ANNEXURE-V
AN ATTEMPT TO EDUCATE THE INVESTORS

The Industrial Credit and Investment Corporation of India (ICICI), in its pioneering attempt, has been issuing a series of advertisements in dailies on savings and investment matters. They are captioned as 'Making money matters easy series'. Such an endeavour will prove beneficial to the investors of financial instruments particularly corporate securities. Some of the relevant advertisements are kept here for reference.

Are you saving wisely today?

By a Panel of Experts

"Have you seen in recent times, newspaper headlines screaming "Are you an investor? Tough luck" or Sultan of Brunei's missing billions would touch a raw nerve if you have been unfortunate enough to lose your money to a smart Alec who, on promiss- ing you the earth, managed to himself disappear from the face of it (along with your money, of course)?

Don't lose heart! You have company of the likes of Sir C. V. Raman, the Nobel Prize winner, who was made to feel like a fool when Gopala Rao of Bangalore swindled him along with several civil servants and businessmen by floating a bank in 1948. "I won the Nobel Prize, but Gopala Rao won the money," he later lamented.

So what can be done? Any individual would realize that it is insufficient to just earn and save. If we have to utilize our savings during our retirement period, it makes sense to have to invest. And invest wisely. That brings us back to square one. Where should we plant our hard-earned savings?

Let us address ourselves, therefore, to the basics of investment planning. Contrary to the general feeling, sound investment is not about making a choice between living well and dying rich. It is an attempt to lead an orderly and even- tually planned life style devoid of unpleasant and embarrassing surprises.

For an average investor, the fundamentals of sound investing are only three: safety, liquidity and returns, strictly in that order.

An investment that is safe may not be liquid. Ask countless Mumbaikars who believed Mark Twain, the famous American wit, when he advised “Invest in land since they have stopped producing it any more”. They felt that the best investment on earth was the earth itself, and put their surplus money in residential flats in far-flung suburbs. Liquidating these flats has become a nightmare since there are no buyers!

Similarly, an investment that offers high returns may be neither safe nor liquid. Ask depositors in the companies that offered interest rates way above the market and gave away gold coins as parting gifts!

Every investor must understand that there is a direct relationship between reward and the investment risk and the risk of losing it. Higher the returns, greater the risk.

Some of these opportunities for investment traditionally are:

- Under current market conditions, savings bank accounts cur- rently yield only 4.5% p.a. interest at present, while bank Fixed Deposits yield a higher rate of 9% and above depending on the duration of the deposit. The deposits are guaran- teed for repayment up to Rs. 1,00,00, and therefore, absolutely safe up to that amount. An LIC Policy is not really a savings or investment instrument. It insures human life at a financial cost. LIC, very tight- ly, does not pretend to give us any returns or our insurance premiums except the sum assured, with bonus thrown in at extra cost. Just as we never conclude Mediclaim and other health insurance poli- cies with our contributions to investments, so should we do with an LIC policy. Bonds issued by financial institutions like IDBI and ICICI offer attractive returns and are high on safety with moderate liquidity. Provident Fund (and PPF) is a savings instrument which yields tax-free returns and is, therefore, an excellent investment. It makes sound financial sense to contribute maximum amounts into these instruments. Both these invest- ment provide highest sale by since they are guaran- teed by the Government of India:

- National Savings Certificates, Post Office Savings Accounts and Deposits, civil servants and businessmen

- LIC, very light-

- An LIC Policy is

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Are you on the road to a secure future?

By a panel of experts.

In our earlier article, we had enumerated several avenues of investment presently available to most of us for parking our savings. Before we analyze, in some detail, the popular saving options, we should consider two key factors affecting our investing, namely, Taxation and Inflation.

As emphasized earlier, safety, liquidity and returns are the three pillars of investing. The fruit of good investing is steady and regular return on our investment. Return on investment may take the form of appreciation in value, receipt of income or both. For example, bonds and debentures give us regular return in the form of interest. Income may take the form of appreciation in value but no regular return. Real estate may give us appreciation in value but no regular income. Equity shares of good companies could yield annual dividends as well as appreciation in value.

Return on investment in the form of income, when received, attracts income tax under the Income Tax Act. The incidence of income tax depends on the nature of our investment income and the quantum of our other income like salary, rent from property, interest etc. Most common investment incomes are: interest on bank deposits, interest on debentures, interest on bonds, interest on deposits with companies, provident fund (and PPF), NSC, dividend income from shares or from mutual fund deposits and debentures of financial institutions which offer returns higher than bank deposits and are safe and liquid as well as the invisible tax of inflation.

Armed with this additional knowledge on the art of sound and profitable investing, let us examine some of the investments in some detail.

The first investment avenue, which concerns most of us, is the savings bank account and fixed deposits with banks. Interest on these accounts is deemed taxable income.

Going back to our earlier example of interest income of Rs. 15,000, the customer had been left with only Rs. 10,500 (after a tax of Rs. 4,500). If the inflation rate for the year is 10%, on the fixed deposit of Rs. 100,000 is now only Rs. 90,000 the investor would have earned an effective post-tax post-inflation return of only Rs. 5,000 (taking out the inflation loss of Rs. 10,000). This is the real return.

Thus, a sound investment is one which gives the investor reasonable return after deduction of income tax as well as the invisible tax of inflation.

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Thus, if an investor has a taxable salary income of Rs. 200,000 and he were to invest Rs. 100,000 in fixed deposits with a company which guarantees 15% return per annum, he will earn Rs. 15,000 as interest income. On this income, he will have to pay income tax at 30% tax rate amounting to Rs. 4,500. This leaves with him an income of Rs. 10,500 after tax. Thus, income tax reduces the effective return on his investment by the amount of tax payable by him.

On top of the levy of income tax, there is the effect of inflation also. Inflation is the invisible tax, which affects everyone through a fall in the purchasing power of money. Citizens in our neighbouring countries in the recent past have been jolted by the sudden fall in the value of their money, virtual wiping out their investments. Thus our country suffers annually an inflation rate of 10%, by simplification, the value of our one hundred rupee note has gone down to Rs. 90 and therefore, it can buy goods worth Rs. 90 only. To put it differently, we will need about Rs. 110 this year to buy the same goods.

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Investing in real estate like plots of land, flats, farmhouses, holiday homes should best be left to experts for the simple reason that there are too many hurdles by way of stamp duty, layor fees, legal documents and approvals from income tax authorities for purchasing and equal number of impediments while selling. Except for one house for the investors own stay, real estate as a pure investment alternative is fraught with several complications for an ordinary busy individual. Recent times have witnessed unprecedented fall in prices of real estate all over India and may, therefore, best avoided.

Compared to all the investment avenues, PPF and PPF offers the best opportunity. Contributions are made in monthly instalments regularly and it offers attractive returns by way of interest and tax. Contributions of Rs. 60,000 per year enjoy a tax rebate equal to 30% with a ceiling of Rs. 12,000.

Public Provident fund offers an additional benefit of contributing to the spouse's account as well as child's accounts (with the ceiling of Rs. 60,000 per year per account). Contributions to minor children's accounts now enjoy total exemption from gift tax as well. Since interest of 12% is tax free under Section 10 of Income Tax Act, there is no clubbing up of such income in the parent's income as well. It is therefore, provides an excellent tool of tax planning with reasonable returns. An investor depositing Rs. 120,000 (Rs. 60,000 per year in two accounts) should consider himself not only lucky, but also intelligent. PPF is referred to as an Income Tax Officers' nightmare and Tax Payers' delight!

