

Fidelity's guide to ELSS



THE GOOD NEWS IS I
GOT A RAISE. THE BAD
NEWS IS IT ALL WENT
IN TAXES!



What you need to know about tax savings

As responsible citizens, our duty is to meet our tax obligations every year. So, there's no escape from tax. However, the government has made certain savings 'tax-deductible' and we owe it to ourselves to benefit from these options, which could translate into savings for the future.

This guide will tell you what the new tax rules are and how you can benefit from them.

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1. Get to know your tax bracket

Everybody who earns an income falls under a 'tax bracket'. It is important to keep in mind that your 'taxable income', or income after deductions, defines your tax bracket which could actually be lower than the amount of money you have earned over the year. The current income tax law has determined four main tax brackets, which are as follows:

Lower Limit	Upper Limit	Tax Payable
0	Rs 1,10,000	Nil
Rs 1,10,001	Rs 1,50,000	10% of income in excess of Rs 1,00,000
Rs 1,50,001	Rs 2,50,000	Rs 4,000 + 20% of income in excess of Rs 1,50,000
Rs 2,50,001	No upper limit	Rs 24,000 + 30% of income in excess of Rs 2,50,000

Source: As at June 2007, Part I of first Schedule to the Finance Act, 2007. These are the slab rates for an individual (except women and senior citizens who get some concessions), HUF, Association of Persons, Body of Individuals, whether incorporated or not. These rates do not include applicable surcharge and the education cess.

For example, if your taxable income is Rs 2,00,000 for the year, you would fall within the Rs 1,50,001 to Rs 2,50,000 tax bracket. You would have to pay the fixed sum for this slab, which is Rs 4,000 plus 20% of the amount that exceeds Rs 1,50,000. In your case, this excess amount would be Rs 50,000. So, your total income tax for the year would be Rs 4,000 + Rs 10,000 = Rs 14,000.

You can 'move' into a lower tax bracket by investing in a tax saving instrument. How does this work? Read on.



2. How much can you save?

The government has made a host of individual savings 'tax-deductible' under one umbrella called Section 80C and a simple new rule has emerged - if you invest up to Rs 1 lakh in a tax saving instrument or even a combination of them, you effectively reduce your taxable income by up to Rs 1 lakh. This means you could save up to Rs 30,000* in taxes.

The chart below shows how this happens:

Your annual taxable income (Rs)	Your applicable tax before investment (Rs)	Amount invested under Section 80C (Rs)	Your 'new' taxable income (Rs)	Your applicable tax after investment (Rs)	Your Savings (Rs)
1,30,000	2,000	1,00,000	30,000	0	2,000
1,50,000	4,000	1,00,000	50,000	0	4,000
2,00,000	14,000	1,00,000	1,00,000	0	14,000
3,00,000	39,000	1,00,000	2,00,000	14,000	25,000
4,00,000	69,000	1,00,000	3,00,000	39,000	30,000
5,00,000	99,000	1,00,000	4,00,000	69,000	30,000
7,50,000	1,74,000	1,00,000	6,50,000	1,44,000	30,000
9,00,000	2,19,000	1,00,000	8,00,000	1,89,000	30,000

Calculations based on income slabs for FY 2007-08. Tax amounts indicated do not include any applicable surcharge and education cess. It is assumed that the total taxable income specified above is after considering all deductions - except deductions under Section 80C of the Income Tax Act, 1961 (Finance Act, 2007). The above example is used only as an illustration.

* This does not consider the applicable surcharge and the education cess.



3. You don't need to invest an entire lakh to cut your tax bill

The chart below shows the optimal amount you could invest to reduce your taxes. As you will see, you don't have to invest an entire lakh!

