NEW CHAPTER!
Essential Formulas Every Investor Should Know

WHAT EVERY INDIAN SHOULD KNOW BEFORE INVESTING

Fixed Deposits, Recurring Deposits, PPF, EPF, Gold, Senior Citizens' Savings Scheme, NSCs, Mutual Funds, SIP, Life Insurance, Health Insurance, Stocks, Real Estate, Writing a Will, Making a Financial Plan and more... explained in simple, easy-to-understand language!

VINOD POTTAYIL

FOREWORD BY **DR. M T RAJU**
PROFESSOR IN-CHARGE,
INDIAN INSTITUTE OF CAPITAL MARKETS

WHAT EVERY **INDIAN** SHOULD KNOW BEFORE **INVESTING**

Investment ideas on Fixed Deposits, Recurring Deposits, PPF, Gold, Senior Citizens' Savings Scheme, Mutual Funds, SIP, Life Insurance, Health Insurance, Stocks, Real Estate and more… explained in a simple, easy-to-understand manner!

Published by Imagine Books Pvt. Ltd.
Lotus, Mulund West, Mumbai - 400080
vinod@everyindian.co.in
What Every Indian Should Know Before Investing
ISBN 978-81-906972-1-7

Printed by
Rashmi Graphics
#3, Amrutwel CHS Ltd.,
C.S. #50/74, Lalbaug,
Mumbai 400 012.

Fourth Edition, 2017

DISCLAIMER

Please note that the facts and figures mentioned in the book are based on the latest information available at the time of publishing. Since they could change with time, readers should verify the information before taking any financial decision.

Also note that not all investments covered in this book may be suitable for every investor. Investment needs depend totally on individual situations and this book in no way recommends one investment option over the other. Readers are requested to make their own investigations and seek appropriate professional advice before opting for any of the investment options mentioned.

While due care has been taken in compiling the information for this book, we do not guarantee that the content, recommendations and analyses are complete and accurate The author and publisher do not accept any responsibility or liability, whatsoever, for any error, omission, opinion or misrepresentation of information, however it may have occurred, and disclaim any liability to any person or group for the consequences of any decisions based on the contents of this book.

For my dad

TABLE OF CONTENTS

FOREWORD

Wealth creation and management have become essential ingredients for a good life in modern society. A disciplined approach towards savings, investment, and investment management are the building blocks to creating wealth.

Every citizen, in any part of the world, needs to understand the available investment products—their features, merits, and demerits—before taking an investment decision. Understanding the ecology of investment presupposes financial planning, which in turn demands the thorough understanding of financial ecology.

With his passion and commitment, Mr Pottayil has systematically analysed various investment opportunities available in the country. He has also taken the best efforts to explain the advantages and disadvantages of each type of product with his analytical abilities and insights to the subject. Even critical and complex features have been put across in a simple and lucid way. I feel the book will be very useful for all the people of the country. Reading and following the advice and suggestions here would make prospective investors wiser. I wish the author and this book great success.

Dr M T Raju

Professor & in-charge, Indian Institute of Capital Markets

ABOUT DR MT RAJU

Dr M Thiripal Raju, Professor & in-charge, Indian Institute of Capital Markets (IICM), has worked as Economic Adviser to the Securities and Exchange Board of India (SEBI). He obtained his PhD from IIT, Mumbai. He has worked with many premier institutions like the Bombay Stock Exchange and was a faculty member of the National Institute for Industrial Engineering (NITIE), Mumbai. He has also been a member of various committees and groups, including the committee set up by SEBI; the Expert Group formed to develop diploma programmes on capital market operations by the School of Management Studies of the Indira Gandhi National Open University (IGNOU), New Delhi; the Board of Studies of Finance, Narsee Monjee Institute of Management Studies (Deemed University); and the Advisory Board of the Institute of Company Secretaries of India to look into post-membership courses on capital markets and financial services.

He has also graced numerous other committees, offered consultancy to private as well as public sector organisations, and published a number of research papers in reputed national and international journals and periodicals.

PREFACE

Writing this book was not something I had planned. The idea for it came to me after having a series of unsuccessful discussions with my sister who had just started on her career and wanted to know about investing. As the older sibling who was already employed, and thereby investing for a few years, it was but natural that she assumed that I would know everything about the subject. For my part, I was confident that I could answer all her questions and help her on the path to investing.

But that's when reality struck. As I tried to answer her questions and explain how investments worked, it became clear to me that I may not know all that I thought I knew. Every question led to even more questions and in many cases I had to check various resources to get the information. Many a times, the information was not easily available or it was available in such a manner that I had to spend days trying to figure out exactly what it meant. I tried to find a single source—a book or a website—that could explain everything I needed to know about investing so that I could use it as reference. But despite my best efforts, I couldn't find any that was simple enough for either of us to understand.

It was during this time that I turned to some of my friends and colleagues for help. As I started talking to them, I realized that most of them were in the same boat as I. Forget about the big picture and information about different schemes available in the market – many of them weren't even sure of the schemes they had invested in…. The more I interacted with people, the more it became clear to me that the majority of us were making investment decisions without being fully aware of what we were getting into. What was even more surprising was that almost everybody seemed to accept their finance-related ignorance as an unavoidable part of life. Nobody was shocked or surprised when I pointed out that this lack of knowledge could have an adverse affect on our future and long-term financial security. The general perception was that we should have faith in the institutions that managed our money and that eventually everything would fall in place. It was an incredible situation and I have to confess that I was investing with a similar mindset until the time I started questioning my fundamental understanding of investing.

My curiosity got me checking the overall scenario and I realised that the problem wasn't limited to the people I knew; it was universal. According to various reports and studies done across the globe, millions of people all over the world were uncomfortable exploring the world of finance and were content investing in time-tested options. Very rarely did people step out of their comfort zone to question and change the way they invested. There were thousands of case studies from almost all parts of the world that showed people's lives getting affected for the

worse due to poor investment decisions or because they hadn't planned their finances well. Along with making mistakes, people were also missing out on wonderful investment opportunities simply because they were not financially aware or updated. People who never explored these options before would curse their luck for having missed out on a profitable investing opportunity: whether it was stocks or real estate or gold and so on. Some amongst them would hastily invest in order to take advantage of the situation, often based on tips from various sources and end up losing their hard-earned money in the process. Even those who had access to financial advisors or relationship managers were not completely updated on the investment scenario and products. Many would happily toe the line drawn by these experts, at times with not-so-happy results!

THE NEED TO BE FINANCIALLY LITERATE

But isn't lack of financial knowledge just one of the many problems we face, you may ask. And like so many other things in life, won't we eventually learn to manage our finances?

The answer, unfortunately, on both counts is "no".

Look around and you'll notice how rising costs are decreasing the value of money with each passing year. Consider the cost of buying a home, hospitalisation, paying for the education of a child, and so on, and you'll realise how easily our life's savings could disappear if we don't manage our money wisely. And it's not just rising costs—the way we plan to take care of unexpected situations like job loss, a serious illness of a family member, a career-threatening accident, and even death, will decide how our families survive such incidents without becoming financially distressed.

If we ignore to plan our investments and assume that the money will take care of itself, it won't be a surprise to find ourselves in financial difficulties if our earnings are affected or if the economy decelerates.

HOW WOULD THIS BOOK HELP?

This book tries to explain investing and investment options in the simplest manner possible. As mentioned earlier in the chapter, I started writing this book to help my sister learn the ropes of investing. So everything in this book is written keeping the beginner's mindset in view. The overall objective of this book is to make you a knowledgeable investor: a person who is aware of what needs to be achieved through investing and knows how to achieve it in real life.

This book gives you both the big picture and the little details that are important for you to take decisions. The big picture will help you understand what investing is all about and how you should invest keeping in mind your life situation. The little details will equip you with the tools and skills required to act on your plan. Some concepts like Stocks and Real Estate are truly complex and require dedicated learning to master and benefit from them. The explanations of such

investment options in this book are therefore limited to the broader concepts and the steps involved to become a better stock or real estate investor. These chapters will thus lay the foundation for you to explore and learn more about these investment options, should you feel you want to invest in them.

This book doesn't assume that you are already aware of the fundamentals of investing, including investing terms, taxation rules, formulas, etc. If you know basic arithmetic, have handled a bit of money and know how to operate a bank account, then you have enough knowledge to learn from this book.

HOW DO YOU READ THIS BOOK?

I would recommend that you read through the book from beginning to end even if some of the options may not interest you or may seem irrelevant because of your current financial situation. This is because only after you understand an investment option clearly should you reach a conclusive decision about it. If you are ignoring an investment option because of some preconceived notions or past experiences, then reading about that option will help you decide whether you were right about it or not. For example, you may think that stocks are too risky or mutual funds too complicated or PPF too slow and boring—which may not be the case, once you understand these investment options better. After you have read and understood each investment option, you can use this book as a handy reference every time you have to make an investment decision. Do note however, that details regarding investment options keep changing, so you should always verify each detail before you take a final decision. There are enough online resources that will provide you the latest information. Because this book tells you what to look for, the task becomes much easier.

You should consider this book as your stepping stone to becoming a knowledgeable investor. The advantages of becoming a knowledgeable investor are many: you will not only be able to understand and manage your investments better, you'll also gain the confidence to explore the world of investing on your own, plus communicate more effectively with financial institutions, advisors, agents—anyone who is involved in managing your money. As a knowledgeable investor, you'll also be able to impart basic knowledge of investing to other members of your family– especially youngsters—a critical but often-neglected aspect in most Indian households.

There are other reasons why you need to be financially aware. In the future, investment products will become more sophisticated (and, in turn, more complicated), their marketing could become more aggressive, and technology will play a dominant role in the way you manage your finances.... From online banking to mobile wallets to the rapid developments in banking and the investment ecosystem—the changes are already happening and unless your fundamentals are clear, you'd struggle to keep up. This, in turn, would affect the quality of your investments and your financial life. If you're financially aware, you'll be in a much better position to safeguard your interests and benefit from

these developments. The knowledge that you acquire through this book will thus lay the foundation for learning and managing your finances more efficiently in the future.

FEEDBACK

Let me clarify here that I'm not a registered investment advisor and this is not a book on investment strategies or tax planning. The role of this book is simply to make you a more aware investor by clearing the confusion and clutter that surrounds investing and investment options. It will answer those small but fundamental questions that would help you make decisions about various investment options. Reading this book doesn't imply that you can manage investments on your own or that you could bypass the needs of a good investment advisor or tax consultant. On the contrary, it will arm you with the knowledge to actively pursue your investments and seek out the best resources available in the market to augment your investments and thereby the returns you gain from it. There's an ocean of investment services available—online and offline—private and by the government—all of which becomes accessible to you once you become a more knowledgeable investor. I sincerely hope that this book will be useful to people of all ages who want to be in control of their financial life.

After reading this book, if you have any suggestions or feedback, please write to me at vinod@everyindian.co.in. I'd also like to remind you that while my editors and I have taken the greatest care about facts and figures, do let us know about any errors, omissions or discrepancies that you may encounter so that we can correct them in future editions. Finally, investment specifications change periodically, so do confirm the latest facts and figures before you take any decision.

I wish you the very best for a prosperous and fulfilling life ahead!

ABOUT THE AUTHOR

Vinod Pottayil is a writer with more than 20 years of experience in the publishing and software industries. Over the years he has been involved in various offline and online projects that required an understanding of consumer behaviour, consumer learning preferences and design methodologies. He has worked with and provided consultancy for organisations like Sobhagya Advertising, Indian Express, Aptech, IL&FS, Netcore Solutions and National Institute of Securities Markets, among others.

Vinod is passionate about ideas and efforts that make a positive difference to the life of the average Indian whose concerns and aspirations he strongly identifies with. He keenly follows developments in the field of mobile technology, environmental design and education as he feels they have the potential to make the greatest difference to society. Originally from Kerala, Vinod considers himself a true-blue Mumbaikar and lives with his family in Mumbai.

ACKNOWLEDGEMENTS

This book wouldn't have happened if the people closest to me hadn't believed and supported me through the effort of putting it together.

This book might still have remained incomplete but for the support and encouragement of many helpful people whom I met during the course of writing it: my professors at SIESCOMS, the teaching staff at various financial institutions, the staff at various banks and post offices and the senior management at some of the leading financial institutions.

My heartfelt thanks to Prof. Subramaniam of SIESCOMS for his enthusiastic belief in my work. His timely tips and references were invaluable in overcoming many stumbling blocks that came my way. Without his help and guidance, my journey would have undoubtedly been much longer!

I'm grateful to Dr Rachana Baid and Dr M T Raju of the Indian Institute of Capital Markets (IICM) for taking time from their busy schedules to offer valuable insights and advice. My special thanks to Dr Raju for writing the foreword.

I would also like to express my gratitude to Ms Alpana Killawala, Chief General Manager at RBI, for giving me her time, inputs, and moral support. Many thanks also to Ms Lakshmi Mohan and Prof. Sharad at ICFAI for giving me a thumbs-up for this book. My warmest, heartfelt thanks to Ms Swati Godbole, professor of Financial Management at SIESCOMS for reviewing my book and pointing out areas for improvement.

There are many people from the banking and investment industry who took the time to review chapters, offer inputs, and discuss the book but didn't want to be publicly acknowledged. I respect their need to remain anonymous, but cannot avoid showing my appreciation here. To all of them: thank you for being such wonderful people!

This book also owes its existence to the help of friends, old and new, who lent their precious knowledge and skills in times of need. Sharon and Hasmita Chander, who gave this book much more than I could have asked for; their editing skills have made this book so much more readable. Special thanks to CA Deepak Lala for the clarifications he provided on various technical matters and to Mr Chetan Bhatia, my personal investment consultant, for wading through chapters that I felt were complex and offering his insights to simplify them. A warm hug and thanks to Gopal Gidwani for providing technical inputs on various topics. Gopal is a self-taught personal investing expert who shares a similar

outlook on financial literacy.

My long-time friends and wonderful visual designers Vivek Surve, Anita Dake, Sachin Parab, Shalaka Shinde, Rupali Dalvi, and Ranajit Tendolkar provided ideas for the book cover, page layouts and formatting, and a great deal of encouragement for tackling a subject that personally gave them the shivers. And last but not least, my love and thanks to Jili, my wife, for her support and patience during the process of writing this book.

CHAPTER

01

TELL ME QUICKLY ABOUT INVESTING

"Investing is simple, but not easy," said Warren Buffett, one of the richest men in the world, and without doubt, the world's most successful investor, having made his fortune of more than $60 billion almost exclusively through investing.

What could Buffett have meant when he said that? If something is simple, why should it be difficult to do? This particular quote is relevant to the concept of investing and it helps us look at investing from the right perspective. I'll use an incident that happened during my childhood to explain it better. The story may sound familiar to some of you because a similar incident might have happened in your life too.

The story goes back to my childhood, when during the festival of Vishu, relatives and friends would drop in for a visit and give children gifts in the form of cash. I remember the first time it happened; we had just finished wishing a favourite uncle when he took some money from his pocket and put it in our hands. This was something that had never happened to us before! You have to remember, I'm referring to an incident that happened a few decades ago—it was a time when children were hardly given any money to spend—at the most, they would be given a few coins to buy sweets or balloons. Otherwise, money was a commodity that children rarely got to handle. So what took place that day was really extraordinary.... To continue with the story, most of the visitors that day repeated this behaviour. It was a strange, magical day and by the time the sun had set, the three of us had collected a tidy sum. And as you'd expect of children, we got all excited about how we would splurge our new-found wealth: chocolates, toys, audio cassettes, cricket bats—all sorts of exciting options filled our little heads.

But even as we were fine-tuning our plans, something unexpected happened. Someone came and calmly took the money from us! And guess who that person

was...? No, it wasn't the neighbourhood bully; it was none other than our dear mom! Although she was “kind” enough to return a small part of the fortune to us, the major part was deposited in her purse which she kept under lock and key in the cupboard.

We were dumbstruck by her actions to say the least. "Why did you do that?" we protested.

"Don't worry. I'll keep it safe so that we can buy something nice and valuable with this later," mom said with a smile.

"Why later? Why not now?" I cried, being the eldest and having overcome the initial shock. "I'll add some money to it in the next few days and we'll buy something you really, really want," she replied.

What did that even mean? It didn't make any sense to us. "It could be a music player or a fish tank or a cricket set..." mom continued, trying to convince us that the deal was in our favour!

Investing is difficult because it challenges our basic human nature to spend, enjoy and satisfy our needs as early as possible—instead of later.

Were we convinced? Not at all! Did we believe what mom told us? Not one bit! But it was tough arguing with her at that time. Over the next few days, we tried everything we could to get our money back. We sulked, threw tantrums, made unreasonable demands in the hope of cutting a deal; we gave mom looks that we hoped would make her feel guilty. But nothing worked. My sisters and I would discuss loudly in her presence about the things we could have bought with the money—but again, mom didn't react. As the weeks dragged on, we realised that our money was as good as gone....

Until a few months later, as we returned home from school, what did we see! A brand new music system—kept strategically beside our television! What a sight it was! And when mom told us that it was purchased from the money we had “given" her, our feeling was one of pure euphoria! My sisters and I were puzzled but thrilled that the money we wanted to spend on chocolates and small toys was really worth so much and that it had turned out to be so useful!

This incident, more or less, captures everything that is simple yet difficult about investing.

Investing is simple because it only requires us to keep some money aside so that it grows more valuable over a period of time. Investing is difficult because it

challenges our basic human nature to spend, enjoy and satisfy our needs as early as possible—instead of later.

It is difficult because we have to be patient and disciplined for long stretches of time. It is difficult because all around us we see people spending and having a good time while we sacrifice those pleasures. In case we have young children or senior citizens who are dependent on us, they too are forced to participate in the process, making it even more challenging (that's why the classic investing advice is to start early and young).

Investing is also difficult because we have to make a lot of decisions—differentiating between “needs” that have to be fulfilled and “wants” that could be reduced. Food, clothing, house, medicines, and education: these are needs and ideally we should not compromise on these. However, eating out, going on vacations, watching movies—these are wants and the money spent on them could be reduced in order to set aside money for investing. Because it is so easy to give in to these temptations, investing is a challenge for most of us. Buffett thus rightly captured the essence of investing when he said that as a concept, it is simple, but putting it into practice is difficult!

The good news is that investing is like any other habit we acquire. If we succeed in remaining disciplined the first few times, investing becomes a matter of routine. And like any successfully acquired habit, the key is to be clear about the goals we hope to achieve with that habit. If our goals are clear, there's motivation to curb our desires and thus become a disciplined investor. To use an analogy, if we can see the finishing line, it makes us move towards the destination in a much more focused manner. If we are unsure about where we are heading, there's nothing to stop us from being distracted and wandering all over the place. Same is the case with investing. Having a purpose or a goal makes you a more disciplined investor. It ensures that you are aware of the consequences of irresponsible or unplanned spending. For someone without goals, this realisation will only occur in the future, when it might be too late for corrective action. (We'll look at identifying goals and creating a financial plan in Chapter 21 of the book. This chapter will also explain how we should go about setting aside money to invest for each goal—a subject many of us are unsure of.)

CAN WE AFFORD NOT TO INVEST?

I'm sure the answer to this is obvious to all by now! Investing is something one just cannot wish away. We have to invest in order to achieve our life's major goals—a house, higher education, marriage, children's education, their marriages, retirement, healthcare and so on. Without proper investments, these expenses can become difficult to cope with for most of us. Proper investing is the only way to ensure that we move smoothly through these phases of life without worrying too much about their financial impact. Even if we decide to do away with some of these goals, there's no escaping some amount of investing for our health, retirement years, etc.

To make sure we are able to achieve our goals, we should not only be able to keep aside money for investing, we should also be able to invest it well. That's the second challenge of investing! Choosing the right investments is not easy; there are too many options in the market. While the right investments can make our dreams a reality, the wrong ones will not only drain our finances but also deprive us of our peace of mind!

To add to the challenge, there is a flood of information about investments and investing all around us in the form of articles, blogs, advertisements, marketing calls, emails, PowerPoint presentations, and so on. Which one can we rely on, which one is an attempt to make us buy an unsuitable investment? Which one is ideal for our future needs, which one is going to be money down the drain? While there may be no deliberate intention to mislead by the people or institutions involved, we have to be very careful as the decisions we take will affect the quality of life we live. Some of the major investment decisions will determine our financial security and that of our loved ones for years to come.

SO HOW DO WE CHOOSE THE RIGHT INVESTMENTS?

While everyone cannot become a financial expert, we can aim to have basic, fundamental knowledge about investing and investment options. This knowledge can help us evaluate investments better and enable us to separate options that are useful from those which are not. It can empower us to look beyond the information provided and seek answers that will lead to the right investment options. It will make us question, probe, and analyse details, and thus take informed investment decisions instead of being swayed by attractive numbers and glowing projections. Becoming a knowledgeable investor is thus the first and most crucial step in safeguarding our financial interests.

The aim of this book is to provide you with the fundamentals of investing and the most commonly available investment options in the market. These investment options suit different investment needs and styles, each having their own set of positives and negatives. Some of them will work well for you but not for others, and vice versa. What you need to do is read these investment options carefully to identify the ones that will help you achieve your financial goals. Use this information to evaluate your existing and future investments, and make this knowledge the stepping stone to your journey into the world of investing. If you know what your goals, dreams, and commitments are, you should be able to identify the right investment options by the end of this book. I wish you the very best in your journey to a prosperous financial future!

OTHER FAMOUS QUOTES BY WARREN BUFFETT FOR YOU TO READ AND PONDER

1. You only have to do a very few things right in your life so long as you don't do too many things wrong.

2. I try to buy stock in businesses that are so wonderful that an idiot can run them. Because sooner or later, one will.

3. Rule number one: Never lose money. Rule number two: Don't forget rule number one.

4. Someone is sitting in the shade today because someone else planted a tree a long time ago.

5. We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.

6. The difference between successful people and really successful people is that really successful people say no to almost everything.

7. In the world of business, the people who are most successful are those who are doing what they love.

8. Diversification is protection against ignorance. It makes little sense if you know what you are doing.

9. If past history was all that is needed to play the game of money, the richest people would be librarians.

10. Chains of habit are too light to be felt until they are too heavy to be broken.

NOTES

CHAPTER
02

WOMEN AND INVESTING

A lot of people, including many women themselves, feel that women are not good at investing. "Women don't understand numbers", "Women cannot manage money", "Women don't read the fine print"; these and other such statements are commonly aired whenever the subject of women and investing is discussed. The supporters of this theory justify it with the low number of women actively involved in investing either professionally or at a personal level. The truth, however, I believe is completely the opposite.

I believe, women can not only be good investors, they also have a natural advantage over men when it comes to investing. It's a broad generalisation, I agree, and there will be exceptions. But based on my experiences and observations over the years, I feel women can excel as investors. The reasons are many. Women have a natural instinct for numbers, they are more security-oriented, they have a long-term view of things, they know how to use money effectively and many of them are good at nurturing their investment portfolios. All ingredients that make for a good investor!

Don't agree? Let me explain with a few examples.

In most Indian homes, the daily expenses are managed by a woman, usually the wife or the mother. Running a house is no easy task. It involves buying the right quantities of each and every item at the right price, ensuring that the family eats healthy, making sure all day-to-day bills are taken care of, and at the end of the month, being able to keep some money aside for emergencies. The housewife does this skilfully, even as inflation rates move up and down, prices of essentials touch the sky and household income fluctuates. Did someone say women couldn't handle numbers?

Women, generally, are also more security-conscious than men. They prefer to follow rules and walk along the path that offers safety rather than adventure. Unlike men, who may jump into schemes even if the details are sketchy, most

women will hesitate to make a commitment until they are completely sure of the smallest detail. A study conducted showed that women spent almost 40% more time than men researching before they invested. Other studies prove that on an average, women take lower risks than men, and thus, make fewer mistakes.

Women also have a natural instinct for nurturing—whether it is babies or pets or plants—somehow, things thrive in their care. It could be the patience they are blessed with or their sincere interest in even the most seemingly insignificant things. The same is the case with investments—most women are able to nurture even the smallest amounts into something meaningful....

With the changing social dynamics, a woman's role in investing could well be the difference between a family that is financially secure and one that's struggling.

And these are just a few qualities that women possess. There are many more examples to prove that given a chance, women can not only become good investors, they could also outshine men. A major reason for the reputation women have acquired as bad investors is that until recently, social conditions and mindsets had sidelined women from taking investment decisions. Even in households where women might have been involved in financial discussions, it would usually be the male members of the family who would take the final decision. The woman's role was thus restricted to managing the household budget and making small investments. That's why this incorrect notion that women cannot be good investors was established, and unfortunately, accepted.

BUT THANKFULLY, THINGS ARE CHANGING NOW

With the growth in the number of nuclear families and a greater number of women joining the workforce, women no longer play a passive role in matters related to finance. Most working women have their own bank accounts, many have investments in equity, tax-saving instruments and a growing number of women play an equal role in the family's buying, saving and investing decisions.

Considering the rapid pace at which this change is happening and its impact on the financial welfare of the household, a woman can no longer afford to remain ignorant about finance. No longer can she rely on just her intuition or the basic knowledge she has acquired on the side to manage her finances. She needs to be actively involved and proactive in learning and understanding how money works and grows. With the changing social dynamics, a woman's role in investing could well be the difference between a family that is financially secure and one that's struggling.

If you're a woman, and you haven't already started investing, it's time you

made a beginning! If you feel you don't have enough knowledge about investing, start with safe and simple investment options. You needn't be working or married or have a big lump sum amount to start. Open a savings account and put in small amounts of money or start a recurring deposit with the minimum deposit possible. Enquire with a nearby bank. Even your local post office has various schemes—you can start with investments as low as ₹ 10 per month with them!

While it's important to make a start, don't make the mistake of being hasty. Knowledge about the investment scheme you opt for is crucial (that's what this book will help you learn). Ensure you don't get misled by an investment option that is suddenly in the news or schemes that are being heavily advertised. Dig deeper, enquire with people, and make the effort to find more information about the scheme before you decide to invest. Don't be a part of the herd that invests simply because others are doing so. Be especially wary of get-rich-quick schemes that offer fabulous returns. More often than not, you will end up losing the amount you invested!

If you don't understand a particular scheme, don't go for it. You may feel it is your lack of knowledge that's preventing you from understanding the scheme, but it may not always be so. Sometimes, the person who's explaining it may not be fully aware of the details to answer your doubts or the scheme itself may have gaps that cannot be explained without exposing its shortcomings. So if you are not completely convinced, just say "no". As far as possible, avoid investing using borrowed money. Make it a point to get involved in discussions on investments in your family. Ask questions, offer suggestions—as a family member, whether you're earning or not, how well your family does financially affects you too! Don't be discouraged if you are ignored initially. When you put in the effort, others will recognize the value of your inputs and make you a part of the discussions.

If you are already a part of the financial discussions or are involved in decision making then do be an attentive and involved participant. This is critical because many a time, the women in the family unquestioningly hand over all financial responsibilities of the family to the male members. And when things go wrong, the men are unable to confide their failures as they feel the women would not be able to understand the details, leading to really unfortunate consequences. Research shows that men can take huge and at times disproportionate risks which could be disastrous if not checked at an early stage. As a woman who's concerned about the well-being of her family, your inputs can moderate the amount of financial risk that a man would otherwise take. As mentioned earlier in the chapter, today, a woman has to be actively involved in financial decisions if her family has to prosper. So get started as early as possible!

SEVEN REASONS WHY WOMEN SHOULD GET MORE PROACTIVE ABOUT INVESTING

1. Life expectancy in India for women is around 70 years compared to 67 years

for men. And since women are usually a few years younger than their husbands, most will outlive their husbands by a few years or even decades. If you are already managing your investments on your own, it wouldn't be a challenge to continue doing so during your later years. But if you had to start doing it after the demise of your partner—that could involve a steep learning curve.

2. Although India still has a low divorce rate compared to many foreign countries, the rate is increasing with each passing year. Women should therefore not discount the possibility that they might have to manage their finances on their own in case of such an eventuality. It's always better to start learning now than to be forced to learn it later.

3. Many women leave their jobs to manage their children and the home. If the woman also gives up her involvement in the investing and retirement planning process, she may find herself in a difficult position in case of early widowhood. Without proper investing and insurance, she would not only have to start earning again but would also have to start learning about investing at a very vulnerable stage in life. So never let go of your involvement in managing your investments even after you stop earning.

4. Many women nowadays opt to remain single. Although they may miss out on the second income of a spouse, they would be totally responsible and in control of their financial life. They may benefit from the assistance of their parents or siblings for some time but there would be no escaping the fact that they will have to eventually manage their finances on their own. So get started now!

5. Because women are more risk-averse than men, many women prefer to invest in options that are low in risk and offer lower returns. While this is a safe strategy, it is not the ideal strategy to earn returns that beat inflation or help you reach your goals faster. Women should therefore explore more about investing in stocks and real estate to earn higher returns on their investments. While such investments are not entirely risk-free, there are ways to minimize risk and earn higher returns than those offered by fixed interest schemes. The key is to understand the options available and invest in a systematic manner after understanding the pros and cons. So do make the effort to learn more.

6. A very disturbing fact that we come across with fair regularity is of families committing suicide en masse because of insurmountable financial problems. This is deeply distressing and becomes heartbreakingly more so when innocent children also become victims of such acts for no fault of theirs. While we cannot pass judgment on such incidents as each case is unique, every parent should do their best to ensure that they do not take unnecessary financial risks to land up in such a situation. The involvement of women in a family's financial discussions and decisions could prevent such situations from

arising. But women would be able to do so in a meaningful way only if they are aware about investing—including the merits and demerits of various investment options. Some investment decisions can be inherently risky and an informed spouse would be able to detect such unsuitable decisions and dissuade the partner from creating a situation that will put the family's survival at stake. There are quite a few instances of such incidents happening across the country and it's the duty of both parents to be aware of their partner's financial decisions before it is too late. In the interest of their family's well-being, it is important that women understand how investing works.

7. Nowadays both parents are equally involved in the upbringing of their children. However, on an average, mothers still spend more time with their children on a dayto-day basis. Women thus have the opportunity to educate their children about good money habits from a young age. Becoming a knowledgeable investor will make your task of imparting the right money skills to your children easier. Good money habits, the right attitude to money, financial discipline—these are some of the best gifts you can give your children, for which they will remain forever grateful.

Although this book is meant for all investors, I would like to dedicate this book to the women in India who are at the forefront of managing their own finances and taking a more proactive interest in investing. To emphasize the importance of the need for women to consider investing more seriously, I've used the personal pronoun "she" instead of the more generic "he" whenever I'm referring to an investor in this book. It's symbolic and it may sound inconvenient to a few, but I feel it's time we addressed this need for change in as many ways as we can.

SPECIAL INCENTIVES & SCHEMES FOR WOMEN

1. Some states like UP, Orissa, Delhi, MP, Punjab and others offer tax benefits, lower stamp duties and easier access to home loans for women. For example, in Delhi, women have to pay a stamp duty of only 4% as compared to 6% for men. Many banks also offer a discounted rate for home loans to women.

2. Along with health insurance, which should be mandatory for all, women can also opt for a critical illness policy that covers women-specific diseases like breast cancer, ovarian cancer, etc. You can read more about critical illness policies in the chapter on Health Insurance.

3. Married women could look at protecting their claims to life insurance benefits from creditors by using Section 6 of the Married Women's Property Act (MWP Act). This Act protects the financial interests of the wife and children following the demise of the husband. The policyholder (husband) needs to fill a separate form for this during the time of applying for the policy. The MWP Act can also be used by women when buying a policy (under section 5). In this

case, her children get the benefits of the policy; her husband doesn't get anything. Do note that the MWP Act passes on all benefits to the beneficiaries of the policy. So the policyholder, whether husband or wife, doesn't get anything even if he/she survives the period of the policy.

4. There are life insurance schemes that cater specifically to women's needs. This includes premium waiver on the death of the husband, premium waiver on diagnosis of specific diseases, etc. You can opt for these schemes instead of choosing a generic life insurance scheme. But do ensure that you study the policy terms well before opting for one.

5. If you are a homemaker with no income from employment or business, you should try to keep aside some money from your monthly expenditure, no matter how small, for investing. A PPF account (minimum ₹ 500 per year), investments in online Gold (GETF or Gold Mutual Funds) or even a long-term Recurring Deposit in a bank or post office (minimum ₹ 50) can accumulate into a sizeable amount over a period of time. These schemes are not specifically for women, but they are the easiest ways to start investing.

NOTES

CHAPTER
03

BASIC INVESTING TERMS AND CONCEPTS

Just like it's impossible to start reading sentences without first being familiar with alphabets and words, it will be difficult to follow topics and discussions on investments without first understanding basic investment terms and concepts. Such terms are not unique to the field of investing—every industry has its own set of unique terms—whether it's engineering, design, manufacturing, performing arts, etc. You should therefore be familiar with at least the commonly used terms and concepts in investing to understand investing better.

More often than not, it's our limited financial vocabulary that stops us from enquiring or discussing investing with others. The moment we hear "Section 80C" or "Bulls and Bears" or "Long Term Capital Gains" or "NEFT" and such terms, we find ourselves searching the financial dictionary in our mind for what they mean. If we're unable to figure it out in time or if we've never encountered that term before, we start losing track of the topic and thereafter find it difficult to make complete sense of what we've just heard or read. Over a period of time, we develop a negative bias or mental block about investing and our mind switches off automatically when we encounter any topic related to investing. That's why many otherwise intelligent and accomplished people (in their respective professions) excuse themselves the moment the topic of discussion shifts to investing.

So is there a solution? Fortunately, there are a set of basic terms and concepts that occur frequently in the world of personal investing. If you become familiar with them, it will make understanding and discussing investing much easier. I recommend that you read this chapter completely before you start reading the investment options in this book. The knowledge you gain will not only help you speed through the chapters inside, it will also give you the confidence to learn about and discuss investments with others.

ASSET

In everyday English, an "asset" is something of value. It could be a thing or even a person. In the world of finance, an asset is anything that has monetary value which can be converted into money. The ease with which a particular asset can be converted into money is called liquidity. From an investment point of view, assets are usually divided into two categories: liquid and non-liquid. A liquid asset refers to any investment that can be converted into money quickly without much loss of value when compared to the prevailing market price. Liquid assets include stocks, mutual funds, fixed deposits, gold, etc. as they can be easily sold and converted into money at their prevailing market price.

Non-liquid assets are investments that cannot be easily converted to cash—e.g. real estate, life insurance returns, provident fund, etc. In case you wish to convert them into money at short notice, you may do it at a loss or at a lower price than the current market price. Money (cash) is the most liquid asset you can possess as it is already money and needn't be converted. But liquidity is not the only factor to be considered when evaluating an asset. The risk and returns offered by each asset also need to be considered.

Assets can also be broadly divided into the following types: Debt, Equity, Real estate and Commodities. Debt is any asset that earns you interest; for example Fixed Deposits, PPF, NSCs, etc. Equity assets are those that give you a share in their growth, for example, shares of companies, and mutual funds that invest in shares of companies. Real estate assets are those which deal with land, homes, etc. while commodities are gold, silver, etc. that can be sold for a profit.

BSE

The Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) are two of India's premier stock exchanges. Established in 1875, BSE is Asia's oldest stock exchange. A stock exchange provides facilities for brokers and traders to trade stocks. Any company that issues shares and wants them traded has to list with a stock exchange. In India, a stock can be listed on the BSE as well as the NSE and an investor can buy and sell shares on either of these stock exchanges. As an investor you do not have to interact directly with the stock exchanges. But when you buy or sell shares through your broker or an online brokerage website, the actual transactions of shares happens on these stock exchanges.

Also see **SENSEX, NSE,** and **NIFTY**

BULLS AND BEARS

Bulls and bears are terms used in the stock market. In a bull market, the prices of stocks continuously move up and there is confidence amongst investors to keep buying. There is a lot of trading at stock exchanges during this time. In a bear market, the exact opposite happens. Prices keep falling and investor confidence reduces. The amount of trading is also limited.

It is to be noted that prices of stocks increase and decrease on a daily basis—this doesn't signify a bull or a bear market. Technically, a market is said to be in a bull or bear phase if there is a change of at least 20% up or down in the overall market. For example, if the SENSEX was at 25,000 points and it falls to 20,000 then we can say there is a bear market happening.

CAPITAL GAINS

Capital gain is the profit you make from selling assets like stocks, mutual funds, bonds, real estate, and gold. If you sell the assets at a lower price than what you bought them for, you incur a capital loss. When calculating capital gain and loss, you should also consider other expenses incurred such as commissions, fees, and documentation costs.

For example, if you bought shares and sold them later, your capital gain/loss would be the result of your selling price minus the cost of shares and the commission you paid while buying and selling (Profit or Loss = Selling Price - Cost Price -Other Costs).

To illustrate, assume that you bought shares worth ₹ 5,000 and sold them later for ₹ 6,000. Consider you paid ₹ 25 as brokerage while buying and ₹ 30 while selling. So the calculation will be:

6000 - 5000 - 25 - 30 = 945

Therefore, your profit or capital gain is ₹ 945, although you might assume it was ₹1,000 (₹ 6,000 - ₹ 5,000). Your capital gains tax would thus be calculated on ₹ 945.

CAPITAL GAINS TAX

Capital gains tax is the tax you pay on the capital gains you earn. There are two types of capital gains tax: short term and long term, depending on how long you held the assets before selling them. This holding period varies for different assets. Also, while you may have to pay short-term as well as long-term capital gains tax on some assets (depending on the holding period), for certain assets you only need to pay short-term capital gains tax.

For example, if you buy gold and sell it within 3 years, you'll have to pay short-term capital gains tax. If you sell it after 3 years, you'll have to pay long-term capital gains tax. However, in case of shares, you'll have to pay short-term capital gains tax if you sell them within one year. But if you sell them after a year, you won't have to pay any long-term capital gains tax on the profit you make (the profits are tax-free).

Short-term capital gains are usually added to your income and then taxed at the tax slab under which your income falls. The exceptions are stocks and equity mutual funds, where you have to pay a flat 15% tax on the short-term capital

gains. Long-term capital gains are taxed at a flat rate (subject to review from time to time)—but after factoring in the effect of inflation, called indexation. To arrive at the exact long-term capital gain, you'll have to inflate your cost price using indexation and then subtract it from your selling price. For details, please check the income tax website at www.incometaxindia.gov.in.

Also see **INDEXATION**

COMPOUND INTEREST

With compound interest, you earn interest not only on the principal—but also on the interest earned thus far. This is different from simple interest where you get interest only on the principal. You therefore earn more from compound interest on your investments.

For example, if you invest ₹ 5,000 at the rate of 8% for 5 years, the interest you get at the end of 5 years will be

= Principal (1+Interest Rate/100)^Period - Principal

= 5000 (1 + 8/100)^5 - 5000

= 5000 (1.08)^5- 5000

= 7346.64-5000 = 2,346.64

In case interest is compounded more frequently, say once every six months, the interest earned will be greater. The formula to calculate the amount in such a case will be P (1 + R/100 x T)^NT (Here, N is the period and T is the number of times you earn interest in a year)

= 5000 (1 + 8/100 x 2)^2x5 - 5000

= 5000 (1+ 0.04)^2 x 5 - 5000

= 5000 (1.48) - 5000

= 7401 – 5000 = 2401

So, when compounding is done more frequently, you earn a higher amount of interest even if the rate of interest is the same. If you were to earn simple interest, the amount you would have earned as interest at the end of 5 years would have been ₹ 2,000.

Also see **SIMPLE INTEREST**

COST OF LIVING

'Cost of living' means the amount of money needed to maintain a certain standard of living. This is measured by calculating the average cost of buying certain goods and services like food, clothing, fuel, medicines, transportation, etc. If inflation rises, the cost of living increases. The cost of living influences salary, minimum wages, tax exemptions, etc.

The cost of living varies from place to place within India. For example, in the metros and major cities, the cost of living is higher. Everything, like food, clothing, rent and transportation will be costlier than in the smaller cities, towns and villages. To compensate for this, salaries and minimum wages are higher in big cities.

DIVIDEND

A dividend is the payment made by a company to its shareholders or by mutual funds to their unit holders from the profits earned. The amount of profit to be shared is decided by the company/ mutual fund.

Earlier, dividends were announced as a percentage of the face value of a share or a unit. For example, consider a company that declared a dividend of 40% on a share with a face value of ₹ 10 and a market price of ₹ 200. At 40% for each share of face value ₹ 10, you'll get ₹ 4 as dividend for one share (10 x 40 / 100). If you held 50 shares, you'll get 50 x 4 = ₹ 200 as dividend.

Investors would sometimes assume that the percentage announced was on the existing market value of the share. In the above example, where the market value of the share was ₹ 200, if you held 50 shares, the market value of your investment would be ₹ 10,000 (50 x 200). A 40% dividend on it would be ₹ 4,000. There's a huge difference between earning ₹ 200 and ₹ 4,000, right? So while announcing dividends as percentages of face value was technically correct, there was scope for misinterpretation by investors.

Same was the case with mutual funds where dividends were announced as percentages of the face value of a unit. When such large percentages were announced, many investors would rush to invest in those schemes without understanding the scheme or the fact behind the numbers.

SEBI (Securities and Exchange Board of India) therefore made it mandatory for companies to declare dividends on a per-share basis. As per this rule, the company in the above example would have to announce a dividend of ₹ 4 per share instead of 40% per share. This method made it easier for investors to calculate their exact returns. So now, if you hold 50 shares, you know that at ₹ 4 per share, you'll earn a dividend of ₹ 200.

This example shows how lack of financial knowledge can mislead people to take incorrect financial decisions. Many investors would wrongly compare the dividend rate offered with the interest rate they earn from Fixed Deposits and Recurring Deposits, and invest their money in mutual funds without understanding the associated risks and the actual returns being generated. SEBI has made it mandatory for even mutual funds to announce the actual amount per unit that they would be offering as dividend instead of announcing it in percentages.

The financial year in which your income tax returns get assessed by the Income Tax department is known as the Assessment Year.

FINANCIAL YEAR (FY) AND ASSESSMENT YEAR (AY)

These are terms that have the potential to confuse many. Let's understand this with an example. You must be aware that unlike the calendar year which starts from January 1 and ends on December 31, the financial year starts from April 1 and ends on March 31, the following year (for example April 1, 2017 to March 31, 2018). This period, which spans two calendar years, is called the Financial Year.

For taxation purpose, a Financial Year can be of two types: Previous Year and Assessment Year. The financial year in which you earn your income is called the Previous Year. For example, if you are filing returns for income earned between April 1, 2016 to March 31, 2017 then the Financial Year 2016-17 will be known as the Previous Year. The financial year in which your income tax returns get assessed by the Income Tax department is known as the Assessment Year.

For the Previous Year 2016-17, the income tax returns will be filed and assessed in the following financial year, which will be 2017-18. So when you file your Income Tax Returns (ITR) form for the income you earned in 2016-17, you'll notice that it is mentioned as Assessment Year 2017-18!

IFSC CODE

The Indian Financial System Code or IFSC is an eleven-character alphanumeric code that is mandatory for making certain electronic fund transfers in India. This code uniquely identifies each branch of the banks involved in the transfer. Electronic fund transfer using IFSC Code can be made through Real Time Gross Settlement (RTGS) and National Electronic Fund Transfer (NEFT). If you have a bank account, you'll find the IFSC code in your cheque book.

Examples of IFSC codes:

- SBIN0006624: (Narkhed, Sholapur, Maharashtra branch of State Bank of India)
- ICIC0000004: (Nariman Point, Mumbai, Maharashtra branch of ICICI Bank)
- HDFC0000727: (Mandi, Himachal Pradesh branch of HDFC bank)

Also read **RTGS** and **NEFT**

INDEXATION

Indexation is a method to adjust the purchase price of an item to the existing inflation rate. It is used to compensate for the effects of inflation while calculating long-term capital gains. The indexation process thus ensures that the difference between the cost price and selling price during the intervening years is

accommodated for inflation. Indexation is calculated by using the Cost-Inflation-Index (CII) which is announced by the Income Tax department every year. Let's understand this with an example.

Suppose you bought a house for ₹ 25 lakh in FY 2000-01 and sold it for ₹ 50 lakh in FY 2007-08 (after 7 years). Since you've sold it after a period of more than 2 years, you'll have to pay long-term capital gains tax on the profit you earned. Now, without indexation, your profit will be ₹ 25 lakh (₹ 50 lakh — ₹ 25 lakh). With long term capital gains tax at 20%, you'd have to pay ₹ 5 lakh as tax on the profit you earned. But with indexation,your buying price gets adjusted and the tax amount will get reduced. The government had announced a CII of 100 for 2000-01 and 129 for 2007-08 (refer to the Cost Inflation Index (CII) Table).

The formula for adjusting cost price is:

Cost price (CP) x (CII of year of Sale / CII of year of Buying).

Adjusted CP thus becomes: 2500000 x (129/100) = 32,25,000

So the cost price of your house after accounting for indexation will be ₹ 32,25,000. The long-term capital gain on your home will therefore become ₹ 17,75,000 (₹ 50 lakh - ₹ 32,25,000).

You'll thus end up paying tax of ₹ 3,55,000 (20% on the indexed profit). Indexation thus considers the effect of inflation over the years on prices and ensures that you pay tax at an adjusted rate.

♦ COST INFLATION INDEX (CII) TABLE ♦

Following is the CII announced for various Financial Years:

Year	CII	Year	CII	Year	CII
2001-02	100	2007-08	129	2013-14	220
2002-03	105	2008-09	137	2014-15	240
2003-04	109	2009-10	148	2015-16	254
2004-05	113	2010-11	167	2016-17	264
2005-06	117	2011-12	184	2017-18	272
2006-07	122	2012-13	200		

Earlier, the base year for CII was 1981. This has now been shifted to 2001 in budget 2017. This implies that any capital asset bought prior to April 1, 2001 will have its purchase price calculated using the CII of 100.

INVESTMENT OBJECTIVES

There are a wide variety of investment options available. Each investment option has certain advantages and disadvantages. They can be evaluated on the

following criteria: liquidity, safety and returns. A fourth criterion—tax savings—is also important if you fall in the taxable bracket.

Your investment objectives determine which options you should select. For example, if liquidity (the ease with which you can get your money back) and safety are important to you, you should be willing to invest in options that may be low on returns. Alternatively, if you want higher returns, you may have to invest in options that are riskier and less liquid.

To arrive at your investment objectives, you should be clear about your needs for the future. For example, if you are planning for the education of your children, you should have some idea about the amount of money (corpus) you'll need and the time period in which you have to create that amount. If you know that you'll need ₹ 5 lakh for your child's education and you have 10 years within which you need to accumulate that amount, you could opt for an investment that is high on safety and returns and low on liquidity. You should then look for investment options that meet these criteria—and then calculate the amount you need to invest regularly over the next 10 years.

You may have more than one goal to fulfil at a time, so your investment objectives could be varied. Make a list of all your needs and then arrive at your investment objectives.

INCOME

Income is the money you receive by way of salary, through rent or sale of property, profits and gains through business, capital gains, and interest earned from any other sources.

INCOME TAX

It's the tax charged by the government on the income you earn in a financial year (April 1 to March 31: period of 12 months). If your total income from all sources is more than the minimum exemption limit specified by the government, you need to pay income tax on the excess amount. The limit for financial year 2017-18 is ₹ 2,50,000 for individuals below the age of 60 years. The exemption limit for senior citizens (anyone who is 60 years or older but below 80 years) is ₹ 3,00,000 while the limit is ₹ 5 lakh for very senior citizens (any one over the age of 80).

Let's understand this with an example. If you are a working woman and you earn an annual income of ₹ 6,00,000, you'll have to first calculate your taxable income by subtracting tax deductions and exemptions from your total income. For example, if you've made investments of ₹ 1,50,000 in Section 80C, your taxable income will reduce to ₹ 4,50,000 (₹ 6,00,000 - ₹ 1,50,000). Of this, ₹ 2,50,000 is exempt from income tax. Your taxable income will thus reduce to ₹ 2,00,000 (₹ 4,50,000 - ₹ 2,50,000). You'll thus have to pay a tax of ₹ 10,000 (5% of 2,00,000) plus the existing education cess of 3% on the tax payable (in this case, you will need to pay ₹ 300 additional tax as education cess). For more information about income

tax slabs, please visit www.incometaxindia.gov.in.

Please note that not all the money you earn during the year is considered as income to calculate income tax. For example, income received as dividend from equities and mutual funds is exempt from tax. Employee Provident Fund (EPF) amounts that are claimed after being active for at least five continuous years are also tax-free. There are many other such exemptions that you can avail of. You can find more about it in Tax Exemptions. For more details and the latest updates on income tax, visit www.incometaxindia.gov.in.

Also see **SECTION 80C, TAX DEDUCTIONS** and **TAX EXEMPTIONS**

INFLATION

A continuous increase in the price of goods and services in a country is called inflation. With rising inflation, the purchasing power of your money decreases. In simple terms, it means that you'll have to spend more than earlier to buy the same item. For example, if you can buy a kilo of sugar for ₹ 50 today, the same amount of sugar may cost you ₹ 60 a year later. This indicates that the purchasing power of the rupee has decreased in a year.

Inflation is the main reason why you should select smarter investment options. Under normal circumstances, inflation grows at a rate of 6%-8%. If your investments earn you interest close to this rate, it means your money is not growing—it has remained what it was. For example, if you had invested ₹ 1 lakh and you got a return of 6% in simple interest, at the end of the year you would have ₹ 1,06,000. But since inflation grows around that rate, it means that the amount you now have will only enable you to buy what you could have, a year back. And while that may be the overall inflation figure, a lot of items may become costlier at a rate higher than 6%—education, health care, real estate—all these could increase by much more than the average inflation rate.

Inflation is the biggest reason why you should invest in options that give you higher returns. Otherwise your wealth will increase a little, numerically, but its actual value will remain stagnant or even decrease. Investments in stocks and mutual funds have the potential to offer higher returns and you should explore the possibility of investing in them after carefully evaluating the amount of risk you can take.

