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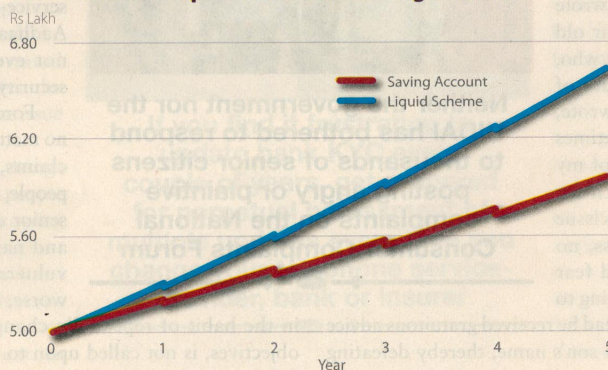
Liquid Fund+Debit Card *Vs* Savings Bank Account

Can there be an alternative to the good old savings bank account? Apparently, there is; and it was started a decade back. We are talking about Reliance Mutual Fund's (RMF's) debt-fund linked debit cards which allow instant withdrawal of funds invested in RMF's liquid schemes, through an ATM. The card comes free of cost and can also be used for payments at point-of-sale terminals and merchant establishments. The debit card offered is of HDFC Bank which has partnered with RMF to offer such a service. So, should you bid goodbye to a bank savings account and move to mutual funds?

The savings bank account has the highest liquidity, other than holding physical cash. You can go to any nearby ATM and withdraw your money up to the applicable withdrawal limit, or go to the bank branch and withdraw from there. Interest earned on savings account is usually low and credited on a quarterly basis. With regard to taxation, one can avail tax exemption on interest earned up to Rs10,000 per financial year under Section 80TTA and the remaining is taxed at the slab rate. Therefore, if the account fetches 4% interest per annum, then up to Rs2.50 lakh can be invested without any tax burden. Anything above Rs2.50 lakh will attract tax on the extra interest earned over the exempted limit of Rs10,000.



Now, liquid funds with a debit card facility offer the same features. But with a catch—you can withdraw only up to 50% of the liquid/debt scheme's balance, or Rs50,000, whichever is lower, in a day. You can withdraw the next day, provided you have sufficient account balance. The restriction on daily withdrawal is a turn-off and can be a hurdle when one needs to withdraw a larger amount. Therefore, the usability of this feature expands (or narrows) to customers who have multiple bank accounts and can substitute some of them for liquid funds. Even the taxation aspect with liquid funds is unfavourable as you have to pay capital gains tax on the units withdrawn.

So, if there were two accounts, a 4%-return bank savings account and another, a liquid scheme delivering 6%, both with a starting balance of Rs5 lakh and regular deposits/withdrawal to the extent of Rs2 lakh in a year, above the Rs5 lakh starting balance. How would both perform over the years, after paying the applicable taxes from the same account and getting the exemptions as well?

The total tax paid on the Rs2 lakh withdrawn every year from liquid schemes aggregates Rs12,000 and the balance at the end of the fifth year was around Rs6.60 lakh. Compare this with bank savings account, where the quarterly compounded interest with Section 80TTA exemption did not lower the tax incidence much, as the tax payable amounted to Rs9,562 in the five years.

Why so? Because liquid funds are taxed only on withdrawal, which is why the tax borne for the entire period was only on the yearly withdrawals of Rs2 lakh, unlike savings bank account where the tax had to be paid on the interest earned irrespective of whether or not it was withdrawn.

Even if you withdraw all the units from the liquid fund after five years, the long-term capital gains will be zero or very low as the indexation benefit lowers the tax incidence substantially.

We assumed that the yearly withdrawals/deposits above the Rs5 lakh balance will be to the extent of Rs2 lakh; but if this amount were higher, say Rs10 lakh in a year, then the short-term capital gains tax on liquid fund withdrawals will increase as well. This, in turn, will reduce the final balance in the liquid fund.

Therefore, you can consider liquid funds as an alternate or substitute to your normal savings account, but avoid other categories of debt funds for this purpose as they are unsuitable. ■