

1951

Present: Jayatileke C.J. and Gunasekara J.

SUTHERLAND, Appellant, and COMMISSIONER OF  
INCOME TAX, Respondent

S. C. 235—CASE STATED FOR THE OPINION OF THE SUPREME COURT  
UNDER THE PROVISIONS OF SECTION 74 OF THE INCOME TAX  
ORDINANCE UPON THE APPLICATION OF MRS. A. J.  
SUTHERLAND, EXECUTRIX OF THE ESTATE OF R. W.  
SUTHERLAND, DECEASED

*Income tax—Employee of Company—Ex gratia payment made to his wife by Company after his death—Profits from employment—Income Tax Ordinance (Cap. 188), Section 6 (1) (b) and Section 6 (2) (a) (i) and (v).*

S was the employee of a Company. In pursuance of a resolution passed by the board of directors of the Company shortly after S's death, a certain sum of money was paid to the appellant, who was S's widow and executrix of his estate. The evidence showed that the payment was a gift to S's widow from the Company that had been her husband's employer and that the motive for the gift was the circumstance that it represented a sum of money that her husband "would have been entitled to if he had survived" though he died before he became entitled to it.

*Held*, that the payment made to S's widow was not a profit from S's employment within the meaning of section 6 (1) (b) and section 6 (2) (a) (i) and (v) of the Income Tax Ordinance. The circumstance that at various times the Company's officials chose such expressions as "overdue leave pay" and "accumulated furlough pay and passage money due to the late Mr. S" to describe the nature of the payment had no bearing on the question.

**T**HIS was a case stated under section 74 of the Income Tax Ordinance.

*H. V. Perera, K.C.*, with *P. Navaratnarajah*, for the assessee-appellant—It is necessary to interpret the resolution. The resolution has legal consequences as it is an act of the Company's board of directors. Even if the sum paid was a "gratuity" the question still arises whether it was a "gratuity" in respect of services rendered. The reason for the gratuity was the fact that Mr. Sutherland did not take leave. If the payment was made to the deceased's estate and not to the widow, it was compensation for not taking leave, not compensation for work done. See *Craib v. Commissioner of Income Tax*<sup>1</sup>; *Benyon v. Thorpe*<sup>2</sup>; *Stedeford v. Beloe*<sup>3</sup>. When section 6 (2) (a) (i) of the Income Tax Ordinance (Cap. 188) defines "profits from employment" to include any "gratuity" the word "gratuity" means gratuity in respect of services—*Iyengar: Indian Income Tax Act, 3rd ed., p. 230*.

If the payment was made to the widow then it was a death-gratuity. Death-gratuities are excluded by section 7 (1).

*H. W. R. Weerasooriya*, Acting Solicitor-General, with *D. Jansze*, Crown Counsel, for the Commissioner of Income Tax, respondent.—The question is what is meant by "leave pay". In the circumstances of this case

<sup>1</sup> (1939) 40 N. L. R. 337.

<sup>3</sup> (1932) A. C. 388.

<sup>2</sup> 14 Tax Cases 1.

it means something superadded to salary in lieu of leave not taken. The document DS shows this. The Court must interpret the terms of the contract and not the resolution of the board of directors. If Mr. Sutherland was alive he could have claimed this money as something due on the contract of service. The fact that he died did not make any difference. Payment was made to the estate. How the particular payment is regarded is a question of fact which has been considered by the Board of Review. The Court should not interfere when the Board of Review had sufficient material to come to a decision—*Guillain v. Commissioner of Income Tax*<sup>1</sup>. The payment accrued at a point of time immediately before death. Therefore it was a "profit" within the period before cessation of office under section 11 (9). See *Davis v. Harrison*<sup>2</sup> and *Dewhurst v. Hunter*<sup>3</sup>. Although payment was made after the period, still it must be regarded as paid on the date it accrued. Section 11 (9) is a special case dealing with cessation of office by employee's death.