Inflation happens mainly because of two reasons:

A. Demand for goods/services exceeds supply.

B. The cost of production increases due to increase in wages, raw materials, power, etc. which in turn increases the cost of goods and services.

Inflation can be controlled by monetary policy measures by the RBI (money supply, interest rates and availability of credit) and fiscal policy measures (tax

collection, expenditure and borrowing) by the government. The Reserve Bank of India (RBI) is the principal organisation that takes the required steps, including monitoring the flow of money in the financial system, interest rates, etc. to make sure that inflation stays under control.

LIQUIDITY

The ease with which an asset can be converted to cash at short notice without losing its true value is called liquidity. For example, gold is highly liquid because you can sell it for cash at the exact market price, almost any time you want. Real estate, on the other hand, is not considered liquid as it is difficult to convert it into cash at short notice—and if you need to do it quickly, you may have to do it at a lower price.

LOCK-IN PERIOD

It is the time period during which an investor cannot sell either part or all of the investment. For example, the 5-year tax saving fixed deposit has a lock-in period of five years. So, in these five years, the FD cannot be redeemed.

LONG-TERM CAPITAL GAINS TAX

See Capital Gains Tax

MATURITY DATE

The maturity date (also called maturity) is the date on which an investment becomes due and the investor gets repaid the principal along with any applicable interest.

NAV

The price of each mutual fund unit is called its Net Asset Value or NAV. Understanding NAV is important to understand the performance of mutual funds. The NAV of a mutual fund is calculated by dividing the total market value of investments made by the fund by the total number of units issued. For example, if the market value of the mutual fund's investments is ₹ 500 lakh and it has issued 20 lakh units—then the NAV would be ₹ 25 (₹ 500 lakhs / 20 lakhs). If the market value of the investments made by the mutual fund increases after some time, the NAV would also increase. For example, if the market value of its investments increases to ₹ 550 lakh, the NAV would increase to ₹ 27.50 (₹ 550 lakhs / 20 lakhs). Similarly, if the market value of its investments decreases to ₹ 450 lakh, the NAV would reduce to ₹ 22.50 (450 lakhs / 20 lakhs).

NEFT AND RTGS

If you are a net banking user, you can use National Electronic Fund Transfer (NEFT) or Real Time Gross Settlement (RTGS) to transfer money from your bank account to any other bank account in India. You could send this money to yourself as well as to anyone else who has a bank account. In a way, it is similar to writing

a cheque or a demand draft – but a lot simpler and quicker. When you transfer money using net banking, the money reaches the destination account on the same day unlike a cheque that takes two or three days to clear. Net banking is also easier as you can carry out these transactions in a few minutes from the convenience of your home or office.

To execute an online fund transfer using NEFT or RTGS you should have a net banking account with your bank along with the right to carry out third party fund transfers. Both of these are fairly simple and one-time tasks that you need to do. Your bank will enable these when you make a request. For an online transaction to be successful, you should have the following details of the beneficiary account:

- the name of the beneficiary,
- her account number,
- the name of the bank, and
- the Indian Financial Services Code (IFSC) of the branch in which the beneficiary has her account.

Once you enter these details along with the amount you want to transfer, the money gets transferred from your bank account to the beneficiary's bank account!

Both NEFT and RTGS can be used to transfer money. There are a few subtle differences between the two. NEFT happens in hourly batches from Monday to Saturday while in RTGS the transfer happens immediately. Transfer fees are minimal. RTGS is meant for transferring large amounts and the minimum amount you could transfer using this method is ₹ 2 lakh. NEFT has no such limit so you could transfer smaller amounts using this service. NEFT services are available between 8 am to 7 pm on weekdays and from 8 am to 1 pm on Saturdays while RTGS services are open from 9 am to 4:30 pm on weekdays and from 9 am to 2:00 pm on Saturdays. These timings could vary depending on your bank.

NSE

Established in 1993, the National Stock Exchange or NSE is the premier stock exchange in the country. A stock exchange provides facilities for brokers and traders to trade stocks. Any company that issues shares and wants its shares to be traded has to list them with a stock exchange. A stock can list on the NSE as well as the BSE and an investor can buy and sell shares in either of these stock exchanges.

Also see **BOMBAY STOCK EXCHANGE**, **NIFTY**, **SENSEX**

NIFTY

The NSE Index, more popularly known as the Nifty 50 or Nifty, is to the National Stock Exchange (NSE) what the SENSEX is to the Bombay Stock Exchange (BSE). The Nifty index is a collection of 50 stocks from various industries. Depending on how these stocks perform, the Nifty value moves up or down, giving investors an

indication of the movement in the overall market.

Some of the companies in the Nifty include: Reliance, Bharti Airtel, NTPC, ICICI Bank and State Bank of India among others.

OVERDRAFT

An overdraft is a facility offered by a bank to an individual to withdraw amounts greater than what is available in her account. For example, if a person issues a cheque of ₹ 6,000, but there is only ₹ 5,000 in her account, the bank will honour the cheque and clear it if the overdraft limit for that person is more than ₹ 1,000.

PORTFOLIO

A portfolio is a collection of all the investments owned by an investor. For example, an investor may have a portfolio that includes investments in stocks, mutual funds, real estate, gold, insurance, fixed income securities, etc.

PREMIUM

Premium is the additional cost you pay over the normal cost of any item. For example, the face value of a company's share may be ₹ 10, but its market price could be ₹ 200. If you buy this share, you're paying a premium of ₹ 190 on the face value of ₹ 10. In case a share is available at less than its face value, we say it's available at a discount to the face value. For example, if a share has a face value of ₹ 10, but is available at ₹ 8, you can say it is trading at a discount to the face value of ₹ 10.

SIMPLE INTEREST

The interest calculated only on the principal amount is called simple interest. For example, if you invest ₹ 5,000 at 8% interest for 5 years, at the end of 5 years you'll get:

Simple Interest = Principal x Interest x Period / 100

= 5000 x 8 x 5 / 100

= 2000

The amount you get at the end of 5 years is Principal + Interest = 5000 + 2000 = ₹ 7,000.

SECTION 80C

For financial year 2017-18, Section 80C of the Income Tax Act allows you to reduce your taxable income by a specified amount. Along with many investment options that are eligible for deduction, certain expenses incurred are also eligible under this section. You can get a deduction from taxable income of up to ₹ 1,50,000 (₹ 1.5 lakh) for income earned in financial year 2017-18 by investing or on expenses incurred on any one or a combination of the following:

1. Contributions to Employee Provident Fund (EPF) and Public Provident Fund (PPF)

2. Life insurance premiums (see chapter on Life Insurance)

3. Investments in pension plans

4. Investments in ELSS (tax saving mutual funds)

5. Investments in NSCs and Senior Citizens' Saving Schemes (SCSS)

6. Repayment of the principal amount for home loans

7. Tuition and hostel fees paid for two children—including fees for school, college, university, etc.

8. Five-year bank fixed deposits

9. Investments in Sukanya Samriddhi Scheme

The above list is subject to review from time to time and new products may be added and some existing ones may be removed.

For example, if your taxable income after income tax exemptions is ₹ 4,00,000 and you invest ₹ 1.5 lakh in any of the above (say ₹ 1.5 lakh in NSCs) or a combination of the above instruments (say ₹ 50,000 in an ELSS and ₹ 1,00,000 as repayment of principal amount of home loan), your taxable income will reduce by ₹ 1.5 lakh to ₹ 2,50,000. You'll thus end up paying tax on just ₹ 2,50,000.

Also see **TAX DEDUCTIONS**

SENSEX

The SENSEX (combination of the words SENSitive and indEX) is also referred to as the BSE SENSEX or the BSE 30. The SENSEX is a collection of 30 large and actively traded companies on the Bombay Stock Exchange (BSE). The movement of these stocks and therefore the SENSEX are an indicator of the stock market's performance. During trading hours, the SENSEX value is calculated every few seconds and relayed to investors instantly. By watching the SENSEX movements, an investor can gauge the general mood of the market. If the SENSEX is down, you will know that the market on the whole is not doing well, and vice versa. Some of the companies currently on the SENSEX include: BHEL, State Bank of India, SAIL and DLF among others.

Also see **BOMBAY STOCK EXCHANGE**, **NSE**, **NIFTY**

TAX DEDUCTIONS

Certain investments and expenditures reduce your taxable income and thereby the amount of tax you need to pay. These investments or expenditures are clubbed under different sections of the Income Tax Act and need to be mentioned while claiming tax deductions. Listed below are some of the more commonly availed tax deduction sections.

Section 80C of the Income Tax Act allows investments and expenditures adding up to ₹ 1.5 lakh to be deducted from your taxable income. These include investments in ELSS, NSCs, Senior Citizens' Savings Schemes, contributions to Employee Provident Fund, Public Provident Fund, Sukanya Samriddhi Scheme, the premiums you pay for life insurance, repayment of housing loan principal, and tuition and hostel fees for children.

Section 87A is a rebate offered to those who earn income below ₹ 5 lakh (₹ 3.5 lakh after Section 80C deductions for FY 2017-18). As per this section, a rebate of up to ₹ 2,500 will be available on the total tax payable for that individual. This rebate will be provided before applying any additional cess. For example, assume that the income of a person for FY 2017-18 is ₹ 3 lakh. Since income up to ₹ 2.5 lakh is tax free, her total taxable income would become ₹ 50,000 (₹ 3 lakh – ₹ 2.5 lakh). At 5% income tax, the total tax before adding education cess would be ₹ 2,500. Because Section 87A offers a rebate of ₹ 2,500, the tax payable for this person would become zero.

In case the income of this person was ₹ 4.5 lakh and she had investments of up to ₹ 1.5 in Section 80C, she too would not have to pay any tax due to this rebate. Let's see how.

- Income: ₹ 4.5 lakh
- Basic exemption: ₹ 2.5 lakh
- Section 80C investments: ₹ 1.5 lakh
- Total taxable income: 4.5 lakh – 2.5 lakh – 1.5 lakh = ₹ 50,000
- Total tax at 5% = ₹ 2,500
- Less rebate under Section 87A = ₹ 2,500 • Total tax = zero

Section 80D provides deduction on the premium paid on health insurance for self and family. The limit is ₹ 25,000 per financial year for self, spouse and dependent children, and an additional ₹ 25,000 for parents (whether dependent or not). The limit increases to ₹ 30,000 if any of the insured is a senior citizen (60 years and above). So, if you insure yourself and your parents, you could get a maximum deduction of up to ₹ 50,000 (theoretically, the limit is ₹ 60,000 if you/your spouse and either of your parents are senior citizens).

A deduction of up to ₹ 5,000 is also available in case of expenses incurred on

preventive medical checkups for self, spouse, dependent children or parents. This amount is part of the Section 80D limit. So, if you paid ₹ 20,000 as premium for your medical insurance and spent ₹ 6,000 on health checkups, you'll still be able to claim only ₹ 25,000 (the maximum deduction available, assuming that you're not a senior citizen). Since April 1, 2010, contributions made to the Central Government Health Scheme (CGHS), a health scheme for serving and retired government employees, are also eligible for deductions under this section.

Section 80DD provides deduction on expenditures incurred on medical treatment, training or rehabilitation of a handicapped dependent. The deduction available is ₹ 75,000 for normal disability and ₹ 1,25,000 in case of extreme disability.

Section 80DDB provides deduction on expenses incurred towards the medical treatment of specific diseases like Parkinson's, malignant cancers, AIDS, thalassaemia, etc. for yourself or your dependents. The deduction available is ₹ 40,000. In case the patient is a senior citizen, the maximum deduction allowed is ₹ 60,000. The deduction available for very senior citizens (80 years and above) is ₹ 80,000.

Section 24(b) provides deduction from taxable income up to ₹ 2 lakh on the interest you pay on your home loan. The loan should however have been taken after April 1, 1999 and the house should be constructed or bought before the end of three years of taking the loan. If the above two conditions are not satisfied, the tax deduction reduces to ₹ 30,000.

Earlier, the limit of ₹ 2 lakh was for self-occupied homes only. If you'd given your second house on rent, the entire interest amount was deductible from the taxable income as per Section 71. But as per Budget 2017, you can no longer claim that benefit. Any interest being paid over and above the limit of ₹ 2 lakh on your second house will only earn you a deduction of ₹ 2 lakh under Section 71(b) of the Income Tax Act. The remaining interest paid can only be offset against house property income during the next 8 assessment years. For example, if you're paying interest of ₹ 6 lakh per year on the home loan repayment of your second home, only ₹ 2 lakh can be claimed for deduction from your taxable income in the current financial year. The remaining ₹ 4 lakh deduction can be claimed up to a period of 8 years against income earned from property.

Note that, you'll also have to show rent as income for this house. This option is possible if you own one or more than one house. If you own just one house then you should have a valid reason for not staying in that house and letting it out on rent and for claiming tax benefits on it. Section 24(b) allows interest to be deducted even for loans taken for carrying out repairs or reconstruction of your home. The limit is ₹ 30,000 for self-occupied house.

Section 80G allows either 100% or 50% tax deduction of the amount you

donate to a recognized charitable institution. The amount of deduction you are eligible for depends on the institution you donate to. For example, donations made to the Prime Minister's Relief Fund are 100% deductible while those made to the Jawaharlal Nehru Fund are eligible for a 50% deduction. Apart from these, there are some institutions to which you cannot donate more than 10% of your gross total income. Within this too, you have two types of institutions for which donations you make are allowed 100% or 50% deductions. So while charity should be done without expecting any returns, if you are interested in the quantum of deduction you'll be eligible for, do check before you donate.

Section 80E provides deduction on the entire amount paid as interest on any loan taken for higher education from a recognised institution. The loan should be taken for the education of yourself, your spouse, or your children.

The above information is a summary of the various sections that offer tax deductions. Please verify each fact and seek professional advice before acting on the above information. For the full list and details, visit www.incometaxindia.gov.in.

TAX EXEMPTIONS

Apart from deductions, certain types of income are totally exempt from income tax. If you earn income from these sources, you need not pay tax on it. Here's a partial list of such income types:

1. The rent or revenue you earn from agriculture

2. The amount you receive from your Public Provident Fund

3. Dividends from mutual funds and equity shares (amount above ₹ 10 lakh is taxable at the rate of 10%)

4. Leave encashment by an employee (check conditions)

5. Amount received on voluntary retirement, subject to a maximum of ₹ 5 lakh

6. Income earned by selling shares held for more than 12 months

There are many more exemptions available. For a complete list and details about each income type, visit the Income Tax website at www.incometaxindia.gov.in.

TAX DEDUCTED AT SOURCE (TDS)

If you're a salaried employee, you must be familiar with Form 16. This form contains details of the tax that has been deducted from your salary on a monthly basis during the financial year.

Apart from salaries, tax is also deducted at source on interest you earn from bank deposits if it exceeds a certain amount, on insurance commissions, on the fees you charge for any professional service, on rental income, prize money that you receive from winning a lottery, horse races or betting, etc.

The rate at which tax gets deducted and the amount above which TDS gets applied varies depending on the sources of income. In case of salaries, tax is deducted as per the income tax slabs. For bank accounts, TDS at the rate of 10% is applicable on interest above ₹ 10,000 from fixed deposits and recurring deposits in a financial year. In case of winnings from lotteries and horse races, the TDS rate is 30%.

Apart from salaries, tax is also deducted at source on interest you earn from bank deposits if it exceeds a certain amount, on insurance commissions, on the fees you charge for any professional service, on rental income, prize money that you receive from winning a lottery, horse races or betting, etc.

Whenever tax gets deducted at source on any income that you earn, you will receive a TDS certificate from the deductor. The Form 16 that you receive from your employer is the TDS certificate in case of salaried employees. In case of banks, you'll receive Form 16A for the TDS deducted. The government provides a consolidated tax statement called 26AS which contains details of all the tax deducted in advance. You can view Form 26AS by registering with NSDL (www.nsdl.co.in) or by logging in at www.incometaxindiaefiling.gov.in. If you have a net-banking account, you may be able to check the same form through a link provided by your bank.

Do note that paying TDS doesn't imply that you can exclude that particular income while filing your income tax returns. If the total TDS amount is less than the tax payable then you need to pay the difference to the IT department; if the TDS paid is higher, you can claim the additional tax that you've overpaid, from the IT department, in the form of an income tax refund.

NOTES

CHAPTER
04

ESSENTIAL FORMULAS EVERY INVESTOR SHOULD KNOW

Being in control of your financial life is one of the keys to leading a happy, fulfilled life. It's true, money may not be everything. But it's a fact that money is required for almost everything. If your money worries are few, you have an advantage over others who are in a similar situation as you, but have more money worries. With fewer money worries, you can focus on things that matter. You can take decisions that benefit you and your family without worrying too much about costs. You can help others. You can travel, read, explore and generally experience life in a better way if you have a little more money at your disposal.

One of the ways you can have fewer money-related worries is to be in control of your finances. It's a reality of life that we all won't inherit a lot of wealth and not all of us would earn huge amount as salaries. But each one of us can definitely take steps to save and invest the money we have to reduce our financial worries. One of the most effective way to do it is to have a financial plan that will guide us in achieving our goals with the money we have. With a financial plan, you'll be able to manage your expenses and investments as per your income and saving levels. You can learn how to do this in Chapter 21, Making an Investment Plan.

A person can be considered financially literate if she is able to do the following two things well: a) understand financial concepts and b) have the numerical skills to to take decisions regarding investments.

But before you make a financial plan, you should be in a position to analyse

financial information so that you can manage your investments in a better way. A person who can do this well can be called a financially literate person. Such a person will be able to do the following two things well: a) understand financial concepts and b) have the numerical skills to take decisions regarding investments.

Both these skills may seem difficult from a layperson's point of view. But they aren't. You may experience some teething troubles in the beginning… until you take the first few steps. Then it gets much easier. The previous chapter on Basic Terms and Concepts was your first step in understanding financial concepts. After reading that chapter, you'd have realised that it's not all that difficult to grasp financial concepts. It's a similar case with learning to handle numbers. While there are numerous formulas that can be used to calculate everything related to investing—from returns to interest rates to profit and profit percentages—you needn't know every one of them to manage your investments. If you only know the commonly used formulas, you should be able to calculate almost everything you'd need to evaluate your investments and make investment decisions.

SO HOW MANY FORMULAS SHOULD YOU KNOW?

Considering the needs of the average investor, she wouldn't need to know a large number of formulas to manager her finances. In fact, the number of formulas she needs to know can be counted on the fingers of one hand....

Yes, it's as few as five! If you know these five formulas well enough, you should be able to calculate almost anything you'd need to manage your investments. These five formulas will also lay the foundation for many of the other formulas that you could learn if you wish to expand your numerical skills.

If that sounded like good news, there's even better news. You don't even have to remember these formulas to use them. If you have Microsoft Excel on your computer, you can simply use their Formula feature to get the answers in a jiffy! And that's what we'll be doing in this chapter. So let's start learning how to do it.

Sr. No	Name of Formula	When to Use	Formula
1	Future Value of an investment	To calculate the amount you'll have at the end of the investment period.	= FV(rate,nper,pmt. pv,type)
2	Present Value of an investment	To calculate the amount you will have to invest now to accumulate a particular amount	= PV(rate,nper,pmt, fv,type)
3	Amount to be invested per Instalment	Calculate the amount you need to invest per period (month, quarter, etc.) to accumulate a particular amount.	= PMT(rate,nper,pv, fv,type)
4	Rate of growth of an investment	To find out the rate at which your investment will grow.	= Rate(nper,pmt,pv, fv,type,guess)
5	Period of Investment	To find out the time, in years, to accumulate a particular amount	= NPer(rate,pmt,pv, fv,type)

As you may have noticed, the formulas have a similar pattern to them. Here's what the terms within these formulas mean:

RATE: The rate of interest that is offered.

NPER: The period of investing. This can be months or years depending on your investments.

PMT: This field captures the amount you invest per period (monthly, quarterly, half yearly or yearly). Leave it blank or enter 0 if you are only making a one-time investment. If you are investing a fixed amount over a regular period, you should enter that amount in this field.

PV: This is the principal amount you are investing.

FV: This is the future value of your investment. It represents the accumulated amount at a future date. If you are calculating the amount at the end of an investment period then this represents the maturity amount or accumulated corpus.

TYPE: It indicates where in the investing period you are investing your money. It can have two values, 1 or 0. Enter 1 if your investing begins at the start of the year or month. Enter 0 if your investing period is at the end of the year. This is important only when you are paying regular instalments. For example, if you are investing ₹ 5,000 per month at the beginning of each month then you should enter Type as 1. If, instead, you are investing the amount at the end of the month, enter Type as 0. For all other types of calculations, you can leave type as 0 or blank.

GUESS: This field indicates a number that you consider to be the answer.

None of these formulas need to be memorised. They are in-built into Excel. You can either use the Financial Formulas dialog box to enter the details or you can directly type the name of the function (for example =FV) in a cell and Excel will display the formula.

1. CALCULATE THE FUTURE VALUE OF AN INVESTMENT

This is one of the most important formulas to know because investing is all about making money at the end of the investment period. The investment period could be as short as 1 or 2 years or as long as 10 or 20 years. Whether it is short term or long term, it's best if you could calculate the amount of money you'd receive at the end of the investment period. And the formula for calculating the future value of an investment will help you do that.

Let's look at an example where we calculate the future value of an investment.

EXAMPLE 1: Consider you are planning to invest an amount of ₹ 1 lakh in a corporate fixed deposit scheme that is offering you an exciting 12.25% rate of interest every year. Your investment period will be 10 years. You have to calculate how much you will earn at the end of 10 years.

First, you should enter the information you have in an Excel worksheet as shown below:

	A	B	C	D
1	Rate	12.25%		
2	Nper	10		
3	PMT	0		
4	PV	100000		
5	Type	0		
6	Future Value	=FV(rate,nper,pmt,pv,type)		
7		=FV(B1,B2,B3,-B4,B5)		
8		₹ 317,587.57		

To calculate the future value of this investment, enter the formula for Future Value (FV) in cell B6. Excel will prompt you to enter the following information "=FV(rate,nper,pmt,pv,type)". Instead of entering the values directly into the formula, you should enter the cell references as shown in the image (=FV(B1,B2,B3,-B4,B5). For example, instead of entering "12.25%" as rate, select or enter "B1". Similarly for the other values.

You'd note that the value for "PV" has been entered as "-B4". The negative sign indicates that money is going out of your pocket or that there is an outflow of money.

After entering the formula values as shown, press Enter.

The answer you'll get is **₹ 3,17,587.57.**

That's the amount you'll have at the end of the investment period.

Let's look at another example.

EXAMPLE 2: In this example, you are again investing ₹ 1 lakh for 10 years but in this option you'll be earning interest at the rate of 12% compounded twice a year. So how much will you have at the end of 10 years?

	A	B	C	D
1	Rate	12%		
2	Nper	10		
3	PMT	0		
4	PV	100000		
5	Type	0		
6	Future Value	=FV(rate,nper,pmt,pv,type)		
7		=FV(B1/2,B2*2,B3,-B4,B5)		
8		₹ 320,731.55		

Again, enter the new values in the respective cells. Then type the formula as shown. Note that in the above formula we wrote B1/2 and B2*2. This is because interest is being compounded twice a year. To capture the effect of this frequency of compounding, we divide the interest rate by two and multiply the period by two. In case compounding was done quarterly, you'll divide interest rate by four and multiply the period by four.

After entering the values, press Enter. The answer you'll get is ₹ **3,20,713.55**.

You can use this formula to calculate returns where you invest a fixed amount at a fixed interest for a fixed period of time. Examples of such investments are Fixed Deposits, National Savings Certificates, and so on. But there are also investments where instead of a lump sum amount, you'd invest your money at intervals—for example Recurring Deposits, Systematic Investment Plans in Mutual Funds, etc. We'll see how we can use the same formula to calculate the returns for such type of investments.

The easy part is that the formula remains the same; we simply have to enter values for different fields. Let's look at an example.

EXAMPLE 3: Consider that you are investing ₹ 5,000 in a monthly SIP in a debt mutual fund scheme in which you expect to earn a return of 9% per year. What is the amount you'll have at the end of 10 years?

	A	B	C	D
1	Rate	9%		
2	Nper	10		
3	PMT	5000		
4	PV	0		
5	Type	0		
6	Future Value	=FV(rate,nper,pmt,pv,type)		
7		=FV(B1/12,B2*12,B3,-B4,B5)		
8		₹ 974,828.17		

By entering the values that we had, we get the figure ₹ 9,74,828.17. That's the amount that we can expect to have at the end of the period. Note that we have divided Rate by 12 and multiplied Period (Nper) by 12 to account for the fact that the investment and earnings are monthly (12 times a year).

Let's look at one last example to complete our understanding of calculating the Future Value of an investment.

EXAMPLE 4: Consider you want to invest ₹ 10,000 per month in an RD that offers 8% interest per year for 5 years. What is the amount you'll have at the end of the period?

Like in the previous examples, let's start by entering the details we know:

	A	B	C	D
1	Rate	8%		
2	Nper	5		
3	PMT	10000		
4	PV	0		
5	Type	1		
6	Future Value	=FV(rate,nper,pmt,pv,type)		
7		=FV(B1/12,B2*12,B3,B4,B5)		
8		₹ 739,667.02		

After entering the details, press Enter. The answer you'll get is **₹ 7,39,667.02**. This is the amount you'll receive at the end of 5 years.

In the above formula, you would notice that we are dividing B1 (Rate of interest) by 12 as we are making monthly deposits (12 deposits in a year). We are also multiplying B2 (Period) by 12 to factor in the number of payments made. But there's a small liberty we've taken in this formula.

While we are investing every month, we don't earn interest on a monthly basis. The interest of 8% therefore cannot be equally divided by 12 as almost every bank pays interest on a quarterly basis. So we'll need to make the correction in this formula to get the correct amount. To do this, we will first have to convert the Quarterly rate of interest (8%) into Annual Rate of Interest and then re-convert the Annual Rate into Monthly Rate.

This is how we do it

First, convert Quarterly Rate of interest into Annual Rate of interest

The Excel formula to calculate effective rate is

=EFFECT(nominal_rate, npery)

Where

Nominal_rate = the available rate of interest

Npery = the number of times it gets compounded per year

In the above example, we should enter the following in an Excel cell
= EFFECT(8%,4) = 0.0824.
We then multiply it by 100 to convert it into percentage.
We thus get Annual Rate of interest as 8.24%.

Now, we'll convert it into Monthly Rate using the **Nominal function in excel** which is
= Nominal(Effect_rate,Npery)

Where
Effect_rate = the effective annual rate of return
Npery = the number of times it gets compounded per year
In the above example, we should enter the following in an Excel cell
= Nominal(8.24%,12) = 0.07947.
We then multiply it by 100 to convert it into percentage. We thus get 7.947%.

If we use this interest rate in our earlier formula, we'll get the following answer: **₹ 7,38,618.66**

	A	B	C	D
1	Rate	7.947%		
2	Nper	5		
3	PMT	10000		
4	PV	0		
5	Type	1		
6	Future Value	=FV(rate,nper,pmt,pv,type)		
7		=FV(B1/12,B2*12,B3,B4,B5)		
8		₹ 738,613.66		

There's more that you can do using the Future Value formula. But this should be a good starting point to calculate the future value of almost any investment you are about to make. But like everything else, practice will help. So here's one calculation that you can do on your own to see how it goes...

Consider that a person is planning to invest for the higher education of her child based on the current cost of a particular course. The current fee for this course is ₹ 5 lakh and she knows that on an average it increases by 10% every year. So how much will be the cost of this course 10 years later when her child is ready to apply for the course? The answer you should get is **₹ 12,96,871.**

2. CALCULATE THE PRESENT VALUE OF AN INVESTMENT

While calculating the Future Value of an Investment will be one of the most commonly used formulas in investing, knowing how much we should invest to collect a certain amount of money in the future is almost as important. You may want to do this to purchase a house or a car a few years down the line, to fund your education, to buy a house or for your child's marriage and other such important financial goals.

Let's use the example of the parent who wanted to save for the education of her daughter to understand how this works. As we saw earlier, the parent has to accumulate almost ₹ 13 lakh in a period of 10 years. Assuming she wants to invest in Mutual Funds which could earn her around 10% interest per year, we'll calculate the amount she'd have to invest now to achieve that amount.

The formula for calculating the Present Value is = PV(rate, nper, pmt, fv, type)

	A	B	C	D
1	Rate	10%		
2	Nper	10		
3	PMT	0		
4	FV	1300000		
5	Type	0		
6	Future Value	=PV(rate,nper,pmt,fv,type)		
7		=PV(B1,B2,B3,B4,B5)		
8		-₹ 501,206.28		

By entering the values as per the formula, amount we get is **₹ 5,01,206.** That's the lump sum amount that the mother will need to invest at 10% to receive ₹ 13 lakh at the end of 10 years. (You'll notice that the answer is shown with a negative sign. As explained earlier in the chapter, the negative sign indicates that the amount is outgoing or being invested.)

Absolute rate of return looks like an impressive number. In fact, many people are sold investments by showing these numbers. But this method of calculation misses a crucial part of investing: the period of investment.

But suppose she doesn't have that kind of money to invest in a lump sum and instead wants to invest money on a monthly basis, how much would she have to invest every month? To calculate that amount, we'll use the PMT function.

3. CALCULATE THE AMOUNT TO BE INVESTED PER INSTALMENT

A journey of a hundred miles begins with a single step. In a similar way, you can achieve almost any financial goal you may have by making small but regular investments in a good investment scheme. But before you start your journey, you should know how small or big each of your investments should be. Helping you get that number is the PMT formula in Excel. If you know the final amount you have in mind, the period and the growth rate of your investment, the PMT function will show how much you should invest at every interval.

Let's continue with the example of the parent who wants to save for the education of her daughter. As we saw, the target was to accumulate ₹13 lakh in a period of 10 years. Since investing a lump sum amount of ₹ 5 lakh was difficult for her, she's planning to invest smaller amounts on a monthly basis. Assuming that the investment will earn her an interest of 10% per year, we'll see how much she needs to invest per month.

The formula for calculating the amount to be invested in regular instalments is = PMT(rate, nper, pv, fv, type). As always, let's enter the values we know.

	A	B	C	D
1	Rate	10%		
2	Nper	10		
3	PV	0		
4	FV	1300000		
5	Type	1		
6	Future Value	=PMT(rate,nper,pv,fv,type)		
7		=PMT(B1/12,B2*12,B3,B4,B5)		
8		-₹ 6,293.81		

(Because investments are done every month, the rate of interest is divided by 12 and the period is multiplied by 12.)

The answer is **₹ -6,293.81** per month. (You can ignore the negative sign as it indicates that the amount will be invested). That's the amount that the parent will need to invest at the beginning of every month (Type = 1) for 10 years at 10% interest to reach the target of ₹ 13 lakh.

The PMT function can also be used to calculate the monthly payments for any loan you've taken. For example, if you've taken a loan of ₹ 10 lakh from a bank or a friend for a period of 10 years at 10% interest, you can easily calculate the amount you need to repay every month. Let's enter these numbers in an Excel sheet.

	A	B	C	D
1	Rate	10%		
2	Nper	10		
3	PV	1000000		

4	FV	0		
5	Type	0		
6	Future Value	=PMT(rate,nper,pv,fv,type)		
7		=PMT(B1/12,B2*12,B3,B4,B5)		
8		-₹ 13,215.07		

As you can see on the previous page, the answer we get is ₹ **-13,215.07** per month. That's the amount you'll need to pay at the end of every month (Type = 0) for the next 10 years to repay your loan. You can also use this formula to calculate the EMI (Equated Monthly Instalments) for your home loan and other loans.

Did you notice that in the first example, the amount of ₹ 13,00,000 was used as FV whereas in the second example, the amount of ₹ 10,00,000 was considered as PV. The reason is that in the first example the amount of ₹ 13 lakh was something that had to be accumulated (in the future) at the rate of 10% at the end of 10 years. In the second example, the loan was already taken—so the amount of ₹ 10 lakh was in your hand (Present Value). In the second example, you were thus working out the amount you need to repay at the rate of 10%. Make sure you use PV and FV correctly in the PMT formula.

4. CALCULATE THE RATE OF GROWTH OF AN INVESTMENT

There are times when you may know how much you plan to invest and the amount you'll receive at the end of the investing period, but you are not sure about the rate at which you earned the money. At such a time, you may not be sure if you really made a smart investment. Sure, the amount of profit you earned may look impressive, but how can you be really sure if it's as good as it looks? The only way to answer this question is by knowing the rate of return or the percentage of profit you earned.

For example, is it better to have invested ₹ 50,000 in a bank FD for 5 years at the rate of 8% or should you have rather invested the same amount in a scheme that gave you ₹ 75,000 at the end of 5 years?

There are different ways that the rate of return for this investment could be calculated. They may all seem correct but not all of them will give you the correct picture. So it's important that you know the right way to calculate the rate of return so that you can know exactly how your investments performed.

ABSOLUTE RATE OF RETURN

This is one way to calculate the rate of return. Here, the profit or loss percentage is calculated without considering the period of investment which is a very important component. It is done in the following manner:

Rate of return = 100 x (Final amount – invested amount) / Invested amount

If we use this formula in the earlier example, we will get the following rate:

= 100 x (75000 – 50000)/50000 = 100 (0.5) = 50%

So you could say that you earned 50% on your investment.

This will look like an impressive number. In fact, many people are sold investments by showing these kinds of numbers. But this method of calculation misses a crucial part of investing: the period of investment.

If you decide to use the period of investment, you will divide the percentage of returns by period to get **Average Annual Return.**

So Average Annual Return = Absolute rate of return / number of years.

In this case, it will be 50%/10 = 10%.

But this return still does not give the correct picture because it doesn't take into account the fact that in most investements the interest gets added to the principal every year. Therefore, to get a true picture, you will have to use compounding. For practical purposes, we therefore use the compound annual

growth rate (CAGR) formula. Contrary to its name, it's relatively easy to calculate using Excel.

For the above example, we can use the Rate function in Excel to calculate the compounded rate of growth.

The formula is =Rate(nper,pmt,pv,fv,type,guess). This is how we'll do it:

	A	B	C	D
1	Nper	5		
2	PMT	0		
3	PV	50000		
4	FV	75000		
5	Type	0		
6	Future Value	=Rate(nper,pmt,pv,fv,type)		
7		=Rate(B1,B2,-B3,B4,B5)		
8		8.45%		

The compounded rate of growth = **8.45%**

This is the actual rate of return that you earned on your investment.

Most investments will mention rate of interest in terms of compound interest—from Fixed Deposits to EPF to NSCs and so on. But in case you come across an investment that mentions interest rate as "Average Annual Rate of Return", you'll either have to ask for the compounded rate of interest or do the conversion on your own to make a meaningful comparison with other investment options.

You will be aware that when you invest in mutual funds or stocks or real estate, you do not earn an income on those investment (except for dividends or rent). You will only make a profit when you sell them. Based on the selling price, you can calculate the growth of your investments by using this formula. Let's see how to do this.

Consider that you had invested ₹ 1 lakh in stocks and at the end of 5 years the value of your stocks became ₹ 1.60 lakh. Doing basic mathis, you may assume that your profit grew at 12% every year. But as we saw in the earlier examples, that's not the correct way of calculating it.

The appropriate way to calculate is to use the Rate formula in Excel which is =Rate(nper,pmt,pv,fv,type,guess). Let's see the answer we get.

	A	B	C	D
1	Nper	5		
2	PMT	0		
3	PV	100000		
4	FV	160000		
5	Type	0		

6	Future Value	=Rate(nper,pmt,pv,fv,type)		
7		=Rate(B1,B2,-B3,B4,B5)		
8		9.86%		

The answer is **9.86%**. This is the rate at which your investment grew every year.

Let's look at another example. Assume that an agent selling a new financial scheme came to you with a scheme that requires you to invest ₹ 50,000 every year for 20 years, at the end of which you'd receive ₹ 15 lakh. You realise that on investing ₹ 10 lakh (20 x 50,000) you'll end up receiving ₹ 15 lakh at the end of 10 years. This looks simple and nice. But is it really a good return on your investment? How can you make sure that this will be better than investing in a risk-free Fixed Deposit which gives you 8% interest or a PPF which offers better rates than even Fixed Deposits and is completely risk free?

Let's use the Rate formula and find out.

	A	B	C	D
1	Nper	20		
2	PMT	50000		
3	PV	0		
4	FV	1500000		
5	Type	0		
6	Future Value	=Rate(nper,pmt,pv,fv,type)		
7		=Rate(B1,-B2,B3,B4,B5)		
8		4.07%		

The answer is **4.07%**.

This is half of what you'd have earned if you had invested in a Fixed Deposit.

You'll find out that if you invested the same amount in a Fixed Deposit at 8%, you would receive almost ₹ 23 lakh at the end of 20 years. So don't go by just the big numbers that you see—always do the calculation to be sure that you are taking the right decision.

This formula is also helpful to calculate the actual rate of return that you earn on your investments. You may also use this formula to decide on the type of investment you should choose. For example, if you want to accumulate ₹ 10 lakh at the end of 5 years and you can invest ₹ 12,000 per month then what is the rate at which it should grow? Based on the answer, you could choose your investment option. If the answer that you get is more than 10% then you may have to invest in higher-risk, higher-return investment options like mutual funds, real estate or stocks. But if the rate of return is lower, you can opt for lower-risk options like debt mutual funds, balanced funds, FDs and so on.

Just to satisfy our curiosity, let's see what the answer is:

	A	B	C	D
1	Nper	60		
2	PMT	12000		
3	PV	0		
4	FV	1000000		
5	Type	0		
6	Future Value	=Rate(nper,pmt,pv,fv,type)		
7		=Rate(B1,-B2,B3,B4,B5)		
8		1.06%		

The answer is 1.06%. But since the investment is being done on a monthly basis, the rate we calculate is also the monthly rate. We'll have to multiply it by 12 to get the annual rate of return. So the annual rate of return that you need to earn is 12.72%. Because it's difficult to earn such a high interest on fixed interest investment schemes, you will have to invest in riskier options like stocks or equity mutual funds that can offer higher returns.

5. CALCULATE THE PERIOD OF INVESTMENT

If you want to know the amount of time in years or months that it will take your investment to reach a particular amount then you should be able to calculate the period of investment. For example, if you know that you'll be able to invest ₹ 5,000 per month at 10% interest and your target is to accumulate ₹ 2 lakh, then for how many months would you have to invest to receive that amount?

We'll use the Nper function in Excel to find that out. Let's enter the values and calculate using Nper.

	A	B	C	D
1	Rate	10%		
2	PMT	5000		
3	PV	0		
4	FV	200000		
5	Type	1		
6	Future Value	=Nper(rate,pmt,pv,fv,type)		
7		=Nper(B1,-B2,B3,B4,B5)		
8		34.42%		

The answer is = 34.42 months

To convert the answer into years, divide the answer by 12. That's almost 3 years needed to accumulate ₹ 2 lakh if you invest ₹ 5,000 per month at the rate of 10% every year.

Consider another example where you want to know how many years it will take to double an investment of ₹ 2 lakh if you are going to earn interest at the rate of 9% compounded twice a year. Let's enter the numbers in the Excel sheet as shown in the following page.

The answer is 15.75. Remember, this is the number of periods, not months or years. Since compounding is happening twice a year, we'll need to also divide the period by 2 to convert the period into years. So the number of years it will take to double the investment is (15.75/2) 7.86 years or almost 8 years.

	A	B	C	D
1	Rate	9%		
2	PMT	0		
3	PV	200000		
4	FV	400000		
5	Type	1		
6	Future Value	=Nper(rate,pmt,pv,fv,type)		
7		=Rate(B1/2,-B2,B3,B4,B5)		
8		15.75%		

These five formulas should be enough to answer most of your investment

related questions. Do practice and then use them to check the numbers before you make any investing decisions. There's a lot of information available on the Internet to help you with all these formulas. You simply need to explore a bit. Do keep in mind that this is just the beginning and you could take this understanding to learn many more ways of evaluating your current and future investments. So go ahead and use these formulas in Excel to find the answers to your investment queries!

NOTES

CHAPTER

05

FIXED DEPOSITS

Any Indian who earns a steady income would have invested in fixed deposits at some time or the other. Perhaps, you have too. Without doubt, it is one of the safest and simplest investment options available.

Like so many other investment options, fixed deposit schemes too have evolved over time. Today, fixed deposits (FDs) not only offer you an assured rate of return, they also offer a lot of flexibility. Some of these options are really innovative in the way they allow you to manage your money and you should be aware of them if you're planning to open a fixed deposit account.

THE FIXED DEPOSIT CONCEPT

The primary idea in fixed deposits is to deposit a lump sum of money (called the principal) in a bank for a certain period of time at a certain rate of interest. Everything about this investment option is "fixed"—the principal, the tenure and the interest rate. At the end of the tenure, the bank will give you the principal along with the interest earned.

For example, if you invested ₹ 10,000 at 10% for 5 years, then at the end of 5 years, you'll be paid ₹ 16,386. Even though the interest mentioned in this example is 10% per annum, banks usually calculate interest on a quarterly basis (every 3 months). So you'll receive interest 4 times a year (12 months/3).

The formula to be used for calculating interest will be:

P (I + R/100)^NT

Where P (principal)	₹ 10,000
R (rate)	10% p.a.
N (period)	5 years
T (frequency)	4 times a year
P (I + R/100)^NT	10000 (1 + 0.025)^20
	16,386

You can also use the Excel Formula, FV, as we learnt in Chapter 4 to calculate it. Let's enter the values and see:

- **Rate:** 10%/4 (interest is compounded quarterly)
- **Nper:** 5x4
- **Pmt:** 0
- **PV:** - 10000 • **Type:** 0
- **FV** (rate, nper, pmt, pv, type)
- Press **OK**

The answer is 16,386

Most fixed deposits pay interest at the end of the period along with the principal. The interest rate and tenure is specified at the time of opening the FD. The interest rate remains constant throughout the tenure of the FD irrespective of the movement in market interest rates.

These fixed deposits, where you get the interest at the end of the term, are known as Cumulative Fixed Deposits. You also have the option of asking your bank to pay monthly, quarterly, half yearly or yearly interest instead of making a

lump sum payment at the end of the tenure. The interest frequency option has to be chosen at the time of making the deposit. For example, you could invest ₹ 1,00,000 at 9% for 3 years and receive around ₹ 750 every month for 3 years as interest. At the end of the period, you'll get back your principal. However, in this case, the interest you earn will not be compounded quarterly. You'll thus earn a lower amount as compared to what you would have earned in a cumulative fixed deposit.

You can open fixed deposits of different durations and varying amounts. The duration can be anything from 7 days to 10 years. The amount can be anything from ₹ 100 to an unlimited amount with some banks.

Note that the rate of interest for the same period could be different across banks since RBI allows banks to decide the rate of interest on their deposit schemes. So do compare interest rates before you invest to get the maximum benefit on your investment! Senior citizens (60 years old and above) may get up to 0.50% higher rate of interest for deposits in their name. Again, do check with the bank before you invest.

Fixed deposits with tenure of 5 years and above also offer income tax benefit under Section 80C provided they meet certain conditions. However, deposits with tax benefits do not get part-withdrawal facilities or a loan on the deposit; both these options are otherwise offered by banks on long-term deposits. If you want to avail of tax benefits for your 5-year FD, you need to inform the bank before making the deposit.

Fixed deposits with tenure of 5 years and above also offer income tax benefit under Section 80C provided they meet certain conditions.

TYPES OF FIXED DEPOSITS

Now that we've seen how basic fixed deposits work, let's look at some of the options available within fixed deposits.

1. FLEXIBLE FIXED DEPOSIT SCHEME

Here, after creating a fixed deposit, you can withdraw part of the deposit before the maturity date. Unlike a traditional FD, where you have to close the fixed deposit even if you need only part of the money, in case of flexible fixed deposits, you can withdraw only the amount you need. The amount left in the deposit will continue to earn interest at the agreed rate. This ensures that your spare money does not lie idle.

2. SAVINGS PLUS ACCOUNT

If you keep surplus cash in your savings account, you can ask the bank to move a certain amount from your savings account into a fixed deposit for a period of your choice or a period determined by the bank. For example, you could instruct the bank that you don't want to keep more than ₹ 10,000 in your savings account. Based on this instruction, if your savings account contained ₹ 15,000, the bank will move the surplus ₹ 5,000 into a fixed deposit for 6 months or 1 year or any period determined by you. This amount will thus earn a higher rate of interest than it would have if it were lying in your savings account. On maturity, you could either choose to renew the deposit or have the amount returned to your savings account. Your bank will do all these transactions automatically. Check with your bank for details.

3. DEPOSIT WITH OVERDRAFT FACILITY

In this type of fixed deposit, you can get an overdraft facility for your savings or current account. For example, if you created an FD of ₹ 1 lakh, the bank will transfer an amount up to 75-80% of this deposit into your savings account that you can withdraw. The FD will continue to earn interest on ₹ 1 lakh. You can repay the amount you've withdrawn in instalments, along with some additional interest, before the expiry of the FD.

These are just a few of the possibilities available with a Fixed Deposit account. They may not be available with all banks and some banks may offer other options. At times, even if a bank offers these facilities, they may be available only at certain branches. You'll have to check with your bank branch to find out their availability. Banks continuously work to make Fixed Deposits as attractive as possible. Check with your bank to get the maximum advantage for your account.

With these and many other options available, fixed deposits offer a great deal of flexibility to manage your money. The returns may seem modest—usually around 6-9%—but they are steady. Plus, your money remains in a fairly liquid state; in an emergency, you can always close your account and get your money back at a working day’s notice. However, you may have to incur a small penalty

on premature withdrawals. The penalty varies across banks. While some banks pay interest only for the duration the amount was deposited, others may levy an additional penalty. For example, consider a bank that pays interest at the rate of 9% for fixed deposits of 3 years and 8% for fixed deposits of 2 years. Now, if you deposit an amount at 9% for 3 years but decide to withdraw the amount at the end of 2 years, you will be paid interest of 8% (since the period for which your money was deposited was actually 2 years). On this 8%, an additional penalty (maximum of 1%) may be levied by some banks. You should check the penalty clause with the bank before you open a deposit.

Apart from banks, even the post office and many private companies, financial institutions, and public sector companies offer deposit schemes that are similar to Fixed Deposits. Let's take a quick look at them.

1. POST OFFICE TIME DEPOSITS

The post office offers fixed deposits of 1, 2, 3 and 5 years for individual and joint accounts. Investments in 5-year Time Deposits are eligible for tax benefits under Section 80C. The interest offered is revised at the end of each financial year. For financial year 2017-18, the interest offered is 6.9% and 7% for 1 and 2-year deposits respectively, while it is 7.20% and 7.70% for 3 and 5-year deposits respectively. Premature withdrawals are allowed with certain penalties. The minimum amount you can invest is ₹ 200. Further investments have to be in multiples of ₹ 200. There is no maximum limit specified.

2. CORPORATE AND GOVERNMENT BONDS

Many bonds issued by private companies, public sector companies, financial institutions and the governments are similar to Fixed Deposits. These bonds offer a fixed rate of interest for investments made for a fixed period of time. The difference is that unlike deposits made in banks and the post office, the investments made in bonds issued by private companies and institutions cannot be considered totally risk-free. So you will have to understand the risk associated with such bonds before you make an investment. The history of the company, its investment rating, existing market conditions, future prospects, etc. indicate how safe or risky your investment could be. Agencies like CRISIL, CARE, ICRA and others analyse the issuer of bonds and provide ratings that help investors make a decision. The ratings range from AAA (highest) to D (defaulter). Bonds with the highest ratings are least likely to default and offer lower interest rates than bonds with lower ratings. Investors need to be extremely cautious while investing in bonds although they offer higher returns than bank and post office fixed deposits. Bonds issued by the government are totally risk-free but they usually offer low interest rates.

Overall, it's always a good idea to have some part of your investment in a steady and reliable investment option like an FD. Just make sure that when you do it, you get the best deal available in the market!

HOW TO INVEST IN FIXED DEPOSIT SCHEMES

1. You can open a fixed deposit with any national, co-operative, private or foreign bank.

2. You will have to submit Know Your Customer (KYC) documents like photograph, proof of identity (PAN card) and address proof.

3. If you have an online account with your bank, you may even have the option of opening an FD online.

4. Deposits can start as low as ₹ 100 but this varies from bank to bank.

5. Instead of investing in one large FD, break it up into multiple FDs of smaller amounts. This way, even if you need to break an FD for an emergency, you can break just one of them and lose interest on that one alone instead of breaking a large FD and losing interest on the whole amount.

POINTS TO CONSIDER BEFORE INVESTING

1. Is the rate of interest offered better or at par with other banks?

2. What is the penalty for withdrawing your deposit before maturity? Is it comparable or less than other leading banks?

3. Is the bank close to your residence or place of work?

ADVANTAGES

1. FDs are a safe and reliable way to grow your wealth.

2. Interest rates are normally higher than the inflation rate.

3. Surplus cash in your savings account can be automatically moved into FDs.

4. Interest is compounded quarterly for FDs of duration 6 months and more.

5. Senior citizens are offered a higher rate of interest.

6. Fixed deposits are fairly liquid. In a crisis, you can get your entire amount back in a day by incurring a small penalty.

7. You can get a loan against your FD (except for tax-saving FDs). The loan is usually given by the bank that has issued the FD and not by some other bank.

