by KAVYA BALAJI

DON'T BE IN A FIX: LOOK BEYOND FDs

The real returns from bank fixed deposits can slowly dent your returns, especially if you invest big and over the long term

Are you one of those investing in bank fixed deposits (FD) for long tenures—five years or more—despite being in the highest tax bracket? Do you also invest huge lump sums—over ₹10 lakh—in bank FDs? If you happen to do both, you have been making serious losses and must take note of it. There are a host of other fixed income (FI) options that would give you higher returns in real value terms in the long term. So, pay heed.

It's probably the convenience of bank FDs that prods investors towards them instead of trying out other FI options. In the process, most don't realise that at the time of maturity they are actually losing out on a considerable part of the returns earnings in the form of taxes. Says Vikas Gupta, executive vice-president, Arthveda Fund Management: "FD investors fail to identify the long-term impact of inflation on their purchasing power. They also incorrectly focus on the Wholesale Price Index (WPI) instead of the Consumer Price Index (CPI) as the true measure of inflation." It is imperative that you take inflation into account while calculating the returns on your investments because the true value of money involves your purchasing power. In the last decade, the prices of all basic commodities have spiralled up, and, thus, the purchasing power of money has gone down. The same is true for your investments. A 10 per cent return on your investments was considered great 10 years back, but it is not so anymore. So, you must consider investments that would give you inflation-adjusted returns.

To calculate inflation-adjusted returns you must look at the CPI. While WPI is based on the prices in the wholesale market, CPI is the index that reflects price rise on the basis of prices you pay at the retail level. Consider this: WPI inflation has decreased from 7.2 per cent in January 2012 to 6.6 per cent in January 2013. However, CPI inflation rose from 7.7 per cent to 10.8 per cent during the same period. Isn't it proof enough that WPI is irrelevant? Well, there's more to it. Says Gupta: "The International Monetary Fund (IMF) expects CPI to hold at a high rate of 8.5 per cent per annum over 2013-18. This implies a huge risk for fixed deposit investors even at 9 per cent per annum rates."

If you are in the highest tax bracket, the implications are even more alarming. Not only do you lose a considerable part of your returns to taxes, if you calculate the after-tax returns from the FD, it would actu-

THE FIXED INCOME PLATTER

There are a host of options to pick from. Take your pick

INSTRUMENT/ INVESTMENT	PRE-TAX RETURN (%)	POST-TAX RETURN(%)#	POST-INFLATION RETURN(%)**
Tax-free bond	9.50	9.50	1.00
Public Provident Fund	8.60	8.60	0.10
Corporate fixed deposit	12.00	8.29	-0.20
Fixed maturity plans	9.00	8.05	-0.45
Bank fixed deposit	9.00	6.21	-2.28
10-year NSC*	8.70	6.01	-2.49

* National Savings Certificate # At 30.9% income tax rate **Inflation is assumed at 8.5%

ally be in the negative. For example, an FD giving you 9 per cent return on your investments would, in real terms, make it 6.3 per cent after tax. And, if you take inflation into account, your real return would be -2.2 per cent. (see *Melting Away*). Therefore, even though you remain invested for long, you actually lose money by investing in bank FDs.

And, if you invest huge amounts, you lose more money. The bad news is not over yet. Says Rakesh Goyal, senior vice-president, Bonanza Portfolio: "If one wishes to redeem FDs before maturity, one will have to pay penalty in the form of a cut in the interest rate." So, FDs don't make sense in the long term if you consider real returns.

For better returns and liquidity, there a host of FI options. Says Vishal Dhawan, director, Plan Ahead Wealth Advisors: "Consider using instruments where the returns are tax-free or you get the benefit of capital gains. For example, debt mutual funds held for periods in excess of one year have a 10 per cent flat tax rate, or 20 per cent with indexation, whichever is lower." In debt funds, liquid funds and bonds can be considered. Says Sudhir Agarwal, fund manager, UTI Mutual Fund: "Liquidity needs of the investor can be met through investments in liquid funds, while fixed maturity plans (FMPs) can be a close substitute for FDs as they are more tax efficient." Agrees Goyal: "Through FMPs one gets safety of capital, high interest rate and indexation benefits in the long term." Indexation benefits are available if you remain invested for more than one year. Says Suresh Sadagopan, principal planner, Ladder7 Financial Advisories: "FMPs and open-ended debt funds are subject to long-term capital gains treatment. This ensures the effective tax will be in single digits." Such FI instruments also help you diversify. Says Rajesh Iyer, head-investments & family office, Kotak Wealth Management: "Debt investments need to be diversified across various instruments to mitigate interest rate and credit risk. An investor can diversify across FMPs, fixed deposits, tax-free bonds and duration products."

Corporate bonds and FDs with high ratings also provide relatively safe, but higher returns. Says Gupta: "Investing in high-grade corporate bonds can be a good strategy to preserve one's purchasing power over the next 2-3 years." It is important to choose those which have ratings greater than or equal to AA. The same is true for corporate deposits, wherein you could earn after-tax returns of over 8 per cent (see *The FI Platter*). Says Gupta: "Corporate deposits of institutions regulated by the Reserve Bank of India and National Housing Bank can be good investments because these have lower default risks due to the strong regulatory presence." Tax-free bonds are yet another investment option. Says Dhawan: "Returns from tax-free bonds are superior to those from bank deposits and, since they are also listed, they have liquidity." So, if you are in the highest tax bracket with tonnes of money to invest, opt for debt funds, tax-free bonds, corporate bonds and deposits instead of the conventional bank FD. So, indulge yourself in the world of fixed income options.

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MELTING AWAY

Loss of purchasing power by inflation and taxes

YEAR	PRE-TAX VALUE	POST-TAX VALUE	INFLATION	INFLATION INDEX	REAL VALUE
0	100	100		1	100
1	109	106	10.70%	1.11	96
2	116	113	9.50%	1.21	93
3	123	120	8.40%	1.31	91
4	131	128	7.40%	1.41	90
5	139	136	6.70%	1.51	90

Source: IMF estimates, ArthVeda. Tax rate of 30.0% and deposit rate of 9.0%

Graphic: VARUN VASHISHTHA