

BUSINESS PROTECTION PLANS

Insurance Scheme

**Bonanza for the Employer
and the Employee!!!**

**LONG TERM LOYALTY
SOLUTIONS**

Caveat

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Employer-Employee

⇒ Objective

- ✓ To provide job satisfaction for the employees
- ✓ Continuity of services with devotion and personal involvement.
 - It acts a motivation for the employees to continue with the organization.
 - It gives additional benefits to a “**select band of employees**” as reward for good services.

Tax Implications for Employer :-

100% of premiums paid by the employer is eligible for deduction as business expenditure under section 37(1) of the Income Tax Act, 1961.

Employer's point of view:-

- 1) The schemes which are adopted for the welfare of the employees certainly help in better productivity and expansion of business which ultimately help to increase the gross profits of the firm. An employer has the insurable interest in the life of an employee is recognised by law under Insurance Act, 1938.
- In view of the above, an employer-employee scheme gains importance.
- 2) The premiums paid by the employer are treated as deductible expenses of business or profession under Section 37(1) of I.T. Act, 1961.
- Section 37(1) is defined as “Any expenditure not being the nature of capital expenditure or personal expenses of the assessee LAID OUT OR EXTENDED WHOLLY AND EXCLUSIVELY FOR THE PURPOSES OF THE BUSINESS OR PROFESSION shall be allowed in computing the income chargeable to income tax. This is besides other specified expenses u/s 30 to 36 and those u/s 37(1)

- 3) Since the premium paid by the employer is treated as perks under Section 17(2)(V), it is binding on the employer to pass a resolution to effect an insurance on the life of employees and contents of the resolution are made known to the employees also.
- 4) The total insurance on the life of an employee or more precisely the premium payable under the life insurance policy should be reasonable and it would be better if the provisions of the Section 40(A) 2(a) and 40(A) 2(B) is taken care of.
- 5) As far as the implementation of statutory schemes like Gratuity, Group Superannuation, employer has to go for long term commitments and formation of relevant trust to manage the scheme to take the tax benefits under the same section.
- But if he adopts employer-employee scheme he can use his own discretion as far as the provisions to be made under the scheme. In other words, he can always decide the duration of payments and thereafter the employee can continue his policy for his own benefits. Besides, employer need not have to form the trust or approval from IT authorities.

Note on tax implications relating to Employer-Employee Insurance Policies

1. Background

IRDA in their circular dated 22nd March 2006 has clarified that products sold under the employer employee schemes could be other than term insurance.

Where the Employer is the policy Holder and the employee is the Life Assured.

The employer would wish to take the policy on the life of the employees in order to use the insurance policy as a retention tool. This need can be met through the employer- employee schemes which have the following condition agreed to by the employer at the time of making the proposal:

- The Employer should undertake to assign the policy in the Employee absolutely upon the employee continuing to remain in employment with the Company for a period specified by the employer.
- If the employee quits the job within the specified period the employer can either surrender the policy for its surrender value to the insurance company, or absolutely assign the policy to the employee as a part of the terminal benefit.
- However if the employee dies during the specified period then the benefits of the policy are passed to the nominees of the employee.
- No withdrawal will be allowed to be made by the employer
- The policy document once issued will be endorsed with a special endorsement and dispatched to the employer.

HDFC Standard Life Insurance Company Limited ('the Company') has requested us to provide tax advice on its specific queries relating to the above-mentioned employer employee scheme.

2. Queries and Our views

The specific queries raised and our high level comments thereon are given in the subsequent paragraphs:

2.1 Tax implications in the hands of Employer

2.1.1 The premium is paid by the employer. Is the employer eligible for any tax benefits, if yes under which section?

Our comments:

It would be possible for the employer to claim deduction u/s 37(1) of the Income-tax Act, 1961 ("the Act"), on the basis that the expenditure is incurred wholly and exclusively for the purpose of business and the employer has no control over the monies paid as a premium.

2.1.2 Will there be any taxation on the value of policy which the Employer is holding?

Our comments:

The life insurance policy is not an asset for the purpose of Wealth Tax Act 1957 (Section [2(ea)]). Accordingly, there will not be any taxation on the value of the policy which the employer is holding.