8. Deposits up to ₹ 1 lakh per person (principal + interest) in a bank are guaranteed by the Deposit Insurance and Credit Guarantee Corporation (DICGC), a subsidiary of the Reserve Bank of India (RBI). So even in the rare possibility of a bank going bankrupt, you'll still get back investments up to ₹ 1 lakh from the DICGC. The insured amount includes the sum of all deposits such as savings, fixed, recurring and current accounts made by a depositor across all the branches of a single bank. DICGC covers depositors of nationalised banks, private banks, foreign banks (operating in India) and co-operative banks in India (except co-operative banks from Meghalaya and Union Territories of Chandigarh, Lakshadweep and Dadra & Nagar Haveli). You can increase the cover if you hold joint accounts with names in different order. For example, if a couple, Anil and Bina have two joint accounts, where their names appear as a) Anil, Bina and b) Bina, Anil—then each account will enjoy an insurance cover of ₹ 1 lakh. They will thus effectively have a cover of ₹ 2 lakh even though the money belongs to the same people. You can even spread the fixed deposits in multiple banks to ensure that your deposits are insured. For example, you could deposit ₹ 1 lakh each in two different banks instead of depositing ₹ 2 lakh in a single bank. The possibility of two banks going bankrupt together is very remote. You can read more on this at www.dicgc.org.in.

DISADVANTAGES

1. Rising inflation could decrease the value of your fixed deposit investments. For example, if you invested when inflation was 4% and it reaches 6% by the time your FD matures, the value of your investment is automatically reduced by 2%. The returns from fixed deposits may therefore not be spectacular.

2. You could end up locking your money for a long time.

3. Interest earned above ₹ 10,000 is taxable at source. If you're a senior citizen, you can get tax exemption by filling Form 15H. Other individuals can get exemption by submitting Form 15G. In both cases, although tax is not deducted at source, you have to include the interest earned while calculating your total income. You'll have to then pay the applicable tax as per the tax bracket you belong to.

4. Banks may levy penalty on premature withdrawals (usually around 1% of the interest rate offered).

INVESTMENT METER

Safety: * * * *

Liquidity: * * * *

Returns: * * *

(Where 5 stars indicate Excellent and 1 star indicates Poor.)

TAX IMPACT

The interest you earn from fixed deposits is not tax-free. Banks deduct tax directly (TDS, i.e. Tax Deducted at Source) at the rate of 10% if the total interest you earn is more than ₹ 10,000 in a financial year. Most banks have implemented Core Banking System (CBS) which allows them to consolidate the interest from your FDs across all the branches in the bank. Interest is thus calculated at the bank level and if it exceeds ₹ 10,000, the bank deducts tax. In case you've NOT submitted your PAN details to the bank, and the interest you earn from your FDs is above ₹ 10,000, TDS will be applicable at the rate of 20%. Once the TDS amount is deducted, you'll not be able to claim a refund from the bank even if you furnish your PAN details. You can only claim it as a refund from the IT department while filing your income tax returns.

Once a bank deducts tax, it will issue a TDS certificate (Form 16A) that you can submit while filing your income tax return. Do check with your bank if you feel your interest for a year will be around this amount. If your interest is less than ₹ 10,000, the bank will not deduct tax, but the interest you earn will still be considered part of your income and you'll have to pay tax on it. You should add the interest amount while calculating your income and pay the appropriate tax, depending on the tax bracket you belong to. Banks furnish details of the interest being credited to you for your Fixed Deposits to the Income Tax (IT) department. If you have not included the interest component while calculating your income, the IT department can send you a notice for under-reporting income along with the required penalty.

In case you've NOT submitted your PAN details to the bank, and the interest you earn from your FDs is above ₹ 10,000, TDS will be applicable at the rate of 20%.

In case of minors the credit for the TDS can be claimed by the person managing the minor's account. If you are a senior citizen earning an income less than ₹ 3,00,000, you can avoid TDS by filing form 15H instructing the bank not to deduct tax at source. Investments up to ₹ 1.5 lakh in fixed deposits of duration 5 years or more get tax benefits under Section 80C provided certain conditions are met. The interest you receive from such a fixed deposit will however be taxable.

NOTES

CHAPTER

06

RECURRING DEPOSITS

Recurring deposits (RDs) are one of the simplest investment options available in the market. They may not offer spectacular returns, but what they offer is something equally valuable: the lesson that one can create a significant amount of money from a modest amount contributed regularly over a period of time. A recurring deposit is therefore one of the finest examples of using patience, discipline and sacrifice (the three main pillars of investing) to create something of value.

For anyone new to investing, RDs are the ideal way to understand the pains and joys of investing. Let's look at this investment idea in detail.

THE RECURRING DEPOSIT CONCEPT

Recurring deposits are not only simple to understand, they are also easy to implement. You can open a recurring deposit with any bank that offers you a good rate of interest and start depositing a fixed amount of money every month for a fixed number of months. For example, you might decide to deposit ₹ 1,000 every month on a fixed date for a period of 2 years in a recurring deposit that offers you 8% interest (compounded quarterly, like fixed deposits). Now, you need to deposit ₹ 1,000 every month for the next 24 months. At the end of 2 years, you'll get a lump sum amount of ₹ 26,092 (principal of ₹ 24,000 + interest of ₹ 2,092).

The wonderful lesson you take from here is that an amount (₹ 1,000) that you may have otherwise spent every month on sundry expenses is now saved in a disciplined manner to create a bigger sum which can be used to buy something valuable or used for further investment. A recurring deposit is a great way to buy household items like a television, refrigerator, washing machine, home computer, furniture and so on. Instead of pulling out a lump sum amount out of your savings for these expenses, you can simply save small amounts every month and buy the item on maturity. A recurring deposit is also a wonderful way to teach the value of investing to youngsters.

The following table shows how an amount invested at 8% (compounded quarterly) over a period of 2 years (24 instalments) grows to a substantial saving on maturity.

♦ RECURRING DEPOSITS AT 8% OVER 2 YEARS ♦

Instalment No	Investment per month	Amount on maturity
1	500	13,046
2	1,000	26,092
3	1,500	39,138
4	2,000	52,184

DIFFERENT OPTIONS WITH RECURRING DEPOSITS

Some banks have made recurring deposits more attractive by allowing investors to deposit varying amounts instead of a fixed amount every month. Such deposits are called Flexible Recurring Deposits. Here, instead of investing a fixed amount every month, you can deposit amounts that are up to 10 times the minimum amount that you decide to invest. For example, if you commit to invest a minimum of ₹ 500 every month, you will have the flexibility of investing any amount ranging from ₹ 500 to ₹ 5,000 per month. So one month you may decide to deposit ₹ 500, the other month ₹ 700, the month following that ₹ 2,000 and so on. What this allows you to do is invest at least the minimum amount every month with the flexibility to invest any surplus amount that you may have and thus earn interest on it. This is very helpful, as earlier, investors would be restricted by the amount they committed and had to invest that extra amount in some other schemes. Usually, people spend the extra money they have instead of investing. Flexible Recurring Deposits ensure that such amounts get invested instead of being spent.

Usually, people spend the extra money they have instead of investing. Flexible Recurring Deposits ensure that such amounts get invested instead of being spent.

Some banks have clubbed benefits like life insurance, loans and overdraft facilities with RDs. For example, if the value of your deposit on maturity is going to be ₹ 2 lakh, you could get a life insurance cover of approximately ₹ 2 lakh from the bank during that period. Banks mostly pay the insurance premium from their pocket in case of such plans. Banks also offer loans and overdraft facilities through which you can withdraw up to 80-90% of the deposited amount. Like most banking accounts, you can close a recurring deposit account before the maturity date, subject to losing some part of the actual interest offered (premature withdrawal penalty).

RECURRING DEPOSITS AT BANKS AND POST OFFICES

You can open a recurring deposit at most banks and post offices. Recurring deposits at post offices have a fixed term of 5 years, while banks are flexible about the period. Recurring deposits at post offices offer a fixed rate of interest for the entire duration of 5 years, while banks pay the rate of interest depending on the period of the deposit. Another difference is the penalty levied on premature closure—a post office will pay back your money along with interest at the current Post Office Savings rate (which is quite low at 4%) whereas most banks will only deduct a maximum of 1% from the recurring deposit rate offered (do confirm with your bank before you invest).

If you're planning to build a decent amount of savings but don't have a large sum of money to invest in a fixed deposit or other such investment options, start with a recurring deposit. You can start with the smallest amount that your bank allows and then move on to other investing options once you have created a bigger amount.

Recurring deposits can also be used for collecting money for goals like buying a vehicle, building a child's education fund, children's marriage, family vacations, etc.

HOW TO INVEST IN A RECURRING DEPOSIT

1. You can open a recurring deposit with any private, national or local bank or the nearest post office.

2. The minimum deposit at a bank can be as low as ₹ 100 per month. At post offices, it can start as low as ₹ 10. Almost anyone can thus open a recurring deposit account.

3. Decide on the duration of the deposit. The minimum duration for most banks is 6 months. The maximum duration for most banks is 5 years.

4. After creating a recurring deposit account, the bank or post office issues a pass-book which will record the deposits and mention the duration of the deposit and the final amount you'll get on maturity.

5. Check the date by which you should make your deposit. Ensure that you do so every month and update your passbook regularly. If you have a savings account in the bank, you could have the bank automatically transfer (ECS) the monthly deposit amount from your savings account to your recurring deposit account.

POINTS TO CONSIDER BEFORE INVESTING

1. What is the rate of interest offered? How does it compare with the rate offered by competing banks?

2. What is the penalty on premature closure of the deposit?

3. If you are interested in insurance or loans, you should check if your bank offers these options and under what conditions.

ADVANTAGES

1. Opening a recurring deposit is simple and easy.

2. Recurring deposits offer returns almost similar to fixed deposits of the same tenure.

3. Because you have to compulsorily deposit a fixed amount every month, you build a habit of saving, which can stay with you for the rest of your life.

4. Banks offer multiple facilities like loans, insurance, overdrafts, and so on with recurring deposits which you could avail of, if required.

5. Recurring deposits are as safe as your savings or fixed deposits.

DISADVANTAGES

1. The rate of return is usually just a little above the inflation rate.

2. In case the bank doesn't automatically deduct the recurring deposit amount from your savings account, you will have to visit the bank or the post office every month.

3. Recurring deposits don't offer any income tax benefits.

INVESTMENT METER

Safety: * * * *
Liquidity: * * * *
Returns: * * *
(Where 5 stars indicate Excellent and 1 star indicates Poor.)

TAX IMPACT

Earlier, interest earned on RDs was not subject to TDS. But from June 1, 2015, like with fixed deposits, banks deduct tax at source (TDS) if your interest for the financial year exceeds ₹ 10,000.

Banks deduct TDS at 10%. But you may still end up paying more tax on the interest earned depending on your income tax slab. Because the interest earned is not tax-free, you'll have to show the entire interest amount as income and pay the remaining tax. For example, if you earned interest of ₹ 50,000, banks will deduct TDS of ₹ 5000 (10% of interest). But in case you belong to the 30% tax bracket, your tax payable will be ₹ 15,000 (30% of 50,000). Since, ₹ 5,000 is already deducted, you'll have to pay the remaining ₹ 10,000 as tax.

NOTES

CHAPTER

07

NATIONAL SAVINGS CERTIFICATES

If you're looking for a medium to long-term, risk-free investment option, you should consider National Savings Certificates (NSCs). It offers a healthy rate of return as well as tax benefits under Section 80C of the Income Tax Act. Moreover, its safety is guaranteed by the Government of India. And finally, it is one of the easiest schemes to apply for—all you have to do is make a quick visit to your nearest post office, submit the duly filled application form, make the payment, and it's done! True, it may sound a bit old-fashioned today, but as a time-tested investment option, you should definitely check to see if it will work for you.

THE NSC CONCEPT

The Government of India started the National Savings Certificates scheme (along with other similar government-sponsored small savings schemes) to encourage the habit of saving among Indians and to use the funds collected for developmental activities. The combination of a good rate of return, safety and tax benefits have made National Savings Certificates hugely successful.

Earlier, the interest rate offered was reviewed on an annual basis. From April, 2016, interest rates are being announced on a quarterly basis. It's important to note that once you invest in NSCs at a particular interest rate, it stays the same throughout the duration of that certificate. For example, if you invested in 5-year NSCs in May 2016, you would earn an interest of 8.10% (compounded yearly) till maturity. This rate of interest will remain constant for that certificate—irrespective of whether interest rates of NSCs go up or down during the period. Does that make adifference? It does, because you are sure about the amount you'll receive on maturity. If you invested ₹ 100 @ 8.10%, at the end of 5 years, you'll receive ₹ 147.61 when you redeem your NSC certificate. So even if interest rates offered during the next quarters may be lower, your maturity amount will not be affected.

Do note that till April 1, 2016, the interest on NSCs was compounded twice a year. The government reduced this to once a year while at the same time reducing the interest rate from 8.50% to 8.10%. The lowering of the interest rate was done to rationalize interest rates across various investment options. Because interest rates were low for FDs, RDs and other banking products, the government reduced interest rates offered on PPF, NSCs and similar schemes to ensure that there was a level playing field for everyone. The change in interest rate on NSCs is not done in an arbitrary manner. It is linked to the interest earned on 10-year government bonds. During April 2016, the interest rates earned on these bonds (called yields) was 7.85%. As per the recommendations of an advisory committee, the government would add another 0.25% to this rate for schemes like NSCs and PPF. As per the budget of 2016-17, the rate for new NSCs should be announced every quarter and will be 0.25% more than the existing 10-year government bond. By doing this, the government aims to offer a reasonably attractive investment option to investors.

HOW TO INVEST IN NSCS

1. You can invest in NSCs at most post offices in India by filling up an application form. You can either do it personally or through an authorised agent. You can purchase it under your name or jointly; you can even nominate someone.

2. Earlier, certificates in denominations of ₹ 100, ₹ 500, ₹ 1,000, ₹ 5,000 and ₹ 10,000 were provided to investors. From July 2016, instead of certificates, investments are in e-mode or recorded in a passbook. For buying NSCs in e-mode, you should have a savings account with a post office that has Internet banking activated for it.

3. The minimum investment is ₹ 100; there is no maximum limit to the amount you can invest. (However, your investment in NSC is eligible for tax benefit under section 80C up to ₹ 1.5 lakh in a financial year along with other eligible investments and expenses.)

4. This is a one-time investment. You can pay through cash, local cheque, demand draft, pay order, or even another NSC that has reached maturity.

5. On maturity, you'll receive the amount due by presenting your passbook or existing NSC certificate at the post office. You can also get the money from any other post office on verification of the NSC certificates/passbook.

6. If your NSCs get lost or stolen, you will be given a passbook instead of duplicate certificates.

It's important to note that once you invest in NSCs at a particular interest rate, it stays the same throughout the duration of that certificate.

---

7. NSCs can be transferred from one person to another on payment of a small fee. They can also be bought in the name of children.

8. NSCs do not allow premature withdrawal except under certain extreme conditions like death, forfeiture against a loan or when ordered by the court.

POINTS TO CONSIDER BEFORE INVESTING

1. The amount you invest will get locked for 5 years. Can you afford not to use this amount during this period?

2. Is this the best return you can get for a totally risk-free investment, currently? (Other options could include long-term FDs, PPF, etc.)

3. How important is risk-free investment compared to the rate of return that NSCs offer?

ADVANTAGES

1. You can avail of income tax deductions under Section 80C for eligible investments (which includes NSCs) up to ₹ 1.5 lakh.

2. Investing in NSCs is easy and simple.

3. Your investment is virtually risk-free as it is guaranteed by the Government of India.

4. NSCs are transferable and can be encashed in any part of India.

5. Although premature withdrawals are not allowed, you can take a loan against your NSCs from a bank or any other financial institution.

6. NSCs are ideal for people who are not willing to take risks and are happy with average or slightly above average returns. It is a good medium-to-long-term investment product which can be used for specific goals like accumulating funds for children's education and marriage.

DISADVANTAGES

1. You have a lock-in period of 5 years during which your money is unavailable to you.

2. NSCs are mostly available in physical form. They have to be presented at the post office on maturity, so you need to keep them safe during the period of investment.

3. On maturity, interest received is taxable although tax is not deducted at the time of encashment.

INVESTMENT METER

Safety: * * * * *
Liquidity: * * *
Returns: * * *

(Where 5 stars indicate Excellent and 1 star indicates Poor.)

TAX IMPACT

In a financial year, investments of up to ₹ 1.5 lakh in NSCs offer tax benefits under Section 80C of the Income Tax Act. The interest you earn on your NSC investment every year cannot be withdrawn, so it gets re-deposited into the NSC. This interest that gets re-deposited can be claimed as fresh investment for income tax benefits under Section 80C for the four years before maturity. For example, if you earned interest of ₹ 1,500 in the 1st year, ₹ 1,600 the second year, ₹ 1,700 the third year and ₹ 1,800 the fourth year—you can show these amounts as fresh investments in NSCs for each of those financial years and claim tax deduction under Section 80C. You can claim deduction while filing your income tax returns by adding the interest amount as an investment made under Section 80C. The interest earned during the fifth year should not be shown as an investment as it will be paid to you at the end of the fifth year.

The interest you earn from NSCs is exempt from TDS. But it is not tax free.So you have to add the interest earned to your total income and pay the appropriate tax as per your tax slab.

Here, you have two options: either show the interest as income on a yearly basis and pay the appropriate tax on your taxable income or show the entire interest earned as income at the end of 5 years and pay the required tax.

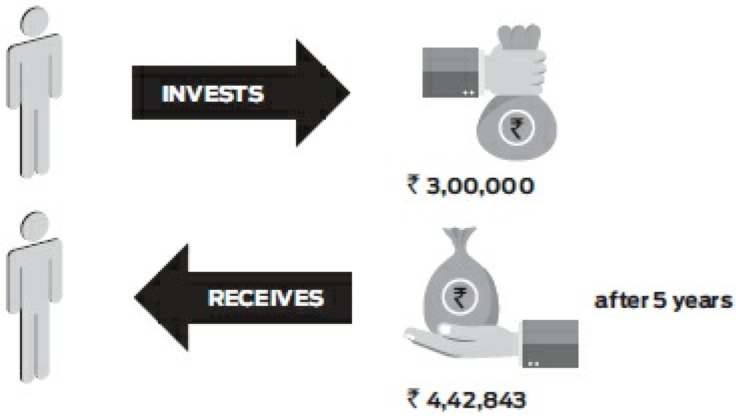
For example, as per the first option, if you earned ₹ 1,500 as interest in the first year, you can add this amount to your total income for that year and pay tax based on the tax slab you belong to. This method of accounting is known as Accrual method. In case you are also showing the interest of ₹ 1,500 earned as an investment under Section 80C, your taxable income would not show this additional amount. It's similar to showing that you have an income of ₹ 1,500 from Other Sources and you are investing that amount in NSCs under Section 80C. So the amount doesn't get added in your taxable income.You can do so for four years during which you earn interest and get tax-free income during those years. You can claim this benefit as long as it is within the ₹ 1.5 lakh deduction that is available under Section 80C. During the fifth year, the interest you earn is not reinvested but paid to you at the end of the year; you would have to add this interest to your income and pay tax as per the tax slab you belong to.

The other option to the Accrual Method is to not show the interest as income on a yearly basis and instead add the total interest earned at maturity to that year's income. For example, if you earned a total sum of ₹ 8,000 as interest during the 5 years, you can add this amount to your annual income in the fifth year and pay tax on it. This method of accounting is known as Receipt method.

The first method is ideal to spread the tax liability over the duration of the

investment. In the other option, you'll have to show the entire interest as income on maturity and that may lead to higher taxes.

♦ NATIONAL SAVINGS CERTIFICATES ♦



Total amount invested	₹ 3,00,000
Total amount received	₹ 4,42,843 (interest rate of 8.10%)
Period of investment	5 years
Eligibility	Any Indian resident
Taxation	Interest gets added to your income and is taxed according to your tax bracket.
Tax Rebate	Available under Section 80C up to a maximum limit of ₹ 1.5 lakh per year.
Minimum investment	₹ 100
Maximum investment	No limit

NOTES

CHAPTER
08

POST OFFICE MONTHLY INCOME SCHEME

If you would like to earn an income every month from your investment instead of getting a lump sum at maturity, the Post Office Monthly Income Scheme (POMIS) could be the option for you. In simple terms, POMIS is nothing but a fixed deposit with a monthly interest payout. The scheme is especially handy for retired persons who are looking to earn a steady income every month from their post-retirement benefits. To illustrate, if you invest ₹ 3 lakh at the current rate of 7.6% per annum (the rate announced for April-June 2017), you'll receive ₹ 1,900 every month for that quarter. You’ll continue to earn interest every month based on the rates announced each quarter. At the end of 5 years, you'll get back your principal of ₹ 3 lakh.

POMIS is suitable not only for senior citizens and the retired, but also for anyone looking for an assured monthly income, irrespective of their employment status or age.

THE POMIS CONCEPT

The Post Office Monthly Income Scheme and the Senior Citizens' Savings Scheme are similar in concept. The SCSS, as the name suggests, is only for senior citizens whereas POMIS is for everyone. Both schemes aim to provide investors with a regular stream of income through the duration of the investment instead of offering a bigger lump sum at maturity. When you invest in these schemes, you do so with the intention of receiving regular payments to manage your day-to-day expenses. So, unlike a recurring deposit or NSC, where you get your investment plus interest at maturity, here, you get interest every month and your investment amount at maturity. This is a crucial difference to understand when you plan your investments.

THE HIGHLIGHTS OF POMIS ARE AS FOLLOWS:

1. Investments earn interest at a fixed rate per annum. Earlier, the announcement of interest to be paid for investments in POMIS was made before the beginning of the financial year. Now, it will be announced at the beginning of every quarter. The new rate will be effective for the entire duration of the scheme. For example, a rate of 7.60% was announced for the quarter of April – June 2017. This is the rate at which you'll earn interest for your investment through the duration of the scheme. The rate announced every quarter will be + 0.25% more than the government bond rate prevailing at that time. The interest earned is paid at the end of every month for 5 years.

2. The minimum investment is ₹ 1,500. You can invest more in multiples of ₹ 1,500. The maximum amount you can invest is ₹ 4.5 lakh if you open an account in a single name and up to ₹ 9 lakh in a joint account.

3. The POMIS scheme doesn't encourage premature withdrawals. You have the option to close an account after the completion of 1 year and before the completion of 3 years. In such a case, a penalty of 2% of the deposit amount is levied. For example, if you deposit ₹ 1 lakh but decide to close your account after 2 years, the amount deducted would be ₹ 2,000 (2% of 1 lakh). So you'll get back a sum of ₹ 98,000. Closing the account after 3 years but before maturity incurs a penalty of 1%. Using the same example as earlier, if you close your account any time after 3 years, you'll get ₹ 99,000 back (1% of ₹ 1 lakh, ₹ 1,000, gets deducted).

Unlike a recurring deposit or NSC, where you get your investment plus interest at maturity, here, you get interest every month and your investment amount at maturity.

---

4. You can get the monthly interest credited to a savings account if both the

accounts are in the same post office.

5. Unlike other schemes (SCSS, EPF), POMIS is available to all Indian citizens. In fact, an account can be opened in the name of a minor aged 10 years or above; this account has a maximum limit of ₹ 3 lakh. This limit is independent of the guardian's limit.

All in all, the Post Office Monthly Income Scheme is reasonably attractive for investors who want 100% safety and an assured income every month.

HOW TO INVEST IN POMIS

1. You can open a POMIS account at any post office in India.

2. Anyone who is 10 years old or above can open an account in their individual name.

3. On successful opening of the account, you'll receive a certificate mentioning your investment amount, your monthly income amount, and the maturity date. You'll also get a passbook to record the monthly amount you'll receive.

POINTS TO CONSIDER BEFORE INVESTING

1. How much of your funds should you invest in POMIS? How should you balance your need for regular income with the need to grow your investments?

2. How will you use your monthly income from POMIS? Will you use it for monthly expenditure? If not, will you re-invest it in some other option—say, a recurring deposit?

3. Can you open a savings account in the same post office where you would open the POMIS account? If not, will you be able to visit the post office on a monthly basis to collect the money?

ADVANTAGES

1. POMIS is guaranteed by the government and is 100% safe.

2. There is minimum penalty on premature closure.

3. You can open more than one account, which can add up to ₹ 4.5 lakh per individual. You can also open a POMIS account for any minor aged 10 years or above.

4. Interest is not taxable at source.

DISADVANTAGES

1. The lock-in period is 5 years.

2. You can close your account prematurely only after 1 year of opening the account.

3. POMIS cannot be operated online. You'll have to open a savings account in the

same post office to get your interest automatically credited. Otherwise you'll have to make monthly visits to collect your interest cheque.

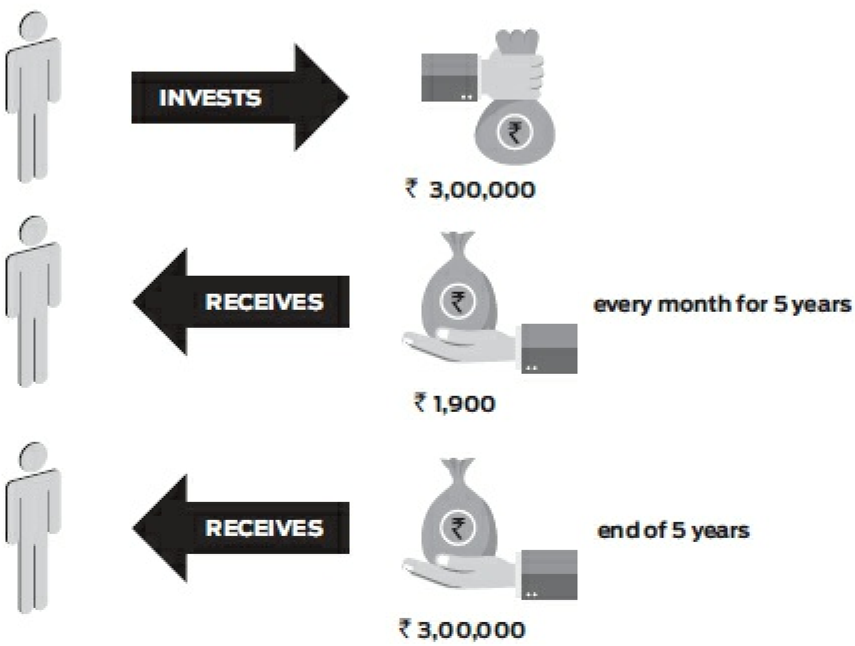
INVESTMENT METER

Safety: * * * * *
Liquidity: * * *
Returns: * * *
(Where 5 stars indicate Excellent and 1 star indicates Poor.)

TAX IMPACT

Investments in POMIS do not offer any tax benefits. Although there is no tax deducted at source on the monthly interest you earn, it will be considered as income and you will have to pay tax on it if you fall under the taxable category.

♦ POST OFFICE MONTHLY INCOME SCHEME ♦



Total amount invested	₹ 3,00,000
Total amount received	₹ 1,14,000 (at 7.60%) as interest + ₹ 3,00,000 = ₹ 4,14,000.
Period of investment	5 years
Eligibility	Any Indian resident aged 10 years or above
Taxation	Yes. As per income bracket.
Tax Rebate	None
Minimum investment	₹ 1,500
Maximum investment	₹ 4.5 lakh for single account and ₹ 9 lakh for joint account (₹ 3 lakh for minors)
Other conditions	A penalty of 2% of the deposit amount is levied if you close your account before 3years. The penalty is reduced to 1% if the

	account is closed after 3 years.

NOTES

CHAPTER

09

THE SENIOR CITIZENS' SAVINGS SCHEME (SCSS)

The Senior Citizens' Savings Scheme (SCSS) was introduced by the government in August 2004 as a fixed deposit scheme that gave senior citizens assured returns at regular intervals. According to this scheme, a senior citizen can invest a lump sum amount and earn interest on a quarterly basis. At the end of the maturity period of 5 years, the investor gets back the original investment. Any resident Indian citizen, who is 60 years of age or above, can invest in SCSS. An individual who has taken voluntary retirement from employment (under VRS/special VRS) and is between 55 and 60 years, can also invest in SCSS. If you're a senior citizen looking for a regular, stable stream of income after retirement, you can consider this option.

THE SCSS CONCEPT

The idea behind the Senior Citizens' Savings Scheme is to enable senior and retired citizens to earn a regular income similar to a salary by using their post-retirement funds. The Government of India currently supports two income schemes: the Post Office Monthly Income Scheme (POMIS) and the Senior Citizens' Savings Scheme. POMIS was launched before SCSS and offers investors assured income every month. Both schemes have their advantages and disadvantages. Become familiar with each to select the one that works best for you. The highlights of SCSS are:

1. Investments in SCSS earn a higher return as compared to other government saving schemes like POMIS, NSCs, PPF, etc. Like every other small savings scheme, the interest rate for SCSS will be announced on a quarterly basis. The SCSS will earn you 1% higher interest than the corresponding government bond rate. For the April-June quarter of 2017, SCSS offered investors a rate of 8.40%. The interest rate for each quarter will be announced before the start of the quarter. The amount you earn as interest will thus change every quarter with the change in interest rate. The interest is paid at the end of every quarter irrespective of your date of investment i.e. on 31st March, 30th June, 30th September and 31st December.

2. SCSS investments have a maturity period of 5 years which can be extended by another 3 years. You can withdraw your money at the end of 5 years or apply for the extension (you'll have to submit a form requesting the extension; it doesn't get automatically extended on maturity). On extension, you'll continue to receive interest every 3 months at the rate being offered at that time.

3. No penalty is levied if the deposit is withdrawn after completion of 1 year of the extension period.

4. An individual can invest a maximum of ₹ 15 lakh in this scheme.

5. Since senior citizens may need to withdraw cash on an emergency basis, SCSS offers the flexibility to do so. There is however a penalty involved for premature withdrawals which is lower than in schemes like POMIS. With SCSS, you lose 1.5% of the deposited amount if the account is closed between 1 and 2 years after opening the account. The penalty is reduced to 1% of the deposit amount if the account is closed 2 years or later from the opening date. For example, if you deposit ₹ 1 lakh but withdraw it after 2 years, the amount deducted would be ₹ 1,000 (1% of 1 lakh). So you'll get a sum of ₹ 99,000 plus any interest that you've earned.

The SCSS will earn you 1% higher
interest than the corresponding

government bond rate.

If you're retired or are about to reach retirement age, you could consider investing in SCSS. Remember, this is not an investment scheme like fixed deposits, NSCs, mutual funds, etc. where your investment grows and you get your investment and interest at maturity. In SCSS, you’ll receive interest on a quarterly basis, and on maturity, you’ll get the invested amount back.

HOW TO INVEST IN SCSS

1. You can apply for SCSS at a post office, any public sector bank that offers the PPF scheme or with ICICI Bank, the only private sector bank that accepts SCSS accounts.

2. Any resident Indian citizen who is 60 years old or above can invest in this scheme. Investors between 55 and 60 years who have retired under a voluntary retirement scheme can only invest their retirement benefits in this scheme. Retired personnel belonging to the defence services (excluding civilian defence employees) enjoy a relaxation in the age limit, subject to certain conditions being met.

3. The minimum investment is ₹ 1,000. You can make deposits in multiples of ₹ 1,000 (e.g. ₹ 25,000 but not ₹ 25,500). The maximum limit is ₹ 15 lakh.

4. You can open a single account, multiple accounts or a joint account with your spouse. However, the sum of all investments should not exceed ₹ 15 lakh. In case of a joint account, the age of only the first applicant is considered for eligibility of the scheme. There is no age bar for the second applicant.

5. Investments less than ₹ 1 lakh can be made in cash. Any investment above that has to be made by cheque or demand draft.

6. Nomination is allowed both at the time of opening the account as well as at any time before the closing of the account.

7. You can transfer your SCSS account from one post office/bank to another in case of a change of residence. A transfer fee of ₹ 5 per lakh of deposit is charged for the first transfer. Subsequent transfers are charged at ₹ 10 per lakh.

8. You can open an account at a post office or at designated branches of around 24 nationalized banks (SBI, Bank of Baroda, and Bank of India among others, and one private bank, i.e. ICICI Bank).

POINTS TO CONSIDER BEFORE INVESTING

1. Do you want a regular stream of income and can you afford to lock your investment for a few years in an investment scheme? (Consider SCSS for regular income, but if you want to grow your investment, consider other options.)

2. How much of your funds do you want to invest in SCSS? How should you balance your need for regular income with the need to grow your investments?

ADVANTAGES

1. SCSS offers a higher rate of interest than other government saving schemes.

2. Your investment is 100% safe as it is guaranteed by the Government of India.

3. You can invest a large amount of money in SCSS if you wish, subject to a maximum of ₹ 15 lakh.

4. SCSS offers a regular stream of income through interest payouts every quarter.

5. Investment is easy as it is available at post offices, most public sector banks and one private sector bank.

6. The penalty for premature withdrawal is minimal.

7. Joint accounts, nominations and account transfers are possible.

DISADVANTAGES

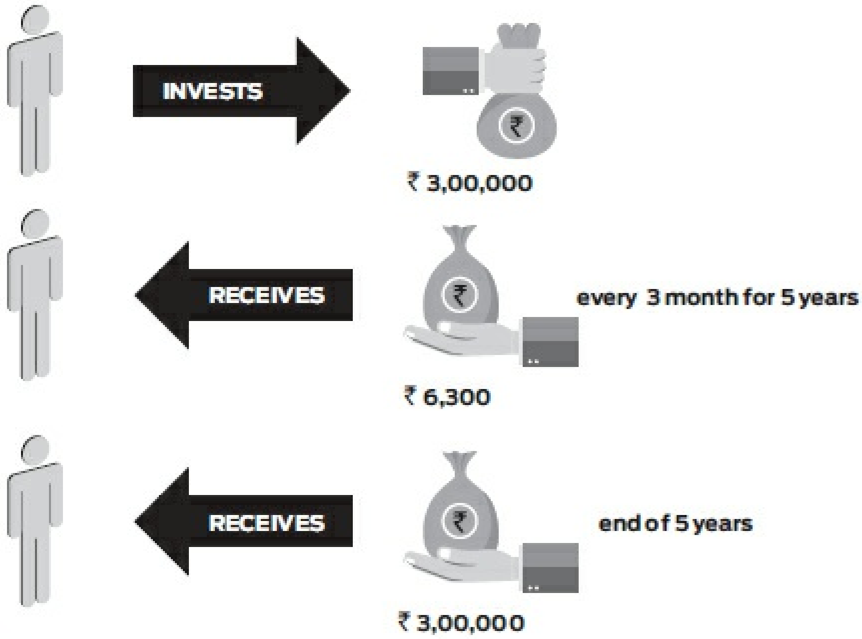
1. Interest is taxable at source unless you provide form 15G (for non-senior citizens) or 15H (for senior citizens) to ensure that you receive the interest without tax deduction.

INVESTMENT METER

Safety: * * * * *
Liquidity: * * *
Returns: * * *
(Where 5 stars indicate Excellent and 1 star indicates Poor.)

TAX IMPACT

Investments up to ₹ 1.5 lakh in SCSS are eligible for tax rebate under Section 80C of the Income Tax Act. Interest is taxable at source (TDS) at the rate of 10% if it exceeds ₹ 10,000 per year. You can claim exemption by submitting Form 15G or 15H. Irrespective of the interest earned, you should include it as part of your annual income and pay tax based on the income tax slab that you belong to.



Total amount invested	₹ 3,00,000
Total amount received	₹ 1,26,000 as interest at 8.40% + ₹ 3,00,000 = ₹ 4,26,000
Period of investment	5 years
Eligibility	Any Indian resident aged 10 years orabove
Taxation	Yes. As per income bracket.
Tax Rebate	None
Minimum investment	₹ 1,500
Maximum investment	₹ 4.5 lakh for single account and ₹ 9 lakh for joint account (₹ 3 lakh for minors)
Other conditions	A penalty of 2% of the deposit amount is levied if you close your account before 3 years. The penalty is reduced to 1% if the account is closed after 3 years.

NOTES

CHAPTER

10

THE PUBLIC PROVIDENT FUND (PPF)

The Public Provident Fund (PPF) is an example of the government stepping in to help people create savings for themselves. The Government of India initiated the Public Provident Fund scheme to ensure that everyone could have some savings available for their old age. By providing incentives like tax deductions on the investment, tax-free returns and complete security of the investment, PPF became a highly attractive scheme for people to regularly invest in. With all the benefits it offers, the PPF should be a definite part of your investment plan. It's truly a product for all seasons. Here's more about this scheme.

THE PUBLIC PROVIDENT FUND CONCEPT

Imagine a bank that makes it compulsory for you to make deposits every year and then gives you back your investment only at the end of 15 years! Would you opt for the services of such a bank? Most of us would think twice, I'm sure. But the PPF concept has so many attractive features that such a condition has been happily accepted by crores of Indians over the years.

The primary reason for the 15-year lock-in is to ensure that you get your money when you actually need it—when you're well into middle age—or, if you started investing late, around or just before retirement. The long lock-in period ensures that you not only have a sizeable amount on maturity, but that you will end up using your money for the more important needs in your life. (Do note that there is no age limit to open a PPF account. You can even open an account for minors.)

From April 1, 2016, the 15-year compulsory lock-in period has been relaxed for those who need money for any critical need (earlier, you could close a PPF account before maturity only on the death of the account holder). According to the new rule, you can close your PPF account prematurely if your account has been active for more than 5 years and the money is needed for meeting expenses related to the higher education needs of your children or for the treatment of a serious illness of the PPF subscriber, her spouse, dependent children or dependent parents. In case of such premature closure, the entire corpus can be withdrawn by paying a penalty of 1% for all the preceding years. In other words, the interest you have earned during the preceding years will be reduced by 1%.

For example, if you opened your PPF account on January 15, 2010, then you can close your account on completing five financial years of investing. In this case, it will include the financial years 2010-11, 2011-12, 2012-13, 2013-14 and 2014-15. So you can close your account any day from April 1, 2015 onwards (the first day of the sixth financial year). Similarly, the interest you earn will be reduced by 1% across all these years when you withdraw your corpus. For example, if you earned interest at the rate of 8.0%, 8.6%, 8.8%, 8.7% and 8.7% during these five years respectively, your corpus will show earnings at the rate of 7.0%, 7.6%, 7.8%, 7.7% and 7.7% respectively (do note that there is no deduction in rates if the account is being closed prematurely due to the demise of the account holder).

In addition to the option to close your PPF account after 5 years, the government has also announced a change in the way your PPF account will earn interest. Earlier, the interest rate for PPF would be announced before the beginning of a financial year which would then be applicable for the entire duration of that financial year. That has changed now. From FY 2016-17, the interest rate would be announced for every quarter and your PPF account will earn interest at that rate for the three months in that quarter. For example, the interest rate announced for the quarter April-June 2017 was 7.90%. This meant that the amount in your PPF account will earn interest at that rate for the months

of April, May and June. The government will then announce a new rate in the month of June for the quarter July-September and so on. The government has implemented this change across all interest earning schemes like SCSS, POMIS, NSC, etc. By doing this, the government hopes to align interest rates with the existing market rates instead of tying it down to a single rate for the entire year.

The minimum investment you can make in PPF is ₹ 500 per year while the upper limit is ₹ 1,50,000 per year. You can make up to 12 deposits (not necessarily 1 per month as in an RD) in your PPF account every year, provided the total annual sum does not exceed ₹ 1,50,000 (if it does, you won't earn interest on the extra amount). An important distinction between PPF and other schemes (like NSCs or POMIS) is that in PPF, you have to invest a minimum amount every year (minimum R₹ 500) while in other schemes, you have to make one lump sum investment (for e.g. ₹ 10,000 in an NSC certificate). Plus the rate announced for PPF in a quarter is applicable only for those three months while in case of other schemes, the rate at which you invest is the rate at which your investment will earn interest throughout the period of its investment. For example, if you invested at 7.60% in 5-year NSCs in June 2016-17, your investment will earn interest at 7.60% for the entire 5 years even if a different interest rate is announced for the next quarter or financial year. For PPF, that's not the case. The rate of interest announced for a quarter will apply to the accumulated amount as well as for investments made during that quarter.

How does it affect your investment in PPF? There are positives as well as negatives. The positive part is that the government will update PPF interest rates in line with the prevailing market rates, so your investments will earn an interest rate that will be 0.25% higher than the actual market rates. The downside is that you wouldn't know how interest rates will change and therefore, how much you'll end up receiving on maturity. For example, you may get 7.90% this quarter, but the rates could go up or down the next quarter and you'll end up earning interest at the new rate the following quarter, until the change of interest in the next quarter.

In case you need money but do not wish to close your PPF account, the 15-year lock-in has in-built flexibility too. PPF allows you to make a partial withdrawal from the 7th year onwards. The amount can be up to 50% of the balance in your account at the end of the fourth year immediately preceding the year in which you want to withdraw or the amount at the end of the previous year, whichever is lower. For example, if you've opened your account in FY 2012-13, then you can withdraw from FY 2018-19 onwards. If you decide to withdraw in FY 2018-19, then the amount you can withdraw will be 50% of the balance on March 31, 2015 or March 31, 2018, whichever is lower. Thereafter, you can make one withdrawal every year.

The amount you withdraw need not be repaid and carries no penalty—the amount remaining in your account continues to earn the applicable rate of interest. In case you need money but don't want to withdraw it, then you can take

a loan any time in or after the 3rd year till the 6th year. If you are taking a loan in the 3rd year, the loan can be up to 25% of the balance in your account at the end of the first financial year. If you're taking a loan in the fourth year, you can take a loan up to 25% of the balance at the end of the second financial year and so on. The loan needs to be repaid within 3 years by paying an additional interest of 2% per year. If you're unable to repay the loan within this period, an additional interest of 6% per year is charged on the outstanding amount.

At the end of 15 years, you can either withdraw the entire amount in your PPF account or extend it indefinitely in blocks of 5 years at a time.

Investments up to ₹ 1,50,000 per year are eligible for tax benefits under Section 80C. At the end of 15 years, you'll get the amount you deposited plus all the interest earned, tax-free! Along with the flexibility and tax benefits, you also have the freedom to invest at your own pace. Depending on the money you are able to keep aside, you can keep depositing it in your PPF through the year. For example, you could deposit ₹ 2,000 one month, ₹ 5,000 the next month, nothing the following month, etc. Or you can make a single lump sum deposit in a year. You have to invest a minimum of ₹ 500 per year to keep your account active. If you neglect to pay this, you'll have to pay a penalty of ₹ 50 the next year to reactivate your account (a total of ₹ 550 for the missed year).

At the end of 15 years, you can either withdraw the entire amount in your PPF account or extend it indefinitely in blocks of 5 years at a time. If you decide to extend it, you can do so with or without making deposits. If you choose to make deposits, you'll have to fill Form H within one year from the end of the maturity period. If you do not fill up Form H, then your account will, by default, be continued without further deposits.

EXTENDING PPF WITH THE OPTION TO DEPOSIT

In case you fill Form H and decide to make further deposits, the same investment limits of a maximum of ₹ 1,50,000 and a minimum of ₹ 500 per year will apply. You can also withdraw up to a maximum of 60% of the amount that is present in your account during the extension period. However, withdrawals can be made only once a year over the 5-year period. For example, if the amount in your account at the end of 15 years was ₹ 10 lakh, then you can withdraw up to ₹ 6 lakh in 5 instalments over the five year period (but only one withdrawal per year). For example, you could withdraw ₹ 1 lakh in the first year, ₹ 50,000 in the next couple of years, and so on. Or you could withdraw the entire ₹ 6 lakh any time during the 5-year period.

EXTENDING PPF WITHOUT DEPOSIT

In case you decide to extend your PPF but not make any deposits, then there is no limit to the amount you can withdraw (although you'll still be allowed to withdraw only once a year). This option applies to you if you do not fill Form H and submit it within one year from the end of the maturity period.

You could also decide not to extend your PPF and withdraw the entire money and start a fresh PPF account, investing only a part of the money you withdrew, in the new account.

The PPF is not an investment option for those looking for liquidity or short-term returns. Look at it instead as a steadily growing, tax-free investment for your retirement years, and you won't go wrong.

HOW TO INVEST IN PPF

1. You can open a PPF account in any post office or public sector bank or even some private banks as specified by the government from time to time.

2. You can open only one PPF account where you can deposit a maximum of ₹ 1,50,000 per year. You need to deposit a minimum of ₹ 500 every year to keep your account active.

3. There is no age limit for opening an account. You can even open an account in the name of a minor.

4. You can invest any amount ranging from ₹ 500 to ₹ 1,50,000 in a year in multiples of ₹ 5. For example, you can invest ₹ 555 or ₹ 550, but not ₹ 552.

5. Non resident Indians (NRIs) cannot open a PPF account. However, if you have already opened a PPF account before becoming an NRI, you can continue to invest into PPF till maturity at 15 years. You will not be able to extend the PPF account following maturity. As an NRI, you can use the money in your NRE or NRO account to make payments into your PPF account.

POINTS TO CONSIDER BEFORE INVESTING

1. What is your financial goal 15 years down the line? The younger you are, the better it is to start with a PPF. For example, if you are 50 years old, it may be better to opt for an investment with a shorter maturity period as you will be 65 years by the time your account reaches maturity.

2. Can you afford not to withdraw the amount till five years after opening the account?

ADVANTAGES

1. Benefits under Section 80C reduces your tax liability for the amount you invest. For example, if you invest ₹ 50,000 in a year, your taxable income gets reduced by ₹ 50,000. The maximum amount you can invest is ₹ 1,50,000 per year.

2. There is no age limit for opening a PPF account. An account can be opened for even the youngest member of your family. Please read the section on rules for investing on behalf of minors at the end of this chapter.

3. You can make multiple deposits (up to 12) in a year.

4. In case of an emergency, you can close the account and withdraw the amount after a period of 5 years. Around 50% of your deposit can be withdrawn after seven years.

5. The entire amount you get on maturity is tax-free.

DISADVANTAGES

1. There is a lock-in period of 15 years—you can only make partial withdrawals during this period. In case you close your account and withdraw the entire amount after completion of 5 years, you lose 1% from the interest you earned every year.

2. The interest rate can change on a quarterly basis. It could therefore go lower than the year in which you opened the account. This could affect your earnings from PPF.

3. You can only operate one account per person. If you shift residence, you can request your bank to move your account to a branch closer to your new residence.

4. Premature closure may be allowed only in case of a genuine emergency and that too only at the end of 5 years from the end of the year in which the account was opened.

INVESTMENT METER

Safety: * * * * *
Liquidity: * * *
Returns: * * *
(Where 5 stars indicate Excellent and 1 star indicates Poor.)

TAX IMPACT

Deposits made every year are eligible for tax deduction under Section 80C up to a limit of ₹ 1,50,000. Interest and the total amount received on maturity are tax-free.

PPF RULES FOR INVESTING ON BEHALF OF MINORS

1. A parent can open PPF accounts for two of his/her minor children.

2. The account can be owned and operated by only one of the parents. Both parents cannot open an account for the same child, either.

3. A legal guardian, for example an uncle, aunt, or grandparent can open an account for minors only if the parents of the children are no longer alive.

4. As a parent, you can claim tax deduction on the investments made in all (maximum three) accounts. However, the combined tax benefit for investments in all three accounts cannot exceed ₹ 1.5 lakh.

5. Your total investment in all accounts cannot exceed ₹ 1.5 lakh. For example, you could invest ₹ 1,00,000 in one account and ₹ 25,000 in the other two accounts.

♦ PPF INVESTMENT TABLE ♦

Assumption: ₹ 1,50,000 invested between 1st and 5th April every year. Assuming interest rate remains the same (8.10%) every quarter for the entire 15 years.

Year	Max Investment (₹)	Interest (₹) At 8.10%	Closing Balance (₹)	Max Withdrawal Limit (₹)	Max Loan Possible (₹)
1	1,50,000	12,150	1,62,150	-	-
2	1,50,000	25,284	3,37,434	-	-
3	1,50,000	39,482	5,26,916	-	40,538
4	1,50,000	54,830	7,31,747	-	84,359
5	1,50,000	71,421	9,53,168	-	1,31,729
6	1,50,000	89,357	11,92,525	-	1,82,937
7	1,50,000	1,08,744	14,51,269	2,63,458	-
8	1,50,000	1,29,703	17,30,972	3,65,873	-
9	1,50,000	1,52,359	20,33,331	4,76,584	-
10	1,50,000	1,76,850	23,60,180	5,96,262	-
11	1,50,000	2,03,325	27,13,505	7,25,635	-
12	1,50,000	2,31,944	30,95,449	8,65,486	-
13	1,50,000	2,62,881	35,08,330	10,16,665	-
14	1,50,000	2,96,325	39,54,655	11,80,090	-
15	1,50,000	3,32,4777	44,37,132	13,56,753	-

♦ PPF INVESTMENT TABLE ♦

Following is a table that shows how PPF interest gets calculated if you deposit multiple times during a year. You'll notice that the amounts that are being deposited every month is not the same.

Sr. No.	Month	Amount deposited on or before 5th of every month	Amount in your account	Interest (8.10%)
1	April	10,000	10,000	67.50
2	May	12,000	22,000	148.50
3	June	Nil	22,000	148.50
4	July	5,000	27,000	182.25
5	August	Nil	27,000	182.25
6	September	1000	28,000	189.00
7	October	Nil	28,000	189.00
8	November	5,000	33,000	222.75
9	December	10,000	43,000	290.25
10	January	10,000	53,000	357.75
11	February	0	53,000	357.75
12	March	1,000	54,000	364.50
				2,700

Balance at the end of the financial year: 54,000 + 2,700 = 56,700

In this example, for the month of April, the interest will be = (10,000 x 8.10/100) / 12 = 810/12 = 67.50

You'll notice that interest gets calculated every month. But the interest gets credited into your account only at the end of the year. An important point about the monthly interest you earn is that it does not get calculated on the amount you have at the end of the month! Instead it's on the lowest amount in your account between the 5th and the last day of the month. Let us understand this with an example.

In the example above, you had deposited ₹ 10,000 in the PPF account in April. Then you deposited ₹ 12,000 on or before May 5th. So on 5th May, the account had ₹ 22,000 deposited in it. So the account looked like this:

Date of Deposit	Amount	Total Amount
April 1	10,000	10,000
May 5	12,000	22,000
May 31	0	22,000

The lowest amount between May 5 and May 31 is ₹ 22,000. So the interest you

earn will be calculated on this amount, which is ₹ 148.50.

