

(1960) 11 PAT CK 0003

In the Patna High Court

Case No : Miscellaneous Judicial Case No. 740 of 1958 (Reference under section 66 (1) of the Indian Income Tax Act, 1922, by the Income Tax Appellate Tribunal, Allahabad Bench, in R. A. No. 666 of 1957)

V. D. TALWAR

APPELLANT

Vs

COMMISSIONER OF Income Tax, BIHAR.

RESPONDENT

Date of Decision : 22-11-1960

Acts Referred:

Income Tax Act, 1961 — Section 66(1)

Citation : (1961) 41 ITR 769

Hon'ble Judges : Ramaswami, C.J;Kanhaiya Singh, J

Bench : Full Bench

Judgement

RAMASWAMI, C. J., - In this case the assessee was employed as the general manager of Messrs. J. K. Iron and Steel Co. Ltd., Kanpur. The terms of his employment as agreed upon by the assessee and the company of his employment as agreed upon by the assess and the company were incorporated in his appointment letter dated February 7, 1946. A formal agreement was also executed between the parties on February 9, 1946. The assessee actually joined the service of the company on May 1, 1946. According to the service agreement, the pay of the assessee was fixed at Rs. 2,000 per month with certain allowances and amenities, like residential accommodation, etc. According to the agreement, the period of service was to be for five years. Clauses 5 and 6 of the appointment letter were in the following terms :

"5. Period of agreement of service to be five years.

6. Termination of service if within five years to be on notice of twelve months on either side or salary in lieu thereof."

Clause 21 of the memorandum of agreement dated February 9, 1946, reads as follows :

"21. If during the currency of this agreement, the employee desires to leave the

services of the employers for any reasons whatsoever, he shall be at liberty to terminate the agreement by giving twelve calendar months notice in writing only after repayment to the employer joining money and all expenses if they have been allowed to the employee, and the employers shall have full power to take all necessary steps in order to enforce such payment. The employers may terminate the service of the employee by giving the twelve calendar months notice in writing or in the case of breach of any of the terms or conditions contained herein at any time without any notice or paying any salary in lieu thereof."

The assessee joined his post as general manager on May 1, 1946. The services of the assessee were, however, terminated with effect from August 31, 1947. It is the admitted case that the services of the assessee were not terminated for any default or misconduct on the part of the assessee, but the services were terminated because the company did not want to continue the assessee in their employment. It is not the admitted case that no notice of twelve months of the termination of the service was given by the company to the assessee as required by the contract. In lieu of the notice the company paid to the assessee on September 12, 1947, a sum of Rs. 18,096 which was the amount computed as salary for twelve months after deduction of the Income Tax at source. The company calculated the salary from twelve months at Rs. 25,200 and deducted therefrom the sum of Rs. 7,103-15-0 as Income Tax. The assessee gave stamped receipt to the company for having received Rs. 18,096-1-0 "in full and final settlement of all his claims and dues against the employer company". In making the assessment for the year 1948-49, the Income Tax Officer held that the sum of Rs. 25,200 was a revenue receipt of the assessee liable to be taxed under the Indian Income Tax Act. The assessee took the matter in appeal to the Appellate Assistant Commissioner, who held that the sum of Rs. 25,200 was received by the assessee as compensation for loss of service and, therefore, was capital receipt not liable to be taxed. The Income Tax Appellate Tribunal, however, reversed the finding of the Appellate Assistant Commissioner and held that the amount of Rs. 25,200 paid to the assessee was rely salary in lieu of twelve months Notice, and, therefore, the amount was liable to be taxed under the Indian Income Tax Act.

Under section 66(1) of the Indian Income Tax Act the Income Tax Appellant Tribunal has submitted the following question of law for the opinion of the High Court :

"Whether the sum of Rs. 25,200 received by the assessee during the previous year was the revenue income of the assessee liable to tax under the Income Tax Act ?"

