Where Am I In The Tax Bracket?

According to the Income Tax Act 1961, Income Tax is a tax imposed by the Government of India on any one who earns income in India. This income is not limited to income earned within the geographical boundaries of the country i.e. certain incomes are also deemed to have been earned in India although they might have been earned outside the country.

Every person, who is an assessee and whose total income exceeds the maximum exemption limit prescribed, shall be chargeable to the income tax at the rate or rates prescribed in the Finance Act. Such income tax shall be paid on the total income of the previous year in the relevant assessment year i.e. An individual files his/her return for the income earned in the previous year (FY 2007-08) in the AY 2008-09.

Taxes are collected by three means: a) Tax Deducted at Source (TDS) on your behalf from the payments received by you b) Tax Collected at Source (TCS) on your behalf at the time of spending c) Voluntary payments like Advance Tax and Self Assessment Tax into various designated banks.

"**Paying** Income Tax every year is mandatory but proper **planning ensures** we not only **save Tax** but invest keeping in mind our **future requirements**."

WHERE AM I IN THE TAX BRACKET?

The rates of Income Tax and corporate tax and the applicable tax deductions are available in the Finance Bill (commonly know as Budget) passed by Parliament every year. Everyone who earns an income falls under a 'tax bracket'. It is important to keep in mind that your 'taxable income' or income after allowable deductions defines your tax bracket which could actually be lower than the amount of money you have earned in the previous year.

The current income tax law has 4 tax brackets, which are as follows:

Limit	Tax Payable
Upto Rs. 1,60,000	NIL
Rs. 1,60,001 - Rs. 3,00,000	10%
Rs. 3,00,001- Rs. 5,00,000	20%
Rs. 5,00,001 - Rs. above	30%

1. In the case of a resident woman below the age of 65 years, the basic exemption limit is Rs 1,90,000
2. In the case of a resident individual of the age of 65 years and above, the basic exemption limit is Rs 2,40,000
3. Surcharge is applicable @10% only when taxable income exceeds Rs 10, 00,000 a year
4. Education cess is applicable @3% on tax payable

"You can **'move'** to a **LOWER tax bracket** by investing in a tax saving instrument. **How**?"

READ ON.........

How Much Tax Can You Save??

HOW MUCH TAX CAN YOU SAVE??

The Government made tax planning a lot simpler for an investor with the introduction of Section 80C (2). This section includes all 'tax deductible' individual saving instruments under one umbrella along with a simple rule – Invest upto Rs 1,00,000 in a tax saving instrument or a combination of them and you can deduct the invested amount from your gross taxable income. This means that you can save upto Rs 30,900 for those earning Rs 6, 00,000 – Rs 8, 40, 000 a year which is more than 3.5 % of your annual income.

Your Annual Taxable Income (Rs.)	Your applicable tax before investment (Rs.)	Amount invested under Section 80C (Rs.)	Your 'new' taxable income (Rs.)	Your applicable tax after investment (Rs.)	Your Savings (Rs.)
2,50,000	10,300	1,00,000	1,50,000	0	10,300
3,60,000	27,810	1,00,000	2,60,000	11,330	16,480
4,80,000	52,530	1,00,000	3,80,000	31,930	32,960
6,00,000	87,550	1,00,000	5,00,000	56,650	30,900
7,20,000	1,24,630	1,00,000	6,20,000	93,730	30,900
8,40,000	1,61,710	1,00,000	7,40,000	1,30,810	30,900
12,00,000	3,00,245	1,00,000	11,00,000	2,66,255	33,990

Note: Calculations based on income slabs for Financial Year 2008-09. Tax amounts indicated include 3% educational cess on the tax payable and a 10% surcharge on total tax if income exceeds Rs 10 lakh a year. It is assumed that the total taxable income specified above is after considering all other deductions – except those under Section 80 C(2) of the Income Tax Act. The above example is for illustrative purpose only.

Section 80C (2) offers a wide range of tax saving options and some popular ones are listed below:

- Employee Provident Fund (EPF)
- Public Provident Fund (PPF)
- Life Insurance Policies
- Pension Funds
- National Saving Certificates (NSC)
- Senior Citizen's Savings Scheme (Over 5 years)
- Equity Linked Saving Schemes (ELSS)
- Infrastructure Bonds
- Housing Loan Payments
- Fixed Deposits (Over 5 years)
- Post Office Term Deposits (Over 5 years)

How Do I Pick The Right One?

