NSDL
Technology, Trust & Reach

October 2015

The Financial Kaleidoscope

Defining the different shapes of investment

From The Editor's Desk

Dear Reader,

Inorder to raise money for funding infrastructure projects through Tax Free Bonds, Central Board of Direct Taxes (CBDT) has approved seven entities viz., The National Highways Authority of India, The Indian Railway Finance Corporation, The Housing and Urban Development Corporation, The Indian Renewable Energy Development Agency, NTPC, Rural Electrification Corporation & Power Finance Corporation to issue Tax Free Bonds for the F.Y. 2015-2016 amounting to ₹40,000 Crores.

Tax Free Bonds are issued by government enterprises where the interest is tax free. Means, you need not pay any income tax on such interest amount irrespective of the amount received. If you invest in Bank FD, you may get 8.5% interest, however you need to pay income tax of 10% or 20% or 30% based on your tax slab. However, in case of tax free bonds, any interest received is tax free. No TDS would be deducted by these companies who are offering these tax free bonds.

To have a glimpse on NTPC's issue, by the end of Day 1, NTPC's issue was oversubscribed by 11.04 times of the base issue size of ₹400 crore and 6.31 times of the overall issue size of ₹700 crore. The retail portion was oversubscribed by 6.60 times (of the total issue size allocated to retail), reflecting a huge confidence of retail investors in the company. The tax free bonds are rated by leading credit rating agencies. Since tax free bonds are mostly issued by government backed companies, the credit risk is quite low. It is advisable to buy Tax-Free Bonds which have good Credit Rating. These ratings can be AAA (good rating), AA+, AA & AA-. Lower the rating, higher would be the interest rate.

Investors can buy tax free bonds both in the primary market and secondary market. Tax free bonds are also listed in the stock exchanges (NSE, BSE etc.) and investors can buy the bonds in the secondary markets (e.g. NSE, BSE etc.). Investors also have the option of buying the bonds in physical form or demat form. If you want to buy the bonds in the demat form, you need to have a demat account. It is better to buy bonds in the demat form, because it will be easier to sell the bond in the stock exchange, in case you wish to sell the bonds before maturity.

In this issue of Kaleidoscope, we will provide insights on Tax Free Bonds. As this is one of the best investment options for investors who want to take low risk but want consistent returns for the long term, Investors can invest part of their investment amount in these tax free bonds.

Best Regards,
NSDL

Click & Find: Tax Free Bonds

Tax free bonds have emerged as a highly popular investment option among investors due to the taxation benefit they offer. We have very few instruments in India where the interest income is exempt from tax. One of them is the PPF (Public Provident Fund) and the second is the Tax Free bonds. Most of the other interest yielding instruments like bank deposits, company fixed deposits, NSC, Post Office Monthly Income Scheme etc., attract tax on interest income.

The Tax free bonds have made a comeback to the market after a gap of one year. The Central Board of Direct Taxes (CBDT) has recently issued a notification related to 'New Tax Free Bonds F.Y. 2015-16'. CBDT has given permission to seven entities to raise funds through the route of Tax Free Bonds worth ₹40,000 crore for the F.Y. 2015-16. These bonds will have tenures of 10, 15 and 20 years. Tax Free bonds will provide an opportunity to the investors to fetch returns at higher interest rate in this declining rate scenario.

Seven Entities are planning to issue Tax Free Bonds in the F.Y. 2015 - 16.

Entity	Allocated Amount of Bonds
The National Highways Authority of India	₹24,000 crore
The Indian Railway Finance Corporation	₹6,000 crore
The Housing and Urban Development Corporation	₹5,000 crore
The Indian Renewable Energy Development Agency	₹2,000 crore
NTPC*	₹1,000 crore
Rural Electrification Corporation	₹1,000 crore
Power Finance Corporation	₹1,000 crore

** Subscription ended on September 30, 2015*

What are the Tax Free Bonds?