And, finally, equity shares of listed companies as an avenue of investment can be extremely rewarding but are also risky and calls for special mental make up and unusually sharp skills on the part of the investor. As Peter Lynch, the acclaimed American fund manager said "common stocks are not for everyone, for all times in the life of the same person."

We will examine each of these products later in a detailed manner.

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Are you financially strong enough to meet future needs?

By a panel of experts

Financial planning helps you to take control of your financial life in the present and to provide for the future. Proper planning begins with three basic questions:
1) Where are you today? (i.e. What is your net worth?)
2) Where do you want to go tomorrow? (What are your financial objectives?)
3) How will you get there? (What is your plan of action?)

Let us deal with the first question of your net worth.

Your net worth is quite simply, the difference between what you own (your assets) and what you owe (your liabilities). Your net assets are indicative of how much income they can generate for you. Your net liabilities are indicative of the cost of your obligations.

You can easily prepare your Net Worth Statement by taking inventory of your assets and liabilities, as shown below. Your net worth tells you your financial standing and provides a basis for finding out how much income you will require to support your chosen standard of living.

Prepare two Net Worth Statements: one for your position as it is today and the other as you estimate it to be at your retirement.

Calculations of your Net Worth:

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Your Course of action:

To bridge this gap you will have to generate an income of Rs.

Your requirement:

Taking 12% p.a. (after tax) as the earnings of this capital, Rs. 7 lac can fetch an annual income of Rs. 84,000. Now, when you know that your annual living expenses are say Rs. 96,000, you will see that this will exceed income by Rs. 12,000 (i.e. Rs. 96,000 less Rs. 84,000). So Rs. 12,000 is the income Deficit (D) or gap that you have to bridge inorder to meet your living expenses.

Bridging the gap between what you have and what you need:

The best way of reducing the income deficit is the creation of capital e.g. by taking a Insurance policy in your life. While other saving plans give you what you have been able to save, life insurance guarantees your family what you hoped to save, in the event of your departure before completion of your plan.

Some more means of increasing your net worth:

1. Save more - about 30% of your income.
2. With safety uppermost, revise your investment portfolio so as to maximise returns.
3. Invest wisely, not speculatively, and in shares of reputed companies. In the long run, equity shares are the best hedge against inflation.
4. Cut your taxes by getting the full benefits of tax-free income under Sec. 80-1 from Bank deposits, N.S.C., units mutual funds etc. and rebates under Sec. 88 by investing in approved schemes like P.P.F., Infrastructure bonds, N.S.C. etc.
5. Split capital and income, bearing in mind the provisions of ‘Clubbing of income’ in the hands of the donor. Passing on capital and the consequent income to the members of your family will reduce your taxes.
6. Invest in collectibles (stamps, antiques, art etc.)
7. Pay proper attention to your health so as to minimise your medical expenses.
8. Cover your family with Mediclaim because hospitalisation expenses can reduce your net worth drastically.
9. Encourage your wife to translate her talents into income.
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By a panel of experts

Globally it is a well-accepted fact that the retail investor rules the roost. Thousands collected from millions of investors have a far greater impact upon the economic welfare of a company in particular and the country in general, than millions collected from thousands of them. In India, the retail customer has chosen to stick to the age-old principles of investing. Technological improvements in the investment markets have added new dimensions to them. These principles are outlined below:

1. Safety
2. Liquidity
3. Returns on investments
4. Tax Efficiency
5. After-investment service

These are the five major factors influencing investment decisions. The die-hard attitude of majority of the investors in refusing to become investment literate has given rise to two situations: One, the bureaucrats tinker with regulatory measures without the mandatory homework. Two, fly-by-night operators and crooks lure investors by persuasive advertising of sweet plantations, sharing holiday resorts etc. promising dreams which eventually get converted into nightmares. Let us now take a look at these influencing factors:

Safety

A retail investor does not have to do research on his own to gauge the safety of an avenue, thanks to the various government approved credit-rating agencies. All that is required is to invest in only those companies which have obtained 'in inveetable-grade' ratings. The blue-blooded 'AAA' rated companies are the best. It is unfortunate but true, that many of the investors have been investing in scheduled or co-operative or foreign banks under the mistaken notion that this is the safest avenue. However some avenues have emerged in the recent past (for instance, public sector bonds and debt-based MF schemes) which are equally safe. These offer same liquidity and are far more tax efficient so as to make the after-tax returns higher.

Liquidity

One of the important concerns facing an investor is the fear of the unknown, which prompts an individual to keep a large sum of his savings in his cupboard, so as to unforeseen calamities. A little more literate ones prefer to have a large balance in their savings bank accounts. There have been instances where some people have purchased gold as a hedge against war. These individuals should have a good hard look at the AAA rated bonds with 'Any-Time Facility' or UTI MF schemes with no load, either at entry or at exit. The only difference is that the money staked in a Cupboard is available any minute (to anybody!); a bank would take five minutes whereas the bonds and the units would be available only after most 5 working days (3 days in any of the metros).

Return on Investment

The worst disease the Indian government suffers from is its disregard for the principle that time is money including the infrastructure ones, are undertaken simultaneously, and these face time and cost overruns because of paucity of funds.

The retail investor suffers from the same malady. A normal human mind does not have a good comprehension of geometric or compound growth. They get misled by unscrupulous advertisements which compute the returns by using nonstandard methods to their advantage. This issue had been taken up with RBI some time back, taking the instance of an advertisement where a certain private sector bank displayed the interest rate as 22.67% for 6-month deposit whereas actually it was compounded at the rate of 15%, payable quarterly.

Tax efficiency

There is no number of provisions in the Income Tax act which can be used to save taxes, legally. To be able to use these effectively, one does not need to know the act in as much detail as a chartered accountant.

Fortunately, most of the companies come out with products, like the deep discount bond or pure growth MF schemes with in-built benefits. To be a savvy investor, it is necessary to obtain the highest mileage out of this tax concession on share dividend and long term capital gains, abolition of gift tax, tax exemption upto Rs. 75,000 on income from avenues under the umbrella of Sec. 80L, tax rebate by Sec. 88 etc.

After-investment service

Most of the products available to retail investors have adequate in-built safety, liquidity, attractive after-tax returns. Given this backdrop, in the current scenario of keen and fierce competition, companies have been focussing their attention on the quality of their front-end offices. When all other things are equal, it is the excellence of support and protection that an investor receives from the company which becomes a decision oriented factor. And in this matter past performance is indicative of future quality.

The best factor

Saving the best of the last, the most important factor of an investor is in educating himself and becoming savvy in the art and science of investment. The annals of Indian investment history is rife with wheeling and dealing of characters who manipulate customers to make a quick buck.

The government contributes its mite by taking advantage of the general lethargy of individuals in the investment matters. When the Indian investor learns to take online decisions and continuously monitor his portfolio to optimize returns on his investments, consistent with his perception of safety and liquidity, India would become a mighty economic force.

We would look these investment factors in greater details in later articles.
By a panel of experts

What do you need to look for, to ensure that your investment is safe? The factors that you need to look for would vary with the type of investment. For example, in the case of shares, the safety may be partially gauged from quantitative data such as the past trend in the price of the stock, the financial performance of the company and also may be supplemented with qualitative factors such as the reputation of the company. Analysing balance sheets and project reports, however, require a great deal of expertise and time, which is usually beyond the scope of the retail investor. Therefore the reputation of the issuer remains the only guide available.

