Tax and retirement planning

Tax-efficient avenues that map with investor's financial goals

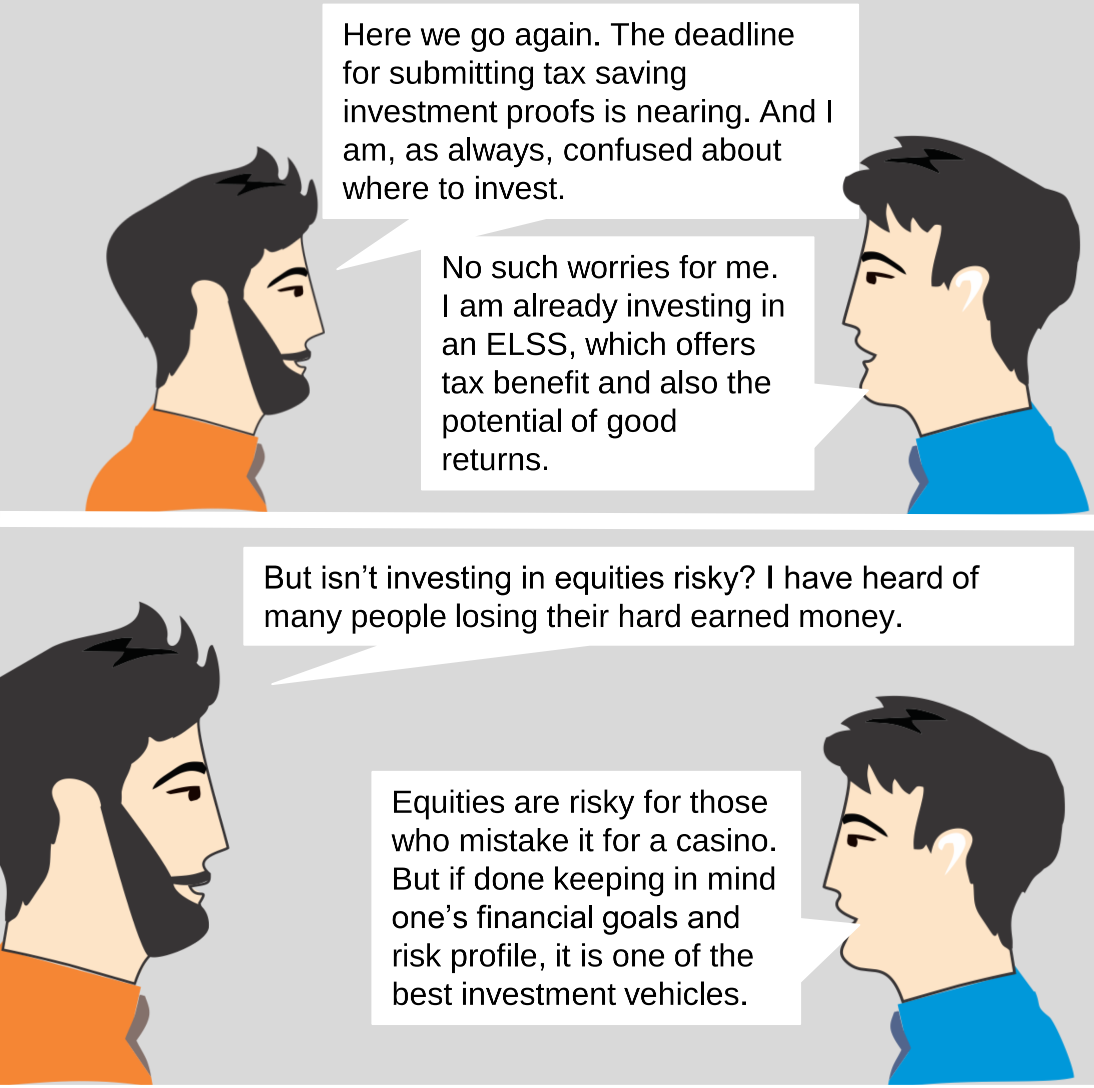
HSBC
Asset Management

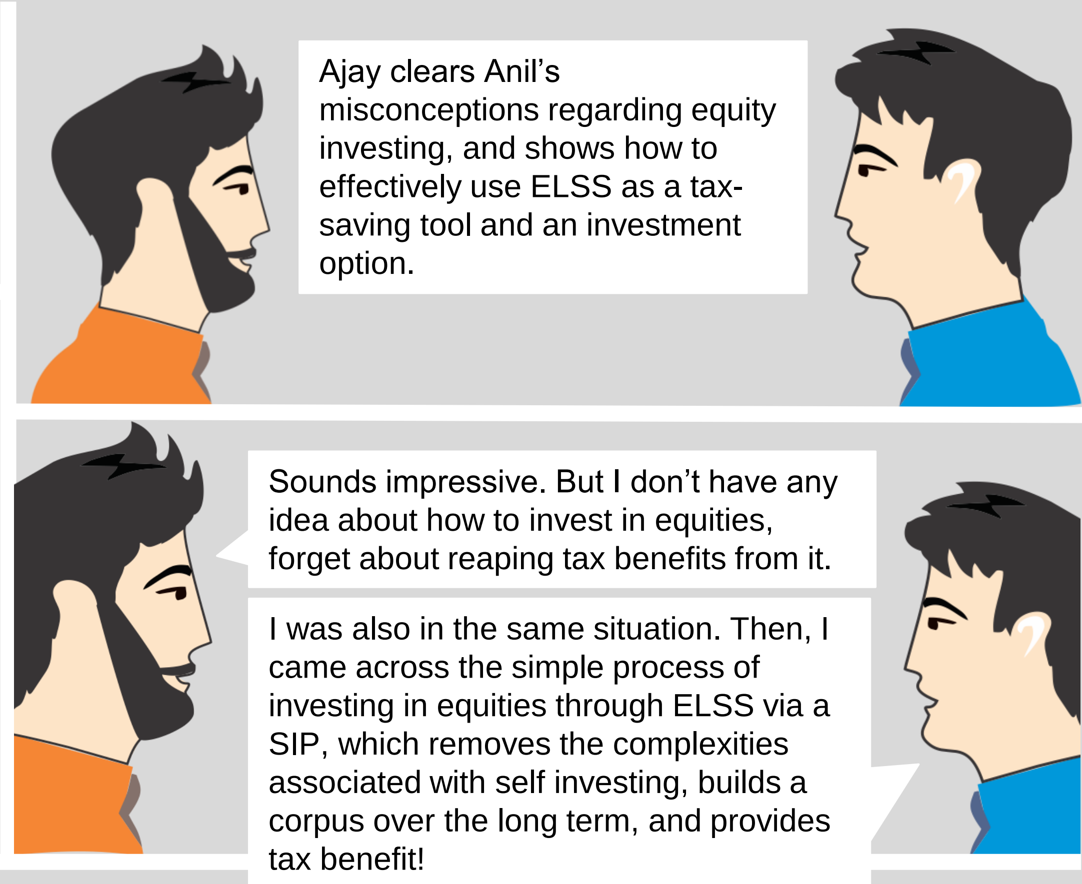
January 2021

Simplify tax planning by investing in ELSS

Here's a conversation between Anil and Ajay

Anil and Ajay are old friends who meet after a long time. They are discussing tax saving avenues, as the current financial year is nearing a close.





Systematic investments in ELSS helps build wealth over the long term, along with tax benefits

ELSS: Equity-linked savings scheme; SIP: Systematic investment plan

Do’s and don’ts of tax planning

Don’t procrastinate - Plan it in advance

Most common mistake in tax planning and how to approach it

- Investing lump sum for tax
- saving towards the end of the year

- Tax planning should not be a last-minute activity
- A tax saving plan at the start of the year will put investors in a better position to estimate cash flow and liabilities that will be due in the coming months
- Investors will also be able to allocate small sums periodically through the year when they start early

For illustration purpose only

It is recommended to consult financial advisor before taking any investment decisions

Understand the options available under Income Tax Act

The Income Tax Act provides several options - investment- as well as non-investment-linked - to save tax

Section of IT Act	Particular	Tax exemption limit
Investment-linked		
80C	Employee provident fund	Rs 1,50,000
	Life insurance premiums (ULIPs)	
	ELSS	
	National Pension System (NPS)	
	FDs (5 years)	
	NSC	
	Sukanya Samriddhi Yojana	
	Senior Citizen Savings Scheme	
	Public provident fund (PPF)	