*H. V. Perera, K.C.*, in reply.—The Court must deal with the appeal on the facts as set out in the case stated—*Cowan v. Seymour*<sup>4</sup>. Here the case stated refers to a "contingent liability". Para. 2 of the case stated gives all facts regarding the contract. The resolution of the Company's board of directors shows that the money was not payable to Mr. Sutherland, that the money was at the disposal of the Company, and that the Company had paid it to Mrs. Sutherland.

*Cur. adv. vult.*

April 27, 1951. GUNASEKARA J.—

This is a Case Stated under section 74 of the Income Tax Ordinance (Cap. 188) upon the application of the appellant, who is the executrix of the estate of her husband R. W. Sutherland. The deceased had been the Managing Director of the Colombo Apothecaries Company Limited from November, 1939, until his death on the 12th June, 1946. The question for decision is whether a sum of Rs. 15,750 that was paid by the Company to the widow in the circumstances set out in the Case Stated was a profit from the deceased's employment within the meaning of section 6 (1) (b) and section 6 (2) (a) (i) and (v) of the Ordinance.

It is stated to be common ground that "the deceased's contract of service was for the normal four-year period with six months full pay leave and the cost of passages to the United Kingdom for himself and his wife". His salary was Rs. 1,500 a month and he had taken no leave at all in the period November, 1939, to 12th June, 1946. On the 17th July, 1946, the Company's board of directors passed the following resolution:

"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, namely, Rs. 1,500, and to authorise a payment to her of Rs. 15,750."

<sup>1</sup> (1949) 51 N. L. R. 241 at p. 247.

<sup>2</sup> 11 Tax Cases 707.

<sup>3</sup> 16 Tax Cases 605.

<sup>4</sup> (1920) 1 K. B. 500.

The Board of Review finds that this sum was "the total of the amounts which the company annually placed to reserve in its accounts to meet the contingent liability of the deceased's leave pay", and also that "after his death the company made a payment to Mrs. Sutherland which included the sum of Rs. 15,750."

This sum was included in the Income Tax Department's assessment of the deceased's income and the executrix appealed to the Board of Review. The Board, consisting of three members, dismissed the appeal by a decision of the majority, who held that the sum in question was part of the deceased's profits from his employment, being "leave pay" that had "accrued to his account". They based this conclusion upon their construction of the resolution of the board of directors and certain statements contained in letters written on behalf of the Company that were produced in evidence.

Three of these are letters written on behalf of the Company by its secretary to Messrs. Julius & Creasy (the appellant's proctors) on the subject of the deceased's estate. The earliest, which is dated the 8th July, 1946, states that the only amount outstanding as Mr. Sutherland's salary is his salary for June, that the amount earned by him as commission has not yet been ascertained, and that no director's fees or allowances are due. The next, dated the 19th July, 1946,—two days after the resolution of the board of directors—states that "a sum of Rs. 1,502 has already been paid on behalf of Mrs. Sutherland's passage and a further sum of Rs. 15,750 is to be paid to Mrs. Sutherland in respect of the late Mr. Sutherland's overdue leave pay". The third letter, which is dated the 8th November, 1946, encloses a cheque for Rs. 17,252 "drawn in your favour on behalf of Mrs. R. W. Sutherland in connection with the above estate". The reference in the second letter to "overdue leave pay" has been treated by the majority of the Board of Review as evidence that the sum of Rs. 15,750 was a sum that had accrued to Mr. Sutherland's account as leave pay. This view of the statement in that letter regarding the sum in question appears to be based on a misapprehension of its effect, for, read in its context, the statement amounts to nothing more than an attempt to convey the gist of the resolution of the board of directors.

