Your insurance payout will now come after a tax cut!

In a quiet move, the impact of which is being felt only now, the statute books have been amended to deduct tax at source on some insurance payouts, which could particularly affect people above 45 and those with single-premium policies.

This, by way of a new section -- 194DA -- in the Income Tax Act, 1961, that took effect Oct 1, and surprised many policy-holders who got to know of it after they received a communique from their insurance companies.

Many more are still unaware.

"Section 194D envisages deduction of tax at source on the life insurance policy payouts which are not exempt under Section 10(10D)," Vibha Padalkar, executive director and chief financial officer of HDFC Standard Life Insurance, told IANS.

Under this section, life insurance companies have to deduct a two-percent tax at source on aggregate payouts exceeding Rs.100,000 during a financial year under life policies. In case where PAN card details are not available, the deduction shall be 20 percent.

For the record, Section 10(10D) of the Income Tax Act exempts any sum received under an insurance policy that is paid from April 1, 2012, if the premium for any of the years during the currency of the policy is within 10 percent of the actual sum assured.

For policies taken between April 1, 2003, to March 31, 2012, the condition was that the premium shall not exceed 20 percent of the actual capital sum assured. The clauses were not applicable if the amount received was on account of the death of an insured.

"The actual capital sum assured excludes the value of any premium agreed to be returned, as also benefit by way of bonus or otherwise that is over and above the policy amount," said C.L. Baradhwaj, senior vice president, Bharti Axa Life Insurance told IANS.

While life insurers try to ensure that the premium amount is compliant with the Income Tax Act at the product-design stage itself, there are some set of policyholders who could be affected by the new provisions, Baradhwaj said.

"All single-premium policies would be the immediate casualty, as the premia paid in one instalment would generally exceed 10 percent of the sum assured," he said.

He said it is possible that people could be paying premia higher than the 10-20 percent limit set by the new provisions on account of their personal health, as also many other reasons. In such cases, too, the TDS liability could arise.

"It is important to note that a person aged, say, 50 years, pays a higher premium for the same sum assured when compared to a person who is 35 years old. Higher the age, higher risk and higher the premium," Baradhwaj added.

Industry officials also maintain that life insurance companies have been asked to make a TDS deduction under policies that are deviant of Section 10(10D), since some people were not reporting the same in their tax returns.

According to Baradhwaj, if the condition of 10-20 percent is not satisfied, all benefits payable -- pertaining to the maturity, survival, or surrender -- under a life insurance policy, excluding the death benefits, shall be liable for TDS.

"Policy loan is not a benefit. It`s a repayable obligation. Hence it is not taxable."

A marketing official of the state-run Life Insurance Corporation of India told IANS that policyholders in rural and small towns would be severely affected by the new provisions, as they might not have PAN cards.

At the same time conflicting views are being expressed on pension polices. According to one view, pension policies are outside the newly introduced section 194DA of the Income Tax Act as they are outside the scope of Section 10(10D).

The argument: Pension policies do not have any death benefit like ULIP Pension Policies, or have only miniscule death benefits like in the current regime pension schemes, so they do not qualify as a pure life insurance policy.

But a Supreme Court advocate and expert in insurance and company laws, D. Varadarajan, differs, raising a fundamental question: "How do life insurance companies sell pension policies if they are not treated as life insurance policies?"

"The regulator`s licence allows insurance companies to only deal with the life insurance business. Hence it will be incongruous with the Insurance Act to keep pension policies outside the ambit of life insurance policy," Varadarajan told IANS.

He said pension policy is also a life insurance policy, as it covers the risk of living longer, as opposed to the conventional life insurance policies which cover the risk of dying early.

Meanwhile, industry officials agree that life insurers have to communicate with their policyholders about the impact of the new section of the Income Tax Act.

"It`s also important to create awareness among the sales force on the need to tell their customers on the need for proper disclosures to the authorities so that insurance firms can avoid unnecessary policy cancellation requests later," Baradhwaj said.

"Software systems also need upgrade to ensure compliance with the new requirements."

(Zee News)