An Investor Education Initiative
MIRAE ASSET
Mutual Fund
by Mirae Asset Knowledge Academy

SYSTEMATIC WITHDRAWAL PLANS – A GOOD ALTERNATIVE TO MEET REGULAR PAY OUT NEEDS

Financial planning is not only about saving and investing. In fact, ensuring cash flow to meet planned expenses is avital component of financial planning. On this account, mutual funds with dividend option have been one of the preferred go-to investment vehicles. But, Union Budget 2020-21 has put a spanner to dividend disbursements, especially for investors in the higher tax bracket.

At the outset, repeal of the dividend distribution tax (DDT) in the budget on dividends paid by companies and mutual fund houses and moving the tax liability of the dividend amount to the investor has resulted in more money in the hands of the investor. The devil, though, is in the fine print - the tax incidence for investors, especially in the higher tax bracket, has effectively increased.

Against this backdrop, Systematic Withdrawal Plans (SWPs) offered by mutual funds can be a prudent alternative for investors looking to generate cash flow from their investments at a regular frequency. Not only is the investor able to quantify the cash flow and frequency, but the plan can also aid in reducing the tax liability for the investor.

In this article, we delve deep into how SWP can be more beneficial than the dividend option.

Abolition of DDT increases money in investor's pocket but may also increase tax liability

The elimination of DDT puts more money in the hands of the investors and also removes the incidence of double taxation - DDT is first applied when the dividend was received by the mutual fund, and then when it is passed onto the investor.

	Pre-Union Budget 2020-21	Proposed changes in Union Budget 2020-21
Equity-oriented funds	10%	Nil
Debt - oriented funds	25%	Nil

Also, if we assume that Rs 5,000 dividend was paid to an equity and debt fund investor, the investor in the lower tax bracket is likely to benefit more from the abolition of DDT. However, for those falling in the higher tax bracket, the tax outgo increases.

**Excludes applicable surcharge and cess*
HUFs: Hindu undivided family

DDT payable by mutual fund schemes for individuals / HUFs*

Illustration of removal of DDT and its implication across tax slabs

Pre-Union Budget 2020-21			Post Union Budget 2020-21 - Net dividend income after deducting tax as per tax slabs			
Type of fund	Tax rate*	Net dividend income post tax	0%	5%	20%	30%
Equity-oriented funds	10%	Rs. 4,500	Rs. 5,000	Rs. 4,750	Rs. 4,000	Rs. 3,500
Debt-oriented funds	25%	Rs. 3,750	Rs. 5,000	Rs. 4,750	Rs. 4,000	Rs. 3,500

**Excludes applicable surcharge and cess. Notes: 1) For illustration purpose only. 2) Assumed dividend of Rs 5,000*

SWP – An ideal strategy for investors in need of regular cash flow

While investors that do not require regular cash flow can move to the growth option of mutual funds to reduce their liability and benefit from long term capital gains (LTCG) tax incidence[1], for investors with a need for regular money flow, SWP could be an optimum option.

Let us look at a case study to assess the benefits of SWP over dividends:

Beneficial tax treatment of SWP versus dividends

Ajay and Samir each have a corpus of Rs 5 lakh and are keen on receiving a monthly income of Rs 10,000 from the subsequent month for payment of tuition fees of their daughters.

Samir

I am going to invest in a monthly dividend plan of a liquid mutual fund, and use the cash flow to pay the monthly fees of my daughter.

Ajay

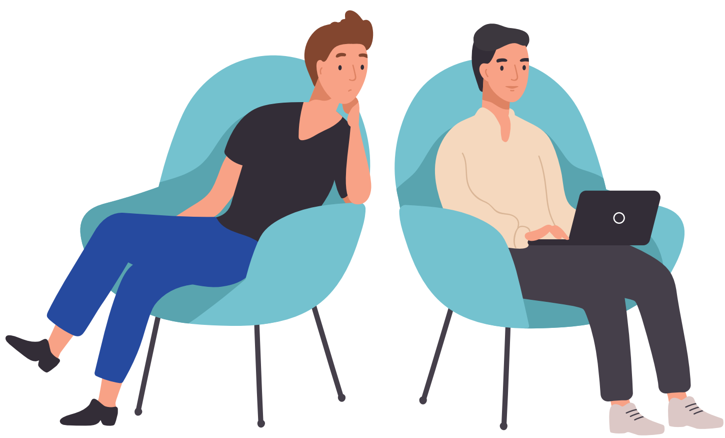
But won't it increase your tax liability? Additionally, the dividend amount and frequency is not fixed, and is on the diligence of the mutual fund scheme, based on profits generated?

Samir

I don't believe it will increase my tax liability, and I am sure the dividends will be as per my requirement and frequency.

