BOMBAY HIGH COURT

Bombay Mutual Life Assurance Co. Ltd

Vs.

Commissioner of Income-Tax

Income tax Ref. No. 40 of 1950

(Chagla, C.J. and Tendolkar, J.)

02.04.1951

JUDGMENT

Chagla, C.J.

1. In order to understand the ground of appeal it is necessary to reproduce below how the assessment for the year 1939-40, for example, was made by the Income-tax Officer.According to the assessee company, instead of deducting Rs. 10,80,218 out of Rs. 27,37,907 the Income-tax Officer should have deducted half of Rs. 27,37,907 that is to say Rs. 13,68,953-8-0. This contention of the assessee company was not accepted by the Appellate Tribunal. It considered, by way of illustration, the major items of Rs. 96,496 and Rs. 77,799 being the items for income-tax deducted at source and provisions for income-tax. The Tribunal considered that these two big items, that is to say, the payment of income tax could not be considered amounts paid to, reserved for, or expended on behalf of policy holders.

The questions of law referred were :

> "(1) Whether the surplus accruing to the assessee company from insurance transactions of a mutual character is assessable to tax under the Indian Income-tax Act?
> (2) Whether the appreciation in the value of securities which is not taken credit for in the revenue account or in the actuarial valuation balance sheet, but is only shown in the balance sheet, should be included in the 'surplus' for the purpose for computing profits of the assessee company, having regard to Rule 3(b) of the schedule of the Indian Income tax Act?
> (3) Whether under Rule 3(a) of the schedule of the Indian Income-tax Act relief should be given to the assessee company on the basis of half the adjusted surplus determined under Rule 2 (b) or half of the actual surplus as computed by the Income-tax Officer?"

Chagla, C.J.

2. The assessee in this reference is the Bombay Mutual Life Assurance Co., Ltd. It is an incorporated company limited by guarantee and all the policy-holders are members of this company. Some policy holders participate in the profits and some do not, and the very important question that arises on this reference is whether the profits made by the participating members is income liable to tax at all. Sir Jamshedji contends that the participating policy holders make contributions in order to meet certain contingent liabilities. It turns out that the liabilities are less than what they contemplate and although the word "profits" is used in substance and in reality what the participating members receive is not profits but the return of their own contributions which were more than sufficient to meet the liabilities contemplated. I think Sir Jamshedji's definition of the profits received by the participating members is perfectly correct. But the question that we have to determine is whether under the Indian Income-tax Act such surplus which is returned to the participating members is made liable to tax. If what was taxed was profits or income in the ordinary sense, then undoubtedly the surplus which was returned to the participating members would not be liable to tax and prior to the amendment of clause (6c) of Section 2 of the Income-tax Act it is common ground that these profits were not subject to taxation. The question really is whether in view of clause (6c) and the scheme of our Act this surplus received by the participating members is subject to tax or not.

2. Now the charging section, as is well known, is Section 3, which charges to tax the total income of every assessee. "Income" is defined by clause (6c) of Section 2. It is an inclusive definition and in the inclusive definition is the profits of any business of insurance carried out by mutual association computed in accordance with R. 9 of the schedule. When we turn to R. 9 of the schedule it says that the rules contained in the schedule apply to the assessment of the profits of any business of insurance carried on by a mutual insurance association. Rule 2 of the rules provides that the profits and gains of life insurance business shall be taken to be either, (a) the gross external incomings of the preceding year from that business less the management expenses of that year, or (b) the annual average of the surplus arrived at by adjusting the surplus or deficit disclosed by the actuarial valuation made for the last intervaluation period ending before the year for which the assessment is to be made. Therefore Clause (b) in terms provides for the taxation of the surplus arrived at as a result of the actuarial valuation. Sir Jamshedji's contention is that the schedule as its heading itself indicates is intended for the computation of the profits and gains of insurance business. The schedule is referred to in Section 10 (7) of the Act which provides that notwithstanding anything to the contrary contained in Sections 8, 9, 10, 12 or 18 the profits and gains of any business of insurance and the tax payable thereon shall be computed in accordance with the rules contained in the schedule to the Act. Sir Jamshedji's argument is that Sections 8, 9, 10, 12 or 18 are not charging sections. They merely deal with the mode of computing the profits of insurance companies. Therefore, according to Sir Jamshedji if the surplus does not constitute profits, the schedule cannot be requisitioned to make what is not profits, profits. According to Sir Jamshedji in the first instance the taxing authorities must establish that the surplus is profits

