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## IRB's Public Ruling No 5/2019: Employee 'Buy-Out' Payments Taxable as Perquisites?

On 19 November 2019, the Inland Revenue Board (**IRB**) issued its Public Ruling (PR) No 5/2019 on "Perquisites from Employment", replacing the earlier PR No 2/2013. Importantly, PR No 5/2019 clarifies the IRB's position on the tax treatment of employee "buy-out" payments, i.e. payments made by employers to the former employers of a new employee (either directly or indirectly) as compensation for the employee's non-service of his/her notice period. The IRB has now clarified that such payments are taxable as perquisites under s 13(1)(a) of the Income Tax Act 1967 (**ITA**).

### Employment income includes 'perquisites' for purposes of income tax

By way of background, "perquisites" fall within the category of employment income which is taxable under ss 4(b) and 13(1)(a) of the ITA.

- **Section 4(b)** provides that the income tax upon which tax is chargeable includes income in respect of gains or profits from employment
- **Section 13(1)(a)** provides that an employee's gross income in respect of gains or profits from an employment includes:

"any wages, salary, remuneration, leave pay, fee, commission, bonus, gratuity, **perquisite** or allowance (whether in money or otherwise) in respect of having or exercising the employment".

"Perquisite" is not defined anywhere within the ITA and reference to guidelines by the IRB and case law is necessary.

### What are perquisites?

#### *Definition of perquisites in IRB's Public Ruling*

Perquisites are defined in PR No 5/2019 to mean "benefits in cash or in kind that are convertible into money received by an employee from the employer or third parties in respect of having or exercising the employment".<sup>[1]</sup> PR No 5/2019 regards perquisites as having the following characteristics:

- (a) They can be received regularly or casually.
- (b) They can be received in cash or in kind. If received in kind, they must have money's worth and are convertible into cash.
- (c) They can be received by an employee in respect of his/her employment contract or given by the employer or a third party voluntarily.
- (d) They are subject to tax only if it arises in respect of having or exercising an employment.

This definition and guidance are the same as that provided in PR No 2/2013.

#### *Perquisites as distinguished from benefits in kind*

Perquisites are to be distinguished from benefits in kind provided for the use or enjoyment of the employee by his employer. The key difference is that perquisites are convertible into cash whereas benefits in kind are not. Benefits in kind are taxable under s 13(1)(b) of the ITA, unless specifically excluded. Benefits in kind which are excluded include medical or dental treatment and childcare,<sup>[2]</sup> leave passage for travel within and outside Malaysia,<sup>[3]</sup> benefits or amenities for the employee's performance of his/her duties<sup>[4]</sup> and living accommodation.<sup>[5]</sup>

#### **Whether 'buy-out' payments are taxable as perquisites**

"Buy-out" payments, also known as payment in lieu of notice, are payments made to the former employers of an employee for non-service of his/her notice period. Such payments can be made by the new employer directly to the former employer, or indirectly through reimbursement to the employee who has made the payment.

Before PR No 5/2019, there was some uncertainty as to whether such payments would be taxable as employment income. It seems evident that these payments would not be regarded as "wages, salary, remuneration, leave pay, fee, commission, bonus, gratuity or allowance". However, they may still fall within the definition of "perquisites" as defined in PR No 2/2013.

Further, there is also arguably a difference between payments made directly to the former employer, or as reimbursement to the new employee. In the former, it is arguable that such payments are not perquisites as they necessarily have to be made as part of the termination of the old employment and before the commencement of the new employment. In other words, the payments are arguably not in respect of the employee's "having or exercising the (new) employment". By contrast, it appears clearer that payments made by way of reimbursement would be regarded as perquisites received in the course of the new employment.

PR No 5/2019 now clarifies that the IRB's position that such payments would be considered as "perquisites" received by the employee and taxable as employment income under s 13(1)(a) of the ITA.<sup>[6]</sup> Example 10 in PR No 5/2019 also explains that payments made directly to the former employer would be regarded as "perquisites" and taxable.

### **“Example 10**

*Mr Low has quit his job with Company A and will be working with Company B. Mr Low has to give one month’s notice or pay 1 month’s salary to Company A. Company B has agreed to make payment in lieu of notice to Company A for such termination. Payment in lieu of notice is part of gross income in relation to having or carrying out employment and being taxed under paragraph 4(b) of the ITA. Furthermore, Monthly Tax Deduction (MTD) need to be made by Company B as payment in lieu of notice is borne by Company B is part of Mr Low’s income.”*

[sic]

### **Conclusion**

It must be borne in mind that the taxability of income is still determined by reference to the ITA. In this regard, s 13(1)(a) of the ITA has not been amended to address the taxability of “buy-out” payments made prior to the termination of the employee’s old employment, and commencement of his/her new employment. The courts have also indicated that public rulings issued by the IRB do not have the force of law. However, taxpayers who wish to adopt a prudent approach should recognise such payments as perquisites and ensure that the necessary monthly tax deductions are made by their new employers to avoid complications.

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- [\[2\]](#) ITA, s 13(1)(b)(i)
- [\[3\]](#) ITA, s 13(1)(b)(ii)
- [\[4\]](#) ITA, s 13(1)(b)(iii)
- [\[5\]](#) ITA, s 13(1)(b)(iv), (1)(c)
- [\[6\]](#) PR No 5/2019, para 6.17