* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% Decision Delivered On: 16th December, 2011

(1) **ITA 400/2008**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

RAJAN NANDA . . .Respondent

(2) **ITA 1428/2008**

RAJAN NANDA . . . Appellant

VERSUS

COMMISSIONER OF INCOME TAX . . .Respondent

(3) **ITA 1429/2008 & CM No.17975/2008**

RAJAN NANDA . . . Appellant

VERSUS

COMMISSIONER OF INCOME TAX . . .Respondent

(4) **ITA 210/2009**

COMMISSIONER OF INCOME TAX CENTRAL-II . . . Appellant

VERSUS

RAJAN NANDA . . .Respondent

(5) **ITA 849/2010**

COMMISSIONER OF INCOME TAX
CENTRAL-II, JHANDEWALAN,
NEW DELHI . . . Appellant

VERSUS

RAJAN NANDA . . .Respondent

(6) **ITA 855/2010**

COMMISSIONER OF INCOME TAX CENTRAL-II . . . Appellant

VERSUS

RAJAN NANDA . . .Respondent

(7) **ITA 1171/2010 & CM No.14476/2010**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

RAJAN NANDA . . .Respondent

(8) **ITA 2075/2010**

CIT . . . Appellant

VERSUS

RAJAN NANDA . . .Respondent

(9) **ITA 518/2011**

CIT . . . Appellant

VERSUS

RAJAN NANDA . . .Respondent

(10) **ITA 165/2011**

CIT . . . Appellant

VERSUS

NARESH KUMAR TREHAN . . .Respondent

(11) **ITA 22/2009**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

Dr. NARESH KUMAR TREHAN . . .Respondent

(12) **ITA 1010/2010**

CIT . . . Appellant

VERSUS

NARESH TREHAN . . .Respondent

(13) **ITA 2073/2010**

CIT . . . Appellant

VERSUS

NARESH TREHAN . . .Respondent

(14) **ITA 152/2011**

CIT . . . Appellant

VERSUS

NARESH TREHAN . . .Respondent

(15) **ITA 232/2011**

CIT . . . Appellant

VERSUS

NARESH TREHAN . . .Respondent

(16) **ITA 398/2009**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

ESCORTS HEART INSTITUTE AND
RESEARCH CENTRE LTD. . . .Respondent

(17) **ITA 484/2009**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

ESCORTS HEART INSTITUTE AND
RESEARCH CENTRE LTD. . . .Respondent

(18) **ITA 1918/2010**

CIT . . . Appellant

VERSUS

ESCORTS HEART INSTITUTE . . .Respondent

(19) **ITA 1919/2010**

CIT . . . Appellant

VERSUS

ESCORTS HEART INSTITUTE . . .Respondent

(20) **ITA 175/2011**

CIT . . . Appellant

VERSUS

ESCORTS HEART INSTITUTE AND
RESEARCH CENTRE LTD. . . .Respondent

Counsel for the Revenue- Ms. Rashmi Chopra, Sr. Standing Counsel, Mr. N.P. Sahni, Sr. Standing Counsel, Ms. Suruchi Aggarwal, Sr. Standing Counsel.

Counsel for the Assessee- Mr. O.S. Bajpai, Sr. Advocate with Mr. V.N. Jha, Advocate.
Mr. V.P. Gupta with Mr. Basant Kumar, Advocates.
Mr. R.M. Mehta, Advocate.

CORAM :-
HON'BLE THE ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE M.L. MEHTA

A.K. SIKRI, Acting Chief Justice (ORAL**)**

1. All these appeals relate to the same episode, which is re-enacted year after year and therefore, various assessment years are involved. Even the characters in the said episode are the same, who are three assessees, though for the purpose of taxability qua each of them, separate cases have originated. However, the disputes which have arisen flow from the same set of facts, although nature of dispute in respect of one assessee is little different from the disputes in respect of other two.

2. One assessee, viz., Escorts Heart Institute & Research Centre Ltd. is the company which had taken "key man" policy for the other two assessees, who were employees/Directors of the assessee company. After nursing these policies for sometime by paying premium thereupon, they were assigned to other two assessees, i.e., employees/Directors receiving surrender value from them. Whereafter, for the remaining period of all those policies, the insurance premium were paid by the assignees. Insofar as the assessee company is concerned, the question is as to

whether premium paid by it, after adjusting the surrender value, is to be treated as business expenditure or not as claimed by the assessee. Insofar as other two assessees are concerned in whose favour the 'key man' policies were assigned, the question is as to whether the difference between the actual premium paid and surrender value given by them is to be treated as 'salary' in their hands and is to be taxed accordingly. Another issue qua these two Directors is as to whether the maturity value received by them on the said policy is to be taxed or not.

3. With this little indication of the nature of issues which arise in three sets of appeal, we advert to the facts in detail, which would be common to all the cases. Thereafter, we will refer to specific issues.

FACTS:

4. As pointed out above, the assessee company has been taking 'key man' insurance policies on the lives of two employees/Directors in different years. For the sake of brevity and clarity, we shall give facts in respect of such 'key man' policy taken by the assessee company on the life of Mr. Rajan Nanda, its Chairman and Director.

