An effective way to manage cash flow

Rakesh K Jain

Last month, I suggested a systematic withdrawal plan (SWP) to one of my clients to manage his cash flow with better returns. The first reaction I got was that we have heard of systematic investment plans (SIP), but never of an SWP. I realized that SWPs are not commonly known and used.

As the name suggest, an SWP is the reverse of an SIP. In SWPs, you regularly withdraw a fixed amount of money from a fund. The amount to be withdrawn and the frequency are fixed by the investor, which can be monthly, quarterly or annual for any fixed amount that you wish to receive from your fund whether liquid, equity, or balanced. This mechanism is very important and good for any client who has erratic earnings or a large corpus of fund and has committed expenses. Especially, this is very suitable for retired people.

Although the cash flow can be generated by opting for daily, weekly or monthly dividend option plan but the problem is that the quantum of the payouts is not fixed. Sometimes, if there is no appreciation which can be distributed, you might have no dividends to receive.

The SWPs also provide for tax efficiency. The suggestion is that the client should opt for a growth scheme. In such a case, on every withdrawal, only a small portion is booked as income while the substantial part received is capital. Such income, if long term, may provide very low tax incidence (virtually nil after indexing), while in dividend option, the dividend distribution tax is very high (effective tax rate is 28.33%).

We strongly suggest SWPs for people having a good corpus or an erratic income and regular cash flow requirement. It is also one of the best retirement plans for senior citizens who are looking for growth in their investments and who need fixed withdrawal amount over a period of time.

By the right mix of investment instruments, one can plan the annual withdrawal in such a way that it is less than the expected annual rate of return.

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To illustrate, if a client needs say Rs 25,000 per month and has a corpus of Rs 30 lakh, one can distribute his corpus in such a way that he gets a return of 10% per annum. With an SWP of Rs 25,000 per month, he will book income of just around Rs 15,000 in the first year, while he receives Rs 3 lakh in a year and the corpus at the end of the year will also remain around Rs 30 lakh.

The tax incidence on this will be low even considering the highest income slab. For subsequent, years the gain shall be long term leading to very low or no taxation. This will ensure that your SWP can go on forever without eating into your capital. Besides all this, SWP has ease of operations as money comes into your bank account directly at the required frequency with paperwork done only once.

The writer is director, Frontline Securities