry out research and commission studies on offshore financial services in Labuan.
  - To make recommendations for the creation and improvement of any facility likely to enhance Labuan's attraction as a centre for offshore financial services.
  - To co-operate with offshore financial institutions and professional and industry associations in Labuan to promote and provide offshore financial services and to foster high standards of offshore financial services in Labuan.
  - To advise the Minister of Finance generally on matters relating to offshore financial services in Labuan.
  - To license or register persons carrying on offshore financial services in Labuan.
  - To regulate and supervise the conduct of offshore financial services in Labuan.
- (b) Give any five of the following conditions a potential applicant must fulfil to obtain an offshore banking licence in Labuan:
- The potential applicant must be either:
    - (i) an offshore company established; or
    - (ii) a foreign offshore company registered for the sole and exclusive purpose of carrying on offshore banking business/offshore investment banking business in Federal Territory Labuan; or
    - (iii) a Malaysian bank.
  - Must be a well-established bank of international standing and meets capital requirements:
    - International bank: capital/shareholders' funds of USD1billion
    - Regional and domestic bank: capital/shareholders' funds of USD500million
  - Setting up a subsidiary requires capital funds, unimpaired by losses, of at least RM10 million or its equivalent in other currencies.
  - Setting up a branch requires the head office to maintain capital funds of not less than the equivalent of at least RM10million.
  - Furnish the Labuan Offshore Financial Services Authority (LOFSA) with a letter of awareness from the home supervisory authority/regulator that effectively supervises the applicant.
  - Furnish a guarantee or an undertaking or both to LOFSA as an assurance that the offshore bank will be able to meet all its liabilities arising from its business in Labuan.

- Has a good credit rating given by established rating agencies e.g. Moody's Investors Services Incorporated, Standard & Poor's Corporation, IBCA Limited.
- Has a good track record of financial performance for at least three years preceding the application.
- Has the necessary expertise in international finance and foreign exchange.
- Has not received any adverse report or announcement in financial journals or newspapers or any other reliable source.
- Is effectively supervised by a strong home regulating authority.
- Has the support of its home regulating authority for its proposal to conduct offshore banking business in Labuan.
- Is committed to setting up a functional operation in Labuan and to develop it into a full-fledged offshore bank.

### Question 3

- There are no examiner's comments for this question.

3. (a) (i) The role of trust companies is to ensure that Labuan is not used as a centre for illicit or illegal activities that will tarnish its reputation as an International Offshore Financial Centre.

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 a role in ensuring offshore companies and offshore trusts are in fact offshore and remain offshore.

- (ii) Five categories of trust services offered by trust companies in Labuan:
1. Trust services:
    - Advice on formation of a trust
    - Drafting and execution of trust deeds
    - Acting as agent or trustee
    - Acting as administrator of a deceased's estate, executor of a will
    - Administration of trusts
  2. Fund/investment management:
    - Investment in shares, bonds, unit trusts/fixed assets, etc.
    - Placement of funds in deposits/repos
  3. Custody services:
    - Assets safekeeping
    - Dividends and other income collection
    - Tax reclamation
    - Notification of corporate actions
  4. Advisory and administrative services:
    - Incorporation of companies in all jurisdictions
    - Provide accounting, secretarial, directorship services, registered office and invoicing services/shipping documentation
    - Registration of trusts created in other jurisdictions

- Ship registration
- Provision of fiduciary, advisory and administrative services such as mailing address, mail forwarding, telex, telefax, lodgement of statutory returns, etc.

5. Portfolio management

(b) Definition of “resident” under the Offshore Companies Act 1990:

- A natural person, a citizen or permanent resident of Malaysia.
- A natural person who has established a place of business and is operating in Malaysia.
- Includes any person who is declared to be a resident pursuant to Section 43 of the Exchange Control Act 1953.

**Question 4**

- Candidates could not state the criteria for approval of credit facilities and were unable to state the advantages of the Labuan International Financial Exchange.

4. (a) Criteria for approval of the credit facilities by Bank Negara Malaysia:

- 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 should ideally be sourced locally in the form of Ringgit facilities.

(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.
- The 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.

### Question 5

- There are no examiner's comments for this question.

5. (a) (i) Stages of money laundering:

1. Placement: It is the physical disposal of cash from illegal sources.
2. Layering: A series of complex financial transactions designed to disguise the audit trail so as to provide anonymity to the source of funds.
3. Integration: The final stage in which illegitimate funds become legitimate.

(ii) Transactions that appear abnormal and are inconsistent with a customer's known legitimate business or personal activities are deemed as suspicious transactions.

Examples of suspicious transactions:

- Unusually large cash deposits by an individual or a company whose business is not reflective of large cash takings.
- Unexplained electronic fund transfers by customers without passing through an account.
- Substantial amount of funds from countries which are noted for production, processing and marketing of drugs or terrorist organisations.

(b) "Know your customer" policy

It is a policy that requires staff of financial institutions, when handling customers, to request for proper identification at the time a relationship is established to prevent fictitious accounts from being opened.

(c) Tax avoidance is an exercise involving the structuring of transactions within the legal framework of the law to minimise present or future tax liabilities. It is called tax planning. It is a well-recognised principle of taxation that every person is free to plan his affairs in a manner that minimises his present or future tax liabilities.