The Commissioner of Income-Tax, Bombay

Vs

E. D. Sheppard

Civil Appeal No. 527 of 1961

(S. K. Das, J. L. Kapur, A. K. Sarkar JJ)

12.12.1962

JUDGMENT

S. K. DAS, J. –

This is an appeal on a certificate of fitness granted by the High Court of Bombay under s. 66-A(2) of the Indian Income-tax Act, 1922.

The relevant facts lie within a narrow compass. The Commissioner of Income-tax, Bombay, is the appellant before us and the assessee, E. D. Sheppard, is the respondent, Killick Nixon & Company was a partnership concern carrying on business on a fairly large scale in India. It owned various mills and managing agencies of a number of limited companies. This partnership firm used to employ officer-assistant mostly Europeans, on the basis of a contract for three years; if the services of the assistants, so employed were found satisfactory, extensions were invariably given after every three years on increased salary. Subject to their works being satisfactory, the assistants so employed expected to become partners of the firm one day. The assessee was one such assistants who joined the firm in 1930. The original contract relating to the assessee's employment was not placed on record. What was placed on record as a specimen copy of the initial agreement, was the contract with one W. J. Heygate. It was undisputed that the terms of employment regarding the assessee were the same as those of the contract with W. J. Heygate. Clause 10 of the said agreement provided that notwithstanding anything contained in it, the firm might terminate the agreement without assigning any reasons after giving the assessee one calendar month's previous notice of its intention so to do. The assessee continued in the employment of the firm and his contract of service was renewed from time to time. On November 1, 1947, was made the last renewal. The terms of this last renewal were the same as those of J. G. Milne, a copy of whose renewed contract was placed on record. This renewal provided for a contract of service from November 1, 1947 to October 31, 1950. Under this contract the assessee was to receive a salary of Rs. 1,200/- per month plus a commission of 2 1/2 per cent on the net profits of the partnership. The Appellate Tribunal found that if the partnership had continued to do business, the assessee would have got approximately Rs. 50,000/- per annum. Sometime about the last quarter of the year 1947 the firm decided to re-organise its business and with that end in view two limited companies were floated : one was called the Killick Industries Ltd., which was a public limited company, and the other was called Killick Nixon and Company which was a private limited company. This private limited company was to take over the business previously carried on by the partnership. This arrangement necessitated the termination of the services of the firm's employees and the assessee received a notice from the firm dated December 29, 1947. This notice stated that in view of the changes proposed, the assessee's employment with the firm would terminate as from January 31, 1948. The assessee was then about 38 years old. There were in all sixteen officers including the assessee who were employed with the firm on "contract

terms". With the exception of one, all these sixteen officers were Europeans. The three years' contracts expired on different dates depending upon the original date of employment in respect of these sixteen officers. So far as the assessee was concerned, it appears that the new company styled Killick Industries Ltd., agreed to take over the services of the assessee on new terms under which his salary was increased but the commission was disallowed, but he was left in more or less the same position financially. The assessee entered the employment of Killick Industries Ltd. on these new terms on February 1, 1948. Killick Nixon and Company transferred their assets to the new companies and received shares of the new companies in lieu thereof. A large number of shares of Killick Industries Ltd. were put on the Indian market. The shares were of the face value Rs. 100/- only put were quoted in market at Rs. 130/- per share. Some of these shares were kept by the partners of Killick Nixon and Company. All the members of the covenanted staff in the partnership firm (who were officers), were given shares of Killick Industries Ltd. free of payment. The assessee received an allotment of 1,700 shares of the face value of Rs. 2,21,000/-. The assessee's case was that the shares were given by the partnership to the members of the staff as compensation for loss of employment resulting from premature termination of their services. The Income-tax Officer, however, sought to bring the shares of the value of Rs. 2,21,000/- to tax on the footing that the shares were allotted to the assessee in consideration of past services. The assessee produced before the Income-tax Officer a letter purporting to be written by one D. R. C. Hartley on October 1, 1952, on behalf of the firm, in which the assessee was informed that the firm had caused 1,700 shares in Killick Industries Ltd. to be allotted as "compensation for loss of employment". In appeal to the Appellate Assistant Commissioner, the order passed by the Income-tax Officer bringing to tax the amount of Rs. 2,21,000/- was confirmed. Before the Income-tax Appellate Tribunal the assessee produced an affidavit dated February 22, 1954, sworn by five out of the six partners who constituted the firm in the month of January 1948, (the sixth partner having died in the meanwhile) which affirmed the terms of a memorandum submitted to the Income-tax Officer by Messrs Crawford Bayley & Co., on behalf of the assessee. It was recited in paragraph 8 of the affidavit that the partners had decided to discontinue the firm and prior to such discontinuance and on December 27, 1947, they wrote to each assistant who was then employed by the firm terminating his services from January 31, 1948, and stating that a further communication would be addressed to him regarding "the question of compensation for loss of employment." It was further recited in paragraph 8 that the intention of the partners on the discontinuance of the firm in causing allotments of certain shares to be made to the assistants was to compensate them for loss of employment and it was "in no sense a reward for past services". It was then recited that all the assistants had accepted the allotment as "compensation for the loss of employment in terms of the letter of December 27, 1947, and in view of such allotment no claim was made by any assistant against the firm" and that a confirmatory letter from the partnership to the assistants was some time thereafter written "for purposes of record".