Credit Rating

When it comes to deposits or bonds issued by public companies or financial institutions, an investor can rely on credit ratings. Credit Rating is an evaluation of the safety of an instrument made by an agency. These credit rating agencies undertake a detailed analysis of the issuer's strengths and weaknesses. The rating is allotted based on a formula that also incorporates past performance. They have a large and expert infrastructure that allows them to make the kind of financial judgement, beyond the scope of an individual retail investor.

Credit rating is valid for the period specified along with the rating. Normally, the credit rating agency keeps a close surveillance and duly upgrades or downgrades the allotted rating as and when needed. Organisations may also request for a relook at the rating if circumstances so desire.

Currently there are four credit rating agencies:
1. Credit Rating Information Services of India (CRISIL)
2. Investment Information Credit Rating Agency of India (ICRA)
3. Credit Analysis & Research (CARE)
4. Duff Phelps Credit Rating India Pvt. Ltd. (DCR India)

Each agency has a slightly different system of rating instruments. The ratings in each system are graded on the basis of safety and are comparable, as some of the ratings in the table below shows:

- One problem typically associated with the validity of ratings is that they do not reflect the changes in the issuer's standing over time, since they are revalidated only at specific intervals.
- However, the agencies are usually conservative in their approach and take into account the possibility of the varying financial conditions of the issuer over the period of the ratings. Also, credit rating apply only to debt issues and not to equity ones.

Credit rating is an important guide available to a retail investor for whom the safety of his investment is of paramount importance. However, it must always be kept in mind that there is no substitute for a watchful and cautious attitude which must at all times remain the foundation of smart investment. An investor would do well to rely on larger, more reputed issuers and then evaluate the relative safety of different products by comparing their credit ratings.
Are 'returns' actually 'rewards'? 

By a panel of experts 

Earlier, in this series we have discussed about Safety, Liquidity and Returns being the three main factors of sound investment. This week we will focus on the issues that need to be kept in mind while evaluating the returns from various investment avenues.

Types of returns

The return on investment may consist of appreciation in the value of the investment or receipt of income or both. The first type of return is typical of real estate whereas the second type is obtained as interest on loans or fixed deposits, savings certificates, bonds or debentures. Both income as well as appreciation in value could be got from equity shares of good companies.

Risk Return linkage

One needs to be aware that there is a direct relationship between 'return' on our investment and the 'Risk' of losing them. Higher the return, greater is the possibility of loss. The Savings Bank Account under the present rules laid down by Reserve Bank of India, gives depending on the duration of the deposit. A long term deposit gives a higher rate of interest. The possibility of losing our money, in the Savings Banks Account is almost negligible, except in remote cases of small-time co-operative banks. While the risk of losing money is almost absent, the Savings Bank Accounts and Bank Fixed Deposits offer interest of 4.5 and 9 percent per annum respectively. The Company Fixed Deposits offer somewhat better rates of 12 to 15 percent per annum. Building contractors and film producers offer very high returns such as 24 to 36 percent per annum, but the probability of losing the entire principal amount in this case is very high.

The Tax Factor

Return on investment in the form of income, attracts income tax under the Income Tax Act. Incidence of this tax depends on the type of the investment income and the quantum of our other income. The interest on Savings Bank Accounts and Bank Fixed Deposits is eligible for a tax concession up to Rs. 12,000 under section 80L of the Income Tax Act. Beyond that, it is taxable under the Income Tax Act as normal income. As seen earlier, Company Fixed Deposits yield higher returns than bank deposits, but they offer no tax concession. Incomes from mutual funds, deposits with notified financial institutions, interest on certain Post Office deposits, interest on NSC, interest on notified bonds and debentures, are also eligible for a tax deduction under Section 80L, all within an overall ceiling of Rs. 15,000.

The Inflation Factor

As mentioned in an earlier article, real return is return that is post tax and post inflation. The value of the investment depends on the amount that the money can buy, and this goes down as the inflation goes up. Therefore while evaluating the return from a scheme, we need to see whether it is giving you returns beyond the inflation rate. The greatest problems with the investment avenues such as gold, silver, diamonds and jewellery have been that they have not served as an effective hedge against inflation.

Be cautious

It has been noticed world over that an investor's greatest and most potent enemy is GREED FOR HIGHER RETURNS. Many a times, rational thinking people tend to behave in the most irrational manner while investing their savings. A well known investment guru has analysed this uncanny behaviour in one sentence - "Investor, protect thyself from thyself".

To conclude, considering the aspects tackled in this article, one is forced to wonder whether all 'returns' are actually 'rewards'!
By a Panel of Experts

Liquidity is the ability to access one's savings as and when needed. Generally speaking, the lower will be its returns. So objectives are to maximise the returns on our investment without compromising either liquidity or safety.

Traditional liquid savings options

Keeping cash in the house is the most safe and liquid option, but this earns no returns. A slightly better option is to keep it in the bank in a saving account. While this offers a great degree of safety and substantial liquidity (money can be withdrawn in a matter of minutes), the interest rate on the savings account still falls far short of the inflation rate.

Fixed Deposits

A better alternative is to keep the money in the bank in a fixed deposit (FD). FDs are available in a range of tenors from 15 days to several years. An FD provides a much higher rate of interest, around twice that of savings account, the same level of safety and slightly lower liquidity. You can either break the FD, or take a loan against it. If you choose to break the FD, you would still be entitled to receive the interest till that date but less the penalty, which is usually 1%. In the case of an FD of longer duration, you can avail of a loan of up to 75% of the amount deposited at approximately 2% higher than the FD rate.

These traditional modes of savings served extremely well in the past, given that capital preservation was far more important to investors than capital appreciation. Discussed below are some of the innovative options available today.

Innovative liquid savings options

Two innovative instruments that are currently serving investors very well are Bonds floated by public companies and pure growth, open-ended, debt-based schemes (PODs) floated by Mutual Funds.

Bonds

Most bonds provide flexibility, liquidity and safety of a very high order and allow investors to use innovative features offered to effectively meet their financial requirements.

The flexibility can be seen from the range of options provided, be it the frequency of income or the duration of the investment or the option to avail of tax benefits. Apart from these attractive features, some bonds for a small charge also offer an ‘Any Time Facility’ thus providing liquidity of a very high order.

These Bonds provide good liquidity through:

- Option to withdraw on pre-specified dates
- Listing on NSE and other stock exchanges
- Market making whereby at any time their is a buyer and seller
- Provisions to avail loans from banks and housing finance institutions, by pledging loans as security. The discretion and terms of these institutions, however, may vary from bank to bank.

Debt based mutual fund units

Unlike equity based schemes, debt based schemes have allowed mutual funds to continue offering the benefits of a broad-based basket of instruments without compromising on safety.

Investors generally have been wary of mutual funds as the BSE Sensex has been sliding since September 1994 (when it had reached a peak of 4360) and is currently languishing at around the 3000 level. This crisis of confidence (in some cases due to bad experience) gave rise to the introduction of Pure Growth Open-ended Debt based (PODs) schemes.

