₹ 200 ISSN - 2249-555X

Volume : 1 Issue : 6 March 2012

Indian Journal Of Applied Research

Journal for All Subjects

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Listed in International ISSN Directory, Paris.

ISSN - 2249-555X

Indian Journal of Applied Research

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Volume : 1 | Issue : 6 | March 2012 ISSN - 2249-555X

Research Paper Management

Investment Avenues and Tax Implications for Small Investors

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ABSTRACT

The paper examines various investment alternatives available for small investors. There are many investment opportunities available in India for small investors. There are also many areas which make perfect places for a sound investment. We can invest into various categories of investments viz., Equity, debt, bank deposits, post office deposits, mutual fund, insurance, public provident fund, company deposits, gold real estate, commodities and miscellaneous. If the investors look for short term investments then they can invest in post offices , government bonds, mutual funds. If they concentrate on long term investments, then public provident funds, life insurance, long term bank deposits are suitable investment options for small investors. The investors should compare the risks and expected return on various investment alternatives while taking investment decisions. The investors could seek advice from experts and consultants of various schemes while making investment decisions. This paper provides an overview about the tax benefits available for various investment alternatives and also recommends the various points to be considered while making an investment decision.

Keywords : Investment Avenues, Small Investors, Tax Benefits, Investment Alternative

Introduction

There are many investment opportunities available in India. The economy of India does not depend on earnings from export; therefore, there is more room for investment in this country. There are many areas which make perfect places for a sound investment. Before selecting the investment choice, the investors should be aware of the risks, returns, safety and liquidity. The purpose of investment may vary one person to another, like, tax reduction, children's education, constructing house, purchase of assets, for marriage, after retirement benefits, meet contingencies, making trust, etc. Clarity in the purpose of investment will help the small investor select proper investment alternatives. Some of them are marketable and liquid while, others are non marketable and some of them also highly risky while others are almost riskless the investor has to choose a proper investment avenue among them. Depending on his specific needs, risk preference, and return expected Investment avenues can broadly categories under the following heads.

Idea of Investment

When a person has more money than he requires for current consumption, he would be coined as a potential investor. The investor who is having extra cash could invest it in securities or in any other assets like or gold or real estate or could simply deposit it in his bank account. The companies that have extra income may like to invest their money in the extension of the existing firm or undertake new venture. We can define investment as the process of, "sacrificing something now for the prospect of gaining something later".

Characteristics of investment

1. Return: -

All investments are characterized by the expectation of a return. The return may be received in the form of yield plus capital appreciation. The difference between the sale price and the purchase price is capital appreciation. The dividend or interest received from the investment is the yield. Different types of investments promise different rates of return. The return from an investment depends upon the nature of investment, the maturity period and a host of other factors.

2. Risk: -

Risk is natural in any investment. The risk may relate to loss of capital, delay in repayment of capital, nonpayment of interest, or variability of returns. While some investments like government securities and bank deposits almost risk less, while others are more risky. The longer the maturity period, the longer is the risk. The lower the credit worthiness of the borrower, the higher is the risk.

3. Safety: -

The safety of an investment implies the certainty of return of capital without loss of money or time. Safety is another feature which investors desire for their investments. Every investor expects to get back his capital on maturity without loss and without delay.

4. Liquidity: -

An investment, which is easily saleable, or marketable without loss of money and without loss of time is said to possess liquidity. Some investments like company deposits, bank deposits, P.O. deposits, NSC, NSS etc. are not saleable. Some investment instrument like preference shares and debentures are marketable, but there are no buyers in many cases & hence their liquidity is negligible.

Golden Rules for an Investor

The following are the three golden rules for investors.

- Invest early
- Invest habitually
- Invest for long-standing and not short-range

Important Steps to for Investment

Before making any investment, the investor must ensure the following points.

1. Acquire written documents explaining the investment.
2. Examine and recognize such documents.
3. Verify the legality of the investment.

4. Find out the expenses and benefits associated with the investment.
5. Appraise the risk-return profile of the investment.
6. Familiar with the liquidity and safety aspects of the investment.
7. Match up to these details with other investment opportunities available.
8. Finally, select the best option.

