Huge rush for Small Savings Schemes in FY22 amid falling bank FD rates

Take into account tax benefit and payout frequency as well when selecting a scheme

Bindisha Sarang | February 13, 2022 20:44 IST

Small Savings instruments found favour with investors in financial year 2020-2021 (FY21). Deposits saw a 21.8 per cent surge while inflows into certificates (like National Savings Certificate or NSC) rose 21.2 per cent against the backdrop of the pandemic. According to government estimates contained in this year's Budget documents, inflows are likely to be reasonably strong in FY22 as well.

Higher returns than bank FDs

With interest rates on bank deposits falling sharply over the past few years, investors turned to small savings instruments for their above-market rates. Adhil Shetty, chief executive officer (CEO), BankBazaar says, "The pandemic was a game changer as people realised the need to build a safety net. With returns from fixed deposits (FDs) at an all-time low, they naturally moved towards small savings instruments for better returns and capital security."

While State Bank of India offers 5.4 per cent on its 5-10-year retail term deposits, the five-year post office time deposit offers 6.7 per cent. Several other small savings instruments offer higher rates of up to 7.6 per cent. Many of these instruments also qualify for Section 80C tax deduction. Interest income from instruments like Public Provident Fund (PPF) and Sukanya Samriddhi Yojana (SSY) are tax-free. Let us look at some of the key small savings instruments.

PPF: Being government backed, it is completely safe. It is a long-term investment instrument that comes with Section 80C benefit. The amount received on maturity is tax-free.

The minimum you can invest in PPF is Rs 500 while the maximum is Rs 1.5 lakh in a year. The government allows investors to deposit money in up to 12 instalments. Vishal Dhawan, board member, Association of Registered Investment Advisors (ARIA) says, "PPF is popular because of its tax-free status (PPF)."

However, PPF offers low liquidity. The first withdrawal can only be made after five years (excluding the year of account opening). PPF, according to Dhawan, is a good option for those in the highest tax bracket who have no liquidity needs.

Senior Citizens Savings Scheme (SCSS): Only those above 60 can avail of this scheme. The interest rate is high at 7.4 per cent. "SCSS pays a fixed interest every quarter, which is great for supporting the cash flow needs of retirees," says Dhawan. It also allows seniors to lock in the rate of interest for five years.

However, SCSS comes with low liquidity. If you close the account before one year, no interest is payable. If you close it between one and two years, 1.5 per cent is deducted from the principal. Between two and five years, 1 per cent is deducted. Extended accounts can be closed after one year without any penalty.

The maximum amount an individual can invest is Rs 15 lakh.

Dhawan says, "The disadvantage of both PPF and SCSS is that there is a limit on the amount you can invest. And both offer low liquidity, unlike bank deposits, which are highly liquid."

Sukanya Samriddhi Yojana (SSY): Parents who want to accumulate money for their daughter's education or wedding may invest in SSY. It pays the highest interest of 7.6 per cent among all small savings instruments.

On the flip side, only parents of a girl child can avail of it. The maximum investment permitted is Rs 1.5 lakh per annum.

Money can only be withdrawn after the girl turns 18 or passes the 10th standard. Dhawan says, "SSY is a good option for parents of girl children who are comfortable with the long lock-in."

NSC: The interest is moderate at 6.8 per cent. It offers Section 80C benefit. However, the interest income is not tax free, and there's a five-year lock-in.

ATTRACTIVE RETURNS WITH TAX BENEFITS		
Instruments	Interest rate (%)	Tax benefits
Savings Account	4.0	80TTA benefit
1, 2 & 3-year Time Deposit*	5.5	
5-year Recurring Deposit	5.8	
5-year Monthly Income Account	6.6	
5 year Time Deposit*	6.7	80C, 80TTA benefit
5-year National Savings Certificate	6.8	80C benefit; No TDS
Kisan Vikas Patra	6.9	
Public Provident Fund	7.1	80C benefit, interest income tax free
Senior Citizens Savings Scheme	7.4	80C benefit, interest taxable if it exceeds ₹50,000
Sukanya Samriddhi Yojana	7.6	80C benefit, interest income tax free

* These are post office time deposits

Source: BankBazaar

Check for right fit

Choose a small savings scheme that suits your needs. Gaurav Aggarwal, senior director, Paisabazaar.com, says, “Consider the interest rate, taxation of interest, lock-in period, periodicity of interest calculation and credit, and the minimum and maximum amount that can be invested each year.”

Suresh Sadagopan, founder and principal officer, Ladder7 Wealth Planners says, “Look at the frequency of income generation—monthly, quarterly, etc. When you invest in a bond, it gives an annual return, but that may not suit everyone.”

Consider debt funds too

Experts say debt mutual funds may be considered, either as an alternative to small savings schemes, or in addition to them. Feroze Azeez, deputy CEO, Anand Rathi Wealth says, “Over longer time frames, they have offered higher returns than small savings schemes. They are also more tax efficient. If you hold them for more than three years, they are taxed at 20 per cent after indexation. The interest income from many small savings schemes is taxed at slab rate.”

Debt funds are liquid, unlike many small savings instruments which come with a lock-in. However, debt funds offer market-based returns, not fixed returns with sovereign backing, as small savings instruments do.

Sadagopan says, “Right now even AA-rated corporate deposits of lower tenures can be considered.”

Finally, while small savings instruments offer attractive returns with capital protection, the interest income is not tax-free for all of them. Those with high returns usually come with long lock-ins. Shetty says, “They should be an important part of your fixed-income portfolio, but they cannot be the primary instruments for building a corpus.”

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