PODs are eligible for a tax rebate under the capital gains tax laws. The schemes by virtue of being open-ended provide very high liquidity. The customer has the option of exit and entry anytime. Requests for redemption are catered to within just few working days, or even less in the metros. Plans are also on to pay over the counter.

The additional incentive offered by these schemes is that almost all of them are free of any charges either at entry or at exit. A few have a nominal exit load in case the instrument is sold within a pre-specified holding period, which is usually one year.

Evaluation of PODs vs Bonds

While PODs offer equivalent or slightly better safety than Bonds and much higher liquidity, most schemes do not promise assured returns like Bonds. While a few PODs do so, these do not match the rates offered by Bonds and come with a number of strings attached.

So if you desire instant liquidity or wish to maximise safety you are better off investing in PODs; otherwise Bonds would earn you the best returns on your investment.
How to plan a happy future for your child?

By a panel of experts

Today we shall look at how you can plan for your child's happy future. The sole major hurdle to financial planning for your child (below 18 years of age) is the provision of clubbing of the minor's income with yours. Clubbing means that any income arising or occurring to your child, including stepchild or adopted child, is included in the total income of that parent whose income is higher.

What are the provisions you can benefit from?

1. Under Sec. 64(1A) basic exemption of Rs. 1500 p.a. is available for each child.
2. The income of a child totally blind, mentally retarded or physically handicapped as specified under Sec.30U is exempted from clubbing.
3. Under Sec. 10 interest from Public Provident Fund (P.P.F), Relief Bonds (Rahat Patra), specified tax free bonds, share dividends etc. is tax free to all. Such income of a child is not clubbed.
4. The income of your child arising from manual work or through the application of its skill and talent is not clubbed with your income.

How can you plan your child's future?

1. Open a separate Bank Account for each child whose name will be first, with joint names of parents who will operate the account on Either/Survivor basis. Make sure to note where the money has been received, to ascertain whether the amount is taxable or not.
2. Develop capital for your child through gifts. Invest in shares or put it in his/her P.P.F. account (Gift tax on gifts given after 1st October 1998 is abolished.)
3. Establish your child’s ownership of shares by paying for them from his/ her Bank account. Get the share broker's bill in your child's name. The dividend for such shares will be in the name of the parent whose name appears first on the share certificate. Deposit such dividends in your child's bank account, since the account has also the parents' joint name(s).
4. Open a P.P.F. Account for child. Under Sec. 88, the parents will get the benefit of tax rebate of 20% on their contributions to this account, subject to a maximum of Rs. 60,000 p.a. per exemption limit of Rs. 50,000 p.a. is crossed. You have to declare your child's income in the I.T. return of that parent whose income is higher. Deductions under Sec. 80L up to a maximum of Rs. 15000 p.a. in respect of eligible incomes from bank deposits, NSC, UTI and Mutual Fund dividends etc. are available from the incomes of parent and child. Nevertheless, once your child reaches 18 years of age do submit a separate I.T. return for him/her, to establish the major child's capital and source of income.
5. For a child, insurance is purposeless. Ignore the lure of low premium and the emotional appeal to 'do something for your child' through insurance.
6. The law does not require submission of Income Tax Return unless the basic planning for your child’s thread ceremony, education, marriage, start-in-life etc. through either Bank/Post Office deposits/Insurance policy (where the sum assured would be paid back to the family in the event of untimely demise of the insured parent)/ other long term instruments.

The planning for your child’s future must ensure the availability of funds at the right time and make adequate provisions for inflation.
Is your family well informed about your financial matters?

By a panel of experts

Suppose there suddenly comes a time when money is urgently needed at home—and you are not around. You could be abroad, away on tour or convalescing in hospital after winning over illness. Or, consider the inescapable finality that eventually catches up with all of us.

Won't you like your family to receive with ease the fruits of your effort you have left behind for them?

If they are not able to do so, all your thoughtful planning for prudent investment will have come to naught. How can you prevent this? Simply by the systematic maintenance of records NOW.

Invest some of your time and make notes of all the important aspects of your arrangements. It will make it easier for your family to access your money.

The details you must put together in a systematic manner in a "Record Book" are:

General

1. The location of these important documents and records
   - Birth, domicile and marriage certificates
   - Receipts of deposits for telephone, gas, electricity, etc.
   - Fixed deposit receipts of banks and companies, life, accident, Mediclaim, and Fire/theft/Burglary policies
   - Car insurance policy
   - Municipal tax and R.T.O. Tax book
   - Income/Gift/Wealth Tax files
   - Legal papers
   - Ownership flat and property deeds
   - Bank lockers

2. The names, addresses and telephone numbers of your advisors
   - Chartered accountant
   - Lawyer
   - Life and General Insurance agents
   - N.S.C. and P.P.F. agents
   - Sharebrokers
   - Investment advisors
   - Doctors
   - Friends

3. Instructions to your family
   - Indicate the provisions you have made, like Mortgage Redemption Policy to pay off the mortgage on your flat; what assets can be disposed of to meet emergency expenses, the verbal commitments that are to be honoured; the names of potential troublemakers and the need for caution; and any other relevant information.

4. Your will
   - Get a copy of your will registered.
   - Whether or not you want your family to be aware of the contents of your will now, registration ensures its future availability at a safe place.

For each member of your family

1. Bank Accounts
   - The name and address of the bank
   - The mode of operation (either/anyone or survivor/s)

2. Fixed Deposits
   - The name and address of the bank/company holding the deposit(s)
   - The amount
   - The Fixed Deposit Receipt number
   - The date of deposit
   - The date of maturity
   - Any Such or other relevant information

3. Shares/Debentures/Bonds and Units
   - The name of the company/mutual fund (M.F.), the number of shares, debentures or units and the face value and folio number
   - The issue date and the renewal date.

4. (A) Policies of Life Insurance
   - The policy numbers
   - The date the policy was purchased
   - The mode of operation (either/anyone or survivor/s)
   - The date when the policy was purchased
   - The name of the insurance company
   - The policy number
   - The type of policy
   - The coverage amount
   - The issue date
   - The renewal date
   - The dates of the installations paid
   - The Self Assessment Tax amount
   - The date the return is filed
   - The date the refund is received

(B) Policies of Mediclaim (Hospitalization)Fire/Theft/Burglary/Liability Insurance
   - The name of the insurance company
   - The policy number
   - The type of policy
   - The coverage amount
   - The issue date
   - The renewal date

5. Property
   - A brief description including the location, the survey number, the names of joint owners/nominees, the size/area, the date when acquired, the cost and the names and addresses of the seller and buyer.

6. Personal Debtors/Creditors
   - The names, addresses and telephone numbers of the those who owe you money/those whom you owe money, the amounts lent/borrowed, the interest amounts receivable/payable and their due dates.

7. Income Tax Summary
   - The assessment year
   - The Advance Tax amounts and the dates of the 1st, 2nd, and 3rd installments paid
   - The Self Assessment Tax amount
   - The date the return is filed
   - The refund due

You must review the information noted in the Record Book twice a year and update it as and when necessary. At each review, discuss your Record Book with your family so that they are equipped with all the relevant information, when time calls.
Are your investments in keeping with your age?

Part-I

By a panel of experts

Life-cycle financial planning divides your adult life into four phases, identifies objectives typical to each phase and offers matching financial strategies. Adopt those that suit your chosen life-style, life goals, needs and attitude to risk.

