



INLAND REVENUE BOARD OF MALAYSIA

GRATUITY

PUBLIC RULING NO. 9/2016

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INLAND REVENUE BOARD OF MALAYSIA **Date of Publication: 23 November 2016**

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DIRECTOR GENERAL'S PUBLIC RULING

Section 138A of the Income Tax Act 1967 [ITA] provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

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

1. Objective

The objective of this Public Ruling (PR) is to explain 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. Relevant Provisions of the Law

- 2.1 This PR takes into account laws which are in force as at the date this PR is published.
- 2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are sections 7, 13, 25, subsection 83(3), 150, paragraphs 14, 25, 25A, 25B, 25D and 30A of Schedule 6.

3. Interpretation

The words used in this PR 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 two 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 contract of employment 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 according to the employer's normal practice in

granting gratuities to employees leaving his service and the rate or amount of gratuities normally granted. The terms of the employment with regards to payment of retirement benefits including gratuities would normally be stated in the contract of service or in other documents that binds the employer and employee.

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 2016, one of its employees who had been in service for 11 years was declared redundant and was paid a lump sum payment of RM50,000 as compensation for loss of employment and gratuity.

The lump sum payment 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

Donald, aged 40, had commenced employment with Sam Electronics Sdn Bhd on 1.6.2005. He was retrenched on 30.6.2016 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 payment paid to the employee would be treated as gratuity if it is payment for past services. 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, gratuity is specifically included in the gross income from an employment. Effective year of assessment 2016, all employment income receivable for any particular period will be taxed in the year the payment is received by virtue of subsection 25(1) of the ITA. In other words, gross income from employment received will be treated as gross income in the year of receipt, regardless of the period to which the income is attributable.

7.1 Full exemption on gratuity payment

According to the Minimum Retirement Age Act 2012 (Act 753), retirement means termination of a contract of service of an employee on the ground of age. 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 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

Retirement due to ill-health

Aiman, a quantity surveyor, had worked for his employer for 22 years. The employer was satisfied with his performance all these years. In 2015, he suffered a heart attack and was diagnosed with serious heart disease. Aiman was advised by his doctor that if he were to continue with his demanding work schedule, he would probably suffer another heart attack, which could be fatal. He had no choice but to opt for early retirement at the age of 53 on 31.1.2016. Aiman's employer accepted his request for early retirement based on –

- (i) the medical report from the company's panel of doctors regarding his serious medical condition and the doctor's recommendation that he should not carry out any further duties inclusive of light duties; and
- (ii) documentary proof of medical treatment received since his heart attack.

The company paid Aiman RM350,000 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 satisfaction of the DGIR that his 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

Zubir retired at the compulsory retirement age of 60 years on 28.2.2014 after working for a telecommunications company for the past 18 years. He was paid a gratuity of RM180,000 for his 18 years of service with the company.

As Zubir retired upon reaching the compulsory age of retirement and he had worked with the same employer for more than 10 years, he qualifies for a full exemption on the retirement gratuity.

Example 5

Retired after age 55 years and worked 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 on 31.5.2016 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.

- (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 6

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 31.1.2016 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, he qualifies for a full exemption of the gratuity.

Note

Effective 1.7.2013, the minimum retirement age for employees is increased from 55 to 60 years under the Minimum Retirement Age Act 2012 (Act 753). However, this new ruling does not prevent an employee from retiring upon attaining the age of optional retirement, as agreed to in the contract of service or collective agreement. The amendment to the minimum retirement age has no effect on the tax treatment of gratuity received.

7.2 Exemption of RM1,000 for each completed year of service on gratuity payment

Effective year of assessment 2016, pursuant to paragraph 25D of Schedule 6 of the ITA, an employee who receives sums by way of gratuity –

- (i) on retirement from an employment; or
- (ii) upon termination of a contract of employment

other than when paragraphs 25, 25A, 25B or 30A of Schedule 6 of the ITA applies, is eligible for an exemption of RM1,000 for each completed year of service (referred to as partial exemption for the purpose of this PR).

However, paragraph 25D of Schedule 6 of the ITA does not regard a period of employment with other companies in the same group as a period of employment with the same employer. In other words, if the employment is with companies in the same group, the partial exemption is only applicable to the gratuity attributable to the service with the last company in the group.

The balance of gratuity after taking into account the partial exemption will be taxed in the year of receipt as provided in subsection 25(1) of the ITA. 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, the lump sum payment is taxed in the year of receipt.

