THE

INDIAN LAW REPORTS

(*MADRAS SERIES*)

PRIVY COUNCIL.

THE COMMISSIONER OF INCOME-TAX, MADRAS, APPELLANT,

v.

B. J. FLETCHER, RESPONDENT.

J.C.* 1937, June 14.

[ON APPEAL FROM THE HIGH COURT AT MADRAS]

Indian Income-tax Act (XI of 1922), sec. 4 (3) (v)—Accumulated bonuses paid to officer of a company on retirement, whether taxable.

An "Officers' Retiring Fund" was established by a company and, under the rules made in connection therewith, bonuses were, in the discretion of the directors, allotted to the fund and accumulated. The bonuses were proportioned to the salaries of the officers. No officer had a claim to the fund till he left the service of the company. After satisfactory service for a period of years, his accumulated bonuses were, on his retirement, to be paid to him. In the event of his death during service, his bonuses accumulated up to the date of his death were to be paid to his legal representative. In the event of his leaving the service of the company before the expiry of the fixed period, or of his being dismissed, he forfeited his claim to the bonuses.

Held, that the sum paid to an officer under the stated rules, on his retirement, out of the "Officers' Retiring Fund", was not income liable to tax.

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* *Present*:—LORD MAUGHAM, SIR LANCELOT SANDERSON and SIR GEORGE LOWNDES.

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APPEAL (No. 122 of 1936) from a judgment of the High Court (April 24, 1935) on a reference by the Commissioner of Income-tax under section 66 (2) of the Income-tax Act.

The judgment of the High Court is reported as *Commissioner of Income-tax, Madras* v. *Fletcher*(1).

The material facts are stated in the judgment of the Judicial Committee.

Tucker K.C. and *Wallach* for appellant.—There is no material difference between the provisions of the Indian Act governing this case and the corresponding provisions of the English Act. Section 3 of the Indian Income-tax Act, 1922, compares with section 1 of the English Income-tax Act, 1918, and section 7 of the Indian Act compares with Case II of Schedules D and E of the English Act. Section 7 of the Indian Act, however, contains a statutory definition of "salaries". By this definition there are included not only gratuities but also profits received in addition to salaries or wages.

When the company in this case decided to set aside a sum of money for the "Officers' Retiring Fund" the employee became entitled to his share of that sum subject to the subsequent fulfilment of certain conditions. These conditions having been satisfied, the employee was absolutely entitled, on the termination of his employment, to claim payment of the sum standing to his credit as shown in his pass book. The sum so received by the employee came to him under his contract of employment and fell within the charging words of the Act. It was not a windfall, nor was it received in commutation of a pension within the meaning of section 4 (3) (v) of the Act.

[The following cases were cited: *Henry* (*H.M. Inspector of Taxes*) v. *Arthur Foster*(2), *Edwards* (*H.M. Inspector of Taxes*) v. *Roberts*(3), *Commissioner of Income-tax, Bengal* v. *Shaw, Wallace and Company*(4) and *In re The Commissioner of Income-tax, Burma* v. *The Rangoon Electric Tramway & Supply Co., Ltd.*(5).]

(1) (1935) I.L.R. 59 Mad. 216.
(2) (1932) 16 T.C. 605.
(3) (1935) 19 T.C. 618.
(4) (1932) L.R. 59 I.A. 206; I.L.R. 59 Cal. 1343.
(5) (1933) I.L.R. 11 Ran. 70, 71.

Needham K.C. for respondent.—*Henry* (*H.M. Inspector of Taxes*) v. *Arthur Foster*(1) indicates that what must be looked at in the first place is the bond of service. The real clue to the case here is to be found in the judgment of CORNISH J. in which the right view, it is submitted, was taken.

Secondly, the company is, in respect of the fund, a trustee. That is an element which should be taken into consideration as it shows the nature of the payment. In a sense it is a reward for services. The real question is whether the payment is income or capital. It is paid after completion of service. If the officer retires before six years, he is not entitled to payment out of the fund. The amount is accumulated year by year. The yearly credit is not taxable. The tax is for a particular year. The accumulated sum cannot be the income of the last year to be taxed as the income of that year.

Under rule 3 of the company's rules the period of service is six consecutive years before there can be a claim. Under section 7 (1) of the Act, the charge is limited to actual receipts. The question is how far the expression "salary" is extended by other words in the section. There is a difference between the English and the Indian Acts in the charging sections. In the English Act the expression is "profits whatsoever". There are no corresponding words in the Indian Act. The Indian Act is narrower. Section 4 (3) (v) deals with exemptions. There is no pension here which is commuted.

[The definition of "commute" in the Oxford Dictionary was cited.]

Talbot following—referred to the difference between the English and Indian Acts. The exemptions throw light on the meaning of section 7. In every case in which a payment is made at the end of the service the question is whether the payment is a part of the salary or a gratuity. There is a distinction between an agreement to serve for a definite term on a salary to be paid periodically with an additional lump sum to be paid at the end of the term and an agreement for payment of a sum on retirement at the age of fifty-five years. The payment here is of a sum on retirement. Section 4 (3) (v) includes a capital sum. The section is put in to remove doubts, e.g., as to pension commutation, pension being taxable.

