

CFL2

Offshore Legislation

10 OCTOBER 2001

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : 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 FIVE (5) QUESTIONS ONLY

1. (a) Answer "True" or "False" for each of the following:
- (i) The Supreme Court is the final court of appeal in Malaysia. [1]
 - (ii) The Sessions Court may hear all cases where the subject matter relates to motor vehicle accidents although the damage amount may exceed RM250,000. [1]
 - (iii) The High Court of the Federal Territory of Labuan has the exclusive jurisdiction to hear all matters pertaining to offshore legislation in Labuan. [1]
 - (iv) The doctrine of judicial precedent is also known as *mens rea*. [1]
 - (v) Section 3(1) of the Civil Law Act 1956 (Revised 1972) allows for English common law and the rules of equity to apply in Peninsula Malaysia. [1]
 - (vi) Since being made a Federal Territory, land law in Labuan is now governed by the National Land Code 1965. [1]
 - (vii) Judge-made law is more properly referred to as common law. [1]
- (b) The general rule in Malaysia is that contracts made by minors are void. List **three** exceptions to this rule. [3]
- (c) In relation to offshore legislation in Labuan, name the statute in each of the following:
- (i) The Act that provides for the establishment, regulation, dissolution, and the operations of offshore limited partnerships. [2]
 - (ii) The Act that provides for the creation and recognition of offshore trusts. [2]
 - (iii) The rate of profits of offshore companies and trusts are taxed under this Act. [2]
 - (iv) The main legislation that governs offshore banking business in Labuan. [2]
 - (v) The Act that sets out the legal framework for the incorporation, registration, and administration of offshore companies in Labuan. [2]
- (Total:20 marks)
2. (a) (i) What is a "contract"? [1]
- (ii) Identify **six** basic elements that constitute a contract. [6]
- (b) Briefly explain the following:
- (i) The difference between "fraud" and "misrepresentation" [2]
 - (ii) The doctrine of undisclosed principal [2]
 - (iii) The term "contributory negligence" [2]
- (c) State the relevant provision and statute that govern contributory negligence in Malaysia. [2]
- (d) In relation to the law of tort, fill in the blanks with the **correct word(s)** for each of the following:
- (i) The second element required in a negligence suit is a breach of the duty of care owed to the plaintiff by the defendant. The test used for the standard of care is that of a _____ [1]
 - (ii) The law of tort is a branch of _____ [1]

- (iii) The tort of defamation seeks to protect a person's _____. [1]
- (iv) The tort of _____ has been described as "a wrongful interference with goods, as by taking, using or destroying them, inconsistent with the owner's right of possession". [1]
- (v) Where both parties to an agreement are under a mistake as to a material matter essential to the agreement, the agreement is deemed _____. [1]
(Total:20 marks)
- 3.**
- (a) Define the term "agency". [2]
- (b) Explain briefly how an agency may be terminated. [6]
- (c) Answer "**True**" or "**False**" for each of the following:
- (i) An offshore bank may deal with Malaysian residents, subject to the Exchange Control Regulations and other restrictions. [1]
- (ii) Offshore banking business in Labuan is governed by the Code of Good Banking Practice. [1]
- (iii) The Powers of Attorney Act 1949 is applicable to Labuan by virtue of Article 5(1) of the Constitution (Amendment) (No. 2) Act 1984. [1]
- (iv) Section 22 of the Offshore Banking Act 1990 provides for the general rule on secrecy. [1]
- (v) The Labuan Offshore Limited Partnerships Act 1997 allows residents of Malaysia to form an offshore limited partnership for any lawful purpose. [1]
- (c) How are offshore banks expected to exercise due diligence in the opening of new accounts? In your answer, describe the core principles on the prevention of money laundering activities.[7]
(Total:20 marks)
- 4.**
- (a) What is meant by the term "tort"? [2]
- (b) Differentiate between "libel" and "slander". [2]
- (c) State **three** defences available for the tort of defamation. [3]
- (d) Identify the instances where specific performance may not be granted by the Courts. [6]
- (d) Explain the Code of Good Banking Practice and its application to the offshore banks in Labuan. [7]
(Total:20 marks)
- 5.**
- (a) Identify the various parties that are involved in the setting up of a trust, and explain briefly their roles and functions. [8]
- (b) Name the Acts that govern the incorporation and registration of trust companies in Labuan. [2]
- (c) In relation to offshore trusts, fill in the blanks with the **correct word(s)** for each of the following:
- (i) A _____ trust is a trust that is created for a particular purpose. [1]
- (ii) A trust that permits the trust property or funds to be used for the conduct of a business by the trustee as tax planning vehicles is known as a _____ trust. [1]