Tax Free Bonds is a document containing the details of transaction of lending of money by bond holder to an entity (usually Government entities or PSUs) at a prefixed interest rate (coupon rate) for a predetermined time period.

Tax Free Bonds are similar to any other coupon bearing bonds which provides a fixed income but unlike other bonds, the interest income from tax free bonds is exempt from taxation u/s 10 of the Income Tax Act, 1961.

History of the Tax Free Bonds

Tax Free Bonds were first issued in the financial year 2011-12 to raise funds of ₹30,000 crore and subsequently in each following year but were absent in the last Financial Year i.e. 2014-15.

The funds raised through these bonds are usually placed in the infrastructure sectors which require funds for longer term as in comparison to any other sector.

The two of the issuer has proposed to use the proceeds to part-finance their capital expenditure and also to utilize the issue to finance the ongoing new or upcoming projects.

Tax Free Bonds issued in previous Financial Years	
Financial Year	**Amount allocated for Tax Free Bonds (In ₹Cr.)**
2011 - 12	30000
2012 - 13	60000
2013 - 14	50000
2014 - 15	Nil
2015 - 16	40000

Source: Budget Documents

"Did You Know"

President Franklin D. Roosevelt placed the first order for a $500 Series E Savings Bond in a radio broadcast on April 30, 1941.

"Quote of the month"

It is better to hang out with people better than you. Pick out associates whose behavior is better than yours and you will drift in that direction. - **Warren Buffett**

Get Started – Invest in Tax Free Bonds

Tax Free Bonds – Useful Information

- ✓ **Tenure:** Choice of 10 years, 15years & 20 years
- ✓ Such bonds are likely to be listed on NSE / BSE
- ✓ No lock-in period
- ✓ Bonds upon trading on NSE/BSE, liquidity is available
- ✓ Normally seen as safe investment
- ✓ Could be held either in Demat or Physical form
- ✓ PAN is Mandatory

Who can Invest in Tax Free Bonds?

- ✓ Retail Individual Investors (RIIs)
- ✓ High Net worth Individuals (HNIs)
- ✓ Corporates/Trusts
- ✓ Qualified Institutional Buyers (QIBs)

Individual investors, Hindu Undivided Family (HUF's) Karta and NRI fall under the category of RIIs. These investors can apply for up to ₹10 lakh in each issue. NRIs can subscribe to Tax free bonds on either repatriation or non-repatriation basis. Individual Investors investing more than ₹10 lakh in Tax free bonds are classified as HNIs.

How to subscribe New Tax Free Bonds?

You can subscribe to new tax free bonds when the Bond Issue is open for subscription. The issues will be open for few days only. The bonds can be bought in physical form or through your Demat account. The subscriber has to furnish Permanent Account Number (PAN) to the issuer of the Bonds.

In case, if you miss buying Tax Free Bonds during the Public issue, you can still buy them from Secondary market through Stock Exchanges. But, they can be traded on the exchanges in Demat mode only.

How to redeem Tax Free Bonds?

Tax Free Bonds are long-term investments with minimum lock-in period of 10 years. So, if you wish to redeem them before the maturity period then you can sell them in secondary market. But, liquidity (finding a buyer) can be a challenge. Hence, it is advisable to subscribe to bonds of a large Public Issues instead of the small ones.

Advantages of Investing in Tax Free Bonds

- ✓ Tax-Free Income
- ✓ Low risk, since companies have a better credit rating
- ✓ Listing of bonds on exchanges provides liquidity
- ✓ Option of holding bonds in 'Demat Form' makes your investments easy to handle & monitor
- ✓ Ratings by agencies like CARE, FITCH, CRISIL, ICRA enables you to assess the quality of instruments

Tax Advantage of Investing in Tax Free Bonds

Tax-exempt bonds enjoy a better credit rating and the interest received is tax-free, thus after-tax returns work out to be higher for the tax-exempt bond.

