Privy Council Appeal No. 49 of 1970

The Comptroller-General of Inland Revenue – – – *Appellant*

v.

Alan Richard Knight – – – – – – – *Respondent*

FROM

THE FEDERAL COURT OF MALAYSIA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 26TH JULY 1972

Present at the Hearing:

LORD WILBERFORCE
LORD PEARSON
LORD KILBRANDON
LORD SALMON
SIR RICHARD WILD

[*Delivered by* LORD WILBERFORCE]

This appeal is from the judgment of the Federal Court of Malaysia which affirmed a judgment of Chang Min Tat J. in the High Court of Malaya. The latter judgment allowed an appeal by the respondent taxpayer from an order of the Special Commissioners of Income Tax who had dismissed his appeal against a notice of amended assessment to income tax dated 30th November 1965. The assessment was in respect of a sum of $28,050 paid to the respondent by his former employers by way of a redundancy payment.

The relevant statutory provisions are contained in s. 10 (1) (*b*) and (2) (*a*) and s. 13 (1) (*i*) of the Income Tax Ordinance No. 48 of 1947. These are as follows:

> "10. (1) Income tax shall, subject to the provisions of this Ordinance, be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person accruing in or derived from the Federation or received in the Federation from outside the Federation in respect of—
>
> . . . .
>
> (*b*) gains or profits from any employment;
>
> . . .
>
> (2) For the purposes of paragraph (*b*) of sub-section (1) of this section, "gains or profits from any employment" means—
>
> (*a*) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance (other than a subsistence, travelling, conveyance or entertainment allowance which is proved to the

satisfaction of the Comptroller to have been expended for purposes other than those in respect of which no deduction is allowed under section 15 of this Ordinance) paid or granted in respect of the employment whether in money or otherwise;

. . .

13. (1) There shall be exempt from tax—

. . .

(*i*) sums received by way of retiring or death gratuities or as consolidated compensation for death or injuries;".

Thus the primary question is whether the sum of $28,050 was a gratuity paid or granted in respect of the employment. If it was not, it is not taxable. If it was, the further question arises whether it was received by way of a retiring gratuity. If so, it is exempted from tax.

The facts were found by the Special Commissioners as follows. The respondent, who is a surveyor, was employed by a company subsequently called the Malaya Borneo Building Society Ltd. His terms of service were defined by an agreement in writing dated 23rd August 1954. The service was not for any fixed period but by Cl. 11 it was provided that it might be determined by either party on not less than three months' notice in writing, as well as in other events such as misconduct, bankruptcy, unfitness or breach of duty, none of which occurred. There was a provision by which the Company agreed to pay the cost of passage of the respondent and, in certain conditions, of his family to Malaya and, on termination of his employment, back to the United Kingdom.

On 6th February 1960 the Company sent a letter to the respondent, as also to other Staff Surveyors. It stated that the conditions of service of technical staff had been reviewed at a Management meeting on 3rd February 1960. It contained two relevant paragraphs as follows:

"(3) *Redundancy Pay*

The subject of redundancy was discussed and it was agreed that should a Staff Surveyor become redundant, Management would consider the payment of redundancy pay to the Surveyor concerned, the maximum benefit payable being limited to one month's pay (based on salary at date of redundancy) for every completed year's service subject to:

(*a*) minimum compensation of 3 months' pay

(*b*) maximum compensation of 12 months' pay.

(4) *Loss of Office*

The Society is a commercial company and as such need not have a Malayanisation policy. Should it eventually become the policy of the Society's Board that expatriate staff should be replaced by suitably qualified local staff, Management would at that time draw up for the Board's consideration a scheme for compensation for loss of office. Management cannot, however, anticipate what the scheme will be neither can it anticipate Board's approval. However, it can safely be assumed that should compulsory replacement be introduced, Staff Surveyors would be granted compensation for loss of office on terms not less generous than those that apply to redundancy."

The Special Commissioners found that there was no evidence that the respondent, after receiving this letter, made any protest or raised any objection on the subject of redundancy and redundancy pay.

By November 1965 the respondent had become Chief Staff Surveyor to the Company, and it appears that there was increasing insistence by the Government on private enterprise to "Malayanise" their staff. On 2nd November 1965 the following resolution was passed by the Board of Directors of the Company:

> "That (*a*) The Society's Chief Staff Surveyor Mr. A. R. Knight be declared redundant as from 1st December 1965. (*b*) Mr. A. R. Knight be given redundancy pay at the rate of one month's basic salary for every completed year's service subject to a maximum of 12 months' pay."

Apart from communicating to the respondent the terms of this resolution, the Company took no steps to terminate his employment and in particular did not give him three months' notice under Cl. 11 of his service agreement.

The respondent left Malaysia for the United Kingdom on 30th November 1965, on which date his employment with the Company terminated. The sum of $28,050 was calculated and paid to the respondent in accordance with paragraph (*b*) of the resolution: the Company also paid the passage money of the respondent and his family in accordance with the Service Agreement. The respondent did not take any action against the Company in respect of its failure to give him three months' notice of termination.

Questions as to the taxability of payments received by employed persons at the end of their employment have frequently come before the Courts: they have often been described as difficult, borderline and depending on narrow distinctions. Two propositions are accepted as common ground in the present case. First, where a sum of money is paid under a contract of employment, it is taxable, even though it is received at or after the termination of the employment (see for example *Henry v. Foster* (1930–2) 16 T.C. 605). Secondly, where a sum of money is paid as consideration for the abrogation of a contract of employment, or as damages for the breach of it, that sum is not taxable (see for example *Henley v. Murray* (1949–50) 31 T.C. 351).