HOW DO I PICK THE RIGHT ONE?

As mentioned earlier Section 80C (2) gives you the option to invest upto Rs 1, 00,000 in a tax saving instrument or a combination of them and deduct the invested amount from your taxable income. These can include long term commitments like Life Insurance premiums and Home Loan payments or in the alternative you can choose to invest for your future. The best option is the one which combines the benefit of saving and provides for your future requirements while keeping in mind your investment horizon, return on investment, attached risk and investment amount.

Let us take a look at the tax saving instruments according to investment type:

1. **Guaranteed Return Options (NSC, PPF, Infrastructure Bonds, Senior Citizen's Saving Schemes, Post Office Term Deposits and Fixed Deposits)**

   These options earn a guaranteed or 'fixed' rate of interest every year (or every 6 months in the case of NSC). These options are generally considered 'safe' as they are backed by government or reputed financial institutions / banks but they are NOT safe from inflation in the long term! The returns from these investments currently are in the range of 6 – 10 % while inflation ranges between 3 – 5 %. The returns / interest received from them are taxed so the effective returns from such returns are not much.

2. **Life Insurance Policies**

   They generally return a pre-determined amount on maturity with the exception of unit linked plans. However insurance policies are primarily an option to provide you cover with the return on investments being a secondary factor. In such unit linked plans a certain percentage of the premium amount goes to providing you insurance cover while the remaining amount is invested to provide you return. This dual facet of insurance effectively reduces the growth potential of your investment. Insurance is a must for any individual but should primarily be used only for life cover rather than as an investment tool i.e. Pure Term Life Insurance Plans providing only risk cover to an individual.

3. **Equity Linked Saving Schemes (ELSS)**

   Equity Linked Saving Schemes invest majority of their assets in equity markets providing investors an opportunity to access equity market returns. Investments in such schemes are locked for 3 years so that the fund manager can take a long term view on investments. Dividends and Long Term Capital Gains from such schemes are tax free so the post tax returns from such schemes are comparatively better than 'fixed return' options.

The ELSS Advantage

The ELSS Advantage – Save TAX and do much more

Equity markets are known to be volatile and many investors have stayed away for fear of losing their money due to a downturn in the markets. Although the wealth creation potential of equity markets over a long term cannot be denied.

If you are willing to invest money for the long term (mandatory 3 year lock in period) and have the risk capacity to ride the ups and downs of the equity market then ELSS or Equity Linked Saving Schemes are an ideal option. Equity Linked Saving Schemes are similar to Diversified Equity Funds in a way that a majority of the investments are in the equity market however the fundamental differentiator is the 3 year lock in period and tax benefit of ELSS funds.

Tax Benefit

Investors can invest upto Rs 1, 00,000 in an ELSS fund and deduct the investment from their taxable income i.e. effectively reducing their tax liability. An added bonus for investing in an ELSS fund is that any income in the form of dividends received is tax free in the hands of the investor. Even the long-term capital gains arising are exempt. This means that post-tax ELSS returns are comparatively better than 'fixed return' options.

Think Long Term

Investments in ELSS funds are locked in for 3 years if you want a tax benefit. The lock in period ensures that short term market volatility is ignored and focus is only on creating wealth in the long term. The fund manager uses the lock in period to invest with a medium to long term perspective and does not worry about managing cash for potential daily redemptions. This stability in the ELSS funds and focus by the fund manager helps in improving the returns from the scheme.

Liquidity

As mentioned above, units of ELSS funds have a 3 year lock in period from the date of allotment of units. The units can be redeemed i.e. sold after the 3 year period at the applicable Net Asset Value (NAV) on a business day.

Options

There are usually 2 options available in ELSS funds – Dividend and Growth, with some fund houses also offering a dividend re-investment option. Dividend Option is for investors who are in need of regular income from their investments (although dividends are paid out if distributable surplus exists), while growth option is ideal for long term investors who would like to realize the true potential of their investment and receive market linked returns over the 3 year period. Dividend reinvestment option is when the dividend announced by the fund house for distribution is reinvested, and instead of receiving money the investor receives additional units of the scheme which is again reinvested (lock in) for a period of 3 years.

