

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON: 24.11.2020
DELIVERED ON: 04.12.2020

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE M.S.RAMESH

Tax Case Appeal No.522 of 2017

Shri Allu Arvind Babu ..Appellant

Vs.

The Assistant Commissioner of Income Tax
Non Corporate Circle-20(1)
Chennai ...Respondent

Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal 'C' Bench, Chennai dated 15.07.2016 passed in ITA No.1254/Mds/2015 for the Assessment Year 2007-08 against the order dated 20/03/2015 and made in (ITCA) No.146/13-14 (ITCA)-14 on the file of the Commissioner of Income Tax (Appeals) - 14, Chennai against the order dated 30/11/13 and the order dated 30/11/13 and made in PANo./GIR No.ADADPA9507B on the file of Assistant Commissioner of Income Tax, Media Circle I, Chennai.

For Appellant : Mr.R.Vijayaraghavan
For Subbaraya Iyer Padmanabhan
For Respondent : Mr.M.Swaminathan
Sr. Standing Counsel
Assisted by Ms.V.Pushpa
Jr. Standing Counsel

Dr.Vineet Kothari,J

J U D G M E N T

The present appeal for the Assessment Year 2007-08, though arises out of a common order passed against the appellant by the Income Tax Appellate Tribunal, "C" Bench, dated 15.07.2016, for the Assessment Years 2006-07 and 2007-08, the issues involved in both the appeals are entirely different and therefore, both the writ appeals are being disposed of by separate orders.

2. The substantial questions of law arising in the present appeal filed by the Assessee, as framed by the Assessee, are as under:

(i) Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is correct in law in sustaining the addition of the surrender value of the assigned keyman insurance policy as income of the appellant and was not exempt under the provisions of Section 10(10D) as it then stood before the amendment by the Finance Act, 2013?

(ii) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is correct in law in not taking notice of the amendment introduced by the Finance Act, 2013, to include the assigned policies also within the ambit of keyman insurance policy for the purpose of taxation with effect from 01.04.2014 which clearly go to prove that the surrender value of the assigned keyman insurance policy was not taxable up to 31.03.2014?

3. By consent of both sides, the matter was heard finally at this stage and is being disposed of.

4. The relevant finding of the Tribunal with regard to the questions raised in the present appeal filed by the Assessee are quoted below:

"14. The facts of the case are that the assessee is the Managing Director of Allu Entertainment Private Ltd. (AEPL). During the F.Y 2004-05, AEPL has taken two Key Man Insurance Policies each amounting to Rs.100 lakh on the life of the assessee. Of which, one policy was assigned in favour of the assessee on 31.03.2006. The surrendered value of the policy amounting to Rs.58,74,752/- was offered as income taxable as perquisite u/s. 173(3) of the Act in that year itself i.e. assessment year 2006-07. Subsequently, the assessee en-cashed the policy at Rs.97,03,083/- on 29.06.2006. The AO has added the sum of Rs.38,28,331 (Rs.97,03,083-Rs.58,74,752). Against this, assessee carried the appeal before the CIT(A).

15. On appeal, the Ld. CIT(A) observed that Section 10 is the first section in chapter III entitled 'Incomes which do not form part of total income. In section 10, various kinds of incomes are stipulated, which are not to be included in total income. This section excludes those sums from income, which are received under a life insurance policy, including the sum allocated by way of bonus of such policy. However, there are certain sums, which are specifically excluded meaning thereby those sums are not excluded from income. Sub-clause (b) of clause (10D) mentions any sum received under a Keyman insurance policy. It would follow that sum received under a Keyman insurance policy is not to be excluded from total income and it would be treated as income. That is provided by clause (xi) of section 2(24). Explanation to clause (xi) states that Keyman insurance policy shall have the same meaning as assigned to it in Explanation to clause (10D) of section 10. This Explanation gives the meaning to 'Keyman insurance policy' and that sum received under this policy would be treated as income. But to circumvent this provision colourable device was adopted to evade tax. The AO had extensively dealt with this scheme in his order in page. During the course of appellate proceedings, the ld.A.R. relied on the case of Rajan Nanda [2012] 18 Taxmann.com 98 (Delhi). But the AO distinguished this case on the lines that no premium was paid by the assessee to continue the policy after assignment and only encashed the surrender value. In the above mentioned case there are two situations after assignment.

