Commissioner Of Income-Tax, Nagpur And ... vs Captain, H.C. Dhanda on 4 December, 1969

Equivalent citations: AIR1970MP205, [1970]76ITR404(MP), AIR 1970 MADHYA PRADESH 205, 1970 MPLJ 403, 76 ITR 404, 1971 JABLJ 19

Author: A.P. Sen

Bench: A.P. Sen

JUDGMENT

A.P. Sen, J.

1. The question of law stated by the Income-tax Appellate Tribunal, Bombay, Bench 'A', at the instance of the Commissioner for the opinion of the Court is as follows:

> "Whether on the facts and in the circumstances of this case the sum of Rs. 1,67,345 received by the assessee during the year under consideration is covered by the 2nd Explanation to Section 7(1) of the Act as it stood prior to its amendment by Section 5 of Finance Act, 1955."

2. The sum of Rs. 1,67,345/- represents the payment to the assessee, Capt. H.C. Dhanda on 28th January 1955 by His Highness Maharaja Yeshwant Rao Holkar, the Senior Up-Rajpramukh of the erstwhile State of Madhya Bharat, in full and final settlement of his claim for damages for wrongful termination of his services as personal Adviser to his Highness. The whole question here is, were the moneys which the assessee so received after cessation of his office as compensation, in respect of which he was assessed for the year 1955-56, part of his income for the year in question as contended for by the Revenue or were they of a capital nature as held by the Tribunal,

3. The facts are not for us; the facts are for the Tribunal which had the case before it. We find that both the parties accepted before the Tribunal, that its order contains all the material facts and that they have been correctly set out therein. We, therefore, find it unnecessary to review the facts in detail. Omitting what is contentious, the following facts which are material have been taken by us, practically verbatim, from the statement of the case as furnished by the Tribunal. After his graduation from the Oxford University, the assessee was called to the Bar and on his return to India in the year 1932, he started practice at Indore. But immediately thereafter, His Highness Maharaja Yeshwantrao Holkar of Indore took him into the services of the then Holkar State. The assessee continued in that service till the year 1947, during which period he held several offices of high responsibility including that of the Deputy Prime Minister, in which capacity he drew salary and

allowances of nearly Rs. 3,000 per month. He retired from the service of the Holkar State w.e.f 27th January 1948. The Rulers of the then princely States of Gwalior, Indore and other States in the Central India, entered into a covenant of merger with the Dominion of India which resulted in the formation of the United State of Gwalior, Indore and Malwa or commonly known as the State of Madhya Bharat which came into being on 20th May 1948, and His Highness Maharaja Yeshwantrao Holkar of Indore became the Senior Up-Rajpramukh of that State. On the formation of that State, the Holkar desired to have the services of the assessee as his Personal Adviser. In connection therewith, the Holkar wrote to the assessee stating, amongst other things:

> "I would very much like to have you for this position (Adviser) in view of the regard which, you know, I have for you. I would like you to hold this position in addition to any post such as an Adviser which may be offered to you in the Union and in any case even if no fitting and acceptable position is offered to you in the Union."

xxx xxx xxx "As regards emoluments, I would offer you the same terms as may be offered to the Advisers in the Union and in any case not less than the emoluments you were receiving at the time of your retirement as my Deputy Prime Minister."

(vide, the Holkar's letter dated 25-5-1948)

4. By his letter dated 11th June 1948, the Holkar as the Senior Up-Rajpramukh informed the Hon'ble Sardar Vallabhbhai Patel, the Deputy Prime Minister of India of his intention of taking the assessee into the services of the State as his Personal Adviser. Pursuant thereto Sardar Patel intimated the acceptance by the Government of India of the proposal of appointing the assessee to that post, On 1st August 1948, there was a Huzur Order No. 354, issued by the Senior Up-Rajpramukh, appointing the assessee as his Personal Adviser. It was stated in that Order:

> "Capt. Dhanda shall receive the same emoluments as other Advisers in the Union or such emoluments as he was receiving as Deputy Prime Minister in the Holkar State at the time of his retirement, whichever are higher."

In the Huzur Order dated 1st March 1950, the terms and conditions for the appointment of the assessee as Personal Adviser to the Senior Up-Rajpramukh were set forth. Amongst other things, the assessee was to receive a salary of Rs. 2500 per mensem, apart from a motor allowance of Rs. 350 and Garden allowance of Rs, 88 per month. The income-tax and super-tax thereon were to be paid by His Highness. Clause 5 of the said Huzur Order provided for the payment of gratuity, while Clause 6 guaranteed the period of his employment. There was a Note appended to these clauses which is of importance. The relevant clauses, with the Note thereto, are set out below--

> "(5) Gratuity--

Capt. Dhanda shall be entitled to receive one month's pay for each completed year of service subject to a minimum of fifteen months' pay as sanctioned under item (1) above. This amount shall become due to him whenever he ceases to be the Personal Adviser to His Highness Maharaja Yeshwant Rao

Holkar, the Senior Up-rajpramukh of Madhya Bharat or his services as such are no longer required for any cause whatever. In the event of Capt. Dhanda's death also, the minimum amount equivalent to his 15 months' pay as sanctioned under item (1) above shall be payable and this shall be paid to his heir and successor.

(6) Period of service, etc.--

Permanence of service on the above mentioned terms is guaranteed under this contract to Capt. Dhanda until the 18th of June, 1963 when he will be 55, the normal age for retirement. This guarantee will be subject to the following conditions:--

> (a) Capt. Dhanda shall continue to make himself available for service on the above mentioned terms until he is of age of 55.
>
> (b) If at any time before he is 55 years of age, Capt. Dhanda ceases to be the Personal Adviser to His Highness Maharaja Yeshwant Rao Holkar the Seniod Up-Rajpramukh of Madhya Bharat, or his services as such are no longer required for any cause whatever, he shall become immediately entitled to receive in one lump sum his total emoluments at half the rates specified under terms (1), (2) and (4) and at the full rate specified under term (5) mentioned above, for the period between the date on which he may cease to be Personal Adviser or the date from which his services as such are no longer required until he is 55 years of age.
>
> (c) In the event of Capt. Dhanda's death at any time during the period of this contract, his heir and successor shall be entitled to receive the amounts mentioned under terms (5) and (7) only.

Note:

> The order regarding terms (5) and (6) above is based on the following considerations :--
>
> Capt. Dhanda prematurely retired from permanent pensionable service of the Holkar State without the usual monthly pension. Further, he has accepted the post of Personal Adviser in preference to other permanent pensionable posts offered to him. Capt. Dhanda has already rendered service of exceptional loyalty and value to His Highness and his House in connection, inter alia, with settlement of His Highuess's private properties and succession."

5. Sometime in April 1948, the Holkar left for the United States of America. He returned to this country in 1949 and again went back to America in April 1950 and remained there till about the end of December 1951. During this period, the assessee continued to render satisfactory service as Personal Adviser to the Senior Up-Rajpramukh. It appears that on or about 21st December 1951, His Highness retunied to India, and immediately thereafter, on 23rd December 1951, by an order of that

date, terminated the services of the assessee with immediate effect, and directed him to hand over his office to one Masood Quli Khan. The order of termination of his services, reads as follows:--

"Windmere"

New Cuff Parade, Bombay 23rd December 1951.

Immediate Dear Capt. Dhanda, As I have terminated your services with immediate effect., I am to direct you to hand over charge of your office as my Adviser to Mr. Masood Quli Khan. You should hand over all the confidential files and papers of the Huzur Officer in your possession to Mr. Masood Quli Khan together with a complete list of all such files and papers signed by you. You should also hand over to him copies of correspondence you have been carrying with the States Ministry of the Government of India and State Govt. of Madhya Bharat on behalf of His Highness the Maharaja Holkar during your period of office along with the connected files. You are therefore to return to Indore and carry out these instructions at once. You are also to hand over Bank Pass Books and Cheque Books to Mr. Masood Quli Khan.

