

(1946) 09 BOM CK 0004

In the Bombay High Court

Case No : Income Tax Reference No. 11 of 1945

In Re: Lady Navajbai Tata

Date of Decision : 11-09-1946

Acts Referred:

Income Tax Act, 1961 — Section 7

Citation : AIR 1947 Bom 331 : (1947) 49 BOMLR 66

Hon'ble Judges : Leonard Stone, J;Chagla, J

Bench : Division Bench

Judgement

Leonard Stone, Kt., C.J.—This is a reference u/s 66(1) of the Indian Income Tax Act and the question referred to us is :

Whether in the circumstances of this case the remuneration of Rs. 40,000 received by the assessee from Messrs. Tata Sons Ltd. in the year of account is salary chargeable u/s 7 of the Indian Income Tax Act ?

2. The assessment year was the year 1942-43, in respect of the accounting year, which is the calendar year 1941, in which year the sum of Us. 40,000 was received by the assessee in respect of her remuneration as a director of Tata Sons, Limited. This sum is made up of remuneration at the rate of Rs. 100 per month, and in addition, Rs. 38,800, being the assessee's share in the remuneration voted to the directors on May 5, 1941, at an annual general meeting of the company, pursuant to the power in that behalf contained in Article 97 of the company's articles. The articles so far as material are as follows:-

3. Article 92 provides, that the number of directors of the company should not be less than three nor more than ten and that the first directors of the company should be six persons whose names are therein set out, three of them being appointed for life, so long as they remained the registered holders of not less than 200 ordinary shares of the company, they are called "permanent directors" and the other three are what is described in the article as "ordinary directors." Article 92A makes special provision with regard to Mr. Saklatvala who was one of the three ordinary directors. Article 93 is concerned with the appointment of other directors besides the six named in Article 92, and provides that the three

permanent directors or their executors or administrators should have the power in the circumstances therein mentioned to appoint a permanent director. It was under this article that the assessee, who is the widow of Sir Ratan Tata (one of the three original permanent directors), was appointed in the year 1925 by Sir Ratan Tata's executors. Article 97 which is headed "Directors' remuneration" is as follows:-

The remuneration of the Directors (other than the managing director, if any) shall be at the rate of Rs. 100 per mensem, and such further sum (if any) as shall be voted to them by the company in general meeting, and such remuneration shall be divided among the directors (other than as aforesaid) as they shall determine, or, failing agreement, equally. The directors shall also be entitled to be repaid all travelling and hotel expenses incurred by them respectively in or about the performance of their duties as directors, including their expenses of travelling to or from board meetings.

4. The only other article to which it is necessary to refer is Article 101 which provides that the business of the company shall be managed by the directors, who, in addition to the powers and authorities by the articles or otherwise expressly conferred upon them, might exercise all such powers of the company as therein mentioned.

5. This article must be read in conjunction with Regulation 71 of Table A of the Indian Companies Act, which is a compulsory regulation and applies to all companies by virtue of Section 17 of that Act. Regulation 71 is in these terms :-

The business of the company shall be managed by the directors, who may pay all expenses incurred in getting up and registering the company, and may exercise all such powers of the company as are not by the Indian Companies Act, 1913, or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the company in general meeting, subject nevertheless to any regulation of these articles, to the provisions of the said Act, and to such regulations being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

6. From the agreed statement of facts contained in the reference it appears that;

All the directors, except the assessee-lady, are full-time directors of the company and attend office every day. Singly or together they look after the management of the concerns taken over by the company for management. The assessee-lady, however, does not attend office every day nor is she allotted any day to day work. She is however a resident of Bombay and attends the board's meetings and is also consulted in all important matters by the directors. As a permanent director she possesses residual powers, including the power of veto described in the articles of association. None of the directors is paid any fees or remuneration

for attending the board's meetings.

7. Counsel in this Court agree that this last sentence with regard to directors not being paid fees or remuneration for attending Board meetings, only means that no separate fees are payable in respect of the attendance at a Board meeting, which is the usual practice in this country, and does not mean that the remuneration provided by Article 97 does not cover the work done by a director in attending meetings of the Board.

8. The Tribunal in their judgment came to the conclusion that the sum of Rs. 40,000 was not taxable u/s 12, but fell to be taxed u/s 7 of the Indian Income Tax Act. At the date of this decision the recent case in this Court of The Commissioner of Income Tax v. Armstrong Smith (1945) Income Tax Reference No. 12 of 1945, decided by Stone C.J. and Kania J., on March 7, 1946 (Unrep.) which was decided on March 7, 1946, had not been so decided and their decision was based on the view that the assessee is "substantially an employee of the company". In my opinion the Tribunal was in error in coming to that conclusion. As was pointed out by me in delivering the judgment of this Court in Armstrong Smith's case, the English cases with regard to the relationship of a director with his company can :

be summarised by saying that a director of a company as such is not a servant of the company and that the fees he receives are by way of gratuity. But that does not prevent a director or a managing director from entering into a contractual relationship with the company, so that, quite apart from his office of director he becomes entitled to remuneration as an employee of the company.

