How some firms use a loophole to save tax with keyman insurance

Unlike typical keyman policies, these come with a savings plan and the maturity benefit is given to employees

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Employee stock options (Esops), bonuses, and health insurance. These are a few perquisites given by companies to retain top talent. A few employers provide life insurance as well.

Typically, there are two types of life insurance policies offered to employees: keyman life insurance and employer-employee (E-E) insurance. In the first, the life insured is of key managerial persons (KMPs)—the employees whose services are indispensable to run the company, as defined by The Companies Act, 2013. The proposer and the premium payer is the employer, who is eligible for tax exemption on premium payments.

In case of an eventuality, the company gets the death benefit and the proceeds are added to the company's business income. Insurance regulator Irdai, however, has specified that only pure term plans can be bought under a keyman policy. The benefits can thus be claimed only if an employee dies in harness. The policy lapses if the employee quits the company ahead of the maturity period.

E-E insurance, though, can incorporate a savings life plan—a financial product that combines savings and life insurance into a single package. Employers can buy it for one or multiple employees. The premium is paid by the employer, with the employee as the proposer. The life insured will be that of the employee. The premium payment by the employer will be considered as perquisite in the hands of employees and will be taxable. The maturity benefit, however, is received by the employee and is tax exempt up to the defined limits.

Now, a seemingly new policy construct has made its way to the industry. It is essentially a keyman insurance but with a savings plan that is supposed to benefit employees eventually.

While many insurance companies are currently offering such policies, financial experts are unsure whether this is authorized by Irda.

An email sent to Irda did not elicit any response.

In such policies, the employer is the proposer and pays the premiums, while the employee is the life assured. The employer gives an undertaking to assign the policy to the employee after the premium payment term is over. Thereafter, the employee gets the survival/maturity benefit. This amount will be treated as profits in lieu of salary under section 17(3) of the income tax Act. The premium payment by the employer is not considered perquisite in the hands of employees. However, employees only benefit if the companies do not renege on the undertakings given to them. A company will be eligible for the maturity proceeds if the policy is not assigned to the employee.

"Companies buy it majorly for its top management such as owners or directors. Some have begun to offer it to all their employees including junior and mid-level ones," says Naveen Kumar Midha, executive director– health & benefits, Global Insurance Brokers.

Rushabh Gandhi, deputy CEO, IndiaFirst Life Insurance, says E-E policies are a great tool for attracting and retaining talent.

"There is no perquisite tax for an employee. From an employer's standpoint, premiums are considered as business expenses and deductible under the income tax Act. In the unfortunate event of the death of the employee, the claim proceeds are tax free," he says, adding "while we offer such policies to various mid-sized companies, this does not tantamount to a sizable portion of our overall premiums."

Many insurers are offering a new type of keyman policy, but with a savings plan rather than a pure term plan

Benefit for employees

If an employer wants to deploy company profits as bonus or a salary hike to its employees, it will be fully taxable in the latter's hands. That is where E-E insurance comes in handy. The employer can purchase one of these policies for its employees instead of issuing bonuses. This payment won't be considered as a perquisite since the employer is the policy proposer.

The employer can assign this policy to the employee after the premium payment term is over. Employees get the survival/maturity benefit which is taxable.

"Even if it is taxable, it is still better than taking a bonus which comes with an upfront tax cut. You would anyway be investing your bonus somewhere. Why lose some of it in taxes? E-E solutions allow you to invest the full amount in a savings life plan," says Sajja Praveen Chowdary, head, business, corporate insurance vertical of Policybazaar.com, an online insurance distributor platform.

For instance, your employer wants to pay you ₹10 lakh per annum over and above your salary. If you are in the 30% income tax slab rate, taking the extra amount as a bonus or salary will reduce this amount to ₹7 lakh. You can make use of the entire ₹10 lakh if your employer can purchase a savings life plan on your behalf with an undertaking that it will assign it to you after the premium payment term is over.

However, this will mean that you will have to stick to the company for a longer term. In case employees quit before the policy is assigned to them, the surrender/maturity benefit will come to the employer and get added to its business income.

How employers stand to gain

Be it the insurance premium, bonus or salary hike, for employers all such transactions fall under business expenses. Companies can claim tax exemption against these under section 37(1) of income tax act. For employers, the policies are a tax-efficient way to deploy company profits.