The two members of the Tribunal differed in their views as to the true character of the payment received by the assessee. The accountant member was of the view that the assessee suffered no loss as a result of the termination of his employment with the partnership firm, because from February 1, 1948, the day after the termination of his employment with the partnership, he was employed by Killick Industries, Ltd., which gave him almost the same emoluments; and furthermore, the payment was not made "solely for loss of employment" because the compensation was paid partly for loss of expectations and future prospects which the assessee had in the partnership firm. Lastly, the accountant member held that the employment of the assessee was terminable on one month's notice and in any event the unexpired portion of his employment would not have amounted to Rs. 2,21,000/-; therefore, the payment could not be treated as compensation for loss of employment, and

at best it was a payment "under the contract" and not for "loss of the contract". The Judicial member disagreed, and expressed the view that the assessee's services were determined by the firm which was ultimately dissolved and the allotment of shares was made to the assessee "at or in connection with the termination of his employment and solely as compensation for loss of employment" and there was no material in the record to support the view that the payment was in lieu of past services. On a difference between the two members of the Tribunal, the question was referred to the President who agreed with the Judicial member and expressed the view that the payment was made to the assessee solely for loss of employment and it was immaterial that the assessee secured another employment, equally advantageous, under another employer on the next day after the termination of his employment with the partnership firm. Referring to the evidence adduced on behalf of the assessee, namely the affidavit field by the partners, the President said that there was no camouflaging as suggested by the department, and both the Judicial member and the President accepted the evidence given in support of his claim by the assessee.

The present appellant then moved the Tribunal to refer the following question of law to the High Court :

> "Whether on the facts and circumstances of the case, the sum of Rs. 2,21,000/-, being the value of the shares received by the assessee free of payment, is income of the assessee and assessable under section 7 of the Income-tax Act ?"

The Tribunal made a reference under s. 66 of the Income-tax Act, 1922. The reference was heard by Shah and Desai, JJ., of the Bombay High Court. The High Court referred to Explanation 2 to s. 7(1) of the Income-tax Act, as it stood at the relevant time, and held that if by an agreement between the assessee and his employer, a certain amount was estimated as compensation for the loss likely to be suffered by the assessee by reason of termination of his employment with the firm and was paid to him, the circumstance that the assessee did not in fact suffer any loss by reason of securing another employment would not, for income-tax purposes, alter the nature of the payment made. The High Court pointed out that the evidence given by the assessee in support of his claim having been accepted by the Tribunal, could not be questioned in the High Court on a reference under s. 66, such a reference being confined to the question of law arising out of the Tribunal. The High Court said that the sole question which fell to be determined was whether the compensation paid to the assessee was to be regarded as an income receipt or a capital receipt in the hands of the assessee. With reference to Explanation 2 of sub-s. (1) of s. 7 an argument was advanced before the High Court to the effect that the payment made to the assessee was not stated to have been made solely or loss of employment but as inclusive of compensation for loss of future of future prospects. The High Court met this argument by stating that the expectations or prospects were rooted in the employment and it would be difficult to distinguish between compensation for loss of employment and compensation for loss of prospects in that employment. The High Court then said :

> "It is true that by the Explanation a payment which is due to or received by an assessee from an employer or a former employer is to be regarded as profit received in lieu of salary for the purposes of sub-section (1) of Section 7; but in our judgment the payment must be made because of the relation between the employee and the employer. If the object of the payment is unrelated to the relation between the employer and the employee, it will not fall within the expression "profit received in lieu of salary" in Explanation 2 to Section 7 (1). Assuming, therefore, that a part of the compensation paid to the assessee was not solely for loss of employment but was attributable to the loss of future prospects which the assessee had of becoming a

> partner in future in the firm, that will not, in our judgment, be regarded as "profit received in lieu of salary" within the meaning of Section 7(1) or the Explanation thereto : and if such payment is not regarded as salary or profits in lieu of salary, there is no other head of income, profits or gains under which it will fall so as to make it taxable. In the ultimate analysis, we have to decide in this reference whether the payment can be regarded as a capital receipt or a revenue receipt in the hands of the assessee; and if, on the view we have taken, it is not a revenue receipt, then it must be regarded as not liable to tax."

We shall presently consider the contentions urged before us on behalf of the appellant. But before we do so, it is necessary to say that s. 7 of the Income-tax Act, 1922, was completely recast by the Finance Act, 1955, and we are concerned with the section as it stood prior to its amendment in 1955. We may now read s. 7(1) and Explanation 2 thereto (so far as it is material for our purpose) as they stood at the relevant time -

> "S. 7 (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 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 :
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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 for the purposes of this sub-section, unless the payment is made solely as compensation for loss of employment and not by way of remuneration for past services :

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Now, learned counsel for the department has urged two main contentions before us. His first contention is that the word 'compensation' in Explanation 2 means what is payable or compellable at law as compensation, that is, monetary equivalent of the damage suffered consequent on the injury caused. He has submitted that the assessee in this case suffered no injury for which the partnership was compellable at law pay any damages. According to learned counsel for the department, compensation for loss of employment means the monetary equivalent for the loss of earning under the existing contract without reckoning the loss of future prospects, and such loss must also be mitigated in the way known to law. His argument is that judged from that standpoint, the payment of Rs. 2,21,000/- to the assessee was not compensation solely for loss of employment within the meaning of Explanation 2. His second contention is that under the Explanation any payment received by an assessee from his employer or former employer (save payment from a provident or other fund mentioned therein) is profit received in lieu of salary for the purpose of sub-s. (1) of s. 7 unless the payment is made solely as compensation for loss of employment. He has submitted that the Explanation creates as it were an artificial definition of 'profits in lieu of salary' and if the payment is not compensation in the sense of payment compellable at law, no further question arises

as to whether the payment is related or unrelated to employment, or whether it is capital or revenue in the hands of the assessee. The argument of learned counsel is that the High Court was in error with regard to both the points stated above and therefore its answer to the question referred was not correct.

