Learn with DNA...

How much life cover to take?

Death is the only certainty in life and as each day goes by we are all one day closer to the end. But when and how, no one really knows! And if *Yamraj* decides to visit a little early, our dependants have a problem on hand.

To take care of this risk, people buy insurance. This ensures that on the untimely death of the policyholder, the nominee gets a certain amount of money, which the individual is insured for. This amount is commonly referred to as the sum assured or cover amount.

But, how much life insurance should one take? Most people do not bother to answer this basic question while taking insurance.

There are a few simple methods through which one can answer this question. The most basic of these is the *debt approach*, under which the life insurance cover should be at least equal to the outstanding amount of loans taken by the individual, so that if he expires, his family can pay off all the debt. The problem with this method is that it takes into account only one aspect of human life, i.e. debt. It does not even take into account the annual income of the individual.

Another method is the *multiple earnings approach* under which the amount of life insurance cover should be a certain number of times the annual income of the individual. The thumb rule is that the life insurance cover should be five to six times the annual income. But the problem with this method is that it does not take into count the age of the individual or his financial obligations.

But, the approach most commonly used these days is the *human life value approach.* This approach was propounded by Solomon S Huebner. Let's consider an individual aged 30, who earns a salary of Rs 5.4 lakh per annum. After paying out his taxes and meeting his his own expenses he still has around Rs 3 lakh per annum left. This is the amount available to his family. If the individual expires today, in order to earn an interest of Rs 3 lakh per annum, the family would require a corpus of around Rs 43 lakh (assuming an interest rate of 7% per annum). Given this, the individual should have a life insurance cover of Rs 43 lakh or more.

A term insurance policy for a period of 25 years, for a person aged 30 and having a cover of Rs 43 lakh, would attract a premium of around Rs 15,400. In term plans, in case of death of the policyholder during the period of the policy, his nominee gets the "sum assured." And if the policyholder survives the period of the policy, he does not get anything. Term plans have the lowest premium among all the different insurance plans.

Had we applied the multiple earnings approach in case of the individual above, he would have taken a life insurance cover of Rs 32.4 lakh (assuming the cover should be six times the annual income). But, in case of his death, the cover would not have sufficed to meet the requirements of his family.

Post office deposit rates and features

Scheme / Feature	
Kisan Vikas Patra	
Interest	Doubles in 8 yrs 7 mnth
Effective interest rate	8.41%
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	None
Monthly Income Scheme	
Interest	8%
Tenure	6 yrs
Min. amount	Rs 1,000
Max. amount	Rs 4.5 lakh for single a/c Rs 9 lakh for joint a/c
Tax breaks	None
National Savings Certificate	
Interest	8%
Effective Interest Rate	8.16% (semi annual compounding)
Tenure	6 yrs
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	Section 80C deduction
Public Provident Fund	
Interest	8%
Tenure	15 -16 yrs
Min. amount	Rs 500
Max. amount	Rs 70,000 p.a.
Tax breaks	Section 80C deduction
Recurring Deposit	
Interest	7.5%
Tenure	5 yrs
Min. amount	Rs 10
Max. amount	No limit
Tax breaks	None
Senior Citizens Savings Scheme	
Interest	9%
Tenure	5 yrs
Min. amount	Rs 1,000
Max. amount	Rs 15 lakh
Tax breaks	None
Min. age	60 years
Time Deposit	
Interest	6.25-7.5%
Tenure	1,2,3,5 yrs
Min. amount	Rs 200
Max. amount	No limit
Tax breaks	None

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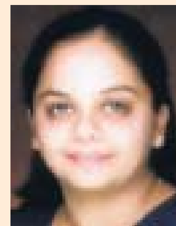
Time to reach for capital gains bonds

Those looking to save tax on real estate sales need to hurry

Mona Shah



The government has opened the Rs 2,000 crore bond issue of National Highways Authority of India (NHAI) for subscription in late September, allowing assesses to save on capital gains tax on sale of real estate.

The bonds are being issued at a face value of Rs 10 each and coupon rate of 5.5% annually. There would be a lock-in period of three years and the issue closes on Mach 31, 2008. However, individual investors can put in only up to Rs 50 lakh in these instruments.

NHAI funds its highway projects through issue of bonds, fuel cess and loans from multilateral funding agencies such as Asian Development Bank and World Bank. The authority is implementing the country's most ambitious highways project under the National Highways Development Project, which is in seven phases, with Phase I & II likely to be completed by December 2008.

Typically, there are three options before those who have sold real estate during any financial year:

i) Invest in a new house;
ii) Invest in 54 EC bonds such as the NHAI issue mentioned above; or
iii) Pay capital gains tax.

