A **UNION CO-OPERATIVE INSURANCE SOCIETY LTD., BOMBAY**

v.

COMMISSIONER OF INCOME-TAX, BOMBAY

March 23, 1967

B

[J. C. SHAH, S. M. SIKRI AND V. RAMASWAMI, JJ.]

Indian Income-tax Act 1922, *s.* 10 *and Rule* 6 *of Schedule—Indian Insurance Act,* 1938, *s.* 15—*Profits of insurance companies, assessment of—Bonus paid by company to policy-holder on renewal of policies on which no claim had been made.—Estimated amount so payable debited by company to appropriation account and not to profit and loss account* C *—Bonus paid during previous year whether allowable expenditure.*

The appellant company carried on general insurance business. One of the bye-laws of the company allowed payment of bonus where a policy was renewed and there had been no claim in the preceding year. The company did not debit in its profit and loss account the amount so paid in the previous years relevant to the assessment years 1957-58 and 1958-59; it showed an amount estimated to be payable as bonus in its D profit appropriation account. The Income-tax Officer held that (i) the payment of bonus was made after the profits for the relevant year were determined and on that account it was only a case of appropriation of profits after they were earned, (ii) in any event since the company had not charged the bonus paid to revenue account and had merely made a provision in the appropriation account, it could not claim relief after modifying the accounts in Form B to Schedule II of the Insurance Act 1938 submitted to the Controller of Insurance. The High Court in E a reference under s. 66 of the Income-tax Act held against the company The company appealed.

HELD : (i) Rule 6 of the Schedule to the Income-tax Act enjoins the Income-tax Officer to take the balance disclosed by the annual accounts as the profits and gains of insurance business other than life insurance : it does not oblige him to accept the figure disclosed at the foot of the profit and loss account in the determination of the quantum of profits and gains F of the insurance business. Section 15 of the Insurance Act requires the insurer to submit not merely the profit and loss account in Form B but also the balance sheet and the account in Form C and other accounts, and there is no warrant for the view that the balance of profits disclosed must be equated with the balance of profits disclosed in Form B. [283G-H]

(ii) By debiting the estimated bonus payment to the profit appropriation account the company did not seek to alter the character of the G expenditure. If it had been debited in the profit and loss account it could not with any show of reason be regarded as not incidental to the business of the assessee company. Merely because it was debited as an estimated amount an intention not to treat it as expenditure for the purpose of the business is not indicated. It was open to the assessee company to debit to its annual accounts a certain outgoing actual or estimated and if sanctioned by the Controller to claim that amount or such other H amount as the Income-tax Officer may under s. 10(2) allow as a permissible deduction. [284B-D]

(iii) The bonus scheme was clearly intended to advance the business of the insurer and the expenditure in this regard was expenditure laid

out wholly and exclusively for the purpose of the business of the company within the meaning of s. 10(2)(xv). [284F] A

(iv) The liability of the company for payment of bonus was not a contingent liability. So long as the year of risk has not expired the liability is contingent, but once the year of risk is over, and the policy is renewed the liability becomes actual and concrete. The assessee company had not claimed the full amount for which an estimate was made in the accounts submitted to the Controller of Insurance but only those amounts which were entered in the balance sheet as actually paid. This expenditure could not be said to be contingent. [284 H; 285 A] B

CIVIL APPELLATE JURISDICTION : Civil Appeals No. 1052 & 1053 of 1966.

Appeals from the judgment and order dated October 4, 5, 1963 of the Bombay High Court in Income-tax Reference No. 50 of 1961. C

R. J. Kolah, and *Ravinder Narain,* for the appellant.

R. M. Hazarnavis, S. K. Aiyar, S. P. Nayyar for *R. N. Sachthey,* for the respondent. D

The Judgment of the Court was delivered by

Shah, J. The Union Co-operative Insurance Society Ltd.—hereinafter called 'the assessee Company'—carries on general insurance business. Bye-law 52 of the assessee Company provides that bonus shall be paid on those policies (not being Reinsurance Policies) on certain conditions, the following of which are relevant : E

"1. That the premium on that policy is more than Rs. 5/-.

2. That there has been no claim on that policy.

"3. That the policy was insured during the year for which bonus is declared. F

4. That the bonus amount will be paid only if the policy is renewed on expiration and the bonus amount may be credited towards premium under the renewed policy."