The hallmarks of disciplined saving and wise investment are safety, adequate returns, liquidity for easy encashment, growth to counter inflation and tax shelter to reduce your tax-bite.

Consider strategies that have all these hallmarks distributed across them and select a suitable mix.

Phase I: Age Group 25 to 30 years

Objective: Funds for an emergency
Maintain about three months' income in Bank Savings, as a constant cash reserve. If you keep very large amounts, inflation will erode your capital.

Objective: Income protection & provision for larger expenses in later life
Your income must be protected to replace the loss of earnings in the event of your disability, untimely demise, or premature retirement.

Insurance Plans that offer periodic returns can, besides protecting your income, meet large cash requirements such as those for your children's education, marriage and augmentation of your retirement income.

Objective: Tax shelters
Take judicious advantage of: i) N.S.C., Units, M.F. etc. for fully tax-exempt incomes under Sec.80L ii) P.P.F., share dividends etc. for fully tax-exempt incomes under Sec.10 iii) P.P.F., L.I.C. premium, N.S.C. - 20% of your contribution (maximum Rs.60,000), is deductible under Sec. 88. iv) Infrastructure bonds.

Here, up to Rs.70,000 of your contribution attracts 20% deduction under Sec.88.

Objective: Hedging against inflation
While evaluating all investment products, you must take care to compute the "real" return, net of inflation and tax. Investment in equity-based funds is the safest recommended means of overcoming inflation in the long run.

Phase II: Age Group 31 to 44 years

The four objectives and their accompanying strategies above continue in this phase. In addition, the following three emerge:

Objective: Health insurance
Health Insurance policies of leading insurance providers which also give tax breaks.

Objective: Home ownership provision
Loans from Employers, P.F. and financial institutions. Secure the prepayment of loan (against your untimely demise) with a mortgage redemption policy.

Objective: Development of capital and generation of income for spouse & children
Give money as gifts to your family. Now that Gift Tax has been abolished, income from gifted amounts invested in shares for spouse and children or deposited in their P.P.F. accounts is tax-free (i.e. not clubbed to your income).

We all desire a comfortable present and a secure future. And you know that proper utilization of your assets now is the only way to attain this goal. For this, financial planning is necessary and action to implement your plan is essential.

Phase III and IV will be discussed next week.
Are your investments in keeping with your age?

Part II

By a panel of experts

Last time we described life-cycle financial planning and discussed Phases I and II. We now move on to the other two.

Phase III: Age Group 45 to 60 years

Objective: Retirement Planning

If you are a salaried individual, you have to only augment your corporate benefits like Provident Fund, Gratuity, Superannuation, Pension, etc. If you are self-employed or a professional you must make full provision for a secure retirement.

You can look at PPF, Infrastructure Bonds and share dividends for fully tax exempt income under Sec.10. Consider N.S.C., Units, Mutual Funds, etc. for tax-free incomes under Sec.80-L.

Objective: Home Ownership Provision

Loans from employer, P.F. and financial institutions. Secure the prepayment of loan (against your untimely demise) with a mortgage redemption policy.

Objective: Preparing your Family for Life without You

Tell your family about your investments and planning and acquaint them with your financial arrangements as well as your financial and legal advisors.

Objective: Opportunity Fund

Set up a fund in bank fixed deposits/bonds to take advantage of opportunities of starting a business or making a good investment.

Phase IV: Age Group above 60 years

Objective: Regular Income from Investments

If you want money at frequent intervals, the Monthly Income Schemes of UTI are best suited. If you prefer a less frequent inflow, say once every three months, there are other avenues such as bonds that will meet your need. Also, shuffle your portfolio of investments in shares.

Objective: Post Demise Provisions

Set up a fund to defray the costs of disposal of the estate and to settle taxes that might remain unpaid at the time of your demise.

This is the phase when a powerful new concern emerges, overriding financial objectives: the occupation of your time. A neat solution is to work as a consultant (rather than do a part/full-time job). The advantage is that, while it takes care of your time, you can reduce your tax liability by claiming part of your house rent, electricity and telephone charges, car expenses, depreciation on car and office equipment, all as business expenses. Besides, you work at your own pace and place.

Your Mediclaim policy allows you annual health check-ups at designated centres. This will enable you to address another concern typical of this phase: your health.

The four phases are not really watertight compartments. The objectives and strategies can overlap across phases and vary from person to person. You must therefore fix your position in your life-cycle, identify those objectives that you want to make your own, select matching strategies, study and analyse the various saving/investment options available, and then decide your plan of action.

Your Net worth (the difference between what you own and what you owe) is a good indicator of your financial planning. You must calculate it and review it every year.

Planning is useful only when it is followed by action. So ACT TODAY!
What are the different kinds of interest rates for loans?

By a panel of experts

In this article, we shall look at some common ways in which interest rates for loans are expressed, and their implications to you as the borrower.

What are the different ways in which interest rates are expressed?

Broadly, there are two ways: flat interest rate and reducing balance interest rate.

Flat Interest Rate: In this interest rate structure, the interest is calculated on the entire loan amount throughout the period of the loan. This means that even though you repay part of the principal with each installment, the interest you continue to pay (as part of the balance EMI's) will be on the full, original principal.

E.g.
Loan amount: Rs. 1,00,000
Flat interest rate: 10% p.a.
Period of loan: 3 years
Total interest paid: Rs. 1,00,000 x (10x3)/100 = Rs. 30,000
So EMI: (Rs. 1,00,000 + Rs 30,000)/ (3x12) = Rs. 3,611

Reducing Balance Interest Rate: Here, you are given the benefit of the fact that the principal amount keeps reducing as you repay the loan. Thus, you pay interest every month on that part of the original principal sum that remains un-repaid till then.

E.g.
Loan amount: Rs. 1,00,000
Reducing balance rate: 10% p.a.
Period of loan: 3 years
Applying the above-mentioned principle,
Total interest paid: Rs. 15,202
EMI works out to: Rs. 3,200

Are there any variations within these interest rate mechanisms?

There is no variation within the Flat Interest Rate mechanism. The Reducing Balance Rate mechanism has three:
1) daily reducing balance,
2) monthly reducing balance and
3) annual reducing balance.

In the daily reducing balance variation, the principal is reduced every day as if you are making repayment of the principal on a daily basis. Whereas, in the cases of monthly and annual reducing balances the reduction in the principal outstanding is made at the end of every month and every year respectively.

How do the flat rate and the reducing balance rate mechanisms compare?

As explained above, a flat interest rate and a reducing balance interest rate are two very different things. For the same loan amount and interest rate, you end up paying much more in a flat rate mechanism than in the reducing balance mechanism. In the above example, the 10% p.a. flat rate for a 3-year loan works out to an equivalent of 19% p.a. monthly reducing balance rate for the same period.

As a thumb rule, 1% flat rate is roughly equivalent to 2% monthly reducing balance rate. This relationship however will change, though slightly, if the period of the loan changes.

In a flat rate mechanism the interest component of EMI remains the same every month, while in the reducing balance mechanism the interest component each month is higher than the one that follows and decreases as you move towards the completion of the repayment period. However the EMI itself, for each of the two mechanisms, remains constant.
Are you using the tax rebate to your advantage?

By a panel of experts

Last time we had examined the ways and means of i) earning tax-free income and ii) earning income which was deductible from taxable income. Today we shall browse through the most effective tax-saving device courtesy Sec.88 of the Income Tax Act (ITA), the Tax Rebate.

