

# **BOMBAY HIGH COURT**

W.A.G. Cuff

Vs.

Commissioner Of Income-Tax

Income Tax Ref. No 32 of 1956

(M.C. Chagla, C.J. and Tendolkar, J.)

05.02.1957

## **JUDGMENT**

### **Chagla, C.J.**

1. The assessee was employed by Messrs. Thos. Cook and Son Ltd. on the 27th of May 1946 as an executive in charge of a newly opened department of the company. On the 23rd of March 1948 he received a communication from London to the effect that it was impossible to continue his activity and that in order to safeguard his personal interest he was being given a chance to explore the sale of business to outside capital. In fact, his services were terminated on the 13th of November 1948 and on the termination of his services he was paid a sum of Rs. 12,000/-. The Taxing Department sought to bring this amount to tax and the contention of the assessee was that this sum represented a compensation for loss of office and therefore it was not liable to tax. The Income-tax Officer took the view against the assessee. The A. A. C. decided in favor of the assessee; but the Tribunal came to a conclusion contrary to the contention of the assessee. The result is the assessee has now come on this reference before us.

2. Now there was an agreement of service between Messrs. Thos. Cook and Son Ltd. and the assessee, and that contract of service provided that the assessee was entitled to six months' notice if his services were to be terminated. It also provided that, if six months' notice was not given, he was entitled to salary for six months. On the question of notice the Tribunal has come to the conclusion that the communication to which reference has been made constituted a notice under the contract, and having come to that conclusion they have taken the view that the assessee was not entitled to anything under the contract and therefore what was paid to him was in the nature of gratuity. They have also stated that this was a payment received from the employer for past services rendered. Now turning to the section in question, which is section 7 which deals with salaries, that section subjects to tax "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"

There is an Explanation 2 to this section, which provides that any payment due to or received by an assessee from an employer or former employer 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, unless the payment is made solely as compensation for loss of employment and not by way of remuneration for past services. 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. If that be the correct view, then undoubtedly the position of the assessee is very difficult because, if a proper notice was given to him as found by the Tribunal, then 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. Whatever the nature of that payment might be, it was certainly not a payment in respect of a legal liability to compensate which was upon the employer. 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? As we shall presently point out, the authorities to which our attention has been drawn have given to the expression "compensation" a wider connotation. 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.

3. Now, first turning to the very well known decision of the Privy Council in *Commissioner of Income Tax. Bengal v. Shaw Wallace and Co<sup>1</sup>*, the Privy Council 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 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 it was legally entitled to; and the ratio of the judgment is to be found at page 181, where their Lordships say :

"But 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."

Therefore, if we have in the first place a compulsory cessation of a business or of an employment

and in respect of that compulsory cessation any amount is paid, whether that amount is a compensation for which the employer is legally liable or whether it is a payment made ex-gratia, it would still be a compensation for the loss of employment within the meaning of section 7. In this case it is not disputed that the cessation of the assessee's employment was compulsory. He did not wish to leave the services of Messrs. Thos. Cook and Son Ltd. : he was compelled to leave it due to the intention of his

<sup>16</sup> ITC 178

employer to terminate his services; and if the amount that was paid and which is in dispute was paid as a solatium for that compulsory cessation, then, in our opinion, the payment would come within the Explanation and would be exempt from tax.

4. Then there is an interesting English judgment of Mr. Justice Rowlatt in *Chibbett v. Joseph Robinson and Sons*<sup>2</sup>, The assessee was employed by a certain steamship company as ship manager 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 50,000/- which was in certain bonds as compensation for loss of office. The question that arose before Mr. Justice Rowlatt was whether this sum was voluntary payment made to them as compensation for loss of profits and therefore capital or it was a revenue; and Mr. Justice Rowlatt held in favour of the assessee. In the Judgment at page 60 the learned Judge points out that you must look at the question, not from the point of view of compellability or liability, but from the point of view of a Person enquiring what is this payment for, and you have to see whether the maker of the payment makes it for the services and the receiver receives it for the services. Therefore, if the payment is not made for past services and is made as a solatium for loss of office, then the question of compellability or liability is irrelevant. In other words, whether the employer was compellable or liable to make the compensation, or not, if in fact he made the payment as a solatium the payment would be a capital receipt not liable to tax. Again at page 61 the learned Judge says : "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." It is true that in this case the employer was not bound to continue the employee in service provided he gave the necessary notice; but it was equally open to the employer not to give the notice and to permit the employee to continue in service; and therefore we have here an employment which was likely to continue, and notwithstanding that likelihood, by action on the part of the employer, the employee was deprived of his employment. Lord Justice Romer, in the case of *Henry v. Arthur Foster*<sup>3</sup>. at page 634, defines the term "compensation for loss of office", which he characterizes as a well-known term, as meaning "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."

