

IN THE HIGH COURT OF JUDICATURE AT MADRAS

CORAM:

THE HON'BLE MR.JUSTICE M.DURAI SWAMY
AND
THE HON'BLE MRS.JUSTICE T.V.THAMILSELVI

Tax Case (Appeal) No.843 of 2013

Judgment reserved on 26.03.2021	Judgment pronounced on 17.04.2021
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Commissioner of Income tax,
Chennai.

.. Appellant

Vs.

M/s.Soundarya Decorators Pvt. Ltd
26 Survey Nos.2 & 3,
Porur Village, Kolathur,
Chennai-600 047.

.. Respondent

PRAYER : Tax Case Appeal filed under Section 260 A of the Income Tax Act, 1961, against the order of the Income-Tax Appellate Tribunal, Chennai Bench "C", dated 07.02.2013 in I.T.A.No.386/Mds/2011 for the assessment year 2005-2006, preferred against the order passed by the Commissioner of Income Tax(Appeals)-V, Chennai-34 dated 15-12-2010 made in ITA.No.525/09-10 preferred against the order passed by the Assistant Commissioner of Income Tax, Company Circle VI(3), Chennai-34, for the Assessment year 2005-2006.

For Appellant : Mr.J.Narayanaswamy
Senior Standing counsel

For Respondent : Mr.V.S.JayaKumar

J U D G M E N T

T.V.THAMILSELVI, J.

This appeal has been filed by the Revenue under Section 260A of the Income Tax Act, 1961, against the order of the Income-Tax Appellate Tribunal, Chennai Bench "C", dated 07.02.2013 in I.T.A.No.386/Mds/ 2011 for the assessment year 2005-2006.

2.The above Tax Case Appeal was admitted on the following

substantial Questions of law:

"(i) Whether on facts and the circumstances of the case, the Tribunal was right in holding that the assessee is eligible for deduction of entire sum paid to the insurance company as premium on Key Man insurance policy and is eligible for deduction under Section 37?

(ii) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in not considering the restriction placed by the insurance company on the sum assured in the case of Key Man insurance policy and allowing the entire premium including the sum assured in excess of such restriction?

(iii) Whether based on material placed before it, the income Tax Appellate Tribunal could have come to the conclusion that the entire premium is towards the sum assured on Key Man insurance policy, though insurance company has placed restriction on the sum assured in the Key Man insurance policies?"

3. Heard Mr.J.Narayanaswamy, learned Senior Standing counsel for the appellant and Mr.V.S.Jayakumar learned counsel for the Respondent.

4. The facts reveal that, the assessee company has debited a sum of Rs.2,39,61,737/- towards insurance under the administrative expense, out of which, Rs.2,35,34,728/- relates to expenses towards Keyman Insurance. The assessee is a Private Limited Company having less than 10 No. of share holders. According to the guidelines of LIC for Keyman Insurance, the concern should be a profit making one and the profits for the last three years should justify the cover being allowed and the maximum sum allowable is three times of average gross profit or five times of average net profit whichever is lower. It is pertinent to note that for a minimum term of 10 years, the annual premium payable for a sum assured value of Rs.4,62,63,345/-, calculating @ 10% of the assured sum works out to only Rs.46,26,334/- per annum. However, the assessee company has claimed a sum of Rs.2,35,34,728/- as Keyman Insurance premium for the assessment year 2005-06. The assessee company was given an opportunity to rebut the same along with documentary evidence to substantiate its claim.

5. The assessee company in its submission has not provided document and / or fact that would justify that the expenditure is wholly and exclusively for the purpose of business. In order to claim deduction under Section 37(1) of the I.T.Act, 1961, the

nexus between the business and the expense has to be proved. In the absence of any explanation, the Assessing Officer did not accept the contention of the assessee. In these circumstances, the Assessing Officer disallowed the expenditure and added the said amount to the total income of the assessee company. Aggrieved by the said order, the assessee has preferred an appeal in ITA No.525/09-10 before the Commissioner of Income Tax (Appeals) and the Commissioner of Income Tax, while disposing of the said appeal, relied upon the CBDT circular No.762, dated 18.02.1998 and also the provisions of Section 10(10D) of the Act to conclude that there is no stipulation as to the restriction of the premium paid and treated the premium paid for Keyman Insurance Company as business expenditure.

6. Accordingly the Commissioner for Income Tax, directed the Assessing officer to allow a sum of Rs.1,89,08,394/- by treating the entire premium paid as business expenditure. Aggrieved over the order of the CIT (Appeals), the Revenue preferred an appeal before the Income Tax Appellate Tribunal in ITA.No.386/Mds/2011 with regard to Keyman Insurance premium and the Tribunal confirmed the order of the CIT (Appeals) and dismissed the appeal. The main contention of the Revenue is that the Tribunal had confirmed the order of the CIT (Appeals) without giving any valid reasons for following the circular. Challenging the said impugned order the Revenue has preferred this appeal.

