TAXATION OF ULIPS

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Introduction

Unit Linked Insurance Plans (ULIPs) have gained popularity as an investment-cum- insurance product in recent years. One of the key attractions of ULIPs is their tax benefits, which make them a preferred choice for many investors.

ULIPs are hybrid financial products that combine life insurance with investment opportunities. A part of the premium paid goes towards providing life insurance coverage, while the remaining amount is invested in various funds such as equity, debt, or hybrid funds, depending on risk appetite. ULIPs offer a unique opportunity for wealth creation and protection, making them an attractive choice for those looking to achieve both financial goals under one roof.

Taxation of ULIPs:

1. **Exemption u/s 10(10D) of the Income Tax Act, 1961 for Maturity Proceeds & Partial Withdrawals:**

   Tax Exemption:

   The proceeds received upon the maturity of a ULIP or partial withdrawals from a ULIP are exempt from income tax under Section 10(10D) of the Income Tax Act. This means that the maturity amount, including any bonuses or gains, is **tax-free**, provided:

a. The annual premium does not exceed 10% of the capital sum assured for policies issued after April 1, 2012, and 20% for policies issued before that date **AND**

b. The aggregate amount of premium does not exceed Rs.2,50,000/- in any of the previous years during the term of policies issued after February 1, 2021.**Example 1:**

   Mr. Rahul has invested in 5 ULIP Policies namely A, B, C, D and E on 01-04-2021. The details of such policies are provided as below:

ULIP	A	B	C	D	E
Annual premium	Rs. 1,00,000	Rs. 1,50,000	Rs. 1,50,000	Rs. 2,00,000	Rs. 3,00,000
Tenure of policy	10 years	10 years	10 years	10 years	10 years
Sum assured	Rs.10,00,000	Rs. 16,00,000	Rs.14,00,000	Rs. 25,00,000	Rs. 35,00,000
Consideration received on 01-04-2031 on maturity	Rs.15,00,000	Rs. 23,00,000	Rs.23,00,000	Rs. 30,00,000	Rs. 40,00,000
Whether premium exceeds 10% of capital	No	No	Yes	No	No
Whether premium of individual policy exceeds	No	No	No	No	Yes
Whether aggregate premium of policies	**NO**	N.A.	No	N.A.	
Whether eligible for exemption under Sec.	**Yes**	**Yes**	**No**	**Yes**	**No**

In the above example,

I. Policies A, B and D are individually eligible for availing exemption u/s 10(10D) as they fulfill the required criteria

II. Policy C does not meet the criteria for availing exemption as the annual premium i.e. Rs. 1,50,000/- exceeds 10% of the Sum assured i.e. Rs. 14,00,000/-

III. Policy E is also does not meet the criteria for availing exemption as the annual premium of the policy i.e. Rs. 3,00,000/- exceeds the prescribed limit of Rs. 2,50,000/-

*** Though Policy A, Policy B and Policy D are eligible for exemption under Section 10(10D) but as the aggregate premium of all 3 policies exceed Rs.2,50,000/-, exemption cannot be claimed in all policies together.**

There will be two options for Mr. Rahul to claim exemption:

Option 1: Policy A and Policy B can be opted together since the aggregate premium of such policies does not exceed Rs.2,50,000/-**Option 2:** Policy D can be opted alone as combining it with any other policy will result in aggregate premium exceeding Rs. 2,50,000/-

2. Capital Gains on ULIPs for Maturity Proceeds and Partial Withdrawals:

ULIPs not eligible for availing exemption u/s 10(10D) shall be considered as a capital asset eventually attracting capital gains upon the maturity or partial withdrawals of such ULIPs

Generally, ULIPs have a Lock-in-period of 5 years. It is important to note that, any withdrawal leading to termination or cessation of ULIP during the lock-in-period will be chargeable to tax as capital gains

Further, the ULIP can be classified under the category of equity-oriented or debt-oriented.

a. Equity ULIPs:

i. When insurance Company invests minimum 90% in case of investments in units of other fund **AND** Such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognized stock exchange, it will be treated as equity oriented funds.