Yours truly, Sd/- Yeshwant Rao Holkar (Maharaja of Indore) Capt. H. C. Dhanda, Taj Mahal Hotel, Bombay."

6. On 24th December 1951, the assessee wrote to His Highness complaining of the unjust manner in which, his services were dispensed with, which was far from fair to him or consistent with the position of the high Trust, status and responsibility which he enjoyed with His Highness for many years. On 2nd February 1952, the assessee forwarded to the Holkar a statement of his claim as regards the amounts payable by His Highness on termination of his service, and the total amount payable was Rupees 2,97,620., as per a statement annexed. The statement also indicated the extent of income-tax and super-tax which would be payable on such sum. It would be convenient to set that out here.

I.	Statement showing last dues payable to Capt. H. C. Dhanda		
	Date of appointment	1.8-1948	
	Date on which he attains 55 years of age	18-6-1968	
	Date of handing over charges.	28.12.1951	
1.	Pay for 28 days (from 1-12.1951) to 23.12.1951) @ Rs. 2.938/- p. m.		Rs. 2,179.18.0
2.	Payable under item (6) (b) @ Rs. 1469/. P.M.		
	(i) for 8 days i.e. from 24.12.51 to 31-12-51	Rs. 879.0,0	
	(ii) for 137 months (from January 1952 to May 1963)	Rs. 2.01,253,0.0	

	(iii)for 18 days of June 1968	Rs. 881.6.0	

		,02,513.7.0	
8.	Gratuity, under Item (5) 15 months' pay @ Rs. 2.500/-	87,500.0.0	
4.	Allowance in lieu of leave earned under		

item (7):-
Privilege leave earned :-- 3 months 13 days.
Leave taken 23 days (from 15-8-1950 to
11-9-1950; both days inclusive)
Therefore earned leave in respect of which
allowance is payable is 2½ months.
For 2½ months @ 2,500/- Rs. 6,250.0.0

Total Rs.2,48,443.4.0

II.Statement of Income-tax liability
Capt. H. C. Dhanda, Indore,
(Status-Individual)
Assessment 1955-56.
COMPUTATION OF INCOME
(Based on the income for the year ended 31st March 1956)
Part I-- Section 'g'
Income from salaries.
I. Salary payable under item (1) of the contract as per
statement attached Rs. 2,46,637/-
II. Garden allowance, under item '4' and 6(b): --
(1)@ Rs. 88/- P. M. for the period from
1.4-51 to 23-12.51 Rs. 769/-
(2)@ Rs. 44/- P. M. for the period from
24-12.51 to 18-6.63 Rs. 6066/-
Rs. 6,835/-
III.Gratuity under item '5' & Re. 2,500/- P.M.
for 15 months. Rs. 87,500/-
IV. Allowance in lieu of leave earned under item '7' Rs. 6,250/-
Rs. 2,97,222/-
Less : Earned income allowance @20% reduced to
maximum Rs. 4,000/-
Rs. 2,93,222/-

	Income-tax	Super-tax	Total
(1) Tax payable by the employers.	19339.7.0	33119.7.0	52458,14.0
(2) Tax payable by the employee.	8882.8.0	9484.11.0	13866.14.0
	23221.10.0	42604.2.0	65825.12.0

Paragraph 7 of the said letter reads as hereunder :--

"7. Your Highness may kindly note that payment of my dues is due to me immediately under Clause 6 (b) of my contract in view of the termination of my appointment. I am emphasising this for one

very important reason which I may be permitted to repeat, namely, that my sudden retirement has placed me in serious financial difficulties in view of which I shall much appreciate the consideration at Your Highness Imnds of the immediate remittance to me of Rupees 2,97,620 as explained in paragraph 3 of this letter. Immediately thereafter and on receipt of the information solicited by me (vide para 1 supra) I shall refund to your Highness such amount as is due to be refunded. I shall also return to Your Highness the amount of income-tax or super-tax which may be paid by Your Highness in pursuance of Clause (1) of the contract in the event of it being finally held that these taxes are not payable in view of the possible ground referred to under paragraph (5) of this letter, On the other hand, I have to mention that if the Income-tax authorities assess the taxes payable at a higher figure or if there is any error in calculations I shall have 10 submit a duly corrected claim for Your Highness' sanction on that basis."

7. The letter pointedly drew the attention, of His Highness to the liability for payment of income-tax and super-tax in these terms :--

> ....
>
> 4. The income-tax experts tell me that it is possible that income and super-tax may ultimately be held to be not payable by Your Highness on the ground which may be urged that the amount due to me in compensation for loss of employment. They say it may be possible to argue on these lines as my contract is clear and permanence of service till the age of 55 was guaranteed to me under it (vide Clause 6). On the other hand, they consider it possible that this argument may not prevail in which case these taxes will be payable. In order to give effect to Clause (1) of my contract providing for the payment by Your Highness of income and super-tax, they say that it is necessary to show my income under this clause as inclusive of the taxes due so that tax on tax may be avoided and that I should receive the net amount in accordance with this clause."

8. As there was no response from the Maharaja Holkar to this letter, the assessee reminded him for payment of his dues in terms of the contract, by his letter dated 10th April 1952, which the assessee asserted had become payable immediately on the termination of his services, In that letter, he also complained that undue delay in settling his claim was creating unnecessary problems for him which "he was no longer able to face" and he, accordingly, asked the Holkar "to make a remittance of whatever was due to him under the contract". The Holkar had, in the meanwhile, by Solicitor's letter dated 10th April 1952, demurred his liability, stating-

> "Eastern Law Consultants Income Tax General Vimal Vihar 21, Yeshwant Niwas Road, Indore, 10th April, 1952.
>
> Legal Practitioners (Drafting, Conveyancing, Company Law, Sales Tax etc.) Shri Capt. H.C. Dhanda, South Tukoganj, Indore.

Dear Sir, Under instructions from our client, His Highness Maharaja Yeshwant Rao Holkar, Senior Uprajpramukh, Madhya Bharat, we write to you as under:--

Our client was simply shocked and surprised to read your letter dated 2nd February, 1952, claiming Rs. 2,97,620 (Rupees two lacs ninety seven thousand six hundred twenty) on the basis of an alleged contract. His Highness never had any copy of the alleged contract as mentioned by you in the last para of your letter nor has the office any such copy. His Highness has read with interest the true copy of a so-called Huzur Order dated the 1st March, 1950 sent by you with your letter under reference upon which you seem to rely. The order in question was never discussed with or made known to His Highness during the past 2 years or so and it is strange that there should be no paper or file on the subject in the office. As you know so well, no contract is binding unless it is made with the free consent of the parties and is not vitiated by misrepresentation or fraud. Some of the terms mentioned in the copy of the order sent by you are so imusual, extraordinary that no reasonable person can be expected to give his free consent thereto. The alleged contract is, therefore, void and has no binding effect or legal force whatsoever.

Without prejudice to the above contention, we are further instructed to add that the termination of your services was by reason of your wilful disregard of the wishes and instructions of your employer. Besides, some instances of gross abuse on your part of the position that you occupied also came to the notice of His Highness. In the circumstances, you cannot claim any compensation for loss of employment since you had forfeited the confidence of His Highness by your acts and omissions amounting to "misconduct" in law which fully justified the termination of your services.

Regarding your advances accounts, you may please contact the Personal Adviser to His Highness and settle the question with him. Thereafter, if any point requires His Highness' orders, it will be considered and decided on its merits.

The delay in sending you this reply is regretted; it was due to His Highness' absence from Indore most of the time during the past two months.