5. 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.

6. Now what are the facts of this case? The A. A. C. and the Income Tax Appellate Tribunal took the view that the communication addressed by the employer to the employee on the 23rd of March 1948 constituted a notice of termination of service. It has been urged before us by the Advocate General that, looking to the language used in this communication, it is difficult to accept the view taken by the A. A.C. and the Tribunal. It is true that the notice does not specifically state when the employee's services were to be

<sup>2</sup>(1924) 9 Tax Cas 48

<sup>3</sup>(1932) 16 Tax Cas 605

terminated; but, on the other hand, it does mention that it was impossible to continue the services of the employee. It may be that the view put forward by the Advocate General is one that can be taken on the construction of this communication; but there are no sufficiently strong reasons why we should differ from the view taken by the Tribunal. If, therefore, the communication of the 23rd of March 1948 constitutes a notice terminating the services of the employee, then he had undoubtedly six months' notice as required by the contract. The question then is whether the amount paid to him, namely, Rs. 12,000/-, constituted a compensation for loss of his employment or a payment revived from the employer for past services. The Tribunal has taken the view that the payment was in the nature of gratuity. Undoubtedly the payment was gratuitous payment and under the contract the assessee was not entitled to any amount : but on the construction that we have placed upon the expression used in Explanation 2 to Section 7, the fact that the payment was voluntary or gratuitous is irrelevant in considering whether the payment was a compensation for loss of employment to the employee. The Tribunal has also, taken the view that this was a payment received from the employer for past services rendered by the employee. Apart from repeating the language of the Explanation, there is nothing on the record which justifies this finding of the Tribunal. The only material on the record is a certificate given by the employer stating that Rs. 12,000/- were paid to the employee as compensation equivalent to six months salary for the termination of his employment owing to the closure of the department. It may be said that the view taken by the employer as to the nature of the payment cannot bind the Tribunal or this Court; but even when we look at the surrounding circumstances, there is nothing to justify the finding of the Tribunal. The service rendered by the employee was of a short duration; the salary paid to him was quite a generous salary; and there is nothing to indicate that there was any reason why the employer should want to appreciate the services of his employee by paying him anything more than what was due to him under the contract. Therefore, on the facts and circumstances of this case, a payment was made by the employer to the employee which was a voluntary payment and which was paid to him, not for past services rendered, but as a compensation or solatium for terminating his employment. It is significant that in this certificate, to which we have referred, the employer mentions that the employment was being terminated owing to the closure of the department. Thus the employer indicates that, but for the accidental closure of the department, the services of the employee would have been continued, and that the employee was without his Job through no fault of his.

7. A very interesting argument has been advanced at the Bar as to what the position would be if the communication of the 23rd of March 1948 did not constitute a notice as required under the contract. We do not think it necessary to express any definite opinion on this question except indicating the arguments that were advanced on either side. On the one hand, it was urged by the Advocate General that, if the communication of the 23rd of March 1948 did not constitute notice, what the employee was being paid was a salary equivalent to six months' notice and this was an amount due to the assessee under the contract and all that the employer was doing was to discharge his contractual obligations; and it was urged that under no circumstances could it be said that, when an employer pays to his employee what is due to him under the contract, he is compensating him for any loss. On the other hand, Mr. Palkhiwalla urged that the amount of six months' salary may be looked upon as liquidated damages. The difficulty in accepting that contention is that the question of liquidated damages arises only when parties determine what the damages should be in the event of there being a breach of the contract. But here we are dealing with a case where there is no breach of the contract. The contracting parties are acting under the contract and are either discharging their obligation or exercising their rights under the contract. What was further urged by Mr. Palkhiwalla was that the contract had stipulated for compensation for loss of office and it was by reason of this stipulation that an amount was being paid to the employee; and it was urged that in law there could be no difference in principle whether an employee received compensation for loss of office by reason of a stipulation arrived at between the contracting parties or whether he received that compensation de hors the contract and even gratuitously as a mere voluntary payment on the part of the employer. The question is an interesting one; but in view of our holding that the communication of the 23rd of March 1948 constitutes a notice, it is unnecessary further to speculate as to what is the correct view of the law. The question may be decided when it directly arises for our determination.

8. The result is that we will answer the question submitted to us : "Capital receipt".

9. Commissioner to pay the costs.

Answer accordingly.