

[IN THE PRIVY COUNCIL]

1952 Present : Lord Normand, Lord Tucker, Lord Asquith of
Bishopstone and Lord Cohen

COMMISSIONER OF INCOME TAX, Appellant, and
MRS. A. J. SUTHERLAND (Executrix of the Estate
of R. W. Sutherland, deceased), Respondent

PRIVY COUNCIL APPEAL NO. 41 OF 1951

S. C. 235—Case stated under Section 74 of the Income Tax Ordinance

Income tax—Contract of employment—Construction—Matter of law and not of evidence—“Leave pay”—“Allowance granted in respect of employment”—Statements in employer’s return concerning employee—Admissibility against employee—Income Tax Ordinance (Cap. 188), ss. 6 (1) (b), 6 (2) (a) (i) and (v), 55 (2), 73 (4) and (7).

The respondent’s husband entered the employment of a Company as its managing director in November or December, 1939, and continued in that employment till his death on June 12, 1946. He had not taken any leave during that period. After his death the Company paid his widow, the respondent, a sum of Rs. 15,750 which had been placed to reserve to meet the contingent liability to pay for the managing director’s leave pay which he would have been entitled to if he had survived. This sum of Rs. 15,750 was declared by the Deputy Commissioner of Income Tax as assessable to income tax in the respondent’s hands as executrix of her late husband. The assessment was made on the footing that the sum was a profit of the deceased’s employment under the head “leave pay” in section 6 (2) (a) (i) or under the head “allowance granted in respect of employment” in section 6 (2) (a) (v) of the Income Tax Ordinance. The respondent’s contention was that the sum was paid by the employer of the deceased as gratuitous payment to her personally, and not to her *qua* executrix as a profit of employment due to her husband or his estate.

The contract of employment between the deceased and the Company was oral, but there was evidence showing that it was “a normal 4-year contract with six months’ leave on full pay”.

Held, that the question whether the payment of the sum of Rs. 15,750 was made *ex gratia* or in discharge of a contractual obligation depended solely on the terms of the contract of employment. On a proper construction of the contract the payment was not contractual and was not due to the deceased’s estate on his death.

In determining the terms of the contract the opinions of the employer Company about the intendment of the contract were irrelevant. Though such opinions could be received in evidence under section 73 (7) of the Income Tax Ordinance they were not in law admissible as aids to the construction of the contract. The language of section 73 (7) was very wide but it did not go so far as to authorise the Board of Review to ignore the rule that construction was a matter of law and not of evidence.

Obiter : A statement made in an income tax return is evidence against those who make the return, but statements made by an employer under section 55 (2) of the Income Tax Ordinance in returning the income of an employee are not evidence against the employee.

APPEAL from a judgment of the Supreme Court reported in (1951) 52 N. L. R. 553.

J. Millard Tucker, Q.C., with *Sir Reginald Hills*, for the appellant.

Roy Borneman, Q.C., with *C. A. Beattie*, for the respondent.

Cur. adv. vult.

June 10, 1952. *Delivered by LORD NORMAND.*—

This is an appeal from a judgment of the Supreme Court of Ceylon on a case stated by the Board of Review for income tax under section 74 of the Income Tax Ordinance, Ceylon (Chapter 188). The case was stated on the application of the respondent in order to bring under review a decision of the Board, affirming a decision of the Deputy Commissioner of Income Tax, that a sum of Rs. 15,750 is assessable to income tax in the respondent's hands as executrix of her late husband. The assessment was made on the footing that this sum was a profit of the deceased's employment under the head "leave pay" in section 6 (2) (a) (i) or under the head "allowance granted in respect of employment" in section 6 (2) (a) (v) of the Income Tax Ordinance (Chapter 188) as amended by section 3 of the Income Tax Amendment Ordinance, No. 25 of 1939. The respondent's contention has been at all stages of the proceedings that the sum was paid as a gratuitous payment to her personally, and not to her *qua* executrix as a profit of employment due to her husband or his estate. She has also put forward alternative contentions which will fall to be considered only if her first contention fails.

