THE ECONOMIC TIMES | wealth
English Edition | 20 November, 2020, 09:32 AM IST | E-Paper

These 4 lesser known tips can help you save tax

Synopsis
If you think your tax liability has been very high so far, follow these tips to bring it down and not pay more than necessary in future.

Investors with running SIPs who want to redeem only at the time of need can also plan their redemption.

Since most people compute their taxes at the time of filing returns, they often land up finding that their final tax liability is much higher than what they had expected. There is little point in repenting not doing enough to bring down that inflated burden. Instead, follow some of the lesser known tips given below to reduce your tax liability in the current year (2020-21) and also in future.

Book capital gains smartly
Most people redeem mutual fund investments whenever they need the money and this could result in high capital gains in a particular financial year. Since Rs 1 lakh of long term capital gains from equity investments— stocks, equity mutual funds, etc— are tax free per financial year, investors should redeem investments in a planned manner. Instead of booking a large amount every four or five years, they should book long term capital gains of Rs 1 lakh every year during the annual rebalancing, and keep the gains tax free.

Investors with running mutual fund SIPs who want to redeem only at the time of need can also plan their redemption. "If you need the money in the first quarter of a financial year, redeem some units in March (the previous financial year) and remaining units in April (current financial year); so that you can claim Rs 1 lakh exemptions each in two financial years," says Amol Joshi, Founder, PlanRupee Investment Services. This is useful because several goals, like college admission fees, holidays, etc tend to come up in the first quarter.

Harvest capital losses
"Investors can reduce tax arising from capital gains by booking capital losses along with it," says Raghvendra Nath, MD, Ladderup Wealth Management. This strategy works because you can set off the capital loss against the gain and since this is specifically allowed by the Act, there is nothing illegal about it. However, investors need to be careful about the

type of capital loss —short-term or long-term—they are booking. While short-term capital loss can be set off against short-term capital gain and long-term capital gain, long-term capital loss can be set off only against long-term capital gains.

Along with booking losses, investors should also try to improve their portfolio. “While booking tax losses, sell lower quality funds and reinvest the amount in better funds,” says Nath. What if all the stocks and funds in your **portfolio** are of good quality? You can still book losses by selling the companies or funds that are at a loss right now and buy them back after a few days of selling.

Use indexation benefit

We all know that debt mutual funds are tax efficient products. Therefore, we can reduce tax by shifting money from fixed deposits to debt funds. The power of compounding works better with mutual funds because of tax deferment—the tax liability hits only when you redeem the units. However, you need to pay tax on fixed deposit interest every year, even if the interest is accumulated.

Indexation benefit—you pay tax only on the gain over and above inflation—is the advantage of debt mutual funds. Your holding period should be more than three years to treat it as long-term capital gain and take indexation benefit. The indexation usually is linked to the number of years of holding. However, you can increase it with smart moves. “You can claim four year indexation benefit for investment of three years and few days provided investment happens in March and redemption in April,” says Ankur Maheshwari, CEO, Equirus Wealth Management (see chart). This is because tax laws define indexation benefit on the basis of financial years. For example, an investment made in March 2017 falls in 2016-17 and the redemption in April 2020 falls in 2020-21 and therefore, it will be eligible for four years of indexation.

Get four-year indexation benefit by investing in March and redeeming in April

Claim four-year indexation benefit for investments just over three years old.

Financial Year	Cost Inflation Index	Note
2016-17	264	
2017-18	272	
2018-19	280	
2019-20	289	Indexation benefit of 9.5% only for 3 years
2020-21	301	Indexation benefit grows to 14% when fourth year is added

BCCL

54EC bonds

We all know that buying another house is the best way to save tax arising from selling a house. However, what if you don't need a new house? Buying another house, just to save tax, is not a smart strategy. "If you don't need another house, you can save tax by investing the capital gains partly in 54EC bonds within six months," says Karan Batra, Founder & CEO, Chartered Club. Since all these bonds are from PSU entities, safety is a given. The 5% interest rates offered by these bonds are also comparable with that of PSU banks. More importantly, there won't be any TDS on interest for resident investors.

However, there are some restrictions on these bonds. First, the bonds can't be transferred for five years and therefore, the investments will be locked in. Second is the investment restriction per financial year. "The maximum investment allowed and maximum tax rebate allowed is Rs 50 lakh per financial year. So, invest the capital gains in the same financial year and do not keep it pending for the next financial year," says Gautam Nayak, Tax Parnter, CNK & Associates LLP. For example, assume that you made a capital gain of Rs 60 lakh in March 2020 and invested Rs 50 lakh in April 2020. As the investment is made in 2020-21, you will not be able to make additional investments in 2020-21. You will lose the investment opportunity for any capital gains earned in the first half of 2020-21. However, if the capital gain is made in the second half of 2020-21, you can save tax by investing in 54EC bonds in 2021-22.