

**CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
NEW DELHI.**

PRINCIPAL BENCH - COURT NO. II

Service Tax Appeal No. 54356 of 2015-CU(DB)

(Arising out of order-in-original No. 12/Commissioner/2015 dated 16.07.2015 passed by the Commissioner, Central Excise and Service Tax, New Delhi).

M/s Max Life Insurance Co. India Limited Appellant

11th Floor, DLF Square
Jacaranda Marg, DLF City
Gurgaon, Haryana

VERSUS

**Commissioner of Central Excise and
Service Tax,**

Large Taxpayer Unit, NBCC Plaza
Pushp Vihar, Sector-III, Saket
New Delhi-110017.

Respondent

APPEARANCE:

Shri Sanjeev Sachdeva and Ms. Neha Gulati, Advocates for the appellant
Shri Amresh Jain, Authorised Representative for the respondent

**CORAM: HON'BLE MR. ANIL CHOUDHARY, MEMBER (JUDICIAL)
HON'BLE MR. BIJAY KUMAR, MEMBER (TECHNICAL)**

FINAL ORDER NO. 51097/2019

DATE OF HEARING: 31.01.2019
DATE OF DECISION: 21.08.2019

ANIL CHOUDHARY:

The issue in the present case is whether Service Tax under the category of "Management of Investment under ULIP service" is leviable on Surrender Charges, which are deducted from fund value, as per policy provisions for pre-mature withdrawal from the scheme.

2. With effect from 16.05.2008, the activity of Management of Investment under ULIP was brought under the Service Tax net in form of Clause 105 (zzzzf) of Section 65 of the Act i.e. "Management of Investment under ULIP service".

3. Sometimes the policy holder or the insurer opts for pre mature termination of the policy. In such case, the insurer / appellant levy surrender charges, which is deducted from the fund value or the benefit value accrued in the policy. The appellant in the business of life insurance and provides several products which are broadly classifiable into term plan product, Unit Link Insurance Product (ULIP) etc. vide show cause notice dated 16.04.2014, invoking the extended period of limitation, service tax was demanded on surrender charges for the following period:

01.10.2008 to 30.06.2010	Demand under ULIP Management service
01.07.2010 to 30.04.2011	No demand (dropped in Adju.)
01.05.2011 to 30.06.2012	Demand under Life Insurance service

4. Section 65(105)(zzzzf) of the Finance Act, 1994 defines taxable service, provided or to be provided to a policy holder, by an insurer carrying on life insurance business, in relation to management of investment under Unit Link Insurance business, commonly known as Unit Link Insurance Plan (ULIP) scheme. Explanation for the purpose of this sub-clause:

(i) **management of segregated fund of unit linked insurance business by the insurer shall be deemed to be the service provided by the insurer to the policy holder in relation to management of investment under unit linked insurance business; and** *(emphasis supplied)*

(ii) the gross amount charged by the insurer from the policy holder for the said services provided or to be provided shall be equivalent to the difference between,—

(a) premium paid by the policy holder for the Unit Linked Insurance Plan policy; and

(b) the sum of premium paid for or attributable to risk cover, whether for life, health or other specified purposes, and the amount segregated for actual investment.

Illustration:

Total premium paid for the Unit Linked Insurance Plan policy = Rs.100

Risk premium = Rs. 10

Amount actually invested = Rs. 85

Gross amount charged for the service provided = Rs. 5 [100-(10+85)];

(iii) in addition to the amount referred to in clause (ii), the gross amount charged shall include any amount charged subsequently, whether or not periodically, by the insurer from the policy holder in relation to management of investment under unit linked insurance business;"

5. Explanation (ii) above was substituted vide Notification No. 24/2010-ST dated 22.06.2010 w.e.f. 01.07.2010, as under:

"(ii) the gross amount charged by the insurer from the policy holder for the said service provided or to be provided shall be equal to the maximum amount fixed by the Insurance Regulatory and Development Authority established under Section 3 of the Insurance Regulatory and Development Authority Act, 1999, as fund management charges for unit linked insurance plan or the actual amount charged for the said purpose by the insurer from the policy holder, whichever is higher".

The aforementioned substituted Explanation (ii) makes it clear that taxable value of service is the difference between the premium paid by the policy holder for the ULIP policy as reduced by the sum of 'premium paid' for or attributable to risk cover and the amount segregated for the actual investment.