The partial exemption does not apply to any sums received by an employee from an unapproved retirement scheme [paragraph 13(1)(d) of the ITA] or compensation for loss of employment [paragraph 13(1)(e) of the ITA].

Example 7

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

Fasha had worked as a secretary in a multinational company for 9 years. She retired upon reaching the age of 60 on 12.8.2016 and received a gratuity of RM100,000.

Fasha qualifies for a partial exemption on the retirement gratuity. The amount that qualifies for the exemption is RM9,000 (RM1,000 X 9 completed years of service). The balance of RM91,000 (RM100,000 less RM9,000) will be taxed in the year of receipt (year of assessment 2016).

Example 8

Retirement under a contract of employment after having worked with the same company for less than 10 years

Pritam worked as a football coach with a club since 1.1.2012. He retired on 31.3.2016 upon reaching the age of 50 years which is the compulsory retirement age pursuant to a contract of employment with the company. A retirement gratuity of RM22,000 was paid to him for his service of 4 years and 3 months.

Pritam qualifies for a partial exemption on the retirement gratuity. He retired upon reaching the age of 50 years as provided in the contract of employment. The amount that qualifies for the exemption is RM4,000 (RM1,000 X 4 completed years of service). The balance of RM18,000 (RM22,000 less RM4,000) will be taxed in the year of receipt (year of assessment 2016).

Example 9

Retirement before the age of 55 years regardless of the years of service in the company

Jamil had worked with an architect firm since 1.1.2000. He decided to retire early from service at the age of 53 years on 31.1.2016. He was paid a retirement gratuity of RM142,000 after working for 16 years and 1 month.

Jamil qualifies for a partial exemption on the retirement gratuity of RM142,000 upon his early retirement. The amount that qualifies for the exemption is RM16,000 (RM1,000 X 16 completed years of service). The balance of RM126,000 (RM142,000 less RM16,000) will be taxed in the year of receipt (year of assessment 2016).

Example 10

Retirement at the optional retirement age under a collective agreement

Joshua had served in three different companies within the same group since 1.6.1995. On 28.2.2016, he retired at the age of 54 years after serving the last company for 6 years and 9 months. He was paid a retirement gratuity of RM120,000 for his years of service within the three different companies. 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 qualifies for a partial exemption on the retirement gratuity of RM120,000 received upon his early retirement. The partial exemption is only applicable to the gratuity attributable to the service with the last company in the group. The amount that qualifies for the exemption is RM6,000 (RM1,000 X 6 completed years of service). The balance of RM114,000 (RM120,000 less RM6,000) will be taxed in the year of receipt (year of assessment 2016).

Example 11

Retirement before the age of 55 years - Served with different companies in the same group

Sara, a financial controller worked at IK Construction Sdn Bhd from 1.1.2008 to 31.12.2011 and at another subsidiary company, IK Design Sdn Bhd from 1.1.2012 on a yearly contract basis. She decided to opt for early retirement on 31.10.2016 at age 50 years upon learning that the group would be undergoing a restructuring exercise in 2017. The employer paid her a retirement gratuity of RM250,000.

Sara qualifies for a partial exemption on the retirement gratuity of RM250,000 upon the termination of the contract of employment. The partial exemption is only applicable to the gratuity attributable to the service with the last company in the group i.e. IK Design Sdn Bhd. The amount that qualifies for the exemption is RM4,000 (RM1,000 X 4 completed years of service). The balance of RM246,000 (RM250,000 less RM4,000) will be taxed in the year of receipt (year of assessment 2016).

Example 12

Retirement before age of 55 years due to health issues

Soo had worked with the same employer for 20 years. He served as a project manager for 10 years. Over the last 3 years, he had been seeking

regular medical treatment for various health issues such as hypertension, prediabetes, chronic backache, migraine, arthritis and frozen shoulder. On 1.6.2016, Soo decided to opt for early retirement at the age of 54 though he was able to work if he had wanted to. Soo's employer accepted his request for early retirement based on –

- (a) the medical report from the company's panel of doctors regarding his ailments; and
- (b) documentary proof of the medical treatment provided.

The company paid Soo RM300,000 in 2016 as retirement gratuity in accordance with the company's policy.

Soo qualifies for a partial exemption on the retirement gratuity of RM300,000 upon his early retirement. The amount that qualifies for the exemption is RM20,000 (RM1,000 X 20 completed years of service). The balance of RM280,000 (RM300,000 less RM20,000) will be taxed in the year of receipt (year of assessment 2016).