5. The assessee company had been taking the 'key man' insurance policies in its name covering Mr. Rajan Nanda and these policies were assigned in favour of Mr. Nanda in the subsequent year. The details of the policies are as under:

A.Y. in which policy is assigned	Policy No.	A.Y. in which policy is taken	Date of maturity	Amount paid by the assessee before assignment	Amount paid by the keymnas for assignment
2002-01	112680817	1999-2000	1.4.2004	37256050	5303407
2001-02	112689240	2000-01	1.4.2005	36738052	5363820
2002-03	112689601	2001-02	1.4.2006	36008700	5398305
	112963783	2001-02	1.4.2006	37970019	5387415

2003-04	113192477	2002-03	1.4.2007	36003400	5400510

6. Insofar as the assessee company is concerned, the Assessing Officer (AO) took the view that since the expenditure incurred on the premia paid on the said keyman insurance policies was much more that the amount realized by the assessee company on the assignment of these policies to the employees/Directors, i.e., the surrender value only was received, the amount paid by the assessee company as premia on the said policies could not be treated as expenditure incurred wholly and exclusively for the business purpose of the assessee company. Therefore, the AO disallowed the premium paid, in different years which was claimed as business expenditure, holding that it was a colourable device adopted by the assessee company to claim a business expenditure, which was not wholly and exclusively for the business of the assessee company.

7. The assessee company preferred appeal against the assessment orders and succeeded before the CIT (A), who held it to be the business expenditure.

8. The view of the CIT (A) was upheld by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal').

9. Insofar as Mr. Nanda is concerned, in his case, the AO took the view that he had taken substantial benefit by paying only surrender value as against much higher amount of premium paid by the company. The difference between the premium paid by the company and the surrender value paid by Mr. Nanda was treated as the benefit to be taxed in his hands. In appeal preferred by Mr. Nanda before the CIT (A), the first appellate authority held that as the Director, he was receiving commission income and was having the status of 'employee' and the aforesaid benefit derived by him was to be treated as 'salary' within the meaning of Section 17 of the Income Tax Act (hereinafter referred to as 'the Act'). However, the Tribunal has reversed the decision of the CIT (A) holding that merely by assignment in a particular year when the policy was still continuing, no taxable event had taken place and therefore, no tax could be charged. It has also held that the amount in question cannot be treated as 'perquisite' so as to fall within the scope of Section 17(3) of the Act. This decision in the case of Mr. Nanda is followed in the case of other Director-assessee, viz. Dr. Naresh Trehan.

10. Challenging the orders of the Tribunal, Revenue has preferred appeals in the case of the company as well as in respect of both the said Directors. With these background facts, we revert to each set of appeal.

Appeals qua Assessee Company:

11. Basic facts and events in this behalf have already been noted above. The appeals of the Revenue were admitted on the following substantial question of law, which is common to all these appeals filed by the Revenue against the assessee company:

> "Whether the I.T.A.T. was correct in law in deleting the addition made by the Assessing Officer by disallowing the business expenditure claimed in respect of keyman insurance premium?"

12. Mr. N.P. Sahni, learned counsel who appeared for the Revenue submitted that the admitted facts would show that the assessee had been taking keyman insurance policy year after year in the name of its employees/Directors paying huge premia and thereafter assigning the same in the very next year to the said keyman at a very nominal value, said to be the surrender value, though the policies were for a period of five years each. This *modus operandi* adopted by the assessee was a clear colourable device to benefit the said keymen who were, in fact at the helm of affairs and

managing the company. Such an expenditure could not be treated as expenditure wholly or exclusively for the purposes of business. The difference between the premium paid and the surrender value received on assignment is substantial in respect of each policy. The assessee has not been able to justify assigning the policies at a nominal value when the same could be continued for another four years and then acquiring fresh policies again in that year by paying heavy premium.

13. Mr. Sahni also invited our attention to the scheme of keyman insurance policy as introduced by the Life Insurance Corporation of India. He argued that it is clearly stated therein that 'the object of kayman insurance is to indemnify the company for the loss of earning resulting from the date of valuable employee and replacement of any trained person to perform his functions. Clause (3) of the Scheme states that "Assignment not allowed except absolute assignment in favour of kayman in case of his leaving the job of the company". Clause 4(e) on the same page reads as under:

> "The following endorsement shall be placed on the policy for which prior consent from the employer should be obtained before the completion of the proposal. It is hereby agreed and declared that in the event of the employee life assured leaving employment

> of the employer, the within mentioned policy will be, (i) either surrendered to corporation for its cash value or (ii) assigned absolutely in favour of the employee life assured. It is further agreed and declared that the within mentioned policy shall not be allowed to be assigned to anyone except life assured himself absolutely."

14. After pointing out the aforesaid clause of the scheme, argument of Mr. Sahni was that the assessee had acted in contravention of various clauses of the LIC's scheme of keyman insurance policy and had been assigning the policies year after year when they were still continuing with the company and had not left it.