Imagine having your real estate sale proceeds lying idle in the savings bank or current account till you decide what to do with the money, generating a mere 3.5% p.a or no interest in the interim, depending on the account it is held in. Surely, the money can be put to better use.

Let us now examine a few basic issues related to capital gains:

■ Any asset purchased or sold invites capital gains. Capital assets mean properties of any kind held by an individual or company whether or not connected with his/its business or profession.

■ Capital assets are classified as long-term or short-term depending on the period of holding of the assets till they are transferred. The classification is made on the following basis:

Nature of asset	Capital gain
i) Shares in a company or any other security listed in a recognised stock exchange in India or a unit of a Unit Trust of India or a unit of a mutual fund specified under section 10(23D)	Short-term capital gain if the period of holding is less than one year. Long-term capital gain if the period of holding is one year or more
ii) Any other capital gain	Short-term capital gain if the holding period is less than three years. Long-term capital gain if it is three years

■ Any long-term capital gain, arising to any assessee from the transfer of any capital asset on or after April 1, 2000 shall be exempt to the extent such capital gain is invested within six months of the date after such transfer in the long-term specified asset, provided such specified asset is not transferred or converted into money within three years from the date of its acquisition.

■ Long-term capital gain on transfer of capital asset is exempt u/s 54 EC in the following circumstances:

i) The asset transferred is a long-term capital asset and hence, there is long-term capital gain;
ii) Such asset is transferred on or after April 1, 2000;
iii) The asset is transferred by the assessee;
iv) The assessee has, within six months after the date of such transfer, invested the capital gain in the long-term specified assets; and
v) The cost of the long-term specified asset considered for the purpose of exemption under 54 EC shall not be eligible for the rebate with reference to such cost under 80C.

■ The quantum of deduction is as follows:

i) If the amount of capital gain is equal to or less than the cost of the long-term specified assets acquired within six months of the date of transfer, the entire capital gain shall be exempt; and
ii) If the amount of capital is greater than the cost of the long-term specified asset, than the cost of the long-term specified asset shall be allowed as exemption.

In other words, capital gain shall be exempt to the extent it is invested in the long-term specified assets within a period of six months from the date of such transfer.

■ Now, if one withdraws or converts into money within 3 years, the amount of capital exempt u/s 54EC claimed earlier, shall be deemed to be long-term capital gain of the previous year, in which the long-term specified asset is transferred or converted into money.

my finance

■ Capital gain is computed taking into consideration the cost of improvement. In case of long-term capital gains benefit, indexation cost can be taken. The central government notifies the cost inflation index for each year.

■ Sec 54EC grants deduction from taxable capital gains on transfer of a capital asset to the extent of investments in notified bonds within six months from the date of transfer of such asset.

Let us say Mr M acquired a residential property from Mr S on December 18, 2002 for Rs 5 lakh and sold the same for Rs 13.5 lakh on June 7, 2006. Expenses incurred on the transfer were Rs 20,000. He then invested Rs 6 lakh in NHAI bonds on November 28, 2006. Cost Inflation Index for 2002-2003 is 447 and for 2006-2007 is 519.

Sale consideration (Rs)	13,50,000
Less: Transfer expenses (Rs)	20,000
Indexed cost of acquisition (Rs) 5,00,000*519/447+20,000 =	6,00,537
	7,49,463
Less: Investment in NHAI bonds (Rs)	6,00,000
Taxable long-term capital gains	1,49,463

As the table shows, tax is to be paid on Rs 1,49,463 and not on Rs 7,49,463.

Time to rush

The NHAI bonds are being marketed by HDFC, IDBI, Union Bank, Syndicate Bank and Canara Bank, among others. The notification covers only bonds issued during 2007-08, so that those who have capital gains after May 2007 will have to make sure that they subscribe to the bonds even before the expiry of six months.

However, given the issue size of Rs 2,000 crore, there is a risk of the bonds not being available after some time, as they would be issued on a first-come-first-serve basis.

If a taxpayer merely deposits the amounts through banks and it is later found that the limit has been exceeded, he will be losing the benefit of this deduction under Sec 54EC.

The writer is a certified financial planner working as senior manager with Mumbai-based SRE Financial Planners. The views expressed are those of the author and do not necessarily represent that of FPSB India. Feedback to the article may be mailed to myplan@fpsbindia.org

If you would like to be featured and need a financial plan made by a qualified planner, mail to: *mymoney@dnaindia.net*

P-note norms won't hit inflows

Nirmal Jain, *CMD, India Infoline is bullish on the economy and the stock market. "In the long term perspective, both will do very well," he says, adding, financial services will be the growth engine for the economy in the next few years. An IIM-A alumnus, Nirmal has seen India Infoline grow from scratch into a financial services major in the last 13 years. Excerpts from a chat with* **N Sundaresha Subramanian**:

What will be the net effect of the new P-note rules and relaxation of FII registration norms?

