

# Tax and retirement planning

Explore tax-efficient avenues that match your financial goals



**HSBC**  
Asset Management



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# Simplify tax planning by investing in ELSS



Here's a conversation between Anil and Ajay

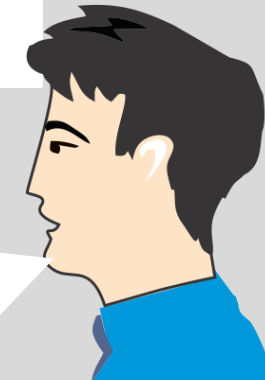


**Anil and Ajay are old friends who meet after a long time. They are discussing tax-saving avenues, as the current financial year is nearing a close.**

Here we go again. The deadline for submitting tax-saving investment proofs is nearing. And I am, as always, confused about where to invest.



No such worries for me. I am already investing in an ELSS, which offers tax benefit and has the potential to offer good returns.



Ajay clears Anil's misconceptions regarding equity investing and shows how to effectively use ELSS as a tax-saving tool and an investment option.



But isn't investing in equities risky? I have heard of many people losing their hard-earned money.



Equities are risky for those who mistake it for a casino. But if done keeping in mind one's financial goals and risk profile, it is one of the best investment vehicles.



Sounds impressive. But I don't have any idea about how to invest in equities, let alone reap tax benefits from it.



I was also in the same situation a few years back. Then, I came across the simple process of investing in equities through ELSS via an SIP, which removes the complexities associated with self-investing, builds a corpus over the long term, and provides tax benefit!



**Systematic investment in ELSS helps build wealth over the long term with tax benefits**

# Do's & Don't: Don't procrastinate, plan ahead

## Most common mistake in tax planning and how to approach it

- ◆ Investing a 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

# Do's & Don't: Understand options available for Tax exemptions

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

Section of the Income Tax Act	Particular	Tax exemption limit
<b>Investment-linked</b>		
80C	Employee Provident Fund	Rs 150,000
	Life Insurance Policy	
	ELSS	
	National Pension System (NPS)	
	FDs (5 years)	
	National Savings Certificate (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)
<b>Non-investment-linked</b>		
80D	Medical insurance	Rs 25,000
80E	Education loan interest	No limit
24B	Payment of interest on home loan	Rs 200,000

For illustration purpose only, Source - CRISIL

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

# Do's & Don't: Use tax-efficient avenues to match financial goals

## Equity-based instruments

- ◆ ELSS: 10% tax on long-term capital gains exceeding Rs 1 lakh (ELSS subject to 3 years lockin period)
- ◆ ULIP: Taxable on contribution of 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 slab rates applicable
- ◆ Tax-saving FDs: Interest income taxed at income tax slab rates applicable

For illustration purpose only, Source - CRISIL

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# Do's & Don't: evaluating lock-in period of tax-saving investments

## Equity-based instruments

- ◆ ELSS: Lock-in period of 3 years. 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 , Source - CRISIL

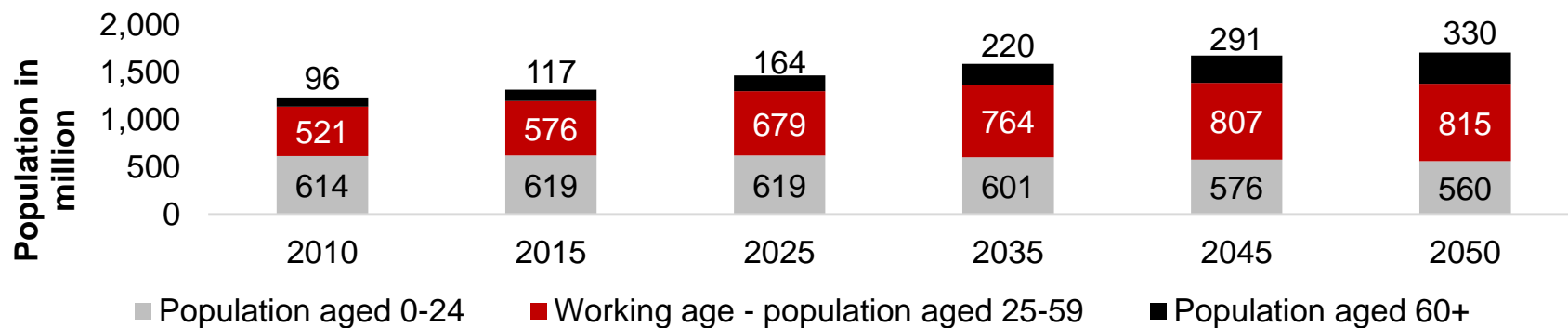
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# Invest as per your risk appetite and age

