Supreme Court of India
Life Insurance Corporation Of ... vs Commissioner Of Income Tax, ... on 19 February, 1996
Equivalent citations: 1996 AIR 1720, JT 1996 (2) 336
Author: J S Verma
Bench: Verma, Jagdish Saran (J)

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           PETITIONER:
LIFE INSURANCE CORPORATION OF INDIA,BOMBAY

        Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAX, BOMBAY

DATE OF JUDGMENT:       19/02/1996

BENCH:
VERMA, JAGDISH SARAN (J)
BENCH:
VERMA, JAGDISH SARAN (J)
VENKATASWAMI K. (J)

CITATION:
 1996 AIR 1720            JT 1996 (2)   336
 1996 SCALE  (2)258


ACT:



HEADNOTE:



JUDGMENT:
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J U D G M E N T J.S.VERMA.J. :

A reference was made by the Income-tax Appellate Tribunal under Section 256(1) Of the Income-tax Act, 1961, at the instance of the assessee, to the Bombay High Court for deciding seven questions of law arising out of the Tribunal's order. The first six questions were answered by the High Court in favour of the assessee, while the seventh question was answered against the assessee. This appeal by special leave is by the assessee challenging the High Court's decision only in respect of the seventh question decided against the assessee. That question is as under:

> "Whether on the fact and in the circumstance of the case,the sum of Rs.23,959/-being the refund of income-tax received by the Corporation during the undervaluation period in respect of the income-tax upto the assessment year 1956-57 of the life insurance bus insurers of the erstwhile insurers whose business had been taken over

> by the Corporation, should be allowed as a deflection while computing the income of the assessee under Rule 2(1)(b) of the First Schedule to the Income-tax Act, 1961?"

In this appeal, no further reference to the other six questions is necessary.

The assessee Life Insurance Corporation of India (Corporation) is a statutory Corporation established under the Life Insurance Corporation Act, 1956 with effect from 1st September, 1956. The relevant assessment year is 1963-64 for which the accounting period ended on 31.3.1963. During the relevant assessment year, the assessee received refunds of income-tax of 3,02,90,898/- in the life insurance business. The assessee contended before the Income-tax officer that the entire amount of refund was not includable in the revenue account and treated as profits and gains of the assessee for the assessment year under consideration. The Income-tax Officer rejected the contention and included the entire amount in the revenue account. In the assessee's appeal, the Appellate Assistant Commissioner held that out of the amount of Rs. 3,02,90,898/ included in the revenue account, the sum of Rs. 2,73,50,939/- only was to be excluded but the balance amount had to be included. The assessee as well as the revenue preferred appeals to the Tribunal.

Before the Tribunal, it was contended by the revenue that in computing the profits of the assessee under Section 44 read with Rule 2(1)(b) of the First Schedule to the Income-tax Act, 1961, the Income-tax Officer can make only such adjustments to the surplus or deficit disclosed by the actuarial valuation which are permissible under the rule; that the rule permits adjustment by way of exclusion of any surplus or deficit included therein which was made in any earlier inter-valuation period relating to the assessee itself and not to that of its predecessor in the business. It was contended that a part of the refund Of taxes received by the Corporation had not been included in the surplus of the earlier inter-valuation period relating to the assessee but of its predecessor since the refund was in respect of the taxes paid by the predecessor prior to the formation of the Corporation on 1st September, 1956. It was contended that the words "included therein" used in Rule 2(1)(b) indicated that the surplus or deficit in any earlier inter- valuation period must relate to that of the Corporation and not its predecessor. The decision of the Bombay High Court in Bombay Mutual Life Assurance Society Ltd. vs. Commissioner of Income-tax. Bombay City, [1951] 20 ITR 189 was distinguished. The contention of the assessee was that the payment of taxes which gave rise to the refund having been made prior to the formation of the Corporation, by the predecessor, there was no occasion for the surplus or deficit in any earlier inter-valuation period of the Corporation being required to be looked into for the purpose. Reliance was placed on Section 7 of the Life Insurance Corporation Act, 1956 (for short "the LIC Act") to contend that the Corporation stepped into the shoes of its predecessor for all practical purposes including the legal consequences flowing from the refund received by the Corporation as the successor of its predecessor in business.

The Tribunal accepted the contention of the revenue and held as under :-

> ".........But only such portion of the refunds which has been included in the surplus or deficit made in the earlier intervaluation period alone has to be excluded. On the analysis of the refunds and the assets to which they related, the Appellate Asstt. Commissioner found that this sum of Rs.2,73,50,939/- only had entered into the

> surplus of the earlier intervaluation period out of Rs.3,02,90,898/-. Therefore, only that portion is allowable u/s.2(1)(b) and has been rightly allowed by the Appellate Asstt. Commissioner. Disallowance of the balance of the tax refund was quite in order because they did not come out of the assets which were included in the surplus of the earlier inter valuation period." The above-quoted question was referred to the High-