Your annual taxable income (Rs)	Your applicable tax before investment (Rs)	Optimal amount to invest (Rs)	Your 'new' taxable income (Rs)	Your applicable tax after investment (Rs)	Your savings (Rs)
1,30,000	2,000	20,000	1,10,000	0	2,000
1,50,000	4,000	40,000	1,10,000	0	4,000
2,00,000	14,000	90,000	1,10,000	0	14,000
2,50,000	24,000	1,00,000	1,50,000	4,000	20,000
3,00,000	39,000	1,00,000	2,00,000	14,000	25,000
4,00,000	69,000	1,00,000	3,00,000	39,000	30,000
5,00,000	99,000	1,00,000	4,00,000	69,000	30,000
9,00,000	2,19,000	1,00,000	8,00,000	1,89,000	30,000

Calculations based on income slabs for FY 2007-08. Tax amounts indicated do not include any applicable surcharge and education cess. It is assumed that the total taxable income specified above is after considering all deductions - except deductions under Section 80C of the Income Tax Act 1961 (Finance Act, 2007). The above example is used only as an illustration.

So, if your taxable income is Rs 1,30,000 during FY 2007-08, you would need to invest just Rs 20,000 in a tax saver to reduce your taxable income to Rs 1,10,000 and drop your tax to zero. When putting money aside for your future, it makes sense to make use of all the tax benefits offered to you.



Section 80C offers a wide range of tax saving options. Your tax adviser can take you through the entire list but here are some of the most popular ones:

- Provident Fund (PF)
- Public Provident Fund (PPF)
- Life Insurance
- Pension funds
- Infrastructure bonds
- National Savings Certificates (NSC) and Kisan Vikas Patras (KVP)
- Equity Linked Savings Schemes (ELSS)
- Tuition fees
- Housing loan repayments

4. Which tax saver is right for you?

Section 80C offers you the flexibility to offset up to Rs 1 lakh of your annual income against long term commitments including life insurance premiums, housing loan repayments and education fees. Alternatively, you can choose to make investments for your future. Or, combine both! If you are opting to invest, the key is to choose the route that suits your personal circumstances and attitude towards risk.

Here's an overview of some popular tax savers:

PPF, NSC, KVP and infrastructure bonds earn a fixed rate of interest every year (or every six months, as the case may be). Many of these options are considered 'safe', since they are backed by the government or by established banks and financial institutions. However, none of these instruments are safe from inflation! PPF currently provides 8% a year, NSCs fetch you a return of around 8% a year (interest earned is subject to tax), and infrastructure bonds return about 5 - 6% a year (again, subject to taxes). With inflation currently ranging

between 4 - 6% every year, real returns on these investments may not be very high.

Insurance policies generally return a pre-determined amount on maturity. However, some unit linked plans are an exception, but they are not actually investments in the strict sense - a part of the amount goes towards providing insurance cover - which does not earn you a return, while the balance goes into long term investments.

While fixed rate savings and insurance are useful in their own right and should be part of a well-balanced portfolio, if you are looking for tax benefits coupled with the earning potential of equities, then consider an **ELSS or Equity Linked Savings Scheme**.

5. The ELSS advantage

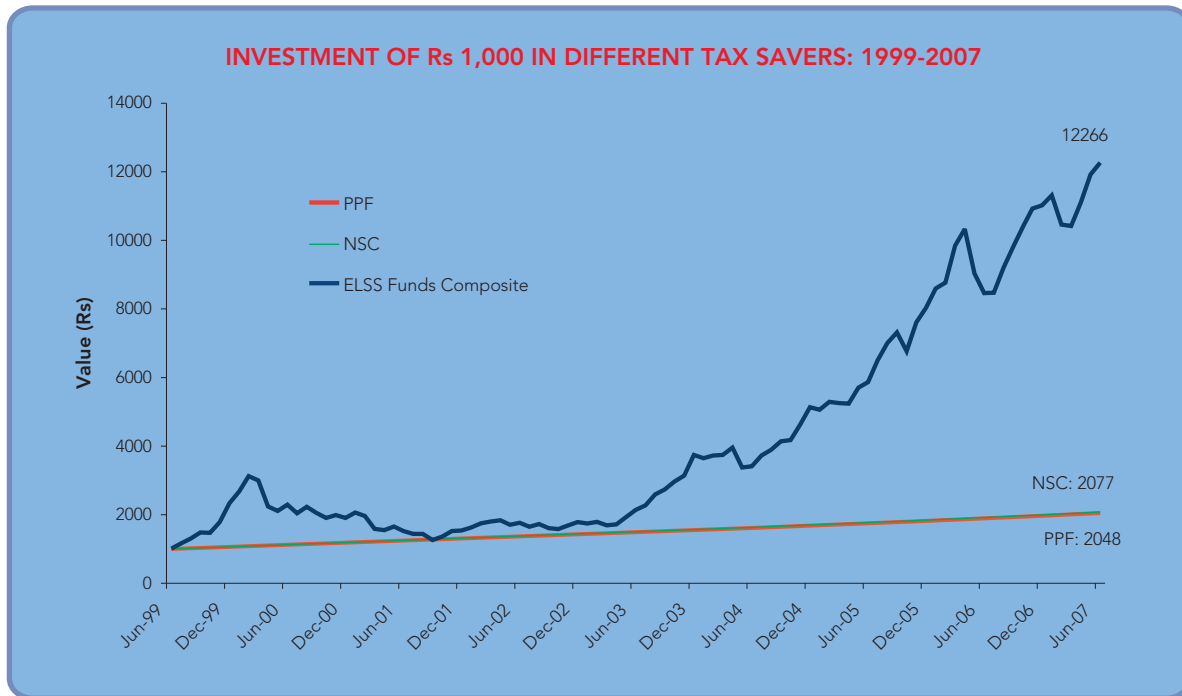
Equity funds can be volatile in the short run, but have been known to beat inflation and create wealth over the long run. If you are looking at investing some money that you won't need in the near future, and are willing to ride the ups and downs of the market, you may find ELSS an ideal tax saving option.