The biggest draw for the investor is the tax free advantage that these bonds offer. Unlike fixed deposits, NSCs and other bonds, the interest earned from these bonds is tax free. Assuming a tax-free coupon yield of 8.2%, the implied pre-tax rate will be to the tune of 11.79% for investors in the 30% tax bracket (those earning more than ₹10 lakh a year).

While short term capital gains from such a sale will be taxed as normal income, long-term capital gains will be taxed at 10%. The bonds must be held for at least 12 months for the profits to be treated as long-term gains.

Details on Tax Free Bonds

In this issue of Kaleidoscope, let us understand what are tax free bonds? Difference between Tax Free & Tax saving / deduction. What are the tax implications of buying and selling of Tax Free Bonds (TFBs)? Difference between Bank FD Vs Tax Free Bond, Debt Mutual Fund Vs Tax Free Bond.

Let us first understand, what is a Bond?

A bond is a Fixed Income security (debt investment) in which an investor loans money to an entity (typically corporate or governmental / PSUs) which borrows the funds for a defined period (tenure) of time at a variable or fixed interest rate (coupon rate).

Those bonds which are exempt from taxation on the 'interest income' under the Income Tax Act, 1961 are called Tax-free bonds. These are usually issued by government-backed entities..

Tax Saving Vs Tax-Free

Though the two terms are used in relation to taxation matters, there exists a considerable difference between the two. Tax-saving implies that there are certain provisions in the Indian Income Tax Act that allows an individual to save tax by investment in some particular investment instruments (like ELSS Mutual Funds or Life insurance premium etc., under Section 80c) or when the taxpayer has incurred some expenses on which tax liability can be minimized to some extent (Example – HRA, LTA etc.,).

Tax-free on the other hand implies income that is not taxable in the hands of investors i.e. the income from such tax-free source is not included in the total income for the purpose of computation of total tax liability. With no income tax being charged on the returns on the tax-free investment no other rebate in the form of tax deduction for the amount invested is provided.

Tax Free Bonds & Tax Implications

- Is TDS applicable on Tax Free Bonds? – These bonds are tax free and hence not subject to TDS.
- Interest income earned on Tax Free Bonds is exempted from Income Tax. The interest earned from these bonds does not part form of your total taxable income.
- The invested amount is not eligible for any tax deduction.

Are Capital Gains taxes applicable on Tax free bonds?

Though the interest earned on these bonds is tax-free, any capital gain from sale in the secondary market is taxable. If you sell your Bond for a price that is more than the cost then you would have to consider this as a capital gain. Short-term capital gains from sale of tax-free bonds on exchanges are taxed at your income tax slab rate, while long-term capital gains are taxed at 10% without indexation. The indexation benefit is not available for Bonds/NCDs. (For STCG holding period is less than 12 months. For LTCG holding period should be more than 12 months)

Tax Free Bonds Vs Bank Fixed Deposits

The interest earned on bank FDs and other types of bonds are not exempted from income tax. It is added to your income and is taxed as per the income-tax slabs. As interest earned from tax-free bonds is not taxed, investors in higher tax brackets mostly earn a better post-tax return than from FDs. But remember, the bank FDs score over tax-free bonds in terms of liquidity as these bonds have longer maturity tenure.

Tax Free Bonds Vs Tax saving Bank FD

The tax saving bank Fixed Deposit has a lock-in period of 5 years. The maturity period of tax free bonds can be in the range of 10 to 20 years. The interest earned on tax saving FD is taxable but the invested amount can be claimed as deduction under Section 80C. You can invest in Bank FD anytime but you can invest in Tax Free Bonds only when the issue opens.

Invest to achieve your Financial Goals

It is advisable to follow the principle –Think beyond taxes when investing. Do not invest in Tax-Free bonds just because the interest income is tax free. Your investment should match your financial goals requirements. Also, if you are looking for a steady source of income annually (periodically) and can afford to lock-in your capital then you may consider investing in Tax Free bonds.

