

## GES NewsFlash

### Malaysia — Public Ruling No.10/2011

January 6, 2012

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**PR No. 10/2011 on gratuity**

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on termination of  
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**Background**

The Malaysian Inland Revenue Board (MIRB) issued a new public ruling (PR) on 5 December 2011, i.e., PR No. 10/2011 on gratuity.

Effective date: Year of assessment 2011.

**Gratuity payment  
credited to  
Employees  
Provident Fund  
(EPF)**

**Overview**

This 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.

**Deloitte's view**

**Lump-sum payment on termination of employment**

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A lump-sum payment may be received in accordance with the terms and conditions of the contract of service upon the cessation of an employee's employment due to variety of reasons, such as retirement, resignation, premature termination of the contract of service, or mutual agreement. Said lump-sum payment may be described as compensation for loss of employment, ex gratia, contractual payment, retrenchment payments, gratuity, etc.

In order to determine the tax treatment of the lump-sum payment received by the employee, the purpose of the payment has to be established. The amount paid upon termination of employment may consist of one of the following elements:

**1. Compensation**

Payment is attributable to the loss of employment such as by layoff, i.e., payment is received due to premature termination of employment that had the prospect of continuing up to the retirement age.

**2. Gratuity**

Payment is attributable to the past services of the employee, where a contract of employment is for a specific number of years and the employment ends at the specified time or the retirement age (i.e., the full term of the contract has expired or the cessation of employment is on the retirement age).

## Tax treatment of gratuity

Gratuity is included in the gross income derived from employment, pursuant to paragraph 13(1)(a) of the Malaysian Income Tax Act 1967 (ITA 1967). However, an employment receiving a gratuity upon retirement from employment would qualify for full exemption under any of the following circumstances:

- a) If the MIRB is satisfied that retirement was due to ill health
- b) If 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 that has lasted 10 years with the same employer or with companies in the same group
- c) If retirement takes place on reaching the compulsory age of retirement pursuant to a contract of employment or collective agreement at the age 50 but before 55 and that employment has lasted for 10 years with the same employer or with companies in the same group

Gratuity that is not exempt from tax (i.e., a lump-sum received by an employee by way of deferred pay, or other gross income, upon the cessation of his employment) will be taxed as follows in the relevant basis period:

- i. Spread over the last six basis periods if the employment began more than five 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

## Gratuity payment credited to Employees Provident Fund (EPF)

For gratuity that is not paid directly to the employee but is paid to the employee's EPF account (either compulsory or optional) shall be treated as income at the time when the payment arises, and it is not exempt from tax. It will be taxed accordingly in the relevant basis period as stated in i. or ii. above. As such, 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, the employers are required to file a Notification of Cessation of Employment (Employment of Private Sector Employees), i.e., Form CP22A, to the MIRB branch office handling the income tax file of the employee concerned. The money payable to the employee will be withheld by the employer until the receipt of a clearance letter from the MIRB.

Examples are provided in the PR to illustrate the factors mentioned above.

### Deloitte's view

There is now more clarity and guidance from the MIRB on the determination of the word "gratuity." This will help in determining the tax treatment of the payment received upon the termination of employment and conclude whether the payment received will be taxable or tax exempted.

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## People to contact

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