7. The learned Senior Standing counsel appearing for the Revenue submitted that the Tribunal failed to appreciate that in view of the restrictions on the sum assured on Keyman Insurance policy, the entire premium cannot be considered as premium towards Keyman Insurance policy. He further submitted that the Tribunal also erred in applying the circular No.762, dated 18.02.1998 on the allowability of premium on Keyman Insurance policy while the issue before it was the quantum of deduction.

8. Per contra, the learned counsel for the respondent / assessee submitted that CIT(A) as well as the Tribunal was right in holding that thus the premium on Keyman Insurance policy was allowable as business expense under Section 37(1) of the Act. In support of his contentions, the learned counsel relied upon the following judgments:

(i) The Hon'ble Supreme Court in the case of Sassoon J.David & Co.P.Ltd. Vs. Commissioner of Income Tax reported in 1979 (Volume 118) ITR 0261, held as follows:

"20. The next contention urged on behalf of the Department was that since Davids and Tatas were indirectly benefited by the retrenchment of the services of the employees of the company and payment of compensation to them and since there was no

necessity to retrench the services of all the employees, the expenditure in question could not be treated as an expenditure laid out wholly and exclusively for the purposes of the company. It has to be observed here that the expression "wholly and exclusively" used in s.10(2)(XV) of the Act does not mean "necessarily". Ordinarily, it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under s.10(2)(XV) of the Act even though there was no compelling necessity to incur such expenditure. It is relevant to refer at this stage to the legislative history of s.37 of the IT Act, 1961, which corresponds to s.10(2)(XV) of the Act. An attempt was made in the IT Bill of 1961 to lay down the "necessity" of the expenditure as a condition for claiming deduction under s.37. Sec.37(1) in the Bill read "any expenditure.... laid out or expended wholly necessarily and exclusively for the purposes of the business or profession shall be allowed..." The introduction of the word "necessarily" in the above section resulted in public protest. Consequently, when s.37 was finally enacted into law, the word "necessarily" came to be dropped. The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction under s.10(2)(XV) of the Act if it satisfies otherwise the tests laid down by law. This view is in accord with the following observations made by this Court in CIT vs. Chandulal Keshavlal & Co: (1960) 38 ITR 601 (SC): TC16R.507:"

(ii) The Hon'ble Division Bench of the High Court of Punjab and Haryana in the case of Principal Commissioner of Income Tax Vs Ramesh Steels, reported in 2016 (Volume 384) ITR 0437 (P&H), held as follows:

"5. The issue is no longer res integra. The Bombay High Court delving into identical issue in Commissioner of Income Tax v. B.N.Exports (2010) 323 ITR 178 after noticing the relevant statutory provisions and the Board Circular No.762 dated 18th February, 1998 issued by the Central Board of Direct Taxes on the issue had held that the premium paid for a 'Keyman Insurance Policy' is allowable as business expenditure under Section 37(1) of the Act. It was

further noted that the object and purpose of the said policy is to protect the business against a financial set back which may occur as a result of a premature death, to the business or professional organization. There is no rational basis to confine the allowability of the expenditure incurred on the premium paid towards such a policy only to a situation where the policy is in respect of the life of an employee. The said policy when obtained to secure the life of a partner against a disruption of the business is equally for the benefit of the partnership business which may be affected as a result of premature death of a partner. Thus, the premium on the 'keyman Insurance Policy' of partner of the firm is wholly and exclusively for the purposes of business and is allowable as business expenditure. The relevant observations read thus:-

4. In order to appreciate the submission which has been made a reference to some of the relevant provisions of the Income Tax Act, 1961 would be in order. Section 2(31) defines the expression "person" to include an individual, a Hindu Undivided Family, a company, a firm, an AOP or a BOI whether incorporated or not, a local authority and every artificial juridical person, not falling within the previous sub clauses. Consequently, for the purposes of taxation, a firm is regarded as a distinct assessable entity. Section 10 provides that in computing the total income of any person for the previous year, income falling within any of the clauses of the provision shall not included. Clause (10D) specifies to any sum received under a life insurance policy, including a sum allocated by way of bonus on such a policy other than, inter alia, "any sum received under a Keyman Insurance Policy". The Explanation to clause (10D) defines what is meant by a Keyman Insurance Policy thus:

"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."

5. The effect of Clause(10D) is that a sum received under a life insurance policy is not to be included in computing the total income of any person. However, a sum received under a Keyman Insurance Policy forms a part of the total income and is liable to be offered to tax. For the purposes of Clause (10D), a Keyman Insurance Policy is a life Insurance policy taken by a person on the life of another person

who is or was the employee of the person who subscribes to the policy of the insurance or is or was connected in any manner whatsoever with the business of the subscriber to the policy. In other words, a Keyman Insurance Policy for Clause (10D) is not confined to a policy taken by a person on the life of an employee, but also extends to an insurance policy taken with respect to the life of another who is connected in any manner whatsoever with the business of the subscriber.

6. The Central Board of Direct Taxes has issued a circular on 18th February, 1998 (Circular 762)[(1998) 145 CTR (St) 5] which clarifies the scope and purpose of the provision. Paragraph 14.1 of the circular states thus:

"14.1. A Key man Insurance policy of the Life Insurance Corporation of India, etc., provides for a insurance policy taken by a business organisation or a profession organisation on the life of an employee, in order to protect the business against the financial loss, which may occur from the employee's premature death. The "Keyman" is as employee or a director, whose services are perceived to have a significant effect on the profitability of the business. The premium is paid by the employer."

