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An Estimate of GST Implications on Insurance Sector in India

Dr. Tina Murarka

Assistant Professor (Finance)
Xavier Institute of Social Service, Ranchi-834001
E-mail: teenamurarka@gmail.com

Background—Goods and Services Tax, popularly known as GST, is a reform for our economy's indirect tax plan. On 8th August 2016, GST Bill (which was long pending) was passed in Lok Sabha. It was possible after a very long journey flooded with challenges, confrontations, and what not. At last, the GST bill has entered the phase of implementation, which will come into effect from July 1, 2017. GST would make changes in the tax structure between the center and the state. GST is a VAT, i.e. Value Added Tax that will eradicate the cascade effect/ double taxation from the price of goods and services down the value chain. It would surely affect the incidence, structure, and calculation of the indirect taxes, which will lead to a comprehensive refurbishment of the current tax system in India.

GST will unify at least 10 types of indirect taxes into one tax, to be collected at federal and state levels. Under the existing structure, at each point of sale, additional taxes are applied to the after-tax value of goods and services. The main purpose of GST is to eliminate this compounding effect by fixing a final tax rate where goods and services will fall under one of the four tax categories - 5 per cent, 12 per cent, 18 per cent and 28 per cent brackets.

The primary beneficiaries of GST will be businesses (manufacturers, retailers, traders and more) for whom a uniform market across India would open up a window of opportunities. A uniform regulation across the country is expected to make compliance easier. It will also lead to cost savings, and the benefits will flow to end customers in the long run as far as reduced pricing is concerned.

The Indian life insurance industry has come a long way indeed, especially in the last decade. Back in the day, people viewed insurance primarily as a tax planning and investment tool, something that people thought gave better returns while saving on pesky taxes.

In a country like ours, where social security doesn't exist and one cannot boast of viable retirement schemes, seeking protection for the future becomes a compelling preoccupation. And that is where buying insurance comes into play.

Of the four GST slabs—5%, 12%, 18%, 28%—insurance falls under the 18% slab, as against the previous service tax of 15%. The increase in indirect taxation is contrary to the positive measures that have been taken over the last few years to develop this sector. Governments across the world, even in the more mature markets, are known to make conditions favourable for insurance protection. In many countries, life insurance is outside the purview of GST. In a few, cash flow system is followed for general insurance, e.g. in countries like Australia, Singapore, and South Africa. For the latter, tax is charged on the premiums received and credit is allowed for claims that are paid.

Under the GST regime in India, taxability on the gross premium for pure risk policies is contrary to the principle of taxing the "value addition". GST is a tax on value addition and net premium after deduction of claim is the net value addition. It is very difficult to segregate the "savings" component and find a "value" that could be treated as the proper base for tax, particularly for every premium transaction during the life-cycle of an insurance policy. We have witnessed impressive growth in this sector so far, but there needs to be a sustained effort to retain the growth momentum. Imparting financial literacy, incentivizing Indian households to transfer savings from physical assets to financial assets and taking the distribution network to rural areas are expected to help bring more individuals under the insurance blanket.

The coming years are critical as the policy and regulatory environment and consumer response will govern the growth and stability of this industry. Buying insurance will continue, provided insurance companies have the right kind of solution-based selling approach and to that extent, a favourable indirect taxation structure would have helped. Insurance companies in India have strived hard to create financial awareness and increase insurance penetration in the country. As the country strides into a new economic phase, we hope that the industry gets the attention and support that it rightfully deserves.

Some Reviews:

Before embarking upon the research study the researcher made an attempt to review the literature on the subject. Since the research area chosen for the study being concept of 'GST and its impact on insurance sector', the researcher reviewed the reports of various committees appointed by the Government of India from time to time and contribution of tax experts by way of books and research articles. The important and few of them are presented here

Kelkar Committee (2002): The Direct and Indirect Tax reforms committee was set up the Government of Indian in July 2002 under the chairmanship of Dr.Vijay L.Kelkar In 2003, the Kelkar Task Force on indirect tax had suggested a comprehensive Goods and Services Tax (GST) based on VAT principle. In 2004 Vijay Kelkar, then advisor to the Finance Ministry, recommends GST to replace the existing tax regime. February 28, 2006: GST appears in the Budget speech for the first time; Finance Minister P Chidambaram sets an ambitious April 1, 2010 as deadline for GST implementation. He says the Empowered Committee of finance ministers will prepare a road map for GST.

Empowered Committee of State Finance Ministers constituted: April 30, 2008: The Empowered Committee submits a report titled 'A Model and Roadmap Goods and Services Tax (GST) in India' to the government.

Dasgupta committee 2009: Finance Minister Pranab Mukherjee announces basic structure of GST as designed by Dasgupta committee; retains 2010 deadline.

