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March 26

V. D. TALWAR (DEAD) AND AFTER HIM HIS HEIRS

v.

THE COMMISSIONER OF INCOME-TAX, BIHAR

(S. K. DAS, A. K. SARKAR and M. HIDAYATULLAH, JJ.)

Income-Tax—Assessment—Assessee's services terminated in terms of contract—Payment of one year's salary in lieu of notice—Amount received by assessee, if compensation for loss of employment—Indian Income-tax Act, 1922 (11 of 1922) s. 7.

The assessee, Mr. V. D. Talwar, was employed as General Manager by a company. According to the service agreement, he was to get Rs. 2,000/- per month as his salary with an increment of Rs. 100/- every year. Deductions for income-tax, absence of duty etc. could be made from his salary. The agreement of service was for five years, but the same could be terminated earlier by the employer after giving a notice of 12 months or payment of salary in lieu thereof.

The assessee joined as General Manager on May 1, 1946 and his services were terminated with effect from August 31, 1947. The services were not terminated for any default or misconduct on the part of the assessee but were terminated because the company did not want to continue the assessee in their employment. No notice of 12 months was given by the company as required by the contract. The company actually paid Rs. 18,096/1/- which was the amount due as salary for twelve months after deduction of Income-tax at the source.

The Income-tax Officer held that the sum of Rs. 25,200/- was a revenue receipt of the assessee liable to be taxed under the Indian Income-tax Act and he rejected the claim of the assessee that the said sum was compensation for loss of employment and the tax amounting to Rs. 7,103/15/- should be refunded to him. The appeal of the assessee was accepted by the Appellate Assistant Commissioner but his decision was reversed by the Income-tax Appellate Tribunal. The question of law referred by the Tribunal to the High Court was whether the sum of Rs. 25,200/- was revenue income of the assessee or not. The High Court gave the decision against the assessee who came to this Court by special leave.

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Held that what was paid to the assessee was his salary in lieu of notice and not compensation for loss of employment. The assessee was not given any notice for the termination of his services. What he was given was his salary for 12 months. He got exactly what he was entitled to get under the terms of his employment. He was not deprived of any rights under his service contract. The payment made to him could not be called compensation for loss of office and he was liable to be taxed under s. 7 of the Act.

Henry (H. M. Inspector of Taxes) v. *Arthur Foster* and *Henry (H. M. Inspector of Taxes)* v. *Joseph Foster* (1932) 16 T. C. 605, *The Commissioner of Income-tax, Bombay City I, Bombay* v. *E. D. Sheppard, Bombay.* [1964] 1 S. C. R. 163, *Henley* v. *Murray (H. M. Inspector of Taxes)* (1950) 31 T. C. 351, *Dale (H. M. Inspector of Taxes)* v. *de Soissons,* (1950), 32 T. C. 118, and *Duff (H. M. Inspector of Taxes)* v. *Barlow,* (1941) 23 T. C. 633, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 673 of 1962.

Appeal by special leave from the judgment and decree dated November 22, 1960, of the Patna High Court in Misc. Judicial Case No. 740 of 1958.

A. V. Viswanatha Sastri and *M. S. Narasimhan,* for the appellants.

Gopal Singh and *R. N. Sachthey,* for the respondent.

1963. March 26. The Judgment of the Court was delivered by

Das J.

S. K. DAS J.—V. D. Talwar, who was assessee before the taxing authorities and whose legal representatives on his death are appellants before us, was employed as the General Manager of Messrs J. K. Iron and Steel Company Ltd., Kanpur. The terms of his employment as agreed upon by the assessee and the Company were incorporated in an appointment letter dated February 7, 1946. A formal memorandum of agreement was also executed

between the parties on February 9, 1946. The assessee actually joined the service of the company on May 1, 1946. According to the service agreement the pay of the assessee was fixed at Rs. 2,000/- per month with an increment of Rs. 100/- p.a. subject to certain deductions for income-tax, absence of duty etc., which need not be set out in detail for the purpose of this case. According to the agreement the period of service was for five years. Clauses (5) and (6) of the appointment letter read—

> "(5) Period of agreement of service to be five years.
>
> (6) Termination of service if within five years to be on notice of twelve months on either side or salary in lieu thereof."

