OUTLOOK

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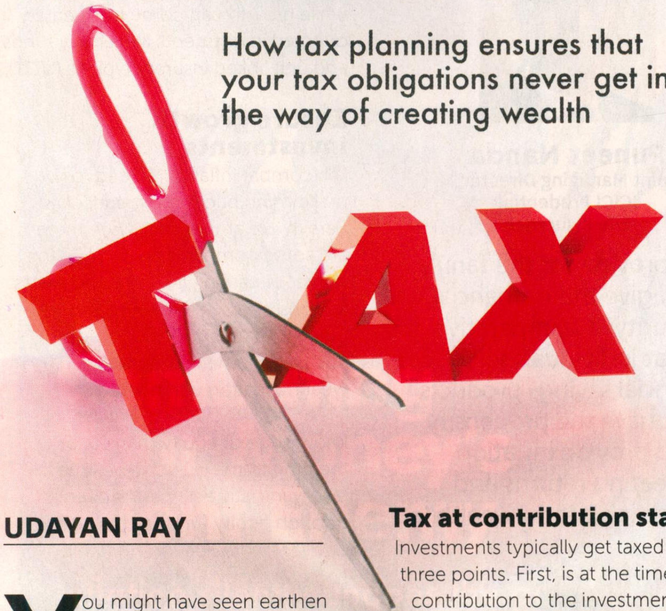
Get Tax Efficient

How tax planning ensures that your tax obligations never get in the way of creating wealth



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You might have seen earthen vessels in many parts of the country used to store liquid jaggery so that they can be used for cooking from time to time. Suppose, an earthen vessel was to develop a crack, or worse, a small perforation, the jaggery would leak over time. Taxes on investments create the same effect of leakages in the process of wealth creation. "One has to pay tax. There is no choice. However, payment of tax takes away your return," says Nilesh Shah, managing director, Kotak Mahindra Asset Management Company. "By planning your tax within the ambit of law, you can defer or lower the tax payment. This lowering or deferment benefits your return. Do remember that tax planning is different from tax avoidance," he adds.

While comparing investments for a financial goal, ensure that you are aware of the taxation at the time of investment, for returns and on maturity

Tax at contribution stage

Investments typically get taxed at three points. First, is at the time of contribution to the investment.

Here the benefits accrue from tax saving investments especially those eligible for annual tax deductions of up to ₹1.5 lakh under Section 80C like Equity Linked Savings Scheme (ELSS). The tax savings is the most for those in the highest tax slab of 30%. "One way of looking at an investment of ₹1.5 lakh in ELSS is that it saves ₹47,000 and adds to your savings from day one," says Kalpen Parekh, president, DSP BlackRock Mutual Fund. Depending on where the every rupee of tax savings is invested, it could become ₹20, especially after long investment periods of say, 20 years, for equity investments."For families often running on a stretched budget, every penny saved is a penny earned," Kailash Kulkarni, CEO, L&T Mutual Fund.

Tax on returns

The second point of taxation of investments is on returns. "Many consumers end up focussing on absolute returns from an investment instead of the returns after tax," says Ashish Vohra, ED & CEO, Reliance Nippon Life Insurance. Here, there are some classes of investments that have an edge. So, while interest from a fixed deposit gets added to your income and taxed according to your tax slab, your returns in an unit linked insurance plan (ULIP) don't get taxed. In case of mutual funds, while dividends are tax-free in the hands of the investor, capital gains get taxed when you sell the units.

Tax on maturity

The tax treatment for maturity proceeds varies among investments. While life insurance maturity proceeds for plans like ULIPs are tax free under Section 10(10)D subject to certain conditions, you need to pay long term or short term capital gains for mutual funds with taxation varying according to factors such as period of investment and whether it is an equity or debt fund. You similarly have tax regulations for capital gains from real estate.

To conclude, wealth creation and tax planning go hand in hand. Sums up Puneet Nanda, joint managing director, ICICI Prudential Life Insurance: "Wealth creation is important but wealth creation with efficient tax planning is equally important."

Kailash Kulkarni
CEO,
L&T Mutual Fund

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The author is a personal finance expert and a founder of FundooMoney Media, an e-learning company