



## **INLAND REVENUE BOARD MALAYSIA**

**GRATUITY**

**PUBLIC RULING NO. 10/2011**

*Translation from the original Bahasa Malaysia text*

**DATE OF ISSUE: 5 DECEMBER 2011**



<b>CONTENTS</b>	<b>Page</b>
1. Introduction	1
2. Interpretation	1
3. Lump Sum Payment On Termination Of Employment	1
4. Situations For Payment Of Gratuity	2
5. Determination Of Elements Of Gratuity And Compensation	2
6. Tax Treatment Of Gratuity	3
7. Gratuity Payment Credited To Employees Provident Fund	10
8. Effective Date	11

#### **DIRECTOR GENERAL'S PUBLIC RULING**

A Public Ruling as provided for under section 138A of the Income Tax Act 1967 is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board Malaysia. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General of Inland Revenue,  
Inland Revenue Board Malaysia.**

1. This Ruling explains the method used to characterise lump sum payments received by employees upon the termination of their employment as gratuity and the tax treatment of gratuity.
2. The relevant provisions of the Income Tax Act 1967 (ITA 1967) in this Ruling are sections 7, 13, 25, subsection 83(3) and paragraph 25 of Schedule 6.
3. The words used in this Ruling have the following meaning:
  - 3.1 “Employer” in relation to an employment, means –
    - (a) where the relationship of master and servant subsists, the master;
    - (b) where the relationship does not subsist, the person who pays or is responsible for paying any remuneration to the employee who has the employment, notwithstanding that that person and the employee may be the same person acting in different capacities.
  - 3.2 “Employee” in relation to an employment, means –
    - (a) where the relationship of servant and master subsists, the servant;
    - (b) where the relationship does not subsist, the holder of the appointment or office which constitutes the employment.
  - 3.3 “Employment” means –
    - (a) employment in which the relationship of master and servant subsists;
    - (b) any appointment or office, whether public or not and whether or not that relationship subsists, for which remuneration is payable.

#### 4. Lump Sum Payment On Termination Of Employment

- 4.1 An employee’s employment may cease due to a variety of reasons such as retirement, resignation, premature termination of the contract of service or by mutual agreement.
- 4.2 When an employment ceases, the employer may make a lump sum payment in accordance with the terms and conditions of the contract of service. The lump sum payment may be described by the employer as compensation for loss of employment, ex-gratia, contractual payment, retrenchment payments, gratuity, etc.
- 4.3 The circumstances and nature of the payment must be reviewed to determine the real character of the payment. The amount paid on the termination of an employment may consist of the following 2 elements:

- (a) it is attributable to the loss of employment such as redundancy (compensation); and
- (b) it is attributable to the past services of the employee (gratuity).

The purpose of the lump sum payment has to be established in order to determine the tax treatment of the payment received by the employee.

- 4.4 Employees can seek redress for wrongful dismissal or termination breaches of the employment contract by the employer by making a complaint or claim to the Department of Industrial Relations Malaysia, Industrial Court, Civil Courts or Labour Court. Where the court finds that the dismissal was without cause or excuse, the two main remedies that are determined by the court are reinstatement of the dismissed employee and/or monetary compensation for the wrongfully dismissed employee. As such, the monetary award by the court to the employee has to be analysed in order to ascertain the tax treatment on the recipient.

## 5. Situations For Payment Of Gratuity

When an individual ceases employment upon resignation or retirement, he may be paid a lump sum termination benefit in respect of his long period of service. If the payment is attributable to the past services of the employee, it would generally be characterised as a gratuity. The particular circumstances of each case would determine whether the termination benefit is indeed a gratuity payment or compensation for loss of employment.

## 6. Determination Of Elements Of Gratuity And Compensation

- (a) For the purposes of income tax exemption, the characteristics and nature of termination payments prevail over form and labelling of such payments.
- (b) The method of making an apportionment between gratuity and compensation depends on the circumstances of each case. In general, consideration is given to the employer's normal practice in granting gratuities to employees leaving his service and the rate or amount of gratuities normally granted.

### Example 1

#### Distinction between gratuity and compensation for loss of employment

It has been the practice of Jaya Builders Sdn Bhd to pay a lump sum gratuity of RM10,000 to all employees who leave after 10 years of service. In 2009, one of its employees who had been in service for 11 years was

declared redundant and was paid a lump sum of RM50,000 as compensation for loss of employment and gratuity.

*The lump sum of RM50,000 is considered to consist of an element of gratuity amounting to RM10,000 (as specified by the employer and calculated by reference to the employer's normal rate and practice) and an element of compensation for loss of employment of RM40,000.*

- (c) If the lump sum payment is received due to premature termination of an employment which has the prospect of continuing up to the retirement age, such sums are treated as compensation for loss of employment and not gratuity.