Clause (1) of the memorandum of the agreement dated February 9, 1946 said that the employee shall serve the employer faithfully and diligently for a term of five years from the date he joins, and cl. 21 read as follows :

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

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We have stated earlier that the assessee joined his post as General Manager on May 1, 1946. The services of the assessee were however terminated with effect from August 31, 1947. It is the admitted case of the parties that the services of the assessee were not terminated for any default or misconduct on the part of the assessee, but the services were terminated because the company did not want to continue the assessee in their employment. It is also the admitted case that no notice of twelve months for the termination of the service was given by the company to the assessee as required by the contract. In lieu of the notice the company paid to the assessee on September 12, 1947 a sum of Rs. 18,096/1/0 which was the amount computed as salary for twelve months after deduction of income-tax at the source. The company calculated the salary for the twelve months at Rs. 25,200/- and deducted therefrom the sum of Rs. 7,103/15/0 as income-tax. The assessee gave a stamped receipt to the company for having recieved Rs. 18,096/1/0 "in full and final settlement of all his claims and dues against the employer company."

In making the assessment for the year 1948-1949 the Income-tax Officer held that the sum of Rs. 25,200/- was a revenue receipt of the assessee liable to be taxed under the Indian Income-tax Act, 1922 and rejected the claim of the assessee that the said sum was compensation for loss of employment and the tax amounting to Rs. 7,103/15/0 should be refunded to him. The assessee took an appeal to the Appellate Assistant Commissioner who held that the sum of Rs. 25,200/-, though calculated on the basis of twelve times his monthly salary, was nothing but compensation for the loss of service and was therefore not taxable as income in the shape of salaries. Then there was an appeal to the Income-tax Appellate Tribunal which reversed the finding of the Appellate Assistant Commissioner and held

that the amount of Rs. 25,200/- paid to the assessee was really salary in lieu of twelve months' notice and, therefore, the amount was liable to be taxed under the Indian Income-tax Act, 1922. Under s. 66(1) of the Indian Income-tax Act, the Income-tax Appellate Tribunal referred the following question of law for the opinion of the High Court :

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

By its judgment and order dated November 22, 1960 the High Court answered the question against the assessee. The assessee then obtained special leave from this court in pursuance whereof the present appeal has been brought to this court.

The short question before us is, whether the sum of Rs. 25,200/- received by the assessee in the circumstances stated above was a revenue income liable to tax under the Indian Income-tax Act or a capital receipt not liable to tax under the said Act ?

We think that the view taken by the High Court is correct. In *Henry* (*H. M. Inspector of Taxes*) v. *Arthur Foster* and *Henry* (*H. M. Inspector of Taxes*) v. *Joseph Foster* (1), Romer, L. J. said " 'Compensation for loss of office' is a well-known term and it means a payment to 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." This court accepted the same meaning in *The Commissioner of Income-tax Bombay City I, Bombay* v. *E. D. Sheppard, Bombay* (2), and said that the emphasis was on the act of deprivation which may or may not give rise to any liability at law. Now, in the present case it is quite clear that the

(1) (1932) 16 T.C. 605. (2) [1964] 1 S.C.R. 163.

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two terms in cls. (5) and (6) of the appointment letter and cls. 1 and 21 of the memorandum of agreement must be read together and so read the true position that emerges is that the contract of service provided that V. D. Talwar could serve either for five years at a monthly salary mentioned therein or, if the company so elected, for a shorter period upon the terms mentioned in cl. 21. If the terms of cl. 21 were complied with, then it could not be said that V. D. Talwar had surrendered any rights under the contract or had been deprived of any such rights. The Court of Appeal dealt with the aforesaid two cases *Henry* (*H. M. Inspector of Taxes*) v. *Arthur Foster* (1), and *Henry* (*H. M. Inspector of Taxes*) v. *Joseph Foster* (1) along with a third case, *Hunter* (*H. M. Inpector of Taxes*) v. *Dewhurst* (1). It came to the same conclusion in all the three cases, though the facts were a little different in the third case where the respondent desired to retire from active management of the company but his co-directors wished to be able still to consult him and it was agreed that he should resign the office of Chairman, receive as "compensation" a lump sum in lieu of the provision under article 109, waiving any future claim under that article and remain on the Board of the company at a reduced rate of remuneration. The decision in this third case was taken to the House of Lords. Lord Dunedin pointed out that assuming that the view of the Court of Appeal in the *Foster casee* was right on consideration of how the question stood upon the sole consideration of the rights arising under article 109, a different question arose in the case of Dewhurst; because Dewhurst was not paid in terms of article 109 but entered into a new bargain in pursuance of which he was paid £ 10,000 in consideration, not of ceasing to be a director, for he did not cease, but of giving up his potential claims under article 109. His Lordship said that this payment for giving up potential claims under article 109 was not income. This was a feature

