Technical

Friends Provident International

Guide to taxation in India

This guide looks at the tax treatment of an FPI policy for an individual who is Resident and Ordinarily Resident in India.

Residency Status in India

An individual's residential status in India could be classed as either:

- Resident and Ordinarily Resident; or
- Not Ordinarily Resident; or
- Non-Resident.

Where an individual is classed as **Resident and Ordinarily Resident** in any tax year they are subject to taxation in India on their worldwide income. Therefore, any gain received from a withdrawal or surrender of an FPI policy would be taxable in India.

The tests used to determine an individual's residential status are complex and outside of the scope of this guide.

Taxation of an FPI policy

For the purpose of taxation in India, the FPI policy is classed as securities and taxable as capital assets.

This means that providing the funds held within the policy are for personal investment and not business assets, on withdrawal or surrender the gain is taxable under the heading 'Capital Gains'.

Taxation while holding the policy

Friends Provident International Limited is based in the Isle of Man and no tax is payable by us on any income or gains that accumulate within the policy.

With the exception of any non-recoverable withholding taxes, for example on US share dividends, the policy will benefit from gross roll-up.

This means that for a Resident and Ordinarily Resident individual of India there would be no tax liability in India on the growth within the policy prior to making any withdrawals or on surrender, nor is there any tax liability when switching funds held within the policy.

Taxation when accessing benefits

It is possible to take withdrawals from the policy in a number of different ways:

- Regular withdrawals (withdrawals setup at a pre-determined amount / frequency)
- Partial lump-sum withdrawals (ad-hoc withdrawals when required);
- Full surrender (bringing the policy to an end), or surrender of segments.

It is only the gain arising that will be taxable and this will depend on how long the policy has been held:

- Gains arising within 36 months of ownership are classed as **short-term gains** and will be taxable at an individual's marginal rate of income tax plus any surcharge and the Health and Education Cess.
- Gains arising after 36 months or more of ownership will be classed as **long-term gains**. Individuals will be liable to tax at a flat rate of 20%, plus any surcharge and the Health and Education Cess.

To counter the effect of inflation, the cost of acquisition is indexed for long-term capital gains.

Taxation on Death

Estate duty was abolished in India in 1985. This means that the estate of the deceased does not pay any inheritance tax.

The tax position on the nominee / beneficiary, who receives the policy or policy benefits, will depend on the type of policy held and whether the last life assured has died resulting in a death benefit becoming payable.

- For a capital redemption policy, or where there is a surviving life assured the transfer of the policy ownership to a nominee / beneficiary is also not taxable in India. Any gain accessed when the new policy owner takes a withdrawal from or surrendering from the policy would be taxable as either **short** or **long-term gains**.
- Where the last life assured has died, the policy is unable to continue and must be surrendered and the proceeds paid out. In this case the sum payable is taxable as either **short** or **long-term gains** in the hands of the nominee.

Where the new policy owner receives the policy by succession or inheritance it may generally be possible for the new owner to include the period of ownership of the previous owners, when determining if short or long-term gains apply.

Gifting a policy

The FPI policy can be assigned as a gift. Where the fair market value of the policy exceeds INR 50,000, it would be taxable in the hands of the recipient. The taxable value of the gift is the difference between the fair market value and the purchase price of the policy, if any. Tax would apply at the normal progressive rates of taxation of the individual recipient.

An Indian resident recipient is exempt from any taxation in India if the gift was:

- Made to a family member who qualifies as a relative;
- Made on the occasion of marriage;
- Made under a will;
- Received by way of inheritance;
- Made in contemplation of the death of the donor.

Where the assignment of the policy is between two individuals that are both resident in India, or from a resident individual to a person that is resident outside of India, the transfer of the policy may require prior approval of the Reserve Bank of India (RBI).

FPI are not responsible for checking that any required approval from the RBI has been obtained before transferring the ownership of the policy.

Disclosure of Foreign Assets

There is a requirement, on an annual basis, for an individual that is classed as a Resident and Ordinarily Resident to disclose details of Foreign Assets held on their Income Tax Return form. In relation to the FPI policy, this could include:

- Name and address of the financial institution where policy is held
- Date of acquisition of the policy
- The cash or surrender value of the policy
- Total gross amount of premiums paid to the policy during the relevant period

Important Notes

For financial advisers only. Not to be distributed to, nor relied on by retail clients.

Please note that every care has been taken to ensure that the information provided is correct and in accordance with our current understanding of the relevant law, as at December 2023.

You should note however, that we cannot take on the role of an individual taxation adviser and independent confirmation should be obtained.

FPI cannot accept any responsibility for any action taken or refrained from being taken as a result of this information.

FPITECH020a 01/24