We consider that both the points urged on behalf of the department are without substance and are not supported by decisions including decisions of this Court. Let us first examine the first point. As Romer, L.J., said in Henry v. Arthur Foster [(1931) 6 Tax Cas. 605. 634.], compensation for loss of office or employment is a well-known term; it means a payment to the holder of an office as compensation for being deprived of profits to which as between himself and his employer he would, but for an act of deprivation by his employer or some third party such as the Legislature, have been entitled. It should be obvious that when the deprivation is by the Legislature, there can be no question of liability or compellability to pay damages at law. The emphasis is on the act of deprivation..... which may or may not give rise to any liability at law. In Chibbett v. Joseph Robinson & Sons [(1924) 9 Tax Cas. 48.] the assessee were employed by a certain steamship company as ship managers and their remuneration was fixed at a percentage of the company's annual profits. The company went into liquidation and the general meeting of the company authorised the liquidators to transfer to the assessee a sum of pounds 50,000 which was in certain bonds as compensation for loss of office. The question that arose before Rowlatt, J., was whether the sum of pounds 50,000 received by the assessees was capital or income. At p. 60 of the judgment the learned Judge said :

> "As Sir Richard Henn Collins said, you must not look at the point of view of the person who pays and see whether he is compellable to pay or not; you have to look at the point of view of the person who receives, to see whether he receives it in respect of his services, if it is a question of an office, and in respect of his trade, if it is a question of trade, and so on. You have to look at this point of view to see whether he receives it in respect of those considerations. That is perfectly true. But when you look at that question from what is described as the point of view of the recipient, that sends you back again, looking, for that purpose, to the point of view of the payer : not from the point of view of compellability or liability, but from the point of view of a person inquiring what is this payment for."

It is worthy of note that on the question of whether a receipt is capital or income in the hands of the assessee, the learned Judge made no distinction between office or trade. The income arising from an employment is taxable as "salaries" under s. 7; the profits of a business are taxable under s. 10; while the income arising from an office which does not involve employment would be taxable under s. 10 as business profits, e.g. in the ordinary case of managing agents or selling agents, where the activities amount to the carrying on of a business, and in other cases, e.g. an ordinary director of a company, it would be taxable under s. 12 as income from other sources. The question whether compensation received for loss of employment or office or for cessation of business is taxable under any of the three sections will fall to be considered, prior to the amendments of 1955, with reference to the general principle of income-tax law, which is to tax income. In other words, the question would be whether it is income or capital in the hands of the assessee.

The same view was expressed by the Privy Council in Commissioner of Income-tax v. Shaw, Wallace and Company [(1932) L.R. 59 I.A. 206.], where it held that a sum of money received as compensation for loss or cessation of oil distributing agencies was not income, profits or gains within the meaning of the Indian Income-tax Act. There is nothing in the judgment of the Privy

Council which suggests that the compensation that was received by the assessee was a compensation which was compellable at law. It was pointed out that the object of the Indian Income-tax Act was to tax "income" a term which it did not define. Income however connoted a periodical monetary return "coming in" with some sort of regularity, or expected regularity, from definite sources. The ratio of the decision was thus stated in the judgment :

> "But when once it is admitted that they were sums received, not for carrying on this business, but as some sort of solatium for its compulsory cessation, the answer seems fairly plain."

The same question arose before the Bombay High Court in W. A. Guff v. Commissioner of Income-tax, Bombay City [[1957] 31 I.T.R. 826.]. There the assessee joined in the service of a company on May 27, 1946, as an executive in charge of a new department of the company under an agreement which provided that his services could be terminated by giving six months' time. On March 23, 1948, he received the communication from the company that the department could not function any more, but the assessee continued to serve until November 10, 1948, for winding up the department. On November 30, 1948, the company paid the assessee of sum of Rs. 12,000/- as compensation equivalent to six months' salary for the termination of his employment owing to the closure of the department. The question was whether the amount of Rs. 12,000/- received by the assessee was a capital receipt or a revenue receipt taxable as salary under s. 7 of the Income-tax Act. It was argued before the Bombay High Court that if there was no legal liability to pay the compensation, then any payment made by the employer would not come within the expression 'compensation' used in Explanation 2; because if a proper notice was given to the assessee as found by the Tribunal in that case, he was not entitled to any compensation when his services were terminated after the lapse of six months from the date when the notice was given. The High Court dealt with this argument and repelled it. Chagla, C.J., who delivered the judgment of the court referred to the decisions in Shaw, Wallace and Company v. Commissioner of Income-tax [(1932) L.R. 59 I.A. 206.] and Chibbett v. Joseph Robinson & Sons [(1924) 9 Tax Cas. 48.] and then said :

> "We are, therefore, of the opinion that the expression "compensation for loss of employment" used in explanation 2 to section 7 refers to any payment made, whether under a legal liability or voluntarily, to compensate or act as a solatium for the loss of employment suffered by the employee."

Now, we come to a decision of this Court, Commissioner of Income-tax, Hyderabad v. Vazir Sultan and Sons [[1959] Supp. 2 S.C.R. 375.]. The assessee there, a registered firm, was appointed the sole selling agent and sole distributor for the Hyderabad State for the cigarettes manufactured by the company. The assessee was allowed a discount on the gross selling price. In 1939 another arrangement was arrived at between the assessee and the company whereby the assessee was given a discount not only on the goods sold in the Hyderabad State but on all goods sold outside the Hyderabad State. In 1950 the assessee and the company reverted to the old arrangement confining the sole agency of the assessee to the Hyderabad State and the assessee was paid a sum of Rs. 2,19,343/- by way of compensation for the loss of the agency outside the Hyderabad State. The question was whether the money received by the assessee was a revenue receipt assessable to income-tax or a capital receipt not so assessable. One of the points canvassed before this Court with some force was that there was no enforceable agreement as between the assessee and the company which could be made the subject matter of a legal claim for damages for compensation at his instance in the event of its termination or cancellation by the company. The agency agreement in that case was terminable at the will of the company and if the company chose to do so, the assessee

had no remedy at law in regard to the same. The argument was that therefore there was no enforceable agreement between the assessee and the company which could be made the subject matter of a legal claim for compensation. This argument was repelled and this Court said that in all such cases one has really to look to the nature of the receipt in the hands of the assessee irrespective of any consideration as to what was actuating the mind of the other party. This Court referred with approval to the observations made by Rowlatt, J., in Chibbett v. Joseph Robinson and Sons [(1924) 9 Tax Cas. 48.], which we have earlier quoted. This Court also referred with approval to the decision of W. A. Guff v. Commissioner of Income-tax [[1957] 31 I.T.R. 826.], and said that was immaterial whether the amount paid was compensation for which the employer was liable at law or was a payment made ex gratia.

In view of these decisions we must over-rule the first contention urged on behalf of the appellant that compensation in Explanation 2 to s. 7(1) means compensation which is payable or compellable at law.

