Commissioner of Income-Tax, Kerala and Coimbatore

Vs

L. W. Russel

Civil Appeal No. 220/1963

(K. Subha Rao, J. C. Shah, S. M. Sikri, N. Rajgopala ayyangar JJ)

01.04.1964

JUDGMENT

SUBBA RAO, J. –

This appeal by special leave preferred against the judgment of the High Court of Kerala at Ernakulam raises the question of the interpretation of s. 7(1) of the Indian Income-tax Act, 1922 (Act No. XI of 1922), hereinafter called the Act.

The respondent, L. W. Russel, is an employee of the English and Scottish Joint Co-operative Wholesale Society Ltd., Kozhikode, hereinafter called the Society, which was incorporated in England. The Society established a superannuation scheme for the benefit of the male European members of the Society's staff employed in India, Ceylon and Africa by means of deferred annuities. The terms of such benefits were incorporated in a trust deed dated July 27, 1934. Every European employee of the Society shall become a member of that scheme as a condition of employment. Under the term of the scheme the trustee has to effect a policy of insurance for the purpose of ensuring an annuity to every member of the Society on his attaining the age of superannuation or on the happening of a specified contingency. The Society contributes 1/3 of the premium payable by such employee. During the year 1956-57 the Society contributed Rs. 3,333/- towards the premium payable by the respondent. The Income-tax Officer, Kozhikode Circle, included the said amount in the taxable income of the respondent for the year 1956-57 under s. 7(1), Explanation 1 Sub-cl. (v) of the Act. The appeal preferred by the respondent against the said inclusion to the Appellate Assistant Commissioner of Income-tax, Kozhikode, was dismissed. The further appeal preferred to the Income-tax Appellate Tribunal received the same fate. The assessee thereupon filed an application under s. 66(1) of the Act to the Income-tax Appellate Tribunal for stating a case to the High Court. By its order dated December 1, 1958, the Tribunal submitted a statement of case referring the following three question of law to the High Court of Kerala at Ernakulam :-

> (1) Whether the contributions paid by the employer to the assessee under the terms of a trust deed in respect of a contract for a deferred annuity on the life of the assessee is a 'perquisite' as contemplated by s. 7(1) of the Indian Income-tax Act ?
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> (2) Whether the said contributions were allowed to or due to the applicant by or from the employer in the accounting year ?
>
> (3) Whether the deferred annuity aforesaid is an annuity hit by section 7(1) and para. (v) of Explanation 1 thereto ?

On the first question the High Court held that the employer's contribution under the terms of the trust deed was not a perquisite as contemplated by s. 7(1) of the Act. On the second question it came to the conclusion that the employer's contributions were not allowed to or due to the employee in the accounting year. On the third question it expressed the opinion that the Legislature not having used the word "deferred" with annuity in s. 7(1) and the statute being a taxing one, the deferred annuity would not be hit by para. (v) of Explanation 1 to s. 7(1) of the Act. The Commissioner of Income-tax has preferred the present appeal to this Court questioning the correctness of the said answers.

The three questions formulated for the High Court's opinion are interdependent and the answer to them turn upon the true interpretation of the relevant part of s. 7(1) of the Act.

Mr. Rajagopala Sastri, learned counsel for the appellant, contends that the amount contributed by the Society under the scheme towards the insurance premium payable by the trustees for arranging a deferred annuity on the respondent's superannuation is a perquisite within the meaning of s. 7(1) of the Act and that the fact that the respondent may not have the benefit of the contributions on the happening of certain contingencies will not make the said contributions anytheless a perquisite. The employer's share of the contributions to the fund earmarked for paying premiums of the insurance policy, the argument proceeds, vests in the respondent as soon as it is paid to the trustee and the happening of a contingency only operates as a defeasance of the vested right. The respondent is ex-parte and, therefore, the Court has not benefit of the exposition of the contrary view.

