Advantage MFs after tax blow on MLDs, insurance

Investors may divert flows towards debt funds, say experts

ABHISHEK KUMAR
Mumbai, 2 February

The ₹40-trillion mutual fund (MF) industry is expected to benefit from stripping of tax advantages to high-ticket insurance products and market-linked debentures (MLDs) in the latest Budget.

"With the attractiveness of MLDs and big-ticket insurance investments diminished, HNIs may allocate more towards debt mutual funds," said N S Venkatesh, CEO of the Association of Mutual Funds in India (Amfi).

"Mutual funds would benefit from the change in the taxation of insurance products and MLDs. Limits on capital gains on real estate investment also augurs well for debt funds," said A Balasubramanian, managing director and chief executive officer, Aditya Birla Sun Life AMC.

In the latest Budget, the government has proposed higher taxes on MLDs by imposing a short-term capital gains tax, irrespective of the investment time frame. As of now, investments in MLDs for more than a year qualify for long-term capital gains tax at 10 per cent. With the change in taxation, investors will have to pay tax at their slab rate, which can be as high as 30 per cent.

ILLUSTRATION: BINAY SINHA

MLDs A POPULAR OPTION

₹1.2 trillion*: Listed MLD market

Top 5 MLD issuers** (₹ crore)

Issuer	₹ crore
DME Development	5,000
Bharti Telecom	3,800
IIFL Wealth Prime	2,400
Shriram Finance	2,361
Provincial Finance & Leasing	1,503

*Issuances not yet matured **Jan-Dec 2022
Source: primedatabase.com

But, this may not be the end of the road for MLDs, feel analysts. "MLDs may have lost the tax advantage but remain a unique offering. These are still one-of-a-kind quasi-equity products that come with downside protection," said Dhaval Kapadia, director, portfolio specialist, Morningstar Investment Adviser India.

For insurance, the government has removed tax exemptions for policies with premia of over ₹5 lakh.

MLD is a structured product that provides returns based on the performance of an underlying index or security. Since most MLDs offer principal protection, they are deemed to be a fixed-income investment option. As MLDs require a minimum investment of ₹10 lakh, their investors are mostly HNIs. The tax structure is now more attractive for debt MFs when it comes to low-risk investments.

"This provision effectively removes the tax arbitrage that was enjoyed by MLDs. This move is likely to be advantageous for debt mutual funds as investments held in these schemes for more than 3 years are taxed as long-term capital gains at 20 per cent with indexation benefits," said Vishal Chandiramani, managing partner-products & COO, TrustPlutus Wealth.