Various types of Investment Alternative

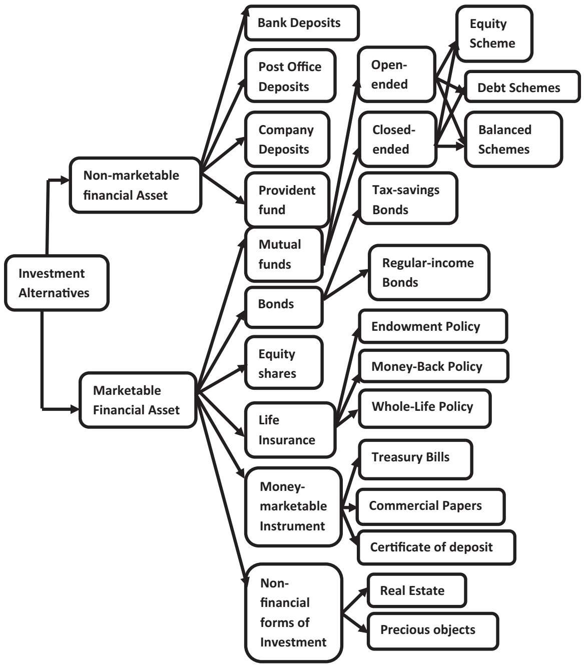

Fig 1
Various types of Investment Alternative

1. BANK DEPOSITS
A fixed deposit account allows depositing our money for a set period of time, thereby earning a higher rate of interest in return. A fixed deposit also gives a higher rate of interest than a savings bank account. Any investment portfolio should consist of the right mix of safe, fair and risky investments. While mutual funds and stocks are the preferred contenders for moderate and risky investments, fixed deposits, government bonds etc. are considered safe and sound investments. Fixed deposits have been particularly well-liked among a huge section of investors in India as a secure investment option for a long period. With fixed deposits or FDs as they are generally known, a person can invest an amount for a fixed duration. The banks give interest rates depending on this loan amount and the tenure of deposit. Banks offer comparatively higher rates for Deposits of resident Indian senior citizens. The interest rates differ from nationalized bank to Private Banks

2. POST OFFICE
A Post-Office Recurring Deposit Account (RDA) meant for investors who would like to deposit a fixed amount every month, so as to get a lump sum after five years. The scheme, an efficient way for long term savings, is one of the best investment options for the low income groups.

Kisan Vikas Patras is a safe and long-standing investment option given by the Government of India which provides interest income similar to bonds. The title of the scheme makes some fallacy that it is only meant for farmers. But anyone can go for. KVP is advantageous for those looking for a safe avenue of investment. Money doubles towards the end of specified period. A Post-Office Time Deposit Account is meant for those investors who want to deposit a huge amount of money for a fixed period; minimum period of one year to three years and a maximum period of five years. Investor gets a lump sum (principal + interest) at the maturity of the deposit. Time Deposits scheme return a lesser, but safer, growth in investment.

National Savings Certificates (NSC) is a certificate issued by Department of post, Government of India and is available at all post office counters in the country. This scheme is specially planned for, Businessmen, Government employees and other salaried classes who are IT assesses. It is a long term safe and sound savings option for the depositor

3. COMPANY / NBFC FIXED DEPOSITS
Fixed deposits in companies that earn a predetermined rate of return over a period of time are called Company Fixed Deposits. Financial institutions and Non-Banking Finance Companies (NBFCs) also accept such deposits. These are not secured deposits, i.e., if the company defaults, the investor cannot sell to recover his capital, thus making them an uncertain investment option.

4. PUBLIC PROVIDENT FUND
Public Provident Fund (PPF) is a long-standing Debt Scheme of the Govt. of India on which regular interest is paid. Any Individual can invest in this scheme and can earn an attractive tax-free return on the same which is usually higher than the return offered by Banks.

5. MUTUAL FUNDS
Mutual funds are investment companies that utilize the funds from investors to put in other companies or investment alternatives. People find mutual fund gain high rate of return by diversifying their investment and risk. But, in reality this scope of high rate of return is just one side of the coin. The other side, is a harsh reality of the highly fluctuating rate of return. There are two types of mutual funds available. i) Schemes according to maturity period i.e., Open-Ended Funds, Close-Ended Funds. ii) Schemes according to investment objective i.e., growth/Equity oriented Scheme, Income/Debt oriented, Balanced funds, Money Market or Liquid Funds, Gilt Funds, Index Funds, Sector Specific Funds, Tax saving Schemes, Leverage Funds, Hedge funds, etc.,

6. SHARES
Shares earn more return and more risk. The investor needs good assistance towards making the right choice of investments in shares of companies and need to understand the company first with whom he or she is making an investment, evaluate the various possible pros and cons of the investment avenues, the benefits to be accrued and the expected returns by understanding the past performance, future trend of the company.

7. BONDS
A Bond is a loan given by the buyer to the issuer of the instrument. Bonds can be issued by companies, financial institutions, or even the government. On top of the scheduled interest payments as and when applicable, the proprietor of a bond is permitted to receive the face value of instrument at the specified maturity date. Bonds can be broadly classified into a. Tax-Saving Bonds

b. Regular Income Bonds.