Ajay

Okay, your choice. I am opting for an SWP.



Post this discussion, both invest their money in liquid mutual funds, the difference being Ajay invests in the growth option whereas Samir opts for the dividend option.

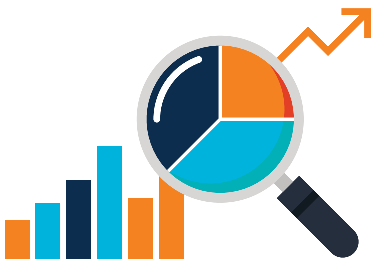
[1]If held for more than one year in the case of equity-oriented funds (10% on gains above Rs 1 lakh per year), and if held for more than three years in the case of debt-oriented funds (20% after indexation)

Let us look at the resultant impact on cash flows and tax liability by opting for SWP and dividend options. For easy referencing, we have assumed that the dividend amount and the frequency of disbursal (monthly) are the same as the amount withdrawn through an SWP.

Illustration - SWP versus dividend plans over short horizon

Ajay's SWP IN growth option										Samir choses dividend option			
Months	Amount Invested/ SWP withdrawn	NAV*	Units withdrawn	Balance Units	Cost of investment	Profit	STCG Tax payable on SWP	Net profit	Balance units value	2% dividend declared by fund house@	10% TDS deducted and TDS to be paid^	Amount received in hands of investor (Rs)	20% taxed in the hands of the investor
Initial investment~	5,00,000	3752	133	133									
1	-10,000	3772	-2.65	131	-9947	53	16	37	492650	10,000	1,000	9,000	2,700
2	-10,000	3795	-2.64	128	-9889	111	33	78	485566	10,000	1,000	9,000	2,700
3	-10,000	3818	-2.62	125	-9828	172	52	120	478556	10,000	1,000	9,000	2,700
4	-10,000	3842	-2.60	123	-9767	233	70	163	471533	10,000	1,000	9,000	2,700
5	-10,000	3864	-2.59	120	-9712	288	86	202	464232	10,000	1,000	9,000	2,700
6	-10,000	3886	-2.57	118	-9657	343	103	240	456876	10,000	1,000	9,000	2,700
7	-10,000	3904	-2.56	115	-9611	389	117	272	449049	10,000	1,000	9,000	2,700
8	-10,000	3923	-2.55	112	-9564	436	131	305	441264	10,000	1,000	9,000	2,700
9	-10,000	3942	-2.54	110	-9518	482	144	337	433376	10,000	1,000	9,000	2,700
10	-10,000	3958	-2.53	107	-9480	520	156	364	425127	10,000	1,000	9,000	2,700
11	-10,000	3976	-2.51	105	-9398	602	180	421	417070	10,000	1,000	9,000	2,700
12	-10,000	3993	-2.50	102	-9398	602	180	421	408780	10,000	1,000	9,000	2,700
	-1,20,000						1269				12,000		32,400

**Schemes' NAV share value of weighted average index of CRISIL ranked liquid funds on the first day of the month for the period March 2019 till February 2020*
^New law requires TDS of 10% to be deducted for any dividend outflow of Rs 5,000 and more
@Dividend assumed declared at 2% per month by the underlying scheme



As can be seen from the table, Ajay's tax liability was far lower compared with Samir's, considering both fall in the highest tax bracket of 30%, showcasing the advantages of SWP over dividend plans.

When we have taken is for someone who has immediate cash flow requirements thus falling part of the STCG regime, in case the investments in the debt mutual fund would have been for more than three years, the outflows of Ajay would have fallen in the preferential LTCG regime reducing his tax outgo, see illustration below for better understanding.

