Important things to know about ELSS and other tax-saving investments

When you buy a phone, do you pick any model that allows communication or you look for more benefits? Naturally, you consider a lot of other factors before making the purchase. So, why not do the save while making tax-saving investments?

When it comes to selecting an investment under Section 80C, there can be two types of investors. One will not mind any instrument as long as they are able to save tax on investments of up to Rs. 1.5 lakh annually. The other will weigh the pros and cons of each option and choose the one that not only helps reduce the taxable income but also fulfil other financial goals.

Do you want to belong to the second category? Here's a table that can help you assess the features of different investment avenues under Section 80C and also find out how they actually performed over the last 10 years.

<table>
<tr><th colspan="2">Particulars.</th><th>PPF</th><th>NSC</th><th>FD</th><th>ELSS Category Average</th></tr>
<tr><td colspan="2">Annual investment made on April 1, 2011 for 10 years.</td><td>Rs. 1.5 lakh</td><td>Rs. 1.5 lakh</td><td>Rs. 1.5 lakh</td><td>Rs. 1.5 lakh</td></tr>
<tr><td colspan="2">Total investment value</td><td>Rs. 15 lakh</td><td>Rs. 15 lakh</td><td>Rs. 15 lakh</td><td>Rs. 15 lakh</td></tr>
<tr><td colspan="2">CAGR over the last 10 years.</td><td>8.01%</td><td>7.96%</td><td>6.86%</td><td>12.99%</td></tr>
<tr><td colspan="2">Investment value as of Nov 30, 2020</td><td>Rs. 23.05 lakh</td><td>Rs. 22.97 lakh</td><td>Rs. 21.65 lakh</td><td>Rs. 30.28 lakh</td></tr>
<tr><th colspan="6">Features</th></tr>
<tr><td colspan="2">Tenure</td><td>15 Years.</td><td>5 Years.</td><td>5 Years.</td><td>Perpetual with 3 years. lock-in</td></tr>
<tr><td colspan="2">Liquidity</td><td>Premature withdrawal allowed*</td><td>Not Available</td><td>Not Available</td><td>Any day post the completion of the lock-in period##</td></tr>
<tr><td rowspan="3">Yearly returns range**</td><td>Lowest</td><td>7.10%</td><td>6.80%</td><td>5.40%</td><td>-23.86%</td></tr>
<tr><td>Highest</td><td>8.80%</td><td>8.60%</td><td>9.25%</td><td>54.19%</td></tr>
<tr><td>Average</td><td>8.22%</td><td>8.13%</td><td>7.44%</td><td>13.90%</td></tr>
<tr><td colspan="2">Risk profile</td><td>Low</td><td>Low</td><td>Low</td><td>Moderate to High</td></tr>
<tr><td colspan="2">Mode of contribution</td><td>Lump Sum / Monthly#</td><td>Lump Sum</td><td>Lump Sum</td><td>Lump Sum/SIP</td></tr>
</table>

Taxation on withdrawals		Interest accrued is tax-free	Interest accrued is taxable	Interest accrued is taxable	LTCG exceeding Rs. 1 lakh annually taxable @ 10%

Source: For FD rate - Fixed deposit rates of SBI, For NSC & PPF - Ministry of Finance, For ELSS - MFI Explorer
Assuming that the said investments (lump sum) are made on 1st April of each year from 2011 to 2020 in each of the tax savings options as mentioned above.
ELSS - Average returns of 27 funds (having full 10 years. track record) in the ELSS category (growth option) has been considered for calculation of returns. Past performance may or may not be sustained in future.
$ ELSS category returns based on the average returns over the 10 years. Period, there was high variation in returns among different schemes with highest & lowest CAGR being 18.17% & 9.19% respectively. $$ as of November 30, 2020 (8 months period)
* Premature withdrawal under PPF is available from 7th financial year. However, the full amount can be withdrawn after 15 years.
**Based on the last 10 years return history of respective tax-saving options
#Cannot exceed 12 contributions in a financial year.
##3 years. Lock-in for each of the investments made.
SIP - Systematic Investment Plan; LTCG – Long Term Capital Gain; CAGR - Compound Annual Growth Rate
Data as of November 30, 2020

To make your choice easier, here's a detailed explanation of the four tax-saving investments compared above:

1. **Equity Linked Savings Scheme (ELSS)**

ELSS is an equity-oriented Mutual Fund with a three-year lock-in period, the shortest among such investment plans. Although subject to some market risks, average long-term yields from equity investments has higher potential of growth. Thus, ELSS may help you build wealth for your long-term life goals such as financial freedom during retirement.

ELSS does not require investing Rest. 1.5 lakh at once. Instead, you can choose the Systematic Investment Plan (SIP) route and spread your investment across 12 months. SIPs allow you to invest a fixed amount in Mutual Funds at regular intervals such as monthly or quarterly. You can start investing with as low as Rs. 500. Besides being light on your pocket, SIPs also give you the advantage of rupee cost averaging. You buy more units when their prices are low, and less when the prices are high. Thus, your investment cost gets averaged out over your investment horizon, increasing your overall profits.

Long-term capital gains accrued from ELSS or any other equity-oriented Mutual Fund up to Rs. 1 lakh in a financial year are tax-free. The gains exceeding Rs. 1 lakh are taxed at 10%

2. **Fixed Deposits (FDs)**

FDs refer to the money that you deposit in a bank or a non-banking financial company for a fixed period in return for a predetermined rate of interest. The interest is added to your total income and is taxable as per your slab rate. Different entities offer different interest rates.

Tax-saving FDs have a lock-in period of five years... Thus, your money gets blocked for a longer time as compared to ELSS. But the returns are guaranteed, and hence the risk is low. However, the returns can be low too. You can expect around 6-8% interest rates with such investments.

3. **Public Provident Fund (PPF)**

PPF is a government-backed investment scheme with a lock-in period of 15 years. However, partial withdrawals are possible after the 7^{th} financial year. The interest rate varies every year, with 7.1% being the current rate in FY 2020-21.

You can either make a lump-sum investment of Rs. 1.5 lakh in a year or stagger it over 12 monthly instalments. PPFs are low risk-low investments and the interest that accrues is also tax-exempt.

4. **National Saving Certificate (NSC)**

NSC is another government initiative, available for purchase from post-offices. This fixed-income savings scheme with a lock-in period of five years. Is also a low-risk investment. Much like PPF, the interest rate changes every year as per the government’s discretion, with 6.8% being the current rate in FY 2020-21. The interest is paid at maturity and is taxable.

Bottom line

Tax planning entails much more than just reducing the taxable income. While tax-efficiency is an important parameter, smart investors. Also choose an investment based on its flexibility, liquidity and potential to deliver returns. Clearly, ELSS outperforms the other investments on all three grounds.

Note: The old tax regime allows you to save tax on investments up to Rs. 1.5 lakh annually, under Section 80C of the Income Tax Act, 1961. However, you will not be able to claim such a deduction if you opt for the new tax regime.