



ULIP vs ELSS: 5 Ways in Which they Differ

The two products are often confused because both are tax saving instruments. Here's what you should know before putting your money in either:

1. Ulip vs ELSS

Ulip is insurance cum investment product sold by insurance companies. Ulip investors have the option to invest in equity, debt, hybrid, and money market funds. The minimum sum assured is 10 times the annual premium (seven times if age of entry is above 45 years). On the other hand, ELSS, or equity linked saving schemes are diversified equity funds that invest in stocks. These are pure investment instruments and don't offer any insurance. The confusion between the two is probably because both make investments in equity markets and are tax-saving instruments. However, one should be clear about one's objective and not mix insurance with investment.



2. Charges & Transparency

ELSS funds have only one charge, which is the fund management fee or expense ratio. This is a maximum of 2.5% and the cost is adjusted in the NAV of the scheme, not charged separately. This means that you know exactly how much amount was invested and can calculate your return, leading to high transparency in transaction.

In Ulips, almost 60% of the charges are incurred in the first few years, including the premium allocation charge (percentage of premium for charges before allocating units, initial and renewal expenses and agent commissions); mortality charge (insurance cost); fund management fee; policy administration charge; fund switching charge and service tax deduction. The remaining money is invested in the market. As the charges start reducing only after 3-4 years, the investment and, hence returns will be very low. To get good returns, you need to stay invested for at least 10-15 years. The transparency is low since you do not know the exact amount being invested. Also, some charges are levied by reducing the units, not deducting from NAV, further reducing transparency.

3. Tax Treatment

Both instruments are eligible for deduction of upto Rs 1.5 Lakh under section 80C. ELSS funds follow the EEE mode, wherein investment, capital gains and maturity amount are tax free. This is because you are locked in for three years, resulting in long term capital gains, which invite zero taxation for equity investment.

As for Ulips, if you surrender before the lock in period, any deduction claimed earlier is reversed and you have pay tax. The maturity amount is tax free only on death of the policyholder. If the premium is more than 10 % of sum assured, the maturity proceeds are added to the insured's income and taxed at applicable rate. If the premium is more than 10 % of sum assured and the proceeds for a year exceed Rs 1 Lakh, tax of 2% is deducted at source.



4. Lock in period

Ulip have a lock in period of five years, whereas in ELSS, your investment remains locked for three years. This means that if you exit before this period, you will have to surrender charges in case of Ulip. This is usually calculated as a percentage of fund or annualized premiums. It is higher if you quit early and keeps getting lower with time. In ELSS funds, since you cannot withdraw before three years, no exit load is applicable. However, it is not advisable to quit Ulip or an ELSS fund even after the lock in period because equity investment gives the best returns in the long term of 7-10 years. In case of Ulip, this period is ideally 10-15 years.

5. Switching Option

Ulips offer a switch option, which means that you can alter the ratio of invested amount in different funds (equity, debt, hybrid, etc). This allows you to shift your funds as per the risk exposure at different life stages. So while you are young, you can have a higher amount in equity, but with age you can shift to debt. You can also switch out of equity if you expect the markets to fall. Remember, however, that there may be a limited number of free switches. In the case of ELSS, there is no such option and you can't touch the investment before the lock in period. However, you can opt for the dividend option to ensure periodic booking of profits.

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