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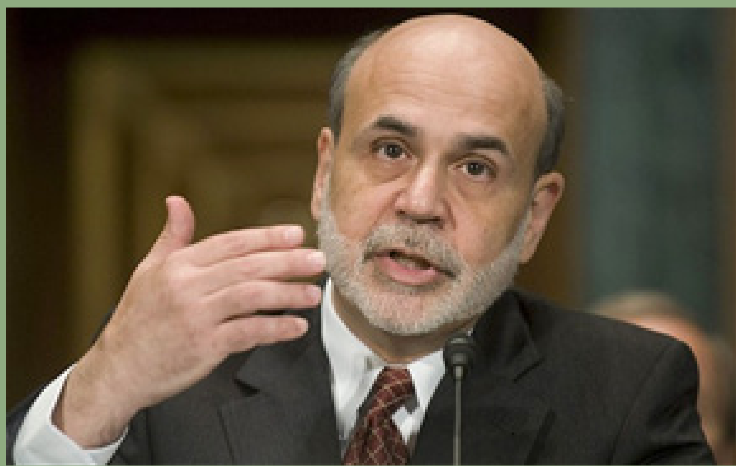
E&T
Taxation at various stages of investment



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RBI Monetary Policy Review: Rates Unchanged

-By Venkatakrishnan Vaidyanathan

Contrary to expectations of Analysts and Economists, The Reserve Bank of India, in its Mid Quarter review of Monetary Policy 2013-14, released on 18th December, 2013, adopted a “Status Quo” position with respect to the Interest Rates.

Key policy rates -CRR at 4%, MSF as well as Repo rate at 7.75% remained unchanged. This despite, last week’s alarming inflationary numbers, released by CSO ,wherein WPI stood at 7.52% and CPI at 11.24 %, driven largely by growing Food and vegetable prices.

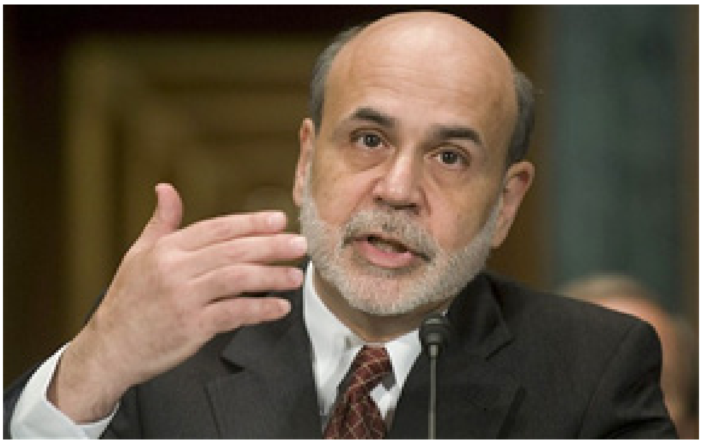
Market Analysts had factored a 25 basis points increase in Repo rates but were completely taken by surprise by RBI Governor, Raghuram Rajan’s announcement. In fact, markets welcomed the decision with a strong Sensex rally of 240 points .Even Industry chambers like CII,FICCI in its statement hailed the Pro growth outlook of the RBI

The Governor, explaining the rationale behind the decision, said that there was a greater chance of the Cooling of the high vegetable prices in the near term translating into reduced Headline inflation numbers.

Also the disinflationary impact of recent exchange rate stability, the slowdown in the IIP numbers including services and manufacturing, effective monetary tightening would contribute to this effect, He said.

Agreeing to the fact that there were risks in waiting for data related to US Fed ‘s tapering of QE, Raghuram Rajan assured that if Food inflation were to increase ,the RBI would take corrective measures by making off-policy announcements ,if the need arises and would curtail inflation.

To Taper or Not to Taper:
The Billion Dollar Question Answered



The US Federal Reserve, under the aegis of the Outgoing Chairman, Ben Bernanke, announced the Tapering of its Quantitative Easing policy on 18th December 2013.The federal reserve agreed to scale back its Bond buying program in 2014 and soften its Economic Stimulus package in existence since late 2012 in response to 2007-08 crisis .

The FOMC(Forward Open Market Commission) directed the Fed to reduce the purchase of Mortgage Based Securities(MBS) to $35 Billion v/s the current $40 Billion and that of Treasury security to $40 Billion v/s the current $45 Billion a month.

It would result in a cumulative $10 Billion reduction from $85 Billion to $75 Billion from January, 2014.This was possible as the US economy was growing steadily over the past few Quarters. The Fed assured that the impact would be minimal and that it had kept the short term interest rates at near zero till unemployment reached to 6.5%.The news was well received by World markets at large ,who responded positively to the Tapering announcement.

This was definitely a more balanced response than the Highly Anxious response which was to be expected if Tapering were to be done in May,2013.While there were some concerns for India in terms of higher FII outflows, the Indian Government assured that the impact would be minimal.

The Uncertainty surrounding both the events, the RBI Monetary Policy and the US Fed Tapering issue, seems to have subsided for now ,allowing the Country ,the Industry and the Markets to focus on important issues challenging the Macroeconomic situation of the country and the World at large .

E&T

How your wealth is taxed at various stages of investment

- By Rakesh Pathak

Most of the people take life insurance policies to have a secure future and you must have heard people saying that life insurance comes under EEE method of taxation.
But what is EEE? This is a way in which your money is taxed at various stages of investment. Let's take a close look at various taxation points:

The Tax Incidence Points

The terms explain the tax treatment of financial tools at different time periods. There are three ways in which your money is taxed at various stages of investment. The different points at which can tax may be payable are:

1) At the time of the investment / transaction

2) During the tenure of the investment when cash flows occur

3) At the time of maturity /sale of the investment

As per tax exempt or applicable, we define method of taxation in various ways like EEE, EET, and ETE etc.