In this case it is not, nor could it be suggested, that the assessee has any other relationship with the company than that of her appointment as a director, and accordingly she is not in my opinion a servant or an employee of the company, and I agree with the submission of Mr. Setalvad, on behalf of the Commissioner, that there is no such relationship in this case. The assessee's position in the company is that of a permanent director only. The articles do not appoint her either a manager or managing director, and she has no contract with the company outside the articles. Her remuneration of Rs. 100 a month and a share in whatever may be voted by the company in general meeting is in respect of her remuneration as director and nothing else.

9. The possible heads of income to be brought to tax u/s 6 of the Act are five and the first of these is salaries, which is particularised and dealt with in Section 7, the last of the five heads being "income from other sources" which is particularised in Section 12. Section 7(1) of the Indian Income Tax Act is as follows :-

The tax shall be payable by an assessee under the head "salaries" in respect of any salary or wages, any annuity, pension or gratuity, and any fees, commissions, perquisites or profits in lieu of, or in addition to, any salary or wages, which are due to him from, whether paid or not, or are paid by or on

behalf of, the Crown, a local authority, a company, or any other public body or association, or any private employer; and for the purposes of this sub-section advances by way of loan or otherwise of income chargeable under this head shall be deemed to be salary due on the date when the advance is received.

10. In my opinion the assessee's remuneration in question is neither a salary nor wages. But it is suggested by Sir Jamshedji Kanga on her behalf that it is a gratuity, and that as such it falls within one of the five substantive items contained in Section 7, viz. "salary or wages, any annuity, pension or gratuity", and it is submitted that the other items mentioned, viz. "fees, commissions, perquisites or profits" are substitutional items qualified by the words "in lieu of, or in addition to". Sir Jamshedji relies upon the word "and" which precedes the words "any fees" as making the break from the substantive list of items previously enumerated. The section as it at present stands amended is both cumbrous and obscure. As it originally stood under the 1922 Act, the section was as follows:-

The tax shall be payable by an assessee under the head salaries", in respect of any salary or wages, any annuity, pension or gratuity, and any fees, commissions, perquisites, or profits received by him in lieu of, or in addition to, any salary or wages, which are paid by or on behalf of the Crown, a local authority, a company or any other public body or association, or by or on behalf of any private employer.

11. Sir Jamshedji suggests that as the section stood, under the 1922 Act, it is clear that the five substantive heads are salary or wages, any annuity, pension or gratuity and that the omission of the words "any annuity, pension or gratuity" in the repetition of the substantive items is explained, because the substituted items are "any fees, commissions, perquisites or profits", which, can only properly be given in lieu of salary or wages and could not be given as an alternative to an annuity, pension or gratuity. In my opinion the amendments made to the section since 1922 do not overthrow the structure of the section as it originally stood and I think that a gratuity is one of the five substantive items which must be brought to tax u/s 7.

12. But that is not an end of the matter, because it is submitted by Mr. Setalvad that a gratuity must be paid by an employer, that is to say, that the relationship of master and servant must exist in order to bring a gratuity received by an assessee under the head of Section 7 for taxation purposes. In my opinion this argument is sound, because all the benefits contained in the section are governed by the source from which they are paid or are to be paid, that is to say "the Crown, a local authority, a company or any other public body or association; or any private employer". The words "or any private employer" are important, particularly when it is found that the notion of employer and employee prevails throughout the provisos and explanations to the section. In the case in the Lahore High Court of Bhagwati Shankar, In re (1943) 12 ITR 193 Mr. Justice Din Mohammad, with whom Mr. Justice Marten agreed, held that the commission earned by the assessee under his appointment as official liquidator by the High

Court, could be taxed only u/s 7, and at p. 198 the learned Judge said :

As I read Section 7 of the Income Tax Act, it contemplates every kind of servant, however highly or lowly placed he may be, and inasmuch as it includes every employee of a local authority, or a company, or any other public body or association or of any private employer, all persons who held an office are to be dealt with under this section in the first instance, and this, irrespective of any prior profession or vocation followed by them.

13. I agree with this passage, but, with respect to the learned Judge, I feel unable to concur with the conclusion at which he arrived, viz. that a liquidator appointed by the Court is a servant. The learned Judge does not say whose servant he is. He is an officer of the Court, and a trustee for the creditors, whilst his remuneration is provided out of the assets of the company, the quantum being fixed by the Court.