On the 15th March, 1947, the Company's secretary sent to the assessor a return regarding Mr. Sutherland's remuneration, which included an item described as "Overdue leave pay Rs. 15,750 paid Messrs Julius & Creasy, Administrators of the Estate", and the covering letter (signed by the secretary on the Company's behalf) states that there "accrued to his account a sum of Rs. 15,750, being overdue leave pay which sum was sent to Messrs. Julius & Creasy the administrators of the estate". Nevertheless, in a letter of the 15th February, 1948, from the Company to the assessor (which too is signed by the secretary) the Company state that the deceased's remuneration for the period 1st April to 12th June, 1946, was Rs. 4,050 (made up of the salary for April, May and June, 1946, totalling Rs. 3,550 and a valuator's fee of Rs. 500) and that they "confirm that a certain amount of leave pay lapsed at his death and his estate was not entitled to it". Upon receipt of this letter the assessor wrote to the Company's secretary referring

to the letter of the 17th March, 1947, and inquiring whether she was to understand "that of the accrued leave pay a sum of Rs. 15,750 was paid and that the balance accrued leave pay lapsed". To this inquiry the Company, through its secretary, replied on the 1st June, 1948, as follows:—

"... the total amount of leave pay amounted to Rs. 15,750 and the whole of this sum on the death of Mr. Sutherland lapsed and his Estate was not entitled to, and was therefore not paid, this sum. This sum was, however, paid to his widow, Mrs. Sutherland, as an *ex gratia* payment in accordance with the following resolutions:—

'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 position taken up on the Company's behalf in this correspondence is that the sum in question represented Mr. Sutherland's "overdue leave pay" that had "accrued to his account" but had "lapsed" upon his death so that "his estate was not entitled to it", and that it was paid to Mrs. Sutherland, through the proctors for the executrix, in pursuance of a resolution of the board of directors to make an *ex gratia* payment to her. Here again it is apparent that what is sought to be conveyed by the Company's letters is no more than the secretary's interpretation of the resolution and the payment; and his interpretation, it seems to me, was not relevant to the question that the Board of Review had to decide. The decision of the Board, however, is to a large extent based on the description given to the payment in the letter of the 15th March, 1947 (which is marked D 1) as appears from the reference to it in the following passage in the "Findings" of the majority—

"When Mr. Sutherland died on the 12th June, 1946, there accrued to his account a sum of Rs. 15,750 being overdue leave pay (D 1) which was sent to Messrs. Julius & Creasy, the Proctors for the Executrix."

By a letter dated the 17th December, 1948, written on behalf of the Company, the managing director informed the assessor that Mr. Sutherland "was due to leave Ceylon on retirement about September or October, 1946, and that the amount of leave pay earned by him would have been paid before his departure". The Company had in the meantime included this sum in a "passage and furlough clam" made by them in respect of the year of assessment 1947-48. On the 1st February, 1949, the assessor who was dealing with the question of the income tax payable by the Company wrote to the Company's accountants stating that it appeared that a sum of Rs. 17,252 had been "paid to the widow of the late Mr. R. W. Sutherland during the year ended 31st March, 1947" and inquiring "whether this payment was made *ex gratia* or in discharge of a legal liability". He asked them to "confirm that

this sum was included in the passage and furlough claim ” and also to send him “ a copy of the Directors’ minute authorising this payment. ” The accountants replied on the 23rd February, 1949, that they had been informed by the managing director “ that the Rs. 17,252 was in respect of accumulated furlough pay and passage money due to the late Mr. Sutherland to the date of his death ”. They added that the payment was not an *ex gratia* payment, and they also confirmed that the sum was included in the passage and furlough claim that had been referred to and they enclosed a copy of the directors’ resolution of the 17th July, 1946. On the 19th March, 1949, in reply to a further request from the assessor for a copy of Mr. Sutherland’s contract of service, they wrote the letter D 8, which is in the following terms:—

“ In reply to your letter of the 4th of March, 1949, we have received the following reply from the Company:—

‘ 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.

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 4 year contract, with six months leave on full pay and the passage money to be paid by the Company for him and his wife.