Court for its decision at the instance of the assessee Corporation, under Section 256(1) of the Income-tax Act. The High Court upheld the view taken by the Tribunal. That decision of the High Court is reported in [1978] 115 ITR 45 (Life Insurance Corporation of India. Bombay vs. Commissioner of Income-tax. Bombay City-III). The relevant part of the High Court's judgment, rejecting the assessee's contention, is as under :-

> "It is difficult to accept this submission. Rule 2(1)(b) is an artificial mode of computation of profits of an assessee who carries on life insurance business. These profits are arrived at by first determining the annual average of the surplus after adjusting the surplus or deficit as disclosed by the actuarial valuation made in accordance with the Insurance Act, 1938, in respect of the last inter-

> valuation period. What is contemplated by rule 2(1)(b) is that if there is a surplus of the earlier inter-valuation period, which was entered in the accounting while finding out the surplus for the inter- valuation period in question, then that surplus has to be deducted for the purposes of finding out the surplus in respect of the assessment year in question. It is necessary to remember that when an actuarial valuation is made by an actuary on behalf of the company, first Of all a consolidated revenue account is prepared, which would show on the one side the amount of life insurance fund at the end of the period for which the consolidated revenue account is prepared. The actuary then finds out what is the net liability of the company under the current policies and after fixing the net liability on the current policies, he deducts that liability from the life assurance fund and the result is the surplus. If this is the concept of the surplus to be found on actuarial valuation, then it is obvious that before a surplus is asked to be deducted on the ground that that part of the surplus was carried forward from the earlier inter- valuation period, it must be found as a fact that what is now sought to be deducted was shown as a surplus of the earlier inter-

> valuation period. Rule 2(1)(b) operates in respect of the particular assessee whose profits of the life insurance business are under computation. Accepting the contention of the learned counsel for the assessee would mean that we would have to add to the language of rule 2(1)(b) so that it should be so construed that what is to be taken into account is not the actual surplus which has been carried forward into the inter- valuation period in question but also some amount which must be deemed to have been carried forward into the surplus of the inter- valuation period. It is, no doubt, true that the legal effect of section 7 of the Life Insurance Act is that the assets of the insurer who carried on the life insurance business are vested in the Life Insurance Corporation, but the legal effect of that vesting cannot be imported into the

> provisions of rule 2(1)(b) where a precondition has to be satisfied before a deduction in respect of the surplus is made, the precondition being that that surplus has to be shown as a surplus Of the previous inter- valuation period. There is no scope for reading into rule 2(1)(b) any additional powers for the income- tax authorities to so amend the figure of surplus that is different from the actual surplus which is shown on the basis of the actuarial valuation. ...."
>
> (at page 55) In substance, the High Court declined to give effect to Section 7 of the LIC Act on its view that the provision in Rule 2(1)(b) alone was decisive and it could not be given effect to, it the legal effect of Section 7 of the LIC Act is to be taken into account. Apparently, the High Court took the view that Rule 2(1)(b) cannot be reconciled with Section 7 of the LIC Act.The question is whether this view is correct.

The relevant provisions in the Life Insurance Corporation Act, 1956 are as under:-

> "7. Transfer of assets and liabilities of existing insurers carrying on controlled business. - (1) On the appointed day* there shall be transferred to and vested in the Corporation all the assets and liabilities appertaining to the controlled business of all insurers.
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> (2) The assets appertaining to the controlled business of an insurer shall be deemed to include all rights and powers, and all property, whether movable or immovable, appertaining to his controlled business, including, in particular, cash balances, reserve funds, investments, deposits and all other interests and rights in or arising out of such property as may be in the possession of the insurer and all books of account or documents relating to the controlled business of the insurer; and liabilities shall be deemed to include all debts, liabilities and obligations of whatever kind then existing and appertaining to the controlled business of the insurer.
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> xxx xxx xxx ____________ * 1st September, 1956."
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> "9. General effect of vesting of controlled business. -(1).. (2) If on the appointed day any suit, appeal or other legal proceeding of whatever nature is pending by or against an insurer, then, in so far as it relates to his controlled business, it shall not abate, be discontinued or be in any way prejudicially affected by reason of the transfer to the Corporation of the business of the insurer or of anything done under this Act, but the appeal or other proceeding may be continued, prosecuted and enforced by or against the Corporation."

Sub-section (1) of Section 7 clearly provides that from the appointed day in 1956, all the assets and liabilities appertaining to the controlled business of all insurers, are to be transferred and vested in the Life Insurance Corporation of India. Sub-section (2) of Section 7 enacts the legal fiction by virtue of which "all rights and powers, and all property, whether movable or immovable, appertaining to his controlled business, including, in particular, cash balances, reserve funds, investments, deposits and all other interests and rights in or arising out of such property as may be in the possession of the insurer and all books of accounts or documents relating to the controlled business of the insurer" were deemed to be the assets of an insurer which came to be transferred and vested in the Corporation from the appointed day, and so also all the liabilities. In other words, from the appointed day, the Corporation stepped into the shoes of all such insurers. Section'9 provides for the general effect of vesting of controlled business and sub-section (2) therein expressly enacts that the Corporation stepped into the shoes of the predecessor- insurer from the appointed day in respect of any suit, appeal or other legal proceeding of whatever nature pending by or against an insurer.

