

# DESAI SAKSENA & ASSOCIATES

14<sup>th</sup> June, 2024

## Friday Tax Alert

### From:

**Tax Team of Desai Saksena and Associates  
Chartered Accountants**

CA Varsha Nanwani (Senior Manager - Taxation)  
Vikas Jogle (Manager - International Taxation)  
CA Neelu Dusseja (Senior Manager – Indirect Taxation)  
CA Neha Patel (Manager - Taxation)  
CA Ajay Sachani (Manager - Taxation)  
Digvijay Hirwani (Assistant Manager - Taxation)  
Alok Sharma (Deputy Manager - Indirect Taxation)

### Contacts:

**If you have any questions or would like to have additional information on the topics covered in this alert, please email one of the following DSA professionals:**

- ✓ CA Varsha Nanwani (Senior Manager – Taxation)  
[varsha@dsaca.co.in](mailto:varsha@dsaca.co.in)
- ✓ Vikas Jogle (Assistant Manager – International Taxation)  
[vikas@dsaca.co.in](mailto:vikas@dsaca.co.in)
- ✓ CA Neelu Dusseja (Senior Manager – Indirect Taxation)  
[neelu@dsaca.co.in](mailto:neelu@dsaca.co.in)
- ✓ CA Neha Patel (Manager - Taxation)  
[neha@dsaca.co.in](mailto:neha@dsaca.co.in)
- ✓ CA Ajay Sachani (Manager – Indirect Taxation)  
[ajay@dsaca.co.in](mailto:ajay@dsaca.co.in)
- ✓ Digvijay Hirwani (Assistant Manager - Taxation)  
[digvijay@dsaca.co.in](mailto:digvijay@dsaca.co.in)
- ✓ Alok Sharma (Deputy Manager – Indirect Taxation)  
[sharma.alok12@gmail.com](mailto:sharma.alok12@gmail.com)

# DESAI SAKSENA & ASSOCIATES

## **IBNR (Incurred but not reported) claims and provision for unsettled claims are not contingent liabilities: Delhi High Court allows a deduction under section 37 of the Income Tax Act.**

### **SUMMARY:**

The insurance companies are required to create a specific provision incurred but not reported (IBNR) in their books of accounts in accordance with the Insurance Regulatory Development Authority of India (IRDAI) Regulations. These provisions are made basis the of scientific calculations and are “ascertained liability” in the books of accounts as per the specified regulations.

However, the tax authorities have considered it an unascertainable liability and accordingly disallowed the amount as contingent liabilities not eligible to be claimed as a deduction under Section 37 of the Income-tax Act, 1961 (IT Act).

In this regard, recently the Delhi High Court has held that the provision made for outstanding unsettled claims cannot be termed as adhoc merely because of the fact that these claims are to be adjudicated subsequently. Further, with respect to the IBNR claims, the Hon’ble High Court concluded that the provision made in respect of IBNR is an ascertainable liability and hence, it cannot be considered as a contingent liability. Thereby, deductions under Section 37 of the IT Act was allowed to the taxpayer.

### **FACTS OF THE CASE:**

- ✓ The taxpayer is a health insurance company registered with the IRDAI.
- ✓ The taxpayer had created provisions for ‘unsettled outstanding claims’ and IBNR in the books of accounts in accordance with IRDAI regulations. Further, the taxpayer had not made any adjustments with respect to the same while computing the income as per the provisions of the Act.
- ✓ The Tax Authorities contended that the aforesaid provisions are contingent in nature and have not been crystallised during the year under consideration. Furthermore, the Tax Authorities held that the provision made on an ad hoc basis was already allowed subject to the limits specified under Rule 6E of the Income-tax Rules, 1962 (IT Rules). The Tax Authorities added the provisions while assessing taxable Income under the provisions of the IT Act.
- ✓ Aggrieved by the additions, the Taxpayer preferred an appeal before the First-Appellate Authority which deleted the additions made on account of the above-mentioned arguments.

# DESAI SAKSENA & ASSOCIATES

- ✓ Further aggrieved, the Tax Authorities, filed an appeal before the Delhi Tax Tribunal which dismissed the contention of the Tax Authorities and held that the provision for unsettled claims cannot be construed as an ad hoc estimate. The Delhi Tax Tribunal relied on the judicial precedent laid down in the case of *DCIT vs. National Insurance Co Ltd* wherein IBNR was considered to be an ascertained liability.
- ✓ Aggrieved by the order of the Tax Tribunal, the Tax Authorities, have preferred an appeal before the Delhi High Court which made the following observations while ruling in favour of the taxpayer.