80 CCD (1B)	NPS	Rs 50,000 (over Rs 1.50 lakh under 80C)
Non-investment linked		
80D	Medical insurance	Rs 25,000
80E	Education loan interest	No limit
24B	Payment of interest on home loan	Rs 2,00,000

For illustration purpose only
It is recommended to consult a financial advisor before making an investment decision
Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme related documents carefully.

Use tax-efficient avenues that map with investor’s financial goals

Equity-based instruments

- ELSS: 10% tax after one year on long-term capital gains over Rs 1.0 lakh
- ULIP: Taxable on contribution more than Rs 2.5 lakh per annum*

Debt-based instruments

- PPF: Tax exempt at contribution, accumulation and withdrawal
- NSC: Interest income taxed at income tax slabs
- Tax saving FDs: Interest income taxed at income tax slabs

For illustration purpose only
*In the Budget 2021-22 it has been proposed that there will be no tax exemption for maturity proceeds of ULIPs with cumulative annual premium above Rs 2.5 lakh
It is recommended to consult a financial advisor before making an investment decision
Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme related documents carefully.

Not evaluating the lock-in period of tax saving investments

Equity-based instruments

- ELSS: Full amount can be withdrawn after three years from date of allotment
- Insurance / ULIP: No surrender charges after five years

Debt-based instruments

- PPF: Lock-in period of 15 years; partial withdrawal permitted after six years
- NSC: No withdrawal prior to maturity, but investments can be used as collateral to avail loans from banks
- Tax saving FDs: Premature exits permitted, subject to applicable charges