Yours faithfully, For Eastern Law Consultants, Sd/- I. L. Mital."

From the tenor of this letter, it was apparent that the Holkar was not only trying to repudiate the contract of employment itself but also all his liabilities thereunder.

9. In reply to this, the assessee explained his position to the Holkar, by his letter dated 14th April 1952 and wanted to know whether the solicitor's letter had been written "with the authority and knowledge of His Highness, with a view to prevent the matter being placed in the hands of lawyers." In that letter, the assessee went on to say that "he was unable to understand why His Highness should have been surprised at the figure of his claim", as submitted. According to him, the sum of Rs, 2,97,620 as claimed, was payable "under terms of his appointment" and "in view of its

termination." The assesee then complained that the Holkar should adopt an attitude "to find fault with the contract which was not based on truth," was "not straight and was utterly callous to his just rights" after he had rendered to him "services of exceptional value while in service as his Adviser' and not at all "one befitting His Highness' position". The assessee further added that such attitude was "very unwise from the Huzur's point of view", pointing out that the Holkar would get a refund of Rs. 52,564 paid by him as income-tax and super-tax, "according to a first class expert's view" as the payment was to he on account of the termination of contract and such payment would, therefore, "be treated in law, as compensation for loss of employment" and not liable to any income-tax and super-tax which would otherwise be payable. The only response from the Holkar to this was, by his letter dated 21st April 1952, to the following effect:--

> "No useful purpose will be served by prolonging such unpleasant correspondence".
>
> Further correspondence appears to have ensued but with no result.
>
> 10. After obtaining requisite permission from the Central Government for the institution of a suit against His Highness Maharaja Yeshwant Rao Holkar of Indore, the assessee brought a suit for recovery of Rupees 2,90,346.62 P. as liquidated damages, being suit No. 1257 of 1954 on the Original side of the Bombay High Court. After narrating the events which culminated in the order of his dismissal, the assessee averred in paras. 17 and 18 of the plaint, as follows:--
>
> "17, The plaintiff says that he had rendered very loyal, faithful and exceptionally valuable services to the defendant during the tenure of his office as Personal Adviser to the defendant. The plaintiff further says that the defendant has in breach of the aforesaid agreement, terminated the plaintiffs services.
>
> 18. The plaintiff submits that on the termination on 23rd December 1951 of his services by the defendant as aforesaid, the defendant became liable to pay immediately to the plaintiff a sum of Rs. 2,46,228 as and by way of liquidated damages as provided in Clause 6(b) of the said Huzur Order dated 1st March 1950, as per particulars hereto annexed and marked Ex. H."

In Paragraph 22 of the plaint, he further stated--

> "22, In the premises, the plaintiff submits that the defendant is bound and liable to pay to the plaintiff the said sum of Rs. 2,46,228 as and by way of liquidated damages as provided in Clause 6 (b) of the said Huzur order dated 1st March 1950. The plaintiff further submits that the defendant is also bound and liable to pay to the plaintiff interest on the said sum of Rupees 2,46,228 at the rate of 6 per cent per annum from the 24th December 1951. Under the circumstances there is now due and payable by the defendant to the plaintiff the sum of Rs. 2,90,346/10 as per the said particular hereto annexed and marked Ex. H. "

An alternative claim was also made by him in para 23 of the plaint, which reads as hereunder:--

> "23. Without prejudice to the aforesaid submission and in the alternative, the plaintiff submits that by reason of the wrongful termination of the plaintiff's service by the defendant, the plaintiff has suffered damage which the plaintiff assesses at the said sum of Rs. 2,90,346/10. The plaintiff says that he has not been able to obtain any similar or suitable employment."

11. His Highness Maharaja Yeshwant Rao Holkar of Indore did not file any written statement in answer to the claim but, instead, settled the claim out of Court. The parties, by an agreement in writing dated 27th January 1955, came to a settlement for payment of Rs. 1,67,345 to the assessee in full and final satisfaction of the claim. The answer to the reference depends on a construction of that agreement. It reads as follows:--

> "This agreement made this the 27th day of January 1955 between His Highness Maharaja Yeshwant Rao Holkar, Maharaja of Indore and Senior Up-Rajpramukh of Madhya Bharat State (hereinafter called the "Employer") of the one part and Capt. H.C. Dhanda of South Tukoganj, Indore, Ex-Personal Adviser to His Highness the Maharaja Holkar (hereinafter called the "Ex-Employee") of the other part witnesseth :
>
> Whereas the Ex-Employee has filed a suit against the Employer in the High Court at Bombay (Suit No. 1257 of 1954) claiming compensation for loss of employment amounting to Rs. 2,92,920/3/- (Rupees two lacs ninety-two thousand nine hundred twenty and annas three only) plus interest and whereas it is settled between the parties that the Ex-Employee should withdraw all his claims against the Employer and get his Suit dismissed:
>
> NOW THEREFORE it is hereby agreed between the parties as under:--
>
> 1. That the Ex-Employee shall forthwith take steps to have his above-mentioned suit in the Bombay High Court dismissed and give a complete and effectual discharge in respect of all his claims against the Employer.
>
> 2. That the Employer agrees to pay to the Ex-Employee on the signing of this agreement a sum of Rs. 1,45,000 (Rupees one lac and forty five thousand only) in cash and remit Rs, 22,345 (Rupees twenty two thousand three hundred fortyfive only) outstanding against the Ex-Employee in connection with his trip to England in 1950, both these amounts are as compensation for the loss of his employment in full and final settlement of all the Ex-Employee's claims.

IN WITNESS WHEREOF the parties hereto have signed this agreement at Indore on the 27th day of January 1955, in the presence of:

(Witnesses)

1. Sd/- (Dinanath Colonel)

2. Sd/- (Masood Quali Khan) Sd/- (Yeshwantrao Holkar) 27-1-1955 Sd/- (H. C, Dhanda) 27-1-1955 The suit, in accordance therewith, was withdrawn and dismissed as compromised out of Court and the assessee received the amount of Rs. 1,67,345/- which, according to the Revenue, is income and not a receipt of a capital nature and, therefore, chargeable under Explanation II to Section 7(1) of the Income-tax Act, 1922.

12. The assessee showed the receipt of Rs. 1,67,345 in Part D of his Return for the assessment year 1955-56 and claimed before the Income-tax Officer that it was received by him as compensation for loss of employment and as such, exempt from tax liability. He urged, inter alia, that the amount has been received by him under the terms of the compromise petition dated 27th January 1955 filed in the Bombay High Court and it was not a receipt under Huzur Order of 1st March 1950; that the payment in question had been understood by the parties and described by them as "compensation for loss of employment", and that there was no element of remuneration for past services but it was only when he abandoned all his claim against the Holkar, that the payment was actually made. The Income-tax: Officer, relying upon the Note after Clause 6 of Huzur Order dated 1st March 1950, took the view that the amount of Rs. 1,67,345 received by the assessee was a payment from his employer under his contract of service and, accordingly, held that the entire amount was taxable under Section 7(1), read with the Explanation II thereunder, of the Income-tax Act, 1922. Being aggrieved, the assessee preferred an appeal before the Appellate Assistant Commissioner who agreed with the Income-tax Officer and dismissed the appeal stating--

> "It has already been stated that the agreement of 1950 provided for a terminal payment in the event of termination of service of the appellant by the Maharaja. The payment made to the appellant cannot, therefore, be regarded solely as compensation for loss of employment. It was a payment which was contemplated under the agreement of 1950. The terms 5 and 6 of that agreement were not only meant for services in future but also to reward him for past services. I, therefore, consider that the I. T. O. was justified in treating the amount of Rs. 1,67,345 as income under Explanation II of Section 7(1) of the I. T. Act before its amendment in 1955."