The accumulated leave pay due to Mr. Sutherland at the time of his death in June, 1946, amounted to Rs. 15,750. Provision was made to pay the above sum of Rs. 15,750 as per the Board of Directors’ resolution at a meeting held on 17th July, 1946, reading as follows:—

(The resolution is quoted) ‘ which amount was accordingly paid to Mrs. Sutherland ’.

Yours faithfully,

(Sgd.) FORD RHODES, THORNTON & Co. ”

Upon the statement about the “ normal practice of the Company ” that is quoted in this letter the majority of the Board has based a finding that under his contract Mr. Sutherland was entitled at any given time to demand in addition to his salary “ leave pay ” in respect of any period of leave which he was entitled to take but had not taken. Even if it is assumed that “ leave pay ” means “ pay instead of leave ” and not exclusively “ pay during leave ”, and that the quotation in D8 is evidence of the “ normal practice of the Company ”, there appears to be nothing to show that this practice was followed in Mr. Sutherland’s case, and there is no other evidence that his contract included a term entitling him to claim a money payment in lieu of leave. On the contrary, the board of directors has acted on the footing that at the time of his death he had no more than a contingent right to “ leave

pay", for that is the basis of the resolution of the 17th July, 1946. The description of the sum of Rs. 15,750 as "the accumulated leave pay due to Mr. Sutherland at the time of his death in June, 1946", which is quoted in D8, may indicate that the person who wrote on the Company's behalf the letter that is quoted by the accountants, held the opinion that Mr. Sutherland had a vested right to that sum and not merely a contingent right as is indicated in the resolution; but there is no evidence of the facts upon which that opinion was based. The same thing may be said of the managing director's statement that is quoted by the accountants in their letter of the 23rd February, 1947, if it means that Mr. Sutherland had a vested and not merely a contingent right; though it seems very improbable that the managing director did purport to say that at the time of Mr. Sutherland's death there was already due to him from the Company the cost of a passage for himself to the United Kingdom, which therefore his estate was entitled to be paid.

There is no evidence that the sum of Rs. 15,750 was in fact paid to the estate: the Case Stated itself says that the payment was made to Mrs. Sutherland, and the circumstance that she happened to be the executrix is by itself insufficient to make it a payment to the estate. There is also no evidence that the sum that was paid represented a debt due from the company to the deceased: the Case itself states that it represented a sum "placed to reserve in its accounts to meet the *contingent* liability of the deceased's leave pay". According to the resolution in pursuance of which the payment was made to Mrs. Sutherland what induced the board of directors to "authorise a payment to her of Rs. 15,750" was the fact that a similar sum "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*". The only evidence as regards the nature of the payment is that it was a gift to Mrs. Sutherland from the Company that had been her husband's employer and that the motive for the gift was the circumstance that it represented a sum of money that her husband "would have been entitled to if he had survived" though he died before he became entitled to it. The circumstance that at various times the Company's officials chose such expressions as "overdue leave pay" and "accumulated furlough pay and passage money due to the late Mr. Sutherland" to describe the nature of the payment that was made in pursuance of the resolution of the board of directors has no bearing on the question. Moseley J. observed in *Craig v. Commissioner of Income Tax*<sup>1</sup> that the assessee in that case should not "be penalized for the choice of a word, whether it be deliberate or accidental, by the party making the payment". That observation was made in regard to the language of a resolution of the board of directors of a Company in pursuance of which the payment in question was made to the assessee who was an employee of the Company. A similar observation may be made with greater force in the present case regarding the expressions chosen by the Company's officials. The only proper conclusion from the facts set out in the Case Stated is that the payment in question was a gift to

<sup>1</sup> (1939) 40 N. L. R. 337 at 340.

Mrs. Sutherland personally of a sum of money to which the deceased was not entitled, and was not a payment made, to her in her capacity of executrix. It was therefore not a profit from the deceased's employment within the meaning of section 6 (1).

I would allow the appeal with costs and direct that the fee of Rs. 50 deposited by the appellant in terms of section 74 (1) of the Ordinance be refunded to her.

JAYETILEKE C.J.—I agree.

*Appeal allowed.*