(i) employee does not continue the policy and does not pay further premiums, then he would get only surrender value: or

(ii) employee continues the policy and pays subsequent premiums, then he would get full amount on maturity.

In the case of Rajan Nanda supra, second situation has occurred as on assignment, the director assessee did not surrender the same to the LIC and chose to continue with the policy by making payment for remaining period of the policy. In that case the court held that the character of the insurance policy changes and it gets converted into an ordinary policy. The CIT(A) observed that in the present case before CIT(A)

no premiums was paid by the assessee to continue the policy after assignment and only en-cashed the policy at Rs.97,03,083/-. Hence, CIT(A) observed that in the light of above the differences of the amount that is not brought to tax in the quantum of surrender encashment should be taxed. Hence, addition made by the AO is sustained. Aggrieved, the assessee is in appeal before us.

16. We have heard both the parties and perused the material on record. Ld.A.R. relied on the judgment of CIT v. Rajan Nanda & Ors. reported in (2012) 349 ITR 008 wherein held that the payment which is received by employee under Key Man Insurance Policy, can be taxed in the hands of employee u/s. 17(3)(ii) of the Act. However, where no such amount was received at time of assignment of policy by employer company, as employee, nothing could be taxed in assessee's hands u/s. 17(3)(ii) of the Act. Further, once there is an assignment of Key Man Insurance Policy by employer company to employee, insurance policy gets converted into an ordinary policy and hence, in that case, maturity value received by employee would not be subject to tax in view of section 10(10D) of the Act. In our opinion, the argument of assessee's counsel is totally misplaced that the two insurance policies were taken in the name of Managing Director of the assessee company i.e. present assessee for amounting to Rs.100 lakhs each. The said policy was assigned to the assessee on 31.03.2006, and the surrender the value of that policy amounting to Rs.58,74,752/- was offered as income as perquisite u/s. 17(3) of the Act for assessment year 2006-07. Subsequently, within a short time, the said policy was encashed at Rs.97,03,083/- on 29.06.2006. In our opinion, the device adopted by the assessee by assigning the policy and encashing the same is nothing but colorable device adopted to evade tax and we do not find any merit in the argument of assessee's counsel. The Ld. CIT(A) has taken the correct view of the facts of the case and as discussed by the CIT(A) in para Nos.9.1 to 9.6, the same is confirmed. This ground of appeal is dismissed."

5. The learned counsel for the Assessee, Mr. Vijayaraghavan, relying upon the decision of the Delhi High Court in the case of CIT v. Rajan Nanda & Ors. [(2012) 349 ITR 008], submitted that 'Key Man Insurance Policy' taken by the company M/s. Allu Entertainment Privated Ltd. (AEPL) was assigned in favour of its Mangaging Director, the present assessee Shri Allu Arvind Babu, to the extent of Rs.100.00 Lakhs, on 31.03.2006 and for Assessment Year 2006-07, the surrender value of the said Insurance Policy to the extent of Rs.58,74,752/- was offered as "income" taxable in the hands of the Assessee as "perquisite" under Section 17(3) of the Act. But, shortly after the assignment in favour of the Assessee on 31.03.2006, which assignment was duly recognised and approved by the Insurance Company, the Assessee got the Insurance Policy encashed on 29.06.2006 and received a sum of Rs.97,03,083/- which was not taxable in the hands of the Assessee, as it was an ordinary Life Insurance claim received by the Assessee on his Life Insurance Policy which was exempted under Section 10(10D) of the Act and therefore, for the Assessment Year 2007-08, such encashment of surrender of one of the two such Insurance Policies taken in favour of the Assessee by the Company was not taxable in the hands of the Assessee and the Assessing Authority has erred in again bringing to tax the difference sum of Rs.38,28,331/- (Rs.97,03,083 - Rs.58,74,752 taxed in the previous year) in the present Assessment Year 2007-08.

6. The learned counsel for the Assessee also relied upon a later Bombay High Court decision, in which, following the decision of the Delhi High Court, the Bombay High Court on a concession made on behalf of the Revenue Department in the case of CIT v. Prashant J Agarwal [(2016) 243 taxmann 119], held that Explanation 1 to Section 10(10D) of the Act had come into force only from 1st April 2014 and therefore, it would not govern/apply to amounts received under assigned Keyman Insurance Policy prior to Assessment year 2014-15. He, therefore, submitted that the appeal of the Assessee deserves to be allowed.

