
(2015) 10 GUJ CK 0064
In the Gujarat High Court
Case No : Tax Appeal No. 23 of 2004

Arunbhai R. Naik

APPELLANT

Vs

I.T. Officer

RESPONDENT

Date of Decision : 12-10-2015

Acts Referred:

Constitution of India, 1950 — Article 12, 226

Income Tax Act, 1961 — Section 10, 10(A), 10(B), 10(C), 143(1)(a)

Citation : (2016) 284 CTR 284 : (2015) 379 ITR 511 : (2016) 236 TAXMAN 190

Hon'ble Judges : Harsha Devani and Abdullah Gulamahmed Uraizee, JJ.

Bench : Division Bench

Advocate : J.P. Shah and Manish J. Shah, Advocates, for the Appellant; K.M. Parikh, Advocate, for the Respondent

Judgement

Harsha Devani, J.—The appellant - assessee in this appeal under section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act") has challenged the order dated 7th July, 2003 passed by the Income Tax Appellate Tribunal, Ahmedabad Bench "B" in ITA No. 4510/Ahd/1996. By an order dated 1st November, 2004, this appeal had been admitted on the following substantial question of law:--

"Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the amount of Rs. 3,51,308/- received by the appellant in accordance with the High Court Judgment, was income liable to tax under section 17(3) of the I.T. Act, 1961?"

2. The assessment year is 1994-95 and the relevant accounting period is the year that ended on 31st March, 1994. The assessee, who is assessed in the status of an individual, filed return of income on 30th June, 2004 showing total income of Rs. 1,32,430/-. The return was processed under section 143(1)(a) of the Act granting refund of Rs. 1,88,550/- on 28th March, 1995. Since the refund was more than Rs. 1,00,000/-, the case was taken up for scrutiny. During the course of assessment, it was found that the assessee had received an amount of

Rs. 3,51,308/- being ex-gratia compensation on premature cessation of his services. In the footnote of the return of income, the assessee had stated that since neither the terms of employment nor the service rules of the company provide for making ex-gratia payment, this claim as capital receipt is not liable to tax as the same is not paid as retrenchment compensation either under labour laws or under the terms of employment. In support of his submissions, the assessee had placed reliance upon the decisions of the Calcutta High Court in the case of Commissioner of Income Tax Vs. Jamini Mohan Kar, and Commissioner of Income Tax Vs. Ajit Kumar Bose, . The Assessing Officer after considering the submissions advanced on behalf of the assessee, held thus:--

"On verification it is seen that the decisions quoted by the assessee is not at all relevant to the case of the assessee. In these cases the payment was made to the employees as the unit was closed down or the business was closed. In the case of the assessee it is not compensation in lieu of salary within the meaning of Section 17(3) of the Act.

The assessee's services was terminated by the company along with four other officers. In appeal, the High Court in its judgment in Letter Patent Appeal No. 375 of 1985 with Civil Application No. 3962 of 1985, it is stated that since the parties have arrived at an agreement the appeal is allowed in terms of the agreement arrived at between the parties. The agreement are as under:

"The concerned officer will be paid compensation equivalent to 3.33 years salary (salary means salary contained in last pay slip details of which are given here below) on basis of last pay and allowances drawn by officers as full and final settlement in respect of all five officers. The so called Association office Civil Suit No. MCA 358/84 pending before Civil Judge, Baroda shall stand withdrawn in terms of settlement and shall give immediate possession of the said premises. The Spl C.A.6647/85 shall stand withdrawn."

The assessee's employer vide letter dated 22.3.1996 has stated that "necessary assessment may kindly be carried out treating as if they have retired from the service. It is further clarified that this is not to be termed as premature cessation as Court has considered it as deemed retirement which is recorded in the judgment". But Court's order clearly mention that assessee will be deemed to have retired from service, and they shall be eligible for retirement benefits like gratuity/pension/post retirement medical benefits scheme as per their eligibility in this behalf. Hence, the deemed retirement is only for ensuring that assessee receives retirement benefits. The Court's order also refers to the agreement between GSFC and the assessee which clearly mentions that the concerned officer will be paid "compensation". Hence this amount of Rs. 3,54,308/- is in the nature of compensation paid to an employee u/s. 47(3) and does not get covered by section 10 , 10(A) , 10(B) , 10(C) .

In view of the above, the assessee's claim that the payment is a capital receipt is not accepted and the amount is added to the total income."