Now, if you had deposited ₹ 12,000 after May 5, say on May 15, your account would have looked like this:

Date of Deposit	Amount Deposited	Total Amount
April 1	10,000	10,000
May 5	0	10,000
May 15	12,000	22,000
May 31	0	22,000

Here, the lowest amount between May 5 and 31 is ₹ 10,000. In this case, although your account will have ₹ 22,000 at the end of May, interest will get calculated only on ₹ 10,000 as that's the lowest amount between May 5 and May 31. So the interest you would have earned for May would be ₹ 67.50 (Interest = (10,000 x 0.081)/12).

At the end of the financial year, the entire interest calculated gets credited to your account. As the calculations in the earlier table shows, at the end of the financial year, your account will show an amount of ₹ 56,700.

PPF SUMMARY	
Maximum investment	₹ 1,50,000 per year for 15 years
Maximum amount on maturity	₹ 44,37,132 (at 8.1% compound interest you will receive per annum for 15 years)
Period of investment	15 years
Eligibility	Any Indian resident, including minors
Taxation	No tax liability. Entire amount is tax-free on maturity.
Tax rebate	Yes. Under Section 80C.
Minimum investment	₹ 500 per year
Other conditions	You can avail of a loan any time after the 3rd year till the 6th year. In the 3rd year, you'll be eligible for a loan of up to 25% of the balance at the end of the first year. If you're taking a loan in the 4th year, the amount will be 25% of the balance at the end of the 2nd year, and so on. From the 7th year onwards, you can withdraw up to 50% of the amount in your account at the end of the 4th year or the financial year immediately prior to the withdrawal, whichever is lower.

NOTES

CHAPTER

11

EMPLOYEES' PROVIDENT FUND (EPF)

If you read the chapter on Public Provident Fund (chapter 10), you will appreciate the government's role in creating a scheme that combines incentives mixed with tight controls to ensure Indian citizens develop the habit of saving. The Employees' Provident Fund (EPF) is similar to the PPF except that it is available only to salaried employees (PPF is available to the public at large).

But that's not the only difference. While PPF is voluntary (you can decide if you want to invest in it or not), EPF is mandatory if you are working in a company that offers the EPF facility and your basic salary is less than ₹ 15,000 (the limit was 6,500 up till September 2014). If your basic salary is above this limit, EPF is optional. Once you sign up for EPF, a certain part of your salary (12% of basic pay and dearness allowance) gets deducted and deposited into your EPF account every month. By making EPF accessible to almost all employees, the government indirectly ensures that people save some part of their salary during their employment years. The accumulated amount can be very useful during the person's retirement years. Because EPF is a scheme that most of us will encounter in our working lives, it's important to know how it works.

THE EMPLOYEES' PROVIDENT FUND CONCEPT

EPF has been such a successful idea that many people take up employment with a company only after checking whether the company offers EPF! And it is not without reasons.

Through EPF, the employer deducts 12% of the employee's salary (basic + dearness allowance) and also contributes a certain amount to the fund. The employer's contribution can be 12% of the actual salary (basic + DA) or 12% of ₹ 15,000. Some employers opt to contribute 12% of the actual salary (even if this amount is more than ₹ 15,000) while others may contribute 12% of only up to the maximum of ₹ 15,000. Let's see how this works.

WHEN BASIC + DA IS LESS THAN ₹ 15,000

Consider that your basic + dearness allowance is ₹ 8,000. In this case, your contribution to EPF will be ₹ 960 (12% of ₹ 8,000). Your employer will contribute an equal amount (₹ 960). Out of the 12% contributed by your employer, 8.33% (₹ 8,000 x 8.33% = ₹ 666) will get deposited in the Employees' Pension Scheme (EPS) and the remaining 3.67% (₹ 8,000 x 3.67% = ₹ 294) will be added to your contribution and deposited into your EPF account. So in this case, every month, ₹ 1,254 (₹ 960 + ₹ 294) will get deposited in your EPF account and ₹ 666 will get deposited in your EPS account. (Note that irrespective of how much your salary is, the contribution to EPS will always be limited to a maximum of ₹ 1,250, which is 8.33% of ₹ 15,000.)

WHEN BASIC + DA IS MORE THAN ₹ 15,000

Assume that your basic salary is ₹ 20,000 per month and you've opted for EPF. In this case, your monthly contribution towards EPF will be ₹ 2,400 (12% of ₹ 20,000). Your employer can now choose to contribute an equal amount (₹ 2,400) or to contribute only 12% of the maximum limit of ₹ 15,000 (₹ 1,800).

Let's assume that the employer decides to contribute 12% of your actual salary. In this case, 8.33% of ₹ 2,400 should be deposited in your EPS. But since this amount (₹ 1,666) exceeds the maximum limit of ₹ 1,250 that can be deposited in an EPS, the remaining part of the amount will get deposited in the EPF. So your EPF will get a contribution of ₹ 1,150 (₹ 2,400 – ₹ 1,250). So every month, your EPF will have a deposit of ₹ 3,550 (₹ 2,400 i.e. your contribution + ₹ 1,150 i.e. your employer's contribution). Your EPS, as mentioned earlier, will see a deposit of ₹ 1,250 per month.

Let's look at the other scenario where your employer decides to contribute only up to the maximum limit of ₹ 15,000. In this case, your EPF will be deducted at 12% of ₹ 20,000 (₹ 2,400) while your employer will pay 8.33% of ₹ 15,000 (₹ 1,250) to your EPS account and 3.67% of ₹ 15,000 (₹ 550) in your EPF account. So every month, your EPF will have a contribution of ₹ 2,950 (your ₹ 2,400 + your

employer's contribution of ₹ 550) and your EPS will grow by ₹ 1,250.

You'll earn interest on the amount accumulated in your EPF account. You will also be eligible for tax benefits under Section 80C with respect to your contribution. In addition to your employer's contribution of 8.33%, the government contributes 1.16% of the amount to the EPS if the basic salary does not exceed ₹ 15,000 (if it does, then this amount will be contributed by the employer or employee; if the contributor does not agree to this then her contribution to the EPS will be stopped and the amount will be deposited in her EPF account).

The amount deposited in the EPS can be claimed when you withdraw your EPF amount on resignation or change of job. EPS pays you a pension on retirement (age 58) if it is not withdrawn for more than 10 years. Although you receive pension only after the age of 58 years, you can choose to receive a reduced pension amount if you leave active employment between 50-57 years of age but after having completed 10 years of service. A pension is also payable in case of the untimely demise or permanent disability of the employee. The minimum pension payable is ₹ 1,000 per month. In case of demise of the employee, the pension is paid to the spouse or children below 25 years of age or to a nominee in case the employee is unmarried. The amount of pension paid depends on the service period and the last drawn salary of the employee. In addition, every employee who has an EPF account is eligible for a maximum life insurance cover of ₹ 6 lakh depending on her basic salary.

Note that a person joining employment on or after September 1, 2014 and earning a basic salary + DA above ₹ 15,000 will not be eligible for the EPS scheme.

The best part of EPF is, all this happens without you having to do any running around—you join a company and the company takes care of the rest! No wonder it is so popular!

Note that a person joining employment on or after September 1, 2014 and earning a basic salary + DA above ₹ 15,000 will not be eligible for the EPS scheme. In this case, the entire 12% of the employer's contribution will be deposited in her EPF account.

FACTS ABOUT EPF EVERY EMPLOYEE SHOULD KNOW

1. The amount deducted from your salary for EPF qualifies for tax deduction under Section 80C. Note that you get tax benefits only for your contribution to the EPF and not the employer's contribution.

2. You can withdraw your EPF money only at the time of retirement, when facing a medical emergency or when unemployed for a period of two or more months. Although it's commonly done, instead of withdrawing your EPF amount, you should transfer it if you are switching jobs from one employer to another.

3. If you withdraw your money after 5 years of active contribution to the EPF account, the money you receive will be tax-free. However, if you withdraw the money before 5 years, the amount you receive will be subject to taxes. (Note that the 5 years of service can be in more than one company. For example, you could leave a company after 2 years of contributing to your EPF and then continue your EPF contribution for another 3 years in another company. The total period of your contribution will be considered as 5 years. But if you leave a company after 2 years and do not withdraw your EPF account for 3 years, it will still be counted as 2 years of contribution.) If the amount received on withdrawal is less than ₹ 50,000 then no TDS is applicable. If the withdrawal amount is more than ₹ 50,000 then a TDS of 10% is levied. The TDS jumps to 34.6% if you have not submitted your PAN to your employer. However, withdrawals before the 5-year period may be exempted from tax if the employment was terminated due to the employee's ill health, due to discontinuation of the employer's business or reasons beyond the control of the employee. You can also avoid the TDS if you submit forms 15G (15H for senior citizens) if your income is less than the taxable limit for the financial year.

If you withdraw your EPF before 5 years of contributions, you need to pay tax on the amount you recieve, plus, all tax benefits you earned during the previous financial years will be revoked and you'll have to pay taxes on those amounts too. You will also have to file revised income tax returns for those years. The revisions will be on: a) the employer's contribution and the interest earned on it (these become taxable); b) the deductions you availed of under Section 80C and c) the interest you earned on your contribution (this becomes taxable). Based on the new calculations, you will have to pay any additional income tax that is incurred and file revised income returns for the previous financial years.

If you withdraw the money before 5 years, the amount you receive will be subject to taxes.

---

4. It is possible to withdraw money from your EPF while you are working. This is

allowed in case of medical emergencies, house construction, loan repayment, or any other emergencies provided your account has been active for at least 5 years.

5. If you switch jobs and your new employer doesn't offer EPF, check with your employer if you could have a voluntary EPF where only you contribute while the employer doesn't. This will help you continue your EPF account.

6. The interest rate offered on EPF is compounded annually and can vary every year based on the government's decision. For example, one year you may get 9%, the next year the government may reduce it to 8% or increase it to 9.5%.

7. Although the government requires you to contribute 12% of your salary, you can check with your company if they allow a higher contribution. For example, if you wish, you could invest 15% of your basic salary. The employer doesn't have to contribute more than 12%, though. You could look at this option if your employer allows it.

8. You cannot make any lump sum payments into EPF unlike other schemes. It will always be 12% of your salary every month or a fixed higher percentage of your salary.

9. Only companies that have 20 or more employees need to have an EPF scheme going. So if you're joining a new company and are interested in continuing with your EPF, you should check whether the new company offers the option.

10. Nobody can claim the amount in your account, except you. No matter how long the amount remains unclaimed, you can always get it back; there is no time frame within which you have to claim the money. Earlier, your account would not receive any interest if it had been dormant (no contributions) for more than 36 months. Now, it continues to earn interest. An account will be considered dormant only if the employee retires and doesn't make an application for withdrawal within 36 months or on death of the account holder.

11. The contribution towards your EPS makes you eligible for pension on retirement (age 58) if it is not withdrawn for more than 10 years. If you withdraw your EPF amount before completion of 10 years, you'll receive a part of the EPS amount depending on the number of years of service.

Without doubt, the EPF is a sound and secure way of saving a decent amount for your retirement. Because it gets directly deducted from your salary, you also don't have to make a separate allocation towards it. The only difficulty with EPF has been the need to open a new EPF account when you switch jobs or to get it transferred. But with the introduction of the Universal Account Number (UAN), many of the procedures, including transfer of your EPF account, have been simplified.

WHAT IS UAN AND HOW DOES IT WORK

A UAN is a 12-digit number that uniquely identifies your EPF account. If you have an EPF account, your employer will share the UAN number that has been assigned to your account. You can also find your UAN number on your own by visiting http://uanmembers.epfoservices.in and entering the required details. Once you have been assigned a UAN, you can communicate directly with the EPFO giving your UAN as reference. You will now start getting SMS updates about EPF deposits being made by your employer. Plus, the next time you switch jobs, you simply have to provide your UAN number to your new employer. Because your KYC details are already submitted, the entire process gets completed quickly and your money gets transferred without the need for you to contact your previous employer. There is also provision for checking your EPF balance directly on the website and even downloading a PDF of the transactions done. If your UAN is KYC verified, you can even withdraw your EPF money online. A UAN is the umbrella number that remains the same throughout your working career even as you get new Member IDs from each new employer.

The contribution towards your EPS makes you eligible for pension on retirement (age 58) if it is not withdrawn for more than 10 years.

POINTS TO CONSIDER BEFORE INVESTING

1. This scheme is mandatory for employees of almost all types of firms that employ more than 20 people. The one question you should ask yourself is if you should consider investing more than the 12% that is required.

ADVANTAGES

1. The amount contributed by you under EPF is eligible for tax deductions under Section 80C up to a limit of ₹ 1.5 lakh.

2. You do not have to open an EPF account; your employer does it for you.

3. On closing your account, your money will be deposited into your bank account directly; it usually takes around a month.

4. With UAN, you can get the amount in your EPF account transferred from your previous employer. It's a simple matter of filling up a Request for transfer form by providing the necessary details. You can check the success of the transfer using the same site.

5. If your new employer doesn't offer EPF, you could have a voluntary EPF where only you contribute and the employer doesn't.

6. If you hold an EPF account for 5 years or more, the amount you get on closing your account is completely tax-free.

7. No one but you can claim the money in your EPF account, except in the case of your demise, where the amount is handed over to your nominee/s.

DISADVANTAGES

1. You cannot withdraw the amount in your EPF while you're working, except in case of emergencies.

2. If you close your EPF account and withdraw your money before 5 years, you will have to pay tax on the amount received. You also lose the tax deductions you got in the earlier years for your contributions into your EPF account.

3. It is not a liquid investment. On closing your account, you do not get the amount due to you immediately; it takes a few weeks.

INVESTMENT METER

Safety: * * * * *
Liquidity: * * *
Returns: * * *
(Where 5 stars indicate Excellent and 1 star indicates Poor.)

TAX IMPACT

Your contribution up to ₹ 1.5 lakh is eligible for tax benefits under Section 80C. If your EPF account has been active for 5 years or more, you won't have to pay any tax while withdrawing the amount in your account; the entire amount you receive will be tax-free. However, if you withdraw your EPF amount before the end of 5 years, the amount you receive will be subject to taxes as follows: the amount paid by your employer plus the interest earned on that will be considered as your salary and taxed accordingly; the interest you earned on the contribution you made will be taxable under "income from other sources"; any tax benefit you claimed under Section 80C during the previous financial years will also be taxed. If the amount you withdraw before the end of 5 years is more than ₹ 50,000, then TDS at 10% will be deducted on the amount. The TDS will be 34.60% if you have not submitted your PAN details. No TDS will be deducted if you submit form 15G (citizens with income less than the taxable limit)/15H (senior citizens with income

less than taxable limit).

NOTES

CHAPTER
12

STOCKS

This is one investment option that will evoke strong reactions from almost every investor. While some people look at equities or stocks as the most profitable investment option available, an equal number, possibly more, condemn it as the most unpredictable and riskiest in the market. If you go by people's experiences, there is truth in both opinions. There are people who have secured their financial future, and in some cases, even that of their future generations, by investing in stocks. And then there are those who have been driven to the point of suicide after incurring staggering losses.

If you look at the following two tables, it's not difficult to understand why stocks have created such a distinct set of investors. The first table shows how investing in the right companies could have made you wealthy beyond belief. The second table shows how you could have easily lost everything you invested, equally fast!

As the table below shows, if you had remained invested in any of these companies from 2005 to 2015, your investment would have grown more than 100 times in just 10 years!

♦ TABLE 1 ♦

Sr. No.	Company	Investment value after 10 years
1	Symphony	₹ 10.73 crore
2	Ajanta Pharma	₹ 1.55 crore
3	DFM Foods	₹ 1.40 crore
4	Relaxo Footwear	₹ 1.36 crore
5	Amara Raja Batteries	₹ 1.34 crore

The table below shows how a similar investment in the wrong stocks would have fared around the same period! Your ₹ 1 lakh investment would be worth less than ₹ 10,000 during the same period from 2005 to 2015.

♦ TABLE 2 ♦

Sr. No.	Company	Investment value after 10 years
1	3i Infotech	₹ 4,100
2	Gujarat NRE Coke	₹ 4,150
3	GTL Infrastructure	₹ 4,351
4	Sterling Biotech	₹ 4,800
5	Jaiprakash Associates	₹ 5,560

Sources: Moneycontrol.com & economictimes.indiatimes.com

So what is it about stocks that can create millionaires and paupers out of its investors? Why do some believe in it so strongly while others avoid it like the plague? Is there a science or logic to investing in stocks or is it totally driven by sentiment and luck?We'll take a look at these questions as we try to demystify stocks as an investment option.

THE STOCK CONCEPT

A stock basically represents fractional ownership in a company. When you own a stock of any company, you effectively become part-owner of that company. Like any owner, you benefit if the company does well and lose if the company does poorly. If the company does well, you could benefit in multiple ways:

1. The company may pay dividends on the shares you own. Although remember, dividends are paid on the face value of the share, not the market price at which it is being traded. The face value of the stock remains constant whereas its market price keeps changing. For example, the price of a share may be ₹ 120 but its face value will be fixed at ₹ 10 (or ₹ 2 or ₹ 100, etc. based on the company whose stock you're dealing with). So when a company offers a dividend of 30%, you'll get ₹ 3 per share if its face value is ₹ 10 (because 30% of ₹ 10 = 3). If you hold 1,000 shares, you'll get ₹ 3,000 as dividend.

2. You also benefit if the company offers bonus shares on the shares you own. For example, if the company offers a bonus of 2:1, you'll get 2 free shares for every share you own. You can sell these extra shares or hold on to them.

3. The company may come up with a Rights Issue where only the existing shareholders of the company can buy a limited number of shares at a discounted price. For example, if the current share price is ₹ 60, the company may give you the option of buying a particular number of shares at ₹ 50 each. Even though the market price of the share may reduce once a rights issue is announced, you should still be able to sell these shares at a profit.

4. And the most obvious benefit is to sell the stocks at a higher price than your purchase cost. For example, if you had bought 100 shares of a company at the rate of ₹ 500 per share for a total investment value of ₹ 50,000, you could sell them once the price reaches ₹ 700. By selling them for ₹ 70,000 you'd make a profit of around ₹ 20,000 (after deducting the expenses you incur like brokerage charges and taxes).

Investing in stocks is therefore all about becoming part-owners of companies that you feel will do well. This confidence, for the knowledgeable investor, is based on multiple factors like the company's past performance and future prospects, the company's management, the business it is in, the current economic scenario, and so on. A novice investor, on the other hand, may buy stocks of companies in the news for a short time or based on tips or rumours from different sources.

In this chapter, we'll look at the factors you should know to become a knowledgeable investor. After reading this chapter, you'll realize how risky it is to invest in stocks without doing the right amount of due diligence and the reason so many people who do not take the trouble to do so end up blaming the stock

market for the losses they incur.

HOW STOCK PRICES ARE DETERMINED

Before you start investing in stocks, you should know why stock prices keep changing and how you can estimate if a stock you're planning to buy has the potential to increase in value in the future. The price of a stock is arrived at by calculating the value of the company—it is first done when the company decides to offer shares to the public in the form of an Initial Public Offering (IPO).

An investment bank calculates the value of the company and arrives at the price at which it should be sold. For example, the value of the company may be determined to be ₹ 100 crore. The company may issue 10 crore shares at a face value of ₹ 10 each or 1 crore shares at ₹ 100 each. (A company may add a premium to this face value even at the IPO stage, but the face value of the share remains ₹ 10 or ₹ 100). If you apply and receive shares through the IPO, you become one of the many part-owners of the company.

From then on, the stock will be traded (bought and sold) on stock exchanges like the BSE and the NSE. People called traders carry out the buying and selling of stocks on these exchanges. The trading works like an auction: people will quote a price for a stock and if there are buyers for that stock at that price, it is sold. If there are no buyers at that price, the seller may reduce the price or decide not to sell. Similarly, a buyer will try to buy stocks at a particular price—if there are no sellers at that price, the buyer may increase the buying price and try again or wait till the prices decrease. The last price at which a stock is traded is considered the current price of the stock. As a stock may get traded multiple times during a day, it will have multiple prices during the course of a day. The price of a stock therefore moves higher or lower depending on the demand and supply of that stock during the day.

WHAT CAUSES STOCK PRICES TO RISE AND FALL

Demand and supply is the reason that causes stock prices to rise or fall. But what are the factors that lead to an increase or decrease in the demand and supply of a particular stock? There are many factors that affect a stock's demand and supply. Not all these factors occur at the same time and not all companies are equally affected by them. The following list contains some of the major reasons for change in demand and supply and thus, fluctuations in stock prices:

1. PROFIT EARNINGS

If a company is expected to earn a healthy profit, it translates to an increase in share prices. The reason is simple: a profit-earning company is expected to grow further and provide greater returns for investors in the future. Every company listed on the stock market is expected to announce its earnings once every three months. These results are highly anticipated by the investor community and it is during such times that the price of a company's stock increases or decreases significantly. A company which announces high profits sees an increase in its share price while companies that show losses usually see a drop in their share prices.

2. FORECASTS BY ANALYSTS AND EXPERTS

Analysts and other experts who study the stock market predict the ability of a company to make a profit or loss by studying industry trends, company decisions, product profiles, etc. These reports could influence investors to either start buying or selling a certain company's shares leading to a demand and supply situation.

3. MANAGEMENT CHANGE

The top management of a company is responsible for its success or failure. High-level appointments and resignations can lead to a change in the company's fortunes and hence its share price.

4. TECHNOLOGY OR SOCIAL CHANGE

If the company is affected by a technology or social change (positively or negatively) it will reflect in the price of its shares. For example, with mobile phones becoming a part of everyone's lives, companies in the mobile communications sector tend to benefit from the increased demand for their products. Similarly, a company negatively affected by such changes will lose demand for its products and hence see a decrease in its share price.

5. INTEREST RATE AND INFLATION

Rising interest rates lead to companies having to repay a higher amount for any loans taken. This may affect their profit margins. Rising interest rates also reduce consumer spending and hence the overall sales of the company. At such times, the company shows reduced profits, which in turn, decreases its share prices. On the other hand, if interest rates fall, there is an increase in demand for goods and

services which lead to an increase in profits and thereby, an increase in the share prices of companies.

6. EXCHANGE RATE OF RUPEE

Companies that export/import goods and services are affected by fluctuations in the exchange rate of international currencies, especially the US dollar. If a company receives payments in dollars, a drop in the dollar exchange rate reduces its profit margins and, hence, its profitability. For example, the IT service sector's profitability is affected by the fluctuating dollar, thereby affecting its share prices. However, companies that import goods (for e.g., oil marketing companies) benefit from a fall in the dollar as they can buy more for the same amount. Their profit margins increase, which could lead to an increase in their share prices.

7. NEWS UPDATES

Any news about changes in the global/national economy, regulations, political environment, industry, etc. that affects a company’s business could impact its share prices. For example, if the government announces a policy change that could affect a particular industry, investors react by either buying or selling shares in anticipation of the profits or losses triggered by this change. Or, if there is news of the company winning or losing a legal case or a patent issue, it could affect the earnings of the company and therefore, its share price.

8. MARKET SENTIMENT

Market sentiment is the overall mood prevailing in the market based on a particular incident and is totally independent of a company's performance. This sentiment could affect the share price of a company positively or negatively. For example, in a bull market, even shares of ordinary and loss-making companies see an increase, while in a bear market, sentiments will drive down the prices of even hugely profitable companies.

That's quite a list, right? But that's not all. There are other factors that could affect the share price of a company—the monsoon, elections, mergers between companies, budget announcements, changes in technology, RBI’s monetary policy, government fiscal policy, and so on.

Also, as recent events have shown, share prices can also be affected by the economic situation or political changes in other countries. An economic downturn or political instability in the US or major countries of Europe or Asia can have an impact on companies in India. A drought in certain parts of the world could impact prices of sugar, coffee and other cash crops that could lead to a surge in prices and thus profitability for companies in that sector. You have to keep an eye on everything happening around to see if such events have a positive or negative impact on the companies whose shares you own. That's why it's so difficult for the ordinary investor to invest in stocks directly and the reason why so many people prefer to invest indirectly through mutual funds.

If you still plan to invest in stocks or are already an investor then you should realize the amount of information that you should have access to in order to make buying or selling decisions. One way to do it is to invest in companies that belong to sectors that you are familiar with. You should also invest in a manageable number of stocks so that you can do justice to each of your investments by being up-to-date about them. For example, 10 stocks in three or four sectors that you are fairly comfortable with can be a good number. This way, you do not have to read up on everything and anything that is happening around and can instead focus your attention and analysis on only these sectors and companies.

WHEN TO BUY AND SELL

Now that you know how stocks are traded and why their prices rise and fall, how do you decide if you should buy a stock at a particular price? Or at what price should you sell so that you earn a decent profit? These are the two most difficult questions to answer—and they are what make investing in stocks so challenging. However, there are ways through which you can get a good idea of whether a stock is worth buying or not. One of them is by understanding the P/E ratio or Price-Earnings ratio of a stock. The P/E ratio is, in turn, dependent on the Earnings per Share. Let's take a look at both these terms.

EARNINGS PER SHARE (EPS)

The EPS is calculated by dividing the net profit of the company by the number of shares issued to shareholders (called outstanding shares). As you realize, the EPS is literally the amount of money each share earns for the investor. For example, if a company made a profit of ₹ 10 crore after tax and it has allocated 1 crore shares, the EPS will be ₹ 10 (10 crore / 1 crore). It means that the company earned ₹ 10 per share. Since company earnings are reported on a quarterly basis, you'll have to add all the four EPS in the year to arrive at the annual consolidated EPS. A rough estimate in this example would be an EPS of ₹ 40 (4 x 10) assuming the profit per quarter remains around ₹ 10 crore. But you don't have to guess; you can find the quarterly EPS of the company from the company's website, annual report or your broker or business news channels. The EPS indicates how much money the company is earning per share. The higher the EPS, the better.

PRICE-EARNINGS RATIO

The Price-Earnings ratio or PE tells you how much an investor is willing to pay for a stock in relation to its earnings. To arrive at the P/E of a stock, you divide its current market price (CMP) by its EPS (which we calculated earlier). For example, if the current stock price of a company is ₹ 600 and its EPS is 40 then the P/E ratio will be 15 (600 / 40). So effectively, the PE ratio tells you how much an investor is willing to pay per rupee of earning. In this example, the share is quoting 15 times its earning.

So what does a P/E signify? Is it good to have a high P/E or is a lower ratio better? Usually, a high P/E ratio indicates that the company is doing well or expected to do well and that's why investors are willing to pay a high premium in the form of a value for its earnings. If the P/E ratio is low, the company may not be doing well or is not expected to do well. Whether a company's P/E ratio is considered high or low depends on the industry the company is part of. For example, the P/E of IT companies is around 20; banks are at a P/E ratio of around 15 while pharmaceutical companies are at a P/E ratio of around 30.

Within an industry, however, the P/E ratio may differ for different sets of companies. For example, in the banking industry, private banks trade at a higher P/E ratio of around 15-20 while public sector banks have a ratio in single digits. If the company is a pharmaceutical company, a P/E of 20 would mean that the

company is an average performer as the best performing pharmaceutical companies would have P/E ratios above 25. But if a steel company had a P/E of more than 15, you could say the company is a great performer or that investors have spectacular expectations from the company!

USING P/E RATIO TO EVALUATE STOCK PRICE

So how do you use the P/E ratio now that you know how to calculate it? If the company has a high P/E ratio, is it enough of an indicator for you to buy? There is no simple answer. A buy or sell decision cannot be taken simply on the basis of P/E ratio. Some homework is needed to find out whether the company really deserves the P/E ratio. Read industry reports and newspapers, find out by talking to people—get as much information as you can to discover whether the company is in a position to grow as expected or if it's just sentiments based on unrealistic expectations. If your research indicates that the high P/E ratio is justified, go ahead and buy its shares, but if at the end of your research you feel the P/E ratio is illogically high, avoid buying those shares.

How about companies that have low P/E ratios—do they merit any attention? Yes, they do. In fact, there are investors who look for companies with low P/E ratios and invest in them in the belief that these companies will do well in the future. You'll have to follow the method mentioned above to see why a company has a low P/E ratio. Is the company facing some unique hardships that are likely to disappear over time? Is there a management change? Is the company investing in a product or service that could bring in more profits in the near future? Based on this data, you'll be able to know if the company deserves the low P/E ratio or if it's a temporary low following which the company might do better.

If you do your homework before buying or selling each stock, the chances of making losses will be small. In reality, however, very few people do this kind of analysis before investing. This is where mutual funds and Equity Linked Saving Schemes (ELSS) come in—they have a team of people who consistently research every company or industry before making investments. If you're not prepared to invest time and effort in doing research before investing in stocks, it's better to start with mutual funds and ELSS schemes. Investments in these instruments can be risky, too, since any trading in stocks is unpredictable, but they are less risky than investing in stocks without research.

Note that checking EPS or P/E ratio is not a sure fire way of deciding whether to buy or sell a stock. These are just two of the more popular ways of determining the value, and therefore, the potential of a stock.

THE PROCESS OF BUYING AND SELLING STOCKS

Previously, stocks were issued in the form of physical certificates called share certificates. Currently, the Securities and Exchange Board of India (SEBI)—the regulatory body for stocks markets in India—has made it compulsory for all stocks to be in electronic format or dematerialised format (demat) in order to be traded. (If you still have physical shares, you should convert them into demat form immediately.)

The first step to stock trading is to open a demat account with a Depository Participant (DP) who will keep an account of all the stocks you own. If you have physical share certificates, you should hand them over to the DP and get them dematerialised. You can call your bank to check if they offer the service—it's as easy as opening any other account there—just fill a form and submit proofs of personal identification like photograph, photo id (PAN Card) and address proof. Submission of these documents is part of the Know Your Customer (KYC) process followed by financial institutions before they accept an individual as a customer.

To start trading, you'll need three types of accounts: 1) a demat account 2) a bank account and 3) a trading account with a broker. You can choose to trade offline or online depending on how comfortable you are trading online. If you choose an offline system, you'll need to inform your buying and selling decisions to the broker personally or over the phone. If you choose the online option, you can do your buying and selling through the broker's website using a computer with an Internet connection.

Once you place the order, your broker/trading system will try to execute it. If the order is successfully executed, your demat account as well as your bank account will reflect the change. If you sell shares, your demat account will show your shares as sold and your bank account will show the amount of money that you received on the sale—and the reverse information if you buy shares. Similarly, if a company whose shares you hold pays any dividends, they are automatically added to your bank account.

There are multiple options available to open a trading account. Check information on the Internet, ask friends and colleagues, check details like brokerage, services offered, service charges and so on before you make the final decision. Nowadays, most banks offer stock trading services and it would be a good idea to start your enquiries with your bank.

BULLS AND BEARS

Let's now take a look at two terms you cannot avoid hearing if you go anywhere near the stock market. Yes, the bulls and the bears.

Although the terms may sound a bit odd in the beginning, they are quite straightforward to understand. When the stock market is rising, it is referred to as a bull market. During a bull market, the economy booms, investors have confidence to buy stocks in the expectation that they will rise further, and employment levels are high. A bull market is also referred to as a bull run. A person who expects the stock market, or sometimes a particular share to rise, is referred to as a bull and is said to be bullish on the market or that share. On the other hand a bear market signifies decline—the economy slows down or there's a recession and employment levels are low. Someone who is pessimistic about the market or a particular share will be considered a bear. You could remember these terms by relating to the manner in which these animals move: a bull usually charges at high speeds while the bear is associated with slow, lumbering movements.

Note that there will be daily swings in the stock markets and prices of a stock or of certain industries will keep moving up and down. This doesn't mean that there's a bull or a bear market happening. Technically, the market is considered to be in a bull or a bear phase if the prices of stocks increase or decrease by at least 20% across most industries.

Discussing stocks can be never-ending because of so many factors involved in the movement of stock prices. There are enough terminologies, rules, theories and views to fill a small library; it's not possible to cover them all in this book. The objective of this chapter was to explain the basics of stock investments to help you make a decision on whether stocks are an option you should consider or not. If you're focused on learning about each company that you plan to invest in and staying invested in the ones you trust, you have a good chance of being a successful stock market investor. On the other hand, if you feel stocks are a way to make quick money by listening to experts and following tips, it may be one of the riskiest investment options to try.

HOW TO INVEST IN STOCKS

1. The first decision you need to make is whether you'd like to trade online or offline. If you have access to a computer with an Internet connection, consider choosing online trading.

2. Irrespective of how you decide to trade, you'll have to open a demat account. The demat account holds the shares you own in demat (electronic) form.

3. For trading online, along with a demat account, you'll need a bank account and a trading account (you can choose an online trading platform provided by your bank as well as players like icicidirect.com, sharekhan.com, zerodha.com, etc.). If you choose the online option, you have the convenience of buying and selling shares without interacting with anyone. Just select the share you want to buy or sell and type the rate at which you want to trade. If the price matches, the trade gets executed.

4. In case of offline trading, you'll have to talk to your broker over the phone or in person every time you want to buy or sell a share. You will pay and receive money by cheque or ECS. You'll also have to open a brokerage account with your broker where you can keep money for buying shares. The money you earn or need to pay the broker will be recorded in this account. In case of IPOs, you'll have to fill up a form and submit a cheque to the broker. In case of online trading, you can apply for IPOs directly using your trading account.

5. Whether you trade online or offline, you'll be charged a brokerage which is a small percentage of your trade value. The brokerage is usually around 0.01-1% (1 paisa to 1 Re for ₹ 100 worth of trade) of the trade value. You'll also have to pay GST of 18% on this brokerage amount plus Securities Transaction Tax (STT), stamp duty, etc. Other costs include a one-time account opening charge and recurring annual maintenance fees.

6. Every time you carry out a trade, the broker is required to provide you with a document called the contract note. This note is given at the end of each day and contains transaction details like the number of stocks bought/sold, the brokerage paid and other charges.

POINTS TO CONSIDER BEFORE INVESTING

1. Do you want to invest in stocks because you know how stock markets work or are you planning to invest in them because everyone else is doing so?

2. Are you prepared to spend time and effort researching companies or industries you plan to invest in?

3. Can you risk losing a major part of your investment if there is a sudden drop in

prices?

4. Have you invested in stocks in any other form—mutual funds, ULIPs, ELSS, etc.? That could give you an idea of how stock prices move.

5. Do you know people who have successfully invested in stocks and who could guide you in the initial stages?

6. Investing in the stock market requires a lot of patience—to overcome a bear market, to resist buying in a market rising purely on sentiment, to sell the moment you see your stock prices reach an all-time high, and so on. Would you be able to restrain yourself from trading under such circumstances?

ADVANTAGES

1. Investing in stocks is a good way to earn high returns if you can manage to buy stocks at a low price and sell them at a higher price.

2. There is no tax liability if you sell your stocks after holding them for a period of at least one year.

3. Stocks are liquid. You can sell them and get your money in two working days.

4. Starting to trade is quite simple with several options in the market in terms of brokerage houses, banks and other services. All you need to get started is the knowledge and a net or phone connection.

5. Information is freely available on the Internet, television, newspapers, financial magazines, etc.

DISADVANTAGES

1. Stocks are the riskiest of investments if you don't have knowledge about them. There's a huge number of people offering everything from insider information to tips that can mislead you into investing in dubious companies.

2. There's a steep learning curve that you need to climb before you can claim to know how the stock market works. It's not uncommon to lose some money during this phase.

3. There is so much information available that you need to spend a lot of time in analysis to arrive at a good decision.

4. One could fall prey to emotions like fear and greed as well as misleading

information or rumours, and make disastrous investing decisions as a result.

INVESTMENT METER

SAFETY: Varies hugely from stock to stock. Blue chip or A-list companies offer high safety. But nothing is guaranteed. You'll have to keep monitoring the stocks you buy.

LIQUIDITY: * * * *

You can sell and receive payment in two working days. Although stocks can be sold any time, they may not be at their best price when you want to sell. Some stocks can even become illiquid if no one wants to buy them.

RETURNS: Very unpredictable. Can swing wide in terms of losses and profits depending on the stocks you own.

TAX IMPACT

If you sell your stocks within a year of buying them, you incur short-term capital gains tax at the rate of 15% on the profit. If you sell your stocks after a year, you don't have to pay any long-term capital gains tax. This tax exemption is available only for stocks for which Security Transaction Tax (STT) is paid. If you sell your shares on a stock exchange using a broker or an online platform, you'll notice that the STT will be part of the bill.

In case of short-term capital loss, you can offset your loss against any short-term capital gains (any investment) or long-term capital gains. Dividend up to ₹ 10 lakh is tax-free in your hands. If the total dividend exceeds ₹ 10 lakh then you'll have to pay a tax of 10% on the excess amount.

In case of stocks not sold on the stock exchange, for example, buy back offers, unlisted shares and open offers, the short term profit you earn (stocks sold within 12 months) will be added to your total income and you'll be taxed as per your tax slab. In case you sell it after 12 months, you'll have to pay tax at 20% with indexation.

NOTES

CHAPTER
13

MUTUAL FUNDS

You must have heard a lot of good things about mutual funds. The surprising part is, most of them are true—mutual funds really are one of the smartest ways to invest your money! But before you decide to skip this chapter and go ahead with investing in mutual funds, a word of caution: there are so many types of mutual fund schemes and so many schemes available that it's easy to get confused and invest in the wrong ones. If you're not careful in choosing the correct schemes, you could just as easily end up losing your money.

The good news is that once you understand how mutual funds work, it's quite simple to identify which schemes will work best for you. So do take some time to understand how they work. As one of the best investing options available in the market, it would be well worth the effort.

THE MUTUAL FUND CONCEPT

When you invest money in a mutual fund scheme, you hand over your money to an Asset Management Company (AMC) that has professional experience in investing. An AMC can offer multiple mutual fund schemes for investment. Each mutual fund scheme is managed by a fund manager or a team of fund managers with a high level of knowledge and professional experience in investing. Currently there are more than 40 AMCs in India that manage over 2000 mutual fund schemes! Examples of AMCs include Axis Mutual Fund, Birla Sun Life Mutual Fund, IDBI Mutual Fund, SBI Mutual Fund, HDFC Mutual Fund and so on —each of which offer hundreds of mutual fund schemes of their own.

When you invest money in a particular mutual fund scheme, the fund managers of that scheme use their investment skills to earn you attractive returns. You get returns from mutual funds in the form of dividends and through the profit you earn by selling your mutual fund scheme units at a higher price. The increase in unit price or the number of times you get dividends depends solely on the performance of each mutual fund scheme. A mutual fund scheme may invest your money in stocks, bonds and other investment options, depending on its type and objectives.

When you invest in a mutual fund scheme, you receive units in exchange. The price of each mutual fund scheme unit is called its Net Asset Value (NAV). Understanding NAV is important to understand the performance of mutual funds.

The NAV of a mutual fund scheme is calculated by dividing the total value of its investments (also called Assets Under Management or AUM) by the total number of units issued. For example, if the total value of its investments (in shares, bonds, etc.) is ₹ 500 crore and the mutual fund has issued 20 crore units to investors, the NAV of the scheme would be ₹ 25 (500 crore / 20 crore). If the value of investments made by a mutual fund scheme increases after some time, its NAV would also increase. For example, if the value of its assets increases to ₹ 550 crore, the NAV would increase to ₹ 27.50 (550 crore /20 crore). Similarly, the NAV would decrease if the value of the investment decreases. The asset value of a mutual fund scheme is calculated once at the end of each working day.

The NAV of a mutual fund is similar to the value of a stock, but there are a few important differences:

1. The NAV of a mutual fund scheme does not fluctuate throughout the day like the value of a stock as mutual funds are not traded (except close-ended mutual funds which are few in number). For most mutual fund schemes, NAV is calculated just once at the end of each day. This is the price at which you will be able to buy/ sell your mutual fund units.

2. Mutual fund units are available in fractions. For example, if you invested ₹ 5,000 and the NAV of the mutual fund scheme is ₹ 30, you'll get 166.67 units (₹ 5000 /

30). Stocks on the other hand are always whole numbers—2, 12, 55, 500, etc.

3. Unlike stock prices which may or may not be affected by dividend payments, when a mutual fund scheme pays dividend, the total value of the scheme actually decreases—so its NAV also reduces proportionately. For example, if a mutual fund scheme decides to distribute ₹ 100 crore as dividend out of its AUM of ₹ 550 crore, its total value becomes ₹ 450 crore (550 crore -100 crore). After distribution of the dividend, the NAV will be calculated on the basis of the remaining assets and it will be ₹ 22.50 (450 crore / 20 crore). So don't think that the same scheme is now available at a cheaper rate after a dividend is announced—the value of its assets has actually reduced after paying the dividend. Or, don't be shocked when you see the NAV of your mutual fund scheme drop after receiving a dividend—although the assets have decreased, the value of the scheme is still the same (total assets / total number of units).

But, like stock prices, NAVs help you track how a mutual fund scheme is performing. If its value keeps rising, it indicates that the value of its investments is increasing—while, if the NAV dips, it indicates that the value of its investments is decreasing (unless a dividend has just been declared). You can sell your fund scheme units at the current NAV any time you wish (the exception is ELSS funds, which is explained in Chapter 14.)

A mutual fund scheme may invest your money in stocks, bonds and other investment options, depending on its type and objectives.

You can find the daily NAVs of all mutual fund schemes at http://www.amfiindia.com, the website of the Association of Mutual Funds in India (AMFI).

Since mutual fund schemes collect money from thousands of investors, they invest in large amounts and in a diversified manner. For example, if a mutual fund scheme is investing in the stock market, it will invest in shares belonging to multiple companies. This ensures that even if shares of some companies perform poorly, the good performance of other companies will average out the losses and the scheme value will not be greatly affected. Because of this averaging, the NAV of a mutual fund scheme will not fluctuate as dramatically as an individual company's share price. Any decrease will be slow—any increase will also be gradual.

In return for the service and to cover the annual costs for fund management and other expenses, the mutual fund scheme levies fund management charges (FMC) which is also called the “expense ratio” of that scheme. The expense ratio levied varies across schemes from around 0.75% to 2.50% (the maximum charge

permitted by SEBI) of the total value of the mutual fund scheme. The profit you make from your investments will thus reduce by this percentage (do note that the daily NAV of a scheme is shown after deducting the expense ratio). You may also be charged a one-time “transaction fee” when you invest in a mutual fund scheme through a registered distributor. If you approach the mutual fund house directly, there is no transaction fee. This amount is ₹ 100 for existing investors who are investing a sum greater than ₹ 10,000. If you're investing a similar amount in a particular mutual fund for the first time, the fee is ₹ 150. There is no transaction fee applied for investments made below ₹ 10,000.

That explains the basic fundamentals of mutual funds. The actual complexity lies in the different types of mutual fund schemes. We'll now take a look at this to complete our understanding of mutual funds.

INVESTING IN MUTUAL FUNDS

Investor invests money in a Mutual Fund Scheme

↓

Mutual Fund invests money in Stocks, Bonds, Government Securities, etc. depending on the type of scheme

↓

Value of the scheme increases/decreases due to investments made

↓

Investor receives dividend or sees increase in NAV per unit

↓

Investor can sell mutual fund scheme units at the current NAV to end up with a profit or loss

TYPES OF MUTUAL FUND SCHEMES

Although there are many types of mutual fund schemes, we'll restrict our understanding to the following list as it covers the major percentage of schemes available in the market. These include:

1. Equity Funds
2. Sectoral Funds
3. Index Funds
4. Debt Funds
5. Balanced Funds
6. Monthly Income Plans
7. Fixed Maturity Plans
8. Liquid Funds

To be a smart investor in mutual funds, you should know how these different types of schemes work so that you can make the right choice. Just to be clear, none of the above types are "right" or "wrong" by themselves, only that some would be more right for you than others. To give you an example, if you're looking for high returns and are willing to accept a higher risk of losing your money, you will invest in equity funds; but if you want steady growth with minimum risk of losing money, investing in equity funds would not be advisable––you would rather invest in Debt or Balanced funds.

Let's do a quick run through each of them:

1. EQUITY FUNDS (ALSO CALLED DIVERSIFIED EQUITY FUNDS)

Many of the mutual fund schemes in the market are of this type. These schemes invest in the stock market. They study different companies and buy stocks that will increase in value over a period of time. The objective is to buy shares at a low price and sell them at a higher price. The profit arising from this is distributed amongst investors as dividend or it gets added to the assets of the mutual fund, which increases its NAV. You can opt to receive dividends or decide to choose the growth option where the NAV grows so that you can earn a profit when selling your units at a higher NAV. Dividends are declared at periodic intervals (the frequency and dividend rate varies with different mutual fund schemes). The dividend is usually deposited directly into your bank through Electronic Clearing Service (ECS). These funds are ideal for investors looking for aggressive returns for their investments over a medium to long-term period (3-5 years) or more.

You can sell your units any time back to the mutual fund company at the prevailing NAV. For example, if you bought 1,000 units at ₹ 15 each and the scheme's NAV rises to ₹ 22, you can sell your units for ₹ 22,000 and make a profit of ₹ 7,000. But if the NAV is lower than what you bought it for, you'd end up with a loss.

If you want to invest in an existing equity mutual fund scheme, make sure you check its performance history to see the kind of returns it has given (although it's not a guarantee that it will continue to perform in the same manner, it's still a good indicator). Compare its performance with similar mutual fund schemes over a period of a few years to get a correct picture. Information about mutual fund schemes are easily available on many online sites like moneycontrol.com, valueresearchonline.com, mutualfundindia.com, morningstar.in, etc. If you are investing in a new equity scheme, read the investment objective of the scheme to find what kind of stocks it will invest in. Invest in the scheme only if you are convinced; otherwise there are always existing equity funds that are already performing well.

Within diversified equity funds, you may find sub-categories like large cap funds, mid cap funds, small cap funds, large and mid cap funds, etc. Here, “cap” represents capitalisation, which signifies the size of the company in terms of its stock value (current stock price x number of outstanding shares). A large cap stock would thus be Reliance Industries, Infosys, ONGC, SBI, etc. while mid-cap stocks will be Apollo Tyres, Bajaj Electricals, India Cements, etc. For those who believe that safety of their investment is of prime importance, investing in a large cap mutual fund may give them that assurance. For others who feel that mid caps and small caps have the potential to offer higher returns (Infosys started as a small cap, for example), investing in mid cap and small cap funds may seem a better option, although with a slightly higher risk than investing in large cap funds which are considered very stable.

2. SECTORAL FUNDS

Like equity funds, sectoral mutual fund schemes also invest in the stock market—but these schemes invest in only one or a few sectors. For example, they may invest in banking stocks or pharmaceuticals or infrastructure & power. The objective of these mutual fund schemes is similar to equity funds: to buy low and sell high, but they invest only in companies belonging to the sectors they understand well. A sectoral mutual fund scheme would give you a return based on how well companies in these sectors perform. Based on the sector's performance, you could end up with very high or very poor returns. Sectoral funds are slightly riskier than equity funds because of this dependency on specific sectors. But if you're convinced that the sector in which a particular mutual fund is operating will do well, go ahead and invest in it!

3. INDEX FUNDS

These schemes also invest in the stock market but only in those stocks that are part of a particular index like the S&P BSE SENSEX (The Bombay Stock Exchange’s 30-share stock index), CNX Nifty (The National Stock Exchange’s 50-share stock index), etc. These mutual fund schemes will not invest in stocks outside the particular index. The investment in a particular company in the index is made in the same proportion as the weightage of that company in the index. For example, if company A forms 5% of the total index value, the investment in

that company's stock will be 5% of the value of the mutual fund scheme. Index funds are also known as passive funds as changes (buying and selling of shares) happen only when some company is dropped from the index and replaced with another company. Index funds are less risky than Equity or Sectoral funds. The returns will also be comparatively lower.

4. DEBT FUNDS

They aim to provide a steady and regular stream of income to investors in the form of dividends. Unlike equity-based mutual fund schemes which aim to increase the value of your investment through an increase in NAV, debt funds strive to provide you with regular income through dividends. Debt funds are safer than equity funds as they invest in more secure assets like bonds, debentures and government securities. Because of their objective to provide income instead of growth, you'll notice there are lesser fluctuations in their NAVs as compared to those of equity funds. Invest in debt funds if safety of your investment and a regular income are your prime concerns. The government charges dividend distribution tax (DDT) on the dividend announced by debt mutual funds (the tax gets deducted at source and is paid by the mutual fund, so you don't have to pay any tax after you receive your dividend). See Tax Impact section at the end of the chapter.

5. BALANCED FUNDS

These funds try to find a balance between growth and income by investing in the stock market as well as in debt instruments (bonds, government securities, etc.) A balanced fund will disclose the proportion of its investment in each of the assets to investors—for example 65% or more in equities and 35% or less in debt. Since they have holdings in debt instruments, their NAVs are less volatile than pure equity mutual funds. Like any other mutual fund scheme, do look at its past performance before you invest. If you are investing in a new balanced fund scheme, make sure you are comfortable with the ratio in which they invest in equities and debt.

6. MONTHLY INCOME PLANS (MIPS)

Unlike their name, these funds don't guarantee a monthly income, but aim to provide a regular stream of income. MIPs pay dividend quarterly, half-yearly, or annually; some schemes pay dividend on a monthly basis, too. MIPs invest around 80% to 90% of their total funds in debt securities (bonds, debentures, government securities) to ensure safe, regular returns. The remaining amount (10-20%) is invested in equities for higher returns. MIPs are ideal for investors who want to earn regular returns at a better rate of return than pure debt funds.

7. FIXED MATURITY PLANS (FMPS)

A Fixed Maturity Plan is a close-ended mutual fund that invests in treasury bills, government bonds, corporate bonds and other kinds of debt instruments. Unlike most other mutual funds that you can buy any time, FMPs can only be bought at the time of a New Fund Offer (NFO) during a limited period of 2-3 days. It can

then be bought/sold through the stock exchange where it gets listed. FMPs also have a fixed tenure that can range from less than a month to a few years. In addition, they offer steady returns. Their fixed tenure and stable nature of returns makes them similar to Bank Fixed Deposits.

