

Aspy B. Talati Vs. Ito

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Court : Mumbai

Decided On : Jun-20-2000

Reported in : (2002)75TTJ(Mumbai)106

Appeal No. : ITA Nos. 4915 & 4916/Bom/1995 20 June 2000 A.Y. 1990-91 & 1991-92

Appellant : Aspy B. Talati

Respondent : ito

Advocate for Pet/Ap. : S.N. Inamdar, *for the Assessee* B.L. Meena, *for the Revenue*

Judgement :

ORDER

S. V. Mehrotra, A.M.

These two appeals filed by the assessee were heard together and are disposed of by this common order for the sake of convenience.

2. Both the appeals are directed against the separate orders of the Commissioner (Appeals) XXXV, Bombay, dated 28-2-1995, for the assessment years 1990-91 and 1991-92.

3. The ground common in both the appeals reads as under :

'1. The learned Commissioner (Appeals) has erred in holding that a sum of Rs. 1,00,000 received by way of ex gratia payment by the appellant from his ex-employer is in the nature of salary. The appellant states that the same is a capital receipt and not chargeable to tax.'

4. The assessee qualified chartered accountant, was employed with M/s. Abbott Laboratories (India) Ltd. till 5-5-1989, as director (Finance) and served the company in various capacities for 17 years. During the two relevant assessment years, the assessee received Rs. 1 lakh each in appreciation of personal attributes and qualities, which were over and above his legal dues and claimed the amount for the two assessment years as exempt from tax in view of the Supreme Court decision in the case of CIT v. K.K. Roy : [1972]84ITR701(SC) and that of the Calcutta High Court in the case of CIT v. Ajit Kumar Bose (1987) 167 ITR 90 . The assessee had tendered his resignation from the company on 6-4-1989, which was acknowledged on 7-4-1989, by Harry Patel, managing director of the company, in which regrets were expressed in accepting the resignation with effect from 6-5-1989, and it was also stated in the said letter as under :

'In recognition of your past 17 years service with the company as finance director and secretary and alternate director on the Board from November, 1981 to May, 1986 and in appreciation of your personal qualities and attributes, management is pleased to approve special ex gratia payments which shall become due and payable on dates specified below:

Rs. 1 Lakh

on 5th May, 1989

Rs. 1 Lakh

on 5th May, 1990

The above sums will be paid by the company to you on above dates in addition to your other dues (provident fund, gratuity, superannuation leave salary, etc.) from the company.'

It was explained before the assessing officer vide letter dated 18-1-1991, that the nature of payment made to the assessee was as under :

'There was a lock-out in the company which lasted over 15 months at the company's factory at Kurla. The entire manufacturing activity came to a standstill forcing acute financial difficulties on the company. During this time of hardship Mr. A.B. Talati, the assessee, designed and successfully implemented various creative financial strategies which helped the company to withstand a long period of lock-out. Accordingly, Rs. 1 lakh has been paid by the company during the relevant financial period.'

The assessing officer referred to the letter dated 22-2-1991, from Shri Harry Patel, managing director of the company, to the assessee in which it was mentioned as under :

'You have received lucrative offers during that period, but you continued to work for us on the request of the management recognising fully well that your experience in more than one occasion was absolutely essential to the company's survival.'

The assessing officer inferred from the wording of this letter that there was a direct nexus between the payment and the employment. She held that the amount of Rs. 1 lakh each is paid by the company to the assessee for the services rendered by him during the lock-out in its factory during the period of 1986-87 in the capacity of his being an employee of the company and, therefore, the amount is treated as compensation taxable in view of section 17(3) of the Income Tax Act. The learned Commissioner (Appeals) held that the receipt in the present case is purely out of the factum of the meritorious services of the assessee rendered by him to the company through his office. He held that there is no personal attribute or quality pointed out either by the employer or by the assessee which could motivate the employer instantaneously to grant a reward of Rs. 2 lakhs. He held that the loyalty, sincerity and excellent performance during the difficult times of the company displayed by the assessee are attributes recognised only because of his office and those are known commercial attributes and there is nothing like a personal gift or ex gratia involved in it. He held that the real motive behind the said payment was