On behalf of the assessee learned counsel put forward the argument that the amount of Rs. 25,200 paid by the company was rely compensation for loss of employment and not by way ore remuneration for past services. It was submitted that the amount was compensation paid by the company to the

assessee for surrendering the valuable right of continuing the service for five years as general manager with certain future prospects. I am unable to accept this argument as right. In my opinion the amount of Rs. 25,200 was part of the remuneration which the assessee was entitled to get under clause 21 of the contract of service and which the assessee actually received from the company in accordance with the terms of the contract of service. The contract provided that the period of service was for five years, but the period could be shortened and the services of the assessee could terminate even before five years on notice of twelve months on either side or on payment of salary in lieu thereof. Clause 21 of the contract of service stipulates that "the employers may terminate the services of the employee by giving twelve calendar months" notice in writing (or in the case of breach of any of the terms or conditions contained herein at any time without any notice) or paying any salary in lieu thereof. "In the present case, therefore, there was no question of any breach of contract and there was no question of any right of service being given up by the assessee. It is not in my opinion correct to say that the assessee surrendered any rights under the contract. On the other hand, the assessee got exactly what he was entitled to get under his contract of employment. The amount of Rs. 25,200 is not, therefore, compensation for loss of office, by legally speaking the amount is part of the remuneration payable to the assessee under the very contract of employment. This view is borne out by the decision of the Court of Appeal in *Dale v. de Soissons*, where the material facts are almost parallel to those of the present case. In that case the respondent was employed as assistant to the managing director of a company and his remuneration consisted of a fixed salary of Pounds 3,000 per annum and a commission calculated on profits. Under the terms of his service agreement, the respondent's appointment was to be for three years from January 1, 1945, but the company was entitled to terminate the agreement at 31st December, 1945, or 31st December, 1946, on payment of Pounds 10,000 or Pounds 6,000, respectively, as "compensation for loss of office". The company actually terminated the agreement at 31st December, 1945, and paid the 10,000 to the respondent. On appeal to the Special Commissioners against an assessment for the years 1945-46 under Schedule E, the respondent contended that the 10,000 being paid as compensation for loss of office was not assessable. For the Crown it was contended that the sum was remuneration and not compensation for loss of office. The Special Commissioners allowed the appeal. Both the Kings Bench Division and the Court of Appeal, however, held that the decision of the Special Commissioners was erroneous and the amount of 10,000 was not compensation for loss of office, but it was assessable to tax. In the course of his judgment Sir Raymond Evershed, M. R., observed as follows :

"The burden of Mr. Grants argument is that, according to its proper construction, you cannot say the Pounds 10,000, which in the event became payable when the option was exercised to terminate at 31st December, 1945, was a payment or

remuneration for rendering the services which Colonel de Soissons undertook to render under this agreement. Mr. Grant accordingly says that it really represents, as a matter of principle as in the *Henley v. Murray* case, in effect a sum paid in consideration for the cancellation of the rights under the agreement with Colonel de Soissons would otherwise have had. As I have already indicated, to my mind the correct answer in that given by Roxburgh, J., namely, that this Pounds 10,000 was part of the remuneration which Colonel de Soissons was entitled to get under, and received from his contract of service. The contract provided that he should serve either for three years at an annual sum or, if the company so elected, for a shorter period of two years or one year at the annual sum in respect of the two years or the one year, as the case might be, plus a further sum, that is to say it was something to which he became entitled as part of the terms upon which he promised to serve, something which he was entitled to receive in the particular event specified, namely, the terms not running the three years but being earlier determined. I agree with the learned judge that there is a true analogy between this case and the cases to which I have referred, called *Henry v. Foster*, where the taxpayer received sums by virtue of the articles of association which were treated, for that purpose, as being a part of the contract of service."

The same principle has been expressed by the Court of Appeal in an earlier case, *Henry v. Arthur Foster* and *Henry v. Joseph Foster*. The respondents in this case were directors of a limited company. They had no written contracts of service with the company. But article 109 of the company's articles provided that in the event of any director, who had held office for not less than five years, dying or resigning or ceasing to hold office for any cause other than misconduct, bankruptcy, lunacy or incompetence, the company should pay to him or his representatives by way of compensation for loss of office a sum equal to the total remuneration received by him in the preceding five years. Both the respondents had held office for not less than five years. But they resigned office as directors and received from the company as "compensation" a payment calculated in accordance with article 109. It was held by Rowlatt, J., that the amount paid was compensation for loss of office and was not taxable, but the decision was reversed by the Court of Appeal on the ground that the payment constituted a profit of the office of director and was properly assessable to Income Tax under Schedule E for the last year of office. At page 632, Lawrence, L. J., stated as follows :

"In my opinion, the view taken both by Commissioners and by the learned Judge is erroneous. As pointed out by Lord Sterndale, Master of the Rolls, in the case of *Cowan v. Seymour*, the judgment of Lord Dunedin in *Duncans* must be read in the light of the facts of that case, which were that the allowance there was in the nature of a compassionate allowance made after the minister had retired on the ground of ill health. In my opinion either *Duncans* case nor any of the cases dealing with voluntary payment made on the relinquishment of an office or an employment of profit has any bearing on the question which we have to decide.

