* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

{ITA No.1431 of 2008}

% Judgment reserve on: 25.08.2010
Judgment delivered on: 14.9.2010

COMMISSIONER OF INCOME TAX . . . APPELLANT

Through: Ms. Prem Lata Bansal, Advocate

VERSUS

DEEPAK VERMA . . .RESPONDENT

Through: Mr. Deepak Vohra,Advocate with Ms. Kavita Jha and Ms. Akansha Aggarwal, Advocate.

CORAM:-

THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. This appeal was admitted on the following question of law:-

> "Whether amount of Rs. 35 lakhs received by the assessee was chargeable to tax under Section 17 (3) of the Income-Tax Act, as 'profits in lieu of salary'?

2. On the same day, with the consent of the learned counsel for the parties, arguments were also finally heard. The genesis, in formulation of the aforesaid question, lies in the following facts:

3. The respondent is an individual who filed his income tax return

computation of income, the Assessing Officer noticed that t assessee had received an amount of Rs. 35 lacs, in addition to normal retiral benefits at the time of his retirement, from H.T. CGU Project Services Pvt. Ltd (employer). This amount of Rs. 35 lacs was claimed as exempted from income-tax by the assessee though the employer had deducted the tax at source and Form No. 16 had been issued to this effect. This return was processed and accepted on 17th July, 2002.

4. The Assessing Officer, however, issued notice dated 30th September, 2002 under Section 148 of the Act proposing the reassessment of income, as according to him there were reasons to believe that income to the extent of Rs. 35 lacs had escaped assessment. The assessee vide letter dated 1st October, 2002 stated that return already filed by him be treated as return under Section 148 of the Income Tax Act (hereinafter referred to as 'the Act') as well. Thereafter, notice under Section 143 (2) was issued to the assessee on 28.10.2002.

5. The reassessment proceedings accordingly were carried out. The plea made by the assessee was that this amount was not exigible to tax as it was outside the scope and ambit of Section 17 (3) of the Act. The explanation of the assessee was that when he was allowed by his employer "exceptional and one off *ex-gratia* payment of Rs.35 lacs" alongwith other retirement benefits, this payment was given as he had resigned from this company during the relevant year to start his own consultancy business. The amount thus given was *ex-gratia* which was voluntary and gratuitous.

tax' under Section 17 (3 (i) of the Act. He noted that this amou was given to the assessee after discussion between him and his employer as revealed from the letter dated 25th January, 2001 of the employer in this behalf. Therefore, opined the Assessing Officer, the payment was made as "compensation" for his services and, thus, liable to tax under Section 17 (3) (i) of the Act. This opinion of the Assessing Officer was confirmed by the CIT (Appeal). The Income Tax Appellate Tribunal, however, repelled this view and deleted the addition holding that it was not chargeable to tax under Section17 (3)(i) of the Act as 'profits in lieu of service'. The Tribunal has observed that the assessee had at no time acquired any vested right to receive this payment which was made voluntarily and at the discretion of the employer. The resignation of the assessee was not contingent upon receiving this *ex-gratia* payment and, therefore, it was not received in connection with the termination of his employment. For these reasons, the provisions of Section 17 (3) (i) of the Act were not applicable to this case. The Tribunal also observed that the provisions of Section 17 (3) of the Act as they stood at the relevant time, were not adequate to cover the present case. It has pointed out that Clause (iii) was inserted in the said Section by the Finance Act, 2002 w.e.f. 1st April, 2002 to bring within tax net such payment as well. Since the amendment is not retrospective and there was no such contingency provided in the Income Tax Act in the year in question, the amount of Rs. 35 lacs received by the assessee could not be added to the income of the assessee.

7. It is the common case of the parties that Section 17 (3) (iii) of

Section 17 (3) (i) of the Act. However, other connected provisio are Section 15 and Section 17 (1) of the Act. It was in this backdrop that question was framed as to whether the amount was chargeable to tax under Section 17 (3) of the Act as "profits in lieu of salary" or not.

8. Chapter-IV deals with computation of total income from salaries. It starts with Section 14 which enumerates various heads of income. The first among them is 'salaries'. Section A of Chapter-IV, which consists of Section 15 to 17, deals with computation of income under the head 'Salaries'. Section 15 of the Act enumerates various kinds of receipts by employees which are treated as income chargeable to income tax under this head. It includes not only the 'salary' simplicitor but also the perquisites etc. as well. Section 16 of the Act permits certain deductions from the income chargeable under this head. Section 17 of the Act defines three important terms namely 'salary', 'perquisites' and 'profits in lieu of salary'. Sub Section (1) of Section 17 of the Act defines certain payments which are included in the term 'salary'. These are wages, pension, gratuity, any fees, commission as well as perquisites or profits in lieu of or in addition to any salary or wages. Sub section (2) specifies various components of the 'perquisite'. Here we are concerned with sub Section (3) which gives the meaning to the expression 'profits in lieu of salary'. If the payment received falls under this expression, it has to be treated as salary and would be chargeable to tax under Section 15 of the Act. Sub Section (3) reads as under:-