6. The aforementioned analysis has been further clarified by legislature by substitution of the clause (ii) in the explanation hereinabove, clearly providing that the amount of service shall be the maximum amount fixed by IRDA, as management charges for

ULIP or actual amounts charged for the said purpose by the insurer from the policy holder, whichever is higher.

7. However, it appeared to Revenue that appellant is liable to pay service tax on the surrender charges levied or recovered from the policy holder.

8. For the period 01.10.2008 to 30.06.2010 service tax have been demanded vide impugned order on surrender charges levied on the surrender of ULIP policy. As regards the period 01.07.2010 to 30.04.2011, as per para 6 of the show cause notice taking notice, of the amendment by way of substitution of Explanation (ii) as referred hereinabove in Section 65(105) (zzzzf), read with CBEC letter F. No.334/1/2010-TRU dated 26.02.2010, which stipulated that fund management charges alone should form the value for taxable service for purpose for ULIP. Since this amount was capped for ULIP by IRDA, it was the value of taxable service for any year for the operation of the policy, shall be the actual amount charged for the said purpose or the maximum amount of fund management charges fixed by IRDA, whichever is higher. Accordingly, Revenue in its wisdom has not raised any demand for this period (01.07.10 to 30.04.2011).

9. For the period 01.05.2011 to 30.06.2012, the definition of insurance service under Section 65(105)(zx) of the Finance Act was amended w.e.f. 01.05.2011. The amended definition provided – taxable service means any service provided to a policy holder or any person by an insurer, including reinsurer, carrying on life insurance

service. Further, taxable value was further explained in Notification No. 35/2011-ST dated 25.04.2011, w.e.f. 01.05.2011 as under:

"On gross premium charged from a policy holder reduced by the amount allocated for investment or saving on behalf of the policy holder, if such amount is intimated to the policy holder at the time of providing of services."

Further, in para 11 of the show cause notice it is observed, that surrender charges as per IRDA guidelines, are the recoveries made to recoup expenses incurred towards procurement, administration of the policy and incidental charges thereto. It appeared to Revenue that surrender charges have a nexus with the service provided to the policy holder. It further appeared that surrender charges are similar to pre-closure/ fore-closure charges, which are levied by a banker, at the time of fore-closure of loan.

10. As regards invocation of extended period of limitation, it is alleged that the appellant had intentionally and wilfully suppressed the facts of the recovery of surrender charges (from the policy holder). Further, they failed to assess and pay service tax due on the said charges for the period under dispute. As appellant did not pay the service tax as applicable on such charges and did not file the prescribed ST-3 returns correctly, thus, the case of non-disclosure of the true facts to the Department is made out, with intention to evade payment of service tax. Accordingly, service tax of Rs.62,82,94,708/- was proposed to be demanded alongwith interest with further proposal to impose penalty. The show cause notice was adjudicated vide impugned order-in-original, and the proposed demand confirmed on contest alongwith interest and further equal amount of penalty imposed under Section 78 alongwith penalty of

Rs. 10,000/- under Section 77 for not filing the proper ST-3 return. Being aggrieved, the appellant is before this Tribunal.

11. Learned Counsel submits that Surrender charges are calculated as a percentage of fund value and are levied at a pre-determined rate (for a policy year) on the fund value at the time of effecting pre-mature surrender of the policy, during the initial years. Therefore, surrender charges do not have any nexus with the provision of service as it is levied on the policyholder for surrender of the ULIP policy.

12. The Appellant submits that the jurisdictional authority, that directs or permits all insurance companies, to demand and collect the surrender charge, is IRDA. That IRDA has clearly provided in its circular no. 032/IRDA/Act-1/Dec-2005, dated 21 December 2005, that surrender means 'terminating the contract once and for all'. Further the same Circular also states that surrender charges are charges levied on the ULIP fund at the time of surrender of the contract. Since, these charges are levied on termination of the contract, it clearly shows that no service will be rendered by the insurer on payment of surrender charges. Further, the Notification F.No. IRDA/Reg/2/52/2010 dated 1 July 2010, also provides that the surrender charges are imposed only to recoup expenses incurred towards procurement, administration of the policy and incidental thereto. The test to determine whether or not the charges are for management is to examine the precise nature of the surrender charges, IRDA in its circular has clearly stated that charges are levied for terminating the contract. The purpose of the charge may

be recoupment of expenses incurred earlier, but the fact remains that the nature of the charge is for cessation/ discontinuance of service and not management of investment under ULIP. Further, the event on which this amount is payable is an act of discontinuance of service and not an act of management of investment under ULIP. The activity, for which surrender charges is recovered, is an activity of discontinuance of service, and such discontinuance of service was not eligible to service tax, during the material period.