before they can rely on the schedule in order to find out how these profits can be computed. There would be considerable force in the argument of Sir Jamshedji if Clause (6c) had not been enacted. But clause (6c) imports into the definition of "income" which is to be found in the charging Section 3 these profits which may not be profits in the ordinary sense of the term but which are made profits by reason of R. 2, because R. 2 really gives an artificial extension to the meaning of the word "profits", when it says that "profits and gains shall be taken to be." Therefore a new class of artificial income is created by this rule and that artificial income is included into the meaning of Section 3 by reason of this rule. Sir Jamshedji relied on English authorities to point out that ever since Styles' case (*New York Life Insurance Co. v. Styles*[1], the view consistently taken by the Judges in England has been that the surplus resulting from mutual activities of persons joining to form an insurance company is not income or profits subject to tax. Sir Jamshedji points out that as recently as in 1948 the House of Lords has rejected an attempt made by the Parliament to include that surplus in the profits which are subjected to tax. The decision is Inl. *Rev. Commrs. v. Employers Mutual Ins. Asson. Ltd*[2]., What the learned Law Lords there had to consider was the effect of Section 31 of the Finance Act of 1933 and the question that fell to be determined was whether the attempt made by the Legislature to tax the surplus was successful. Lord Macmillan pointed out that the Legislature had plainly misfired and the reason why it had misfired was that they had misapprehended the nature of the surplus which it had attempted to tax. The view it took was that it was membership or non-membership in the company which determined immunity from or liability to tax whereas, as the House of Lords pointed out, what determined the immunity or liability was the real nature of the transaction. Lord Macmillan was happy that the far-from-praiseworthy attempt to tax the surplus which was not profits at all had not succeeded. We might sympathise with Sir Jamshedji that here also the Legislature showed what cannot be described as a very laudable intention, but what we have to consider is whether our Legislature like the Parliament in England has plainly misfired. Looking to the scheme of our Act and according to the clear language used in clause (6c) it is difficult to accept Sir Jamshedji's contention that the Legislature while intending to bring the surplus within the ambit of the taxing law has failed to express its intention in sufficiently clear language which would compel us to hold that the surplus to which the participating members are entitled is not subject to tax.

3. The second question raised on this reference is with regard to two sums of Rs. 2,72,946 which is shown in the balance sheet as of 31-12-1937, under the head investment reserve fund and a sum of Rs. 1,00,000 shown in the balance sheet as of 31-12-1940, also under the head investment reserve fund. Now in order to understand the contention of the assessee it is necessary to understand how the actuarial valuation is made by the actuary on behalf of the company. A consolidated revenue account is prepared which would show on one side the amount of life assurance fund at the end of the period for which the consolidated revenue account is prepared. Then the actuary finds out what is the nett liability of the company under the current policies and he fixes the liability on the basis of a rate of interest on the investment of the company which he expects the company to realise in coming years. After fixing the net liability of the company on

the current policies he deducts the liability from the life assurance fund and the result is the surplus. If the liability is more than the life assurance fund, then there is a deficit. Now, in the case of the assessee company, the life assurance fund at the end of the actuarial period January 1, 1934, to 31-12-1937, was Rs. 1,01,53,809 and the nett liability was worked out at Rs. 78,57,741. This resulted in a surplus of Rs. 22,96,068. Now the sum of Rs. 2,72,946 was not added to the life assurance fund. If it had been added, it would have resulted in the surplus being increased by that amount. It was not so added in the life assurance fund because the company did not take this amount to the revenue account in which case it would have increased the life assurance fund, but they took this amount direct to the balance sheet and showed it as investment reserve fund. Now the question is whether