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

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Tucker K.C. in reply.—Under *Henry* (*H.M. Inspector of Taxes*) v. *Arthur Foster*(1) there must be a contractual right as distinguished from a mere gratuity. Here there is a contractual right, even though the sum was to be paid at the end of the service. If there is an enforceable obligation to pay, the sum paid is taxable.

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The JUDGMENT of the Judicial Committee was delivered by Sir GEORGE LOWNDES.—The question for determination in this appeal lies in a small compass but it involves a question of considerable nicety under the provisions of the Indian Income-tax law. It is in effect, whether a sum of money payable to the respondent on his retirement after long service with an Indian company is taxable as part of his income of the year in which his retirement took place. The learned Judges in the Madras High Court by whom the case was heard have—not unreasonably, as their Lordships think—differed in their conclusions and in the reasoning upon which those conclusions were arrived at.

The facts may be stated shortly. The respondent was an employee of the Buckingham and Carnatic Company Ltd., and was paid a monthly salary with a half-yearly bonus, both of which were taxed in the ordinary course, and his liability in this respect was not challenged. He retired in February 1933, and was then entitled to receive from the company a sum of Rs. 36,794 which stood to his credit at that date in a fund called the "Officers' Retiring Fund". It is with this sum that the present appeal is concerned.

The fund was constituted and managed by the company under the following rules :—

"1. All bonuses which the Company may from time to time allot to credit of this fund shall be invested and

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

accumulated at the discretion of the Directors. All interest accruing on the fund shall be dealt with in the manner provided in the next rule and as if such interest was a bonus allotted by the Company.

2. Every bonus shall in the first instance be apportioned as between the officers of the Company for the time being in proportion to the salaries drawn by them respectively at the date of the allotment of such bonus by the Company and shall be credited in such proportions to such officers in account with the fund. Provided always that no officer shall have any claim against the Company in respect of any bonus or otherwise as regarding this fund until he leaves the service of the Company and shall have previously served the Company continuously and satisfactorily for the period required of him under these rules.

3. The period of such service shall as regards all officers who shall have come out from England to join the service of the Company be six consecutive years and shall in the case of officers who have been engaged by the Company in India or any place east of Suez be ten consecutive years. Provided always that the Directors may in their discretion vary such latter period of ten years to one of six years.

4. On any officer who shall have served the Company for the full consecutive period required of him by these rules leaving the service of the Company, the Company will pay to him the aggregate amount of his share in the various bonuses that may have been credited to the fund by the Company during the period of his service with the Company.

5. In the event of the death of any officer during, or after having completed, the said term of service, the shares standing to the credit of the deceased shall be paid to his legal representative.

6. In the event of any officer leaving the service of the Company or being dismissed before having completed the term of service hereby required, the sums standing to his credit shall be apportioned to the credit of the other officers then in the employ of the Company in the same way as if such sums were a bonus allotted by the Company.

7. Nothing herein contained shall in any way be taken as restricting the powers of the Company from at any time dispensing with the services of, or dismissing any officer, and

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any officer whose services shall be dispensed with or who shall be dismissed before the full period of service required of him under these rules, shall have no claim whatsoever against the fund.

8. The Directors of the Company for the time being shall have full discretion as to which of the officers or employees of the Company shall from time to time be eligible for the benefit of this fund, and as to any alteration or addition to these rules, and the decision of the Directors on such points, and as to the meaning of these rules, and on all other matters in any way connected with the fund or the administration of the same shall be final and conclusive."

The rules were apparently communicated to the employees, and those who were placed upon the fund were given "pass books" in which were entered the amounts credited to them from time to time under the rules. Their Lordships think that the effect of this procedure was to create a trust in their favour which each of them could enforce upon fulfilment of the conditions by which his interests were bound, and it is not disputed that the respondent was so entitled. But their Lordships do not think the equitable nature of the respondent's claim affects in any way the question now in issue.

On the respondent's retirement, the company, acting under section 18 (2) of the Income-tax Act, (XI of 1922), deducted from the Rs. 36,794, which the assessor claimed to be part of his salary, the appropriate tax, and presumably passed it on to the Government. The respondent claimed a refund but this was refused, and after the usual departmental references the matter came up to the High Court under section 66 (1) of the Act.

The question referred for the Court's determination was whether the sum of Rs. 36,794 paid to the respondent in 1932–33 was income liable

to tax or was a capital sum exempted under section 4 (3) (v) of the Act or otherwise. The reference also covered another question which is not material to the present appeal and has not been discussed before the Board.

Section 4 (3) (v) is in the following terms :—

"Any capital sum received in commutation of the whole or a portion of a pension, or in the nature of consolidated compensation for death or injuries, or in payment of any insurance policy, or as the accumulated balance at the credit of a subscriber to any such Provident Fund."

The reference was heard by the CHIEF JUSTICE sitting with CORNISH and PANDRANG ROW JJ. Separate judgments were delivered by each of them.

