U N I V E R S I T Y O F D E L H I

# PERSONAL TAX PLANNING AND TAX MANAGEMENT

D S E 7 . 9

B.Com (Hons.) | B.Com (Prog.) — Fourth Year, Semester VII

## U N I T 3

# TAX PLANNING THROUGH INVESTMENTS

*The Avenues, and the Deductions that Attach to Them*

*Life Insurance • Unit Linked Insurance Plans • Provident Funds • Public Provident Fund*

*Pension Schemes • Equity Linked Savings Schemes • Mutual Funds • Bonds*

*Post Office and Small Savings Schemes • The Hindu Undivided Family*

*Tax deductions under the Income-tax Act, recapitulated*

**Governed by the INCOME-TAX ACT, 2025**

*(Act No. 30 of 2025, as amended by the Finance Act, 2026)*

**read with the INCOME-TAX RULES, 2026**

T A X Y E A R 2 0 2 6 - 2 7

1 April 2026 to 31 March 2027

*Academic Year 2026-27*

*Compiled by*

**ADVOCATE DR. S. B. RATHORE**

M.Com; M.Phil; LL.B.; Ph.D.

Associate Professor of Commerce (Oct. 1977 – Dec. 2019)

Shyam Lal College (University of Delhi), Delhi-110032

www.taxclasses.in | YouTube: Tax Doctor | Facebook: DrSb Rathore

Mobile / WhatsApp: 9811116835 | E-mail: rathore_incometax@yahoo.co.in

## The Prescribed Syllabus for this Unit

**UNIT 3: TAX PLANNING THROUGH INVESTMENTS (11 HOURS)**

"Tax planning through various tax saving investment avenues available for individuals and HUF like Mutual funds unit linked insurance plans, Bonds, Equity linked savings schemes, Post office savings schemes and others. Tax deductions under Income-Tax Act."

*Discipline Specific Elective Course 7.9, placed before the Executive Council of the University of Delhi, EC (1282) dated 29.04.2026, effective from the Academic Year 2026-27.*

Two words in that paragraph decide the whole of this Unit. The first is **investments** — the syllabus does not ask what an investment is, or which one pays best; it asks how the Income-tax Act, 2025 treats each of them, and what a planner does with that treatment. The second is **and others**, which the Board of Studies added deliberately: the list of avenues is illustrative, not exhaustive, and a question may be set on any avenue available to a resident individual or a Hindu undivided family.

### Where this Unit sits in the paper

| Unit | Content | Hours |
|---|---|---|
| **Unit 1** | Basic concepts of tax planning; avoidance and evasion; scope; planning through exempted income, permissible deductions and clubbing | 14 |
| **Unit 2** | Tax planning under the five heads of income | 11 |
| **Unit 3** | Tax planning through investments; deductions under the Act — this booklet | 11 |
| **Unit 4 (A)** | Advance tax, TDS, TCS, refund | 9 |
| **Unit 4 (B)** | Income-tax authorities; return; assessments; appeals and revision | (with A) |

### The avenues, and where each is dealt with

| Avenue | Principal provisions | Chapter |
|---|---|---|
| **Life insurance** | Section 123 with Schedule XV, para 2; Schedule II; section 92(2)(l) | 2 |
| **Unit linked insurance plans** | Section 123; Schedule II; sections 67, 72 and 198 | 3 |
| **Provident funds — statutory, recognised, unrecognised** | Schedule XI; section 17(1)(h); Schedule III; section 123 | 4 |
| **Public provident fund** | Section 123 with Schedule XV; Schedule II | 5 |
| **National Pension System, Atal Pension Yojana, Agnipath** | Sections 123, 124 and 125; Schedule III, Sl. No. 4 | 6 |
| **Equity linked savings schemes** | Section 123 with Schedule XV; sections 196 and 198 | 7 |
| **Mutual funds — the other classes** | Sections 67, 72, 76, 92(2)(a), 196, 197 and 198 | 8 |
| **Bonds and debentures** | Sections 85, 76 and 92(2)(e); Schedule II | 9 |
| **Post office and small savings schemes** | Section 123 with Schedule XV; sections 92 and 153; Schedule II | 10 |
| **Bank deposits, shares, gold, real estate, business trusts** | Sections 92, 123, 153, 196, 197 and 198 | 11 |
| **The Hindu undivided family as a vehicle** | Sections 96 to 100; section 25(a); Chapter VIII | 12 |
| **The deductions themselves** | Chapter VIII — sections 122 to 154 | 13 |

## The teachers' meeting of 6 September 2025

An online meeting was held on Saturday, 6 September 2025 to prepare the Guidelines for the NEP: UGCF Syllabus (w.e.f. 2022-23) for this paper, organised by the Department of Commerce, Delhi School of Economics, University of Delhi and Sri Aurobindo College (Evening), University of Delhi. Dr. Supreet Kaur, Assistant Professor, Department of Commerce, represented the Department; the meeting was convened by Mr. Varun Panwar, Assistant Professor, Sri Aurobindo College (Evening); and fourteen other members of the faculty were present. The B.Com (Hons.) guidelines were settled at 4:00 PM and the B.Com (Prog.) guidelines at 5:00 PM; they are identical in every respect that bears on this booklet. **Those guidelines that bear on this booklet are set out below.**

### The question paper

- The total number of questions will be **five**.
- All questions carry equal weightage of **18 marks each**.
- **Each question shall have an internal choice.**
- The question format must ensure comprehensive coverage of the entire syllabus.
- **No question shall contain more than two parts** — the illustrative format being (a) and (b), *or* (c) and (d).

### The allocation of lectures, marks and questions

| Unit | Name of the Unit | Hours | Marks | Questions |
|---|---|---|---|---|
| **Unit 1** | Basic Concepts | 14 | 18 | 1 question with internal choice |
| **Unit 2** | Tax Planning under different heads of Income | 11 | 36 | 2 questions with internal choice |
| **Unit 3** | Tax Planning through investments | 11 | 18 | 1 question with internal choice |
| **Unit 4 (A)** | Deduction, collection and recovery of tax | 4 | 9 | 1 question with internal choice, covering both parts |
| **Unit 4 (B)** | Assessment Procedures, Income-tax Authorities and Appeal and Revision | 5 | 9 | |
| **Total** | | 45 | 90 | 5 questions with internal choice |

> **WHAT THE ALLOCATION MEANS FOR THIS UNIT**
>
> Unit 3 carries **18 marks of the 90** — one question, with an internal choice, and no more than two parts to it. It carries **11 of the 45 hours**.
>
> The guidelines name **six avenues and three deductions**, and nothing else. That is a far narrower list than the syllabus paragraph, which speaks of mutual funds, bonds and “others”. The two are reconciled in this booklet as follows: **the six named avenues and the three named deductions are in the body and are examinable**; mutual funds and bonds, which the syllabus names but the guidelines do not develop, are given a chapter each in outline; and everything else has gone to the Annexe.
>
> *The practical coverage for both limbs is **case studies**, not computation. So an answer here is built differently from an answer in Unit 2: state the treatment at entry, accrual and exit with the section for each, then advise, and support the advice with a figure. A pure computation without advice will not score.*

### The prescribed scope of this Unit

The guidelines set out, against each limb of the syllabus, the scope to which teaching and examination are to be confined, and the practical coverage expected. What follows is that table for this Unit, reproduced as settled.

| Syllabus of the Unit | Scope of the Unit | Practical Coverage |
|---|---|---|
| Tax planning through various tax saving investment avenues available for individuals and HUF like Mutual | **1. Tax planning through various tax-saving investment avenues**<br>(i) **Equity Linked Saving Scheme (ELSS)** — deduction under section 80C up to ₹1.5 lakh.<br>(ii) **Unit Linked Insurance Plans (ULIPs)** — covered under | Case studies on tax planning through various tax-saving investment avenues available for |

| Syllabus of the Unit | Scope of the Unit | Practical Coverage |
|---|---|---|
| funds, unit linked insurance plans, Bonds, Equity linked savings schemes, Post office savings schemes. | section 80C; premium up to 10% of the sum assured.<br>(iii) **Post Office Savings Schemes** — Public Provident Fund; National Savings Certificate; Senior Citizens Savings Scheme. | individuals. |
| Other Tax deductions under Income-Tax Act. | **1. Tax planning through other investment-linked deductions**<br>(i) **Section 80C** — Sukanya Samriddhi Yojana.<br>(ii) **Section 80CCD(1B)** — additional ₹50,000 deduction.<br>(iii) **Section 80E** — deduction for interest on a higher education loan. | Case studies on tax planning through other investment-linked deductions for individuals. |

**THE GUIDELINES AND THE INCOME-TAX ACT, 2025 — HOW TO READ THEM TOGETHER**

The guidelines were settled on 6 September 2025. The Income-tax Act, 2025 came into force on 1 April 2026. The scope tables are therefore expressed in the section numbers of the Income-tax Act, **1961** — 80C, 80D, 10(13A), 54EC, 115BAC and the rest.

The syllabus itself, as amended by the Executive Council in EC (1282) dated 29.04.2026, is a syllabus on the Income-tax Act, **2025**. The two are not in conflict: **the guidelines settle what is examinable; the Act settles the law in which it is to be stated.**

This booklet therefore takes its **scope** from the guidelines and its **law** from the Income-tax Act, 2025 as amended by the Finance Act, 2026. So where the guidelines say "80C", read section 123 with Schedule XV; where they say "10(13A)", read Schedule III, Sl. No. 11 with Rule 279; where they say "115BAC", read section 202; where they say "54EC", read section 85. The full conversion table is in the last chapter of this booklet.

*In the examination, give the section number of the 2025 Act. If you wish, add the 1961 number in brackets. Never give the 1961 number alone.*

### What this booklet does with the guidelines

The body of this booklet has been rebuilt to follow the guidelines' order: the framework and the regime filter; then the two avenues the guidelines name first — equity linked savings schemes and unit linked insurance plans; then the post office schemes, the public provident fund taken separately because of its length; then the three prescribed deductions; then mutual funds, bonds and the Hindu undivided family, which the syllabus names; and then the comparative framework and the question bank. **A new Chapter 6 has been written** to cover sections 124(3) and 129, which the guidelines prescribe and the earlier printing did not develop. Five chapters have moved to the **Annexe**, and are marked there as not examinable.

## Before You Begin

### What this Unit asks of you

Unit 1 gave you the idea of tax planning and Unit 2 its application head by head. This Unit is the part a student will actually use in life, and it is also the part most often answered badly — because candidates describe schemes instead of taxing them. For every avenue in this booklet you must be able to do four things, in this order —

1. **Place the avenue on the grid.** Every investment is touched by the Act at three points — when money goes in, while it grows, and when it comes out. Say for each point whether the law exempts or taxes. That is the whole of Chapter 1, and it is the sentence an examiner is looking for.
2. **State the section, not the scheme.** "ELSS gives 80C benefit" earns nothing in 2026-27. "An equity linked savings scheme is an eligible investment in Schedule XV, and so qualifies for deduction under section 123 within the aggregate ceiling of ₹1,50,000" earns the mark.
3. **Apply the regime filter.** Section 202(2)(a)(xii) withdraws the whole of Chapter VIII in the default regime except sections 124(1), 124(2), 125(2) and 146. In the default regime the deduction side of almost every avenue in this booklet is worth nothing — but the exemption side survives untouched. That distinction is the single most examinable point in the Unit.
4. **Show the arithmetic.** Compute the post-tax yield, or the saving, in rupees. A planning answer without a figure is an essay, and essays do not score in a tax paper.

### How this booklet is arranged

Chapter 1 builds the framework — the three points at which the Act touches an investment, the four patterns they generate, and the regime filter. **Chapters 2 to 5 take the avenues the guidelines name**, one at a time: equity linked savings schemes; unit linked insurance plans; the public provident fund; and the post office schemes, being the national savings certificate, the Senior Citizens Savings Scheme and the Sukanya Samriddhi account. Each of those four chapters has the same four-part shape, and you should read them the same way every time:

| Part | What it does |
|---|---|
| PART A — The scheme | What the investment is, in the language of the regulator, in one page. No tax. |
| PART B — The tax treatment | The three points — entry, accrual, exit — with the section for each. |
| PART C — The planning measures | What a planner does with that treatment, and the caution attached to each. |
| PART D — Illustrations | Worked in rupees. Work them with a pen before you read the answer. |

**Chapter 6 takes the other two prescribed deductions** — the additional ₹50,000 on the notified pension scheme under section 124(3), and the interest on a loan for higher education under section 129. Chapters 7 and 8 take mutual funds and bonds, which the syllabus names but the guidelines do not develop, in outline. Chapter 9 takes the Hindu undivided family, which the syllabus names expressly. Chapter 10 puts the avenues side by side and gives a framework for choosing between them. Chapter 11 is revision and the question bank. The **Annexe** at the end holds the five chapters that fall outside the scope settled by the teachers' meeting.

THE ONE THING TO CARRY FROM UNITS 1 AND 2 INTO EVERY CHAPTER OF THIS ONE

**A deduction and an exemption are not the same animal, and the regime treats them differently.** An exemption keeps the receipt out of total income altogether; it lives in section 11 with Schedules II to VIII, and section 202(2) touches only a handful of its entries. A deduction takes an amount *out* of a gross total income that already includes it; it lives in Chapter VIII, and section 202(2)(a)(xii) sweeps almost the whole of that Chapter away in the default regime.

So: in the default regime the public provident fund still pays tax-free interest, the life policy still matures tax-free, and the equity fund still enjoys the ₹1,25,000 shelter in section 198 — but the ₹1,50,000 deduction under section 123 that used to be the reason for buying them has gone.

*Read Chapter 1 before anything else. Do not skip it.*

## The sources from which this material has been written

| Source | What it settles in this Unit |
|---|---|
| Income-tax Act, 2025 (Act No. 30 of 2025) — assent 21 August 2025, in force 1 April 2026 | Section 11 with Schedules II and III (the exemptions); Chapter VIII, sections 122 to 154 (the deductions); Schedule XV (the eligible investments under section 123); Schedule XI (recognised provident funds); sections 67 to 91 and 196 to 198 (capital gains and their rates); section 76 (market linked debentures and specified mutual funds); section 92 (other sources); section 202 (the two regimes) |
| Income-tax Rules, 2026 — G.S.R. 198(E) dated 20 March 2026, in force 1 April 2026 | The valuation and computation rules, the forms, and the conditions attached to the Schedule XV entries |
| Finance Act, 2026 — assent 30 March 2026 | The rates for Tax Year 2026-27 in Part I-B of the First Schedule; and the rationalisation of Schedule XI, which aligned the recognised provident fund with the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and brought employer contributions under the single ₹7,50,000 ceiling in |

| Source | What it settles in this Unit |
|---|---|
| | section 17(1)(h) |
| Memorandum explaining the provisions of the Finance Bill, 2026 | The reasoning behind the provident fund rationalisation, and the confirmation that no change was proposed in the rates in section 202 or in the Chapter VIII ceilings |
| Notifications of the Department of Economic Affairs, Ministry of Finance | The quarterly rates of interest on the small savings schemes — unchanged for the quarter 1 July 2026 to 30 September 2026 |

### A warning about older books, and about the internet, sharper for this Unit than for either of the others

Every popular article on tax-saving investments written before April 2026 speaks of “section 80C”. There is no section 80C in force in Tax Year 2026-27. The deduction is section 123, and the list of eligible investments is not in the section at all but in **Schedule XV**. A candidate who writes 80C, 80D, 80CCD or 10(10D) in the examination is quoting a repealed statute, and will be marked accordingly. **Paragraph 11.1** gives the whole conversion table for this Unit; learn it early rather than late.

Two further traps peculiar to this Unit. First, **interest rates change quarterly.** The rates given in Chapter 10 are those notified for the quarter 1 July 2026 to 30 September 2026; they are given so that the illustrations have real figures in them, not because they are part of the law. Check the current quarter before you quote a rate anywhere outside this booklet. Second, **a scheme can be withdrawn while its tax treatment survives.** Sovereign gold bonds and the Mahila Samman Savings Certificate are both closed to fresh subscription, yet both are still held by lakhs of assessees and are still examinable. Chapter 9 and Chapter 10 deal with each as it now stands.

### About this booklet

This booklet has been prepared by Artificial Intelligence — Claude Opus 5.0 (Anthropic), Max — under the guidance and supervision of Advocate Dr. S. B. Rathore, and edited by him. Every section number, ceiling and rate has been taken from the Income-tax Act, 2025 as amended by the Finance Act, 2026, and from the Income-tax Rules, 2026.

It is issued free of cost to the students of the University of Delhi and to anyone else who finds it useful. It is not for sale.

*Date: 08-08-26 (Original)*

**Suggestions and corrections are welcome**

E-mail: rathore_incometax@yahoo.co.in | Mobile / WhatsApp: 9811116835

Website: www.taxclasses.in | YouTube: Tax Doctor | Facebook: DrSb Rathore

*Corrections received will be carried into the next revision, and the corrected file will be uploaded on the website.*

CONTENTS

# Contents

*Page numbers refer to this booklet. Chapter headings are shown in bold.*

CHAPTER 1

# The Framework — How an Investment is Taxed

*Before any avenue is examined it must be known how the Act touches an investment at all. It touches it at three points and never at more; and the pattern of exemption and charge at those three points is the whole of the tax character of the investment. Learn the framework and the ten chapters that follow become a filling-in exercise.*

## 1.1 The three points at which the law touches an investment

Take any investment — a life policy, a public provident fund account, an equity fund, a post office deposit. Money enters it, sits in it and grows, and eventually leaves it. The Income-tax Act, 2025 has something to say at each of those three moments, and nothing to say in between.

| Point | The question the Act asks | Where the answer is found |
|---|---|---|
| **Entry** — the contribution | Is the sum paid deductible from gross total income? | Chapter VIII — chiefly section 123 with Schedule XV, and sections 124 and 125. Subject always to section 202(2)(a)(xii) |
| **Accrual** — the growth | Is the interest, dividend or accretion chargeable as it arises? | Section 11 with Schedule II (exemption), or section 92 as income from other sources (charge) |
| **Exit** — the maturity, redemption or transfer | Is the sum received chargeable, and if so under which head and at what rate? | Section 11 with Schedules II and III (exemption); or sections 67 to 91 with 196 to 198 (capital gains); or section 92 (other sources) |

**WHY THREE AND NOT TWO**

Students who have read only the popular literature think in terms of two points — "tax saving" at entry and "tax free" at exit. That is the error that produces the commonest wrong answer in this Unit.

The middle point is where the money actually is for most of the life of the investment, and it is the point at which the avenues differ most sharply. A five-year bank deposit and a five-year national savings certificate are identical at entry (both deductible under section 123) and nearly identical at exit; they differ entirely in the middle, because the interest on the certificate is deemed reinvested and itself qualifies afresh under Schedule XV, while the interest on the deposit does not.

*When a question asks you to "compare the tax treatment" of two avenues, it is almost always the middle point that carries the marks.*

## 1.2 The four patterns — E-E-E, E-E-T, T-E-E, T-T-E

Writing **E** for exempt or deductible and **T** for taxable at each of the three points in turn gives a three-letter code for every investment in existence. Only four codes occur in practice.

| Pattern | Meaning | Examples | The planner's view |
|---|---|---|---|
| **E-E-E** | Deductible going in; growth untaxed; maturity untaxed | Public provident fund; Sukanya Samriddhi account; recognised provident fund on a qualifying withdrawal; National Pension System to the extent of the 60% lump sum | The best treatment the Act offers. Fill these first, in the optional regime |
| **E-E-T** | Deductible going in; growth untaxed; maturity taxed | The annuity limb of the National Pension System; certain superannuation payments | Tax is deferred, not forgiven. Worth taking where the rate on exit will be lower than the rate on entry — that is, for a person who will retire into a lower slab |
| **T-E-E** | Not deductible going in; growth untaxed; maturity untaxed | A life insurance policy or unit linked plan bought in the default regime; sovereign gold bonds held to maturity by the | The pattern that survives the default regime intact. Its value rises, relatively, the |

| Pattern | Meaning | Examples | The planner's view |
|---|---|---|---|
| | | original subscriber | moment section 202(1) applies |
| **T-T-E** or **T-T-T** | Nothing deductible; growth taxed; exit taxed or partly sheltered | Bank deposits other than the five-year tax saver; most debt mutual funds after section 76; corporate bonds; post office monthly income scheme | Judge these only on post-tax yield. They have no tax advantage and must earn their place on return alone |

**The examinable sentence**

**"The tax character of an investment is the pattern of exemption and charge at its three points — entry, accrual and exit — and the pattern must be stated with the section that produces it at each point."**

Write that sentence, then apply it. It will carry an answer on any avenue, including one you have never seen, because it forces you to look for three sections rather than repeat a brochure.

## 1.3 The regime filter for investments

Section 202(1) is the default. The optional regime applies only if the assessee exercises the option under section 202(4). Unit 1 set out what the default regime takes away; what follows is the same rule read for this Unit alone.

| | Default regime [section 202(1)] | Optional regime [First Schedule, Part I-B] |
|---|---|---|
| Entry — Chapter VIII | Withdrawn in its entirety by section 202(2)(a)(xii), **except** sections 124(1), 124(2), 125(2) and 146 | Available in full — sections 123 to 154 |
| Section 123 — the ₹1,50,000 | **Not available.** Life insurance, public provident fund, equity linked savings schemes, national savings certificates, tuition fees, housing loan principal — none of them earns a deduction | Available, aggregate ceiling ₹1,50,000 |
| Section 124(3) and (4) — the extra ₹50,000 on the assessee's own pension contribution | **Not available** | Available |
| Section 124(1) and (2) — the employer's pension contribution | **Available**, at 14% of salary in every case [124(2)] | Available, at 14% of salary for a Government employer and 10% otherwise [124(1)] |
| Section 125(2) — the Agnipath Scheme | **Available** | Available |
| Accrual — section 11 with Schedule II | **Untouched.** Interest on the public provident fund, on the Sukanya Samriddhi account and on tax-free bonds remains exempt | Untouched |
| Exit — Schedules II and III, and sections 196 to 198 | **Untouched.** The ₹1,25,000 shelter in section 198, the exemption of life policy proceeds, the 60% lump sum on the pension scheme — all survive | Untouched |

**The three consequences, and they are the whole of the planning in this Unit**

**One.** In the default regime the only investment that still earns a deduction is a contribution made by the *employer* to a notified pension scheme under section 124(2), and the Agnipath Scheme under section 125(2). Everything else in this booklet must justify itself on its exemption at accrual and exit, and on its return.

**Two.** That does not make the avenues worthless in the default regime — it makes them worth *less*. The public provident fund still compounds tax-free and matures tax-free; it simply no longer saves tax at the point of subscription. A candidate who writes that "PPF has no benefit in the new regime" has made a serious error.

**Three.** The deduction under section 124(2) is the one lever a salaried assessee in the default regime still has, and it is a large one: 14% of salary, with no monetary ceiling of its own, subject only to the aggregate ₹7,50,000 perquisite ceiling in section 17(1)(h). the Annexe, A.3 works it out.

## 1.4 Every avenue on one grid

The table below is the map of this Unit. Every entry is worked out in the chapter shown, and the regime column assumes the *optional* regime; in the default regime read every **E** in the entry column as **T**, except the two pension entries.

| Avenue | Entry | Accrual | Exit | Ch. |
|---|---|---|---|---|
| Life insurance policy — qualifying | E [s. 123] | E | E [Sch. II] | 2 |
| Life insurance policy — premium above ₹5,00,000, issued on or after 1 April 2023 | E [s. 123] | E | **T** [s. 92(2)(l)] | 2 |
| Unit linked plan — aggregate premium up to ₹2,50,000 | E [s. 123] | E | E [Sch. II] | 3 |
| Unit linked plan — aggregate premium above ₹2,50,000 | E [s. 123] | E | **T** — capital gains [ss. 67, 198] | 3 |
| Recognised provident fund — employee's share | E [s. 123] | E up to ₹2,50,000 a year of contribution | E on a qualifying withdrawal [Sch. III] | 4 |
| Recognised provident fund — employer's share | Not income up to ₹7,50,000 [s. 17(1)(h)] | E | E | 4 |
| Public provident fund | E [s. 123] | E [Sch. II] | E [Sch. II] | 5 |
| National Pension System — own contribution | E [ss. 123, 124(3)] | E | E to 60%; **T** on the annuity | 6 |
| National Pension System — employer's contribution | E [s. 124(1) or (2)] | E | E to 60%; **T** on the annuity | 6 |
| Equity linked savings scheme | E [s. 123] | E — growth option | **T** at 12.5% above ₹1,25,000 [s. 198] | 7 |
| Equity oriented mutual fund — not an ELSS | **T** | **T** on dividend [s. 92(2)(a)] | **T** [ss. 196, 198] | 8 |
| Specified mutual fund — debt | **T** | **T** on dividend | **T** at slab, always short-term [s. 76] | 8 |
| Section 85 bonds | Gain exempt on investment | **T** on interest | E on maturity of the exemption | 9 |
| Tax-free bonds | **T** | E [Sch. II] | **T** — capital gains on sale | 9 |
| National savings certificate VIII issue | E [s. 123] | E — interest deemed reinvested and itself eligible | **T** on the final year's interest | 10 |
| Sukanya Samriddhi account | E [s. 123] | E [Sch. II] | E [Sch. II] | 10 |

| Avenue | Entry | Accrual | Exit | Ch. |
|---|---|---|---|---|
| Senior citizens savings scheme | E [s. 123] | **T** [s. 92], with s. 153 relief | E — principal returned | 10 |
| Five-year bank deposit | E [s. 123] | **T** [s. 92] | E — principal returned | 11 |
| Ordinary bank deposit | **T** | **T** [s. 92], with s. 153 relief | E — principal returned | 11 |

## 1.5 Post-tax yield — the only honest comparison

Two investments cannot be compared by their advertised rates unless both are taxed the same way, and in this Unit almost no two are. Reduce every avenue to its post-tax yield before you say a word about which is better.