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

The investment duration should ideally be in inverse proportion to age, i.e. the 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 an 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, allow investors to use this demographic advantage to their benefit, while also saving on tax in the process

Source: United Nations data , CRISIL

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## Traditional instruments – pros

- ◆ Key attraction of traditional debt-based instruments is safety
- ◆ Apart from tax deductions, investors use debt instruments to meet their financial 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 (if money not invested)	Period	Maturity value assuming interest rate of 5.40%*
Year 1	77,000	23,100	Year 6	100,160
Year 2	77,000	23,100	Year 7	100,160
Year 3	77,000	23,100	Year 8	100,160
Year 4	77,000	23,100	Year 9	100,160
Year 5	77,000	23,100	Year 10	100,160

Source – CRISIL, \*SBI fixed deposit rate for 5 years, with effect from January 15, 2022

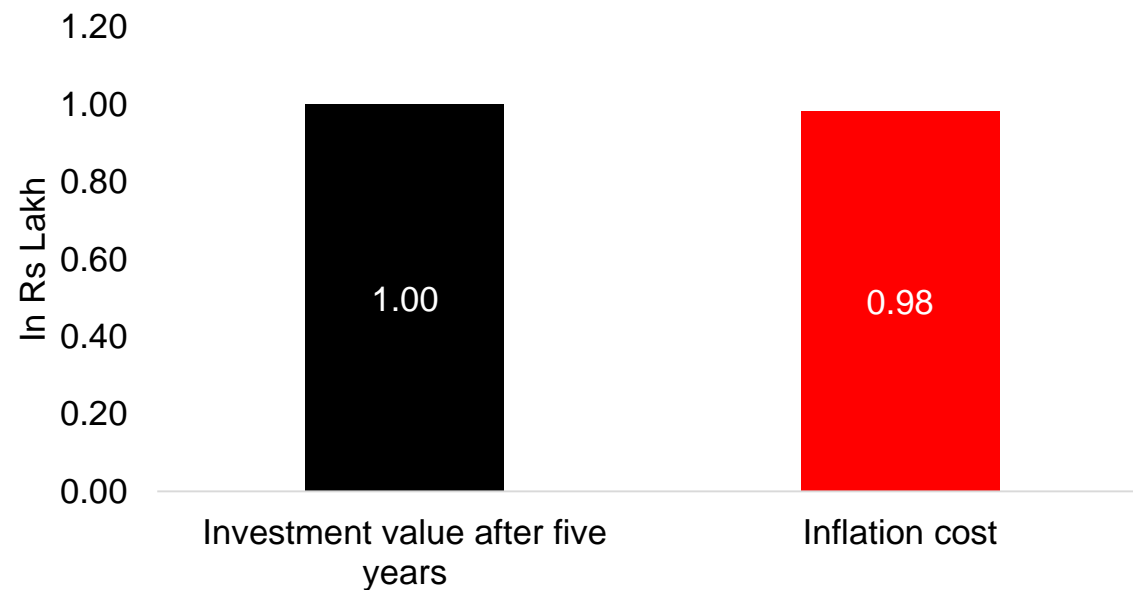
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## Traditional instruments – cons

- ◆ 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 offer better inflation-adjusted returns
- ◆ If we look at the earlier illustration, even though Anil's Rs 77,000 investment in FD grew 5.4% to Rs 1 lakh, the inflation, considering the same amount, grew about 5% to Rs 98,000, resulting in a meagre inflation-adjusted return of Rs 2,000