More importantly, it offers the companies a chance to log perpetual tax benefits.

Industry insiders say some companies use it to defer corporate tax for perpetuity as there is no upper limit under section 37(1). In fact, they can buy a single premium payment policy in which they are the proposer and the life assured is of a KMP. This amount claimed under section 37(1) substantially reduces the taxable profit.

It is likely that some such companies may never assign the policy to the employee. After the policy matures, the proceeds is received by the company and is considered business income. The company is liable to pay tax on the same. However, if it again buys one or multiple employer-employee insurance solutions with that amount, the firm can again claim it as business expenses.

It is open to interpretation if this practice falls under tax planning or tax avoidance, say experts.

"Insurance should not be treated only as tax-saving instruments. The regulator and the government may not appreciate it given they have already started taxing the maturity benefit in high-premium traditional and unit-linked policies," says Yogesh Agarwal, founder & CEO, Onsurity, an employee benefits company that works with small and medium enterprises and startups.

The E-E solution is largely sold as a tax solution to small businesses. But, it can be designed as a social security benefit for all employees. "It can get a good offtake if they link such policies to the employee's compensation package. The employees can receive their due periodic/lump-sum income after the payout period starts, provided they stay with the company till then," says Midha of Globe Insurance Brokers, a composite insurance broker.

"It can be designed as defined contribution plans to minimise an employer's long-term financial obligations while still enhancing employee engagement. Under this construct, the employer and employee can jointly fund the plan, much akin to how it works in a provident fund," he adds.

Employers can consider buying such a policy in a group construct also.

"If the employer takes the group insurance policy, neither premium nor maturity benefit shall be taxable in the hands of the employees," says Naveen Wadhwa, vice president of Taxmann, a tax consultancy firm.

Keyman insurance, but with a twist

Such savings life insurance-based solutions create a win-win scenario for employers and employees to reduce tax liability

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WHAT'S IN IT FOR EMPLOYEES

Small businesses may want to share profits, offer bonus to employees over and above the annual salary

Scenario 1

The employee receives the bonus as part of salary

Amount ₹10 lakh

Post-tax amount* ₹7 lakh

*Considering 30% income tax slab rate

Scenario 2

Employer pays premium on behalf of employee which does not get taxed as salary/perquisite

Premium ₹10 lakh | Policy term 25 years | Premium payment term 10 years | Pay-out 12th year onwards

Year 1 → Employer to pay premium; no tax liability for employee → Year 10 → Year 11 one-year gap → Year 12: Policy gets assigned to the employee; pay-out to be taxable

If an employee resigns or dies

	Before policy assignment	After policy assignment
Death benefit	Goes to company as business income	Goes to family; **tax-free**
Survival/ maturity benefit	Goes to company as business income	**Taxable** for the employee

WHAT'S IN IT FOR EMPLOYERS

The employer buys an E-E solution for the company director

Premium payment term 15 years | policy cover ₹10 crore | Policy term 20 years | Premium ₹50 lakh

	Without any policy	E-E solution
Total profit of the company	₹1 crore	
Premium paid for E-E*		₹50 lakh
Taxable profit	₹1 crore	₹50 lakh
Tax @ 25% on profit	₹25 lakh	₹12.5 lakh
Tax saved per year	₹12.5 lakh (₹25 lakh-₹12.5 lakh)	
Total tax saved in 15 years	₹1.87 crore	

*eligible for tax exemption under sec 37(1) of I-T Act

How employer defers tax for perpetuity

Not assigning it to the employee

Year 1 → Pay premium and claim as tax exemption → Year 15 → Year 16 → Pay-out to be added in business income → Year 19 → Year 20 → Maturity value to be added in business income → Buying new E-E policies → Claiming tax exemption under section 37(1)

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DEV ASHISH
We welcome your views and comments at
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WHICH FINANCIAL PRODUCTS SHOULD YOU BE WARY OF?

The financial landscape is full of products jostling to grab your attention (and of course, money). And while each product has its own set of target population, the problem arises when the wrong (or rather unsuitable) product lands in the hands of investors. The result? Undesired investment outcomes. It is therefore very important to understand which products are best avoided. More so for small investors who have limited capital and, hence, pay a proportionately bigger price if they get into unsuitable products. So, let's have a look at a few products which are best avoided.

