

TECHNICAL

Direct Taxation

PUBLIC RULING NO. 9/2016 – GRATUITY

The above Public Ruling (PR) was issued on 23 November 2016. (Please refer to our [e-CTIM TECH-DT 98/2016](#) dated 25 November 2016.) The PR explains the method used to characterize lump sum payments received by employees upon the termination of their employment as gratuity and the tax treatment of gratuity.

This PR supersedes [PR No. 8/2013](#).

Definitions

The words “employer”, “employee” and “employment” are defined in para. 3. The meanings given are the same as found in [S2](#) of the Income Tax Act 1967 (ITA). (Any section cited hereinafter is from the ITA unless otherwise stated.)

The contents of the PR are summarized below:

Paragraph # in PR	Subject matter
4	<p><i>Payments to employees on termination of employment</i></p> <ul style="list-style-type: none"> • Upon cessation of employment (which may be due to various reasons such as retirement, resignation or termination of a contract etc.) an employee may be paid a lump sum payment by the employer in accordance with the terms of the contract of employment. • To determine the real character of the payment, the circumstances and nature of the payment must be reviewed, even though the payment may be described by the employer using terms, such as compensation for loss of employment, ex-gratia, gratuity etc. • Lump sum payments made upon termination of employment may be attributable to the following elements: <ul style="list-style-type: none"> (a) loss of employment (compensation); (b) past services of the employee (gratuity). <p>The purpose of the payment must be established in order to determine the tax treatment for such payments in relation to the recipient.</p> • If an employee takes a case for wrongful dismissal to the relevant authority/court, and is awarded monetary compensation for wrongful dismissal by the court, the award must be analyzed in order to determine the tax treatment in respect of the recipient of the award.
5 – 6	<p><i>Gratuity versus compensation</i></p> <ul style="list-style-type: none"> • A lump sum payment made to an employee upon his resignation or retirement may be attributable to past services of the employee (generally regarded as

	<p>gratuity). The circumstances of each case would determine whether the payment of such “termination benefit” is a gratuity or compensation for loss of employment.</p> <ul style="list-style-type: none"> • The characteristics and nature of the termination payment prevail over the form and labeling of the payment. • In making apportionment between gratuity and compensation, consideration must be given to the employer’s normal practice in payment of gratuities to employees leaving his service and the rate or amounts normally paid. (Example 1) • 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, the payment is treated as compensation for loss of employment and not gratuity. (Example 2) • If a contract is for a specified period of time and the employment ends at the specified time or the retirement age, any lump sum paid to the employee will be regarded as gratuity if it is payment for past services.
7	<p><i>Tax treatment of gratuity</i></p> <ul style="list-style-type: none"> • Gratuity is to be included as employment income under S13(1)(a). W.e.f YA 2016, employment income receivable for any particular period is taxed in the year of receipt under S25(1).
7.1	<p><i>Full exemption of gratuity</i></p> <ul style="list-style-type: none"> • Gratuity received upon retirement qualifies for full exemption under para. 25 of Sch. 6 under the following conditions: <ul style="list-style-type: none"> (a) If the DGIR is satisfied that the retirement is due to ill health. (Example 3) (b) If the retirement takes place at, or after, the age of 55, or on reaching the compulsory retirement age as specified in 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. (Examples 4 & 5) (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)
7.2	<p><i>Partial exemption – RM 1000 for each completed year of service</i></p> <ul style="list-style-type: none"> • W.e.f YA 2016, under para. 25D of Sch.6, an employee who receives a sum by way of gratuity – <ul style="list-style-type: none"> (a) on retirement from employment; or (b) upon termination of a contract of employment <ul style="list-style-type: none"> - other than when para. 25, 25A, 25B or 30A of Sch. 6 applies, is eligible for an exemption of RM1000 for each completed year of service (“partial exemption”). • However, if the employment is with companies in the same group, partial exemption applies only to gratuity attributable to service with the last company