In proceedings for assessment of the income of the assessee Company for the assessment years 1957-58 and 1958-59 the assessee Company claimed allowance of Rs. 29,615/- and Rs. 44,920/- respectively, paid under the bonus scheme under Bye-law 52, in the computation of its taxable income. The Income-tax Officer rejected the claim holding that payment of bonus was made after its profits for the relevant years were determined and on that account it was only a case of appropriation of profit after it was earned, and that in any event since the assessee Company had not charged the bonus paid to the revenue account and had merely made a G H

A provision in the appropriation account, it could not claim relief after modifying the accounts in Form B to Schedule II of the Insurance Act, 1938, submitted to the Controller of Insurance. The Appellate Assistant Commissioner upheld the order of the Income-tax Officer. The Income-tax Appellate Tribunal, however, held that the payments were not mere appropriation of profits, and were B admissible as permissible deductions on the ground of business expediency. The following question submitted for determination of the High Court of Judicature at Bombay—

> "Whether on the facts and in the circumstances of the case, the amounts of Rs. 29,615/- and Rs. 44,920/- paid to certain policy-holders in the calendar years 1956 C and 1957 respectively by the assessee Company were admissible deductions for the purpose of computation of its taxable income for the assessment years 1957-58 and 1958-59 ?"

was answered in the negative.

D The High Court held that since the amounts paid were not entered in the Profit & Loss account in Form B Schedule II to the Insurance Act and were also not regarded by the assessee Company as expenditure charged on profits, they were not admissible as deductions in the computation of the taxable income of the assessee Company under r. 6 of the Schedule to the Income-tax Act. With E special leave, the assessee Company has appealed to this Court.

By s. 10(7) of the Income-tax Act the profits and gains of any business of insurance and the tax payable thereon are computable, notwithstanding anything to the contrary contained in ss. 8, 9, 10, 12 or 18, in accordance with the rules contained in the Schedule to the Act. Rule 6 of the Schedule which prescribes the method of F computation of taxable income of insurance business (other than life insurance) provides :

> "The profits and gains of any business of insurance other than life insurance shall be taken to be the balance of the profits disclosed by the annual accounts, copies of which are required under the Insurance Act, 1938, to be G furnished to the Controller of Insurance after adjusting such balance so as to exclude from it any expenditure other than expenditure which may under the provisions of section 10 of this Act be allowed for in computing the profits and gains of a business . . . . ."

H By s. 15 of the Insurance Act 4 of 1938 every insurer is directed to furnish to the Controller of Insurance, among others, the audited accounts and statements referred to in s. 11 of that Act. By s. 11(1) of the Insurance Act every insurer is directed to prepare at

the expiration of each calendar year with reference to that year, the following accounts and statements in respect of all insurance business transacted by him :

> "(a) in accordance with the regulations contained in Part I of the First Schedule, a balance-sheet in the form setforth in Part II of that Schedule;
>
> (b) in accordance with the regulations contained in Part I of the Second Schedule, a profit and loss account in the forms setforth in Part II of that Schedule, except where the insurer carries on business of one class only of the classes specified in clauses (a), (b) and (c) of sub-section (1) of section 7 and no other business."

Section 21 of the Insurance Act authorises the Controller of Insurance, if it appears to him that any return furnished to him under the provisions of the Act is inaccurate or defective in any respect, to require the insurer to correct or supplement such return, or to call upon the insurer to submit for his examination any book of account, register or other document or to examine any officer of the insurer on oath in relation to the return, or to decline to accept any such return unless the inaccuracy has been corrected or the deficiency has been supplied. By s. 22 the Controller has the power to order investigation or re-valuation to be made by an actuary appointed by the insurer for the purpose. Having regard to the wide powers conferred upon the Controller, the Income-tax Act has in respect of the business of insurance, other than life insurance, provided that the balance of the profits disclosed by the annual accounts, copies of which are required under the Insurance Act, 1938, to be furnished to the Controller of Insurance, shall be accepted by the Income-tax Officer, subject to any adjustment he may make so as to exclude from it any expenditure other than expenditure which may under the provisions of s. 10 of the Income-tax Act be allowed for in computing the profits and gains of the business.

It is common ground that the assessee Company had submitted its balance-sheet, the profit & loss account and profit & loss appropriation account. The balance-sheets for the two years 1956 and 1957 have not been printed in the record and only the profit & loss accounts and the profit & loss appropriation accounts have been printed. In the statements of profit & loss account (Form B) for the years 1956 and 1957 disbursements by way of bonus to the renewing policy-holders under Bye-law 52 are not included. But in the profit & loss appropriation accounts (Form C) for the years 1956 and 1957 entries for allocations for Rs. 50,000/- and Rs. 70,000/- respectively are made under the head "Policy-holders Bonus Fund". In Form 'B' in Schedule II of the Insurance Act

A under the head "Other Expenditure (to be specified)", outgoings other than taxes, expenses of management, loss on realization of investments, depreciation and loss transferred from Revenue Account are required to be included. In Form C which is the form of profit & loss appropriation account the following appropriations are directed to be made :

B "Balance being loss brought forward from last year.

Balance being loss for the year brought from Profit & Loss Account (as in Form B).

Dividends paid during the year on account of the current year.

C Transfers to any particular Funds or Accounts, and

Balance at the end of the year as shown in the Balance-Sheet."

