

News Alert

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Surrender value at the time of assignment of Keyman Insurance Policy taxable out of total maturity proceeds received

In brief

- In a recent ruling in the case of Rajan Nanda ¹, the Delhi Income-tax Appellate Tribunal (“the Tribunal”) held that out of the total proceeds received on maturity, a sum equivalent to the surrender value of the Keyman Insurance Policy (“KIP”) at the time of assignment by the Company in favour of the keyman is taxable.
- The maturity proceeds as reduced by the surrender value would not be liable to tax as per the provisions of section 10(10D) of the Income-tax Act, 1961 (“the Act”), if the same can be said to have been received under an ordinary insurance policy (i.e. not KIP) subsequent to the assignment of KIP. For determination of whether upon assignment the KIP gets covered into an ordinary insurance policy, the Tribunal restored the matter back to the Assessing Officer (“AO”).

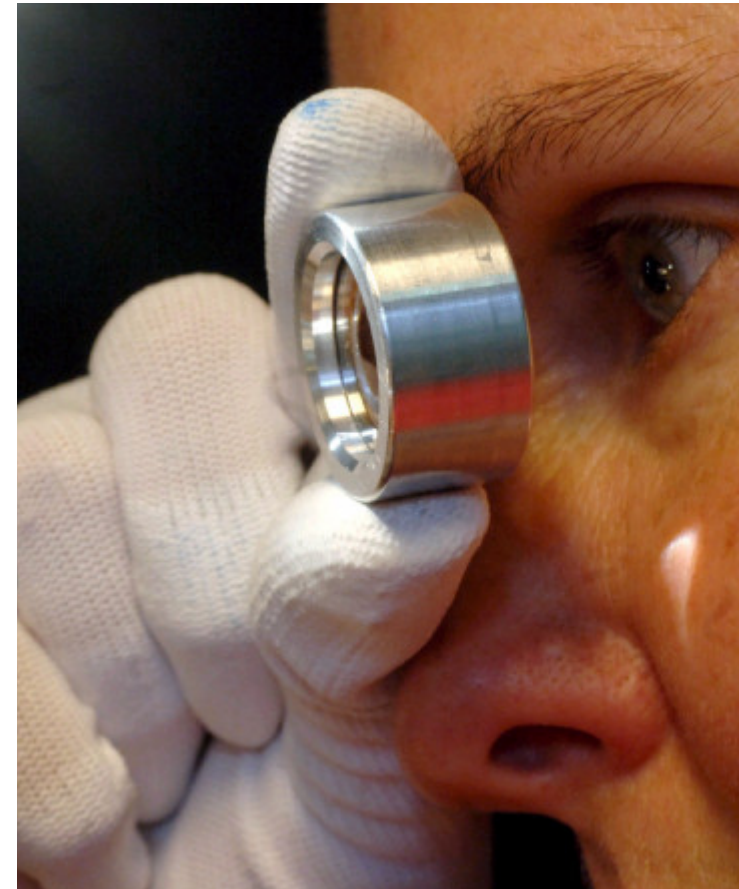
- In the aforesaid decision, the Tribunal has reiterated its decision in earlier cases for the same assessee. Along with this decision, the Delhi Tribunal also rendered a decision in another case of Dr. Naresh Trehan ², taking a similar view on an identical issue.

Facts

- During Assessment Year (“AY”) 2006-07, Mr. Rajan Nanda (“assessee”) had received maturity proceeds of INR 235,125,000 under four KIPs taken on his life from the Life Insurance Corporation of India (“LIC”) by certain group companies. These KIPs were assigned in the assessee’s favour upon the assessee paying an amount equivalent to surrender value of the policies to these companies.

² Dr. Naresh Trehan v. DCIT [2010-TIOL-418-ITAT-DEL] .