Checklist to buy Tax Free Bonds

How to select best Tax free bonds? Below are the some of the important factors that need to be considered before investing in a Tax free bond public issue.

- ✓ **Credit Rating :** Credit rating of a bond is a third party assessment of the quality of bond in terms of its credit performance. Some of the leading credit rating agencies in India are CRISIL, ICRA, and Fitch. It is advisable to buy Tax-Free Bonds which have good Credit Rating. These ratings can be AAA (good rating), AA+, AA & AA-. Lower the rating, higher would be the interest rate.
- ✓ **Coupon Rate:** The rate of interest offered by the issuer of the bond is called Coupon. Interest rate is the most important parameter to evaluate a bond. The coupon rate of Tax Free Bonds is benchmarked against the government securities (G-Sec) of equal maturity. So, for 10 year lock-in tax free bond the benchmark would be 10 year G-Sec rates. The current 10 year G-Sec rate is around 7.75%. Coupon Rate is calculated based on the type of investor, G-Sec yield and the credit rating. (Most of the Tax-free bonds that were issued in FY 2013-14 carried interest rate of 8% to 9%.
- ✓ **Tenure :** Another important factor that you need to look at is 'Bond Tenure'. The tenure of bonds shall be for 10 or 15 or 20 years. The significance of tenure lies in the fact that investment in bonds must be aligned to the time horizon set for your financial goals.
- ✓ **Payment Frequency:** Payment frequency shows how many times in a given year the coupon is being paid by the company. Higher the payment frequency for a given coupon better it is for the investor. But, most of the Tax free bond issues offer annual payment option only.

Blog

Tax Free Bonds

By Sandesh S. Dadarkar, Student,
Maharshi Dayanand College of Arts, Science & Commerce

People find any product without tax as interesting & hence people opt for tax free bonds. It is once said by **Michael Jordan** that **"In any investment, you expect to have fun and make money".** The interest earned from these bonds is tax free & risk of default is minimal. Such bonds are issued by government backed entities like IRFC, PFC, NHAI, HUDCO, REC, NTPC, NHPC, IREDA, etc. which raises funds from issue of these tax free bonds. These are listed on BSE-NSE which are traded in a demat form. According to I.T. Act, 1961, it is authorized to issue tax free bonds. In the current volatile market, investors keep checking the new tax free investment schemes to avoid more tax. It offers an exit route to investors.

Exactly, around a month before, when a GOI enterprise like NTPC announced for tax free bonds scheme for seven days, investors really rushed for this scheme on 1st day & it got oversubscribed by 11.04 times of the base issue size of ₹400 crore and 6.31 times of the overall issue size of ₹700 crore by the investors who mainly fall in 20-30% tax bracket. The shocking thing is, it got pre-closed on first day itself. The tenure for these bonds is of 10 years, 15 years & 20 years which encourages for the long term capital gains. These bonds were rated as AAA/stable by ICRA & CRISIL & AAA by CARE. Here are some things that investors must check before opting for tax free bonds such as:

- Looking for steady source of income
- Whether he can afford to lock in his capital for the long term
- No concerns on liquidity as it is for long term
- Bonds are having low risk & rated by CRISIL, CARE, ICRA, etc.,

At last, Investors should make their own assessment before investing in such bonds. As **F. J. Raymond** has said that **"Next to being shot at and missed, nothing is quite as satisfying as an income tax refund".**

Your Questions Our Answers: Tax Free Bonds

1. **What kinds of income can I get from tax free bonds? Are these taxable?**

   You get 2 kinds of income from your investment in bonds as follows:

   ✓ **Regular Interest:** Exempt from tax under Section 10(15)(iv)(h) of Income Tax Act

   ✓ **Profit (in case you sell the bond at stock exchange):** Taxed as "Income from Capital Gains"

2. **What is the tenure of Tax Free Bonds?**

   Mostly, Bonds have tenure of 10 or 15 or 20 years.

