

K. Gopalakrishnan Vs. Central Board of Direct Taxes and Others

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Court : Chennai

Decided On : Apr-21-1993

Reported in : (1994)118CTR(Mad)396; [1994]206ITR183(Mad)

Judge : M. Srinivasan and;Thangamani, JJ.

Acts : [Income Tax Act, 1961](#) - Sections 10, 10(10), 10(10AA), 10(10C), 10(26), 15, 16, 17 and 36(1); [Constitution of India](#) - Articles 14 and 226

Appeal No. : W.P. No. 3838 of 1992

Appellant : K. Gopalakrishnan

Respondent : Central Board of Direct Taxes and Others

Advocate for Def. : M.V. Balasubramaniam, Adv.

Advocate for Pet/Ap. : Party in Person

Judgement :

Srinivasan, J.

1. The petitioner prays for issue of a writ of declaration declaring that section 10(10) and section 10(10AA) of the Income-tax Act, 1961, as relating to any other gratuities received by the employees of statutory corporations and employees in the private sector, who are not covered by the Payment of Gratuity Act, 1972, as

null and void as the said provisions are discriminatory in law and is in gross violation of article 14 of the [Constitution of India](#) and also declaring the implausible clarification of the Central Board of Direct Taxes about the meaning of the term 'salary' as used in section 10(10) and section 10(10AA) of the Income-tax Act, 1961, and their discordant interpretation as null and void and render justice with the apropos interpretation for the meaning of the term 'salary' to be used in the above sections of the Income-tax Act.

2. The petitioner retired from service in the Indian Airlines on superannuation at the close of work on January 31, 1991. He received the terminal benefits like gratuity and leave encashment. As per the regulations, the petitioner was entitled to the maximum amount of gratuity at 16 1/2 months of provident fund pay (basic pay, variable dearness allowance, special compensatory allowance and additional pay) and similarly leave encashment calculated on provident fund pay last drawn. The petitioner wrote a letter on September 26, 1990, to the Director, Finance, Indian Airlines, stating that he was entitled to get exemption from income-tax under section 10(10) of the income-tax Act in respect of the gratuity payment and under section 10(10AA) in respect of leave encashment on superannuation. He referred to a circular issued by the Central Board of Direct Taxes under Circular No. 46 F. No. 194/9/70 I. T. (AI), dated September 14, 1970. He claimed that the meaning of 'salary' as defined under rule 2(h) of Part A of the Fourth Schedule to the Act should not be made applicable to the employees who were members of the Employees' Provident Fund Regulations. He prayed for issue of suitable instructions to all concerned as regards the components which are to be included under the head 'Salary' for the purpose of computing income-tax exemption on gratuity payment and leave encashment in consultation with the competent authority in the office of the Central Board of Direct Taxes. He sent a letter on November 26, 1990, to the Secretary, Central Board of Direct Taxes, New Delhi, making the same claim and praying for issuing of guidelines by means of a circular, notification or in any other manner as regards the import of the expression 'salary' used in section 10(10) and section 10(10AA) of the Income-tax Act.

3. The Department of Revenue, Ministry of Finance, sent a reply on January 3, 1991, stating the individual taxpayers should as far as possible raise their legal

doubts or other issues initially before the concerned local income-tax authorities, viz., the Public Relations Officer, the Deputy Commissioner of Income-tax, and that only such doubts or issues as remained unresolved at the local level, may be referred to the Board. He was, therefore, directed to contact the Public Relations Officer in the office of the Chief Commissioner of Income-tax, Madras. The petitioner wrote a letter to the Chief Commissioner of Income-tax on February 4, 1991, reiterating his contentions. The latter sent a reply on July 8, 1991, that the petitioner's reasoning was not acceptable, as the circular on which reliance was placed by him had no application after the insertion of an Explanation to clause (10) of section 10 in the Finance Act, 1974, with effect from April 1, 1975, forming part of the substantial provisions of the Act and that the Department had to rely on that definition irrespective of the fact whether it has been inserted from rule 2(h) of Part A of the Fourth Schedule. The petitioner sent a communication on July 12, 1991, to the Secretary, Central Board of Direct Taxes, drawing his attention to the view taken by the Chief Commissioner of Income-tax and requesting the Board to issue suitable clarifications. The petitioner followed it with a registered letter on October 9, 1991. The Central Board of Direct Taxes sent a communication dated December 27, 1991, to the petitioner that the Board concurred with the clarification given by the Chief Commissioner of Income-tax, Madras.

