Tax-Saving Options That Can Help You Build Wealth

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For many people tax-saving and investment are two different aspects. They think both can't be done together. As a result, they blindly invest the Rs 1.5 lakh deduction limit available under Section 80C of Income Tax Act in sub-optimal tax saving instruments and thus lock-in their money in options that hardly yield them anything above inflation.

So, if you are looking an alternative to save tax as well as grow your money, following are the options for you.

Tax-saving mutual funds

These are basically equity diversified funds that invest in a basket of companies. Equity linked saving schemes or tax saving mutual funds score in term of offering better inflation-adjusted returns and also have the lowest lock-in period of three years. Such funds have delivered an annualised return of 17.78 per cent over the past 3-years as on December 21st, 2015.

"Volatility is much higher but when it comes to returns they outsmart all the other options", says certified financial planner Surya Bhatia.

Also, unlike tax-saving bank deposits where the interest income is taxable, the gains from these funds are tax-free. As these funds invest majority of their assets in equities, the dividend from these funds are also tax-free. Another advantage of tax-savings mutual funds is that they help you avoid the last -minute rush as you can invest in them through systematic investment plans on a monthly basis.

Public provident fund

It is a debt instrument with complete capital protection and the EEE (exempt, exempt and exempt) tax status makes it a good option for conservative investors. The EEE tax status implies that the investments, the income and the maturity amount are all tax-free.

The interest on PPF is notified on April 1 every year and is linked to government securities rates of the same maturity. The lock-in period is 15 years but one is allowed to take loan between the third and sixth financial year of opening the account subject to conditions.

"Only 10-15 per cent of the working force in India has access to employee provident fund (EPF), so it is a good option for 85-90 per cent of the people", says Vishal Dhawan, certified financial planner.

New Pension System (NPS)

Investors can choose to invest up to 50 per cent of their assets in equities under NPS. The scheme is structured into two tiers: Tier-I and Tier II accounts. The Tier-I account is the non-withdrawable account and is only eligible for tax benefits. Under the equity option of Tier-I account one can invest up to 50 per cent of the assets in equities. With the equity exposure, investments in NPS are expected to deliver superior returns. As per Valueresearchonline.com, the average return delivered by the funds in Tier-I equity option is 12 per cent annually over past 3 years (as on December 21, 2015).

From this year onwards, one can avail an additional deduction of Rs 50,000 for the investment made in NPS under the Section 80CCD apart from the Section 80C deduction of Rs 1.5 lakh.

The only dampener about NPS is tax treatment of withdrawals. The contribution to NPS and the interest earned are not taxed but the withdrawal becomes taxable.

New Ulips

Unit linked insurance plans or Ulips provide a combination of insurance and investments. These are just like mutual funds with an insurance cover. ULIPs have undergone big changes since IRDA brought in few regulations in 2010. Earlier Ulips were high cost products with poor returns and low insurance cover.

However, in case of new Ulips, the expenses are capped to 3 per cent in case of policy of term up to 10 years while 2.25 per cent for more than 10 year. The lock-in has been increased to five year from earlier three year.

As Ulips have the option to invest up to 100 per cent of their assets in equities, they can help you grow your wealth.

As per Mr Dhawan, "The new Ulips can be a good tax-saving options to build wealth over long-term but investor have to be selective while buying ULIPs as they may end up putting their money in Ulips which have high agent commission and charges."

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