7. Per contra, Mr. M. Swaminathan, learned Senior Standing Counsel appearing for the Revenue vehemently opposed these submissions and drawing the attention of this Court to the provision of Section 10(10D) of the Act, submitted that only the sum received under Life Insurance Policy is exempt from taxation under Section 10(10D) of the Act. But, clause (b) thereafter makes an exception with regard to Keyman Insurance Policy and therefore, the sum received by the Assessee under the Keyman Insurance Policy after the assignment in his favour on 31.03.2006 was also clearly taxable as perquisite in the hands of the Assessee.

8. The learned Senior Standing Counsel further submitted that the present Assessee individually never paid any premium on the said Keyman Insurance Policy after its assignment in its favour on 31.03.2006 and soon after three months of assignment, he got it surrendered, encashed and received the additional sum of Rs.97,03,083/- and therefore, the balance sum was rightly taxed as "perquisite" in the hands of the Assessee.

9. Drawing our attention towards Explanation 1 to Section 10 (10D) of the Act inserted by the Finance Act, 2012 with effect from 01.04.2013 and further amendment of Explanation 1 by Finance Act, 2013, with effect from 01.04.2014, which was only clarificatory in nature and was brought to undo the effect of Delhi High Court judgment in the case of Rajan Nanda (supra), he submitted that Explanation 1 effect will always relate back to parent provision and it clearly spelt that even after assignment, the Keyman Insurance Policy will continue to bear the character of a Keyman Insurance Policy, even though it is a Life Insurance of the Key employees of the Company and therefore, its surrender value will be an exception to Section 10(10D) of the Act vide Clause (b) thereafter and therefore, the income received by the Assessee would continue to be taxable.

10. The learned counsel also submitted that the concession given on behalf of the Department before the Bombay High Court was misplaced and he is not conceding to any such legal position on behalf of Department as was done before the Bombay High Court. He further submitted that the decision of the Delhi High Court is also not applicable and the effect of the Delhi High Court judgment was undone by the Parliament by the aforesaid Explanation 1 to Section 10(10D) of the Act and therefore, the said decision cannot enure to the benefit of the Assessee. In other words, he submitted that Explanation 1 would clarify the position for the Assessment Year 2007-08 involved in the present case and the surrender encashment value received by the Assessee was liable to be taxed in his hands upon surrendering the Keyman Insurance Policy during the Assessment Year 2007-08 also.

11. We have heard both the counsel at length.

12. Section 10(10D) of the Act, which gives exemptions to various types of income under the Act, relating to sum received under Life Insurance Policy, is quoted below for ready reference:

(10D) any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, other than—

- (a) any sum received under sub-section (3) of section 80DD or sub-section (3) of section 80DDA; or
- (b) any sum received under a Keyman insurance policy; or
- (c) any sum received under an insurance policy issued on or after the 1st day of April, 2003 ⁸⁷[but on or before the 31st day of March, 2012] in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured; ⁸⁷[or]

⁸⁸[(d) any sum received under an insurance policy issued on or after the 1st day of April, 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds ten per cent of the actual capital sum assured:]

Provided that the provisions of ⁸⁹[sub-clauses (c) and (d)] shall not apply to any sum received on the death of a person:

Provided further that for the purpose of calculating the actual capital sum assured under ⁹⁰[sub-clause (c)], effect shall be given to the ⁹¹[Explanation to sub-section (3) of section 80C or the Explanation to sub-section (2A) of section 88, as the case may be] :

⁹²[Provided also that where the policy, issued on or after the 1st day of April, 2013, is for insurance on life of any person, who is—

- (i) a person with disability or a person with severe disability as referred to in section 80U; or
 - (ii) suffering from disease or ailment as specified in the rules made under section 80DDB,
- the provisions of this sub-clause shall have effect as if for the words "ten per cent", the words "fifteen per cent" had been substituted.]