### **Example 2**

#### **Premature termination prior to 1.7.2008**

Donald, aged 40, had commenced employment with Sam Electronics Sdn Bhd on 1.6.1998. He was retrenched on 30.6.2008 due to a merger exercise which involved his employer and this resulted in his post being declared redundant. His employer paid him retrenchment benefits of RM100,000.

*Donald was prematurely terminated in an employment which had the real prospect of continuing up to retirement age. The retrenchment benefits received is considered as compensation for loss of employment.*

- (d) Where a contract of employment is for a specific number of years and the employment ends at the specified time or the retirement age, any lump sum paid to the employee should not be treated as compensation for loss of employment. This is because the full term of the contract has expired or the cessation of employment is on the retirement age.

## **7. Tax Treatment Of Gratuity**

Pursuant to paragraph 13(1)(a) of the ITA 1967, gratuity is specifically included in the gross income from an employment. However, an employee receiving a gratuity upon retirement from an employment would qualify for full exemption by virtue of paragraph 25 of Schedule 6 of the ITA 1967 under the following circumstances:

- (a) if the Director General of Inland Revenue (DGIR) is satisfied that the retirement was due to ill-health;

### Example 3

#### Early retirement due to ill-health

Aiman, a quantity surveyor, had worked for his employer for 22 years. In 2008 he met with an accident which left him with a serious health problem. He was advised by his doctor to stop working. He had no choice but to opt for early retirement at the age of 53 on 1.1.2009. Aiman's employer accepted his request for early retirement based on the medical report from the company's panel of doctors and paid him RM150,000 as retirement gratuity in accordance with the company's policy.

*Aiman qualifies for a full exemption on the retirement gratuity as he was able to prove to the DGIR that his early retirement was due to ill health.*

- (b) If the retirement takes place on or after reaching the age of 55, or on reaching the compulsory age of retirement from employment specified under any written law, and in either case from an employment which has lasted 10 years with the same employer or with companies in the same group;

### Example 4

#### Compulsory retirement after working in the same company for more than 10 years

Rani had worked as a secretary in a multinational company for 23 years. She retired upon reaching the age of 55 and received a gratuity of RM100,000.

*As Rani retired at the age of 55 years and had worked with the same employer for more than 10 years, she qualifies for a full exemption on the retirement gratuity.*

### Example 5

#### Early retirement – worked for more than 10 years in the same company

Jamil had worked with an architect firm since 1.1.1980. He decided to retire early from service (not based on any collective agreement or compulsory age of retirement) at the age of 53 years on 31.1.2009. He was paid a retirement gratuity of RM142,000.

*Although Jamil worked with the same company for more than 10 years but he retired before the compulsory retirement age of 55 years. Therefore, he does not qualify for an exemption on the retirement gratuity received.*

### Example 6

#### **Compulsory retirement of a non-executive director who had served on the board of directors for more than 10 years**

Ramlee had been a non-executive director on the board of directors of a telecommunications company in Kuala Lumpur since 1.1.1999. He retired at the Annual General Meeting (AGM) of the company at the age of 70 on 31.1.2009. Pursuant to section 139(6) of the Companies Act 1965, directors over 70 years of age are required to retire at every AGM and may offer themselves for reappointment. Ramlee decided not to offer himself for reappointment as a director. The company awarded him a retirement gratuity of RM300,000.

*As Ramlee had reached the compulsory age of retirement as a director and had served for more than 10 years (10 years and 1 month) in the same company, he qualified for full exemption on the retirement gratuity received.*

### Example 7

#### **Compulsory retirement of a non-executive director who had served on the board of directors for less than 10 years**

The facts are the same as in Example 6 except that Ramlee was initially appointed as a non-executive director since 1.1.2003 instead of 1.1.1999.

*Ramlee does not qualify for exemption on the gratuity received although he had reached the compulsory age of retirement as a director at 70 years as he had only served on the board of directors for 6 years and 1 month.*

*Ramlee's employment commenced more than 5 years before 1.1.2009 (beginning of the basis period in which the employment ceased). As such, the lump sum gratuity payment cannot be divided according to the period of employment but will be spread back equally over the last 6 basis periods i.e. from 2004 to 2009 as follows:*

<i>Year Of Assessment</i>	<i>Basis Period</i>	<i>Apportionment</i>	<i>RM</i>
2004	1.1.2004 - 31.12.2004	300,000 ÷ 6	50,000
2005	1.1.2005 - 31.12.2005	300,000 ÷ 6	50,000
2006	1.1.2006 - 31.12.2006	300,000 ÷ 6	50,000
2007	1.1.2007 - 31.12.2007	300,000 ÷ 6	50,000
2008	1.1.2008 - 31.12.2008	300,000 ÷ 6	50,000
2009	1.1.2009 - 31.1.2009	300,000 ÷ 6	50,000
<i>Total</i>			300,000

- (c) If the retirement takes place on reaching the compulsory age of retirement pursuant to a contract of employment or collective agreement at the age of 50 but before 55 and that employment has lasted 10 years with the same employer or with companies in the same group.