15. His other submission was that the surrender value relates and is applicable only to the LIC when a policy is paid up by the insurer (in this case, the assessee company) and not to keyman or any third person. If a company does not wish to continue the policy, it can surrender the same to the LIC for its cash value or assign it absolutely in favour of employee, as per the scheme. The surrender value is not relevant insofar as the value of the benefit passed on to the keyman is concerned; nor can it be treated as full and true value of the consideration for assigning the policy before its maturity. The position is akin to various schemes of statutory authorities like DDA, HUDCO, etc. where plots/flats are

allotted and if the same are surrendered, only the amount as per allotment scheme is paid even, if the market value is much higher. In some such schemes, even unearned increase has to be shared with the concerned authority. The assessee company is, thus, not justified in asserting that it has shown the surrender value received from kayman as its income and the huge premium paid cannot be tinkered with or disallowed under Section 37(1) of the Act.

16. Mr. Sahni further argued that the Tribunal placed reliance upon Circular No.762 dated 18th February, 1998 explaining the tax aspect relating to keyman insurance policy was not appropriate and the Tribunal neither appreciated the import of the said Circular in a proper manner, nor it examined the effect of Sections 2(24)(xi), 10(10D) and 37(1) of the Act in a proper perspective. He argued that as per the aforesaid Circular, the object of a keyman insurance policy is to enable business organizations to insure the life of a keyman in order to protect the business against the financial loss which may occur in the likely eventuality of premature death. It was submitted that the main thrust of argument of the respondent before the CIT (A) as well as the Tribunal was that the payment of keyman insurance premium is allowable

as revenue expenditure in view of the aforesaid Circular dated 18th February, 1998. While not disputing that the payment of keyman insurance policy premium paid by the company was allowable in view of the said Circular, he argued that the Tribunal failed to appreciate the true spirit of this Circular as the purpose was to cover the risk of premature death of the key persons of the organization and it could not be applicable in the instant case where the assessee company was assigning these keyman policies in the subsequent years, though the term of the policy was 5 years. According to Mr. Sahni, in such eventuality, payment of excess premium could not be treated as 'business expenditure' under Section 37(1) of the Act, as there was no commercial expediency on the part of the assessee to make such exorbitant payment. He argued that the test of commercial expediency could not be reduced to the shape of a ritualistic formula, nor could it be put in a water-tight compartment so as to be confined in a straitjacket formula. All that the law requires is that the expenditure should not be in the nature of capital expenditure or personal expenditure of the assessee and it should be wholly and exclusively laid out for the purpose of the business. It is

well settled that the items of expenditure are to be considered from the point of view of a normal, prudent businessman. The test would merely mean that the Court would place itself in the position of a businessman and find whether the expenses incurred could be said to have been laid out for the purposes of the business. The ultimate analysis of the transaction would depend on the status of the parties as spelt out and nature or character of the trade or the venture, the purpose for which the expenses were incurred and the object which was sought to be achieved in incurring those expenses. Such an expenditure, however, must not suffer from the vice of collusiveness or colourable device. It was submitted that the instant case is a clear case of colourable transactions which are executed by the assessee at behest of its Directors/employees managing the assessee company.

17. It was further submitted that colourable devices cannot be part of tax planning and it would be wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resort to dubious methods as held in the case of ***McDowell & Co. Ltd. Vs. CTO*** [154 ITR 148 (SC)]. Reliance was also placed on the decisions of Supreme Court

in the case of ***CIT Vs. Durga Prasad More*** [82 ITR 540 (SC)]. In the latter case, the Apex Court in arriving at its conclusion has laid emphasis on the surrounding circumstances and test of human probabilities.

18. Per contra, the submission of Mr. V.P. Gupta, learned counsel appearing for the assessee company that the CIT (A) as well as the Tribunal had followed its earlier orders in the case of group companies. It was pointed out in the impugned order dated 29th August, 2008 (which is the subject matter in ITA No.398 of 2009), the Tribunal had referred to the orders for Assessment Years 1991-92, 1992-93, 1993-94 and 1997-98. In fact, the claim of the assessee company was also accepted for the Assessment Years 2001-02 and 2002-03. On this premise, it was argued that premium paid by the assessee company on keyman insurance policy had been held to be allowable as business expenditure under Section 37(1) of the Act for number of years and the order of the Tribunal had been accepted by the Department. Therefore, principle of consistency should be followed and the Department should not be allowed to rake up this issue.

19. On merits, it was argued that the scheme of the Act was quite clear in this behalf, which was amply clarified vide CBDT's Circular dated 18th February, 1998 that the premium paid to the keyman insurance policy is allowable as business expenditure. This Circular was binding on the Department.

20. Mr. Gupta also referred to the judgment of the Bombay High Court in the case of ***Commissioner of Income Tax Vs. B.N. Exports*** [(2010) 323 ITR 178 (Bom.), wherein the insurance premium on keyman insurance policy had been considered to be allowable.

