Is your single premium life insurance policy eligible for tax benefits?

Life insurance doesn't necessarily mean that you have to keep paying the premium every year. There are single premium life insurance (SPLI) policies as well, which provide similar benefits of protection and savings as the regular premium ones. The term of SPLI policies is usually 10 years, but one can exit after five years.

Recently, the interest in SPLI policies seems to have increased. As on January 31, 2017, the total premium of such policies was Rs 22,591.53 crore as against Rs 10,025.49 in the same period last year.

But, as an SPLI policyholder, are you getting the various tax benefits such policies are eligible for? Will your policy be eligible to claim Section 80C benefit and will the maturity proceed be tax-free? Remember, not all SPLI policies are structured to help you avail such tax benefits. So before you lose out on such benefits, it's better to be aware of the tax rules.

Being a life insurance policy, SPLI too qualifies for tax benefits, both under Section 80C (at the time of investment) and for making the maturity proceeds tax-free under Section 10 (10D). But one needs to be little careful while buying such policies, otherwise both these benefits might not be availed.

The benefit under Section 80C and Section 10 (10D) will hold true only when certain conditions are met in the policy.

Income tax exemption on maturity proceeds

What the tax rule says: Under normal circumstances, for policies issued on or after April 1, 2012, the exemption is available only if the premium amount in any financial year does not exceed 10 per cent of the actual capital sum assured. This is applicable to all life insurance policies, including SPLI. Archit Gupta, Founder & CEO, ClearTax.com, informs, "The maturity proceeds from the single premium life insurance policy will be tax-free only if the minimum sum assured throughout the policy term remains at least 10 times the single premium paid. So if the sum assured on single premium life insurance policies is 1.25 times the premium amount, then the maturity proceeds will be taxable."

Illustratively, if the premium is Rs 10,000, the life cover (sum assured) should be Rs 1 lakh for the maturity proceeds to be tax-free. If, say, the sum assured is Rs 12,500 or Rs 90,000, the policy loses the tax benefit under Section 10 (10D). Therefore, make sure the sum assured is at least 10 times the premium amount.

If this condition is not met, then the entire maturity proceeds are fully taxable in the year of receipt. It has to be shown as income while filing one's income tax return. "The only exception in this case is the proceeds from life insurance plan arising due to the death of the policyholder are exempt from tax irrespective of the level of the premium," says Gupta.

Moreover, the insurer is supposed to deduct tax at source (TDS) on such payments. As per Section 194DA of the Income Tax Act, 1961, any sum received by an insured Indian resident from an

insurer under a life insurance policy shall be subject to TDS of 2 per cent if the maturity proceed is not exempted under Section 10(10D), i.e., on policies where the sum assured is less than 10 times the premium amount.

What the insurers offer: In SPLI policies, the insurers define the minimum and the maximum sum assured. In most policies, the minimum sum assured is 1.25 times the single premium, or even 1.10 times the single premium. The maximum sum assured is typically 10 times the single premium for lower ages, while for those above 35 or 45, even the maximum is 1.25 or 1.10 times the single premium. So unless one chooses to go with the maximum cover of 10 times, the tax benefit is lost.

Investors generally opt for a lower cover because of lower incidence of mortality charges, i.e., cost of providing life cover. The lower the deduction of mortality charges, the more will be the fund available towards investment. Even though the mortality charges in a policy with 10 times the sum assured will be more than a policy with 1.25 times the sum assured, remember, the tax benefits are lost in opting for the latter.

Income tax deduction on investment

Premium paid towards life insurance policies qualifies for deduction under Section 80C, up to a maximum of Rs 1.5 lakh a year. The gross total income gets reduced by the premium amount and, thus, reduces the tax liability.

What the tax rule says: As per the rule, for a life insurance policy issued on or after April 1, 2012, if the premium paid exceeds 10 per cent of the sum assured, then the deduction (from the gross total income) will be available to the extent of 10 per cent of the sum assured and the premium paid in excess of this amount cannot be claimed as deduction. Gupta says, "Single premium paid should not exceed 10 per cent of the sum assured. In other words, the sum assured should be at least 10 times the single premium paid."

Illustratively, if one buys an SPLI policy by paying a premium of Rs 2 lakh and a sum assured of Rs 20 lakh, the Section 80C benefit will be restricted to Rs 1.5 lakh of the premium. But if by paying a premium of Rs 2 lakh, if the sum assured is Rs 2.5 lakh (or any amount less than 10 times the premium), the deduction under Section 80C will be restricted to Rs 25,000, i.e., 10 per cent of the sum assured.

Also, early exit from the policy may be an unfriendly tax move. Gupta says, "The policy should not be surrendered within two years. If a single premium policy is surrendered within two years, the deduction allowed in the past under Section 80C will be considered as income of the taxpayer in the year in which insurance policy is surrendered."

Conclusion

When you're buying SPLI, make sure to keep the right amount of life cover, especially if you wish to take tax benefits. Although income tax rules will apply as on the date of maturity, leaving things to chance may, in fact, increase your tax liability. An SPLI policy may help you not only take advantage of tax benefit but also provide protection and save for long term goals. Watch out, however, for the quantum of sum assured.

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