**THE FORMULA, AND THE TWO FORMS IT TAKES**

**Where the return is taxable at the slab rate —** Post-tax yield = r × (1 − t)

**Where the return is exempt —** Post-tax yield = r

**Where the entry also earns a deduction —** Effective cost of the investment = C × (1 − t), so that the yield on the *money actually parted with* is r × C ÷ [C × (1 − t)] = r ÷ (1 − t)

Here r is the nominal rate, t the marginal rate of tax including cess, and C the sum invested. The third line is the one candidates forget, and it is the reason a 7.1% public provident fund beats an 8.5% corporate deposit for a person in the 30% slab in the optional regime.

A worked comparison, for an assessee whose marginal rate is 30% plus 4% cess, that is 31.2%, and who is in the *optional* regime:

| Avenue | Nominal rate | Taxed at accrual? | Post-tax yield | Yield on money actually parted with |
|---|---|---|---|---|
| Public provident fund | 7.10% | No | 7.10% | 10.32% |
| National savings certificate | 7.70% | Deemed reinvested; effectively no | 7.70% | 11.19% |
| Five-year bank tax-saver deposit | 6.75% (say) | Yes | 4.64% | 6.75% |
| Senior citizens savings scheme | 8.20% | Yes, subject to section 153 | 5.64% | 8.20% |
| Ordinary five-year bank deposit | 6.75% (say) | Yes | 4.64% | 4.64% |

The last column is computed as r ÷ (1 − t) where the subscription qualifies under section 123 and the assessee has not otherwise exhausted the ₹1,50,000; the deduction is what turns 7.10% into 10.32%. **In the default regime the last column collapses into the fourth**, and the ranking changes completely — which is the point of section 1.3.

## 1.6 The order of work for any problem in this Unit

1. **Fix the regime.** Nothing in this Unit can be answered until section 202 is settled. If the question is silent, compute both and say which is better.
2. **Fix the person.** An individual and a Hindu undivided family are not identical: the family gets sections 123, 126, 127, 128 and 133 but not 124(3), 129, 134, 151, 152, 153 or 154. Chapter 9 sets out the difference.
3. **Place each avenue on the grid.** Entry, accrual, exit — with the section for each.
4. **Apply the ceilings in the right order.** The ₹1,50,000 in section 123 is an aggregate for all Schedule XV entries taken together; the ₹50,000 in section 124(3) sits *above* it; the ₹7,50,000 in section 17(1)(h) is a perquisite ceiling, not a deduction ceiling, and is a different animal altogether.
5. **Compute the tax saved, and the post-tax yield.** In rupees.

6. **State the caution.** Every measure in this booklet has one — a lock-in, a clubbing risk, a recapture provision, or a liquidity cost. An answer that gives the benefit without the caution is half an answer.

**THE THREE CEILINGS, KEPT APART**

- **₹1,50,000 — section 123.** An aggregate deduction ceiling for everything in Schedule XV. Optional regime only.
- **₹50,000 — section 124(3) and (4).** The assessee's own contribution to the notified pension scheme, over and above the ₹1,50,000. Optional regime only.
- **₹7,50,000 — section 17(1)(h).** The aggregate of the *employer's* contributions to a recognised provident fund, an approved superannuation fund and a notified pension scheme. Beyond it the excess is a taxable perquisite in the employee's hands. It applies in *both* regimes, because it is a charging provision and not a deduction.

*Confusing the third with the first two is the single commonest error in this Unit. The first two reduce total income; the third increases it.*

CHAPTER 2

# Equity Linked Savings Schemes

*The shortest lock-in of any avenue eligible under section 123, and the only one of them that is an equity investment. Three years, and then the ordinary law of capital gains applies.*

## 2.1 PART A — The scheme

An equity linked savings scheme is a mutual fund scheme framed under the guidelines notified by the Central Government, under which not less than **80% of the money collected is invested in equity and equity-related instruments**, and every unit is subject to a **lock-in of three years from the date of allotment**.

| Feature | Position |
|---|---|
| Lock-in | Three years, from the date of allotment of **each** unit. The lock-in is on the unit, not on the folio |
| Minimum investment | Ordinarily ₹500, and in multiples thereof |
| Maximum | None — but only ₹1,50,000 in the aggregate qualifies for deduction under section 123, and only in the optional regime |
| Options | Growth and dividend (income distribution cum capital withdrawal). The growth option is almost always the correct choice — see 7.3 |
| Redemption | Free after three years. There is no compulsion to redeem, and no upper limit on the holding period |

## 2.2 PART B — The tax treatment

| Point | Treatment | Provision |
|---|---|---|
| Entry | Eligible sum; deductible within the aggregate ₹1,50,000. Optional regime only | Section 123 with Schedule XV |
| Accrual — growth option | Nothing chargeable. The net asset value rises; there is no distribution and no transfer | — |
| Accrual — dividend option | The distribution is **chargeable in full** as income from other sources at slab rates | Section 92(2)(a) |
| Exit — after three years | The units are units of an **equity oriented fund**; held more than twelve months the gain is long-term, charged at **12.5% on the amount exceeding ₹1,25,000** | Sections 67, 72 and 198 |
| Exit — within three years | Cannot happen. The units are locked in | — |

**WHY THE TWELVE-MONTH RULE NEVER BITES ON AN EQUITY LINKED SAVINGS SCHEME**

A unit of an equity oriented fund is short-term if held for **not more than twelve months** [Unit 2, Chapter 4]. But an equity linked savings scheme unit **cannot be transferred for three years**.

It follows that every gain on such a scheme is necessarily long-term, and **section 196 — the 20% short-term rate — can never apply to it**. Only section 198 can.

*This is a small point that examiners like, because it can only be got right by someone who has understood both the lock-in and the holding-period rule.*

## 2.3 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|

| Measure | How it works | Caution |
|---|---|---|
| | | |
| Choose the **growth** option, never the dividend option | A dividend is chargeable in full at the slab rate — up to 31.2%. Growth is charged at 12.5% and only above ₹1,25,000. On the same underlying portfolio the growth option is simply a lower rate of tax | There is no circumstance in which the dividend option of an equity fund is better for an assessee above the exemption limit. It exists for institutional reasons, not for planning |
| Compare it with the other Schedule XV entries on lock-in, not on return | Public provident fund fifteen years; national savings certificate five; five-year bank deposit five; equity linked savings scheme **three**. It is the most liquid deduction in the Act | Three years is a lock-in, not a horizon. Equity should not be bought with money needed in three years. Match the horizon to the asset, not to the lock-in |
| Invest by monthly instalment, but understand what the lock-in does to it | Averages the entry price over the year and imposes discipline | **Each instalment carries its own three-year lock-in.** The instalment of March 2027 is free only in March 2030. A twelve-instalment plan is not free after three years; it becomes free instalment by instalment over the fourth year |
| Harvest the ₹1,25,000 shelter every year once the lock-in has run | Redeem enough units each year to realise a gain of about ₹1,25,000, and reinvest immediately. The gain is untaxed, and the cost of acquisition of the new units is stepped up | The reinvested units carry a **fresh three-year lock-in** if put back into the same kind of scheme. Reinvest in an ordinary equity fund, which has no lock-in, unless a further deduction is wanted |
| Do not redeem merely because the lock-in has ended | There is no tax event on the third anniversary and no reason to sell. Continued holding defers the charge indefinitely | But do not let a poor fund run for sentimental reasons. Switching costs 12.5% on the gain above the shelter, which is a real but not prohibitive cost |
| In the default regime, buy an ordinary equity fund instead | Without section 123 there is no reason to accept a three-year lock-in. The exit treatment of an ordinary equity oriented fund is identical — section 198, 12.5% above ₹1,25,000 | Existing units remain locked until their own three years have run. The regime does not release them |

## 2.4 PART D — Illustrations

**ILLUSTRATION 7.1 — THE SCHEME AGAINST THE PUBLIC PROVIDENT FUND, OVER TEN YEARS**

Shri Aditya, aged 30, in the *optional* regime, marginal rate 31.2%, can invest ₹1,50,000 a year for ten years. Compare (a) the public provident fund at 7.1%, and (b) an equity linked savings scheme assumed to return 12% a year. Ignore the deduction, which is the same for both.

**(a) Public provident fund.** ₹1,50,000 a year for ten years at 7.1%, subscribed on 1 April: ₹1,50,000 × [(1.071^10 − 1) ÷ 0.071] × 1.071 ≈ **₹22,30,000**. Tax on maturity — **nil**. Net ₹22,29,000.

**(b) Equity linked savings scheme.** ₹1,50,000 a year for ten years at 12%: ₹1,50,000 × [(1.12^10 − 1) ÷ 0.12] × 1.12 ≈ **₹29,48,000**. Cost ₹15,00,000; gain ₹14,48,000, long-term. If the whole is redeemed in one year: tax = 12.5% of (₹14,48,000 − ₹1,25,000) = 12.5% of ₹13,23,000 = ₹1,65,375, plus cess ₹6,615 = ₹1,71,990. **Net ₹27,76,010.**

**The scheme wins by about ₹5,46,000** — but only if the 12% is earned, which is not guaranteed, whereas the 7.1% is.

**And the planning refinement.** If instead of redeeming in one year he redeems over eight years, using the ₹1,25,000 shelter each year, the whole of the ₹14,49,000 gain can be realised **entirely free of tax**, and the net becomes ₹29,48,000 — a further ₹1,71,990. *The shelter is annual; use it annually.*

**Illustration 7.2 — the instalment plan and its lock-in**

Smt. Neha begins a monthly instalment of ₹12,500 into an equity linked savings scheme on 5 April 2026, intending to invest ₹1,50,000 in the tax year. She believes the whole sum will be free in April 2029. *Is she right?*

**No.** The lock-in attaches to each unit from the date of its allotment. The units bought on 5 April 2026 are free on 5 April 2029; those bought on 5 March 2027 are free only on 5 March 2030. Her ₹1,50,000 becomes free in twelve monthly tranches between April 2029 and March 2030.

**The deduction, however, is not affected.** Section 123 allows the deduction for the sums *paid* in the tax year, and all twelve instalments fall in 2026-27. She gets the full ₹1,50,000 deduction in 2026-27 whatever happens to the lock-in.

*State both halves. The deduction follows the payment; the lock-in follows the allotment; and they do not move together.*

**Illustration 7.3 — the growth option against the dividend option**

Two investors each hold ₹10,00,000 in the same equity linked savings scheme, which earns 12% in the year. One holds the growth option; the other the dividend option, and the fund distributes 8% of the net asset value. Both are at 31.2%.

**Dividend option.** Distribution ₹80,000, chargeable in full under section 92(2)(a) at 31.2% = **₹24,960 of tax, this year**. The net asset value falls by the distribution, so the holding is worth ₹10,40,000 and he holds ₹80,000 in cash less tax, that is ₹55,040. **Total ₹10,95,040.**

**Growth option.** Nothing distributed, nothing chargeable. The holding is worth ₹11,20,000. **Total ₹11,20,000.**

**Difference ₹24,960 in one year** — the whole of the tax. And it recurs annually, compounding against the dividend investor for as long as he holds the option.

**The point of principle.** A distribution converts a gain taxable at 12.5% above a ₹1,25,000 shelter into an income taxable at 31.2% from the first rupee. **It is the single worst tax decision available in a mutual fund**, and it is the default option on many application forms.

CHAPTER 3

# Unit Linked Insurance Plans

*An insurance contract with a mutual fund inside it. Until 2021 that combination enjoyed the tax treatment of the insurance and the returns of the fund; the law has since closed the gap, and the closing is what is examined.*

## 3.1 PART A — The scheme

A unit linked insurance plan is a policy of life insurance under which the premium, after deduction of the mortality charge and the expenses, is invested in units of a fund chosen by the policyholder — equity, debt or balanced — and the policyholder bears the investment risk. The Act defines it, for the purposes of the exemption, as a policy having a component of investment and a component of insurance, issued by an insurer registered under the Insurance Act, 1938 or under a scheme of the Unit Trust of India.

| Feature | Position |
|---|---|
| Lock-in | Five years, prescribed by the Insurance Regulatory and Development Authority. Partial withdrawal is permitted after it |
| Switching | Between the funds of the same insurer, without a charge in most contracts, and — importantly — **without a transfer for the purposes of section 67** |
| Charges | Premium allocation charge, policy administration charge, fund management charge, mortality charge, and a surrender charge in the early years |
| Sum assured | Ordinarily ten times the annual premium for a policyholder below 45, seven times above — which happens to satisfy the 10% ratio |

## 3.2 PART B — The tax treatment

### Entry — the premium [section 123 with Schedule XV]

A unit linked insurance plan is a policy of life insurance, and the premium is an eligible sum under Schedule XV in the same way and subject to the same 10% capital-sum-assured ratio as any other policy. There is nothing special about a unit linked plan at entry.

### Accrual — the growth in the fund

Nothing is chargeable. The units appreciate, and a switch from one fund of the insurer to another is not a transfer, so no capital gain arises on switching. **This is a real and often-overlooked advantage over a mutual fund**, in which every switch is a redemption and a fresh purchase, and therefore a transfer under section 67.

### Exit — and the ₹2,50,000 threshold

The sum received on maturity or surrender is exempt under Schedule II — but not if the policy fails **either** of two tests:

| Test | The rule | Applies to |
|---|---|---|
| The 10% ratio | The premium payable for any year during the term must not exceed 10% of the actual capital sum assured | Every unit linked plan, whenever issued after 1 April 2012 |
| The ₹2,50,000 aggregate premium test | The **aggregate** of the premiums payable on **all** unit linked plans of the assessee must not exceed ₹2,50,000 for any year during the term of the policy | Policies issued **on or after 1 February 2021** |

**WHERE THE EXEMPTION FAILS, THE CHARGE IS CAPITAL GAINS — NOT OTHER SOURCES**

This is the point that distinguishes a unit linked plan from every other life policy, and the point most often got wrong.

Where a **conventional** policy loses its exemption, the excess of the receipt over the premiums paid is charged under **section 92(2)(l)** as income from other sources, at slab rates.

Where a **unit linked plan** loses its exemption, the units are treated as a **capital asset**, the sum received is the full value of the consideration, and the difference is a **capital gain** under section 67. And because the fund is treated as an equity oriented fund where it qualifies as one, the gain is charged under **section 198 at 12.5% on the amount exceeding ₹1,25,000**, the units having been held for more than twelve months.

*So the failure of the exemption on a unit linked plan costs the assessee 12.5%, while the failure of the exemption on an endowment policy can cost him 30% plus cess. That difference is examinable, and it is counter-intuitive — the policy with the worse tax status on paper often bears the lighter tax in fact.*

Two consequences follow, and both should be stated in any answer on this chapter:

- The ₹1,25,000 shelter in section 198 is a **single** shelter for the tax year. A gain on a unit linked plan competes for it with gains on equity shares and on equity oriented funds. It cannot be claimed twice.
- The **death benefit remains exempt in every case**, whatever the premium and whenever the policy was issued. Neither the ₹2,50,000 test nor the 10% test touches it.

## 3.3 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| Keep the aggregate annual premium on all unit linked plans within ₹2,50,000 | Preserves the exemption under Schedule II absolutely | The test is on the aggregate, and on the premium **payable** for *any* year of the term — not merely the premium actually paid. A top-up premium in year three can retrospectively spoil the policy |
| Where more than ₹2,50,000 is to be invested, put the excess in an equity oriented mutual fund rather than a second unit linked plan | The fund is taxed on exit at exactly the same rate — 12.5% above ₹1,25,000 under section 198 — but carries no mortality charge, no allocation charge and no five-year lock-in | The fund gives no life cover and no deduction under section 123. Buy the cover with a term policy |
| Use the switching facility rather than redeeming and reinvesting | A switch within the policy is not a transfer; a switch between mutual funds is. On a portfolio rebalanced twice a year this is worth a great deal over twenty years | Only within the same insurer's funds. Do not confuse it with a switch between insurers, which is a surrender |
| Keep the sum assured at ten times the annual premium | Satisfies the 10% ratio automatically, and gives real cover | Insurers will offer a lower multiple for older lives. Below the multiple the 10% test fails and the exemption goes |
| Do not surrender before five years | Surrender within the lock-in attracts a discontinuance charge, and surrender before premiums for two years have been paid triggers the recapture of past deductions under section 123 | The recapture is a charge to tax on a sum already spent. It is the most avoidable tax in this Unit |
| In the default regime, compare the plan with a term policy plus an index fund | Section 123 being withdrawn, the plan's only remaining advantages are the tax-free switch and the exemption on exit | Those two advantages are real. Do not dismiss the plan in the default regime; price it |

## 3.4 PART D — Illustrations

**Illustration 3.1 — the ₹2,50,000 threshold, on both sides of it**

Shri Vikram, resident, aged 40, in the *optional* regime with a marginal rate of 31.2%, takes a unit linked plan on 1 July 2026. Sum assured ₹30,00,000. He is considering an annual premium of either ₹2,50,000 or ₹3,00,000. Assume the fund is equity oriented and that the policy matures after 15 years, the fund value being 3.2 times the total premiums paid. He has no other capital gain in the year of maturity.

**Case A — premium ₹2,50,000.** Aggregate premium does not exceed ₹2,50,000; the 10% ratio is satisfied (₹2,50,000 is 8.33% of ₹30,00,000). The exemption under Schedule II holds. Total premiums ₹37,50,000; maturity ₹1,20,00,000; **tax on maturity — nil**. Deduction under section 123 limited to ₹1,50,000 a year.

**Case B — premium ₹3,00,000.** The 10% ratio is still satisfied (10% of ₹30,00,000 = ₹3,00,000, and the premium does not exceed it). But the aggregate premium exceeds ₹2,50,000, and the policy was issued after 1 February 2021. **The exemption fails.** Total premiums ₹45,00,000; maturity ₹1,44,00,000; capital gain ₹99,00,000, long-term, the units being units of an equity oriented fund held for more than twelve months.

Tax under section 198 = 12.5% of (₹99,00,000 − ₹1,25,000) = 12.5% of ₹97,75,000 = ₹12,21,875, plus cess at 4% = **₹12,70,750**.

**The comparison.** The extra ₹50,000 a year of premium — ₹7,50,000 over fifteen years — produced an extra ₹24,00,000 of maturity value and a tax bill of ₹12,70,750 on the whole gain, not merely on the incremental part. **The threshold is a cliff, not a slope.**

**The planning answer.** Take the unit linked plan at exactly ₹2,50,000 and put the remaining ₹50,000 a year into an equity oriented mutual fund. The fund's own gain would then be about ₹16,50,000, taxed at 12.5% above ₹1,25,000 — roughly ₹1,98,000 — against ₹12,70,750. **A saving of about ₹10,72,000**, for a change of container and nothing else.

### Illustration 3.2 — the switch, and what it is worth

Smt. Anita holds ₹20,00,000 in an equity fund and rebalances to debt and back once a year, realising an average gain of ₹2,00,000 on each rebalancing. Compare the position over ten years if she does this (a) through two mutual funds, and (b) inside a unit linked plan.

**(a) Through mutual funds.** Each rebalancing is a redemption and therefore a transfer under section 67. On a holding of more than twelve months the gain is long-term and charged under section 198 at 12.5% above ₹1,25,000. Gain ₹2,00,000 less the shelter ₹1,25,000 = ₹75,000 charged at 12.5% = ₹9,375 plus cess = ₹9,750 a year, and the shelter is consumed and unavailable for anything else. Over ten years, ₹97,500 of tax paid *and* the shelter lost ten times over.

**(b) Inside a unit linked plan.** A switch between the insurer's funds is not a transfer. **No tax at all** over the ten years, and the ₹1,25,000 shelter remains available each year for her other equity holdings.

*The moral is not that unit linked plans are better than mutual funds. It is that the frequency of rebalancing is a tax variable, and the more often a portfolio is churned the more the tax-free switch is worth. For a buy-and-hold investor it is worth nothing.*

### Illustration 3.3 — the death benefit, which no threshold touches

Shri Mohan took a unit linked plan in 2024 with an annual premium of ₹6,00,000 and a sum assured of ₹60,00,000. He dies in 2026-27, the fund value then being ₹19,00,000 and the sum payable ₹60,00,000. *What is the position of his widow, the nominee?*

The aggregate premium of ₹6,00,000 far exceeds ₹2,50,000 and the policy was issued after 1 February 2021, so on *maturity or surrender* the exemption would have failed. **But the sum here is received on death.** The exemption for a sum received on the death of the life assured is unconditional: it is not subject to the 10% ratio, not subject to the ₹2,50,000 test, and not subject to the ₹5,00,000 test in the Annexe, A.1.

**The whole of ₹60,00,000 is exempt.** Nothing is chargeable in the hands of the widow, and nothing is chargeable under section 92(2)(m) either, a sum received under a life policy on death not being a gift.

CHAPTER 4

# The Public Provident Fund

*The only avenue in this booklet that is exempt at all three points, open to every resident individual, guaranteed by the Central Government, and protected from attachment. Nothing else in the Act comes close.*

## 4.1 PART A — The scheme

| Feature | Position for 2026-27 |
|---|---|
| Who may open | Any resident individual, in his own name or as guardian of a minor. A Hindu undivided family may **not** open an account, and one opened before 13 May 2005 could not be extended beyond its original maturity |
| Number of accounts | One per individual, plus one as guardian for each minor child. A second account in one's own name is irregular and earns no interest on discovery |
| Minimum and maximum | ₹500 and ₹1,50,000 in a tax year, taken together for the subscriber's own account and any account he operates as guardian |
| Term | Fifteen tax years from the end of the year in which the account is opened; extendable in blocks of five years, with or without further subscription |
| Rate of interest | **7.1% per annum**, compounded annually, for the quarter 1 July 2026 to 30 September 2026. Notified quarterly by the Department of Economic Affairs |
| Interest computation | On the **lowest balance between the close of the fifth day and the last day of the month** |
| Loan | From the third to the sixth year, up to 25% of the balance at the end of the second preceding year |
| Partial withdrawal | From the seventh year, once a year, up to 50% of the balance at the end of the fourth preceding year or the preceding year, whichever is lower |
| Premature closure | After five years, on grounds of serious illness, higher education, or change of residency status, with an interest penalty of 1% |
| Attachment | The balance is **not liable to attachment** under any decree or order of a court in respect of any debt or liability of the subscriber |

## 4.2 PART B — The tax treatment

| Point | Treatment | Provision |
|---|---|---|
| Entry — the subscription | Eligible sum; deductible within the aggregate ceiling of ₹1,50,000 | Section 123 with Schedule XV |
| Accrual — the interest | **Wholly exempt**, and exempt in the default regime as well | Section 11 with Schedule II |
| Exit — the maturity or withdrawal | **Wholly exempt**, whether on maturity, on partial withdrawal or on premature closure | Section 11 with Schedule II |

**E-E-E, AND WHAT THAT IS WORTH**

The public provident fund is one of a very small number of E-E-E investments left in Indian law. Put a figure on it. A subscription of ₹1,50,000 a year for fifteen years at 7.1% produces about ₹40,68,000, of which ₹22,50,000 is capital and about ₹18,18,000 is interest — **and not one rupee of that interest is ever taxed.**

The same ₹1,50,000 a year in a bank deposit at 7.1%, for a person at 31.2%, accumulates about ₹33,66,000, because the interest is taxed every year as it accrues. **The difference of about ₹7,02,000 is the value of the middle E alone**, before any deduction at entry is counted.

*This is the calculation to put in an answer on "tax planning through investments". It shows the middle point of the grid doing the work, which is exactly what section 1.1 said it would.*

## 4.3 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| Subscribe on or before the 5th of the month — and best of all on 1 April | Interest is on the lowest balance between the close of the 5th and the end of the month. A deposit on the 6th earns nothing for that month. A single ₹1,50,000 deposited on 1 April earns a full year's interest; the same sum deposited on 31 March earns none | Over fifteen years the difference between subscribing on 1 April and on 31 March each year is of the order of ₹2,70,000 on a ₹1,50,000 subscription. It is the largest free gain in this Unit |
| Open accounts for the spouse and for each minor child | The ₹1,50,000 ceiling is per individual. A family of four can hold four accounts, and the interest in every one of them is exempt | **The ₹1,50,000 limit for the subscriber and any account he operates as guardian is a combined limit.** A father subscribing ₹1,50,000 to his own account may not also subscribe ₹1,50,000 to his minor child's. He may, however, gift to his major child, who subscribes in his own right |
| Where money is gifted to a spouse for the account, expect clubbing | Section 99(1)(a) clubs the income arising from an asset transferred to the spouse without adequate consideration | **But the income here is exempt**, so clubbing it produces nothing. Clubbing an exempt income adds nothing to total income. This is the one place in the Act where the clubbing provisions are harmless |
| Extend the account rather than closing it | At the end of fifteen years the account may be extended in blocks of five, with or without subscription. With no further subscription the balance simply continues to compound tax-free, and one withdrawal a year is permitted | The election to extend *with* subscription must be made within one year of maturity, in Form 4. If it is missed, the account is treated as extended without subscription and later deposits earn no interest |
| Use it as the debt component of the portfolio | 7.1% wholly exempt is equivalent to 10.32% before tax at the 31.2% rate — a return no bank deposit and no debt fund can match after section 76 | The lock-in is real. Do not put money there that will be needed within seven years |
| In the default regime, keep subscribing | The entry deduction goes; the exempt accrual and exempt exit remain. Its post-tax yield is still the best available on a Government-guaranteed rupee | It no longer beats an equity linked savings scheme on *post-tax* return over long periods; it beats everything on risk |
| Use the loan facility rather than a withdrawal | A loan between the third and sixth years costs 1% over the account rate and leaves the corpus compounding | Repay within thirty-six months or the rate rises to 6% over the account rate |

## 4.4 PART D — Illustrations

**ILLUSTRATION 5.1 — THE FIFTH OF APRIL**

Shri Ganesh subscribes ₹1,50,000 to his public provident fund account each year for fifteen years, at 7.1%. Compare the maturity value if he subscribes (a) on 1 April each year, and (b) on 31 March each year.

