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Optimise Your Tax Savings

A guide to aligning tax savings with the overall portfolio goals.

By Renu Yadav (/search.jsp?searchword=By Renu Yadav&searchtype=text&searchphrase=exact&search_type=author)
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tax saving

W e are approaching that time of the year again when we have to look at our finances afresh to see if we are using all the options available to us to save tax. As the deadline for furnishing proofs of tax-saving investments approaches, most of us rush to buy tax-saving products without looking at their suitability to our larger portfolio. Financial experts warn against this. "Saving tax should be an incidental pursuit, not the main one. The investments being done should be in line with the overall goals," says Suresh Sadagopan, Founder, Ladder 7 Financial Advisories.

There is a plethora of instruments for tax-saving with each having different lock-in periods, duration and return/risk profile. Therefore, one instrument may not be suitable for all. For instance, a young person may find tax-saving mutual funds a better choice while an older person close to retirement might go for fixed-income options. Also, with interest rates on fixed deposits at a decade low, these are no longer the obvious option for many. People are scouting for options.

"A tax planning instrument could either be fixed income oriented, or 100 per cent equity, or hybrid, that is, a combination of equity and debt. Thus, the choice may vary depending on the investor's risk tolerance and comfort with volatility," says Vishal Dhawan, Founder and CEO, Plan Ahead Wealth Advisors.

Let's understand the different tax-saving options that we can avail of.

Options Under Section 80C

There is a deduction of `1.5 lakh available under Section 80C. Here are some of the investments that are covered under this.

Expenses you can claim as deduction	Deduction Limit	
Life Insurance premium paid during the year	₹1.5 lakh under Sec80C	
Tution fee of up to two children		
Payment of home loan principal		
Stamp duty registration charges paid		
HRA against the rent paid		
Health insurance premium	up to ₹25,000	
Leave travel allowance	LTA received as part of salary or actual expense	

1. Equity Linked Saving Schemes (ELSS)

These are mutual funds which invest in equity and related instruments. These can be a good point for starting investing in mutual funds. These work like normal equity funds but with varying strategies - some have a higher exposure to mid- and small-cap stocks while some focus on large-caps. Choose the one that suits your risk profile. It is always advisable to invest through a systematic investment plan rather than in one go to average out costs and lower risk.

Lock-in: Three years, the least among all tax-saving instruments.

Returns: Will depend upon the performance of equity markets as well as the performance of stocks in which the fund manager has invested. These have the potential to deliver the highest returns among tax-saving instruments. The past one-year average return from these funds is around 42 per cent, while the three-year return is 15 per cent.

Taxation of gains: As gains from equity after one year are tax free, there will be no tax if you withdraw the money after the lock-in period of three years.

2. Public Provident Fund (PPF)

It is one of the most popular tax-saving options. However, PPF interest rates have fallen to a low of close to 40 years, in line with the fall in yields on government bonds to which they have been linked; the rates are revised quarterly. Still, they are far above what banks are offering on fixed deposits. The best part is that the returns are not taxed. Given these benefits, experts strongly recommend this product for tax saving, especially to those who fall in the 30 per cent tax bracket. "Self-employed individuals could also consider investing the maximum permissible amount of `1.5 lakh. The salaried should put in an amount such that the exposure to the EPF is also kept under consideration. Roughly, these investors can invest one-fourth of the amount in PPF and the rest in shorter lock-in products like ELSS," says Vishal Dhawan of Plan Ahead Wealth Advisors.

Lock-in: Fifteen years. Partial withdrawal is possible under certain circumstances from seventh financial year onwards. In 2016, the government allowed premature closure after five years for medical emergency and higher education after paying a penalty of 1 per cent less interest as applicable from time to time.

Return: PPF provides guaranteed return but the interest rate is aligned to yields on government securities with a small mark-up. The rates are subject to revision every quarter. The latest is 7.6 per cent for quarter ended March 31, 2018. For a person in the highest tax bracket of 30.9 per cent, the effective tax rate comes to 10.86 per cent.

Taxability: All the gains are tax-free.

3) Employee Provident Fund (EPF)

It is a retirement benefit scheme available to all salaried employees. Under this, every month, you contribute 12 per cent (basic plus dearness allowance) to your EPF account. Your employer makes a matching contribution.

Lock-in: You can withdraw the entire amount at the time of retirement. You can also withdraw if you stay unemployed for more than two months. Partial withdrawal is possible under certain specified circumstances.

Return: Fixed by the government once a year.