Different financial tools will have different times during which tax may be payable.

EEE:

EEE stands for Exempt-Exempt-Exempt. Here, the first exempt means that your investment is allowed for a deduction. So, you don't have to pay tax on part of the salary that equals the invested amount.

Similarly, the second exempt implies that you don't have to pay any tax on the returns earned during the accumulation phase. The third and final exempt means that your income from the investment would be tax-free in your hands at the time of withdrawal.

EEE status is generally enjoyed by long-term investment vehicles, such as Public Provident Fund and Employees Provident Fund. Currently, other instruments such as equity-linked savings schemes (ELSS) and life insurance policies also enjoy the EEE status.

However, under the revised draft Direct Taxes Code, the New Pension System will also enjoy the EEE status, but insurance-cum-investment plans and ELSS will move to the EET category.

Almost all the tax saving financial instruments today falls in the EEE tax regime. The taxman is truly the best friend for the investors in these tools. These investments do not tax us, the investors, at the time of investment, during the tenure of the investment and also at the time of the maturity.

The situation is the same with a number of other tax saving instruments – Equity Linked Savings Scheme (ELSS) Mutual Funds, and 5 years Tax Saving Bank Deposit.

ETE:

ETE stands for Exempt-Taxed-Exempt. If you have an instrument with this status, you would have to pay a tax only on the interest component. For example, a five-year fixed deposit (FD) enjoys the ETE status, where the amount you invest qualifies for a deduction, the interest is taxed and at the time of maturity you needn't pay tax on your principal.

EET:

EET is Exempt-Exempt-Taxed. Your money at the stages of contribution and accumulation is exempt from tax, which is explained by EE, but at the time of withdrawal, you need to pay a tax on it, denoted by T. Since your accumulation—principal plus return—is taxed at the time of withdrawal, your returns from such instruments come down, depending on your tax slabs.

For instance, if you fall in the 20% tax bracket and the rate of return on your investment is 8%, you will lose out 20% of that return and make only 6.4% on your investment.

EET tax regime is basically to exempt the tax at the time of investment and during the tenure of the investment but to tax the proceeds of the investment at the time of maturity / sale of the investment. This is a cause of worry.

We do get tax benefits at 2 places so why worry? The reason is that we are in reality never exempt from tax but only given more time to pay up the tax. Also, we pay for the growth on the investment too under EET. Thus EET is only a way to defer tax but is not tax free in spite of the 2 Es (exempts).

EET Example

Let us take an example to understand the situation better. Let us assume that we invest Rs.10, 000/- every year in a tax saving financial tools that provides a return of 10% over 10 years. Also let us assume that the investor is a male in the 10% tax bracket (Income in the range of Rs.1.5 to 3 L category).

The value of the investment at the end of the 10 years will be around Rs1.75 L. In the EEE regime this amount will come to us tax free!!

We would also have got the tax benefits on the Rs.10, 000/- invested every year -Rs.1, 000/- per year. Joy!!!

In the EET regime, the Rs.1.75 L will be taxed at 10%. Thus the investor will lose Rs.17, 500 to tax after 10 years. The effect is really that instead of paying tax every year at Rs.1, 000/- the investor has paid it all in one lump sum at the end of the 10th year.

The investor may comfort himself by saying "Ok, but at least I do not pay tax every year. And I can make use of the money for the 10 years before giving it back to the Government." Guess what the value of the deferred tax of Rs.1, 000/- every year for 10 years and 10% return will be? Bingo. Rs.17, 500 – effectively negating the comforting thought!

No More Tax Savings???

Are there no more tax saving opportunities if EET is implemented? The answer here is 'It Depends' – on a number of factors. In the EET regime the tax man has a number of options for administering the tax. The maturity amount instead of being added to income may be a charged at a fixed percentage of maturity as tax (as in capital gains tax). There can be separate income head created for the investments to be taxed and different slabs even. But all these tax reducing measures goes against the principle of simplifying the taxation process.

Worldwide EET has been the favourite method of Governments to tax citizens. Indian may also follow suit soon. We cannot wish it away.

Proper Planning – Creating Wealth

EET will remove almost all the tax-free investments from the market. EET will bring in awareness to make investments with a purpose of creating wealth not just to save tax. In one way, EET is positive. Till date, in spite of the financial reforms happening for the past 15 years, Financial Planning in India = Tax Planning. This has been brought about because of the EEE regime.

TTE:

Let us see how transactions related to shares are taxed.

At the time of purchase of the shares, Securities Transaction Tax (STT) has to be paid. STT has to be paid by both the buyer and seller of the shares. It should be noted that the amount to be invested should have already suffered Income Tax in the hands of the investor.

When we receive dividends from the company, Dividend Distribution Tax (DDT) has to be paid. DDT is paid by the company directly and thus is a form of Tax Deducted at Source.

Finally at the time of selling the share, there will be Capital Gains Tax. Capital gains for shares can be Short Term (if the share is help for less than a year – 365 days) taxed at 10%; or Long Term (greater than 1 year holding period) which is tax free.

Equating tax planning with financial planning has lead to financial disasters. Many people have even borrowed (at a higher interest) to invest in tax saving instruments. Housing loans have been taken without considering the potential income that the property could generate. Insurance Plans have been taken without life cover. Many business people have shown lower income in their tax returns. The list goes on.

The effects of all these are to save on tax but lose out on wealth. So people, it's time to get out of "Saving-Tax Mode" act smart and get into "Creating Wealth Mode".

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