14. Tested in this way, can it be said that the sum of Rs. 40,000 paid to the assessee as director's remuneration for the accounting year in question is a gratuity, not only paid to her as such but also paid to her by an employer. In my opinion the remuneration satisfies the first qualification, but fails to satisfy the second, that is to say whilst a director's remuneration is to be regarded as a gratuity, it is a gratuity paid to a director by virtue of his or her office as such, and not as a servant or employee of the company. That being so, the sum in question does not, in my judgment, fall to be taxed u/s 7 of the Indian Income Tax Act, but must be brought to tax as income received from other sources u/s 12. Accordingly the question should be answered in the negative. The assessee must pay the costs.

Chagla, J.

15. I agree. u/s 6 of the Indian Income Tax Act are enumerated the five heads under which income is classified and which are chargeable to Income Tax, and the following sections lay down the mode of computation. Section 7 deals with salaries and it provides the various heads under which salaries are to be taxed. Three main heads are provided :

- (1) salaries or wages;
- (2) annuity, pension or gratuity; and
- (3) fees, commissions, perquisites or profits in lieu of, or in addition to, any salary or wages.

These various heads are to be taxed whether the amounts are actually paid or not and even if they are merely due to the assessee; or, in other words, u/s 7 of the Act, salaries are taxed both on the accrual and the receipt basis. It will be remembered that before the amendment of the Act salaries were only taxed on the receipt and not on the accrual basis. In my opinion Section 7 deals with different kinds of payments made by an employer to an employee. It has been

contended by Sir Jamshedji Kanga that even if the assessee is not an employee of the company, gratuity is an independent head and it is liable to tax under the head "salaries" although it may not be paid to an employee by an employer. I am not prepared to accept that contention. In the first place, when one looks at the context in which the expression "gratuity" finds itself, it is clear that it must be a payment arising out of a contract of employment. But to my mind the key words of the section which help us to a correct interpretation thereof are "any private employer". These words indicate that all the bodies and authorities which precede that expression "any private employer" and by which payments are made to the assessee should all be employers and payments should be made to the assessee in the character of an employee. If that were not so, then one would not expect the expression "or any private employer" and one would expect the expression "any individual or person". The fact that the legislature, after enumerating the various authorities or bodies, namely, the Crown, a local authority, a company, or any other public body or association ends up by mentioning "any private employer" clearly indicates the relationship which exists or which should exist between the person making the payment enumerated in the earlier part of the section and the assessee who receives that payment, and that relationship is that of an employer and an employee.

16. Sir Jamshedji Kanga on behalf of the assessee has further contended that in this case the assessee was employed by the company. Now it is true that a director holds an office under the company; he is either appointed or elected by the company. But I am not prepared to accept the contention that every person who holds an office is necessarily an employee. In the case of a director there may be special terms in the articles of association, or there may be an independent contract which may bring about contractual relationship between the company and the director and constitute the director an employee of the company; but independently of such special contract, a director of a company is not the employee of a company.

17. The learned Chief Justice has referred to the decision of Mr. Justice Din Mohammad in *Bhagwati Shankar, In re* (1943) 12 ITR 193. In that case the Lahore High Court held that the official liquidator was an employee and the remuneration received by him fell under the head "salaries". Now, with respect to the learned Judges, who decided that case, I agree with the learned Chief Justice that although, again with respect, the reasoning of the decision is sound, the conclusion arrived at seems to be erroneous and does not logically follow upon the reasoning advanced in the judgment. The decision seems merely to be based on the fact that the official liquidator holds an office and is appointed by the Court and that he is to receive a salary or a remuneration. Now these three ingredients by themselves do not constitute the official liquidator an employee, The fact that a person may hold an office and that he should receive a remuneration by virtue of that office does not necessarily bring about a relationship of master and servant between him and the person who pays him the remuneration or the relationship of an employer and an employee.

18. Sir Jamshedji Kanga has relied on Article 97 of the articles of association of Tata Sons, Limited, as constituting a contract of employment between the company and the assessee. That article fixes the remuneration to be paid to the directors. It is true that in this particular company there are no managing agents, there is no managing director and there are no managers to manage the affairs of the company, and in fact all the affairs are managed by the directors of the company. Therefore, says Sir Jamshedji, the remuneration paid to the directors is for managing the company and in order to act as the managers of the company. In my opinion that argument is fallacious because in law, and also expressly under Article 101 of the articles of this company, the business of the company is to be managed by the directors and the remuneration that is to be paid to the directors under Article 97 is to be paid to them quae directors in the capacity of directors and not as managers or for any special work to be done by them. The articles could very well have provided for a special remuneration either to all the directors or to any one of them for any special services to be rendered by them, or there could have been an independent contract of employment between the company and the directors or any of them. Admittedly there is no special contract, and I see nothing in the articles which, would lead one to hold that any one of the articles constitutes a special contract of employment between the company and the directors in respect of which any special remuneration is to be paid to them.

19. I, therefore, agree with the learned Chief Justice that the income of the assessee should be classified as "Income from other sources", and the question should be answered in the manner suggested by the learned Chief Justice.