7. The Circular notes that there were certain doubts on the taxability of the income, including bonus, received from such policies and as regards whether the premium paid should be allowed as capital or as revenue expenditure. The circular clarifies that the Act lays down the tax treatment for a Keyman Insurance Policy. The circular clarifies that the premium paid on a Keyman Insurance Policy. The circular clarifies that the premium paid on a keyman Insurance Policy is allowable as business expenditure."

(iii) The Hon'ble Division Bench of the High Court of Delhi in the case of Commissioner of Income Tax &ORS Vs Rajan Nanda & ORS., reported in 2012(Volume 349) ITR 8(Delhi), held as follows:

"25. After giving our due and thoughtful consideration to the submissions of the parties of both sides, we feel that the assessee has been able to make out a case in its favour and order of the Tribunal does not call for any interference. We are persuaded by the following reasons in support of this vies of ours:

(i) The Department has itself allowed the expenditure incurred on the premium paid for keyman insurance policies in previous years as business expenditure under Section 37 of the Act. Right from 1991-92 upto 1993-94 and thereafter even in respect of Assessment year 1997-98, the expenditure was allowed. Though thereafter, the expenditure was disallowed, but again the claim was accepted for the Assessment years 2001-02 and 2002-03. Principle of consistency would, therefore, be applicable in such a case.

(ii) The Tribunal has rightly referred to and relied upon the CBDT's Circular dated 18.02.1998. This Circular is binding on the Income Tax Department, which categorically stipulates that premium on keyman policy should be allowed as business expenses. The assessee would, naturally, take in to consideration such clarifications issued by the CBDT and would act on the basis thereof. When the assessee was given the impression, by means of the aforesaid Circular, that if expenditure is incurred on the keyman policy, it would be treated as business expenditure. There is no reason for the Department to deviate therefrom when it comes to the assessment.

.....

(iv) The argument of Mr.N.P.Sahni, learned counsel for the Revenue that taking such keyman insurance policy every year and thereafter assigning the same to the beneficiaries may be treated as colourable device, may not be correct. Though this argument appears to be attractive when we look into the fact that the assessee had been taking the policies and thereafter assigning the same year after year in favour of the beneficiaries, what cannot be ignored that this course of action is permitted by the Department itself as stated in CBDT's Circular dated 18.02.1998."

9. Section 10(10D) of the Act deals with taxation of money received under the insurance policy. The issue that has to be decided in this appeal is as to the question of expense incurred towards the payment of insurance premium on a Keyman Insurance policy. The circular, which has been issued by the CBDT, clarifies the position by stipulating that the premium paid for a Keyman Insurance policy should be allowed as business expenditure.

10. In the case on hand, with regard to the insurance

premium paid by the assessee is concerned, the Tribunal, without giving any acceptable finding, came to the conclusion that a sum of Rs.1,89,08,394/- should be treated as business expenditure. That apart, the assessee also failed to produce any documentary evidence to justify their claim under Section 37(1) of the Act.

11. The learned Senior Standing Counsel for the appellant submitted that since the Commissioner of Income Tax (Appeals) as well as the Income Tax Appellate Tribunal have not considered the contentions of the revenue in entirety, it would be appropriate to remit the matter back to the Commissioner of Income Tax (Appeals) for fresh consideration.

12. On a reading of the orders passed by the Commissioner of Income Tax (Appeals) as well as the Income Tax Appellate Tribunal, we are convinced that the Commissioner of Income Tax (Appeals) and the Tribunal have not considered the case of the revenue in a proper manner. Therefore, agreeing with the submissions made by the learned Senior Standing Counsel for the appellant, in the interest of justice, we are of the considered view that the orders passed by the Commissioner of Income Tax (Appeals) and that of the Income Tax Appellate Tribunal are liable to be set aside and the matter should be remitted back to the Commissioner of Income Tax (Appeals) for fresh consideration.

13. Accordingly, the orders passed by the Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal are set aside and the matter is remitted back to the Commissioner of Income Tax (Appeals) for fresh consideration. The Commissioner of Income Tax (Appeals) shall decide the matter afresh, after taking into consideration the case of revenue as well as the assessee and pass orders, on merits and in accordance with law.

14. With the above observations, the Tax Case Appeal is allowed. No costs.

Sd/-
Assistant Registrar(CS-III)

//True Copy//

Sub Assistant Registrar

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To

1.Income Tax Appellate Tribunal "C" Bench,
Chennai.

2.The Commissioner of Income-Tax,
Chennai.

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

4.The Assistant Commissioner of Income Tax,
Company Circle-VI(3),
Chennai-34.

5.The Income Tax Officer(OSD),
Company Circle VI(3), Chennai.

+1cc to Mr.J.Narayanaswamy, Advocate, S.R.No.23832

+1cc to Mr.V.S.Jayakumar, Advocate, S.R.No.23487

Tax Case Appeal No.843 of 2013

PM(CO)
CB(21/05/2021)