

**TECHNICAL**

---

**Direct Taxation**

**TAX CASE UPDATE**

**Whether payment of an Equivalent Cash Consideration in lieu of shares offered under an Employee Share Option Scheme comes within section 25(1A) and section 32(1A) of the Act.**

***Ketua Pengarah Hasil Dalam Negeri & Lembaga Hasil Dalam Negeri Malaysia v Maxis Communication Berhad (2012) [CA] (Civil Appeal No: W-01-665-2010)***

**Facts:**

There was in place a binding Maxis Employee Share Option Scheme (ESOS). Pursuant to the conditional takeover offer by Binariang GSM Sdn Bhd to acquire all voting shares in Maxis for a determined cash consideration, Maxis could no longer honour its obligations under the ESOS. Hence the following parallel offers were made to Maxis employees who are holders of outstanding options under the Maxis ESOS:

- (i) In respect of vested/exercisable options, the Maxis employees must exercise their options before the takeover in order to be entitled to accept the offer by Binariang; and
- (ii) In respect of unvested options, the Maxis employees will be paid in lieu thereof, an Equivalent Cash Consideration (ECC), the acceptance of which would relieve Maxis of its contractual obligations under the ESOS to offer shares to participating employees.

In view of the conditional takeover offer, Maxis had requested confirmation from the IRB on the taxation of the ECC received by Maxis employees with unvested options before they could proceed with filing of the Return of Remuneration by an Employer and with reporting the taxable income arising from the Offer in the respective employees' annual income statement (Form EA).

If the unvested share option is considered as the right to acquire shares in Maxis, the amount to be included in the employees' gross income from employment shall be calculated based on [S.32\(1A\)](#) for the year in which the right is exercised, assigned, released or acquired as enunciated in [S.25\(1A\)](#). Otherwise, the payment received will be considered as a gross income under [S.13\(1\)](#) and [S.25\(1\)](#) applies. The payment must be reflected in the employees' income statement for the year in which the payments were received.

The DGIR ruled (among other points made in the ruling) that:

- (i) Under the relevant ESOS Byelaw, the option only vested from the date of the first anniversary that the employee is offered the option and not from the date of grant. Consequently, an employee does not have any rights in an unvested option before the date of the first anniversary, and the requirement that there be a "right to acquire shares in a company..." in [S.25\(1A\)](#) of the Act is not fulfilled.
- (ii) The alternative consideration paid to employees is no longer in the form of shares which need to be valued, but is a receipt of cash arising from employment;
- (iii) Employees are not offered fresh share options in consequence of the takeover, but are paid a sum of money as ECC, the value and timing of which is based on the ESOS. Further, unlike offers under the ESOS, they do not have to pay anything to receive the said payment.

Maxis is of the view that the ECC payment was made to relieve it from its contractual obligations under the ESOS and therefore was not a salary or cash remuneration under [S13\(1\)\(a\)](#) of the Act, but was a share-based payment that falls under [S.25\(1A\)](#) and S.32(1A) of the Act.

Consequently, Maxis filed an appeal by way of judicial review to the High Court which ruled in favour of Maxis and set aside the order of the Director General of Inland Revenue (DGIR) on the following grounds:

- [S.25\(1A\)](#) does not impose any vesting element before its applicability. The fact that the options will only be vested based on the vesting schedule is immaterial.
- The grant of option gives rise to a right to acquire shares at the point of the grant. [Public Ruling No.4/2004 – Employee Share Option Scheme Benefit](#) defines “option” as right offered in respect of a number of shares at a specific price to be exercised at a future date. When the offer takes place is dependent on the date the employer offers their employee the right to purchase a number of shares in the company which is at the point of grant.
- [S.25\(1A\)](#) clearly provides that the gross income in respect of any right to acquire shares in a company is taxed in the year where the right is exercised, assigned, released or acquired. In the instant case, the acceptance of respective employees to surrender all outstanding unvested options for cancellation in consideration of the ECC payments by Maxis gives rise to the “release” event which is the taxing point of a right to acquire shares under [S.25\(1A\)](#).
- [S.32\(1A\)](#) provides the method of ascertaining the gross income from an employment in respect of any right to acquire shares in a company.

The IRB appealed to the Court of Appeal on the High Court decision.

#### Issue:

Whether the ECC payment

- a) is ordinary cash remuneration falling under [S.13\(1\)\(a\)](#) of the Act, or
- b) is to release the employee of his right to acquire shares, and is gross income to which [S.25\(1A\)](#) and [S.32\(1A\)](#) of the Act applies.

#### Decision:

The appeal was allowed. The Court of Appeal was of the view that [S.32\(1A\)](#) means that the exercise, assignment, release or acquisition of the right to the shares relates to shares an employee is determined to be entitled to since in order for vesting to occur, the number of shares awarded/offered must be determined. The ECC exercise did not appear to be part of any such exercise. There was no vesting of any rights to shares. Hence, it was not made under the ESOS per se, but a collateral and separate exercise to relieve Maxis of its obligations under ESOS while the shares were not yet offered and therefore, remain unvested. The application of [S.25\(1A\)](#) and [S.32\(1A\)](#) therefore does not arise.

Consequently, there was no reason for judicial intervention by the High Court and the ruling of the DGIR dated 10/10/2008 was affirmed.

Members may view the [judgment](#) of Court of Appeal at the Official Website of the Office of the Chief Registrar of Federal Court of Malaysia.

#### Disclaimer

This document is meant for the members of the Chartered Tax Institute of Malaysia (CTIM) only. This summary is based on publicly available documents sourced from the relevant websites, and is provided gratuitously and without liability. CTIM herein expressly disclaims all and any liability or responsibility to any person(s) for any errors or omissions in reliance whether wholly or partially, upon the whole or any part of this e-CTIM.