Taxation: Withdrawals are tax free. Just like PPF, it also falls under the EEE tax regime - exempt at all three stages of investment, accumulation and withdrawal.

Tax saving instrument	Returns	Lock-in period (in years)
ELSS	Market linked	3
Ulip	Market linked	5
NPS	Market linked	Till 60 years of age
EPF	8.65%	Until retirement
PPF	7.60%	15
NSC	7.60%	5
FD's- Banks and Post offices	6.50%	5
Senior citizen savings schemes	8.30%	5
Traditional insurance policies	5-6%	3
Sukanya Samriddhi Scheme	8.10%	18

4) National Savings Certificate

It is another popular small savings scheme which provides guaranteed income. There is no investment cap.

Lock-in: Five years.

Return: At present, NSC is offering 7.6 per cent. Like other small savings schemes, the rate is aligned to yields on government securities of the same maturity and revised every quarter. The interest accrues every year but is paid at maturity.

Taxation: Interest is added to the income of the investor and taxed. This reduces the effective return of the instrument.

5) Unit-Linked Insurance Policy

It is a financial instrument which provides the benefit of both life insurance and investment.

Lock-in: Five years.

Return: As ULIPs invest in market instruments such as debt and equity, the returns will depend upon the performance of the underlying instrument(s).

Taxation: If the premium paid on the policy is less than 10 per cent of the sum assured for policies purchased after April 2012 and 20 per cent before that, the amount received on maturity is exempt from tax. If it higher than 10 per cent, the entire amount is added to the income and taxed as per the person's income tax slab.

6) Sukanya Samriddhi Scheme

Parents or legal guardian of a girl child up to the age of 10 years can open an account in the name of the child and invest up to `1.5 lakh a year. The minimum investment is `1,000 every year. One can open up to two accounts under the scheme. The third can be opened if case of twins.

Lock-in: The account can be closed after the child turns 21. Premature withdrawal of up to 50 per cent accumulated sum is possible after the child turns 18 but only for the purpose of marriage or higher education.

Return: The interest rate is linked to G-sec yields with a mark-up and is subject to revision every quarter. The current interest rate is 8.1 per cent.

Taxation: It falls under the EEE tax regime.

7) National Pension System

This makes you eligible for three types of deductions.

- Up to `1.5 lakh under Section 80C.
- Apart from this, an additional deduction of `50,000 is allowed under Section 80CCD (1B). This is over and above what you can claim under Section 80C.
- An employee can also claim deduction against contribution made by the employer of up to 10 per cent of the salary (basic salary plus dearness allowance) under Section 80CCD(2). There is no limit on this deduction.

Lock-in: Till retirement, that is, 60 years of age.

Return: Market-linked, will depend on the allocation to equity and debt.

Taxation: At the time of maturity, 60 per cent amount can be withdrawn; the rest has to be invested in annuity. Of the 60 per cent withdrawable amount, 40 per cent is tax-free.

<u>EXPENSES THAT CAN BE CLAIMED AS DEDUCTION</u>

The cap of `1,50,000 under Section 80C means you have to look at other options too as your income rises.

<u>1) Interest deduction on home loan:</u>

Home buyers are allowed a deduction of up to `2 lakh on interest paid on home loan taken to buy a self-occupied house property. In case of second house property, the interest paid during the year is allowed to be deducted from income from house property. Till last year, the entire loss was allowed to be set off against other income, but in Budget 2017, the set off for the loss was capped at `2 lakh per year. The remaining amount can be carried forward for the next eight years. This has substantially reduced tax benefits from second house property. However, remember that deduction against interest paid on home loan can be availed of after the construction of the property is complete. Also, the construction should be complete within five years from the date the loan is taken; if the property is not constructed within five years, the deduction limit gets reduced to `30,000 per year.

3)House Rent Allowance

If you are a salaried person staying on rent and house rent allowance, or, HRA, is part of your salary, you can claim deduction of the minimum of the these three amounts:

- Actual HRA received
- 50 per cent basic salary plus dearness allowance if living in a metro and 40 per cent if living in a non-metro.
- Actual rent paid minus 10 per cent of salary.

If you are staying with your parents, you can pay them rent and claim deduction. They will have to show the amount received as their income.

4) Deduction on rent paid for self-employed:

If you are not a salaried person or HRA is not part of your salary, you can still claim this deduction if you are staying in a rented accommodation. The deduction amount will be the least among the following.