(emphasis supplied)

13. At the time of entering into a contract of ULIP services with the policyholder, the Appellant does not charge / recover any surrender charges from the policy holder. It is, therefore, apparent that surrender charges are not meant for management of investment under ULIP and there is no question of ULIP service being provided to the policyholder in lieu of the surrender charges. Thus, surrender charges, which are merely a charge for pre-mature termination of the policy, cannot be treated as a consideration for provision of the service.

14. It is further submitted that Service Tax has been paid by the Appellant on charges recovered from a policy, under the heads of premium allocation charges, policy administration charges, fund management charges, etc. under the taxable service category of "management of investment under ULIP". Surrender charges, however, are deducted by the Appellant from the fund value of prematurely terminated policy at the time of surrender. Therefore, surrender charges are an outcome of surrender of policy by

policyholder and hence cannot be deemed to have a nexus with the provision of "life insurance services" or "management of investment under ULIP".

15. Learned Counsel submits that similar issue arose before the coordinate Bench of this Tribunal in the case of **Reliance Life Insurance Company Ltd. vs. CST, Mumbai-II -2018-TIOL-1308-CESTAT-MUM**. In the said decision, the Tribunal has held that surrender charges under ULIP are not charges towards fund management and hence are not taxable. Further, the Tribunal observed as follows:

- In nutshell, whatever amount is charged for the management of investment portion in ULIP policy is a taxable service and thus liable for service tax. On the contrary, the surrender charges are charged by the assessee when the person dilutes the policy completely or partially.
- Notification F. No. IRDA/Reg/2/52/2010 dt. 01.07.2010 issued by the Insurance Regulatory and Development Authority (Treatment of Discontinued Linked Insurance Policy) Regulations, 2010 specifies that the major objective of discontinuance charges are either to recoup expenses incurred towards procurement, administration of the policy and incidental thereto and design the discontinuance charges to encourage the policyholder to continue with the contract for full term.
- The fact which emerges from the above shows that the charges are either in the nature of 'penalty' or liquidated damages or a combination of both. Thus, in no way it can be considered as charges towards providing of any services of management of investment under Unit Linked Insurance Plan. The clause 2 of Letter Ref: 055/IRDA/Act/ULIP/2009 - 10 DT. 24.09.2009 defined it as surrender penalty.
- ULIP is primarily a contract between the insurer and insured and thus when seen in the context of Section 73 and 74 of the Contract Act, 1872 what transpires is that surrender of policy is nothing but ending of contract for which compensation in the form of damages which cannot be termed as charges towards management.
- Parallel can be drawn from Circular No. 94/5/2007-ST dt. 15.05.2007 wherein the entry and exit load charges of the Mutual fund were held not to chargeable to tax as they are not towards fund management service.
- Similarly, in case of Container Detention charges the Board vide Circular No. 121/2/2010-ST dt. 26.04.2010 held that the detention charges is not a service but can be called penal rent and hence not chargeable to tax.
- Drawing analogy from above, the surrender charges under ULIP cannot be held as charges towards fund management and hence are not taxable.

- Demand is also time barred as the issue involved is of interpretation and therefore no element of suppression, fraud or intention to evade taxes can be made against Appellant. The information of surrender charges stands disclosed in books of accounts and also in Balance Sheet as per the directions of IRDA. Hence it is not a case of suppression.

Similar view has been taken by this Tribunal, that surrender charges are outside the purview of service tax in Sriram Life Insurance Company vide Final order No. A/30187-30189/2019 (Hyderabad) dated 08.02.2019 wherein this Tribunal held as under:

In the said decision at Para 12, the Tribunal, held that since the surrender charges were collected by the insurer, in exercise of its right to receive insurance money from insurer-the same is an actionable claim and therefore outside the purview of service tax. The relevant extract of the said decision is reproduced below:

"12.While, it is true that the expression of 'Service' under Section 65B(44) only w.e.f. 01.07.2012, however, even for the period prior thereto the transaction in question is a actionable claim and not a service. It has to be also noted that for the period prior to 01.07.2012, for an activity to be tax it had to qualify as a taxable service in one of the specified services. Since we are of the view, the transaction in question is not a service at all but the transaction in a actionable claim hence could not have been by any stretch of imagination covered under any of the specified taxable heads of service even for the period prior to 01.07.2012."

