



Life Insurance Policies & ULIPs

DTC 2009 spells death-knell for life insurance policies

The Direct Taxes Code 2009 not only proposes to tax the bonus earned by the life insurance policyholders, but also the principal amount paid by them, which is highly inequitable. It also takes away the other benefits available to life insurance policyholders and to those investing in ULIPs under the IT Act, 1961. All these provisions of the DTC 2009 need to be revoked, says **Rajesh Relan**

The Direct Tax Code unveiled by the Finance Minister on 12th August 2009 seeks to bring radical changes in personal and corporate taxation. One such change is that the life insurance policies shall be brought under the exempt-exempt-tax (EET) regime. The provision with respect to taxation of life insurance policies is contained in clause 56(2)(f) of the Code which provides that any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy shall be taxable under the head "gross residuary income". However clause 57(3)(a) provides a saving grace as it exempts from tax any sum received under a life insurance policy if the following two conditions are satisfied :-

- The premium payable for any of the years during the term of the policy does not exceed 5% of the capital sum assured; and
- The sum is received only upon completion of the original period of contract of the insurance or upon the death of the insured.

The provisions of clause 56(2)(f) read with clause 57(3)(a) of the Code are in sharp contrast to the existing Section 10(10D) of the Income Tax Act, 1961 which provides that the amount received on maturity shall be exempt in case the premium paid under the policy during any of the years does not exceed 20% of the

capital sum assured. Thus the aforesaid provisions of the Code have the capacity to upset the financial plans of large number of individuals who have taken insurance policies in the anticipation that the maturity proceeds shall be tax free. Let's examine the various adverse consequences of these clauses of the Direct Tax Code.

PROPOSED LAW IS NOTHING BUT TAXATION OF CAPITAL

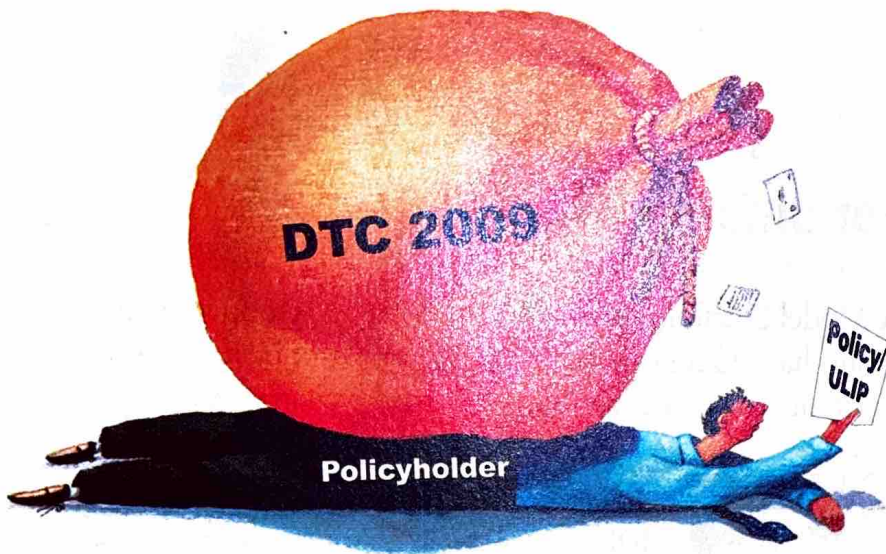
Clause 56(2)(f) of the Code has used the words, "sum received under a life insurance policy shall be taxable". A policyholder receives a lumpsum amount on maturity which obviously also includes the annual premium paid by the policyholder during the tenure of the policy. Taxing the entire amount received on maturity is nothing but taxing the capital or principal amount that was contributed in the form of annual premiums. If at all any tax is to be levied it should be levied only on the bonus portion of the maturity proceeds, that can be deemed to be the income of the policyholder, and not on the gross amount.

The insurance policies qualify for tax exemption under section 80C of the Income Tax Act, 1961 and the Code also proposes to continue the aforesaid exemption. It is heartening to note that the Code has enhanced the investment limit for tax exemp-

tion from the existing Rs 1 lakh to Rs 3 lakh per annum. However, the negative aspect is that the said benefit shall be more or less negated as the tax is proposed to be levied on the entire amount of maturity proceeds. Moreover, think about the persons who take insurance policies just for the sake of risk cover and not to claim any tax exemption because their annual income is less than the taxable limit. The maturity proceeds from insurance policies received by such persons shall also be taxable, despite the fact that they have not claimed any tax exemption on the premiums paid. The concept of "EET" should not be made applicable to such policies.