We now turn to the second contention. Prior to the amendments introduced by the Finance Act, 1955, Explanation 2 to s. 7(1) made it clear that a payment which was made solely as compensation for loss of employment was not assessable, while a payment which was made as remuneration for past services was taxable as income. The principle was that compensation for wrongful repudiation of a service agreement or for loss of office or employment or cessation of business was a capital receipt, though the payment might be entirely voluntary and the recipient might have no legal right to any compensation at all. In such cases compensation was deemed to be a capital receipt because it was in respect of the source of income. The argument of learned counsel for the department however is that Explanation 2 treated any payment received by an assessee from an employer or former employer as a profit in lieu of salary (except where the payment was from a provident or other fund mentioned therein); therefore, the explanation was an artificial definition which treated any payment received by an assessee from his employer or former employer as income and no consideration as to whether the payment related to employment or not or whether it was capital or income need be considered, though learned counsel for the department concedes that a payment made solely as compensation for loss of employment does not come within the artificial definition of the Explanation. We do not think that the proposition put in the very wide form in which learned counsel for the department has put it, can be accepted as correct. In Mahesh Anantrai Pattani v. The Commissioner of Income-tax, Bombay North, Ahmedabad [[1961] 2 S.C.R. 742.], this Court had to consider s. 7(1) of the Act and Explanation 2 thereto, as they stood prior to the amendments in 1955. The facts of that case were these. M. A. Pattani who was the Dewan of the State of Bhavnagar was granted a monthly pension of Rs. 2,000/- by the Maharajah of the State by an order dated January 15, 1948. On March 1, 1948, the State of Bhavnagar merged in the United State of Saurashtra and the Maharajah ceased to be the ruler of the State. Subsequently on May 31, 1950, the Maharajah directed his banker in Bombay to pay Pattani a sum of Rs. 5,00,000/- and said that the payment was made in consideration of the loyal and meritorious services which Pattani had rendered to the State. The question which arose for decision was whether the aforesaid payment of Rs. 5,00,000/- was liable to tax under s. 7(1) read with Explanation 2. This Court held that the sum of Rs. 5,00,000/- was given to Pattani not as a payment in consideration of the services already rendered by Pattani as the Dewan of the State but merely as a gift in token of the Maharajah's affection and regard for the assessee. Therefore, it was held that the payment was not liable to be assessed to tax under s. 7(1), Explanation 2. The ratio of the decision was that the payment was a capital receipt, and not income assessable to income-tax, in the hands of the assessee. Apparently, this Court did not accept the proposition that every payment to an assessee by his employer or former employer was income and no question of treating such payment as capital in the hands of the

assessee need be considered.

Once it is held that the payment in the present case was a payment made solely as compensation for loss of employment, there is an end of the appeal; because Explanation 2 in clear terms excepts such payment from being treated as a profit received in lieu of salary. The Tribunal held on the evidence before it that the payment was made solely as compensation for loss of employment. The High Court rightly took the view that no distinction could be made between compensation for loss of employment and compensation for loss of prospects rooted in that employment. The High Court also rightly pointed out that if the object of the payment was unrelated to the relation between the employer and the employee, it would not fall within the expression "profit received in lieu of salary" in Explanation 2. We think that the High Court committed no error in answering the question referred to it.

For the reasons given above, we have come to the conclusion that there is no substance in this appeal. The appeal is accordingly dismissed with costs.

RAGHUBAR DAYAL, J. –

I have had the advantage of perusing the majority judgment of my learned brother, S. K. Das, J., but regret that I am unable to agree that the sum of Rs. 2,21,000/- was paid solely as compensation for loss of employment and did not amount to 'profit in lieu of salary'.

Mr. Rajagopala Sastri, for the appellant, concedes that the impugned sum received by the assessee-respondent, is not liable to income-tax unless it can be considered to be profit received in lieu of salary, in view of Explanation 2 to s. 7(1) of the Income-tax Act, as it stood prior to the amendment in 1955. Section 7 deals with the tax payable by an assessee under the head 'salaries'. It is not necessary to read the entire section. The relevant portion of Explanation 2 to s. 7(1) reads :

> "A payment due to or received by an assessee from an employer or former employer..... is.... a profit received in lieu of salary for the purposes of this sub-section, unless the payment is made solely as compensation for loss of employment and not by way of remuneration for past services."

Mr. Sastri contends that the sum of Rs. 2,21,000/- was received by the assessee from his employer Killick Nixon & Co., on January 30, a day before the termination of his services by that company, that it will be deemed to be profit received in lieu of salary unless the payment can be said to be made by the employer solely as compensation for loss of employment and not by way of remuneration for past services and that the amount was not paid solely as compensation for loss of employment. He has submitted that the expression 'compensation' means what is legally payable as a monetary equivalent of the damage suffered by the wrongful termination of service, that the amount of compensation is usually equivalent to the loss of earnings under the contract which had come to an end minus the expected reimbursement from any fresh employment.

Mr. Palkhivala, for the assessee, has urged that the intention of the parties is not main thing for determining the nature of the amount paid by the employer to the employee at the termination of the service and that compensation, for the purpose of this provision of the Income-tax Act, need not be equivalent to what Courts of law would allow as damages for injury caused to the person claiming compensation. It is urged that the word 'compensation' has got a well-established meaning for the purpose of the Act, the meaning being as stated by Romer, L.J., in Henry (H.M. Inspector of Taxes)

v. Arthur Foster; Henry (H.M. Inspector of Taxes) v. Joseph Foster [(1931) 16 Tax. Cas. 605, 634.].

It has not been disputed that by virtue of the contract between the assessee and the company the services of the assessee could have been terminated by giving him one calendar month's notice. It follows that on such termination of service the assessee could not have claimed any compensation, as the termination of service would not have been wrongful would have been under the terms of the contract.