Counsel for the appellant in opening the case represented that it involved general questions of importance in the administration of the income tax law, but as the argument developed it became apparent that the question of the nature of the payment and its assessability to income tax depended on the special facts of the case.

The relevant provisions of the Income Tax Ordinance (Chapter 188) as amended by subsequent Ordinances to the date of the deceased's death are the following:—

Section 5 (1). Income tax shall, subject to the provisions of this Ordinance, be charged in respect of the profits and income of every person—

(a) wherever arising, in the case of a person resident in Ceylon, and

(b) arising in or derived from Ceylon, in the case of every other person.

Section 6 (1). For the purposes of this Ordinance, "profits and income" or "profits" or "income" means—

(b) the profits from any employment;

Section 6 (2) (as amended by section 3 of the Income Tax Amendment Ordinance, No. 25 of 1939). For the purposes of this section—

(a) "Profits from any employment" includes—

- (i) any wages, salary, leave pay, fee, pension, commission, bonus, gratuity, or perquisite, whether derived from the employer or others, except the value of any holiday warrant, passage, or other form of free conveyance granted by an employer to an employee, or any allowance for the purchase of any such conveyance in so far as it is expended for such purpose;
- (v) any other allowance granted in respect of employment whether in money or otherwise.

Section 7 (i). There shall be exempt from the tax—

- (k) any capital sum received by way of retiring gratuity (other than a sum received in commutation of pension) or death gratuity, or as consolidated compensation for death or injuries.

Section 11 (1). Save as provided in this section, the statutory income of every person for each year of assessment from each source of his profits and income in respect of which tax is charged by this Ordinance shall be the full amount of the profits or income which was derived by him or arose or accrued to his benefit from such source during the year preceding the year of assessment, notwithstanding that he may have ceased to possess such source or that such source may have ceased to produce income.

(9) Where any person dies on a day within a year of assessment, his statutory income for such year shall be the amount of profits and income of the period beginning on the first day of April in that year and ending on that day.

Section 27. The executor of a deceased person shall be chargeable with the tax for all periods prior to the date of such person's death with which the said person would be chargeable if he were alive, and shall be liable to do all such acts, matters and things as the deceased person if he were alive would be liable to do under this Ordinance.

Section 55 (2). Every person who is an employer shall, when required to do so by notice in writing given by an Assessor, furnish within the time limited by such notice a return containing the names and places of residence and the full amount of the remuneration, whether in cash or otherwise for the period specified in the notice, of—

(a) all persons employed by him in receipt of remuneration in excess of a minimum figure to be fixed by the Assessor; and

(b) any other person employed by him named by the Assessor.

(3) Any director of a company, or person engaged in the management of a company, shall be deemed to be a person employed by the company.

Section 69 (1). Any person aggrieved by the amount of an assessment made under this Ordinance may within twenty-one days from the date of the notice of such assessment appeal to the Commissioner by notice of objection in writing to review and revise such assessment. Any person so appealing (hereinafter referred to as "the appellant") shall state precisely in his notice the grounds of his objection and the notice shall not be valid unless it contains such grounds and is made within the period above mentioned.

(6) In disposing of an appeal the Commissioner may confirm, reduce, increase, or annul the assessment, and shall record his determination in writing and announce it orally.

Section 70 provides for Appeals to the Board of Review against the decision of the Commissioner and Section 73 provides for the regulation of such appeals.

Sub-sections (4) and (7) of Section 73 are as follows:—

Section 73 (4). The onus of proving that the assessment as determined by the Commissioner on appeal is excessive shall be on the appellant.

(7) At the hearing of the appeal the Board may, subject to the provisions of Section 71 (4), admit or reject any evidence adduced, whether oral or documentary, and the provisions of the Evidence Ordinance relating to the admissibility of evidence shall not apply.

74.—(1) The decision of the Board shall be final:

Provided that either the Appellant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the Supreme Court.