The question of the taxability in the hands of the employer would arise only in a situation where the employer receives some benefit from the policy i.e. surrender value. However it would be possible for the employer to claim benefit of exemption u/s 10(10D) of the Act and claim such receipt to be exempt. Section 10(10D) provides that no exemption is available for "keyman policy". This can be interpreted to mean that it is possible for a corporate assessee to avail benefit of section 10(10D) for policies other than keyman policy.

Exemption under section 10(10D) of the Act would be available subject to the satisfaction of conditions summarized in Annexure A.

2.1.3 If an employer has to surrender the policy back to the insurance company because the employee did not meet the criteria. What will be the tax treatment on the surrender value in the hands on the employer?

Our comments:

Please refer to answer in para 2.1.2 above.

2.2 Tax Implications In the hands of Employee

2.2.1 When the company is paying the premium on behalf of employee will it be treated as perquisite in hands of employee?

Our comments:

Pre-assignment period: The premium paid would not be taxable as perquisite as the employee does not enjoy any benefit till the assignment of the policy.

Based on the judicial decisions summarized in Annexure B, it may be stated that since there is no vesting of interest in the hands of employee, the amount of premium paid by employer, could not be treated as perquisite in the hands of employee.

Post-assignment: The premium paid by the employer would be treated as perquisite in the hands of the employee.

Assignment value: --

The Act or the Income-tax Rules, 1962 ('the Rules') do not specifically provide the value at which the perquisite in the nature of assigned policy would be subject to tax in the hands of the policy.

However, it is pertinent to note that Central Board of Direct Taxes ('CBDT') has vide circular no. 762 dated February 18, 1998 clarified that the surrender value of the policy, endorsed in favour of the employee (keyman) would be taxable in the hands of the employee as 'profit in lieu of salary'.

Based on the aforesaid circular, a possible argument could be that when such policy is assigned after the payment of few premiums by the employer, the surrender value of the policy on the date of assignment would be taxable in the hands of the employee.

However, the aforesaid circular was issued in the context of keyman policies and in view thereof, one may challenge that the same would not apply to policies other than keyman policies.

Given this, while the Act as well as the Rules are silent on the issue of valuation in such cases, analogy can be drawn from the valuation norms for other items of perquisites.

For most of the other items / perquisites, the Rules provide that the expenditure incurred by the employer would be subject to tax as perquisite. Accordingly, this may be applied to for assignment of policy as well. Further, the Rules specifically provides that in case of transfer of movable assets, the value of perquisite would be the cost incurred by the employer on such asset as reduced by depreciation. It can be argued that a policy is a "movable asset".

Based on the above, it can be argued that the value of perquisite for an assigned policy would be the cost incurred (premiums paid) by the employer.

- 2.2.2 As the Employee does not enjoy immediate benefit on that value will he have to pay tax on it?

Our comments:

Refer to reply given in para 2.2.1.

- 2.2.3 When the lock in period is over and the policy is assigned to the employee, what will be the tax treatment in the hands of the employee? Kindly specify in light of the fact that the employee now has legal right to a policy that now has a monetary value if surrendered.

Our comments:

When the lock in period is over, the policy shall be assigned to the employee. Refer to reply given in para 2.2.1

- 2.2.4 If the value of such a policy is taxable as a perquisite then the taxation is based on which value of the policy (premiums paid or fund value or surrender value)

Our comments:

The employee shall be eligible for tax exemption u/s 10(10D) of the Act subject to fulfillment of conditions laid out in section 10(10D). For taxation on assignment, refer to reply given in para 2.2.1.

Exemption under section 10(10D) of the Act would be available subject to the conditions summarized in Annexure A.

- 2.2.5 What will be the tax treatment of the proceeds of the policy in following circumstances:

- a) Death of the employee during the specified period
- b) Death of the employee after the specified period
- c) Maturity, withdrawals or surrender done by employee after the specified period.

Our comments to all three questions:

The exemption u/s 10(10D) would be available subject to fulfillment of conditions summarized in Annexure A.

General

The above note is prepared based on the information given to us by HDFC Standard Life Insurance Company Ltd. ('HDFC Std Life') and is accordingly given for the specific purpose of internal use by HDFC Std Life. Our conclusions are based on the completeness and accuracy of the above stated facts and assumptions; which if not entirely complete or accurate, should be communicated to us immediately, as the inaccuracy or incompleteness could have a material impact on our conclusions.