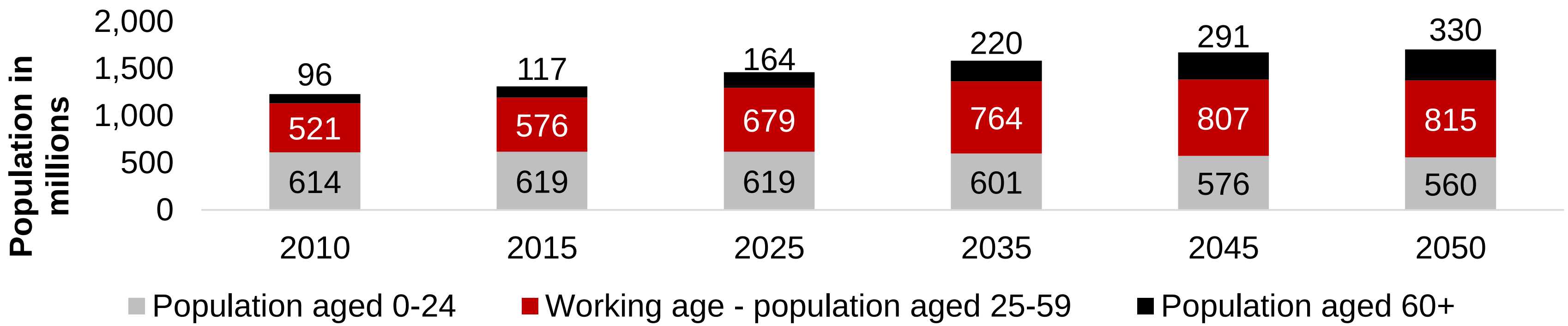
For illustration purpose only
It is recommended to consult a financial advisor before making an investment decision
Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme related documents carefully.

Invest as per risk appetite and age profile

The costliest mistake that investors make in investment and tax saving decisions is not investing as per risk appetite and age

The investment duration should ideally be in inverse proportion, i.e. younger the investor, the longer timeframe the investment horizon should be, and vice-versa

- India has a demographic advantage over most major economies. The country has a relatively young population, with average age of less than 30 years. The country will continue to have a large young population in the foreseeable future



- By a basic thumb rule, a young investor has a higher risk profile, i.e. ability to take higher risks and, thus, generate higher returns on his / her investments
- In this case, ELSS funds, with their mandate to invest in equity, allows investors to use this demographic advantage to their benefit, while also saving on tax in the process

Source: United Nations data
It is recommended to consult a financial advisor before making an investment decision
Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme related documents carefully.

Traditional bent toward fixed income instruments might not be optimum tax saving strategy

HSBC Asset Management

Traditional instruments - Pros

- Key attraction of traditional debt-based instruments is safety
- Apart from tax deductions, investors use debt instruments to meet their financial planning goals. As debt offers relatively stable returns, it is easier for investors to predict the end value of the corpus
- Another advantage is that a change in interest rate only affects the interest component and not the invested amount. As a result, there is no risk of negative returns

Illustration

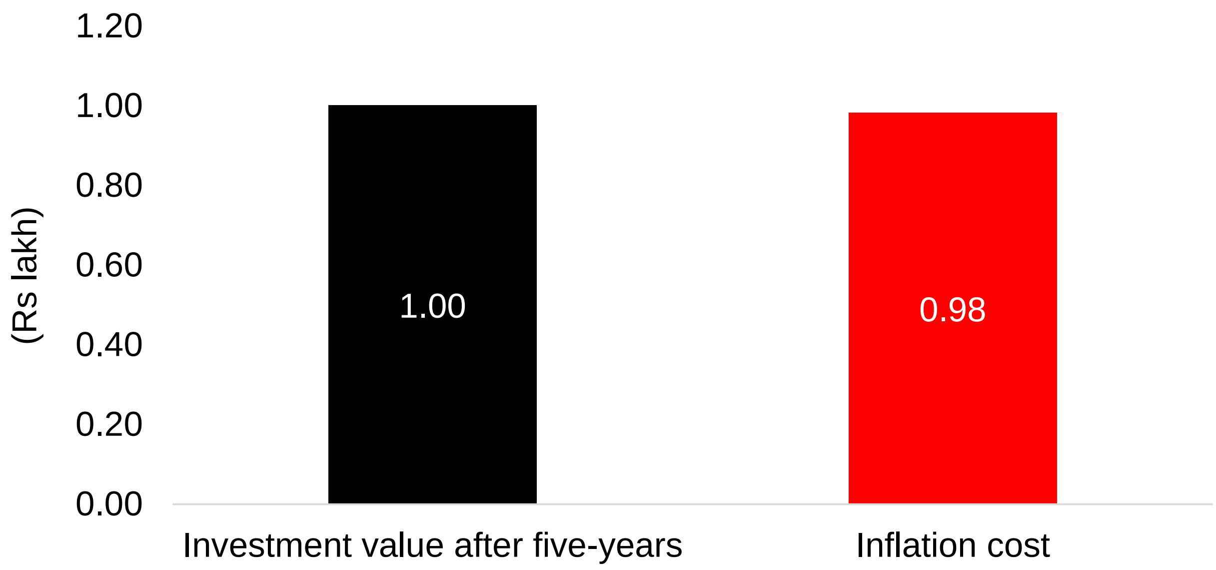
Suppose Anil requires Rs 1 lakh annually to meet his son's educational expenses five years from now. He can realise this by investing Rs 77,000 annually in a five-year FD. This way, he will be able to meet his objective and also save on tax every year.

Period	Investment in 5-year FD	Tax savings assuming 30% tax slab	Period	Maturity value assuming interest rate of 5.40%*
Year 1	77,000	23,100	Year 6	1,00,160
Year 2	77,000	23,100	Year 7	1,00,160
Year 3	77,000	23,100	Year 8	1,00,160
Year 4	77,000	23,100	Year 9	1,00,160
Year 5	77,000	23,100	Year 10	1,00,160

*SBI fixed deposit rate for 5 years, as in December 2020
For illustration purpose only
Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme related documents carefully.