Note

Soo does not qualify for a full exemption on the retirement gratuity as –

- (i) he was not able to prove to the satisfaction of the DGIR that his retirement was due to ill health. Although he is suffering from various ailments that affects his performance and productivity as verified by the company's panel of doctors, he was not certified to be unfit to continue working permanently; and
- (ii) he retired before reaching the age of 55 years although he worked with the same company for more than 10 years.

Example 13

Reemployed on a contract basis by the same employer after compulsory retirement

Same facts as in Example 4.

The company offered Zubir a 2-year contract to continue working under the same terms and conditions. Zubir accepted the offer to continue working with the company after the age of 60. His contract of service commenced from 1.4.2014. Upon completing his contract on 31.3.2016, the company paid Zubir a gratuity of RM20,000.

As Zubir had already received the gratuity payment upon his compulsory retirement on 28.2.2014, his employment period during his 2-year contract is considered to have commenced from 1.4.2014. Therefore, he qualifies for a partial exemption on the gratuity payment of RM20,000 received after the 2-year contract. The amount that qualifies for the exemption is RM2,000 (RM1,000 X 2 completed years of service). The balance of RM18,000 (RM20,000 less RM2,000) will be taxed in the year of receipt (year of assessment 2016).

Example 14

Retired before age 55 years in order to assume a senior management position pursuant to a contract of employment and gratuity payment is received upon both retirement and termination of contract of employment

Alias, a senior officer was asked to retire early at the age of 48 years on 31.1.2013 so that he can be appointed to a senior management position on contract basis. His contract will be for 3 years with effect from 1.2.2013 and is renewable based on performance. Alias was paid a gratuity of RM120,000 on 31.1.2013 for his service of 20 years and 8 months with the company prior to his appointment to a senior management position. After his 3-year contract which ended on 31.1.2016, he was paid a gratuity of RM100,000 on 31.1.2016 for his 3 year service.

The gratuity of RM120,000 which Alias received on 31.1.2013 (before coming into effect of paragraph 25D, Schedule 6 of the ITA) did not qualify for any exemption as he had retired before the age of 55 years.

As Alias had already received a gratuity of RM120,000 on 31.1.2013, his employment period for the 3-year contract was considered to have commenced from 1.2.2013. Alias qualifies for a partial exemption for the gratuity received due to the termination of the contract of employment on 31.1.2016. The amount that qualifies for the exemption is RM3,000 (RM1,000 X 3 completed years of service). The balance of RM97,000 (RM100,000 less RM3,000) will be taxed in the year of receipt (year of assessment 2016).

Example 15

Retired before age 55 years in order to assume a senior management position pursuant to a contract of employment and gratuity payment is only received upon termination of the contract

Same facts as in Example 14 and Alias receives the gratuity payment of RM220,000 upon the termination of his contract on 31.1.2016 at the age of 51 years.

As Alias received the gratuity payment of RM220,000 upon termination of his contract of employment on 31.1.2016, his employment period is considered to have commenced from the date he joined the company. Therefore his employment period with the company is for 23 years and 8 months. Alias qualifies for a partial exemption as the gratuity was received due to the termination of a contract of employment at the age of 51 years. The amount that qualifies for the exemption is RM23,000 (RM1,000 X 23 completed years of service). The balance of RM197,000 (RM220,000 less RM23,000) will be taxed in the year of receipt (year of assessment 2016).

7.3 Sums received by way of gratuity while still in service

In some cases, an employer may opt to make gratuity payments to a serving employee who has reached the age of 55 years. When the employee reaches the compulsory age of retirement of 60 years, no further gratuity is paid. Under such circumstances, the gratuity payment is to be taxed as part of the remuneration of the employee under paragraph 13(1)(a) of the ITA.

Example 16

Employee receives gratuity payment while still under employment

Selva has been working for a manufacturing company for the past 15 years. The company decided to make gratuity payments to all serving employees when they reach the age of 55 years. No further sums by way of gratuity will be paid by the company when the employee retires at the compulsory age of retirement. Selva received a gratuity payment of RM150,000 upon reaching the age of 55 years on 1.5.2016. He will only retire upon reaching the compulsory retirement age in 2021.

Selva had worked for the company for more than 10 years and was still under employment when he received the gratuity at the age of 55 years. He does not qualify for any exemption as the gratuity payment was not received due to a retirement from employment or upon termination of a contract employment. The payment of RM150,000 is part of Selva's gross income

from employment and is taxed in the year of receipt (year of assessment 2016).