21. Mr. Gupta also argued that the allowability of the deduction is being disputed only for the reason that the concerned individuals have raised claim in their cases regarding non-taxability of the maturity value received by them pursuant to assignment of policies in their favour. Claim made regarding exemption of amount in the hands of individuals cannot determine or impact allowability of the expenditure in the case of the respondent company. In this regard, he placed reliance on the decision of the Supreme Court in the case of ***Empire Jute Company Limited Vs. Commissioner of Income Tax*** [124 ITR 1 (SC)], wherein it has been observed that a certain payment constitutes income or

capital receipt in the hands of recipient is not material in determining whether the payment is revenue or capital disbursement qua the payer.

22. His further submission was that no such case of colourable device could be projected by the Department when assignment of such policies was envisaged in the CBDT's Circular dated 18th February, 1998 itself. It was further argued that the ingredients under Section 37 were duly met and satisfied as the expenditure incurred by the company was only on business considerations and the assignment of policy was also in the larger interest of business. It was, *inter alia*, submitted in this behalf that the assessee company was able to earn substantial profit by availing services of these individuals (keyman) by incurring the expenditure under reference and it is a fact duly recorded by the Tribunal in the impugned order that these persons were very important in the assessee organization and when they left their assignments, its profit were drastically reduced. Accordingly, the expenditure was incurred only with business consideration and is, therefore, an allowable deduction.

23. Another dimension, which was given by the learned counsel for the assessee company was that the Department could

not sit on the armchair of the assessee and decide as to whether it was appropriate, as a business expediency, for the assessee to incur certain expenditure or not. It was for the assessee company to arrange its affairs in a manner which reduce its tax liability. There was no provision in the Act, which had been violated by assigning the policies in favour of the individuals. Reference in this regard was made to the decisions of Punjab & Haryana High Court in the case of ***Commissioner of Income Tax Vs. Pivete Finance Ltd.*** [(2010) 192 Taxman 21 (P & H), wherein it was alleged by the Department that the assessee has been consistently resorting to colourable device with the object for reducing the tax liability by transferring shares to another group of companies with a view to reduce the table income. The Court reiterated its holding in earlier decision in the case of ***Porrits & Spencer (Asia) Ltd. Vs. Commissioner of Income Tax*** [(2010) 190 Taxman 174 to the effect that if the transaction was otherwise valid in law and a part of tax planning then merely because it has resulted in reduction of tax, it cannot be ignored on the ground that the underlying motive of entering into such a transaction by the assessee was to reduce its tax liability to the State. He also drew our

attention to the judgment of this Court in the case of ***Commissioner of Income Tax Vs. Panacea Biotech Ltd.*** [(2010) 324 ITR 311 (Del.) wherein this Court has observed in connection with the claim of the assessee for allowability of depreciation on purchase of a flat towards the end of the previous year that obviously, the assessee must have purchased this flat within the relevant financial year to take benefit of depreciation as tax planning.

24. Rebutting the arguments of Mr. Sahni, predicated on the alleged violation of terms of scheme of keyman insurance policy by assigning the same to the kayman, it was argued that no such contention was ever raised before the Authorities below. Even otherwise, the insurance company had accepted the assignment. So much so, even the Department had accepted the assignment and had taxed surrender value of the assignment and therefore, such an argument could not be raised.

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 view 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, by applicable in such a case.

(ii) The Tribunal has rightly referred to and relied upon the CBDT's Circular dated 18.2.1998. 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 into 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.

(iii) The nature of expenditure incurred on keyman insurance policy has even been judicially considered and Bombay High Court has held in ***B.N. Exports (supra)*** that this expenditure is to be allowed as business expenditure, in the following words:

> "The effect of Section 10(10D) is that monies which are received under a life insurance policy are not included in the computation of the total income of a person for a previous year. However, any sum received under a Keyman insurance policy is to be reckoned while computing the total income. For that purpose, a Keyman insurance policy means a life insurance policy taken by a person on the life of another person who is or was in employment as well as on a person on who is or was connected in any manner whatsoever with the business of the subscriber. The words "is or was connected in any manner whatsoever with the business of the subscriber" are wider than what would be subsumed under a contract of employment. The latter part makes it clear that a Keyman insurance policy for the

purposes of Clause (10D) is not confined to a situation where there is a contract of employment. Clause (10D) relates to the treatment for the purpose of taxation of moneys received under an insurance policy. In this appeal, the court has to determine the question of expenditure incurred towards the payment of insurance premium on a Keyman insurance policy. The circular which has been issued by the Central Board of Direct Taxes clarifies the position by stipulating that the premium paid for a Keyman insurance policy is allowable as business expenditure. In the present case, on the question whether the premium which was paid by the firm could have been allowed as business expenditure, there is a finding of fact by the Tribunal that the firm had not taken insurance for the personal benefit of the partner, but for the benefit of the firm, in order to protect itself against the set back that may be caused on account of the death of a partner. The object and purpose of a Keyman insurance 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. A Keyman insurance policy is obtained on the life of a partner to safeguard the firm against a disruption of the business that may result due to the premature death of a partner. Therefore, the expenditure which is laid out for the payment of premium on such a policy is incurred wholly and exclusively for the purposes of business."

(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 18.2.1998.