OR

ii. In any other case, 65% of the total proceeds is invested in equity shares of a domestic company, it will be treated as equity oriented funds.

b. Debt ULIPs: For ULIPs that primarily invest in debt funds, will be classified as debt- oriented ULIPs.

Regardless of the ULIP's classification as short-term or long-term, equity-oriented or debt-oriented, it will be deemed to be taxable u/s 112A of Income Tax Act, 1961 at the rate of 10% in excess of Rs. 1 lakh as per Rule 8AD.

Further, **Notification No. 08/2022-Income Tax dated 18th January 2022** has been issued by CBDT for computation of capital gain:

I. If the amount is received for the first time, the following formula should be used:

"A – B", where

A = the amount received for the first time including bonus

B = the aggregate of the premium paid during the term of policy till date of receipt of the amount

II. If the amount is received any time after the initial receipt, the following formula should be used:

"C – D", where

C = the amount received any time after the initial receipt

D = the aggregate of the premium paid during the term of policy till date of receipt of the amount **less** the amount already considered in **point B** above.

Example 2:

Particulars	Policy A
Date of Policy	01-04-2022
Tenure of the Policy	10 years
Annual Premium	Rs. 3,00,000
Sum assured	Rs. 21,00,000
Consideration received on 31-03-2027 on partial maturity	Rs. 15,00,000
Bonus received on 31-03-2027 on partial maturity	Rs. 3,00,000
Consideration received on 31-03-2032 on full maturity	Rs. 35,00,000
Bonus received on 31-03-2032 on full maturity	Rs. 5,00,000

Computation of Capital Gains for A.Y. 2027-28:

Particulars	Policy A
Sum received for the first time on 31-03-2027	Rs. 15,00,000
Add: Bonus received on 31-03-2027	Rs. 3,00,000
Less: Aggregate of premium paid till date of receipt of partial maturity (3,00,000 per year x 5 years)	Rs. (15,00,000)
Long Term Capital Gain for A.Y. 2027-28	**Rs. 3,00,000**

Computation of Capital Gains for A.Y. 2032-33:

Particulars	Policy A
Sum received on full maturity of ULIP on 31-03-2032	Rs. 35,00,000
Add: Bonus received on 31-03-2032	Rs. 5,00,000
Less: Aggregate of premium paid till date of receipt of full maturity (-) amount of premium considered while computing capital gain for previous years [(3,00,000 per year x 10 years) – 15,00,000]	Rs. (15,00,000)
Long Term Capital Gain for A.Y. 2032-33	**Rs. 25,00,000**

3. **Benefits under section 80C:**

   Tax Deduction:

   Premiums paid for ULIP are eligible for a tax deduction u/s 80C of the Income Tax Act, 1961 under old regime, subject to a maximum limit of Rs. 1,50,000/- per financial year.

   The deduction u/s 80C is restricted to 10% of the sum assured, and any premium paid beyond this limit is not eligible for deduction.Also, the deduction is allowed only if the individual contributes to ULIP for the first 5 years of the plan. If such contributions are discontinued before 5 years, the aggregate deductions claimed in earlier years shall be deemed as income and will be charged to tax in the year of termination or cessation.

4. **Maturity proceeds not taxable in case of Death:**

   Tax-Free:

   In the unfortunate event of the policyholder's demise during the policy term, the death benefit paid to the nominee is tax-free under Section 10(10D).

Conclusion

Unit Linked Insurance Plans (ULIPs) emerge as compelling financial instruments, blending insurance and investment benefits. The tax implications associated with ULIPs are vital considerations for investors. Under Section 10(10D), ULIP maturity proceeds and partial withdrawals can enjoy tax exemptions, provided specific conditions regarding premium limits are met. Capital gains on non-exempt ULIPs are subject to the nature of the plan— equity or debt. Additionally, Section 80C offers tax deductions for ULIP premiums, with a restriction and continuity in contributions for the initial five years. Notably, in the event of the policyholder's demise, the tax-free status of death benefits under Section 10(10D) adds to the appeal of ULIPs as comprehensive financial tools. Navigating these tax nuances is crucial for investors seeking optimal wealth management through ULIPs.