

Tax Flash News

21 August 2023

Guidelines for taxation of the consideration received from a life insurance policy

Background

As per Finance Act 2023, maturity proceeds from a life insurance policy (LIP) (other than a Unit Linked Insurance Policy (ULIP)) issued on or after 1 April 2023 would be subjected to tax¹, if the aggregate annual premium paid (on all policies except ULIP) exceeds INR 500,000 in any of the financial years (FY or tax year) during the term of any of those life insurance policies. However, such maturity proceeds would be exempt if the same is received on the death of the insured person or for a term life insurance policy.

Maturity proceeds from a LIP (other than a ULIP) issued before 1 April 2023 would continue to be exempt¹. Accordingly, such LIPs issued on or after 1 April 2023 have been referred to as eligible LIPs.

In this regard, the Central Board of Direct Taxes (CBDT), vide Notification² dated 16 August 2023, has inserted a new Rule³, wherein the method of computation had been specified. Also, CBDT, vide Circular⁴ dated 16 August 2023 has issued guidelines for such computation of exemption/ taxable values. A harmonious reading of Notification and circular *inter-alia* highlight the following:

- Where the taxpayer receives consideration under one or more of eligible LIPs and the aggregate amount of premium payable on such eligible LIP/ LIPs along with old eligible LIPs⁵ does not exceed INR 500,000 for any of the tax years during the term of such eligible LIP/ LIPs, then such consideration shall be eligible for exemption⁶.
- Where the taxpayer receives consideration under one or more of eligible LIPs and the amount of premium payable on such eligible LIPs exceeds INR 500,000 for any of the tax years during the term of such eligible LIP/ LIPs along with old eligible LIPs, then consideration under only eligible LIPs (where the aggregate premium paid is less than INR 500,000) shall be eligible for exemption and the balance would be subjected to tax.

Method and guidelines to compute the taxable income

1. In case a taxpayer receives any amount for the first time under an eligible LIP, at any time during a particular FY, then the income chargeable to tax from receipt of such amount shall be calculated as below:

Income chargeable to tax = A-B

A refers to the amount received under the life insurance policy during the first FY; and

B refers to the aggregate of the premium paid during the term of the LIP till the date of receipt of the amount (as referred to in A above) that has not been claimed as a deduction under any other provision of the Act.

¹ Section 10(10D) of the Act

² No. 61/ 2023/ F.No 370142/28/2023-TPL

³ Rule 11UACA under Income-tax Rules, 1962, for computation of income chargeable to tax under clause (xiii) of sub-section (2) of section 56 of the Act

⁴ Circular No. 15 of 2023

⁵ Where the taxpayer receives consideration under one/ more of eligible LIPs during any FY preceding the current FY and in case it has been claimed as exempt then such policies are referred to as old eligible LIPs

⁶ Section 10(10D) of the Act

2. In case a taxpayer receives any amount under a LIP during a FY, after the receipt of the amount as mentioned in point 1 above, then the income chargeable to tax from receipt of such amount shall be calculated as below:

Income chargeable to tax = C-D

C refers to the amount received under a LIP during the FY, after the receipt of the amount as referred above in point 1; and D refers to the aggregate of the premium paid during the term of LIP till the date of receipt of the amount but shall not include the following:

- the premium that has already been considered for calculation of the taxable amount in FYs (refer B); and
- amount of premium that has been claimed as a deduction, if any, under any other provision of the Act.

However, amounts received under any ULIP or Keyman insurance policy would not form a part of the above.

Illustrations

Some of the following illustrations could further clarify the impact of this amendment:

- The taxpayer has the following policies all of which satisfy all the conditions laid down⁵ and the taxpayer did not receive any consideration under any other eligible LIPs in earlier FYs preceding the FY 2030-31.