The facts have to be gathered from the case stated and the documents incorporated with it and annexed to it. The respondent's husband, the late R. W. Sutherland, entered the employment of the Colombo Apothecaries Company, Limited (hereinafter referred to as the company) as its managing director in November or December, 1939, and continued in that employment till his death on June 12, 1946. He had not taken any leave during that period. After his death the company paid to Mrs. Sutherland the sum of Rs. 15,750. The payment was made under the authority of a resolution passed by the directors of the company on July 17, 1946, in these terms:—

"The Directors having taken note that a sum of Rs. 15,750 had been placed to reserve to meet the contingent liability to pay for Mr. Sutherland's leave pay which he would have been entitled to if he had survived, it was decided to pay Mrs. Sutherland's passage to England and to authorise a payment to her of Rs. 15,750 which amount was accordingly paid to Mrs. Sutherland."

The reserve was created by setting aside annually a sum equal to one and a half month's salary. The cheque for the amount was sent to the proctors for Mr. Sutherland's estate and it was drawn in their favour. They paid the sum, less a small and unexplained deduction, to a Mr. Adamson, who appears to have held a Power of Attorney for Mrs. Sutherland, and he paid it to her as a sum free from all tax liability. The company on March 15, 1947, made a return of Mr. Sutherland's income from employment for the period April 1, 1946, to the date of his death. The return was made by entering figures in blank spaces on a form which categorized the income from employment under a series of headings. Thus the first item is "gross salary Rs. 3,550" where the figure alone had to be filled in by the company. One of the items is "Leave Pay Rs." and opposite it the company entered no figure, but left the space for the figure blank. Another item is "Other remuneration (if any) Rs." There again the company left the space for the figure blank. But opposite this item it entered a note "Overdue leave pay Rs. 15,750 paid Messrs. Julius & Creasy, Administrators of the Estate". It was in consequence of this note that the assessment, made under section 11 (9) above cited for the period April 1, 1946, to June 12, 1946, in the year of assessment 1946-47, included the sum of Rs. 15,750. The facts with regard to the deceased's contract of employment are set out in statement 3 of the Case, where two paragraphs are incorporated from a letter, D8 of the documents, written by the company's accountants in reply to an enquiry by the assessor. The first of these paragraphs reads:—

" We advise that there is no written agreement to show the late Mr. Sutherland's contract of service with this Company. It has however been the normal practice of the Company to pay leave pay in proportion to the length of service which has elapsed without leave."

The second paragraph reads:—

" Mr. Sutherland took up duties as Managing Director in December, 1939, and although there was nothing in writing, he was understood to be on a normal four-year contract, with six months' leave on full pay and the passage money to be paid by the Company for him and his wife."

Statement 3 continues with this finding by the Board:—

" It is common ground that the Deceased's contract of service was for the normal 4-year period with 6 months' full pay leave and the cost of passages to the United Kingdom for himself and his wife."

The members of the Board of Review who heard the appeal were not unanimous in affirming the assessment. The two members who formed the majority held that Mr. Sutherland, though he had never taken leave, was entitled to be paid leave pay in proportion to his length

of service without leave. They said that the practice of paying leave pay when no leave is taken is fairly common in mercantile firms in Ceylon and that the leave pay is generally paid when the employee eventually does go on leave or retires. They found that when Mr. Sutherland died on June 12, 1946, there had accrued to his account a sum of Rs. 15,750. They were aided in arriving at this conclusion by the construction which they put on the directors' resolution of July 17, 1946, and by certain opinions elicited from the company by requests for information addressed to it by its own assessor. The dissenting member of the Board held that if an employee under such a contract as Mr. Sutherland's took no leave he was not entitled to any leave pay, and that his heirs on his death could have no claim. He construed the resolution of July 17, 1946, as meaning "had Mr. Sutherland not died a sum would have been available to pay him leave pay; owing to his death he could not get this. We will however pay that sum to his widow although the deceased was not entitled."

