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A Guide To Smart Investing: Save Tax



The end of a financial year marks an important time for many businesses and individuals alike. However, as an individual, the only time we are cognizant of is the cut-off date for filing our income tax returns. Many still jostle at the last minute to adjust, find receipts, and forget about planning for the next year's tax liabilities as soon as their income tax return is generated.

The need of the hour is to increase awareness and involvement in the entire tax planning process.

Why Go for Tax Planning?

Tax planning serves multiple purposes than simply reducing your tax liability. Here's a look at some key purposes it serves:

1. Ensuring Financial Stability

Tax planning is a necessity not just to increase your net income but is also an enabler to help secure your financial health and future. Many of these instruments serve the dual purpose of saving tax and creating wealth by offering security of assets.

The investments you make today in tax-saving instruments will help create a financial cushion for your old age / retirement and also act as a security for your family / loved ones.

2. Inculcate the saving habit

Many tax-planning instruments lead to compulsory saving. For example, in the case of many working professionals, certain components of their salary are diverted to compulsory tax-saving instruments as part of their salary structure such as EPF etc. which is crucial to create a security cushion for them.

Apart from this, proactive investments in tax-saving instruments under Section 80C/80CC/80D under the Income Tax Act 1961 inculcates the saving habit among many people. They may primarily invest to save tax, but also end up paving the way to begin their investment and wealth creation journey by taking this step.

3. Stabilize the economy

While it is essential to strike a balance between tax liability and financial investments, the taxes you end up paying to the Government are used for the betterment of society and its overall development ranging from meeting infrastructure needs or creation of a good public healthcare system. The end-use of taxes remains the benefit of the society at large.

Types of Tax Planning

There are four types of tax planning:

1. Short-range tax planning:

Under this, tax planning happens towards the end of the financial year. Investors resort to this in a last-minute attempt to reduce tax liabilities following due processes.

2. Long-range tax planning:

This type of tax plan is chalked out at the beginning of the financial year. Under this, tax-relief may not be immediate but actually prove to be beneficial in the long-run. You must start investing when the new financial year begins and must hold on to it at least for a period exceeding one year.

3. Permissive tax planning:

This refers to investments under the provisions of the taxation laws in India. There are many provisions offering exemptions, incentives, and contributions. An example is the Income Tax Act of 1961.

4. Purposive tax planning:

This refers to planning your investments with a specific purpose or objective in mind. It may include diversification of business and income assets based on residential status and replacing assets if necessary.

Start Early

It is always advisable to begin your tax saving and investment journey earlier in the financial year as compared to rushed investments towards the end of the year just to tick the initiative off your checklist. Here are few reasons why this will work in your favor:

1. Availability is key

At the beginning of the financial year, you will have more funds at your disposal to consider investments across multiple avenues. Always invest earlier to make up for any deficiencies related to tax deducted at source (TDS).

2. Track your progress

As a hygiene practice, once you have committed a certain amount to investment, you can continue to track how your investments are faring over the course of the year – thereby learning how your money is working for your growth.

You will be more adept in understanding what market situations work for you and will have a better idea of your risk appetite as time passes.

3. Avoid the last-minute hassle

There are plenty of people who enjoy instant gratification by not starting this process early and rushing about to close investments only once the deadline for the end of the financial year is at a close. In this situation, the investment is made only for the sake of reducing your taxable income alone, without considering wealth or value creation for your money.

Investing early helps spread your investments spread out over a larger period of time helps thereby combating market volatility and offering higher security. You are also more relaxed towards the end of the financial year knowing all possible steps have been taken in a systematic manner to save tax.

4. Pay the right amount of tax

Detailed and proper planning will ensure that you end up meeting your fiscal responsibility by paying income tax and also saving to cement your financial well-being. The earlier you showcase your expenditure or investment plans, the more seamless it is for calculating your accurate tax liability.

A Look at Some Key Tax-Saving Instruments

It is important to remember your tax-saving journey will not resemble another's. Investments must be made keeping in mind your professional and personal journey, short-term and long-term goals.

You can avail tax benefits of up to INR 1.5 lakh under Section 80C of the Income Tax Act. Here are some of the best instruments which provide an opportunity to save tax:

1. Public Provident Fund (PPF)

This is a long-term Government-backed savings scheme by virtue of having a minimum lock-in period of 15 years. It aims to create a safety net for investors post retirement. The minimum

investment is INR 500 and the maximum is INR 1,50,000. The deposit can be made either in installments or in a lump sum.