4. The present writ petition was filed on March 6, 1992, with the prayer set out earlier. The contention raised in the writ petition is that section 10(10) and section 10(10AA) of the Income-tax Act make a discrimination between the Central and State Government employees on the one hand and the employees of the statutory corporations and the private sector on the other. According to the petitioner, the classification is arbitrary and there is no nexus between the same and the object of the enactment. Thus, the petitioner contends that the sections are unconstitutional as they offend article 14 of the [Constitution of India](#) so far as they make a discrimination between the two sets of employees. Another contention of the petitioner is that the term 'salary' found in the sections should be interpreted to mean and include all the allowances received by the employee including provident fund, gratuity and leave encashment. According to him, the expression should have the same meaning as it had under section 58F of the old Income-tax Act of 1922 and should not be restricted by the definition found in clause (h) of rule 2 of

Part A of the Fourth Schedule.

5. The first respondent is the Secretary, Central Board of Direct Taxes, the second respondent is the Chief Commissioner of Income-tax and the third respondent is the Director of Finance, Indian Airlines. The second respondent has filed a counter-affidavit. An objection is taken by the second respondent to the maintainability of the writ petition in view of the amounts received by him by way of gratuity and leave encashment. It is submitted that unless the amounts exceed the ceiling limit fixed in the section, the petitioner cannot claim to be aggrieved by the provisions in the sections. It is also stated in the counter-affidavit that the provisions of the section do not in any way violate article 14 of the [Constitution of India](#) and the classification is reasonable and valid. It is also submitted that the Explanation to section 10(10) of the Income-tax Act places the matter of interpretation beyond doubt in stating that the expression 'salary' in section 10(10) and section 10(10AA) of the Income-tax Act shall have the meaning assigned to it in clause (h) of rule 2 of Part A of the Fourth Schedule to the Act.

6. The petitioner appeared in person and submitted written arguments. He supplemented the same with his oral arguments. He contended that taxation enactments are not exempted from the provisions of articles 13 and 14 of the [Constitution of India](#) and they have to satisfy the test of equality. He referred to some passages in the Constitutional Law of India by Mr. Basu and the Constitutional Law of India by Mr. H. M. Seervai. The substance of his contention is that all employees from one class in so far as the object of section 10(10) and section 10(10AA) of the Income-tax Act is concerned and there cannot be any discrimination on the basis that some are employees of the Central or State Governments, some are employees of statutory corporations and some are employees in the private sector. It makes no difference whether they are employees of the government or otherwise as regards grant of exemption from payment of income-tax under section 10(10) and section 10(10AA) of the income-tax Act. He relied on the judgment of the Supreme Court in *S. K. Dutta, ITO v. Lawrence Singh Ingty* : [1968]68ITR272(SC) . In that case, the provisions of section 10(26) of the Income-tax Act were considered. It was held that the sections offended article 14 of the Constitution to the extent to which they excluded the

government servants from the benefit of the exemption given therein. The court observed : [1968]1SCR833 :

'We know of no legislative practice or history treating government servants as a separate class for the purpose of income-tax. The Government servants' income has all along been treated in the same manner as the income of other salaries officers. We do not know under what circumstances the notifications dated June 6, 1890, and March 21, 1922, referred to earlier, came to be issued. But they are insufficient to prove a well-established legislative practice. At the time those notifications were issued the power of the Legislature to grant or withhold any exemption from tax was not subject to any constitutional limitation. Hence the validity of the impugned provisions cannot be tested from what our Legislatures or Governments did or omitted to do before the Constitution came into force. If that should be considered as a true test then article 13(1) would become otiose and most, if not all, of our constitutional guarantees would lose their content. Sri Setalvad, learned counsel for the respondent, is justified in his comment that classification based on past legislative practice and history does not mean that because in the past the Legislature was enacting arbitrary laws, it could do so now.

It was the contention of the learned Solicitor-General that exemption from income-tax was given to members of certain scheduled tribes due to their economic and social backwardness; it is not possible to consider a Government servant as socially and economically backward and hence the exemption was justly denied to him. According to the Solicitor-General, once a tribal becomes a Government servant he is lifted out of his social environment and assimilated into the forward sections of the society and therefore he needs no more any crutch to lean on. This argument appears to us to be wholly irrelevant. The exemption in question was not given to individuals either on the basis of their social status or economic resources. It was given to a class. Hence individuals as individuals do not come into the picture. We fail to see in what manner the social status and economic resources of a Government servant can be different from that of another holding a similar position in a corporation different from that of another holding a similar position in a corporation or that of a successful medical practitioner, lawyer,

architect, etc. To overpaint the picture of a Government servant as the embodiment of all power and prestige would sound ironical. Today his position in the society, to put it at the highest, is no higher than that of others who in other walks of life have the same income. For the purpose of valid classification what is required is not some imaginary difference but a reasonable and substantial distinction having regard to the purpose of the law.'

