Maximising Returns on Savings Bank Account

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Introduction: Most people earning a salary have a Savings Bank account where the salary is deposited every month. After incurring household expenses there is still some amount left mostly lying idle in our savings account earning a low rate of interest. A majority of people desire to invest their hard earned money in schemes which would give us high returns, but at the same time we would like to ensure that our money is safe and the scheme provides immediate liquidity so as to meet any unforeseen expenditure that may occur in our life at any given point of time.

Most financial advisors would advise investors to keep only a minimum amount in their Savings Account because banks offer a low rate of interest on the savings account. So most of us would prefer to keep only a minimum amount in our savings account and invest our savings in deposits offering higher interest, like a fixed deposit which is considered to be a safe option and provides immediate liquidity. Thus a cautious individual's investment decision would normally be based on three factors viz. Maximum Returns, Safety of Investment and Immediate liquidity.

The Reserve Bank of India and the Union Budget 2012-13 has made announcements on savings account which has made investors change their way of thinking. With these announcements an investor may actually lose out by not investing in savings account and investing in marginally higher interest fixed deposits. So at this stage one may ask whether **7% is greater than 8.75%?** The obvious answer would be **NO**. Through this paper we will find out if this answer is true and understand HOW and the reasons for the same and start with the announcement made about interest on savings account.

Deregulation of Interest Rate: The Reserve Bank of India has deregulated interest rates on savings accounts in India in October 2011. Before the deregulation, all banks offered the same rate of interest i.e.

4% on savings account. After deregulation, some banks have increased the interest rate on savings account. At present there are banks who are offering interest rate on savings account which is as high as 7%.

Section 80TTA: The then Finance Minister and now President of India Shri Pranab Mukherji in his Budget speech of 2012 proposed to introduce Section 80TTA in the Income Tax Act to provide **deduction** to an **individual or a Hindu Undivided Family** in respect of interest received on deposits (not being time deposits) in a savings account held with banks, cooperative banks and post office. The deduction is restricted to ₹ 10,000 or actual interest whichever is lower. This deduction is in addition to the Post office savings bank interest which is exempt upto ₹ 3,500 (in an individual account) and ₹ 7,000 (in a joint account) under section 10(15)(i) of the Income Tax Act. This section is applicable with effect from April 01, 2012 and will apply from AY 2013-14 and onwards.

Tax Structure: The present tax structure of Individuals (excluding senior and very senior citizens) for the year 2012-13 and 2013-14 is as follows:

Income Tax Slabs for Individuals	**Tax Rate (%)**
Income up to Rs. 2,00,000	NIL
Income between Rs. 2,00,001 – Rs. 5,00,000	10%
Income between Rs. 5,00,001 – Rs. 10,00,000	20%
Income of Rs. 10,00,001 and above	30%
Education Cess as a percentage of Income Tax	3%

Options for maximizing returns on SB Accounts:

Given the above background, one can maximize returns on savings account with a little planning. There are 3 options available to a SB account holder to maximize returns on savings account, keeping in mind the requirement of safety and liquidity.

Option 1: Keep money in Savings Account: The first and the safest option is to keep the surplus in savings account only. It would not only give safety and liquidity to the account holder but also higher returns than the Fixed deposit. To understand how money kept in savings account can give you higher returns than fixed deposits, we can study the example given below:

First identify a bank which gives higher interest rate on your savings account ie 7% (if your current bank is not offering higher interest rate on savings account). Open a savings account with such banks and keep your money over there. Now, let us assume that you have ₹ 1,10,000 in your savings bank account which you will maintain throughout the year. You want to invest this amount for one year in such an account which will give you maximum return, safety and liquidity. The choice available to you is:

1. Let the amount remain in savings bank account which is offering 7% rate of interest or
2. Invest the amount in Fixed deposit which gives you 8.75% rate of interest for one year.