¹ Rajan Nanda v. ACIT [ITA No. 922/DEL/2010] dated 4 June, 2010



- The AO made an addition of the entire maturity proceeds of INR 235,125,000, disregarding the decision of the Delhi Tribunal in the assessee's own case (for AY 2003-04), wherein it was held that a sum equivalent to the surrender value of the policy at the time of its assignment by the company in favour of the assessee would be taxable out of the total maturity proceeds. The AO disregarded the Tribunal's decision on the ground that the Tax department had preferred an appeal to the High Court against the said decision.
- In an appeal filed by the assessee, the Commissioner of Income-tax Appeals ("CIT(A)") relied upon the aforesaid decision of the Tribunal (reiterated by the Tribunal in AY 2004-05) to conclude that a sum equivalent to the surrender value of the policy at the time of its assignment by the company in favour of the assessee would be taxable out of the total amount received on maturity of a policy.
- The CIT(A) computed the taxable surrender value of INR 132,592,264 by applying a self derived formula and directed the AO to tax the amount so computed as income of the assessee during the current AY 2006-07.
- In a further appeal to the Tribunal, the assessee raised a ground that the CIT(A) had misinterpreted the decisions of the Tribunal for earlier assessment years in sustaining the addition of INR 132,592,264 out of the total addition of INR 235,125,000. The assessee also raised a ground that the entire amount of INR 235,125,000 should be entitled for exemption under section 10(10D) of the Act i.e. even the surrender value amount is not liable to tax as it was paid by the assessee to the respective companies at the time of assignment of the KIPs.
- The Tribunal in its earlier decision for AY 2005-06 had observed that the letters issued by LIC to the Income-tax department and to the assessee were contrary to each other as to whether the KIPs gets converted into an ordinary policy or not upon assignment. Accordingly, the Tribunal had restored the matter back to the AO to get clarification from the higher authorities of LIC with regard to the correct status of the KIPs upon assignment to determine the consequential tax treatment in the hands of the assessee and also to decide the issue afresh based on the terms and conditions applicable to the KIPs upon their assignment to the assessee. To determine the same aspects for the current AY 2006-07 as well, the Tribunal restored the matter back to the AO.
- As regards the present appeal for AY 2006-07, the Tribunal noticed that the CIT(A), while following the directions of the Tribunal of earlier years' *in principle* to tax the surrender value, also proceeded with determining the ratio between the premiums paid by the assessee and the company, to the final maturity proceeds, to arrive at the taxable (i.e. surrender value) and the non-taxable portions. That is, in the view of the CIT(A), to the extent the maturity value bears a ratio to the premium paid by the company (out of the total premium payable under the policy), the same was to be treated as the 'surrender value' and the equivalent amount received was to be taxed. Only the portion of maturity proceeds which bore a ratio to the premium paid by the assessee were to be considered as the proceeds of an ordinary policy and therefore, not taxable.
- According to the Tribunal, as per the terms applicable in an insurance policy and the insurance industry, the 'surrender value' is 'the value which is received on premature surrender'. Thus, the Tribunal agreed with the assessee's contention that to this extent, the CIT(A)'s order was not in accordance with the ratio laid down by the Tribunal in the assessee's own case for earlier years.

Tribunal ruling

- The Tribunal observed that identical issues were considered in the assessee's own case for earlier years³. The Tribunal observed that in its earlier decisions, it was held that only a sum equivalent to the surrender value of the policy at the time of its assignment by the company in favour of the assessee was taxable out of the total amount received by the assessee on maturity. The Tribunal also made reference to the observations in its decision for AY 2003-04 that the amount equivalent to the surrender value was to be taxed in the year in which it was received.
- The Tribunal for the current AY 2006-07, concluded that if the AO comes to the conclusion that the KIP is converted into an ordinary policy, then he should follow the earlier years' decision of the Tribunal to the effect that out of the total proceeds received on maturity, only a sum equivalent to the surrender value of the KIP at the time of assignment by the Company in favour of the keyman is taxable.
- Reiterating the ratio laid down in its earlier decision for AY 2005-06, the Tribunal restored the matter back to the AO for clarification from higher authorities of LIC and based on the exact terms and conditions applicable to the KIPs, to decide the issue afresh with regard to the correct status of the KIPs on the occasion of assignment and consequential treatment of taxability in the hands of the assessee.

³ For AY 2003-04, 2004-05 & 2005-06

Conclusion

- Given the fact that the Tribunal placed importance on the communication between the Insurance Company and the policyholder and also on the key terms and conditions of the KIPs, it is essential that the key documentation in this regard is in order to support the argument that upon assignment, the KIPs get converted into an ordinary insurance policy.
- It may be noted that the Central Board of Direct Taxes ("CBDT") had issued Circular No. 762, dated 18 February, 1998 clarifying that the surrender value of the policy, endorsed in favour of the employee (keyman) would be taxable in the hands of an employee as 'profit in lieu of salary'. Furthermore, in the case of other persons having no employer-employee relationship, the surrender value of the policy or the sum received under the policy should be taken as 'income from other

sources' and taxed accordingly. The circular suggests that in the year of assignment, the amount representing the surrender value becomes taxable.

- However, in the above decision, the Tribunal confined itself to answering the limited question raised as regards the taxability of amount received by the assessee on maturity. To this extent, the decision is without considering the effect of the CBDT circular. Further, the point raised by the assessee as to non taxability of the 'surrender value' as the same was paid by him to the respective companies has not been addressed by the Tribunal while pronouncing the decision.

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