Knowledge Consortium of Gujarat
Department of Higher Education, Government of Gujarat
JOURNAL OF COMMERCE AND MANAGEMENT
ISSN : 2279-025X

Year-1 | Issue-4 | Continuous issue-4 | January-February 2013

Rajiv Gandhi Equity Saving Scheme (RGESS) An Overview

Introduction:

In the recent time the improved market sentiment on the back of liquidity enhancement measures adopted by various Central Banks at the global level coupled has boosted market sentiment. In recent times RBI has cut CRR by 25 basis resulting boosting the liquidity in Indian Economy.In our Nation, the Central Government headed by Dr. Manmohansinh has bold action on implementation of key policy changes as part of long stuck reform process such as: Allowing 51% Foreign Direct Investments in Multi-Brand Retail,Foreign Direct Investment (FDI) in Aviation Sector, Increasing the prices of diesel, Enhancement in FDI in Insurance Sector from 26 % to 49%,Allowing 26 % FDI in Pension Sector, Approval of Forward Contract Regulation Act Amendment Bill, Approval of Companies Amendment Bill-2012, Reduction in withholding tax on overseas borrowings to 5% from 20%;have not only proved to be a booster dose for the markets, but has also changed the attitude of Foreign Institutional Investors (FIIs) towards India. As per Recent Report of Crisil Research, "The government kick-started the next wave of reforms with a slew of policy measures. India's outlook in the near-to-medium term will be shaped by successful implementation of these measures.The immediate and much-needed positive impact of thesemeasures will be on investment climate and businessconfidence.The resultant improvement in investor sentiment is expectedto boost capital inflows, which will be aided by furthereasing of monetary policy by US Federal Reserve (QE3) and European Central Bank".In Europe to increase retail participation in Securities Market introduced a Modelwas introduced in 1970s.A similar scheme, with much higher cut-off, was first introduced in France which was then used by Belgium, West Germany and Sweden.Former Finance Minister Pranab Mukherjee, in his Budget-speech for 2012-13, had announced introduction of the Rajiv Gandhi Equity Savings Scheme.The Union Finance Minister Shri P. Chidambaram approved a new tax savingscheme called "Rajiv Gandhi Equity Saving Scheme"(RGESS),exclusively for the first time retail investors in Securities Market.

OBJECTIVES OF "RAJIV GANDHI EQUITY SAVING SCHEME"(RGESS):

- To encourage the flow of savings and improve the depth of domestic capital markets
- To promote an 'Equity Culture' in India.
- To widen the retail investor base in the Indian securities markets.
- To channelize household savings into stock markets.

SALIENT FEATURES OF THE SCHEME:

- Scheme is open to new retail investors who have to open a New Demat Account and will be identified on the basis of their PAN numbers. Those who have opened the Demat Account but have not made any transaction in equity and /or in derivatives till the date of notification of this Scheme will also eligible for this scheme. Moreover,all those account holders other than the first account holder who wish to open a fresh account are also eligible.
- An investor whose annual taxable income is ≤ Rs. 10 lack is eligible under the Scheme.
- The maximum investment permissible under the Scheme is Rs. 50,000 and the investor will get a 50% deduction of the amount invested from the taxable income for that financial year.If one invests Rs.50,000 in RGESS then Rs.25,000 will be deducted from taxable income. So one can save about Rs.2,500, Rs.5,000 and Rs.7,500 for slabs 10%, 20% and 30% respectively under this scheme.
- To have income tax benefits under the scheme a new Section 80 CCG- of the Income Tax Act, 1961 been incorporated by amending the Finance Act, 2012.
- The stocks listed under the BSE 100 or CNX 100, or those of Public Sector Undertakings which

are Navratnas, Maharatnas and Miniratnas would be eligible for investment under the Scheme. Follow-on Public Offers (FPOs) of the above companies and IPOs of PSUs, which are getting listed in the relevant financial year and whose annual turnover is not less than Rs. 4000 Crore for each of the immediate past three years, would also be eligible.

- Exchange Traded Funds (ETFs) and Mutual Funds (MFs) that have RGESS eligible securities as their underlying and are listed and traded in the stock exchanges and settled through a depository mechanism have also been brought under RGESS.
- The small investors are allowed to invest;the investments in installments in the financial year in which tax claims are made.<>/
- The total lock-in period for investments under the Scheme would be three years including an initial blanket lock-in period of one year, commencing from the date of last purchase of securities under RGESS.
- After the blanket lock-in period of one year, investors would be allowed to trade in the securities in furtherance of the goal of promoting an equity culture and as a provision to protect them from adverse market movements or stock specific risks as well as to give them avenues to realize profits.Investors would, however, be required to maintain their level of investment during these two years at the amount for which they have claimed income tax benefit or at the value of the portfolio before initiating a sale transaction, whichever is less, for at least 270 days in a year. The calculation of 270 days includes those days pursuant to the day on which the market value of the residual stocks has automatically touched the stipulated value after the date of debit.
- The general principle under which trading is allowed is that whatever is the value of stocks sold by the investor from the RGESS portfolio, RGESS compliant securities of at least the same value are credited back into the account subsequently. However, the investor is allowed to take benefits of the appreciation of his/her RGESS portfolio, provided its value, as on the previous day of trading, remains above the investment for which they have claimed income tax benefit.
- For the purpose of valuation of shares, the closing price as on the previous day of the date of trading will be considered so that new investors are certain about their debits and credits into the account.
- In case the investor fails to meet the conditions mentioned above, the tax benefit will be withdrawn.