But there are two differences that you need to be aware of. One: banks guarantee you a fixed return whereas an FMP cannot—it can only indicate the dividend that you could earn. However, because debt is less volatile than equity, FMPs that invest in sound instruments usually meet the interest projections that they make.

Two: the interest you earn from a bank fixed deposit is taxable as per your income slab whereas the dividend you earn from growth FMPs that are held for at least 3-years get the benefit of indexation (it will be taxed at 20% after indexation). In case of FMPs with tenure less than 3 years, the profit you earn will get added to your income and you'll have to pay tax as per your income tax slab. FMPs are thus better tax saving instruments if they are held for three or more years.

8. LIQUID FUNDS

True to their name, Liquid Funds allow you to redeem your investment at a short notice with minimum volatility in returns. Liquid Funds are thus considered a better option than Savings Accounts for keeping money that you may need in the short term. So instead of keeping your money in a Savings Account that pays you around 4% interest, Liquid Funds could earn you as high as 7% to 8% while offering almost the same level of liquidity. Liquid funds invest primarily in financial instruments like treasury bills, certificate of deposits, commercial papers and fixed deposits that have short maturity periods (less than 91 days). The short-term nature of these investments enables Liquid Funds to meet the payment demands of its investors at a short notice. This is a particularly good option when inflation is high, because at such times, interest rates are usually high.

If you need to redeem a liquid fund, you can simply place a redemption request before the end of the business day (2 pm) and your money will be credited to your bank account the next morning. If you keep a large amount of money in your Savings Account to meet any unforeseen emergencies, or if you receive a lump sum amount all of a sudden and aren't sure where to invest, it would be a good idea to invest it in a Liquid Fund.

Liquid Funds offer both Dividend and Growth options. They also have management expenses but it is quite low at around 0.5% to 1%. In terms of taxation, if you sell your Liquid Funds (Growth) within 3 years of investing you'll have to add the profit you earned to your income and pay tax accordingly. If you sell your Liquid Funds after 3 years, you will have to pay Long Term Capital Gains on the profit you made at 20% with the benefit of indexation. If you are in the 30% income tax bracket, this works out to be a better option than earning interest through Fixed Deposits. If you've invested in the Dividend option of a Liquid

Fund then the dividends you receive will be tax-free in your hands (although the scheme will have to pay a dividend distribution tax). As with all mutual fund investments, do look at the fund house and its performance history before you invest.

All these mutual fund schemes can be open-ended funds or close-ended. The majority of the schemes in the market are open-ended (you can buy and sell them any time). Although open-ended and close-ended funds are dissimilar in many ways, the important differences for you to know as a new investor are:

1. Open-ended mutual fund schemes can manage an unlimited amount of money and can therefore issue an unlimited number of units. Close-ended mutual funds, on the other hand, deal with a fixed amount of capital and units.

2. Open-ended mutual fund schemes can be bought any time from the mutual fund company at the existing NAV rate. Close-ended mutual fund schemes cannot be bought directly from the mutual fund company after their initial listing. They must be bought from the stock exchange like a share. They are usually not available at their NAV rate—they cost either more or less than their actual NAV. Fixed Maturity Plans (FMPs) are examples of close-ended mutual fund schemes as they have a fixed tenure and you can invest in them only during the Offer period.

Since open-ended mutual fund schemes are more easily available and are easier to understand and manage, you can consider them as your entry point to mutual funds. Once you've figured how they work, you could venture into investing in close-ended mutual fund schemes.

Equity Linked Savings Schemes (ELSS) is another highly attractive investment option within mutual funds. But explaining it along with all the other types of mutual funds will not do it justice—you need to understand it as a separate investment option. It is therefore explained in detail in the following chapter. Do read it to complete your understanding of mutual funds.

HOW TO INVEST IN MUTUAL FUNDS

There are many ways in which you can invest in a Mutual Fund schemes. You can invest directly with the Asset Management Company (AMC) or you could use the services of an agent, your bank, an online investing portal or a financial planner. The process for all of them is quite similar. If you are a first time investor, you'll need to have your identity verified through the Know Your Customer (KYC) process. Once your KYC is done, you can invest in as many mutual fund schemes as you want.

When you invest in a mutual fund scheme, you are assigned a folio number by the AMC. Using this folio number, you can invest in various mutual fund schemes issued by the same AMC. For example, if you invest in multiple mutual fund schemes of Edelweiss Asset Management, you'll get a common folio number for all your investments. In case you change any investing detail, for example, if decide to invest jointly with someone, you will be assigned a different folio number. You will also get a new folio number if you invest in a mutual fund schemes belonging to another AMC. For example, when you invest in a scheme of Axis Mutual Fund and another scheme of Franklin Templeton, you will get two different folio numbers. The folio number (also called folio ID) is printed on the mutual fund statements that you receive. You can request for statements or details of your transactions using this folio number. The folio number is thus like an account number for all mutual fund schemes that you invest with a particular mutual fund house.

DEMAT ACCOUNTS NOT A NECESSITY

Unlike investing in stocks where it is mandatory for you to have a demat account, there is no such necessity for mutual funds. If you are already investing in stocks and have a demat account then you can use the same demat account to hold your mutual fund units. If you wish not to use a demat account, you can directly invest with the mutual fund, a broker or any online portal that offers such a service.

You can buy and sell your Mutual Fund units by physically filling and submitting forms with the mutual fund or broker or you can even do it online through the websites of the AMC or service provider. If you opt not to have a demat account, you save on demat and trading charges. With a demat account, you will have the convenience of having all your mutual fund investments at a single location and receiving consolidated account statements for all your mutual fund holdings.

DIRECT AND REGULAR MUTUAL FUNDS

When you invest in mutual funds directly through the mutual fund company (AMC), you enjoy another benefit that other investors lose out on. As explained earlier, a mutual fund deducts a small percentage of the total assets it manages for meeting various expenses like fund management, agent commissions, promotions, and so on. All these expenses are clubbed together and called the "expense ratio" of the mutual fund. As per SEBI regulations, equity funds can charge a maximum of 2.5% of the total assets they manage as expense ratio while debt funds can charge up to 2.25%. When you invest directly with a mutual fund, the expense ratio gets reduced by the percentage that gets paid as commission to its agents. This translates into a higher earning for you over the long term.

To ensure that this difference is transparent to every investor, each mutual fund scheme is identified as a Direct or Regular plan. An investor can decide whether she wants to invest in a Direct plan or a Regular plan at the time of investing. Investing in a Direct plan means that you are investing directly with the mutual fund and no agents or brokers are involved. Because of the zero commissions paid, the NAV of the Direct Plans will always be higher than that of its Regular Plan.

Let's look at an example to understand this clearly. The NAV of a mutual fund scheme, let's call it ABC Top Equity Fund (Growth), could be ₹ 368.05 for its Direct Plan on August 12, 2016. The same fund ABC Top Equity Fund (Growth) – Regular could be ₹ 359.94 on the same date. These two funds will be exactly same in all regards except for the commission being paid in the Regular plan. The mutual fund will disclose the expense ratios for both funds. For example, it could be 1.25% for the Direct Plan while that of the Regular Plan could be 2.25%. So there's a difference of 1% between the expenses of the two funds. The difference in their NAV is around 2%. Usually, the difference in NAVs between Direct and Regular plans would be anywhere between 0.50% and 2.0%.

This may look like a small difference, but once compounded over a period of 20-25 years, it can be a huge sum. For example, if a Regular Plan gave a return of 12% compounded over a 25 year period on a one time investment of ₹ 1 lakh, you'd end up with ₹ 17 lakh. The same investment in a Direct Plan that gives you a return of 13% will create a corpus of over ₹ 21 lakh. That's a sizeable difference. If you had invested in a SIP of ₹ 10,000 over the same period then the corpus for a Regular Plan will be ₹ 1.88 crore while it will be ₹ 2.24 crore for Direct Plans. That's a difference of ₹ 40 lakh at the end of 25 years. So investing in Direct Plans does make a difference.

You can invest in Direct Mutual funds by directly approaching the mutual fund AMC, through Mutual Fund Utilities (explained later in this chapter) as well as through certain online service providers that specifically allow investments in Direct Plans. Investing in Direct Plans would require you to do your own research regarding the schemes that you should invest in and then making the effort to

invest as well as monitor them over a period of time.

Investing in Regular Plans can be comparatively simpler because you can use a single interface to invest in various mutual funds. Plus you may get advice on your portfolio, reports, and additional support from their support team. Whenever you invest through an agent or an online distributor, you are invariably investing in Regular Funds. Irrespective of whether you are using additional services or not, you'd end up paying a higher expense ratio. In the longer run, you've seen that you do end up paying a huge amount when you invest in Regular Funds. So do weigh the amount of money you are paying for convenience against your comfort level and confidence in investing directly in mutual funds before taking a decision.

Do not take a decision to invest in Mutual Funds directly just to save on the expense ratio. If you feel you are receiving valuable support and information that helps you make better investing decisions in Mutual Funds, you can continue to invest the Regular way.

In case you have already been investing in mutual funds the regular way and are planning to invest directly, be aware that you can convert your existing Regular funds to Direct. But when you switch from a Regular Plan, it is considered as redeeming your existing investment and starting a new investment. In such a case, all taxes and penalties that are levied on redemption will be applied to your investment. This could include an exit load in addition to paying Short Term or Long Term Capital Gains tax. Switching is also allowed in existing Mutual Fund SIPs with similar conditions.

INVESTING DIRECTLY USING MUTUAL FUND UTILITIES AND CAN

When you invest directly with a mutual fund, you can save on the commission that the AMC pays to the intermediaries. This can translate to a saving of around 1% on your investments. However, when you invest in multiple schemes issued by different mutual fund houses, it can become difficult to manage them. Tracking all investments made, calculating their returns, sending mails, changing records like addresses, KYC documents and so on could become a very difficult and time-consuming task.

To make the task of investing directly easier for the common investor, the mutual fund industry got together and announced a new number called the Common Account Number (CAN) that clubs all your mutual fund investments under one common ID. You can create a CAN by visiting the Mutual Funds Utility website at www.mfuindia.com and downloading the application form. After filling this form, you need to submit it for processing along with the necessary documents. The forms can be submitted at various centres across the country. If you are already KYC compliant, then your CAN number will be created immediately. In case you are not KYC compliant, Mutual Fund Utility will provide you the required support to submit your documents. Note that in case you decide to change your investing details—like investing jointly instead of singly, you will have to apply for a new CAN.

Once you receive your CAN, your next task is to send a written request for online access. On approval, you'll receive the login details that will allow you to manage your account using the Mutual Fund Utility website. Once online, you can buy, sell and manage your mutual fund investments quoting your common CAN. You can also use your CAN and transact in mutual funds offline. To do this, you can use the services of a distributor or bank or the AMC itself. Payments can be done through cheque, demand draft and electronically through NEFT, RTGs, etc.

With a common CAN, managing your mutual fund investments becomes a lot easier. You now need to update just one source, fill just one form to apply to any of the mutual fund schemes and make a single, consolidated payment for all investments made. And the best part is, you can invest in Direct Plans using a single website (www.mfuindia.com). Also, because it's an initiative by the mutual fund industry, the usage of the website and all services associated with it is completely free as of now. There are other websites that also allow you to invest in Direct Plans—but they would usually charge a small fee. These websites would however provide additional services like advice on which mutual fund schemes to buy based on your profile along with regular updates, reviews and suggestions to buy or sell depending on market conditions.

POINTS TO CONSIDER BEFORE INVESTING

1. What kind of risk are you willing to take when investing? If it is high, then equity funds—either diversified or sectoral or index—will do. If it is low, the

choice should be debt funds. For medium risks and returns, check out balanced funds.

2. Although entry loads have been abolished, there are transactions fees levied in certain conditions (as explained earlier in Mutual Funds Concept) and distributors and online services also charge a flat transaction fee or a fixed amount per year. Check before you invest. Mutual fund schemes charge an exit load when you sell your unit before a certain period.

3. What has been the past performance of the mutual fund schemes you are considering investing in?

4. Don't be misled by mutual fund advertising. Check facts before you invest.

5. Would you like to invest directly through the Direct Plan of a mutual fund scheme or would you prefer to invest in a Regular Plan even if you have to pay an additional fee for recommendations and convenience?

6. If you are investing directly, have you got a CAN? Have you checked the Mutual Funds Utilities website that helps you manage all your mutual fund investments using a common interface?

ADVANTAGES

1. Mutual funds spare you the effort and detailed knowledge required to invest in stocks and bonds directly.

2. You get the services of an organisation dedicated to maximising your returns, no matter how small your investment. You could start with an investment as low as ₹ 5,000.

3. Mutual funds are simple to invest in. You can apply online, or call a mutual fund company and they'll send an agent to explain their products.

4. Because mutual funds invest in multiple assets, your risks are reduced as losses in a few can be balanced by gains in others.

5. There are different types of mutual fund schemes in the market to cover your specific investing needs. If you understand your needs, you can narrow down your search to a few well-performing schemes to invest in. Information about the past performance of each mutual fund scheme is also publicly available for you to make your final choice. You could also get the details from an agent.

6. Mutual funds are liquid as you can convert them into cash at any time. The money usually gets deposited in your bank within 3 working days.

7. Dividends are not taxable, except for debt funds, which attract dividend distribution tax that gets paid by the mutual fund company.

8. If you sell your equity mutual funds at a profit after a year, you don't have to pay long-term capital gains tax.

DISADVANTAGES

1. All mutual fund schemes carry an element of risk. Although some mutual fund schemes invest in government bonds and securities, the mutual funds themselves are not guaranteed by the government.

2. Just because mutual funds are professionally managed doesn't mean you can be less cautious. Do your homework, ask questions, and invest only if you are personally satisfied about the mutual fund scheme.

3. Past performance is just an indicator; it does not guarantee future performance.

4. Mutual fund companies manage their operational costs from the funds available in the mutual fund. These costs are deducted irrespective of the scheme's performance.

5. Mutual fund schemes levy exit loads if the investor exits the scheme before the specified period. This affects your actual investment or profit.

6. Once you select a mutual fund scheme, it's totally up to the fund managers on how they invest your money.

7. If you sell equity mutual funds at a profit within a year of buying them, you'll have to pay 15% short-term capital gains tax. Debt mutual funds attract short-term as well as long-term capital gains tax.

INVESTMENT METER

SAFETY: Can vary hugely depending on the type of mutual fund scheme you've invested in.

LIQUIDITY: Most mutual fund schemes can be redeemed at a short notice.

RETURNS: Can vary hugely depending on the type of mutual fund and the exact scheme you invest in.

TAX IMPACT

Investments in mutual fund schemes don't offer tax benefits (except for ELSS mutual funds, covered in Chapter 14).

If you sell equity funds within a year of buying them, you'll have to pay short-term capital gains tax of 15% on the profit. If you sell your equity fund units after a year of buying, you don't have to pay any capital gains tax on the profits earned. In case of non-equity funds (any Debt, Balanced Fund, Monthly Income Plan or other mutual funds that invest less than 65% of their assets in equities), the profit earned by selling units within 3 years is considered as short-term capital gains and gets added to your taxable income. You will have to pay tax as per the income tax slab you belong to. If you earn a profit on selling them after a period of three years, these funds will incur long-term capital gains tax of 20% after adjusting for indexation.

Any short-term capital loss you incur can be adjusted against short-term or long-term capital gains to reduce your tax liability. Long-term capital loss can only be offset against long-term capital gains. Dividend received is tax-free in your hands. Dividends from debt funds attract dividend distribution tax which gets paid by the mutual fund company.

NOTES

CHAPTER
14

EQUITY LINKED SAVINGS SCHEME (ELSS)

Don't be put off by the technical sounding name! An Equity Linked Savings Scheme (ELSS) is one of the best investment options available for investors willing to accept a little more risk. ELSS schemes not only offer the possibility of earning higher returns, they also help you save tax. Now, doesn't that sound attractive!

THE EQUITY LINKED SAVINGS SCHEME (ELSS) CONCEPT

ELSS is a type of mutual fund scheme (if you are not familiar with mutual funds, please read Chapter 13) but it is not covered in the chapter on mutual funds as it differs from other types of mutual fund schemes in terms of its investment period and taxation. A separate chapter on it was therefore necessary to make these distinctions clear.

The primary difference between a mutual fund and an ELSS is that the money invested in an ELSS scheme gets locked for a period of 3 years. In other words, you need to remain invested for 3 years in the ELSS. But the other big difference that should interest you is that under Section 80C, any amount up to ₹ 1.5 lakh that you invest in ELSS in a financial year qualifies for deduction from your taxable income—thus helping you bring down your tax liability! This tax benefit is not available when you invest in other types of mutual fund schemes.

Let's understand this with the help of an example:

Let's say you're a working woman earning a salary of ₹ 6 lakh per year. The current income tax exemptions (FY 2017-18) will reduce your taxable income to ₹ 3.5 lakh (₹ 6 lakh - ₹ 2.5 lakh). If you invest ₹ 1.5 lakh in an ELSS scheme, your taxable income will reduce further to ₹ 2 lakh (Rs 3.5 - ₹ 1.5 lakh). You'll now have to pay tax only on ₹ 2 lakh.

The tax you would have to pay at 5% on the amount you saved (that is, ₹ 1.5 lakh), would have been ₹ 7,500. By investing in an ELSS scheme, you have thus saved ₹ 7,500 right there. The high returns that you could get in ELSS adds to the attractiveness of this investment option. You could invest any amount, from ₹ 500 to the entire ₹ 1,50,000 for which you'd get tax benefits.

(Note that ELSS is one of the many investment options that provide tax benefits under Section 80C. Other such investment options include: life insurance premiums, Employees' Provident Fund, Public Provident Fund, repayment of principal amount on housing loans, National Savings Certificates, Senior Citizen Saving Scheme, etc. You can invest in a single instrument or a combination of these investments up to a total of ₹ 1.5 lakh to get tax benefits under Section 80C.)

Because ELSS schemes have a lock-in period of 3 years, fund managers get to invest with a greater degree of freedom and with a long-term approach. If you pick the right ELSS scheme, your chances of ending up with good earnings are quite high.

However, since ELSS schemes invest in the stock market, the risk factor remains. But it's a safer bet than investing directly in the stock market, especially if you're a new investor. Plus, you could invest through a Systematic Investment Plan (explained in the following chapter) to reduce your risk further. So if you want a slice of the high returns offered by the stock market without taking the risk

of directly investing in stocks, ELSS could be a good option. The tax saving being the icing on the cake!

Budget 2012-13 had introduced the Rajiv Gandhi Equity Savings Scheme (RGESS), which, like ELSS, aimed to promote investment in equities. The scheme did not enjoy the expected popularity due to conditions that were complex to understand and execute. This scheme now stands discontinued and no benefits can be claimed against investment made in this scheme from April 1, 2018. RGESS allowed for a 50% tax deduction to new retail investors on investments up to ₹ 50,000 directly in equities if their annual incomes were below ₹ 12 lakh. (A new investor was defined as someone who had not created a Demat account before November 23, 2012 or who had not used the account to trade if it was created before that date.) Investments in this scheme resulted in reducing the taxable income by a maximum of ₹ 25,000 (50% of ₹ 50,000) for such investors. This saving was under Section 80 CCG, which was over and above the ₹ 1.5 lakh limit under Section 80C. Similar to ELSS, the RGESS scheme also had a lock-in period of 3 years of which the first year was a mandatory lock-in and the following two years offered flexible lock-in. The investments under RGESS could only be done in shares of specific companies, ETFS, Mutual Funds and Initial Public Offerings (IPOs).

Because ELSS schemes have a lock-in period of 3 years, fund managers get to invest with a greater degree of freedom and with a long-term approach.

HOW TO INVEST IN ELSS

1. If you have an online trading account, you can invest online.

2. You can also invest offline by submitting an application form available with any distributor or the mutual fund's office. Although entry loads have been abolished, you may still have to pay some service fee if you go through a distributor. You could also invest directly through the website or the office of the mutual fund company. You can do this by downloading the form from the website and submitting it at the mutual fund's office or collection centre. Make sure you always write "Direct" as the broker code while submitting the form.

3. The minimum investment is as low as ₹ 500, so most investors should be able to invest in an ELSS fund.

4. You can either invest a lump sum amount or invest a particular sum at regular intervals through Systematic Investment Plan (SIP). Do remember, every instalment has a lock-in period of 3 years from the date of investment (read chapter on SIP to know more).

POINTS TO CONSIDER BEFORE INVESTING

1. What is the performance of the ELSS scheme in the last 3-5 years? Compare it with other high-performing ELSS schemes in the market. Make sure you compare it with similar type of funds (It's important to note here that past performance is just an indicator and not a guarantee to future performance. You will therefore have to look for other indicators like its expense ratio, the total asset value of the fund, the type of assets it invests in, etc. before you make a decision to invest.)

2. There is a lock-in period of three years. So you should be aware that you will not be able to access this money for that period.

ADVANTAGES

1. Reduces taxable income up to a maximum of ₹ 1.5 lakh under Section 80C.

2. Manageable lock-in period of just 3 years unlike 5 years for tax-saving FDs, 5—10 years for NSCs and 15 years for PPF.

3. The lock-in period ensures that you don't pull out your money at the first need, thus ensuring that your money stays invested.

4. Potential to earn much higher returns than with fixed deposits. In a good year, returns of 15% to 20% are possible, compared to around 8% to 10% in fixed

deposits, NSCs and PPF.

5. The dividend received is tax-free.

6. Long-term capital gains made on ELSS investments are not taxable. So when you sell the units at the end of 3 years, you don't have to pay long-term capital gains tax.

DISADVANTAGES

1. Your money gets locked for a period of 3 years. You cannot make part-withdrawals or take a loan on your investment during the lock-in period.

2. Since ELSS schemes invest in stocks, there is an element of risk involved. Invest only if you're confident you can bear the risk.

3. Premature withdrawal is not allowed. You cannot get back your money before 3 years even in an emergency.

INVESTMENT METER

Safety * * *
Liquidity: * *
Returns: Can vary hugely depending on the scheme you invested in. Since ELSS invests in stocks, it has the potential to offer both healthy as well as poor returns depending on how the scheme is managed.

(Where 5 stars indicate Excellent and 1 star indicates Poor)

TAX IMPACT

Any amount you invest in ELSS up to ₹ 1.5 lakh offers tax benefits under Section 80C. The dividend amount you receive is tax-free. Since ELSS investments are locked for 3 years, capital gains are tax-free when you withdraw your investment.

NOTES

CHAPTER

15

SYSTEMATIC INVESTMENT PLAN (SIP)

Systematic Investment Plan (SIP) is one of the buzzwords in the world of investments. Interestingly, SIP is not a scheme, but a way of investing. SIP has been so successful that many investors swear by this method.

So what exactly is SIP? If you consider investing in mutual funds a smart option, SIP is an even smarter way to invest in mutual funds! So simply said, SIP is a method of investing by which you can maximise returns on your mutual fund investments.

THE SIP CONCEPT

SIP is similar to recurring deposits. In a recurring deposit, you invest a fixed amount of money in a bank at regular intervals for a fixed duration of time. In SIP, you invest a fixed amount in a mutual fund scheme (usually equity based) at regular intervals for a fixed duration of time. The difference is that recurring deposits being a debt investment, earn you a fixed rate of interest, while through SIP, you invest mostly in equity and therefore your returns depend on how the equity markets perform. In a SIP, you receive varying number of mutual fund units every month, depending on the NAV of the scheme at the time of purchase.

For those who are not familiar with mutual funds, let's take a quick look at what they are (detailed explanation in Chapter 13). If you are familiar with mutual funds, skip the next paragraph.

A mutual fund company collects money from investors like you and me and invests it in various instruments like stocks, bonds and government securities on our behalf. Depending on whether they make a profit or loss, the value of this investment increases or decreases. This increase/decrease is reflected in the Net Asset Value (NAV) of the mutual fund. You can earn a profit by selling your mutual fund units at a higher NAV than the NAV at which you bought. You can also earn returns when a mutual fund shares this profit in the form of dividends. A mutual fund is considered a smart way to invest because it is managed by professionals who understand investing better than most of us. Investing in mutual funds that invest in stocks is safer than investing directly in stocks because mutual funds invest in multiple and different types of companies, thus reducing the overall risk. There are two ways of investing in mutual funds. The first is by investing a lump sum amount (for example, ₹ 50,000) in one go. The other option is to invest through SIP, where, instead of investing a lump sum, you could invest a smaller but regular amount (every week or month or quarter) for a fixed period of 2-5 years or more.

SO HOW DO YOU BENEFIT FROM SIP?

Although you can invest in different types of mutual funds using SIP, it works best for equity mutual funds (mutual funds that invest in the stock market). As you are aware, stock prices go through constant ups and downs. An investor makes money primarily by buying stocks at a lower price and selling them at a higher price. The problem is that a lot of people wait for the "lowest" price for a stock, which no one can predict. Many a time, new investors in their quest to make a profit, end up buying at a high price and selling for less. Due to the immediate and often high losses they incur, some of these investors give up investing in the stock market altogether.

SIP makes investing in equity mutual funds even safer and more profitable.

Investing in a mutual fund reduces this risk as mutual fund managers do the investing for you. They study different companies and market conditions before investing. So you have a better chance of making profits in the stock markets by putting your money in a good equity mutual fund. SIP makes investing in equity mutual funds even safer and more profitable.

Let's understand SIPs with the help of an example.

Suppose the NAV of the mutual fund you're planning to invest in is ₹ 50 and you invest ₹ 20,000 in it. You get 400 units (20,000 / 50). Now, assume that the stock market falls and with it, the NAV of your mutual fund. If the NAV drops to ₹ 40, your investment value decreases to ₹ 16,000 (400 units x ₹ 40); that's a loss of ₹ 4,000. Later, if the market recovers and the mutual fund reaches an NAV of ₹ 55, your investment will be worth ₹ 22,000 (400 units x 55) giving you a profit of ₹ 2,000 (22,000 - 20,000) at that time.

Now imagine you invest through SIP. Then, instead of investing ₹ 20,000 at one go, you could opt for an SIP of ₹ 2,000 per month for 10 months. In this case, your investment would be as shown in the following page:

Because the NAV fluctuates, you'll get a different number of units every month for your investment. When the NAV decreases, you'll get a higher number of units. Eventually, as shown in the table, you end up with 428.42 units for ₹ 20,000 instead of the 400 units you got initially. So, when the NAV reaches ₹ 55 at the end of the 10th month, your investment is worth ₹ 23,563 (428.42 x 55), earning you a profit of ₹ 3,563 on your investment instead of ₹ 2,000 that you earned by investing in a lump sum.

♦ MONTHLY SIP ♦

Month	NAV (₹)	Investment (₹)	Units received
1	50	2,000	40.00
2	48	2,000	41.66
3	45	2,000	44.44
4	42	2,000	47.61
5	40	2,000	50.00
6	44	2,000	45.45
7	45	2,000	44.44
8	50	2,000	40.00
9	52	2,000	38.46
10	55	2,000	36.36
		20,000	428.42

However, it may not always work like this. For example, if the market keeps

rising, the NAV of the mutual fund will keep increasing and you'll get fewer units; if the market keeps falling, the NAV will decrease and you'll get more units for the same amount.

The whole idea behind SIP is that instead of investing a lump sum, you spread your investment over a period of time—this way, you don't have to worry about the "right time" to invest in the market. You keep investing at regular intervals, and because the stock market is cyclical in nature, you'll be able to reap good returns when the market does well. But remember, you need to look at investing in SIP for at least 3-5 years to benefit from this method. If you're looking for short-term investment periods of a year or less, SIP may not be the best method. This is because the stock market takes time—sometimes years to change direction. But a systematic investment plan has a greater chance of giving you a good return than you trying to figure out market movements. SIP thus work best for those who are planning to invest for a period of around 3-5 years.

Like a recurring deposit, SIP instils discipline in you. It also gives you an idea of how the stock market works without having to bear the risks of investing directly in the stock market.

HOW TO INVEST USING SIP

1. The first step is to identify the mutual fund schemes that you'd like to invest in. To reach this decision you may want to ask your friends or colleagues who have already invested in mutual funds. (Avoid asking people who have not invested in mutual funds as they may provide misleading information.) Along with checking with your friends and colleagues, also do your own research by reading reports on websites or newspapers or watching discussions and advice on business news channels about the best performing funds. Once you arrive at a list of mutual funds you'd like to invest in, request these mutual fund houses to send their representatives over to explain the details of their schemes. You can do this by visiting their websites or calling their helpline number, etc. After you've understood the various schemes, you can arrive at a decision on which mutual fund scheme/s you want to invest in. Don't rush—even if it takes a few additional days or weeks, it makes sense to do your homework before investing. The investment you make will be for years, so it's essential that you're sure about where you're investing. If you feel you won't be able to do the due diligence required, you can always use the services of a good financial advisor who can help you select the right funds.

Like a recurring deposit, SIP instils discipline in you. It also gives you an idea of how the stock market works without having to bear the risks of investing directly in the stock market.

---

2. Decide on a duration for which you'd like to invest. Most SIPs require you to invest for at least six months. The frequency at which you invest can be weekly, monthly or quarterly; you can choose the payment time frame that works best for you.

3. You can pay through post-dated cheques (PDCs) or through ECS (the amount gets automatically transferred from your bank account).

4. If you have any surplus amount, you could invest it in your SIP even though your regular SIP amount may be lower. For example, if you were investing ₹ 5,000 per month through SIP and you had an extra ₹ 10,000 with you, you could invest ₹ 15,000 in your existing SIP account. Similarly, you can also skip a payment if you are unable to do so for some reason. There is no penalty involved.

5. The minimum amount to start an SIP can be as little as ₹ 100.

6. Although mutual funds no longer charge an entry load (applicable for all SIPs started on or after August 1, 2009) you may still have to pay transaction fees. You

should check with your distributor or online service provider for the exact charges for your existing investment.

7. If you're investing in an ELSS scheme (see Chapter 14) then every SIP instalment will have a lock-in period of 3 years (unlike other mutual funds, units of ELSS funds cannot be sold before 3 years as they offer tax benefits under Section 80C). So, if your first SIP investment was in March 2014, you can sell these units only in March 2017. Units of non-ELSS mutual funds can however be sold any time, but they'll attract capital gains tax on the profit you earn (long-term and short-term in case of debt funds and short-term in case of equity funds depending on when you sell).

8. You can stop an SIP payment in between and sell your units any time. There's no penalty for stopping an SIP in between. But if you sell your units within a year, you may have to pay an exit load to the mutual fund. However, do check with your mutual fund on premature exit charges.

POINTS TO CONSIDER BEFORE INVESTING

1. Do you want to invest your money in the stock market even though it's indirectly through mutual funds?

2. Are you sure about the mutual fund scheme in which you want to invest through SIP?

3. What are the terms of investment, including frequency of payments, exit load charges and penalty on premature exit?

4. The performance of your SIP depends on the market as well as the mutual funds you choose. Investing in sound mutual funds is in your hands; market performance is unpredictable. You'll have to show discipline and patience during a market downturn to benefit using the SIP method.

ADVANTAGES

1. Just like a recurring deposit, with SIP too, you can start with small amounts. The minimum amount that you can invest would start from ₹ 100 and could go up to ₹ 5,000 per month or more depending on the mutual fund scheme.

2. You learn the importance of discipline and patience in investing.

3. You can take advantage of the high returns offered by equity (stocks) without exposing yourself to the risks involved in investing directly in stocks.

4. You can invest any surplus amount that you have. Skipping a payment doesn't incur a penalty either. However, if you skip three continuous payments, your SIP usually gets terminated and you'd have to start afresh.

5. Investments in mutual funds could earn you better returns than most other investments in the long run. An SIP makes it easier to invest in mutual funds.

6. You can stop your SIP whenever you want or sell your mutual fund units any time (except in the case of ELSS mutual funds where the lock-in period is 3 years).

DISADVANTAGES

1. Investing in a poorly performing mutual fund scheme will not work out even if you invest through SIP. Choosing the right mutual fund scheme is important for the success of your SIP.

2. An SIP doesn't guarantee a fixed return like a fixed deposit or a recurring deposit. If you invest in equity mutual fund schemes, there will always be an element of risk involved.

3. Although entry loads no longer exist, do check if you are paying for investments made before August 1, 2009. Mutual funds may also levy a "transaction fee" based on certain conditions. It's a small amount, but do enquire before you start investing. If you sell your units within a year, you may also have to pay an exit charge (of around 1-2% of the total value). The exit load may vary across mutual fund companies.

INVESTMENT METER

SAFETY: Depends on the scheme you invest in.

LIQUIDITY: Can be redeemed at a short notice except for SIPs in ELSS funds. (There is a lock-in period of 3 years for investments in SIPs done in ELSS. SIPs in other types of mutual fund schemes don't have lock-in periods.)

RETURNS: Will vary depending on the scheme you invest in and the prevailing market conditions.

TAX IMPACT

If your SIP investment is in an ELSS scheme, the amount you pay during a financial year (April 1 to March 31) will offer tax deductions up to ₹ 1.5 lakh under Section 80C. There are no tax benefits on SIP investments made in non-ELSS mutual funds.

If you sell your equity mutual fund units before the completion of 1 year of buying them, you'll have to pay short-term capital gains tax of 15% on the profit. For example, if you bought 200 units at ₹ 25 each in January 2017 and sold them in June 2017 (less than 1 year) at ₹ 30 each, you profit by ₹ 1,000 (200 x 30 - 200 x 25 = 1,000) so you'll have to pay a tax of around ₹ 150 (minus any expenses). In case of debt funds, this profit would be added to your income and taxed according to the tax bracket you belong to.

Long-term capital gains tax is not applicable for equity units sold after a year. Debt funds, however, incur long-term capital gains tax of 20% with the benefit of indexation.

If you incur a short-term loss, you can offset the loss against any other short-term or long-term capital gains to reduce your total capital gains and thereby the tax you need to pay. In case of debt funds, long-term capital loss can be offset against long-term capital gains (except in case of equity mutual funds, where long-term capital gains are not considered).

NOTES

CHAPTER

16

GOLD

The amount of gold bought in India is a clear indication of how much we Indians value financial security. Although gold is mostly bought in the form of jewellery and usually during important social occasions, the thought at the back of the buyer's mind is that it is an investment; that gold will always increase in value in the years to come. No wonder then that gold has been one of India's favourite investment options over the years.

The spectacular rise in the price of gold during the last one decade had rewarded all those who believed in the metal's unique ability to remain in demand. For those who weren't convinced about gold as an investment option, it was a lesson learnt the hard way.

Since a majority of Indians consider gold to be an important part of their investment plan, how does one go about investing in gold? Is buying gold in ornament form the best way to invest or are there better options available? What is the tax impact of buying and selling gold? We’ll find out all these in this chapter.

HOW GOLD WORKS AS AN INVESTMENT

Buying gold is a matter of habit for many Indians. There are specific occasions where tradition requires us to buy gold: festivals, birthdays, naming ceremonies and weddings being some of them. Most of this gold is bought in the form of ornaments. The price of these ornaments not only includes the cost of the gold but also the charge for crafting them (called "making charges"). At the time of selling the ornaments, however, you only get the value of the gold back—the making charges are not returned to you. So, if you treat gold ornaments as pure investment, you'll always end up with a loss as you will never receive the making charges at the time of selling. Remember, the more intricate the design, the higher the making charges and greater the amount you'll lose when selling.

Also, while it's true that gold is considered an investment, most of us will not look at gold ornaments as a means of making a profit. We won't sell our ornaments to earn profits just because gold prices are high (the way we would sell stocks or mutual funds). Since most ornaments are connected to some occasion or the other, there's an emotional attachment formed which makes selling them off for pure monetary gain, difficult. Because we lose out on the making charges and the fact that we won't sell our ornaments when gold prices increase, buying gold ornaments cannot be considered an ideal investment option. But that should not deter investors from planning to invest in gold. Gold offers many other investment opportunities that you can take advantage of: you can invest in gold bars, coins and even gold mutual funds—all, as the saying goes, worth their weight in gold… and more!

Because we lose out on making charges and the fact that we won't sell our ornaments when gold prices increase, buying gold ornaments cannot be considered an ideal investment option.

♦ PRICE OF GOLD OVER THE LAST FEW YEARS ♦

No.	On March 31	Price for 10 grams of gold
1	2000	₹ 4,395
2	2001	₹ 4,410
3	2002	₹ 5,020
4	2003	₹ 5,260
5	2004	₹ 6,065
6	2005	₹ 6,180
7	2006	₹ 8,490

8	2007	₹ 9,395
9	2008	₹ 12,125
10	2009	₹ 15,105
11	2010	₹ 16,320
12	2011	₹ 20,775
13	2012	₹ 28,040
14	2013	₹ 29,610
15	2014	₹ 28,470
16	2015	₹ 26,245
17	2016	₹ 28,340
18	2017	₹ 28,510

GOLD BARS AND COINS

Gold bars and coins have minimal to zero making charges, so you don't lose out when you sell the gold. Since there is no emotional value attached to this gold, you can treat it as pure investment and sell it when you feel the price is right. Do make sure that you buy the gold from a bank or a reputed jeweller and that there are proper markings indicating its weight and quality. Note that banks only sell gold; they won't buy it back. So you'll always have to sell them to a jeweller. When you buy gold bars and coins, it's best to buy by cheque or credit/debit card, and collect a receipt on payment.

Gold bars and coins are available in different weights, from 1 gram to 50 grams and more. When you buy a bar or a coin from a bank, you may receive a certificate mentioning the weight and purity of the gold. But since banks do not buy back the gold, it may not make a difference when you sell it to a jeweller as they will check for purity and weight, anyway. If you are asked to pay an additional amount for the certificate, you can probably choose not to, as long as you have a bill of the transaction.

GOLD EXCHANGE TRADED FUNDS (GOLD ETFS)

There's another interesting format in which you can invest in gold: Gold Exchange Traded Funds (GETFs). These funds invest only in gold—almost like a sectoral mutual fund scheme (sectoral mutual funds invest in stocks that belong to a particular sector—banking, pharmaceuticals, information technology, etc.).

Like mutual funds, you can buy units of GETFs. The price of each unit of this fund is linked to the price of gold at that particular time. This way, no matter how the price of gold fluctuates, if you invested in X grams of gold, you'll get the price for X grams when you sell the units.

Following is an example to understand how exactly it works.

Assume that you want to invest ₹ 50,000 in Gold ETFs when the price of gold is ₹ 2,500 per gram. If each unit of the GETF is priced for 1 gram of gold, the price of one unit would be ₹ 2,500. In this case, you would get 20 units (50,000 /2,500 = 20). After a few months, if the price of gold rises to ₹ 3,000, the GETF price will now become ₹ 3,000 per unit. If, at this date, you decide to sell your funds, you'll get ₹ 60,000 back (20 units x 3,000 = 60,000). If you were to now go and purchase physical gold in the market with this amount, you'd be able to buy 20 grams at the current market price. That's the same amount of gold (20 grams) you would have got if you had bought gold for ₹ 50,000 at ₹ 2,500 per gram, earlier.

As this example shows, the value of your investment gets directly linked to the price of gold. Your investment in a Gold Exchange Traded Fund moves up or down depending on the movement of the gold price, thus allowing you to buy the same amount of gold you hold in the fund at any point of time.

If gold price reduces to ₹ 2,400 per gram, then, in the abovementioned case, the price of each GETF unit would become ₹ 2,400 and you would get back ₹ 48,000 (20 units x 2,400 = 48,000). At the prevailing gold price, you'd be able to buy 20 grams of physical gold with that amount. Investing in GETF is thus almost like buying gold but in a safer and easier way, as you don't have to physically store your gold.

However, as GETF is a type of mutual fund, you'll have to bear some additional expenses like operational costs (around 1% to 2%) and the brokerage (around 0.5%) charged by your broker. Because of these costs, the price of one GETF unit may not be exactly a replica of the market price of 1 gram of gold as explained in the above example. The difference will be small, however. Do check out the various GETFs in the market to find out which one has the lowest expenses and is closest to the prevailing gold price. The costs incurred in investing in GETFs will still be much lower than what you would lose on making charges (around 5% to 20%) when you sell a gold ornament of the equivalent weight.

Although GETFs are open-ended mutual funds, they are traded on the stock

exchange just like shares. So, while you cannot buy open-ended mutual fund units on a stock exchange (you have to invest in them through a mutual fund), you can buy and sell GETF units through the stock exchange. This is an important difference in the way GETF works that you should be aware of as it makes buying and selling units really simple. Overall, these are the advantages of buying GETFs over gold ornaments or gold bars and coins:

1. You don't have to buy gold physically and keep it in a locker. You can just buy GETF units and sell them whenever you want to buy physical gold.

2. Unlike physical gold where you may need to buy at least a few grams' worth every time you're buying ornaments or coins, GETF units can be bought in small amounts of 1 gram. Since the NAV directly tracks domestic gold prices, you will be paying standard rates.

3. You don't incur any making charges. The only cost you'll have to bear will be brokerage fees (around 0.5%) and the fund management charges (around 1% to 2%).

4. As there is no physical gold involved, you don't have to verify the quality of gold.

5. To buy and sell GETF units, you only need to have a demat account (also used to trade stocks). This is much easier than visiting a jeweller or a bank and buying and storing physical gold.

SOME DISADVANTAGES TO WATCH OUT FOR

1. Since GETFs are passively managed funds, operating costs will be low. The best managed funds will have costs around 1%. It is small, but you should still factor it in.

2. GETFs are traded on the stock exchange and you'll need a demat account to invest in them. The annual charges for the demat account will be an additional expense.

3. You'll have to pay a small brokerage fee every time you buy or sell GETF units.

4. As there are very few agencies involved, you'll rarely find anyone educating investors about GETFs. The acceptance of GETFs as an alternative to physical gold is still low in India.

5. If you sell GETF units before 3 years, the profit gets added to your income and you have to pay tax as per your income tax slab. If you sell after 3 years, you'll have to pay long-term capital gains tax of 20% with indexation on the profit you

make (The same applies when you buy and sell physical gold).

Following is a list of GETFs that are currently available on the National Stock Exchange for you to invest in.

♦ GOLD ETFS LISTED ON NSE ♦

Issuer	Name	Symbol
Axis Mutual Fund	Axis Gold ETF	AXISGOLD
Birla Sun Life Mutual Fund	Birla Sun Life Gold ETF	BSLGOLDETF
Canara Robeco MF	Canara Robeco Gold ETF	CANGOLD
Goldman Sachs Asset Management	Goldman Sachs Gold Exchange Traded Scheme	GOLDBEES
HDFC Mutual Fund	HDFC Gold Exchange Traded Fund	HDFCMFGETF
ICICI Prudential Mutual Fund	ICICI Prudential Gold Exchange Traded Fund	IPGETF
IDBI AMC	IDBI Gold ETF	IDBIGOLD
Kotak Mutal Fund	Kotak Gold Exchange Traded Fund	KOTAKGOLD
Quantum Mutual Fund	Quantum Gold Fund	QGOLDHALF
Reliance Mutual Fund	Reliance Gold Exchange Traded Fund	RELGOLD
Religare Mutual Fund	Religare Gold Exchange Traded Fund	RELIGAREGO
SBI Mutual Fund	SBI Gold Exchange Traded Scheme	SBIGETS
UTI Mutual Fund	UTI GOLD Exchange Traded Fund	GOLDSHARE

GOLD FUND OF FUNDS

Another way of investing in gold is through Gold mutual funds that invest in GETFs. Such mutual funds are called Gold Fund of Funds (FoFs). In this case, instead of investing in a GETF, you are investing indirectly in them using the services of a mutual fund. Investing in Gold FoFs has its advantages and disadvantages over GETFs. Let's look at what they are:

1. A Gold FoF normally invests in the parent mutual fund's GETF and each unit of the FoF can be a fraction of the GETF unit. This allows you to invest smaller amounts, unlike in GETF, where you have to invest in a minimum of 1 or half a gram's value of gold.

2. Another advantage over GETFs is that you can invest in Gold FoFs without having a demat account. So you don't incur the annual charges required to maintain a demat account.

3. You can start an SIP in any Gold FoF and thus invest a regular amount every month in gold. The SIP option is not available with GETF. Investing in Gold FoF can thus be a simpler way of investing in gold instead of GETFs.

4. Gold FoFs, however, have higher expenses (around 0.5% over the costs of a GETF). Some Gold FoFs may even charge an exit load if you sell your units within six months to one year of purchase (around 1% to 2% of the total value). This is not the case with GETF which can be bought and sold any time through the stock exchange.

Do consider the pros and cons before you decide to invest in any of these options.

An important point to remember here is that both GETFs and Gold FoFs are different from Gold Mutual Funds which invest in gold mining companies. So, while GETFs and Gold FoFs are directly linked to the price of gold, Gold Mutual Funds simply invest in shares of gold mining companies. The returns on such mutual funds are dependent on the performance of those mining companies and should not be seen as linked to the performance of gold in the market.

E-GOLD: BUYING GOLD IN ELECTRONIC FORMAT

This option combines the convenience of buying gold in an electronic format with the benefit of actually receiving physical gold when you want it. In case you do not want to take physical delivery of the gold, you have the option of simply selling off the accumulated e-gold and earn a profit if the market price exceeds your cost. The e-gold option is currently offered by National Spot Exchange Ltd. (NSEL), an exchange that allows investors to trade in various commodities.

An important point to remember here is that both GETFs and Gold FoFs are different from Gold Mutual Funds which invest in gold mining companies.

The concept of e-gold is similar to Gold ETFs with a few differences. A unit of e-gold is equivalent to 1 gram of 24-carat gold. You have to have a demat account through which you can purchase the e-gold units. However, you cannot use the existing Depository Participants (DP) that you use for stocks and GETFs—you'll have to open a new demat account with a DP listed with NSEL (check Member List for Account Opening on www.nationalspotexchange.com). Once that's done, you can buy and sell e-gold using the NSEL website by paying a minimal brokerage fee. If you wish, you can take physical delivery of the e-gold you have in multiples of 8 grams, 10 grams, 100 grams and 1 kg. Currently, delivery is provided at Ahmedabad, Delhi and Mumbai. When you take physical delivery, you'll have to pay accompanying taxes. There are also recurring expenses like storage and turnover charges that are incurred. However, e-gold can deliver better returns than Gold ETFs because there are zero management fees involved. The downsides are that you have to open a new demat account just for buying e-gold and that it is treated as physical gold for tax purposes. So Long Term Capital Gains are applicable on e-gold if held for more than three years and they are not exempt from wealth tax. The major advantage with e-gold is that it allows you to accumulate as much gold as you need without having to take physical possession of it until you need it.

GOLD DEPOSITS WITH BANKS

If you've already bought physical gold and don't plan to sell it any time soon, you could earn some money out of it by depositing it in a bank account instead of keeping it in a bank locker. This way, you get a return of around 1% per year on the actual value of the gold. The deposit can be for a period of 6 months to 7 years and the minimum amount of gold to be deposited is 500 grams. You need to declare the origin of the gold while depositing it. Not all banks provide this deposit facility, so you'll have to check if there's a bank around your neighbourhood that does.

It's important to know that when you deposit your gold, you will not get back your gold in its original form at the end of the tenure. Instead, you'll get back the gold in the form of gold coins or bars. You can also choose to receive the value of gold in cash. Because you don't get back your gold in the form that you submitted, handing over jewellery that you use or which has emotional value is not a good idea. The advantages are—you can get the interest in cash or gold; you get back your gold in a pure form; and you won't incur any locker charges for the period that the gold is with the bank. The interest you earn is free of income and capital gains tax.

SOVEREIGN GOLD BONDS

These bonds are linked to the price of gold and issued by the Reserve Bank of India on behalf of the government. Sovereign Gold Bonds are issued during a certain period and investors have to apply for them through an application form available at post offices, banks and designated agents. The forms could also be downloaded from the RBI website. The minimum value of a bond is 1 gram worth of the gold price announced. For example, the price of 1 gram of gold announced in the September 2016 scheme was ₹ 3,150. The last scheme was open for subscription from September 1 to September 9, 2016. The maximum value that an individual can apply for is 500 grams per year. The bonds are available in denominations of 1, 2, 5, 10, 50, and 100 grams with the option to hold them in paper or electronic format (in case you have a demat account). In addition to being linked to the price of gold, these bonds also offer interest at a rate of 2.75 % per year that is credited to the investor's bank account directly every six months. The interest will be considered as income and will be taxed as per the investor's income tax slab. The bonds have a maturity period of 8 years with exit options in the 5th, 6th and 7th year. These bonds are also traded on the stock exchanges—so you can sell or buy before the maturity period. The whole purpose of sovereign gold bonds is to enable individuals to receive returns that are similar to what gold would offer without having to buy physical gold. Further, like physical gold, these bonds can be used as collateral for loans. On maturity, the investor will receive the value of the bond in terms of the prevailing price of gold. In case gold prices fall dramatically at maturity, the investor has the option to extend the scheme by another three years to avoid loss.

It's important to know that when you deposit your gold, you will not get back your gold in its original form at the end of the tenure. Instead, you'll get back the gold in the form of gold coins or bars. You can also choose to receive the value of gold in cash.

GOLD LOANS FROM BANKS

Banks and Non-Banking Finance Companies (NBFCs) provide loans against gold as collateral. Earlier, you could have got loans up to 90% of the value of the gold you mortgaged. But in 2012, as per RBI directions, the loan amount offered by NBFCs could not exceed 60% of the value of the gold. This loan-to-value ceiling has since been increased to 75% in 2014. Also, NBFCs can only lend against gold jewellery; they cannot offer loans against gold coins or bars. Banks, however, do not have such restrictions.

Gold loans are usually taken for short periods of 6 months to a year. Gold loans may seem convenient with the minimum paperwork involved and quick loan disbursal, but interest rates are high and if gold prices crash, the financial institution will ask you to repay the difference or deposit more gold as collateral. They may even auction the gold if you're unable to make the payment. So do consider these eventualities before you opt for a gold loan.