SINGLE PREMIUM POLICIES & ULIPs BROUGHT UNDER THE TAX NET

All the single premium policies like Jeevan Aastha etc., shall come under the tax net because the premium paid at the time of taking the policy was more than 5 per cent of the capital sum assured. Actually, LIC has framed Jeevan Aastha policy in such a manner that the risk cover or basic sum assured is around six times the premium paid during the first year of the policy. Thus premium paid in first year is less than 20 per cent of the capital sum assured. However, from second year onwards, the risk cover falls to just twice of the



premium paid in the first year but as no premium is to be paid from second year onwards, the policy is eligible for tax exemption under section 10(10D) of the Income Tax Act, 1961. It may be noted here that Jeevan Astha policy and other popular single premium policies comply with Section 10(10D) of the Income Tax Act, 1961 but they would not be compliant with the proposed clause 57(3)(a) of the Code. Accordingly, the entire sum received from single premium policies maturing after 1st April 2011 shall be subject to tax at the personal marginal tax rate. This would adversely affect the return on investment from such policies. For example, a person of 35 years of age had to pay single premium of Rs 48,975 for 10 years policy and he was to get approximately Rs 100,000 on maturity (as per the website of LIC). Therefore, if the entire proceeds of Jeevan Aastha policy are taxed at 30 per cent, assuming that the annual income of the policyholder exceeds Rs 25 lakh, then post-tax he would retain only Rs 70,000, instead of earlier expectation of Rs 100,000. Similarly, Unit Linked Insurance Plans (ULIPs) shall also be taxable on maturity as the premium paid is more than 5 per cent of the capital sum assured.

The taxation of single premium policies and ULIPs is totally unfair as the investors had relied on the prevailing tax laws which guarantee tax exemption. Thus, the proposed Direct Taxes Code would have retrospective effect as far as taxation of life insurance

policies is concerned. It is worthwhile to note here that when Finance Act, 2003 amended Section 10(10D) of the Income Tax Act, 1961 it was specifically provided that the new law would be applicable only to the insurance policies that are issued after 1st April 2003. The Direct Tax Code does not provide any such exemption to the existing life insurance policies. Therefore, it is imperative that the new provisions are made applicable only to the policies that are issued after 1st April 2011, i.e., when the proposed Code replaces the Income Tax Act, 1961.

In view of the above facts it is advisable that the persons who are intending to take fresh insurance policies and ULIPs must ensure that the premium to be paid in any of the years during the policy term does not exceed 5 per cent of the capital sum assured.

CLAIM AMOUNT RECEIVED ON DEATH ALSO LIABLE TO TAX

The proviso to existing Section 10(10D)(c) of the Income Tax Act, 1961 provides that the claim amount received by the nominees or legal heirs of the deceased shall be tax free even if the annual premium exceeds 20 per cent of the capital sum assured. It is worthwhile to note here that the proposed clause 57(3)(a) does not provide any such exemption. The withdrawal of the aforesaid exemption is without any sound reasoning. Hence, instead of extending a helping hand to the families in distress, the government would

increase their problems by taxing the insurance amount.

TREATMENT OF LOANS & MONEY BACK POLICIES

Many persons avail loans against their insurance policies in order to meet their urgent fund requirements. The fate of such loans from taxation perspective is uncertain because clause 56(2)(f) uses the words, "sum received under a life insurance policy". Thus, the loan amount comes within the ambit of clause 56(2)(f) of the Code. Moreover, clause 57(3)(a) also exempts only those payments that are received either on the completion of the original period of the policy or upon the death of the insured. None of these conditions are satisfied in case of loans advanced by the insurance companies. Therefore, most probably, the loans would also become taxable until and unless the proposed tax law provides any specific exemption in this regard. Similarly, the money back policies shall also be taxable because the amount is being paid before the date of maturity. Thus, the persons who have taken money back policies relying on the provisions of the Income Tax Act, 1961 would be hit hard as all their money back instalments received after 1st April 2011 shall be subject to tax.

NEED FOR STATUS QUO

After going through the aforesaid draconian provisions of the Code, most of us would decide to refrain from taking life insurance policies. However, this is not the right approach because the basic objective of a life insurance policy is to secure the future of the family members and not to earn a return on investment. Still many persons would avoid taking fresh life insurance policies due to low yield on investment, which is not good from the point of view of the society. Thus, there is need for the Finance Ministry to maintain *status quo* with respect to the taxation of insurance policies, lest the new tax law becomes death knell for life insurance policies. ■

*The author is Joint Company Secretary,
HeidelbergCement India*