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Full GST exemption on health and life insurance premiums proposed: While insurers may hike premium, post tax cost for consumer is likely to come down

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Synopsis
The GST Group of Ministers has proposed exempting health and life insurance premiums from GST, a move intended to make insurance more affordable. However, experts warn that entirely eliminating GST could remove input tax credit benefits for insurers. This could increase insurers' overall expenses, potentially leading to higher premiums for policyholders, effectively negating the intended affordability. However, the post tax premium is likely to come down.

In all likelihood, exempting life and health insurance policies from GST levy will drive up premium prices

The GST Group of Ministers (GoM) has today proposed to completely exempt premiums paid towards health and life insurance policies from the GST levy, ET reported. While this may seem like a great move to make insurance-related products more affordable for Indians, the final decision rests with the GST Council.

However, this may not spell great news for policyholders, as this move could only mean slightly lower post-tax premiums for them. Read on to know more about how slashing GST on health and life insurance premiums to zero could bring some respite to policyholders, and potentially serve the purpose of making insurance more affordable for Indians.

Says Pankaj Goel, Partner with Chartered Accountant firm, CNK, "Rationalising GST on insurance is a progressive step that will enhance affordability and strengthen social security. Exempting premiums will make health and life cover more accessible, especially for the middle class. It shall lower the cost of insurance and will marginally increase the disposable income. While there may be a short-term revenue impact for the Government, the long-term social and economic benefits of higher insurance penetration may compensate for it".

What is the current rate of GST levied on insurance premiums?

At present, GST is levied at the rate of 18% on both health and life insurance policy premiums. This means that if you buy a life insurance policy which has a premium of Rs 100, at 18% GST, you will have to pay Rs 118 while purchasing the policy.

This 18% GST comes with input tax credit advantages. Under GST, businesses (in this case, insurers) can reduce their taxable liability by offsetting and claiming credits to the tune of GST they have paid on goods and services they utilised.

Naturally, the insurer incurs other expenses as well, such as maintaining an office, commission to agents, marketing expenses, etc. Since they are paying GST on all these activities as well, the government allows them to claim credits against the GST they have collected from policyholders and reduce their overall tax liability.

So, say the insurer charges Rs 100 as a premium for the purchase of a life insurance policy, on which 18% (Rs 18) is charged as GST. Your post-tax cost comes out to be Rs 118. Assume that out of the Rs 100 that the insurer received as premium, it sets aside Rs 30 to pay office rent and Rs 40 to pay commission to agents. The overall expense becomes Rs 70 (Rs 40 + Rs 30). Remember that it has to pay GST at the rate of 18% on both of these. Hence, the total GST paid by your insurer comes to Rs 12.6 (18% of Rs 70).

The insurer uses this as an input tax credit, which is adjusted against its own GST liability. Therefore, the insurer sets off this Rs 12.6 GST liability against the GST of Rs 18 that it has collected from policyholders. After adjusting the input tax credit, the net GST liability for the insurer comes down to only Rs 5.4.

What happens if the GST levy is done away with?

According to experts, in the absence of GST from customers, ITC credits will also likely be eliminated, unless the government takes action otherwise. Hence, insurers would still have to incur Rs 12.6 worth of GST expenses per Rs 100 of premium, but would have no GST collected from policyholders (Rs 18) to set it off against. As a result, they will have to make necessary changes in their finances to absorb this additional GST burden, which may result in increasing the pre-tax premium.

However, in case both health and life insurance premiums payments are classified as zero-rated, or nil, the post tax insurance premium for consumers would come down, since ITC credits would still be available to insurers.

The amount of benefit to policyholders will depend upon how much of this Rs 12.6 is passed on to policyholders and how much the insurers are able to absorb.

In the event that the insurer decides to pass on the entire burden to the policyholder, the premium in our example may increase to Rs 112.6, resulting in a post-tax premium of Rs 5.4, compared to Rs 118 paid earlier.

Mr. Alok Rungta, MD & CEO, Generali Central Life Insurance, says that since life insurance is fundamentally a product of protection, removing the tax burden will directly ease costs for customers. "For example, on a premium of ₹100, customers currently pay Rs 118 after GST. With the exemption, the tax component will drop to zero, and the full benefit will be passed on to policyholders. Since the tax is disclosed separately in premium receipts, customers will clearly see the reduction in their total payable amount", he adds.

However, the post-tax savings on premiums could be higher if insurers are able to absorb some amount of input tax credit.

Explains Hemik Shah, Co-Founder Qian Insurance, "to determine if a reduction in GST rate will help policyholders, we will have to first determine whether health and life insurance services are going to be considered as Nil Rated or will they be considered as exempt from GST. The answer to this will determine the eligibility for input tax credit. In case the services are considered as exempt, then input tax credit will not be available, and therefore, the savings on account of GST rate reduction will be negated by the hike in premiums due to unavailability of credit"

However, he further adds that if the health and life insurance services are classified as zero-rated or nil-rated, then credit will be available and can be used to set off the GST liability of other lines of business. "In the absence of ITC, it seems unlikely that insurance companies will be able to pass on the benefits. This is because unavailability of credit will make the GST on goods purchased and services availed a cost for the insurance companies, which in turn may lead to a hike in premiums to maintain profitability and solvency for the insurers", he says.

Anandaday Misshra, Founder & Managing Partner, AMLEGALS, concurs. "The core challenge lies in a critical fiscal technicality, i.e a full exemption would prevent insurance companies from claiming Input Tax Credit (ITC) on their expenses. This could create a counterintuitive outcome, where insurers' operational costs increase. The proposal's true test lies not in its intention but in its execution.* It necessitates rigorous regulatory oversight to ensure the full benefit is transferred to the policyholder. The ultimate impact remains complex, balancing the profound goal of establishing financial security as a public good against the fiscal realities of the GST framework.

Sudipta Sengupta, Founder & CEO, The Healthy Indian Project, also emphasises that the extent to which the benefit is transferred to policyholders will largely depend on ITC. "Unless input tax credits (ITC) are reinstated, the insurers may be forced to adjust pricing to offset their unrecoverable costs. This could dilute the intended benefit for end-users. The GST Council must balance consumer relief with industry viability. Done right, this reform can be a game-changer in bridging India’s alarming protection gap".

However, Ayush Patodia, Associate Vice President, Avalon Consulting, says that removing ITC and thereby eroding margins for insurers is the kind of push the insurance industry really needs. "Most of the marketing expenditures are skewed towards urban cities and the affluent class, while the underserved population remains neglected. By becoming leaner - trimming wasteful advertising, leveraging digital initiatives (digital underwriting, e-KYC, telemedicine), innovating with microinsurance, exploring partnerships (e-commerce, cooperatives, MFIs, etc.) – insurance companies can expand distribution reach into underserved markets".

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