The conclusions reached and views expressed in the Note are matters of opinion. Our opinion is based on our understanding of the law and regulations prevailing as of the date of this Note and our past experience with the tax and/or regulatory authorities. However, there can be no assurance that the tax authorities or regulators may not take a position contrary to our views.

Legislation, its judicial interpretation and the policies of the tax and/or regulatory authorities are also subject to change from time to time, and these may have a bearing on the advice that we have given. Accordingly, any change or amendment in the law or relevant regulations would necessitate a review of our comments and recommendations contained in this Note. Unless specifically requested, we have no responsibility to carry out any review of our comments for changes in laws or regulations occurring after the date of issue of this Note.

Notwithstanding anything to the contrary, this tax advice was prepared exclusively for HDFC Std Life, and is based on the facts as presented to PricewaterhouseCoopers as at the date the advice was given. The advice is dependent on specific facts and circumstances and may not be appropriate to another party. This tax advice was prepared with only the interests of HDFC Std Life in mind, and was not planned or carried out in contemplation of any use by any other party. This tax advice may not be distributed or otherwise made available by HDFC Std Life to other parties without our consent. PricewaterhouseCoopers, its partners, employees and or agents, neither owe nor accept any duty of care or any responsibility to any other party, whether in contract or in tort (including without limitation, negligence or breach of statutory duty) however arising, and shall not be liable in respect of any loss, damage or expense of whatever nature which is caused to any other party.

Annexure A

Exemption under section 10(10D) of the Act would be available subject to the satisfaction the following:

- i. Such sum is not received by Assessee in respect of maintenance including medical treatment of a dependant who is a person with disability (as prescribed for deduction under section 80DD of the Act)
- ii. Such sum is not received under the keyman insurance policy
- iii. The policy premium payable for any of the years during the term of the policy does not exceed twenty per cent of the actual capital sum assured. This condition would not apply in case the sum is received on death.

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Annexure B

SINGLE PREMIUM/ ANNUITY POLICY CAN NOT BE REGARDED AS PERKS

- CIT vs. L. W. Russel (53 ITR 91) (SC)

In this case certain contribution was paid by the employer society towards the premium payable by the respondent-employee to a superannuation fund set up by the society. From that fund, certain payments were to be made to the employees upon their reaching the age of superannuation. It was sought to be added in the taxable income of the employee in the concerned assessment year as contribution towards perquisite under s. 7(1) Explanation 1 sub-cl. (v) of the IT Act, 1922. The apex Court held that to be a perquisite, it implies that an immediate right is conferred on the employee in respect of those benefits. It cannot apply to contingent payments to which the employee has no right till the contingency occurs. It was only contingent interest depending upon the reaching of the age of superannuation. Hence, it was not a perquisite allowed to the employee.

- Commissioner Of Income-Tax, Delhi vs Lala Shri Dhar (84 ITR 192) (Del HC)
- Commissioner Of Income-tax, Delhi Vs. Vinay Bharat Ram. (79 ITR 128) (Del HC)

In both the cases the question was raised as to the premium paid by the employer towards policy of personal accident insurance of the employee. It was held that neither clause (iii) nor (iv) of Explanation 1 to s. 7(1) of the 1922 Act would be applicable to the amount of premium paid by employer. The premium could not be assessed in the hands of the employee as "perquisite".

- Commissioner Of Income-Tax vs N. Vas. (240 ITR 101)(Bom HC)

Employer paid a sum for the purchase of single premium annuity policy on the life of the employee cannot be regarded as a perquisite within the meaning of section 17(2) of the Income-tax Act, 1961, and consequently cannot be included in the assessee's income under the head 'Salaries'. The amount of premium paid towards single premium insurance policy did not vest in the assessee. At best he had a contingent right therein.