13. On the facts as stated, the Tribunal, however, on further appeal by the assessee, upheld his contention and was of the view that the receipt of Rs. 1,67,345 by him from His Highness Maharaja Yeshwantrao Holkar of Indore, was "solely as compensation for loss of employment and not by way of remuneration for past services", within the meaning of Explanation II to Section 7(1) of the Income-tax Act, 1922, and being a receipt of capital nature was not taxable in his hands. The Tribunal, in considering the question, observed as follows:

> "8. Therefore the question is whether the payment of Rs. 1,67,345 received by the assessee is compensation solely as such for termination of service. In this case the

assessee had already been adequately remunerated for the past services. The Maharaja Holkar repudiated the agreement on the 23rd December 1951 and once that agreement was repudiated, we fail to see how it could form the basis for this payment. The assessee has claimed damages for wrongful termination of his services and claimed damages both liquidated and alternatively as damages to be fixed by the Court. The Maharaja Holkar terminated the services because according to him the assessee was guilty of wilful disregard of his wishes and instructions and had misconducted himself, It is difficult to say therefore that the Maharaja paid or agreed to pay this amount in appreciation of the assessee's past services. The several averments in the plaint, especially Clauses 22 and 23 make this position clear. The agreement dated 27th January 1955 also clearly mentions that the sum was paid "as compensation for the loss of his employment" and naturally when the Holkar was making a large payment it was thought necessary to protect him from further action and hence it was mentioned that the assessee was to have the suit dismissed and to give complete and effectual discharge in respect of all his claims against the employer i. e. Holkar. No doubt we are entitled to examine the nature of this receipt notwithstanding the fact of the amount having been described as compensation for loss of employment. But even on facts we are of the view that this amount was received by the assessee as damages or as compensation for the loss of his employment, In no sense this can be said to be a payment or even partly in consideration or the past services. The Department has strongly relied upon the Note in the 1950 agreement. The Note, which we have already extracted, merely mentions the fact that the assessee had prematurely retired from permanent pensionable service of the Holkar State without the usual monthly pension. It also mentions that the assessee had accepted the post of Personal Adviser in preference to other permanent pensionable posts offered to him. It is also mentioned that the assessee had already rendered service of exceptional loyalty and value to His Highness and his House in connection with the settlement of His Highness's Private properties and succession. This note at best would only indicate what was in the mind of the Holkar in giving certain generous terms. This in our opinion would not indicate that the provision of compensation for termination of services was under Clause 6(b) of the Huzur Order. Again we may repeat that the assessee had already been remunerated for his earlier services. The assessee served the State upto his retirement in January 1948. The services under the Holkar personally had nothing to do with the earlier services of the assessee under a different employer, What the assessee received was only in and by way of damages for wrongful dismissal."

We are inclined to think that the Tribunal was right in its view for reasons we shall presently State.

14. It is common ground that the provision which would be applicable was the old Second Explanation to Section 7(1) of the Income-tax Act, 1922, as it stood before its amendment by Section 5 of the Finance Act, 1955. That provision reads as follows:

"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 purpose 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."

15. Relying on the dictum of Lord Greene M. R. in Rustproof Metal Window Co. Ltd. v. Inland Revenue Commissioners, (1947) 2 All ER 454, Shri M. Adhikari, learned counsel for the Commissioner urges that the exchange of letters between the parties culminating In the institution of Suit No. 1257 of 1954 and the compromise thereof under the agreement dated 27th January 1955, were merely a "device or camouflage" to defeat Income-tax liability and, therefore, the agreement in question cannot be read separately but must be read in the context of the Huzur Order of 1st March 1950 and, therefore, the payment received thereunder cannot be regarded as having been made solely as compensation for loss of employment. According to the learned counsel, the whole thing was a mere show, and the payment was as a result of an integrated activity and, therefore, the Court was entitled to lift the veil to ascertain the true nature of payment. It is also urged that what had been paid to the assessee, had been paid to him "under the terms of his employment" i. e, as "part of his remuneration" and the more fact that he settled his claim by acceptance of a lesser sum in lieu of the sum which was actually payable, would not change its intrinsic character which would still partake of the same character as "terminal payment" and, therefore, was taxable as an income receipt. Strong reliance is placed on the Note appended to Clauses 5 and 6 of the Huzur Order dated 1st March 1950 which, the learned counsel suggests, indicate that the payment was "in consideration of past services as remuneration already earned" or was a "deferred payment".

It is also urged that Clause 6(b) was not a term providing for payment of compensation but for payment in consideration of past services, and the Note underneath it was in the nature of a "testimonial". On these submissions, the learned counsel urges that the payment of Rs. 1,67,345 was "contractual" and, therefore, taxable in the hands of the assessee as his income. Alternatively, he urges that the payment of Rs. 1,67,345 was not a payment made "solely" on account of compensation for loss of employment, within the meaning of the Second Explanation to Section 7(1), and rests his argument on the circumstance that the assessee had also made a claim for arrears of salary for 23 days in the suit filed by him. In view of this, he urges that the payment of Rs, 1,67,345 cannot be treated to be a payment solely as compensation for loss of employment, but the amount paid was inclusive of arrears of salary,

16. On the other hand, the assessee Shri H.C. Dhanda, who argued his own case, urges in reply. The terms of the bargain under which the payment of Rs. 1,67,345 was made to him, were, on his relinquishment of all rights to damages for repudiation of the contract of service, as described in the agreement dated 27th January 1955. As a result of the agreement, there was a complete release of the employer from all his liabilities. It was, therefore, a payment made solely as "compensation for loss of employment". At no stage, had the department ever suggested that the transaction did not represent the real bargain between the parties. It was not now open to the Commissioner to urge that the parties had camouflaged the payment in the guise of compensation for loss of employment

with a view to avoid their income-tax liability. The correspondence which ensued between them upon the sudden dismissal of the assessee from service, clearly showed that the payment was not in consideration of his past services but in reality was one towards settlement of his claim for damages for wrongful breach of the contract. He had an enduring prospect under the contract of service, the tenure of his office being guaranteed till the attainment of 55 years or age. He was deprived of profits to which ho would, but for the unilateral act of deprivation by the employer, have been entitled. The payment could he treated as remuneration for past services or a terminal payment or additional deferred payment under the contract of service, within, the meaning of Clause 6(b) of the Huzur Order dated Ist March 1950, for different reasons: Firstly, the payment due to the assessee under Clause 6(b) was Rs. 2,90,346.62 and, therefore, the payment of Rupees 1,67,345 was not a payment under it. Secondly, he had been adequately remunerated for his entire period of service except for 23 days. Thirdly, no such payment was due to his estate in the event of his death, and fourthly, payment to him thereunder was not exigible in the event of his dismissal from service for misconduct.

As to the Note appended to Clauses 5 and 6, as a testimonial it merely recorded the reasons which influenced the employer to take him in service. It could not, by any stretch of imagination, be projected into Clause 6(b). Nor could it be made to govern the agreement dated 27th January 1955, by any rule of construction. The employer had not only dismissed him from service for alleged misconduct and wilful disregard of his orders but had further tried to repudiate his contractual liability under Clause 6(b) by alleging that the agreement dated 1st March 1950 was vitiated by practice of fraud. In those circumstances he was constrained to bring a suit for recovery of Rs. 2,90,346.62P., the estimated amount of damages under Clause 6(b) to which he became entitled upon repudiation of the contract. As a term for payment of liquidated damages, there was nothing unusual in that term to appear in the contract of service itself. The payment ultimately made under the agreement dated 27th January 1955 was in settlement of that claim. The contract of employment having been repudiated, the payment on such repudiation was not under the service agreement. It was de hors the contract as compensation or solatium for premature termination of the services. The finding of the Tribunal that the payment was received by him solely as compensation for loss of employment is a finding of fact which cannot e assailed on a reference under Section 66 (1) of the Income-tax Act,

17. So far as the genuineness of the transaction embodied in the agreement dated 27th January 1955 is concerned, we agree with the assessee that in view of the admission made by the department before the Tribunal, the Revenue cannot at this stage urge that the payment of Rs. 1,67,345 as compensation for loss of employment in pursuance thereof was a cloak in disguise to shield a wholly different arrangement or that the words "compensation for loss of employment" in that agreement were used to give to it a semblance of reality. In that context the Tribunal, in its order, while dealing with the appeal before it, observed :--

> "7. The bona fides of parties for entering into the agreement dated 27th January 1955 had never been in dispute. There is no allegation of any collusion between the par-tics in this case....."