[1](1889) 14 AC 381)

[2](1948) 16 ITR (Sup.) 80 (Eng)

although the company has not shown it in the revenue account this sum of Rs. 2,72,946 still forms part of the surplus or not. For that purpose, we must look at R. 3 (b) which provides that any sums taken credit for in the accounts or actuarial valuation balance sheet on account of appreciation of loss or gains on the realization of the securities or other assets shall be included in the surplus. Now it is not disputed that Rs. 2,72,946 does constitute appreciation of securities, but what is contended is that this was not taken credit for in the accounts, the argument being that "accounts" in this sub rule must be read to mean "revenue account". Now there is no warrant for qualifying the expression "accounts" used by the Legislature by characterizing these accounts as revenue account. The only question is that if credit is taken by an assessee in his accounts for appreciation of securities, then that credit must form part of the surplus and it cannot be disputed that the assessee has taken credit for appreciation of these securities. Whether that credit is taken in the balance sheet or the revenue account makes no difference. The balance sheet is as much a part of the accounts of the assessee as the revenue account and the Legislature has not chosen to indicate any particular account in which credit should be taken.

4. It is then argued that this sum of Rs. 2,72,946 never formed part of the surplus as it was not taken into the revenue account and was merely shown in the balance sheet as the investment reserve fund. But surely, it cannot be left to the volition of the aasessee to determine what the surplus should be in respect of any particular actuarial valuation. The surplus contemplated by R. 2 (b) is the surplus which is the result of the annual average of the surplus arrived at by adjusting the surplus or deficit disclosed by the actuarial valuation and, therefore, if in fact the sum of Rs. 2,72,946 should have formed part of the surplus on a proper actuarial valuation the mere fact that the assessee did not choose to take it to the revenue account can make no difference to his liability to tax on this amount. It is contended that if this sum of Rs. 2,72,946 had formed part of the life assurance fund it may be that the rate accepted by the actuary for working out the yield on the investment of the company might have been different and the result might have been that the surplus might have been less than what it would be by the addition of this sum of Rs. 2,72,946 to the life assurance fund. We cannot speculate on the possibility of the actuary reducing the rate of interest with the result that the surplus may not have been the same by the addition of Rs. 2,72,946 as the surplus now shown in the valuation.

5. The same considerations apply to the sum of Rs. 1,00,000 which is shown in the balance sheet as of 31-12-1940.

6. With regard to these two sums, we would like to add that as we are holding that these two amounts form part of the surplus and, therefore, liable to tax although in the accounts of the company they have not been shown as forming part of the surplus Sir Jamshedji apprehends that when in fact these amounts are shown as part of the surplus in future the taxing authorities will tax this amount over again. Now it is clear that when you determine the surplus for the purposes of R. 2 (b) you have to deduct from it any surplus or deficit included therein which was made in any earlier inter valuation period. Therefore, if the Department proposes to tax this sum of Rs. 2,72,946 and also the sum of Rs. 1,00,000 it can only be on the basis that these two amounts formed part of the surplus. Therefore, in future if these two amounts are shown in the actuarial valuation as part of the surplus, they would not be liable to tax over again as the position in law is clear and we have no doubt that the Department will act in accordance with the directions we are giving in this reference.