- (iii) A _____ trust is a type of offshore trust that may render the interest of the beneficiaries in the trust property, or in any income or capital of such property, be terminated or restricted from being alienated or disposed, in order to protect the settlor's interest and intention. [1]
- (iv) If a settlor retains too much control or influence over the manner in which the trust should be managed, then it can be construed as a _____ trust. [1]
- (v) A Labuan trust company must always be a _____ company. [1]
- (d) Describe how an offshore trust may be rendered invalid and unenforceable in Labuan. [3]
- (e) State briefly how the taxation provisions for an offshore trust operating in an offshore trading activity differ from those of a non-trading offshore trust. [2]
(Total:20 marks)
- 6.** (a) What are the various ways in which a power of attorney may be revoked? [4]
- (b) List the persons who may authenticate a power of attorney executed in Peninsula Malaysia pursuant to the First Schedule of the Powers of Attorney Act 1949. [6]
- (c) Identify **three** actions that a general partner of an offshore limited partnership has no authority to carry out. [3]
- (d) In relation to an offshore limited partnership, answer the following questions:
- (i) What is the minimum number of partners required to form a partnership? [1]
- (ii) A partnership may not consist of more than _____ partners. [1]
- (iii) What is the required composition of partners in an offshore limited partnership? [2]
- (e) Name the **three** types of limited partnership that can be established under the Labuan Offshore Limited Partnerships Act 1997. [3]
(Total:20 marks)

- END OF QUESTION PAPER -

OUTLINE ANSWERS

Question 1

While this question was generally well answered, there were candidates who were unable to provide the proper names of the various offshore statutes. Some of the common errors in stating these statutes included adding the word 'Labuan' before every statute and not stating the year of the statute.

1. (a) (i) False
- (ii) True
- (iii) False
- (iv) False
- (v) True
- (vi) False
- (vii) True

- (b) A minor can enter into a contract in any **one** of the following exceptions:
 - It is a contract for necessities.
 - It is a contract of scholarship.
 - It is a contract of insurance.

- (c) (i) Labuan Offshore Limited Partnership Act 1997
- (ii) Labuan Offshore Trusts Act 1996
- (iii) Labuan Offshore Business Activity Tax Act 1990
- (iv) Offshore Banking Act 1990 (Amendment Act 1996)
- (v) Offshore Companies Act 1990

Question 2

Although candidates did well in part (a) of the question, many had difficulty providing the definition of the doctrine of undisclosed principal. Also, many of the candidates could not name the statute governing contributory negligence although they knew the meaning of contributory negligence. The majority of candidates did not know that the test used for the standard of care in a negligence suit was that of a 'reasonable person'.

2. (a) (i) A contract is an agreement enforceable by law – Section 2(b) of the Contracts Act 1950.
- (ii) The basic elements that constitute a contract are as follows:
- an offer or proposal
 - acceptance of that offer/proposal
 - an intention to create legal relations
 - consideration
 - certainty of the terms
 - capacity of the parties
- (b) (i) The basic difference between fraud and misrepresentation is that in fraud the person making the representation does not, himself, believe in the truth of the representation. Fraud has the element of fraudulent intention. In the case of a misrepresentation, the person believes, even if it is a mistaken belief, that the representation he makes is true.
- (ii) This doctrine applies where the principal is not disclosed and the agent acts as if he is the principal.
- (iii) Contributory negligence is a defense available to a defendant if the plaintiff has contributed in any way to the negligence of the defendant, thereby resulting in the damage suffered. If the defendant succeeds in proving contributory negligence, the damages awarded to the plaintiff will be apportioned and reduced accordingly.
- (c) In Malaysia, contributory negligence is governed by Section 12(1) of the Civil Law Act 1956.
- (d) (i) reasonable person
- (ii) civil law
- (iii) reputation
- (iv) conversion
- (v) void

Question 3

This was another question (apart from question 1) in which most candidates did well. The only weak point was that when candidates were asked on how an agency may be terminated, they failed to mention that an agency could also be terminated upon the performance of the contract.