The parties had agreed before the Tribunal that all the material facts in its order were correctly stated (para 2). The statement of the case was drawn by the Tribunal with the consent of the parties (para 13) and it again recites the same thing (para 8):

> "8. The bona fides of parties for entering into the agreement dated 27th January 1955 had never been in dispute. There was no allegation of any collusion between parties in this case. ....."

In view of this the contention by the Commission that the whole thing was a mere camouflage for avoiding tax cannot possibly be accepted.

18. We would, however, make it clear that on principle, the mere description of a lump sum payment as compensation for the loss of employment is not determinative of any capital content therein. In matters relating to revenue, the Court must regard what is called "the substance of the matter" to bring the subject within the charge to a tax. And, therefore, the outward form of a transaction might be disregarded. In Hunter v. Dewhurst, 1932-16 Tax Cas 635 Viscount Dunedin stated:

> "The mention of the words, 'in consideration of loss of office' cannot be allowed to make a change in the true nature of the payment "

In that case, Lord Macmillan stated---

> "The circumstance that a payment is described as 'compensation for the loss of office is to my mind immaterial if the payment be in truth made as part of the bargain for remuneration on which the services in the office have been rendered."

See also, Dale v. de Soissons, (1950) 32 Tax Cas 118 (CA). The dictum of Lord Greene, M. R. in Rustproof Metal Window Co. Ltd. v. Inland Revenue Commissioners, 1947-2 All ER 454 reiterated the same principle though in different context. In Henley v. Murray, (1950) 31 Tax Cas 351 it was stated by Sir Raymond Evershed, M. R. --

> "..... It is the duty of the Court to see what in substance and in truth the bargain was and not to be blinded by some formulae which the party may have used. ..."

However, in the special circumstances of this case, where the department had itself accepted the truth of the bargain as real, the words "compensation for loss of employment" appearing in the agreement cannot be deprived of their legal significance.

19. The question then is whether the (finding of the Tribunal that the payment of Rs, 1,67,345 was solely on account of compensation for loss of employment is one of fact. It was argued by the assessce that the decision of the Tribunal upon a question of this kind ought not to be disturbed unless It can be said that the Tribunal had misdirected itself in law. The question whether a particular item is to be regarded for income-tax purposes as capital or income may involve questions both of law or fact. The terms of a bargain under which the sum was paid in respect of the

relinquishment of an office are a question of fact, but the effect of bargain, once its terms have been found on the character of the sum paid, is a question of law--1950-31 Tax Cas 351. But, in the present case, the Tribunal's determination does not appear to us to disclose any conclusion of fact which would justify the view in law that the money was received by the assessee in settlement of his claim otherwise than as compensation by way of solatium for the loss of office.

20. The decision of the Tribunal in the present case, regarded as a matter of law, appears to be correct. The Second Explanation to Section 7(1) of the Act, prior to its amendment, applies to two classes of receipts namely, (a) sums which would be totally exempt from tax being receipts of a capital nature, and (b) sums which would be otherwise assessable in full. Included in the first class is "compensation for loss of office" as defined by Romer, L. J. in Henry v. A. Foster; Henry v. J. Foster (1932) 16 Tax Cas 605 at p. 634. Included in the second class is a sum paid in terms of a service agreement on termination of employment as in (1950) 32 Tax Cas 118 (supra).

21. What is attributable to capital and what to revenue has led to a long controversy and Hidayatullah J. (as he then was), speaking for the Court stated this problem in Abdul Kayoorn v. Commissioner of Income-tax,, 44 ITR 689 at p. 703 = (AIR 1962 SC 680 at p. 688) in these words:

> "Each case depends on its own facts, and ft close similarity between one case and another is not enough, because even a single significant detail may alter the entire aspect. In deciding such cases, one should avoid the temptation to decide cases (as said by Cor-dozo) by matching the colour of one case against the colour of another. To decide, therefore, on which side of the line a case falls, its broad resemblance to another case is not at all decisive. What is decisive is the nature of the business, the nature of the expenditure, the nature of the right acquired, and their relation inter se and this is the only key to resolve the issue in the light of the general principles, which are followed in such cases."

In dealing with a similar case, Rowlatt, J. observed in Chibbett v. Joseph Robinson and Sons, 1932-9 Tax Cas 48 at p. 60:

> "This ease, like all cases of a similar nature, is very troublesome; because all these cases turn upon nice questions of fact, and at least I find very great difficulty in apprehending any permanent and clear line of division between the cases which are' within and the cases which are without the scope of the Income-tax Acts. I think everybody is agreed, and has been agreed for a long time, that in cases of this kind the circumstance that the payment in question is a voluntary one does not matter."

22. Compensation for loss of employment is a capital receipt under the general law and was so under Section 7(1) read with the Second Explanation, prior to its amendment. The leading case on the point that compensation paid for cessation of business is a capital receipt is Commissioner of Income-tax v. Shaw Wallace and Company, 59 Ind App 206 = (AIR 1932 PC 138). The Judicial Committee of the Privy Council, while dealing with the nature of payment to an assessee on termination of its managing agency, held that the payment was not an income receipt but only

intended to act as solatium for the compulsory cessation of its agency. The assessee in that case also carried on business as managing agents of various other companies and its business as such did, in fact, go on throughout the year. In rejecting the contention of the defendant that the sum though called compensation for the cessation of the agency was clearly profit earned during the year, their Lordships stated:--.

> "It is contended for the appellant that the "business" of the assessee did in fact go on throughout the year, and this is no doubt true in a sense. They had other independent commercial interests which they continued to pursue, and the profits of which have been taxed in the ordinary course without objection on their part. But it is clear that the sum in question in this appeal had no connection with the continuance of the as sessee's other business. The profits earned by them in 1928 were the fruit of a different tree, the crop of a different field."

See also Commissioner of Income-tax v. Vazir Sultan and Sons: 36 ITR 175 = (AIR 1959 SC 814). These observations have been followed by the different High Courts in India and by their Lordships of the Supreme Court in dealing with payments given to an employee on cessation of employment. In such cases, the compensation was taken to be a capital receipt because it was in respect of the source of income.

23. The expression "compensation for loss of office" is a well-known term, and, as we 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 a Legislature, have been entitled, per Romer, L. J. in (1932) 16 Tax Cas 605 Henry v. A. Foster (supra). This definition of the expression by Romer, L. J. has been accepted by their Lordships of the Supreme Court in Commissioner of Income-tax v. E. D. Sheppard, 48 ITR 237 -- (AIR 1963 SC 1343) as laying down its true meaning. The crux of the matter is whether the payment related to employment. Otherwise, it would not fall within the expression "profit received in lieu of salary" in Explanation II to Section 7(1), being unrelated to the relation between employer and employee. In dealing with the question, it is necessary to recall the observations of Rowlatt, J. in Chhibett's case, (1932) 9 Tax Cas 48 (supra):--

> "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 a 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; and you have to see whether the maker of the payment makes it for the services and the receiver receives it for the services."