Any Risk

ANY RISK?

All ELSS funds invest predominantly in equity and related instruments so an inherent risk exists. A sustained fall or a bearish phase in the market may result in a drop in the fund value at the end of the three-year term. However the investor may to an extent minimize this fall in fund value by postponing the time of exit.

Investors need to keep in mind that equities tend to perform better than other asset classes over the long term and should invest only after keeping the risk factors in mind. A thorough research on the performance and pedigree of a fund house and its ELSS offering over different time periods ensures that this risk is minimized to an extent.

ELSS vs. other Tax Saving Options

4 REASONS TO CHOOSE ELSS VS. OTHER TAX SAVING OPTIONS

1. A lower lock-in period of 3 years compared to other tax saving options
2. Investments in equity over a long-term (i.e. more than 5 - 7 years) have historically delivered better returns than 'guaranteed return' tax saving options*
3. Dividends and Long Term Capital Gains are tax free
4. Lower Entry Barrier to invest
   - Can invest as low as Rs 500 in an ELSS (a lumpsum investment) or every month through a Systematic Investment Plan (SIP), and
   - Lower entry load for any equity-linked product i.e. generally around 2.25% (For Direct Investment the Entry Load is NIL)

Returns of Tax saving options like

- PPF with a 15 year lock-in is 8.5% (compounded annually),
- NSC with a 6 year lock-in is 8% (compounded half yearly)
- Nationalised Bank's Tax Saving Fixed Deposit with a 5 year lock-in is generally around 8.5%
- ELSS Category with a lock-in of 3 years has delivered average returns of 10.22% (in 5 years)
  Source: ICRA Online (Past Performance may or may not be sustained in the future)
  (Performance as on December 30, 2008)

Note: ELSS are equity based funds which provide you an opportunity to access market linked returns, hence an inherent risk exists compared to Guaranteed Return Options like PPF, NSC and Bank Deposits which offer lower returns but are assured.

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* Returns of Tax Saving options like PPF with a 15 year lock-in is 8.5% (compounded annually), NSC with a 6 year lock-in is 8% (compounded half yearly) and Nationalised Bank's Tax Saving Fixed Deposit with a 5 year lock-in is generally around 8.5%. The ELSS Category with a lock-in of 3 years has delivered average returns of 10.22% (in 5 years). Source: ICRA Online. (Past Performance may or may not be sustained in the future). The performance indicated is as on December 30, 2008.

"ELSS have given better returns than Guaranteed Return Tax Saving Options"

SIP – A Boon For Investors

A TIME TESTED PRINCIPLE - START INVESTING EARLY AND INVEST REGULARLY

SIP – A Boon For Investors

One of the best rules of investing is to save and invest on a regular basis. SIP or Systematic Investment Plan provides the investor the best combination - rupee cost averaging and compounding, available to investors. Investing a fixed amount every month through SIP makes the investor disciplined and benefit from the market appreciation over time. Investors can invest as low as Rs 500 per month in an ELSS fund!!