The assessee Company in drawing up its profit & loss account instead of showing the actual disbursement in Form B against the head "Other Expenditure" estimated the amounts which it would be D liable to pay and debited the same against the head "Transfers to any particular Funds or Accounts" in Form C. The High Court held that r. 6 merely provides for adjustment of the balance of expenses which are in the opinion of the Income-tax Officer not permissible allowances under s. 10, and on that hypothesis inferred that the annual accounts referred to in r. 6 of the Schedule mean E the profit & loss account submitted in Form B and not the profit & loss appropriation account submitted in Form C. In our judgment that view cannot be sustained. In Form B expenditure which is already incurred or which is capable of being actually ascertained at the close of the year may be included. But the insurer who has incurred a liability may allocate (subject to adjustment in the balance-sheet) an estimated amount out of the profit & loss account F and enter it in the profit & loss appropriation account. The Controller of Insurance may, if he is not satisfied with the correctness of the estimate, or the allocation refuse to accept it, and may call upon the insurer to rectify the accounts. If the Controller certifies the accounts, the expenditure cannot be disallowed by the Income-tax Officer, merely because it is not entered in the profit & loss G account, and is found appropriated in the profit & loss appropriation account. Rule 6 of the Schedule to the Income-tax Act enjoins the Income-tax Officer to take the balance disclosed by the annual accounts as the profits and gains of insurance business other than life insurance : it does not oblige him to accept the figure disclosed at the foot of the profit & loss account as determinative of H the quantum of profits and gains of that insurance business. Section 15 requires the insurer to submit not merely the profit & loss account in Form 'B', but also the balance-sheet and the account in Form 'C' and other accounts, and there is no warrant for the view

that the balance of profits disclosed by the annual account must be equated with the balance of profits disclosed in Form 'B'. A

The other plea which appealed to the High Court that the assessee Company had itself not treated the bonus paid as an expenditure related to the business, but only as disbursements made out of the profit after it had accrued to the assessee Company, also cannot be sustained. The assessee Company maintains its accounts according to the mercantile system. It chose to estimate the liability arising under Bye-law 52 in respect of the business transacted by it, and debited it in the profit & loss appropriation account. By adopting that method of accounting the assessee Company did not seek to alter the character of the expenditure. If it had been debited in the profit & loss account it could not with any show of reason be regarded as not incidental to the business of the assessee Company. Merely because it was debited as an estimated amount, an intention not to treat it as expenditure for the purpose of the business is not indicated. In our judgment, it was open to the assessee Company to debit in its annual accounts a certain outgoing actual or estimated, and if sanctioned by the Controller to claim that amount or such other amount as the Income-tax Officer may under s. 10(2) allow as a permissible deduction. B C D

The High Court did not express any view on the question whether the expenditure was a permissible allowance under s. 10(2)(xv) of the Income-tax Act. It appears from the scheme for payment of bonus to the policy-holders who renew their policies that bonus would be admissible if there was no claim on the policy and the renewal policy was issued during the year for which bonus was declared. This scheme was evolved to induce the policy-holders to renew their policies with the assessee Company. Even if no immediate benefit results therefrom to the trade of the insurer, the scheme is clearly intended to advance the business of the insurer, and payment to renewing policy-holders or adjustment of bonus against renewal premium made under that scheme constitutes expenditure laid out wholly and exclusively for the purpose of the business of the assessee Company. E F

Counsel for the Commissioner contended that the estimated liability was not "crystallised liability" and was on that account inadmissible as an allowance in the computation of taxable income. The liability, submitted counsel, was a mere contingent liability which could not amount to expenditure within the meaning of s. 10(2)(xv), nor a permissible outgoing in the determination of the income, profits or gains of the business. This question was apparently not raised before the Tribunal. Assuming that it could be raised before the High Court and this Court, we are of the view that under the scheme of Bye-law 52, the liability is not a contingent liability. So long as the year of risk has not expired, the G H

A liability is contingent; but once the year of risk is over, and the policy is renewed the liability becomes actual and concrete. The assessee Company has not claimed the full amount for which an estimate was made in the accounts submitted to the Controller of Insurance, but only those amounts which were entered in the balance-sheet as actually paid. This expenditure cannot be said B to be "contingent".

It was finally said that under s. 41 of the Insurance Act there is prohibition against the grant of any rebate and it is urged that no insurer can in the course of assessment proceedings claim deduction in respect of the amounts allowed by him by way rebate when grant of rebate is expressly prohibited by statute. Section 41(1) of C the Insurance Act prohibits the allowance or offer of allowance either directly or indirectly as an inducement to any person to take out or renew or continue an insurance in respect of any kind of risk relating to lives or property in India. But the question whether grant or bonus is a rebate within the meaning of s. 41 was never raised before the Tribunal. This Court will not be justified D in entering upon an investigation whether payment of bonus was in the nature of rebate and on that account offended s. 41 of the Insurance Act.

The answer recorded by the High Court will be discharged and an answer in the affirmative be recorded on the question submitted.

E The appeals will be allowed. The assessee Company will be entitled to its costs in this Court and the High Court. One hearing fee.

G.C. *Appeals allowed.*