(v) The expenditure incurred has to be tested on the touchstone of Section 37 of the Act and to see as to whether such expenditure is permissible or not. No doubt, the object of a keyman insurance policy is to enable business organizations to insure the life of a keyman in order to protect the business against the financial loss which may occur in the likely eventuality of premature death. Such an expenditure is treated as business expenditure by the Department itself and recognized as such in Circular dated 18.2.1998. The expenditure is to be seen at the

time it is incurred. Merely because the policy was assigned after sometime would not mean that the expenditure incurred in the first instance would lose the flavour of it being 'business expenditure'.

(vi) Once the legal provisions and the outlook of Department itself based on such legal provisions permit the assessee to have the tax planning of this nature, and the course of action taken by the assessee is permissible under law, the argument of colourable device cannot be advanced by the Revenue. When expenditure of this nature is treated 'business expenditure' per se by the Department itself, there cannot be any question of raising the issue of want of business expediency. The learned counsel for the respondent is right in his submission that the Department could not sit on the armchair of the assessee and decide as to whether it was appropriate on business expediency for the assessee to incur such an expenditure or not. If the transaction is otherwise valid in law and is a

part of tax planning, merely because it has resulted in reduction of tax, such expenditure cannot be ignored raising the issue of underlying motive of entering into this type of transaction. Various judgments cited by the learned counsel for the respondents clearly get attracted to this Court.

26. The question of law is, thus, decided against the Revenue. As a result, appeals filed by the Revenue against the assessee company are dismissed.

Appeals qua Directors Assessee:

27. These appeals were admitted on the following questions of law:

(i) Whether on the facts and circumstances of the case, there was any justification to tax the difference between the premium paid by the employer and the surrender value paid by the employee to the employer at the time of assignment of the policy and whether it could be taxed in the year of assignment?

(ii) Whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal was

justified in restoring back the matter to the AO to ascertain whether the keyman insurance policy on assignment by the employer to the employee was converted into an ordinary policy so as to determine the question of taxability of the amount received by the employee on the maturity of such a policy; and if answer to the preceding part to this question is in the affirmative, then, whether the insurance money received on maturity by the employee is exempt in full under Section 10(10D) of the Income Tax Act?

(iii) Whether the Tribunal in spite of being of the view that the keyman insurance policy after its assignment to the keyman assumed the character of an ordinary insurance policy erred in law in holding that out of the sum received on maturity of the said policy, a sum equivalent to the surrender value of the policy at the time of assignment in favour of the assessee be subjected to tax?

(iv) Whether the Tribunal erred in directing the surrender value of Rs.35,28,815/- to be taxed in spite of the fact that at the time of assignment the assessee had made a payment of the said amount to the assignor, i.e., the employer company?

(v) Whether the Tribunal was justified in law in rejecting the alternative the alternative claim of the assessee that in the eventuality that the amount received on maturity becomes liable to tax then deduction be allowed in respect of the premiums paid by the assessee after assignment to him of the policies in question as also the surrender value paid by him to the employer at the time of assignment and which was embedded in the figure of Rs.2,85,00,000/-?

28. Ms. Rashmi Chpora, learned counsel appeared for the Department in these appeals. She reiterated and highlighted the modus adopted by the company in taking Keyman Insurance Policy year after year in the name of the two Directors and then assigning the same in favour of these Director assessees at a value much less than the amount

paid by the companies in the very next year of taking the policy. Her submission was that in this manner, by assigning the policy and receiving only surrender value as against the actual premia paid, which was much higher, the difference between two amounts was the benefit received by the Director assessees, which would be treated as income assessable to tax. Taxability was sought to be covered by the provisions of Section 17 of the Act treating the same as profits in lieu of salary, i.e., perquisite in the hands of employee.

29. She further submitted that the maturity amount received by the assessee on the export of premium of policies, which is generally five years, was also taxable income as per Section 2(24) of the Act. Her submission was that the letter from LIC on surrender the Keyman Insurance Policy turns into an ordinary policy is of no consequence as the treatment by the LIC under the Rules and Regulations therein and for such purpose cannot govern the taxability of income is governed by the provisions of Act, which is self-contained stature. Original terms and conditions of the Keyman Insurance Policy cannot change on surrender as the quantum of premium and maturity amount remains as per the original

terms and conditions. The Legislature has specifically brought in provisions to tax the maturity value alongwith bonus, etc. as income under salary, business and profession and income from other sources, etc. by incorporating various provisions such as 2(24)(xi), 17(3)(ii), 28(vi) and 56(iv) of the Act, which govern the taxability of amount received towards Keyman Insurance Policies including the sum allocated by way of bonus, etc.

30. She also hammered the issue of colourable device adopted by the company and echoed the same sentiments as expressed by Mr. N.P. Sahni while arguing the appeals of the Department qua the assessee company and submitted that by this device, company was benefitted by treating the expenditure as business expenditure under Section 37(1) of the Act and Director assessees were benefitted on the ground that the same was exempt under Section 10(10D) of the Act. According to her, such a device was impermissible. She concluded her arguments by submitting that the LIC is a commercial organisation, which formulates its own terms and policies and/or allows conversion of one policy to another, but the same cannot govern the taxability of income, but the same cannot cover the taxability of income

which has to be determined on the basis of specific provisions of the Act.