LIP Description	X	A	B	C
Date of issue	01-04-2022	01-04-2023	01-04-2023	01-04-2023
Annual premium in INR	500,000	1,00,000	3,50,000	6,00,000
Sum Assured in INR	50,00,000	10,00,000	35,00,000	60,00,000
Consideration received as on 01-11-2032 on maturity	60,00,000			
Consideration received as on 01-11-2033 on maturity		12,00,000	40,00,000	70,00,000

- The consideration under LIP X will be exempted⁶ as the policy has been issued before 1-04-2023.
 - The consideration received under LIPs A and B shall be exempt since the aggregate of annual premiums payable for these two policies does not exceed INR 500,000 for any FY during the term of these two policies.
 - The consideration received under LIP C will not be exempt since the aggregate of the premium payable for LIP A, B and C exceeds INR 500,000 during the term of these policies.
- In the above example, in case LIP X is purchased on 1-04-2023 and other LIPS (A, B, C) are also purchased on 1-04-2023, and the proceeds are received 10 years later, then please note the following:
 - The consideration under LIP X will be exempt for the tax year 2033-34 since the annual premium does not exceed INR 500,000.
 - The consideration received under LIPs A, B and C will not be exempt since the aggregate of the annual premium payable for these three LIPs and LIP X exceeds INR 500,000 for the tax years 2023-24 to 2033-34 which fall under the tenure of these policies.
 - The consideration under LIP A or B will also not be eligible for exemption under the said clause as the aggregate of the annual premium of LIPs X and A or X and B exceeds INR 500,000.
 - In another instance, the taxpayer has the following policies all of which satisfy all the conditions laid down and the taxpayer did not receive any consideration under any other eligible LIPs in earlier tax years preceding the tax year 2035-36 other than under LIPs X and Y.

LIP Description	X	Y	A	B	C
Date of issue	01-04-2023	01-04-2023	01-04-2024	01-04-2024	01-04-2024
Annual premium in INR	200,000	200,000	200,000	300,000	600,000
Sum Assured in INR	20,00,000	20,00,000	20,00,000	30,00,000	60,00,000
Consideration received as on 01-07-2033 on surrender	12,00,000				

Consideration received as on 01-11-2034 on maturity		24,00,000			
Consideration received as on 01-11-2035 on maturity			24,00,000	36,00,000	70,00,000

- The consideration under LIP X and Y will be exempt as the annual premium payable for these two policies does not exceed INR 500,000 for any FY during the term of these two policies.
 - The consideration received under LIP A, B and C will not be exempt, as the aggregate of premium payable for LIP X and Y for the FYs 2023-24 to 2033-34 is INR 400,000 and if any of LIPs A or B or C is added, then the aggregate of premium will exceed INR 500,000 during the above said FY.
- In the above example, in case the taxpayer does not claim an exemption under LIP X, then note the following:
 - The consideration under Y will continue to be exempt
 - Consideration received under LIP B will be exempt as well for the tax year 2034-35 since the aggregate of the annual premium payable for the LIPs Y and B together does not exceed INR 500,000 for any of the tax years during the term of LIP Y or B. Please note this exemption is made available as the taxpayer did not claim consideration under LIP X as exempt, and that LIP B is preferred for exemption as its more beneficial to the taxpayer when compared to LIP A or C.
 - Further, it was also clarified that the premium payable for a LIP shall be computed (for the purpose of computation of income chargeable to tax) exclusive of the amount of Goods and service tax payable on such premium.
 - Additionally, any sum received under a term insurance policy shall continue to be exempt irrespective of the amount of premium paid/ payable and such premium paid/ payable for term life insurance policies would not be counted for checking INR 500,000 limit.

Our comments

The notification along with the circular for guidelines clearly explains (along with relevant scenarios) the taxability of proceeds from LIPs issued on or after 1 April 2023, where the amount of premium payable for any of the years during the term of the policy/policies exceeds INR 500,000⁷.

⁷ Also, please refer to our flash news <http://www.in.kpmg.com/TaxFlashNews-INT/KPMG-Flash-News-Computation-of-capital-gains-on-amounts-received-under-unit-linked-insurance-policy.pdf> for taxability pertaining to ULIPs.

KPMG in India addresses:

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru

Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytila, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

2nd Floor, Block T2 (B Wing),
Lodha Excelus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi, Mumbai- 400011
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, N M Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

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