8. LIFE INSURANCE
Both government and private players are in the market at present in this sector of investment which not only secures the future of the insured but also protects the family in times of uncertainty with very small amount of investment made systematically and regularly. There are many variants of a life insurance policies: Whole Life Assurance Plans, Endowment Assurance Plans, Term Assurance Plans, Pension Plans, etc.,

9. NON-FINANCIAL FORMS OF INVESTMENT
These are very attractive forms of investment .The investment taken by large number of people in land and house

property, precious objects i.e., gold, silver, platinum etc., capital appreciation is high in these investments and loans are available .The purchase of land must always be determined after carefully examining the payment of tax on property. Tax must be paid on house property. Tax must be paid on house property as well as after property is sold under Capital Gains Act. Investment in non-organized sector i.e., chit funds are another attractive form of investment. It is easy way to get huge money for fulfill our objective.

Tax Benefit for various Investment Alternatives:

S. No	Investment Alternative	Schemes	Period	Rates	Interest exemption	Capital tax exemption
1	Nationalized Banks	Bank fixed deposit	Depending upon maturity period	4-6%	Upto 10000 Tax exempted	Exempted
	Private Banks			10.00%		
2	Nationalized Banks	Domestic term deposits	Depending upon maturity period	7-9.25%	Upto 12000 Tax exempted	Exempted
	Private Banks			10.25%-10.50%		
3	Nationalized Banks	Deposits of resident Indian senior citizens	Depending upon maturity period	7-9.25 %	Taxable	Exempted
	Private Banks			10.50 %-11%		
4	Post Office	Post office time deposits	Depending upon maturity period	6.25 -7.50 %	Upto 9000 Tax exempted	Exempted
		Post office recurring deposits	5 years	7.50 % (Fixed rate)	Exempted	Exempted
		Senior citizen scheme	5 years (may extend another 3 years)	9%	Taxable	Exempted
		Kisan vikas patra (KVP)	7months-8years	8.40%	Taxable	Exempted
		National savings scheme (NSC)	6 years	8%	Taxable	Exempted
5	**Company/NBFC Fixed Deposits**	**Company / NBFC Fixed Deposit**	Depending upon maturity period	14% (varies from different companies)	Taxable	**Depending upon the profit/ loss**
6	Provident fund	Public provident fund	15 years	8%	Exempted	Exempted
7	Mutual Fund	Open-Ended Scheme	Depending upon maturity period	12% (varies from different schemes)	Exempted	Taxable
		Closed-Ended Scheme	Vary between 5 to 15 years			
8	Shares	Equity shares	Depending upon the market movement			
		Preference shares	Short-term	10%	Exempted	Taxable
			Long-term	20%	Exempted	Taxable
9	Bonds	Individual Bonds (except government bonds)	Depending upon maturity period	Depending upon bond selection	Taxable	Purchased in primary market –No capital tax
			Depending upon maturity period	Depending upon bond selection	Taxable	Purchased in secondary market- Capital tax is available
		Government Bonds	Depending upon maturity period	Depending upon bond Selection	Exempted	Exempted
10	Insurance	Life-Insurance	Depending upon maturity period	Depending upon policy selection	Exempted	Exempted

Suggestions:

Every investor can invest at least 10% from their income in life insurance not for the purpose of their future benefit but for their safety in life. It is better to invest in government insurance companies than private companies.

Investors prefer to invest in short-term periods. They choose the private bank deposits (i.e., Tamilnadu Mercantile Bank, Karur Vyshya Bank, Axis Bank, ICICI bank,) for higher interest rates than nationalized banks.

For senior citizens, retirement benefits are more feasible if investments are made in nationalized banks. Even for long-term investment, nationalized banks are suitable for all investors.

Post-office deposit is suitable for repaying loan, meeting expenses, etc., it being treated as working capital.

Those who have surplus money can go for real estate. It is not recommended for small investor because government has increased guideline value.

Be aware and alert on hidden charges and find out the cost and benefits associated with the investment. Try getting maximum details about the investment. Always deal with SEBI registered or authorized intermediaries only and try getting maximum information about the intermediaries and types of investment offered by them

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Indian Journal Of Applied Research
8-A, Banans, Opp. SLU Girls College,
New Congres Bhavan, Paldi, Ahmedabad-380006.
Contact.: +91-9824097643 E-mail : editor@ijar.in

Printed at Unique Offset, Novatsing Rupam Estate, Opp. Abhay Estate, Tavdipura, Shahibaug, Ahmedabad