(emphasis supplied)

16. So far the demand for the period 2011-12 has been made, with respect to surrender charges, form the life insurance policy in general, the learned Counsel states that the demand is wholly misconceived as the same logic applies, which has been considered

by Revenue for 2010-11. There being no change in the provisions of Section 65(105)(zzzzf) read with Section 65(105)(zx).

17. The SCN as well as the impugned order rely on amendment in definition and coverage of life insurance services in Section 65(105)(zx), to demand service tax on surrender charges, during 2011-12. This is illegal and improper. When there was no change in the coverage / definition of ULIP Management, when surrender charges are related only to ULIP and when surrender charges are accepted to be not taxable under 65(105)(zzzzf), service tax cannot be demanded on surrender charges under life insurance service.

18. Board circular TRU No - DOF No 334/3/2011, dated 28.02.2011, wherein Para 2.1 seeks to explain the amendment in the coverage of life insurance services and states as follows :

"2.1 Life insurance companies provide services relating to risk cover and managing investment for the policy holders. The former is already subjected to service tax. The latter is now being brought into the tax net. Similar services rendered by way of ULIP are already subject to service tax since 2008."

It is evident that the amendment in life insurance service was not intended to make any difference in the coverage of investment under ULIP Management services.

19. If all the services provided by the insurer are made taxable in the general provision of life insurance service, i.e. Section 65(105)(zx), then it would lead to redundancy of Section 65(105)(zzzzf) of the Finance act, 1994. Therefore, both the provisions are to be harmoniously construed in a manner that effect can be given to both, and one provision does not become redundant due to action of another.

20. It is well accepted principle that there has to be a nexus, a link, between consideration and taxable event. Reference in this regard is made to the decision of Bombay High Court in the case of **C.K. P. Mandal Vs, CCE, Mumbai-IV** reported in 2006 (4) STR 183 (Bom.).

21. It is further urged that IRDA vide Circular No. 055/IRDA/Actl/ULIP/2009-10 dated 24.09.2009, the terminology used by the IRDA is 'surrender penalty'. The relevant extract of the circular is produced herein below:

"2. Surrender penalty should be zero after completion of five policy years and thereafter, irrespective of the number of premiums paid (e.g. if DOC is 01.01.2003 then no surrender penalty w.e.f. 01.01.2008)".

22. The CBEC has clarified that no service tax can be levied on charges of penal nature. Reliance is placed on:- (i) CBEC vide Circular No. 96/7/2007-ST dated 23.08.2007 (ii) CBEC vide Circular No. 121/02/2010-ST dated 26.4.2010; (iii) CBEC vide its letter F. No. 137/25/2011-ST dated 3.08.2011.

23. Learned Counsel also urges that the show cause notice is bad for invocation of extended period of limitation. He further urges that the departmental audit of the appellant has been conducted by the office of the Commissioner of Service Tax, LTU in 2008 and again in August 2012, during which the department was made aware of the business activity of the appellant and the practice adopted by the appellant. In absence of any suppression or mis-statement by the appellant extended period of limitation could not have been invoked.

24. Practice of imposing surrender charges in case of pre-mature termination of ULIP policy has been in existence even prior to 2008. All along the department was aware of the nature of transactions from financial and other documents and service tax returns filed. Despite being aware of the practice of the industry, the Department did not raise any objections prior to 2011. Therefore, at this juncture, the department cannot allege that the appellant has suppressed facts.

25. Learned Authorised Representative for Revenue states that surrender charges defined by IRDA's Notification dated 01.07.2010 which are as under:

The charges under dispute i.e. "surrender charges" are defined in IRDA's Notification No. F. No. IRDA/Reg/2/52/2010 dated 1.7.2010 as follows:

"The surrender charges are imposed only to recoup expenses incurred towards procurement, administration of the policy and incidental thereto. The meaning of the term 'surrender' has been given in IRDA's Circular No. 032/IRDA/Act-1/Dec-2005 dated 21.12.2005, which states that surrender means 'terminating the contract once and for all' and that "surrender charges are charges levied on the ULIP fund at the time of surrender of the contract".

26. The "Surrender Charges" are based on and are calculated as a percentage of annual target premium; and gets reduced with every passing year.