31. The aforesaid submissions were refuted by Mr. R.M. Mehta and Mr. Bajpai who appeared for the assessee. Mr. Mehta argued that the case had to be examined having regard to the specific provision incorporated under the Act relating to the Keyman Insurance Policy with effect from 01.10.1996. On that basis, it was to be found as to whether the difference between the premium paid by the company prior to the date of assignment and the surrender value of the policy as computed by the LIC could be treated as income at the hands of the assessee, viz., whether such a difference was 'perquisite' within the meaning of Section 17(3)(ii) of the Act as done by the AO. His submission, in this behalf, was that the Tribunal rightly came to the conclusion that Section 10(10D) of the Act as well as other consequential Amendments read with CBDT's Circular No.762 dated 18.2.1998 would clearly demonstrate that it is only "sum received" under the Keyman Insurance Policy, that would be treated as "profits in lieu of salary" in terms of Section 17(3) of Act. CBDT Circular dated 18.2.1998 clearly postulates that only the surrender value of the policy at the time of

assignment or the sum received by an individual at the time f retirement was taxable.

32. On the second issue, viz., taxability of the amount at the time of maturity of the insurance policy was untenable inasmuch as after the assignment of the policy, at the hands of the assessee, it became an ordinary policy and no one assignment Keyman Policy for the balanced terms of the policy insurance premium was paid by the assessee as payable in an ordinary policy. Therefore, as per CBDT Circular itself, which was rightly relied upon by the Tribunal, such an amount received on maturity could not be added as income of the assessee.

33. Mr. O.S. Bajpai specifically refuted the arguments of learned counsel for the Revenue by giving his own analysis to the various provisions of the Act. His submission, in this behalf, was that the concept of assignment is embedded in the very scheme of Keyman Insurance Policy. He submitted that the provisions of Section 10(10D) of the Act were to be read conjointly with Section 17(3)(ii) of the Act.

34. He first sought to highlight distinction between the Keyman Insurance Policy and ordinary policy by submitting that in case of keyman policy there have to be two players, viz., (i)

one who pays premium to secure the life of the other and (ii) the other whose life is secures. In contrast, there is only a single player in an ordinary policy, who gets his life secured and pays the premium himself. In the present case, this person happens to be an employee after policy is assigned to him. In this scenario, learned Senior Counsel argued that Section 17(3)(ii) comes into picture when the recipient is to be taxed for the amount of insurance received by him on maturity or he is taxed on surrender value as profit in lieu of salary. In other words, if there is no assignment of Keyman Insurance Policy, there is no question of invoking Section 17(3)(ii) as an employer cannot be taxed under this Section, but only an employee can be taxed. When there is no assignment, Section 37 and Section 28 or Section 56 of the Act will operate. The employer will seek deduction under Section 37 and pay tax under Section 28 or 56 of the Act. Section 17(3)(ii) of the Act comes into play only if an employee is to be taxed and an employee does not come into picture if there is no assignment. If employer does not continue the policy and surrenders it midway, he too would get only surrender value. But when there is assignment, the employee comes into picture and Section 17(3)(ii) of the Act

becomes operative. Thus, in the case of an employee, Section 17(3)(ii) of the Act can co-exist only with assignment to the employee. This makes assignment a part of the scheme of the Act itself. He, thus, argued that the assignment leads to conversion and changes the character of keyman insurance policy into an ordinary policy. Further, assignment is a followed transaction between the LIC's employer and employee. With this assignment, LIC not only agrees to convert the policy from keyman insurance policy to general insurance policy, it also agrees to receive the premium from the employee. When such a course is legally permissible, there is no question of adoption of colourable device, was the submission of Mr. Bajpai for which he referred to the judgment of the Supreme Court in the case of ***Union of India Vs. Azadi Bachao Andolan***, (2003) 263 ITR 706 (SC) followed in ***Walfort Share & Stock Brokers P. Ltd. v. CIT*** [2010] 326 ITR 1 (SC).

35. On the aforesaid premise, his submission was that when the amount received by the employee on maturity of the policy is the amount received in respect of ordinary policy; it was exempt from taxation by the statutes itself and, therefore, such an amount could not be taxed at all.

36. Insofar as taxability of difference between the premium paid by the employer and the surrender value paid by the employee (assessee) is concerned, the same was to be examined only if it was (perquisites within the meaning of Section 17(3)(ii) of the Act. His submission, in this behalf, was that the keyman insurance is taxable under Section 17(3)(ii) of the Act as a 'profit in lieu of salary' only when it is actually received. If it is not actually received, the condition of taxability is not satisfied and it cannot be taxed under Section 17(3)(ii) of the Act. He highlighted the fact that Section 28(iv), Section 56(2)(iv) as well as Sections 2(24)(xi) and Section 17(3)(ii) of the Act used the word "received" and therefore, unless the amount is received under Keyman Insurance Policy, it could not be taxed under any other provision.