Traditional instruments - Cons

- While fixed income investments provide the benefit of capital protection and stable returns, the returns can be inadequate, after factoring in inflation
- This highlights the biggest drawback of traditional investments – their inability to act as return enhancers. Hence, there is a need to look at instruments that give better inflation-adjusted returns
- If week look at the earlier illustration, even though Anil's Rs 77000 investment in FD grew at 5.4% to Rs 1 lakh, the inflation, considering the same amount, grew at about 5% to Rs 98000, resulting in meagre inflation-adjusted returns of just Rs 2000.



Assuming inflation of ~5% (five-year average inflation rate for period ended fiscals 2016 to 2021 CPI)
Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme related documents carefully.

Advantage ELSS funds

HSBC
Asset Management

ELSS – A good combo to save tax and build wealth over the long term

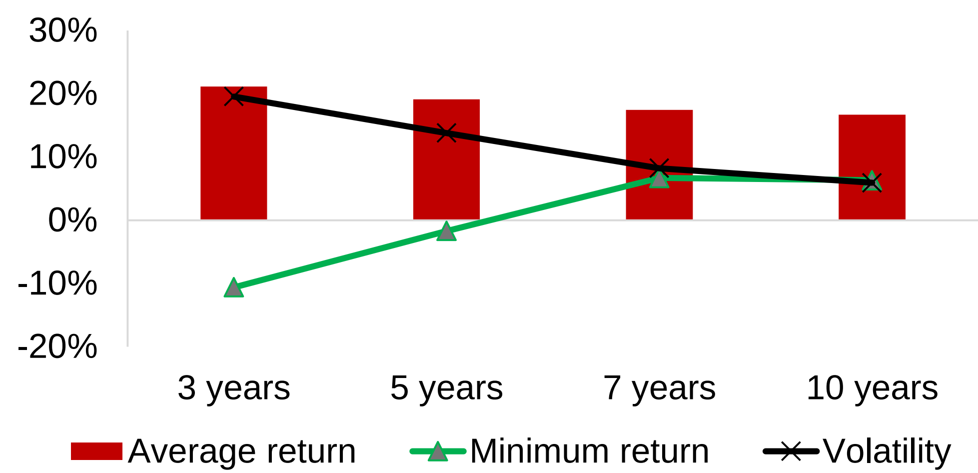
- Is a tax saving scheme that predominantly invests in equity securities
  - Managed by fund managers with experience and backed by research
  - Diversified portfolio across sectors and market capitalisation
- Investors need to hold units for at least three years to claim a tax rebate
  - Longer investment horizon increases the probability of higher risk-adjusted returns for the investor
- Withdrawals from ELSS after the three-year lock-in period are tax-free up to Rs 1 lakh in a financial year
- Flexibility to invest on monthly basis through systematic investment plans
  - Minimum investment can be as low as Rs 500 per month
  - Reduces market volatility and averages out the cost for the investor
- Investments are subject to market risk, and, hence, investors must consider their age and risk appetite

Return and risk characteristics

- An ELSS is for investors who have an investment horizon of at least three years. As can be seen by the scheme's return and risk characteristics, investors who stay invested over longer holding periods are rewarded
- Being an equity product, ELSS funds are volatile only in the short term. As seen in the graph, volatility decreases and minimum returns increase with an increase in the investment horizon.
- Thus, young investors such as Ajay, who have a longer time horizon and greater risk tolerance, stand to gain the most from ELSS.

Performance (%)*	3 years	5 years	7 years	10 years
ELSS funds *	5.26	11.05	14.57	11.03
Nifty 50	9.88	11.95	12.04	8.58
Nifty 500	6.65	11.35	12.93	8.82

Annualised returns as of December 31, 2020



Data as of December 31, 2020
Returns are annualized, calculated on a daily rolling basis of a weighted average index of CRISIL-ranked ELSS funds from December 2003 till December 2020
Volatility represented by standard deviation

For illustration purpose only
* The ELSS category is represented by CRISIL-ranked ELSS funds
Investments are subject to market risks. Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme-related documents carefully.