Illustration - SWP versus dividend plans over long horizon

Ajay's SWP IN growth option											Samir choses dividend option			
Months	Amount Invested/ SWP withdrawn	NAV*	Cost index of inflation	Units withdrawn	Balance units	Indexed cost of investment #	LTCG	LTCG Tax liability (Rs)	Net profit	Balance units value	2% dividend declared by fund house@	10% TDS deducted and TDS to be paid^	Amount received in hands of investor (Rs)	20% taxed in the hands of the investor
Initial investment~	6,08,867	3,065		199	199									
1	-10,000	3,772	3548	-2.65	196	-9406	594	119	475	739324	10,000	1,000	9,000	2,700
2	-10,000	3,795	3548	-2.64	193	-9351	649	130	519	733700	10,000	1,000	9,000	2,700
3	-10,000	3,818	3548	-2.62	191	-9294	706	141	565	728218	10,000	1,000	9,000	2,700
4	-10,000	3,842	3548	-2.60	188	-9236	764	153	611	722747	10,000	1,000	9,000	2,700
5	-10,000	3,864	3548	-2.59	186	-9184	816	163	653	716884	10,000	1,000	9,000	2,700
6	-10,000	3,886	3548	-2.57	183	-9132	868	174	695	710968	10,000	1,000	9,000	2,700
7	-10,000	3,904	3548	-2.56	180	-9089	911	182	729	704349	10,000	1,000	9,000	2,700
8	-10,000	3,923	3548	-2.55	178	-9044	956	191	765	697823	10,000	1,000	9,000	2,700
9	-10,000	3,942	3548	-2.54	175	-9001	999	200	799	691163	10,000	1,000	9,000	2,700
10	-10,000	3,958	3548	-2.53	173	-8965	1035	207	828	683956	10,000	1,000	9,000	2,700
11	-10,000	3,976	3548	-2.51	170	-8924	1076	215	861	677083	10,000	1,000	9,000	2,700
12	-10,000	3,993	3548	-2.50	168	-8887	1113	223	890	669858	10,000	1,000	9,000	2,700
	-1,20,000							2098				12,000		32,400

*~Initial corpus of Rs 5 lakh at 6.78% for three years, which is the three-year return of weighted average index of CRISIL ranked liquid fundsas of February 28, 2020 * Schemes' NAVsare performance of CRISIL liquid fund index on the first day of the month for the period March 2019 till February 2020. ^New law requires TDS of 10% to be deducted for dividend outflow of Rs 5,000 and more. @Dividend assumed at 2% per month by the underlying scheme. #Indexation of 5% applied on investments. Note: Investment corpus before cash flows assumed to be the same to maintain uniformity in tax computation*

Because of having an investment period of three years, Ajay is taxed at 20% with indexation,whereas Samir continues to be taxed as per his income tax slab of 30%, thus having a higher tax outgo compared with Ajay.

SWP and its benefits

SWP enables investors to redeem/withdraw money from a mutual fund scheme at pre-determined intervals (monthly, quarterly, half-yearly, or yearly). Based on the investor's instruction, an equivalent amount is deducted by the fund house. The investor can start an SWP by giving instructions to the asset management company and providing relevant details, such as folio number, scheme name, withdrawal amount, timing, and bank account in which the amount is to be credited.

Advantages of SWP

SWP	Dividend plan
Allows redemption of fixed amount of the investment from the mutual fund at a pre-determined frequency	Dividend amount is not guaranteed
Design and customise the amount and timing of cash flow in sync with the requirement	Dividend is based on the discretion of the fund house
Has favourable tax treatment compared with dividend option post Union Budget 2020	DDT has been abolished, but dividend is taxable in the hands of the investor at applicable tax rates

Map SWP with your financial goals

Investors should sync the SWP with their financial goals. For instance, as illustrated in the case study, Ajay managed his regular cash flow requirement for his daughter's school fees through SWP. Another important financial goal that investors can map through SWP is to fund their retirement money flows.

Investors can use the combination of systematic investment plan (SIP) and SWP to meet their retirement goal requirements. They can use the SIP vehicle during the investment phase by investing in equity-oriented mutual funds for the long term which may generate optimum returns, and subsequently move the accumulated corpus into a debt mutual fund, and then employ SWP to meet their cash flow requirement during retirement.

Some other goals that investors can look at mapping through SWP include paying off their loans, such as house loan, car loan, etc.

Regular income to meet post retirement requirement

Payment of children's tuition fees

Equated monthly installment for car, personal or home loan

SWP can, therefore, help investors design a more customised investment strategy and ensure cash flow from their investments at regular frequencies. Investors, however, should take a note of the following before opting for an SWP:

- Build a healthy investment corpus to facilitate adequate cash flow from SWPs
- If possible, consider withdrawing smaller amounts via SWP so that the amount that is deducted is largely that of capital appreciation,ensuring that the capital invested stays intact
- Evaluate the tax incidence and exit loads of schemes before settling for the SWP
- Mutual funds are market-linked. Fluctuations in the underlying market can impact the investment corpus

An investor education initiative by Mirae Asset Mutual Fund.

All Mutual Fund investors have to go through a one-time KYC (Know Your Customer) process. Investors should deal only with Registered Mutual Funds (RMF). For further information on KYC, RMFs and procedure to lodge a complaint in case of any grievance, you may refer the Knowledge Center section available on the website of Mirae Asset Mutual Fund.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

Email Us customercare@miraeasset.com | Call Us 1800-2090-777 (Toll Free) Mon-Sat: 9 a.m. to 6 p.m. | Internet www.miraeassetmf.co.in | Twitter @MiraeAsset_IN | Facebook MiraeAssetIN | Contact your financial advisor for details