3. **What is the interest I can earn on the bonds?**

   Interest earned on bonds is tax free. Hence, the real return from these bonds will vary from individual to individual basis the tax slab he/she falls into.

   If I assume a tax free bond issue with an annual interest rate of 8%, the real yield will be as follows:

Coupon Rate	Tax Bracket	Real Yield
8.00%	10.00%	8.89%
8.00%	20.00%	10.00%
8.00%	30.00%	11.43%

   You have to compare this real yield with the rates of fixed deposits (around 8-9%), PPF (8.8%), NSC, etc. and then take a decision.

4. **How will I get paid for the Interest rate of Bonds?**
   You will get paid your interest rate directly to your bank account with which you have bought the Bonds.

5. **Do I need to hold these bonds till maturity, or I can sell in between too?**
   No, you do not need to hold the bonds till maturity. The bonds get listed on the Stock Exchanges (BSE/NSE or both), so you can sell the bond on the Stock Exchange. However, note that bond prices are dependent on the interest rates. If interest rates go down, bond prices go up and vice versa.

6. **What is the impact of credit rating of bonds?**
   As per SEBI Regulations, companies proposing to come out with bond issue have to get themselves rated by at least one credit rating agency.

   A credit rating gives a clear idea on the strength of the company to repay its debt obligations. For e.g. AAA rating signifies highest degree of safety and there is a very less chance of that company defaulting on its obligations.

7. **What will be the capital gains tax impact if I sell these bonds in between?**
   If you sell the bond within 3 years of purchase, it will be treated as "short term capital gain" and gain will be included in your income, and accordingly taxed as per the tax slab in which you fall in.

   In case you sell the bond after 3 years, it will qualify as long term capital gain and taxed @20%.

8. **Can a minor apply to these bonds?**
   Yes, a minor can apply for these bonds, but only through a guardian.

9. **Can one apply in joint names?**
   Yes, In case of Application Form being submitted in joint names, the applicants should ensure that the de-mat account is also held in the same joint names, and the names are in the same sequence in which they appear in the Application Form.

10. **Who will get the interest in case of joint application?**
    In case of joint application, interest will be accounted to the first holder only.

11. **If I'm an NRI can I invest in these bonds?**
    Yes. NRI's can invest in bonds through Repatriable as well as Non-Repatriable basis.

12. **I don't have a PAN card. Can I still apply for subscription?**
    PAN card is mandatory for subscribing to these bonds.

Subscription to *SPEED-e*

During September 2015, five more Participants have subscribed to the *SPEED-e* facility viz.,

- IndiaNivesh Securities Private Limited (DP ID IN303534)
- CSE Capital Markets Private Limited (DP ID IN305082)
- Nam Securities Limited (DP ID IN301782)
- Merrill Lynch Wealth Advisors Private Limited (DP ID IN305099)
- Arch Finance Limited (DP ID IN303403)

Clients of the above mentioned Participants can now avail the facility of submitting various instructions through *SPEED-e* facility.

This takes the total number of Participants who have subscribed to *SPEED-e* to 180.

Investor Education initiatives undertaken by NSDL

- **Joint Awareness Programmes :**

  In order to reach out to investors that are spread across the country and to apprise them about the facilities available in NSDL depository system and the awareness on stock markets, NSDL conducted 20 Joint Awareness Programmes during September 2015 in association with Axis Securities Limited, BMA Wealth Creators Limited, Farsight Securities Limited, Geojit BNP Paribas Financial Services Limited, Guiness Securities Limited, ICICI Securities Limited, Integrated Enterprises (India) Limited, Jhaveri Securities Limited, Kotak Securities Limited, Peerless Securities Limited, Sharekhan Limited & Ventura Securities Limited. NSDL also conducted Investor Awareness Programmes with NSE, Utkal Stock Broking Private Limited & Nanayam Vikatan. These programmes were attended by more than 1,800 investors.

Joint Awareness Programme organized by NSDL in association with Farsight Securities Limited at Delhi in September 2015.