7. he invited our attention to another ruling of the Supreme Court in ITO v. N. Taking Roy Rymbai : [1976]103ITR82(SC) . That judgment, however, does not help the petitioner in any manner. The court explained the ruling in Lawrence Singh's case : [1968]68ITR272(SC) in the following manner (at page 87 of 103 ITR and at page 673 of AIR 1976 SC) :

'With due respect to the learned judges of the High Court, we are unable to accept this reasoning. The matter now in controversy was not even obliquely in issue before this court in Lawrence Singh Ingty's case : [1968]68ITR272(SC) . Therein, the only question for decision was, whether the exclusion of the government servants from the exemptions given in section 4(3)(xxi) of the Indian Income-tax Act, 1922, and later on in section 10(26) of the Income-tax Act, 1961, was violative of article 14 of the Constitution. Although sub-clause (a) was very much there, its validity was not even indirectly questioned. The contention of the Revenue, there, was that the exemption from income-tax was given to members of certain scheduled tribes, due to their economic and social backwardness; that it was not possible to consider Government servants as socially and economically backward and hence the exemption was justly denied to the assessee, who was a Government servant having income from salary. It was further urged by the Revenue that once a tribal becomes a Government servant, he is lifted out of his social environment and assimilated into forward sections of society and, therefore, he needs no more any crutch to lean on.

These arguments were found to be irrelevant and unsustainable. In that context, the court observed :

'The exemption in question was not given to individuals either on the basis of their social status or economic resources. It was given to a class. Hence individuals as

individuals do not come into the picture.

We fail to see in what manner the social status and economic resources of a Government servant can be different from that of another holding a similar position in a corporation or that of a successful medical practitioner, lawyer, architect, etc. To overpaint the picture of a Government servant as the embodiment of all power and prestige would sound ironical. Today his position in the society, to put it at the highest, is no higher than that of others who in other walks of life have the same income. For the purpose of valid classification what is required is not some imaginary difference but a reasonable and substantial distinction having regard to the purpose of the law."

8. The sentences which have been underlined are the sheet-anchor of the arguments advanced by Mr. Lahiri. In our opinion, they cannot be torn out of context and used for spelling out a proposition different from what was actually decided in that case. The ratio of that decision is that within the members of the scheduled tribes residing in specified areas, selected by the State for the purpose of exemption, the mini-classification between individuals who were government servants deriving income from between individuals who were Government servants deriving income from salary, and those who were not such government servants, was not based on intelligible differential. Since there was no rational basis whatever for this differentiation, it was held that within the range of the election, the Government servants had been unfairly discriminated against lawyers, was derived from non-Government sources, and that the exclusion of government servants from the exemption under section 10(26) was bad and unconstitutional. This vice of discrimination from which section 10(26) was then suffering was removed when the Amending Act 42 of 1970 excised the obnoxious limb of the provision :

'The decision in Lawrence Singh Ingty's case : [1968]68ITR272(SC) is thus no authority for the proposition that the exemption granted under section 10(26) to the members of the scheduled tribe residing in the specified areas, as a class, could not be validly subjected to the condition contained in sub-clause (a) of the provision.'

9. The court went on to point out that the Legislature had wide powers in making a classification for the purpose of imposing a tax or for granting exemption. It said (at page 89) :

'While it is true that a taxation law cannot claim immunity from the equality clause in article 14 of the Constitution, and has to pass, like any other law, the equality test of that article, it must be remembered that the State has, in view of the intrinsic complexity of fiscal adjustments of diverse elements, a considerably wide discretion in the matter of classification for taxation purposes. Given legislative competence, the Legislature has amply freedom to select and classify persons, districts, goods, properties, incomes and objects which it would tax, and which it would not tax. So long as the classification made within this wide and flexible range by a taxing statute does transgress the fundamental principles underlying the doctrine of equality, it is not vulnerable on the ground of discrimination merely because it taxes or exempts from tax some incomes or objects and not others. Nor is the mere fact that a tax falls more heavily on some in the same category, by itself a ground to render the law invalid. It is only when within the range of its selection, the law operates unequally and cannot be justified on the basis of a valid classification, that there would be a violation of article 14. (See *East India Tobacco Co. v. State of Andhra Pradesh* : [1963]1SCR404 , *Vivian Joseph Ferreira v. Municipal Corporation of Greater Bombay* : [1972]2SCR257 , *Jaipur Hosiery Mills P. Ltd. v. State of Rajasthan* : [1997]1SCR396

Classification for purposes of taxation or for exempting from tax with reference to the source of the income is integral to the fundamental scheme of the Income-tax Act. Indeed, the entire warp and woof of the 1961 Act has been woven on this pattern.'