The assessee could have normally expected renewal of his contract at the expiry of the term, just as three had been renewal of the previous contracts and he could also have expected to become, eventually, a partner in the firm as other assistants had become, in the past. The firm purported to allot the shares to the assessee as compensation for the loss of employment and the assessee accepted the same as such compensation. What the parties intended the sum to represent is immaterial and has no bearing on the determination of the true nature of the payment. Of course, it can be a factor which can be taken into consideration in arriving at the proper conclusion. The question, however, is whether in its real nature the sum received by the assessee does come within the expression 'compensation for loss of employment'. If it comes within that expression, it would not be taxable under s. 7, as in that case, it would not be deemed to be 'profit in lieu of salary'. If it does not come under that expression, it would be taken to be 'profit in lieu of salary'. If it comes within the scope of the first part of Explanation 2 to sub-s. (1) of s. 7 it would then be assessable to tax under the provisions of s. 7 and other relevant sections of the Act. We have therefore to determine whether the sum received is compensation and whether it is compensation for loss of employment.

We have been referred to a number of cases by learned counsel for the appellant, in support of the proposition that one can get compensation only when one is entitled to it and, even then, the amount of compensation is not to deviate much from the damages he is likely to get, on account of any injury to his right. The contention for the respondent is that, for the purposes of the Act, it is not necessary for a payment to amount to compensation that the recipient be entitled to it under the law and that the principles applying for the determination of the amount of damages in civil suit will not apply to the determination of the compensation for loss of office. It may be assumed, without deciding, that the contention for the respondent is correct. This by itself, does not solve the problem.

The expression 'compensation' by itself connotes some payment to make up certain loss suffered by the person getting the compensation. If no loss is suffered, no occasions for getting compensation arises. If follows that if an employee, by the terms of his employment, is not entitled to any relief on the termination of his service in accordance with the terms of the contract, there can arise no occasion for his claiming any compensation for the loss of employment or his being paid any compensation for any loss of employment.

It is contended for the respondent that it is not necessary for a sum, paid to an employee on the occasion of the termination of his services, to amount to a compensation that the employee should have a legal claim to it. It is urged that any voluntary payment on such occasion by way of gift or solatium will amount to compensation for loss of employment. Reliance is placed, in this connection, to what Romer L.J., said in Henry (H.M. Inspector of Taxes) v. Arthur Foster etc. [(1931) 16 Tax Cas. 605, 634.] :

> ""Compensation for loss of office" is a well-known term, and, as I understand it, it means a payment to the holder of an office as compensation for being deprived of

> profits to which as between himself and his employer he would, but for an act of deprivation by his employer or some third party such as the Legislature, have entitled."

The expression 'deprived' connotes some idea of the holder of the office not getting the profits due to some unjustified act of the employer, as 'depriving' is a coercive measure (Law Lexicon of British India by P. Ramanatha Aiyar). The word 'entitled' connotes that the employee should have a legal claim to the profits of which he is deprived and for which deprivation he gets the compensation. Neither of these two words would be properly applicable to the case of the person whose tenure of office is cut short by the employer in exercise of his right under the contract in such circumstances which do not give the employee right to any relief on account of such termination of his service.

What Romer, L.J., said further in Henry (H.M. Inspector of Taxes v. Arthur Foster. etc.) [(1931) 16 Tax Cas. 605, 634.] explains what he meant by the aforesaid meaning of the expression 'compensation' and that is consistent with the view I have expressed. He said at p. 634 :

> "In the present case, the payments are to be made on the death or resignation or cesser of office on any ground other than those specially excepted in the article, events, be it observed, on which in the very terms of the man's employment, his office, and therefore his emolument, would come to an end. It is impossible, therefore, in such a case, to say that when he dies or resigns or his office otherwise comes to an end he has lost any salary or any profits at all. The words 'compensation for loss of office' in such a case seem to me to be wholly misleading."

It is obvious from these observations that when under a contract the employee has no further claim to salary or profits on the termination of his service in terms of the contract, any payment made to him cannot be a payment as compensation for loss of office and that therefore what Romer, L.J., meant by the meaning given to the expression 'compensation for loss of office' was that that expression meant such payment which the holder of the office was entitled in law to get on account of his being, against his will, deprived of the profits to which as between himself and his employer he was entitled. If he was not entitled to any such profits on the cessation of office, any payment to him could not be compensation for loss of office.

We have been referred, for the respondent, to a number of cases in support of the contention that the amount received by the assessee is covered by the expression 'compensation for loss of office' which may be taken to be synonymous with 'compensation for loss of employment'. I may now deal with those cases.

The case reported as Commissioner of Income-tax v. Shaw, Wallace & Co [(1932) L.R. 59 I.A. 206.], dealt with the question as to whether a certain sum received by a firm as compensation for the termination of certain agencies was assessable income or not, under ss. 10 and 12 of the Income-tax Act. Section 10 dealt with income, profits and gains from business and s. 12 dealt with income from other sources in respect of income, profits and gain of every kind which might be included in the assessee's total income if not already included under other preceding heads. It was held that that sum was not taxable as income from business because, under s. 10, the tax is to be payable by an assessee under the head 'business' in respect of the profits or gains of any business carried on by him, and that the sums were not received for carrying on business, but as some sort of solatium for its compulsory cessation. This reason for the decision does not help us in construing whether the sum received by the assessee in the present case amounts to 'compensation for loss of employment'.

It was not considered in the case whether the sum received did amount to 'compensation' as there was no dispute about it. The cases dealing with payments in connection with cessation of agencies are therefore not of any help in determining the question before us. I however refer to them as much reliance has been placed on them for the respondent.

Anglo-French Exploration Co. Ltd., v. Clayson (H.M. Inspector of Taxes) [(1956) 36 Taz Cas. 545.], was a case with respect to assessment of Income-tax under Schedule D of the English Income Tax and the question was whether the sum sought to be assessed, amounted to annual profits arising or accuring from any trade exercised within the United Kingdom. The sum to be assessed was paid to the assessee for its resigning as agents of another company. It was remarked at p. 557, by Lord Evershed, M.R. :

> "But the question remains, not whether that sum in some senses or in some contexts as a payment might sensibly be called a 'capital' payment, but whether within the terms of Schedule D it is a profit or gain arising from the trade of the recipient."

