DEBT Mutual Funds over Traditional Debt Instruments (Fixed Deposits, Insurance, PPF etc)

GREETINGS FROM ETHOS WEALTH MANAGEMENT (P) LTD.

We go to any extent to save on Taxes. We buy Low-yield, traditional insurance policies or buy additional medical cover, as long as it saves us on taxes.

But this zeal to dodge taxes is missing from debt instruments. WHY?

Bank deposits and small savings schemes today are where every family invests their savings. If we are so worried about saving taxes and reducing our Taxable Income, then why are tax-efficient debt funds not more famous in India today?

INSIGHT: Interest earned on deposits and bonds is added to your income and taxed at your current Tax Slab whereas income from debt funds, held for more than one year, is treated as long-term capital gain and taxed at a lower rate. Instead of paying 30% tax on interest from fixed deposits, you can pay a flat 10% tax on long-term capital gains on Debt funds. Your tax-burden could be further reduced if you opt for the indexation benefit, which adjusts for inflation.

> Pankaj Gulati is putting away money in dynamic bond funds for retirement & invests in short-term debt funds for his daughter's marriage in next two years. "Debt funds offer a tremendous tax advantages to investors in the highest tax bracket," he says.

Debt funds today are majorly invested by high net worth individuals (HNIs). "HNIs are showing a lot of interest in debt funds. They clearly see the tax benefits of these schemes," says Harshendu Bindal, president, Franklin Templeton India.

Additional Advantages of Debt Mutual Funds over Traditional Instruments:

1. Tax Haven for Investors:

Lower tax rate on capital gains is just one of the benefits of these schemes. Another major benefit is that you can indefinitely postpone your tax liability by investing in debt funds. In comparison, you need to pay tax on the interest accruing on a cumulative fixed deposit or a recurring deposit even though the instrument has to mature in 5-10 years. On the other hand, your investments in debt funds will not be taxed till you withdraw them.

> DEBT FUNDS are the best way to invest in your child's name.
> When you put the money in your minor child's name, the income from the investment is treated as that of the parent. But if the funds are redeemed after the child turns 18, the gains will be treated as his income, not yours.

2. Off-setting Losses:

Debt Mutual Funds gives us the opportunity to set off losses from other assets against the gains from these schemes. If you had booked short-term losses on stocks and equity funds when the markets slump, you can adjust them against the gains from your debt fund investments.

3. **High on Liquidity**:

Apart from tax advantages, debt funds also offer a higher liquidity & more flexibility than a bank deposit. If you redeem before 2 pm, money is in your account the next day. Yes, your Bank FD can also be broken at any time, but you: Sacrifice returns & pay charges. Debt funds also levy an exit load, but most liquid funds and ultra short-term funds do not have exit loads. Also, the procedure for breaking a fixed deposit requires more paperwork than the click of a mouse.

4. **Investment Flexibility:**

An added advantage is flexibility and ease of investment. You can invest as much as your pocket allows. Unlike small savings schemes such as PPF and Senior Citizens' Savings Scheme, there is no limit to how much an individual can invest in debt funds. Can you imagine opening a fixed deposit every time you have an extra Rs 2,000-3,000 in your bank account?

Your choice of debt fund depends on how soon you will need the money. Short-term debt funds are relatively safe bets and can give stable returns comparable to those from fixed deposits.

5. **Benefit of Capital Gains:**

The pre-tax returns from debt funds are comparable with those from other debt options such as fixed deposits and bonds. But if there are changes in interest rates, debt fund will give higher returns.

Short-term debt funds are not affected too much by rate changes. Generally, their returns are aligned with the prevailing fixed deposit returns and the investor gains from the accrual of interest on the bonds in the fund's portfolio.

Funds that invest in long-term bonds are more sensitive to changes in interest rates. If interest rates decline, the value of the bonds in their portfolio shoots up, leading to capital gains for the investor. While the average short-term debt fund has given 9.5% returns in the past one year, many long-term bond funds have risen by more than 12% during the same period.

> "When investing in a debt fund, keep in mind the liquidity of your portfolio, the quality of holdings in the fund, its risk-adjusted performance and the track record of fund manager," says Nandkumar Surti, managing director and CEO of JP Morgan Asset Management.

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