That broadly covers the different ways you could use gold as an investment option. Although investing in gold ornaments is part of our culture, it's not the smartest way to invest in gold. You should consider investing in gold bars, gold coins, GETFs, e-Gold, Sovereign Gold Bonds or Gold FoFs for better returns. It's always good to have some part of your investments in gold.

HOW TO INVEST IN GOLD

1. If you are buying gold ornaments, select those with lower making charges. They will give you better value for money. Buy gold ornaments only from reputed stores. Get a bill that clearly states the weight and quality of gold.

2. You can buy gold bars and coins from banks as well as a jewellery store. Banks usually charge a premium on the gold they sell and will not buy back the gold. If you decide to buy from a jeweller, make sure it's a reputed store and that the gold is genuine. Get a receipt from the issuer, irrespective of whether it's a bank or a jeweller.

3. You need to have a demat account to invest in GETFs. To invest, you could apply directly through the fund house that issues GETF units or buy them through a financial consultant or from your online trading account. In case of e-gold, you'll have to open a demat account with a DP recognized by NSEL.

POINTS TO CONSIDER BEFORE INVESTING IN GOLD

1. What is the price of gold on a particular day? Gold prices fluctuate daily. Check the price to see if it's the rate at which you'd like to buy; you can find this information on television, in newspapers, websites and even at a jeweller's shop.

2. What are the making charges for the ornaments you are buying? Remember that you'll lose that amount when you sell the ornament.

3. Deduction of making charges when you sell gold ornaments can vary from store to store. If you feel the deduction being charged by a jeweller is unreasonable, do consider selling your gold at a different store that offers a better deal.

4. Is the gold branded? Can you sell it to a jeweller other than the one you are buying it from?

5. If you're investing in bars or coins, do they levy any making charges? Check the markings of weight and quality on them.

ADVANTAGES

1. Gold is very liquid. You can sell and convert it into cash almost any time without much loss of value.

2. Gold can be bought not only as ornaments but also as coins and bars, which have minimum making charges, and also as mutual funds.

3. You can easily take a loan against gold if you so wish.

4. Gold may not enjoy spectacular growth like stocks, but it is safer than most other investments.

DISADVANTAGES

1. You have to be careful while buying and storing gold in physical form (unless you invest digitally in ETFs, FoFs, e-gold or sovereign gold bonds).

2. If a high percentage of your gold investments are in the form of ornaments, you will lose money on making charges.

3. It does not offer dramatic growth like some other investment options (except during periods of economic or political uncertainty).

INVESTMENT METER

Safety: * * * * *
Liquidity: * * * * *
Returns: * * *
(Where 5 stars indicate Excellent and 1 star indicates Poor.

TAX IMPACT

Earlier a tax of 1% was applicable when you bought gold jewellery worth ₹ 5 lakh or more. A similar tax was applied if you bought non-jewellery gold items (coins, bars, etc.) worth more than ₹ 2 lakh in cash. In budget 2017-18, cash transactions above 2 lakh has been restricted. Purchasing any type of gold for ₹ 2 lakh or above in cash will therefore incur penalties.

Investments in physical gold also attract capital gains. If physical gold (ornaments, bars, coins, etc.) is sold within 3 years, the profit gets added to your income and you have to pay tax accordingly. If you sell physical gold after holding it for 3 years, you need to pay 20% long-term capital gains tax on the profit after taking indexation into account. To avoid paying long-term capital tax, you can invest the profit in capital gains bonds or in a residential property.

Investments in GETFs are free of wealth tax. However, the profit you make by selling GETFs, Gold FoFs or Gold Mutual Funds is taxable. The taxation is similar to that of debt mutual funds. If you sell the units within three years of purchasing them, the profit will be treated as short-term capital gains (STCG); the profit will get added to your income and you'll have to pay the applicable tax. If you sell

your funds after three years, the profit will be treated as long-term capital gain (LTCG) and you will have to pay tax on it at the rate of 20% with indexation.

Investments in Sovereign Gold Bonds are exempt from capital gains if they are sold on maturity. However, if you transfer the bonds to another person before maturity, then you have to pay long term capital gains tax while availing the advantage of indexation. Interest earned on these bonds will be added to your income and will be taxed as per your income tax slab. In case of e-gold, any profit earned by selling within three years of purchase will get added to your income. If you sell after a period of three years, long-term capital gains will be applicable that will be taxed at 20% with the benefit of indexation.

♦ OVERVIEW OF INVESTMENT OPTIONS IN GOLD ♦

Format	Holding Type	Features	Additional Charges	Taxation
Gold Jewellery	Physical	Used primarily for personal use.	Making charges. Locker fees in case you use them for storage and safekeeping.	If sold before 3 years, you have to add the profit to your income. Long term capital gains tax of 20% with benefit of indexation.
Gold bars, coins	Physical	Can be used for investment.	Zero or minimal making charges. Locker fees in case you use them for storage and safekeeping.	Same as gold jewellery.
GETF	Electronic. Some GETFs may offer physical delivery	Can be bought and sold electronically on the stock exchange. Can be bought in units of 1 gram worth of gold.	Brokerage, fund management charges and demat fees (if you opt for a demat account). You may be charged an exit load of 1% or more if you sell before 1 year.	If sold before 3 years, you have to add the profit to your income. Long term capital gains tax of 20% with benefit of indexation.
Gold FOFs	Electronic	Mutual funds that invest in GETFs.	Brokerage fees and management fees. You may be charged an exit load of 1% or more if you sell before 1 year.	Same as GETF.
Gold Mutual Funds	Electronic	Mutual funds that invest in gold mining companies	Same as mutual funds: brokerage and management fees.	Same as GETF and Gold FOFs.
E-gold	Electronic with option to take physical delivery	Can be used to safely accumulate gold and take delivery when needed.	Demat charges and VAT charges on delivery. Minimal brokerage charges.	If sold before 3 years, you have to add profit to your income. Long term capital gains tax of 20% with benefit of indexation.
Sovereign Gold Bonds	Electronic	Earns interest of 2.75%.	None	Interest earned is taxable. Exempt from capital gains tax if sold on maturity. If transferred before maturity, they attract long term capital gains tax with benefit of indexation.

NOTES

CHAPTER

17

REAL ESTATE

Mention "real estate" and chances are that you would immediately think of your home or the house you plan to buy. But real estate deals with much more than one's dream home—it can be any property that you use to earn a steady income through rent and generate profit when you sell it. However, because of the cost and effort associated with buying and selling property, for most of us, our home remains the only real estate investment. But things have changed ever since India's economic boom in the last few decades.

Over the past two and a half decades, Indians have been aggressively investing in real estate—either in a second home or a vacation home, or in any property that offers the potential to grow. This change in mindset has been brought about by the rise in employment, rising incomes, world-class construction projects, easier access to loans and the overall economic growth in the country.

In spite of its attractiveness, however, real estate as an investment option is complex and requires hands-on experience with most of its concepts. In this chapter, we'll take a broad look at how investing in real estate works. After reading this chapter you should have a fair idea of whether you'd like to get involved in this investment option or not. We'll also take a look at the factors you should consider before buying a home—that one real estate investment all of us would like to get involved in as early as possible!

THE REAL ESTATE CONCEPT

A real estate investment is unique in many ways and unlike any other investments discussed in this book. Some of the major differences between real estate and other investments are:

1. Real estate is an investment that no one can physically steal from you.

2. Real estate investments take time to materialise—it's never a simple matter of making a decision and investing in some property in the next couple of days. People spend months deciding on a property, and in some cases such as buying a home, even years.

3. Real estate investments involve a substantial amount of money.

4. A decision on real estate usually involves all or the majority of the people who could be affected—family members in case of a house, business partners in case of a business, office staff in case it's an office building, etc.

5. Each piece of real estate is unique—even two houses in the same location will have their pluses and minuses and therefore, a difference in rates. An investor has to consider each property on its merits before arriving at a decision.

6. Information on every aspect of a property that you're interested in, is critical. You could end up with a bad deal because you were unaware of certain details and this could have a major impact on your investment.

7. Real estate is not a very liquid asset. Finding a buyer who offers the right price could take a long time and test your patience.

This is just a partial list, but it highlights how different real estate is as an investment option and the kind of skills required for investing in it profitably. But all said and done, most of us may get involved in at least one real estate deal in our lifetime. It could be the home you buy for yourself, a vacation home, a family property, an office space, etc. So do read the rest of the chapter to prepare for it!

HOW REAL ESTATE INVESTING WORKS

To be a successful investor in real estate, you should be able to evaluate a location, inspect the property for its positives and negatives, negotiate a good deal, arrange finances for the purchase and close the transaction with all the documentation required. It's not possible to learn all this at once; the only way you'll understand and master it is by actually going through the process in real-life situations.

Out of all the skills mentioned above, perhaps the most important one is of being able to judge the potential of a property and arrive at the correct price for it. To make matters more complicated, the correct price of a property can be different at different times! There are various factors that determine the price of real estate; let's have a look at them.

FACTORS THAT AFFECT REAL ESTATE PRICES

The factors that affect real estate prices can be as general as the overall economic scenario prevailing in the country and as specific as the quality of that particular land or building. The factor that impacts real estate prices the most is the ratio of demand and supply. If there is huge demand for real estate but supply is short, prices rise. If demand is low and there is a lot of property available, prices dip.

In a booming economy, the demand will usually be higher than supply because more people will have money, interest rates will be low and there will be an overall mood of optimism. At such times, a greater number of people will be interested in investing in real estate, making prices move up. Because it takes years for projects to be completed, such boom periods can last for years and even decades. On the other hand, if the economy goes down, demand will drop too, as people lose jobs, banks hesitate to provide loans, there is economic uncertainty and the overall mood becomes pessimistic. In such a scenario, real estate prices will go down.

But demand and supply is just one factor. Changes in loan interest rates, government policies on tax, government incentives to builders and home buyers and general speculation can lead to price changes. If you're planning to invest in real estate other than your house, keep yourself updated about the happenings around that could affect real estate prices.

To ensure that you make a profit, you have to do your homework! If you just buy a property in the hope that its value will increase, you're merely speculating—not investing (For that matter, any investment done without proper knowledge can be considered speculation—in real estate, it's just much more expensive to do that!). So don't be lured by the possibility of real estate prices going up unless you have sound reasons to believe it will happen.

TYPES OF REAL ESTATE INVESTMENT STRATEGIES

Although buying property at a low price and holding it till you can sell it at a higher price is the strategy most people adopt, there are other strategies that real estate investors around the world use. Some of these include:

1. PROPERTY IMPROVEMENT

Here, investors buy an 'unattractive' property which has no buyers, and turn it around into a more valuable property by making structural and cosmetic changes. For example, an investor may buy a property for ₹ 50 lakh and spend another ₹ 10 lakh fixing and improving it. Based on these enhancements, she may then sell it for a higher amount—say ₹ 75 lakh—and earn a decent profit. The challenge in this case is to find property that does not appear valuable but has potential. Spotting such opportunities requires knowledge and patience.

2. RENT IT OUT

Here, an investor will buy property and rent it out to a customer. The amount of rent received will depend on various factors like the location of the property, size, accessibility, etc. This can be a good way of earning income even as the value of the property appreciates with time.

3. BUY AT A SALE, SELL AT A PREMIUM

Some investors keep a look out for owners who want to sell their property on an immediate basis (usually termed as a 'distress sale')—either due to personal reasons or because they are in need of money urgently. The investor takes advantage of the owner's urgency and buys the property at a discount, then sells it off at a higher rate later.

Needless to say, you need to exercise caution, use your knowledge about real estate and evaluate the potential of the property before rushing into such deals. For real estate investors, knowledge is no doubt the greatest tool. This includes awareness about rules and regulations regarding construction, the paperwork involved, information about the surrounding area, etc. You should also know how to take care of the property in an economical way so that the property looks attractive to a potential buyer. Apart from this, you should also have good negotiating skills to get yourself the best bargain or a higher rate for your property.

There are different types of properties you could invest in, from flats to independent homes, office spaces, shops, service apartments, buildings, plots and more. Each of these can be a good investment option. Explaining how you could invest in each of these options is not possible in this book. However, since a home is one of the most common real estate investments, let's take a quick look at some dos and don'ts you should be aware of when investing in one.

BUYING A HOME

Buying a home is not just a matter of getting a roof over our heads. All of us want our home to be the best place we can afford to buy—a place that reflects our personality, our dreams; a place that allows us to relax, raise children and grow old. Investing in a home is therefore not just a matter of finding a house that we can afford—but also of finding a house that connects to the heart. Here are some helpful tips for first-time home buyers looking for their dream home:

1. If you plan to opt for a loan, get a pre-approved loan from your bank or a housing finance company. The difference here is that you can get the loan even before you decide on your property. With an already sanctioned loan, you can get a better rate while negotiating as the seller will realise that you can make an immediate purchase. Normally, for pre-approved loans, banks allow a period of six months within which the buyer can find the property and get the loan disbursed.

2. Make sure to deal with an agent you can trust. If you're uncomfortable, it will be smarter to find another agent you feel you can deal with easily. A good agent can make finding your dream house a more peaceful experience.

3. Make sure you carefully inspect the home you are planning to buy. If you feel positive about a house, have your close ones visit it for an inspection as well. Pay attention to the surroundings and the locality. Make sure it goes with your overall lifestyle.

4. If the previous owner has made any structural changes that you feel might affect the stability of the house, get it checked by a professional architect or engineer.

5. Set a budget. If you feel a house is overpriced, let your mind take the decision instead of your heart. Eventually, you'll have to pay the instalments using your hard-earned money, so don't make the mistake of putting all your money, including your future income, on your home.

6. Don't keep waiting for that "perfect" house. If you feel your house search is taking too long, be realistic and cut down on your expectations or you may find that rising prices make things even more difficult.

7. If you are buying a house in an apartment complex, do find out if the rate quoted is for carpet, built-up, or super-built up area. The price of the house can vary depending on how the area is being measured. Carpet area literally means the area in which you can lay the carpet—so the area occupied by the walls is not included. Built-up area includes the carpet area and the area occupied by the walls. Super-built-up area includes the built-up area plus the area that is common for all residents such as passages, lifts, staircases, lobby, and in some cases, even the area for the garden, swimming pool, etc. This area is divided proportionately

amongst all the houses in the complex. As you'd have realised, depending on how the area is calculated, there would be quite a difference in the actual carpet area of the house and therefore the rate charged. The difference between carpet area and built-up area is usually around 15% to 25%. The difference between carpet area and super-built up area can range from 25% to 50%. If you are looking for a house, do make sure that when you compare rates, it's against the same area types. For example, if you are quoted ₹ 2,000 per sq. ft. for a 1,000 sq. ft. flat in terms of carpet area, but only ₹ 1,800 for a 1,000 sq. ft. flat in terms of built up area, the first option will actually work out cheaper. Assuming a difference of 20% in the carpet area and built up area, you'll be getting just 800 sq. ft. of carpet area in the second flat—which translates to a cost of ₹ 2,250 per sq. ft. (Actual Cost / Carpet Area = 1800 x 1000 / 800 = 2,250). So make sure you ask for details before you decide.

8. Make a list of all the documents the seller should have and inspect them carefully before you sign the deal and make the down payment. Take the help of a home loan counsellor or a property expert to make a list of the necessary documents required. In case you are buying a house on resale in a registered co-operative society, check for the share certificate issued by the society in the name of the seller. Also make sure that the seller has no outstanding dues to the society and that the society can offer a No Objection Certificate (NOC) for the sale. If you are buying a home directly from the builder, check the approved layout plan, the approved building plan along with the number of floors approved, the land ownership documents, NOCs from the municipality, water authority, electricity boards, the brochure or specifications document that lists all the facilities that will be provided, etc.

If you prepare well, you should be moving into your new home without much worries. Wish you the very best for it!

With so many innovations happening in other investment options, can real estate be left behind! There are two new ideas that you should be aware of. Let's take a look at them—they might well take off in the next few years!

REAL ESTATE INVESTMENT TRUST (REIT)

The REIT concept is similar to Gold Exchange Traded Funds (where investors could invest in gold without having to buy physical gold). With REIT, investors can invest in property without having to buy physical property. REIT works like a mutual fund where the money invested by multiple investors is used by the fund company to invest in various commercial properties. Of the total assets of an REIT, at least 80% will have to be mandatorily invested in revenue-generating and completed projects. The other 20% of the assets could be invested in under-construction projects, shares of listed properties and other real estate activities. REITs are required to distribute at least 90% of their profit every year. With such a high percentage of distribution of profits and with the main source of revenue for REITs being in the form of rent, investors are assured of a steady, secure income through regular dividends. Like shares, REIT units can be bought and sold at any time through the stock exchange. The minimum investment amount is ₹ 2 lakh for an individual investor.

REVERSE MORTGAGE

Another new idea in real estate that has a lot of potential is reverse mortgage. A mortgage is the loan we take from a bank to buy a house. We repay the loan by paying fixed monthly payments called Equated Monthly Instalments (EMIs) for a fixed number of years. Reverse mortgage is the exact opposite of a mortgage.

In reverse mortgage, instead of you paying the bank, the bank pays you EMIs every month. Why would a bank do this? It's because when you get into a reverse mortgage agreement with a bank, you're offering your house as a guarantee for the amount the bank pays. This can be of great help for senior citizens who do not have a steady income after retirement but have a home of their own. Reverse mortgage thus enables senior citizens to continue staying in their existing home while earning an income from it.

The bank appoints property valuation experts to inspect the house and arrive at a value for the property. A certain margin is factored in by the bank to protect it from variation in property prices. After deduction of this margin amount from the property value, the bank arrives at the loan amount. This loan amount is paid to the borrower in monthly instalments. The minimum loan amount can be ₹ 1 lakh while the maximum can be ₹ 1 crore. The tenure can vary with the borrower's age (the minimum will be 10 years while the maximum tenure is 20 years). There are some reverse mortgage plans which provide a monthly income throughout the life of the house owner too (there is no 20-year limit in such a case).

Once the bank approves a reverse mortgage, it will continue to pay EMIs as long as the owner is alive, or for a fixed number of years. If the owner or his/her spouse survives the term of the loan, the bank cannot take possession of the house. Once the last survivor of the loan dies or if they express a need to shift to an old age home or to any other place of residence, the bank will start the process for recovery of the loan. The bank will first approach the borrowers (in case they are alive) or their legal heirs to repay the loan with interest. In case they are not interested or unable to do so, the bank will sell the house and recover the loan amount along with the interest. Any additional money received from the sale of the house will be paid to the owner (in case he/she is alive) or to the heirs of the owner.

If you are buying a house in an apartment complex, do find out if the rate quoted is for carpet, built-up, or super-built up area. The price of the house can vary depending on how the area is being measured.

In today's times where children live separately from parents, reverse mortgage could be an ideal scheme for senior citizens who want a regular income without wanting to sell off their house.

A reverse mortgage scheme is only available for home owners who are 60 years old and above. If your spouse is a co-owner of the house and is older than 55 years then he/she can be made a co-applicant to the loan. In such a case, the survivor among the two will continue to receive EMIs till their demise. Do note that irrespective of whether you apply singly or jointly, the bank will sell the house only on demise of the last surviving spouse or if they decide to give up their house on their own.

Reverse mortgage has been very popular in western countries as it allows retired and senior citizens to live a comfortable life on the value of their home. Since the amount received is considered a loan and not an income, it doesn't attract any tax either. In today's times where children live separately from parents, reverse mortgage could be an ideal scheme for senior citizens who want a regular income without wanting to sell off their house.

HOW TO INVEST IN REAL ESTATE

1. Don't believe everything you hear. Go and inspect the place. Ask for documentation. Check the locality. Remember, there are no shortcuts in this investment.

2. Don't let emotions override your financial concerns. Have a plan; decide on the maximum amount over which you will not invest.

3. If you're going to take a loan, go in for a pre-approved one or find out the maximum amount of loan you're eligible for or can afford.

4. Make sure the property has all the legal documentation in place.

5. If you aren't sure how things work, take the help of someone who understands it before you make a decision.

POINTS TO CONSIDER BEFORE INVESTING

1. Does the property you're planning to buy serve the purpose for which you're buying it?

2. Does everyone involved in the buying decision agree that it's the best option for the price you're paying?

3. Are you sure about how you intend to pay back the loan?

4. Does the property have all documentation and approvals required to make a legal transaction?

5. Have you considered the extra expenses that could increase your cost of buying? This includes the cost of documentation, agent commissions, legal fees, etc.

6. If you're renting out the place, ensure that you do a background check on your tenants before signing the deal.

ADVANTAGES

1. One has easier access to a loan when buying real estate.

2. Investing in a home can offer long-term tax benefits.

3. Real estate is something you can use even if its value decreases. It will not

disappear the way an investment in a bad stock can. It is therefore much more reliable.

DISADVANTAGES

1. You need to do a lot of groundwork and get personally involved to invest in real estate.

2. Investment in real estate is not a one-time activity. You'll need to spend on maintenance to ensure that it retains its value.

3. Your investment could get tied down for a long time if there is a real estate crash.

INVESTMENT METER

It is not possible to offer an investment meter for this as safety, liquidity, and returns can vary hugely from one property to another throughout the country.

TAX IMPACT

If you're investing in a home for yourself and are financing it through a home loan, you can avail of substantial tax benefits. Let's understand how.

The EMI that you pay on your home loan consists of two parts: a part of the amount is actual repayment of the loan amount (principal) while the other part of the EMI is the interest you pay on the loan amount. You can see this break-up when you receive your EMI statement. Both these components of the EMI offer tax benefits, although under different sections of the Income Tax Act and for varying amounts. Under Section 80C of the Income Tax Act, you can claim a deduction of up to ₹ 1.5 lakh on the principal amount you repay and under Section 24(b), you can claim deduction up to ₹ 2 lakh towards the interest paid. Along with other investments and expenditures, principal repayment is one of the expenses eligible for deduction under Section 80C. The total deduction cannot exceed the current limit of ₹ 1,50,000 under Section 80C.

To consider an example, if you're paying an EMI of ₹ 10,000, where the interest component is ₹ 9,000 and the principal-reducing amount is ₹ 1,000, you'll be paying ₹ 1,08,000 (12 x 9000) as interest and ₹ 12,000 (12 x 1,000) as principal repayment. If your taxable income was ₹ 5 lakh, the deductions under Section 80C and Section 24(b) will reduce it to ₹ 3,80,000 (5 lakh - 1.20 lakh). So now, you'll have to pay tax only on ₹ 3,80,000 instead of ₹ 5 lakh. (Please note that in this example, under Section 80C, only principal repayment of ₹ 12,000 is considered.

An individual can invest in other investment options and claim deductions up to a maximum of ₹ 1,50,000 under Section 80C of the Income Tax Act.)

JOINT HOME LOANS

In case you opt for a joint home loan, then both co-owners can avail of the tax benefit of ₹ 1.5 lakh on the principal amount and ₹ 2 lakh on the interest paid per year. The total tax benefit will also be twice that amount (the tax benefits can be ₹ 3 lakh for the principal amount and ₹ 4 lakh on the interest amount). Do note, however, that the tax benefit should be claimed in the ratio of the ownership of the home loan i.e. the same amount cannot be claimed by both for tax deduction. For example, if a husband and wife share the home loan in a ratio of 60:40, the tax deduction should also be claimed in the ratio of 60:40. To illustrate, if the total interest and principal repayments for the year are ₹ 3,00,000 and ₹ 1,00,000 respectively then the husband can claim a deduction of ₹ 1,80,000 (Section 24b) and ₹ 60,000 (Section 80C) while the wife can claim a deduction of ₹ 1,20,000 (Section 24b) and ₹ 40,000 (Section 80C) on the interest and principal components, respectively. In case the shareholding ratio is not mentioned, they can execute an agreement on stamp paper mentioning the shareholding ratio.

In case you opt for a joint home loan, then both co-owners can avail of the tax benefit of ₹ 1.5 lakh on the principal amount and ₹ 2 lakh on the interest paid per year. The total tax benefit will also be twice that amount.

TERMS AND CONDITIONS FOR TAX BENEFIT

The tax benefits offered under Section 80C is subject to the condition that the house is not sold before a period of five years from the end of the financial year in which you bought it. For example, if you bought the house in December 2005, the financial year would end on March 31, 2006. To enjoy the tax benefits, you should sell the house after March 31, 2011. If you sell the house earlier, the tax deduction that you had claimed under Section 80C during the previous years will be added to your income for the current financial year and you'll have to pay tax on it. Tax benefits on interest deduction under Section 24(b) will however remain.

Prior to Budget 2017, under Section 71 of the Income Tax Act, you could earn tax deduction on the entire interest you paid on your second home loan. There was no upper limit and investors could reduce their tax payable by deducting this interest from the income they earned through salaries, business income and capital gains. In Budget 2017, this limit has now been capped to ₹ 2 lakh per year with the addition of a new sub-section (3A) to Section 71. As per the new rule, investors can only deduct a maximum of ₹ 2 lakh per year and in case the interest

paid is higher, then the remaining amount can be deducted for up to eight consecutive years against income arising from house property. For example, if the interest you’re paying on your second home loan is ₹ 6 lakh per year and you’re receiving rental income of ₹ 1 lakh then you can claim tax deduction on the remaining ₹ 5 lakh as loss under income from home property over a period of 8 years.

Earlier, you could have offset the entire amount (₹ 5 lakh) against your income in the same financial year. For financial year 2017-18, you can only offset ₹ 2 lakh against your income; the remaining 3 lakh will have to be adjusted in the forthcoming financial years if there is income from house property. In case of second homes, you'll have to show that you have rented out this property and that you’re paying income tax on it, irrespective of whether it has been rented out or not.

LOANS FOR UNDER-CONSTRUCTION HOMES

For those who have taken a loan for an under-construction house, taking advantage of tax deductions works in a slightly different manner. In case of under-construction homes, banks usually make partial disbursements of the total loan amount at specific time intervals, depending on the stage of construction. The amount you repay the bank during this period is called pre-EMI as you're only repaying the interest on the amounts being disbursed by the bank during this period. The total loan amount gets paid by the bank to the builder when you receive possession of the house. And that's when your actual EMI starts. This EMI that you pay is made up of principal repayment and interest payment.

It's important to note that you can claim deduction only on the interest that you paid before getting possession; in case your pre-EMI had a principal component, then you cannot claim deduction on it and you will have to forgo tax benefits on that amount.

Once you receive possession of the house, you can claim tax deductions under Section 80C for principal repayment and under Section 24(b) for interest paid. It's during this period that you can claim tax deduction for the pre-EMIs (only interest) you've paid earlier. But you cannot claim the deduction in one year itself. Income tax laws allow you to club just 1/5th or 20% of the total pre-EMI that you've paid (spread over 5 years) along with interest amount for the current year under Section 24(b). The limit of ₹ 2 lakh exists for such a combination whether it is going to be self-occupied or rented out.

Let's understand this with an example: suppose your total home loan is ₹ 25 lakh but since your home is under construction, the bank had agreed to pay the builder an initial amount of ₹ 10 lakh during the first year of construction and another ₹ 10 lakh at the end of the second year. The final ₹ 5 lakh will be given in the third year when construction will be complete and you'll receive possession of the house. In this case, assume that you had to pay a pre-EMI amount of ₹ 1 lakh

in the first year and ₹ 2 lakh in the second year. So you've paid a total of ₹ 3 lakh as pre-EMI. Now, you can claim tax deduction on this amount you've paid by adding ₹ 60,000 (1/5th of ₹ 3 lakh) to the current interest amount you're paying for the financial year under Section 24(b). You can keep claiming tax deduction on ₹ 60,000 per year for a total of five years.

SHORT TERM AND LONG TERM CAPITAL GAINS

If you sell your house before the end of two years of buying it, you'll have to pay short-term capital gains. The profit you earn will be added to your income and you'll have to pay tax based on the tax bracket you belong to. In case you sell it after two years, the profit you earn will be considered as long-term capital gains. In case of long-term capital gains, you can reduce the amount of tax you pay by claiming the benefit of indexation which adjusts your buying price for inflation. Indexation is calculated by using the Cost-Inflation-Index (CII) that is announced by the Income Tax department. Let's understand this with an example.

Suppose you bought a house for ₹ 25 lakh in FY 2001-02 and sold it for ₹ 50 lakh in FY 2007-08 (after 6 years). Since you've sold it after a period of more than 3 years, you'll have to pay long-term capital gains tax on the profit you earned. Now, without indexation, your profit will be ₹ 25 lakh (₹ 50 lakh — ₹ 25 lakh). With long term capital gains tax at 20%, you'd have to pay ₹ 5 lakh as tax on the profit you earned. But with indexation,your buying price gets adjusted and the tax amount will get reduced. The government had announced a CII of 100 for 2001-02 and 129 for 2007-08 (refer to the Cost Inflation Index (CII) Table).

The formula for adjusting cost price is:

Cost price (CP) x (CII of year of Sale / CII of year of Buying).

Adjusted CP thus becomes: 2500000 x (129/100) = 32,25,000

So the cost price of your house after accounting for indexation will be ₹ 32,25,000. The long-term capital gain on your home will therefore become ₹ 17,75,000 (₹ 50 lakh - ₹ 32,25,000).

You'll thus end up paying tax of ₹ 3,55,000 (20% on the indexed profit). Indexation thus considers the effect of inflation over the years on prices and ensures that you pay tax at an adjusted rate.

FOLLOWING IS THE CII ANNOUNCED FOR VARIOUS FINANCIAL YEARS, FROM 2001 ONWARDS:

Year	CII	Year	CII	Year	CII
2001-02	100	2007-08	129	2013-14	220
2002-03	105	2008-09	137	2014-15	240
2003-04	109	2009-10	148	2015-16	254
2004-05	113	2010-11	167	2016-17	264

2005-06	117	2011-12	184	2017-18	272
2006-07	122	2012-13	200		

You can avail of tax exemption on long-term capital gains if you invest the profit amount (₹ 16,07,143 in the above example) in a new house—either one year prior to or two years after the sale of the previous house. In case you invest in an under-construction home then the construction of the house should be completed within three years from the sale of the previous home to get tax benefits. During the period that it takes you to buy or build a new home for investing the capital gains, you should deposit the profit in a special account called the Capital Gain Account Scheme (CGAS) with any bank. You should use the amount in this account only to pay for your new home to ensure that the capital gains is tax-free.

If you do not plan to buy a home with the profit earned, you can also save tax by investing the profit in capital gains tax saving bonds under section 54EC. NHAI (National Highway Authority of India) and REC (Rural Electrification Corporation) issue such bonds; you can invest up to a maximum of ₹ 50 lakh per financial year. You can also invest just a part of the profits and pay tax on the rest.

In addition to Section 80C and 24(b), Budget 2017-18 reintroduced tax deduction benefits of ₹ 50,000 under Section 80EE if the loan satisfies certain criteria as follows:

1. The purchaser should be a first-time buyer. On the date of sanction of loan, the individual should not own any residential property.

2. The value of the house should not exceed ₹ 50 lakh.

3. Loan amount should not exceed ₹ 35 lakh.

4. Loan should be from a Financial Institution or Housing Finance Company.

5. Loan should have been sanctioned between April 1, 2016 and March 31, 2017.

If the home loan you've availed of meets these conditions, you can claim a tax deduction of ₹ 50 thousand over and above the benefits you enjoy under Section 80C and Section 24(b) every year till repayment of the loan.

This is a very brief overview of taxation on home loans. Please do check with a tax-planning expert before you take any decision.

NOTES

CHAPTER

18

LIFE INSURANCE

Almost everyone I know who is above the age of 25 and earning a steady income has invested in some form of life insurance. I'm sure that's the case with people you know too. If you've just started your career, chances are that you’ve already been approached to invest in an insurance plan. To sum it up, this is one investment you'll have to decide about at some point in your life.

So what exactly is life insurance and why do people have to buy it? Is it really worthwhile or is it an unnecessary expense that can be avoided? How much insurance does one actually need?

Irrespective of whether you've already bought life insurance or are planning to, these are questions you may wonder about.

We'll try to find answers to these questions in this chapter. We’ll also look at the various types of life insurance plans available in the market to help you choose the ones that best meet your needs. Since your choice of life insurance will affect the financial security of those closest to you, it's important to give it enough thought before you choose an insurance plan.

Life insurance is a necessity for anyone who has family members who are financially dependent on them. If you do not have any dependants, life insurance should not be a necessity for you.

THE LIFE INSURANCE CONCEPT

Why should people buy life insurance? To answer this question, let's first understand what life insurance is.

Simply put, life insurance is a contract between you and an insurance company that promises to pay a certain, fixed amount of money (Sum Assured) in case of your demise, to the people you choose (Beneficiaries). In exchange for the company's promise to pay the sum assured to your beneficiaries, you pay the insurance company an amount called a premium, either in instalments or in a lump sum.

The agreement that you have with an insurance company is called a Policy. Every policy is valid for a fixed period of time called the policy tenure. If the Policyholder (the person whose life is being insured) happens to die during this period, the insurance company will pay the beneficiaries the sum assured plus bonuses (if any). In case the policyholder survives the policy tenure, then depending on the terms and conditions of the policy, the company may or may not pay the sum assured along with bonuses (if any) to the policyholder. That is the basic concept of life insurance.

People buy life insurance to ensure that their dependants remain financially secure when they themselves may not be around to provide for them. Safeguarding one's family against financial risk is the main reason why people opt for life insurance. Life insurance is therefore a necessity for anyone who has family members who are financially dependent on them. If you do not have any dependants, life insurance should not be a necessity for you.

MORE THAN JUST INSURANCE

The astonishing fact about life insurance is that even though the primary reason for buying life insurance is to ensure financial security for one's dependants, many people buy life insurance for reasons other than that. Many people buy or continue buying life insurance to take advantage of the income tax benefits under Section 80C of the Income Tax Act. Others do it to get assured returns on maturity. While still others use it as an attractive investment option that will earn them handsome returns once they survive the policy tenure.

Although it's not wrong to use life insurance policies to serve other objectives, the primary reason for considering life insurance should be the financial security of dependants. If that purpose gets diluted, the whole rationale for buying life insurance gets compromised. And that's what you as an investor should be aware of when you buy a life insurance policy.

LET'S TRY TO UNDERSTAND THIS WITH AN EXAMPLE

Consider you are 25 years old and in your first job that earns you a salary of ₹ 25,000 per month. Assume that you have dependent parents and a younger sibling who is still studying. Without another earning member in the family, your financial responsibility at the current stage is quite substantial. Now, if you have to consider buying a life insurance policy, and you are presented with two of the following choices, which option would you choose?

Sr. No.	Annual Premium	Tenure	Death Cover	Maturity Benefit
Option 1	₹ 5,000	15 years	₹ 50 Lakh	Nil
Option 2	₹ 25,000	15 years	₹ 5 Lakh Plus Bonus	₹ 5 Lakh Plus Bonus (around 1 lakh)

In the situation described above, I'm sure you'll agree that the two main factors to influence your decision would be: a) the amount you pay as premium and b) the amount your dependants will receive in case of your demise.

If you agree, then Option 1 should automatically be the better choice. In Option 1, by paying a small amount of ₹ 5,000 per year, you will ensure that your family will receive ₹ 50 lakh in case of your demise. This amount, equivalent to 200 times your monthly income, will help them manage their finances for a decent period of time in your absence. Compare this with Option 2, where the sum your beneficiaries receive in case of your demise is ₹ 5 lakh (20 times your monthly income). In spite of the obvious disadvantage, many people choose the second option for the simple reason that they will get some amount in case they survive the period of the policy. So they pay ₹ 25,000 every year for 15 years even though they realise that the amount their family gets in case they die will be inadequate to meet their financial needs.

Investing in the second option may be profitable if you survive the policy period. But, by combining insurance needs with the desire to earn profits, you could be compromising your family's financial security in case the unfortunate event actually occurs. That's something each one of us needs to understand before we buy an insurance policy.

Irrespective of the decision you take, you should always review your life insurance needs at regular intervals. Because our financial condition and needs keep changing, we cannot invest in an insurance policy and consider the issue closed. It may happen that you may have to go for a higher insurance cover after a few years. This would be required if the number of dependants increases or if you have greater financial liabilities. For example, if you have a child or have taken a large home loan, it will be prudent for you to increase your life cover so that your survivors don't have to manage these expenses on their own. In an opposite scenario, where your financial liabilities and dependants reduce, you could look at decreasing your life insurance cover. Such a situation may arise if you have already paid off your home loan or if your children have started earning.

If you treat life insurance as an investment that will offer you peace of mind by guaranteeing financial security for your dependants, then it's a reasonably inexpensive and an easy-to-manage investment option. But if you try to mix it with other objectives, you may find it an expensive proposition over the long run. You'll learn more about these different types of insurance plans further into this chapter.

HOW MUCH INSURANCE SHOULD YOU GET?

The general consensus in the insurance industry is that Indians are under-insured. The average sum assured per policy according to reliable sources is around ₹ 1 lakh. Considering the reason why people buy life insurance, that's the average amount dependants receive on the demise of a breadwinner! One reason for the low average amount could be that most insurance sold in India is a combination of insurance and investment—which turns out to be very expensive (option 2 in the example given earlier). If the majority of Indians would choose insurance of the type described in option 1 instead, which is a pure insurance plan without any investment component, the average insurance cover per policy would have been much higher.

Since the average insured amount is so low, what should be the amount you should insure your life for? There is no ideal figure that suits all. Since the objective of life insurance is to ensure financial stability of your dependants, the amount should be sufficient to meet their future needs. Following are a few methods you could use to arrive at the correct amount.

By combining insurance needs with the desire to earn profits, you could be compromising your family's financial security in case the unfortunate event actually occurs.

INCOME MULTIPLE METHOD

This is the simplest of all methods. Here, people go for multiples of anywhere between five to ten times their annual income to decide the amount of insurance needed. For example, if your annual income, after paying tax, is ₹ 5 lakh per year, you may opt for an insurance cover that's between ₹ 25 lakh (five times the annual income) to ₹ 50 lakh (ten times the annual income).

INCOME REPLACEMENT METHOD

If a person dies an untimely death, all the income that she would have earned in the future (had she survived) would be lost. So to arrive at the insurance amount, some people take into account the future income they will earn during the remaining working years. This future income amount is discounted in terms of its value today and accordingly the insurance amount is arrived at.

NEED BASED METHOD

A more practical way would be to consider all the financial expenses (day-to-day expenses, children's education, their marriage expenses, spouse's retirement, etc.) and financial liabilities (home loan and other loans) that you foresee for your family in the period that they'll need to become financially independent. So if you

have a home loan of ₹ 20 lakh and you assume that your family will need another ₹ 40 lakh before they become financially stable, you should opt for a cover of ₹ 60 lakh. Although the amount may seem huge and you may be worried about the costs involved, if you keep insurance separate from investing, the costs should be manageable.

Also, you needn't invest in a policy for the entire life cover in one go. You can plan it over a period of time using two or three policies. But don't let the time period drag. The earlier you do it, the lower will be the premiums. Do keep in mind that along with insurance needs, you also have to meet your household expenses as well as invest some money to grow your wealth. Don't let your lifestyle be unduly restricted or your investments be completely cut off simply because of the high premium you pay for your insurance.

Once you decide on the insurance amount, there are various types of insurance plans you can consider.

TYPES OF LIFE INSURANCE

Before we move to the types of plans, let's understand that a life insurance plan offers a combination of these two benefits:

A) DEATH COVER: This is the amount paid by the life insurance company to the beneficiaries if the life insured dies during the tenure of the policy.

B) MATURITY BENEFIT: This is the amount paid by the life insurance company to the life insured if the policyholder survives the entire tenure of the policy.

Based on the way the death and maturity benefits are offered, life insurance plans can be categorised into any one of the following:

1. PURE TERM PLAN

This is the simplest and purest form of life insurance. It is also the least expensive way of insuring your life. In a term policy, you pay a small premium to insure your life for a comparatively higher value. The objective of a Pure Term Plan is simply to insure the financial future of your dependants in case of your demise. It does not offer any maturity benefits. The premium for a term policy is thus much lower than in other policies.

Let's understand it with an example

A 25-year-old person can opt for a pure term insurance cover of ₹ 1 crore for a period of 20 years at an annual premium of approximately ₹ 6,000 per year. If the policyholder dies before the 20 years are up, the beneficiaries get ₹ 1 crore. However, if the policyholder survives the period of 20 years, the insurance company doesn't pay anything to the policyholder. So, effectively, the person ends up buying peace of mind for ₹ 1,20,000 (6,000 x 20) during a period of 20 years.

With a term policy, you don't get any maturity benefits, and the tax benefits are minimal since the premium is lower compared to other insurance types. But you get more cover at a lower premium—and you could use the money you save on the premium to invest in other options that give you better returns. For example, an endowment policy of ₹ 1 crore for the same person would cost around ₹ 1 lakh per annum. In this case, the person could buy term insurance worth ₹ 1 crore for ₹ 6,000 and invest the remaining ₹ 94,000 in pure investment options like stocks, MFs, gold, PPF, FDs, etc. as per her need.

2. WHOLE LIFE PLAN

As the name suggests, this policy remains active as long as the policyholder is alive. The policyholder has to pay the premium throughout her life or till she attains a certain age (as mentioned in the policy terms) and the amount insured is paid to the beneficiaries on her demise.

Whole life policies are for people who are certain that their family or a loved one will remain financially dependent on them, no matter at what age they expire.

An approximate annual premium for a 25-year-old person who wants a cover of ₹ 10 lakh would work out to ₹ 20,000 (the amount is indicative; there can be significant variations in premiums charged by different insurance companies). The reason a whole life policy is more expensive than a term policy is because in term policies, the insurance company has to pay only in case of the demise of the policyholder (since a percentage of term policyholders will survive the period of the policy, the insurance company does not have to pay the sum assured to every policyholder who chooses this option). In a whole life policy, on the other hand, the money has to be paid to the beneficiaries in almost every case—so the insurance company has to pay back an amount for every policy that is sold. Insurance companies therefore charge a higher premium for whole life policies.

> The objective of a Pure Term Plan is simply to insure the financial future of your dependants in case of your demise.

> Whole life policies are for people who are certain that their family or a loved one will remain financially dependent on them, no matter at what age they expire.

3. ENDOWMENT ASSURANCE PLAN

An endowment assurance plan is a combination of an investment plan and term life insurance. The objective of this plan is to provide an assured sum, either in the event of the policyholder's death or at the expiry of the policy. The premium collected for an endowment assurance plan has an investment component also. This investment component is invested by the life insurance company on behalf of the policyholder. The returns earned are shared with the policyholder in the form of bonuses. The bonus amount gets added to the assured amount every year. This bonus amount gets accumulated over the years and is paid along with the sum assured to the beneficiaries in the event of the death of the policyholder during the tenure of the plan. If the policyholder survives the plan tenure, then on maturity, the sum assured is paid along with the accumulated bonuses. (Do note that the bonus amount is not guaranteed and depends on the performance of the assets in which the premium is invested.) Till just a few years back, before the introduction of term policies in a major way, endowment policies were the most popular type of life insurance in India.

Endowment plans may sound attractive, but they may not be the best life insurance option for dependants as you end up paying a high premium for a relatively smaller insurance cover. But if you're looking for a combination of limited insurance and a decent return at the end of the policy tenure, you could consider it.

A typical example of an endowment policy would be where the policyholder takes insurance for ₹ 6 lakh for a period of 15 years. If the policyholder is 25 years old when she takes the policy, she would have to pay a premium of about ₹ 25,000 (amount is indicative; premiums can vary across plans offered by insurance companies) every year till she is 39 years old. If the policyholder dies during this period, her beneficiaries would get ₹ 6 lakh plus the bonus amount accumulated till that time. If the policyholder survives the period, she would get ₹ 6 lakh plus the bonus amount.

The advantage of endowment policies is that you get higher tax benefits since you pay a higher amount of premium and you also get back the money if you survive the policy tenure. This is unlike a term policy where you get no benefits if you survive the policy period, or a whole life policy where only your beneficiaries get the benefit. The drawback is the high premium amount for a much smaller insurance cover. Added to this is the long period for the policy to mature—you don't get back your money till the policy matures (although these schemes may allow you to take a loan after a certain number of premiums have been paid).

4. MONEY BACK POLICY: In this type of insurance plan, the insurance company pays a specified portion of the sum assured at periodic intervals to the policyholder. In addition, the entire sum assured is paid to the beneficiaries in case of the policyholder's demise during the policy tenure (this is irrespective of the amount paid earlier).

Let us understand this with the help of an example.

An individual buys a 20-year money back policy that promises to pay 25% of the sum assured at the end of the 5th, 10th, 15th and 20th years for a sum assured of ₹ 10 lakh. Here, the policyholder will get around ₹ 2.5 lakh at the end of every 5 years for the first 15 years (₹ 2.5 lakh every 5 years adding to ₹ 7.5 lakh), and the remaining amount (₹ 2.5 lakh) plus a bonus on survival of the 20 years. If the policyholder dies before maturity, the beneficiaries will get the guaranteed amount (₹ 10 lakh) plus the accumulated bonus till that date. The guaranteed amount is not reduced even if payments were made earlier to the policyholder.

You need to be a proactive and a knowledgeable investor to make such decisions—as this is also where people make

mistakes with ULIPs.

Money back policies are the most expensive types of life insurance. For a 30-year old who wishes to get an insurance cover of ₹ 10 lakh for 20 years, the premium may work out to around ₹ 60,000 a year (premium is indicative only). This is like an endowment scheme, except that in money back, you get the sum assured at regular intervals, while in endowment you get it only on maturity.

5. ULIPS: Unit Linked Insurance Plans (ULIPs) are a combination of life insurance and mutual funds. In ULIPs, the beneficiaries receive a sum assured or fund value (whichever is higher) in the event of the investor's death. Investments in ULIPs have two components—one part is used as the premium for life insurance while the other part is used as the investment fund.

The investment component of ULIPs works exactly like a mutual fund: your money gets invested in stocks, bonds, government securities, and so on, and you receive units in return. But the best part about ULIPs is that it allows you the flexibility to choose where your money gets invested. And you can change this decision (switching) without any extra charge a few times a year. For example, if you feel stocks are doing well, you could have your investment put in stocks instead of debt. Or you could choose the opposite option if stocks are doing poorly. You could also choose a balanced option—50% in stocks and 50% in debt—or any other ratio. (This kind of flexibility is not available with mutual fund schemes.) Investors prefer ULIPs for the flexibility it offers. However, you need to be a proactive and a knowledgeable investor to make such decisions—as this is also where people make mistakes with ULIPs.

Let's understand ULIPs with an example:

Assume that a person has invested in a ULIP where she pays a premium of ₹ 50,000 for a 20-year ULIP that gives her a life insurance cover of ₹ 12 lakh. In this case, a part of the ₹ 50,000 she pays will form the premium for the insurance cover and other expenses, while the rest will get invested in various investment options. At the end of 5 years, assume that the value of her investments is ₹ 3 lakh. If she dies around this period, her beneficiaries would get the sum assured—i.e. ₹ 12 lakh. However, if she dies around the 8th year and the value of her investments was around ₹ 12.5 lakh (greater than the sum insured), her beneficiaries would get ₹ 12.5 lakh and not ₹ 12 lakh.

This is how most ULIPs work: the beneficiaries receive the higher of the two amounts—the sum assured or the value of investments. Such ULIPs are also called Type 1 ULIPs.

A Type 2 ULIP on the other hand, offers both, the sum of the insurance amount and the value of investments. If we use the same example as above, the

beneficiaries would get ₹ 15 lakh (12 lakh + 3 lakh if the policyholder dies during the 5th year) or ₹ 24.5 lakh (12 lakh + 12.5 lakh if the policyholder dies during the 8th year), respectively.

If you're looking for greater insurance cover, Type 2 would be a better option. However, in Type 2 ULIPs, a higher percentage of your money gets diverted to your life insurance component, so your investment component will be less. For example, if ₹ 5,000 was your insurance component in a Type 1 ULIP, it may be ₹ 10,000 in Type 2. Note that if the investor survives the period of the ULIP, she will receive only the investment component (fund value) on maturity.

ULIPs are not the simplest of investment options. If you plan to invest in ULIPs, do make sure you understand all the aspects of investing in it—the charges applied, the insurance component, the flexibility to switch between investment types, and so on. Also note that ULIPs may have management costs, so make sure you invest for the long term to get the maximum benefit from your investments. ULIPs also have exit charges (surrender charges)—in case you decide to exit your ULIP before maturity.

6. CHILD PLANS: These are a combination of insurance and investments that are targeted at parents who are planning for their children's future. Although a few schemes insure the life of the child, in the majority of schemes, it's the lives of the parents that are insured. Most child plans are variations of ULIPs, endowment or money back schemes explained earlier in the chapter.

Like any life insurance, in the event of the death of the parent/ child (depending on whose life is insured), the insurance company pays the sum assured to the beneficiary. In most child plans, where the child is the beneficiary, there is a Premium Waiver option that waives off the premium to be paid on the demise of the premium-paying parent. For example, if the policy is for 20 years and if the parent dies after paying the initial few premiums, the policy will continue to be active and the child will get the sum assured plus any bonus incurred at the time of maturity. In some schemes, the sum assured is paid at the time of the death of the parent as well as during maturity. You'll have to check the policy to know the type of benefits offered by a particular child plan. Other child plans, like money back policies, pay a certain amount at periodic intervals that match the various milestones in a child's life like higher education, marriage, etc.

Although traditional child plans (endowment and money back) hold tremendous emotional appeal for parents, the returns offered can be quite low. As a pure investment option, child plans may not be the optimal way to plan for your child's future. If you are adequately insured, investing in a child plan is just another insurance cover for you.

Since the whole purpose of investing in a child plan is to safeguard your child's financial future, do make sure that the numbers are convincing before you decide to invest.

Following is a quick summary of the various types of life insurance scheme that we saw.

OVERVIEW OF TYPES OF LIFE INSURANCE SCHEMES

1. PURE TERM PLANS

Money gets paid only on demise of the policyholder during the period of the policy. No money is paid if policyholder survives the period of the policy. Small premium for high life cover.