3. (a) An agency is the relationship that subsists between a principal and an agent who is authorised to act for him or represent him in dealings with others.
- (b) An agency may be terminated by
- the act of the parties.
 - upon revocation by the principal
 - renunciation by the agent
 - mutual consent of both parties
 - operation of law
 - upon performance of the contract
 - upon expiry of the fixed period in the contract of the agency
 - upon death of either principal or agent
 - when either principal or agent becomes insane
 - when principal or agent is rendered insolvent or made a bankrupt
 - illegality - when an event occurs that renders the agency unlawful
- (c) (i) True
- (ii) False
- (iii) False
- (iv) True
- (v) True
- (d) The Offshore Banking Act (OBA) 1990 specifically states that no licensed offshore bank shall open an account for a customer whose identity is not known to the bank. LOFSA has also issued and recommended several preventive measures to be followed in order to ensure that the offshore bank does not get involved, whether intentionally or otherwise, in money laundering activities.

The core principles for the prevention of money laundering activities are as follows:

- **Know your customer**
Offshore banks should be familiar with the identity and business of the customer. Section 15(2) of the OBA prohibits an offshore bank from opening an account for a customer whose identity is not known to the offshore bank. For this purpose a lot of verification work is involved. This means even if a potential customer has the necessary documents that can vouch for his identity and business, that factor alone may not suffice and thus it may not automatically allow him to open an account.

With respect to the opening of accounts most offshore banks have strict procedures in place for ascertaining the identity of customers, beneficial owners and the source of funds deposited into an account. Some of the procedures could include customer referrals or recommendations, information regarding clients' affairs, interviews and sight of original documents. (e.g. passports.)

- **Comply with legislation and cooperate with law enforcement agencies**
An offshore bank should ensure that business is conducted in conformity with high ethical standards and local laws and regulations pertaining to financial transactions. Offshore banks should also cooperate fully with national law enforcement authorities to the extent permitted without breaching customer confidentiality.

- **Maintain records**
An offshore bank should keep records and have adequate procedures for maintaining internal records. For example, they should maintain all necessary records on transactions for at least five years, to enable them to comply swiftly with information requests from the regulatory authorities. Such records must be sufficient to permit reconstruction of individual transaction or audit trails so as to provide evidence for prosecution purposes, if necessary. Essential information would include records on customer identification (copies of official identification documents like passports, driving licenses or other similar documents), account files and business correspondence.

Question 4

Candidates were familiar with the terms “tort”, “libel” and “slander”.

Many of the candidates did not know the defences available for defamation nor were they familiar at all with the circumstances in which a court would not grant the remedy of a specific performance.

4. (a) A tort is a civil wrong that is committed against a person or an individual.
- (b) Libel is a defamatory statement in a permanent form, usually in written form, while slander is a defamatory statement in oral form, i.e. – it is spoken.
- (c) The **three** defences available for an action of defamation are:
- (i) **Justification**
 - where the defamatory words are true.

 - (ii) **Fair comment**
 - defamatory words relate to public interest
 - it is an expression of opinion
 - it is fair

 - (iii) **Privilege**
 - statements made on the grounds of public policy – e.g. statements made during judicial proceedings
 - it is not malicious

- (d) Specific performance may not be granted in any **one** of the following circumstances, where:
- (i) damages will provide adequate remedy
 - (ii) the terms of the contract are uncertain
 - (iii) there has been a delay in instituting action
 - (iv) there is an evidence of fraud
 - (v) to do so would require constant supervision of the court
 - (vi) the contracts are for personal services
- (e) The Code of Good Banking Practice was implemented by the Association of Bankers in Malaysia on July 1, 1995, for banks to observe in their dealings with their customers. The Code espouses good banking practices, which are considered universal in nature. Therefore, it serves as a useful guide for offshore banks in their dealings with their customers.

However, offshore banks in Labuan are not bound by this Code as they are not members of the Association. Furthermore, not all the practices enumerated in the Code are relevant to offshore banks, for example the practices relating to cheques, credit cards and electronic banking cards, which are services offshore banks are prohibited from providing. Finally, it should also be noted that LOFSA has not issued this Code to offshore banks in Labuan.