Source – CRISIL, Assuming inflation of ~5% (5-year average inflation rate for fiscals 2016-21 CPI)

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

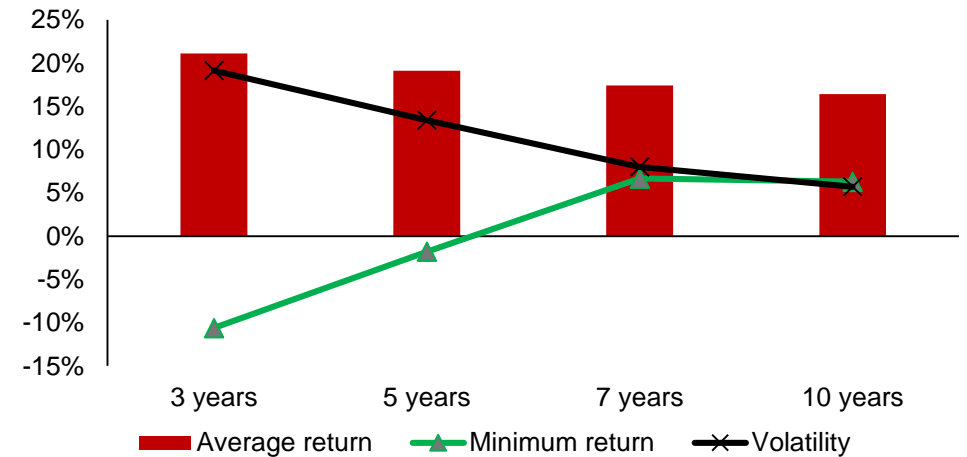
- ◆ Is a tax saving scheme that predominantly invests in equity securities
  - Managed by fund managers with experience and backed by research
  - Diversified portfolio across sectors and market capitalisation
- ◆ Investors need to hold units for at least three years to claim a tax rebate
  - Longer 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 (%) <sup>*</sup>	3 years	5 years	7 years	10 years
<b>ELSS funds *</b>	18.45	16.74	12.72	17.24
<b>Nifty 50</b>	16.89	16.20	11.14	14.12
<b>Nifty 500</b>	17.80	16.50	12.01	15.33

Annualised returns as of December 31, 2021



Data as of December 31, 2021

Returns are annualized, calculated on a daily rolling basis of a weighted average index of CRISIL-ranked ELSS funds from June 2001 till December 2021

Volatility represented by standard deviation

For illustration purpose only, Source - CRISIL

\* The ELSS category is represented by CRISIL-ranked ELSS funds

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# 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, 2021, with a fresh investment at the start of each fiscal
- ◆ While the PPF investment grew to ~Rs 12 lakh at ~8%CAGR, the ELSS garnered Rs 18 lakh at ~18%CAGR

	PPF			ELSS		
	Beginning balance	Interest rate	Ending balance	Beginning balance	ELSS Funds*	Ending balance
<b>FY13</b>	75000	8.60%	81450	75000	6%	79500
<b>FY14</b>	156450	8.80%	170217.6	154500	18%	182310
<b>FY15</b>	245217.6	8.70%	266551.5	257310	50%	385965
<b>FY16</b>	341551.5	8.70%	371266.5	460965	-7%	428697.5
<b>FY17</b>	446266.5	8.10%	482414.1	503697.5	26%	634658.8
<b>FY18</b>	557414.1	7.80%	600892.4	709658.8	12%	794817.8
<b>FY19</b>	675892.4	7.90%	729287.9	869817.8	5%	913308.7
<b>FY20</b>	804287.9	7.90%	867826.6	988308.7	-24%	751114.6
<b>FY21</b>	942826.6	7.10%	1009767	826114.6	71%	1412656
<b>FY22*</b>	1084767	7.10%	1161786	1487656	23%	1829817