Endowment & unit-linked insurance plans (Ulips): These traditional life insurance plans neither provide sufficient life cover nor provide good investment returns (you get 5-6% maximum). You are better off without them. Like traditional insurances, Ulips also hybrid products offering both insurance and investment. But since there is an option to invest in equities via Ulips, they give potentially better returns than endowment or moneyback plans. But for most, Ulips are best avoided as first, they don't give good life cover for the premium charged; secondly, actual investor-level returns get subdued due to different deducted made via unit cancellations.

Thematic and sector funds: Every now and then, there is a sector or thematic fund that ends up topping the returns chart. This attracts the attention of many who rely (solely) on past returns to pick funds. But given the cyclical nature of each industry or sector, the chances of sectoral bets doing well one year after the other are low. So, while some sectors will do very well and give market-beating returns in the short term, chances are they will fall flat over the next year due to cyclicity. So, small investors should at best avoid investing in risky sectoral funds as there is no perfect way to predict which sector will do best the next year or the year after.

For most people, diversified equity funds, PF, and NPS are enough for the long term

Small-cap funds : Due to their inherent nature, smaller companies pose higher investment risks. And this holds true for smallcap funds that invest in such companies. While these funds generate impressive returns on certain occasions, they are also prone to periods of low-to-no returns during economic downturns, which affect smaller companies much more than larger ones. So, the resulting fluctuations in returns are what makes these funds unsuitable for many, even though the long-term CAGR profile for many small-cap funds may make them seem sure-shot bets. The CAGR figures hide the emotional upheaval that an investor goes through in such funds.

Given the inability of active large-cap funds to consistently beat passive large-cap indices like Nifty50, there is merit in just investing in passive funds for large-cap exposure instead of active funds. So, even active large-cap funds can be avoided to keep the portfolio simple.

PMS: Porfolio management services (PMS) have a minimum ₹50 lakh requirement and hence, it is out of most small investor's reach. But even if one has ₹50 lakh to spare(!), it is best to avoid PMS. Most PMS are high-risk-high-return kind of products which target high returns by taking concentrated bets. Also, the fees (fixed and performance-linked) are not very investor-friendly. This product is best suited for larger investors who have sufficient surplus to take small risky bets via the PMS route.

Unlisted shares: This is a highly risky and illiquid space. There is no transparency in the unlisted space with no guarantees that the shares will ever list or generate good returns.

This list isn't exhaustive by any means. But as an investor, I can tell you that you need to say 'No' more often than 'Yes' when you are looking to invest in some new product. Just a few reliable instruments like term life insurance, family floater health insurance, bank fixed deposits (or a few debt funds) for short-term and diversified equity funds, provident fund, national pension scheme, etc., for long-term are enough for most people.

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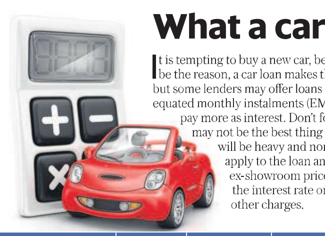
What a car loan costs you



It is tempting to buy a new car, be it an upgrade, a first car or another car for the family. Whatever be the reason, a car loan makes the purchase easier. Car loans are usually of three to five years but some lenders may offer loans for up to seven years too. A loan for longer may mean smaller equated monthly instalments (EMIs), which makes the car seem more affordable, but overall, you pay more as interest. Don't forget that a car is a depreciating asset, so taking a bigger loan may not be the best thing to do. But if you take a car loan for a short duration, the EMIs will be heavy and non-payment will mean a blot on your credit report. Conditions apply to the loan amount also. For instance, some lenders give a loan for the full ex-showroom price of the car, while others may offer a loan up to 80%. Apart from the interest rate on a car loan, also take a look at the applicable processing fee and other charges.