Mutual fund-based instruments (ELSS) versus traditional instruments

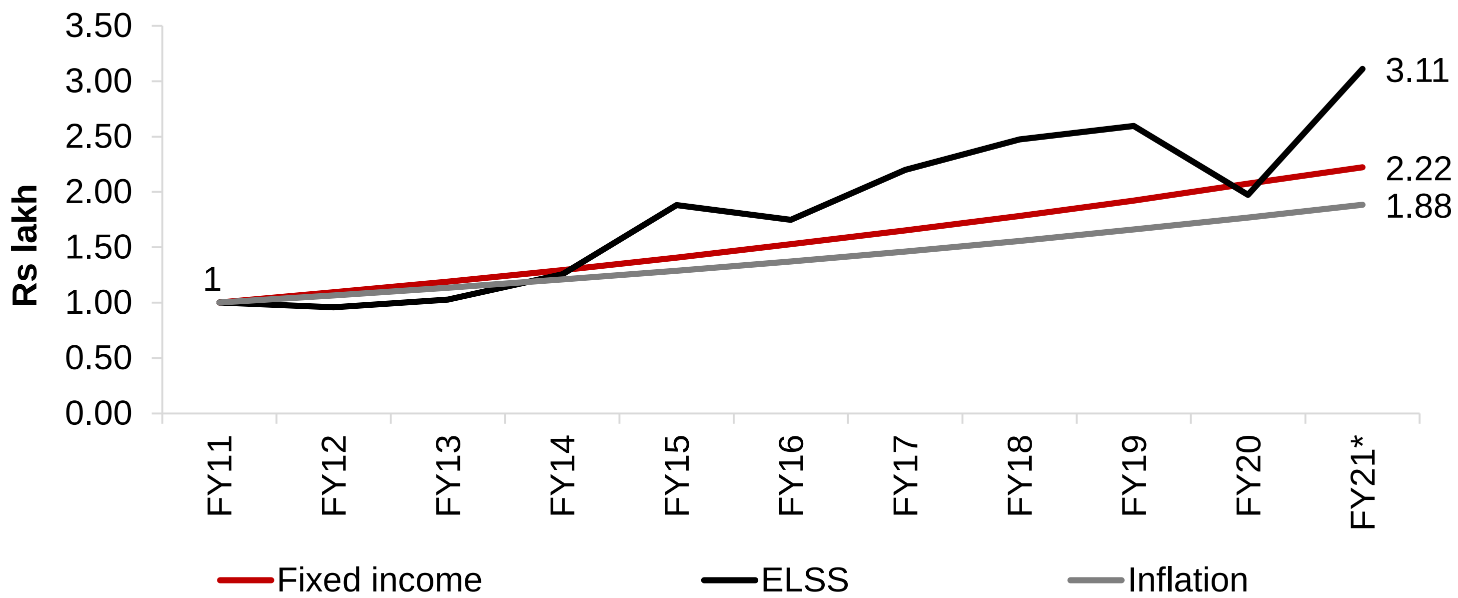
- In terms of returns, the equity exposure of an ELSS helps it score over fixed income investments such as PPF in the long term.
- As tabled, Rs 75,000 each is assumed to have been invested in the PPF and an ELSS for 10 years ended December 31, 2020, with a fresh investment at the start of each fiscal
- While the PPF investment grew to ~Rs 12 lakh at ~8.3%, the ELSS garnered Rs 16 lakh at ~15%

	PPF			ELSS		
	Beginning balance	Interest rate	Ending balance	Beginning balance	ELSS Funds	Ending balance
FY12	75,000	9.50%	82,125	75000	-4%	71,775
FY13	157,125	8.60%	170,638	146775	7%	157,695
FY14	245,638	8.80%	267,254	232695	22%	284,377
FY15	342,254	8.70%	372,030	359377	50%	537,807
FY16	447,030	8.70%	485,922	612807	-7%	569,788
FY17	560,922	8.10%	606,356	644788	26%	811,079
FY18	681,356	7.80%	734,502	886079	13%	997,016
FY19	809,502	7.90%	873,453	1072016	5%	1,124,330
FY20	948,453	7.90%	1,023,380	1199330	-24%	912,331
FY21*	1,098,380	7.10%	1,176,365	987331	57%	1,554,848

*till December 2020
For illustration purpose only
Source for PPF rates - Department of Economic Affairs
Returns for ELSS schemes are based on average of CRISIL-ranked ELSS funds. PPF returns are based on the interest rate announced every year.
Investments are subject to market risks. Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme-related documents carefully.

ELSS aims for higher inflation-adjusted returns

- Equity exposure helps an ELSS generate higher inflation-adjusted returns as compared with traditional instruments
- If Rs 1 lakh each is invested in, say, a traditional fixed income product such as a PPF and ELSS at the end of fiscal 2011 for 10 years ended December 31, 2020, the investments would grow to Rs 2.22 lakh and Rs 3.11 lakh, respectively, compared with inflation (Rs 1.88 lakh)
- In terms of gross returns, the ELSS generated 12.01% CAGR and the PPF 8.31% CAGR. On an inflation-adjusted basis, the ELSS generated a higher CAGR of 5.47% versus PPF's 1.77%



*till December 2020
For illustration purpose only
Performance of ELSS represents averaged CRISIL-ranked ELSS funds, fixed income by PPF and inflation by CPI
Investments are subject to market risks. Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme-related documents carefully.