7. With regard to the third question under Rule 3 (a) a deduction is permitted to the assessee of half of the amounts paid to or reserved for or expended on behalf of the policy-holders. Now a surplus is arrived at under Rule 2 (b) by taking an actuarial surplus excluding from it any surplus included in an earlier valuation and adding to it all expenditure which is not allowable under Section 10 of the Act and from this surplus is to be further deducted under Rule 3 (a) half of the amounts paid to or reserved for or expended on behalf of the policy holders and tax is to be paid on the balance left after this deduction is made. Now when we turn to the assessment made for the year 1939-40 we find that what the income tax authorities have done is that they have taken the surplus as shown in the valuation report viz., Rs. 22,96,068; then they have added to it Rs. 87,816 for interim bonus paid; then they have deducted from this amount the surplus which was already shown in the previous valuation, viz. Rs. 170,139. This resulted in a sum of Rs. 22,13,745. To this has been added the sum of Rs. 2,72,946 which is the amount which we have considered when considering the second question bringing the total surplus to the figure of Rs. 24,86,711. To this amount they have added a sum of Rs. 2,51,196. This is made up of Rs. 94,496 for income-tax deducted at source Rs. 51,859 for depreciation and Rs. 17,799 set apart as provision for income-tax; then there are three items debited to the building expenses account amounting in all to Rs. 18,273; then there are various small items of expenditure totaling up to Rs. 6,769. The total comes to Rs. 27,37,907 which is taken as the surplus for the purpose of R. 2 (b). But for the purpose of R. 3 (a) the amount taken into consideration is Rs. 22,96,068 the surplus shown in the valuation report. Now Sir Jamshedji's contention is that although for the purpose of arriving at the surplus under Rule 2 (b) certain expenses may be added to it, for the purpose of deduction under Rule 3 (a) every expenditure incurred by the assessee must be deemed to be expenditure on behalf of the policy-holders. Sir Jamshedji says that here we have not a company where there are shareholders in which case it might be stated that some

expenditure was on behalf of the shareholders and the other on behalf of the policy-holders, and the expenditure on behalf of the shareholders would not have fallen under Rule 3 (a). But where we have a company where all members are policy-holders and there is no share capital at all, then the expenditure incurred by the company can be on behalf of no one else but the policy holders. I should like to point out that question 3 as raised by the Tribunal does not really bring out the effect of the contention put forward by Sir Jamshedji. We are not concerned with the surplus as shown by the company or the surplus adjusted by the taxing authorities; surplus has to be adjusted in order to bring it within the compass of Rule 2(b). What we are concerned with is not R. 2 (b) but R. 3 (a) which deals with deductions on the basis of the amounts paid to or reserved for or expended on behalf of the policy-holders. The real question is which are the items which the taxing authorities consider as part of the surplus which can be deducted as having been paid to, or reserved for, or expended on behalf of the policy-holders. Therefore, it is necessary to deal with these items to which reference has been made separately. There is no dispute as to the items of Rs. 87,816 and Rs. 1,70,139.

8. Coming then to income-tax deducted at source, it was the company as an entity that was assessed to tax; it was the company as an entity that was liable to pay tax; and it was the company as an entity that in fact paid the tax. It cannot possibly be stated that the tax was paid by the company on behalf of the policy-holders. The policy-holders were not liable to pay tax either individually or as a body. Under the Income-tax Act, a company is recognised as a separate entity and as that separate entity its liability to pay tax arose. The assessee is, therefore, not entitled to claim a deduction with regard to the item of income-tax deducted at source. The same arguments apply with regard to the item of Rs. 77,799 reserved as provision for income-tax.

9. With regard to depreciation it is not contended by the Department that the sum of Rs. 51,859 has not been reserved on behalf of the policy-holders and credit has already been given to the assessees for it by the tribunal.

10. Coming to the building expenses and miscellaneous expenses, although these amounts have been paid by the company, they have been and could only have been paid on behalf of the policy-holders and therefore, they are entitled to claim this item as deduction under Rule 3 (a).

11. With regard to the sum of Rs. 2,72,946 which has been added to the surplus, the assessee is entitled to a deduction in respect of this item also under Rule 3 (a) because this amount must be considered to have been reserved for and on behalf of the policy-holders. It stands on the same footing as the sum of Rs. 22,96,068 shown as surplus under the valuation report. The same applies to the sum of Rs. 1,00,000 also added to the surplus.

12. We would, therefore, answer the questions referred to us as follows : No. 1 in the affirmative, No. 2 in the affirmative. We would re-frame the third question as follows :

"Whether the amounts paid to or reserved for or expended on behalf of the policy-holders within the meaning of R. 3 (a) of the schedule to the Income-tax Act include the expenses incurred by the company for payment of income-tax or provision for income-tax?" Having re-framed the question thus we would answer the third question in the negative.

13. No order for the costs of the reference.

Reference answered.