How parents can bring down your tax liability

Your parents can help bring down your tax liability in several ways. Here are four smart strategies that can reduce your tax outgo.

1 Invest in their name if they are in a lower tax bracket

Every adult enjoys a basic tax exemption limit. For senior citizens (above 65 years), the basic exemption limit is Rs 2.4 lakh a year. If any or both of your parents do not have a high income but you have an investible surplus, you can avoid tax by transferring money to them which can then be invested in their name.

There is no tax on such gifts and the income from the investments will be treated as theirs. There are plenty of options. The Senior Citizen's Savings Scheme offers an attractive 9% per annum. But the income is taxable and the investor must be over 55 years.

The Public Provident Fund offers tax-free income but there is a limit of Rs 70,000 a year. Invest in your parents' names if your own limit is exhausted. Or open a demat account in their name and dabble in stocks. Short-term capital gains will not attract 15% tax if the basic exemption limit has not been crossed.

This strategy won't work in the case of your spouse or minor children. Any amount given to a spouse is tax free but if it's invested, the income is treated as that of the giver. Similarly, income from investments in a minor child's name is added to the income of the parent who earns more and is taxed accordingly. No such clubbing provisions come into play when money is transferred to a parent. There is also no limit on the amount you can give to your parents.

2 Pay them rent if you live in their house

Do you live in your parents' house? You can pay them rent to claim House Rent Allowance exemption. This is possible only if the property is registered in the name of your parent. The owner will be taxed for the rental income after a 30% deduction. So, if you pay your father a rent of Rs 3 lakh a year (Rs 25,000 a month), he will be taxed for only Rs 2.1 lakh.

It gets better if the property is jointly owned by both parents. Then you can divide the rent two-ways so that the tax liability gets split between the two parents. If their income exceeds the basic exemption limit, you can help them save tax by investing in their name under Section 80C options such as the Senior Citizens' Saving Scheme, five-year bank fixed deposits or tax-saving equity mutual funds.

However, this tax-free window will become smaller next year after the proposed Direct Taxes Code (DTC) comes into effect from April 2012. The DTC has proposed to bring down the 30% standard deduction on rental income to 20%. This would push up the tax liability of the senior citizens who receive rent from property. Also, many of the existing tax saving options will no longer be available under the DTC regime.

3 Sell them shares and offset losses

Tax laws allow you to adjust short-term losses from stocks against certain gains. But what if you have been holding junk stocks in your portfolio for more than a year? If you ask your broker to sell them, you won't be able to adjust the long-term capital losses against any gain.

However, if you sell them through an off-market transaction where no securities transaction tax is paid, you are not only allowed to adjust the loss against a gain, but also carry forward the unadjusted loss for up to eight financial years. That's easier said than done. It's already tough finding buyers for junk stocks on the exchanges. Finding one for a private deal is infinitely more difficult.

It’s here where your parents can help you. Sell the junk stocks to them in an off-market transaction. An off-market transaction is a private deal between the buyer and seller without the exchange as an intermediary. The losses you book can then be adjusted against capital gains from other assets such as property, gold, debt funds, etc. It can also be carried forward for up to eight financial years. Keep a few things in mind while you go about this. The sale should be at the market price of the shares and the buyer should pay the sum by cheque. Otherwise, the taxman might treat the transfer as a gift.

4 Buy them a health insurance policy

This is the simplest and most commonly used strategy to save tax through your parents. Buy a health insurance policy for them and get deduction for the premium paid under Section 80D. Up to Rs 15,000 a year is deductible from your taxable income if you buy a health insurance policy for your parents. If the parents are senior citizens, the deduction is even higher at Rs 20,000.

This deduction is over and above the Rs 15,000 that one can claim as deduction for the health insurance premium paid for himself and his family (spouse and children). Also, this deduction is available irrespective of whether parents are financially dependent on the taxpayer or not.

The tax-saving potential of this option too will shrink after the DTC comes into effect in April 2012. It has proposed to reduce the deduction for health insurance, life insurance and tuition fees for children to a combined limit of Rs 50,000. That would be a setback for those looking for tax savings from health and life insurance.

But it should not keep you from buying a health insurance cover for your parents. After all, they looked after your needs when you were a child. Now it is time you repay that debt.

Source : The Economic Times.