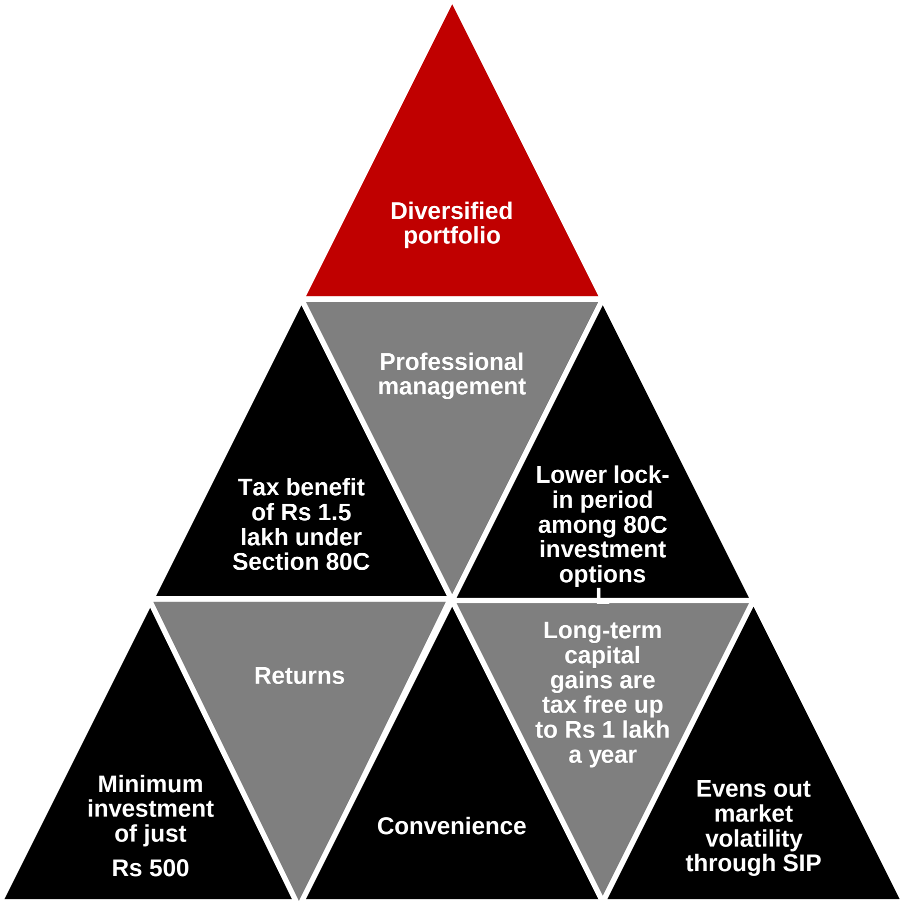
SIPs through the year

- SIPs allow investors to park funds in an ELSS, starting with Rs 500 per month, at regular intervals. They help investors benefit from rupee cost averaging and, thus, offset volatility in the equity market
- SIPs also negate the need to time the market since they rely on time spent in the market to generate returns (read: discipline). Thus, investors can invest in SIPs through the year

ELSS funds				
Period	**SIP start date**	**Total amount invested (Rs)**	**Market value (Rs)**	**SIP returns (%)**
3 years' SIP	01-Jan-18	18,000	22,239	14.21
5 years' SIP	01-Jan-16	30,000	39,984	11.43
7 years' SIP	01-Jan-14	42,000	62,267	11.05
10 years' SIP	03-Jan-11	60,000	115,913	12.63

For illustration purpose only
Data an of December 31, 2020
Performance of the ELSS is represented by the weighted average index of CRISIL-ranked ELSS funds
SIP returns are annualised
Investments are subject to market risks. Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme-related documents carefully.

An ELSS offers many benefits…



- A word of caution: Investors must remember that as returns are market-linked, they are prone to volatility. Hence, an ELSS may not be suitable for very risk-averse investors. Also, investors must remain invested for at least three years to claim tax benefits

…including building a retirement kitty

- In India, it is common for young investors to not take retirement planning seriously. This is because investors entering the workforce usually make the mistake of believing there will be time to do so in the years ahead
- What's more, many investors who plan for their retirement rely on fixed income investments for this purpose
- Since retirement planning is a long-term goal, it can effectively be met by investing in an ELSS
- If Amish wants to build a retirement kitty of Rs 5 crore at the retirement age of 60, he can achieve it by investing ~Rs 14,000 on a monthly basis (assuming 12% CAGR*) in an ELSS for the next 30 years

* Based on 15-year annualized point to point returns as of December 31, 2020 of a weighted averaged fund performance index created for ELSS funds

Times are changing and we can’t ignore retirement planning

Rising expenses of lifestyle

If we assume a yearly inflation rate of 6%, Rs 1 lakh in expenses today will increase to ~ Rs 5.74 lakh per year in 30 years. An investor’s retirement kitty will have to grow at a rate which is high enough to factor in the rise in living expenses

Span of retirement

With improved healthcare delivery and higher economic growth, Indians are expected to live longer. According to World Health Organisation data, the expected lifespan of an average Indian is ~68 years at present and is expected to rise in the coming decades

Nuclearisation of family

Indian households are becoming more nuclear; the average number** of people in a house has decreased to less than five from over five a decade ago. This means that most retirees are expected to fend for themselves rather than look at the traditional joint family system