Attempts were made, in the course of the present litigation, to bring the case within the first proposition. It was said that a new term was introduced into the contract of employment by the letter of 6th February 1960: this, it was contended, was an offer which the respondent must be taken to have accepted by remaining in employment.

Although this view of the matter was favoured by the Special Commissioners, their Lordships have no doubt that Chang Min Tat J. and the Federal Court were right in rejecting it. The letter of 6th February 1960 was, in their Lordships' view, nothing more than an expression of the Company's intentions and called, neither expressly nor by implication, for any acceptance or reaction by the respondent. It merely stated that, in the event of redundancy, Management "would consider the payment of redundancy pay" and that in the event of Malayanisation "it could safely be assumed" that compensation not less generous than for redundancy would be granted. These expressions were quite inappropriate if a variation of the contract was intended. And mere silence in the face of such an expression of intention cannot be taken as assent to a contractual change.

Before their Lordships the argument for variation took a different form. By 1965, it was said, it had become the policy of the Company, under Government insistence, to Malayanise its staff. Evidence as to this was given by the Secretary to the Company in a letter dated 16th April 1966 to the Income Tax Department: he also gave oral evidence

before the Special Commissioners. The Special Commissioners considered this evidence inadmissible but a contrary view was taken by both Courts. Their Lordships are of opinion that even if the evidence is accepted it does not support the argument in favour of a variation of the contract. It is quite possible that the respondent, from 1965 onwards, appreciated that at some time his post might be "Malayanised" but this in no way involved any acceptance by him of any variation in his contract such as would entitle the Company to dismiss him, or declare him redundant, or in any way to terminate his contract otherwise than as the contract provided.

Their Lordships consider therefore that, however it is expressed, the argument that the payment in question was made under the contract, or under the contract as varied, fails.

The appellant's next argument was that the payment was not exempt from tax under the second proposition stated above: there was, in his contention, no separate agreement by which the respondent agreed to accept the sum in question as consideration for the abrogation of his contract of service.

Their Lordships will comment later upon the factual basis for this argument, but they are of opinion that, even if it is accepted, it does not follow that the payment is taxable. The question, under s. 10 (2) (*a*) of the Ordinance, is whether the money was paid "in respect of the employment". If the fact is that it was paid in respect of the loss of the employment, it does not come within the taxing words.

Their Lordships find support for this in the English case of *Chibbett v. Robinson* (1924) 9 T.C. 48 where a sum of £50,000 was granted by a company in voluntary liquidation to a firm of ship managers as compensation for loss of office. Although there was no specific agreement or bargain that the payment should be made as consideration for abrogating the employment, the payment was held not to be taxable. This case was later considered in *Hunter v. Dewhurst* (1930–2) 16 T.C. 605, and although Lord Macmillan, in the House of Lords, found some of the words used by Rowlatt J. too widely expressed, the actual decision seems not to have been disapproved. Their Lordships consider it a right decision in law.

It was argued by the appellant that this, and other cases, decided upon the English Income Tax Legislation, do not govern the present case under the Malayan Income Tax Ordinance. S. 10 (2) (*a*) certainly refers expressly to gratuities. But it remains the case that, in order to be taxable, a gratuity must be paid in respect of the employment—many gratuities are so paid such as "tips" and these no doubt are taxable. If the gratuity is not so paid, but is paid in respect of the termination of his employment, it is not taxable.

Their Lordships revert, finally, to the facts of this payment. Although not made directly as consideration for an agreement by the respondent that his employment should be abrogated, it would be wrong in their Lordships' opinion to regard it as a wholly voluntary payment. The Company was under a legal obligation to give the respondent three months' notice: it was under a moral obligation to treat him fairly, if not generously, after 11 years' employment. In fact it paid him the equivalent of 11 months' salary, it paid his passage home and he made no claim in respect of the failure to give him three months' notice.

Although there was no express bargain between the Company and the respondent, their Lordships do not see any valid reason in principle for making a distinction between this case and cases (admittedly involving

no charge to tax) where the payment is made expressly as consideration for abrogating a service agreement. Equally with such cases the payment falls outside the taxing words " in respect of his employment ".

In their Lordships' opinion, therefore, the respondent succeeds in showing that the payment is not within the taxing provision.

It was held by the Federal Court that the payment was exempted as a retiring gratuity under s. 13 (1) (*i*). Their Lordships see the force of this. They would agree that the words " retiring gratuity " should not be narrowly interpreted, so as to include only cases of voluntary retirement. They would also agree that the fact that the respondent sought and obtained other employment in Trinidad does not prevent him from claiming that he retired from his previous employment. But the expression " retiring gratuity " has not, it appears, been judicially considered apart from the present case; and since it is not necessary for the decision upon this appeal, their Lordships consider it preferable not to express a final opinion upon it.

Their Lordships will advise the Head of Malaysia that the appeal should be dismissed. The appellant must pay the costs of the appeal.

3131997—3 Dd. 178189 80 8/72

In the Privy Council

THE COMPTROLLER-GENERAL OF INLAND REVENUE

v.

ALAN RICHARD KNIGHT

DELIVERED BY
LORD WILBERFORCE

Printed by HER MAJESTY'S STATIONERY OFFICE
1972