Use the tax-friendly Ulips to rebalance your portfolio

Before you target your mutual fund investments for rebalancing the portfolio or booking profits, spare a thought for your Ulip.

You can seamlessly switch from the equity option to debt in your Ulip without any tax implication. They can change the allocation to various funds as per their expectation of the market.

If the markets correct, you can switch back to equity. This is a luxury that mutual fund investors do not have.

In mutual funds, redeeming equity schemes within a year of buying attracts a 15% tax on the short-term capital gains, besides the exit load on the NAV. Likewise, switching from debt to equity will mean the gains on the debt fund will be added to your income and taxed accordingly. You will also have to pay an exit load if you switch out before the minimum period specified under the scheme.

Despite these advantages, very few Ulip investors touch their investments in these plans, preferring to be passive instead. "Policyholders rarely exercise switch options. Most do not track the performance of their investments in Ulips closely enough, and those who do, typically end up exiting the investment rather than switching across options due to the relatively poor performance of the equity funds," says Arvind Laddha, CEO of the Pune-based Vantage Insurance Brokers.

Last year saw many Ulip holders, who had bought these products before September 2010 (when the cap on Ulip charges came into force), rushing to redeem their investments as soon as the three-year lock-in period expired in 2013.

Should Ulip holders switch out of equity and book profits? "Yes, Ulip investors should switch a part of their equity investments to debt funds, to safeguard the gains made in recent weeks," says Laddha.

The amount to be switched from equity to debt will depend on your risk appetite and, most importantly, your investment horizon. If you are closer to your goals, it makes eminent sense to lock a part of the gains, instead of risking exposure to any market volatility that may follow the election results.

Fund options in a typical Ulip

FUND	EQUITY EXPOSURE %	WHAT YOU SHOULD DO
Growth	60-100	Risk is high. Cut allocation to this fund.
Balanced	30-60	Risk moderate. Switch if you want safety.
Defensive	15-30	Best option at this juncture.
Income	Nil	Low risk. Could rise if interest rates are cut.
Liquid	Nil	Virtually risk-free but offer low returns.

If, like many investors, you have invested in both Ulips and mutual funds and wish to book profits, you need to target the former. "There are typically no costs involved in Ulip switching, neither is there any incidence of taxation. If someone has both mutual funds and Ulips, he should use the full portion of Ulip funds for rebalancing," says Uday Dhoot, deputy CEO of Bangalore-based investment advisory firm, International Money Matters.

The number of free switches allowed on a Ulip differs across insurers and schemes. Typically, an investor is allowed 10-12 free switches in a year. Some insurers have completely waived the switching charges. If your company has specified a limit, you may have to pay Rs 100-500 per switch if you breach the cap.

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