to reward the assessee for his past long meritorious services and the true and basic character of the receipt is not ex gratia but profit in lieu of salary. He further held that the company in its books of account treated the payment as ex gratia and recorded the payment as remuneration to employees and incorporated the said amounts in the salary certificates issued and deductions under sections 16(i), 80CC, 80CCA, etc., were granted by the company out of the said receipt and the resultant has been subjected to tax deduction at source. He referred particularly to the salary certificate issued by the company for the second instalment of Rs. 1 lakh in which the assessee had received, nothing else but only the second instalment of Rs. 1 lakh and the same was subjected to deduction under section 16(i) of Rs. 12,000 and the resultant of Rs 88,000 was further subjected to deduction of Rs. 4,000 under section 80CCA. On the net balance, deduction of tax at source to the extent of Rs. 7,000 was made. On the basis of this treatment to the receipt of the assessee accorded by the employer, the learned Commissioner (Appeals) came to the conclusion that the said payment was not an ex gratia payment but payment in the nature of salary. As regards the assessee's argument that the receipt of the amount was from a former employer, the learned Commissioner (Appeals) held that the first instalment was received on 5-5-1989, when the assessee was in the service of the company and was a full-fledged director (Finance) of the company and his resignation came into effect on and from 6-5-1989. He also held that the right to receive Rs. 2 lakhs was granted vide letter dated 7-4-1989, of the managing director while the assessee was in service. Accordingly, he held that the assessee acquired the right to receive Rs. 2 lakhs on 7-4-1989, itself and, likewise, the company accepted the obligation of paying Rs. 2 lakhs to the assessee on 7-4-1989. He also observed as under :

'10..... The hospitable haste in which the reward of Rs. 2,00,000 has been announced in writing within hours of the acceptance of the resignation letter of the appellant, does not smell of a real voluntary payment of the said reward on behalf of the management. In fact, the management was certainly not confident about the 'voluntary' nature of the payment and that is why the managing director Shri Harry Patel had to undertake the exercise of writing a letter as late as on 22-2-1991 to characterise the said payment as voluntary and ex gratia and that too with retrospective effect.'

The learned Commissioner (Appeals) referred to the receipts issued by the assessee dated 5-5-1989, and 5-5-1990. In the first receipt dated 5-5-1989, the assessee acknowledged the receipt of Rs. 1,91,174 (inclusive of Rs. 1,00,000, the first instalment) as 'full and final settlement of all dues in respect of my services with the company and I hereby acknowledge that I have no claim of any nature whatever against the company in respect of or arising out of my said service except second instalment of special ex gratia payment stated in letter dated 7-4-1989'. The learned Commissioner (Appeals) observed that the assessee himself linked the receipt of Rs. 1 lakh with his services and goes further to say that the second instalment is yet to be received. In the opinion of the learned Commissioner (Appeals), the assessee had developed and possessed a justiciable right to receive the said instalments, although characterising the same as special ex gratia, which is an act of self-convenience and has no bearing upon the real character of the receipt. He also observed that if the assessee did not have any right to receive, he could not have used the words 'except the second instalment'. This right was, in his opinion, borne out of the employer-employee relationship and in respect of the services of the assessee. From the contents of the second receipt dated 5-5-1990, the learned Commissioner (Appeals) observed that the assessee further confirmed that the receipt is a 'full and final settlement and satisfaction of all dues in respect of my services with the company and I hereby acknowledge that I have no claim of any nature whatever against the company in respect of or arising out of my said services'. The learned Commissioner (Appeals) observed that by issuing this receipt, the assessee granted freedom to the company from the bondage of its obligation to pay the assessee the said amount of Rs. 2 lakhs, a bondage which emerged from Shri Harry Patel's letter dated 7-4-1989, addressed to the assessee. Taking into account all surrounding circumstances and facts of the case, the learned Commissioner (Appeals) held that the receipt in question is a direct emolument paid to the assessee-employee in recognition of his past services and, therefore, was nothing but profit in lieu of salary.

5. The learned counsel for the assessee submitted that there was no obligation on the part of the management to make the payment of Rs. 2 lakhs and it was only in recognition of the personal attributes of the assessee that these payments were

made by his employer. These amounts had no relation to the length of service or salary drawn, etc. He submitted that these amounts were spontaneously declared by the management after receiving the resignation letter. He further submitted that the payment was made not as a recompense for services rendered but in appreciation of the assessee's loyalty, sincerity and trustworthiness. The payment was not connected with the period of service or any such factor and was given purely as a gift after the assessee ceased to be an employee. He referred to p. 10 of the paper book which is letter dated 7-4-1989, of the managing director to the assessee in which it was clearly mentioned that the payment is in appreciation of personal qualities and attributes and was approved by the management as special ex gratia payment. He also referred to the letter dated 22-2-1991, from Harry A. Patel to the assessee, which is at page 11 of the paper book. This letter was written by Shri Harry A. Patel, managing director, at the request of the assessee for elaborating the reasons for making the above payments. In this letter the managing director categorically stated that the basic quality that impressed the management was absolute loyalty of the assessee which prompted them to make the payment. He submitted that though the assessee was offered lucrative jobs during the period of lock-out, he preferred to remain with the company and helped the management in its most difficult times. He observed as under :

'I understand that you had received lucrative offers during that period, but you continued to work for us on the request of the management recognising fully well that your experience on more than one occasion was absolutely essential to the company's survival and, this you did willingly without expecting any extra remuneration. We cannot forget this gesture.'

