distinguish cases in which a payment has been made by way of compensation for premature determination of a contract and the like." (at p. 559).

Similarly, under Malaysian legislation, for a gratuity to be chargeable to income tax, it must be received by the employee "in respect of having or exercising the employment."

Jaginder Singh

THE FINAL EPISODE?

H. v. Comptroller of Inland Revenue.[1]

The taxability of the "golden handshake" under the Income Tax Act, 1967 (hereinafter referred to as the 1967 Act) has finally received consideration from the Privy Council in *H. v. Comptroller of Inland Revenue.* The case was decided by the Privy Council after the publication of *Income Tax Liability of Terminal Payments* (Jaginder Singh, [1974] JMCL 72), and the writer notes with some pride that the Privy Council endorsed some of the arguments put forward in that article. The material facts of the case were as follows: The appellant was employed by Sime Darby Malaysia Bhd. under five separate contracts of employment. The first, for four years, was dated April 24, 1951, at the end of which he was entitled to eight months leave. The following three contracts were for three years each followed by six months leave at the end of each period. The respective dates of commencement of each of these contracts were February 16, 1956, August 21, 1959 and March 27, 1963. His fifth and final contract was for 2 years, commencing October 26, 1966. Cl.2 of a further written agreement between the parties dated March 27, 1962 provided that upon the expiration of the contract commencing on the last date of return to Malaysia for service, all future engagements were to be deemed to be from year to year determinable at any time by three months notice on either side. On July 31, 1968, the appellant received a letter giving him three months notice of termination of employment (his contract was due to terminate on October 26, 1968 in any event). The letter also stated that "as compensation for loss of employment you have been accorded a sum of $32,000 *ex gratia.*" This sum had been paid to him under a scheme of "Proposed Compensation in Cases of Possible Amalgamation", which

[1] [1974] 2 M.L.J. 135.

scheme had been voluntarily drawn up by the employers.

The Inland Revenue contended that the sum received was a gratuity "in respect of having or exercising the employment" falling within S. 13(1)(a) of the 1967 Act, whereas the taxpayer contended that the sum was "compensation for loss of employment" within S. 13(1)(e) in which case the whole of the sum received would be exempt from tax by virtue of Sch. 6, Para. 15.[2] The Privy Council reversed the decision of the Federal Court. ([1973] 2 M.L.J 40). The Board held that the sum was compensation for loss of employment within S. 13(1)(e) and hence exempt from tax by virtue of Sch. 6, Para. 15, and not a gratuity in respect of having or exercising an employment within S. 13(1)(a), as had been held by the Federal Court. The assessments on the taxpayer were accordingly discharged.

The test as to what is compensation for loss of employment as stated by Romer L.J. in *Henry* v. *Foster* ([1931] 16 T.C. 615) and used by the Federal Court in the present case was rejected by the Board.

> "'Compensation for loss of office' . . . . means a payment to the holder of an office as compensation for being *deprived* of profits to which as between himself and his employer he would, but for an act of deprivation by his employer or some party, such as the Legislature, *have been entitled.*" (at p. 634; emphasis added).

Instead the Board relied on the judgment of Rowlatt J. in *Chibbett* v. *Joseph Robinson & Sons* ((1924) 9 T.C. 48, at p. 61): "compensation for loss of an employment *which need not continue but which was likely to continue*, is not an annual profit within the scope of the Income Tax at all." (emphasis added). Viscount Dilhorne agreed with the Federal Court that the taxpayer had not been deprived of anything to which he was entitled. There was nothing in his contract giving him a right to the sum. The examples given by Romer L.J. in *Henry* v. *Foster* preceeding the test

[2]The relevant provisions of the 1967 Act are as follows: S. 13(1). Gross income of an employee in respect of gains or profits from an employment includes –

> (a) any wages, salary, remuneration, leave pay, fee, commission, bonus, gratuity, perquisite or allowance . . . . in respect of having or exercising the employment; . . . .
>
> (b) any amount received by the employee, whether before or after his employment ceases, by way of compensation for loss of the employment . . . ."
>
> Schedule 6. Exemptions From Tax. Part 1. Income which is exempt.
>
> 15. A payment . . . . made by an employer to an employee of his as compensation for loss of employment . . . .
>
> (b) in the case of a payment made in connection with a period of employment with the same employer or with companies in the same group, in respect of so much of the payment as does not exceed an amount ascertained by multiplying the sum of two thousand dollars by the number of completed years of service with that employer or those companies."

stated above refer to the situation where the taxpayer is entitled to a sum by contract, upon the termination of his employment. Such sum is nothing more than deferred remuneration. Hence, Viscount Dilhorne suggests that the phrase "*have earned*" would be more appropriate than the phrase "have been entitled".