**(a) 1 April.** Each subscription earns interest for the whole of the year in which it is made. The accumulation is ₹1,50,000 × [(1.071^15 − 1) ÷ 0.071] × 1.071 ≈ **₹40,68,000**.

**(b) 31 March.** Each subscription is credited after the 5th of March and so earns nothing in the month of deposit, and effectively nothing in the year of deposit. The accumulation is ₹1,50,000 × [(1.071^15 − 1) ÷ 0.071] ≈ **₹37,98,000**.

**Difference ₹2,70,000**, for the same money, the same scheme and the same fifteen years. There is no tax provision involved at all — only the rule that interest runs on the lowest balance after the 5th.

*Examiners like this illustration because it makes the point that tax planning and financial planning are not the same thing, and that the second sometimes pays better than the first.*

**Illustration 5.2 — the family, and the combined ceiling**

Shri and Smt. Bhatia have two children, aged 19 and 12. Shri Bhatia's income is ₹30,00,000; Smt. Bhatia has income of ₹4,00,000; the elder child has no income; the younger is a minor. They wish to place the maximum possible in public provident fund accounts. *How much, and in whose names?*

- **Shri Bhatia's own account** — ₹1,50,000. But this is a *combined* ceiling with any account he operates as guardian, so if he also subscribes for the minor, the two together may not exceed ₹1,50,000.
- **Smt. Bhatia's own account** — ₹1,50,000, subscribed by her. If Shri Bhatia gifts her the money, section 99(1)(a) clubs the income — but the income is exempt, so nothing is added. **Full ₹1,50,000, no tax consequence.**
- **The elder child, aged 19** — a major, with his own account and his own ₹1,50,000 ceiling. A gift from the father attracts no clubbing at all, section 99 having no application to a major child, and no charge under section 92(2)(m), the father being a relative.
- **The minor child** — an account may be opened by either parent as guardian, but the subscription counts against that parent's own ceiling. If Smt. Bhatia is the guardian, her own ₹1,50,000 must be shared with it.

**The efficient answer.** Shri Bhatia ₹1,50,000 in his own account; Smt. Bhatia ₹1,50,000 in hers; the elder child ₹1,50,000 in his; the minor's account funded to the extent the guardian's ceiling permits. **Aggregate ₹4,50,000 a year at 7.1%, entirely exempt at accrual and at exit.**

**Deduction under section 123**, in the optional regime, is another matter: Shri Bhatia may claim only what he pays for himself, his spouse and his children within his own ₹1,50,000; Smt. Bhatia may claim her own subscription against her own income of ₹4,00,000, which is below the exemption limit and so needs no deduction at all.

**Illustration 5.3 — the regime, and whether to continue**

Smt. Latha, aged 45, is in the **default** regime. Her marginal rate is 20% plus cess, that is 20.8%. She has subscribed ₹1,50,000 a year to her public provident fund for eight years. A relation tells her that “PPF is useless in the new regime”. *Is that right?*

**No, and the error is instructive.** What the default regime takes away is the *entry* deduction under section 123. What it leaves untouched is the exemption of the interest under Schedule II and the exemption of the maturity value.

Her post-tax yield remains **7.10%**. The nearest comparable safe alternative is a five-year bank deposit at, say, 6.75%, on which the interest is taxable at 20.8%, giving **5.35%**. The public provident fund therefore still beats it by 175 basis points a year, on a Government-guaranteed rupee.

What *has* changed is the ranking against equity. In the optional regime the deduction pushed the effective yield to 8.96% and made the account competitive with an equity linked savings scheme on a risk-adjusted view. In the default regime it is simply the best safe asset available, and the growth part of her portfolio should now be built with equity oriented funds, which pay 12.5% on gains above ₹1,25,000 and nothing at all below it.

*The examinable sentence:* ***the default regime does not destroy the public provident fund; it demotes it from a tax-saving instrument to a debt instrument, and a very good one.***

CHAPTER 5

# Post Office and Small Savings Schemes

*Nine schemes, administered by the Department of Posts under the Government Savings Promotion Act, 1873, guaranteed by the Central Government, and taxed in five different ways. The rates move every quarter; the tax treatment does not.*

## 5.1 PART A — The family of schemes

**A NECESSARY CAUTION ABOUT THE RATES IN THIS CHAPTER**

The rates below are those notified by the Department of Economic Affairs, Ministry of Finance, for the quarter **1 July 2026 to 30 September 2026**, and are unchanged from the preceding quarter.

**They are not part of the Income-tax Act, 2025 and are not examinable as law.** They are given so that the illustrations in this chapter work with real figures. Before quoting a rate anywhere outside this booklet, check the notification for the current quarter.

| Scheme | Rate | Term | Limits |
|---|---|---|---|
| Post Office Savings Account | 4.0% | Running | No maximum |
| Post Office Recurring Deposit — 5 year | 6.7% | 5 years | Minimum ₹100 a month |
| Post Office Time Deposit — 1 year | 6.9% | 1 year | Minimum ₹1,000 |
| Post Office Time Deposit — 2 year | 7.0% | 2 years | Minimum ₹1,000 |
| Post Office Time Deposit — 3 year | 7.1% | 3 years | Minimum ₹1,000 |
| Post Office Time Deposit — 5 year | 7.5% | 5 years | Minimum ₹1,000 |
| Post Office Monthly Income Scheme | 7.4% | 5 years | ₹9,00,000 single; ₹15,00,000 joint |
| National Savings Certificate, VIII Issue | 7.7% | 5 years | No maximum |
| Kisan Vikas Patra | 7.5% | 115 months | No maximum |
| Senior Citizens Savings Scheme | 8.2% | 5 years, extendable by 3 | ₹30,00,000 |
| Sukanya Samriddhi Account | 8.2% | 21 years from opening | ₹1,50,000 a year |
| Mahila Samman Savings Certificate | 7.5% | 2 years | ₹2,00,000. **Closed to fresh deposits since 1 April 2025**; existing accounts run to maturity |
| Public Provident Fund | 7.1% | 15 years | ₹1,50,000 a year — Chapter 4 |

## 5.2 PART B — The tax treatment, scheme by scheme

| Scheme | Entry — section 123? | Accrual | Exit |
|---|---|---|---|
| Post Office Savings Account | No | Interest chargeable under section 92, but **deduction under section 153 up to ₹10,000** (₹50,000 for a senior citizen, on any account) | Principal returned; nothing chargeable |
| Recurring deposit | No | Interest chargeable at slab, year by year on accrual | Principal returned |

| Scheme | Entry — section 123? | Accrual | Exit |
|---|---|---|---|
| Time deposit — 1, 2 and 3 year | No | Interest chargeable at slab | Principal returned |
| Time deposit — **5 year** | **Yes** — an eligible sum in Schedule XV | Interest chargeable at slab | Principal returned |
| Monthly income scheme | No | The monthly interest is chargeable at slab as it is received | Principal returned |
| National Savings Certificate | **Yes** | Interest accrues annually and is chargeable — **but is deemed reinvested and so itself qualifies afresh under section 123** for the first four years | The fifth year's interest is chargeable and is **not** reinvested; the principal is returned |
| Kisan Vikas Patra | **No** | Interest chargeable on accrual, or on receipt if the assessee so accounts, at slab | Principal returned |
| Senior Citizens Savings Scheme | **Yes** | Interest chargeable at slab, paid quarterly; section 153 gives a senior citizen ₹50,000 across all accounts | Principal returned |
| Sukanya Samriddhi Account | **Yes** | **Exempt** [Schedule II] | **Exempt** [Schedule II] |
| Mahila Samman Savings Certificate | No | Interest chargeable at slab | Principal returned |

**THE NATIONAL SAVINGS CERTIFICATE, AND THE TRICK IN ITS MIDDLE YEAR**

The interest on a national savings certificate is not paid out; it accrues and is added to the certificate. The Act charges it as it accrues — but because the accrued interest is treated as reinvested in the certificate, **it is itself an eligible sum under Schedule XV** and qualifies for deduction under section 123 in the same year.

So for years one to four the charge and the deduction cancel out, and the effective tax is nil. In the **fifth year** the interest is paid out with the principal, is not reinvested, and therefore attracts no deduction. **That fifth year's interest is the only taxable event in the life of the certificate.**

Two cautions. First, this works only if the assessee has room within the ₹1,50,000 ceiling; if section 123 is already exhausted by other investments, the accrued interest is charged and nothing offsets it. Second, **in the default regime the whole mechanism fails**, section 123 being unavailable, and the interest is charged in every one of the five years.

### Sukanya Samriddhi — the only other E-E-E in the Act

An account may be opened by the guardian of a girl child below the age of ten, in her name, and only one account per girl child and at most two per family (with an exception for twins or triplets). The subscription qualifies under section 123 within the aggregate ₹1,50,000; the interest is exempt under Schedule II; and the maturity value is exempt. It carries the highest rate of any Government-guaranteed scheme — **8.2%** — and it is exempt at all three points. **No other avenue in this booklet combines those two facts.**

The account matures twenty-one years from opening, or on the marriage of the account holder after eighteen. Fifty per cent may be withdrawn after she attains eighteen or passes the tenth standard, for education. Subscription is required only for the first fifteen years; the balance then compounds for six more years without further deposit.

## 5.3 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| For a daughter under ten, open | 8.2% wholly exempt is equivalent to | Two accounts per family only. The |

| Measure | How it works | Caution |
|---|---|---|
| a Sukanya Samriddhi account before anything else | 11.92% before tax at the 31.2% rate — the highest risk-free post-tax return available to a resident individual anywhere in Indian law | money is the child's, and is not available to the parent for any purpose. Twenty-one years is a very long lock-in |
| For a senior citizen, use the Senior Citizens Savings Scheme with section 153 | 8.2% quarterly, up to ₹30,00,000, with a deduction of ₹50,000 of interest under section 153 in the optional regime | **Section 153 does not survive the default regime.** For a senior citizen in the default regime the whole interest is charged. Compute both regimes before advising |
| Prefer the 5-year time deposit to the 1, 2 and 3 year deposits where a deduction is wanted | Only the five-year deposit is an eligible sum in Schedule XV | The five-year deposit cannot be withdrawn prematurely for the purposes of the deduction, and premature closure reverses it |
| Prefer the national savings certificate to a bank deposit of the same tenor | 7.7% against about 6.75%, and the reinvestment mechanism makes years one to four effectively tax-free where there is room in the ₹1,50,000 | Only in the optional regime. In the default regime the certificate is simply a 7.7% taxable instrument, though still a good one |
| Use the monthly income scheme for a person with no other income | Where total income is below the exemption limit the interest bears no tax at all, and the scheme provides a monthly cash flow at 7.4% | The ceiling is ₹9,00,000 single and ₹15,00,000 joint. Interest is chargeable at slab for anyone above the limit and there is no section 153 relief for it |
| Split deposits across family members below the exemption limit | A resident individual with total income up to ₹12,00,000 in the default regime pays no tax after the rebate in section 156(2) | **Section 99 clubs the income where the money was gifted to a spouse or a minor child.** It does not club where the recipient is a major child or a parent. This is the boundary of the measure and it must be stated |
| Where a certificate is held by a person below the exemption limit, file Form 15G or 15H | Prevents deduction of tax at source and avoids waiting for a refund | Form 15H is for a senior citizen; 15G for others. A false declaration is an offence |

## 5.4 PART D — Illustrations

**ILLUSTRATION 10.1 — THE NATIONAL SAVINGS CERTIFICATE THROUGH ITS FIVE YEARS**

Shri Mahesh invests ₹1,00,000 in a national savings certificate on 1 April 2026 at 7.7%. He is in the *optional* regime, at 31.2%, and has ₹50,000 of room left in his section 123 ceiling in each year. *Show the tax position year by year.*

Interest accrues at 7.7% compounded annually: year 1 ₹7,700; year 2 ₹8,293; year 3 ₹8,931; year 4 ₹9,619; year 5 ₹10,360. Maturity ₹1,44,903.

- **Years 1 to 4.** Interest chargeable under section 92; the same sum deemed reinvested and deductible under section 123, there being room. **Net effect nil in each year.**
- **Year 5.** Interest ₹10,360 chargeable; **not reinvested**, so no deduction. Tax at 31.2% = **₹3,232**.

**Total tax over five years ₹3,232 on interest of ₹44,903** — an effective rate of 7.2% against a nominal 31.2%.

**Now change one fact:** he is in the **default** regime. Section 123 is unavailable, so the interest is charged in all five years: total tax = 31.2% of ₹44,903 = **₹14,010**. The certificate loses more than four-fifths of its tax advantage, though it remains a 7.7% Government-guaranteed instrument.

**ILLUSTRATION 10.2 — THE SENIOR CITIZEN, AND THE TWO REGIMES**

Shri Rao, aged 68, resident, retired. He has ₹30,00,000 in the Senior Citizens Savings Scheme at 8.2%, ₹6,00,000 in a savings bank account at 3%, and a pension of ₹3,60,000. He has no other income and no investments. *Which regime,* *and what planning?*

Interest: Senior Citizens Savings Scheme ₹2,46,000; savings bank ₹18,000. Pension ₹3,60,000. **Gross total income ₹6,24,000.**

**Optional regime.** Standard deduction on pension ₹50,000 → ₹5,74,000. Section 153 for a senior citizen: ₹50,000 against interest on *any* account → ₹5,24,000. Basic exemption for a senior citizen ₹3,00,000. Tax: 5% of ₹2,00,000 = ₹10,000; 20% of ₹24,000 = ₹4,800 → ₹14,800. Rebate under section 156(1) not available, total income exceeding ₹5,00,000. Plus cess = **₹15,392**.

**Default regime.** Standard deduction ₹75,000 → ₹5,49,000. **No section 153.** Total income ₹5,49,000. Tax: nil to ₹4,00,000; 5% of ₹1,49,000 = ₹7,450. **Rebate under section 156(2): total income does not exceed ₹12,00,000, so the whole tax is rebated. Tax nil.**

**The default regime is better by ₹15,392, and he pays nothing at all.** The loss of section 153 is irrelevant because the rebate wipes out the liability altogether.

*The lesson for this Unit:* ***for a small or moderate income the rebate in section 156(2) is worth more than every deduction in Chapter VIII put together.*** *Test it before planning anything else.*

**ILLUSTRATION 10.3 — THE SUKANYA SAMRIDDHI ACCOUNT, VALUED**

Smt. Sudha opens a Sukanya Samriddhi account for her daughter, aged 4, on 1 April 2026, and subscribes ₹1,50,000 a year for fifteen years at 8.2%. *What is it worth, and what would the same money have produced in a taxable deposit?*

**Sukanya Samriddhi.** ₹1,50,000 a year for fifteen years at 8.2%, then compounding alone for six more years to the twenty-first year. Accumulation at year 15 ≈ ₹1,50,000 × [(1.082^15 − 1) ÷ 0.082] × 1.082 ≈ ₹44,76,000. Compounded for six further years at 8.2%: ₹44,76,000 × 1.082^6 ≈ **₹71,82,000**. **Tax on maturity — nil.**

**A taxable deposit at the same 8.2%, taxed at 31.2% throughout** — that is, a net 5.64%. Accumulation at year 15 ≈ ₹35,89,000; compounded six more years at 5.64% ≈ **₹49,89,000**.

**Difference about ₹21,93,000** — and that is before counting the deduction under section 123, which in the optional regime is worth a further ₹46,800 a year for fifteen years.

**The examinable conclusion.** The Sukanya Samriddhi account is exempt at all three points and carries the highest guaranteed rate in the system. For an assessee with an eligible daughter it should be the *first* rupee invested, before the public provident fund and before any equity linked savings scheme.

CHAPTER 6

# The Other Investment-linked Deductions

*The second limb of the Unit 3 syllabus — "Tax deductions under the Income-tax Act". The guidelines confine it to three: the Sukanya Samriddhi account, the additional ₹50,000 on the notified pension scheme, and the interest on a loan taken for higher education. The first is dealt with in Chapter 5 with the other post office schemes; the other two are taken here.*

**WHAT THE GUIDELINES PRESCRIBE FOR THIS CHAPTER**

**Other Tax deductions under Income-Tax Act** — tax planning through other investment-linked deductions:

- **Section 80C: Sukanya Samriddhi Yojana** — section 123 with Schedule XV. Dealt with in **Chapter 5**, paragraph 5.2, with the other post office schemes.
- **Section 80CCD(1B): the additional ₹50,000 deduction** — sections 124(3) and 124(4). Paragraph 6.1 below.
- **Section 80E: deduction for interest on a higher education loan** — section 129. Paragraph 6.2 below.

**Practical coverage:** case studies on tax planning through other investment-linked deductions for individuals.

## 6.1 The additional ₹50,000 on the notified pension scheme [section 124]

The guidelines' section 80CCD(1B). It is the only deduction in the Act that sits **above** the ₹1,50,000 ceiling in section 123, and for that reason it is the most valuable marginal rupee a planner can find in the optional regime.

### The four limbs of section 124

| Limb | Whose contribution | Ceiling | Regime |
|---|---|---|---|
| **124(1)** | The **employer's** contribution to the notified pension scheme | 14% of salary where the employer is the Central or a State Government; 10% otherwise | Optional |
| **124(2)** | The **employer's** contribution, where tax is computed under section 202(1) | **14% of salary in every case** | **Default — it survives section 202(2)(a)(xii)** |
| **124(3) and (4)** | The **assessee's own** contribution, and a contribution to NPS Vatsalya for up to two minor children | ₹50,000, **over and above** the ₹1,50,000 in section 123 | Optional only |

**"SALARY" FOR SECTION 124, AND THE THREE RULES THAT GO WITH IT**

**Salary means basic salary plus dearness allowance**, where the terms of employment so provide, and nothing else. Not house rent allowance, not bonus, not commission, not any other allowance. On a package of ₹24,00,000 of which basic is ₹10,00,000 and dearness allowance ₹2,00,000, the 14% is computed on ₹12,00,000 — a deduction of ₹1,68,000, not ₹3,36,000.

**Rule one — no double counting.** The same rupee cannot be claimed under section 123 and again under section 124(3). Claim it first under section 123 only if there is room; if the ₹1,50,000 is already exhausted, put the whole ₹50,000 under section 124(3).

**Rule two — the employer's contribution is also income.** It is included in gross salary and then deducted. It is not a deduction out of nothing.

**Rule three — the ₹7,50,000 ceiling in section 17(1)(h)** applies to the aggregate of the employer's contributions to provident fund, approved superannuation fund and the pension scheme taken together. Beyond it the excess is a taxable **perquisite**, in both regimes. That ceiling increases total income; it is not a deduction ceiling and must never be confused with the other two.

### Exit from the scheme

- Up to **60%** of the corpus may be withdrawn as a lump sum at 60, and it is **exempt** — Schedule III, Sl. No. 4.

- At least **40%** must be applied in purchasing an annuity. Nothing is chargeable at the time of purchase, the sum not being received by the assessee.
- **The annuity is chargeable as it is received**, at slab rates, year by year.
- So the scheme is exempt-exempt-exempt on three-fifths of the corpus and exempt-exempt-taxed on two-fifths. The final charge falls in retirement, when the rate is usually lower than the rate at which the deduction was taken — which is the whole case for it.

**ILLUSTRATION 6.1 — THE ₹50,000 THAT SITS ABOVE THE CEILING**

Shri Vinod, aged 38, resident, in the **optional** regime, marginal rate 31.2%. His provident fund contribution alone is ₹1,80,000, which already exhausts section 123. He has ₹50,000 more to invest and is considering (a) a five-year bank deposit and (b) the notified pension scheme.

**(a) The deposit.** No deduction — section 123 is exhausted. Interest taxable at 31.2% throughout. **Tax saved today: nil.**

**(b) The pension scheme.** Section 124(3) allows ₹50,000 **over and above** the ₹1,50,000. Deduction ₹50,000; **tax saved ₹15,600** in the year of contribution. The corpus then grows untaxed, and 60% of it comes out exempt.

**The ₹50,000 costs him ₹34,400 of after-tax money.** No other avenue in the Act will do that once section 123 is full.

*The examinable sequence: **fill section 123 first, then section 124(3).** Never the other way round, because a rupee put into the pension scheme and claimed under section 123 wastes the separate ₹50,000 ceiling.*

**ILLUSTRATION 6.2 — THE SAME FACTS IN THE DEFAULT REGIME**

Take Shri Vinod again, but taxed under **section 202(1)**. Section 124(3) is withdrawn by section 202(2)(a)(xii); so is section 123. **His own contribution earns nothing.**

What survives is section 124(2) — the **employer's** contribution, at 14% of salary in every case. If his basic plus dearness allowance is ₹12,00,000, and he persuades the employer to contribute 14% (₹1,68,000) in place of an equal amount of taxable allowance, his total income falls by ₹1,68,000. At the 20% slab plus cess that is **₹34,944 saved** on a package unchanged in cost to the employer.

**The planning conclusion, and it is the most examinable sentence in this Unit:** in the default regime the assessee's own contribution is worthless and the employer's contribution is the only investment deduction left standing. Move the contribution from the employee's side of the payslip to the employer's.

## 6.2 Interest on a loan for higher education [section 129]

The guidelines' section 80E. It is not an investment at all — it is the servicing of a debt — but the guidelines place it in this Unit, and rightly, because the decision to borrow for education rather than to liquidate an investment is itself an investment decision.

| Element | The rule [section 129] |
|---|---|
| What is deductible | **The interest only.** Not the principal. The repayment of principal on an education loan earns nothing under section 123 or anywhere else |
| Ceiling | **None.** The whole of the interest actually paid in the tax year is deductible, however large |
| Whose education | The assessee himself, his spouse, his children, or a student of whom he is the legal guardian |
| What course | Higher education — any course of study pursued after passing the Senior Secondary Examination or its equivalent, from a recognised school, board or university. **Courses in India and abroad both qualify** |
| From whom borrowed | A **financial institution** — a bank or a notified institution — or an approved charitable institution. **A loan from a relative, an employer or a private lender earns nothing** |
| Period | The tax year in which the assessee begins to pay the interest, and **seven tax years immediately succeeding it**, or until the interest is paid in full, whichever is earlier |
| Who may claim | **A resident or non-resident individual.** Not a Hindu undivided family, not a firm |
| Regime | **Not available in the default regime** — section 202(2)(a)(xii) |

**THE EIGHT-YEAR WINDOW, AND HOW TO PLAN IT**

The eight-year window runs from the year the interest **begins to be paid**, not from the year the loan is taken and not from the year the course ends. Most education loans carry a moratorium during the course and for six or twelve months after it; **the clock starts when the first instalment of interest is actually paid.**

**Two planning points follow.** First, do not begin paying interest during the moratorium out of sentiment: starting early starts the clock early and may waste years of the window on a small interest burden. Second, where the loan will run longer than eight years, **repay so as to front-load the interest into the window** — because interest paid in the ninth year and afterwards earns nothing.

**And the parent-versus-child question**, which is the commonest case study on this section. The deduction belongs to the person who *pays* the interest and is liable on the loan. Where the parent is in the 30% slab and the child, newly employed, is in the 5% slab, the loan should be in the parent's name, or the parent should be a co-borrower who actually pays. ₹1,00,000 of interest is worth ₹31,200 to the parent and ₹5,200 to the child.

**ILLUSTRATION 6.3 — PARENT OR CHILD, AND THE EIGHT-YEAR WINDOW**

Kum. Ananya takes an education loan of ₹20,00,000 in 2026 for a two-year postgraduate course abroad. Interest at 10%. The moratorium runs to March 2029. She will earn ₹9,00,000 a year from 2029; her father earns ₹30,00,000. Both would be in the **optional** regime if it suited them. *Who should service the loan, and from when?*

**Who.** Section 129 allows the deduction to the individual who pays the interest on a loan taken by him for the higher education of his child. The father qualifies. His marginal rate is 31.2%; hers, on ₹9,00,000, is 20.8%. **The father should be the borrower or co-borrower and should pay.**

**How much it is worth.** Interest in the first full year of repayment is about ₹2,00,000. To the father that is ₹62,400 of tax saved; to Kum. Ananya, ₹41,600. Over eight years, on a declining balance, the difference is of the order of ₹80,000.

**From when.** Not during the moratorium. If he pays a token instalment of interest in 2026-27, the eight-year window runs from 2026-27 and expires in 2033-34 — and the years 2026-27 to 2028-29, when little interest is being paid, are consumed for nothing. **Begin in 2029-30**, when the full interest starts to run, and the window covers the years in which the interest is largest.

*But check the regime first. If the father will in any event be better off under section 202(1), section 129 is unavailable to him and the whole of this analysis falls away — in which case the loan should simply be repaid as fast as the interest rate justifies.*

## 6.3 The three prescribed deductions on one page

| Guidelines | 2025 Act | What it covers | Ceiling | Default regime |
|---|---|---|---|---|
| 80C — Sukanya Samriddhi Yojana | **123** with Schedule XV | Subscription to the account of a girl child below ten, opened by a parent or guardian | Within the aggregate ₹1,50,000; and ₹1,50,000 a year is the scheme's own limit | **No** |
| 80CCD(1B) | **124(3) and (4)** | The assessee's own contribution to the notified pension scheme, and NPS Vatsalya for up to two minor children | ₹50,000, **above** the ₹1,50,000 | **No** |
| 80E | **129** | Interest on a loan from a financial or approved charitable institution for the higher education of the assessee, his spouse, his children or a ward | **No ceiling.** Eight tax years from the year interest is first paid | **No** |

**ALL THREE FALL IN THE DEFAULT REGIME — SO WHAT IS LEFT?**

Every one of the three deductions the guidelines prescribe for this chapter is withdrawn by section 202(2)(a)(xii). A candidate should say so, and should then say what survives, because that is the planning answer —

- **Section 124(2)** — the employer's contribution at 14% of salary. The only investment-linked deduction left in the default regime.
- **The exemptions are untouched.** The Sukanya Samriddhi account still pays 8.2% wholly exempt; the public provident fund still pays 7.1% wholly exempt; the ₹1,25,000 shelter in section 198 still stands.
- **The rebate under section 156(2)** — which for a resident individual with total income up to ₹12,00,000 wipes out the tax altogether, and is worth more than all of these deductions put together.