Understanding how it works.......

An investment in certain schemes (see Table) as specified by the ITA, entitles the individual to a tax rebate of 20% of the investment amount. For example, if the investment is Rs.25,000, the tax payable for that year is reduced by Rs. 5000 (20% of Rs. 25,000).

This section allows an overall investment ceiling of Rs. 60,000 p.a. There is also an additional Rs. 10,000 earmarked for investment in the infrastructure, power and telecom sectors (investment can be directly through equity and debenture issues of the companies themselves or indirectly through Mutual fund schemes).

Reviewing the tax planning process....

Step One - Determine the taxable income after adding all types of income that is accruing to you i.e. salary, rent, dividends, interest, etc.

Table: Schemes eligible for the Tax Rebate

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Investment Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Insurance Premiums</td>
<td>No Limit</td>
</tr>
<tr>
<td>Recognised Provident Fund</td>
<td>No Limit</td>
</tr>
<tr>
<td>16-yr Public Provident Fund</td>
<td>No Limit</td>
</tr>
<tr>
<td>10/15 yr Unit Linked Insurance Plan</td>
<td>Rs. 60,000 p.a.</td>
</tr>
<tr>
<td>10/15 yr Dhanarashtra</td>
<td>Rs. 60,000 target amount</td>
</tr>
<tr>
<td>National Savings Certificate-VIII</td>
<td>No Limit</td>
</tr>
<tr>
<td>National Housing Bank</td>
<td>No Limit</td>
</tr>
<tr>
<td>National Savings Scheme-92</td>
<td>No Limit</td>
</tr>
<tr>
<td>Jeevan Dhara / Jeevan Akshay of LIC</td>
<td>No Limit*</td>
</tr>
<tr>
<td>Equity-Linked Tax-Saving Schemes</td>
<td>No Limit</td>
</tr>
<tr>
<td>Retirement Benefit Plan of UTI</td>
<td>No Limit*</td>
</tr>
<tr>
<td>Repayment Instalment of Housing Loan</td>
<td>No Limit*</td>
</tr>
<tr>
<td>Instruments of Infrastructure Companies</td>
<td>No Limit*</td>
</tr>
<tr>
<td>Units of MFs Dedicated to Infrastructure</td>
<td>No Limit*</td>
</tr>
<tr>
<td>Approved Bonds of ICICI, IDBI,etc.</td>
<td>No Limit*</td>
</tr>
</tbody>
</table>

* These schemes attract an extra ceiling of Rs. 10,000.

Note: Investments for life cover and in PPF, ULIP and Dhanaraksha made in the name of one's spouse and all children (major or minor, are also eligible for the tax rebate.

Step Two - Make maximum usage of the tax concessions by earning tax-free income and income which is deductible from the total taxable income, as explained last week. After allowing for these deductions, compute the next tax liability. This can now be reduced even further by making investments in the Sec. 88 rebate eligible schemes.

Step Three - Tax rebate is not the only thing that you should look for in the investment. There are other needs such as

- Need for Insurance
- Need for low capital investment
- Need for shorter lock-in period for your funds.
- Need for reasonable returns from the investment

Look at the combination of needs that you may want your investment to satisfy. According to those need combinations, one should look at different investment product combinations.

Exploring some combinations....

Need for tax rebate + Insurance + Returns: If this is the need, then you can choose either only life insurance products or a combination of life insurance and Sec.88 products. Here there is an option of doing either an endowment policy or a whole life policy clubbed with a Tax Saving Bond.

Need for tax rebate + Short lock in period + Low capital outlay: If this is the need, then you can choose Sec.88 products such as Tax Saving Bond or PPF. The Tax Saving Bond would lock in your funds for three years, and from the fourth year you can reinvest the proceeds. A PPF has a lock in period of 7 years and would allow you to reinvest from the seventh year onwards.

Need for tax rebate + Reasonable returns + Short lock in period: If this is the need, then you can use both Sec. 88 products as well as PPF. The pre tax return on the PPF is very good. But to take a full advantage of Sec. 88, one should invest Rs. 10,000 in a tax saving bond. This way the returns would also be the highest.

A detailed analysis of these issues would follow in future articles.
Income from investments is not always taxable if you choose your investments wisely. The Income Tax Act in India grants several incentives, concessions and rebates with a view to encouraging savings in specified avenues. One of the most prominent sections under the Income Tax Act is Sec. 80L.

What is Section 80L?

Under Section 80L of the Income Tax Act, the tax concession is in the form of a deduction from the tax payer's gross total income. A tax payer (Individual or Hindu Undivided Family) is granted a deduction from the gross total income for income up to a maximum of Rs. 12,000 from certain investments (additional Rs. 3,000 in the case of income from government securities, UTI and Mutual Fund Units).

What are the incomes eligible for deduction under Section 80L?

1. Interest on Government (Central or State) security;
2. Interest on National Saving Certificates (VI, VII & VIII issue);
3. Interest on debentures/bonds of an Institution or authority or any public sector company or a co-operative society as notified by the Central Government;
4. Interest on deposits under National Deposit Scheme as notified by the Central Government;
5. Interest on deposits under any other scheme notified by the Central Government for eg. National Saving Scheme, Post Office (time deposit and recurring deposit) schemes;
6. Interest on deposits under the Monthly Income Scheme of the Post Office;
7. Income received in respect of units of Unit Trust of India and Mutual Funds specified under Section 10 (23D) of the Income Tax Act;
8. Interest on deposits with Banks including Co-operative Banks;
9. Interest on deposits with an approved financial corporation which is engaged in providing long-term finance for industrial development in India;
10. Interest on deposits with an approved public company engaged in long-term financing of housing accommodation;
11. Interest on deposits with authorities set up under the law enacted to deal with the need for housing accommodation or for planning and development of cities or villages;
12. Dividend from co-operative societies;
13. Interest on deposits (made by a member) with co-operative societies.

What is the limit for deduction under Section 80L?

As mentioned earlier, the amount of deduction that can be availed of under Section 80L is limited to Rs. 12,000. However, if the income from investments includes income from government securities, units of Unit Trust of India and specified Mutual Fund units then the limit is Rs. 15,000.

Exempt incomes do not enter into the computation of a tax payer's income statement. While income which qualify for deduction under Section 80L, first gets included in the gross total income and then from such total income, a deduction up to Rs. 12,000 (or Rs. 15,000 as the case may be) is allowed to arrive at the Net Taxable Total Income. By implication, if there is no positive gross total income, then there is no deduction under Section 80L.

To sum up, Section 80L specifies several types of income from approved sources each eligible for the deduction with the ceiling on such deduction not exceeding Rs. 15,000 per year.
I'arl-U

As we had stated last week, today we shall look in detail at the various tax provisions applicable to perks for salaried individuals. Many a times, salaried employees do not consider perks as part of their income. But they are very much so, and it is important to be aware of the different types of perks as also their associated tax implications. Certain perks are fully taxable and others are fully tax exempt as notified under the Income Tax Act. In addition to perks that are tax exempt by notification, certain other perks are also customarily considered as exempt, though they are not specifically mentioned as such under the Act.