> "In their Lordships' opinion Romer L.J. was in his judgment contrasting payment made to a man for services he had rendered with compensation for loss of earnings he would have received if his employment had not been terminated". (at p. 137).

It is respectjully submitted that there is no material difference between the phraseology suggested by Viscount Dilhorne and that used by Romer L.J. Whilst it is true that the taxpayer cannot be "entitled" to a sum unless he has performed the requisite services in his employment, he can certainly be "entitled" to a sum as compensation for being prevented from *earning* that remuneration. Perhaps the clearest phraseology would be "have been entitled to earn". In any event *H's Case* is clearly outside the Romer L.J. test. Since all that happened was that the taxpayer's contract was not renewed upon expiry, there was no deprivation of any sort, be it of profits he would "have been entitled" to, or would "have earned" or would "have been entitled to earn."

Turning to the Rowlatt J. test, Viscound Dilhorne said:

> ". . . . their Lordships in this case see no reason to dissent from or to question the proposition that for a payment to be compensation for loss of employment, *there must be a real prospect of future employment.* If that does not exist, then the payment cannot be compensation for the loss of earnings for the prospect of future earnings is not there." (at p. 137; emphasis added).

The Privy Council reviewed the facts of the case, especially the various contracts and came to the conclusion that "unless his employment was terminated by notice or salary in lieu of notice, the appellant had a clear expectation of employment until he reached (retirement) age" ie. fifty-five years. (per Viscount Dilhorne at p. 136). It was said that the scheme in accordance with which the payment was calculated indicated that it was designed only for calculating the amounts to be paid as compensation for the loss of future earnings, although it took into consideration the remuneration received by the taxpayer.

It is respectfully submitted that the Privy Council erred in applying this test to the present case. The Board made no clarification of the test enunciated by Rowlatt J. in using the phrase "real prospect of future employment" in place of employment "which need not continue but which was likely to continue." It would be necessary to examine the terms of the service contracts between the taxpayer and the employer to determine whether there was a real prospect or a likelihood of the employment continuing. The Board said that the construction of a written agreement is

a question of law and not of fact, and it was upon a construction of the agreements that the Board concluded that there was a real prospect of the taxpayer's employment continuing. In arriving at this conclusion the Board relied on the terms of c1.2 of the March 1962 agreement. When the taxpayer's contract was renewed in 1966 for two years, c1.2. of the 1962 agreement continued in effect. Viscount Dilhorne said:

> "Construing this letter with that agreement, the appellant was engaged for a further tour of two years and thereafter unless his employment was terminated in accordance with the agreement, to be deemed to be engaged from year to year." (at p. 136).

Whilst it is true that upon the expiry of the tour of duty under the 1966 agreement the taxpayer could look forward to being engaged from year to year, yet when it is considered that that engagement could be terminated at anytime in accordance with the *express* terms of the contract, it cannot be said that there was a "real prospect" or likelihood of the employment continuing until retirement age. The fact that the taxpayer was engaged under fresh contracts of service each time his tour of duty ended must mean that the taxpayer could not be certain that his contract would necessarily be renewed. C1.2 of the 1962 agreement in such circumstances would be nothing more than a saving provision, giving the employers a chance to consider whether or not to renew the taxpayer's contract whilst allowing him to continue the employment on a temporary basis.

Furthermore, Rowlatt, J. in *Chibbett* v. *Robinson* itself explained the circumstances in which his test would be applicable.

> " . . . . It seems to me that a payment to make up for the cessation of future annual taxable profits is not itself an annual profit at all . . . . I should not have thought that either damages for wrongful dismissal or . . . . a voluntary payment in respect of breaking an agreement which had some time to run would be taxable profits . . . . ((1924) 9 T.C. 48 at p. 61).

In the present case the sum paid was not damages nor a voluntary payment in respect of breach of agreement. The contract had run its normal course, the notice of termination being nothing more than notice that the agreement would not be renewed for a further period. This course therefore prevented c1.2 of the 1962 agreement coming into effect at all.

The nature of the service agreements in the present case can also be usefully contrasted with the service agreement in *T.* v. *Comptroller-General of Inland Revenue* (Knight's Case) ([1972] 2 M.L.J. 73). In that case the taxpayer was employed under one contract of service of indeterminate period although the contract was terminable by three calendar months' notice by either party. The sum received upon termination was regarded as compensation for loss of employment. The major difference between that case and the present case is that in the present case the engagement was not of indeterminate length when the first contract was entered into. It would

only become of indeterminate length if cl.2 of the 1962 agreement was allowed to come into operation, but this never happened.

