RESTRICTING
SECTION 80C INVESTMENTS

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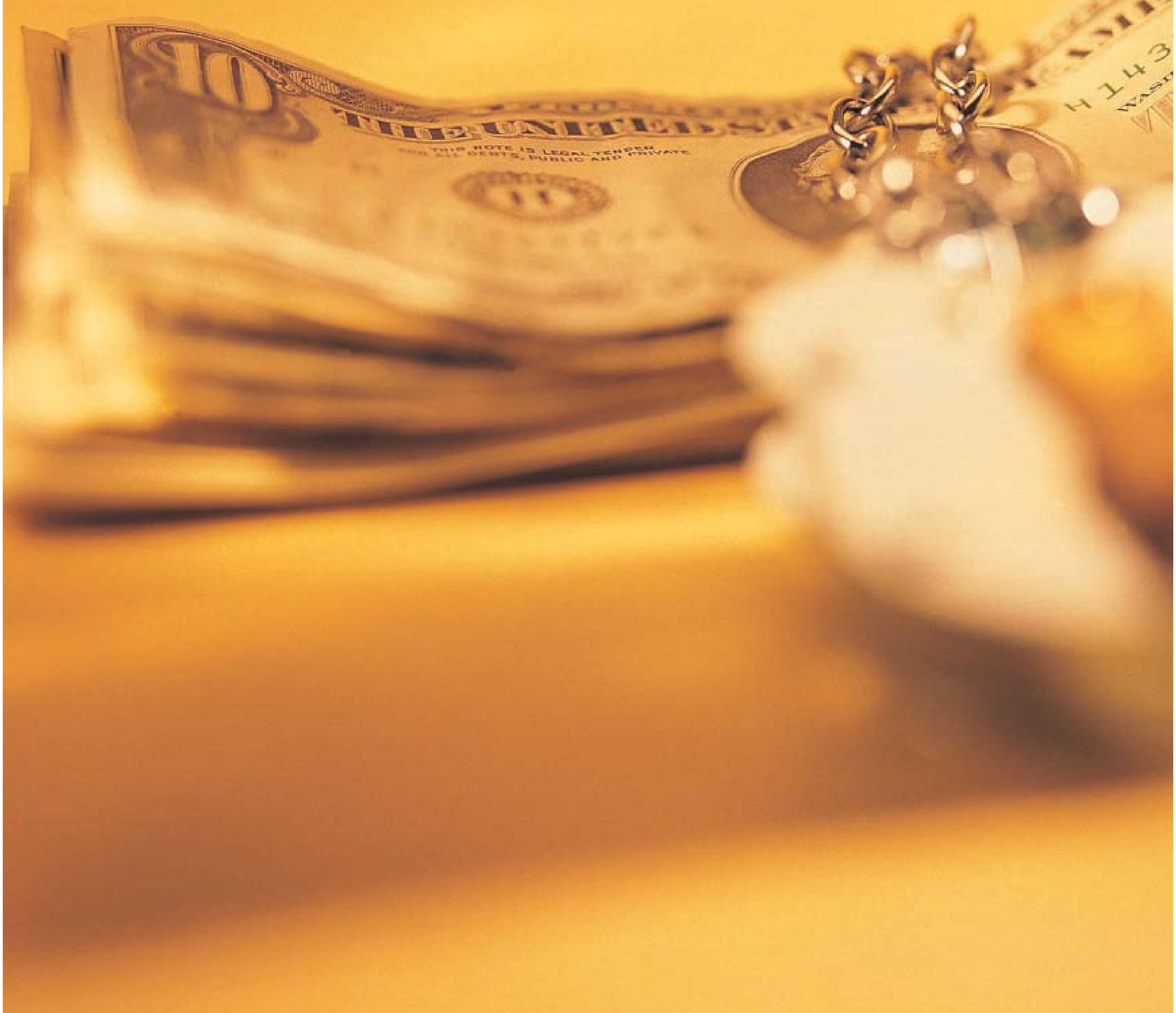

When it comes to the issue of tax saving investments the main concentration is on selection of various instruments that will help one make the maximum use of the overall limit. However for Financial Planners there is also an issue of restricting the investment because several people are investing more than what is actually required. Let's take a look at this issue and the means to tackle it.

One of the major concerns of people who are looking at making tax compliant investments is how they can effectively make use of the benefits of Section 80C routes. Everyone wants to know how to completely use the limit available for this investment and due to this there is a need to plan out the entire range of section 80C eligible investments. Along with this there is a different problem that many people face but there is very little discussion of this. Even Financial Planners do not have adequate planning on this issue.

The Other Angle

The real challenge before many people is how they should select their investments such that there is a limit maintained on their Section 80C investment. This limit is required because the existing investments are already a bit more than required. There is a need to ensure that the investment in this tax benefit route is cut down and reduced because the extra investments made here will not serve any purpose. There is a need to clearly look at each of the items in detail and hence this will give an idea about which is the area that one must use sparingly or reduce in their entire efforts.

This exercise is completely opposite to the problem of where to invest but it requires the same amount of importance and attention.

The Benefit

Before going to the details of the exercise one must take a look at the entire benefit that is available to individuals. Section 80C of the Income Tax Act provides for a deduction from the income of an individual upto a sum of Rs 1 lakh in a financial year. The maximum amount of tax benefit that will be available under this section is thus restricted to Rs 1 lakh.