⁹³[Explanation 1].—For the purposes of this clause, "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the

first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person ⁹⁴[and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration];]

⁹⁵[Explanation 2.—For the purposes of sub-clause (d), the expression "actual capital sum assured" shall have the meaning assigned to it in the Explanation to sub-section (3A) of section 80C;]

86. Substituted by the Finance Act, 2003, w.e.f. 1.4.2004. Prior to its substitution, clause (10D), as inserted by the Finance (No.2) Act, 1991, w.r.e.f. 1.4.1962, and later on amended by the Finance Act, 1995, w.e.f. 1.4.1996 and Finance (No.2) Act, 1996, w.e.f. 1.10.1996, read as under:

(10D) any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy other than any sum received under sub-section (3) of section 80DDA or under a Keyman insurance policy.

Explanation.— For the purposes of this clause, "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person;

87. Inserted by the Finance Act, 2012, w.e.f. 1.4.2013.

88. Inserted, *ibid*

89. Substituted for "this sub-clause" by the Finance Act, 2012, w.e.f. 1.4.2013.

90. Substituted, *ibid*

91. Substituted for "Explanation to sub-section (2A) of section 88" by the Finance Act, 2005, w.e.f. 1.4.2006.

92. Inserted by the Finance Act, 2013, w.e.f. 1.4.2014.

93. Explanation renumbered as Explanation 1 by the Finance Act, 2012, w.e.f. 1.4.2013.

94. Inserted by the Finance Act, 2013, w.e.f. 1.4.2014.

95. Inserted by the Finance Act, 2012, w.e.f. 1.4.2013.

13. We find considerable force in the submission made by the learned counsel for the Revenue and we are unable to accept the submissions made by the learned counsel for the Assessee.

14. The Key Insurance Policy taken by a limited company in favour of its key employee, the Managing Director of the Company in the present case, even though it is Life Insurance Policy, is excluded from the ambit of exemption under Section 10(10D) by specifically mentioning the same in Clause (b) of the said exception of the provision quoted above. Therefore, any amount received under Keyman Insurance Policy is a taxable receipt in the hands of the employee concerned as perquisite.

15. In the present facts, the Keyman Insurance Policy was taken out by the Company and was assigned in favour of the Managing Director on 31.03.2006. To the extent of surrender value accrued as on 31.03.2006, namely Rs.58,74,752/-, was offered for taxation as "perquisite" in the hands of the Assessee. The character of Insurance Policies does not change after assignment. The Assessee himself has never paid any premium on the said Keyman Insurance Policy from his own resources. Therefore, even if the assignment is endorsed by the Insurance Company as on 31.03.2006, the character of the Policy does not convert into an ordinary Life Insurance Policy in the hands of the Assessee. The Keyman Insurance Policy is a Life Insurance Policy taken by the employer company in favour of its employee Managing Director. Its character continues to be the same.

16. The view expressed by the Delhi High Court quoted below in Rajan Nanda case was undone by the Parliament by inserting Explanation 1 to Section 10(10D) of the Act, which was further amended to include the case of the Policy which has been assigned to a person at any time during term of the Policy with or without any consideration. This Explanation 1, in our opinion, is merely of clarificatory nature and like all other Explanations, which are inserted to clarify certain issues relevant in the parent provision, apply retrospectively back for correct interpretation to the date of insertion of main provision itself. The Explanation is not a substantive provision which creates a new tax liability on the Assessee and which only could be normally applied prospectively. The Explanation in the present case as

well as others will therefore have to be read with the main provision right from day one as they are only of clarificatory nature and explain the position as the Legislature always intended it to mean. Therefore, in our opinion the amendment by way of Explanation is merely of clarificatory nature and effectively wipes out the effect of the decision of the Delhi High Court in the case of Rajan Nanda (supra).

17. A Division Bench of Delhi High Court, in the case of CIT v. Rajan Nanda & Ors. [(2012) 349 ITR 008] with regard to Keyman Insurance Policy, had earlier held as under:

"52. Thus, the issue depends on the question as to whether on assignment of the insurance policy to the assessee, it changes its character from Keyman insurance also to an ordinary policy. It is because of the reason that if it remains Keyman insurance policy, then the maturity value received is subjected to tax as per Section 10 (10D) of the Act. On the other hand, if it had become ordinary policy, the premium received under this policy, in view of the aforesaid Section 10(10D) itself, the same would not be subjected to tax.