3. The assessee carried the matter in appeal before the Commissioner (Appeals) who held that the amount received by the appellant was not taxable and deleted the addition made by the Assessing Officer. According to the Commissioner (Appeals), the employer of the appellant offered to give a compensation of Rs. 3,51,308/- in case where he voluntarily retired from service, which the appellant accepted. The said amount was paid de hors any contract of employment and was paid voluntarily and was paid as compensation for premature termination of employment. The Commissioner (Appeals) placed reliance upon the above referred two decisions of the Calcutta High Court wherein it was held that the amount being capital receipt is not taxable under section 17(3) of the Act. The Commissioner (Appeals) also placed reliance upon a decision of the Madras High Court in the case of R. Venketkrishna, 215 ITR 586 wherein a similar view was taken namely, that the amount of similar nature is not taxable as salary. Revenue went in appeal before the Tribunal and succeeded in relation to the addition in question.

4. Mr. J.P. Shah, learned counsel for the appellant invited attention to the provisions of section 17(3) of the Act to submit that the amount paid to the appellant would fall within the ambit of clause (i) of section 17(3) of the Act only if the same were paid by the employer to discharge any obligation cast upon him. According to the learned counsel, insofar as the obligation of the employer is concerned, the same stood discharged when the appellant's services came to be terminated by resorting to rule 44 of the Service Rules. It was submitted that the amount paid to the appellant pursuant to the settlement arrived at between the parties was not pursuant to any obligation on the part of the employer and hence, the provisions of section 17(3)(i) would not be attracted. In support of his submissions, the learned counsel placed reliance upon the decisions of the Calcutta High Court in the case of Commissioner of Income-Tax v. Jamini Mohan Kar and Commissioner of Income-Tax v. Ajit Kumar Bose (supra) as well as the decision of the Delhi High Court in the case of Commissioner of Income Tax Vs. Deepak Verma, .

5. On the other hand, Mr. K.M. Parikh, learned senior standing counsel for the respondent, submitted that after his termination under rule 44 of the Service Rules, the appellant challenged the premature termination of his services before this High Court and succeeded before the learned Single Judge. During the pendency of the letters patent appeal preferred by the employer against the judgment of the learned Single Judge, the parties arrived at a settlement under which the amount in question was paid to the appellant. The attention of the court was drawn to the terms of settlement, which read thus:--

"The Concerned officer will be paid compensation equivalent to 3.33 years" salary (salary means salary contained in last pay slip details of which are given here-below) on basis of last pay and allowances drawn by officers as full and final settlement in respect of all five officers. The so called Association office Civil Suit No. MCA 358/84 pending before Civil Judge, Baroda shall stand withdrawn in

terms of settlement and shall give immediate possession of the said premises. The Spl. C.A.6647/85 shall stand withdrawn.

The amount of compensation as agreed shall be payable within one month from the date of judgment.

Plus professional allowances, fixed Medical reimbursement allowance, Reimbursement Salary and Suit length as per eligibility and Silver Memento if eligible.

They shall be eligible for retirement benefits like Gratuity/Pension/Post retirement Medical benefits scheme as per their eligibility in this behalf.

The Association of Officers shall not litigate any further in this matter."

It was submitted that the mode and manner of computation of compensation under the terms of settlement is clearly indicative of the fact that compensation was to be paid in connection with the termination of employment of the appellant and squarely falls within the ambit of section 17(3) of the Act. Reference was made to the letter dated 1st March, 1994 of the employer, wherein it is stated that the payment of compensation including the terminal benefits as may be payable according to his eligibility are enclosed therewith. It was submitted that the above letter clearly shows that the appellant was discharged from his services in terms of rule 44 and compensation was paid to him in connection with the termination of employment which is, therefore, liable to be taxed under section 17(3) of the Act. It was, accordingly, urged that the impugned order passed by the Tribunal being in consonance with the provisions of section 17(3) of the Act, the appeal deserves to be dismissed.

6. Before advertng to the merits of the case, reference may be made to certain relevant facts as noticed by the Tribunal.

"The appointment letter of the assessee is dated 12th January, 1971 Clause 4 of which read as under:--

"4. You shall be on probation for an initial period of six months from the date of your joining the service under the company, which may be extended at the discretion of the company to enable you to achieve the expected standard of work performance. During the period of probation your services can be terminated forthwith and without assigning any reasons. It is further provided that in the event of such termination you will not be entitled to compensation except as provided for in service rules. At the end of such period of probation or extended period of probation, as the case may be, you may be either

a. confirmed in the services of the company; or

b. if your work performance does not reach the expected standard, your services may be discontinued.