Surrender Charge:

This charge is calculated as a percentage of first year ATP and shall be levied at the following rates on the Fund Value at the time of effecting surrender of the Policy:

If the Policy is surrendered	Surrender Charge (as % of first year ATP*)
In the 1 st Policy year	Surrender is not allowed
In the 2 nd Policy year	40%
In the 3 rd Policy year	30%

In the 4 th Policy year	20%
In the 5 th Policy year	10%
In the 6 th Policy year and onwards	Nil

* Annual Target Premium

As evident from above, if the ULIP policy is surrendered in the 6th policy year or thereafter, there is no loss either to the insurer. But if the ULIP policy is surrendered in the second, third, fourth or fifth year, the fund value would be reduced by percentage point shown against the column. This reduced amount is an income of the insurer, charged from the ULIP policy holder in the form of surrender charges, to cover the expenses, which the company, though incurred at the time of beginning of the ULIP policy, could not recover because of IRDA capping in the initial years and later due to premature closure of the policy by the policy holder.

27. The surrender charges have a nexus with the management of investment under ULIP and other policies.

The surrender charges are nothing but unrecovered expenses as on the date of surrender, which the insurance companies (i.e. M/s Max) had already incurred towards procurement, administration of the policy and incidental thereto. The reason because of which such expenses remain unrecovered is due to the capping policy of the IRDA which restrain and restrict the insurance companies to recover the total expenses in the initial year of the policy, as a result of which, the said expenses, even though incurred at the initial stages of the policy, are spread over the policy period and are recovered in the first 5-6 years of the policy period, in order to comply with the IRDA's instructions and guidelines, and capping policy.

The fact that the said charges, as explained earlier are in the nature of procurement, administration of the policy and incidental thereto, clearly show that the same have a prima facie nexus with the management of investment under ULIP policies.

28. Learned Authorised Representative further submitted that surrender charges levied at the time of fore-closure of loan are similar. He relied on the ruling of this Tribunal in **Housing and Development Corporation Ltd vs. CST, Ahmedabad -2012 (26) STR 531 (Tri. Ahmd.)** wherein this Tribunal held that there is definitely an element of service involved in considering the request of the borrower for prepayment of loan, fixing of prepayment charges, collection of the same and closure of loan. These activities can be definitely in relation to Banking & other Financial Services, which includes lending after 1.9.04. Further, when loans are fore closed, the situation gives rise to the issue of asset liability mismatch for the lender since lender, has to find alternative source for deployment of such funds. Prepayment charges are the charges leviable by a bank/ lender to offset the cost of finding such alternative source for deployment of fund and also intended to make exist difficult for the borrower. This shows that prepayment charges can never be considered to be in the nature of interest.

30. Learned Authorised Representative further urges that as the issue of taxability of fore-closure charges has been referred to Larger Bench in the case of **Small Industries Dev. Bank of India vs. CST, Ahmedabad -2015 (38) STR 666 (Tri. Ahmd.) -2015 (38) STR 666 (Tri. Ahmd.)**, this matter may be kept pending till

decision by the larger bench in the case of SIDBI. He further urges for dismissal of the appeal.

31. Having considered the rival contentions, we are satisfied that surrender charges are permitted to be levied by IRDA, by way of penal charges towards recovery of initial expenses incurred by the insurer in marketing and distribution of the policy. As IRDA has fixed limits as to recovery, which can be made from time to time from the initial cost, accordingly, IRDA have permitted to recover surrender charges in case of pre-mature policy, as per the table given hereinabove, so as to enable the insurer to recoup the cost incurred by them. Further, we find that legislature have clarified by substituting clause (ii) in Explanation to Section 65(105)(zzzzf), clarified that service tax is leviable only on the management fee or charges which are either fixed by IRDA or actually levied by the insurer, whichever is higher by substituting the explanation w.e.f. 01.07.2010. An Explanation is meant for clarifying the provision of the main section and accordingly has retrospective effect and is normally effective from the date of the statute, unless otherwise provided in the amending Act or notification. Thus, we hold that in view of the clarification by way of substitution of Explanation-II, service tax is not leviable on surrender charges by any stretch of imagination.

32. We further hold that there being no substantial change in the legislation for the period 2011-12 also, and as appreciated by Revenue, that no service tax is demandable on surrender charges for the period 2011-12 also. It has also been clarified by the CBEC vide

TRU No. 334/1/2010, that the charge pertaining to asset management alone should form the value for taxation in case of ULIP policy. Accordingly, we hold that no service can be leviable for the period 2011-12 also as surrender charges towards renting of service being penalty. Accordingly, we allow the appeal and set aside the impugned order. The appellant shall be entitled to consequential benefit in accordance with law. As we have allowed the appeal on merit, we have left the question of limitation open.

(Order pronounced on 21.08.2019).

(Anil Choudhary)
Member (Judicial)

(Bijay Kumar)
Member (Technical)

Pant