53. Once there is an assignment of company/employer in favour of the individual, the character of the insurance policy changes and it gets converted into an ordinary policy. Contracting parties also change inasmuch as after the assignment which is accepted by the insurance, the contract is now between the insurance company and the individual and not the company/employer which initially took the policy. Such company/employer no more remains the contracting parties. We have to bear in mind that law permits such an assignment even LIC accepted the assignment and the same is permissible. There is no prohibition as to the assignment or conversion under the Act. Once there is an assignment, it leads to conversion and the character of policy changes. The insurance company has itself clarified that on assignment, it does not remain a keyman policy and gets converted into an ordinary policy. In these circumstances, it is not open to the Revenue to still allege that the policy in question is

keyman policy and when it matures, the advantage drawn therefrom is taxable. One has to keep in mind on maturity, it does not the company but who is an individual getting the matured value of the insurance.

54. No doubt, the parties here, viz., the company as well as the individual taken huge benefit of these provisions, but it cannot be treated as the case of tax evasion. It is a case of arranging the affairs in such a manner as to avail the state exemption as provided in Section 10(10D) of the Act. Law is clear. Every assessee has right to plan its affairs in such a manner which may result in payment of least tax possible, albeit, in conformity with the provisions of Act. It is also permissible to the assessee to take advantage of the gaping holes in the provisions of the Act. The job of the Court is to simply look at the provisions of the Act and to see whether these provisions allow the assessee to arrange their affairs to ensure lesser payment of tax. If that is permissible, no further scrutiny is required and this would not amount to tax evasion. Benefit inured owing to the combined effect of a prudent investment and statutory exemption provided under Section 10(10D) of the Act, the section does not envisage of any bifurcation in the amount received on maturity on any basis whatsoever. Nothing can be read in Section 10(10D) of the Act, which is not specifically provided because any attempt in that behalf as contended by Revenue would be tantamount to legislation and not interpretation.

18. The Delhi High Court decision quoted above, clearly expresses that the character of the Insurance Policy gets converted into an ordinary policy. Because Section 10(10D) of the Act does not make any such distinction, it cannot be said to be a case of tax evasion, but rather a case of tax planning, even if huge benefit of these provisions are taken by both company as well as individual. It is this caveat, along with the pronouncement of Delhi High Court, led to the insertion of aforesaid Explanation 1 to Section 10(10D) of the Act and therefore, after such amendment, which in our opinion applies retrospectively to all the previous years, including the Assessment Year 2007-08 in the present case, the reliance placed by the learned counsel for the Assessee of Delhi High Court decision is misplaced and cannot enure to the benefit of the Assessee.

19. We are also a bit surprised by the concession given on behalf of the Department before the Bombay High Court in the case of Prashant J Agarwal. The relevant portion of the short judgment of the Bombay High Court in this regard is quoted below for ready reference:

"5. The Revenue's appeal before the Tribunal was dismissed by the impugned order dated 6th September, 2013. It held that the assessment year being A.Y. 2010-11, the issue stand concluded against the Revenue by the decision of Delhi High Court in Rajan Nanda (supra) on identical facts. This it held is particularly so as Explanation -I to Sectionn 10(10D) of the Act was amended by clarifying the meaning of "Keyman Insurance Policy" to include a Keyman Policy which has been assigned to any other person only effective from 1st April, 2014. The amended Explanation I to Section 10(10D) of the Act now reads as under:

"[Explanation 1] - For the purposes of this clause, "Keyman insurance Policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person [and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration]."

6. However, as we are concerned with the period prior to 1st April, 2014, the above amendment would not apply in the subject assessment year.

7. Ms.Bharucha, learned counsel for the Revenue very fairly states that the issue arising stands concluded against the Revenue for the reasons mentioned by the Delhi High Court in Rajan Nanda (supra). It is also accepted by the Revenue that the amendment in Explanation I to Section 10(10D) of the Act has specifically come into force only from 1st April, 2014 and it would not govern / apply to amounts received under the assigned Keyman Insurance Policy prior to Assessment Year 2014-15.

8. In view of the above, the question as proposed does not give rise to any substantial question of law. Hence, not entertained."