37. While dealing with the case of the assessee company, we have already referred to the provisions of Section 10(10D) of the Act, which defines the insurance policy. The scheme of purpose of Keyman Insurance Policy has also been adverted to at that stage. Since two kinds of additions were made by the AO, which are the subject matter of the present appeals, we now take these two aspects for discussion:

(i) Difference between the premium paid by the company and the surrender value paid by the assessee at the time of assignment: Whether it is 'profit in lieu of salary' within the meaning of Section 17(3)(ii) read with Section 2(24)(xi) of the Act:

Section 2(24) gives the definition of income which is inclusive as it starts with "income includes……" Thereafter, various heads are specified, which would be treated as income. We are concerned with Clause (xi), which relates to Keyman Insurance Policy which is worded as under:

> "any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.
>
> *Explanation.* – For the purposes of this clause, the expression "Keyman insurance policy" shall have the meaning assigned to it in the *Explanation* to clause (10D) of section 28;"

38. For the purpose of this Clause, expression "Keyman Insurance Policy" shall have the meaning assigned to Clause (10D) of Section 10 of the Act, which reads as under:

> "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 if any manner

whatsoever with the business of the first mentioned person."

39. Section 10 is the first Section in Chapter III entitled 'Incomes which do not form part of total income'. In Section 10 of the Act, 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 under an 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) of the Act. Since 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 of the Act, we merely reproduce the said Explanation:

> "*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."

40. This Explanation, thus, gives the meaning to "Keyman insurance policy" and only that sum received under this policy would be treated as income. As per this Explanation, Keyman insurance policy is the one which is taken by a person on the life of another person who is or was the employee of the first mentioned person, etc. It means, in our context, the person who has taken the policy is the company/employer and the person on whose life the policy taken is the Director assessee. It is not a case where the employer kept the policy with itself till end and on maturity, the amount received was given to the employee. In that case, the provision would have attracted.

41. The moot question here is as to whether any such tax event has occurred within the meaning of Section 17(3)(ii) of the Act. Section 17 defines "salary", "perquisite" and "profits in lieu of salary". The amount in question admittedly is not "salary". However, this provides "in lieu of salary" as defined in Section 17(3) of the Act, then also it would be chargeable to tax under the head "salary". Clause (ii) of Sub-section (3) of Section 17 reads as under:

> "(ii) Any payment other than any payment referred to in clause (10), clause (10A), clause (10B), clause (11), clause (12), clause (13) or clause (13A) of section (10), due to or received by an assessee from an employer or a former employer or from a provident or other fund, to the extent to which it does not consist of contributions by the assessee or interest on such contributions or any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.
>
> Explanation : For the purposes of this sub-clause, the expression "Keyman insurance policy" shall have the meaning assigned to it in clause (10D) of section 10."

42. As noted above, the contention of the Department is that the amount in question is received in the form of difference between the amount paid by the employer to the insurance company and the amount received from the employee in the form of surrender value. The contention of the Director assessee, on the other hand, is that on the assignment of policy, no such amount is received. The contention of the assessee is predicated on the following expression in Clause (ii) of sub-section (3) of Section 17 of the Act:

> "Any sum received under a Keyman insurance policy……"

43. Obviously, Section 17(3)(ii) of the Act would come into pay only when the policy is assigned by the employer to the employment as employer cannot be taxed under this

Section, which is applicable only to the employee. After assignment, there may be two situations, viz.,

(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.

44. In the present case, 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. It is also to be borne in mind that the LIC has accepted the said assignment and from the date of assignment, it has become a policy between the LIC and the Director assessee, viz., the employees. However, no particular amount was received by these Director assessees on assignment. Clause (ii) of sub-section (3) of Section 17 taxes "any sum received in a Keyman policy insurance". The word "received" assumes significance. The Legislature in its wisdom thought to tax only that payment, which is received by the employee assessee under Keyman insurance policy.

45. Once we find that for Keyman insurance policy, specific provision is made under clause (ii) of sub-section (3) of Section 17 of the Act and the case is not covered by that clause. Can it be treated as covered under Clause (iii)? Answer has to be in the negative for various reasons, which are underlined below:

(i) Section 17(3)(ii) was amended by incorporating the provision of Keyman insurance policy with effect from 01.10.1996 to take care of specific scheme of Keyman insurance policy added/introduced by the said amendment vide Finance (No.2) Act, 1996. Clause (3) of Section 17 of the Act, on the other hand, was already in existence. When the Legislature intended to cover the amount received under Keyman insurance policy under Clause (ii), for the purpose of taxability of amounts received under a Keyman insurance policy, one has to look into this Clause and not Clause (iii).

(ii) Even clause (iii) uses expression "any amount due or received". Thus, it is also on receipt of this amount with this Clause gets triggered.

(iii) The purport of Clause (iii) is altogether different. Such an amount due or received by the assessee has to be:

(a) Before joining any employee; or

(b) After cessation of its employee.

No such contingency occurred when his Keyman insurance policy was assigned by the company in favour of the Director assessees.

(iv) Other provisions, which were introduced/amended while providing the Keyman insurance policy scheme under the Act by Finance (No.2) Act, 1996 are Section 28(iv) and Section 56(2). Section 28 deals with profits and gains of business or profession and Clause (iv) thereof reads as under:

> "(iv) The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;"

This Section would obviously apply when the assessee is assessed under for income under the head "profits and gains of business or profession" which is specific head provided under Section 28 of the Act. Even qua such an assessee, the amount is made taxable as income only when the sum is "received".