Before we attempt to construe the scope of s. 7(1) of the Act it will be convenient at the outset to notice the provisions of the scheme, for the scope of the respondent's right in the amounts representing the employer's contributions thereunder depends upon it. The trust deed and the rules dated July 27, 1934, embody the superannuation scheme. The scheme is described as the English and Scottish Joint Co-operative Wholesale Society Limited Overseas European Employees' Superannuation Scheme, hereinafter called the Scheme. It is established for the benefit of the male European members of the Society's staff employed in India, Ceylon and Africa by means of deferred annuities. The Society itself is appointed thereunder as the first trustee. The trustees shall act as agents for and on behalf of the Society and the members respectively; they shall effect or cause to be effected such policy or policies as may be necessary to carry out the scheme and shall collect and arrange for the payment of the moneys payable under such policy or policies and shall hold such moneys as trustees for and on behalf of the person or persons entitled thereto under the rules of the scheme. The object of the Scheme is to provide for pensions by means of deferred annuities for the members upon retirement from employment on attaining certain age under the conditions mentioned therein, namely, every European employee of the Society shall be required as a condition of employment to apply to become a member of the Scheme from the date of his engagement by the Society and no member shall be entitled to relinquish his membership except on the termination of his employment with Society; the pension payable to a member shall be provided by means of a policy securing a deferred annuity upon the life of such member to be effected by the Trustees as agents for and on behalf of the Society and the members respectively with the Co-operative Insurance Society Limited securing the payment to the Trustees of an annuity equivalent to the pension to which such member shall be entitled under the Scheme and the Rules; the insurers shall agree that the Trustees shall be entitled to surrender such deferred annuity and that, on such deferred annuity being so surrendered, the insurers will pay to the Trustees the total amount of the premiums paid in respect thereof together with compound interest thereon; all moneys received by the Trustees from the insurers shall be held by them as Trustees for and on behalf of the person or persons entitled thereto under the Rules of the Scheme; any policy or policies issued by the insurers

in connection with the Scheme shall be deposited with the Trustees; the Society shall contribute one-third of the premium from time to time payable in respect of the policy securing the deferred annuity in respect of each member as thereinbefore provided and the member shall contribute the remaining two-thirds; the age at which a member shall normally retire from the service of the Society shall be age of 55 years and on retirement at such age a member shall be entitled to receive a pension of the amount specified in Rule 6; a member may also, after following the prescribed procedure, commute the pension to which he is entitled for a payment in cash in accordance with the fourth column of the Table in the Appendix annexed to the Rules; if a member shall leave or be dismissed from the service of the Society for any reason whatsoever or shall die while in the service of the Society there shall be paid to him or his legal personal representative the total amount of the portions of the premiums paid by such member and if he shall die whilst in the service of the Society there shall be paid to him or his legal personal representatives the total amount of the portions of the premiums paid by such member and if he shall die whilst in the service of the Society or shall leave or be dismissed from the service of the Society on account of permanent breakdown in health (as to the bona fides of which the Trustees shall be satisfied) such further proportion (if any) of the total amount of the portions of the premiums paid by the Society in respect of that member shall be payable in accordance with Table C in the Appendix to the Rules; if the total amount of the portions of the premiums in respect of such member paid by the Society together with interest thereon as aforesaid shall not be paid by the Trustees to him or his legal personal representative under sub-s. (1) of r. 15 then such proportion or the whole, as the case may be, of the Society's portion of such premiums and interest thereon as aforesaid as shall not be paid by the Trustees to such member or his legal personal representatives as aforesaid shall be paid by the Trustees to the Society; the rules may be altered, amended or rescinded and new rules may be made in accordance with the provisions of the Trust Deed but not otherwise.

We have given the relevant part of the Scheme and the Rules. The gist of the Scheme may be stated thus : The object of the Scheme is to provide for pensions to its employees. It is achieved by creating a trust. The Trustees appointed thereunder are the agents of the employer as well as of the employees and hold the moneys received from the employer, the employee and the insurer in trust for and on behalf of the person or persons entitled thereto under the rules of the Scheme. The Trustees are enjoined to take out policies of insurance securing a deferred annuity upon the life of each member, and funds are provided by contributions from the employer as well as from the employees. The trustees realise the annuities and pay the pensions to the employees. Under certain contingencies mentioned above, an employee would be entitled to the pension only after superannuation. If the employee leave the service of the Society or is dismissed from service or dies in the service of the Society, he will be entitled only to get back the total amount of the portion of the premium paid by him, though the trustees in their discretion under certain circumstances may give him a proportion of the premiums paid by the Society. The entire amount representing the contributions made by the Society or part thereof, as the case may be, will then have to be paid by the Trustees to the Society. Under the scheme the employee has not acquired any vested right in the contributions made by the Society. Such a right vests in him only when he attains the age of superannuation. Till that date that amount vests in the Trustees to be administered in accordance with the rules; that is to say, in case the employee ceases to be a member of the Society by death or otherwise, the amounts contributed by the employer with interest thereon, subject to the discretionary power exercisable by the trustees, become payable to the Society. If he reaches the age of superannuation, the said contributions irrevocably become fixed as part of the funds yielding the pension. To put it in other words, till a member attains the age of superannuation the employer's share of the contributions towards the premiums does not vest in the employee. At best he has a

contingent right therein. In one contingency the said amount becomes payable to the employer and in another contingency, to the employee.