## CONCLUSION:

- ✓ In respect of unsettled claims, quantification or adjudication of the claim may happen subsequently, the same would only have an impact in the subsequent period and that such adjustments would not warrant the same being viewed as a contingent liability.
- ✓ IBNR provision was based upon historical trends and actuarial methods for estimation. Furthermore, these methods were in accordance with the regulations laid down by IRDAI. In light of the same, the IBNR could not be considered to be a contingent liability.
- ✓ Reliance is placed on the Supreme Court's (SC) judgement in the case of *Rotork Controls*, wherein the concept of 'provision' has been elaborated, which indicates a substantial degree of estimation' while creating provisions in the books of accounts.
- ✓ Reliance is also placed on jurisdictional High Court decision in the case of *Whirlpool India* wherein it was held that additional provision for warranty made in the subsequent year was not a contingent liability as such provision was made based on estimated historical data and actuarial methods;
- ✓ As long as a liability is properly ascertainable on the basis of empirical data or a known methodology, the same cannot possibly be held to be a contingent liability.

## **Guidelines for Initiation of Recovery Proceedings Before Three Months from the Date of Service of Demand Order**

**Vide Instruction No. 01/2024-GST dated 30 May 2024, CBIC has issued an instruction regarding the timelines for commencing the recovery proceedings.**

# DESAI SAKSENA & ASSOCIATES

Section 78 of the Central Goods and Services Tax Act, 2017 (CGST Act) mandates a 3-month waiting period for initiating recovery proceedings for unpaid tax dues pursuant to the receipt of the order by the taxpayer. However, proviso to Section 78 of the CGST Act stipulates that in exceptional circumstances, the tax authorities are permitted to shorten this period, provided that they record reasons for the same in writing. The recovery proceedings can be initiated by the proper officer under Section 79 of the CGST Act.

To ensure consistent application of this provision, the Central Board of Indirect Taxes and Customs (CBIC) has issued the following clarifications:

✓ **Proper Officer:**

1. The proper officer for initiating recovery proceedings under Section 79 of the CGST Act is the jurisdictional Deputy or Assistant Commissioner of Central Tax (DC/AC).
2. Further, the proper officer under proviso to Section 78 of the CGST Act (for commencing recovery proceedings in a period of less than 3 months) is the jurisdictional Principal Commissioner / Commissioner of Central Tax (PC/C).  
(See Circular No.3/3/2017-GST dated 5 July 2017)

✓ **Procedure for initiating recovery under exceptional circumstances:**

1. While recovery proceedings under Section 79(1) of the CGST Act would be undertaken by the DC/AC, in exceptional circumstances where it is felt that recovery proceedings in respect of an amount payable by a taxable person in pursuance of an order needs to be initiated in the interest of revenue before completion of 3 months from the date of service of the order, the matter must be placed by such officer before the PC/C, along with the reasons/ justification for such an action.
2. Subsequently, the PC/C shall examine the reasons/ justification given by the DC/AC at the earliest, and if he is satisfied that it is expedient in the interest of revenue to mandate the taxable person to pay the dues (as per the order) before completion of 3 months from the date of service of the order, he must record in writing, the reasons as to why the taxable person is required to make payment of such amount within such period (as may be specified) being less than a period of 3 months.
3. After recording such reasons, the PC/C may issue directions to the concerned taxable person to pay the said amount within the specified period, sending a copy of such directions to DC/AC.

✓ **Recording of reasons:**

1. PC/C should provide the specific reason(s) for asking the taxable person for early payment of dues, clearly outlining the circumstances prompting such early action. –
2. Such reasons could include high risk to revenue involved in waiting till the completion of the 3-month period due to apprehension that the concerned taxable person may

# DESAI SAKSENA & ASSOCIATES

close the business operations in the near future, or due to the possibility of default by the taxable person due to his declining financial conditions or impending insolvency, or likely initiation of proceedings under Insolvency and Bankruptcy Code, etc. Such reasons should also be based on credible evidence, which may be kept on record to the extent possible.

3. While issuing directions, the proper officer must duly consider the financial health, status of business operations, infrastructure, and credibility of the taxable person, and strike a balance between the interest of the revenue and ease of doing business. Such directions should not be issued in a mechanical manner and must be issued only in apprehension/circumstances in the said case.
4. Wherever any directions are issued under proviso to Section 78 of the CGST Act, and where the taxable person fails to make payment within the specified period, the DC/AC shall proceed to recover the said amount as per Section 79(1) of the CGST Act.

## **CBDT Notified Cost Inflation Index for FY 2024-25**

- ✓ CBDT Notified Cost Inflation Index as 363 for FY 2024-25