Moreover, the contribution towards PPF, interest earned, and maturity proceeds are all exempt from income tax making it one of the most popular instruments for tax-saving.

2. Equity Linked Savings Scheme (ELSS)

This is the only type of mutual fund which is eligible for income tax deduction under Section 80C of the Income Tax Act 1961. A majority of the portfolio is invested in equity and equity-linked securities. The lock-in period for this investment is 3 years, and investors are free to choose between a dividend and a growth option.

The investor receives dual benefits – saving tax coupled with returns linked to market performance of the fund. You may also choose to go with a Systematic Investment Plan (SIP) model or invest a lump sum amount as per your risk appetite.

3. Tax Saving Fixed Deposit

For those who have a low-risk appetite, this would be one of the most preferable tax saving instruments. The maturity period of the tax saver fixed deposit is five years, and customers can earn interest of around 5% to 6% annually. It guarantees return and security of investments.

You can receive a tax deduction under Section 80C of up to INR 1,50,000 when you invest in a tax-saver fixed deposit scheme with a minimum lock-in period of five years.

4. National Pension Scheme (NPS)

This is a voluntary, long-term investment plan for retirement under the purview of the Pension Fund Regulatory and Development Authority (PFRDA) and the Union Government, by virtue of which, it provides sufficient safety to investors and guarantees security of their investments.

This pension scheme is open to employees from public, private and even the unorganized sectors. It encourages you to invest a certain amount at regular intervals during your employment. Post your retirement, you are entitled to withdraw a certain amount, after which the balance will be paid to you in monthly installments as your pension.

Your investment contribution up to a maximum limit of INR 1,50,000 can be claimed for tax exemption under section 80C of the IT Act. However, under Section 80CCD (1b), you can receive additional deduction up to INR 50,000 by investing in this scheme.

5. National Savings Certificate (NSC)

This too is a government-backed savings initiative. Under this scheme, investors can open a fixed income tax saving scheme with any post office. Given the number of post offices present in India, the reach of this scheme is far and wide, making it a popular and accessible mode of investment.

Similar to NPS, it guarantees safety and security of your investments and offers the option of going for a low-risk investment for those with a low-risk appetite. The aim is to inculcate a saving habit among individuals.

The minimum amount required for investing in NSC is INR 1,000, making it a very pocket-friendly investment scheme for the public.

6. Life Insurance Premium

Life insurance policies are multi-faceted offering options for wealth creation, retirement planning, children's education, and others. Under Section 80C, premium paid for any life insurance policy also qualifies for tax deduction.

You can purchase a Unit Linked Insurance Plan (ULIP), traditional policy or a term policy to avail dual benefits of security combined with income tax rebates.

The maximum amount which can be exempted is INR 1,50,000 in a financial year.

7. Medical Insurance Premium (Self and family)

Under Section 80D, you are allowed to claim a tax deduction of up to Rs. 25,000 for medical insurance / mediclaim towards the premium paid towards health insurance purchased for you, your spouse and your dependent children. The deduction amount increases to INR 50,000 in the event the premium is being paid for senior citizen parents.

Hence, this premium not only helps save tax but also helps in creating a robust financial cover to protect your loved ones from any critical diseases and the risk of high medical expenses.

8. Home Loan

You are eligible for a rebate for up to INR 2,00,000 per annum under Section 24 of Income tax Act, 1961. Additionally, the payment of principal amount of home loan is eligible for deduction under Section 80C.

Tax planning serves a dual purpose – not only does it work to increase your net income in hand, but it also helps to secure your financial future. Keep this in mind when you are evaluating newer investment avenues to generate wealth and security.

Have detailed discussions with your financial planner, if you have one, or feel free access to a multitude of credible reading resources to find out which investment vehicles can reduce your taxable income. It is necessary to understand that tax planning is not an overnight process and requires sufficient research along with detailed examination of prospective incomes and expenditures for the year.

In an ever-changing market scenario, you must always keep yourself updated about the latest market trends or changes in investment policies. Keep the conversation line open between yourself and your financial planner or always undertake healthy research from credible sources to calculate your tax liabilities sooner rather than later.

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