These observations of his have been received with approval by their Lordships of the Supreme Court in Sheppard's case 48 ITR 237 = (AIR 1963 SC 1343) and they must be taken to be the law governing the subject.

24. The Court of Appeal in (1950) 31 Tax Cas 351 (supra) pointed out that bargains of this nature may take one of the two forms: a tax-payer who has a contract under which he is entitled to remuneration may agree to accept a lump sum in lieu of future remuneration on condition that he did less work in future or even no work at all. In this class of case, the lump sum would be assessable as a profit arising out of his contract and payable by virtue of his office or employment. Examples of such bargains are these: In (1932) 16 Tax Cas 605 (HL) a Company's articles of association provided for the payment of compensation for loss of office in the event of a person ceasing to be a director (after 5 or more years service) by reason of death or any other cause other than misconduct, bankruptcy or incompetence. The director retired, and Lawrence, L. J. in giving judgment for the Revenue, stated:

> "..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 part of his remuneration for his services as a director"

The decision in that case, however, turned on the meaning of a particular agreement. In Prendergast v. Cameron, (1940) 23 Tax Cas 122 (HL) a tax-payer wished to retire from his directorship but the company wishing to retain his services, paid him the sum of pounds 45,000 upon his agreeing not to resign but to continue devoting less time to the company's affairs and receiving a smaller salary. The majority of the Court of Appeal (Greene, M. R. dissenting) and a unanimous House of Lords held that the payment arose from the director's office and was, therefore, taxable. In the Court of Appeal, Finlay, L. J. said:

> "His fellow directors highly valued his services and were willing to pay him a large sum to retain him. He was the director when the payment was arranged for. He was the director when the payment was received. I cannot resist the view that in the circumstances the sum paid to him was paid to him in respect of his continued service as a director."

In his opinion in the House of Lords, Viscount Caldecote, L. C, said--

> "I can see no difference between a promise not to resign and a promise to continue to serve as director."

The same principle was applied in Tilley v. Wales, (1943) 25 Tax Cas 136. In that case, part of the consideration for a single sum of pounds 40,000 was the acceptance of a salary in future, less than that secured by the taxpayer's service agreement. The portion attributable fro the acceptance of a reduced salary was held by the House of Lords to be taxable as emoluments. In Hofman v. Wad-man, (1946) 27 Tax Cas 192 periodical payments to an employee after the cancellation of his service agreement, were held to be assessable. In 1950-32 Tax Cas 118 (supra), the tax payer was

employed as an Assistant to the Managing Director of a company. His remuneration and terms of employment were the subject of a number of service agreements. The last of these provided for the termination of his appointment on 31st December 1945 if in the interest of the company, and in that event, payment to him, by way of compensation for loss of office of the sum of pounds 10,000. His appointment was terminated on 31st December 1945. He contended that the sum was not assessable to tax since it was a payment of compensation for loss of office and in essence, damages for breach of contract. Rox-burgh, J. holding that the sum was not compensation for loss of office but profits from an office of employment, contrasted the case with (1950) 31 Tax Cas 351 (supra) and pointed out that in the latter case, the sum was paid for the total abrogation of the; contract of employment, and concluded his judgment with the words:

> "In the present case, the tax-payer surrendered no rights. He got exactly what he was entitled to get under his contract of employment. Accordingly, the payment in my judgment falls within the tax-payer class."

25. From a review of these English decisions, which though phrased in terms of Schedule E (which is in pari materia with our Second Explanation to Section 7(1) prior to its amendment) are founded (sic) on judicial recognition of a certain capital amount arising out of contract of service in circumstances where the rights acquired or surrendered by the employee thereunder are sufficiently enduring and defined. The rule that income-tax does not tax the value of the source of income or the amount of a capital gain therefrom ought, on principle, to apply equally to all and every form of transaction. Accordingly payments received for the surrender of rights acquired under the service agreement and found to be in the nature of capital would be excluded from taxation as income. Sec 20 Halsbury's Laws of England, Simonds' edition p, 14, pp. 150-1 and 324-5; Simon's Income-tax, Replacement 1964-65, Vol. III, pp. 109-13; Income-tax Law and Practice, Plunket and Newport, 29th edition, pp. 152-3; Principles of Income Taxation by Hannan, p. 271 et seq. and The Meaning of Income in the Law of Income-tax, by F. E. La Brie, 1953 edition pp. 205-15.

26. There are two decisions of the Supreme Court which deal with the question. In Mahesh Anantra Pattani v. Commissioner of Income-tax, 41 ITR 481 = (AIR 1961 SC 946) their Lordships were concerned with the assessability to income-tax of an amount of rupees five lacs paid by Maharaja of Bhavnagar to the assesses who was the Chief Dewan of the native State upon its merger in the United State of Saurashtra, on his ceasing to be the ruler of that Stale. At the request of the assessee, the Maharaja subsequently wrote a letter to him stating that the payment was a gift in token of his affection and regard for his loyal and meritorious services. The income-tax authorities as well as the appellate Tribunal relying on the Maharaja's letter to which they attached more importance and which they treated as a contemporaneous document and disregarding his earlier letter to Messrs Premchand Raichand and Sons, with whom he had an account, to pay by a cheque to the assessee rupees five lacs out of the amount lying to the credit of his account, held that the amount was a taxable receipt in the hands of the assessee under Section 7(1) of the Income-tax Act read with Explanation 2, before its amendment in 1955. On a reference, the High Court affirmed the decision of the Appellate Tribunal. On appeal to the Supreme Court, Kapur and Shah, JJ. (Hidayatullah, J. dissenting) held on the facts that the Tribunal was in error in treating the subsequent letter as a contemporaneous document and its finding arrived at by the erroneous approach was not binding

on the Court. The sum of rupees five lacs was paid to the assessee, according to the majority decision, not in token of appreciation for the services rendered as the Dewan of the Bhavnagar State but as a personal gift by the Maharaja, as a token of his personal esteem for his loyal and meritorious services and the amount was, therefore, not taxable.

27. In 48 ITR 237 = (AIR 1963 SC 1343) the assessee was employed in Messrs Killick Nixon and Company which carried on business on a fairly large scale in India. The assessee was employed originally as an. Assistant for a term of 3 years and his employment was subject to termination by giving one months' notice without assigning any reasons. The contract of service was renewed from time to time and the last of such renewals was for the period from 1st November 1947, to 31st October 1950. During that period, the assessee was entitled to a salary of Rs. 1,200 per month and a commission of 21/2 per cent or the net profits of the firm. On 29th December, 1947, the assessee along with 15 other officers received a notice from the company stating that in view of its decision to float two subsidiary companies to take over its business, his employment would terminate as from 31st of January 1948. On 30th January 1948, out of the shares received by Messrs Killick Nixon and Company in lieu of the assets transferred to the subsidiary companies, 1,700 shares of the market value of Rs. 2,21,000 were caused to be allotted to the assessee in, the company which took over its business. The assessee entered the employment of that company on 1st February 1948 on new terms under which his salary was increased but no commission was allowed.

During the assessment proceedings, the assessee produced a letter written on behalf of Messrs. Killick Nixon and Company and an affidavit by 5 out of the 6 partners who constituted that firm, to the effect that the shares were allotted to compensate the officers for loss of employment and not by way of reward for past services. The majority of the members of the Appellate Tribunal held that the allotment of the shares was made solely to compensate the assessee for loss of employment and that it was not made as a reward for past services. Das, Kapur and Sarkar, JJ. (Raghubar Dayal, J, dissenting), speaking for the Supreme Court, stated that the question whether compensation received for loss of employment or office or for cessation of business was taxable under Section 7 fell to be considered prior to the amendment of the Act in 1955 with reference to the general principle of income-tax law which was to tax income. In other words, according to their Lordships, the question would be whether it was income or capital in the hands of the assessee. Following the dictum of Rowlatt, J. in Chibbett's case, (1932) 9 Tax Cas 48 their Lordships held that the payment in question was made solely as compensation for loss of employment and, therefore, could not be treated under Explanation 2 of Section 7(1) as profit received in lieu of salary.