CHAPTER 7

# Mutual Funds

*One legal form, three tax treatments, and the whole difference turns on what the fund holds. Get the classification right and the rest follows; get it wrong and every figure in the answer is wrong.*

## 7.1 PART A — The classes of fund

The Income-tax Act, 2025 does not tax a mutual fund by its marketing name. It taxes it according to the class into which its portfolio falls. There are three classes, and only three.

| Class | Definition | Typical schemes |
|---|---|---|
| **Equity oriented fund** | A fund investing **more than 65%** of its total proceeds in equity shares of domestic companies, in respect of the units of which securities transaction tax is paid on transfer | Large-cap, mid-cap, small-cap, flexi-cap, index and sectoral funds; equity linked savings schemes; aggressive hybrid funds; arbitrage funds |
| **Specified mutual fund** [section 76] | A fund investing **more than 65%** of its total proceeds in **debt and money market instruments**, or a fund investing 65% or more of its proceeds in units of such a fund | Liquid, ultra-short, low-duration, short-duration, corporate bond, gilt, credit risk and dynamic bond funds; most fund-of-funds investing in debt |
| **Other funds** | Everything that is neither — that is, a fund in which neither domestic equity nor debt exceeds 65% | Conservative hybrid funds, balanced advantage funds in some months, gold funds, international equity funds, funds of funds investing abroad |

**THE 65% TEST, AND HOW TO APPLY IT IN AN EXAMINATION**

The question will tell you the composition. If it does not, say what you are assuming and why. **Do not guess from the name of the fund** — a “balanced” fund may be equity oriented one month and not the next, and an “arbitrage” fund holds equity even though its economic character is that of a deposit.

The consequences of the classification are extreme, so state it as a separate step in the answer: *“The fund holds 72% in equity shares of domestic companies and is therefore an equity oriented fund; the units held for more than twelve months are long-term capital assets and section 198 applies.”*

## 7.2 PART B — The tax treatment

### Entry

**Nothing is deductible** on the purchase of a mutual fund unit, with the single exception of an equity linked savings scheme, which is an eligible sum under Schedule XV. This is the point at which the ordinary mutual fund differs from every avenue in Chapters 2 to 6.

### Accrual

Nothing is chargeable on a growth option. On an income-distribution option the distribution is chargeable in full as income from other sources under section 92(2)(a), at slab rates, and tax is deducted at source by the fund where the distribution in the year exceeds the prescribed threshold.

### Exit — the table that must be memorised

| Class of fund | Period of holding | Character | Rate |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Equity oriented fund | Not more than 12 months | Short-term | **20%** [section 196] |
| Equity oriented fund | More than 12 months | Long-term | **12.5% on the amount exceeding ₹1,25,000** [section 198] |
| Specified mutual fund | Any period whatever | **Deemed short-term** [section 76] | **Slab rates** |
| Other funds | Not more than 24 months | Short-term | Slab rates |
| Other funds | More than 24 months | Long-term | **12.5%** [section 197] |

**Section 76, and what it did to the debt fund**

Section 76 provides that, notwithstanding section 2(101) or section 72, the gain on the transfer, redemption or maturity of a market linked debenture or of a unit of a specified mutual fund **shall be treated as a short-term capital gain irrespective of the period of holding**, and shall be computed as the full value of the consideration less the cost of acquisition and the expenditure on the transfer. No deduction is allowed for securities transaction tax.

Two consequences. **First, indexation is gone and cannot return** — there is no long-term gain to index. **Second, the rate is the slab rate**, so a debt fund held for twenty years by a person at 31.2% is taxed at 31.2%, exactly as a bank deposit would be, except that the charge is deferred to the year of redemption.

*That deferral is now the only tax advantage a debt fund has over a bank deposit. It is a real advantage — the tax is paid at the end rather than annually — but it is a small one, and it should be stated as such.*

## 7.3 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| Harvest the ₹1,25,000 shelter in section 198 every year | Redeem equity oriented units so as to realise a long-term gain of about ₹1,25,000, and buy back the same day. The gain is untaxed and the cost of acquisition of the new units is stepped up by the same amount | The shelter is **one shelter for all section 198 income taken together** — shares, equity funds, business trust units and a defaulting unit linked plan compete for it. And the buy-back starts a fresh twelve-month clock |
| Prefer the growth option to the income-distribution option, always | Slab rate on a distribution against 12.5% above a shelter on a gain | None. This measure has no downside for any assessee above the exemption limit |
| Hold an equity oriented fund for at least twelve months and a day | 20% under section 196 becomes 12.5% above ₹1,25,000 under section 198. On a gain of ₹5,00,000 that is ₹1,00,000 against ₹46,875 | Count from the *date of allotment* of each unit, and apply first-in-first-out where units were bought on several dates |
| Use a systematic withdrawal plan rather than a lump-sum redemption | Each withdrawal is a part redemption. Spread over years, the gains fall within the annual ₹1,25,000 shelter and may bear no tax at all | It works only for equity oriented funds. On a specified mutual fund every withdrawal is a slab-rate short-term gain and spreading merely spreads the charge |
| Prefer an arbitrage fund to a liquid fund for parking short-term money | An arbitrage fund holds more than 65% in equity and is an **equity oriented fund**, so the gain after twelve months is charged at 12.5% above the shelter. A liquid fund is a specified mutual fund and is charged at the slab rate however long it is held | The return of an arbitrage fund is not guaranteed and depends on the futures spread. This is a tax point, not an investment recommendation |

| Measure | How it works | Caution |
|---|---|---|
| Set off losses before harvesting gains | A short-term capital loss may be set off against **any** capital gain, long-term or short-term; a long-term loss only against a long-term gain [sections 108 and 109]. Unabsorbed losses carry forward eight tax years | The return must be furnished by the due date under section 263 for the loss to be carried forward. A loss not returned in time is a loss twice over |
| Do not switch between schemes of the same fund house casually | A switch is a redemption and a fresh purchase — a **transfer** under section 67, and a taxable event. Contrast the unit linked plan in Chapter 3, where it is not | The absence of a cash movement misleads people constantly. The unit register is what matters, not the bank account |

## 7.4 PART D — Illustrations

**ILLUSTRATION 8.1 — THE CLASSIFICATION, AND WHAT TURNS ON IT**

Shri Rahul invests ₹10,00,000 on 1 May 2024 and redeems on 1 August 2026 — a holding of two years and three months — for ₹13,00,000. Gain ₹3,00,000. He has no other capital gain. His slab rate is 31.2%. *Compute the tax on three assumptions as to the fund.*

**(a) An equity oriented fund.** Held more than twelve months, therefore long-term. Section 198: 12.5% of (₹3,00,000 – ₹1,25,000) = 12.5% of ₹1,75,000 = ₹21,875, plus cess ₹875 = **₹22,750**.

**(b) A specified mutual fund — a debt fund.** Section 76 deems the gain short-term whatever the holding. Charged at slab: 30% of ₹3,00,000 = ₹90,000, plus cess ₹3,600 = **₹93,600**.

**(c) An international equity fund of funds** — neither more than 65% in domestic equity nor more than 65% in debt, so an "other fund". Held more than twenty-four months, therefore long-term. Section 197: 12.5% of ₹3,00,000 = ₹37,500, plus cess ₹1,500 = **₹39,000**.

**Same money, same period, same gain — ₹22,750, ₹93,600 or ₹39,000.** The classification is not a preliminary; it is the answer.

**ILLUSTRATION 8.2 — HARVESTING THE SHELTER**

Smt. Meera holds units of an equity oriented fund bought in 2020 for ₹20,00,000, now worth ₹44,00,000. Unrealised gain ₹24,00,000. She needs the money in 2035. *Compare doing nothing with harvesting.*

**Doing nothing.** In 2035 she redeems. Assume no further growth for simplicity. Gain ₹24,00,000. Tax = 12.5% of (₹24,00,000 – ₹1,25,000) = ₹2,84,375, plus cess = **₹2,95,750**.

**Harvesting.** Each year she redeems units carrying a gain of ₹1,25,000 and repurchases the same day. The gain is within the shelter, so **no tax**, and the cost of acquisition of the repurchased units rises by ₹1,25,000. Over nine years she moves ₹11,25,000 of gain out of charge altogether. In 2035 the remaining gain is ₹12,75,000; tax = 12.5% of (₹12,75,000 – ₹1,25,000) = ₹1,43,750, plus cess = **₹1,49,500**.

**Saving ₹1,46,250**, for nine round-trips and no change in the investment.

- **Caution one.** The shelter is one shelter. If she also sells shares in a year, the two gains share the ₹1,25,000.
- **Caution two.** Each repurchase restarts the twelve-month clock. Harvest early in the year, not in March, or a sudden need for money in the following February will produce a short-term gain at 20%.
- **Caution three.** Do not harvest a *loss* and repurchase immediately with the object of creating a set-off. The general anti-avoidance rule in sections 178 to 184 is available against an arrangement whose main purpose is a tax benefit and which lacks commercial substance. Harvesting a genuine gain within a statutory exemption is not that; a circular sale and repurchase to manufacture a loss may be.

**ILLUSTRATION 8.3 — THE SYSTEMATIC WITHDRAWAL PLAN**

Shri Kamal, retired, aged 66, holds ₹60,00,000 in an equity oriented fund bought for ₹30,00,000. He needs ₹50,000 a month. *Compare a lump-sum redemption of ₹6,00,000 a year with a monthly systematic withdrawal of ₹50,000.*

In each case the proportion of gain in every rupee redeemed is (₹60,00,000 – ₹30,00,000) ÷ ₹60,00,000 = **50%**.

**Either way he redeems ₹6,00,000 in the year, of which ₹3,00,000 is gain.** Tax = 12.5% of (₹3,00,000 – ₹1,25,000) = ₹21,875, plus cess = **₹22,750**. The withdrawal plan is not, by itself, a tax device: it changes the timing within the year, not the amount.

**Where it does help.** If he needed only ₹20,000 a month — ₹2,40,000 a year, of which ₹1,20,000 gain — the gain would fall **within the ₹1,25,000 shelter and bear no tax at all**, year after year. The plan is worth having precisely when the annual gain can be kept under the shelter.

**And what he should not do.** Move the corpus into a debt fund "for safety in retirement". Every withdrawal would then be a short-term gain at his slab rate under section 76, and the ₹1,25,000 shelter would be lost entirely.

CHAPTER 8

# Bonds and Debentures

*A class in which almost nothing is deductible at entry, and where the whole of the planning lies at the other two points — in the exemption of the interest, and in the shelter that section 85 gives to a capital gain.*

## 8.1 PART A — The classes of bond

| Class | What it is | Issued by |
|---|---|---|
| **Section 85 bonds** (long-term specified assets) | Bonds redeemable after five years, subscription to which within six months of a transfer exempts a capital gain on land or building | National Highways Authority of India; Rural Electrification Corporation; Power Finance Corporation; Indian Railway Finance Corporation, as notified |
| **Tax-free bonds** | Bonds issued under a notification of the Central Government, the interest on which is exempt under Schedule II | Public sector undertakings, in issues made between 2012 and 2016. No fresh issue since; available only in the secondary market |
| **RBI Floating Rate Savings Bonds, 2020 (Taxable)** | Seven-year bonds of the Government of India, the rate being reset half-yearly at 35 basis points above the national savings certificate rate | Reserve Bank of India, on tap |
| **Sovereign gold bonds** | Bonds denominated in grams of gold, carrying 2.5% interest and redeemable at the then price of gold after eight years | Reserve Bank of India for the Government. **Closed to fresh subscription**; no tranche since February 2024 |
| **Zero coupon bonds** | Bonds issued at a discount and redeemed at face value, with no interest in between, notified by the Central Government | Infrastructure and specified financial institutions |
| **Market linked debentures** | A debt security whose return is linked to the movement of an index or of other securities, so classified or regulated by the Securities and Exchange Board of India | Non-banking financial companies and others |
| **Ordinary corporate bonds and debentures** | Listed or unlisted, secured or unsecured, at a stated coupon | Companies |

## 8.2 PART B — The tax treatment

| Bond | Entry | Accrual — the interest | Exit |
|---|---|---|---|
| Section 85 bonds | The **capital gain** is exempt to the extent invested — not the investment itself | **Taxable** at slab under section 92(2)(e) | Principal returned; no gain. But see the recapture in 9.3 |
| Tax-free bonds | Nothing | **Exempt** [Schedule II] | Sale in the market is a transfer; gain long-term if held more than 12 months (listed), at 12.5% under section 197 |
| RBI Floating Rate Savings Bonds | Nothing | **Taxable** at slab; tax deducted at source | Not transferable; redeemed at par. No gain |
| Sovereign gold bonds | Nothing | 2.5% interest **taxable** at slab | **Exempt on redemption at the end of the eighth year, in the hands of the original subscriber who has held to** |

| Bond | Entry | Accrual — the interest | Exit |
|---|---|---|---|
| | | | **maturity.** On a sale in the market, a capital gain arises — long-term after 12 months, at 12.5% under section 197 |
| Zero coupon bonds | Nothing | No interest arises | The difference between issue price and redemption is a **capital gain**; short-term if held not more than 12 months, otherwise long-term at 12.5% under section 197 |
| Market linked debentures | Nothing | As the contract provides | **Deemed short-term whatever the holding period; slab rate** [section 76] |
| Ordinary bonds and debentures | Nothing | **Taxable** at slab under section 92(2)(e) | Listed: 12 months. Unlisted: 24 months. Long-term at 12.5% under section 197 |

**Sovereign gold bonds — a scheme that has been withdrawn but is still examinable**

No tranche has been issued since February 2024 and the Government has announced no issuance calendar for 2026-27. **But some thirty tranches remain outstanding**, held by lakhs of assessees, and questions on them are entirely fair.

State three things: **(i)** the 2.5% interest is and always was taxable; **(ii)** redemption at the end of the eighth year in the hands of the original subscriber who has held to maturity attracts no capital gains tax; **(iii)** a sale on the exchange before maturity, or a purchase from the secondary market followed by redemption, does **not** get that exemption — the gain is a long-term capital gain at 12.5% under section 197 where the bond has been held for more than twelve months.

*The distinction between the original subscriber holding to maturity and everyone else is the examinable point, and it was tightened with effect from 1 April 2026.*

## 8.3 The section 85 bonds — the capital gains route

This is the only provision in the whole of Chapter 8 that produces a large and immediate tax saving, and it belongs as much to Unit 2 as to Unit 3. It is set out here because the *investment* is a bond.

| Element | The rule [section 85] |
|---|---|
| The gain that qualifies | A **long-term** capital gain arising on the transfer of **land or building, or both**. Not shares, not units, not jewellery |
| The investment | Long-term specified assets — bonds redeemable after five years, notified by the Central Government |
| The time limit | Within **six months** of the date of transfer |
| The ceiling | ₹50,00,000, taken for the tax year in which the transfer took place **and** the following tax year together [section 85(2)] — so the ceiling cannot be doubled by straddling a year end |
| The lock-in | **Five years.** Where the bond is transferred, or converted into money, or a loan is taken on its security, within five years, the exemption allowed is deemed to be a long-term capital gain **of the year in which that happens** [section 85(3)] |
| The rate of interest | Presently in the region of 5.25% a year, and **taxable** |

**Is it worth it? — the calculation the examiner wants**

The exemption saves 12.5% plus cess, that is 13% of the gain, at once. The cost is five years at about 5.25% taxable, against whatever the money would otherwise have earned.

For a gain of ₹50,00,000 the tax saved is ₹6,50,000 immediately. Over five years the bond at 5.25%, taxed at 31.2%, yields about 3.61% net — say ₹9,71,000 in all on ₹50,00,000. The alternative is to pay the ₹6,50,000 and invest ₹43,50,000 elsewhere; at 8% net that is about ₹20,42,000 over five years. **₹50,00,000 + ₹9,71,000 = ₹59,71,000**

**against ₹43,50,000 + ₹20,42,000 = ₹63,92,000.**

**So the exemption is not automatically worth taking.** It is worth taking where the alternative return is modest, where the assessee is risk-averse, or where the ₹50,00,000 would otherwise sit in a bank. It is not worth taking where he has a confident use for the money at a materially better return.

*Say so in the answer. An examiner marking a planning paper is looking for the candidate who tests the benefit instead of assuming it.*

## 8.4 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| For a person in the 30% slab, prefer a tax-free bond to a taxable bond of the same tenor | A tax-free bond at 6.0% is equivalent to 8.72% before tax at 31.2%. Very few taxable bonds of comparable safety pay that | No fresh issues exist. In the secondary market the price already reflects the exemption, so the *yield to maturity* is what matters, not the coupon. Compute it |
| Use section 85 within six months, and watch the year-end | The ceiling of ₹50,00,000 spans the year of transfer and the following year taken together | A transfer in February leaves only until August. A transfer in September leaves until March, and the bonds are often in short supply in March |
| Where the gain exceeds ₹50,00,000, combine section 85 with section 82 or 86 | The house-property exemptions have their own ceilings and are not affected by the ₹50,00,000 | Section 82 requires the gain to be on a residential house; section 86 requires the *net consideration*, not merely the gain, to be invested |
| Buy a zero coupon bond rather than a coupon bond where the money is not needed | No interest arises year by year, so nothing is charged at accrual; the whole return is a capital gain at 12.5% under section 197 after twelve months | Only a bond **notified** by the Central Government as a zero coupon bond gets this treatment. A deep discount bond that is not notified is charged as interest on accrual |
| Avoid market linked debentures for tax purposes | Section 76 taxes the gain at slab rates whatever the holding period. The structured pay-off buys nothing in tax terms | They are sold on their pay-off profile, not their tax treatment, and the tax treatment is now the worst in this chapter |
| Hold sovereign gold bonds to the eighth year if you are the original subscriber | Redemption is then free of capital gains tax altogether — an exemption available on no other gold holding | Selling on the exchange, even one day early, forfeits it. And a bond *bought* on the exchange never had it |

## 8.5 PART D — Illustrations

**ILLUSTRATION 9.1 — SECTION 85, AND THE FIVE-YEAR LOCK-IN BROKEN**

Shri Iqbal sells a plot of land on 10 June 2026 for ₹1,40,00,000; indexed cost is not available, the land having been bought in 2019 for ₹62,00,000. Long-term capital gain ₹78,00,000. On 20 October 2026 he invests ₹50,00,000 in notified bonds under section 85.

**Position in 2026-27.** The investment is within six months (10 June to 20 October is four months and ten days) and within the ceiling. Exemption **₹50,00,000**. Taxable long-term gain ₹28,00,000, charged under section 197 at 12.5% = ₹3,50,000, plus cess = **₹3,64,000**. Tax saved by the investment: 12.5% of ₹50,00,000 plus cess = **₹6,50,000**.

**Now suppose that in March 2029 he takes a loan of ₹30,00,000 against the bonds.** Section 85(3) applies: taking a loan on the security of the bonds within five years is treated in the same way as transferring them. **The ₹50,00,000 exempted in 2026-27 is deemed to be a long-term capital gain of Tax Year 2028-29**, and is charged in that year at the rate then in force.

He pays ₹6,50,000 of tax in 2028-29, having had the use of it for two and a half years — and the interest on the loan is not deductible against it. **The loan was the most expensive ₹30,00,000 he could have raised.**

**Illustration 9.2 — the tax-free bond in the secondary market**

A tax-free bond of face value ₹1,000 carrying a coupon of 7.35%, maturing in 2031, is quoted at ₹1,150. Smt. Farida, at 31.2%, is considering it against a five-year bank deposit at 6.9%. *Advise.*

**The coupon is not the yield.** She pays ₹1,150 to receive ₹73.50 a year and ₹1,000 at maturity in five years. The yield to maturity, allowing for the capital loss of ₹150 spread over five years, is approximately (73.50 − 30) ÷ 1,150 ≈ **3.78%**, entirely exempt.

**The bank deposit** at 6.9% taxed at 31.2% yields **4.75%** net.

**The deposit wins**, and the reason is that the market has already priced the exemption into the bond — and over-priced it. The exemption belongs to the bond, but the *benefit* of it has been paid over to the seller in the premium.

*The general principle, and it is worth stating in any answer on bonds:* ***a tax exemption attaching to a tradeable security is capitalised in its price.*** *The buyer gets the exemption; he does not necessarily get the benefit.*

**Illustration 9.3 — sovereign gold bonds, three holders**

A tranche of sovereign gold bonds was issued in August 2018 at ₹3,050 a gram and matures in August 2026 at the then price of ₹9,800 a gram. Consider three holders of 100 grams each.

- **Shri A**, the original subscriber, holds to maturity. Redemption proceeds ₹9,80,000; cost ₹3,05,000. **No capital gains tax on redemption.** The 2.5% interest received each year — ₹7,625 a year — was taxable at slab throughout.
- **Smt. B** bought on the exchange in 2022 at ₹5,200 a gram and holds to maturity. She is **not** the original subscriber. Gain ₹9,80,000 − ₹5,20,000 = ₹4,60,000, long-term, charged under section 197 at 12.5% = ₹57,500 plus cess = **₹59,800**.
- **Shri C**, the original subscriber, sells on the exchange in July 2026 at ₹9,750 a gram, one month before maturity. He has **not held to maturity**. Gain ₹9,75,000 − ₹3,05,000 = ₹6,70,000, long-term, at 12.5% = ₹83,750 plus cess = **₹87,100**.

**Shri C's impatience cost him ₹87,100 for one month.** The exemption requires both limbs — original subscription *and* holding to maturity — and there is no relief for coming close.

CHAPTER 9

# The Hindu Undivided Family as an Investment Vehicle

*The syllabus names the family expressly, and for good reason: it is a separate assessee with its own exemption limit, its own slabs and its own Chapter VIII, and it is the only lawful way in the Act to create a second taxable person out of one household's capital.*

## 9.1 Why the family matters to a planner

A Hindu undivided family is a person within the meaning of section 2 and is assessed as such. It has its own permanent account number, files its own return, and is entitled to the basic exemption limit and to the slab rates in its own right. **Income that would otherwise be assessed in the karta's hands at 30% may be assessed in the family's hands at nil, 5% or 10%.**

This is not avoidance. The Hindu undivided family is a creature of personal law and not of the Income-tax Act; the Act merely recognises it. The planning consists in ensuring that income which *belongs* to the family is assessed in the family, and that income which belongs to an individual is not artificially routed through it.

## 9.2 What income belongs to the family

| Source | Belongs to the family? |
|---|---|
| Ancestral property, and income from it | **Yes** — this is the core case |
| Property received on a partial or total partition of a larger family | **Yes** |
| Property thrown into the common stock by a coparcener | Yes, but **section 99(3) and (4) club the income back** in the transferor's hands — see 12.4 |
| A gift to the family from a stranger | Yes. But section 92(2)(m) charges the family if the aggregate exceeds ₹50,000, a stranger not being a "relative" of the family |
| A gift to the family from a member | Yes, and **exempt** — a member is a relative of the family for section 92(3). But watch section 99(3) |
| A bequest under a will to the family as such | **Yes**, and this is the cleanest way to create or fund a family. A will may direct that property go to "the Hindu undivided family of X" |
| Salary or fees earned by the karta personally | **No** — personal exertion is individual income, unless the remuneration is paid for services rendered to the family business out of family funds |
| Income from the karta's separate property | **No** |

## 9.3 What the family gets, and what it does not

| Provision | Available to a Hindu undivided family? |
|---|---|
| Basic exemption limit and slab rates, both regimes | **Yes** — but no relief for a senior citizen; the family has no age |
| Rebate under section 156 | **No.** Both limbs are confined to a resident **individual**. This is a large point |
| Section 123 — Schedule XV investments | **Yes**, up to ₹1,50,000, for premia on the life of any member, and for the eligible deposits and certificates. **Not** for tuition fees, which require a child of the assessee |
| Section 124(3) — the pension scheme | **No** — an individual only |
| Section 126 — health insurance | **Yes**, for the health of any member; ₹25,000, or ₹50,000 where the member insured is a senior citizen |

| Provision | Available to a Hindu undivided family? |
|---|---|
| Section 127 — dependant with a disability | **Yes**, where the dependant is a member of the family |
| Section 128 — medical treatment of a specified disease | **Yes**, for a member |
| Section 129 — interest on an education loan | **No** — an individual only |
| Section 133 — donations | **Yes** |
| Section 134 — rent paid | **No** — an individual only |
| Sections 151, 152 — royalty | **No** |
| Section 153 — interest on deposits | **No** — an individual only. The family gets no shelter for its bank interest at all |
| Section 154 — the assessee's own disability | **No** |
| Public provident fund account | **No** — a family may not open one. It may, however, contribute to the account of a member and claim under section 123 |
| Sections 82, 85, 86 — the capital gains exemptions | **Yes**, all three |
| Section 197(3) — the 12.5%/20% option on pre-23 July 2024 property | **Yes** — expressly extended to a resident individual *or* Hindu undivided family |

## 9.4 The clubbing bar

Two provisions stand between the planner and the obvious device of transferring one's own property to one's own family.

**SECTION 99(3) AND SECTION 99(4) — THE WHOLE OF THE DIFFICULTY IN ONE BOX**

**Section 99(3).** Where an individual, being a member of a Hindu undivided family, converts his separate property into property of the family — “throws it into the common stock” — otherwise than for adequate consideration, **the income from that property continues to be included in his own total income** and not in the family's.

**Section 99(4).** Where such converted property is afterwards partitioned among the members, the income from the portion received by the **spouse** of the transferor is likewise included in the transferor's total income, and continues to be so included even after the partition.