10. Ultimately, it was held in that case that the classification found in sub-clause (a) of clause (26) of section 10 of the Income-tax Act was valid.

11. No doubt a differentiation is made between the employees of the Central and State governments on the one hand and the other employees on the other in section 10(10) and section 10(10AA) of the Income-tax Act. When full exemption is provided in the sections to retirement gratuity and encashment of earned leave by

the Government employees, the exemption in the case of other employees had been restricted to a limit calculated in accordance with the provisions in the section on the basis of the salary of those employees. But, that would not by itself make the sections discriminatory or violative of article 14 of the [Constitution of India](#). It has become unnecessary for us to dilate on the subject at length in view of the judgment of the Supreme Court in *Shashikant Laxman Kale v. Union of India* : [1990]185ITR104(SC) . Arguments similar to those of the petitioner herein were advanced in that case as against the provisions of section 10(10C) of the Income-tax Act. Negating the same, the court held that the scope of the classification in taxation statutes is wider and the Legislature has more freedom in such matters. The court said (at page 111) :

'It is well-settled that the latitude for classification in a taxing statute is much greater; and, in order to tax something, it is not necessary to tax everything. These basic postulates have to be borne in mind while determining the constitutional validity of a taxing provision challenged on the ground of discrimination.....

We must, therefore, look beyond the ostensible classification and to the purpose of the law and apply the test of palpable arbitrariness' in the context of the felt needs of the times and societal exigencies informed by experience to determine the reasonableness of the classification. It is clear that the role of the public sector in the sphere of promoting the national economy and the context of the felt needs of the times and societal exigencies informed by experience gained for its functioning till the enactment is of significance. There is no dispute that the impugned provision includes all employees of the public sector and none in the private sector. The question is whether those left out are similarly situated for the purpose of the enactment to render the classification palpably arbitrary. It is only if this test of palpable arbitrariness applied in this manner is satisfied, that the provision can be faulted as discriminatory but not otherwise. Unless such a defect can be found, the further question of construing the provision in such a manner as to include all employees and not merely employees of public sector companies, does not arise.'

12. The court also considered the reasons for making a distinction between Government employees and other employees and observed (at page 121) :

'The factual matrix and historical background appearing from the above material prove that the public sector needs toning up. One of its afflictions is overmanning or surplus staff, the obvious remedy of which is streamlining, by removing the non-productive and unwanted personnel, if possible, without any complication. Retrenchment is often an unsafe course to adopt since it may lead to protracted litigation and uncertain outcome. We cannot overlook this well-known, though unfortunate fact.

A safe mode to relieve the public sector of its unproductive and surplus manpower is to induce those persons to seek voluntary retirement under a scheme providing some incentive or inducement for seeking voluntary retirement. Clause (10B) of section 10 of the Income-tax Act, 1961, does grant tax exemption in respect of any compensation received at the time of retrenchment up to the prescribed limit. That limit, however, does not apply to compensation received under certain schemes same benefit be also extended in respect of any payment received by an employee of the public sector on his voluntary retirement under a scheme similarly approved by the Central Government.

The public sector's role visualised on the advent of freedom, was as an 'instrument of development and national strength', a 'key to our self-reliance', 'catalyst of social change' and for attaining 'commanding heights of the economy' in keeping with our national aim of a welfare State and a socialist economy. Unfortunately, in spite of a strong rationale for setting up and promoting the public sector in the national economy, it has not so far fully justified the legitimate expectation and a large number of public sector undertakings are losing concerns. A study into the causes which ail the public sector has shown that one of its drawbacks is over-staffing. Streamlining the public sector to get rid of its unproductive and unwanted personnel is, therefore, a felt need. A scheme whereby such unwanted personnel can be induced to leave voluntarily granting some incentive for doing so is, therefore, ultimately beneficial to the health and prosperity of the public sector and consequently to the national economy. These factors alone are sufficient to provide an intelligible differential between public and private sectors and a rational nexus with the object of improving the performance of the public sector, promoting national economy.

