The 2008 Guide To Tax Planning

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What is Tax Planning ?

Tax planning is an essential part of your financial planning. Efficient tax planning enables you to reduce your tax liability to the minimum. This is done by legitimately taking advantage of all tax exemptions, deductions rebates and allowances while ensuring that your investments are in line with your long term goals.

What tax planning is not...

- Tax Planning is NOT tax evasion. It involves sensible planning of your income sources and investments. It is not tax evasion which is illegal under Indian laws.
- Tax Planning is NOT just putting your money blindly into any 80C investments.
- Tax Planning is NOT difficult. Tax Planning is easy. It can be practiced by everyone and with a very little time commitment as long as one is organized with their finances.

Planning taxes this year

A. You will have certain needs and goals to meet. Understand what those are and then figure out how to maximize tax efficiency in your effort to meet them. Tax planning should be a part of the overall financial planning that you must do.

For instance, you might be getting married and need to buy a house. In this situation you need to get insurance to protect you spouse if they are financially dependant upon you, as well as you need to get a home loan. What should you prioritize and what do you have the capacity to afford? If you blindly put money into an insurance policy, it might not even be sufficient to give you adequate

insurance cover. However, if you choose to pay off the principal on your home loan, that could be a better option in this situation.

B. Do not blindly invest money with the first agent that you might come across. You might end up making mistakes. A lot of people end up buying insurance policies with minimal insurance coverage or putting money in instruments where they cannot access the money when they need it.

C. Do not make last minute decisions just because your payroll department has reminded you that the internal deadline for submitting proofs is approaching. Tax planning involves planning in advance to avoid the last minute scramble.

Selecting tax saving investments

You should think about the following criteria, before selecting your tax saving investments for the year:

Introduction

- **Liquidity:**

How quickly will you need the money?
Will you need to access the money within the next year or two years or over what duration ?
None of the above instruments let you withdraw your money quickly, in fact there is a minimum three year lock in for all tax saving investments.

- **Risk and Return:**

How much risk do you want to take. There is a trade off between the two, some instruments are very low risk, but as a result they give low returns which are capped.

- **Inflation protection:**

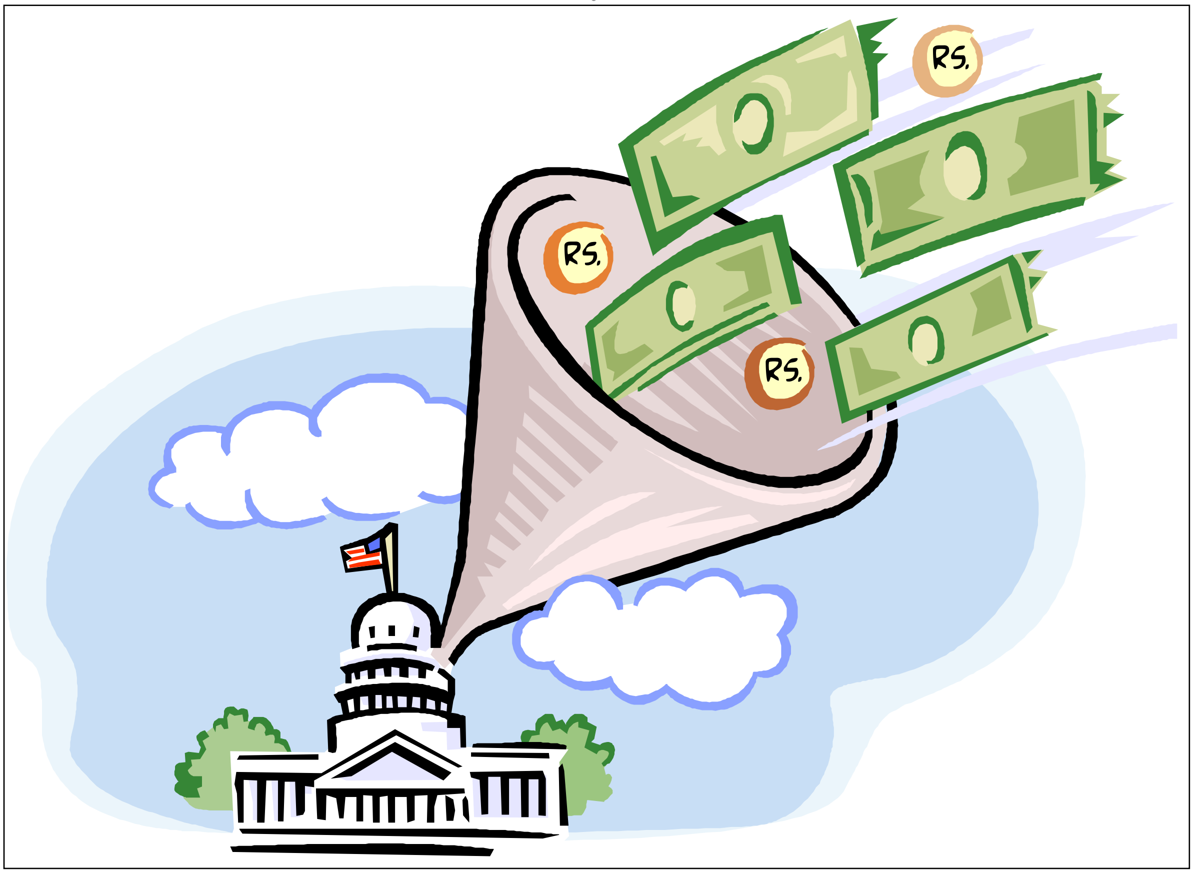
The instruments that give you a low return typically are the worst type of investments regarding inflation. This is important because many of the instruments give you a fixed rate of interest, and lock in your money for a long period. This is not a good protection against inflation.