**Section 25(a)** does the same work for house property, by making the transferor the deemed owner.

*The effect is that self-created funding of a Hindu undivided family by its own karta achieves nothing. The family must be funded from a source outside the clubbing net.*

**Three sources lie outside it**, and they are the whole of the practical planning:

1. **A bequest.** A will in favour of “the Hindu undivided family of X” vests the property in the family from the outset. There is no transfer by a member and therefore nothing for section 99(3) to bite on. This is the classic and unimpeachable route.
2. **A gift from a stranger, or from a relative who is not a member** — for example the karta's father-in-law, or a maternal uncle. Section 99 has no application, the donor not being a member of the family. But section 92(2)(m) will charge the family where the aggregate exceeds ₹50,000, the donor not being a “relative” of a family. **A gift up to ₹50,000 is therefore free of both provisions**, and the income from it accumulates in the family thereafter, free of clubbing.
3. **Income on income.** Once the family has any income of its own, however small, the income *generated by that income* belongs to the family absolutely. Clubbing under section 99 attaches to the income from the transferred asset; it does not attach to the income from the accumulations. This is slow, but it is entirely safe, and over a decade it builds a real corpus.

## 9.5 The planning measures, and the cautions

| Measure | How it works | Caution |
|---|---|---|
| Assess ancestral property in the family, not in the karta | A second assessee with its own exemption limit and slabs. On ₹12,00,000 of income moved from a karta at 30% to a family taxed from the bottom of the table, the saving in the default regime is of the order of ₹2,40,000 a year | The property must genuinely be ancestral or family property. Labelling does not create a family, and the Assessing Officer will look at the source |
| Fund the family by will or by a gift from a non-member | Avoids sections 99(3) and 99(4) altogether | A gift from a non-member above ₹50,000 is charged under section 92(2)(m) in the family's hands |
| Use the family's own ₹1,50,000 under section 123 | A second ₹1,50,000, quite separate from the karta's own. Life insurance on any member, five-year deposits, national savings certificates, equity linked savings schemes | Optional regime only. And the family cannot open a public provident fund account, though it may subscribe to a member's |
| Use the family's own ₹1,25,000 shelter under section 198 | The shelter is per assessee. A family holding equity in its own right has its own ₹1,25,000, independent of the karta's | The shares must be bought with family funds and held in the family's demat account. A holding in the karta's name is his |
| Take health insurance for the members through the family under section 126 | The family gets its own ₹25,000 or ₹50,000, and the karta separately gets his own for his parents | The premium must be paid by the family, out of family funds, otherwise than in cash |
| Pay reasonable remuneration to the karta for managing a family business | Deductible in computing the family's income and taxable in his hands. Where his personal slab is lower than the family's, this shifts income downwards | Must be for services actually rendered and reasonable in amount, and must be authorised. An excessive or colourable payment will be disallowed |
| Consider a partial partition — with eyes open | Historically the standard device for multiplying assessees | **A partial partition is not recognised for income-tax purposes.** The family continues to be assessed as if no partition had taken place. Only a *total* partition, recorded and accepted on an order under the assessment provisions, is effective |

## 9.6 Illustrations

**Illustration 12.1 — The second assessee, valued**

Shri Damodar has salary income of ₹28,00,000. He is also the karta of a Hindu undivided family which owns ancestral commercial property yielding rent of ₹14,00,000 a year, gross. He has hitherto returned the rent in his own hands. Both are in the **default** regime. *What is the effect of returning it in the family's hands, where it belongs?*

**As returned hitherto.** Salary ₹28,00,000 *less* standard deduction ₹75,000 = ₹27,25,000. House property: ₹14,00,000 *less* 30% under section 22(1)(a) = ₹9,80,000. **Total income ₹37,05,000.** Tax: ₹20,000 + ₹40,000 + ₹60,000 + ₹80,000 + ₹1,00,000 + 30% of ₹13,05,000 (₹3,91,500) = ₹6,91,500, plus cess = **₹7,19,160**.

**Returned correctly.** Shri Damodar: total income ₹27,25,000. Tax: ₹20,000 + ₹40,000 + ₹60,000 + ₹80,000 + ₹1,00,000 + 30% of ₹3,25,000 (₹97,500) = ₹3,97,500, plus cess = ₹4,13,400. The family: total income ₹9,80,000. Tax: nil to ₹4,00,000; 5% of ₹4,00,000 = ₹20,000; 10% of ₹1,80,000 = ₹18,000 → ₹38,000, plus cess = ₹39,520. **Together ₹4,52,920.**

**Saving ₹2,66,240 a year**, achieved not by any device but by assessing the income in the hands to which it belongs.

*Note the framing. This is not planning in the sense of arranging affairs; it is the correction of a wrong return. But it is the largest single figure most families will ever see in this paper, and it is the reason the syllabus mentions the Hindu undivided family at all.*

**ILLUSTRATION 12.2 — THE KARTA WHO TRIES TO FUND HIS OWN FAMILY**

Shri Ramesh owns shares worth ₹60,00,000 which yield a dividend of ₹2,40,000 a year. Wishing to shift the dividend to his Hindu undivided family, he executes a declaration throwing the shares into the common stock on 1 April 2026. *What follows?*

**Section 99(3) applies.** The shares were his separate property; he has converted them into property of the family otherwise than for adequate consideration. **The dividend of ₹2,40,000 continues to be included in his own total income**, year after year, exactly as before. Nothing has been achieved.

**And it gets worse.** If the family is later partitioned and the shares, or part of them, go to his wife, section 99(4) includes the income from her portion in his total income too — permanently, even after the partition.

**What he should have done.** If his father is alive and holds separate property, ask the father to bequeath it — or gift it — to the Hindu undivided family of Shri Ramesh. The father is not a member of that family; section 99 has no application; and the income belongs to the family from the first day. A gift would be charged under section 92(2)(m) above ₹50,000; a bequest under a will is expressly excepted by section 92(3) and is charged not at all.

***A bequest is the cleanest method of funding a Hindu undivided family known to the Act**, and it costs nothing but the drafting of a will.*

CHAPTER 10

# Choosing the Avenue

*Eleven chapters of law, reduced to a method. The examiner who sets a case study is asking whether the candidate can put the avenues in an order and defend the order in rupees.*

## 10.1 The four tests

| Test | The question | Where the answer comes from |
|---|---|---|
| **Safety** | Can the capital be lost? | The nature of the issuer. A Government-guaranteed scheme, a bank deposit within the deposit insurance limit, and an equity fund are three different animals |
| **Liquidity** | When can the money be had back? | The lock-in. Three years for an equity linked savings scheme; five for a national savings certificate; fifteen for a public provident fund; until 60 for the pension scheme |
| **Return** | What does it pay, before tax? | The scheme's own terms, or the market |
| **Tax** | What is the pattern at the three points, and what is the post-tax yield? | Chapters 1 to 8 of this booklet |

The four are not of equal weight, and their weight changes with the person. **For an assessee below the rebate threshold the fourth test does not apply at all**; for an assessee at 31.2% in the optional regime it dominates the other three; for the same assessee in the default regime it recedes again, most of the deductions having gone.

## 10.2 The avenues compared

For a resident individual at a marginal rate of 31.2%, in the **optional** regime, with room in the ₹1,50,000 —

| Avenue | Pattern | Nominal | Post-tax | Lock-in | Risk |
|---|---|---|---|---|---|
| Sukanya Samriddhi Account | E-E-E | 8.20% | 8.20% | 21 years | Nil |
| Public provident fund | E-E-E | 7.10% | 7.10% | 15 years | Nil |
| Recognised provident fund, within ₹2,50,000 | E-E-E | 8.25% | 8.25% | To retirement | Nil |
| National Pension System | E-E-T | Market | Market, less tax on 40% | To age 60 | Market |
| Equity linked savings scheme | E-E-T | Market | Market, less 12.5% above ₹1,25,000 | 3 years | High |
| National savings certificate | E-E-T | 7.70% | ≈7.22% over five years | 5 years | Nil |
| Senior Citizens Savings Scheme | E-T-E | 8.20% | 5.64%, or more with section 153 | 5 years | Nil |
| Five-year bank / post office deposit | E-T-E | 6.75% / 7.50% | 4.64% / 5.16% | 5 years | Low |
| Life insurance — endowment | E-E-E | ≈4.8% | ≈4.8% | 15-20 years | Low |
| Unit linked insurance plan | E-E-E | Market | Market | 5 years | High |
| Equity oriented fund — not ELSS | T-E-T | Market | Market, less 12.5% above ₹1,25,000 | Nil | High |
| Specified mutual fund — debt | T-E-T | ≈7.0% | ≈4.82%, deferred | Nil | Low |
| Ordinary bank deposit | T-T-E | 6.75% | 4.64% | Nil | Low |

| Avenue | Pattern | Nominal | Post-tax | Lock-in | Risk |
|---|---|---|---|---|---|
| | | | | | |

**HOW THE RANKING CHANGES IN THE DEFAULT REGIME**

Strike out the first **E** in every line except the National Pension System, and the table reorders itself. The four avenues that keep their whole value are —

- **The employer's contribution to the notified pension scheme** — section 124(2) survives, at 14% of salary.
- **The Sukanya Samriddhi account and the public provident fund** — the deduction goes, but the exempt accrual and exempt exit remain, and they remain the best safe rupees available.
- **The equity oriented fund** — it never had an entry deduction to lose, and the ₹1,25,000 shelter in section 198 survives untouched.
- **Life insurance already bought** — the exemption on maturity is unaffected, and surrender costs are not tax costs.

And the avenues that lose most are the five-year bank deposit, the national savings certificate and the endowment policy — the three whose entire case rested on section 123.

## 10.3 A portfolio for each regime

### In the optional regime, for an assessee at 31.2% with ₹2,00,000 a year to invest

| Order | Where | Amount | Why |
|---|---|---|---|
| 1 | Sukanya Samriddhi, if there is an eligible daughter | Up to ₹1,50,000 | 8.20%, E-E-E. Nothing else in the Act matches it |
| 2 | Public provident fund, on 1 April | Balance of the ₹1,50,000 | 7.10%, E-E-E, and the deduction |
| 3 | Own contribution to the pension scheme | ₹50,000 | Section 124(3) is a *separate* ceiling. Worth ₹15,600 of tax |
| 4 | Health insurance for self and parents | As required | Section 126, and the cover is needed in any event |
| 5 | Equity oriented fund, beyond the ceilings | Whatever remains | No deduction, but 12.5% above ₹1,25,000 on exit, and no lock-in |

### In the default regime, for the same assessee

| Order | Where | Amount | Why |
|---|---|---|---|
| 1 | Employer's contribution to the notified pension scheme | 14% of basic plus dearness allowance | **The only deduction left.** Restructure the package to get it |
| 2 | Sukanya Samriddhi, if eligible | Up to ₹1,50,000 | 8.20% exempt. The deduction is gone; the exemption is not |
| 3 | Equity oriented fund | The bulk of the balance | The ₹1,25,000 shelter survives, and there is no lock-in to accept |
| 4 | Public provident fund | As much as is wanted in safe assets | 7.10% exempt still beats any taxable deposit |
| 5 | Term insurance and health insurance | As required | Neither is deductible now. Buy them because they are needed, not for tax |

## 10.4 The life-cycle framework

| Stage | The dominant need | The avenues that fit |
|---|---|---|
| **Entry — 22 to 30** | Habit, liquidity, and cover for dependants | Equity linked savings scheme, or an ordinary equity fund in the default regime; term insurance; the provident fund by force of law; a small public provident fund account opened early, because the fifteen years run from opening |
| **Accumulation — 30 to 45** | Growth, and the children's education | Equity oriented funds; Sukanya Samriddhi for a daughter; public provident fund; the pension scheme; health insurance for the family |
| **Consolidation — 45 to 58** | Shifting from growth to certainty, and the retirement corpus | Increase the pension scheme; the public provident fund extended in blocks of five; begin harvesting the ₹1,25,000 shelter annually |
| **Retirement — 58 onwards** | Income, safety, and the rebate | Senior Citizens Savings Scheme up to ₹30,00,000; post office monthly income scheme; a systematic withdrawal plan from an equity fund; section 153 in the optional regime; and above all **test section 156(2) first** |

## 10.5 The eight mistakes that recur

1. **Planning before choosing the regime.** Everything in this Unit is conditional on section 202. Compute both, then plan.
2. **Ignoring the rebate.** For an income at or below ₹12,00,000 in the default regime the tax is nil after section 156(2). No investment is needed for tax purposes at all.
3. **Buying insurance as an investment.** An endowment policy returning 4.8% is a poor investment and an expensive way to buy cover. Separate the two.
4. **Choosing the dividend option.** It converts a gain taxable at 12.5% above a shelter into an income taxable at 31.2% from the first rupee.
5. **Forgetting that the ₹1,25,000 shelter is one shelter.** Shares, equity funds, business trusts and a defaulting unit linked plan all compete for it.
6. **Investing in March.** The subscription qualifies, but the decision is taken badly, and eleven months of return have been given away — most visibly in the public provident fund, where a deposit after the 5th of the month earns nothing that month.
7. **Withdrawing a provident fund on changing employment.** It destroys the continuity of service, taxes the employer's share as salary, and recaptures past deductions — for want of a transfer form.
8. **Confusing the three ceilings** — ₹1,50,000 under section 123, ₹50,000 under section 124(3), and ₹7,50,000 under section 17(1)(h). The first two reduce total income. The third *increases* it.

> **THE SENTENCE TO CLOSE AN ANSWER ON THIS UNIT**
>
> **“An investment should be chosen for what it does, and taxed for what it is; the tax treatment should decide between two investments that are otherwise equal, and should never by itself decide to make an investment at all.”**
>
> That is the difference between tax planning and tax-driven investing, and it is the difference an examiner setting a case study is testing for.

CHAPTER 11

# Revision, Ready Reckoner and Question Bank

*Eleven avenues compressed onto a few pages, and then the practice. Work the problems with a pen before you look at the solutions.*

## 11.1 Old section to new section — a ready reckoner for Unit 3

| Subject | Income-tax Act, 1961 | Income-tax Act, 2025 |
|---|---|---|
| Deductions from gross total income — the Chapter | Chapter VI-A | Chapter VIII, sections 122 to 154 |
| Gross total income defined | 80B(5) | 122(10) |
| Deductions not to exceed gross total income | 80A(2) | 122(2) |
| Life insurance, provident fund, ELSS, NSC, tuition fees — the ₹1,50,000 | 80C | **123, with Schedule XV** |
| The list of eligible investments | 80C(2) | **Schedule XV** |
| Premium capped by capital sum assured | 80C(3), (3A) | Schedule XV, para 2 |
| Pension fund contributions | 80CCC | 123 (within Schedule XV) |
| National Pension System — employer | 80CCD(2) | **124(1) and 124(2)** |
| National Pension System — the extra ₹50,000 | 80CCD(1B) | **124(3) and (4)** |
| Agnipath Scheme | 80CCH | **125** |
| Health insurance | 80D | 126 |
| Dependant with a disability | 80DD | 127 |
| Medical treatment of a specified disease | 80DDB | 128 |
| Interest on an education loan | 80E | 129 |
| Housing loan interest — 2016-17 | 80EE | 130 |
| Housing loan interest — 2019 to 2022 | 80EEA | 131 |
| Electric vehicle loan interest | 80EEB | 132 |
| Donations | 80G | 133 |
| Rent paid | 80GG | 134 |
| Scientific research and rural development | 80GGA | 135 |
| Political contributions | 80GGB, 80GGC | 136, 137 |
| Additional employee cost | 80JJAA | 146 |
| Royalty of an author; royalty on a patent | 80QQB, 80RRB | 151, 152 |
| Interest on deposits — savings account; senior citizen | 80TTA, 80TTB | **153** |
| The assessee's own disability | 80U | 154 |
| Rebate | 87A | 155, 156 |
| Exempt incomes — general | Section 10 | **Section 11 with Schedule II** |

| Subject | Income-tax Act, 1961 | Income-tax Act, 2025 |
|---|---|---|
| Exempt incomes — eligible persons | Section 10, various | **Section 11 with Schedule III** |
| Life insurance proceeds | **10(10D)** | **Schedule II, Sl. No. 2** |
| Provident fund — accumulated balance | 10(11), 10(12) with Rule 8, Part A of the Fourth Schedule | Schedule II and Schedule III, with **Schedule XI** |
| Recognised provident fund — the rules of recognition | Part A of the Fourth Schedule | **Schedule XI** |
| National Pension System — the 60% lump sum | 10(12A) | Schedule III, Sl. No. 4 |
| Partial withdrawal from the pension scheme | 10(12B) | Schedule III |
| Agniveer Corpus Fund | 10(12C) | Schedule III |
| Employer's contribution above ₹7,50,000 — perquisite | 17(2)(vii) | **17(1)(h)** |
| Interest on the excess employer contribution | 17(2)(viia) | 17(1)(h), with the Rules |
| Interest on own contribution above ₹2,50,000 | 10(11) and 10(12) provisos, with Rule 9D | Schedule II and Schedule III, with the Rules |
| Profits in lieu of salary — unrecognised fund | 17(3) | 18 |
| Capital gains — charge | 45 | 67 |
| Mode of computation | 48 | 72 |
| Market linked debentures and specified mutual funds | **50AA** | **76** |
| Exemption — bonds | **54EC** | **85** |
| Exemption — residential house | 54 | 82 |
| Exemption — investment in a residential house | 54F | 86 |
| Dividend | 56(2)(i) | 92(2)(a) |
| Interest on securities | 56(2)(id) | 92(2)(e) |
| Life policy proceeds not exempt | 56(2)(xiii) | **92(2)(l)** |
| Gifts | 56(2)(x) | 92(2)(m), with the exceptions in 92(3) |
| Deductions from other sources | 57 | 93 |
| Amounts not deductible | 58 | 94 |
| Set-off — same head; inter-head | 70, 71 | 108, 109 |
| STCG on listed equity | 111A | **196** |
| LTCG generally | 112 | **197** |
| LTCG on listed equity — the ₹1,25,000 | 112A | **198** |
| Winnings | 115BB | 194 |
| Clubbing — conversion into family property | 64(2) | **99(3) and 99(4)** |
| The two regimes | 115BAC | **202** |
| Rounding | 288A, 288B | 516 |

## 11.2 Every figure in this Unit on two pages

| Topic | Point | Figure |
|---|---|---|
| Section 123 | Aggregate ceiling | ₹1,50,000 |
| Section 124(3) | Own pension contribution, above the ₹1,50,000 | ₹50,000 |
| Section 124(1) | Employer's contribution — Government / others | 14% / 10% of salary |
| Section 124(2) | Employer's contribution, default regime | **14% of salary in every case** |
| Section 17(1)(h) | Aggregate employer contribution to PF + superannuation + pension scheme | ₹7,50,000 |
| Provident fund | Own contribution beyond which interest is taxable | ₹2,50,000 (₹5,00,000 where the employer contributes nothing) |
| Provident fund | Continuous service for exemption on withdrawal | 5 years |
| Life insurance | Premium-to-sum-assured, policy on or after 1 April 2012 | 10% |
| Life insurance | Policy on or before 31 March 2012 | 20% |
| Life insurance | Disabled or diseased life, policy on or after 1 April 2013 | 15% |
| Life insurance | Aggregate premium ceiling, non-linked policy issued on or after 1 April 2023 | ₹5,00,000 |
| Life insurance | Recapture on lapse or surrender | Before 2 years' premiums paid |
| Unit linked plan | Aggregate premium ceiling, policy issued on or after 1 February 2021 | ₹2,50,000 |
| Unit linked plan | Charge where the exemption fails | Capital gains — section 198, 12.5% above ₹1,25,000 |
| Conventional policy | Charge where the exemption fails | Section 92(2)(l), slab rates, on the excess over premiums paid |
| Public provident fund | Minimum / maximum a year | ₹500 / ₹1,50,000 |
| Public provident fund | Term; extension | 15 years; blocks of 5 |
| Public provident fund | Interest computed on | Lowest balance between the close of the 5th and the last day of the month |
| Equity linked savings scheme | Lock-in; equity holding | 3 years per unit; not less than 80% |
| Equity oriented fund | Definition | More than 65% in equity shares of domestic companies |
| Specified mutual fund | Definition; charge | More than 65% in debt and money market instruments; **short-term at slab, section 76** |
| Section 196 | STCG on listed equity with STT | **20%** |
| Section 197 | LTCG generally | **12.5%** |

| Topic | Point | Figure |
|---|---|---|
| Section 198 | LTCG on listed equity, equity oriented funds, business trusts | **12.5% above ₹1,25,000** |
| Holding period | Listed securities, units of an equity oriented fund, zero coupon bonds | 12 months |
| Holding period | Everything else — gold, unlisted shares, land, buildings | 24 months |
| Section 85 | Ceiling; time; lock-in | ₹50,00,000; 6 months; 5 years |
| Section 153 | Savings account / any account, senior citizen | ₹10,000 / ₹50,000 |
| Section 156(1) | Rebate, total income up to ₹5,00,000 | ₹12,500 |
| Section 156(2) | Rebate, default regime, total income up to ₹12,00,000 | ₹60,000, with marginal relief to about ₹12,70,588 |
| Section 92(2)(m) | Gift threshold | ₹50,000 — the whole sum is charged once crossed |
| Small savings, Q2 2026-27 | PPF / NSC / SCSS / SSA / KVP / POMIS | 7.1% / 7.7% / 8.2% / 8.2% / 7.5% (115 months) / 7.4% |
| Small savings, Q2 2026-27 | Post office time deposit 1 / 2 / 3 / 5 year | 6.9% / 7.0% / 7.1% / 7.5% |
| Small savings, Q2 2026-27 | Savings account; 5-year recurring deposit | 4.0%; 6.7% |
| Sukanya Samriddhi | Age of the girl; accounts per family; term; subscription years | Below 10; two; 21 years; 15 years |
| Senior Citizens Savings Scheme | Ceiling; term | ₹30,00,000; 5 years, extendable by 3 |
| Post office monthly income scheme | Ceiling single / joint | ₹9,00,000 / ₹15,00,000 |
| Sovereign gold bonds | Interest; exemption on redemption | 2.5% taxable; exempt only for the **original subscriber holding to maturity** |
| National Pension System | Lump sum exempt at 60; annuity | 60% exempt; the annuity is taxable as received |
| Cess | On the tax and surcharge | 4% |
| Rounding | Total income, and tax payable or refundable | Nearest ₹10 [section 516] |

## 11.3 Objective questions

| No. | Question and options |
|---|---|
| 1 | The deduction for investments listed in Schedule XV is allowed by —<br>(a) section 80C (b) **section 123** (c) section 124 (d) section 122 |
| 2 | The aggregate ceiling under section 123 for Tax Year 2026-27 is —<br>(a) ₹1,00,000 (b) ₹2,00,000 (c) **₹1,50,000** (d) ₹1,25,000 |
| 3 | In the default regime under section 202(1), which of the following deductions survives?<br>(a) section 123 (b) section 126 (c) **section 124(2)** (d) section 153 |

| No. | Question and options |
|---|---|
| 4 | The premium on a life policy issued on 1 July 2026 is deductible only to the extent of — (a) 20% of the capital sum assured (b) **10% of the capital sum assured** (c) 15% (d) the whole premium |
| 5 | The aggregate annual premium ceiling for the exemption of a non-linked life policy issued on or after 1 April 2023 is — (a) ₹2,50,000 (b) **₹5,00,000** (c) ₹1,50,000 (d) no ceiling |
| 6 | The aggregate annual premium ceiling for a unit linked plan issued on or after 1 February 2021 is — (a) **₹2,50,000** (b) ₹5,00,000 (c) ₹7,50,000 (d) ₹1,50,000 |
| 7 | Where the exemption fails on a unit linked plan, the excess is charged as — (a) salary (b) income from other sources (c) **capital gains** (d) business income |
| 8 | Where the exemption fails on a conventional endowment policy, the excess over premiums paid is charged under — (a) section 67 (b) **section 92(2)(l)** (c) section 198 (d) section 18 |
| 9 | The sum received on the **death** of the life assured is — (a) exempt only if the premium is within 10% (b) exempt only up to ₹5,00,000 of premium (c) **always exempt** (d) taxable as capital gains |
| 10 | The aggregate ceiling on the employer's contribution to provident fund, superannuation fund and the notified pension scheme, beyond which the excess is a perquisite, is — (a) ₹2,50,000 (b) ₹5,00,000 (c) **₹7,50,000** (d) ₹1,50,000 |
| 11 | Interest on an employee's **own** contribution to a recognised provident fund is taxable to the extent it relates to a contribution exceeding — (a) **₹2,50,000** (b) ₹5,00,000 (c) ₹1,50,000 (d) ₹7,50,000 |
| 12 | The accumulated balance of a recognised provident fund is exempt where the employee has rendered continuous service of — (a) 3 years (b) **5 years** (c) 7 years (d) 10 years |
| 13 | The recognised provident fund is now governed by — (a) Part A of the Fourth Schedule (b) **Schedule XI** (c) Schedule XV (d) Schedule III |
| 14 | Interest in a public provident fund account is computed on the lowest balance between — (a) the 1st and the last day of the month (b) **the close of the 5th and the last day of the month** (c) the 10th and the last day (d) the whole month's average |
| 15 | A public provident fund account may be opened by — (a) a Hindu undivided family (b) a firm (c) **a resident individual** (d) a non-resident |
| 16 | The lock-in of an equity linked savings scheme runs from — (a) the end of the tax year (b) **the date of allotment of each unit** (c) the date the folio was opened (d) the date of the first instalment |
| 17 | A gain on an equity linked savings scheme can never be charged under section 196, because — (a) the units are exempt (b) securities transaction tax is not paid (c) **the units cannot be transferred within three years** (d) the scheme is a specified mutual fund |
| 18 | A fund investing more than 65% of its proceeds in debt and money market instruments is — (a) an equity oriented fund (b) **a specified mutual fund** (c) an other fund (d) a business trust |
| 19 | The gain on a specified mutual fund is — (a) long-term after 24 months (b) long-term after 12 months (c) **short-term irrespective of the holding period** (d) exempt |
| 20 | The section that so provides is — (a) section 72 (b) **section 76** (c) section 50AA (d) section 197 |
| 21 | The rate under section 198 on a long-term capital gain on listed equity shares is — (a) 20% (b) 10% above ₹1,00,000 (c) **12.5% above ₹1,25,000** (d) slab rates |

| No. | Question and options |
|---|---|
| 22 | The ₹1,25,000 shelter in section 198 is available — (a) separately for shares and for units (b) **once, for all such gains taken together** (c) once for each folio (d) only to a senior citizen |
| 23 | The ceiling on investment in bonds under section 85 is — (a) ₹25,00,000 (b) **₹50,00,000** (c) ₹1,00,00,000 (d) no ceiling |
| 24 | The lock-in on section 85 bonds is — (a) 3 years (b) **5 years** (c) 6 months (d) 8 years |
| 25 | Taking a loan on the security of section 85 bonds within the lock-in — (a) has no consequence (b) attracts a penalty only (c) **causes the exemption to be charged as a long-term capital gain of that year** (d) is prohibited by law |
| 26 | Redemption of a sovereign gold bond at the end of the eighth year is exempt from capital gains tax — (a) for every holder (b) **only for the original subscriber who has held to maturity** (c) only where bought on the exchange (d) never |
| 27 | The interest accruing on a national savings certificate in years one to four is — (a) exempt (b) **chargeable, but deemed reinvested and eligible afresh under section 123** (c) not chargeable at all (d) charged at 12.5% |
| 28 | The Sukanya Samriddhi account is exempt — (a) at entry only (b) at exit only (c) **at all three points** (d) not at all |
| 29 | The deduction under section 153 for a senior citizen is — (a) ₹10,000 on a savings account (b) **₹50,000 on any account** (c) ₹75,000 (d) not available |
| 30 | Section 153 in the default regime is — (a) available in full (b) available at half (c) **not available** (d) available only to a Hindu undivided family |
| 31 | A Hindu undivided family is **not** entitled to a deduction under — (a) section 123 (b) section 126 (c) **section 153** (d) section 133 |
| 32 | Where a member converts his separate property into property of the family without adequate consideration, the income from it is — (a) assessed in the family (b) exempt (c) **included in the transferor's total income under section 99(3)** (d) charged at 30% |
| 33 | The rebate under section 156(2) is available to — (a) any assessee (b) a Hindu undivided family (c) **a resident individual taxed under section 202(1)** (d) a non-resident individual |
| 34 | Marginal relief under section 156(2)(b) runs out at a total income of approximately — (a) ₹12,00,000 (b) **₹12,70,588** (c) ₹13,50,000 (d) ₹15,00,000 |
| 35 | The rate of interest on the public provident fund for the quarter July to September 2026 is — (a) 7.5% (b) **7.1%** (c) 8.2% (d) 7.7% |
| 36 | The dividend option of an equity mutual fund is taxed — (a) at 12.5% above ₹1,25,000 (b) at 20% (c) **at slab rates, in full** (d) not at all |
| 37 | A switch between two funds inside a unit linked insurance plan is — (a) a transfer under section 67 (b) **not a transfer** (c) a deemed dividend (d) a surrender |
| 38 | A switch between two schemes of the same mutual fund house is — (a) not a transfer (b) **a transfer under section 67** (c) exempt (d) charged as other sources |
| 39 | Under section 124(2), “salary” for computing 14% means — (a) gross salary (b) **basic salary plus dearness allowance where the terms so provide** (c) cost to company (d) total income |
| 40 | Winnings from a lottery are charged under section 194 at — |

| No. | Question and options |
|---|---|
| | (a) slab rates (b) 20% (c) 12.5% (d) **30%, with no deduction and no rebate** |