Regarding the second ground of appeal on the applicability of S. 13(1)(a) of the 1967 Act, the Privy Council said that the sum was not a gratuity paid in respect of having or exercising the employment. In the course of its judgment the Board clarified a number of matters regarding the interpretation of S. 13(1)(a), especially the phrase "in respect of having or exercising the employment." Firstly, it was said that the manner of computing the sum ie. relating quantum to total period of service, did not *ipso facto* bring the sum within the ambit of S. 13(1)(a). (p. 137 and p. 138). Secondly, a voluntary payment falls within the express terms of S. 13(1)(a) as being a gratuity, but in order to be taxable the gratuity must be received "in respect of having or exercising the employment." (p. 137). Thirdly, the Board affirmed the decision of the Privy Council in *Knight's Case* that a sum paid in respect of the loss of the employment is not paid in respect of the employment. In applying this statement to the 1967 Act, Viscount Dilhorne said:

> "In this case the payment made to the appellant cannot be regarded as one in respect of his exercising his employment for it was one in respect of the cessation of his employment; nor is it to be regarded as one in respect of his having the employment. Those words would be apt to include *deferred remuneration*". (at p. 138; emphasis added).

Deferred remuneration would cover sums to which the taxpayer is entitled under his contract upon the termination or expiry of his contract in the normal course of events. (See for example *Henry* v. *Foster* ((1931) 16 T.C. 605). Finally, the Privy Council limited the scope of the phrase "having or exercising" by accepting the test enumerated by Upjohn J. in *Hochstrasser* v. *Mayes* ([1959] Ch. 22 at p. 33).

> " . . . . the authorities show that to be a profit arising from the employment *the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future.*" (emphasis added). (Viscount Simonds in the House of Lords endorsed this statement [1960] A.C. 376).

The Board also stated that compensation for loss of employment (S. 13(1)(e)) and payment in respect of having or exercising the employment (S. 13(1)(a)) are mutually exclusive.

The Privy Council is to be congratulated for laying down a definite limit on the scope of S. 13(1)(a). The *prima facie* implications of the word "having" in S. 13(1)(a) are so wide as to include every sum received by a taxpayer simply because he is an employee and not because of his performing the duties of that employment. However, it is unfortunate that the Board saw fit to regard the sum as compensation for loss of employment

in the present case. This brings the sum within the charge but relief was available under Sch. 6 Para. 15. The relief in the present case allowed the whole sum to go untaxed, but there may be other cases where only a portion of the sum received would escape tax. It is respectfully submitted that the better test for determining whether or not a sum is compensation for loss of employment is the Romer L.J. test in *Henry* v. *Foster* rather than the Rowlatt J. test in *Chibett* v. *Robinson* as it is so much more precise and easier to apply.[3]

Jaginder Singh.

THE NATIONAL LAND CODE
FORM 16D v. *FORM 16E*
JACOB v. *OVERSEAS-CHINESE BANKING CORPORATION*[1]

The recent Federal Court decision of *Jacob* v. *Overseas-Chinese Banking Corporation, Ipoh* should come as a boon to practitioners. It seems to have laid to rest the continuing battle between the question of whether to use Form 16D or Form 16E in the First Schedule of the National Land Code Act 56 of 1965 to set in motion the machinery for foreclosing a charge payable on demand. In this case the appellant (hereinafter called "the chargor") had charged his land to the respondent bank (hereinafter called "the chargee") to secure the repayment of an overdraft up to a maximum of $6,000 "and for interest". The charge was executed on the 16th August 1966. From the time of the execution of the charge to the 2nd of December 1971, the chargor withdrew up to the limit of $6,000 and consequently caused interest to accumulate so that the actual amount owing to the chargee well exceeded $6,000. The chargee wrote to the chargor on several occasions requesting him to pay the excess over-drawings. The chargor made no attempt to reimburse the chargee for interest and on the 5th April 1972 the chargee served on the chargor a notice to begin the machinery for sale of the chargor's land. The notice took the form of Form 16D. Later, the chargee applied for an order of sale and this was granted by the late Sharma J. in the High Court. The chargor[2]

[3]See further Jaginder Singh, *Income Tax Liability of Terminal Payments* [1974] JMCL 72, pp. 78 to 89, for a more elaborate discussion of the scope of this test.

[1] [1974] 2 M.L.J. 1

[2]The word "chargee" at p. 162 r.h.c. para C of the report should read "chargor".