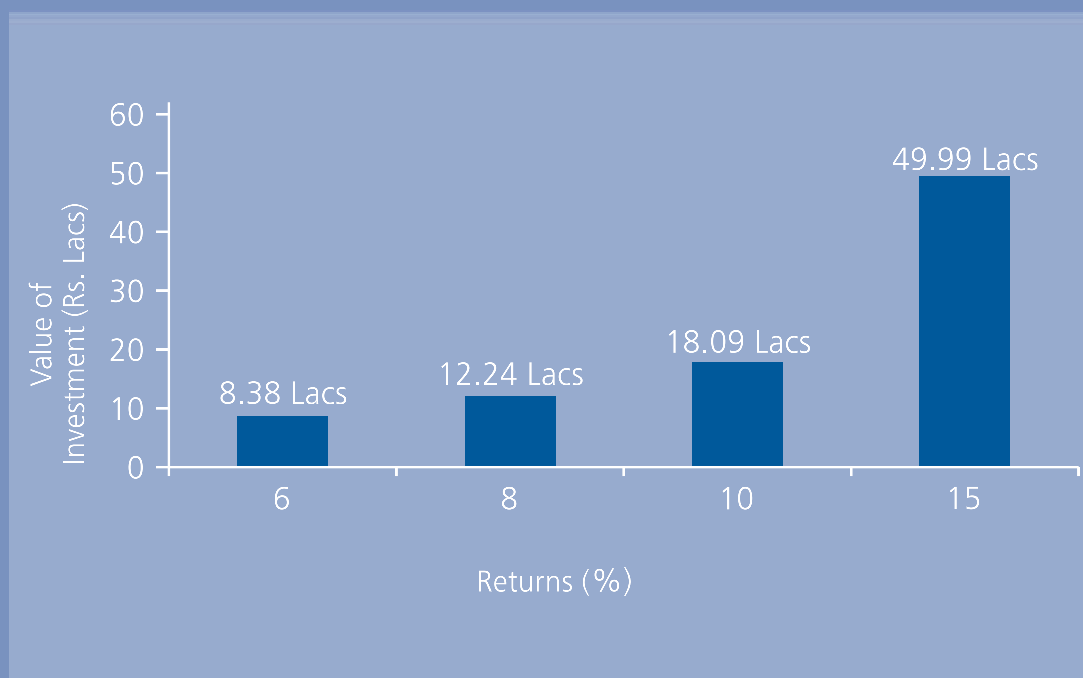
Rupee Cost Averaging

Investing a fixed sum regularly means averaging out the cost, as the investor gets fewer units when the NAV goes up and more when the NAV goes down. Investing through SIP, an investor can invest a fixed amount every month in an ELSS scheme and take advantage of the fluctuations in the market by buying fewer units when the markets go up and more units when the markets go down. Rupee cost averaging can be explained with the help of the following example. If Rs 1000 is invested a month in a scheme which has a NAV of Rs 25 a unit, the investor will have bought 40 units (1000/25). However if the markets have gone down next month and now the NAV is Rs 20 per unit, he will get 50 units (1000/20) i.e. 10 units more on the same investment.

Compounding

Compounding basically means earning money not only on your investment, but also on the amount your investment earns. The earlier you start investing the longer your money can work for you. By starting early and continuously reinvesting your earnings you increase both your investment and earnings over time. This effectively makes even small investments become larger, over time. For instance, if you begin investing at age 30 and invest Rs 1000 every month (i.e. Rs 12000 a year) at 9 per cent a year and roll over the proceeds until you 60, you will get Rs 17.02 lacs. If you begin 10 years later i.e. at age 40 and invest the same amount at the same rate (9 per cent a year) you will only get Rs 6.39 lacs. That is, by allowing your money to compound longer, you can be richer by Rs 10.63 lacs.

