Who’s afraid of ULIPs

It’s that time of the year when you start getting mails from your company’s finance department asking for the taxes planning you have done for the current financial year. At the same time, you are inundated with related advertisements and suggestions from financial advisor-sounding tele-callers who rant out several tax planning avenues for you. And not surprisingly, all those who come in your aid are not free from biases and is often found lacking in knowledge.

What most of them undermine are your financial needs and a long-term perspective of the tax saving investment you will make. Unfortunately, several effective modes of tax saving that come with lots of benefits are marketed without a clear perspective, need or reason.

The current equity market scenario and growth in corporate incomes are now making the scene compelling for more equity exposure in your tax planning investments.

As per media reports, an analysis of the earnings of 129 companies that have announced their results for the December quarter for the fiscal year 2013 showed that while net sales grew 19.35 per cent, below the 30.22 per cent growth recorded in the year-ago quarter, operating profit rose 36.34 per cent, the highest in at least two years.

Given that the Indian economy is slowly emerging out of subdued growth over the last few quarters and stalling of the General Anti Avoidance Rules (GAAR) guidelines till 2016, the time is ripe to look at ULIPs or unit linked insurance plans, as a vital part of your tax planning.

ULIPs serve dual purpose of investment and insurance at the same time. However, people have lot of concerns pertaining to ULIPs. People remain skeptical about the practicality of ULIPs and return-generation capability of the product despite changes made towards the same.

But first of all, let’s touch the basic concern people have against ULIPs. The product, as the name suggests, is not just about equities. ULIP is not just about investing in equity alone, but about investing in equity or debt, or a blend of both equity and debt depending on your age and risk appetite and your long-term financial goal.

ULIPs provide you the flexibility to choose how you want to invest on the basis of risk return profile, through their various funds and at the same time offer the insurance umbrella for unforeseen eventualities. If we take an example of a child plan, ULIP is probably the only instrument which will ensure that the funds you planned for your child’s future is available whether you are around or not.

Historically, it is proven that if one stays invested in equities for short periods, then the risk of loss is high. The risk of loss decreases as the investment horizon increases.

Also, several fund options with different mix of equities and debt in money market help the customer change his asset allocation depending on the market conditions very easily by switching from one fund to the other. This helps save the returns earned from a growing equities market over a period of time.

Additionally, ULIP funds allow the investors to gain benefit from specific sectors or theme based funds. The purpose of thematic funds is to take advantage of a growing sector.

Investors should bear in mind that the entire premium is not invested. There four key charges which are deducted. First is a premium allocation charge which falls steadily in the subsequent years. Mortality charges, or simply put, the cost of life cover, will be charged as per the age of the policyholder. Thirdly, there are policy administrations charges, and lastly, minor fund management charges. Thus, one must calculate the returns on the basis of the amount allocated in the respective fund finally.

Of late, the regulatory changes have made ULIPs even more attractive for investors with cap on charges and reducing surrender charges drastically. With the cap on charges, the difference between net yield and gross yield cannot exceed 3 per cent. At 1 per cent to 1.5 per cent, it has lower fund management charge compared to mutual funds.

Policy surrender charges too have been capped as per the latest guidelines. ULIPs offer tax-free income if the policy offers a cover of 10 times the annual premium. Also there is no tax implication if switched from one fund allocation to the other and no tax on partial withdrawals of funds.

The death benefit of ULIPs varies depending on the type of plan you have opted for. Some ULIPs give out either the sum assured or the fund value, whichever is higher. Others give out both the sum assured as well as the fund value. The latter certainly appears better, but the mortality charges in the former progressively come down as the fund value goes up.

So, who should invest in ULIPs? The ideal candidate for the product is someone who has a long-term investment horizon. It is a common belief that ULIPs are expensive products. But it is a competitively priced product if you stay invested over a long term.

(Financial Express)