> **"**(3) "profits in lieu of salary" includes-
>
> (i) The amount of any compensation due to or

termination of his employment or the modification of the terms and conditions relating thereto;

(ii) Any payment (other than any payment referred to in clause (10) (clause (10A) clause (10B), clause (11) clause (12), clause (13) or clause (13A) of Section 10), due to or received by an assessee from an employer or a former employer or from a provident or other fund, to the extent to which it does not consist of contributions by the assessee or {interest on such contributions or any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

Explanation- For the purposes of this sub-clause, the expression "keyman insurance policy" shall have the meaning assigned to it in clause (10D) of Section 10;]

(iii) Any amount due to or received, whether in lump sum or otherwise, by any assessee from any person-

(A) Before his joining any employment with that person; or

(B) after cessation of his employment with that person.]

9. It is the common case of the parties that Clause (ii) does not apply. Further, though Clause (iii) would squarely cover the nature of payment received by the assessee, that did not exist in the relevant assessment year and was incorporated only w.e.f. 1st April, 2002.Therefore, this provision is not applicable either. For this reason, attempt of the Revenue is to bring the payment within the fold of clause (i) of the Act.

10. As pointed out above, the Assessing Officer held the view that the aforesaid amount of 'compensation' had been received by the assessee from his employer in connection with the termination of his employment and, therefore, it falls within the ambit of Clause (i) and is exigible to tax. The case of the assessee on the other hand is,

employment but was voluntarily given by the erstwhile employer him.

11. Before discussing the nature of the payment received by the assessee, we deem it proper to point out the distinction between Clause (i) and Clause (iii) of sub Section (3) of Section 17 of the Act. Sub Clause (B) of clause (iii) enumerates that when any 'amount' is due or received after cession of the employment it is treated as 'profits in lieu of salary'. The expression used here is "amount'. Therefore, when an amount is received by an employer whether due or not, on the cession of the employment from the employer, this partakes the character of 'salary' and is chargeable to tax. In contra distinction sub clause (i) uses the expression "compensation" (rather than "amount"). Therefore, under clause (i), in order to characterize a particular payment received from the employer, on termination of the employment, as 'profits in lieu of salary', it has necessarily to be shown that this amount is due or received as 'compensation'.

12. The word 'compensation' is not defined under the Income Tax Act. Therefore, one has to take into consideration the ordinary connotation of this expression in common parlance. The Oxford Dictionary of English language gives the following meaning to the word 'compensation':-

> (i) Something awarded to compensate for loss, suffering, or injury.
>
> (ii) Something that compensates for an undesirable state of affairs.
>
> (iii) The action or process of compensation."

> "Indemnification; payment of damages; making amends; making whole; giving an equivalent or substitute of equivalent value. That which is necessary to restore an injured party to his former position. Remuneration for services rendered, whether in salary, fees, or commissions. Consideration or price of a privilege purchased.
>
> Equivalent in money for a loss sustained; equivalent given for property taken or for an injury done to another; giving back an equivalent in either money which is but the measure of the value, or in actual value otherwise conferred; recompense in value; recompense for some loss, injury, or service, especially when it is given by statue; remuneration for injury directly and proximately caused by a breach of contract or duty; remuneration or satisfaction for injury or damage of every description (including medical expenses). An act which court or other tribunal orders to be paid, by a person whose acts or omissions have caused loss or injury to another, in order that thereby the person damnified may receive equal value for his loss, or be made whole in respect of his injury"

14. It is clear from the above that when the payment is to be received as 'compensation', the employee would have right to received such a payment. If the employee has no right, it cannot be treated as 'compensation'. It is for this reason that if the payment is made as *ex-gratia* or voluntary by an employer out of his own sweet will and not conditioned by any legal duty or legal obligation, whether on sympathetic reasons or otherwise, such payment is not to be treated as 'profits in lieu of salary' under clause (i). We have the judgment of this court in the case *of* ***Lachman Das.*** *Vs****. CIT*** (124) ITR 706 taking this view. In that case voluntary payments made by

In that case, the assessee employees received compensation frc their employer for loss of movable assets in Pakistan at the time of partition. Likewise, the Calcutta High Court in the case of ***Commissioner of Income Tax*** *Vs****. Jamini Mohan Kar,*** *176 ITR 127* and also ***Commission of Income Tax*** Vs. ***Ajit Kumar Bose,*** *1265 ITR 90* held that the ex-gratia payment made at the time of retirement of the employee was not taxable as 'profits in lieu of salary' as the payment was totally voluntary and not sanctioned by the terms of employment. The employee could claim no vested right in the same, since the amount was paid at the discretion of the employer.