Question 5

While candidates could identify the various parties involved in setting up a trust, only a few could name the two Acts governing the incorporation and registration of trust companies in Labuan.

Some of the candidates mixed up the types of trust. Many also failed to state that a sham trust was also an invalid trust.

5. (a) There are generally **four** parties involved in the setting up of a trust.
- **Settlor**
A settlor is a person who creates the trust and includes the person who provides trust property to the trust. In essence, the settlor is disposing off the legal title to the property to the trustee.
 - **Beneficiary**
A beneficiary is the person entitled to benefit under the trust or entitled to exercise discretion to distribute the property held in the trust. Generally there are two categories of beneficiaries. Capital beneficiaries are those entitled to the capital of the trust at a future date. Income beneficiaries are those individuals entitled only to the income of the trust.
 - **Trustee**
A trustee is a person appointed to act as an administrator of a trust to which a property has been transferred. He holds the legal title to the property held under the trust but generally holds no beneficial interest in the trust.
 - **Protector**
A protector is a person appointed to act on behalf of the settlor in protecting the settlor's interest and may be granted wide powers. The protector links the settlor and the trustee. His powers as a watchdog include the ability to terminate the services of the trustee and appoint a new one.

- (b) Labuan trust companies are incorporated under the Companies Act 1965 and registered under the Labuan Trust Companies Act 1990.
- (c) (i) purpose
(ii) trading
(iii) protective
(iv) sham
(v) domestic
- (d) An offshore trust may be rendered invalid and unenforceable in Labuan where it requires, purports or encourages the doing of an act which is an offence under the laws of Malaysia. If the act is punishable as a criminal offence and unlawful under the laws of another country or jurisdiction, it is also an offence and unlawful in Malaysia if it is carried out in Malaysia.
- Further, where a trust is created and appears as a valid trust but in fact the settlor or trustee has no intention of carrying out the terms of the trust in accordance with the trust deed. This is known as a sham trust and will also be held as invalid and unenforceable.
- (e) Pursuant to Sections 4 and 7 of the Labuan Offshore Business Activity Tax Act 1990 of Labuan, an offshore trust carrying on any offshore trading activity will be taxed respectively at the rate of three percent (3%) of the net income or a fixed sum of RM20,000 whichever is elected. In contrast, an offshore trust that carries on purely offshore non-trading activity will not be taxed.

Question 6

Almost half the candidates confused the revocation of a power of attorney with the termination of an agency.

Candidates did not know the limitations of a general partner's authority in an offshore limited partnership.

The most notable weakness was spotted in the question that asked candidates to list the persons who could certify or vouch for the power of attorney that has been created. The answers the candidates gave included the High Court and Sessions Court (it should be noted that the Courts are not persons), judges, agency company, with one candidate even naming the Yang diPertuan Agung.

6. (a) A power of attorney may be revoked in any one of the following ways:
- by notice of revocation by the donor
 - by notice of renunciation by the donee
 - by effluxion of time, frustration or impossibility of performance
 - by operation of law – when prohibited by law
- (b) Any one of the following persons may authenticate a power of attorney in Peninsular Malaysia pursuant to the First Schedule of the Powers of Attorney Act 1949:
- a magistrate
 - a Justice of Peace
 - a Land Administrator
 - a notary public
 - a Commissioner for Oaths

- an advocate and solicitor
 - an officer acting in the course of his employment, of a company carrying on the business of banking in Peninsular Malaysia and incorporated by or under any written law in force in Peninsular Malaysia
- (c) A general partner of an offshore limited partnership has no authority to:
- commit an act that makes it impossible for the partnership to operate;
 - possess property or dispose of any right of the partnership for any purpose other than the partnership's purposes; and
 - admit a person as general or limited partner unless provided for in the partnership agreement.
- (d) (i) 2 – a partnership shall consist of not less than **two** partners.
- (ii) 20 – a partnership shall not have more than 20 partners.
- (iii) An offshore limited partnership must comprise of at least one general partner and at least one limited partner.
- (d) **Three** types of limited partnership under LOLPA:
- Offshore professional partnership
 - Offshore project partnership
 - Offshore general limited partnership