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THE JOURNEY TOWARDS FINANCIAL FREEDOM

Smart Tax Savings

The choice of instrument to save income tax is wide, but the ELSS stands out for its equity exposure and short lock-in

Income tax savings is not just about reducing one's tax liability; it is also to do with making the right choice with the right product. The tax saving instruments under Section 80C that one can choose from have different risk grade, tenure, type of returns, tax treatment on the gains and also the type of asset class they represent. This choice offers scope to follow the asset allocation suitable to you as well as the risk that you are comfortable to take when investing. By design most products are structured with a 5-year lock in and fixed interest on the investments (See: How they stack up).

For many taxpayers, the annual tax-savings exercise is also perhaps the only major savings and investment opportunity. It thus becomes important for one to use this option wisely and look for ways to maximise savings into wealth creation. The PPF has a 15-year lock-in and EPF which has a much longer lock-in, depending on the number of years one is employed. There is also scope for long-term savings with the NPS (National Pension System), making these suitable to accumulate retirement savings.

Typically, long-term wealth creation is possible with equity exposure, which makes tax saving instruments with significant equity exposure is a favourable alternative to the many fixed return instruments. Among the many tax saving instruments in which savings qualify for tax deduction under Section 80C, the EPF has a small equity exposure, but taxpayers have little say in where and how this can be invested.

The other options with equity exposure include the NPS, Ulips (Unit-linked insurance plans) and ELSS. There is fair degree of choice within NPS and Ulips on the equity exposure that one could take, with the highest exposure in NPS being 75% and in case of Ulips the equity exposure seldom goes beyond 80%. That leaves, the equity-linked savings scheme (ELSS) as a choice which has a significant equity exposure where the minimum exposure is pegged at 65%, with no upper limit. There are many other advantages to choose ELSS like its short three-year lock in or the convenience of investing regularly through SIPs in it.

There are also several funds to choose from when investing in ELSS which offers a wide choice to pick a fund from. Active fund management makes ELSS suited to grow with stock market movements. To evaluate the potential gains from investing in ELSS we compared how tax savings in PPF, one of the oldest and widely popular tax-saving instruments compares to ELSS, an equity-market linked investment. For illustration purposes, given the 15-year lock-in of PPF, we took the past 15-year data, to see how an investment of ₹ 1.5 lakh each financial year (on the first business day of April) would fare in PPF and BSE Sensex, since ELSS are equity-market linked.

So, for the 15-year period from 2004-5 to 2018-19, a total of ₹ 22.5 lakh would be invested to maximise the tax savings under Section 80C. Incidentally, this is also the period when the returns on PPF fluctuated and the stock market cycle witnessed a significant fall in 2009 that captures volatility which is inherent with stock market investments. Yet, the outcome (See: PPF vs Equity) shows that investing in ELSS is a better option, if an investor is comfortable with the risk of equity-oriented funds and taxation.

The savings in PPF grow from ₹22.5 lakh to ₹44.2 lakh, whereas it touches ₹61.4 lakh in case of the Sensex-linked investment. In reality, the ELSS returns could be higher, given the active management of investments in it. However, the gains from ELSS when redeemed after the lock-in are taxable, unlike the tax-exempt treatment of gains from PPF. The long term capital gains (LTCG) of up to ₹1 lakh a year from equity-oriented schemes like ELSS are exempt from income tax. The LTCG above ₹1 lakh are taxed at 10%, which takes off a little sheen off them.

If planned well, tax savings in ELSS can club financial planning with tax planning, making it a very attractive combination to consider. The inflation beating returns from equity investing and long-term wealth creation potential make the case for ELSS over other tax saving options which offer fixed returns. The incentive to save tax, conveniences of a mutual fund and potential for long-term wealth creation makes ELSS a choice worth considering from the Section 80C basket.

Do note that the comparison of ELSS vs. other tax saving options is given for information purposes only. Investment in ELSS carries high risk and investors are advised to consult their tax/financial adviser before taking any investment decision. •

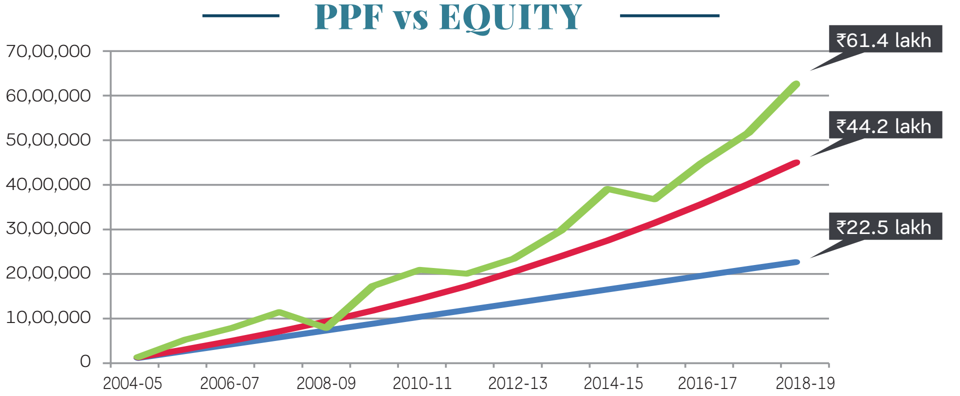
HOW THEY STACK UP

Instrument	Safety/ Risk	Lock-in (Years)	Returns	Tax Free Gains
SCSS (Senior Citizens Savings Scheme)	Low Risk	5	8.6%^	No
NSC (National Savings Scheme)	Highest Safety	5	7.9%^	No
PPF (Public Provident Fund)	Highest Safety	15	7.9%^	Yes
Bank FD	Low Risk	5	6.25*	No
ELSS (Equity linked savings scheme)	High Risk	3	Market linked	No
Life Insurance Premiums	Moderate Risk	Minimum 5	Variable	Yes
NPS (National Pension System)	Moderate Risk	Till age 60	Variable	Partially
EPF (Employee Provident Fund)	Low Risk	Till age 60	8.65%	Yes
Sukanya Samriddhi Yojana	Low Risk	15	8.4%^	Yes

^ Rates applicable for Oct-Dec 2019; * For non senior citizens, senior citizens get 6.75% from SBI

Source: Finance Ministry for Government-linked investment returns

PPF vs EQUITY



Data as on March 31st, 2019.
Source: PPF returns from dailytools.in/PPFCalculator;
Equity returns has been represented using Sensex data from BSE Sensex