Similarly, it can be said, in the present case, that the question is not whether the sum of Rs. 2,21,000/- can be called, in any sense, a capital receipt, but is whether it can be said to be a payment to the assessee as compensation for the loss of his employment with Killick Nixon & Co.

In The Commissioner of Income-tax, Hyderabad-Deccan v. Messrs. Vazir Sultan & Sons [[1959] Supp. 2 S.C.R. 375.], the assessee received certain amount as compensation for the termination of his agency over a certain area, even though it continued over other areas. It was held that the sum sought to be taxed was a capital receipt in the hands of the assessee and was not income from business which was to be taxed under s. 10 of the Income-tax Act. We are not really concerned with the question whether the amount of Rs. 2,21,000/- is a capital receipt or a revenue in the hands of the respondent. In view of Explanation 2, it would be a revenue receipt in the sense that it would be deemed to be 'profit in lieu of salary', it being a payment by the employer to the employee in case it be not a payment as compensation for loss of employment.

In connection with the question whether the sum sought to be taxed was capital receipt or revenue receipt, in Vazir Sultan's Case [[1959] Supp. 2 S.C.R. 375.] it was canvassed that :

> "there was no enforceable agreement as between the assessee and the Company which could be made subject-matter of a legal claim for damages or compensation at his instance in the event of its termination or cancellation by the Company. The agency agreement was terminable at the will of the Company and if the Company chose to do so the assessee had no remedy at law in regard to the same."

Bhagwati, J., said at p. 392 :

> "It is, however, to be remembered that in all these cases one has really got to look to the nature of the receipt in the hands of the assessee irrespective of any consideration as to what was actuating the mind of the other party."

It may now be pointed out that for the purposes of Explanation 2 to sub-s. (1) of s. 7 one has to look to the point of view of the employer who makes the payment and not of the receipt who receives it. The payment excepted from the purview of the first part of the Explanation is 'the payment made solely as compensation for loss of employment'. The exception is not for the payment received by the employee. The employer is to make the payment as compensation only when he be compellable

or liable to pay compensation and therefore the observations of this Court do not go against what I have said about the meaning of the word 'compensation'.

There are, however, certain other cases which deal with payments made to employees at the termination of their services. The English cases are not much in point for the simple reason that there such payment were sought to be taxed under Schedule E of the Income Tax Act which related to assessment of income-tax on persons having or exercising an office or employment or profit mentioned in that schedule. It was held that such payments did not accrue to a person by reason of his office which had really come to an end and were in the nature of testimonials, solatium or gift and so were not taxable. Explanation 2 to sub-s. (1) of s. 7 of the Indian Income-tax Act provides for assessment of the sum to income-tax on a different basis and therefore what has been held not assessable to tax under Schedule E of the English Act is no guide for our determining whether a certain sum does or does not amount to compensation for loss of employment.

In Cowan v. Seymour [(1919) 7 Tax Cas. 372.], payments made to one who had been Secretary of the Company by the share-holders out of the profit payable to them was held not to accrue to him in respect of an office or employment of profits and was therefore not chargeable under Schedule E. It was, however, said at p. 378 :

> "It is now well settled, whatever might have been considered before, that a voluntary payment, if it accrues by reason of an office or employment, is a profit under this Section..... it has been quite clearly decided that a voluntary payment or a gift, call it which you like, can be a profit and is a profit if it accrues by reason of the office."

It was held that the amount was paid to him as a testimonial for what he had done in the past while in office, which had then terminated and not as payment for those services. The factors leading to such a view were that the payment was made after the office had terminated and was not made by the employer, but by others.

In Chibbett v. Joseph Robinson & Sons [(1924) 9 Tax Cas. 48.], the assessee was taxed under Schedule D of the English Income-tax Act. The assessees were a firm of ship-managers and were employed in that capacity by a certain steam-ship company. The company went into liquidation and the liquidator transferred Pounds 50,000/- of 5% National War Bonds to the assessees as compensation for loss of office. Subsequently, in pursuance of the arrangements already made, the undertaking of the company including two ships and its remaining assets were transferred to a new company of the same name consisting of the same shareholders. The assessee firm was appointed the first manager of the new company and its remuneration was fixed on similar lines. It was held that the nature of the payment of pounds 50,000/- was not a profit liable to income-tax or excess profits tax duty. Rowlatt, J., finally said at p. 61 :

> "But at any rate it does seem to me that compensation for loss of an employment which need not continue, but which was likely to continue, is not an annual profit within the scope of the Income Tax at all."

These observations were with reference to the terms of the provisions relating to income-tax there. These observations did not meet with full approval in Henry (H.M. Inspector of Taxes) v. Arthur Foster, Etc. [(1931) 16 Tax Cas. 605, 634.], in which case the amount paid to Dewhurst, whose nature was under consideration, was a payment to him with reference to an article of association which governed his remuneration for services as a director of the company. Lord Macmillan said, at

p. 653 :

> "I am disposed to regard them as too widely expressed, for remuneration for services may take, in part, the from of a payment at the end of the employment, and a payment does not necessarily cease to be remuneration for services because it is payable when the services come to an end."

Further, in Chibbett'a Case [(1924) 9 Tax Cas. 48.] Rowlatt, J., himself observed at p. 61 :

> "The company as then constituted certainly came to an end, and when it came to an end they gave this solatium to this firm out of their abundant prosperity, once for all, not because of anything they were doing, but really every much, I think, as the Master of the Rolls puts it, as a testimonial for what they had done in the past in their office which had now terminated.
>
> Of course it is true that it is a trade receipt in this sense, that if these people had not been managers they never would have got it. It was not a gift to them as individuals or anything of that sort; it was because they were people of this kind... after all, the old arrangement has come to an end and he gets this lump sum given him as compensation for loss of office, if you like to put it that way, or if you like to put it as a testimonial because of the work he had done in the past, work which was now at an end."

The main point for consideration in the case was whether the amount in dispute amounted to profits within the meaning of Schedule D. What its true nature was, it was not necessary to determine, so long as it was not held to be profits. It was therefore that alternative opinion was expressed by Rowlatt, J., about its nature which could be either compensation for loss of office or a testimonial on account of the past work rendered by the assessee. I do not think that this case really helps the respondent in his contention that the sum of Rs. 2,21,000/- amounts to compensation for loss of employment.