Loan amount = ₹1 lakh. Tenure = 5 years

Lender	Interest rate (%)	EMI (₹)	Processing fee
Indian Bank	8.60-9.50	2,056-2,100	Nil
State Bank of India	8.65-9.70	2,059-2,110	Nil
Bank of Maharashtra	8.70-13.00	2,061-2,275	Nil
Canara Bank	8.70-11.95	2,061-2,222	**100%** waiver from 01.09.2023 to 31.12.2023 under Retail Loan Festival
Central Bank of India	8.70-10.15	2,061-2,132	Completely waived till 31.12.2023
UCO Bank	8.70-10.55	2,061-2,152	**0.50%** (Max **₹5,000**) + GST
Bank of Baroda	8.75-12.05	2,064-2,227	**₹500** + GST#
Bank of India	8.75-10.75	2,064-2,162	**100%** waiver till 31.12.2023
IDBI Bank Limited	8.75-9.55	2,064-2,103	Up to **₹2,500**
Punjab National Bank	8.75-9.60	2,064-2,105	**0.25%** of the loan amount (Minimum **₹1,000** and Maximum **₹1,500**)
Union Bank of India	8.75-10.50	2,064-2,149	**100%** waiver from 16.11.2023 to 31.12.2023
CSB Bank	8.75-11.00	2,064-2,174	Not Available^
HDFC Bank	8.80	2,066	**₹3000** for loan<**₹10 lakh, ₹7500** for>**₹10 lakh**
Indian Overseas Bank	8.85-10.05	2,069-2,127	As applicable
Punjab & Sind Bank	8.85-10.25	2,069-2,137	**0.25%** (Min **₹1,000** and Max **₹15,000**); Up to **50%** concession available

Banks that have not updated information on their websites are not included here. Data was taken from bank websites on 18 November 2021. The EMI range is indicative and calculated on the basis of interest rate range. In an actual situation, it may include other fees and charges. Actual applicable interest rate may vary based on the credit profile, loan amount, tenure and as per bank's discretion.

PRANAY BHARDWAJ/MINT

Source: MyMoneyMantra.com

How is the profit on my bond sale taxed?

Neeraj Agarwala

Three months ago, I bought IFCI bonds, issued on 1 August 2011, for ₹34,000. The date of maturity of these bonds, with a face value of ₹10,000, is 1 August 2026. On maturity, IFCI will pay ₹10,000 as capital and ₹36,250 as interest, subject to tax deducted at source, or TDS. Can I show this amount received (₹46,250 less TDS) as sale proceeds in my income tax returns and claim long term profit? Note that there was no TDS till last year in the earlier IFCI bond series that matured in 2021-22.

—*Vijay Desai*

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TAXATION

In accordance with Section 56 of the Income Tax Act, income in the nature of interest is subject to taxation under the head 'Income from other sources.' This encompasses all types of interest, including those from bank accounts, fixed deposits and debentures, whether convertible or non-convertible.

Notably, the tax treatment of interest remains consistent regardless of whether the securities are listed on the stock market. However, taxpayers possess the flexibility to declare this income for taxation either on an accrual basis—when the interest income becomes due—or on a receipt basis—when the interest is received in their bank account.

Thus, the cumulative amount of ₹36,250 received at the time of redemption of the bonds would qualify as interest and hence taxable at the applicable slab rate.

With regards to the purchase price of the bonds amounting to ₹34,000, there are two contrasting perspectives on its treatment. The first posits that the excess amount paid by the taxpayer over the face value constitutes a capital loss. In this instance, a capital loss of ₹24,000 (purchase price ₹34,000 less face value ₹10,000) is incurred. However, it is crucial to note that such capital losses cannot be utilized to offset the interest income. However, the same can be utilized to set off other capital gains income either in the year of maturity or carried forward for up to eight subsequent assessment years.

The second suggests that the excess amount over the face value represents expenses incurred for earning the interest income and therefore can be claimed as a deduction. Under this scenario, the interest income would be ₹36,250, and the deduction would amount to ₹24,000. Consequently, only the net income of ₹12,250 would be subject to taxation. This option is open to debate and may not be readily accepted by the income tax officer.

As stipulated in section 193 of the Act, any entity responsible for disbursing interest income on securities to a resident is obligated to deduct tax at source. In the case of interest payable to an individual or a Hindu Undivided Family (HUF) resident in India, on debentures issued by a publicly-interested company, TDS is applicable only if the aggregate interest amount exceeds ₹5,000 during the financial year. The TDS deducted can be claimed as a credit in the year in which the income is subjected to taxation. Note that TDS should not be deducted from the taxable income; instead, credit should be claimed against the income tax payable and the amount becomes refundable to the taxpayer if no income tax is payable.

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Do you have a personal finance query? Send in your queries at **mintmoney@livemint.com** and get them answered by industry experts.