(1) (1932) 16 T.C. 605.

which distinguished *Hunter* (*H.M. Inspector of Taxes*) v. *Dewhurst* (1), from the two *Foster cases* (Supra) and it brought into relief the distinction between the two classes of cases, one in which there is deprivation of rights under the agreement and this would fall under compensation and the other in which there is no such deprivation. Perhaps Sir Raymond Evershed, M. R. (as he then was) had this distinction in mind when in *Henley* v. *Murry* (*H. M. Inspector of Taxes* (2), he said that there were two kinds of cases which fell for consideration under this head : one in which the right of one party to call upon the other for performance of the terms of agreement may be modified or indeed wholly given up, still the corresponding right to acquire payment either of the whole sum or some less figure is preserved and is still payable under the contract and the other is where the contract itself goes altogether and some sum becomes payable for the consideration of the total abandonment of all the contractual rights which the other party had under the contract. In one class of cases the contract persists and the amount is payable under the contract and in the other class of cases there is total abandonment of all the contractual rights and what is paid is in consideration of that abandonment. The present case in our opinion comes under the first of these two classes.

Now, the High Court has rightly pointed out that the principle which will apply in a case like this is that laid down in *Dale* (*H. M. Inspector of Taxes*) v. *de Soissons* (3). There the respondent was employed as assistant to the managing director of a company, his remuneration consisting of a fixed salary of £ 3,000 per annum and a commission calculated on profits. Under the terms of his service agreement, the respondent's appointment was to be for three years from January 1, 1945 but the company was entitled to terminate the agreement at December 31, 1945 or December 31, 1946 on payment

(1) (1932) 16 T.C. 605. (2) (1950) 31 T.C. 351.
(3) (1950) 32 T.C. 118.

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of £ 10,000 or £ 6,000 respectively, as compensation for loss of office. The company terminated the agreement at December 31, 1945 and paid £ 10,000 to the respondent. It was held that the Payment was not compensation for loss of office. Roxburgh, J. who dealt with the case in the first instance pointed out that the agreement of service must be read as a whole and so read the agreement provided that the respondent's employment was to be for three more years unless curtailed under clause 4 or clause 5 and that he was to receive as a profit for his employment the payments provided by the agreement including the payment provided by clause 5; therefore the respondent had never any right to be employed for three more years and had no legal claim which would justify compensation. He then said that the respondent surrendered no rights under the agreement and got exactly what he was entitled to get under his contract of employment. Here the position is exactly the same. It is true that under one of the clauses of the agreement of service V. D. Talwar was to serve for five years; but under another term of the same agreement it was provided that the employer might terminate the service of V. D. Talwar by giving twelve calender months' notice in writing or paying any salary in lieu thereof. The expression "any salary" must be construed in the context of the appointment letter which said that if Mr. V. D. Talwar's service was to be terminated within five years he would be entitled to a notice of twelve months or salary in lieu thereof. No notice for the termination of service was given to him in the present case, but he was given twelve months' salary. He therefore got exactly what he was entitled to under the terms of his employment and he was not deprived of any rights under the contract of service. There being no deprivation of his rights under the contract, the payment cannot be said to be "compensation for

loss of office" within the meaning of that expression. Jenkins, L.J. observed in *Henley* v. *Murray* (1).

> "As the many cases on the topic show, it is often very difficult to determine the character of a payment made to the holder of an office when his tenure of the office is determined or the terms on which he holds it are altered, and the question in each case is, whether, on the facts of the case, the lump sum paid is in the nature of remuneration or profits in respect of the office or is in the nature of a sum paid in consideration of the surrender by the recipient of his rights in respect of the office."