### Answers

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 1 b | 2 c | 3 c | 4 b | 5 b | 6 a | 7 c | 8 b | 9 c | 10 c |
| 11 a | 12 b | 13 b | 14 b | 15 c | 16 b | 17 c | 18 b | 19 c | 20 b |
| 21 c | 22 b | 23 b | 24 b | 25 c | 26 b | 27 b | 28 c | 29 b | 30 c |
| 31 c | 32 c | 33 c | 34 b | 35 b | 36 c | 37 b | 38 b | 39 b | 40 d |

## 11.4 Fill in the blanks

1. The deduction for the investments listed in Schedule XV is allowed by section _____. **[123]**
2. The additional deduction of ₹50,000 for the assessee's own contribution to the notified pension scheme is given by section _____. **[124(3) and (4)]**
3. The aggregate employer contribution beyond which the excess is a perquisite is ₹_____. **[7,50,000]**
4. Interest on the employee's own provident fund contribution is taxable where the contribution in the year exceeds ₹_____. **[2,50,000]**
5. A unit linked insurance plan issued on or after 1 February 2021 loses its exemption where the aggregate annual premium exceeds ₹_____. **[2,50,000]**
6. A conventional life policy issued on or after 1 April 2023 loses its exemption where the aggregate annual premium exceeds ₹_____. **[5,00,000]**
7. The lock-in of an equity linked savings scheme is _____ years from the date of allotment of each unit. **[three]**
8. A fund investing more than _____ per cent of its proceeds in equity shares of domestic companies is an equity oriented fund. **[65]**
9. Section _____ deems the gain on a specified mutual fund to be short-term irrespective of the holding period. **[76]**
10. The exemption under section 85 is available only where the investment is made within _____ months of the transfer. **[six]**
11. The rate of interest on the Sukanya Samriddhi account for the quarter July to September 2026 is _____ per cent. **[8.2]**
12. Section _____ clubs the income from property converted by a member into property of the Hindu undivided family. **[99(3)]**
13. The rebate under section 156(2) is ₹_____ where total income does not exceed ₹12,00,000. **[60,000]**
14. Total income is rounded off to the nearest ₹_____ under section 516. **[10]**
15. Winnings from a lottery are charged at _____ per cent under section 194. **[30]**

## 11.5 Short-answer and long-answer questions

### Short answer (4 to 6 marks)

1. Explain the three points at which the Income-tax Act, 2025 touches an investment, and illustrate with the public provident fund.
2. Distinguish E-E-E from E-E-T, with one example of each from the Act.
3. What survives of Chapter VIII in the default regime, and why is section 124(2) so important there?
4. State the two ratios that govern the deduction and the exemption on a life insurance policy, and the dates from which each applies.
5. Explain the ₹5,00,000 aggregate premium ceiling, and how an assessee holding several policies should choose between them.
6. Explain the ₹2,50,000 ceiling on unit linked insurance plans, and state the head under which the excess is charged.
7. Why is the failure of the exemption less costly on a unit linked plan than on an endowment policy?
8. Distinguish a statutory, a recognised and an unrecognised provident fund at the four points of charge.
9. State the effect of the Finance Act, 2026 on Schedule XI and on the employer's contribution.
10. Explain the five-year rule on the withdrawal of a recognised provident fund and the three saving causes.
11. State the three ceilings — ₹1,50,000, ₹50,000 and ₹7,50,000 — and distinguish their operation.
12. Explain why a subscription to the public provident fund should be made on or before the 5th of April.

13. State the position where a father subscribes to his own public provident fund account and to that of his minor child.
14. Explain the tax treatment of the National Pension System at exit, and why E-E-T is not fatal.
15. Why can a gain on an equity linked savings scheme never be charged under section 196?
16. Distinguish an equity oriented fund, a specified mutual fund and an "other fund", and state the rate applicable to each.
17. Explain section 76 and what it did to the taxation of debt funds.
18. Explain the harvesting of the ₹1,25,000 shelter in section 198, and state two cautions.
19. Explain the conditions in section 85 and state the consequence of taking a loan against the bonds.
20. State the tax treatment of sovereign gold bonds in the hands of (a) the original subscriber holding to maturity and (b) a purchaser on the exchange.
21. Explain the reinvestment mechanism on a national savings certificate, and what becomes of it in the default regime.
22. Why is the Sukanya Samriddhi account said to be the best avenue in the Act for an eligible assessee?
23. State four deductions available to an individual but not to a Hindu undivided family.
24. Explain sections 99(3) and 99(4), and state three ways of funding a Hindu undivided family that avoid them.
25. Explain section 156(2) and its significance for investment planning.

### Long answer (10 to 15 marks)

1. "The tax character of an investment is the pattern of exemption and charge at its three points." Discuss with reference to at least five avenues available to a resident individual.
2. Examine the effect of section 202(2) on tax planning through investments, distinguishing between what the default regime removes and what it leaves standing.
3. Discuss the tax treatment of life insurance and unit linked insurance plans under the Income-tax Act, 2025, and set out the planning measures available under each.
4. Explain the tax treatment of provident funds under the Income-tax Act, 2025, dealing with the changes made by the Finance Act, 2026.
5. "The public provident fund is not a tax-saving instrument in the default regime; it is a debt instrument, and a very good one." Discuss.
6. Discuss the National Pension System as a planning vehicle, with particular reference to section 124(2) and to an assessee taxed under section 202(1).
7. Compare the equity linked savings scheme with the other avenues eligible under section 123, on the tests of lock-in, return and taxation on exit.
8. Explain the taxation of mutual funds under the Income-tax Act, 2025, and set out the planning measures open to an investor.
9. Discuss the small savings schemes as instruments of tax planning, dealing with at least five of them and with the deduction under section 153.
10. Examine the Hindu undivided family as a vehicle for investment, dealing with what income belongs to it, what deductions it gets, and the operation of section 99.
11. Set out the scheme of Chapter VIII of the Income-tax Act, 2025 and the order in which its deductions are to be applied.
12. A client aged 35, with a salary of ₹24,00,000 and no investments, asks you to design a plan. Set out the steps you would follow, the information you would need, and the recommendations you would make under each regime.
13. "An investment should be chosen for what it does, and taxed for what it is." Discuss with reference to the mis-selling of insurance as an investment.

## 11.6 Practical problems with solutions

**PROBLEM 1 — THE REGIME, AND THE WHOLE OF CHAPTER VIII**

Shri Naveen, aged 44, resident. Basic salary ₹14,00,000; dearness allowance ₹2,00,000 (forming part of salary for retirement benefits); house rent allowance ₹5,00,000, rent paid ₹4,80,000 in Hyderabad; other taxable allowances ₹2,40,000. The employer contributes 10% of salary to the notified pension scheme, ₹1,60,000, included in gross salary. Gross salary ₹25,00,000.

He has invested: life insurance premium ₹60,000 (sum assured ₹8,00,000, policy of 2019); public provident fund ₹70,000; equity linked savings scheme ₹50,000; his own pension contribution ₹50,000; health insurance for himself ₹28,000 and for his parents, aged 71, ₹42,000. Savings bank interest ₹14,000. *Compute the total income and tax under both regimes and advise.*

**OPTIONAL REGIME.** House rent allowance exempt to the least of — ₹5,00,000; ₹4,80,000 − 10% of ₹16,00,000 = ₹3,20,000; 50% of ₹16,00,000 = ₹8,00,000 (Hyderabad is one of the eight cities) → **₹3,20,000**.

Gross salary ₹25,00,000 − ₹3,20,000 = ₹21,80,000. Less standard deduction ₹50,000 → salary ₹21,30,000. Other sources ₹14,000. **Gross total income ₹21,44,000.**

Chapter VIII — section 123: life premium ₹60,000 (within 10% of ₹8,00,000 = ₹80,000, so allowed in full) + public provident fund ₹70,000 + equity linked savings scheme ₹50,000 = ₹1,80,000, restricted to **₹1,50,000**. Section 124(1): employer's contribution, 10% of ₹16,00,000 = ₹1,60,000, and the actual contribution is ₹1,60,000 → **₹1,60,000**. Section 124(3): **₹50,000**. Section 126: self ₹25,000 (restricted from ₹28,000) + parents, senior citizens, ₹42,000 → **₹67,000**. Section 153: savings bank interest **₹10,000**.

Total deductions ₹1,50,000 + ₹1,60,000 + ₹50,000 + ₹67,000 + ₹10,000 = ₹4,37,000. **Total income ₹17,07,000.**

Tax: nil to ₹2,50,000; 5% of ₹2,50,000 = ₹12,500; 20% of ₹5,00,000 = ₹1,00,000; 30% of ₹7,07,000 = ₹2,12,100 → ₹3,24,600. Cess 4% ₹12,984. **Tax ₹3,37,584, say ₹3,37,580.**

**DEFAULT REGIME.** No house rent allowance exemption. Gross salary ₹25,00,000. Less standard deduction ₹75,000 → ₹24,25,000. Other sources ₹14,000. **Gross total income ₹24,39,000.**

Chapter VIII — only section 124(2): 14% of ₹16,00,000 = ₹2,24,000, but the employer contributed only ₹1,60,000 → **₹1,60,000**. Nothing else. **Total income ₹22,79,000.**

Tax: ₹20,000 + ₹40,000 + ₹60,000 + ₹80,000 + 25% of ₹2,79,000 = ₹69,750 → ₹2,69,750. Cess ₹10,790. **Tax ₹2,80,540.**

**The default regime is better by ₹57,044**, notwithstanding that he has made every investment the optional regime rewards.

**Advice.** (i) Opt for the default regime, that is, do nothing, section 202(1) being the default. (ii) Ask the employer to raise its contribution from 10% to 14% of salary — from ₹1,60,000 to ₹2,24,000 — adjusting other allowances downward by ₹64,000. Total income falls to ₹22,15,000; tax ₹2,53,750 plus cess = **₹2,63,900**, a further saving of ₹16,640. (iii) The life policy, the public provident fund and the equity linked savings scheme now earn nothing at entry. **Do not surrender them** — the policy would attract no recapture, premiums for more than two years having been paid, but the surrender value would be punitive, and the public provident fund and the scheme still compound tax-free. Direct *fresh* savings to an equity oriented fund, which has no lock-in and enjoys the ₹1,25,000 shelter in both regimes.

### Problem 2 — five avenues, one ₹1,50,000

Smt. Jyoti, aged 36, resident, in the **optional** regime with a marginal rate of 31.2%, has ₹1,50,000 to place and a daughter aged 6. Rank the following and state what each is worth over ten years: (a) Sukanya Samriddhi at 8.2%; (b) public provident fund at 7.1%; (c) national savings certificate at 7.7%; (d) five-year bank tax-saver deposit at 6.75%; (e) equity linked savings scheme, assumed 12%.

Each earns the same deduction of ₹1,50,000, worth ₹46,800 of tax. So the deduction is neutral between them and the ranking must be made on the other two points.

- **(a) Sukanya Samriddhi.** E-E-E at 8.2%. ₹1,50,000 compounded ten years = ₹1,50,000 × 1.082^10 ≈ **₹3,30,000**, wholly exempt. Lock-in to the daughter's 21st year.
- **(b) Public provident fund.** E-E-E at 7.1%. ₹1,50,000 × 1.071^10 ≈ **₹2,98,000**, wholly exempt. Lock-in 15 years.
- **(c) National savings certificate.** Matures in five years at ₹1,50,000 × 1.077^5 ≈ ₹2,17,400; years 1 to 4 effectively untaxed by reinvestment, the fifth year's interest of about ₹15,540 taxed at 31.2% = ₹4,848. Reinvested for a further five years, ≈ **₹3,07,000** net.
- **(d) Five-year bank deposit.** T at accrual. Net rate 6.75% × (1 − 0.312) = 4.64%. ₹1,50,000 × 1.0464^10 ≈ **₹2,36,000**.
- **(e) Equity linked savings scheme.** ₹1,50,000 × 1.12^10 ≈ ₹4,66,000; gain ₹3,16,000; if redeemed in one year, tax = 12.5% of (₹3,16,000 − ₹1,25,000) plus cess = ₹24,830 → **₹4,41,000**. If redeemed over three years using the shelter each year, **₹4,66,000**, wholly untaxed.

**Ranking: (e), (a), (c), (b), (d)** — but (e) carries market risk and the other four do not. The correct *advice* is a split: the daughter's education money to (a), the retirement money to (b), and the growth money to (e). (c) is a reasonable substitute for (b) where fifteen years is too long. **(d) should never be chosen** — it is dominated by (c) on every test.

### Problem 3 — capital gains, section 85, and the choice

Shri Bhaskar sells a plot on 5 May 2026 for ₹1,80,00,000. He bought it in March 2015 for ₹48,00,000. He also sells listed equity shares in September 2026 for ₹26,00,000, bought in 2021 for ₹11,00,000, and units of a debt fund for ₹8,00,000, bought in 2019 for ₹5,00,000. He has salary income of ₹18,00,000 and is in the **optional** regime. *Compute, and advise on section 85.*

**Capital gains.** Plot: held more than 24 months, long-term. Gain ₹1,80,00,000 − ₹48,00,000 = **₹1,32,00,000**, charged under section 197. The plot having been acquired before 23 July 2024, section 197(3) gives him the option of 12.5% without indexation or 20% with; assume the 12.5% route is the lower.

Shares: listed, held more than 12 months, securities transaction tax paid. Gain ₹26,00,000 − ₹11,00,000 = **₹15,00,000**, charged under **section 198** at 12.5% above ₹1,25,000.

Debt fund: **section 76** deems the gain short-term whatever the holding. Gain ₹8,00,000 − ₹5,00,000 = **₹3,00,000**, charged at slab.

**Without section 85.** Ordinary income: salary ₹18,00,000 − standard deduction ₹50,000 = ₹17,50,000, plus debt fund gain ₹3,00,000 = ₹20,50,000. Tax at slab: ₹12,500 + ₹1,00,000 + 30% of ₹10,50,000 (₹3,15,000) = ₹4,27,500. Section 197 on ₹1,32,00,000 at 12.5% = ₹16,50,000. Section 198 on (₹15,00,000 − ₹1,25,000) at 12.5% = ₹1,71,875. Total ₹22,49,375, plus cess ₹89,975 = **₹23,39,350** (before surcharge).

**With section 85.** He invests ₹50,00,000 in notified bonds by 4 November 2026. Exemption ₹50,00,000; the section 197 gain falls to ₹82,00,000; tax on it 12.5% = ₹10,25,000. **Saving ₹6,25,000 plus cess ₹25,000 = ₹6,50,000.**

**Advice.** Take the exemption, but with three cautions. **(i)** The ₹50,00,000 ceiling covers this year and the next taken together — he cannot invest another ₹50,00,000 in April 2027 against the same transfer. **(ii)** The six months expire on 4 November 2026; the bonds are often rationed and he should apply early. **(iii)** He must not transfer the bonds, convert them into money **or take a loan against them** for five years, failing which the ₹50,00,000 is charged as a long-term capital gain of the year in which he does so. **(iv)** He should also consider section 86 for the balance if he is minded to buy a residential house, the net consideration and not merely the gain being the measure there.

### PROBLEM 4 — THE FAMILY, AND THE SECOND ASSESSEE

Shri Om Prakash, aged 52, has salary income of ₹22,00,000. His Hindu undivided family, of which he is karta, owns ancestral property let at ₹9,00,000 a year and holds shares received under his father's will, yielding a dividend of ₹1,80,000 and a long-term capital gain on sale in the year of ₹3,40,000. The family pays a life insurance premium of ₹60,000 on the life of Shri Om Prakash's son, a member, and health insurance of ₹30,000 for the members. Both are in the **optional** regime. *Compute the family's total income and tax.*

**Income from house property.** Gross annual value ₹9,00,000; *less* 30% under section 22(1)(a) ₹2,70,000 → **₹6,30,000**.

**Income from other sources.** Dividend ₹1,80,000, chargeable in full under section 92(2)(a) → **₹1,80,000**.

**Capital gains.** Long-term on listed equity with securities transaction tax paid: ₹3,40,000, charged under **section 198** at 12.5% above ₹1,25,000 — that is on ₹2,15,000.

**Gross total income ₹11,50,000**, of which ₹3,40,000 is special-rate income under section 198.

**Chapter VIII.** Section 123: life premium ₹60,000, the life assured being a member — allowed, being within the ceiling. Section 126: health insurance ₹25,000 (restricted). **Total ₹85,000.** These are set against the ordinary income of ₹8,10,000, not against the section 198 gain.

**Total income ₹10,65,000.** Ordinary income ₹7,25,000; section 198 income ₹3,40,000.

Tax on ordinary income: nil to ₹2,50,000 — **note that the family gets no senior-citizen limit, having no age**; 5% of ₹2,50,000 = ₹12,500; 20% of ₹2,25,000 = ₹45,000 → ₹57,500. Tax under section 198: 12.5% of ₹2,15,000 = ₹26,875. **Total ₹84,375.** No rebate — section 156 is confined to a resident **individual**. Cess 4% ₹3,375. **Tax payable ₹87,750.**

**The planning point.** Had all this income been returned by Shri Om Prakash, whose salary already reaches the 30% slab, the ordinary income of ₹8,10,000 would have borne ₹2,43,000 of tax instead of ₹57,500 — **a difference of ₹1,85,500 a year**, quite apart from the family's own ₹1,25,000 shelter under section 198, which is additional to his.

### PROBLEM 5 — DESIGNING A PACKAGE IN THE DEFAULT REGIME

Shri Farhan, aged 31, joins a company on 1 April 2026. The company will spend ₹22,00,000 a year on him and will structure the package as he wishes. He is unmarried, lives with his parents and pays no rent, and has no investments. *Design the package, both regimes considered.*

**Step 1 — the regime.** With no rent paid there is no house rent allowance exemption to have, and with no dependants there is little to deduct. The optional regime therefore offers him almost nothing. **He will be in the default regime**, and the design must be made for it.

**Step 2 — the one lever.** Section 124(2) allows a deduction of 14% of basic plus dearness allowance for the employer's contribution to the notified pension scheme, and it survives section 202(2). To maximise it, **basic salary should be as high as the employer will allow.**

**Step 3 — the design.** Basic salary ₹16,00,000; employer's contribution to the notified pension scheme 14% = ₹2,24,000; employer's contribution to the recognised provident fund 12% of basic = ₹1,92,000; balance as taxable allowances ₹1,84,000. **Total cost to the employer ₹22,00,000.**

**Step 4 — the computation.** Gross salary = basic ₹16,00,000 + allowances ₹1,84,000 + employer's pension contribution ₹2,24,000 = ₹20,08,000. (The provident fund contribution of ₹1,92,000 is not a perquisite, the aggregate of ₹4,16,000 being well within the ₹7,50,000 in section 17(1)(h).) *Less* standard deduction ₹75,000 → ₹19,33,000. *Less* section 124(2), ₹2,24,000 → **total income ₹17,09,000.**

Tax: ₹20,000 + ₹40,000 + ₹60,000 + 20% of ₹1,09,000 (₹21,800) = ₹1,41,800, plus cess ₹5,672 = **₹1,47,472, say ₹1,47,470.**

**Step 5 — the comparison.** Had the whole ₹22,00,000 been paid as salary with no retirement contributions at all: gross ₹22,00,000 less ₹75,000 = ₹21,25,000; tax ₹20,000 + ₹40,000 + ₹60,000 + ₹80,000 + 25% of ₹1,25,000 (₹31,250) = ₹2,31,250, plus cess = **₹2,40,500**.

**Saving ₹93,028 a year**, and ₹4,16,000 a year placed in retirement vehicles that compound untaxed — on a package that costs the employer exactly the same.

*This is the model answer to the case-study question, and the shape is worth memorising: fix the regime → identify the surviving levers → design → compute → compare with the naive package.*

## 11.7 Where to go next

Unit 4 turns from planning to management. It has two parts. Part A takes the collection of tax — advance tax, tax deducted at source, tax collected at source and refunds; and much of it applies directly to the avenues in this booklet, because a mutual fund deducts tax on a distribution, a bank deducts tax on interest, and the sale of immovable property attracts deduction at source in the buyer's hands. Part B takes the income-tax authorities, the return of income, the several kinds of assessment, and appeals and revision.

Read Unit 4, Part A immediately after this Unit, and not after a gap. The two are continuous: this Unit decides what is invested and what is earned, and that Unit decides when the tax on it must be paid and by whom it must be deducted.

**A CLOSING WORD ON THIS UNIT**

Eleven avenues, one Chapter of deductions, and a single organising idea — **entry, accrual, exit**. If you remember nothing else from this booklet, remember to ask those three questions of any investment put in front of you, and to name the section that answers each.

And remember the order of the questions in practice, which is not the order of the syllabus. **First**, is any tax payable at all after the rebate in section 156? **Second**, which regime? **Third**, which avenues does that regime reward? **Only fourth**, what does the client actually need — cover, liquidity, growth or income?

*A planner who asks them in that order will rarely be wrong. A planner who begins with the fourth question and works backwards will sell a great many insurance policies in March.*

ANNEXE

# Beyond the Prescribed Scope

*Material retained for the student who wants it, and for the classroom — but outside the scope settled by the teachers' meeting of 6 September 2025, and therefore not examinable.*

> **How to use this Annexe**
>
> This Annexe holds five whole chapters that stood in the body of the earlier printing. The guidelines confine Unit 3 to six avenues — equity linked savings schemes, unit linked insurance plans, the public provident fund, national savings certificates, the Senior Citizens Savings Scheme and the Sukanya Samriddhi account — and to three deductions. Life insurance, the provident funds, the pension schemes in full, the remaining avenues and the whole of Chapter VIII therefore fall outside it. They are kept because the syllabus itself says "and others", because they are asked about in practice, and because Unit 4 and the Semester V paper both draw on them.
>
> **Nothing in this Annexe is required for the examination.** Read the body of the booklet first, and completely. Come here only if you have time, or if a question in class or in practice takes you beyond the syllabus.
>
> *The paragraphs have been renumbered A.1, A.2 and so on. Their former numbers are shown in brackets so that anyone working from an earlier printing can find them.*

# A.1 Life Insurance [formerly Ch. 2]

*The oldest of the tax-saving avenues, and the one most often mis-sold. Its tax treatment turns on two ratios and one date, and a planner who knows those three things can answer any question on it.*

## A.1.1 PART A — The scheme

A contract of life insurance is a contract under which the insurer, in consideration of a premium, undertakes to pay a stated sum on the death of the life assured or on the expiry of a stated term, whichever is earlier. Four families of policy are met in practice —

| Type | What it is | Where the money goes |
|---|---|---|
| Term assurance | Pays only on death within the term. No maturity value | Entirely to mortality cover — the cheapest cover per rupee of sum assured |
| Endowment | Pays on death within the term, or a stated sum on survival to the end of it | Part to mortality cover, the rest to a participating fund managed by the insurer |
| Whole life | Pays on death whenever it occurs | As for endowment, over a longer term |
| Money-back / anticipated endowment | Pays instalments of the sum assured at intervals during the term, and the balance on maturity | As for endowment |

The unit linked insurance plan is a fifth family and is dealt with separately in Chapter 3, because its tax treatment on exit is entirely different.