2. WHOLE LIFE PLAN

Money gets paid to survivors only at the time of demise of policyholder or after the policyholder attains a certain age. High premiums for low cover.

3. ENDOWMENT PLAN

Money gets paid to survivors on demise of policyholder. Money paid to policyholder on maturity of the policy. High premiums for low cover.

4. MONEY BACK POLICIES

Part of sum assured is paid at regular intervals to policyholder. Plus, entire sum assured paid to beneficiaries on demise of policyholder during policy tenure. Very high premiums for low cover.

5. ULIPS

Combination of life insurance and mutual funds. Money gets paid to survivors on demise of policyholder. Policyholder also receives money on maturity. Potential for good returns but can be complicated to manage for new investors.

6. CHILD PLANS

Combination of insurance and investments targeted at parents of young childern. Should be ignored if one already has adequate insurance cover.

DECIDING ON THE RIGHT INSURANCE SCHEME

You'll notice that there is a huge difference in the premiums paid for a term policy and every other type of insurance. Many investors prefer to opt for a term policy and invest the difference in other investment options. For example, instead of investing in an endowment policy that offers them ₹ 10 lakh sum assured for a premium of ₹ 50,000, they may opt for a term policy with a cover of ₹ 50 lakh, paying a premium of around ₹ 5,000 per year for it and then investing the difference (₹ 50,000 – 5,000 = ₹ 45,000) separately in other investment avenues like stocks, mutual funds or fixed deposits to earn higher returns.

Such investors keep their investments and life insurance cover separate. The major advantage of keeping both separate is that in the event of a financial crisis (job loss, career break, business failure, etc.), you can stop your investments without worrying about paying your term life insurance premium which will be quite low. This way, your life cover continues even through the financial downturn. On the other hand, if your life insurance and investments are clubbed together (e.g. in a ULIP or an endowment scheme) and if you're unable to pay the high premiums for any reason, you may stop paying the high premium and end up losing your life cover, too. So weigh your options before you buy life insurance.

Because income, security needs and number of dependants change with time, life insurance decisions may also need to be reviewed and acted upon accordingly. If you have a young family, home loans to repay, and so on, opt for a higher insurance cover—a term policy is the simplest and least expensive. If the needs of your dependants are lower, you could opt for an endowment or a ULIP, both of which offer returns along with some insurance cover. Along with basic insurance cover, some insurance policies pay an additional amount if the policyholder's death is caused by an accident while some policies also cover permanent disability and critical illnesses on paying a slightly higher premium—these additions or modifications to life insurance are called riders and must be added at the time of buying the policy. Riders are additional benefits that are offered along with base plans, and are optional.

By adding riders to the base plan, the insurance requirement can be customised to suit one’s need. In case the policyholder suffers an accident or is diagnosed with a critical illness like cancer, she is paid a specified sum as per the rider terms and conditions. Weigh your insurance needs along with your investment needs to arrive at the right decision so that you have adequate finances for your retirement years.

FREE LOOK PERIOD

Every insurance company offers you a minimum period of 15 days from the day you receive the insurance policy to check if the policy issued to you is as per your requirement. If at any time during this period you feel the policy does not match with what was asked for, you can ask for modifications to the policy or even return the policy and get your premium refunded (the insurance company may deduct medical check-up charges, if any, stamp duty and mortality charges for the number of days the policy was active). Ideally, you should do your homework and ensure that you buy the right policy instead of analysing it after you've bought it. But even if you've done your homework and bought the right policy, use the 15-day time period to check all details and study the fine print so that you are sure that you've received the right policy in every way. If in doubt, ask for clarifications. If you're not satisfied with the replies, you have the option to ask for changes or even to return the policy.

The 15-day free look period starts from the day you receive the policy document. It is a right offered to you by insurance companies, so do make full use of it.

SURRENDERING A POLICY

If you've bought a policy many years ago and you realise that it is not serving the purpose for which it was bought, you have the option of surrendering your policy to the insurance company. When you surrender your policy, you have the option of either receiving the surrender value or converting your policy into a paid-up policy.

WHAT IS THE DIFFERENCE?

When you surrender a policy (non-ULIP), you receive part of the premium (surrender value) you paid over the years. If you've paid premiums for less than 3 years, you'll not receive any surrender value (yes, you'll not receive any money, irrespective of the amount you paid). If you've paid premiums for at least 3 years, then you will receive some part of the premium based on the computation of the surrender value done by the insurance company. The greater the number of premiums you've paid, the more the amount you would get on surrendering. But be aware that the amount you get on surrendering your policy may well be lower than the amount you've paid as premium over the years. So consider surrendering your policy only if you have very convincing reasons to do so.

Because income, security needs and number of dependants change with time, life insurance decisions may also need to be reviewed and acted upon accordingly.

In case of ULIPs bought before September 1, 2010, you can surrender your policy within 3 years and receive some money (although it will be negligible). For ULIPs bought on or after this date, the lock-in period for surrendering is 5 years (policy term 10 years or less) or 6 years (for policy term more than 10 years). The good news is that there will be no deductions made from your fund value. You can also surrender your new ULIPs before the end of the lock-in period if you wish. However, in this case you will get the surrender value only after the lock-in period (as mentioned above) and your money will only earn 4% interest during this period.

The other option is to convert an insurance policy to a paid-up policy. This option is available only if you've paid premiums for at least three years. In this case, after you stop paying further premiums, the policy remains active for a reduced sum assured based on the premiums paid so far. The maturity period will be the original period of the policy and you'll get the reduced sum assured at the maturity of the policy. Your beneficiaries will also receive the reduced sum assured in case of your demise. ULIPs bought after September 1, 2010 cannot be converted to paid-up policies; they can only be surrendered.

PENSION PLANS AND ANNUITIES

Apart from insurance plans that we have already studied in this chapter, there are Pension Plans (also called Retirement or Annuity Plans) that are offered by life insurance companies. These plans provide you a steady income during your retirement years. Some pension plans may also offer life insurance cover.

The primary difference between life insurance and pension plans is that life insurance aims to provide financial security to your dependants in case of your demise while pension plans aim to provide financial security to you in case you live a long, retired life. Both of them are critical for leading a financially stable life —although equally critical are the schemes you choose to invest in.

HOW PENSION PLANS WORK

Pension plans are exactly the reverse of a typical life insurance plan. In an insurance plan, you make regular payments to the insurance company and on death the insurance company pays a lump sum amount to the beneficiary. In a pension plan, the exact opposite of the above process happens. The applicant pays an amount (either lump sum or in instalments) to the insurance company in the beginning and the insurance company makes regular payments to her after retirement. On the death of the applicant, the payment may or may not stop depending on the scheme. There are different variants in pension plans that are offered by life insurance companies. Let us have a look at them in detail.

A pension plan has two stages: the first stage is where you contribute to the plan in the form of premiums (Accumulation phase) and the second stage is where you receive pension at regular periods (Annuity phase) from the date of your retirement. In the accumulation phase, you pay the money to the insurance company as either a lump sum amount or make regular payments over a period of time. For example, at the age of 40, you may decide to invest in a pension plan that requires you to pay a premium of ₹ 50,000 per year till the age of 55 years.The insurance company will invest the premium that you pay every year and after you reach the age of 55 years, it will start paying you a fixed amount on a monthly, quarterly, half-yearly or annual basis (based on the payment frequency chosen) till a fixed age or till your demise as per the policy you invested in. You also have the option to withdraw up to 33% of the accumulated funds in a lump sum, before the annuity starts. This is known as Commutation. In such a case, the annuity that you receive will be paid from the remaining funds.

Like life insurance, pension plans also offer flexibility in the way you pay your premium and the way you receive your annuity. Following are some of the options you can choose from:

1. IMMEDIATE ANNUITY PLANS

In this type of plan, instead of making regular contributions over a period of years, you can pay a single lump sum amount and start receiving regular payments from the next year onwards. Since you start receiving regular income

immediately, they are called Immediate Annuity Plans. For example, if you are retiring from your job and you receive an amount of ₹ 15 lakh on retirement, you can invest that in an Immediate Annuity Plan and start receiving regular income from the next year onwards.

2. DEFERRED ANNUITY PLANS

Here, you have the choice of paying the premium in one lump sum or over a period of time. But you'll start receiving regular payments only after a specified number of years. Since the payment is postponed till you reach a specified age, it is called a Deferred Annuity Plan.

There are many options within Pension Plans that you can choose from, depending on your needs:

Annuity payable for life pays you a fixed income at regular intervals (monthly, quarterly, etc. depending on your need) till your demise. On your demise, the insurance company stops paying the annuity. This is ideal for people who do not have any financial dependants.

Annuity for life with guarantee period pays a guaranteed income for a fixed period of time irrespective of whether you survive that period or not. If you die before the guaranteed period, the insurance company continues to pay your beneficiaries the amount till the end of the guaranteed period. In case you survive, you continue receiving the amount till your demise. This is ideal for people who know their family will be financially dependent on them for a fixed number of years, post-retirement.

Annuity for life with return of purchase price is ideal for those who want to leave some money for their survivors. Here, you'll receive an income till your demise. On your demise, the insurance company will return to your beneficiaries the amount you had invested in your annuity.

Joint life and last survivor annuity is where you will receive the annuities, but in case of your demise, your spouse will continue to receive the annuities till his demise.

Annuity with increase at a fixed rate increases your annual annuity pay-out by a certain percentage. The objective of such annuities is to counter some of the effects of inflation by increasing the pay-outs every year.

During the contribution stage, pension plans can be with or without life insurance cover. If it has life insurance included, then the sum assured will be paid to your beneficiaries in case of your demise, irrespective of the amount you've contributed. If the pension plan is without life insurance, then only the amount accumulated will be paid to the beneficiaries. But as with everything, you will have to pay for the life cover. So pension plans with insurance cover will earn you lower pension as compared to pension plans without insurance. Ideally, you

should invest in life insurance separately and have a pension plan that specifically meets only your retirement needs.

As explained earlier, the objective of pension plans is to provide you with regular income during your retirement years. The age at which you plan to retire and start receiving annuities is for you to decide. Since pension plans are managed by life insurance companies on your behalf, there are administrative costs along with management fees, etc. that can bring down your returns. Although returns can be low due to these expenses, the advantage of pension plans is that they force you to invest a particular amount for your retirement years. Other investment options like mutual funds, PPF, NSCs, etc. may offer higher returns, but since they don't force you to invest a specific amount, you may neglect your commitments and thus find yourself short of funds at retirement. But if you are confident of investing on your own, you could opt for a combination of schemes to take care of your retirement years. On retirement, you could invest your funds into a Senior Citizens' Savings Scheme (SCSS) or the Post Office Monthly Income Scheme (POMIS) to receive regular income.

Following the guidelines specified by IRDA in November 2011 to the insurance industry on providing clearly defined assured benefits, there have been quite a few pension plans announced in the market. The New Pension Scheme (NPS), managed by the Pension Fund Regulatory and Development Authority (PFRDA), is an option available to all Indian citizens and NRIs from the age of 18; exit is at the age of 60 years. NPS is a mandatory pension scheme for all new employees of the Central Government (except the Armed Forces) appointed on or after January 1, 2004. The most attractive feature of NPS is the low management fees and other expenses incurred. The minimum total amount that you can invest per year is ₹ 6,000 while the minimum amount you can invest at a single time is ₹ 500. There is no limit to the amount you can contribute. You can find more details about NPS at www.pfrda.org.in and by enquiring with LIC, branches of State Bank of India and a few other banking and non-banking institutions approved by PFRDA.

HOW TO BUY INSURANCE POLICIES

1. You can apply for insurance through an agent or even online as most insurance companies today offer services through their websites.

2. Decide on the frequency of premium payments. You can either pay in regular instalments or as a single lump sum.

3. Unlike medical insurance, your policy will not expire if you don't pay the premium by the renewal date. All insurance companies provide a grace period of up to 30 days. A policy may lapse if you don't pay the premium for a particular period. Most insurance companies allow a lapsed policy to be revived on payment of the earlier premium and a minimal penalty. In case of ULIPs, you can revive a lapsed policy within 2 years from the date of lapse. If any discontinuance charges

are levied, they will get deducted from your policy value. The insurance company may, however, ask you to undergo a medical test in some cases.

POINTS TO CONSIDER BEFORE BUYING LIFE INSURANCE

1. Do you have dependants who will be financially affected in the event of your death?

2. What would be the financial impact of your death on your dependants? How much insurance cover would they need to clear pending debts and manage their lives at a reasonable standard of living?

3. How long would it take your dependants to make a financial recovery after your demise?

4. How much premium can you afford to pay at this point of time?

5. How many years from now do you see your dependants becoming self-sufficient? Would you want to take life insurance only up to that period?

ADVANTAGES

1. You can go about your life and plan your future knowing that in case of your death, your dependants will be financially secure.

2. Life insurance premium payments enjoy tax benefits, including deductions under Section 80C. Read 'Tax Impact' at the end of the chapter for more details.

3. The insurance company settles a claim within 30 days of receiving all documents. As per a new IRDA rule, it is mandatory for insurance companies to pay any claim made three years after the commencement of a policy. This new ruling ensures that an insurance company cannot reject any claim made three years after a policy has been issued, for any reason.

DISADVANTAGES

1. As long as you have financial dependants, you should opt for life insurance. Life insurance becomes a disadvantage when you opt for schemes that aim to fulfil your investment or tax-saving objectives instead of meeting your insurance needs.

INVESTMENT METER

Safety: Depends on the track record of the insurance company.

Liquidity: Depends on the insurance type and the plan within that particular insurance type.

Returns: Will vary depending on the type of life insurance chosen (endowment, money back, ULIP, etc.) and the sum offered on maturity. Term policies do not offer any returns.

TAX IMPACT

You can claim deductions up to ₹ 1.5 lakh under Section 80C for the life insurance premiums you pay for yourself, your spouse or your children (the children may be married or unmarried, dependent or financially independent).

As per a new IRDA rule, it is mandatory for insurance companies to pay any claim made three years after the commencement of a policy. They cannot reject a claim for any reason whatsoever.

But not all the premium that you pay for life insurance will be automatically eligible for tax benefits. Under Section 80C, the premium amount eligible for deduction will be limited to 10% of the sum assured on policies bought from April 1, 2012 onwards. For example, if you're paying an annual premium of ₹ 5,000 on your life insurance policy and the sum assured is ₹ 1 lakh or more, then the entire ₹ 5,000 is eligible for tax deduction (since ₹ 5,000 is less than 10% of ₹1,00,000). But suppose you paid ₹ 25,000 as premium and your sum assured was ₹ 2 lakh, then only ₹ 20,000 (10% of 2 lakh) will be eligible for tax deduction. The remaining ₹ 5,000 (25,000 - 20,000) will not be eligible for deduction under Section 80C. For older policies (issued till March 31, 2012), the premium amount eligible for deduction is limited to 20% of the sum assured. So check the date of issue of your policy and calculate the premium available for tax deduction accordingly.

Investors also assume that any sum received on maturity from a life insurance policy is tax-free. Unfortunately, some agents also mention it as a fact. But that is not always the case.

If you've bought your policy before April 1, 2003, then the sum assured you receive is completely tax-free. But under Section 10 10(D), if you bought your investment policy between April 1, 2003 and April 1, 2012, then, for the maturity amount to be tax-free, none of the premiums you paid between those years

should exceed 20% of the sum assured! (The other way of looking at it is that the sum assured should be more than 5 times the premium paid.) If it is less, the amount you receive on maturity will be taxable. For example, if you received a sum of ₹ 1 lakh on maturity, but had paid a premium of more than ₹ 20,000 (20% of ₹ 1 lakh) even once during these years, then the entire amount you receive on maturity will be taxable.

For life insurance policies bought after March 31, 2012, the premiums you pay should not exceed 10% of the sum assured (for every ₹ 1 lakh, the annual premium should not exceed ₹ 10,000). Or, in simpler words, the sum assured should be 10 times or more than the premium paid. Any policy should have been in existence for at least five years for the sum assured to be considered tax-free. However, any amount received on the death of the insured is entirely tax-free, irrespective of the premium paid during any of the years.

Do remember that in case you allow your traditional life insurance policies (endowment, money back, whole life) to lapse within 2 years by not paying further premiums, the sum of all the deductions allowed in the previous years will be cancelled. Plus, the amount deducted under Section 80C will be treated as income for the year in which the policy lapsed. In such a case, you will not only lose the amount you invested (read about Surrendering a Policy earlier in this chapter), you'll also have to return any tax benefits that you earned under Section 80C during those years.

For example, if you've paid a premium of ₹ 20,000 in the first year and thereafter terminated the policy, then the tax benefits which you availed of will be cancelled and that amount will also get added to your income for the current financial year. In the case of ULIPs, you should have paid premium for at least 5 years to ensure that the tax benefits are not revoked. So do ensure you understand the tax impact of the insurance scheme you plan to invest in before taking a decision.

HOW THE PREMIUM YOU PAY DECIDES THE AMOUNT YOU RECEIVE:

Policy bought before April 1, 2003	Policy bought after April 1, 2003 but before April 1, 2012	Policy bought after April 1, 2012	On death
Sum assured is completely tax-free on maturity irrespective of the premium amount.	Sum assured is tax-free if it is less than 5 times the premium paid. This is in case the policyholder survives the policy period.	Sum assured is tax-free if it is is less than 10 times the premium paid. This is in case the policyholder survives the policy period.	Sum assured is completely tax free irrespective of the premium amount paid.
	Example: If sum assured is ₹ 10 lakh then none of the premiums paid should exceed ₹ 2 lakh.	Example: If sum assured is ₹ 10 lakh then none of the premiums paid should exceed ₹ 1 lakh.	

NOTES

CHAPTER
19

HEALTH INSURANCE

"Health is wealth" is an ancient proverb that we've been hearing since childhood. It's such a simple and oft-repeated statement that most of the time it hardly registers. Sure, health is a valuable asset, we'd agree, but the actual correlation between health and wealth becomes clear only when either we or someone in the family undergoes hospitalisation. That's when we realise the value of health in real monetary terms.

According to a World Health Organization (WHO) study, almost 40% of Indian families end up in debt due to health-related expenses. The same report declares, that of these, around 16% of families would slip below the poverty line trying to meet healthcare expenditures. The report mentions many instances where a family has had to dispose of their life savings and in some cases, even sell their home, to meet medical expenses. Anyone who has spent money on a major illness or accident would immediately identify with this report.

For those who have been lucky enough to escape serious medical care expenses, the warning bells about huge expenditures may seem unnecessarily alarming. But the numbers are there for all to see.

To understand how medical costs can affect your finances, have a look at the expenses that you could incur for some of the major ailments that require hospitalisation:

Sr. No.	Reason for Hospitalisation	Costs in ₹
1	Cancer diagnostics	50,000 to 1 lakh
2	Chemotherapy sessions	70,000 per cycle
3	Radiation sessions	1 lakh per cycle
4	Knee replacement	3 to 5 lakh
5	Heart surgery	2.5 to 5 lakh
6	Organ transplant	20 to 30 lakh

Although healthcare costs will vary based on the hospital, location,

specialization, etc., these costs continue to rise with each passing year. Even hospitalisation for a simple procedure at a private hospital will set you back by a minimum of ₹ 30,000 to ₹ 40,000. With medical inflation increasing every year—around 15-20% per year—these costs will only become higher in the coming years.

Why are medical costs so high? Simply said, the miracle of modern medicine does not come cheap; the costs of various facilities, new technologies, medicines and quality medical professionals are huge expenses that hospitals can only recover from patients. In addition, they also have to make a profit. So unless there are drastic changes in the way hospitals are run or medicines are priced, medical bills will continue to remain high. Although we cannot change the way hospitals are run and how pharmaceutical companies charge for their medicines, the good news is that we can certainly take steps to ensure that hospitalisation expenses have a minimal impact on our finances. The best way to do that today is by buying health insurance.

THE HEALTH INSURANCE CONCEPT

As a concept, health insurance works on the basic principle of insurance: people pool in money with an insurance company which then provides the money to those in need. A health insurance policy is valid for a fixed period of one or more years at a time. In case you are hospitalised during this period, the insurance company will either directly pay the hospital for the treatment or reimburse the amount you paid the hospital. The amount you receive and the conditions for payment will depend on the policy you have taken. During the period of the policy, you can undergo multiple hospitalisations and make those many claims—provided the amount you claim is within the amount you are eligible for. To understand this with an example, if you have health insurance worth ₹ 5 lakh valid between February 1, 2017 and January 31, 2018 and if you claim hospitalisation expenses of ₹ 2 lakh in March 2017, you can still make a claim for the remaining ₹ 3 lakh before January 31, 2018.

Do note that at the end of a policy period, if you have not been hospitalised and therefore do not make any claim, you will not get back the money you paid. You may however receive a bonus in the way of an increase in the insurance amount for not making a claim. For example, if you had a health insurance worth ₹ 5 lakh, a 10% bonus will increase your cover to ₹ 5.5 lakh. At the end of the period of the policy, you can renew your insurance for the next one year/few years by paying your part of the premium. By paying the premiums, you keep the policy active till you reach the age at which the policy expires (although many policies can be continued for a lifetime). The premium amount usually increases with your age and the number of claims you make.

Do note that at the end of a policy period, if you have not been hospitalised and therefore do not make any claim, you will not get back the money you paid.

A HEALTH INSURANCE POLICY USUALLY COVERS THE FOLLOWING:

1. Room and boarding expenses

2. Fees of the surgeon, anaesthesiologist, physician and consulting physician

3. Nursing expenses

4. Anaesthesia, blood, oxygen, operation theatre charges, surgical appliances, medicines, drugs, diagnostic materials, X-ray, dialysis, chemotherapy, radiotherapy, cost of pacemaker, artificial limbs, cost of organs and similar expenses

5. Expenses incurred prior and post hospitalisation up to a certain number of days. The number of days covered will vary across policies.

Once you've accepted that you need health insurance, the challenge lies in understanding the kind of insurance you should buy. That and the various ways you can make health insurance work for you is what this chapter will focus on. Remember that there are many plans available in the market and it is your duty to understand what you need and buy accordingly. The time that you spend in choosing the right medical plan can save you a lot of time, money and anxiety, later.

TYPES OF HEALTH INSURANCE

Health insurance policies are primarily of two types: **Individual policies** and **Family Floater policies.**

INDIVIDUAL HEALTH INSURANCE POLICY

As the name suggests, this is a policy where each individual has a separate health insurance cover (the amount the insurance company will pay against your hospitalisation expense). So if there are five members in the family, each member of the family will have a separate policy with their individual health insurance cover. Depending on various factors like age, gender, medical history, profession and so on, each member will also pay a different premium (the annual amount to be paid for keeping the health insurance active).

For example, a family consisting of a couple, a child and two senior citizens may have insurance covers worth ₹ 3 lakh each for the couple, ₹ 5 lakh for the senior citizens and ₹ 3 lakh for the child. The annual premiums for them could be ₹ 5,000 each for the couple, ₹ 15,000 each for the senior citizens and ₹ 2,000 for the child. The total combined premium will be ₹ 42,000 per year.

Sr. No.	Policyholder	Insurance Cover (₹)	Premium (₹)
1	Wife	3 lakh	5,000
2	Husband	3 lakh	5,000
3	Senior Citizen -1	5 lakh	15,000
4	Senior Citizen -2	5 lakh	15,000
5	Child	3 lakh	2,000
			42,000

Note: The above prices are indicative and market rates will vary depending on the policy and the insurer.

FAMILY FLOATER HEALTH INSURANCE POLICY

In case of family floater health insurance policy, there is a main policyholder who is the owner of the policy and additional members of the family get insured along with the policy owner. Unlike individual policies where you can have different cover amounts for each member, in a family floater policy, there is a common cover for the whole family. For example, the same family above can take a family floater policy of ₹ 5 lakh for a premium of around ₹ 30,000. You'll notice that the medical cover is higher at ₹ 5 lakh (in the earlier example, only senior citizens had a cover of ₹ 5 lakh) and the premium (₹ 30,000) is lower than the combined premium in the first example (₹ 42,000). Although this may seem attractive, you should be aware that in this case, the medical cover is not ₹ 5 lakh for each member of the family. Instead, it is the total reimbursement that the family can claim for all hospitalisation expenses incurred during the period of the policy. For example, if someone in the family undergoes hospitalisation at the beginning of the year and gets reimbursed ₹ 3 lakh, the entire family can only make a claim of the balance ₹ 2 lakh during the remainder of the year.

Sr. No.	Policyholder	Insurance Cover (₹)	Premium (₹)
1	Wife		
2	Husband		
3	Senior Citizen -1	5 lakh	30,000
4	Senior Citizen -2		
5	Child		
			30,000

Note: The above prices are indicative and market rates will vary depending on the policy and the insurer.

Whether you opt for an individual or a family floater policy is up to you. There are a few pros and cons that you should be aware of before you decide.

INDIVIDUAL POLICY VERSUS FAMILY FLOATER POLICY

1. A family floater policy may seem a smart option, but it carries an inherent risk. If more than one member of the family undergoes hospitalisation within the year, the cover may not be enough; you may end up having to pay for hospitalisation and medical care from your own pocket. To overcome this concern, some policies replenish the cover under certain conditions. For example, they'd provide a similar amount as cover if the treatment was not for an illness for which they had earlier claimed reimbursement. Some policies replenish it in case of critical illness or accidents, etc. You will have to check if your medical policy provides this facility as it's not a normal feature of all family floater policies. Without this additional feature, you will have to pay money from your own savings in case the medical bill for the year exceeds the insurance cover.

2. If you have senior citizens in your family, the chances of making a claim will always be higher. This may leave the other members of the family underinsured. With regular claims made on behalf of the senior citizens, the family will also miss out on any no-claim benefits (usually a bonus that increases the amount of health insurance) that the plan offers. In such a case, it's always better to have separate policies for the senior citizens and the rest of your family.

3. Floater scheme premiums are calculated on the age of the eldest member of the family. In such a case, it could make the plan expensive for the entire family. Similarly, if someone in the family has a history of smoking, heart attack, diabetes, etc. there will be a higher premium charged for the policy.

4. Family floater policies are, however, easier to manage. You need to pay a single amount on one date and the cover gets renewed immediately. In case of individual policies, if you have bought them at intervals, you may have to pay individual premiums on different dates. In such a case, you will have to remember these individual dates and renew the policies on time. Although most health insurance policies offer a grace period of around 30 days, you should renew the policy before it expires to enjoy any eligible benefits like a no-claim bonus and to avoid the possibility of your claim being rejected due to non-renewal of the policy. Set up reminders on your mobile or ask a family member or agent to

remind you so that you don't miss renewing your policy on time!

To sum, if you have senior citizens in your family, the chances of them needing medical attention and hospitalisation is higher; in such a case, buying individual health insurance policies for senior citizens will ensure that their expenses are taken care of without burdening the rest of the family. A floater policy would be better for a young family where the chances of more than one or two hospitalisations during the same year will be rare. If your family includes senior citizens as well as young members, you could opt for a family floater scheme for the younger members (couple and children) and individual plans for the seniors.

Although most health insurance policies offer a grace period of around 30 days, you should renew the policy before it expires to enjoy any eligible benefits like a no-claim bonus and to avoid the possibility of your claim being rejected due to non-renewal of the policy.

WAITING PERIOD

Whether you buy Individual or Family health insurance, note that you cannot make a claim immediately on receiving the policy. There is a waiting period, only on completion of which, you can make a claim. This period is usually 30 days from the date of issue of the policy. The waiting period prevents people from buying a policy after being diagnosed with a serious ailment and thus misusing the benefit of health insurance. The exception to this is usually hospitalisation due to accidents where you can make a claim within the waiting period. The waiting period is much longer for any pre-existing diseases that you may have (diabetes, hypertension, ENT disorders, osteoporosis, etc.). Always declare such conditions during the time of buying the policy as non-declaration will lead to rejection when you eventually make a claim. Although declaring existing conditions will make you pay a higher premium and add a waiting period, in the long run, it will turn out to be beneficial as your claims will not be rejected for non-disclosure. The waiting period for pre-existing diseases may range from 1-4 years depending on the policy and the medical history of the individual.

Do note that in case you have more than one medical insurance policy, you cannot claim reimbursements from all of them. You can either make a claim from one or divide the reimbursements amongst them.

BUYING THE RIGHT HEALTH INSURANCE

Buying health insurance is easy. Making sure that you buy the right health insurance is not.

You can buy health insurance online as well as offline. If you visit the website of an insurance company or an online service provider, you will get step-by-step instructions on buying your policy. Similarly, you can request a health insurance agent to help you and you will get all the assistance you need to get the policy you want.

But you need to make sure that you end up buying the right policy. An insurance company considers your age, medical history, the number of pre-existing diseases you have, your family's medical history, your lifestyle, etc. before they offer a policy and arrive at the premium for your cover. You should also do a similar exercise to understand the amount of cover that you'll need.

If you smoke or drink, the chances that you'll face health issues in the future are greater. If you are in a profession that is associated with high mental stress, a lot of travelling, or exposure to physical danger, you should consider buying a higher health insurance cover on an immediate basis. If you are the main or only earning member of your family, you should definitely opt for a high cover. Age is also a factor. If you are young and unmarried, you could opt for a lower insurance cover. You can then keep increasing the cover every few years.

Earlier, most companies would not offer insurance for people above the age of 65. The situation has changed for the better now. Apart from insurance companies, even national banks now offer medical policies for senior citizens. Check out the options available before you make your decision.

THE REIMBURSEMENT PROCESS

There are two ways a health insurance policy reimburses you for the hospitalisation expenses you incur. In the first method, you pay for the expenses and then get the amount reimbursed by filing a claim. To do this, you have to fill a Claim Reimbursement form and attach all documentation related to the hospitalisation along with the bills. The form and other documents are usually submitted to a Third Party Administrator (TPA) which will carry out a due diligence on the documents you submitted (in some cases, you may directly hand over the documents to the insurance company). They may ask you for additional documents or clarifications if needed. Once all queries have been addressed, you will receive a cheque or get the final amount credited directly into your bank account.

The other method is Cashless Hospitalisation where you inform the TPA right at the time of hospitalisation. The TPA will inform the hospital about their willingness to bear the expenses as per the details of your policy. Any difference in the amount paid by the TPA will have to be borne by you. For example, if your sum assured was ₹ 3 lakh and your expenses come up to ₹ 4 lakh, you will have to

pay the difference of ₹ 1 lakh from your own pocket. Sometimes, there might be a difference in amount due to the limits in your policy—for example, the rent for the hospital room or ICU would be more than what is mentioned in your policy. Or there might be sub-limits for certain ailments and procedures. In such cases, you will have to bear the additional cost.

While reimbursement works in all cases, cashless hospitalisation is possible only if the hospital at which you are undergoing treatment is part of the TPA's network of approved hospitals. In case of planned hospitalisation, you can ensure that the hospital you choose is covered by the TPA. In case of emergencies, it may not be possible and you may have to make the payment and get the amount reimbursed later. Cashless hospitalisation has become very popular due to the convenience it offers. It is especially useful in times of emergencies when you are unable to arrange cash at a short notice or if you have to undergo hospitalisation in an unfamiliar city where you may not have the sources to arrange for immediate funds.

For any kind of reimbursement, it's important that you retain all bills, discharge cards, medical reports, laboratory findings, etc. Keep a photocopy of all originals so that in case you misplace a document, there's always a backup that you can refer to and provide proof of. Do note that in case you have more than one medical insurance policy, you cannot claim reimbursements from all of them. You can either make a claim from one or divide the reimbursements amongst them.

THIRD PARTY ADMINISTRATORS (TPAS)

Third Party Administrators or TPAs are IRDA-approved firms that verify claims made by policyholders and ratify the amount to be paid by insurance companies. TPAs have medical specialists on board who co-ordinate with hospitals to assess the need for hospitalisation, the treatment being offered and the costs incurred. While the policy and the final amount are offered by the insurance company, the TPA manages most of the processes involved in settling a claim. The TPA issues an ID card to the individual which is useful at the time of hospitalisation.

CONDITIONS NOT COVERED BY HEALTH INSURANCE

You should be aware that a health insurance policy does not cover any and every hospitalisation expense. Apart from preexisting diseases which are covered after a waiting period, there are certain conditions and treatments that are usually not covered. These include:

1. Dental treatment, except arising out of an accident or requiring hospitalisation
2. Cosmetic, aesthetic and obesity related treatment
3. General debility, sexually transmitted diseases, HIV/AIDS
4. Cost of spectacles, contact lenses, hearing aids
5. Circumcision, cosmetic surgery, plastic surgery (unless required to treat injury

or illness)

6. Vaccination and inoculation

7. Treatment relating to infertility, pregnancy and childbirth

8. Naturopathy treatment

The actual list of exclusions will vary across policies. Group and company policies may, however, cover some of these exclusions.

TOP UP POLICIES

If you feel your existing health insurance cover is inadequate, you can opt for a top up policy instead of increasing the cover of your existing policy or buying another health insurance policy. The benefit of choosing a top up policy instead of going for a new policy or increasing the cover of your existing policy lies in the low premium that you need to pay. For example, if have an existing policy from your employer worth ₹ 3 lakh and you want to increase the cover by another ₹ 5 lakh, you can buy a top up policy by paying a premium that will be around 50% of the actual premium. For example, if the premium for a new ₹ 5 lakh policy was ₹ 10,000, you could get a new top up policy worth ₹ 5 lakh for around ₹ 4,000.

There are a couple of things to remember while buying a top up policy. Almost all top up policies accept a claim only after you've paid a certain amount on your hospitalisation. This is called their threshold limit. For example, if your top up policy has a threshold limit of ₹ 3 lakh, then the first ₹ 3 lakh of your hospitalisation expenses will not be paid by your top up policy. It will reimburse only that amount which is above ₹ 3 lakh. So always make sure that you have a health insurance cover for the threshold limit. Otherwise, you will have to make that payment from your own pocket. Another point to remember is that there are two types of top up policies, Top Ups and Super Top Ups. What's the difference?

In a top up policy, the threshold limit is applied to each individual hospitalisation expense that you incur, while in a super top up, the threshold limit is applied on the sum of all hospitalisation expenses incurred within the year. For example, consider you have a health insurance cover of ₹ 5 lakh which you have kept as the threshold limit. Now, assume that you have two hospitalisation expenses of ₹ 3 lakh and ₹ 4 lakh each in a year. If you have a simple top up policy, you will not be able to make any claim, as the individual expenses were less than the threshold limit of ₹ 5 lakh. With a super top up, the sum of the two hospitalisation expenses would be added (₹ 7 lakh) which is ₹ 2 lakh above the threshold limit. In a super top up policy, you'd be able to claim a reimbursement of ₹ 2 lakh.

FIXED BENEFIT PLANS

While a health insurance policy reimburses hospitalisation and medical care expenses for an illness or accident, it may not always help you overcome all the financial troubles you could face. For example, in case you have to undergo prolonged medical treatment or if you become physically incapable of continuing in your profession due to an accident or illness, then you need additional funds to sustain your medical expenses as well as your daily living costs. This is where Fixed Benefit Plans come in handy.

A Fixed Benefit Plan or Defined Benefit Plan is exactly what it sounds like. It gives you a fixed amount of money to overcome your financial liabilities when you face a medical emergency. There are three main types of fixed benefit plans that you should be aware of. They are:

1. Critical Illness Plan
2. Personal Accident Insurance
3. Hospital Cash Policy

CRITICAL ILLNESS PLAN

A critical illness plan provides additional protection for the policyholder if she is afflicted with a serious illness. With a critical illness plan, the insured is paid a lump sum amount as soon as the disease is diagnosed.

If a person has both Critical Illness and health insurance, the health insurance cover can be used to pay for the hospitalisation while the lump sum payment from Critical Illness cover can pay for other expenses during a period of great emotional and financial stress.

DIFFERENCE BETWEEN HEALTH INSURANCE AND CRITICAL ILLNESS

The objective of health insurance is to reimburse you the hospitalisation costs along with pre and post-hospitalisation expenses. A critical illness cover, on the other hand, provides a lump sum amount on diagnosis of the illness. This is an important difference to understand: health insurance only reimburses what you spend on hospitalisation, which may not be sufficient when you suffer from a critical illness. Receiving a lump sum amount on being diagnosed with a critical illness could help the patient recover from the disease and compensate for any loss of pay during the period of illness.

Many major health diseases are covered by a critical illness cover. But they may vary across policies. Some of the diseases include:

1. Cancer
2. Coronary artery bypass surgery
3. Myocardial infarction (heart attack)
4. Kidney failure (end stage renal failure)
5. Major organ transplant
6. Stroke
7. Permanent paralysis of limbs
8. Heart valve replacement surgery
9. Multiple sclerosis
10. Deafness
11. Loss of speech
12. Major burns

As you can see, surviving these diseases will not only be expensive but will also affect the future earning capacity of an individual. If the individual is the primary earning member, it will have an effect on the entire household. Having adequate critical illness cover will therefore be an important factor in helping the individual as well as the family overcome a difficult emotional and financial situation.

Do note, however, that to make a valid claim, these diseases should match the

conditions exactly as mentioned in the policy. It's therefore important that you check each and every specification and exclusion before you buy a critical illness cover. For example, in case of kidney failure, you cannot make a claim if only one of your kidneys fail. You can make a claim only if it's proven that both your kidneys have failed and you have been advised long-term dialysis or a transplant. Most of the critical illness policies also have a mandatory survival period of 30 days (this period may vary). This condition implies that the insured has to survive a period of 30 days before she can make the claim. If the insured expires before this period, the claim cannot be made. The good news is that some of the new critical plans have no survival period clause. When you opt for a critical illness plan, opt for the one that has minimum or no survival period clause.

Another difference between health insurance and critical illness is that while a health insurance cover continues even after you make a claim, a critical illness policy expires once a claim is made. So you need to choose your cover wisely. In case you already have medical insurance, you can get a critical illness rider added to it or you can buy it separately from the same insurance company or a different one. With premiums around ₹ 5,000 for a ₹ 10 lakh cover for a non-smoking, 30-year-old individual, critical illness plans are quite affordable. In addition, the premium paid is eligible for tax benefits under Section 80D.

PERSONAL ACCIDENT INSURANCE

While health insurance schemes reimburse your medical expenses and critical illness plans pay you a fixed amount on the diagnosis of a critical illness, you may still find yourself in financial difficulties if you suffer an accident that leaves you temporarily or permanently disabled. As per the IRDA, an accident is defined as a "sudden, unforeseen, involuntary event caused by external and visible means".

It is not uncommon to hear of people losing their life or limb due to an accident suffered when travelling, while at work, or any other reason. If the person loses her hand or leg or an eye due to the accident it would seriously impact the livelihood of that person. If the disability is permanent, the person may even become financially dependent on others for a lifetime. A personal accident insurance scheme can overcome the limitations of a health insurance scheme or a critical illness scheme in such a situation. The insured can use the money received to meet their financial obligations or they could invest the money to receive a steady income over the period of their disability.

Like a critical illness plan, a personal accident insurance policy pays a fixed amount if the condition for the claim is met. A personal accident policy claim can be made for any of the following reasons:

1. DEATH DUE TO AN ACCIDENT

The policy pays 100% of the insured amount in case of the demise of the insured in an accident.

2. TOTAL PERMANENT DISABILITY

The policy pays 100% of the sum assured if the insured is disabled for life due to an accident. This could be considered in case the insured loses both hands or feet, or one hand and one foot, or a hand/foot and an eye, or total loss of sight, or total loss of hearing and speech.

3. PERMANENT PARTIAL DISABILITY

If the insured is partially disabled, the policy pays a percentage of the sum assured to the insured. For example, if the insured loses sight in an eye, or one hand or foot, or loss of speech or hearing. The amount may be paid as a lump sum (50% of the sum assured) or in parts (1% of the sum assured for 100 weeks) and so on.

4. TEMPORARY TOTAL DISABILITY

In case the insured is disabled temporarily due to an accident, the policy will pay a certain part of the cover to the insured. For example, the insured may receive 20% of the cover spread over a period of 50 weeks for a fracture or bed rest due to a fall, etc.

The premiums for a personal accidental policy are comparatively lower. For a ₹

10 lakh cover, the premium would be around ₹ 1,500. The premium will be higher for those who work in conditions that are more risk-prone. Doctors, software engineers, teachers, and bankers for example will be considered as professionals with low-risk profiles, while mountaineers, construction workers, miners, jockeys, etc. would be considered as professionals with high-risk profiles.

Do note that accident insurance plans will not provide cover for self-inflicted injuries, suicides or suicide attempts. These plans also exclude injuries caused under the influence of alcohol or suffered during an adventure or sport activity. As usual, do read the exclusions and terms and conditions carefully before you buy a policy. There are no tax benefits for the premium you pay for an accident insurance policy.

HOSPITAL CASH INSURANCE POLICY

A Hospital Cash Insurance policy can be very useful for self-employed professionals and businesspersons as it compensates for the loss of income incurred during the time the insured is hospitalised.

Hospital cash insurance is not an alternative to health insurance. Like top up plans and critical illness policies, it supports an existing health insurance plan. Hospital cash insurance simply pays a certain fixed amount for the number of days you spend in a hospital. If your condition is critical and you are admitted to an ICU or if you have to undergo surgery, you get paid additional amounts. For example, hospital cash insurance may pay ₹ 4,000 per day that you are in a hospital. If you are admitted to an ICU, you will get paid an additional ₹ 4,000 per day. If you undergo surgery, it will pay a flat amount of ₹ 4 lakh. Your actual hospitalisation expenses are not taken into consideration here. You'll get paid a fixed amount, irrespective of how high or low your medical expenses are. Some hospital cash insurance plans cover the cost of certain investigations and nursing expenses and for an additional, fixed number of days that you are out of the hospital. Some plans do not cover surgeries unless they are related to a critical illness.

Like every other type of policy, there are multiple options on offer. If you feel you should opt for hospital cash insurance, do make sure you go through the conditions carefully and do adequate research before you decide on a policy.

HEALTH INSURANCE: YES? NO? HOW MUCH?

If you think that a medical emergency is the last thing that will unsettle your life, think again. You may be physically fit, having a great job, an EMI-free home, sufficient savings, and investments and no family history of family disorders—but a medical emergency could happen anytime and it could strike when you are vulnerable. It could be during that time you are between jobs or when you've just made a huge down payment on a second home and are short of funds. In such a scenario, having to face the expenses of hospitalisation and the psychological uncertainties that accidents or ill health cause, can be a huge challenge. A good health insurance cover will keep you protected from unexpectedly huge medical expenses. Experts recommend that you consider the needs of your family for the next 10-15 years and choose a health insurance option that will take care of their needs to ensure that medical care expenses do not derail your finances.

Many of you may have a health insurance cover from your employer as part of your benefits. You need to remember that the health insurance cover provided by your company stops the moment you leave your job. Even though you may have paid the premium for the whole year, the insurance stops the day you quit the company. It therefore makes sense to have a second health insurance cover to take care of such an eventuality. This can be a smaller cover, but it should be for the entire family. Once you move on to your next job you may once again receive a similar kind of health insurance cover. But if there is a gap of a few months

between the two jobs or if you do not get a job immediately then this backup insurance can be a real life saver. It is also important to note that some companies allow you the option of converting your company insurance to a personal policy once you leave the company. If you get that option, it may be worth buying. Buying a new policy around or after your retirement may include a lot of limitations and exclusions, which you could avoid by having a personal health insurance plan.

People also wonder if they should opt for life insurance first or buy health insurance. Both of them take care of two different needs. Unless finances are a big concern, you should buy both.

But if you are short on money and if you have dependants, then go for term insurance immediately, as loss of life is permanent and irreplaceable. However, no matter how small, do buy a health insurance cover—it will ensure there is some buffer for your finances. You can then keep increasing your life as well as health insurance covers as you go.

You need to remember that the health insurance cover provided by your company stops the moment you leave your job.

GRIEVANCES

There are many instances where a policyholder feels dissatisfied with the amount reimbursed or the way the insurance company handled their claim requests. The reasons for this dissatisfaction could be many. In some cases, people do not read the fine print and realise that their claim is inadmissible or limited by a clause only at the time of claiming the reimbursement. There is not much you can do in such a situation. The only wise thing to do is to spend some time before you buy the policy by reading up and getting familiar with all the terms and conditions so that you do not get a nasty surprise at the time of making a claim.

However, there have been instances where claims were incorrectly processed and insurance companies have erroneously rejected claims or paid inadequate amounts. If it happens with you, there are avenues through which you can get your complaint heard and receive justice. To start, you should submit your complaint to the grievance cell of the insurance company in writing along with the necessary supporting documents. Do collect a written acknowledgement of your complaint. If they are unable to resolve the issue or do not attend to your complaint within 15 days, you can escalate your complaint to the Grievance Redressal Cell of the Insurance Regulatory and Development Authority. You can call them toll free at 18004254732 or 155255. You can also email your complaints at complaints@irda.gov.in or register your complaint online at http://www.igms.irda.gov.in

POINTS TO CONSIDER BEFORE BUYING HEALTH INSURANCE

Checking the premium amount is where most of us start and end. But that shouldn't be the only factor in choosing a health insurance policy. Do look for the following points before you finalise on a policy:

1. How does the policy treat pre-existing diseases? There is usually a waiting period clause for pre-existing diseases that is included in all policies. The period can range from one to four years. The shorter the period, the better it is for you. After this period, all expenses associated with the condition will be reimbursed. You can also check if you can reduce the period by paying an extra premium.

2. If you are newly married or are planning a baby, you may want to choose policies that cover maternity expenses and any complications that may arise during pregnancy.

3. Some policies offer a no-claim bonus. The bonus here is that your cover gets a boost of around 5-10% for every year that you do not make a claim (called a claim-free year). Check how premium amounts vary between policies that offer and those that do not offer this benefit.

4. Check the exclusions mentioned in the policy. Fewer the exclusions, the better it is. Some of these exclusions may also be time-based. Check, compare and then decide.

5. Some policies reimburse you the cost of your annual health check-up after a certain number of continuous claim-free years. Check if this service adds value in terms of the premium you are paying.

6. Check the maximum age up to which you can renew the policy. Most policies offer cover up to the age of 70 years. Others offer up to 80 and even 90 years and some even for your entire lifetime. You will need insurance right through your life so anything less than 75 years should not be considered.

7. If you are a senior citizen or if you are planning to get health insurance for a senior citizen, be prepared to pay high premiums as well as find limits on reimbursement claims. Most policies will also have a co-pay option where you will be required to mandatorily pay a certain percentage of the expenses incurred. For example, a policy will mention that you need to co-pay 30% on all preexisting diseases. In such a case, if the hospitalisation expense is ₹ 1 lakh, you will have to pay ₹ 30,000 while the insurance company will pay ₹ 70,000. Such clauses are unavoidable, but do compare reimbursement limits and co-pay terms before you decide.

ADVANTAGES

1. By paying an annual premium, you ensure that you and your family members receive quality medical service any time during the period of the policy.

2. By buying adequate health insurance cover, you protect your savings and investments from sudden and high medical expenses.

3. You can expect to receive quality medical care anywhere in India even if you do not know anyone at that location and are unable to raise cash at a short notice.

4. With cashless hospitalisation, you can plan the medical treatment of anyone in your family in a manner that causes minimal financial stress.

5. You can transfer your health insurance policy from one company to another if you are not happy with the services you are currently receiving. But premium amounts, benefits, exclusions, etc. should be checked again with the new company before you decide to make the switch. This is an option that is available to you but which should be exercised with extreme caution to ensure that you do not end up losing your existing benefits.

DISADVANTAGES

You may be at a disadvantage if you buy health insurance that will not be of use when you need it most. It is therefore recommended that you go through the fine print, the limits, the various clauses and exclusions before buying a policy. These are two broad conditions that you should consider so that the policy you buy doesn't put you at a disadvantage:

1. Make sure you are buying a policy that provides enough cover at a premium that you can afford. It doesn't make sense to have a policy that has too many limits and exclusions.

2. Your policy should ideally provide lifetime cover. Anything less than 75 years is not to your benefit.

TAX IMPACT

Individuals can claim tax benefits if they have paid health insurance premiums for themselves, their spouse, children and parents. An individual under the age of 60 years can claim deduction under Section 80D for health insurance premium up to ₹ 25,000 for herself, her spouse and children. Out of the total tax deduction benefit of ₹ 25,000, a sum of ₹ 5,000 can be availed for Preventive Health Check-ups. She can further claim a deduction of up to Rs 25,000 under the same section for premiums paid for her parents and ₹ 30,000 if either of her parents are senior citizens. So the total maximum deduction possible is ₹ 60,000 (in case you as well

as your parents are senior citizens).

Most health insurance plans require annual renewals. So the premium you pay is eligible for tax benefits every year. However, if you opt for a plan that is valid for more than one year then the tax benefit is available only for the first year. For example, if you bought a two-year policy worth ₹ 6 lakh and paid ₹ 30,000 as premium, you will receive a cover of ₹ 6 lakh per year—but you can claim tax deduction of ₹ 25,000 (assuming you are not a senior citizen) only for the first year. You cannot claim any tax deduction on health insurance for this policy during the second year.

♦ OVERVIEW OF VARIOUS HEALTH INSURANCE OPTIONS ♦

Policy Type	Reimbursement	Renewal	Making a Claim	Tax benefits
Health Insurance Plan	Reimburses pre and post- hospitalisation expenses up to your cover limit	Can be renewed every year up to a certain age. Some policies can be renewed for a lifetime.	Waiting period of 30 days. Exception made for accidents. Amount paid is reimbursement of actual expenses made.	Tax deductions under Section 80D
Critical Illness Plan	Pays you the total sum assured if the critical illness is as defined in the policy and the insured survives the survival period.	Can be renewed for a lifetime. But policy expires once a claim is made.	Waiting period of around 3 months before you can make a claim. Some policies have a survival period, only after which, can you make a claim. Total sum assured is paid if all conditions are met.	Tax deductions under Section 80D
Personal Accident Plan	Pays you either 100% or part of the sum assured depending on the severity of loss.	Can be renewed for a lifetime. Policy may expire on payout equal to the total sum insured or on death of the insured.	For most policies there is no waiting period. Amount paid will depend on the severity of disability as described in the policy document.	No tax benefits
Hospital Cash Plan	Pays you a daily amount for the number of days the insured is hospitalised.	Can be renewed for a lifetime.	Waiting period of 30 days which is waived off in case of accidents. May have longer waiting period of up to two years for pre-existing diseases.	Tax deductions under Section 80D

NOTES

CHAPTER
20

MAKING A WILL

You've invested carefully over the years; you've made a solid financial plan; you've got your insurance in place; you've taken all the necessary steps to make sure your family and dear ones will be financially secure even in your absence. Is there anything you've overlooked that could derail your plans?