### **Example 8**

#### **Compulsory retirement under collective agreement - after having worked with companies in the same group for more than 10 years**

Chan had worked in two different companies under the same group of companies since 1.9.1995. According to a collective agreement between the employees union and the company, he was required to retire at the age of 50 years. Chan retired on 31.1.2009 upon reaching the age of 50 years and received RM108,000 as retirement gratuities.

*As Chan retired at the compulsory retirement age of 50 years in accordance with the collective agreement and had worked for more than 10 years with companies in the same group of companies, he qualified for a full exemption of the gratuity received.*

### **Example 9**

#### **Compulsory retirement under contract of employment - after having worked with companies in the same group for less than 10 years**

Pritam worked as a football coach with a club since 1.1.2005. He retired on 31.3.2009 upon reaching the age of 50 years which is the compulsory

retirement age pursuant to an employment contract with the company. A retirement gratuity of RM22,000 was paid to him.

*Although Pritam retired at the compulsory retirement age of 50 years pursuant to the employment contract but because the period of employment with the employer was less than 10 years, he did not qualify for an exemption on the gratuity received.*

*As Pritam's period of employment was less than 5 years, the gratuity will be spread back equally over the period of employment as follows:*

Year Of Assessment	Basis Period	Apportionment	RM
2005	1.1.2005 - 31.12.2005 (12 months)	12/51 X 22,000	5,176
2006	1.1.2006 - 31.12.2006 (12 months)	12/51 X 22,000	5,176
2007	1.1.2007 - 31.12.2007 (12 months)	12/51 X 22,000	5,176
2008	1.1.2008 - 31.12.2008 (12 months)	12/51 X 22,000	5,176
2009	1.1.2009 - 31.3.2009 (3 months)	3/51 X 22,000	1,296
<i>Total</i>			22,000

### Example 10

#### Retirement at the optional retirement age under a collective agreement

Joshua had served in 3 different companies within the same group of companies since 1.6.1996. On 28.2.2009, he retired at the age of 54 years. He was paid a retirement gratuity of RM120,000. According to a collective agreement between the employees union and the company, the compulsory age of retirement is 55 years with an option to retire at the age of 50 years.

*Joshua did not qualify for exemption on the retirement gratuity received as he did not retire at the compulsory age of retirement although he had worked for more than 10 years within the same group of companies.*

*Joshua commenced his employment more than 5 years prior to 1.1.2009. As such, the lump sum gratuity payment will be spread back equally over the last 6 basis periods i.e. from 2004 to 2009 as follows:*

<i>Year Of Assessment</i>	<i>Basis Period</i>	<i>Apportionment</i>	<i>RM</i>
2004	1.1.2004 - 31.12.2004	120,000 ÷ 6	20,000
2005	1.1.2005 - 31.12.2005	120,000 ÷ 6	20,000
2006	1.1.2006 - 31.12.2006	120,000 ÷ 6	20,000
2007	1.1.2007 - 31.12.2007	120,000 ÷ 6	20,000
2008	1.1.2008 - 31.12.2008	120,000 ÷ 6	20,000
2009	1.1.2009 - 28.2.2009	120,000 ÷ 6	20,000
		<i>Total</i>	120,000

### **Example 11**

#### **Reemployed by the same employer after compulsory retirement**

Zubir retired at the compulsory retirement age of 55 years on 28.2.2010 after working for a telecommunications company for the past 18 years. He received a gratuity of RM200,000 on 28.2.2010. The company offered Zubir a contract on a year-to-year basis to continue working under the same terms and conditions. Zubir accepted the offer to continue working with the company after the age of 55.

*Zubir had retired at the compulsory age of retirement of 55 before accepting the offer to work on a contract on a year-to-year basis. As he had worked for more than 10 years with the same company, he was entitled to exemption on the retirement gratuity of RM200,000.*

- (d) Gratuity that is not exempt from tax pursuant to subparagraph 25(1) of Schedule 6 of the ITA 1967 will be taxed accordingly in the relevant basis period as provided in the proviso to subsection 25(4) of the ITA 1967. Where, on cessation of his employment, an employee receives a lump sum payment by way of deferred pay, gratuity or otherwise, other than gross income under paragraph 13(1)(d) or (e) of the ITA 1967, the lump sum is:

- (i) spread over the last 6 basis periods (as shown in Example 7) if the employment began more than 5 years before the beginning of the basis period in which the employment ceased;
- (ii) spread over the period of employment, including periods during which the employee was employed by a different company, but within the same group of companies (as shown in Example 12).