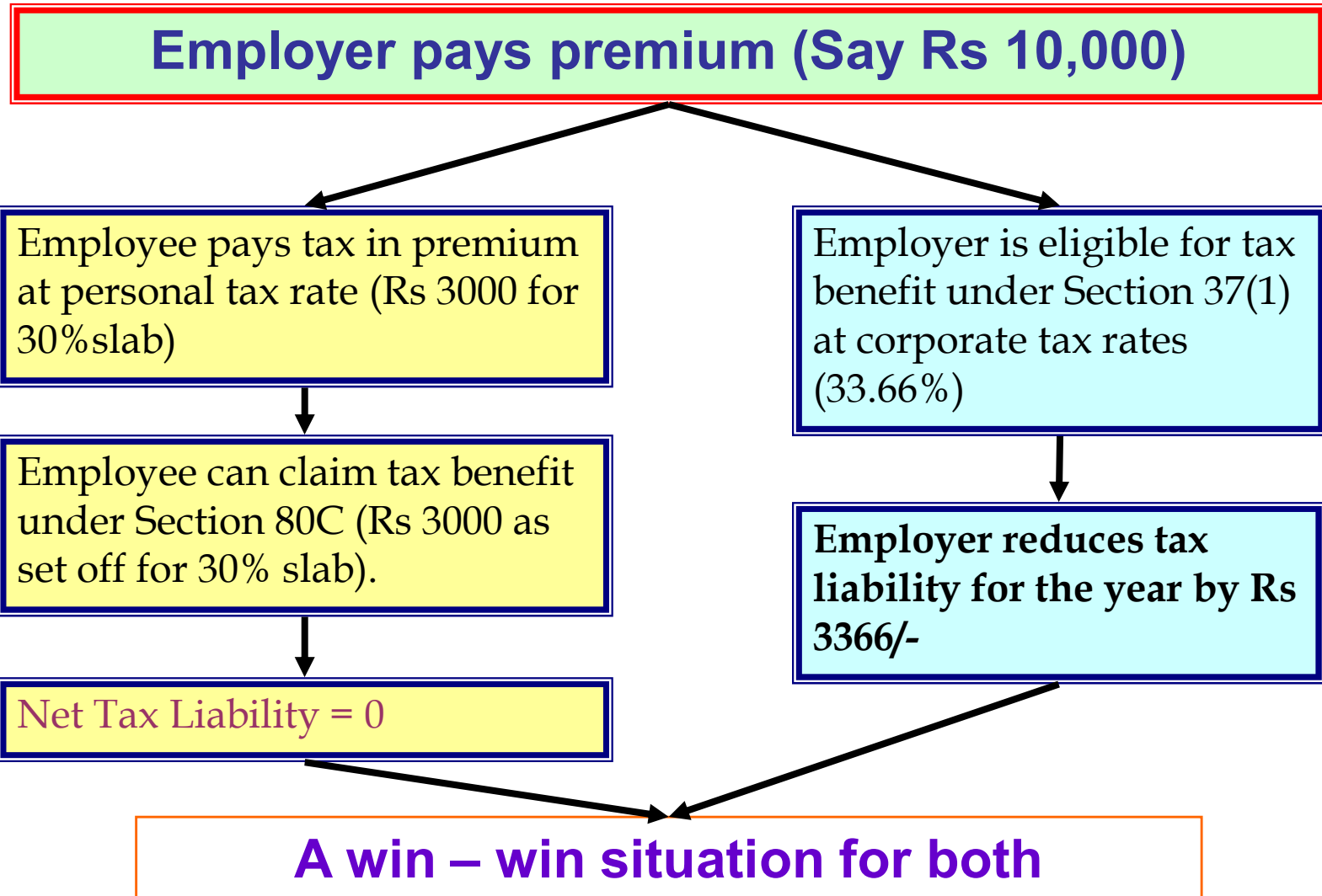
- Commissioner Of Income-Tax, Karnataka, Bangalore. Vs Amco Batteries Limited. (150 ITR 48)(Kar HC)

Employer paid the premium on the accident insurance policy taken by the assessee-company in relation to personal accident or death by accident of some of the employees. It was held that the premium paid on personal accident insurance policies of its employees should not be treated as a perquisite.

Tax Implications for Employee

- The premium paid by the employer will be treated a perquisite in the hands of the employee under Section 17 (2) (v), and the employee has to pay tax on the same.
- **However, the employee can get tax relief for the premiums paid by the employer under Sec 80C, and therefore, the tax liability for the employee is NIL. (Remember, there is no income limit for Section 80C anymore, but check for exhaustion of limit through other investments like PF)**
- Maturity and Death Benefit are eligible for tax benefits under Section 10(10)D.