The assessee's services were terminated by discharge letter dated 6.5.1984

which reads as under:--

1. You are hereby discharged from the services of the company with immediate effect under Rule 44 of the Company's Service Rules by payment of 3 months basic pay and DA in lieu of 3 months notice.
2. If there are any dues payable by you to the company, your 3 months basic pay and DA will be adjusted against such dues. You are hereby requested to clear the dues payable you to the company.
3. You are further requested to submit the enclosed clearance for final settlement of your account.

Rule 44 of the company's rules dealing with the employment under which the assessee's services have been discharged reads as under:--

"RULE 44 DISCHARGE OR TERMINATION OF SERVICE AFTER CONFIRMATION:--

After confirmation, an employee in grade I or II may be discharged from the company for sufficient reasons by the competent appointing authority, or he may leave or discontinue from the service of the company after giving three months' notice in writing in that behalf or by payment of three months' basic pay and Dearness Allowance as in force from time to time in lieu of such notice an employee in any other Grade may be discharged from the service of the company for sufficient reasons by the Competent appointing authority or he may leave or discontinue from the service of the company, after giving the month's notice in writing that behalf by payment of one month's basic pay and dearness allowance as in force from time to time in lieu of such notice, provided that the Board or the Personnel Committee may waive such notice or payment in lieu thereof in case of any employee in Grade-I and the Managing Director may waive such notice or payment in lieu thereof in case of an employee in Grade II, III or IV."

A letter was written to the assessee by the employer Gujarat State Fertilizer Company Ltd. on 1st March, 1994 which reads as under:--

"This has reference to the settlement dated 2nd February, 1994 which is a part of the Hon'ble High Court's judgment.

In this connection, we are enclosing herewith the payment of compensation including the terminal benefits as may be payable according to your eligibility. The detailed calculations are enclosed in the meets and for income tax deduction, a separate certificate may be obtained from the company.

In the meantime, this is in compliance with the Court order regarding the payment to be made within one month from the date of the order."

According to the Tribunal, the payment is not in the nature of an ex-gratia payment or without there being any obligation on the part of the employer as claimed by the assessee. The Tribunal was of the opinion that the payment is

taxable within the meaning of section 17(3) of the Act which provides for inclusion of compensation received by an assessee from his employer or former employer at or in connection with the termination of his employment, as it could not be said that the payment received by the assessee was without any connection with the termination of his employment.

7. At this juncture, reference may be made to section 2(24) of the Act, which defines "income" as inclusive of the value of any perquisite or profit in lieu of salary taxable under clause (2) and (3) of section 17 of the Act. Section 15 of the Act lays down as to which income shall be chargeable to income-tax under the head "Salaries". Section 16 provides for the deductions to be made while computing the income chargeable under the head "Salaries". Section 17 of the Act defines "Salary", "perquisite" and "profits in lieu of salary" for the purposes of section 15, 16 and 17 of the Act. Sub-section (3) of section 17 of the Act defines "Profits in lieu of salary", and as it stood at the relevant time and to the extent the same is relevant for the present purpose, says that "profits in lieu of salary" includes (i) the amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto. Thus, if any amount falls within the ambit of the expression "Profits in lieu of salary", it has to be treated as salary and would be chargeable to tax under section 15 of the Act. At this juncture, reference may be made to the decisions on which reliance has been placed by the learned counsel for the appellant.

8. The Calcutta High Court in the case of Commissioner of Income-Tax v. Ajit Kumar Bose (supra) in a case where the employer terminated the services of the assessee by giving him the requisite three months' notice and in addition to the pay and salary for the period of notice, paid to the assessee a sum of Rs. 24,933/-, held that there was nothing to indicate that the assessee was entitled to continue in the employment of the company up to any particular age. Under the conditions of service, his services were liable to be terminated on giving three months' notice without assigning any reason. Under the circumstances, it could not be said that the assessee was entitled to remain in service for any period after the requisite notice had been given or that the employer was under any obligation to pay anything to the assessee in connection with the termination of his employment other than the salary for the period of notice. The court was of the view that in its true nature and character, the payment was ex-gratia, that is to say, totally voluntary; it was not compensation which implies some sort of an obligation to pay. The court, accordingly, held that it cannot be said that the amount in question was "profits in lieu of salary" within the meaning of clause (3) of section 17 of the Act and was not taxable as such. In Commissioner of Income-Tax v. Jamini Mohan Kar (supra), the Calcutta High Court followed its earlier decision in the case of Commissioner of Income-Tax v. Ajit Kumar Bose.