28. In In re P.D. Khosla, (1945) 13 ITR 436 (Lah) the assessee who was the manager of an insurance company, was compelled to resign as a result of disputes with the new Board of Directors and in consideration of his resignation, the company paid him Rupees 1,10,000. He had appointment for 5 years renewable for a further term of 5 years, on a monthly salary of Rs, 1500 and a certain commission which was subject to the maximum of Rs. 20,000 in any one year. Relying on Explanation II to Section 7(1), as it then stood, it was held that the payment was a capital receipt, being compensation for loss of employment and not by way of remuneration for past services. So also, in W. A. Guff v. Commissioner of Income-tax, (1957) 31 ITR 826 (Bom), Chagla, C. J. stated:

> "The expression "compensation for loss of employment", used in Explanation 2 to Section 7 of the Indian Income-tax Act, refers to any payment made whether under a legal liability or voluntarily to compensate or act as a solatium for loss of employment suffered by an employee.
>
> Consequently, if there is 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 compensation for the loss of employment within the meaning of Section 7 and the amount paid would be a capital receipt and exempt from tax."

This construction of his, has been approved of by their Lordships in Sheppard's case 48 I. T. R. 237 = (AIR 1963 SC 1343) as laying down the correct law. On the construction placed upon the expression "compensation for loss of employment", although the payment of Rs. 12,000 to the assessee equivalent to 6 months' salary for termination of his employment owing to the closure of the department of which he was an executive in charge, was a gratuitous payment and under the contract of service, nevertheless, the payment was treated as a compensation for loss of employment. The other cases on the point are: R. N. Agarwala v. Commissioner of Income-tax, (1960) 38 ITR 67 (Bom); Commissioner of Income-tax v. S.P. Jain, 1965-56 ITR 724 (Bom); Commissioner of Income-tax v. K.K. Roy, 1967-66 ITR 179 (Cal) and Indian Overseas Bank Ltd. v. Commissioner of Income-tax, (1967) 66 ITR 270 (Mad).

29. The second class of case is where the contract itself ceases altogether and the sum becomes payable in consideration of the total abandonment or abrogation of all contractual rights which the recipient had under the contract. The sum received would not be assessable except to the extent provided. In Henlev v. Murray (1950) 31 Tax Cas 351 (supra) although the sum paid by way of compensation for loss of office was equal to the balance of the salary to the end of the employee's period of service, nevertheless the sum was paid in consideration of his resigning his office at the request of the Board, It was described as compensation for loss of office by the asses-see, in a letter to the company. The Court of Appeal held that the payment, being payable in consideration of the abrogation of the contract, and not under the contract, was not taxable. Evershed, M. R. described the payment as follows:

> "There is another class of case where the bargain is ..... of an essentially different character, (viz., 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."

The other cases on this aspect are: (1943) 25 Tax Cas 136 (commutation of pension rights); Barr. Crornbie and Company v. Inland Revenue Commissioners, 1945-26 Tax Cas 406 (a sum paid on termination of a management agreement, treated as capital); Duff v. Barlow, (1941) 23 Tax Cas 633 and Hose v. Warwick, 1940-27 Tax Cas 459 (lump sums paid to directors as compensation for relinquishing their right to remuneration).

30. There is yet another class of case, as indicated by the Court of Appeal in (1950) 31 Tax Cas 351 (supra) viz. where the payment is as damages for the repudiation of the service agreement due to the abrupt and unilateral act of the employer. In dealing with that class of case, Evershed, M. R. stated:--

> "But there is another class of case where the bargain is, as it seems to me, of an essentially different character, for in the second class of case 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 the course of the argument an extreme case was put to Mr. Selwyu Lloyd and Mr. Hills of an employer who breaks wrongfully a contract of service and discharges a servant wholly therefrom and the servant then sues for damages for wrongful dismissal. Although of course it is true to say that the sum awarded as damages arises from the contract in the sense that if there had never been a contract the sum of damages could never have been awarded, still both Mr. Selwyn Lloyd and Mr, Hills admitted, as I think they were bound to do, that in a case of that sort it would be impossible to suggest, if the facts were merely as I have stated them, that the sum awarded to him for damages was taxable under Schedule E."

Somervell, L. J. also stated:--

> "If in the case of dismissal where the employee says "I am wrongfully dismissed" and sues for damages he is admittedly outside Schedule E and untaxable, it seems to me to follow from that, if one goes by stages, that if you take a case where equally the employer dismisses his employee and the damages are agreed without litigation, the fact that they are agreed instead of being awarded by a judge or jury cannot affect their legal position in regard to the Income-tax Code. It seems to me on the evidence that that is what happened here. The employer said, "you, must go". I think it is perhaps clear from the position that he held that he need not have gone, but he, as he said, was forced into it; he did it at the request of the employers. The sum which he stipulated for according to his letter, it seems to me, must legally be in precisely the same position as would have been a sum for damages for wrongful dismissal."

31. The direct authority which furnishes a complete answer to the question before us is in Du Cros v. Ryall 1935-19 Tax Cas 444, That was a case in which the General Manager of a company working on a fixed salary and a commission on profits had a contract for a fixed term. It was repudiated by the employing company. He brought an action which was compromised and the question was whether the large sum paid as agreed damages under the compromise was assessable' under Schedule E. The contract of service was at an end. The source of income had disappeared, and the sum paid by way of damages could not be regarded as a sum derived from the employment. It was something which arose outside the employment. It was something to which the assessee became entitled by reason of the disappearance of the employment. In those circumstances, Finlay, J. held that the damages must

be regarded as a capital sum not assessable to tax. His observations are:

> "I am of opinion that these damages for the wrongful repudiation of the contract cannot be regarded as profits and gains. I do not see that they can be considered as being the profits and gains of any particular year. I think that the damages are just a capital sum arrived at -- I do not in the least know how, and there seem to be no materials for deciding it -- arrived at no doubt as a compromise as these things always are, but simply a capital sum which it was agreed should be paid to Mr. Du Cros in respect of the cancellation of the agreement, That is all, and I arrive at the conclusion that it is a capital sum and, therefore, is not assessable to Income-tax."

That precisely is the case here.

32. A reading of these decisions clearly shows that the distinction between one class of case (where the payment of compensation is in lieu of abandonment of all contractual rights which the recipient had under the contract or as damages for its wrongful repudiation due to unilateral act of the employer) and another class of case (where the payment of compensation is in terms of the contract of service as remuneration for past services or as deferred payment is terms thereof), runs through. If this distinction is borne in mind, there would be no difficulty in appreciating the cases falling on the other side of the line.

In V. D. Talwar v. Commissioner of Income-tax, 49 ITR 122 = (AIR 1963 SG 1583) their Lordships of the Supreme Court were dealing with payment of salary in lieu of notice as provided for in the contract of service. The assessee was employed as the general manager of a company under a service agreement which provided inter alia that the period of service was 5 years, and that the company might terminate his services by giving 12 months notice and paying salary in lieu thereof or in the case of any breach of any of the terms thereof or conditions of the service without any notice. The assessee joined his post on 1st May 1946 but his services were terminated with effect from 31st August 1947 without giving 12 months' notice. The services were terminated because the company did not want to continue the assessee in their employment and not for any default or misconduct on his part. In Men of the notice, the company paid the assessee a sum oj Rs, 18,096 (which was the amount arrived at after deducting from 12 months' salary of Rs. 25,200, income-tax of Rs. 7,104) and he gave a receipt for Rs. 18,096, in full and final settlement of all his claims against the company. The question was whether the sum of Rs. 25,200 was taxable in the hands of the assessee. The High Court held that the amount was not compensation for loss of employment within the meaning of Explanation 2 to Section 7(1) of the Income-tax Act (before amendment in 1955) as it was part of the remuneration to which the assessee was entitled under the contract of service and was received by him in accordance with the terms thereof and the assessee had not surrendered any rights under the contract and, therefore, it was assessable to tax.