## A.1.2 PART B — The tax treatment

### Entry — the premium [section 123 with Schedule XV]

The premium paid on a policy on the life of the assessee, the spouse or any child of the assessee is an eligible sum under Schedule XV, and so qualifies for deduction under section 123 within the aggregate ceiling of ₹1,50,000. For a Hindu undivided family, the life insured must be that of any member of the family.

**But the deduction is capped by reference to the capital sum assured** — this is the first of the two ratios, and it is in Schedule XV, para 2:

| Policy issued | Premium deductible only to the extent of |
|---|---|
| On or before 31 March 2012 | 20% of the capital sum assured |
| On or after 1 April 2012 | 10% of the capital sum assured |
| On or after 1 April 2013, on the life of a person with a disability under section 154, or suffering a disease specified for section 128 | 15% of the capital sum assured |

**What "capital sum assured" means, and why it matters**

It is the minimum amount assured under the policy on the happening of the insured event, taken **without** regard to any bonus, and **without** regard to any premium agreed to be returned. A policy that promises "sum assured plus bonus" is measured on the sum assured alone.

So on a policy issued in 2026 with a sum assured of ₹5,00,000 and an annual premium of ₹75,000, the deduction is limited to 10% of ₹5,00,000 = **₹50,000**, and ₹25,000 of the premium earns nothing. The excess is not carried forward and is not deductible in any other year.

*The practical rule for a planner: the sum assured should be at least ten times the annual premium. Any policy that fails that test is failing it for a reason, and the reason is usually that it is an investment dressed as insurance.*

### Accrual — the bonus

Nothing is chargeable while the policy runs. A reversionary bonus declared by the insurer is not income of the policyholder as it is declared; it is part of the sum received on maturity or death, and is taxed, or not taxed, along with it.

### Exit — the proceeds [section 11 with Schedule II; section 92(2)(l)]

Any sum received under a life insurance policy, including the sum allocated by way of bonus, is **not** included in total income — Schedule II, Sl. No. 2, which reproduces what was section 10(10D) of the Income-tax Act, 1961. The exemption is subject to conditions, and it is the conditions that are examined.

| Condition | The rule |
|---|---|
| Death benefit | **Always exempt**, whatever the premium and whenever the policy was issued. This is absolute and admits of no exception |
| Premium-to-sum-assured, policy issued on or after 1 April 2003 and before 1 April 2012 | Exempt only if the annual premium does not exceed **20%** of the actual capital sum assured |
| Premium-to-sum-assured, policy issued on or after 1 April 2012 | Exempt only if the annual premium does not exceed **10%** of the actual capital sum assured |
| Premium-to-sum-assured, disabled or diseased life, policy issued on or after 1 April 2013 | **15%** |
| The aggregate premium test, policy issued on or after 1 April 2023 (other than a unit linked plan) | Exempt only if the **aggregate** annual premium on all such policies of the assessee does not exceed **₹5,00,000**. Where more than one policy is held, the exemption may be claimed on such of them as the assessee chooses, so long as their aggregate premium is within ₹5,00,000 |
| Keyman insurance policy | Never exempt. Chargeable under section 92(2)(d) |

Where the exemption fails, the sum received is chargeable under **section 92(2)(l)** as income from other sources, and — this is the mercy in the provision — **only to the extent that it exceeds the premium paid**. It is not the gross receipt that is taxed. The Rules prescribe the manner of computing the excess where several policies are involved.

**The three dates to memorise, and what each does**

- **1 April 2012** — the ratio for both the deduction and the exemption falls from 20% to 10%.
- **1 April 2023** — the aggregate premium ceiling of ₹5,00,000 begins to apply to non-linked policies. Policies issued before that date are wholly outside it, however large the premium.
- **1 February 2021** — the aggregate premium ceiling of ₹2,50,000 begins to apply to unit linked plans. That date belongs to Chapter 3, and the two ceilings must never be mixed up.

A question that gives you a date of issue is giving you the answer. Read it first.

### A.1.3 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| Keep the annual premium within 10% of the sum assured | Preserves the deduction under section 123 in full and the exemption under Schedule II in full. Both tests use the same ratio, so satisfying one satisfies the other | Test each policy separately. One defective policy does not spoil the others, but its own proceeds become chargeable under section 92(2)(l) |
| Keep the aggregate annual premium on non-linked policies within ₹5,00,000 | Preserves the exemption for a high-premium buyer whose policies were issued on or after 1 April 2023 | The test is on the aggregate across all policies, not policy by policy. A person adding a sixth policy can destroy the exemption on the first five |
| Where the aggregate must exceed ₹5,00,000, choose which policies to shelter | The Act allows the assessee to select the policies whose aggregate premium is within ₹5,00,000 and claim exemption on those | Choose the policies with the *largest expected maturity value*, not the largest premium. The object is to shelter the biggest receipt |
| Insure the life, invest the money — separately | A term policy buys the cover; an equity linked savings scheme or a public provident fund account buys the growth. Both premium and subscription qualify under section 123 | This is advice, not law, and an examiner will expect it framed as planning. Say why: the endowment policy's internal return is typically 4% to 5%, against 7.1% tax-free in the public provident fund |
| Take the policy on the life of a non-earning spouse or a child | The premium still qualifies under section 123 in the hands of the payer | The proceeds belong to the life assured or the nominee. Where the policy is on a minor child's life and the maturity proceeds are received during minority, consider section 99(1)(c) |
| Time the commencement so that the first premium falls in the tax year | The deduction is on the sum *paid* in the tax year, not on the sum accrued or due | A premium paid in March 2027 for the year beginning April 2027 is deductible in Tax Year 2026-27. A premium due in March 2027 but paid in April 2027 is not |
| In the default regime, judge the policy on cover alone | Section 123 being unavailable, an endowment policy offers a 4% to 5% return with a lock-in of fifteen or twenty years and nothing else | The exemption on exit survives — so an *existing* policy should ordinarily be kept, not surrendered. Surrender within two years also reverses deductions already allowed |

**THE RECAPTURE PROVISION — THE TRAP IN SURRENDER**

Where a policy is terminated by failure to pay premium, or is surrendered, **before premiums for two years have been paid**, two things follow: no deduction is allowed under section 123 for any premium paid in the year of termination, and the aggregate of the deductions allowed in the preceding years is **deemed to be the income of the assessee in the year of termination** and is charged to tax in that year.

For a single-premium policy the period is two years from the date of commencement.

*This is the provision that catches the client who buys a policy in March to save tax and stops paying in the following year. He does not merely lose the future deduction; he pays tax on the past one.*

## A.1.4 PART D — Illustrations

**ILLUSTRATION 2.1 — THE 10% RATIO, AT BOTH ENDS**

Shri Naresh, aged 42, resident, in the **optional** regime, takes a policy on 1 June 2026 with a capital sum assured of ₹4,00,000 and an annual premium of ₹60,000. He pays the premium on 1 June 2026. He has no other Schedule XV investment. His total income before deduction is ₹14,00,000. *Compute the deduction, and state the position on maturity.*

**Deduction under section 123.** The policy having been issued after 1 April 2012, the premium is deductible only to the extent of 10% of the capital sum assured — that is, 10% of ₹4,00,000 = **₹40,000**. The balance of ₹20,000 earns nothing, in this year or any other.

**Tax saved.** ₹40,000 at 30% plus 4% cess = **₹12,480**. The effective cost of the ₹60,000 premium is therefore ₹47,520.

**On maturity.** The same 10% test governs the exemption under Schedule II. The premium of ₹60,000 exceeds 10% of ₹4,00,000, so **the exemption fails**. On maturity, say after 20 years, with proceeds of ₹18,00,000 against total premiums of ₹12,00,000, the chargeable sum under section 92(2)(l) is ₹18,00,000 − ₹12,00,000 = **₹6,00,000**, taxed at slab rates in the year of receipt.

**The planning point.** Had the sum assured been ₹6,00,000 for the same premium, the ratio would have been exactly 10%, the whole ₹60,000 would have been deductible, and the entire maturity value would have been exempt. The insurer would have charged a slightly higher mortality cost. The difference in tax is ₹6,00,000 at the marginal rate — on these facts, of the order of ₹1,87,000. *A ratio worth checking before signing.*

**ILLUSTRATION 2.2 — THE ₹5,00,000 AGGREGATE CEILING, AND THE CHOICE OF POLICIES**

Smt. Kavita holds four endowment policies, all issued after 1 April 2023, all with premiums well within 10% of the sum assured. The annual premiums and the expected maturity values are —

Policy A: premium ₹1,00,000, expected maturity ₹22,00,000. Policy B: premium ₹2,00,000, expected maturity ₹38,00,000. Policy C: premium ₹2,50,000, expected maturity ₹40,00,000. Policy D: premium ₹1,50,000, expected maturity ₹26,00,000.

Aggregate premium = ₹7,00,000, which exceeds ₹5,00,000. The exemption cannot be claimed on all four. *Which does she choose?*

**The wrong answer** is to take the policies in order of premium, or the policies she likes best. **The right answer** is to select the combination whose aggregate premium is within ₹5,00,000 and whose aggregate expected maturity value is the largest.

Try C + B: premium ₹4,50,000 (within the ceiling); maturity sheltered ₹78,00,000. Try C + D + A: premium ₹5,00,000 (exactly at the ceiling); maturity sheltered ₹88,00,000. Try B + D + A: premium ₹4,50,000; maturity sheltered ₹86,00,000.

**The best combination is C + D + A** — premium exactly ₹5,00,000, maturity sheltered ₹88,00,000. Policy B's maturity of ₹38,00,000 becomes chargeable under section 92(2)(l), but only on the excess over the premiums paid on it.

*The examinable principle: the ceiling is applied to premiums, but the benefit is measured in maturity values. Optimise on the second, subject to the first.*

**ILLUSTRATION 2.3 — THE REGIME, AND AN EXISTING POLICY**

Shri Prakash, aged 35, salaried, gross salary ₹16,00,000, has an endowment policy taken in 2020 with an annual premium of ₹1,00,000 and a sum assured of ₹12,00,000. He has no other investment. *Should he continue it?*

**In the optional regime.** The premium is well within 10% of the sum assured, so ₹1,00,000 is deductible under section 123. At his marginal rate of 30% plus cess the deduction is worth ₹31,200 a year. Add the internal return of the policy — say 4.8% — and the effective return on ₹1,00,000 laid out is comfortably above what a taxable deposit would give. **Continue.**

**In the default regime.** Section 123 is withdrawn by section 202(2)(a)(xii). The ₹31,200 disappears. The policy now offers 4.8% tax-free and ₹12,00,000 of cover, against a public provident fund at 7.1% tax-free with no cover, or a term policy of ₹1,00,00,000 for about ₹15,000 a year plus ₹85,000 into the provident fund.

**But he should still not surrender it.** Premiums for more than two years have been paid, so there is no recapture; the exemption on maturity survives in both regimes; and a surrender value in the early years of an endowment policy is punitive — typically well below the premiums paid. **The correct advice is to continue the existing policy and direct all fresh savings elsewhere.**

*Note the shape of the answer. The regime changes the advice on new money; it very rarely changes the advice on old money, because surrender costs are not tax costs and the Act does not refund them.*

# A.2 Provident Funds [formerly Ch. 4]

*The largest pool of household savings in India, and the avenue on which the Finance Act, 2026 made the most substantial change of the year. Four funds, four treatments, and one new ceiling.*

## A.2.1 PART A — The four funds

| Fund | Who maintains it | Governing law |
|---|---|---|
| Statutory provident fund | Government, local authorities, universities, recognised educational institutions, railways | Provident Funds Act, 1925 |
| Recognised provident fund | An employer whose fund is recognised for the purposes of the Income-tax Act, 2025 | Schedule XI to the Act, read — since the Finance Act, 2026 — with the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and the Employees' Provident Fund Scheme, 1952 |
| Unrecognised provident fund | An employer whose fund is not so recognised | None; the fund is a private arrangement |
| Public provident fund | The subscriber himself, with a bank or post office. Not an employment fund at all | Public Provident Fund Act, 1968 and the Scheme made under it — dealt with in Chapter 4 |

## A.2.2 PART B — The tax treatment

Four events, four funds. This is the table the examiner sets, and it should be reproduced from memory.

| Event | Statutory PF | Recognised PF | Unrecognised PF |
|---|---|---|---|
| Employer's contribution | Not a perquisite, whatever the amount | Not a perquisite up to the aggregate ceiling of ₹7,50,000 in section 17(1)(h); the excess is a taxable perquisite | Not taxed at the time of contribution |
| Employee's own contribution | Deductible under section 123 | Deductible under section 123 | **Not** deductible — the fund not being recognised |
| Interest credited on the employer's share | Exempt | Exempt; but interest on the employer's contribution in excess of ₹7,50,000 is itself a perquisite | Not taxed at the time of credit |
| Interest credited on the employee's share | Exempt | Exempt, **except** the interest on the employee's own contribution in excess of ₹2,50,000 in the tax year, which is chargeable under section 92 as income from other sources | Not taxed at the time of credit |
| Lump sum on retirement — employer's share and interest on it | Exempt | Exempt, on the conditions in Schedule XI | **Taxable as salary** — “profits in lieu of salary” under section 18 |
| Lump sum on retirement — employee's own share | Exempt | Exempt | Not taxable — it is a return of the assessee's own money |
| Lump sum on retirement — interest on the employee's share | Exempt | Exempt | **Taxable as income from other sources** under section 92 |

### The ₹2,50,000 threshold on the employee's own contribution

Where the employee's own contribution to a recognised provident fund — including any voluntary contribution — exceeds ₹2,50,000 in a tax year, the interest attributable to the excess is chargeable as income from other sources. The Rules require the fund to maintain two accounts, a taxable and a non-taxable one, and the interest on the taxable account is reported and charged year by year as it accrues.

Where the employer makes **no** contribution to the fund — the case of a Government employee subscribing to the General Provident Fund — the threshold is **₹5,00,000** instead of ₹2,50,000.

### The five-year rule on withdrawal

The accumulated balance in a recognised provident fund is exempt where the employee has rendered continuous service of **five years or more**. Where he has not, the exemption is lost and the fund is treated as though it had never been recognised, unless the service was terminated by ill health, by the discontinuance of the employer's business, or by any other cause beyond the employee's control; or unless the balance is transferred to the fund of the new employer.

**How to count the five years**

Continuous service includes service with a **previous** employer where the balance was transferred rather than withdrawn. This is the whole reason for transferring a provident fund account on changing jobs instead of closing it.

A worked case: an employee serves three years with A and withdraws; then four years with B. Neither period reaches five, and the first withdrawal is fully taxable. Had he transferred, the seven years would have been continuous and both would have been exempt.

*This is the most valuable piece of purely administrative tax planning in the whole paper, and it costs nothing to do.*

## A.2.3 What the Finance Act, 2026 changed

The Finance Act, 2026 rationalised Schedule XI and aligned the income-tax treatment of recognised provident funds with the framework of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Four changes matter to a planner, and all take effect from Tax Year 2026-27.

| Change | The position before | The position for Tax Year 2026-27 |
|---|---|---|
| Employer's contribution — the limit | Schedule XI imposed its own limits: parity with the employee's contribution, and a percentage of salary | Those limits are **removed**. The employer's contribution is governed by the single aggregate monetary ceiling of ₹7,50,000 in section 17(1)(h), covering provident fund, approved superannuation fund and the notified pension scheme taken together |
| Shareholder employees | A separate and more restrictive framework applied to an employee who was also a shareholder | The same framework as for every other employee. The ₹7,50,000 ceiling applies uniformly |
| Recognition | Recognition was granted under Schedule XI on the Commissioner's satisfaction | Recognition is available only to a fund which has obtained exemption under section 17 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 — one gate instead of two |
| Investment of the fund's monies | Schedule XI capped investment in Government securities at 50% | The cap is **removed**, the pattern of investment being governed by the norms of the Ministry of Labour and Employment and the Employees' Provident Fund Organisation |

**Why the change matters to a planner, and not merely to a payroll department**

Before the amendment an employer could not usefully contribute more than a percentage of salary, whatever the employee wanted. Now the only limit is ₹7,50,000 across all three retirement vehicles.

For an employee in the **default** regime this is the single most important number in the Unit. Section 123 is gone; section 124(3) is gone; but the employer's contribution up to ₹7,50,000 is not income at all, and the deduction under section 124(2) for the pension-scheme part of it survives section 202(2). **The whole of the remaining**

**planning for a salaried person in the default regime is the design of that ₹7,50,000.**
*the Annexe, A.3 works the figure out. Read the two chapters together.*

## A.2.4 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| Transfer the fund on changing employment; never withdraw | Preserves continuity of service for the five-year test, and preserves the compounding | Transfer must be effected through the Employees' Provident Fund Organisation portal. An account left dormant continues to earn interest, but the interest on a dormant account after the employee ceases employment is chargeable as income from other sources |
| Use the voluntary provident fund up to the ₹2,50,000 line — and stop there | Contributions beyond the statutory 12% earn the same rate, which is far above any comparable safe rate, and qualify under section 123 up to the aggregate ₹1,50,000 | Beyond ₹2,50,000 of *own* contribution in the year, the interest on the excess is taxable under section 92, and the advantage largely disappears. Count the statutory contribution towards the ₹2,50,000 |
| In the default regime, restructure the package so that the employer contributes more and pays less as salary | The employer's contribution is not income up to ₹7,50,000 under section 17(1)(h); salary is income in full | Requires the employer's agreement, and reduces take-home pay. The employee must be able to live on the balance |
| Keep the aggregate of all three employer contributions under ₹7,50,000 | Beyond it the excess is a taxable perquisite, *and* the interest or accretion on the excess is itself a perquisite year after year | The ceiling is on the aggregate of provident fund, superannuation and pension scheme. A generous superannuation scheme can push the provident fund contribution over the line without anyone noticing |
| Do not withdraw before five years unless one of the three saving causes applies | The exemption is lost entirely and the fund is treated as never recognised — the employer's share and all interest become chargeable | Ill health, discontinuance of the employer's business, and causes beyond the employee's control are the only saving causes. Resignation to take a better job is not one of them |
| For an unrecognised fund, press for recognition | The difference in treatment is total: an unrecognised fund gives no deduction at entry and taxes the employer's share as salary at exit | Recognition now requires exemption under section 17 of the 1952 Act. For a small employer that may not be attainable, in which case the employee should treat his own contribution as ordinary savings |

## A.2.5 PART D — Illustrations

**ILLUSTRATION 4.1 — THE ₹2,50,000 LINE**

Shri Deepak, aged 38, is employed in the private sector. His basic salary is ₹18,00,000 a year. He contributes the statutory 12% to the recognised provident fund and, wishing to save more, adds a voluntary contribution of ₹1,50,000. The fund credits interest at 8.25%. He is in the *optional* regime; marginal rate 31.2%. *Advise him.*

**Own contribution.** Statutory 12% of ₹18,00,000 = ₹2,16,000. Plus voluntary ₹1,50,000 = **₹3,66,000**.

**The excess over ₹2,50,000** = ₹1,16,000. The interest attributable to that excess — approximately ₹9,570 in the first year and rising thereafter — is chargeable under section 92 as income from other sources at his slab rate, costing about ₹2,986 in year one.

**Deduction under section 123.** ₹3,66,000 is an eligible sum but the aggregate ceiling is ₹1,50,000, and he has no other Schedule XV investment, so the deduction is ₹1,50,000. Note that ₹2,16,000 of statutory contribution alone already exhausts the ceiling — **the voluntary ₹1,50,000 earns no deduction whatever.**

**Advice.** Reduce the voluntary contribution to ₹34,000, which brings his own contribution to exactly ₹2,50,000 and keeps every rupee of interest exempt. The remaining ₹1,16,000 should go to the public provident fund (7.1% wholly exempt) or an equity linked savings scheme; neither earns him a further deduction, the ₹1,50,000 being exhausted, but both are taxed no worse and the second may return considerably more.

*The lesson: a voluntary provident fund contribution made after the statutory contribution has exhausted the ₹1,50,000 buys nothing at entry and may cost something at accrual. Check the statutory figure first.*

**ILLUSTRATION 4.2 — THE FIVE-YEAR RULE, AND THE COST OF A WITHDRAWAL**

Smt. Rekha worked for Alpha Ltd from 1 May 2022 to 30 June 2026 — four years and two months — and withdrew her provident fund balance of ₹9,40,000 on leaving. Of this, ₹3,90,000 was her own contribution, ₹3,90,000 the employer's, and ₹1,60,000 interest, of which ₹80,000 was on the employer's share. She joins Beta Ltd on 1 August 2026. Her total income otherwise is ₹13,00,000; she is in the optional regime.

**Because she has not completed five years of continuous service, and resignation is not a cause beyond her control, the exemption fails.** The fund is treated as though it had never been recognised. The consequences —

- The employer's contribution of ₹3,90,000 and the interest on it of ₹80,000 — ₹4,70,000 in all — are chargeable as **profits in lieu of salary** under section 18.
- The interest on her own contribution, ₹80,000, is chargeable as **income from other sources** under section 92.
- The deductions allowed to her under section 123 in the four earlier years in respect of her own contributions are **recomputed and brought to tax** in Tax Year 2026-27.
- Her own contribution of ₹3,90,000 is not taxed — it is her own money returned.

**Additional income ₹5,50,000**, taxed largely at 30%: a tax cost of the order of ₹1,71,600, plus the recomputed deductions.

**Had she transferred the balance to Beta Ltd's fund**, nothing at all would have been chargeable, the four years and two months would have counted towards the five, and she would have crossed the line ten months into the new employment. **The cost of the withdrawal was therefore about ₹1,71,600 plus the recomputation — for want of a form.**

**ILLUSTRATION 4.3 — THE ₹7,50,000 CEILING, AND HOW THREE CONTRIBUTIONS CROSS IT**

Shri Aravind's employer contributes, in Tax Year 2026-27 — to the recognised provident fund ₹3,60,000; to an approved superannuation fund ₹2,20,000; and to the notified pension scheme ₹2,50,000. *State the position.*

**Aggregate ₹8,30,000**, against the ceiling of ₹7,50,000 in section 17(1)(h). The excess of **₹80,000** is a taxable perquisite in Shri Aravind's hands, chargeable as salary under section 17, *in both regimes*. The annual accretion attributable to that excess is likewise a perquisite in each later year.

**Note what does not happen.** The employer still gets its deduction; the ceiling is a charging provision in the employee's hands, not a disallowance in the employer's. And the deduction under section 124(1) or (2) for the pension-scheme contribution is computed on its own footing — 10% or 14% of salary — and is unaffected by the ₹7,50,000 arithmetic.

**The planning answer.** Ask the employer to reduce the superannuation contribution by ₹80,000 and pay it as salary, or to reduce the provident fund contribution to the statutory minimum. Either brings the aggregate to ₹7,50,000 and removes the perquisite. Reducing the *pension scheme* contribution would be the worst choice of the three, because that is the one contribution that also earns a deduction under section 124 in the default regime.

# A.3 The Pension Schemes — National Pension System, Atal Pension Yojana, Agnipath [formerly Ch. 6]

*The only avenues in this booklet that still earn a deduction in the default regime. That single fact makes this the most important chapter in the Unit for a salaried assessee taxed under section 202(1).*

## A.3.1 PART A — The schemes

### The National Pension System

| Feature | Position |
|---|---|
| Tier I | The pension account proper. Contributions are locked until 60, with limited premature exit. This is the account that attracts the deductions |
| Tier II | A voluntary savings account, freely withdrawable. **No deduction** for an ordinary subscriber; a Central Government employee may claim under section 123 for a Tier II contribution with a three-year lock-in |
| Who may join | Any citizen of India between 18 and 70. An employer may enrol its employees under the corporate model |
| Investment choice | Active or auto choice across equity, corporate debt, Government securities and alternative assets. Equity is capped at 75% until age 50 under the active choice |
| Exit at 60 | At least 40% of the corpus must purchase an annuity from a registered insurer; up to 60% may be taken as a lump sum |
| Exit before 60 | At least 80% must purchase an annuity; up to 20% as a lump sum. Where the corpus does not exceed the prescribed small threshold, the whole may be withdrawn |
| NPS Vatsalya | An account opened by a parent or guardian for a minor, converting to an ordinary Tier I account at majority |

### The Atal Pension Yojana and the Agnipath Scheme

The **Atal Pension Yojana** is a guaranteed-pension scheme for subscribers in the unorganised sector between 18 and 40, giving a pension of ₹1,000 to ₹5,000 a month from age 60 according to the contribution. It is administered under the same authority as the National Pension System and its contributions are treated under section 124.

The **Agnipath Scheme** is the scheme of enrolment in the armed forces notified by the Central Government, under which the Agniveer and the Central Government both contribute to the Agniveer Corpus Fund. **Section 125** allows a deduction of the whole of the assessee's contribution and of the Central Government's contribution to that fund, without ceiling; and section 125(2), which deals with the Central Government's contribution, is one of the four provisions of Chapter VIII that survive the default regime.