9. The Delhi High Court in the case of Commissioner of Income-Tax v. Deepak

Verma (supra) observed that the word "compensation" is not defined under the Income Tax Act. Therefore, one has to take into consideration the ordinary connotation of this expression in common parlance. The court after referring to the dictionary meaning of "compensation" observed that it is clear that when the payment is to be received as "compensation", the employee would have a right to receive such payment. If the employee has no right, it cannot be treated as "compensation". The court held that it is for this reason that if the payment is made ex-gratia or voluntary by an employer out of his own sweet will and not conditioned by any legal duty or legal obligation, whether on sympathetic reasons or otherwise, such payment is not to be treated as "profits in lieu of salary" under clause (i).

10. This court is in agreement with the view adopted by the Calcutta High Court and the Delhi High Court in the above decisions. The question that arises in the aforesaid legal backdrop is whether the payment received by the appellant - assessee from his employer was a voluntary payment given by the employer or was it in the nature of compensation. As noticed earlier, the Managing Director of Gujarat State Fertilizers Company Limited, viz., the company where the assessee was employed, passed an order dated 6th May, 1984 discharging the assessee from service under rule 44 of the Service Rules which provides for discharge of an employee for sufficient reasons by the competent appointing authority after giving three months' notice in writing in that behalf or by payment of three months' basic pay and Dearness Allowance as in force from time to time in lieu of such notice. Against the order of termination, the assessee preferred an appeal to the higher authority in the company, but did not succeed. He, therefore, approached this court by way of a writ petition under Article 226 of the Constitution of India being Special Civil Application No. 5039/1984 challenging the discharge. The said petition came to be allowed by the learned Single Judge holding that (1) the employer was a State within the meaning of Article 12 of the Constitution, and (2) the order of discharge was by way of a punishment and the assessee was entitled to reinstatement of his services. The employer challenged the order in letters patent appeal before a Division Bench of this court, which held that the employer - Gujarat State Fertilizer Company Limited was not a State or authority under Article 12 of the Constitution and allowed the appeal. However, the court recorded the agreement arrived at between the parties as reproduced hereinabove and disposed the appeal in terms of the agreement. It is pursuant to the above agreement that the amount in question came to be paid to the appellant.

11. Thus, the assessee's services came to be terminated by the order dated 6th May, 1984 under rule 44 of the relevant Service Rules after giving three months' pay. Therefore, insofar as the obligation of the employer to pay any amount to the assessee in relation to the termination of his services, the same came to an end in view of the discharge of his services under rule 44. While the assessee succeeded in the writ petition filed by him, the letters patent appeal preferred by the employer came to be allowed. Therefore, the discharge of the assessee's

services by the employer attained finality. However, during the pendency of the letters patent appeal, the assessee and the employer arrived at a settlement, in terms whereof, the amount was to be computed in the manner stated therein and was to be paid to the assessee. Therefore, the services of the assessee came to be terminated in terms of the rules, and the amount in question was paid only in terms of the settlement, without there being any obligation on the part of the employer to pay any further amount to the assessee in terms of the service rules. The employer, voluntarily at its discretion, agreed to pay the amount in question to the assessee with a view to bring an end to the litigation. There was no obligation cast upon the employer to make such payment and, therefore, the same would not take the colour of compensation as envisaged under section 17(3)(i) of the Act. The amount in question would, therefore, not fall within the ambit of the expression "profits in lieu of salary" as contemplated under section 17(3)(i) of the Act.

12. It has been contended on behalf of the revenue that the manner of computation of the amount to be paid to the appellant under the settlement, reveals that the same is in the nature of terminal benefits on account of bringing an end to the services of the appellant. In the opinion of this court, the manner of computation of the amount payable to the assessee in terms of the settlement, would not change the character of the payment, inasmuch as, the same being voluntary in nature and without any obligation on the part of the employer, would not amount to compensation in terms of section 17(3)(i) of the Act. The Tribunal was, therefore, not justified in holding that the amount of Rs. 3,51,308/- received by the appellant pursuant to the judgment of the High Court was income liable to tax under section 17(3) of the Act.

13. The question stands answered accordingly, in favour of the appellant assessee and against the revenue. The appeal is accordingly allowed. The impugned order passed by the Tribunal is hereby quashed and set aside and the order passed by the Commissioner (Appeals) deleting the addition made by the Assessing Officer is, hereby restored.