Ahmad E. & Poddar (2009) authors in the paper have discussed the proposed GST to be introduced in India, specifically in relation to the place of supply rules for services to be adopted, the method to apply dual GST i.e. how would the GST operate between states and the center, the tax rate to be applied etc. The authors have discussed the options to introduce the dual GST in India which could be Concurrent Dual GST, National GST or State GST. Under the concurrent dual GST the better option was the one where GST is applied on both goods and services. The other option explored was where the Central GST would be on goods and services but state GST would be only on goods since state to collect GST in services is difficult to determine.

Benedict, (2011) studied the provisions dealing with financial services under the Australian GST law with the intention to verify whether the provisions have been construed correctly in light of the original purpose of the legislation and how the concerns identified may be rectified. The author also examines the provisions followed in Australia to tax financial services provisions and whether the intention of the legislature in taxing the financial services is apposite. Through the paper the author has shown how clear-cut drafting of the said provisions has resulted in literal interpretation of the same by Courts and has therefore resulted in frustration of the legislative intention behind the provisions.

Analysis of impact of GST on Insurance Sector:

On July 1st 2017 the most awaited and historic change to the Indian Taxation system was made with the introduction of the Goods and Services Tax (GST). So far, many speculations have been made regarding the effect of GST on day to day necessities as well as luxuries. This article discusses the effect of GST at a glance on the insurance premiums of Top 5 Insurance Plans. For instance, if you have bought an insurance policy for 2 purposes namely, insurance and investment, only that part which provides life cover will be liable to be taxed under GST. Let's take a look on the impact GST will have on insurance premium based on different types of insurance policies:

The Premium Deciding Factor: Basically, the premium deciding factor of an insurance plan is subject to the insurance plan type you want to purchase. Based on that, we have two major categories of insurance policies.

Life Insurance

General Insurance

Life Insurance:

Unit Linked Life Insurance Plans

In these plans the insurance part and the investment part are categorized clearly and GST will be levied only on the risk cover part. The investment part will not attract any taxation under GST.

In ULIPs, every month or quarter, these charges are commonly recuperated through liquidation of reserve units. Also, risk cover charges increase with an increase in age. Also, fund management charges increase with corpus.

Along these lines, it may not be as simple to evaluate the correct effect however, there is still a marginal increase since GST is 18% and Service Tax including cess was 15%.

Term Life Insurance Plans

Life Insurance plans only serve 1 purpose and that is risk cover and since GST will be levied on the part which goes towards risk cover hence, the entire premium will be taxed under GST. The service tax was levied at the rate of 15% however 18% GST will now be charged which leads to a 2.61% marginal increase in rate of taxation.

For Example: You have taken a life insurance policy whose annual insurance premium is ₹20,000. Under service tax you would have paid premium of ₹23,000 i.e. ₹20,000 + ₹3,000 (15% of ₹20,000). However under GST you'll be paying ₹23,600 i.e. ₹20,000 + ₹23,600 (18% of ₹20,000), thereby, effective increment in the premium will be 2.61%.

Traditional Life Insurance plans – Recurring Premium

These plans serve a dual purpose i.e. both insurance as well as investment, however, GST will only be charged on the Insurance premium towards risk cover. But it is difficult to categorize between the insurance and investment portion in the entire premium and thus, the categorization is done in the following manner whereby the premium paid in 1st year is different than the premium paid in the subsequent years:

i) For the 1st Year, GST is charged on 25% of the insurance premium which is going to be 4.5% (25%x18%) which earlier used to be 3.75% under Service Tax.

ii) For the subsequent years, GST will be charged on 12.5% of the insurance premium which is going to be 2.25% (12.5%x18%) which earlier used to be 1.875% under Service Tax.

Traditional Life Insurance Plans - Single Premium

For single premium traditional life insurance plans, 18% GST is going to be levied on 10% of the annual premium paid.

For instance: ₹5 Lakhs is the base premium, then the GST amount to be paid is 1.8% i.e. (10% x18%) of the premium amount which comes to a total of ₹5.09 Lakhs however if the same was to be paid before July 1st under the Service Tax regime then a Service Tax would have been 1.5% i.e. (10%x15%) of the premium that is ₹5,07500, which shows a minimal increase of 0.30%.Impact of GST on Non-life Insurance Premiums

Non-life insurance premiums can be health policies, home insurance, or motor insurance. For these policies, you pay the premium that will be used to compensate the loss as and when you encounter it.

Under the current regime, all non-life insurance policies are charged at 15 percent of the service tax. So this will also go up by 3 percent, meaning the new rate will be as high as 18 percent.

General Insurance :

Health Plans

As of now, the health insurance policies (standalone as well as a family health plan) charge 15 percent as the service tax on the premium. After the updated GST is implemented, the medical insurance plans would be costlier such as mediclaim policy for senior citizens. It would attract an increase of 3 percent in its tax regime, making it 18 percent that will be charged on the premium from 1st July 2017.

Travel Insurance

Those who are looking forward to traveling abroad anytime soon will also have to pay an additional tax of 3% as the new GST will be in effect from July 1. The customer will now have to pay 18% GST instead of 15% service tax earlier in effect. So, if you don't want to pay more money than buy or renew travel insurance before 1st July 2017.