EXPECTATIONS OF THE RGESS:

- Like all financial products which are used by the retail investors (post office savings, life insurance policies etc) for tax benefits, this tax break for direct investment in equity is expected to substantially encourage the retail participation in securities market as well as to enhance their participation in the growth of Indian industry.
- Entry of more new retail investors are expected to further deepen the securities markets as they bring in the long-term stable funds, which can counteract the volatility created by the liquidity providers of the market. The Scheme, thus, also furthers the goal of financial stability and promotes financial inclusion.
- Exchange Traded Funds and Mutual Funds have also been brought under the Scheme,the Scheme will provide encouragement and re-assurance to the first time investors.

COMPARISON OF RGESS V/S ELSS V/S PPF:

Particulars	RGESS	ELSS	PPE
Eligibility	Annual Taxable Income ≤10 lakh.	None	None
Lock-in Period	3 years(proposed)	3 years	15 Years
Tax Benefits	50% (80 CCG)	100% (80 C)	100% (80 C)
Maximum Investment	Rs.50,000	No Limit	Rs.1,00,000/ p.a.
Minimum Investment	--	Rs.500 to Rs.5000	Rs.500
Need for- DEMAT	Yes	No	No
Equity Linked	Yes	Yes	No
Annual Return	Market Based	Market Based	8.8%
Interest Earned	Non Taxable	Non Taxable	Non Taxable
Risk	Medium	Medium	Low
Max Tax Savings(10% Slab)	Rs.2500	Rs.1,00,000(u/s 80c)*	Rs.1,00,000(u/s 80c)*

Max Tax Savings20% Slab)	Rs.5000	Rs.1,00,000(u/s 80c)*	Rs.1,00,000(u/s 80c)*
Max Tax Savings30% Slab)	Rs.7500	Rs.1,00,000(u/s 80c)*	Rs.1,00,000(u/s 80c)*

Note: You need a PAN Card and a Bank Account for theabove scheme.::

* Normally, an individual having a taxable income of less then Rs. 10 lack will have their investment under various avenues like repayments of Home-Loan, Insurance Premium, GPF (incase of Government Servants) etc; to get advantage of 80 C. Hence, maximum tax savings under RGESS scheme will be higher as compared to ELLS and PPF.

DOUBTS FOR RGESS

The scheme may not pull in more retail participants as there is a lock-in period of three years.Despite the one-time tax benefit, investors will be reluctant to lock-in their money for a long period.If the overall market sentiment remains positive, participants might enter the markets directly.The primary market cannot revive only on the announcement of this scheme. For this there has to be more active participation from the retail investors in the secondary market. The following are areas where more clarity is needed:

- Whether existing MF investors will be eligible?
- Who would be responsible for monitoring?
- Will secondary market purchase of MFs and ETFs units be allowed?
- Who will guide first-time investors?

Whether existing MF investors will be eligible?
Although the government has said that the scheme is exclusively for first-time investors in the securities market. It raises doubts whether existing equity mutual fund investors will be not be allowed to participate in this scheme or not? RGESS was earlier meant for direct investments into the stock market; however after requests from various stakeholders, including market regulator SEBI, the government also allowed MFs and ETFs to be part of this scheme. “As the government has also included mutual funds for RGESS, theoretically it will disqualify existing mutual fund investors,” So if an individual has never invested in stocks directly but has been an investor in mutual fund schemes that qualify for RGESS, will he/she still qualify?

Who would be responsible for monitoring?
The scheme is only open to new retail investors. Those who have already have opened the demat account but have not made any transaction till the date of notification of this scheme will also be eligible. Further, all existing demat account holders other than the first account holder who wish to open a fresh account will also qualify for tax breaks. Althoughthe government has said such investors will be identified on the basis of their permanent account number (PAN), monitoring and filtering eligible investors will be too difficult a task. There no clarification on who will determine the new retail investor? The Income Tax (IT) Department, SEBI or Brokers?

Will secondary market purchase of MFs and ETFs units be allowed?
The scheme has allowed mutual funds and ETF schemes with specified stocks as their underlying to be part of this scheme. It, however, remains to be seen whether both open-ended as well as close ended schemes will be allowed. Also, whether secondary market purchases of MFs and ETFs through the stock exchange platform will also be considered valid investments?

Who will guide first-time investors?
The conditions laid out are too complicated for first-time investors and they may not have enough knowledge to understand the scheme.

Like other tax-saving schemes, RGESS too has a three year investment lock-in period. The unique features about this scheme is that it allows investors to trade in securities that they had bought to avail tax benefit after a blanket lock-in of one-year. However, the government has stipulated tough conditions for trading in RGESS portfolio. For instance, investor has to maintain investment level for which tax benefit is availed for at least 270 days. Also, shares sold have to be replenished with only

RGESS compliant securities of at least the same value. In case the investor fails to meet the conditions specified, the tax benefit will be withdrawn.

The first-time investors will need a lot of guidance right from investing in the correct stocks to ensuring portfolio value is properly maintained. But the question is who will do this task on behalf of new investors?

Suggestions ::

As this scheme is mainly introduced to widen the Securities Market of India. For the better success of this scheme the author feels that if following suggestions are incorporated along with notification, the scheme will truly prove buster for the Securities Market of India:

1. The scheme is open to only new investors but it should be allowed to the existing investors also.
2. The ceiling of taxable income up to Rs.10 lakh to have the benefit of this scheme should be abolished.
3. The scheme will be open for once in a life time for new investors; instead of this it should be open for at least five years. After five years; keeping in view the results proper decision should be made.

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