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Tax-Free Bonds for Risk-Averse Investors

Manan Vatsyayana/Agence France-Presse/Getty Images

Pictured, Indian five rupee and ten rupee coins.

Risk-averse investors now have new options to park their money.

The tax-free bonds, which are lesser-known, have become available for sale today through early February.

The interest earned on these bonds will not be subject to income tax. These are different from the so-called tax-saving bonds issued by infrastructure companies like Infrastructure Development Finance Co. and L&T Infrastructure Finance Co.

Money invested in infrastructure bonds, up to 20,000 rupees ($400), can be deducted from an individual's total income when calculating income tax. This deduction can be claimed under Section 80CCF of India's Income Tax Act, 1961. However, the interest earned on these bonds is subject to income tax.

The new breed of tax-free bonds is almost the reverse. There is no deduction for the principal invested in these bonds, but the interest earned is not taxed.

The tax-free bonds make sense for individuals with a lot of money to invest- say upward of 100,000 rupees.

The current spate of bonds are being issued by the Indian Railways Finance Corp. Ltd., the financial arm of Indian Railways, and the Housing and Development Corp. Ltd., a financer of housing schemes.

The railways bond is offering a simple interest of 8.15% to individual or retail investors for a 10-year bond, and 8.30% annually for a 15-year bond.

Investors who invest more than 500,000 rupees per issue are considered "high networth" investors and get lower rates: 8% for the 10-year bond and 8.10% for 15 years. See their prospectus here.

This issue closes for subscription on Feb. 10.

Housing and Development Corp., considered a little riskier than Indian Railways by credit rating agencies, is offering slightly better yields at 8.22% for 10-year bonds and 8.35% for 15-year bonds. Their issue is open till Feb. 6 (you can read their prospectus here.)

These bonds will be eventually listed on the Bombay and National Stock Exchange, so investors will have the option of selling them before the full term of the bond. However, the price you may get for selling before they mature will depend on market conditions.

Financial advisers say these bonds make sense only for very risk-averse investors with a lot of cash at hand.

Hemant Beniwal, a financial adviser in Jaipur, is not advising his clients to buy these. He says investors with a long investment time-frame are better off buying a diversified stock mutual fund, which are available at lower prices.

Over 10 years, "equities will be outperforming these bonds," says Mr. Beniwal.