A comparative analysis of the above choices gives you the following:

	If amount is kept in SB a/c	**If amount is kept in Fixed Deposit**		
Interest Rate	7%	8.75%	8.75%	8.75%
If you fall in the tax slab of	**Any tax slab**	**10%**	**20%**	**30%**
*Interest earned on Rs. 1,10,000	Rs. 7,700	Rs. 9,625	Rs. 9,625	Rs. 9,625
Less: Tax	00	(-) Rs. 963	(-) Rs. 1,925	(-)Rs. 2887
Education Cess of 3% on Tax amount	00	(-) Rs. 29	(-) Rs. 58	(-)Rs. 87
Net interest you receive at the end of the year	Rs. 7,700	Rs. 8,633	Rs. 7,642	Rs. 6,651

*Subject to compounding

As can be seen from the above table, because of Section 80TTA of the Income Tax Act, you do not pay any tax on interest earned on savings account up to ₹ 10,000. Interest on savings account up to ₹ 10,000 is exempt from tax under section 80TTA. This benefit is not available to interest earned on Fixed deposit. Therefore all interest on fixed deposits is subject to tax. Those falling in the tax slab of 20% and 30% and investing in fixed deposits get less interest in hand than the interest earned on savings account. Therefore what interest income you get or earn at the end of one year by investing in fixed deposit (although it offers higher rate of interest) is lower than the amount you get, had you invested in savings account(although it offers a lower rate of interest than fixed deposits). Thus by keeping money in savings account you get higher returns, there is safety and liquidity also. The above table answers our earlier question that **7% is greater than 8.75%.**

Option 2: Invest in Liquid Mutual Funds: The second best option is to ask your bank to invest your surplus money lying in savings account in liquid mutual funds. On your instructions, your bank will invest your surplus money in liquid mutual funds. The banks usually invest in Government Securities and Treasury bills which offer higher rate of returns. The money can be withdrawn within 24 hours. The only trouble here is that you would have to give instructions to bank every time you want to invest in liquid mutual funds or whenever you want to withdraw the money from the liquid mutual funds. The income earned under this scheme is subject to tax.

Option 3: Use Sweep Facility: The third option is to take a sweep facility on your savings bank account. Some banks give a sweep in facility by which individuals are required to maintain only a minimum amount in their savings account and the amount in excess of the pre-specified minimum amount is automatically swept out and converted into a fixed deposit. Thus by using the sweep in facility, you request your bank to keep a certain minimum amount in your savings bank account and transfer the surplus funds in your savings account to Fixed deposits. At any time, any amount deposited in the savings account will be swept into the fixed deposit and any amount withdrawn from the savings account will be swept out of the fixed deposit. Thus using sweep facility you earn a higher rate of interest i.e. interest rate applicable to fixed deposits. This interest income is however subject to tax.

Non-nationalized Banks:

When opening an account with a bank, one also needs to see how safe their money in that bank is. Nationalized banks are government owned and controlled and so they are considered to be safe. When opening an account with a non-nationalized bank one needs to be a little careful. Every non-nationalized bank is required to take an insurance on their deposits under the DICGC cover (Deposit Insurance and Credit Guarantee Corporation).

Banks covered by Deposit Insurance Scheme are:

1) All commercial banks including the branches of foreign banks functioning in India, Local Area Banks and Regional Rural Banks

2) Co-operative Banks

DICGC guarantees depositors a repayment **upto Rs. 1,00,000 only** (all deposit taken together), in case the bank collapses.

DICGC insures all bank deposits, such as saving, fixed, current, and recurring except the following types of deposits:

(i) Deposits of foreign Governments;
(ii) Deposits of Central/State Governments;
(iii) Inter-bank deposits;
(iv) Deposits of the State Land Development Banks with the State co-operative banks;
(v) Any amount due on account of and deposit received outside India;
(vi) Any amount which has been specifically exempted by the corporation with the previous approval of the RBI.

Depositors in those non-nationalized banks which have not taken DICGC cover would not get any repayment of their deposit if the bank collapses.

Therefore when investing in non-nationalized banks, investors must first check if the bank has taken a DICGC cover and if yes then they must invest a maximum of ₹ 1,00,000 (all deposit taken together) in such banks.

Conclusion:

1. Deregulation has provided an opportunity to those individuals who keep their funds idle in savings accounts which offer lower rate of interest. They may now open savings account in banks which give higher interest rate on their savings accounts and keep their money over there and thereby earn higher interest.

2. Section 80TTA has not exempted the entire savings bank interest from tax. It has exempted interest on savings account only upto ₹ 10,000/-. Interest on savings account above this limit will be taxed.

3. In order to maximize tax benefits, an individual must rework the maximum amount to be kept in their savings account. The amount will vary with the savings interest rate.

4. Individuals who opt for sweep in facility must compare the tax implications. They may opt out of the sweep facility in case their post tax returns are less.

5. When investing in Non-nationalized banks, amount must be invested in co- Non-nationalized banks with DICGC cover.

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