

Compensation received by prospective employee on termination of employment contract isn't taxable

Summary – The High Court of Delhi in a recent case of Pritam Das Narang, (the Assessee) held that an amount received by a prospective employee 'as compensation for denial of employment' was not in nature of profits in lieu of salary. It was a capital receipt that could not be taxed as income under any other head

Facts

- In terms of employment agreement, the assessee was to be employed as CEO of M/s ACEE Enterprises ('ACEE'). The ACEE was unable to take assessee on board due to sudden change in its business plan. The ACEE paid compensation of 1.95 crores to assessee as a "one-time payment for non-commencement of employment as proposed".
- The assessee had not offered such compensation to tax. The AO rejected the claim of assessee on the ground that under Section 17(3)(iii) receipt by the assessee of any sum from any person prior to his joining with such person was taxable.
- As per Section 17(3)(iii) "*profits in lieu of salary*" include any amount due to or received, whether in lump sum or otherwise, by any assessee from any person before his joining any employment with that person or after cessation of his employment with that person.
- However, the CIT(A) held that Section 17(3)(iii) had been brought in to account for taxing 'joining bonus' received from the prospective employer as profit in lieu of salary. The ITAT upheld the findings of CIT(A).
- The Id. Counsel of department urged that since the wording of Section 17(3)(iii) was that "any amount received from any person", it was not necessary that the amount had to be received only from an employer in order that such sum be brought to tax in the hands of an assessee under the had 'profits in lieu of salary'. It was submitted that the expression any person could include a prospective employer in the present case.

The High Court held as under:

- The interpretation sought to be placed by revenue on plain language of Section 17(3)(iii) could not be accepted. The words "from any person" occurring therein have to be read together with the following words in sub-clause (A): "before his joining any employment with that person". In other words, Section 17(3)(iii) pre-supposes the existence of the relationship of employee and employer between the assessee and the person who makes the payment of "any amount" in terms of Section 17(3)(iii).
- Therefore the words in Section 17(3)(iii) cannot be read disjunctively to overlook the essential facet of the provision, viz, the existence of 'employment', i.e., a relationship of employer and employee between the person who makes the payment of the amount and the assessee.

- The other plea of revenue that said amount should be taxed under some other head of income, including 'income from other sources', was also unsustainable. In case of CIT v. Rani Shankar Mishra [2009] 178 Taxman 324 (Delhi) it was held that where an amount was received by a prospective employee 'as compensation for denial of employment', such amount was not in nature of profits in lieu of salary. Thus, it was a capital receipt that could not be taxed as income under any other head.