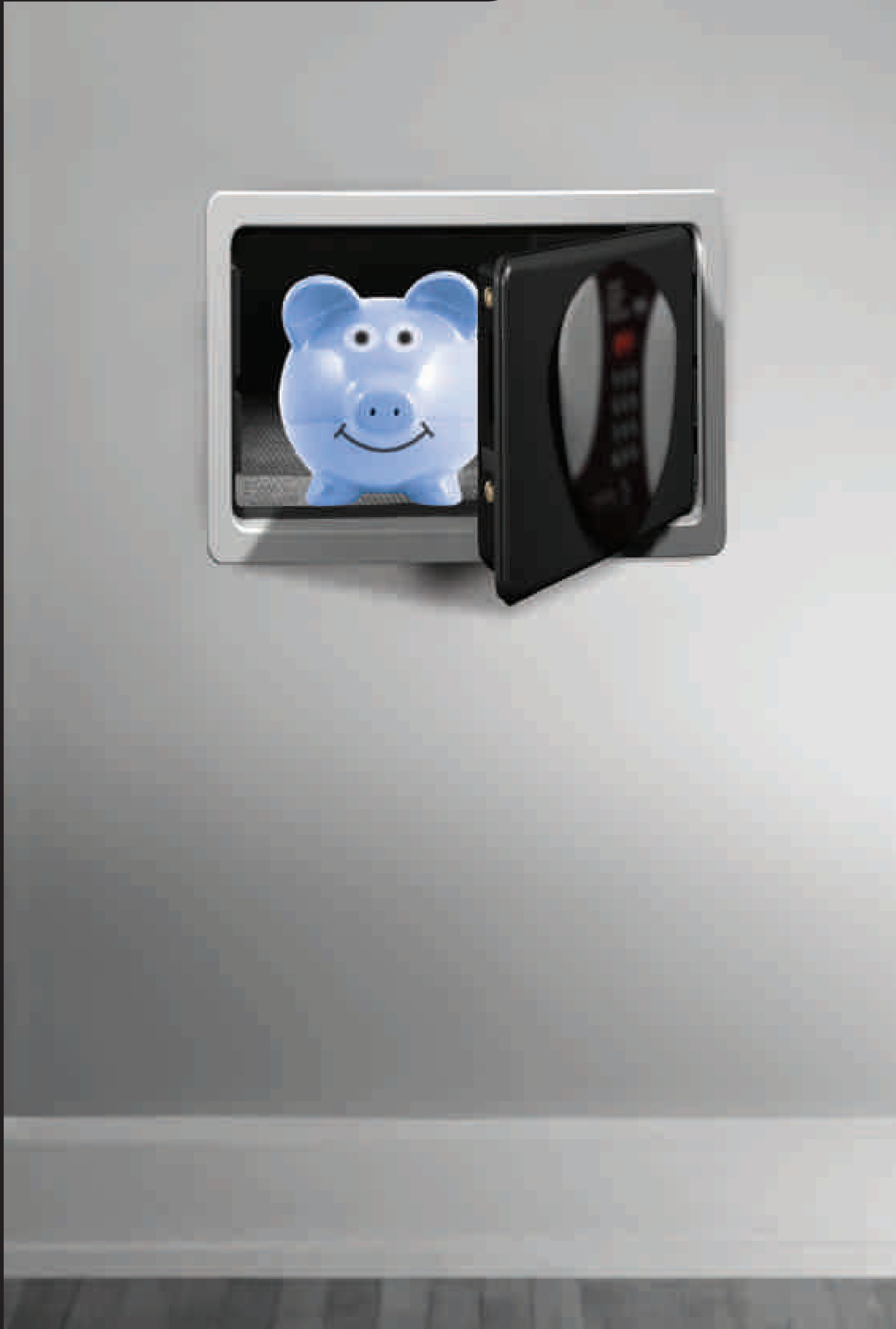
Growth



The chart shows 4 possible comparable investment scenarios – Rs 10000 every year in different instruments that gives 6 %, 8%, 10% and 15% returns. At the end of 30 years, total investment of Rs 3 lacs will aggregate to Rs 49.99 lacs in an instrument that gives 15% while the same investment will only aggregate to Rs 8.38 lacs in a 6% return instrument.

"Higher the returns from the invested amount, Greater the benefit accrued due to the power of compounding"

Pick The Right Fund?



HOW TO PICK THE RIGHT FUND?

- Save Upto Rs 1,00,000 Under Section 80C (2)
- Tax Free Returns
- Invest As Low As Rs 500 a Month
- Dividend Track Record

Have you read this before?

All ELSS funds will promote these features to investors but picking the right fund to invest is of the utmost importance. Investors need to keep in mind that their investments are locked in for 3 years so choosing the right ELSS fund is crucial.

Investors can invest in existing ELSS options available or a New Fund Offer (NFO) by a fund house at the time, if any. They can invest in either one fund or spread it across different top performing ELSS funds to mitigate risk further.

The main criteria in picking any funds to invest should be:

- Reputation and Performance of the fund house in the industry
- Credentials and Expertise of the fund house and the fund manager
- Past Performance of the ELSS fund (if it is an existing scheme)
- Other fund's performance managed by the fund manager (if it is a new fund offer)

Avoid any myths of not investing in a fund with a higher NAV. **Investment decision should be based only on the fund houses' reputation and the performance of its schemes**. A lower NAV does not guarantee good returns in comparison to a higher NAV ELSS fund. If efficient processes are set in place the fund house and its schemes will perform well over time irrespective of its NAV.

Investors should do their own research and compare performance of various schemes from websites, magazines and other sources before arriving at a decision. Finally, speaking to your tax / and or investment advisor before making any investment decision is always helpful and recommended.

Follow these simple steps and you are well on your way to an effective tax planning and investment journey.