

Sum paid by employer voluntarily to settle dispute on premature cessation of employment is tax free

Summary – The High Court of Gujarat in a recent case of Arunbhai R. Naik, (the Assessee) held that where ex gratia compensation paid to assessee on his discharge from services was voluntary in nature, it would not amount to compensation in terms of section 17(3)(i)

Facts

- The assessee was an employee of company 'G'. He was discharged from service under relevant rule of Service Rules after giving three month's pay. Further, as per settlement agreement between the parties, the assessee received certain amount as *ex-gratia* compensation on premature cessation of his services.
- The Assessing Officer took a view that compensation so received was to be taxed under section 17(3) as 'profits in lieu of salary'.
- The Tribunal confirmed the order passed by Assessing Officer.
- On appeal:

Held

- The assessee's services came to be terminated under rule 44 of the relevant service rules after giving three months' pay. Therefore, insofar as the obligation of the employer to pay any amount to the assessee in relation to the termination of his services, the same came to an end in view of the discharge of his services under rule 44. While the assessee succeeded in the writ petition filed by him, the letters patent appeal preferred by the employer came to be allowed. Therefore, the discharge of the assessee's services by the employer attained finality. However, during the pendency of the letters patent appeal, the assessee and the employer arrived at a settlement, in terms whereof, the amount was to be computed in the manner stated therein and was to be paid to the assessee.
- Therefore, the services of the assessee came to be terminated in terms of the rules, and the amount in question was paid only in terms of the settlement, without there being any obligation on the part of the employer to pay any further amount to the assessee in terms of the services rules. The employer, voluntarily at its discretion, agreed to pay the amount in question to the assessee with a view to bring an end to the litigation. There was no obligation cast upon the employer to make such payment and, therefore, the same would not take the colour of compensation as envisaged under section 17(3)(i). The amount in question would, therefore, not fall within the ambit of the expression 'profits in lieu of salary' as contemplated under section 17(3)(i).
- It has been contended by the revenue that the manner of computation of the amount to be paid to the assessee under the settlement reveals that the same is in the nature of terminal benefits on

account of bringing an end to the services of the assessee. The manner of computation of the amount payable to the assessee in terms of the settlement, would not change the character of the payment, inasmuch as, the same being voluntary in nature and without any obligation on the part of the employer, would not amount to compensation in terms of section 17(3)(i). The Tribunal was, therefore, not justified in holding that the amount of Rs. 3,51,308 received by the assessee was income liable to tax under section 17(3).

- The appeal is accordingly allowed. The impugned order passed by the Tribunal is hereby quashed and set aside and the order passed by the Commissioner (Appeals) deleting the addition made by the Assessing Officer is, hereby restored.