

Tax Alert | Delivering clarity

9 August 2022

Non-exempt maturity proceeds of life insurance policy, taxable as capital gains

The Kolkata Bench of Income-tax Appellate Tribunal has rendered its decision that the entire maturity value/gains at the time of extinguishment of the rights of the taxpayer in the life insurance policy having premium of more than 20% of the sum assured, are liable to be treated as capital gains. Further, the cost of acquisition in such cases, shall be the premium paid in excess of 20% of the sum assured.

Background:

- The taxpayer¹, a resident individual, during the Financial Year (FY) 2016-17, corresponding to Assessment Year (AY) 2017-18 filed his return of income, inter-alia, declaring total income of INR 100 and a carried forward loss of say INR 30.
- During the year under consideration, the taxpayer had received a sum (say INR 50) as maturity proceeds of life insurance policy (Policy); on which the taxpayer computed long-term capital gains (LTCG) and offered a loss of INR 30.
- During the course of audit proceedings, the Assessing Officer (AO) disallowed the aforesaid capital loss claimed by the taxpayer and taxed the maturity proceeds as income from other sources.
- Aggrieved, the taxpayer filed an appeal and in the course of appellate proceedings, the matter reached before the Kolkata Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant extracts of certain provisions in brief:

- **Section 10(10D) of the Income-tax Act, 1961 (ITA) [relating to certain income not forming part of total income]**

“Section 10 : In computing the total income of a previous year of any person, any income falling within following clauses shall not be included...

...(10D) any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, other than...

...

(c) any sum received under an insurance policy issued on or after the 1st day of April 2003 but on or before the 31st day of March 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured; or

¹Bishista Bagchi v. DCIT [2022] 138 taxmann.com 419 (Kolkata-Trib)

(d) any sum received under an insurance policy issued on or after the 1st day of April, 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds ten per cent of the actual capital sum assured..”

Provided that the provisions of sub-clauses (c) and (d) shall not apply to any sum received on the death of a person:

- **Section 88 of the ITA (relating to rebate on life insurance premia, contribution to provident fund, etc.)**

“Section 88-

(1) Subject to the provisions of this section, an assessee, being an individual, or a Hindu undivided family, shall be entitled to a deduction, from the amount of income-tax (as computed before allowing the deductions under this Chapter) on his total income with which he is chargeable for any assessment year, of an amount equal to...

... (2) The sums referred to in sub-section (1) shall be any sums paid or deposited in the previous year by the assessee—

(i) to effect or to keep in force an insurance on the life of persons specified in sub-section (4); ...

...(2A) The provisions of sub-section (2) shall apply only to so much of any premium or other payment made on an insurance policy other than a contract for a deferred annuity as is not in excess of twenty per cent of the actual capital sum assured.”

Decision of the ITAT:

- The ITAT observed that the relevant issue which required adjudication was:
 - (i) Whether a life insurance policy is a ‘capital asset?; and
 - (ii) Whether proceeds of a maturity of a single/double premium life insurance policy are to be assessed under the head ‘Capital gains’ or ‘Income from other sources’?
- The ITAT observed / noted as follows:

Facts/ features/terms of the Policy

- The taxpayer purchased a life insurance policy in the year 2006 (with sum assured of say INR PQR); with its date of commencement in April 2006 and maturity date in April 2016 (i.e., 10-year term).
- The annual premium paying term was initial two (2) years only.
- The taxpayer received a maturity amount of the policy comprising of sum assured (INR 40) along with an additional amount say INR 10 i.e. total of INR 50.
- Considering the amount of premium paid, the sum assured on the life and the actual maturity value received by the taxpayer, there were the following two elements embedded in the policy:
 - (i) Firstly, the hedging of the risk of life and related benefits as are available under a simple life insurance policy; and

(ii) Secondly, the element of investment.

Exemption of maturity proceeds under section 10(10D), pre and post amendment vide the Finance Act 2003

- Before the substitution of section 10(10D) of the ITA by Finance Act 2003 with effect from 1 April 2004, any sum received under a life insurance policy included sum allocated by way of bonus of such policy, was exempt from taxation. However, with effect from 1 April 2004, certain exceptions were provided to the said exemption.
- Based on the explanation given in Memorandum of Finance Bill 2003 (introducing the exceptions), the purpose of the amendment/substitution of section 10(10D) was that the government did not intend to pass the exemption benefit of maturity sum received in respect of insurance policies in which the purpose of investment was embedded along with insurance.
- Therefore, these types of policies were similar to investments and bonds.

Corresponding amendment under section 88(2A) of the ITA vide the Finance Act 2003

- On the same line, the new section 88(2A) vide Finance Act 2003 was inserted providing that the deduction in respect any premium or other payment paid on an insurance policy would not be allowed in excess of 20% of the actual capital sum assured.
- The aforesaid provisions introduced with effect from 1 April 2004 showed that any sum paid in excess of 20% of the sum assured on an insurance policy was treated towards investment. However, deduction from the amount of income-tax was available in respect of any sum of premium which was upto 20% of the sum assured.

Whether Life Insurance policy a 'capital asset'?

- The Parliament while substituting section 10(10D) and inserting section 88(2A) of the ITA had denied the benefit of exemption and deduction in respect of policies, which were similar to deposits/investments and also has treated the premium paid over and above of 20% of the sum assured towards investment and not towards insurance or hedging of life risk.
- Hence, the amount of premium paid by the taxpayer, which was more than 20% of the sum assured was investment made by the taxpayer.

Computation of capital gains

- The exclusion under section 10(10D) of the ITA is not for any amount received over and above the sum assured, rather the entire amount received under the policy is excluded.
- Therefore, the entire maturity value/gains at the time of extinguishment of the rights of the taxpayer in the said policy i.e. on the date of maturity were liable to be treated as capital gains.
- While computing the capital gains, the cost of acquisition was the amount paid towards premium less 20% of the sum assured.
- The premium up to 20% of the sum assured was to be treated as not part of the investment rather towards the cost of hedging of risk under the insurance policy, for which a deduction was

already available to that extent under section 88(2A) of the ITA and thereafter, indexation was to be allowed accordingly.

Comment:

Taxpayers often avail life insurance policy, having premium of more than 10% / 20% of the sum insured. In such cases, the exemption provided under section 10(10D) of the ITA for receipt of life insurance policy maturity proceeds is not available.

A question that arises in such cases is whether the maturity proceeds would be taxable as capital gains or as income from other sources?

This ruling, based on facts of the case, has observed that:

- These types of policies are similar to investments and bonds and the amount of premium paid by the taxpayer, which is more than 20% of the sum assured is investment made by the taxpayer.
- The entire maturity value/gains at the time of extinguishment of the rights of the taxpayer in the said policy i.e., on the date of maturity are liable to be treated as capital gains. Further, it has also observed that the cost of acquisition is the amount paid towards premium less 20% of the sum assured.

It may be pertinent to note that section 10(10D) of the ITA has been amended to state that the exemption would not be available for any sum received under an insurance policy issued on or after the 1 April 2012, in respect of which the premium payable for any of the years during the term of the policy exceeds 10% of the actual capital sum assured (except for sum received on death of a person).

Taxpayers with similar facts may evaluate the impact of this ruling to the specific facts of their cases.

Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This material and the information contained herein prepared by Deloitte Touche Tohmatsu India LLP (DTTI LLP) is intended to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s). This material contains information sourced from third party sites (external sites).

DTTI LLP is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such external sites. None of DTTI LLP, Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this material, rendering professional advice or services. This information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this material.

©2022 Deloitte Touche Tohmatsu India LLP. Member of Deloitte Touche Tohmatsu Limited