In Duff (H.M. Inspector of Taxes) v. Barlow [(1941) 23 Tax Cas. 633.], the assessee, the Managing Director of a company, was paid Pounds 4,000/- for the loss of his right to further remuneration which he was entitled to get under the terms of an earlier agreement. He continued to be the Managing Director. It was held that the sum of pounds 4,000/- received by the assessee was not under the contract of employment nor as remuneration for services rendered or to be rendered, but was compensation for giving up a right to remuneration. There is nothing in this case which can be of any guidance in determining the question before us.

In Hose v. Warwick (H.M. Inspector of Taxes) [(1946) 27 Tax Cas. 459.], a certain sum paid to the assessee was considered to be compensation for the relinquishment by the assessee of his rights under his previous agreement for service with the company and his personal connection.

In both the last two cases, it is to be noticed that the payment was for the loss of something to which the recipient was entitled under his agreement with the person paying the amount. The decisions in these cases therefore do not help the respondent who had no right to any emoluments after the cessation of the service on one month's notice in view of the original agreement.

Reference has been made to some cases decided by this Court and the High Courts of this country. The only case of this Court dealing with an assessment under Explanation 2 to sub-s. (1) of s. 7 of

the Act is Mahesh Anantrai Pattani v. The Commissioner of Income-tax, Bombay North, Ahmedabad [[1961] 2 S.C.R. 742.]. The assessee in that case served as Dewan of the State of Bhavnagar and, on retirement, was sanctioned a monthly pension of Rs. 2,000/-. Later on, after the State had merged in the United States of Saurashtra on March 1, 1950, and the Maharajah ceased to be the ruler of the State, he ordered, on May 31, 1950, the payment of Rs. 5,00,000/- to the assessee. In his letter dated March 10, 1953, the Maharajah stated that this amount was paid as a gift in token of his affection and regard for the assessee and his family, though, earlier, in his letter dated December 27, 1950, the Maharajah had said that this amount was given as gift in consideration of the assessee, the ex-Dewan of the State, having rendered meritorious and loyal services. This Court, by majority, held that the Income-tax Appellate Tribunal should have relied on the letter dated March 10, 1953, and held that the payment was as a personal gift for the personal qualities of the assessee and as a token of personal esteem and was not in token of appreciation for the services rendered as a Dewan of the Bhavnagar State. This Court accepted the contention for the assessee that the payment did not fall within Explanation 2 to sub-s. (1) of s. 7 because it was neither made by the Maharajah for services rendered to him nor was relatable to the office of the Dewan held by the assessee, he having already been compensated for his services to the Maharajah personally and to the State. Kapur, J., said at p. 749 :

> "There is no mention in the document of December, 1950, of any services rendered to the Maharaja and it does not seem to have been considered by the Tribunal as to why the Maharaja should make out of his personal account the gift of such a large amount for something which was not done for the Maharaja specifically, particularly when the services to the State and to the Maharaja and his family had already been well compensated. This lends support to the submission of the appellants that the amount was paid merely as a gift in token of the Maharaja's affection and regard for the assessee."

And again, at p. 752 :

> ".... that the gift was voluntary is clear but it is not quite clear how the amount can be said to be relatable to the office held by the recipient. Even according to the case of the respondent the amount was paid about two years after the assessee had ceased to be an employee of the Maharaja of the State and immediately on his ceasing to be the Dewan of Bhavnagar State, the Maharaja had granted him a pension from out of the public funds for his services to the State as Dewan and for services rendered to the Maharaja and his family a handsome and a generous monthly pension of Rs. 2,000 per mensem".

Explanation 2 to sub-s. (1) of s. 7 of the Act was not held applicable to the sum of Rs. 5,00,000/-, in my opinion, as that sum was not paid by the State, the former employer, to the Dewan, its employee out of the public funds for services rendered, but was paid by the Maharajah personally from his personal funds to the assessee in token of affection and regard to him and his family and not with reference to any services rendered to him.

The facts of the present case are different from Pattani's Case [[1961] 2 S.C.R. 742.]. It cannot be said, in the present case, and is not the contention either for the respondent, that the sum of Rs. 2,21,000/- was paid to him as a personal gift for the personal qualities of the assessee and as a token of personal esteem. Similar payment was made to all the employees of the company. Payment was certainly related to past services. It was made a day before the termination of services. The case

therefore does not help the respondent.

In several cases the High Courts had to consider whether a certain sum was taxable or not under Explanation 2 to sub-s. (1) of s. 7 of the Act. In most of the cases, in which the sum was held to be paid as compensation for loss of employment, the recipient was entitled to compensation under the law. These cases are P. D. Khosla, In re [[1945] 13 I.T.R. 436.]; H. S. Captain v. Commissioner of Income-tax [[1959] 36 I.T.R. 84.]; Agarwala v. Commissioner of Income-tax [[1960] 38 I.T.R. 67.]. Only in one case, he was not so entitled, and it was held that a wider meaning be given to the expression 'compensation for loss of employment'. I do not consider this to be the correct view.

In W. A. Guff v. Commissioner of Income-tax [[1957] 31 I.T.R. 826.], strongly relied on by the respondent, the assessee had jointed the service of the company as an executive in charge of the new department under an agreement which provided that his services could be terminated by giving him six months' notice. On March 23, 1948, he received communication from the company that the department could not function any more. He, however, continued to serve until November 10, 1948, for winding up the department. On November 13, 1948, the company paid him a sum of Rs. 12,000/- as compensation, equivalent to six months' salary for the termination of his employment owing to the closure of the department. It was held that the communication of March 23, 1948, constituted a notice terminating the services of the assessee as required by the contract of service and that the payment of Rs. 12,000/- was made not for past services, but as compensation or solatium for termination of his office and as compensation was a capital receipt and exempt from tax. Chagla C.J., rightly said at p. 831 :

> "Therefore, in order that the assessee should succeed, he must establish that this payment which he has received from his employer is a payment made solely as compensation for loss of employment. Now the difficulty is caused by the expression 'compensation for loss of employment. Two views are possible. One view is that the compensation contemplated by the Legislature is a compensation which the employer was liable in law to pay to the employee : in other words, the loss suffered by the employee must be such as would render the employer liable to make good that loss. On this view, if there is no legal liability to pay the compensation, then any payment made by the employer would not come within this expression used in Explanation 2".