8. Gratuity Payment Credited to Employees Provident Fund

- (a) There may be certain collective agreements between the employer and employee 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(1) of the ITA are also applicable on the lump sum gratuity payment, that is, gratuity is taxed in the year of receipt of the income. 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 CP 22A [Notification of Cessation of Employment (Employment of Private Sector Employees)] to the Inland Revenue Board of 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 17

Gratuity credited to the EPF account in accordance with a collective agreement

Ruben had served with a bank in Kuala Lumpur since 1.4.2000. When the bank underwent a restructuring in 2015, he decided to retire early. His resignation took effect on 31.3.2016 after 16 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).

Ruben qualifies for a partial exemption on the retirement gratuity of RM190,000 upon his early retirement. The amount that qualifies for the exemption is RM16,000 (RM1,000 X 16 completed years of service). The balance of RM174,000 (RM190,000 less RM16,000) will be taxed in the year of receipt (year of assessment 2016).

The employer can credit the net amount of gratuity to Ruben's EPF account after deducting the tax to be remitted to the DGIR.

Example 18

Gratuity credited to EPF account upon request by employee

The facts are the same as in Example 17 except that the bank paid the retirement gratuity in cash to Ruben. However, Ruben made a request to the bank to credit the retirement gratuity to his EPF account.

The tax treatment on Ruben's retirement gratuity is the same as in Example 17.

The employer can credit the net amount of gratuity to Ruben's EPF account after deducting the tax to be remitted to the DGIR.

9. Death Gratuities

Sums received by way of death gratuities or as consolidated compensation for death or injuries is tax exempt [paragraph 14 of Schedule 6 of the ITA].

Example 19

Mike worked for an oil and gas company since 1996. The employer (policy holder) had taken up a group term life insurance for the employees who are not named as beneficiaries. It was not stated in the contract of employment that the employees, employee's nominated beneficiaries or employee's next of kin would be paid any compensation in the event of a claim. While on duty, Mike was injured which resulted in his death on 15.5.2016. On 15.6.2016, the employer disbursed the payout of RM300,000 from the group insurance policy by way of death gratuity to Mike's widow (next-of-kin).

The sum received by way of death gratuity by Mike's widow is tax exempt.

10. Retirement Benefits

10.1 Taxability of retirement benefits

All retirement benefits including gratuities and pensions are taxable unless they are specifically exempted under Schedule 6 of the ITA and Exemption Orders.

Retirement benefits are not taxable if they are received by an employee from a pension or provident fund, scheme or society approved under section 150 of the ITA in accordance with the conditions imposed by the DGIR.

10.2 Payment from an unapproved pension or provident fund, scheme or society

Where an approved retirement scheme has its approved status under section 150 of the ITA withdrawn so that it becomes an **unapproved** scheme, all contributions made by the employer, if they are received by the employee are to be included in the gross employment income of the employee as provided under section 13(1)(d) of the ITA. Where the employee receives from an unapproved scheme his own contribution, his employer's contribution and any return on investment, such return on investment element is not to be included in the employee's gross employment income and should not be subject to tax.

There may be a condition whereby the lump sum payment from the unapproved scheme is not paid directly to the employee but is made to the employee's EPF account. In such cases, such lump sum payment accrues as income at the date the said payment is credited to the EPF account. All contributions made by the employer are to be included as part of the employee's gross employment income under paragraph 13(1)(d) of the ITA.

Example 20

Bank AA had merged with Bank BB on 31.5.2016 and the bank was renamed Bank AB. The service of the executive officers from Bank AA were not terminated but they continued their employment under the new management of Bank AB. Prior to the said merger, the lump sum payment from the AA Retirement Benefit Scheme was credited directly to the EPF account of the executives on 30.4.2016. The lump sum payment included contributions made by Bank AA, executive officers of Bank AA and interest earned by AA Retirement Benefit Scheme. AA Retirement Benefit Scheme was not an approved scheme under section 150 of the ITA.

Although the lump sum payment from the AA Retirement Benefit Scheme was credited directly to the EPF account of the executive officers, only the employer's contribution is taxable under paragraph 13(1)(d) of the ITA in the year of assessment 2016 [subsection 25(1) of the ITA]. As the executive officers had continued their service with Bank AB, the employer has to make the necessary tax deductions before crediting the net lump sum payment to the executive officers' EPF accounts.

11. Updates And Amendments

The contents of PR No. 8/2013 have been amended and updated.

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