The learned CHIEF JUSTICE held that the respondent was rightly assessed upon the sum in question. He was of opinion that the case could not be brought within the exemptions referred to by the Commissioner ; that the allotments made to the respondent from time to time, which resulted in the total sum of Rs. 36,794, were made for current services, and so were a part of his regular remuneration ; that the sum in question was not a gift or an act of grace on the part of the company or in the nature of a windfall, but that it was in reality payment of deferred salary and therefore taxable in the year in which it was paid.

CORNISH J. took the opposite view. He thought that the nature of the fund from which the payment was made showed that it was not part of the respondent's "salary" but that it was a lump sum paid on retirement, in its nature indistinguishable from a similar sum paid under

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a provident fund which, apart from its specific exemption under the Act, could not, in accordance with the judgment in *Shaw, Wallace's* case(1), be regarded as income.

PANDRANG ROW J. came to the same conclusion as CORNISH J., but on somewhat different reasoning. He thought that the payment was made by the company not as employer but as trustee and that this was in itself sufficient, apparently, to take it out of the category of salary—a view with which their Lordships are unable to concur. He also held that it was a lump sum payment *in lieu* of a pension, and therefore equivalent to a pension commutation which is specifically exempted under section 4 (3) (v).

The question referred by the Commissioner was, in accordance with the opinion of the majority of the Court, answered in favour of the respondent. The present appellant, the Commissioner of Income-tax, was, by Order in Council dated 30th April 1936, granted special leave to appeal upon the condition that he paid in any event the costs of the respondent as between solicitor and client.

Before their Lordships it has been contended that the sum in question is taxable under the head "salaries" which by section 7 (1) of the Act includes any profits received by an assessee in addition to his salary, and the judgment of the CHIEF JUSTICE is supported on this ground. Their Lordships have also been invited to consider the corresponding provisions of the law in this country and the cases decided thereunder, special reliance being placed on the judgments of the

(1) (1932) L.R. 59 I.A. 206, 214 : I.L.R. 59 Cal. 1343.

Court of Appeal in *Foster's* case(1). Their Lordships are, however, unwilling to embark on a critical comparison of the two Acts which admittedly differ widely in their scope and details : this has been laid down in a previous judgment of the Board in *Shaw, Wallace's* case(2) and their Lordships see no reason to adopt a different course in the present case.

Assuming that the sum in question was a "profit" arising from the respondent's employment, the question still remains whether it was received by him as income or was in the nature of a capital receipt. If it represented merely the payment of accumulated portions of a salary held up by the employers until the employee's retirement it would, their Lordships think, be received by him as deferred income and therefore be taxable, and it is on this question that the decision of the case must turn. Their Lordships have no doubt that the answer must depend mainly on the constitution of the fund. The first point that emerges from an examination of the rules set out above is that the sums to be allotted were entirely in the discretion of the company. They were not bound to make any allotment in any year, and it was only if an allotment was in fact made that the officer concerned could have any claim. This of itself tends to negative the idea that the allotments were part of the officer's current salary. Nor is it suggested that it was part of the respondent's original contract of service that he should have the benefit of this fund ; and unless the company chose to put him on the list he would

(1) (1932) 16 T.C. 605, 625.
(2) (1932) L.R. 59 I.A. 206, 212; I.L.R. 59 Cal. 1343.

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have no interest whatever in it. Even when so listed he would have no rights until he had served continuously and satisfactorily for a period of six years. And in no case could he make any claim upon the sums allotted to him until he retired. If he died before retirement the payment of his share would be made to his legal representative, and the appellant's Counsel concedes that in that event no tax would be payable. The consideration of these factors leads their Lordships to the conclusion that the allotments made to the fund in the name of an officer of the company were not in the nature of salary for current services, but were merely the measure of a sum which the company volunteered to pay to him on the termination of his service, and that this sum when paid was not "*income*" and therefore not taxable.

The company did not pension its officers, but in lieu of doing so, and no doubt with the object of keeping deserving employees in its service, it promised such persons a lump sum on retirement to be computed on terms formulated by the rules of the fund.

This was not, their Lordships think, within the specific exemptions of section 4 (3) (v), and they are unable to accept the dictum of PANDRANG ROW J. that a lump sum in lieu of a pension, where no pension is payable, is the same thing as the commutation of a pension already earned, and therefore within the words of the exemption. But they agree with CORNISH J. in thinking that such a payment is just as much a capital receipt in the hands of an employee as would be the payment of a lump sum from a provident fund

on the employee's retirement. The latter would, apart from the specific exemption in the clause under consideration, be, by its nature, capital and not income [see *Shaw, Wallace's* case (1) at page 214], and it follows that the sum now in question must be treated in the same way.

For the reasons given above their Lordships will humbly advise His Majesty that the first of the two questions submitted to the High Court should be answered as follows :—"The sum of Rs. 36,794 payable to the respondent out of the 'Officers' Retiring Fund' in 1933 was not income liable to tax"; and that the appeal should be dismissed.

The order for costs will follow the terms of the Order in Council of 30th April 1936.

Solicitor for appellant: *The Solicitor, India Office.*

Solicitors for respondent: *Percy Short & Cuthbert.*

C.S.S.

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(1) (1932) L.R. 59 I.A. 206; I.L.R. 59 Cal. 1343.