It is useful to remember that the country having opted for mixed economy, the healthy and vigorous functioning of public sector undertakings is conducive to the benefit of the private sector as well, in addition to promoting the well-being of the national economy. A point of view emerging currently is that just as public sector undertakings are outside the purview of the Monopolies and Restrictive Trade Practices Act by virtue of the exemption conferred on them, the Income-tax Act should confer similar exemption to it from tax liability by suitable amendment in section 10 of the Act as is given to local authorities, housing boards, etc. This view is supported on the ground that the exemption from tax liability of public sector undertakings would ultimately benefit the consumers of the products of the public sector undertakings. This is not an irrelevant circumstance to indicate that, according to the general perception, there is a distinction between the public and private sectors. In some earlier decisions of this court, the public sector has been treated as a distinct class for the purpose of exemption under statutes.....

It is clear that Government or public sector undertakings have been treated as a distinct class separate from those in the private sector and the fact that the profit earned in the former is for public benefit instead of private benefit provides an intelligible differentia from the social point of view which is of prime importance for the national economy. Thus, there exists an intelligible differential between the two categories which has a rational nexus with the main object of promoting the national economic policy or the public policy. This element also appears in the impugned enactment itself wherein 'economic viability of such company' is specified as the most relevant circumstance for grant of approval of the scheme by the Central Government. This intrinsic element in the provision itself supports the view that the main object thereof is to promote and improve the health of the public sector companies even though its effect is a benefit to its employees.'

13. The court pointed out that clause (10C) of section 10 of the Income-tax Act was in accordance with the scheme embedded already in the section when the clause was introduced in 1987. Reference was made to clauses (10A) and (10B). The relevant passage reads thus (at page 124) :

'We shall now refer to some other clauses of section 10 of the Act to which reference was made at the hearing in support of the rival contentions. Sub-clause (i) of clause (10) of section 10 confines the benefit thereunder only to the government servants defence personnel and employees of a local authority. Sub-clause (i) of clause (10A) similarly confines the benefit to Government servants, defence personnel and employees of a local authority or a corporation established by a statute. Clause (10A) also makes a distinction between Government employees and other employees. Clause (10B) also removes the limit in respect of any payment as retrenchment compensation under a scheme approved by the Central Government. Some other clauses in section 10 of the Act further show that the scheme of section 10 contemplates a distinction between the employees based on the category of their employer. Accordingly, clause (10C) therein is not a departure from the existing scheme but in conformity with some clauses earlier enacted therein..... With this perspective, keeping in view the true object of the impugned enactment, there is no doubt that employees of the private sector who are left out of the ambit of the impugned provision do not fall in the same class as employees of the public sector and the benefit of the fall out of the provision being available only to the public sector employees cannot render the classification invalid or arbitrary. This classification cannot, therefore, be faulted.'

14. Thus, all the contentions raised by the petitioner in this case have been considered and refuted by the apex court in the above case. We have no hesitation to hold that the said ruling of the Supreme Court applies on all fours to the present case and that there is no substance in the contention that section 10(10) and 10(10AA) of the Income-tax Act are unconstitutional and void. We hold that the classification found in the sections is valid and based on sound reasoning.

15. The next contention of the petitioner is equally without any substance. According to him, the expression 'salary' found in section 10(10) and section 10(10AA) of the Income-tax Act should have a wider meaning so as to include all the allowances and amounts received by the employee in return for the services rendered by him. He placed reliance on some passages in the book Principles of Statutory Interpretation by G. P. Singh, third edition. We are unable to accept his contention in view of the Explanation found in section 10(10) of the Act. It reads

thus :

'In this clause, and in clause (10AA) 'salary' shall have the meaning assigned to it in clause (h) of rule 2 of Part A of the Fourth Schedule.'

16. Clause (h) of rule 2 of Part A of the Fourth Schedule reads that 'salary' includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites. There is no ambiguity whatever in the definition contained in the above clause, and it is the said definition which should be applied while construing section 10(10) and section 10(10AA) of the Income-tax Act. It is to be noted that there is no general definition of the word 'salary' applicable for all the provisions of the Income-tax Act. Section 17 of the Income-tax Act contains a definition for the purpose of section 15, 16 and 17 of the Act. Explanation 1 to section 36(1)(iia) of the Income-tax Act is to the effect that the expression 'salary' in that clause includes the pay, allowances, bonus or commission payable monthly or otherwise. Hence, the contention of the petitioner that the expression 'salary' found in section 10(10) and section 10(10AA) of the Income-tax Act should be given a wider meaning than found in clause (h) of rule 2 of Part A of the Fourth Schedule is wholly untenable. Thus, the petitioner is not entitled to the grant of any part of the prayer made by him in the writ petition.

17. It is now admitted that the petitioner has filed a return before the Income-tax Officer. It is open to the petitioner to raise before the concerned officials all such contentions which are available to him in law excepting what we have decided herein.

18. The writ petition is dismissed. There will be no order as to costs.