- **Regional Investor Awareness Programme with Securities and Exchange Board of India (SEBI) & National Stock Exchange of India Limited (NSE):**

  In order to reach out to masses spread across the country and to apprise them about the facilities available in NSDL depository system, NSDL conducted two Joint Awareness Programmes with SEBI at Chandigarh & Madurai & a Joint Awareness Programme with SEBI & NSE at Shillong in September 2015 which were attended by more than 400 investors.

- **Training Programme conducted for college students:**

  In September 2015, NSDL conducted two training programmes for students representing from Shankar Narayan College of Arts & Commerce & S.I.A College of Higher Education, Mumbai. Various aspects on Depository related services were addressed to these students attending these programmes.

- **Compliance related training programme to Depository Participants with Securities and Exchange Board of India (SEBI) & National Stock Exchange of India Limited (NSE):**

  In September 2015, two training sessions on current compliance of NSDL jointly with SEBI & NSE were conducted at Kolkata and Patna for Depository Participants and Brokers. These programmes were attended by 48 participants.

Read and Win!

What is Tax Free Bonds? Can Tax Free Bonds be held in demat form?

Send your replies providing your contact details (Name, address and contact no.) with the subject 'Knowledge Wins Contest - October 2015' to info@nsdl.co.in

Terms and Conditions

- NSDL shall be solely responsible for the execution and administration of this Contest.
- This Contest is only open to Indian Citizens. (NSDL employees are not allowed to participate in this contest.)
- All personal details submitted must be accurate and complete and are subject to proof upon request by NSDL.
- NSDL reserves the right, at any time, to verify the validity of entries and entrants and to disqualify any entry not submitted in accordance with these Terms or which tampers with the entry process.
- NSDL reserves the right to discontinue the contest at any given point of time without prior intimation.
- All prize drawings will made on a strictly random basis and the decision made by NSDL will be final

Your suggestions for newsletter are valuable to us. Send in your suggestions mentioning your contact details (contact name, address & contact number) with the subject "Suggestions for the newsletter" to info@nsdl.co.in

NSDL Offices

Head Office	Branch Offices	
Mumbai Trade World, A wing, 4th & 5th Floors, Kamala Mills Compound, Lower Parel, Mumbai - 400 013. Tel.:(022) 2499 4200 Fax:(022) 2497 6351	**Ahmedabad** Unit No. 407, 4th floor, 3rd Eye One Commercial Complex Co-op. Soc. Ltd., C. G. Road, Near Panchvati Circle, Ahmedabad - 380006 Tel.:(079) - 26461376 | Fax:(079) - 26461375	**Chennai** 6A, 6th Floor, Kences Towers, #1 Ramkrishna Street, North Usman Road, T. Nagar, Chennai - 600 017. Tel.:(044) 2814 3917 / 18 | Fax:(044) 2814 4593
	Kolkata 5th Floor, The Millenium, Flat No. 5W, 235/2A, Acharya Jagdish Chandra Bose Road, Kolkata - 700 020. Tel.:(033) 2281 4661 / 2281 4662 | Fax:(033) 2289 1945	**New Delhi** 409/410, Ashoka Estate Building, 4th floor, Barakhamba Road, Connaught Place, New Delhi - 110 001. Tel.:(011) 2335 3815 / 2335 3817 | Fax:(011) 2335 3756

Investor Relationship Cell	NSDL Certification Program
Officer-In-Charge National Securities Depository Ltd. Trade World, A Wing, 4th floor, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai - 400 013. Tel.:(022) 2499 4200 | Fax:(022) 2497 6351 Email: relations@nsdl.co.in	Officer-In-Charge National Securities Depository Ltd. Trade World, 4th floor, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai - 400 013. Tel.:(022) 2499 4200 | Fax:(022) 2497 6351 Email: trainingdept@nsdl.co.in

For more information, email us at info@nsdl.co.in

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