The way in which this section works is that the eligible amount that is allowed as a deduction will be reduced from the income of the individual and then the remaining amount of the income would be taxed at the applicable rates for that individual.

Consider a case where the total income of a person is Rs 345,000 and the eligible investments and other sums under Section 80C come to Rs 85,000. In this case the amount of Rs 85,000 is reduced from the overall figure and the taxable income of the person will be Rs 260,000.

In another case where a person has an income of Rs 636,000 and the eligible investments under Section 80C come to Rs 156,000 the benefit of the deduction will be retained at Rs 1 lakh. The taxable income in this case will come to Rs 536,000 and the appropriate tax calculated on this amount. In this case the additional investments or expenses of Rs 56,000 have not provided any tax benefit.

It is this kind of problem that many investors face because the eligible investment or spending goes above the Rs 1 lakh amount. This is especially so for someone from the high earning background and more so for people who have done some investing and planning for several years in their life.

The Issue

The number of alternatives available in the list is quite long and these are increasing with each passing day. This has resulted in a situation where a large number of options are providing the same benefit and it is more likely that one will have some expense or investment in several areas due to which the amount will exceed the Rs 1 lakh limit that has been set.

In the last year and a half several new options have come into effect. First the limit for premium paid for a pension plan with insurance companies was raised from Rs 10,000 earlier to Rs 1 lakh now. This benefit was available under Section 80CCC and this along with Section 80C qualifies for the total overall limit.

In addition the bank term deposits as a route of eligible investment was introduced and the government has framed a scheme for the deposits whereby there will be a lock in of 5 years for the investors and these will be eligible for the tax benefit upto a limit of Rs 1 lakh.

Clogging the Routes

Consider the case of a salaried individual and for this category of people there is a deduction that is possible on account of the provident fund contribution. This amount is the starting point for the Section 80C deduction. There is little that a person can do in controlling this investment except investing more through a voluntary contribution because it gets deducted each month directly from the salary.

There are lot of people who have taken a housing loan and the regular repayment of the loan amount will consists of repayment of both the principal as well as the interest. While the interest is allowed as a deduction under section 24, the principal amount repaid during the year is considered as a deduction under Section 80C. For many people especially those in the slightly higher salary bracket who have taken a big loan this amount will constitute a significant portion of the available limit.

Then there are the tuition fees of the children. The full limit of Rs 1 lakh can be exhausted by this item and for a middle aged person who has children in school this will be an expense that will be incurred each year and hence this will get added to the overall total and thus contribute to the overall limit that is present.

Further there are likely to be some insurance policies that a person has bought in the past. It is very unlikely that they just have a term cover where the premium payment is quite low but the chances of having some endowment and other policies is much higher which would have some premium to be paid as this has to be made each year. This premium can often run to Rs 20,000-30,000 in a year and this would mean that considering this together with the other areas for the deduction a person is already completing the overall limit.

Here we have considered just a few of the common examples of what are the items that one would normally have investment in. There are further choices available and a person who has already run up the required benefit can say that they

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will not make any further investments because they are not necessary. However this is not what people do and they actually go and invests more than what is actually necessary for the purpose. In such a situation there arises a question of how to control the extra investment.

The Other Items

There is the contribution to the public provident fund (PPF) that many people use as a means of an alternative to fund their retirement plans. For those who are professionals or self employed; using this route is a very good option as there is some corpus being built for them on a regular basis in the absence of a provident fund benefit. The maximum investment possible in this area in a year is just Rs 70,000 and even if a person uses this entire amount then there will be an additional choice that they will have to make to complete the overall limit.

For a person who looks at the PPF as an additional option to the entire list that we considered earlier this would mean that using a large part of the balance here would push the overall figure above the Rs 1 lakh limit.

Another common route adopted now is the pension policies of insurance companies. Many people prefer to have their own pension policies and to pay a regular premium here but this amount is also eligible for a deduction. In addition this is a regular payment that has to come in each year and hence one might witness that there is little tax benefit left in this investment.

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There are two more areas that are extremely popular and hence it is likely that a lot of people are putting money into these areas but the question is whether this is actually useful because they might have already completed their overall limit that is present with them. One of them is equity linked saving schemes (ELSS). These schemes invest their corpus into equities and they are raking in large amounts of money from investors. Mutual fund advisors as well as agents are selling these schemes aggressively to people who want to make tax savings investments. There is a three year lock in and the question for people is that if they have already have other tax benefits then is this route necessary. The option for them is to use similar options that have the same feature but not the restrictions.

The issue of bank deposits also needs some careful attention because a lot of people would prefer to keep their money safe for the long term and deposit them in a bank fixed deposit rather than look at various other options present. The high rate that is being offered by the banks in recent months is also an attracting feature for investors.

The Route Forward

The first thing for Financial Planners is to see is the extent of the existing investments that have already been made. This will vary according to the nature of activities of a person and their individual features. Further payments that have to be made during the year because of past commitments have to be added to this figure.

If the amount here is lower than the Rs 1lakh figure then additional routes have to be selected for the investment. In several cases where the amount exceeds the maximum total amount the idea should be to stop additional investments in tax saving routes and find out alternative avenues that will have the same features as that of the existing tax saving investment but does not impose several restrictions. There are always several restrictions and reservations that come along with the tax saving investment and then this can be avoided.

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