46. Section 56 deals with "income from other sources", which is income No. F of stipulated in Section 14 of the Act. Clause (iv)

of sub-section (2) of Section 56 makes particular income referred to in Section 2(24)(xi) chargeable as tax if it is not taxed under the head "profit and gains of business or profession" or under the head "salary". Thus, we fall back on Section 2(24)(xi), which also uses the expression "received" and would imply that the amount should have been actually received. We, thus, agree with the opinion of the learned Tribunal that the tax event did not occur, as no such amount was received at the time of assignment of the policy by the company as employer to the Director assessee, as employee. It is trite that income can be charged only if it comes under the heads of Section 14. [See ***Nalnikant Ambalal Mody Vs. Commissioner of Income-Tax, Bombay***, (1966) 61 ITR 428 (SC)].

47. The scheme of the Act by introducing Keyman insurance policy, clearly provides that such an amount can be taxed either as business profits or surrender value of the policy endorsed in favour of the employee (Keyman) or the sum received by him at the time of retirement and in all these cases, it would be profits in lieu of salary for tax purpose. In case there is no employee-employer relationship, then the surrender value of the policy or the business profits are to

be taken from other sources. We are also supported our conclusion by CBDT's Circular No.762 dated 18.2.1998, which reads as under

> "Taxation of a sum received under the Keyman insurance policy.
>
> 14.1 A Keyman insurance policy of the Life Insurance corporation of India, etc. provides for an insurance policy taken by a business organization or a professional organization 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 an 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.
>
> 14.2 There were some doubts on the taxability of the income including bonus, etc. from such policy and also regarding the treatment of the premium paid – whether it should be allowed as a capital expenditure or as a revenue expenditure. The Finance (No.2) Act, 1996, therefore, lays down the tax treatment f the Keyman Insurance Policy.
>
> 14.3 Clause (10D) of Section 10 of the Income Tax Act exempts certain income from tax. The Finance (No.2) Act, 1996 mends clause (10D) of Section 10 to exclude any sum received under a Keyman Insurance Policy including the sum allocated by way of bonus of such policy for this purpose.
>
> 14.4 The Finance (No.2) Act, 1996, also lays doen that the sums received by the said organization on such policies be taxed as business profits; the surrender value of the policy, endorsed in favour of the employee (Keyman); or the sum received by him at the time of retirement be taken as "profits in lieu of salary" for tax purposes; and in case other persons having no employer-employee relationship the surrender value of the policy or the sum received under the policy be taken as income from other sources and taxed accordingly. The premium paid on

> the Keyman Insurance Policy is allowed as business expenditure.
>
> 14.5 The amendments take effect from the 1st day of October, 1996."

48. It also follows from the aforesaid that it was only the surrender value of the policy at the time of assignment or the sum received by an individual at the time of retirement, which is taxable.

49. Insofar as assignment is concerned, at that time surrender value was paid by the Director and therefore, nothing could be taxed. Therefore, from any angle, matter is to be looked into, this component cannot be taxed at the hands of the Director assesses as mentioned.

Re: Whether the maturity value of the insurance policy received by the assessee is taxable:

50. The Tribunal has taken the view that the Keyman insurance policy was taken in a particular year and assigned in the next year and both these events had taken place in the years preceding the assessment year in question. The Tribunal took note of the certificate obtained by the assessee from the LIC whereby it had certified that a Keyman insurance policy after assignment assumed the status of an ordinary insurance policy. The Tribunal also took note of the

relevant provisions of the Act and the aforesaid CBDT Circular to hold as under:

> "All this shows that from the time of taking out the policy upto its maturity, the Legislature has envisaged the treatment to be given with regard to sums involved in the hands of the players involved. The players involved obviously are two-one, the person on the life of whom the insurance policy is taken out and second he person who takes out such policy. The premium is borne by the second person. Where such a dual role comes to an end, the very essence of the Keyman Insurance Policy is lost. This is the reason why the LIC of India confirmed that after assignment of a Keyman Insurance Policy in the name of the individual and the premiums thereafter being paid by such individual, the hitherto Keyman Insurance Policy becomes an ordinary policy. In this case, on the date of maturity, the policy in question is rightly to be accepted as an ordinary insurance policy."

51. The Tribunal while giving requisite relief brought to tax the amount of surrender value at the time of assignment subject to verification by the AO. It also rejected the alternative argument of the assessee that in case the sum received on maturity was held to be taxable then deduction be allowed for the premia paid by the assessee after the assignment of the policy, which were embedded in the maturity amount and not claimed as a deduction in the tax assessments.

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 no 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 t 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.

55. Accordingly, we answer the questions of law as framed in favour of the assessees and against the Revenue. As a result, the appeals of the Revenue are dismissed and those of the assessees are hereby allowed.

ACTING CHIEF JUSTICE

(M.L. MEHTA)
JUDGE

DECEMBER 16, 2011
pmc