He, however, further posed a question in this form :

> "But the question that we have to consider is whether the expression used in Explanation 2 is used in this narrow sense or it is used in the wider sense as meaning a solatium for the deprivation by the employer of his employment. In other words, did the Legislature merely contemplate the factual loss of employment and any amount paid for that loss, whether that payment was under a legal liability or not ?"

He then expressed his opinion thus :

> "It also seems to us, apart from the authorities, that it is the better view to take of this expression, because if an employee loses his employment which is the source of his income, any payment made by his employer for that loss should not be looked upon as income liable to tax, as in its very nature the payment is to compensate for or to act as a solatium for the very source which produced the income and in respect of which the employee is liable to tax."

'Solatium' is not a synonym for 'compensation'. It is 'compensation for loss of employment' which is not considered to be 'profit in lieu of salary' in Explanation 2 to sub-s. (1) of s. 7 and not 'solatium' in the sense of a 'gift' or any payment distinguished from compensation.

In support of his view, Chagla, C.J., placed reliance on Commissioner of Income-tax v. Shaw, Wallace & Co. [(1932) L.R. 59 I.A. 206.]. I have already considered that case and have stated that it has no bearing on construing Explanation 2 to sub-s. (1) of s. 7 of the Act. The definite opinion of the Privy Council was that the sums received in that case were not for carrying on business and therefore not assessable to tax. It was of course stated that they were received as some sort of solatium for the compulsory cessation of the agencies. It was neither necessary to state, nor was it stated, what the actual nature of that solatium was. I am of opinion that the compulsory cessation of employment is not equivalent to the compulsory cessation of an agency for the purpose of considering whether any voluntary amount paid at the cessation of the employment or the cessation of an agency is assessable to tax or not as the two amounts are assessable under different provisions of the Act. The nature of the amount has to be considered from the point of view of explanation 2 to sub-s. (1) of s. 7 of the Act in one case and from the point of view of s. 10 in the other.

In Guff's case [[1957] 31 I.T.R. 826.] Chagla, C.J., also relied on Chibbett's case [(1924) 9 Tax Cas. 48.], and on the observation of Romer, L.J., in Henry (H.M. Inspector of Taxes) v. Arthur Foster Etc. [(1931) 16 Tax Cas. 605, 634.]. I have already considered that observation along with what Romer, L.J., said in that very case about the nature of the payment in dispute and have also dealt with Chibbett's case [(1924) 9 Tax Cas. 48.] and need say nothing more about them.

I am therefore of opinion that any sum by an employer or former employer to an employee at the termination of his services will be a 'payment made solely as compensation for loss of employment' only when it is made in consideration of what the employee can claim as such compensation under law or the terms of the contract of service. If he cannot claim such compensation, the sum paid to the employee will not be by way of compensation for loss of employment. It is immaterial that the employer pays it or the employee receives it as compensation for loss of employment. The true nature of the sum received to be determined in accordance with what has been stated above.

In the present case, the assessee's services were terminated by giving one month's notice in accordance with the service contract. He had no claim for compensation. The payment of Rs. 2,21,000/- by this employer firm cannot therefore be said to have been made as compensation for loss of employment.

The question then arises whether this payment comes within the first part of Explanation 2 to sub-s. (1) of s. 7 and thus amounts to 'profits in lieu of salary'. This sum was received by the assessee from his employer a day before the termination of his services. The payment was made by the firm as employer to the assessee as employee and therefore comes within the purview of the Explanation. The sum comes within the language of the first part of the aforesaid Explanation and will be treated as 'profits in lieu of salary', for the purposes of sub-s. (1) of s. 7. It follows that tax will be payable by the assessee under the head 'salaries' in respect of this sum, in view of the provisions of s. 7 of the Act. It is not necessary, in my opinion, to determine whether the sum was received by the assessee as capital receipt or revenue receipt. In fact, it will be deemed to be revenue receipt as 'profit in lieu of salary' must be deemed to be 'income' for the purposes of the Act.

It has, however, been argued for the respondent that the language of the first part of the explanation should not be given a wide meaning and should be given a restricted meaning so that it be taken to

refer to such payment as is made because of the relation between the employer and his employee; and that the object of the payment of the sum of Rs. 2,21,000/- being unrelated to the relation between the firm and the assessee, it cannot be deemed to be 'profit in lieu of salary'. Even if such a restricted construction be put on the language of the aforesaid Explanation, that will not take the sum of Rs. 2,21,000/- out of its scope. This sum was paid to the assessee because of the relation between the employer and him. It was related to the service of the assessee with the firm. It was made because he was an employee whose service was to cease in accordance with the terms of the contract. It was not paid for any extraneous consideration. It was also not paid for any personal relations between the partners of the firm and the assessee or for any particular affection or esteem they held for him or for any particular personal qualities of his. The payment was made in view of the past service of the assessee which it may be granted, was appreciated.

In view of what has been stated above, I am of opinion that the sum of Rs. 2,21,000/- received by the respondent as employee from Killick Nixon & Co., his employers, on the occasion of the termination of his services after appropriate notice of one month, was not a payment made as compensation for loss of employment and therefore amounted to 'profit in lieu of salary' in view of explanation 2 to s. 7(1) of the Act and was, as such, taxable to income-tax. The High Court was therefore in error in holding otherwise. I would accordingly allow the appeal with costs and my answer to the question referred would be that the sum of Rs. 2,21,000/- received by the respondent is taxable to income-tax as 'profit in lieu of salary' under sub-s. (1) of s. 7 of the Act.

BY COURT : In view of the majority judgment, the appeal is dismissed with costs.

Appeal Dismissed.

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