Now let us look at the provisions of s. 7(1) of the Act in order to ascertain whether which a contingent right is hit by the said provisions. The material part of the section reads :-

> "Section 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 allowed to him by or are due to him, whether paid or not, from, or are paid by or on behalf of,.....a company.....".

Explanation 1 - For the purpose of this section perquisite includes -

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> (v) any sum payable by the employer, whether directly or through a fund to which the provisions of Chapters IX-A and IX-B do not apply, to effect an assurance on the life of the assessee or in respect of a contract of annuity on the life of the assessee.

This section imposes a tax on the remuneration of an employee. It presupposes the existence of the relationship of employer and employee. The present case is sought to be brought under the head "perquisites in lieu of, or in addition to, any salary or wages, which are allowed to him by or are due to him, whether paid or not, from, or are paid by or on behalf of a company". The expression "perquisites" is defined in the Oxford Dictionary as "casual emolument, fee or profit attached to an office or position in addition to salary or wages". Explanation 1 to s. 7(1) of the Act gives an inclusive definition. Clause (v) thereof includes within the meaning of "perquisites" any sum payable by the employer, whether directly or through a fund to which the provisions of Chs. IX-A and IX-B do not apply, to effect an assurance on the life of the assessee or in respect of a contract for an annuity on the life of the assessee. A combined reading of the substantive part of s. 7(1) and cl. (v) of Expl. 1 thereto makes it clear that if a sum of money is allowed to the employee by or is due to him from or is paid to enable the latter to effect in insurance on his life, the said sum would be a perquisite within the meaning of s. 7(1) of the Act and, therefore, would be exigible to tax. But before such sum becomes so exigible, it shall either be paid to the employee or allowed to him by or due to him from the employer. So far as the expression "paid" is concerned, there is no difficulty, for it takes in every receipt by the employee from the employer whether it was due to him or not. The expression "due" followed by the qualifying clause "whether paid or not" shows that there shall be an obligation on the part of the employer to pay that amount and a right on the employee to claim the same. The expression "allowed", it is said, is of a wider connotation and any credit made in the employer's account is covered thereby. The word "allowed" was introduced in the section by the Finance Act of 1955. The said expression in the legal terminology is equivalent to "fixed, taken into account, set apart, granted". It takes in perquisites given in cash or in kind or in money or money's worth and also amenities which are not convertible into money. It implies that a right is conferred on the employee in respect of those perquisites. One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payments to which the employee has no right till the contingency occurs. In short, the employee must have a vested right therein.

If that be the interpretation of s. 7(1) of the Act, it is not possible to hold that the amounts paid by

the Society to the Trustees to be administered by them in accordance with the rule framed under the Scheme are perquisites allowed to the respondent or due to him. Till he reaches the age of superannuation, the amounts vest in the Trustees and the beneficiary under the trust can be ascertained only on the happening of one or other of the contingencies provided for under the trust deed. On the happening of one contingency, the employer becomes the beneficiary, and on the happening of another contingency, the employee becomes the beneficiary. Learned counsel for the appellants strongly relied upon the decision of the King's Bench Division in Smyth v. Stretton [(1904) 5 T.C. 36, 46]. There, one Stretton, one of the Assistant Masters of Dulwich College, was assessed to income-tax in the sum of Pounds 385 in respect of his emoluments as Assistant Master received from the Governors of Dulwich College for the year ended the 5th day of April, 1901. He objected to the assessment on the ground that it included Pounds 35 not liable to taxation, being amount placed to his credit by the Governors under the Provident Fund Scheme for the year 1900. Channell, J., with some hesitation, came to the conclusion that the said sum was taxable. That case was dealing with a scheme for the establishment of provident fund for the benefit of the Assistant Masters on the permanent staff of the Dulwich College. Under para. 1 of the scheme the salaries of the Assistant Masters were increased. Clause (a) of para. 1 of the scheme provided that Assistant Masters having not less than five years, but less than fifteen years' service, would be allowed an increase of 5 per cent, in their salaries; under cl. (b) thereof, Assistant Masters having not less than 15 years' of service and over, would get an increase of 7 1/2 per cent. in their salaries; under cl. (c) thereof, a further addition in their salaries, equal in amount to the above sums, should be granted from the same date to the Assistant Masters alluded to in (a) and (b), such addition being, however, subject to the conditions provided by para. 5. Paragraph 5 read :-

> "That Assistant Masters having less than ten years' service who may resign their appointments, or from any other cause than ill-health cease to belong to the College, shall be entitled to receive the total increase sanctioned by (a) and the accumulations thereof, but shall not receive the additional increase sanctioned by (c), or the accumulations thereof. In the event of any such Assistant Master retiring from ill-health the Governors, in addition to the increase sanctioned by (a), may grant him the further 5 per cent. sanctioned by (c), and the accumulations thereof. In the event of death of any such Assistant Master whilst in the service of the College, the 5 per cent. due by (c) as well as under (a) with the accumulations thereof, shall be did to his legal representatives".