The graph opposite shows three separate investments of Rs 1,000 each made in June 1999. Two investors invested Rs. 1,000 into NSCs and PPF. Alongside, another investor invested Rs. 1,000 in an ELSS.

As you can see, the ELSS investment experienced greater volatility than the other options over the short term. But over time, its performance proved to be far stronger.

Now, here's the eye opener: The Rs. 1,000 invested in an ELSS in June 1999 would be worth over Rs.12,226 today. In sharp contrast, the fixed rate savings would be worth approximately Rs. 2,077.

If you are looking at investing some money that you won't need in the near future, and are willing to ride the ups and downs of the market, you may find ELSS an ideal tax-saving option.



Sources: ELSS data - MFI Explorer. PPF Data - Indian Public Finance Statistics 05-06, Ministry of Finance (Department of Economic Affairs). NSC Data - Maharashtra Govt., Directorate of Small Savings. To represent ELSS, we have taken the NAVs of the five largest ELSS funds that published their first NAVs before September 30, 1998, and indexed the NAVs to 10. We have then taken a simple average of the indexed NAVs and plotted their value over time. Assumes an investment of Rs 1000 begun on September 30, 1998. PPF - Assumes Rs 1000 invested in the Public Provident Fund. For the purposes of simplicity, rate changes announced any time during a month are assumed to be effective for the entire month for the purposes of calculating accrued interest at the end of the month. Interest for the month is calculated by dividing the effective annual PPF rate by 12. For the purposes of simplicity, interest is assumed to accrue on monthly balance in the PPF account and is added to the account on the last recorded trading day of the financial year for which ELSS data is available (interest is actually credited to PPF accounts every year on 31st March). Portfolio value shown here is notional value based on accrued interest till Sep 30, 2006 only. NSC - Assumes Rs 1000 invested in NSC at the prevailing interest rate, held for duration of certificate and then rolled over into a new certificate at the current prevailing interest rate. Assumes half-year compounding at prevailing interest rate. Past performance may or may not be sustained in future. The minimum amount actually required for these investments may be more or less than Rs 1000. This graph is for illustrative purposes only. Ending values are rounded off.

ELSS - more than just a tax saver

An ELSS fund is very similar to an equity fund. The main difference however is a three-year lock-in period, which means you cannot withdraw your money for the first three years. This may seem harsh, but the lock-in period can work to your advantage. How? The fund manager does not need to hold large amounts of cash to service redemptions, but can devote a larger portion of the portfolio to equities, which have the potential to perform better over the long term.

If you would like more information about how Fidelity can help you achieve your investment goals, speak to your Financial Adviser or visit us at fidelity.co.in or email us at info@fidelity.co.in

Illustrations by *Mospasia*



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