Illustration



Note: Personal Income Tax Surcharges not taken into account, but the impact will not change because of that.

TAX IMPLICATIONS.....

THERE ARE TWO PARTIES INVOLVED IN THE TRANSACTION
ONE IS EMPLOYEE ANOTHER IS EMPLOYER

EXAMPLE

PREM AMT IS RS. 1,00,00,000

EMPLOYER

(-) 1,00,00,000 AS BUSINESS
EXPENSES U/S 37(1)

EMPLOYEE

(+) 1,00,00,000
U/S 17 (2) V
I.TAX @ 30%

EMPLOYER CAN PAY I.TAX ON BEHALF OF THE
EMPLOYEE U/S 192 (1A) ON PERKS.

HENCE THE TAX LIABILITY U/S 17 (2)
SHIFTED TO EMPLOYER

(-)30,00,000 ←----- RS. 30,00,000

NOW TAX ON TAX ALSO WILL BE PAYABLE BY EMPLOYER

Rs.9,00,000 AND THIS AMT CAN NOT BE CLAIMED U/S 37(1)

BUT WHY SHOULD EMPLOYER DO IT?

EXAMPLE:

**IF WE DON'T TAKE THE POLICY UNDER THE SCHEME
PROFIT OF THE COMPANY WOULD HAVE INCREASED BY
RS. 1,30,00,000**

**I. TAX WOULD HAVE BEEN RS. 39,00,000
NET PROFIT WOULD HAVE BEEN INCREASED BY
RS. 91,00,000**

**AND IF THE COMPANY DECLARES THIS AMT AS DIVIDEND
AGAIN DIVIDEND DISTRIBUTION TAX @16.5%+3%=16.995 %
RS.15,46,545**

**TOTAL TAX LIABILITY OF CO. WILL BE
(3900000+1546545)= 5446545
WHILE WE HAVE PAID ONLY Rs.900000**

NET SAVING IS Rs.4546545

Long Term Retention Programme

	Salary	Tax	Investment	Total Benefit on 20 th yr. (Tax free)
			Rs.	Rs.
Option 1	1,000,000	@30%	700,000	13,252,635
Option 2	Investment in LTL HDFC LIFE		Investment	Total Benefit on 20 th yr. (Tax free)
			Rs.	Rs.
	1,000,000	+	1,000,000	21,131,654
	(Individual's tax @ 30% on policy value (S.V) after 7 years. Gurantted SV on 7 th yr is Rs. 30 lacs) I.e Rs. 30 lacs x 30% = Rs. 9,00,000 tax		(SV) Less tax:	900,000
			Total	20,231,654

Savings by investing in LTLP Rs.	20,231,654	13,252,635	6,979,019
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Total benefit due to tax deferment is Rs. 69.79 lacs

The Sales Proposition

- The company reduces tax liability...
- The cash outflow impact on the employee is NIL...
- Premiums paid can be looked upon as a salary paid to the employee... in lieu of superannuation funds...Superannuation funds come under the purview of Fringe Benefits Tax.
- **Remember...after the introduction of Fringe Benefits Tax, employer-employee insurance provides companies with the BEST possible option to reduce taxes while keeping their employees happy....**

Recommended Plans

- (SP Endowment Plan)
- (New Endowment Plan)
- (New Money Back Plan)
- (Pension Plan): Tax benefit to be claimed under 80C,
- **(JEEVAN AROGYA & LIC's Cancer Cover (Plan 905))**
- Tax benefit to be claimed under 80D, and to be sold to lives that are medically unfit

ARE YOU INTERESTED

WHAT NEXT

- The proposals will be treated as individual proposals from the employees. Employer is concerned only as far as the premium payment is concerned.
- The acceptance of insurance depends upon the medical & financial state of the proposed employees.

Requirements/Conditions

- Employee signs the form & attaches consent from employer to finance & remit the premium.
- Salary slip to be attached in all cases. Standard eligibility (based on age) to be computed for max risk to be accepted.
- In case salary slip cannot be provided, company financials to be submitted.

