ARE YOU INVESTING IN FMPs INTELLIGENTLY?


ILLUSTRATION: SACHIN VARADKAR

If you invest in these funds with duration of three years and a few days at the right time, you could claim tax benefits for four years

Often investors wonder how they could invest in debt instruments, considered less risky than equities, and yet can manage to get some extra return. Theoretically returns from fixed income funds could be slightly higher than the rate of inflation. In comparison in the long run, equities usually give much superior return, but could be risky in the short run. One of the solutions to investors' problem in fixed income could be putting money in fixed maturity plans (FMPs) and time it well.

Advantages of FMP

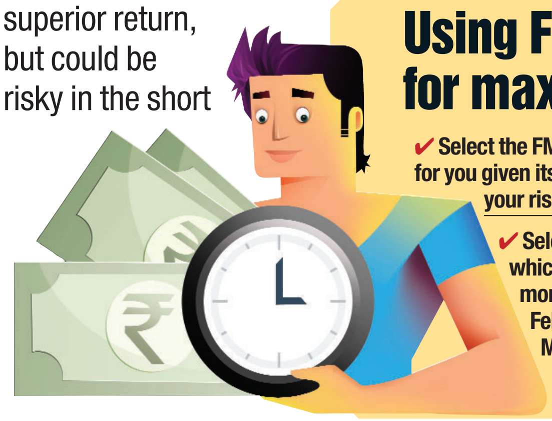
Fixed maturity plans (FMPs) come with several benefits over bank fixed deposits or company fixed deposits and bonds. For one, it offers diversification. FMPs invest in a number of company bonds and fixed income instruments issued by banks. This offers the FMP investor the opportunity to diversify and hence minimise the risks associated with investing in the bonds or fixed deposits issued by a single company.

Secondly, if invested at the right time of the year, it can give the investor the advantage of claiming four indexation benefits over three years and a few days, and thus reduce the overall tax burden to some extent.

Under Sebi rules, the portfolio duration of every FMP should match the residual duration of the fund itself. So in a sense the portfolio duration is tailor-made to match the investment horizon of all the investors in the fund. So with the passage of time, as an investor remains invested in an FMP, the holding period also reduces and the risks associated with the portfolio also goes down.

Another advantage of investing in FMPs is that (which is true for all types of investments in mutual funds) until the investor redeems his investments, no tax burden accrues to the investor. This is not the case if one invests in bank deposits. In case of bank deposits, as interest accrues, the investor has to show the same in his income and the same is taxed.

Using FMPs for maximum benefit



- ✔ Select the FMP that is right for you given its duration and your risk profile
- ✔ Select the FMPs which take in money in February and March months of the year
- ✔ Select the ones that have a maturity of three years and some days so that you cover four financial years
- ✔ In these funds, under the current income tax rules, you can claim indexation benefits for four financial years
- ✔ So in effect, even if you keep your money for a little over three full (financial) years, you enjoy the indexation benefits of four (financial) years
- ✔ Indexation benefits are aimed at neutralising the impact of inflation on your portfolio

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