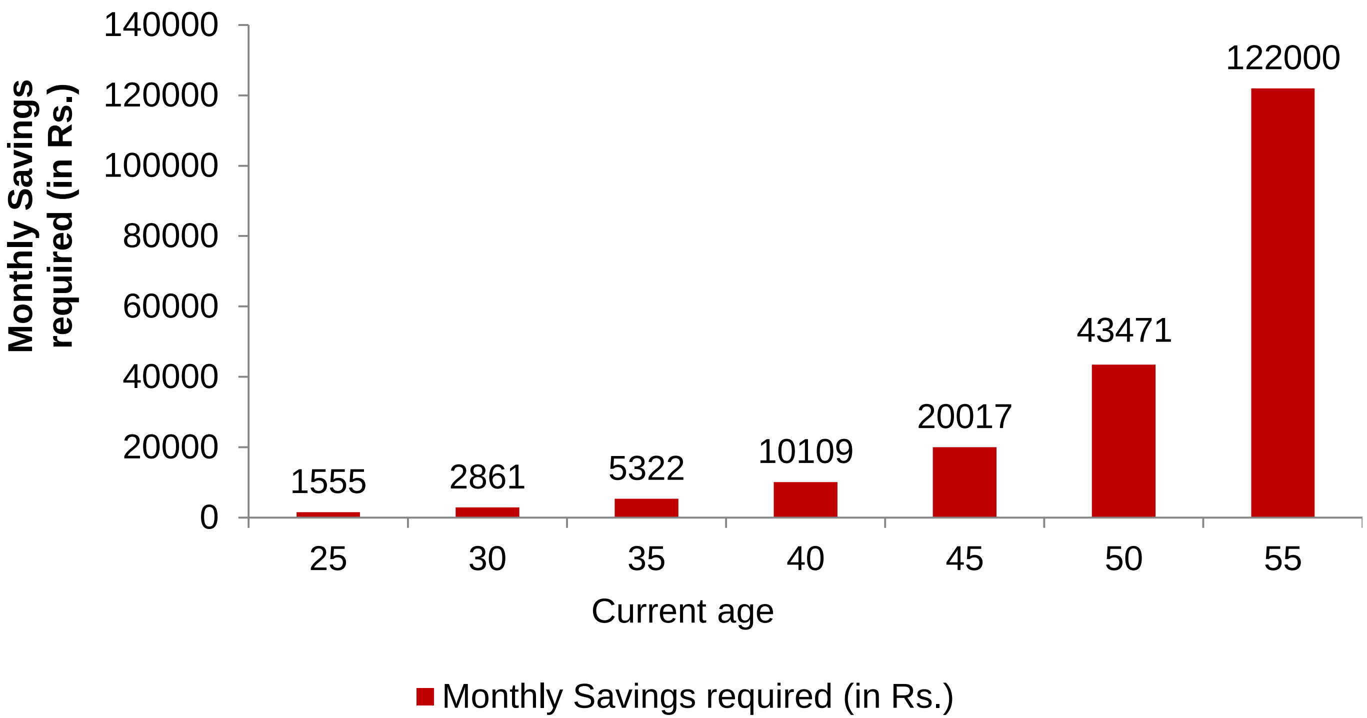
** According to Census 2011 data

A ready reckoner on retirement planning

- Start early – No time is considered too soon to begin retirement planning. The sooner you start, the more time you give the funds to grow through compounding
- Decide how big a retirement kitty you want – This amount varies among investors. At a bare minimum, the retirement kitty needs to be big enough to pay for essential living expenses, which could include expenditure for medical treatment. Additional funds can then be used for specific goals that the investor may have, such as donations to charitable causes and foreign vacations
- Invest according to your risk profile – Determine the optimum mix of investments according to your risk profile that will help the retirement kitty grow optimally.
  - A young investor has greater risk-taking ability and a longer investment horizon. Accordingly, allocate more funds to equity, which acts as a return enhancer
  - Middle-aged investors, who have greater responsibilities and reduced risk tolerance, should invest in a prudent mix of equities and fixed income instruments
  - Investors nearing retirement, who can't tolerate heavy losses, must allocate most of their funds to safe fixed income investments
- Monitor and rebalance – Allocation to risky assets should be gradually reduced as you grow older

Start early to avoid a large financial burden later

- Amit and Isha, both professionals, wish to have a retirement kitty of Rs 1 crore when they retire at the age of 60
- Amit is 45 years old and is 15 years away from retirement. Isha is 25 and has just begun her career. Assuming both can deploy their monthly savings in an investment scheme that provides 12%* growth per year, the table below shows how the required monthly savings increase the more you delay
- As can be seen, Isha needs to save only Rs 1,555 per month compared with Amit's Rs 20,017



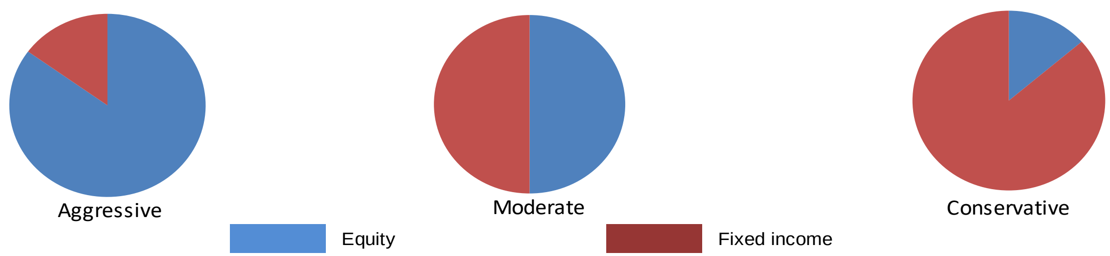
* Based on 15-year annualised point-to-point returns as of December 31, 2020 of a weighted averaged fund performance index created for ELSS funds
Investments are subject to market risks. Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all scheme-related documents carefully.

Follow a glide path

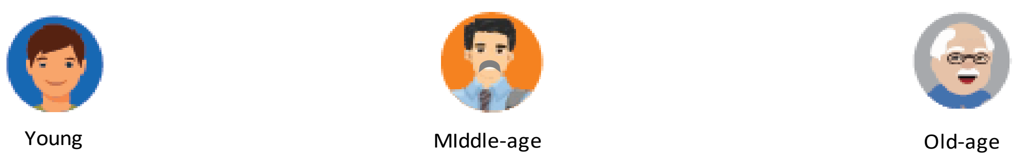
- To optimise the retirement planning process, investors must follow a glide path wherein allocation to equities is gradually reduced with the advancement of age. This maps the reduction in risk appetite accurately with the change in invested asset class
- This is also known as lifecycle-based investment, wherein the retirement planning is split into three phases - accumulation, consolidation and distribution

	Accumulation phase	Consolidation phase	Distribution phase
Phase	It is the starting point of one's career. As young individuals have longer time horizons, fewer responsibilities and high risk tolerance levels, their asset allocation should be aggressive. Accordingly, investors would have higher exposure to riskier investments such as equity.	**It** represented by middle-aged individuals who have a higher responsibility. Hence, their risk appetite is moderate. At this stage, investors should follow a moderate approach and use the balanced model of equity and debt so that they can preserve their wealth.	This is the stage of retirement as well as post-retirement. During this stage, one may no longer derive regular income from profession / business. The financial plan should be robust enough so that these years are carefree. There should not be risky investments in the portfolio, but only safe options .