On appeal, their Lordships held that as under the contract of service, the assessee could serve for a period of 5 years or for a shorter period if the company decided to terminate it, it could not be said that the assessee surrendered any right or was deprived of any benefits. He received exact / what he was entitled to under the contract and the amount received by him was not compensation for loss of

office. It was an amount paid in respect of his office though he did not do any work and the amount was, therefore, taxable under Section 7 of the Income-tax Act. So also, in D. D. Datar v. Commissioner of Income-tax, (1952) 21 ITR 558 (Nag) and R. D. Datar v. Commissioner of Income-tax, 1961-43 ITR 22 (Bom) the Datars received the payment under peculiar terms of their contract of service with the All India Reporter Limited.

33. Strong reliance is placed by the Commissioner on 1950-32 Tax Cas 118 and the two Datars" cases, 1952-21 ITR 558 (Nag) and 1961-43 ITR 22 (Bom) (supra) for the submission that the payment of Rs. 1,67,345 to the assessee was contractual, being a terminal payment in commutation of the remuneration payable to him, in the event of termination of his services under the contract of employment. It was said that a lump sum payment under Clause 6(b), was for services rendered at the conculsion of service. It was, therefore, a terminal payment or in the nature of additional remuneration for services which he had already performed in the past. We are of the view that the decisions relied upon are clearly distinguishable. As already stated, the taxpayer in 1950-32 Tax Cas 118 received a sum of pounds 10,000 on termination of his employment,. The service agreement provided for the payment in the event of such termination. In that context, Roxburgh, J. held that the sum was not compensation for loss of office but profits from an office of employment. In para 24 above, we have set out the words of Roxburgh, J, and they are worth repeating again:--

> "In the present case, the tax-payer surrendered no rights. He got exactly what he was entitled to get under his contract of employment".

34. The two Datars' cases 1952 21 ITR 558 (Nag) and (1961) 43 ITR 22 (Bom) are entirely distinguishable. These cases depended on their special features. In D. D. Datars case, 1952-21 ITR 558 (Nag) the assessee on the termination of his service received a net payment of Rs. 85,000 in full satisfaction of his claim on account of arrears of salary under Clause 1 of the service agreement for the period he had served, a sum equal to 3 years' salary payable under a Clause (3) in the event of termination, and 6 months' salary in lieu of notice under Clause 7. The Court, accordingly held that the net amount of Rs. 85,000 received by the asses-see could not be regarded to be payment solely for compensation for loss of employment because it included other elements of income. So also, in R. D. Datar's case 1961-43 ITR 22 (Bom) the service agreement was identically in similar terms and it provided for a terminal payment if his services were terminated for any cause whatsoever and also in the event of his death, in addition to payment of 6 months' salary in lieu of notice. Under these circumstances, the payment of a lump sum to him on the termination of his services, was treated as by way of salary or profits in lieu of or in addition to salary within the meaning of Section 7(1) because the amount was payable to him under a contract of service, irrespective of the cause of termination. The payments to the Datars were as clearly income as their salary was.

35. We are of the view that the assessee's case is entirely different. Though the words "for any cause whatsoever" appear in Clause 6(b) of the Huzur Order dated 1st March 1950, the payment of Rs. 1,67,345 was not in terms thereof. The payment was received by him "solely as compensation for loss of employment", under the terms of the agreement dated 27th January 1955. The payment was as damages for the repudiation of his service agreement due to the abrupt and unilateral act of the employer. The sum of Rs. 1,67,345 paid to him by way of damages could not be regarded as a sum

derived from the contract of employment, The bargain under the agreement dated 27th January 1955 was of an essentially different character. The contract had already been repudiated and therefore, it was not in terms thereof. Besides, the payment under Clause 6(b) of the service agreement would have been a much larger sum. The assessee was constrained to bring a suit for recovery of damages for the wrongful repudiation of his contract of service. This position clearly emerges from the narration of facts leading to his dismissal from service and the correspondence which ensued between the parties thereafter. We think that the damages paid under the agreement dated 27th January 1955 was a capital sum arrived at, which became payable to the assessee for the total abandonment of all his contractual rights.

36. We are, therefore, of the view that the payment of Rs, 1,67,345 to the assessee under the agreement dated 27th January 1955 cannot, in truth, be regarded as having been made under Clause 6 (b) of the Huzur Order dated 1st March 1950. Such being the position, it is futile for the Commissioner to contend that the payment in question was a payment of additional remuneration or a deferred payment, in terms of the contract of service. We are of the view that the note underneath Clauses 5 and 6 of the Huzur Order dated 1st March 1950 does not control the operative part of the agreement dated 27th January 1955 under which the payment was made. From the sequence of events narrated above, it is clear that the payment to the assessee was not made in appreciation of his past services., but solely on account of compensation for loss of employment, as a result of a fresh agreement between the parties on 27th January 1955 whereby in lieu of the payment of Rupees 1,67,345 to him, the assessee relinquished all the rights that he had under his contract of service.

37. The only other question for us to consider is whether the inclusion by the assessee of a claim for 23 days salary in his suit filed in the High Court of Bombay must lead to the irresistible inference that the payment of Rs. 1,67,345 was not "solely" as compensation for loss of employment within the meaning of Explanation II to Section 7 (1) of the Act, as it then stood prior to its amendment. The Tribunal has not stated this part of the case because the contention was apparently never raised before it. Even assuming that this arises on the question referred by the Tribunal, we are unable to hold that the amount of Rs. 1,67,345 was not received solely as compensation for loss of employment. From the fact that the whole of the sum received by the assessee was in the nature of a capital receipt, it may be assumed that no ascertainable part of it represented arrears of salary. The assessee's claim on this account in the suit had become merged or extinguished as a result of the compromise arrived at between the parties. The entire sum was paid to him by way of damages, and it could not be regarded partly as derived from employment. The assessee became entitled to that payment by reason of disappearance of the contract or employment, by its repudiation due to the unilateral act of his employer and the payment of Rs. 1,67,345 was for abandonment of all his rights thereunder.

38. We are, therefore, of the view that the payment of Rs. 1,67,345 being solely as compensation for loss of employment as stipulated for in the agreement dated 27th January 1955, the question raised does not arise and no part of the amount can be considered to be in lieu of salary for 23 days, the claim for which was withdrawn as a result of the compromise arrived at. Even if it were so included, the entire amount of Rs. 1,67,345 could not be regarded as payment towards salary, In (1946) 28 TC

41, a lump sum paid to terminate the service agreement and expressed to be "in full settlement of all past, present and future claims", was held to be apportionable so as to render such part of it as it did not relate to future services' income chargeable under Schedule E and the case accordingly remitted to the Commissioners to make such apportionment. Similarly, in 1943-25 Tax Cas 130 (supra), the case was remitted to the Commissioners for them to find out how much of the payment was referable to past services till the date of repudiation of the agreement (See Simon's Income-tax, Replacement 1964-65, Vol. 3, pp. 126-7).

39. For the reasons stated, we are of the opinion that the question referred to us ought to be answered in the affirmative. The assessee shall have the costs of this reference. Hearing fee Rs. 500.