**Example 12**

**Gratuity spread over period of employment**

Ernest, 50 a financial controller worked at Designer Shoes Sdn Bhd from 1.1.2005 to 31.12.2006 and at another subsidiary company, Footwear Sdn Bhd from 1.1.2007. He decided to opt for early retirement on 30.9.2008 upon learning that the group of companies would be undergoing a restructuring exercise in 2009. The employer paid him a retirement gratuity of RM50,000.

*Ernest worked for the two different companies within the same group from 1.1.2005 to 30.9.2008 (3 years and 9 months). As his employment period was less than 5 years, the lump sum gratuity will be spread back equally over the period of employment as follows:*

Year Of Assessment	Basis Period	Apportionment	RM
2005	1.1.2005 - 31.12.2005 (12 months)	$12/45 \times 50,000$	13,333
2006	1.1.2006 - 31.12.2006 (12 months)	$12/45 \times 50,000$	13,333
2007	1.1.2007 - 31.12.2007 (12 months)	$12/45 \times 50,000$	13,333
2008	1.1.2008 - 30.9.2008 (9 months)	$9/45 \times 50,000$	10,001
<i>Total</i>			<i>50,000</i>

**8. Gratuity Payment Credited To Employees Provident Fund**

- (a) There may be certain collective agreements between the employer and employee, or under a scheme that benefits the employees, where gratuity is paid when a resignation takes place prior to retirement. However, there may be a condition whereby the gratuity is not paid directly to the employee but is paid to the employee's Employees Provident Fund (EPF) account.
- (b) In the above situation, where crediting of the gratuity to the EPF account is either compulsory or optional, the gratuity accrues as income at the time when the payment arises. As such, the provisions of subsection 25(4) of the ITA 1967 are also applicable on the lump sum gratuity payment (refer to paragraph 7(d) of this Ruling). Employers are required to credit the net amount (after deducting income tax) to the EPF account.

In order to determine the amount of tax to be deducted, employers are required to file a Form 22A [Notification Of Cessation Of Employment (Employment of Private Sector Employees)] to Inland Revenue Board Malaysia's (IRBM) branch office handling the income tax file of the employee concerned. The employer must withhold money payable to the employee until they receive a Clearance Letter from IRBM.

**Example 13**

**Gratuity credited to approved fund**

Ruben had served with a bank in Kuala Lumpur since 1.4.1990. When the bank underwent a restructuring in 2008, he decided to retire earlier. His resignation took effect from 31.3.2009 after 19 years of service at the age of 50 years. The bank paid Ruben a retirement gratuity of RM190,000 which was to be credited to his EPF account (in accordance with a collective agreement between the bank and the employees' union). The employer credited the net amount of gratuity to Ruben's EPF account after deducting tax to be remitted to the DGIR.

*Ruben did not qualify for exemption on the gratuity received as he resigned from his employment before the compulsory age of retirement at 55 years. The gratuity accrues as income at the date the gratuity was credited into Ruben's EPF account. As Ruben's employment commenced more than 5 years before 1.1.2009 (beginning of the basis period in which his employment ceased), the gratuity is spread back equally over the last 6 basis period, i.e. from 2004 to 2009 as follows:*

<i>Year Of Assessment</i>	<i>Basis Period</i>	<i>Apportionment</i>	<i>RM</i>
2004	1.1.2004 - 31.12.2004	190,000 ÷ 6	31,667
2005	1.1.2005 - 31.12.2005	190,000 ÷ 6	31,667
2006	1.1.2006 - 31.12.2006	190,000 ÷ 6	31,667
2007	1.1.2007 - 31.12.2007	190,000 ÷ 6	31,667
2008	1.1.2008 - 31.12.2008	190,000 ÷ 6	31,666
2009	1.1.2009 - 31.3.2009	190,000 ÷ 6	31,666
		<i>Total</i>	190,000

**Example 14**

**Gratuity credited to approved fund**

Haizal worked for an oil and gas company in Malaysia since 1999. His employer had been contributing to an approved retirement fund since he joined service. Haizal, aged 48 opted for early retirement with effect from 1.5.2009. Pursuant to a collective agreement between the company and the employees' union, the accumulated retirement benefits of RM240,000 from the approved retirement fund was paid into Haizal's account with the EPF.

*Haizal did not qualify for exemption on the retirement benefit received as he opted for an early retirement at the age of 48. The retirement gratuity accrued as income at the date the gratuity was credited into Haizal's EPF account. As Haizal's employment commenced more than 5 years before 1.1.2009 (beginning of the basis period in which his employment ceased), therefore the gratuity is spread back equally over the last 6 basis period i.e. from 2004 to 2009. The employer has to deduct tax from the retirement benefit of RM240,000 before crediting the balance into the EPF account.*

**9. Effective Date**

This ruling is effective for the year of assessment 2011 and subsequent years of assessment.

**Director General of Inland Revenue,  
Inland Revenue Board Malaysia.**