Automobile Insurance

Automobile insurance premium includes 15 percent as the service tax. It will be hiked to 18 percent when the tax rate is frozen up to this particular percentage. If you are die heart fan / lover of your car & two wheeler then it's best time to renew your policy with insurance companies so that you can save your money & plan to travel somewhere with your family.

The Relationship between the GST Rule and Insurance Business

The insurance policies' premium represents two components- savings and risk coverage. The service tax is levied specified only on the premium component. According to the GST rules, the value of service on which the GST is levied regarding the life insurance sector shall be accordingly.

The gross premium would be reduced by the amount allocated for or savings or investment on policyholders' behalf.

When it comes to the single premium annual policies, ten percent of the single premium would be charged from the policyholder.

In other cases, 25 percent of the premium for the first year and 12.5 percent of the premium in the upcoming years will be charged. For example, if an endowment plan's premium is Rs. 100, then the 18 percent GST would be levied on the 25 percent of premium (which would be Rs. 25) the GST would be Rs. 4.50.

In case the total premium paid by the policyholder is towards the life insurance's risk cover, only the 18 percent GST would be levied on the total premium.

Because of the increased GST percentage that awaits the implementation. The overall impact of the GST would be the increased expenditure (premium and the increased GST), when it comes to term insurance and endowment plans.

The policyholders stand a chance to be benefited if the insurance providers get a green signal on the input tax credit benefit. Unfortunately, as of yet, it is still unclear since the center/state GST structure is very complex. It might create confusions and conformity for the insurance buyers and increase the administrative expenses for the insurance providers. If the insurance buyers remain confused about the GST update, then irrespective of the increase or decrease in the prices, the solvency of the market along with the financial strength will be adversely affected.

The general insurance sector will be equally impacted. The overall outgo for health, car, and various non-life plans would be increased by 3 percent.

Post GST implementation, the existing and new insurance buyers would have to bear the updated prices. For example, the current insurance premium of a term plan is Rs. 10,000, (without the 15 percent service tax) the updated GST will increase the premium comprising taxes by Rs. 300. It means from Rs. 11,500, it will be changed to Rs. 11,800.

When you compare insurance premiums, especially for the term plans ensure that you look out for the premiums including or excluding GST by the various insurance providers. There should be no changes in the selection process, as the GST impact is the same for all the insurance providers. Follow a proper selection process in order to get the right insurance plan that offers you maximum coverage and fulfills your insurance expectations.

The following table will help us to get a better understanding of how the updated GST impacts the various insurance products and to which extent.

Table: Revision in Premium Rate after GST

Nature of insurance policy	Rate before GST	Rates after GST
Pure risk insurance/term insurance	15%	18%
ULIPs	15%	18%
Annuity: single premium	1.5%	1.8%
Motor insurance	15%	18%
Endowment policies (1st year)	3.75%	4.5%
Endowment policies (2nd year onwards)	1.88%	2.25%
Health insurance	15%	18%

Findings and Suggestions

Insurance industry is positively affected after the implementation of demonetization and GST. Sale of single premium policy have increased as the customers wants to invest money in bulk. Thereby there is an increase in growth of business. Agents dealing with premium customers have a positive impact as their commission rates were increased compared to sales before demonetization and GST. Agents dealing with middle and low income earning customers were slightly affected as there is an increase in the premium amount some customers were not willing to purchase policies. So the commission of those agents decreased. In order to increase the Life insurance policy sale, new policies have introduced according to the current market scenario. Rural areas are slightly affected because most of the customers are middle or low income earners. Most of the insurance agents are full time agents.

Conclusions

Due to unstable environment of Indian economy, it is demand of time to implement GST. Consumption and productions of goods and services is undoubtedly increasing and because of multiplicity of taxes in current tax regime administration complexities and compliance cost is also accelerating. Thus, a simplify user -friendly and transparent tax system is required which can be fulfilled by implementation of GST. he insurance industry is also not going to remain unaffected from its impact. It will certainly have an impact on the insurance industry as well as policyholders. Typically, policyholder's pay service tax on the risk element of the premium component whereas the investment element of the policies is usually out of the service tax scope. With the implementation of the GST, insurance policies including life, health and motor will all be costlier

Insurers need to ensure that their GST implementation plan achieves the key objectives of zero business disruption and 100% compliance. One of the critical success factors for a business to smoothly transition into the GST regime would be process-readiness and technology-readiness to take on not only higher compliances, but also transaction-level reporting — a novel concept in the prevalent indirect tax regimes. Gearing up to ensure that all transactions are appropriately mapped and measured would be essential. The GST regime is likely to throw up interesting opportunities and challenges for insurers. They need to consider GST as a business transformation lever to strengthen their present business processes, identify opportunities and have a first mover advantage.

Though the impact of GST on insurance products, premium hike is nominal, the increased insurance premiums seem too much for a major section of policyholders.

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