While you may feel it's too early to think about it, the lack of a Will can pose major problems to your loved ones in smoothly inheriting your wealth. Contrary to what many think, a Will is not just for the super-rich or for those with plenty of assets. A Will is a necessity for anyone who has any assets that need to be distributed after their death.

The absence of a Will can seriously undermine all the efforts you've made to create your wealth. In a best-case scenario, it will lead to unnecessary delays and expenditures for your survivors to impartially distribute, and later, get the assets legally transferred to their names. In a worst-case scenario, your wealth may go to those you wouldn't have wanted to give anything. While disputes about who gets what and long-drawn legal cases are understandable, there are also instances of people or institutions disputing the legal rights of the survivors over a property or asset. In such a situation, your survivors will be left with no option but to run from pillar to post collecting documents or fighting out long-drawn cases in the court of law. Would you wish your near and dear ones to go through this ordeal? All these time-consuming, expensive and emotionally draining situations can easily be avoided by leaving a Will.

If you are looking forward to your retirement years before writing a Will—please don't wait. Life may not work out as planned for everyone. So prepare for the worst-case scenario. If you have assets and dependants, it's time you took paper and pen and started writing your Will!

The good news about writing a Will is that you can do it in a matter of hours. To start, create a list of all the assets you own. Then decide who gets what after your demise. Once you've got that clear, write it or get it typed on paper. Then

mention the date, location and sign it. Finally, get two people who are not included in the Will to sign as witnesses. That's all. It is not mandatory to register the Will or type it on stamp paper or get the services of a lawyer. However, if you have property in your name, it is ideal to get your Will registered. If you feel your assets are too numerous or complicated to divide then it is strongly advised that you get the services of a lawyer or an expert in the field to help you write the Will. This will ensure that there aren't unnecessary complications due to lack of clarity in your Will. Even otherwise, leaving an unregistered will is better than not writing a Will. So write one soon.

THE CONCEPT OF A WILL

A Will can be defined as a document that states how the wealth of a person gets distributed after her demise. (A person making the Will is called a Testator. The people or organisations that receive the assets mentioned in a Will are called Beneficiaries.) A Will can be made by any Indian who is mentally sound and over the age of 21.

Although there are no strict rules to be followed, for a Will to be clearly understood, it should have the following parts:

1. A declaration with the name and address of the testator
2. A list of assets and to whom they should be distributed
3. The names and addresses of the executors to the Will
4. The signature of the testator
5. The signatures of two witnesses
6. The date on which the Will was made

A DECLARATION

You should declare that you are writing this Will without any outside pressure or influence and that you are mentally fit to write it. You should write your name, age, address to identify yourself clearly.

DISTRIBUTION OF ASSETS

You should list each asset you own and clearly mention who should get ownership after your demise. Be as specific as you can while writing this part so that there is no confusion later. For example, if you have two Fixed Deposits in a bank that you want to allocate to your children, you should mention clearly who gets which. The Fixed Deposits can be identified by their serial numbers or their maturity amounts. If you have gold jewellery that you would want to be distributed amongst your survivors, be as specific as you can. Provide a description of the jewellery along with its weight/current cost so that there is absolute clarity during distribution.

In case there are assets that can increase or decrease in value or quantity, it's better to mention the distribution in terms of percentages. For example, you may currently own shares of 20 companies or maybe 500 shares of a company. This number may increase or decrease as you keep buying and selling shares. Here, instead of writing the number of shares that each beneficiary will receive, you can mention their share in terms of percentages. For example, you could write that each of your two children will get 30% of the shares you have while your spouse will get 40%. This way, they needn't go to the courts to decide if there are any discrepancies in the actual number of shares.

You could also mention where the documentation for each of these assets are kept. Nowadays, many people hold assets in online accounts. Mentioning the

login details of such assets will be really helpful for your survivors.

IDENTIFYING THE EXECUTOR

An executor is the person who manages the distribution of your assets after your demise. There is no compulsion to mention an executor for a Will. But it can be helpful if there is someone who can take the trouble of ensuring that your Will gets executed the way you wanted it. You can mention one or more executors in your Will. But do take their permissions before you include their names as executors. It should not come as a surprise to them. Be clear in identifying who the executor or executors are. Just including their names will not be sufficient as there may be more than one person with the same name in your circle of family and friends. Mention their age, address and profession so that there is no doubt about the identity of the executor.

SIGNING THE WILL

Finally, you need to sign the Will to authenticate it. You should sign the Will in the presence of two witnesses and write the date on which you've signed the Will. However, the witnesses needn't sign in each other's presence; neither do they need to read the Will. They are simply confirming that this particular Will was signed by you in their presence and that they are witnesses to it. Make sure all pages are numbered and that you've signed on each and every page.

REGISTERING THE WILL

The law does not require you to register your Will to make it a valid document. However, if your Will contains property as an asset or if you are giving any of your assets to a charitable organisation, then you should get your Will registered.

Registering a Will is recommended as it makes it a more credible document that cannot be easily challenged. If you wish to get your Will registered, you can do it at the Registrar/ Sub-Registrar of Assurances' office for a nominal fee. On registration, a copy of the Will is kept safely with the Registrar and only released to the testator or to an authorised person after the demise of the testator.

That's all to making a Will. Once the Will is ready, keep it in a safe place and inform your family or executors about it so that they are aware of it and know where to get it from after your demise. Writing a Will sometimes is not the end of it. Over time, your asset list could undergo a change. Or you may want to change the way you had distributed your assets. If these changes are minor, you can mention the change on a fresh paper and sign it along with the signatures of two witnesses (not necessarily the same witnesses) and attach it to the existing Will. This change is called a Codicil. But in some cases, you may want to completely rewrite your Will; a divorce, a death in the family, a change in fortune are reasons that may make you want to do so. In such a case, you will have to destroy the first Will and write a new one. You can simply tear up the first Will and follow the same process that you did while writing your earlier Will. Make sure to mention that this is your latest Will and that any Will that was written previously is invalid.

(At the end of this chapter is a sample Will for your reference.)

PROBATE

Any Will, including a registered one, can be challenged by the heirs of the deceased in case they are unhappy with the distribution of assets or for any other reason. In such a case, only a court can certify whether the Will is authentic and that it's the last and final testament of the deceased. This legally certified copy of the Will is called a probate. Although there is no compulsion to register a Will, it is much easier to authenticate than a Will that has not been registered. To receive a probate, an application has to be made to the court. The court will summon the necessary documents and proofs to validate the legality of the Will. A notification is also issued to all legal heirs to submit any objections they may have regarding the Will. A notice is also published in any of the leading newspapers of the district in which the deceased lived. This notice is to the general public to come forward with any objections they may have regarding the Will, within a certain period of time. If the court is satisfied about the authenticity of the Will after this process, it grants a probate to the executors named in the Will. This Will is now a legal document and the executors can carry out the wishes of the deceased as mentioned in the Will. A probate is mandatory if a Will is executed in the cities of Mumbai, Kolkata or Chennai or if an immovable property mentioned in the Will is located in any of these three cities. A petition for a probate must be filed within three years from the death of the testator. The court imposes a percentage of the value of assets mentioned in the Will as fees for the probate. This percentage may vary from state to state. In Maharashtra, for example, the court can levy a maximum fee of ₹ 75,000 for issuing a probate.

WHEN A TESTATOR DIES WITHOUT MAKING A WILL

When a person dies without making a Will, in legal terms, that person is said to have died "intestate". In this case the property gets distributed as per law. So what exactly happens to the assets owned by the person? Does it automatically go to the spouse and children? Do their parents or siblings get a share? What about other close relatives? The answer is not simple.

Hindus, Buddhists, Jains and Sikhs are governed by the Hindu Succession Act, 1956 (the act was amended in 2005 to give additional rights to daughters). With the exception of Muslims, everyone else (Jews, Parsis, Christians, etc.) is covered by the Indian Succession Act, 1925. For Muslims, the properties pass on to their heirs as per the Muslim Personal Law which is based on their religious text. If you are a Muslim, you should remember that as per Muslim Personal Law, you cannot give away more than 1/3 of your assets to anyone who is not your legal heir. It is also necessary to get the permission of your legal heirs before you can leave this 1/3rd of your assets to someone else. The remaining 2/3rds of your property will automatically go to your legal heirs. If you do not make a Will, all your assets will be divided amongst your surviving relatives as per Muslim Personal Law. In addition, Muslim Personal Law does not require a Will to be made in any particular format. It can be in writing or even communicated orally as long as it is clearly understood by the heirs.

The distribution of assets in case the deceased does not leave a Will is thus carried out along religious lines.

As per the Hindu Succession Act, if a male dies without a Will, his heirs are divided into two main classes: Class 1 and Class 2. As per the Act, heirs in Class 1 have first rights over Class 2 heirs. Only if the deceased doesn't have survivors in Class 1 category do his assets go to his Class 2 heirs. If there are no Class 2 heirs either then the assets will first go to his agnates (distant male or female relatives, related uninterruptedly through a male lineage). If there are no agnates then the assets go to his cognates (distant male/female relatives, related through one or more females).

CLASS 1 RELATIONS INCLUDE:

1. Son, daughter, wife, mother
2. Widow of a pre-deceased son (son who is no longer alive)
3. Daughter/son of a pre-deceased son
4. Widow of a pre-deceased son of a pre-deceased son
5. Daughter/son of a pre-deceased son of a pre-deceased son
6. Daughter/son of a pre-deceased daughter
7. Daughter/son of a pre-deceased daughter of a pre-deceased daughter
8. Daughter of a pre-deceased son of a pre-deceased daughter
9. Daughter of a pre-deceased daughter of a pre-deceased son

Within Class 1, distribution of property happens in the following manner:

1. The widow, or in case there are more than one widows, will together get 1 share.

2. The mother, daughter and son will get 1 share each.

3. All heirs of the pre-deceased sons or pre-deceased daughters will together get 1 share.

CLASS 2 RELATIONS INCLUDE:

1. Father

2. Son's daughter's son/daughter

3. Brother/sister

4. Daughter's son's son/daughter

5. Daughter's daughter's son/daughter

6. Brother's son/daughter

7. Sister's son/daughter

8. Father's father/mother

9. Father's widow

10. Brother's widow

11. Father's brother/sister

12. Mother's father/mother

13. Mother's brother/sister

The law treats natural as well as adopted children as same in case of inheritance. So in all the above cases, the adopted son or adopted daughter will have the same rights as the natural son or daughter.

Class 2 heirs contain multiple categories (levels). The father belongs to Category 1 within Class 2. The heirs following him are distributed over multiple, lower categories. If there is an heir in an earlier category then none of the heirs in the lower categories get any share of the assets.

IN CASE A HINDU WOMAN DIES INTESTATE, HER HEIRS WILL BE HER:

1. Daughters/sons

2. Daughters/sons of pre-deceased sons or daughters

3. Husband

IF HER SURVIVORS DO NOT INCLUDE ANY OF THE ABOVE HEIRS THEN HER ASSETS WILL GO TO:

1. Heirs of her husband

IF THERE ARE NO HEIRS OF HER HUSBAND, HER ASSETS WILL GO TO:

1. Her mother and father

IN CASE HER MOTHER AND FATHER ARE NO LONGER ALIVE, HER BENEFICIARIES WILL BE:

1. Heirs of her father

IN CASE THERE ARE NO HEIRS OF HER FATHER, THE BENEFICIARIES WILL BE:

1. Heirs of her mother

In case the deceased woman does not have any children, the rules are different. In such a situation, if she has received any assets from her parents then those assets will go to the heirs of her father and not to the husband. In a similar situation, if she had inherited assets from her husband or her father-in-law, the same will go to the heirs of her husband. Let's understand this with examples:

EXAMPLE 1

A childless widow dies intestate. Her wealth includes movable (cash, gold, etc.) as well as immovable assets (land, house, etc.). All her assets were self-acquired. Because she does not have children, her assets will go to the heirs of her husband. In this case, it will be her husband's mother. If she is not alive, it will go to her father-inlaw or her husband’s brothers and sisters. Only if none of them are alive, it will go to her own mother and father and then to their heirs.

EXAMPLE 2

A childless widow dies without writing a Will. Her assets include movable as well as immovable assets. While some of her assets were self-acquired, she had received a house and gold from her father. In this case, the house and gold that she received from her father will go to her father and mother and in case they are not alive, to the heirs of her father. The other assets will go to the heirs of her husband. In this case, it will be her husband's mother. If she is not alive, it will go to her father-in-law or her husband's brothers and sisters. And if none of them are alive, it will go to her mother and father and in case they are not alive, to the heirs of her mother.

The law treats natural as well as adopted children as same in case of inheritance. So in all the above cases, the adopted son or adopted daughter will have the same rights as the natural son or daughter.

To avoid this kind of complex distribution of your wealth, it's best to leave a

Will that clearly states how you want your assets to be distributed and to get the services of an expert in the field or a lawyer.

POINTS TO CONSIDER WHILE WRITING A WILL

1. Is there any other Will that exists before the one you are writing? If so, please tear that Will up. Also, don't forget to date this Will and mention that this new Will overrides any other previous Will.

2. Always identify the Beneficiaries clearly by their full names and some other distinguishing features. For example, instead of writing my friend Mrs. Sushila Nair, mention her address, her age and her profession to make sure there is no confusion about which Sushila Nair you're referring to. This will make it easier for your executor to identify the right person in case there is more than one person with the same name in your circle of friends.

3. Make sure you've taken the permission of the people you're going to mention as executors of your Will. An executor can be a beneficiary in the Will (except for Parsis and Christians). Although having just one executor is enough, you can take the liberty of having more than one executor for your Will.

4. Your witnesses needn't read the Will before they sign it. In fact, it's best that they do not know the contents of the Will so that the details remain confidential till your demise. Your witnesses can also be executors of the Will as long as they are not beneficiaries in the Will. The exception is for Wills made by Parsis and Christians where witnesses or beneficiaries cannot be executors.

5. If you are a senior citizen, it would be a good idea to have a doctor as one of the witnesses. This will reduce the chances of the Will being contested on the premise that the testator was not of sound mind while writing the Will.

6. You can make a Will any number of times. Just make sure that you destroy the earlier Wills to avoid multiple versions of your Will.

7. Make sure that you number and sign each page of the Will so that a page doesn't get inserted, replaced or deleted by someone with fraudulent intentions.

8. If you want to make minor changes to the Will, you needn't write a new one. You can simply add a page mentioning the changes and sign it. Have it signed by witnesses too. This addition to an existing Will is called a Codicil.

9. Keep the Will in a safe place like a bank locker or your personal vault at home. Do inform your executors about the location of the Will so that they know where to find it after your demise. You can also keep copies of the Will with someone you trust in the event that the original may get misplaced or destroyed for some reason.

10. If you are a Hindu, you cannot assign inherited property to anyone except your legal heirs. For example, the property that you inherited from your father will be inherited equally by your children; you cannot leave it to your wife or

anyone else who you feel should receive it.

11. Write the Will in a language that you know and in which you sign. Do not get it written in a language that you are not familiar with. In case you do so, the person who has written the Will should write at the end of the Will that everything was explained to you and sign it.

12. As long as what you write is clearly understood, it should be fine. A Will can be handwritten or typed.

13. Although it is not necessary to register a Will, doing so makes it a document that can be presented as strong evidence about the genuineness of the Will.

14. Under the law, a nominee is considered a caretaker of a particular asset and not its owner. The rightful owner of that asset is decided by your Will and in the absence of a Will, by the laws of succession. So do not assume that by including nominees to your account or property, you have taken care of your succession and you needn't write a Will. Other legal heirs can challenge the nominees and get possession of the assets. This is particularly true in the case of property. For example, the nominee of your flat doesn't automatically become the owner of the flat after your demise. You have to mention in your Will who should get your flat after your demise.

15. In case of shares, the joint holder of your shares or demat account automatically becomes the owner after your demise. In case there were no joint holders then the nominee of the account became the legal heir. This was a rare instance where even if you had left your shares to someone in your Will, the joint holder and the nominee had first rights to it (read High Court judgment on the Kokate case). This is no longer the case now. A recent High Court judgment (Salgaonkar case) has ruled that a nominee can only be a custodian of the shares—the rightful owners of the shares will be the legal heirs of the deceased.

16. For Parsis and Christians, any Will made before a person is married becomes automatically invalid after marriage. People belonging to these religions will have to make a fresh Will after their marriage. This is not the case for persons belonging to other religions (Hindus, Sikhs, Jains, etc.).

PRIVILEGED WILL—FOR EXCEPTIONAL CIRCUMSTANCES

Soldiers in the army, navy and air force are given a special concession for writing their Will due to the nature of their jobs. Soldiers who are involved in actual warfare or are out at sea can make a Privileged Will where they can communicate their Will verbally to two witnesses. Such a Will is considered legal unless the testator (the solider) is still alive after a period of one month from the date of making that Will. In addition, soldiers in such a situation can also write a Will by hand without having to sign it or having to get signatures of any witnesses. If the Will is written by someone else—partly or wholly—then the testator should sign

it. There are other exemptions that make it relatively easier for a soldier on the warfront or out at sea to make a Will.

NOMINATION, JOINT HOLDINGS AND WILLS

Sometimes people may wonder if they really need to write a Will if they have already got nominations and joint accounts in place. There might also be doubts whether a Will supersedes nominations and joint account holdings in every situation. We'll look at these concerns quickly.

Every time you make an investment, you invariably are asked to appoint a nominee for it. So who exactly is a nominee and who should you appoint when the need arises? A nominee's primary role is to take custody of your assets from the institution that holds your asset, after your demise. In most cases, the nominee is just the custodian who then ensures that your rightful heirs get their share of your assets as per your Will or laws of succession. You should therefore appoint someone you really trust as your nominee. You can appoint the same person as nominee for all your assets or different people for different assets—you can even change nominees any time you want. A nominee can be a family member, a relative or even a friend. You can appoint a nominee while making an investment or even at a later time. Appointing a nominee does not override the rights of your legal heirs. For example, if a father has his son as the nominee of a bank account, the son doesn't automatically become the rightful owner of the amount in the account on the demise of the father. If the father mentions in his Will that his daughter should be the beneficiary of that account then the son will have to hand over the money to his sister. In case the father does not leave a Will, all legal survivors will have a right to it as per the laws of succession and the son will have to distribute the money as per everyone's right.

So how does a nomination help? It simply ensures the smooth transfer of the asset from the bank or institution to your legal heirs. In case you do not appoint a nominee and do not write a Will then getting the assets transferred from the financial institution can be a long process. For example, if you have bank FDs without nomination and you do not make a Will then it can be a long and lengthy process for your legal heirs to get the FDs transferred to their name. Having a nominee thus makes the transfer of assets very smooth in the absence of a Will. If you intend to have your nominees inherit those specific investments, you should mention them as beneficiaries of those assets in your Will. This can save a lot of trouble later. The role of the nominee remains the same for any asset including bank accounts, mutual funds, shares, property, life insurance proceeds and so on.

In case of joint accounts, the joint account holder becomes the owner of the asset on the demise of the other account holder. In case a nominee has been appointed, she gets access to it only on the demise of both account holders. In case of property, the legal heirs or the person named in the Will of the deceased joint holder will become co-owner(s) of the property with the surviving joint holder. In all other cases, the surviving joint holder becomes the owner of the asset. There have been instances, however, of the legal heirs of the deceased challenging this decision which then becomes a matter for the courts to decide.

A Will is the best way to ensure that your assets are distributed in the manner

you wish. At the same time, you should ensure that the nominees you appoint and the joint holdings you have are with people you consider trustworthy.

Following is a sample Will for your reference.

SAMPLE WILL FOR REFERENCE

I, Mrs. Meena Patel, aged 47 years and a resident of Colaba, Mumbai having sound mind and memory declares this to be my last Will. This Will revokes any earlier Will and Codicils made by me. I am writing this Will as per my choice without any external influence or pressure.

I am presently married to Mr. Rajesh Patel, aged 49 years and we have two children: Asha (21 years old) and Ajay (19 years old). My current address is A/103, Dreamland Apts, Colaba, Mumbai.

1. I nominate Mr. Amar Jain, my younger brother as the executor of my Will.

2. I leave my plot of land along with the house situated at (address) in my native village of Gujarat to my two children Asha and Ajay. They are free to sell the property or hold it and pass it on to their legal heirs in the future.

3. I leave all the jewellery in my bank locker (bank address and locker number) to my daughter Asha. I wish to leave my diamond wedding ring and my Rolex Watch to my husband.

4. I leave my car (license number, car model) to my son Ajay.

5. I wish that my shares (demat account numbers) and proceeds from my life insurance (details of policies along with their sum assured can be mentioned) be equally divided amongst my husband and two children.

6. To my brother Amar Jain, aged 43, I leave my collection of antique stamps (details of where it is kept) and paintings (list of paintings with their titles and the names of artists).

Signature

____

(Mrs. Meena Patel)

Date: ________________________

Signature of Witness 1

____

Name:

____

Address:

____

____

Signature of Witness 2

____

Name:

____

Address:

____

____

NOTES

CHAPTER
21

MAKING AN INVESTMENT PLAN

Once we decide to make an investment, the next logical step is to select the right investment options from the many that are available to us. As we saw in the previous chapters, there are so many options available that it's easy to get confused about where to invest and how much to invest. What most of us try to do is invest in investment schemes that are familiar to us or which are recommended to us by our family, close friends or colleagues. Sometimes we may come to know about it from a newspaper article or a TV show. Once we become aware of a particular scheme, we make basic enquiries regarding it and if everything seems fine, we go ahead and invest an amount of money that seems reasonable to us.

This is not the best way to invest your hard-earned money.

Instead of relying on luck, it's always smarter to know for sure why you should choose one investment option over another. Remember that how you invest today will decide the future financial security of your life and that of your loved ones. It will decide the quality of life you'll lead when you may not be in a situation to earn money. Investing in the wrong investment options could thus seriously affect the quality of the life you end up living.

So how do you ensure that you make the right decisions?

Whether you are just about to start investing or whether you're planning for your retirement years or even if you are already retired, the best way to manage your money is to have a plan for it. This plan will be the roadmap to your financial journey and it will help you identify the milestones and challenges that you'll face on the way. A properly made plan will help you realize, at various stages of your life, how well you are moving on this journey.

Like any other plans that we make, the first step should always be to take note

of our current situation. Following that we should identify all the important goals in our life that will cost money. Finally, we should allocate the money we have into various investment options available in the market to achieve those goals. That shouldn’t be the end of it, however. You should keep evaluating your investments to know if you’d need to revise your plans.

Let’s get started with the first step.

1. UNDERSTANDING YOUR CURRENT SITUATION

To understand your current financial situation, you should first be honest about everything related to your finances. Unless you do this properly, you will not be able to plan for your future correctly. There are two parts to understanding your current financial situation. They are:

- Understanding your net worth
- Understanding your savings potential

You should start with evaluating your current financial situation to find out your net worth. The net worth tells you how "wealthy" you are. You may have some idea of your financial status—but a vague idea wouldn't be enough. Carry out this small exercise to know for sure how wealthy you are.

There are two tables that you need to fill. You'll need to arrive at the value of each item listed in the tables in rupee terms and write it against that item. You can enter the amounts right here in this book or photocopy the pages and then enter the amounts, or copy the table on a separate notebook and calculate.

♦ ASSET TABLE ♦

Assets	Value in rupees
Cash in your house	
Amount in all savings accounts	
Current value of fixed deposits and recurring deposits	
Current value of all stocks	
Current value of all bonds	
Current value of mutual funds	
Current value of gold you own	
Current value of your life insurance	
Amount invested in PPF	
Amount invested in EPF	
Current value of your home	
Current value of any other property that you own	
Any rent that you earn from property	
Business income	
Current value of vehicles you own	
Current value of electronic items (TV, music systems, computers, etc. that has sizeable value)	
Current value of all furniture you own	
Any other asset that has monetary value (Collector's items, antiques, etc.)	
Total assets	

♦ LIABILITIES TABLE ♦

Liabilities	Value in rupees

Total home loan still to pay	
Education loan still to pay	
Personal loan still to pay	
Car loan still to pay	
Business loan still to pay	
Credit card payments still to pay	
Insurance payments still to pay	
Medical insurance to be paid	
Unpaid taxes	
Any other liabilities (other loan repayments, EMI on goods, etc.)	
Total liabilities	

Net Worth = Total Assets - Total Liabilities

If your net worth is positive then you are managing your finances well. For example, if your total assets are ₹ 22 lakh and total liabilities are ₹ 20 lakh, you have a positive net worth of ₹ 2 lakh. However, if your total assets are ₹ 20 lakh and your total liabilities are ₹ 22 lakh, then your net worth is negative.

You may earn a high salary—but if your net worth is low or negative, it's a poor reflection of your spending habits and you need to take corrective action. Go through the tables to see where you have heavy liabilities. Take a hard look at your loans. Especially the ones for which you are paying high interest. While some loans are necessary, make sure they're not beyond what you can repay. Do you have pending credit card payments? If so, not repaying them on time could result in the dues ballooning to a size that could destroy your savings. Try to have a positive and high net worth as early in life as possible. This may be difficult when you are just starting out in your career and trying to create assets. But as you grow older, your net worth should become positive or if it is already positive, it should keep growing regularly. Do this exercise once in six months in the beginning. Later, as you become familiar with your assets and liabilities, you can do it less frequently.

CALCULATING YOUR SAVING POTENTIAL

Now let's have a look at your saving potential. This amount will determine how many of your goals you could achieve.

As before, enter the amount against each item in the following tables. The amount you enter should be for a month. If some of the values are not monthly by nature, convert them before you enter the amount. For example, if your life insurance premium is ₹ 24,000 per year, enter a monthly figure of ₹ 2,000 (24000/12) against it.

♦ INCOME TABLE ♦

Income	Amount in rupees
Total salary after tax	
Pension	
Business income	
Interests, dividends, etc.	
Any other income (rent earned, royalties, etc.)	
Total income	

What this exercise shows us is that it's not just the "amount" of money that you have as assets or which you earn as income that's important—equally important are your liabilities and the amount that goes into the expense column.

Once you've filled your income sheet, fill the form below to calculate your monthly expenses.

♦ EXPENSE TABLE ♦

Expenses	Amount in rupees
Rent or home loan EMI	
Car loan EMI	
Personal loan EMI	
Electricity bill	
Telephone + mobile phone bill	
Cable TV	
Groceries (milk, vegetables, biscuits, cold drinks, cereals, oil, etc.)	
Education fees	
Books, magazines, newspapers	
Clothes and accessories (shoes, bags, belts, makeup, etc.)	

Transport (petrol + public transport)	
Entertainment (movies, theatre, CDs, DVDs)	
Eating out at restaurants, alcohol and cigarettes	
Insurance premiums (life, health, etc.)	
Doctor + medicines	
Childcare	
Any other expenses	
Total expenses	

Total Saving Potential = Total Income - Total Expenses

Again, I hope your Total Saving Potential is positive. Positive savings indicates that you have the potential to invest your money and thus achieve your financial goals. If your Total Saving Potential is negative, you should identify ways to either reduce your expenses or increase your income. Since it's always easier to reduce your expenses than to increase your income, take a look at your expense sheet to identify where exactly you could save. In fact, even if your total savings is positive, you should try to find out if you can save a bit more every month so that you can increase your investments and thereby your net worth.

So apart from telling you where you stand financially, how do these calculations help you?

You must have heard of film stars, businessmen, musicians, sports persons, and even people whom you may have known personally, who were fabulously rich at one time, but ended up paupers all of a sudden. They lost everything they had earned either in their own lifetimes, or their families went bankrupt immediately after their death. Why does this happen…? Yes, you guessed it—it's because their net worth and total savings would be in the negative. They may be earning in crores—but their lavish lifestyles and extravagant spending would mean their liabilities and expenses were in equally high amounts. Once the flow of income stopped, their assets got offset by their liabilities. To repay the loans and taxes, they'd have no other option but to sell off whatever assets they had, even if they have to do it at a loss. More often than not, they are unable to meet these obligations in an effective manner as their accumulated liabilities would be huge.

What this exercise shows us is that it's not just the "amount" of money that you have as assets or which you earn as income that's important—equally important are your liabilities and the amount that goes into the expense column. Most of us know how much we earn every month, but not many of us are clear about where our money gets spent. This exercise should show you clearly how you should manage your finances to achieve your goals.

Before you move to the second step, which is to identify your financial goals, promise yourself to take decisions that will increase your net worth and total saving potential. If it is negative, make it positive. If it is positive, find out ways to

make it even greater. That is the secret to becoming wealthy.

One simple way to save more and become saving-positive is to go over your liabilities and expense columns carefully. Could your entertainment bills be reduced? Could you reduce the number of times you visit movie halls? How about electricity bills—can you reduce the use of heaters, fans, lights and air conditioners to lower your electricity bill? Could you reduce the amount you spend while eating out? If you can save an additional ₹ 4,000 every month based on these decisions, you will end up saving ₹ 1 lakh in just 2 years!

2. IDENTIFYING YOUR FINANCIAL GOALS

The primary reason for saving and investing money is to achieve the financial goals in your life. They are the milestones on your journey that you hope to achieve in the timeframe you set for yourself. For some of you, these goals are crystal clear, while for others they're hazy and changeable. Investing becomes easier and efficient if you are sure about your needs for investing. So try to be as clear as possible about your goals before you start investing.

Let's take a look at typical plans for people at various stages of their life:

NEWLY-EMPLOYED, UNMARRIED PERSON WITHOUT DEPENDANTS (GOALS FOR AGE 20 TO 30 YEARS)

1. Buy own house.

2. Buy a car.

3. Emergency fund to cover expenses in case of sudden job loss.

4. Enrol for a professional course after a few years of working.

5. Marriage expenses.

6. Health insurance to pay for medical needs.

7. Travel abroad on a holiday.

MIDDLE-AGED COUPLE WITH DEPENDENT CHILDREN AND RETIRED PARENTS (GOALS FOR AGE 30 TO 45 YEARS)

1. Emergency fund to take care of expenses in case of job loss.

2. Life insurance to ensure financial security of the family in case of demise of either spouse. Health insurance in case someone in the family has to undergo hospitalisation.

3. Education expenses of the children.

4. Children's marriage expenses.

5. EMI of a home loan and to pay off the home loan at the earliest.

6. Start retirement fund so that one can live one's retirement years with dignity and in reasonable comfort.

7. Holidays abroad.

8. Start a business.

9. Look after aged parents

COUPLE PLANNING FOR RETIREMENT WITH DEPENDENT CHILDREN AND OLD PARENTS (GOALS FOR AGE 45 TO 60 YEARS)

1. Fund to take care of old parents.

2. Post-graduation fees and/or marriage expenses of children.

3. Pay off any remaining loan amount on home.

4. Increase medical insurance to ensure various contingencies are taken care of.

5. Ensure retirement fund is sufficient to live an independent life in reasonable

comfort.

6. Vacations with spouse.

RETIRED COUPLE WITH NO DEPENDANTS (GOALS FOR AGE 60 ONWARDS)

1. Evaluate investments periodically to ensure investments are giving optimal returns.

2. Have the right medical insurance so that medical needs are not compromised.

3. Ensure there will be a source of funds in case you outlive your retirement fund.

These are typical goals for people at various stages of their life. You could belong to one of these categories and your goals could be similar or entirely different from this. The best way to ensure that you invest right is to first write down your list of goals.

3. MAKING A FINANCIAL PLAN

Once you've got your goals in place, the next step is to assign a monetary value and time frame for these goals. This will be the crucial step that will help you decide on the investment options you should choose from the vast number available to you.

Let look at a case study to understand how you can go about doing it.

Case Study: Jyoti and Karthik are a happily married couple with two children—Anita, aged two years and Arjun, aged 6 months. Both Jyoti and Karthik are 29 years old. Karthik works as an investment banker with an MNC bank while Jyoti is employed as a software engineer in a small IT firm. Together, the couple earns a net monthly salary of ₹ 90,000. Their current monthly expenses are ₹ 30,000 (which includes a home loan EMI of ₹ 15,000 a month). So after deducting ₹ 30,000 (₹ 15,000 for expenses + ₹ 15,000 for EMI) they are left with ₹ 60,000 per month for their investments that will help them meet their financial goals.

FINANCIAL GOALS

Jyoti and Karthik have the following financial goals:

1. Create a contingency fund: This fund will take care of a situation where either one or both of them lose their jobs. This fund will ensure that they can meet their household expenses for at least three to six months.

2. Life insurance: It's tough in today's times to achieve many of our life goals without both partners contributing. Jyoti and Karthik find themselves in a similar position. They realize that they need insurance to ensure that the surviving spouse and children are protected from financial difficulties.

3. Children's higher education: Although it's too early to plan a career for the children, the couple want to start saving for their education as early as possible.

4. Children's marriage: The couple also want to start a fund to contribute for their children's marriage expenses.

5. Retirement planning: Jyoti and Karthik are also looking at building a retirement fund so that they can maintain the same standard of living even after they retire.

FINANCIAL PLAN

After understanding their current needs, we can detail the financial plan in the following manner:

STEP 1: EMERGENCY/CONTINGENCY FUND

An emergency /contingency fund will help the family in case either one of the

earning members lose their jobs. This fund should be enough to meet expenses for a period of three to six months.

Jyoti and Karthik should keep aside ₹ 1,20,000 (₹ 30,000 x 4 months) to meet their monthly household expenses. They should invest this amount in a safe option that has minimum risk yet provides them with a rate of interest that will keep pace with inflation. They could invest the amount in a FD or a Liquid Mutual Fund to ensure it's available whenever needed and that it can earn a decent return.

STEP 2: INSURANCE

The 2nd step in their financial plan is to have adequate life insurance cover for both of them.

Their current combined annual income is ₹ 9,60,000 (₹ 80,000 x 12). If they decide to go in for an insurance amount that's 8-10 times their current income, a combined Term Insurance plan of ₹ 1 crore at a premium of around ₹ 12,000 per year should suit their needs for the next 5-10 years. They could review their insurance needs after that period.

STEP 3: CHILDREN'S EDUCATION FUND

Although it's too early for the couple to know what careers their children would choose, they could look to target an amount that will help their children get the best education possible when they are grown up.

Jyoti and Karthik could use the expenses required for a career in medicine and engineering as their benchmarks.

ANITA'S EDUCATION FUND: Jyoti and Karthik could benchmark Anita's education expenses to that of an engineering degree which she would do after her 12th standard. The money will be required after 15 years, when Anita turns 17 years old. If an engineering education costs around ₹ 12 lakh today and education costs increase at the rate of 10% every year (inflation), the same course will cost ₹ 50.12 lakh, 15 years from now.

You can use the Future Value formula to calculate the future cost of the course, as shown below.

FV = (rate, nper, pmt, pv)

= (10%, 15, , 1200000)

= ₹ 50,12,697

If Jyoti and Karthik want to accumulate ₹ 50 lakh in the next 15 years, how much should they invest to reach that figure? Since they have time on their hands, they could look at investing in investment options that can offer them a high rate of return even if they have to take a slightly higher risk. The longer

duration of their investing will help them re-evaluate their decision a few years down the line if they feel it's not going as per their plan. They could thus look at investing in stocks, equity mutual funds, sectoral mutual funds or balanced mutual funds to achieve this goal. We can assume that they can safely earn around 12% returns during these 15 years. With these details in hand, let's calculate how much they would have to invest for the next 15 years.

As we learnt earlier in the chapter on Financial Formulas, we can use the formula for PMT to calculate the amount they need to invest every month.

The information we have is:

Future Value (FV): ₹ 50 lakh

Period (n) = 15 x 12 (total number of months they have to invest)

Rate = 12%/12 (because investments will be done 12 times a year)

By using the PMT function within Formulas in MS Excel, we will get

= PMT (12%/12, 15x12, 0, 5000000)

= ₹ 10,008.40

That's the amount that the couple will have to save every month to create a corpus of ₹ 50 lakh by the end of 15 years.

ARJUN'S EDUCATION FUND: If Arjun decides to become a doctor, the money required for an MBBS course should be available 17 years from now when he turns 18. Assuming the cost of an MBBS degree today is around ₹ 10 lakh (the fees may vary from college to college), and considering that education costs would increase at the rate of 10% every year, the same course will cost ₹ 50.54 lakh, 17 years from now.

Here again, you can use the Future Value formula to calculate this.

FV = (rate, nper, pmt, pv)

= (10%, 17, , 1000000)

= ₹ 50,54,470

To accumulate ₹ 50.50 lakh, Jyoti and Karthik have a slightly longer duration than they have for creating Anita's fund. They could again invest in equity or balanced mutual funds to earn returns of around 11 to 12%. Assuming they earn around 12% over 17 years, let's calculate how much they should invest every year. We'll again use the PMT function to calculate the amount.

The information we have is:

Future Value (fv): ₹ 50.50 lakh

Period (n) = 17 x 12 (total number of months they have for investing)

Rate = 12%/12

By using the PMT function within Formulas in MS Excel, we will get

= PMT (12%/12, 17x12, , 5050000)

= ₹ 7,636.38

That's the amount that Jyoti and Karthik will have to invest every month to create a corpus of ₹ 50.50 lakh in a period of 17 years.

STEP 4: CHILDREN'S MARRIAGE FUND

The couple can also contribute to the marriage expenses of their children in the following way:

ANITA'S MARRIAGE FUND: If we assume that Anita would be ready to marry when she is around 25 years old, Jyoti and Karthik would need the money 23 years from now. If they plan to contribute around ₹ 3 lakh (excluding expenses for gold) in today's times, the couple would need around ₹ 26.86 lakh (at an inflation rate of 10%) after 23 years.

You can use the Future Value formula to calculate this.

FV = (rate, nper, pmt, pv)

= (10%, 23, , 300000)

= ₹ 26,86,290

To accumulate ₹ 26.86 lakh in 23 years, the couple plan to invest on a monthly basis. We can calculate how much they would have to invest on a monthly basis to reach the target. The couple can look at investing in safer options like debt mutual funds or balanced funds to earn around 9% returns during this period.

We'll use the PMT feature within Excel to calculate the amount. The details we have are:

FV: ₹ 26.86 lakh

Period (n) = 23 x12 = 276 months

Rate = 9%/12

The answer you'll get is ₹ 2,935 per month.

ARJUN'S MARRIAGE FUND

The couple plan to build a corpus for Arjun's marriage along similar lines. They will thus invest a similar sum of ₹ 2,935 per month for Arjun's marriage expenses.

Accumulation of Gold: If Jyoti and Karthik decide to give around 250 grams of gold to Anita on her wedding, the couple has 23 years (276 months) to accumulate this quantity. If they decide to buy 1 unit (1 gram) of Gold ETF every month for

the next 21 years (252 months), by the time their daughter turns 23, the couple will be ready with the required gold, two years ahead of their target date.

STEP 5: RETIREMENT FUND

The current monthly expenses of the couple are ₹ 15,000 (excluding EMI). This translates to annual expenses of ₹ 1,80,000 (15,000 x 12). If we assume that annual expenses will grow at the rate of 8% (inflation) every year then by the time the couple retires in 31 years, their annual expenses in the 60th year (retirement year) will increase to ₹ 19,56,180 (₹ 19.56 lakh). You will use the Future Value feature of Excel to calculate the amount.

FV = (rate, nper, pmt, pv)

FV = (8%,31,,-180000)

= ₹ 19,56,180.

Post retirement, if Jyoti and Karthik expect to live for another 20 years (life expectancy of 80 years) they will have to rely on their retirement corpus to provide them an income to meet all their expenses since they will cease to earn an income from their 61st year onwards.

WHAT IS THE AMOUNT THEY WILL NEED TO SURVIVE THESE YEARS?

As we saw, at the age of 60, their annual expenses will be ₹ 19,56,180. This annual expense will keep increasing at the rate of inflation. Let's assume that the rate of inflation over the 20-year period that they survive will be 6%. So their actual cost of living will increase by that every year. At the same time, the couple will also invest the corpus that they have created (by the time they retire at 60) and earn returns on it. Since they will be investing it in risk-free investment options, we can assume that it will earn them around 6% returns. To keep the calculation simple, we've kept the rate of interest earned as the same as inflation.

In case there is a difference in the rate of interest and inflation, you can use the following formula to calculate the real rate of return: (1+rate of return/1+rate of inflation) -1

For example, if rate of return was 8% and inflation was 6%, the actual rate of return will be

= [(1+8%) / (1+6%) -1]

= [(1.08/1.06)-1]

= 1.89%

Using this information, we can calculate the present value of the amount that Jyoti and Karthik (at age 60) will need to meet their expenses for the next 20 years after retirement.

Rate = 0% (the actual rate of return that their corpus will earn for 20 years)

Period = 20 years (the period for which corpus will remain invested)

PMT =- 19,56,180 (expenses per year which will keep increasing at 6%)

FV = 0 (the amount remaining when they are 80 years old)

Type = 1 (we need to find out the amount that the couple need at the beginning of their retirement years)

So PV = (rate,nper,pmt,fv,type)

= (0,20,1956180,0,1)

= ₹ 4,14,71,020.

That's ₹ 4.14 crore that the couple will need to have in hand by the time they are 60. That's a huge sum. But the good news is that they have got around 30 years to do so. Let's see how much they'll have to invest to earn this amount.

BUILDING THE RETIREMENT FUND

To accumulate the fund of ₹ 4.14 crore in the next 31 years, assuming their investments earns 10% return, the monthly investment required will be ₹ 16,523.92. We used the PMT function to calculate this amount.

PMT = (rate, nper, pv, fv, type)

= (10%/12, 31x12,0,41471020)

= 16,523.92

Once they retire, the couple can invest the corpus of ₹ 4.14 crore in safe investment options which can give them an annual return of 6%. By the time the couple turns 80 years old, the fund will get exhausted (see following table). In the rare scenario that either Jyoti or Karthik or both of them outlive this age, they can consider taking a loan against their home (reverse mortgage) from a bank and continue to earn an income till their demise.

Age	Amount at the beginning of each year (A)	Annual expenses increasing at 6% (B)	Amount left after annual expenses (C)	Interest earned on corpus at rate of 6% (D)	Amount remaining at end of the year (C + D)
61	41471020	2073551	39397469	2363848	41761317
62	41761317	2197964	39563353	2373801	41937154
63	41937154	2329842	39607312	2376439	41983751
64	41983751	2469632	39514119	2370847	41884966
65	41884966	2617810	39267155	2356029	41623185
66	41623185	2774879	38848306	2330898	41179204
67	41179204	2941372	38237832	2294270	40532102
68	40532102	3117854	37414248	2244855	39659103
69	39659103	3304925	36354178	2181251	38535429
70	38535429	3503221	35032208	2101932	37134140
71	37134140	3713414	33420726	2005244	35425970
72	35425970	3936219	31489751	1889385	33379136
73	33379136	4172392	29206744	1752405	30959149

74	30959149	4422736	26536413	1592185	28128598
75	28128598	4688100	23440498	1406430	24846928
76	24846928	4969386	19877543	1192653	21070195
77	21070195	5267549	15802646	948159	16750805
78	16750805	5583602	11167203	670032	11837236
79	11837236	5918618	5918618	355117	6273735
80	6273735	6273735	0	0	0

Based on the financial plan the total outgoings look like this

Sr. NO.	Investment	Amount per month
1	Term insurance premium, per month	₹ 1,000
2	Anita's education fund	₹ 10,008
3	Arjun's education fund	₹ 7,636
4	Anita's marriage fund	₹ 2,935
5	Gold for Anita (1 gram per month)	₹ 3,000
6	Arjun's marriage fund	₹ 2,935
7	Retirement fund	₹ 16,523
	Total	44,037

As we saw earlier in the chapter, after meeting their daily expenses, Jyoti and Karthik have ₹ 60,000 available for their investments every month. Since the total amount they need to invest is only Rs. 44,037, they can easily manage to do so without compromising on their lifestyle. Jyoti and Karthik can thus be confident that they will be able to achieve their financial goals if everything goes as planned.

There's one serious drawback to this plan, however. And it's a major one that could easily derail the plan they've drawn up. Yes... we are talking about medical expenses. In case any member in the family has to undergo hospitalisation, the costs of treatment could easily upset their budget. If Jyoti and Karthik want their plan to succeed, they have to consider medical insurance. A cover of around ₹ 4 lakh for the whole family would be sufficient to take care of such eventualities. The premium for this can be around ₹ 6-7 thousand. The amount remaining after they have made allocations for their investments can be spent on things that the family enjoys – movies, eating out, vacations, etc.

Now that Jyoti and Karthik are aware of the amount they need to keep aside every month, they are in a better position to make their investment decisions. If they can stick to this plan, there's a very high chance that they will be able to achieve the milestones they have set for themselves on their financial journey. It will require a lot of discipline and life will surely throw surprises at them – so they will need to keep checking and tweaking their plans at least once a year to make sure they are on course.

CAN YOU MAKE A SIMILAR PLAN FOR YOURSELF?

Make sure that when you make your plan, you do not eliminate the small joys of life. Keep a balance between leading a happy, satisfied life yet keeping aside enough to meet your future needs.

When you make a financial plan for your family, try to get every member in your family involved. When everyone in the family contributes to the plan and they know they are working towards common goals that will benefit everyone, their participation will be wholehearted. The chances of impulsive spending also reduce as each family member will now be aware of the impact of the money they spend.

At times, parents leave out children from the saving and investment process assuming that they'll get unnecessarily burdened with financial worries. But if you completely leave them out of the process, they may not appreciate your sacrifices and may in fact rebel against such efforts. Also, your children will grow up without having any understanding of investing and money management, which can have a negative effect on the way they invest once they start earning. Many children grow up with the perception that being rich is simply a matter of earning a lot of money—when the truth as you learnt is—it's more about managing the money you earn! Use your discretion on how much your children should know. Explain to them that there are challenges but with the right plan and a positive approach, you can achieve your goals. Done in the right spirit, saving and investing together will not only be enriching in the monetary sense, they can also bring your family closer.

I wish you the very best for a prosperous future!

NOTES

♦ AQUICK OVERVIEW OF INVESTMENTS WITH FIXED RETURNS ♦

Investment	Safety	Liquidity	Returns	Tenure	Interest	Min. Amount	Max. Amount	Tax Benefit
Fixed Deposits	****	****	***	15 days to 5 years	Varies. Compounded quarterly.	Varies. Usually ₹ 1,000.	No limit	Interest taxable. TDS if interest is more than ₹ 10,000. Tax benefits under Section 80C for 5-year deposits.
Recurring Deposits	****	****	***	6 months to 5 years	Varies. Compounded quarterly.	Varies. From ₹ 10 to ₹ 100.	No limit	Interest taxable. TDS if interest is more than ₹ 10,000.
NSCs	*****	***	***	5 years	Interest constant for each certificate. Compounded twice a year.	₹ 100	No limit	Benefits under Section 80C. Interest taxable. No TDS.
PPF	*****	***	***	15 years. For genuine need, 5 years.	Changes every quarter. Interest compounded yearly.	₹ 500 per year.	₹ 1,50,000 per year.	Benefits under Section 80C. Interest, tax-free.
EPF	*****	***	***	Not fixed. Maximum period up to age of retirement.	Changes every year. Compounded yearly.	12% of salary (Basic + DA).	No limit.	Employees contribution enjoys benefit of Section 80C. Tax-free if withdrawn after 5 years of continuous service.
POMIS	*****	***	***	5 years	Can vary on quarterly basis. Compounded annually.	₹ 1,500	₹ 4.5 lakh for single account. ₹ 9 lakh for joint account.	No TDS. But interest earned is taxable.
SCSS	*****	***	***	5 years. Can be extended by 3 years.	Changes on quarterly basis. Interest compounded annually.	₹ 1,000	₹ 15 lakh.	Benefits under Section 80C. TDS if interest exceeds ₹ 10,000 per year.

NOTES

NOTES

FIND ANSWERS TO ALL YOUR INVESTMENT QUESTIONS AND MORE!

- What do they mean by Cost of Living, Inflation, NIFTY, NAV, Bulls and Bears, TDS, Section 80C....?
- How can I invest in gold without making frequent trips to the jeweller?
- Everyone talks about mutual funds; should I invest in them, too?
- What are the different types of mutual funds I can invest in?
- Should I look at life insurance as an expenditure or an investment?
- How does the stock market work?
- How does one know if the price of a stock is right to buy?
- Why are ELSS schemes so popular amongst the salaried class?
- Can I invest in PPF even after 15 years? What is the limit for investing in my children's PPF accounts?
- Is my Employee Provident Scheme tax-free on withdrawal?
- What are the different ways one can profit by investing in real estate?
- Do I really need health insurance? If yes, how much cover should I have?
- What is cashless health insurance? What are top us and super top ups in health insurance?
- What is a Will and should I have to write one? How are the assets distributed if someone dies without writing a Will?
- What is a Financial Plan? How do I go about making one? How much money should I invest for my varions goals?
- I'm not comfortable with numbers and calculations? Is there a simple way I can calculate the future value of my investments and similar numbers?

What Every Indian Should Know Before Investing explains how the most popular investment options available in the market work. The knowledge you gain will not only enable you to manage your investments better, it will give you the confidence to explore the world of investing on your own. This book will be a useful tool for people of all ages who want to be in a control of their financial life.

ISBN-13: 978-81-906972-1-7

9 788190 697217

₹395