Print This Pa

Confused on how NPS investments are taxed? Here's everything you need to know

Navneet Dubey

Moneycontrol News

The tax saving season is near and the Union Cabinet announced some welcome moves for streamlining the National Pension System (NPS). The NPS is a voluntary defined-contribution retirement savings scheme where you can invest till you attain your retirement age. Also, along with this, you can plan your tax savings every year.

However, if you are still confused about the tax treatment of NPS under the new ruling then you should know that this new Avatar of NPS will surely give you relief in understanding the product and help you plan your taxes in line with your retirement planning henceforth.

Let us understand how the new guidelines under NPS can serve your retirement needs as well as provide you tax benefits.

Earlier tax treatment of NPS

Investors are aware of the fact that the NPS is subject to EET â€" exempt, exempt and tax. This means that the contributions you make are tax exempt and accumulations are too exempt from tax. However, the maturity amount is taxable in some proportion.

The NPS scheme is a retirement product and it is designed in such a way that you have to compulsorily buy an annuity with 40 percent of the corpus. Thus, it means that the income from the annuitised portion of the corpus will be subject to tax as per the applicable tax slab. Whereas, at the time of maturity, investors/subscribers can withdraw 60 percent of their money in a lumpsum, where again the tax exemption is applicable only on the 40 percent and the remaining balance of 20 percent of the corpus which can be withdrawn remains taxable.

Tax treatment of NPS under new guidelines

On 10th December, the Government announced "the tax exemption limit for lump sum withdrawal on exit has been enhanced to 60 percent. With this, the entire withdrawal will now be exempt from income tax." This means the balance 20 percent of the corpus which can be withdrawn now is also tax-free.

Vishal Dhawan, CFP & founder, Plan Ahead says, "This is an improvement of NPS what it was earlier before the change came in. Knowing what is tax exempt and what is tax-free creates a bit of confusion among investors but this new rule has simplified the taxation part to an extent."

Srikanth Meenakshi, co-founder and COO, FundsIndia says that still, 100 percent EEE benefit is not there as earlier one could withdraw 60 percent lumpsum which was subjected to tax treatment in some proportion and with the remaining 40 percent one had to purchase an annuity, which was taxable.

"However, with this move where the government has made entire 60 percent lumpsum withdrawal tax-free, investors should not forget that still, NPS rules require that 40 percent corpus to put into an annuity, which is still taxable. Wherein you need to purchase annuity plan from an insurance company," he said.

NPS should be a part of your retirement portfolio

Among other investment options, NPS is a more viable retirement product. Also, if you are not comfortable in making investment decisions for your retirement, NPS is the best solution because the assigned fund managers look after your portfolio when it comes to managing debt and equity. Thus, this product is best suited for those who are busy working in their life and cannot take calls over their investments at a regular interval.

Unlike products like PPF and EPF, where investors most likely use their money for purposes beyond the retirement planning NPS is designed in a way that the annutisation part makes people think about doing their retirement planning and also makes sure that they use this money for their post-retirement purposes only.

"Right from allowing higher equity investments to make it a low-cost product. NPS is now becoming a more attractive investment product when we talk about securing one's retirement life," said Dhawan.

Srikanth says, "NPS should be a part of every investor's retirement portfolio because it is a low-cost product, have equity options which can boost your investment returns and above all this, it is a tax-saving product.â€

One should also not forget the fact that investors can invest an overall Rs 1.5 lakh deduction under section 80C, where aÂ further deduction of Rs 50,000 is available under section 80 CCD(1b) of income tax. The more you save under the NPS scheme, the more corpus you will be able to generate at the time of retirement.