Invest in EPF for tax free and safe returns

GET PERSONAL

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THE LAST few weeks have seen a lot of uncertainty around the final rate of interest for the Employee Provident Fund (EPF). While the rate over the past few years has been kept at 8.5 per cent per annum, this year EPFO has announced a bonanza of sorts — 9.5 per cent.

This was enabled after a sum of ₹1,700 crore plus was discovered in an audit. Although the finance ministry has yet to approve the recommendation, the higher interest rate makes EPF a very attractive option for investors, especially those who are worried by the fluctuations in stocks and want safety above all.

It is not as if there is a lack of fixed return, safe options. The past few weeks have seen bank fixed deposit rates move up substantially. SBI, IDFC, L&T are also issuing bonds for retail investors. All of these may look more glamorous than EPF, especially since money is locked up here for a long time.

However, we believe that the EPF brings with it certain key advantages making it an ideal fixed income instrument. The key advantages of contributions to the Employee Provident Fund are:

- Employee contributions to provident fund give you a tax benefit under Section 80C at the time of investment. Since this is a forced saving and you have no control over it, the tax benefit definitely comes in handy.
- Since the returns from EPF are also tax free on maturity, the effective pre-tax return on the EPF works out in excess of 13.5 per cent per annum for an investor in the highest tax bracket i.e. a competing fixed income instrument would be required to deliver more than 13.5 per cent per annum to match the post tax returns of 9.5 per cent per annum that the EPF offers. Most banks are currently offering a little over NINE per cent.
- Since the employer makes a matching contribution to the EPF, the overall sums of money going towards retirement will help in providing a decent lumpsum at the time of maturity. EPF holdings can only be withdrawn prematurely in the case of certain situations including job changes, home purchases, medical reasons amongst a few others. Whilst a lot of investors perceive this as a negative, we believe that the EPF actually allows withdrawals for too many reasons. Ideally, EPF withdrawals should only be permitted at the time of retirement in our opinion due to the lack of a social security system in India. We believe that a combination of the EPF and index/diversified equity funds are ideal to build a long term retirement portfolio.While the existing options like bank deposits and retail bonds can also be considered for their advantages of liquidity and tax benefits, we believe investors in the highest tax bracket should explore the possibility of using a voluntary provident fund (VPF) contribution, in addition to their regular EPF contribution to take advantage of the higher post tax returns that the EPF/VPF offers.

LONG TERM SECURITY

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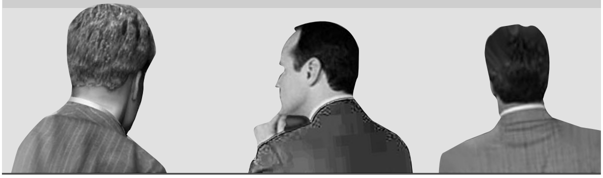
- Ideally, EPF withdrawals should only be permitted at the time of retirement due to the lack of a social security systemin India.



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