

Sec 54EC bonds a boon to save capital gains

Even at 30% tax, the net equivalent return of investing in such bonds works out to an eye-popping 12.60% p.a. post tax!



MONEY WISE

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It was over a decade ago that a client of mine, Ravi, had invested in some property at Pune.

Convinced that real estate prices have peaked, he sold this property for a handsome profit. But along with this profit also came the capital gains tax liability.

He had two options — He could either invest the capital gains amount in Section 54EC bonds (currently being issued by REC and NHAI) and thereby save the entire amount of tax, or he could actually pay the tax and invest the balance in quality equity funds.

Ravi was inclined towards the second option. His reasoning was on the following lines — while it is true that investing in the bonds could save him the tax, the bonds per se offer very little inter-

est. Currently it is 6% p.a. — that too fully taxable. Plus the money is locked in for three years. Wouldn't it be a better idea instead, to pay the tax and earn good returns with the remaining money?

Towards this end, we decided to run some numbers. The analysis threw up some fascinating results and Ravi left the office clutching the application form for the bonds close to his chest.

The analysis

Here's what we found. If you are lucky enough to have earned long-term capital gains, the Section 54EC bonds is one of the best investments you could make. In spite of the fact that the returns are low. In spite of the fact that the interest is taxable. And in spite of the fact that there is a three year lock-in (see table for returns calculation).

The key thing is that on account of the tax saving, the bonds effectively offer the investor an up-front 20% discount. It is like investing ₹80 but earning a return on ₹100. Also, the 20% gets spread

over just three years which is the lock-in period of the bonds.

For example, in the above table, say the investor has earned a capital gain of ₹100. Effectively, he will end up investing ₹80 in the bonds as he saves a tax of ₹20. At the rate of 6%, he earns ₹6 every year and at the end of three years, he gets his original investment back.

The net equivalent return works out to an eye-popping 12.60% p.a. after tax! And if the investor does not have other taxable income, the return climbs to 14.70% p.a!

A happy Ravi says that any which way he looks at it, investing in these bonds is like getting to save his tax and also get paid for it!! One would be crazy not to go for it.

As already mentioned earlier, Ravi's earlier idea was to pay tax and take the remaining funds to greener pastures. Therefore, we thought it could also be interesting to see how green the pasture could be.

Let's say Ravi were to invest ₹1 lakh in the market. At

► Outstanding returns

	In ₹ (Pre-tax)	In ₹ (post-tax)
Amount of long-term capital gains	100	100
Tax saved on account of investment	20	20
July 31, 2010 Net effective amount invested in bonds	80	80
July 31, 2011 Interest earned for the first year	6.00	4.20
July 31, 2012 Interest earned for the second year	6.00	4.20
July 31, 2013 Interest earned for the third year	6.00	4.20
July 31, 2013 Maturity amount	100	100
Equivalent rate of returns	14.70%	12.60%

Note: Tax rate assumed to be 30%. Surcharge has been ignored for simplicity

the rate of 14.70% p.a. over three years, the money should grow to around ₹1,51,000 i.e., almost 50% more. And this is just to break even. After that, he will actually start making any money.

No wonder Ravi was clutching the form as if it was cold cash. It is!

Works for all

Last but not the least, it may be noted that these Section 54EC bonds may be used to save tax on any long-term capital gain and not necessarily that from sale of prop-

erty. For example, apart from property, sale of say non-equity mutual funds, bonds, debentures gold, jewellery or even gold ETFs etc may result in long-term capital gains. Such gains may be saved by investing the capital gain amount in the 54EC bonds as detailed above.

There is only one drawback to these bonds — the maximum investment in any one financial year is capped at ₹50 lakh. While by no means a small amount, however, the way property prices have spiralled, some in-

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vestors may just find it not enough to cover the entire amount of capital gains.

However, some planning may help.

Remember, you have six months to invest in the bonds from the time of earning the capital gain.

If you find that you would need a tax cover of more than ₹50 lakh, then it would help if you time the sale transaction between December and March of any year. This way, the six-month period would overlap two financial years, which would enable you to double the investible amount to ₹1 crore.

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