**Fully taxable perks as notified in the IT Act**

A fully taxable perk as notified in the IT Act is any sum paid by the employer which would otherwise have been payable by the employee, such as:

- Gas, electricity, water, etc.
- Club fees or bills.
- Insurance premiums on the employee's life.
- Employee's tax dues.
- Any other allowance towards expenditure which is not actually incurred solely in the performances of office duties.
- Goods at a concession rate.
- Premium paid by the employer on accident insurance policy for an employee-director.
- Foreign tour of an employee and the spouse on the company's insistence.
- Club subscriptions (maximum two) for entertainment of official guests.
- Memberships of professional associations.
- Holiday home facility for employees drawing salary less than Rs.2,000 per month, while for others, at a reasonable rent.
- Subscription for technical business journals and newspapers.

This completes our discussion on the tax management of salary and perks, which began last week. However, there are ways and means available to salaried individuals to reduce their tax liability, courtesy section 80L and section 88 of the Income Tax Act, which provide incentives for investment.

**Reducing tax liability through investment**

Individuals can reduce their tax liability by investing in certain specified securities, earnings from which are deductible under Section 80L and Section 88 from the taxable income. Taking full advantage of these provisions can significantly reduce the tax liability of an investor. We shall discuss the details of these provisions and their implications in a forthcoming article.

**To summarise**

First, find out all the components of your salary. Next, make sure that you are utilising all the allowances possible. Also carefully obtain and maintain all bills related to allowances and perks that are eligible for exemption. Once you have minimised your taxable income through effective tax management of your salary, you are ready to move on to the next stage - reducing your tax liability further through effective investment.
How do you compute tax on your total income?

By a panel of experts

There is no need for you as an individual, to take recourse to a tax consultant merely for the purpose of calculating the tax payable and filing your returns. You would do better if, instead, you utilise the consultant’s expertise to obtain advice to design an investment strategy that maximises your take-home strategy based on your own risk taking capacity and your need for liquidity.

But to most taxpayers, working out the amount of tax payable seems a complicated exercise requiring the attention of a chartered accountant until you learn the simple algorithm of computing the tax payable.

So how do you go about it all by yourself? To begin with, all that you have to do is take your bank passbook and classify your incomes under the heads given below. Then, understand the provisions and follow the steps given under each head.

1. Salaries

This is the simplest to handle. The salary and taxable perquisites are chargeable to tax. Standard deduction is allowed @ 33.33% of the salary with a ceiling of Rs. 25,000 for those having salary up to Rs. 1 lakh, Rs. 20,000 for those with a salary between Rs. 1 lakh and 5 lakhs and nil for those with a salary higher than Rs. 5 lakhs.

Over and above this, Professional tax paid, if any is deductible. This tax varies from state to state.

2. Income from House Property

The owner of a house property, inclusive of the land attached, is taxed on the ‘annual value’ of the property. If the assessee has only one property where he is residing, the annual value is nil. If he has taken a loan to buy this property from some permitted sources, the interest is deductible with a ceiling of Rs. 30,000 and the capital attracts rebate u/s 88. If you have more than one property, go to a consultant. Where there are additional properties or the property is let out, there is no ceiling on the interest deductible.

3. Capital Gains

Long-term capital gains are treated as a separate block and charged to tax at the flat rate of 20%, irrespective of the size of the gains. Even this cost can be saved by investing the net sale proceeds in avenues covered by Sec.54EA with a lock-in of 3 years or the capital gains in avenues covered by Sec. 54EB with a lock-in of 7 years.

Short-term capital gains are added to the normal income.

4. Income from Other Sources

This consists of all the other investment avenues such as banks, post offices, Co-FDs, bonds of financial institution such as ICICI, IDBI, etc.

5. Exemptions and Deductions

Dividend from shares is now exempt, so ignore it while computing ‘Gross Total Income’.

Add the incomes from the four heads above and from the total, subtract the deductions available under Sec. 80L, 80D, 80G, etc. to arrive at ‘Total Income’. Refer to the previous article for details.

6. Income Tax Rates

Now, compute the tax payable by applying the following rates.

<table>
<thead>
<tr>
<th>Income range</th>
<th>Rs. under 50,000</th>
<th>50,000 to 60,000</th>
<th>60,000 to 1,50,000</th>
<th>Over 1,50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax at Minimum Level</td>
<td>Nil</td>
<td>Nil</td>
<td>1,900</td>
<td>17,000</td>
</tr>
<tr>
<td>Marginal Rate</td>
<td>10</td>
<td>Nil</td>
<td>Nil</td>
<td>10</td>
</tr>
</tbody>
</table>

7. Tax Rebates

From the tax arrived at as per the above formula, you are allowed to subtract 20% of the contributions made by you in instruments qualified under Sec. 88 such as PPF, LIC, ULIP and NSC VIII.

For infrastructure-related instruments, a higher limit of Rs. 70,000 (in place of Rs. 60,000) is available for the qualifying investment.

Amongst the avenues under Sec. 88, PPF was the leader of the pack until the infrastructure-related instruments like the Tax Saving Bonds of ICICI and IDBI with lock-in of only 3 years come into the arena.

Then again Sec. 88B, all senior citizens can claim a tax rebate up to Rs. 10,000, irrespective of the size of the income. If your 65th birthday falls within the relevant financial year, you get the title of ‘senior citizen’ for the year and all the subsequent years.

8. Agricultural Income

The general perception is that this income is tax-free. It is not.

The income is required to be clubbed with others for the computation of tax purposes.

Do you find all this complicated? Well an illustrative example next week will show you how easy it is.
What is a Fixed Deposit?

A fixed deposit is an investment of a certain sum of money that you make in a particular bank, non-banking finance company or manufacturing company for a specific period of time. You receive interest at a stipulated rate and at the end of the period you receive the deposited sum back.

Since both the period and the interest rate are pre-fixed, the invested sum is termed a Fixed Deposit. A fixed deposit is unsecured in nature.

What is the tenure for a fixed deposit?

There is no standard tenure. Generally, the period of a fixed deposit varies from a minimum of 15 days to a maximum of more than 3 years in the case of a bank, 1 year to 5 years in the case of a non-banking finance company and 6 months to 3 years in the case of a manufacturing company.

What are the interest rates on offer?

The interest rates depend on both the period of the investment and its depository i.e. whether it is a bank, non-banking finance company or manufacturing company. Generally speaking, in the case of a bank, and specifically a nationalised bank, they range from (approximately) 9.5% for a 1-year deposit to 10.5% for a 3-year deposit. Co-operative and private banks normally offer higher rates. Non-banking finance companies offer rates between (approximately) 10% for a 1-year deposit and 14% for a 3-year deposit and then taper it down to around 13% for a 5-year deposit. In the case of a manufacturing company, the interest rates vary from 10% for a 1-year deposit to around 14%, and in certain cases even 15% for a 3-year deposit.

What is the frequency of interest payments in the case of fixed deposits?

With the increasing availability of alternative avenues of investment over the years, the frequency of interest payments on fixed deposits has become flexible. Today, in order to appeal to a broader band of investors, different segments of which have different needs, interest is paid monthly, quarterly, half-yearly or annually.

What is a cumulative fixed deposit?

A cumulative fixed deposit is one where you choose to receive the due interest only at the end of, and not during, the period of the deposit. The accrued interest gets added to your deposited amount and the subsequent interest instalments are calculated on the sum of the deposited amount and the accrued interest. This is done progressively till the end of the period when you receive a lumpsum comprising your deposited amount and the accumulated, compounded interest.