Allocation



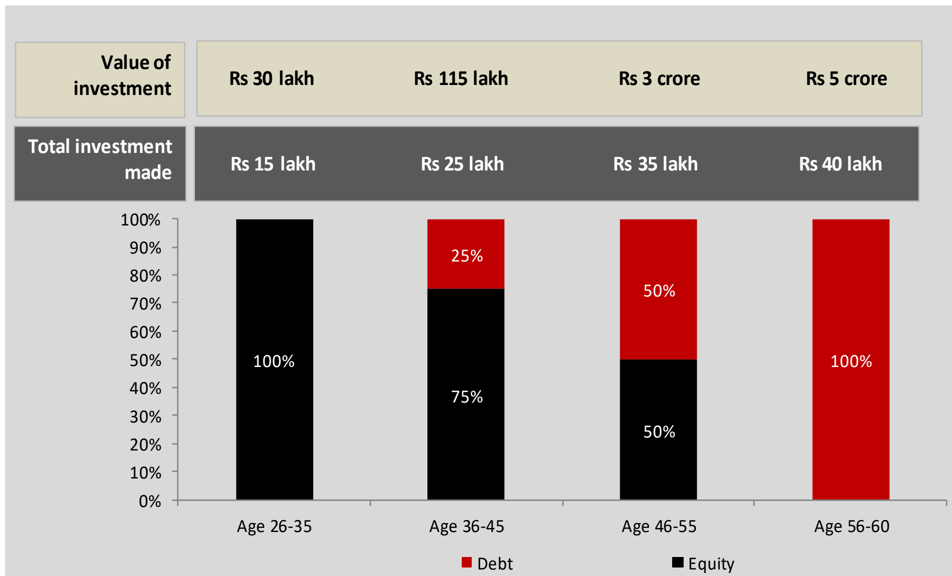
Age



For illustration purpose only
It is recommended to consult a financial advisor before taking any investment decisions
Investments are subject to market risks. Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all-scheme related documents carefully.

Change in asset allocation when following the glide path

- Illustration – Ravi, 25, wants to build a retirement corpus of Rs 5 crore till he turns 60. His financial advisor suggests investing Rs 1.5 lakh annually and following the glide path. His investment should have higher allocation to equity in the beginning. The amount in equities would reduce at various life stages, with more being allocated to debt funds later
- Ravi planned to invest 100% in equity funds between ages 26 and 35; 75% equity and 25% debt funds between ages 36 and 45; 50% each in equity and debt funds between ages 46 and 55; and 100% in debt funds after 55-60.
- At the age of 60, Ravi would be able to achieve his retirement corpus of Rs 5 crore after which he would stay invested in fixed income and withdraw the required amount monthly to enjoy a stress-free retirement life



Aforementioned values pertains to end of the period; Equity and debt funds returns assumed at 12% and 9% CAGR respectively

For illustration purpose only. It is recommended to consult a financial advisor before taking any investment decisions
Equity fund returns are based on 15-year annualised point-to-point returns as of December 31, 2020 of a weighted averaged fund performance index created for ELSS funds
Fixed income fund returns are based on past one-year returns as of December 31, 2020 of a weighted average fund performance index created for short-duration debt funds
Investments are subject to market risks. Past performance may or may not be sustained in the future. Mutual fund investments are subject to market risks. Read all-scheme related documents carefully.

Disclaimer

This document has been prepared by HSBC Asset Management (India) Private Limited (HSBC) for information purposes only and should not be construed as i) an offer or recommendation to buy or sell securities, commodities, currencies or other investments referred to herein; or ii) an offer to sell or a solicitation or an offer for purchase of any of the funds of HSBC Mutual Fund; or iii) an investment research or investment advice. It does not have regard to specific investment objectives, financial situation and the particular needs of any specific person who may receive this document. Investors should seek personal and independent advice regarding the appropriateness of investing in any of the funds, securities, other investment or investment strategies that may have been discussed or referred herein and should understand that the views regarding future prospects may or may not be realized. In no event shall HSBC Mutual Fund/HSBC Asset management (India) Private Limited and / or its affiliates or any of their directors, trustees, officers and employees be liable for any direct, indirect, special, incidental or consequential damages arising out of the use of information / opinion herein.

This document is intended only for those who access it from within India and approved for distribution in Indian jurisdiction only. Distribution of this document to anyone (including investors, prospective investors or distributors) who are located outside India or foreign nationals residing in India, is strictly prohibited. Neither this document nor the units of HSBC Mutual Fund have been registered under Securities law/Regulations in any foreign jurisdiction. The distribution of this document in certain jurisdictions may be unlawful or restricted or totally prohibited and accordingly, persons who come into possession of this document are required to inform themselves about, and to observe, any such restrictions. If any person chooses to access this document from a jurisdiction other than India, then such person do so at his/her own risk and HSBC and its group companies will not be liable for any breach of local law or regulation that such person commits as a result of doing so.

HSBC Asset Management (India) Private Limited, 16, V.N. Road, Fort, Mumbai-400001
Email: hsbcmf@camsonline.com | Website: www.assetmanagement.hsbc.com/in

Mutual fund investments are subject to market risks, read all scheme related documents carefully.