The Supreme Court referred to correspondence between the company through its officers, and its assessor or the assessor for Mr. Sutherland's estate. In this correspondence the company expressed varying and contradictory opinions about the character of the sum in question. Sometimes it was said that the payment was an *ex gratia* payment to the widow and sometimes that was denied and it was said that it was a sum legally due to Mr. Sutherland at his death. But the court rejected all such expressions of opinion as irrelevant, and their unanimous judgment proceeds upon the terms of the contract of employment as set out in statement 3 of the stated case. They held that it was not shewn that the practice by which leave pay was paid when no leave had been taken was part of the contract in Mr. Sutherland's case, and that there was no other evidence that his contract included a term entitling him to claim a money payment in lieu of leave.

When as in this case, the true question is whether a payment was made *ex gratia* or in discharge of a contractual obligation the primary and best evidence is the contract. If the contract is in writing or, if it is oral but its terms are known beyond doubt, the question whether the payment was contractual depends on the contract alone. But if the contract is oral and if the direct evidence leaves it in doubt whether or not it contained a term providing for the payment, it is legitimate to have regard to the circumstances surrounding the payment and receipt, and in such a case the evidence of the surrounding circumstances may be used to show what the terms of the contract in fact were. But in this case the circumstances attending the payment and receipt of the money are of no assistance. The payment by cheque to the proctors for Mr. Sutherland's estate favours the contention that it was a payment due under the contract of employment. But the language of the directors' resolution, which their Lordships construe in the same sense as the dissenting member of the Board of Review, and all the other circumstances favour the contention that it was an *ex gratia* payment to Mr. Sutherland's widow. No reasonably safe inference about the nature of the contract or its terms can be drawn from these conflicting

circumstances. The opinions of the company about the intendment of the contract are irrelevant. Though such opinions may have been received in evidence under section 73 (7) of the Ordinance they are not in law admissible as aids to the construction of the contract. The language of section 73 (7) is very wide but it does not go so far as to authorise the Board to ignore the rule that construction is a matter of law and not of evidence. The note written in the income tax return made by the company, on which the appellant's counsel greatly relied, does not help his argument. A statement made in a return is evidence against those who make the return, but statements made by employers in returning the income of an employee are not evidence against him. In this case, moreover, the return was non-committal on the question whether the payment was contractual, and the note referring to it was very properly written on the return in order that there should be no reproach of non-disclosure of a payment that might eventually be found to have been due under Mr. Sutherland's contract with the company.

It remains to consider the only direct evidence about the terms of the contract. It is to be found in statement 3 of the Case. The company was clearly in great doubt about the terms and in the letter D8 it strove to set them out as fairly as it could. The letter, in the two paragraphs quoted in statement 3, purports to deal with two separate things, first the company's normal practice of paying leave pay in proportion to the length of service which had elapsed without leave, and second, the company's understanding of Mr. Sutherland's contract which is described as a normal 4-year contract with six months' leave on full pay. It is the contract so described in the second paragraph that is found by the Board to be common ground between the parties. The respondent is entitled to have the terms of the contract, as described in the letter and found to be common ground, construed in their natural sense and without the addition of unexpressed terms unless they are clearly implied. The words which have to be construed are "a normal 4-year contract with six months' leave on full pay". Their Lordships find no ambiguity in this description; it means a contract for four years' service with six months' leave, which leave shall be on full pay. If that is the true construction there is no basis for a claim by Mr. Sutherland's executrix for pay in lieu of leave on his death without having had leave. The normal practice of the company is not expressly incorporated and there is no need or justification for implying a term by which the company would be bound to pay leave pay when no leave was taken. The contract before the Board therefore did not provide for any payment of leave pay except on a contingency which was never fulfilled, and the respondent has discharged the *onus* which rested on her (Section 73 (4) of the Ordinance) by showing that the payment of Rs. 15,750 was not contractual and was not due to Mr. Sutherland's estate on his death.

Their Lordships will therefore humbly advise Her Majesty that the appeal should be dismissed. The appellant will pay the costs of the appeal.

Appeal dismissed.