In my judgment, the determining factor in the present case is that the payment to the respondent whatever the parties may have chosen to call it was a payment which the company had contracted to make to him or part of his remuneration for his services as a director. It is true that payment of this part of his remuneration was deferred until his death or retirement or cesser of office, and that in the articles it is called "compensation for loss of office". It is, however, a sum agreed to be paid in consideration of the respondent accepting and serving in the office of director, and consequently is a sum paid by way of remuneration for his services as director."

In my opinion, the principle of these authorities applies to the present case. It follows, therefore, that the amount of Rs. 25,200 paid to the assessee was part of the remuneration which the assessee was entitled to get under the contract of service. The amount paid to the assessee cannot, therefore, be treated as compensation for loss of employment within the meaning of Explanation 2 of section 7. The section as it stood prior to the amendment of 1955 reads as follows :

"7. Salaries. - (1) 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 Government, a local authority, a company, or any other public body or association, or any private employer; and for the purposes of this subsection 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 :.....

Explanation 2. - A payment due to or received by an assessee from an employer or former employer or from a provident or other fund, is to the extent to which it does not consist of contributions by the assessee or interest on such contributions a profit received in lieu of salary of the purposes of this subsection, unless the payment is made solely as compensation for loss of employment and not by way of remuneration for past services."

On behalf of the assessee learned counsel referred to the decision of the House of Lords in *Hunter v. Dewhurst*. But the material facts of that case are different from those in the present case. In *Dewhurst's* case article 109 of the company's articles provided that when a director died or resigned or ceased to hold his office for a cause not reflecting upon his conduct or competence, the company should pay to him or his representatives by "way of compensation of the loss of office" a sum equal to the total amount of his remuneration in the preceding five years. Commander Dewhurst subsequently agreed with the company, at a time when he was ceasing to be chairman but was remaining a director, that in lieu of his rights under this article he should be paid 10,000, while his remuneration as director was at the same time reduced to 250 per annum. It was held by the majority of the House of Lords that the amount of 10,000 was not a profit from

his employment as director and did not represent salary, but was a sum of money paid down by the company to obtain a release from a contingent liability as distinguished from being remuneration under the contract of employment. That is the true ratio decided in Dewhurst's case and it is manifest that the present case does not fall within the ambit of that principle.

Learned counsel for the assessee also referred to a decision of the Bombay High Court in *W. A. Guff v. Commissioner of Income Tax*. But the material facts of that case are different. In that case the assessee joined the service of a company on May 27, 1946, under an agreement which provided that his services could be terminated by giving six months notice. On March 23, 1948, he received a communication from the company, which, according to the finding of the High Court, constituted the notice required under the contract. The assessee continued to serve the company till November 10, 1948, for winding up the department. On November 13, 1948, the company paid him a sum of Rs. 12,000 "as compensation for the termination of his employment." It was held by the High Court that the communication of March 23, 1948, was tantamount to an notice required under the contract, and the payment of Rs. 12,000 was a voluntary payment made by the company, not under the contract but as an *ex gratia* payment outside the terms of the contract. Learned counsel for the assessee also relied upon *R. N. Agrawala v. Commissioner of Income Tax*. But in that case also the payment to the assessee was made not under the terms of the contract of service but the payment was made after the contract of service was broken and the compensation was fixed as a result of a subsequent agreement. It is manifest that the principle of that case has no application to the present case. On the contrary, my concluded opinion is that the present case falls within the principle initiated in *Dale v. de Soissons* and *Henry v. Arthur Foster* and *Henry v. Joseph Foster*, to which I have already made reference.

For these reasons I hold that in the facts and circumstances of this case the sum of Rs. 25,200 received by the assessee is liable to be taxed under the Income Tax Act. I would accordingly answer the question of law referred by the Income Tax Appellate Tribunal against the assessee and in favour of the Income Tax Department. The assessee must pay the costs of this reference. Hearing fee Rs. 250.

KANHAIYA SINGH, J. - I agree.

Question answered accordingly.