



INLAND REVENUE BOARD OF MALAYSIA

GRATUITY

PUBLIC RULING NO. 8/2013

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A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling.

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

1. **Objective**

The objective of this Ruling 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. **Summary Of Changes**

This Ruling is published to replace Public Ruling No.10/2011 issued on 5.12.2011. The changes made to that Public Ruling are summarised as follows:

Paragraph In Public Ruling No. 10/2011	Changes In This Ruling		
	Paragraph	Item	Reference
2	3	} Renumbered	
3	4		
4	5		
5	6		
6	7		
7	8		
6(b)	7(b)	<ul style="list-style-type: none"> Replaced 	Clarification
7(b)	8(b)	<ul style="list-style-type: none"> Replaced Example 4 amended New Example 5 and 7 inserted Previous Examples 5, 6 and 7 renumbered as Examples 6, 8 and 9 	Clarification Budget 2013
7(c)	8(c)	<ul style="list-style-type: none"> Previous Examples 8, 9, 10 and 11 renumbered as Examples 10, 11, 12 and 13 	
7(d)	8(d)	<ul style="list-style-type: none"> Replaced Previous Example 12 renumbered as Example 14 New Example 15 	Clarification

Paragraph In Public Ruling No. 10/2011	Changes In This Ruling		
	Paragraph	Item	Reference
8	9	<ul style="list-style-type: none"> • Replaced • Previous Example 13 renumbered as Examples 16 • Previous Example 14 deleted • New Example 17 	Clarification
None	10 11	} New	Clarification

3. Related Provisions

The relevant provisions of the Income Tax Act 1967 (ITA 1967) in this Ruling are sections 7, 13, 25, subsection 83(3), 150 and paragraph 25 of Schedule 6.

4. Interpretation

The words used in this Ruling have the following meaning:

4.1 “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.

4.2 “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.

4.3 “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.

5. Lump Sum Payment On Termination Of Employment

- 5.1 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.
- 5.2 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.
- 5.3 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.

- 5.4 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.

6. 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.

7. 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. 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 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.

8. 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 on the medical board 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.

Effective from 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.

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 on 31.10.2011 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

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

Maria had worked as a secretary in a multinational company for 23 years. She retires upon reaching the age of 60 on 12.12.2018 and receives a gratuity of RM100,000.

As Maria retires after reaching the age of 55 and works with the same employer for more than 10 years, she qualifies for a full exemption on the retirement gratuity.

Example 6

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 age of 55 years. Therefore, he does not qualify for an exemption on the retirement gratuity received.

Example 7

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

James 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 56 years on 31.1.2014. He was paid a retirement gratuity of RM142,000.

As James works for the same company for more than 10 years and he retires after the age of 55 years, he qualifies for an exemption on the retirement gratuity.

Example 8

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 9

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 8 except that Ramlee was initially appointed as a non-executive director since 1.1.2003 instead of 1.1.1999.

Ramlee would 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:

Year Of Assessment	Basis Period	Apportionment	RM
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 - 31.01.2009	300,000 ÷ 6	50,000
		Total	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 10

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 11

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
Total			22,000

Example 12

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 period of employment i.e. from 2004 to 2009 as follows:

Year Of Assessment	Basis Period	Apportionment	RM
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 - 28.02.2009	120,000 ÷ 6	20,000
Total			120,000

Example 13

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 9) 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).

However, effective from 1.1.2014 any lump sum received on cessation of employment is spread over the last 5 basis periods if the employment began more than 4 years before the beginning of the basis period in which the employment ceases (as shown in Example 15).

The above treatment does not apply to any sums received by an employee from an unapproved retirement scheme [paragraph 13(1)(d) of the ITA 1967] or compensation for loss of employment [paragraph 13(1)(e) of the ITA 1967].

Example 14

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 X 50,000	13,333
2006	1.1.2006 - 31.12.2006 (12 months)	12/45 X 50,000	13,333
2007	1.1.2007 - 31.12.2007 (12 months)	12/45 X 50,000	13,333
2008	1.1.2008 - 30.9.2008 (9 months)	9/45 X 50,000	10,001
		Total	50,000

Example 15

The facts are the same as in Example 12 except that Joshua retired on 28.2.2014 instead of 28.2.2009.

Joshua does not qualify for exemption on the retirement gratuity received as he is not retiring at the age of 55 years although he has worked for more than 10 years within the same group of companies.

Joshua commenced his employment more than 4 years prior to 1.1.2014. As such, the gratuity payment will be spread back equally over the last 5 basis periods i.e. from 2010 to 2014 as follows:

Year Of Assessment	Basis Period	Apportionment	RM
2010	1.1.2010 - 31.12.2010	120,000 ÷ 5	24,000
2011	1.1.2011 - 31.12.2011	120,000 ÷ 5	24,000
2012	1.1.2012 - 31.12.2012	120,000 ÷ 5	24,000
2013	1.1.2013 - 31.12.2013	120,000 ÷ 5	24,000
2014	1.1.2014 - 28.02.2014	120,000 ÷ 5	24,000
Total			120,000

9. 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(4) of the ITA 1967 are also applicable on the lump sum gratuity payment (refer to paragraph 8(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 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 16

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

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:

Year Of Assessment	Basis Period	Apportionment	RM
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 - 31.03.2009	190,000 ÷ 6	31,666
		Total	190,000

Example 17

Gratuity credited to EPF account upon request by employee

The facts are the same as in Example 16 except that the bank was to have 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.

As Ruben did not qualify for exemption on the gratuity received because he had resigned from his employment before the compulsory age of retirement at 55 years, the employer has to make the necessary tax deductions before crediting the net amount of gratuity into Ruben's EPF account. The tax treatment on Ruben's retirement gratuity is the same as the computation shown in Example 16.

10. 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 1967].

Example 18

Mike worked for an oil and gas company since 1996. The employer (policyholder) had taken up a group term life insurance for the employees who are not named as beneficiaries. It was not stated in the employment contract 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 15.5.2012. On 15.6.2012, 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.

11. Retirement Benefits

11.1 Taxability of retirement benefits

All retirement benefits including gratuities and pensions are taxable unless they are specifically exempted under schedule 6 of the ITA 1967 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 1967 in accordance with the conditions imposed by the Director General of IRBM.

11.2 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 1967 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 1967. Where the employee receives from an unapproved scheme his own contribution, his employer's contribution and any interest, the interest element is not to be included in the employee's gross employment income.

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 Employees Provident Fund (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 1967.

Example 19

Bank AA had merged with Bank BB on 31.7.2012 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 30.6.2012. 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 1967.

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 1967 in the year of assessment 2012 [subsection 25(1) of the ITA 1967]. As the executive officers had continued their service with Bank AB, paragraph 25(4) of the ITA 1967 (refer to paragraph 8(d) of this Ruling) is not applicable as there was no cessation of employment. The employer has to make the necessary tax deductions before crediting the net lump sum payment into the executive officers' EPF accounts.