How You Can Save an Extra Rs 15,000 in Taxes This Year

Reported by Renu Yadav | Last Updated: January 18, 2016 09:48 (IST)

The onset of tax-saving season leads to a mad scramble for investment instruments to cut down tax liabilities. This financial year, tax payers can save an additional Rs 15,000 in taxes courtesy the New Pension Scheme (NPS).

Announced in this fiscal year's Budget, the New Pension Scheme allows taxpayers to invest an additional Rs 50,000 under Section 80CCD. This additional investment is above the 80C investment limit that is extremely popular among taxpayers.

Taxpayers in the highest tax bracket of 30 per cent can save Rs 15,000 by investing Rs 50,000 in the NPS. Those in the 20 per cent tax bracket can save around Rs 10,000, while people in the 10 per cent tax bracket can save Rs 5,000 per year by investing in the NPS.

NPS is a voluntary pension scheme which is regulated by the Pension Fund Regulatory and Development Authority (PFRDA) where an individual invests till the age of 60 to draw pension after attaining the age of 60.

Experts believe that it's a low-cost retirement product which provides equity exposure and investors especially those falling in the highest tax bracket should avail this deduction.

"I would recommend people to avail this extra tax benefit and invest Rs 50,000 in NPS as there are very few investments options for retirement. Even if in instruments like public provident fund (PPF), there is no option for equity exposure while in case of NPS one can invest up to 50 per cent in equities," Vishal Dhawan, founder and chief executive officer of Plan Ahead Wealth Advisor.

In NPS, investors have the option to put money in government bonds, corporate debt and equities. The investment in equities can't exceed 50 per cent. Unlike PPF, returns in NPS are not guaranteed and are market-linked.

"NPS is a low-cost product with an option to invest in a combination of equity and debt. Given the tax benefit it makes sense for somebody in the 20-30 per cent tax bracket to invest in it," says Anil Rego, CEO of Right Horizons, a wealth management firm.

Individuals can open two types of accounts under NPS -tier-I and tier-II. Tier-I is the primary account; 60 per cent of the accumulated wealth in this account can be withdrawn once the account holder attains the age of 60, while the rest 40 per cent has to be compulsorily invested in an annuity. Tier-II is highly liquid account from which investors can withdraw money anytime.

Investors can avail tax-deduction for investments and gains earned in tier-I account, but the withdrawals are taxable. There are no tax benefits on investments in the tier-II account. In the tier-I account one has to invest a minimum Rs 6,000 in a year and minimum Rs 500 at one time.

"NPS is not a tax-saving scheme, it is a tax deferral scheme, that is your accumulation will be taxed at the time of withdrawal. Therefore, a person who is falling in the highest tax bracket should invest in the product as he is expected to be taxed at a lower rate post retirement as his income is expected to go down," says Manoj Nagpal,CEO, Outlook Asia Capital, a wealth management firm.