Requirements/Conditions

- Cancer Cover



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please read the sales brochure carefully before concluding a sale.

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OPTIONS TO BE EXECUTED BY THE EMPLOYER

OPTION 1

*EMPLOYEE IS ASKED TO PROPOSE FOR THE POLICY ON HIS OWN LIFE AND HIS PROPOSAL WILL BE SENT TOGETHER WITH A LETTER FROM THE EMPLOYER THAT THE PREMIUM WILL BE PAID BY THE EMPLOYER. IN THIS CASE NO FURTHER ASSIGNMENT IS REQUIRED.

OPTION 2

*MANAGEMENT INFORMS THE EMPLOYEE ABOUT THE LIFE COVER AS PART OF THE TERM AND CONDITION OF HIS EMPLOYMENT.

*IN SUCH CASES AN OFFICER OF THE COMPANY IS DULY AUTHORISED BY THE COMPANY TO SIGN THE PROPOSAL FORM AND ENTER IN TO THE CONTRACT OF LIFE INSURANCE WITH CORPORATION IN THE LIFE OF THE EMPLOYEE AS WELL AS TO ASSIGN THE POLICY IN FAVOUR OF THE EMPLOYEE LATER.

REQUIREMENTS

1. PROPOSAL FORM MAY BE SUBMITTED EITHER IN FORM NO. 300 OR 340.
 2. MEDICAL REPORTS AND SPECIAL REPORTS WILL BE DECIDED ON THE BASIS OF SUC.
 3. MAX SUM ASSURED WILL BE DECIDED AS PER THE FINANCIAL UNDERWRITING PROVISIONS.
 4. IF EMPLOYER IS THE PROPOSER A SEPARATE LETTER SHALL BE OBTAINED FROM THE EMPLOYER, STATING-
 - ◆ OBJECT OF INSURANCE
 - ◆ RESTRICTION TO BE IMPOSED IN RESPECT OF SURRENDER, LOAN.
 - ◆ ASSIGNING THE POLICY IMMEDIATELY AFTER THE ISSUE OF POLICY.
 - ◆ LETTER SHOULD FORM PART OF THE PROPOSAL.
- IT IS NOT NECESSARY THAT ALL THE INSURABLE EMPLOYEES OF THE EMPLOYER BE COVERED UNDER THE SCHEME.

PROCEDURES TO BE FOLLOWED TO ADOPT THE SCHEME

- 1) Obtain approval from the Board or the sources authorised to act for and on behalf of the firm (Board resolution is to be passed).
- 2) Arrange power of attorney in favour of persons to execute the scheme.
- 3) Put up the proposal to LIC of India to effect the coverage and for the issuance of policies as per the Plan & Term selected. The proposals will be treated as individual proposals received from the employees concerned irrespective of whether the proponent is any employer or an employee. Requirements of medical examination etc., shall be decided on that basis. The maximum sum assured shall be determined in terms of the rules relating to financial underwriting for individual assurances taking into account the existing life insurance in force on the life of the employee.
- 4) If the employee is the proponent, the policy shall be assigned to the life assured at the earliest but under no circumstances later than 5 yrs depending on the terms of agreement between the employer and the employee. Separate letter from the employer stating the object of insurance, the restrictions he desires to be considered in respect of surrender, loan, etc., and that he would assign the policy to the life assured at a pre-decided stage, should be obtained stating clearly that this letter of the employer will form a part of the proposal. It is not necessary that all the insurable employees of the employer be covered under this scheme.
- 5) Ensure payment of premium on time.
- 6) Proposal Form No.340 has to be used for the purpose.

PROCEDURES TO BE FOLLOWED...

- 7) In some instance employer may like to finance loan towards
- payment of premium to the employee. Form No.300 can be
- used to assign the policy as a collateral security.
- 8) i) Copy of the resolution annexed (Annexure “X”).
- ii) Letter addressed to the employees mentioning the decision
- to insure his life.
- iii) Copies of the IT returns of the company to check the profit
- position.
- iv) Employee’s previous insurance is to be taken into account
- and, if required, individual ITR’s to be called for.
- v) Details regarding total employees working in the company,
- their cadres and salaries drawn by them.



R. Ravindra Kumar
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We help YOU to



Tranform YOUR Life...



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