20. Since the position of law with regard to only prospective application of Explanation 1 was recorded by Bombay High Court on the basis of a concession of the Department, which in our opinion is not the correct legal position, we are unable to agree with the said decision of the Bombay High Court to this extent, on the basis of a concession made by the counsel for the Revenue. The Court itself has not discussed the necessity of reading the said Explanation only prospectively from the Assessment Year 2014-15 onwards. Therefore, the said judgment as well as the Delhi High Court decision are of no avail to the Assessee in the present case.

21. On the basis of Section 10(10D) of the Act, with its Explanation 1, the clear position of law which emerges is that the character of the Keyman Insurance Policy does not get converted into ordinary Life Insurance Policy despite its assignment and therefore, any benefit accruing to the employee upon its surrender or encashment will be taxable in the hands of the Employee as "perquisite".

22. The appeal filed by the Assessee, therefore, deserves to be dismissed and the same is accordingly dismissed. The questions are answered in favour of the Revenue and against the Assessee. No costs.

Sd/-

Assistant Registrar(CS VII)

//True Copy//

Sub Assistant Registrar

kpl

To

1.The Assistant Commissioner of Income Tax
Non Corporate Circle-20(1)
Chennai

2.The Income Tax Appellate
Tribunal 'C' Bench, Chennai.

3.The Commissioner of Income Tax
(Appeals)-14, Chennai 34.

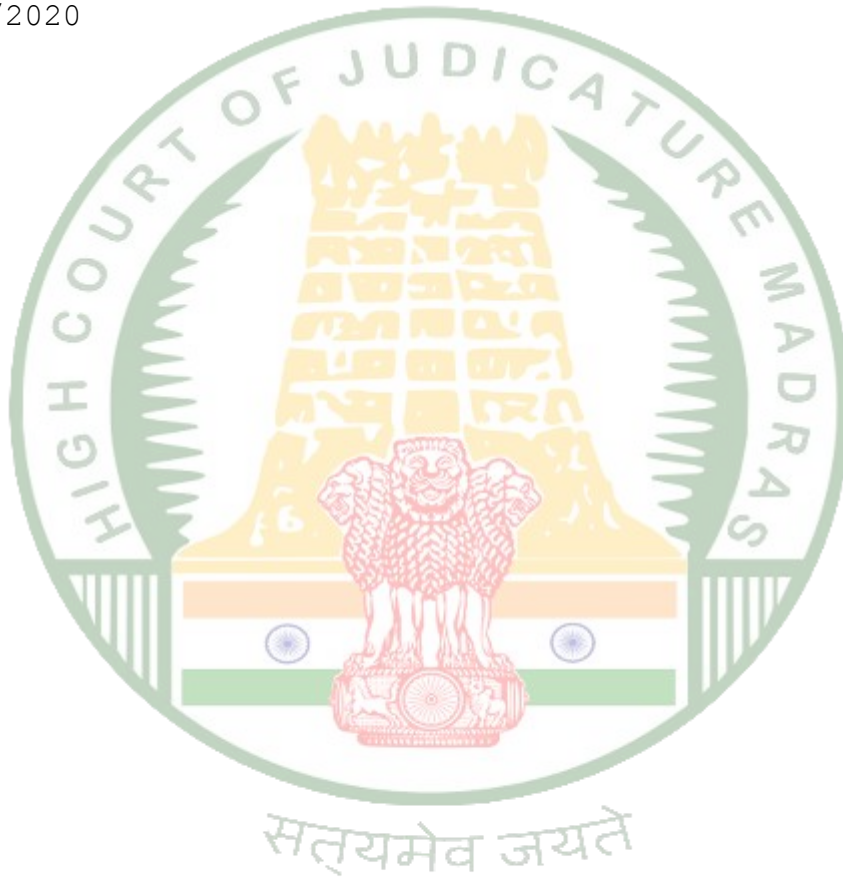
4.The Assistant Commissioner
of Income Tax, Media Circle I,
Chennai.

+1cc to Mr.M.Swaminathan, Advocate, S.R.No.39168

+1cc to M/s.Subbaraya Aiyar Padmanabhan, Advocate, S.R.No.39485

Judgment in
TCA No.522 of 2017

VD (CO)
KKV/22/12/2020



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