- 25 per cent of the total gross income
- `5,000 per month (till 2016, the limit was `2,000 per month)
- Actual rent paid minus 10 per cent of total income

5) Health insurance:

The premium paid by you is eligible for tax deduction of up to `25,000 for self, spouse and children. In case of senior citizens, the deduction limit is `30,000. This includes preventive health check-ups of up to `5,000.

6) Interest earned up to `10,000 from savings bank account is exempt from tax.

7) Deduction on education loan:

If you have taken a loan for higher education of your child, self or spouse or a child of whom you are a guardian, you can claim deduction against interest paid for up to eight years or the tenure of the loan, whichever is earlier. There is no deduction on the principal repayment.

<u>Save tax by restructuring salary</u>

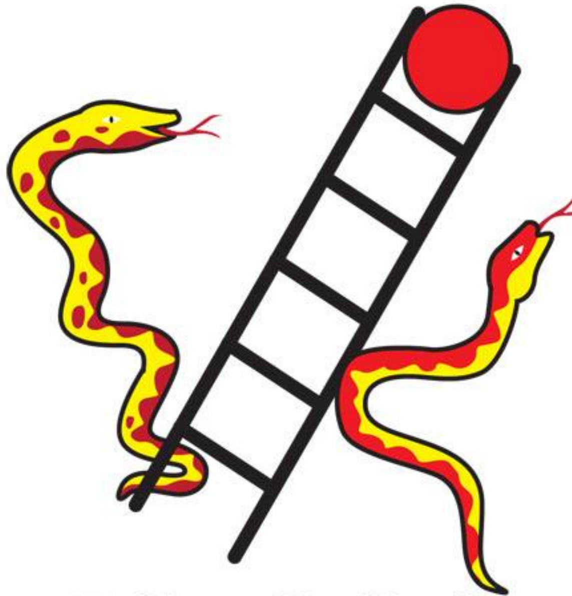
Making some tweaks in your salary structure can also help you save tax.

Following are some allowances and reimbursements which are not taxed and can be made part of the salary.

1. Conveyance allowance: One can claim an amount of up to `1,600 per month under this.
2. Medical reimbursement: Non-taxable up to `15,000 per annum subject to submission of medical bills (of self and dependents).
3. Uniform allowance: Non-taxable subject to submission of bills (self only). Even laundry and dry-cleaning bills can be submitted.
4. Knowledge update: Non-taxable subject to submission of original bills of training, books, magazines, periodicals, seminars, etc.
5. Telephone/internet reimbursement: Non-taxable subject to submission of original bills of landline/internet connection, provided these amounts are not claimed as official expenses.
6. Meal voucher: Non-taxable up to `2,000-2,500 per month. (` 50 per meal * 2 meals per day * working days)
7. Gift Voucher: Non-taxable up to `5,000 per year
8. Leave Travel allowance: Exemption is available on submission of travel bills. You can claim LTA twice for two domestic trips with family in a block of four years. 'Family' includes spouse and children and parents, brothers and sisters who are wholly or mainly dependent on you. Only expenses incurred on travelling are covered.

<u>Take help from family</u>

Pay rent to parents: If you stay with your parents and HRA is part your salary, you can pay them rent and claim HRA deduction. Your parents will have to show the rental income in their returns. If their income is below the exempted limit, they will not have



to pay any tax on it. If they fall in a tax bracket that is lower than yours, they will have or pay lesser tax than you. So, as a family, you can save more tax.

Invest in the name of your adult child or parent: If you invest in the name of your minor child or spouse, the income will be clubbed with your income for taxation, but if you gift money (gift tax does not apply in case of relatives) to your parent or your adult child (above 18 years of age) and invest in their name, you can save tax, as the income will be taxable in their hands. Suppose your parents are senior citizens and don't have any income of their own. In such a case, you can gift them money to invest; income of up to `3 lakh from the investment (exemption for senior citizens) or `5 lakh in case of super senior citizens will be tax exempt in their hands.

Pay health insurance premium for your parents: Apart from the `25,000 deduction that you can avail of against the health insurance premium paid for self, spouse and children under Section 80D, you can also get an extra deduction of `25,000 (for parents less than 60 years old) or `30,000 (in case of senior citizens).

Create HUF (Hindu Undivided Family): You can also create an HUF and transfer inherited property or corpus to the HUF. Otherwise, the additional income will normally be taxed in your or your spouses name, which can be hefty sum if you fall in the 30 per cent tax bracket. The income would be taxed in the hands of the HUF. As the HUF can avail of an exemption limit of `2.5 lakh, the tax would be much less.

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