It was contended that the amount payable under cl. (c) of para. 1 was a contingent one with any vested character and, therefore, could not be described as in any way. The learned Judge construed the provisions of the scheme and rejected the contention. The main reason for his conclusion is stated thus :-

> "The result seems to me to be that I must take that sum as a sum which really has been added to the salary and is taxable, and it is not the less added to the salary because there has been a binding obligation created between the Assistant Masters and Governors of the Schools that they should apply it in a particular way".

No doubt it is possible for another court to come to a different conclusion on the construction of the provisions of the scheme; but the learned Judge came to the conclusion that cl. (c) of para. 1 of the scheme provided for an additional salary to the Assistant Masters. Indeed, the Court of Appeal in Edwards (H.M. Inspector of Taxes) v. Roberts [(1935) 19 T.C. 618, 638, 640] construed a similar scheme and came to the contrary conclusion and explained the earlier decision on the basis we have

indicated. There, the respondent was employed by a company under a service agreement dated August 21, 1921, which provided inter alia, that, in addition to an annual salary, he should have an interest in a "conditional fund", which was to be created by the company by the payment after the end of each financial year of a sum out of its profits to the trustees of the fund to be invested by them in the purchase of the company's shares or debenture stock. Subject to possible forfeiture of his interest in certain events, the respondent was entitled to receive the income produced by the fund at the expiration of each financial year, and to receive part of the capital of the fund, (or, at the trustees' option, the investments representing the same) at the expiration of five financial years and of each succeeding year, and, on death whilst in the company's service or on the termination of his employment by the company, to receive the whole amount then standing to the credit of the capital account of the fund (or the actual investments). The respondent resigned from the service of the company in September, 1927, and at that date the trustees of the fund transferred to him the shares which they had purchased out of the payments made to them by the company in the years 1922 to 1927. He was assessed to income-tax on the amount of the current market value of the shares at the date of transfer. The assessee contended the immediately a sum was paid by the company to the trustees of the fund he became invested with a beneficial interest in the payment which formed part of his emoluments for the year in which it was made, and for no other year, and that, accordingly, the amount of the assessment for the year 1927-28 ought not, in any event, to exceed the aggregate of the sums paid by the company to the trustees, the difference between the amount and the value of the investments at the date of transfer representing a capital appreciation not liable to tax for any year. The Court of Appeal rejected the contention. Lord Hanworth, M.R., in rejecting the contention, observed :-

> ".....under these circumstances they could not be said to have accrued to this employee a vested interest in these successive sums placed to his credit, but only that he had a chance of being paid a sum at the end of six years if all went well. That absence has now supervened, and he has got it by reasons of the fact of his employment, or by reason of his exercising an employment of profit within Schedule E.".

Maugham, L.J., said much to the same effect thus :

> "The true nature of the agreement was that he was to be entitled in the events, and only in the events mentioned in Clause 8 of the agreement, to the investments made by the Company out of the net profits of the company as provided in Clause 6.".

The decision of Channell, J., in Smyth v. Stretton [(1904) 5 T.C. 35, 46] was strongly relied upon before the appellate court. But the learned Judges distinguished that case on the ground that under the scheme which was the subject-matter of that decision the same taxed were really additions to the salary of the Assistant Master and that, in any view, that decision should be confined to the facts of that case. The principle laid down by the Court of Appeal, namely, that unless a vested interest in the sum accrues to an employee it is not taxable, equally applies to the present case. As we have pointed out earlier, no interest in the sum contributed by the employer under the scheme vested in the employee, as it was only a contingent interest depending upon his reaching the age of superannuation. It is not a perquisite allowed to him by the employer or an amount due to him from the employer within the meaning of s. 7(1) of the Act. We, therefore, hold that the High Court has given correct answers to the questions of law submitted to it by the Income-tax Appellate Tribunal.

In the result, the appeal fails and is dismissed.

Appeal dismissed.

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