R.N. Agrawala vs Commissioner Of Income-Tax, Bombay ... on 26 June, 1959

Equivalent citations: [1960]38ITR67(BOM)

JUDGMENT

Shah, J.

1. By an agreement dated the of October 15, 1949, the assessee was appointed general manager of the Orissa Textile Mills Ltd. By that agreement, the appointment of the assessee was to be in force for a period of five years in the first instance with option of renewal for a further period of two years. The assessee was to be paid a monthly remuneration of Rs. 2,100 and a monthly allowance of Rs. 900 for entertainments, maintenance of car etc. Besides this remuneration he was to be paid commission at 3% on the net profits of the company and was to be provided with a furnished bungalow, four servants, free use of the company's transport and separate allowance for entertainment on behalf of the company and free medical aid. The assessee undertook to manage the affairs of the mills efficiently and on a profit earning basis and if he "failed to establish the mills on a sound basis within 12 months from the date" of his joining, i.e., April 1, 1950, the company reserved its rights to terminate his services by giving him six months' notice in writing on the April 1, 1951, stating the various grounds of inefficiency. It was further provided that neither party could terminate the contract except on account of continued illness or permanent incapacity (of the assessee). It was also provided that in the event of any one of the parties terminating the contract except for reasons "stated before", the party terminating the contract will be responsible to pay to the other the balance of the monthly remuneration for the unexpired period of the contract as provided for in condition 7 of the letter of appointment. This last condition is somewhat obscure, because there could evidently be no monthly remuneration being paid by the assessee to the company in the event of the assessee putting an end to the contract. In the context in which the condition is found, it must mean that in the event of the contract being terminated by the company for reasons other than those set out earlier, the company will pay to the assessee the balance of the monthly remuneration for the unexpired period of the contract. On the of July 2, 1951, the company served a notice upon the assessee terminating his appointment as the general manager of the company with immediate effect and three reasons were given in that notice : (1) that for some time past the assessee had been inciting the labour of the mills against the company; (2) that the assessee had been acting in a manner prejudicial to the interest of the company and (3) that the assessee had failed to manage the affairs of the mill either efficiently or on a profit earning basis and had also failed to establish the mills on a sound basis within 12 months from April 1, 1950. Eight particulars of the charges against the assessee were then set out in that notice. It is unnecessary to consider these particulars in detail in the view we take on this reference. It may be sufficient to observe that some of the particulars relate to the the first reason, some others to the second reason and two more to the third reason. Thereafter, the assessee served a notice upon the company demanding payment

of Rs. 2,70,750, for termination of his employment. Negotiations were then held and on the of July 17, 1951, it was agreed between the company and the assessee that the services of the assessee as the general manager were to be deemed to be terminated with effect from the of July 2, 1951, and that the company shall pay to the assessee a sum of Rs. 1 lakh in full settlement of all his claims for compensation for termination of the agreement in the instalments specified. Besides this payment of Rs. 1 lakh certain amounts to which the assessee was entitled under the terms of the agreement were also agreed to be paid to him. It was then provided that the assessee had no claim whatsoever against the company either under the agreement dated the of October 15, 1949, or arising out of the same or otherwise howsoever on any account whatsoever and the assessee agreed that he will not for a period of one year from the date of the agreement engage himself in any profession or business either in his own account or in the services of others within 100 miles of Chowdwar which may be detrimental to the interest of the company. It was finally agreed that the company withdrew all the allegations against the assessee and the assessee withdrew all the allegations against the company, its managing agents and directors.

2. The Income-tax Officer brought the amount of Rs. 1 lakh to tax on the view that it was not received solely as compensation for loss of employment. In appeal to the Appellate Assistant Commissioner, the order made by the Income-tax Officer was reversed. In appeal to the Income-tax Tribunal, it was held that the termination of employment of the assessee was made in exercise of the powers vested in the company under clause 11 of the agreement dated the October 15, 1949, and that the amount of Rs. 1 lakh paid to the assessee was "under" this agreement and not "for" it. They further expressed the opinion that the assessee had received from the employer a certain sum of money which "went to fill the hole created in his 'salary' income by reason of premature termination of service contract, such premature termination of contract with consequent damages payable on account of it being provided by the agreement of service itself. " On the view taken by the Tribunal, the appeal filed by the Commissioner was allowed.

3. The Tribunal has referred to this court the following question :

> "Whether the sum of Rs. 1 lakh received by the assessee from the employer mills is income liable to tax under the Indian Income-tax Act, 1922 ?"