This legal fiction enacted in Section 7(2) includes within the assets transferred and vested in the Corporation of all such insurers any amounts which were due to the predecessor-insurer and which remained to be recovered. Section 9(2) enabled the Corporation to prosecute any legal proceeding of whatever nature for the purpose of recovering amounts due to the predecessor on the appointed day. There is no dispute that any liability of the insurer also stood transferred similarly to the Corporation. Accordingly, if any amount remained due towards taxes to be recovered from the predecessor, it was a liability transferred to the Corporation and the Corporation became liable to discharge the same. It is also not in dispute that it is only by virtue of this character of the Corporation that the amount refunded as excess tax paid prior to the appointed day by the predecessor came to be refunded to the Corporation to whom all the assets of the predecessor stood transferred and vested from the appointed day in 1956. It is also not disputed that the opening balance inherited by the Corporation from the predecessor on the appointed day had to be deducted under Rule 2(1)(b) and the amount shown as such was so deducted. It is further not disputed that if this excess amount of tax paid by the predecessor had not been so paid and the question of refund did not arise, then this extra amount would have formed a part of the inherited opening balance with the Corporation and deduction of the same would have been given under Rule 2(1)(b). The question is : Whether, the refund having been made to the Corporation only because of the provision in Section 7 of the LIC Act, the same result should not follow on the wording of Rule 2(1)(b) ?

Rule 2(1)(b) of the First Schedule to the Income- tax Act, 1961 is as under:-

> "2. Computation of profits of life insurance business. -(1) The profits and gains of life insurance business shall be taken to be the greater of the following
>
> (a)............
>
> (b) the annual average of the surplus arrived at by adjusting the surplus or deficit disclosed by the actuarial valuation made in accordance with the Insurance Act, 1938 (4 of 1938), in respect of the last inter-valuation period ending before the commencement of the assessment year, so as to exclude from it any surplus or deficit included therein which was made in any earlier inter-valuation period and any expenditure or allowance which is wot deductible under the provisions of [Sections 30 to 43- Al* in computing income chargeable under the head "Profits and gains of business or profession".

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*Subs. by Finance (No. 2) Act of 1967 (w.e.f. 1-4-1967).

It is obvious that in the surplus or deficit in any inter-valuation period relating to the Corporation which came to be formed only on the appointed day in 1956, this amount could not be reflected since it related to a period prior to the formation of the Corporation. The law does not contemplate or require the performance of an impossible act- lex non cogit ad impossibilia. It is now to be seen whether the expression "included therein" in Rule 2(1)(b) is alone sufficient to negative the logical legal effect of Section 7 of the LIC Act.

The legal fiction enacted in Section 7(2) of the LIC Act must be taken to its logical conclusion. For this reason, the amount of refund made to the Corporation because of the excess tax paid by the predecessor prior to the appointed day on which the Corporation was formed, must form a part of the assets of the predecessor which came to be transferred and vested in the Corporation on the appointed day in 1956 on the formation of the Corporation. For the same reason, this amount of refund, even though made later, must also be deemed to be included in the inherited opening balance shown by the Corporation in the earlier inter- valuation period which undisputedly had to be deducted under Rule 2(1)(b). It follows that because of this legal fiction being required to be taken to its logical conclusion, the amount so refunded to the Corporation must be deemed to be included in the earlier inter-valuation period of the Corporation. On this conclusion, the requirement of Rule 2(1)(b) is satisfied since the amount is deemed to be included in the earlier inter-valuation period of the Corporation itself. The expression "included therein" which is the basis of the view taken by the Tribunal and the High Court and is also the contention of the revenue before us, must be construed to mean also the amount deemed to be included therein because of the legal effect of Section 7 of the LIC Act.

The High Court failed to appreciate the true import of the decision in Bombay Mutual Life Assurance Society Ltd vs. Commissioner of Income-tax. Bombay City, [1951] 20 ITR 189, to take the view that the decision turned on the application of Rule 3(b) of the Schedule which made certain provisions for the purposes of computing surplus for the purposes of Rule 2; and that the latter part of Rule 3(b) was given effect to because it was found that that amount was liable to be included as a part of the surplus. The significance of that decision in the present context is in the observations of Chagla, C.J. speaking for the Bench, as under :-

> "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 Rule 2(b) you have to deduct from it any surplus or deficit included therein which was made in any earlier intervaluation 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."

(at page 198) The principle enunciated in the above passage to be noticed is :

"........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. ....."

This aspect has been overlooked by the High Court.

A harmonious construction of the provisions of the LIC Act, particularly Section 7 therein, and Rule 2(1)(b) of the First Schedule to the Income-tax Act, 1961, requires this construction to be made. Unless this is done, full effect cannot be given to Section 7 of the LIC Act, for which we find no reason. Since the requirement of harmonious construction leads to this result which is also in consonance with logic and justice of the cause, we do not find any reason to take a different view.

Consequently, the appeal is allowed. The judgments of the High Court and the Tribunal are set aside. The aforesaid question is answered in favour of the assessee and against the revenue. No costs.