Thursday's decision of Sebi board to change p-note regulations may dampen near-term flows, but they will help tighten KYC norms and improve transparency, and thus have a positive effect on the markets over the long term. With this change, a lot many P-note users will seek direct FII licence. The eligibility criteria for FIIs have also been relaxed by changing the definition of broad-based funds and taking fund manager's track record (rather than the fund management company's) as a reference point. In the very short term, the "registered but not regulated" entities, which are currently using p-notes, may be rendered ineligible to buy fresh P-notes, but we believe serious India investors will seek voluntary regulation.

Will India lose some of the flows to other emerging markets?

I don't think there will be too much impact. Now that Sebi has been proactive and positive in registering and relaxing the norms for FIIs, we will see a lot of these P-Note accounts changing into FIIs. This will be a good move since quite a few large good investors earlier coming in through P-notes will now register themselves as FIIs. It is positive that FIIs who want to invest for a longer term of 5-10 years will feel more encouraged to invest in markets for two reasons. Firstly, there is now a level playing field in terms of regulatory environment vis-à-vis FIIs and hedge funds. Secondly, valuations will be more sensible, so one will be able to invest in the market with greater ease. It will be very difficult to quantify how much funds will be diverted from India to other emerging economies, if at all such a scenario should arise.

What do you expect of the Fed meet on October 31?

Most people were earlier expecting the Fed to keep rates unchanged till the year-end. However, there seems to be a consensus now that rates would be cut on October 31, 2007. Concerns over a possible slowdown in the US economy, negative news on the housing segment and expected losses by the finance sector may prompt a rate cut of 25 bps.

Will a strong rupee affect the India growth story?

Some of the industries will be impacted, but I don't think India's growth story will be impacted. Government has taken proactive steps. It is not likely that rupee will be allowed to appreciate significantly.

In case the Fed goes ahead with a cut, what are the options available with the RBI and the government to rein in the rupee and excess liquidity?

A Fed rate cut would result in weakening of the dollar against the rupee. More money would then start pouring into emerging markets like India. While the P-note restrictions may result in a capital flight by hedge funds in the near term, the RBI may resort to a CRR hike to control excess liquidity. However, these measures may prove successful only in the short term.

Is it a good time to enter equities? What is your advice?

Equity investment is always asset allocation rather than timing the market. You can invest at anytime. You should say that I have this much resources and I will put this part in equity. As your savings grow up, you can keep putting more and more money in equity.

Financial services seem to have a lot of buzz about them...

As the FM has rightly put, financial service industry is going to be the growth engine for economy, which has structurally changed in last two three decades from an agrarian economy to a services economy. Services now contribute 60-65% of our GDP or even more. Entire growth is driven by the services industry; within those, financial services have a major chunk of it. As economy grows, we will see growth from all facets of capital market — stock market, IPOs, investments, deals and mergers, acquisitions, private equity. We will see significant growth and lot of value addition. This can drive employment and this can drive income growth. In short, it is going to be engine for growth.

When people say there is growth potential in the non-metros and smaller towns, a lot of people there are still untouched by equity culture. How easy it is to bring them into capital market?

It is a very long process, not easy at all. People do passive investing; they put their money in banks, post office savings, things they understand. It is a very long process and is going to continue for next 10-20 years. The process of education is gradual.

Some say India's demographic advantage will remain for 10-15 years. But, you say it will take 10-20 yrs for the industry to bring people into equity culture. Do you think you will be able to capitalise on opportunities within that period?

It's a very long-term phenomenon. The process will be slow and gradual. In a way, it is good because you will have good incremental growth. Because it is such a large country with 1.2 billion population, it will be difficult to convert all of them together. But you can maintain 15% growth year after year, the delta will be good. In a way it is very good.

JUST 5 ? ? ? ? ? Questions

Vikram Kotak
CIO, Birla Sun Life Insurance Co

■ **Have the final Sebi guidelines on P-notes pacified the markets?**

We believe the guidelines were very appropriate and well-timed. The only criterion that will control the flow of future capital to India is the potential of markets to deliver superior returns, which is undisputable as the economy is structurally on a long growth path. We think the markets have behaved normally on the Sebi move. Even after certain P-notes are barred, authentic long-term investors will come through the FII route over a period of time as investors always look for growth assets and Indian markets provide the opportunities.