4. Evidently, the termination of employment of the assessee was not made on account of inefficiency of the nature that the assessee failed to establish the mills on a sound basis within 12 months from the date of his joining, nor was the employment termination on account of continued illness or permanent incapacity of the assessee. Under the express agreement, when there was termination of the employment for reasons other than those of inefficiency, illness or incapacity, the company was liable to pay the assessee the balance of the monthly remuneration for the unexpired period of the contract. The monthly remuneration for the unexpired period stipulated to be paid on termination of the contract was compensation for termination of employment. Even if the agreement was terminated for reasons other than of inefficiency of the nature specified or of incapacity resulting from illness, the employment was to be terminated and for termination of employment, the assessee was to be paid compensation equivalent to the balance of the monthly remuneration for the unexpired period of the contract. It cannot be said that the amount or amounts agreed to be paid

were to be paid on the footing that the contract was to continue to remain in force. Evidently the assessee was, on termination of employment for any reason, to cease to be an employee of the company whether the termination of the contract was for reasons of inefficiency or illness or permanent incapacity or other reasons. We are, therefore, unable to accept the argument of Mr. Joshi for the Department that the payment made to the assessee in this case is a payment "under" the terms of the agreement. It is true that under the agreement a certain amount capable of being ascertained was agreed to be paid in the event of termination of the employment of the assessee in certain eventualities. But all the same, the payment was to be made as compensation for termination of the employment.

5. In Guff v. Commissioner of Income-tax, Chagla, C.J., in delivering the judgment of the court referred to the scheme of section 7 and Explanation (2) before its amendment in the year 1955 and observed :

> "In other words, did the Legislature merely contemplate the factual loss of employment and any amount paid for that loss, whether that payment was under a legal liability or not ? As we shall presently point out, the authorities to which our attention has been drawn have given to the expression 'compensation' a wider connotation. It also seems to us, apart from the authorities, that it is the better view to take of this expression, because if an employee loses his employment which is the source of his income, any payment made by his employer for that loss should not be looked upon as income liable to tax, as in its very nature the payment is to compensate for or to act as a solatium for the very source which produced the income and in respect of which the employee is liable to tax."

6. The learned Chief Justice then proceeded to consider whether the compensation paid which was equivalent to six months' salary in lieu of notice was within the meaning of Explanation (2) of section 7 salary or remuneration for loss of employment.

7. Mr. Joshi for the Department contends that, in the present case, the compensation paid to the assessee was not solely for loss of employment and he invites our attention to the covenants contained in the agreement whereby the assessee had undertaken not to accept within a radius of 100 miles from Chardum. Employment which was prejudicial to the interest of the company and the assessee had abandoned all his rights arising under the terms of the agreement of employment or otherwise. This, Mr. Joshi says, being also the consideration for payment of Rs. 1 lakh by the company, it could not be said that the compensation paid was "solely for loss of employment." Explanation 2 to section 7 as it stood before the Act was amended in 1955, in so far as it is material, provided that a payment due to or received by an assessee from an employer or former employer, unless the payment is made solely as compensation for loss of employment and not by way of remuneration for past services, is to be regarded as a profit received in lieu of salary for the purpose of sub-section (1) of section 7, and profits in lieu of salary were to be regarded as "salary" and chargeable to tax. But, evidently on the Explanation, it cannot be said that a payment which is made as compensation but not solely for loss of employment must always be regarded as revenue receipt. The Legislature regards a payment made solely for loss of employment, which is not made by way of

remuneration for past services, as a capital payment. It is implicit in the Explanation that a payment made as remuneration for past services is to be regarded as a revenue payment. But in the absence of any express provision about payments which are neither of the nature of compensation paid solely for loss of employment, nor as remuneration for past service it would be difficult to rely upon the Explanation to support the view that the payment is capital payment or revenue payment. The decided cases here have taken the view (Guff's case to which we have already referred and Khosla, CFXH that a payment made as compensation for loss of employment is to be CFAXI regarded as a capital payment. If that be the correct view, in the present case notwithstanding the fact that for the payment of Rs. 1 lakh by the company to the assessee, the assessee was being compensated for loss of employment and was also giving up all his claims against the company and binding himself to a covenant not to accept employment which may be detrimental to the interest of the company out of a certain area, it would not in our judgment make any difference as to the nature of the payment made to him.

8. On that view of the case, we answer the question referred to us in the negative.

9. Commissioner to pay the costs of the reference.

10. Question answered in the negative.