Consider a two year cumulative deposit of Rs 10,000 with an interest rate of 10%. At the end of one year, the interest sum of Rs. 1,000 (viz. 10% of Rs.10,000) gets added to the principal sum. At the end of the second year, the interest of 10% works out to Rs. 1,100 (viz 10% on the cumulative sum, Rs. 11,000). Hence at the end of the two year tenure you will receive Rs. 12,100 comprising the principal sum invested (Rs. 10,000) and the cumulative interest (Rs. 1000 + RS. 1100) thereon.

Is a cumulative fixed deposit better than a regular fixed deposit?

Not necessarily. If you have taken care of your immediate requirement of funds and so do not accord any preference to liquidity, a cumulative deposit would be better because of its optimum yield. If, however, you were without an alternative steady income flow, a regular fixed deposit would be preferable.
How to balance safety and return in a fixed deposit investment?

By a panel of experts

In finance, there is a time-proven theory about the relationship between risk and return, which states that risk is directly proportional to return. This means that the greater the risk, the higher is the return and vice versa. Thus, if you are unwilling to take risks you must realise and accept that the returns expected may be lower. Striking the right balance between risk and return is really what you should look for.

Why do some companies offer very high interest rates while others offer relatively lower interest rates?

Depending upon the fund requirement and the availability of internal funds, different companies accept fixed deposits at different rates of interest. While in case of banks, even though there are RBI regulations that determine the upper limit of the rate of interest, of late they have been relaxed to a great extent. However there is complete absence of any such regulation, that can determine the upper interest rate limits, in the case of companies. Mostly, there is not much variation between the interest rates offered by reputed companies. Sometimes companies that offer significantly higher interest rates are found to be less reputed and enjoying of low investor confidence. Hence, while it is imprudent to give a conclusive answer, it is for you to check the antecedents and immediate plans of a company before investing your money in its fixed deposit scheme.

How do you evaluate the safety of a Fixed Deposit?

You can gauge the safety level of a fixed deposit from the credit ratings awarded by credit rating agencies. The credit rating of a fixed deposit reflects the evaluation of its safety level with regard to timely payment of interest and repayment of your principal amount. At present there are four credit rating agencies in India:

- Credit Rating Information Services of India Limited (CRISIL)
- Investment information and Credit Rating Agency of India (ICRA)
- Credit Analysis & Research (CARE)
- Duff & Phelps Credit Rating India Pvt. Ltd. (DCR India)

How do you understand and distinguish between the different ratings awarded by the major credit rating agencies?

The different ratings awarded by the major credit rating agencies are:

- AAA • Highest Safety
- AA • High Safety
- A • Adequate Safety
- BBB • Moderate Safety
- BB • Sub-moderate
- B • Inadequate Safety
- C • Substantial Risk
- D • Default

Does a credit rating, once awarded, remain constant throughout the period of the Fixed Deposit?

Not necessary. A credit rating is valid normally for a specified period only. However, credit rating agencies keep a close watch over the performance of the company and, whenever it so merits during that period, can downgrade or even upgrade the awarded rating. All said and done, while you may rely on the ratings awarded by credit rating agencies, it is not they who are responsible for the safety of your funds. It is for you, the investor, to exercise your own discretion while making an investment.
What factors should you consider before investing in a bond?

By a panel of experts

In the last article, we looked at the characteristics of bonds and some aspects of bonds as an investment option. Now, how to select a suitable investment option from the choices before you? Simple. Examine the features of the issues and rate each bond on five key counts: safety, return, tax benefits, liquidity and service.

How do you know which bonds are the safest?

The best determinant of safety is the credit rating that is issued by independent credit rating agencies. The Reserve Bank of India has made it compulsory for all domestic debt issues to be rated. Before choosing a bond, therefore, check its credit rating. A bond rated AAA (pronounced "triple A") has the highest safety.

How do you evaluate the rate of interest?

Any investor would like to see his money earn more interest. But, you must bear in mind that higher the return, higher the risk. So, try to strike a balance between return and safety.

The coupon rate will indicate the amount of interest that you will get on your investment. The coupon rate is the interest rate that the company agrees to pay each year. However, in your evaluation of the returns from a bond, what you should look at closely is the yield. The yield depends on several factors. It is not necessarily the same as the coupon rate.

We shall discuss the difference between yield and the coupon rate in detail in later articles.

How important are the tax benefits available on bonds?

Tax benefits too can have a bearing on the effective return to you. Tax rebates available under sections of the Income Tax Act can be determinant for investment in bonds. The various tax benefits from bonds will be covered in detail in a separate article of this series.

What if you need your money at short notice?

You must evaluate the liquidity of the bond because it will determine the ease with which you are able to access your funds, if you need them in an emergency. The main avenues of liquidity are listing of the bond on recognised stock exchanges and the facility of early encashment of the bond.

Why is service an important factor?

When there is more than one instrument bearing similar safety, return and tax-benefit features, the differentiating and deciding factor can be service. Avoid companies that are known to delay mailing out of cheques. Look for companies that have set up dedicated investor service cells to handle investor-related grievances. They are likely to be prompt in answering your queries.

Each of these factors would be examined in greater detail in future articles.
What should you know about filing your income tax returns?

By a panel of experts

Today, let us look at the various aspects that concern the filing of your return of income.

Who should file a return of income?
It now has become mandatory for you to file your tax return if you fulfill any one of these six criteria:
1. You have a telephone (including cellular telephone) subscriber.
2. You have spent on foreign travel.
3. You own a motor vehicle (two-wheelers, including those with sidecars, are not treated as motor vehicles)
4. You own residential or commercial premises with floor area above certain specified limits. This is applicable at present in each of 54 cities that have a population of over 5 lakhs.
5. You hold a credit card.
6. You are a member of an expensive club.

Senior citizens with no business or professional income, even if they possess immovable property or have subscribed to a telephone, are exempted from filing their tax return by Notification No. 10674 dated 20 August 1998.

How does one file a return of income?
Personal return of income is filed in Form no. 3 and corporate return of income is filed in Form no. 1.

What is the importance of Permanent Account Number (PAN) / General Index Registration number (GIR)?
It is now statutory for every person having taxable income to have PAN (in the absence of which a GIR no. is issued temporarily). This apart, you will require a PAN/GIR for:
- Transactions in share exceeding Rs. 10 lakhs.
- Opening new bank accounts.
- Bank/Company FDs, Bonds or Debentures over Rs. 50,000.
- Post Office Savings Bank Deposits exceeding Rs. 50,000.
- Making an application for a telephone (including cellular) connection.
- Making payment exceeding Rs. 25,000 to a hotel.

If you have not been allotted PAN or GIR, you must fill Form 60, giving therein the particulars of the transaction in question.

Application for PAN/GIR is to be made in form no. 49-A before 31st May of the assessment year (i.e. the year in which you file your returns).

What is the last day for filing income tax returns?
The last dates for filing the returns for the financial year 1998-99 for different entities are:
1. All individuals, HUFs and other entities: 30th June.
2. Business income or income from a profession: 31st August.
3. Assesses whose accounts are required to be audited: 31st October.
4. Companies: 30th November.

What happens if you do not file your return of income?
Not filing your Income Tax return before the last date will invite penalty proceedings from the Income Tax authority. However, such penalty proceedings can be avoided by filing your return of income within one year from the end of the assessment year.