The learned counsel for the assessee also referred to the following observations in the letter :

'The Board of our company always consisted of professionals and all of them had spoken to me quite often of the manner in which the company benefitted from a trusted man like you in the most difficult times. It was a rare display of total loyalty and sincerity. I had the same experience after I took over as managing director.'

The learned counsel for the assessee relied on the decision of the High Court of Justice (Chancery Division) in the case of Bridges (H.M. Inspector of Taxes) v. Bearsley 37 Tax Cas 289, in which the headnote reads as under:

'Income-tax, Schedule E Shares in company transferred to director whether profits of office.

The respondents were at the material times respectively managing director and a director of a limited company which they had served for many years in those, and other capacities. They had greatly helped in building up the business and in running it when it had become established. Most of the shares in the company were held in trust, under the will of the former principal shareholder (who died in 1936), for his widow during her life and thereafter for his two sons in equal shares absolutely. The respondents wished to have a fairly substantial holding in the company. They had been under the impression that the former principal shareholder would bequeath them shares by his will, but he had not done so. In due course they approached the sons about the matter and in 1945 the sons entered into covenants under which the respondents, in consideration of their continuing their engagements with the company for four years, were, each to receive 8,000 of the shares within three months of the death of the widow. These shares were transferred to the respondents in July, 1953.

On appeal to the Special Commissioners against assessments to income-tax under Schedule E made on them for 1953-54 in sums which included the value of the shares at the date of transfer, the respondents contended that the transfers were pure acts of bounty and in no sense rewards for past or future services., and that the stipulations that the covenants were in consideration of continued services were conventional and inserted simply to give the respondents a procedural right to sue on the documents effectively. Alternatively, it was contended that if the value of the shares transferred was income assessable under Schedule E, such income either arose on the execution of the deeds or should be spread over the four years 1945-46 to 1948-49. The Special Commissioners found that the transfers and covenants were not remuneration for the respondents' services in their current office and held that neither the value of the shares nor the value of

the covenants represented income assessable under Schedule E.

Held (Jenkins, L.J., dissenting), that the shares were not profits from the respondents' current offices because they were not remuneration for services in those offices but testimonials (which under the covenants might not have accrued until after retirement) for what they had done, including what they had done before holding those offices.'

The learned counsel for the assessee, taking assistance from this judgment, submitted that in the present case also the assessee received the amount not as remuneration for services but as ex gratia for what he had done earlier. The employer was not legally obliged to make the payment. The learned counsel for the assessee referred to the decision of the Hon'ble Calcutta High Court in the case of CIT v. Ajit Kumar Bose (supra) in which it was held that the employer was under no obligation to pay anything to the assessee in connection with termination of his employment otherwise than salary for notice period. The payment made by the employer over and above the dues was ex gratia and totally voluntary. The payment does not amount to compensation which implied an obligation to pay. Accordingly, it was held that the amount received by the employee was not profit in lieu of salary. He also relied upon the decision of the Hon'ble Calcutta High Court in the case of CIT v. Jamini Mohan Kar : [1989]176ITR127(Cal) wherein also a similar view was taken. The learned counsel for the assessee submitted that the amount paid cannot be called as payment for deprivation of any right. He also referred to the decision of the Tribunal, Mumbai Bench 'A', in the case of ITO v. Shri Anilkumar Rudra in ITA No. 8975/Bom/1990, dated 12-10-1998 in which it was held that amounts received after superannuation had nothing to do with the employment and so they are not in the nature of compensation received by the assessee in connection with the termination of employment or the modifications of the terms and conditions relating to his employment and as such cannot be treated as profits in lieu of salary under section 17(3). The amount is received purely in lieu of a restrictive covenant which puts fetters on the freedom of the assessee to engage in employment of his choice. The right surrendered by the assessee is only a personal right and not a proprietary right. Thus, the learned counsel for the assessee submitted that the payments made in the two

assessment years were for personal attributes of the assessee.

6. The learned Departmental Representative submitted that the right to receive the amount had accrued by virtue of letter dated 7-4-1989, of the managing director. The amount is borne out of employer-employee relationship and the payment was committed by the company when the employer-employee relationship subsisted. The assessee had acquired a vested right in the payment, as though the resignation was accepted on 7-4-1989, the assessee continued to serve the company upto 5-5-1989. He submitted that there was no need to commit this payment vide letter dated 7-4-1989, if there was no obligation to make the said payment on the part of the company. He also submitted that the employer treated the amount as part of salary and deducted tax therefrom after allowing the statutory admissible deductions.