■ **Have concerns related to liquidity abated?**

Subprime defaults in the US, followed by the Fed rate cut of 50 bps, led to the reallocation of investment portfolios towards emerging markets and commodities. We believe the liquidity glut created by the Fed will eventually move to stronger and new asset classes, which exhibit better fundamentals and sustained growth. We feel concerns relating to liquidity following subprime defaults are abating.

■ **Now that the Sensex has made yet another all-time high, are we headed for 20,000?**

We strongly believe the Indian stock market is in a sweet spot on the back of massive foreign inflows and robust economic conditions. Corporate earnings growth is likely to remain intact, the interest rate outlook remains stable, and a healthy GDP growth target with strong possibilities of an upside from agriculture and strong capex cycle will keep fundamentals and momentum in place. We don't see 20,000 as a magic number; it's just a number, which will be surpassed sooner or later.

■ **Are there any sectors/ stocks you are extremely bullish/bearish on?**

Broadly, infrastructure and capital goods related sectors are showing healthy long-term earnings visibility and have better profit margins backed by strong operating leverage.

These sectors would enjoy sustainable business accumulation and have buoyant long-term prospects.

Banking and financial services are also poised to perform well. We expect their asset quality to remain robust and incremental slippages to remain low due to prudent monitoring. Further, there is healthy improvement in net interest margins and earnings visibility is strong. We feel IT services would underperform in the medium term on the back of US slowdown worries and a strong rupee outlook.

■ **Any negatives for the market?**

We should be vigilant about risks like US recession, early elections and fast rising prices of oil and other commodities.

The hyper sales pitch everywhere has taken the joy out of shopping

Of coffee shops, discount sales and a headache

Vivek Kaul
Mumbai

I woke up around noon this Sunday with a splitting headache and an SMS reminding me that it was the last day of a discount sale.

Now, shopping is a good stress-buster, and even rids a bad headache, sometimes. So I got to the mall as quickly as I could and once in, made for the coffee shop, hoping to get a fresh sandwich with a hot cuppa.

But, ordering coffee can be extremely stressful these days, I realised in no time. "Cold or hot?" the attendant asked. I said 'hot', and he handed me a huge menu with nearly one hundred ten names to choose from. I asked for cappuccino, and he asked, "Will that be small, medium or large?" as if it was alcohol I was ordering instead. I settled for 'medium', hoping he was through with his questions. But he wasn't. "Would you like it with some whipped cream or chocolate, sir?" he asked. "A plain cuppa cappuccino," I said aloud, sealing the conversation.

Why are these guys so persistent? Even women wouldn't make so much ordering their marriage trousseaus, I thought as I flipped open Tim Harford's *The Undercover Economist*, which I had bought sometime back but never opened. I got my answer just a few pages into the book.

The idea, says Harford, is to figure out whether the customer is less sensitive to price. If the answer is in the affirmative, then the next step is to get him to pay more. Obviously you can't get the customer to pay more for the same product. Hence, the first step is to make the product a little different from the standard offering, in my case a cup of cappuccino.

"It doesn't cost much more to make a larger cup, to use flavoured syrup or add chocolate power or a squirt of whipped cream," writes the author, citing the example of coffee chain Starbucks.

"By charging wildly different prices for products that have largely the same cost, Starbucks is able to smoke out customers who are less sensitive about the price," he adds.

Indian coffee shops have obviously been picking up the tricks of the trade from the international market.

Brunch over, I stepped out of the coffee shop and into the retail outlet next door, where the discount sale was. Retail chains in the country generally organise such sales twice a year, in February-March and August-September, offering discounts as high as 50% on the maximum retail price.

Every time a retail chain sells a product at a discount, the average price at which they are able to sell that particular product comes down. So, why don't they offer a 10% discount throughout the year, instead of offering a 50% discount twice a year, I wondered as I went about my shopping.

Harford had the answer. "If some customers shop around for a good deal and some customers do not, it's best for stores to have either high prices to prise cash from the loyal (or lazy) customers, or low prices to win business from bargain hunters. Middle-of-the-road prices are not good: not high enough to exploit loyal customers, not low enough to attract bargain hunters. But that's not the end of the story, because if prices were stable, then surely even the most price sensitive customers would learn where to get particular goods cheaply. So rather than stick to either high or low prices, shops jump between two extremes."

As I walked home, the headache was still on. The cup of coffee and some good discount shopping hadn't really helped. So I made for a chemist on the way to buy some headache pills. But, there were questions waiting, here as well: "Saridon, Anacin, Disprin…?"