- **Tax Exemption:**

All tax saving investments under Section 80C are alike in one respect that they are tax exempt when they are invested. But they differ with respect to the tax on the income you earn from such an investment as well as the tax on the maturity of the investment

How you can save Taxes this year?

Some of the Sections of Income Tax Act, 1961 are detailed below which detail few exemptions and categories of exempt income that you can take advantage of:



Section 80C

Section 80C:

Investment in specified instruments and expenses Section 80C gives every income tax payer up to a maximum of Rs. 1,00,000 tax free income in a year if they invest in or buy the following instruments. Please note that this is a combined total of Rs. 1,00,000 and not an individual figure for every instrument:

1. Premium for Life Insurance or ULIP
2. Provident Fund (PF) contribution
3. Public Provident Fund (PPF) - only up to Rs. 70,000 in a year
4. Repayment of home loan principal
5. Equity Linked Savings Schemes (ELSS) of Mutual Fund Companies
6. Infrastructure Bonds
7. National Savings Certificates (NSC)
8. Tax Saving Fixed Deposits with Banks
9. Tuition Fees of children

Type of 80C Instrument	Lock In Period	Returns	Risk	Taxation of Returns
Equity Linked Savings Scheme (Mutual Fund)	3 years	Market Linked (58% Category Average for yr ending Dec 28,2007)	High	No tax
Life Insurance Premium	2 years	6%	Low	No tax
ULIP Premium 1	3 years	Market Linked	High	No tax
PPF (fixed returns)	15 years	8%	Low 2	No tax
Home Loan Repayment	5 years	NA	NA	NA
Infrastructure Bonds (fixed returns)	3 years (min)	6%	Risk Free	Interest is taxed
NSC (fixed returns)	6 years	8.16%	Risk Free	Interest is taxed
Tax Saving Fixed				
Deposits (fixed returns)	5 years	8%-8.75%	Risk Free	Interest is taxed

Under Section 24, a maximum of Rs 1,50,000 can be deducted from your taxable income as interest repayment for a self occupied house. Please note that this deduction is not available if you the house is still under construction and you do not have occupation of the house.
Provisions that you should take advantage of if you are a salaried employee:

Section 10(13A) :
House Rent Allowance
You can take advantage of the provisions under this section if you are renting an accommodation. These provisions will not be available to you if you stay in a rent-free accommodation or live with your family or in your own house.
Under Section 10(13A), HRA is exempt to the least of the following:
i) 50/40 per cent of basic salary= Dearness Allowance (if, applicable),
ii) excess of rent paid over 10 per cent of basic salary; and iii) actual HRA received.
Lets illustrate this calculation with an example:
Paying Rent to parents or relatives
If you want to pay rent to your parents or any relatives (like uncle/cousin) whom you are staying with. You will need to treat them as landlords. And request the owner of the house (which will be one of your parents) to declare it in his/ her personal income tax return. This will prevent any litigation in the future.

Section 10 (14) Rule 2BB(10):
Transport Allowance
Transport allowance granted for commuting between your residence and place of work is exempt up to Rs. 800 a month. You can take advantage of this provision to get a tax exemption of Rs 9600 annually by providing your employer with bills or a self declaration.

Section 17(2):
Medical Reimbursement
You can claim exemption up to Rs 15,000 annually on actual expenditure incurred on your medical treatment or for treatment of any of your dependants. Moreover, there is no restriction of approved hospitals or clinic for the same. This is exempt only on provision of actual bills.
However, if the amount is paid out as an allowance not a reimbursement then it would be fully taxable.