15. Having regard to this legal position, we have to decide as to whether payment of Rs.35 lacs received by the assessee on cessation of his employment was a voluntary payment given by the employer or it was in the nature of 'compensation'.

16. The controversy revolves round the meaning which is to be given to the words contained in the letter dated 25th January, 2001 issued by the employer of the assessee. Based on the language of that letter, the Assessing Officer has framed the opinion that the amount of Rs. 35 lacs offered was in the nature of compensation. On the other hand, that very letter has been interpreted by the ITAT to hold that it conveys *ex-gratia* payment. We reproduce the exact words of the said letter:-

> "Further to your resignation, I am writing to confirm the exceptional final payments to be made to you and which we have verbally agreed.
>
> The management in its discretion has decided that you will receive an exceptional and one off ex-gratia

17. The Assessing Officer has laid thrust on the words "which we have verbally agreed" and from this, he inferred that since there were mutual discussions between the employer and the assessee on the question of what final payment was to be made, it could not be treated as ex-gratia payment. More so, when even TDS was deducted by the employer on this amount. The CIT (A) accepting this view of the Assessing Officer gave additional reason, viz., though the assessee had no vested right in the said amount earlier, but because of the discussion between the employer and the assessee, the right to receive came into existence when a written understanding was reached. The Tribunal, however, negatived this reasoning of the authorities below observing that the words "which we have verbally agreed" only imply that employer volunteered to pay the "exceptional" amount by way of "ex-gratia" at its "discretion" and the assessee accepted the gratuitous sum offered by the employer. The discussion of the Tribunal on this aspect goes as under:-

> "The impugned payment (s) were made by HTCGU suo-moto, in its own discretion, voluntarily, without any right vested in the assessee under the contract of employment. The payment was not made to compensate the assessee for the services rendered as an employee, the assessee would have had no remedy against HTCGU had it decided not to make payment of the above amount. The words –"which we have verbally agreed..." only implies that the employer volunteered to pay the exception amount by way of ex-gratia and the assessee accepted the gratuitous offer from the employer, merely because the payment was decided to be made by the employer on 25.1.2001, immediately before the cession of services of the assessee w.e.f. 1.2.2001, also does not lead to the conclusion that payment was to compensate the assessee for services rendered. It is nobody's case that the salary received by the assessee was not fair

> though such resignation was effective from a later date, which is even evident from the extracts of letter which grants the payment – "further to your resignation..." The aforesaid would show that the ex-gratia payment was not a condition precedent to the employee resigning from services or agreed prior thereto Merely because payment was to be received on resignation would not change the character of the payment being voluntary in nature granted by HTCGU suo-moto in its own discretion without any vested right of the assessee to claim the same under the employment contract The courts in the following cases have held that voluntary payments made by the employer to the employee without any right vested in the employee enforceable at law, is in the nature of Capital receipt not exigible to tax as 'salary'".

18. We are inclined to agree with the aforesaid approach of the Tribunal. The connotation to the word "compensation" which needs to be given has already been highlighted above. It has to be in the nature of something awarded to compensate for loss, suffering or injury. When translated in the context of employment, it would imply monetary and non-monetary amount to be given to the employee in return of some services rendered by him. Inherent in this would be the obligation of the employer to pay some amount to the employee to "compensate" him. This would also mean that the employee gets vested right to get such an amount.

19. In the present case, all dues which were admissible to the assessee on his resignation are, otherwise, paid by the employer to him. Therefore, whatever terminal dues including earned salary etc. which were payable to the assessee in terms of contract or otherwise were paid to him. In addition, the employer agreed to pay "in its discretion" Rs. 35 lacs as an "exceptionable" and "one off ex-gratia

by any obligation to pay this amount which would assume the natu of any 'compensation'. The amount is also described as not only exceptionable but ex-gratia. It, therefore, clearly partakes the character of voluntary payment and cannot be termed as payment by way of 'compensation'.

20. In fact, the legislature wanted such type of payments also to be treated as income at the hands of the employees/persons and to tax them. For this reason, clause (iii) was inserted in Section 17 (3). This also implies that such a payment was not taxable before this amendment was carried out by inserting this clause w.e.f 1.4.2002.

21. In so far as the assessee is concerned, the receipt of this payment by him would not be covered under clause (i) of sub section (3) of Section 17 of the Act.

22. We, thus, answer the question in the negative holding that the amount received was not "profits in lieu of salary", therefore, not an income exigible to tax. Consequently, appeal of the revenue is dismissed.

(A.K. SIKRI)
JUDGE

(REVA KHETRAPAL)
JUDGE

SEPTEMBER 14,2010
skb