7. The learned counsel for the assessee in the rejoinder, submitted that the assessee had acquired no vested right in the said amounts and it is to be seen whether the amounts constituted compensation. The learned counsel for the assessee also submitted that salary certificate does not determine the character of income. The employer deducted the tax as a precautionary measure in order to avoid any default under the various provisions of the Act.

8. We have considered the rival submissions of the learned parties and have perused the record of the case. The terms of the agreement are at pages 4 to 9 of the paper book, in para 3 of which the remuneration payable to the assessee has been spelt out in the minutest possible details, from clauses (a) to (1). However this amount has nowhere been contemplated in the said para 3. The letter dated 7-4-1989, is the most important and crucial piece of evidence in deciding the nature of receipt in the hands of the assessee. This letter has been written by the managing director of the company on the very next day of the resignation letter of the assessee. In this letter it has been clearly spelt out that the payment is being made in appreciation of personal qualities and attributes, as special ex gratia payment, which has been approved by the management also. It was not only the managing director's decision but had the approval of the management. So it cannot be said that the managing director termed the payment as special ex gratia

payment. It was basically the personal loyalty of the assessee towards the management which in English proverb is termed as 'A friend in need is a friend indeed', which prompted the management to make this payment and this had no relation to the services rendered by virtue of the agreement of employment. This amount is not paid by virtue of the employment but only a voluntary payment by the management recognising the loyalty and sincerity of the assessee towards the company. In the case of *Cooper Blakistan* (1907) Tax Cas 347, it was held that payment in appreciation of personal qualities is not taxable as salary. Similarly, in the case of *Benyon v. Thorpe* (1928) 14 Tax Cas 1 it was held that a payment made as a gift in appreciation of personality and character of the employee is not taxable as salary. The letter dated 7-4-1989, addressed to the assessee by the managing director was written on the next day of the resignation of the assessee clearly spells out the intention of the management for making the payment, which was in appreciation of the personal qualities and attributes of the assessee and made as special ex gratia payment. The letter dated 22-2-1991, was addressed to the assessee by the managing director at his request to elaborate the reasons for making the above payment. Though this letter has been given quite late but it only explains and elaborates the basic intention of the management expressed in the letter dated 7-4-1989. The real motive behind the payment is to be seen with reference to the letter given on the very next day of the tendering of resignation by the assessee. We find no evidence, on record for the learned Commissioner (Appeals) to come to the conclusion that the real motive behind the said payment was to reward the assessee for his past long meritorious service and the basic character of the receipt was not ex gratia but profit in lieu of salary. The only reason for coming to this conclusion by the learned Commissioner (Appeals) was the treatment accorded to the payment in the books of account of the company. The first receipt dated 5-5-1989, issued by the, assessee in acknowledgement of the receipt of Rs. 1,91,174 (inclusive of Rs, 1,00,000, the first instalment) wherein he says that the amount was received in full and final settlement of all dues in respect of his services with the company and that he had no claim of any nature whatsoever against the company in respect of or arising out of his said services except the second instalment of special ex gratia stated in the letter dated 7-4-1989, in our opinion, cannot determine the true nature of the payment, and for

determining the true nature, of payment it is to be seen (i) whether there was any liability to make the payment, (ii) whether or not the assessee had any legal enforceable right against the company for claiming this payment, and (iii) whether or not the, amount has been paid as compensation. The unilateral commitment made by the management without any requirement of the same being accepted by the assessee, as he had already tendered his resignation on 6-4-1989, will not make the payment enforceable in law. In the case of Dilip Kumar Roy v. CIT : [1974]94ITR1(Bom) , it has been held by the Hon'ble Bombay High Court that the test in such cases is to find out if the sum is paid to the assessee in respect of his services and accrues to him by virtue of his office. If the amount is paid to a person as a personal gift for his personal qualities as a token of personal esteem and veneration, the receipt cannot be subjected to tax. Accordingly, we hold that the amount of Rs. 1,00,000 each received by the assessee in the two assessment years under consideration is not taxable as compensation as contemplated under section 17(3) as profit in lieu of salary and hold that this is a capital receipt in the hands of the assessee.

9. The assessee has taken one more ground in the assessment year 1991-92 with regard to levy of interest under section 220(2) amounting to Rs. 2,715 which the learned Commissioner (Appeals) had not decided. No such interest has been levied in the assessment order and, therefore, the learned Commissioner (Appeals) rightly did not entertain this ground. The learned counsel for the assessee did not press this ground at the time of hearing. Accordingly, it is dismissed as not pressed.

10. In the result, the appeal for the assessment year 1990-91 is allowed and that for the assessment year 1991-92 is partly allowed.