	<p>(which employed him) in that group.</p> <ul style="list-style-type: none"> The balance of gratuity after deducting the exempt portion, is taxed in the year of receipt [S25(1)]. A lump sum payment received on cessation of employment by way of deferred pay, gratuity or otherwise, other than gross income under S13(1)(d) and S13(1)(e), is taxed in the year of receipt [S25(1)]. Partial exemption is not applicable to sums received by an employee from an unapproved pension fund [S13(1)(d)] or compensation for loss of employment [S13(1)(e)]. The following examples in the PR show the tax treatment of gratuity received under different circumstances: <p><u>Example Circumstance for payment of gratuity</u></p> <table border="0"> <tr> <td style="vertical-align: top; padding-right: 20px;">7</td><td>• Compulsory retirement after working with the same company for less than 10 years.</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">8</td><td>• Retirement under a contract of employment after working with the same company for less than 10 years</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">9</td><td>• Retirement before the age of 55 years regardless of the years of service in the company</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">10</td><td>• Retirement at the optional retirement age under a collective agreement</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">11</td><td>• Retirement before the age of 55 years – served with different companies in the same group</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">12</td><td>• Retirement before age 55 due to ill health</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">13</td><td>• Re-employed on a contract basis by the same employer after compulsory retirement</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">14</td><td>• Retired before age 55 in order to take a senior management position pursuant to a contract of employment and gratuity is received upon both retirement and termination of contract of employment</td></tr> <tr> <td style="vertical-align: top; padding-right: 20px;">15</td><td>• Retired before age 55 to take a senior management position pursuant to a contract of employment and gratuity is only received upon termination of contract</td></tr> </table>	7	• Compulsory retirement after working with the same company for less than 10 years.	8	• Retirement under a contract of employment after working with the same company for less than 10 years	9	• Retirement before the age of 55 years regardless of the years of service in the company	10	• Retirement at the optional retirement age under a collective agreement	11	• Retirement before the age of 55 years – served with different companies in the same group	12	• Retirement before age 55 due to ill health	13	• Re-employed on a contract basis by the same employer after compulsory retirement	14	• Retired before age 55 in order to take a senior management position pursuant to a contract of employment and gratuity is received upon both retirement and termination of contract of employment	15	• Retired before age 55 to take a senior management position pursuant to a contract of employment and gratuity is only received upon termination of contract
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7.3	<p><i>Gratuity received while still in service</i></p> <ul style="list-style-type: none"> An employer may opt to pay gratuity to an employee upon his reaching the age of 55. No further gratuity is paid when the employee reaches the compulsory retirement age of 60. In such a case the gratuity payment is treated as remuneration of the employee under S13(1)(a), in the year of receipt [S25(1)]. (<u>Example 16</u>) 																		

8	<p><i>Gratuity credited to an employee's EPF Account</i></p> <ul style="list-style-type: none"> If (pursuant to certain collective agreements between employer and employee) gratuity is credited to an employee's EPF account (either compulsory or optional) when a resignation takes place prior to retirement, the gratuity is taxed in the year of receipt [S25(1)]. The employer is required to: <ul style="list-style-type: none"> credit the net amount (after deducting income tax) into the EPF account; file Form CP 22A [(Notification of Cessation Of Employment (Employment Of Private Sector Employees)] to the IRBM branch handling the employee's file; withhold money payable to the employee pending issue of clearance letter by the IRBM. <p>(Examples 17 and 18)</p>
9	<p><i>Death gratuities</i></p> <ul style="list-style-type: none"> Sums received by way of death gratuities or consolidated compensation for death or injuries is tax exempt under para. 14 of Sch. 6. (Example 19)
10	<p><i>Retirement benefits</i></p> <ul style="list-style-type: none"> All retirement benefits including gratuities and pensions are taxable unless specifically exempted under Sch. 6 of the ITA or Exemption Orders. Retirement benefits are not taxable if received from a pension or provident fund, scheme or society which is approved under S150 in accordance with conditions imposed by the DGIR. If an approved pension scheme subsequently has its approved status withdrawn (thereby becoming an unapproved scheme), contributions by the employer, if received by the employee, are taxed under S13(1)(d). Where the sum received (from an unapproved scheme) consists of the employee's own contribution, the employer's contribution and any return on investment, the amount attributable to return on investment is not taxable. If a lump sum is paid into the employee's EPF account (from an unapproved scheme), the sum accrues as income on the date of crediting into the EPF account. All contributions by the employer are to be included as the employee's income from an employment under S13(1)(d). (Example 20)

Members may read the PR in full at the websites of the [Institute](#) and the [LHDNM](#).

You may write to the Institute at technical@ctim.org.my or secretariat@ctim.org.my in respect of any suggestions, concern or comments you may have on the [PR](#) so that we may raise them to the LHDNM.

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