In the present case, if V. D. Talwar had been served with a notice for the termination of his service he would have worked for twelve months and got his salary and thereafter his service would have come to an end. Instead of giving him a notice the company paid him twelve months' salary in lieu thereof. The true position is that he received twelve months' salary in respect of his office though he did not do any work for that period. By no stretch of imagination can it be said that the sum paid to him was in consideration of the surrender by the recipient of his rights in respect of the office. It is worthy of note here that in *Henley* v. *Murray* (1), their Lordships came to the conclusion that what was paid to the appellant in that case was paid in consideration of his surrendering his right to serve on and be remunerated down to the end of his contractual engagement, for in that case the appellant had the right to continue in service till March 31, 1944 and his service was terminable by three months' notice only after that date. He however resigned at the request of the Bord of Directors on an earlier date, namely, September 2, 1943. Therefore, the principle laid down in *Henley* v. *Murray* (1), is not the principle which is applicable in the present case.

(1) (1950) 31 T. C. 351

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Learned counsel for the appellant has then relied on *Duff (H. M. Inspector of Taxes) v. Barlow* (1). That was also a case where the parties agreed that the arrangement arrived at between them should subsist up to 1945 though no exact percentage of the remuneration payable was fixed. The arrangement however was brought to an end prematurely in November 1937 and in consideration of his premature termination some remuneration was paid for services up to November, 1937 and a sum of £4,000 was paid as compensation for the loss of the employee's right to future remuneration under the earlier agreement of 1935. In these circumstances it was held that the sum of £4,000 was received by the respondent of that case not under the contract of employment nor as remuneration for services rendered or to be rendered but as compensation for giving up a right to remuneration. We are unable to see how that decision is of any help to the appellant in the present case. It seems clear to us that in the present case the appellant has surrendered no rights under the contract ; what has been paid to him has been paid under the terms of contract and as salary which he would have earned if twelve months' notice had been given to him. As no notice was given he was treated as though he was in service and entitled to salary for twelve months and that was what was paid to him. It is difficult to see how such payment can be treated as compensation for loss of office.

The present case is similar to the two cases of *Henry v. Arthur Foster* and *Henry v. Joseph Foster* (2) and different from the case of *Hunter v. Dewhurst* (3). In the first two cases the respondents were directors of a limited company. They had no written contracts of services with the company but Article 109 of the company's articles provided that in the event of any director who held office for not less than five years, dying or resigning or ceasing to hold office for any cause other than misconduct,

(1) (1941) 23 T.C. 635. (2) (1932) 16 T.C. 605.

bankruptcy, lunacy or incompetence, the company should pay to him or his representatives by way of compensation for loss of office a sum equal to the total remuneration received by him in the preceding five years. The respondents resigned office as director in these two cases and received from the company as "compensation" a payment calculated in accordance with Article 109. It was held by the Court of Appeal that the payment constituted a profit of the office of Director and was properly assessable to income-tax. Lord Hanworth, M. R. said at page 629 :

> "Now it is argued that those sums which became payable under the terms recorded in article 109 were compensation for the loss of office. Is that the substance of the matter ? When a man has died he is not compensated for the loss of his life ; if he resigns voluntarily, why should he be paid compensation for the loss of his office? It would seem as if those words were put in in view of the possibility thereunder of escaping the charge to tax ; but, as I have said, we have got to look at the substance of the matter, and the substance of this payment is this : It is contemplated as a part of the remuneration of the Director payable to him, and estimated according to his service during a certain time, and in addition to the amount paid to him under clause 104, there shall be estimated a sum which is to fall to be paid to him under clause 109."

Lawrence L. J. said at page 632 :

> "In my judgment, the determining factor in the present case is that the payment to the Respondent whatever the parties may have chosen to call it was a payment which the company had contracted to make to him as

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part of his remuneration for his services as a director. It is true that payment of this part of his remuneration was deferred until his death or retirement or cesser of office, and that in the articles it is called "compensation for loss of office." It is, however, a sum agreed to be paid in consideration of the Respondent accepting and serving in the office of Director, and consequentely is a sum paid by way of remuneration for his services as Director."

It seems to us that the same principle should apply in the present case. What has been paid to the appellant is his salary in lieu of notice. If that is the true position then the amount paid is taxable under s. 7 of the Indian Income-tax Act, 1922. It is not compensation for loss of employment within the meaning of Explanation 2 thereto.

For the reasons given above we think that the High Court correctly answered the question. The appeal fails and is dismissed with costs.

Appeal dismissed.