## A.3.2 PART B — The tax treatment

### Entry — sections 123, 124 and 125

| Contribution | Deduction | Ceiling | Survives the default regime? |
|---|---|---|---|
| The assessee's own contribution to Tier I | Section 123, as an eligible sum in Schedule XV | Within the aggregate ₹1,50,000 | **No** |
| The assessee's own contribution to Tier I, over and above that | Section 124(3) and (4) | ₹50,000, *in addition to* the ₹1,50,000 | **No** |
| The employer's contribution, optional regime | Section 124(1) | 14% of salary where the employer is the Central or a State Government; 10% | — |

| Contribution | Deduction | Ceiling | Survives the default regime? |
|---|---|---|---|
| | | otherwise | |
| The employer's contribution, default regime | Section 124(2) | **14% of salary in every case** | **Yes** |
| Contribution to NPS Vatsalya, for up to two minor children | Section 124(3) and (4) | Within the same ₹50,000, taken with the assessee's own | **No** |
| The Agniveer's and the Central Government's contribution to the Agniveer Corpus Fund | Section 125 | No ceiling | **Yes**, as to section 125(2) |

**"SALARY" FOR SECTION 124, AND THE TRAP IN IT**

For the purposes of section 124 salary means **basic salary plus dearness allowance**, where the terms of employment so provide, and nothing else. It does not include house rent allowance, bonus, commission or any other allowance.

So on a package of ₹24,00,000 of which basic is ₹10,00,000 and dearness allowance ₹2,00,000, the 14% is computed on ₹12,00,000 and not on ₹24,00,000 — a deduction of ₹1,68,000, not ₹3,36,000.

***The planning consequence is immediate: in the default regime, a higher basic salary is worth more than it used to be****, because it enlarges the one deduction that survives. That is the opposite of the advice given in the optional regime, where a lower basic enlarges the house rent allowance exemption. See Unit 2, the Annexe, A.1.*

### Accrual

Nothing is chargeable. The corpus grows untaxed, and a switch between the pension funds or between the asset classes within the scheme is not a transfer under section 67.

### Exit

| Receipt | Treatment |
|---|---|
| The lump sum at 60 — up to 60% of the corpus | **Exempt** — Schedule III, Sl. No. 4 |
| The 40% applied in purchasing the annuity | Not chargeable at the time of purchase — the sum is not received by the assessee |
| The annuity itself, when received | **Chargeable as income**, year by year, at slab rates. Where received by the subscriber it is taxed as salary or as income from other sources according to the source; where received by a family member after his death, as family pension under section 92, with the deduction in section 93(1)(d) |
| Partial withdrawal from Tier I during the term | Exempt to the extent of 25% of the *assessee's own* contributions, on the prescribed grounds |
| Withdrawal from Tier II | Chargeable — the units being a capital asset, the gain is computed under section 67 and taxed according to the composition of the fund |
| The Agniveer Corpus Fund on completion of the engagement | **Exempt** — the whole of it |

**E-E-T, AND WHY IT IS STILL WORTH HAVING**

The National Pension System is the clearest E-E-T instrument in the Act: deductible going in, untaxed while it grows, and taxed on the annuity coming out. Students often treat the final T as fatal. It is not, for three reasons.

- **Only 40% of the corpus is ever taxed**, and it is taxed as it is received, over twenty or thirty years, not in one year.
- **It is taxed at the rate applicable in retirement**, which for most assessees is lower than the rate at which the

deduction was taken. A deduction at 31.2% and a charge at 5.2% is a very good exchange.

- **The 60% lump sum is exempt outright.** So the effective position is E-E-E on three-fifths of the corpus and E-E-T on two-fifths.

### A.3.3 PART C — The planning measures

| Measure | How it works | Caution |
|---|---|---|
| **In the default regime, ask the employer to contribute 14% of salary to the scheme** | Section 124(2) survives section 202(2)(a)(xii). On a basic of ₹12,00,000 that is ₹1,68,000 of deduction where nothing else is available at all | The contribution must come from the employer under the terms of employment, not from the employee. A voluntary contribution by the employee earns nothing in the default regime |
| Restructure the package to raise basic salary before asking for the contribution | 14% is computed on basic plus dearness allowance only | Raising basic raises the gratuity liability, the provident fund contribution and the leave encashment liability. The employer may resist |
| Keep the aggregate employer contribution within ₹7,50,000 | Section 17(1)(h). Beyond it the excess is a perquisite, and the deduction under section 124 does not cure the charge | Provident fund and superannuation count towards the same ₹7,50,000 |
| In the optional regime, use section 124(3) after exhausting section 123 | The ₹50,000 sits *above* the ₹1,50,000 and is a genuine addition. Worth ₹15,600 at the 31.2% rate | The same ₹50,000 cannot be claimed twice. An amount already counted under section 123 cannot be counted again under section 124(3) |
| Choose the aggressive equity allocation while young | Accrual is untaxed, so the compounding is uninterrupted; equity's advantage over debt is greatest over long periods | Equity is capped at 75% under the active choice until age 50 and tapers thereafter |
| Plan the annuity, not merely the corpus | The annuity is taxed as received. A joint-life annuity with return of purchase price gives a lower pension but returns the capital to the nominee tax-free | Once purchased, an annuity cannot be commuted. This is the most irreversible decision in the whole of personal finance |
| For a minor child, prefer NPS Vatsalya to a second public provident fund account | The contribution counts towards the ₹50,000 in section 124(3), which is a *separate* ceiling from the ₹1,50,000; the public provident fund account of a minor shares the guardian's ₹1,50,000 | Optional regime only. And the lock-in runs to the child's sixtieth year, which is a very long time |

### A.3.4 PART D — Illustrations

**ILLUSTRATION 6.1 — THE ONLY DEDUCTION LEFT IN THE DEFAULT REGIME**

Shri Sanjay, aged 34, is salaried in a private company. Basic salary ₹12,00,000; dearness allowance nil; house rent allowance ₹4,80,000; other allowances ₹3,20,000. Gross salary ₹20,00,000. He is taxed under the **default** regime. He has no other income and no investments. *What planning is open to him, and what is it worth?*

**As matters stand.** Gross salary ₹20,00,000, *less* standard deduction ₹75,000 = total income ₹19,25,000. Tax: nil to ₹4,00,000; 5% of ₹4,00,000 = ₹20,000; 10% of ₹4,00,000 = ₹40,000; 15% of ₹4,00,000 = ₹60,000; 20% of ₹3,25,000 = ₹65,000. **Tax ₹1,85,000**, plus 4% cess ₹7,400 = **₹1,92,400**.

**The one measure available.** He asks his employer to contribute 14% of basic salary to the notified pension scheme, and to reduce his other allowances by the same amount so that the cost to the employer is unchanged. Contribution = 14% of ₹12,00,000 = **₹1,68,000**.

Gross salary becomes ₹20,00,000 − ₹1,68,000 + ₹1,68,000 (the employer's contribution being included in salary) = ₹20,00,000. *Less* standard deduction ₹75,000 = ₹19,25,000. *Less* deduction under section 124(2), ₹1,68,000 = **total**

**income ₹17,57,000**.

Tax: ₹20,000 + ₹40,000 + ₹60,000 + 20% of ₹1,57,000 (₹31,400) = ₹1,51,400, plus cess ₹6,056 = **₹1,57,456**.

**Saving ₹34,944 a year**, on a package unchanged in cost to the employer, achieved by a single provision that section 202(2) leaves standing. Over a working life of twenty-five years, and before counting the compounding of the ₹1,68,000 itself, that is over ₹8,70,000 of tax.

*This is the answer to the question "what is left to plan in the default regime?" — and it is the answer an examiner is looking for.*

**Illustration 6.2 — the two regimes on the same facts, with the pension scheme in both**

Smt. Priya, aged 41, resident. Basic ₹9,00,000; dearness allowance ₹1,00,000; house rent allowance ₹3,60,000 (rent paid ₹3,60,000, Bengaluru); other allowances ₹1,40,000. Gross ₹15,00,000. Employer contributes 10% of salary to the notified pension scheme, that is ₹1,00,000, included in gross. She subscribes ₹1,50,000 to the public provident fund and ₹50,000 to her own pension account. *Which regime?*

**Optional regime.** House rent allowance exempt to the least of: ₹3,60,000; ₹3,60,000 − 10% of ₹10,00,000 = ₹2,60,000; 50% of ₹10,00,000 = ₹5,00,000 → **₹2,60,000**. Gross salary ₹15,00,000 − ₹2,60,000 = ₹12,40,000. *Less* standard deduction ₹50,000 = ₹11,90,000. *Less* section 123 ₹1,50,000; section 124(1) ₹1,00,000; section 124(3) ₹50,000 → **total income ₹8,90,000**. Tax: nil to ₹2,50,000; 5% of ₹2,50,000 = ₹12,500; 20% of ₹3,90,000 = ₹78,000 → ₹90,500, plus cess ₹3,620 = **₹94,120**.

**Default regime.** No house rent allowance exemption; no section 123; no section 124(3). Gross salary ₹15,00,000. *Less* standard deduction ₹75,000 = ₹14,25,000. *Less* section 124(2), 14% of ₹10,00,000 = ₹1,40,000 — *but the employer contributes only ₹1,00,000*, and the deduction cannot exceed the contribution, so **₹1,00,000**. Total income **₹13,25,000**. Tax: ₹20,000 + ₹40,000 + 15% of ₹1,25,000 (₹18,750) = ₹78,750, plus cess ₹3,150 = **₹81,900**.

**The default regime is better by ₹12,220** — even though she has made every investment the optional regime rewards.

**Now the planning.** She asks the employer to raise its contribution from 10% to 14% of salary, that is to ₹1,40,000, reducing her other allowances by ₹40,000. Default-regime total income becomes ₹12,85,000; tax ₹20,000 + ₹40,000 + 15% of ₹85,000 (₹12,750) = ₹72,750, plus cess = **₹75,660**. **A further ₹6,240 saved**, and ₹40,000 a year moved from her pocket into a retirement corpus that compounds untaxed.

*Note the order of the answer: compute both regimes first, choose, and only then plan within the chosen regime. Planning before choosing is the commonest structural error in this Unit.*

# A.4 Other Avenues [formerly Ch. 11]

*The syllabus says "and others", and means it. Five further classes of investment, each with a tax point that is examinable, and one thing that is not an investment at all.*

## A.4.1 Bank deposits and the five-year tax saver

| Point | Ordinary deposit | Five-year tax-saver deposit |
|---|---|---|
| Entry | Nothing deductible | **Eligible sum in Schedule XV** — deductible under section 123 within the ₹1,50,000 |
| Accrual | Interest chargeable at slab under section 92, on accrual | The same |
| Section 153 relief | ₹10,000 on a **savings** account only; a senior citizen gets ₹50,000 on any account including a time deposit | The same |
| Tax deducted at source | At 10% where the interest exceeds the prescribed threshold; Form 15G or 15H may be filed | The same |
| Premature withdrawal | Permitted, with a rate penalty | **Not permitted at all** during the five years |
| Loan against the deposit | Permitted | **Not permitted** — it would defeat the lock-in |

The five-year tax-saver deposit is the least attractive of the Schedule XV entries: the interest is fully taxable at accrual, the lock-in is absolute, and the rate is ordinarily below that on the national savings certificate. **It is chosen for convenience, not for merit.** A candidate asked to compare the Schedule XV avenues should place it last.

## A.4.2 Direct equity

| Point | Treatment | Provision |
|---|---|---|
| Entry | Nothing deductible | — |
| Dividend | **Chargeable in full** as income from other sources at slab rates. Interest on money borrowed to buy the shares is deductible up to 20% of the dividend, and no other expenditure is allowed | Sections 92(2)(a) and 93 |
| Sale within 12 months, listed, securities transaction tax paid | Short-term capital gain at **20%** | Section 196 |
| Sale after 12 months, listed, securities transaction tax paid | Long-term capital gain at **12.5% on the amount exceeding ₹1,25,000** | Section 198 |
| Unlisted shares | Short-term if held not more than **24 months**; long-term thereafter at 12.5% | Sections 72 and 197 |
| Buy-back by the company | Charged in the shareholder's hands | Section 69 |
| Bonus and rights shares | Cost of a bonus share is **nil**; period of holding runs from allotment. Cost of a right acquired and renounced is nil | Sections 73 and 90 |

**THE ₹1,25,000 SHELTER IS ONE SHELTER — SAY SO EVERY TIME**

Section 198 charges 12.5% on "the amount exceeding ₹1,25,000" of long-term capital gain on listed equity shares, units of an equity oriented fund and units of a business trust **taken together**.

A candidate who gives the assessee ₹1,25,000 against his shares and another ₹1,25,000 against his equity fund has doubled a statutory allowance and will lose the marks for the whole computation.

### A.4.3 Gold

| Form | Accrual | Exit |
|---|---|---|
| Physical gold — jewellery, coins, bars | Nothing | Capital asset; short-term if held **not more than 24 months**; long-term thereafter at **12.5%** under section 197 |
| Gold exchange traded funds and gold mutual funds | Nothing | Not an equity oriented fund and not a specified mutual fund; “other fund” — 24 months, then 12.5% under section 197 |
| Sovereign gold bonds | 2.5% interest, chargeable at slab | Exempt on redemption at maturity for the original subscriber; otherwise 12.5% under section 197 — Chapter 8 |
| Digital gold | Nothing | As for physical gold. **Not a regulated product**; there is no statutory protection for the holder |

Gold received as a gift is subject to **section 92(2)(m)**: jewellery and bullion are “property” for that purpose, and where the aggregate fair market value of property received without consideration in the year exceeds ₹50,000 the whole of it is charged — unless the donor is a relative, or the occasion is the marriage of the recipient, or one of the other seven exceptions in section 92(3) applies. See Unit 2, the Annexe, A.3.

### A.4.4 Real estate

Real estate is dealt with under two heads and belongs in substance to Unit 2, but three points are properly investment-planning points and are collected here.

- **The principal repaid on a housing loan is an eligible sum in Schedule XV**, and so qualifies under section 123 within the ₹1,50,000. Stamp duty and registration charges paid on the purchase also qualify, but only in the year of payment.
- **The interest is a deduction under section 22, not under Chapter VIII** — ₹2,00,000 for a self-occupied house and without ceiling for a let-out one, in the optional regime; **nil for a self-occupied house in the default regime** [section 202(2)(a)(iv)].
- **Sections 130, 131 and 132** give further interest deductions for loans of specified vintages — 2016-17, 2019 to 2022, and electric vehicles — and none of the three survives the default regime.
- **On sale**, the period of holding is 24 months; the gain is long-term thereafter at 12.5% under section 197, with the option in section 197(3) for a resident individual or Hindu undivided family, where the property was acquired before 23 July 2024, to pay the lower of 12.5% without indexation and 20% with it. Sections 82, 85 and 86 give the exemptions.
- **Where the principal deduction is claimed and the house is transferred within five years** of the end of the tax year in which possession was taken, the deductions allowed are deemed to be the income of the year of transfer — the same recapture as on a life policy.

### A.4.5 Business trusts — REITs and InvITs

A real estate investment trust and an infrastructure investment trust are “business trusts”. Their units are listed, and the pass-through regime in the Act gives each stream of distribution the character it had in the trust's hands.

| Component of the distribution | Treatment in the unit holder's hands |
|---|---|
| Interest | Chargeable at slab under section 92 |
| Dividend | Chargeable at slab, unless the special purpose vehicle has opted for the concessional corporate rate |
| Rental income | Chargeable at slab |

| Component of the distribution | Treatment in the unit holder's hands |
|---|---|
| Repayment of debt — “return of capital” | Not income; it **reduces the cost of acquisition** of the unit, and so is taxed later as a capital gain |
| Sale of the unit — held more than 12 months | Long-term; **section 198 applies** — 12.5% above the shared ₹1,25,000 |
| Sale of the unit — held not more than 12 months | Short-term; **20% under section 196** |

### A.4.6 What is not an investment at all

**THREE THINGS THAT ARE SOLD AS INVESTMENTS AND ARE NOT**

- **A lottery ticket, a card game, a horse race or a betting arrangement.** Winnings are charged at a **flat 30% under section 194**, *no deduction of any kind is allowed* against them by section 94(4), the basic exemption limit does not shelter them, and section 156(3) denies the rebate. There is no worse-treated receipt in the Act.
- **A cryptocurrency or other virtual digital asset.** The gain is charged at a flat rate; no expenditure other than the cost of acquisition is allowed; and a loss may not be set off against any income nor carried forward. Note also the tax deducted at source on the transfer.
- **An insurance policy bought in March.** Not because insurance is bad, but because a decision taken in the last week of the tax year, to save a tax already largely incurred, is a decision taken under pressure and almost always taken wrongly. Unit 1 called this the difference between planning and reaction; it is nowhere more visible than here.

# A.5 Tax Deductions under the Income-tax Act — Chapter VIII Recapitulated [formerly Ch. 13]

*The last words of the syllabus for this Unit. Unit 1, the Annexe, A.3 dealt with these deductions at length and should be read with this chapter; what follows is the recapitulation, arranged for an investor rather than for a beginner.*

## A.5.1 The architecture of Chapter VIII

Chapter VIII of the Income-tax Act, 2025 runs from section 122 to section 154 and contains every deduction allowed from gross total income. It falls into four natural groups.

| Group | Sections | What it covers |
|---|---|---|
| **A — Payments and investments** | 123, 124, 125 | Schedule XV investments; the notified pension scheme; the Agnipath Scheme |
| **B — Health, disability and education** | 126, 127, 128, 129 | Health insurance and medical expenditure; a dependant with a disability; a specified disease; interest on an education loan |
| **C — Interest, rent and donations** | 130, 131, 132, 133, 134, 135, 136, 137 | Interest on housing loans of specified vintages; on an electric vehicle loan; rent paid; donations to funds, institutions, scientific research and political parties |
| **D — Income-based deductions** | 146, 151, 152, 153, 154 | Additional employee cost; royalty of an author and on a patent; interest on deposits; the assessee's own disability |

Sections 155 and 156 are not deductions but **rebates** — a reduction of the tax itself, not of the income — and are dealt with in 13.5.

## A.5.2 The recapitulation table

| Section | Deduction | Ceiling | Individual | HUF | Default regime |
|---|---|---|---|---|---|
| 123 | Schedule XV — life insurance premia, provident fund, public provident fund, national savings certificates, equity linked savings schemes, five-year deposits, Sukanya Samriddhi, tuition fees, housing loan principal, stamp duty | ₹1,50,000 in the aggregate | Yes | Yes | **No** |
| 124(1) | Employer's contribution to the notified pension scheme | 14% of salary — Government; 10% otherwise | Yes | No | — |
| 124(2) | The same, where tax is computed under section 202(1) | **14% of salary in every case** | Yes | No | **Yes** |
| 124(3), (4) | The assessee's own contribution, and NPS Vatsalya for up to two minor children | ₹50,000, above the ₹1,50,000 | Yes | No | **No** |
| 125 | Agnipath Scheme — the Agniveer's and the Central Government's contribution | No ceiling | Yes | No | **Yes** as to 125(2) |

| Section | Deduction | Ceiling | Individual | HUF | Default regime |
|---|---|---|---|---|---|
| 126 | Health insurance premia and medical expenditure — self, family, parents | ₹25,000 each; ₹50,000 where the insured is a senior citizen; preventive check-up ₹5,000; maximum ₹1,00,000 | Yes | Yes | **No** |
| 127 | Maintenance and medical treatment of a dependant with a disability | ₹75,000; ₹1,25,000 for severe disability | Yes | Yes | **No** |
| 128 | Medical treatment of a specified disease | ₹40,000; ₹1,00,000 for a senior citizen; less insurance or reimbursement | Yes | Yes | **No** |
| 129 | Interest on a loan for higher education | No ceiling; the initial year and seven more | Yes | No | **No** |
| 130 | Interest on a housing loan sanctioned in 2016-17 | ₹50,000; loan ₹35,00,000; value ₹50,00,000 | Yes | No | **No** |
| 131 | Interest on a housing loan sanctioned 2019 to 2022 | ₹1,50,000; stamp duty value ₹45,00,000 | Yes | No | **No** |
| 132 | Interest on an electric vehicle loan sanctioned 2019 to 2023 | ₹1,50,000 | Yes | No | **No** |
| 133 | Donations to certain funds and institutions | 100% or 50%, with or without the 10% qualifying limit. **Nothing in cash above ₹2,000** | Yes | Yes | **No** |
| 134 | Rent paid, where no house rent allowance is received | Least of: rent less 10% of total income; ₹5,000 a month; 25% of total income | Yes | No | **No** |
| 135 | Donations for scientific research or rural development | Nothing in cash above ₹2,000 | Yes | Yes | **No** |
| 136, 137 | Contributions to political parties and electoral trusts | No ceiling; **nothing in cash at all** | Yes | Yes | **No** |
| 146 | Additional employee cost | 30% for three tax years | Yes | Yes | **Yes** |
| 151, 152 | Royalty of an author; royalty on a patent | ₹3,00,000 each | Yes | No | **No** |
| 153 | Interest on deposits | ₹10,000 on a savings account; ₹50,000 on any account for a senior citizen | Yes | No | **No** |
| 154 | The assessee's own disability — resident individual only | ₹75,000; ₹1,25,000 for severe disability | Yes | No | **No** |

## A.5.3 The deduction-to-avenue map

Read from the investment to the section, which is the direction in which a question is usually put.

| The investment | The section | Point to watch |
|---|---|---|
| Life insurance premium | 123 | Capped at 10% of the capital sum assured for a policy issued after 1 April 2012 |
| Unit linked insurance plan premium | 123 | Same 10% cap. The ₹2,50,000 test is about the *exemption*, not the deduction |

| The investment | The section | Point to watch |
|---|---|---|
| Employee's provident fund — own contribution | 123 | The statutory 12% alone often exhausts the ₹1,50,000 |
| Voluntary provident fund | 123 | Interest on own contributions above ₹2,50,000 in the year is chargeable |
| Public provident fund | 123 | Combined ₹1,50,000 for the subscriber and any minor's account he operates |
| Equity linked savings scheme | 123 | Three-year lock-in per unit |
| Five-year post office time deposit; five-year bank deposit | 123 | The one, two and three year deposits do not qualify |
| National savings certificate | 123 | Accrued interest reinvested qualifies afresh in years 1 to 4 |
| Senior Citizens Savings Scheme | 123 | Interest is taxable; section 153 gives ₹50,000 of relief to a senior citizen |
| Sukanya Samriddhi Account | 123 | Interest and maturity both exempt under Schedule II |
| Tuition fees | 123 | Full-time education, in India, any two children. Not for a Hindu undivided family |
| Housing loan — principal, stamp duty, registration | 123 | Recaptured if the house is transferred within five years |
| Housing loan — interest | **22**, and 130/131/132 | Not Chapter VIII at all, except the three special sections |
| National Pension System — own | 123 and 124(3) | The ₹50,000 is above the ₹1,50,000; the same rupee cannot be counted twice |
| National Pension System — employer's | 124(1) or 124(2) | **The only investment deduction surviving the default regime** |
| Health insurance | 126 | Cash payment is not allowed, except for a preventive health check-up |
| Donation to a fund or institution | 133 | Nothing in cash above ₹2,000 |

## A.5.4 The order of claiming, and the three general rules

1. **Compute gross total income first.** "Gross total income" means the total income computed under the Act **before** any deduction under Chapter VIII [section 122(10)]. Every ceiling in the Chapter that is expressed as a percentage of income is a percentage of that figure, or of the adjusted figure the particular section defines.

2. **The aggregate of the deductions cannot exceed gross total income** [section 122(2)]. A deduction can reduce total income to nil; it can never create a loss and it can never be carried forward.

3. **No double deduction.** A sum allowed under one section of the Chapter cannot be allowed again under another. The same ₹50,000 of pension contribution cannot be claimed under section 123 and again under section 124(3).

4. **Claim in the return.** The deduction must be claimed in the return of income, and where the section so requires the return must be furnished by the due date under section 263.

5. **Deduct against the right income.** Where the gross total income includes a short-term capital gain charged under section 196, section 196(4) allows the Chapter VIII deductions only from the *balance* of gross total income. The special-rate income is not available to absorb them. The same principle governs sections 197 and 198.

**THE SEQUENCE TO FOLLOW IN ANY COMPUTATION**

- Compute the five heads. → Set off under Chapter VII. → **Gross total income.**
- Segregate the special-rate income — sections 194, 196, 197, 198.
- Apply Chapter VIII **against the ordinary-rate income only**.
- → **Total income**, rounded to the nearest ₹10 under section 516.

- Compute tax on the ordinary income at slab and on the special-rate income at its own rate.
- Apply the rebate under section 156, then surcharge if any, then cess at 4%.

### A.5.5 The rebate under section 156

| Provision | Who | Condition | Rebate |
|---|---|---|---|
| 156(1) | Resident individual | Total income does not exceed ₹5,00,000 | The tax, or ₹12,500, whichever is less |
| 156(2)(a) | Resident individual taxed under **section 202(1)** | Total income does not exceed ₹12,00,000 | The tax, or ₹60,000, whichever is less |
| 156(2)(b) | The same | Total income marginally exceeds ₹12,00,000 | **Marginal relief** — the tax cannot exceed the excess of total income over ₹12,00,000. Relief runs out at about ₹12,70,588 |
| 156(3) | Everyone | — | **No rebate against tax on income charged at the special rates** in sections 194, 196, 197 and 198 |

**THE REBATE IS WORTH MORE THAN THE WHOLE OF CHAPTER VIII TO MOST ASSESSEES**

For a resident individual whose total income is at or below ₹12,00,000 and who is taxed under section 202(1), the tax is nil after the rebate — **without a single rupee of investment**.

It follows that for such a person the entire apparatus of section 123, section 126 and the rest is of no value whatever, and any adviser who sells him an insurance policy "to save tax" is selling him something he does not need. **Test the rebate before recommending any investment.** It is the first question of Chapter 10 and the first question of practice.

*Note also section 156(3). A person with ₹8,00,000 of salary and ₹5,00,000 of long-term capital gain on shares has a total income of ₹13,00,000 and gets no rebate on the gain at all, whatever his other figures. The special rates stand outside the rebate.*