For illustration purpose only, , Source – CRISIL, Data till 31 December 2021

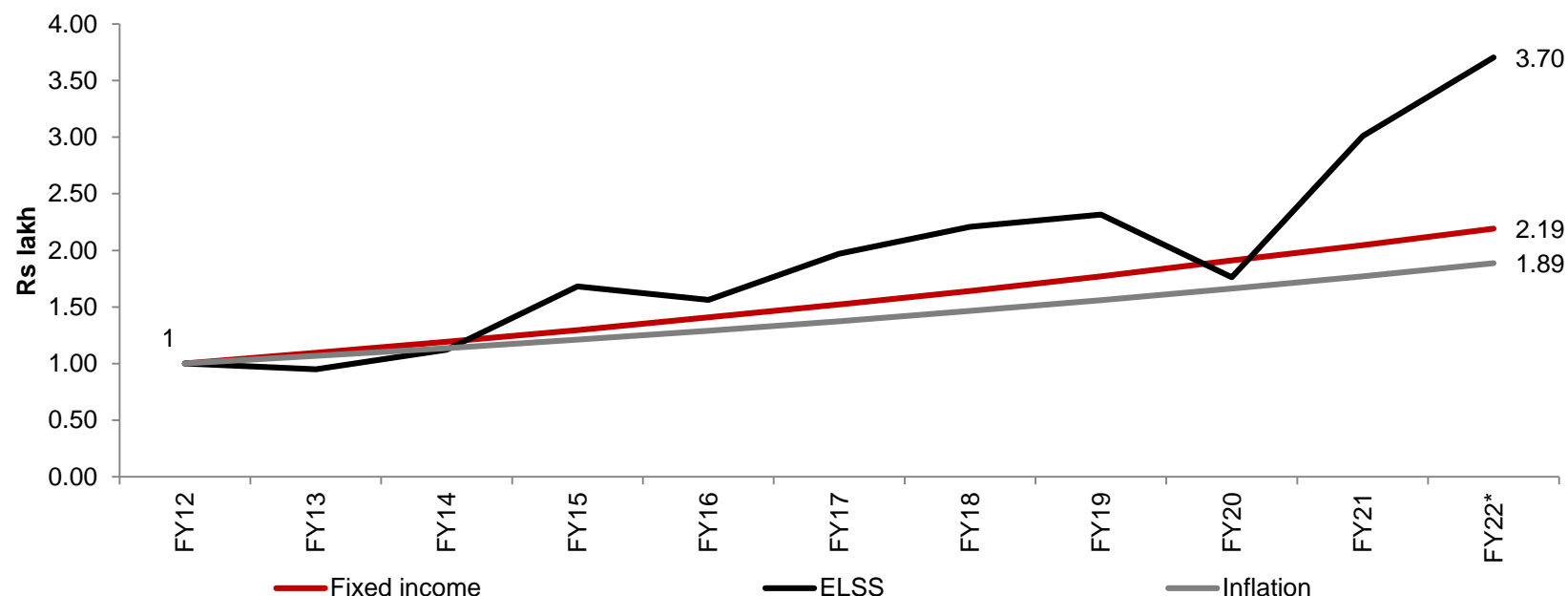
Source for PPF rates - Department of Economic Affairs, \* The ELSS category is represented by CRISIL-ranked ELSS funds

Returns for ELSS schemes are based on average of CRISIL-ranked ELSS funds. PPF returns are based on the interest rate announced every year.

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# 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 2012 for 10 years ended December 31, 2021, the investments would grow to Rs 2.19 lakh and Rs 3.70 lakh, respectively, compared with inflation (Rs 1.89 lakh)
- ◆ The ELSS generated 13.99% CAGR and the PPF 8.16% CAGR. On an inflation-adjusted basis, the ELSS\* generated a higher CAGR of 7.30% versus PPF's 1.46%



Source – CRISIL, Data as at December 2021

For illustration purpose only, \* The ELSS category is represented by CRISIL-ranked ELSS funds

Performance of ELSS represents averaged CRISIL-ranked ELSS funds, fixed income by PPF and inflation by CPI

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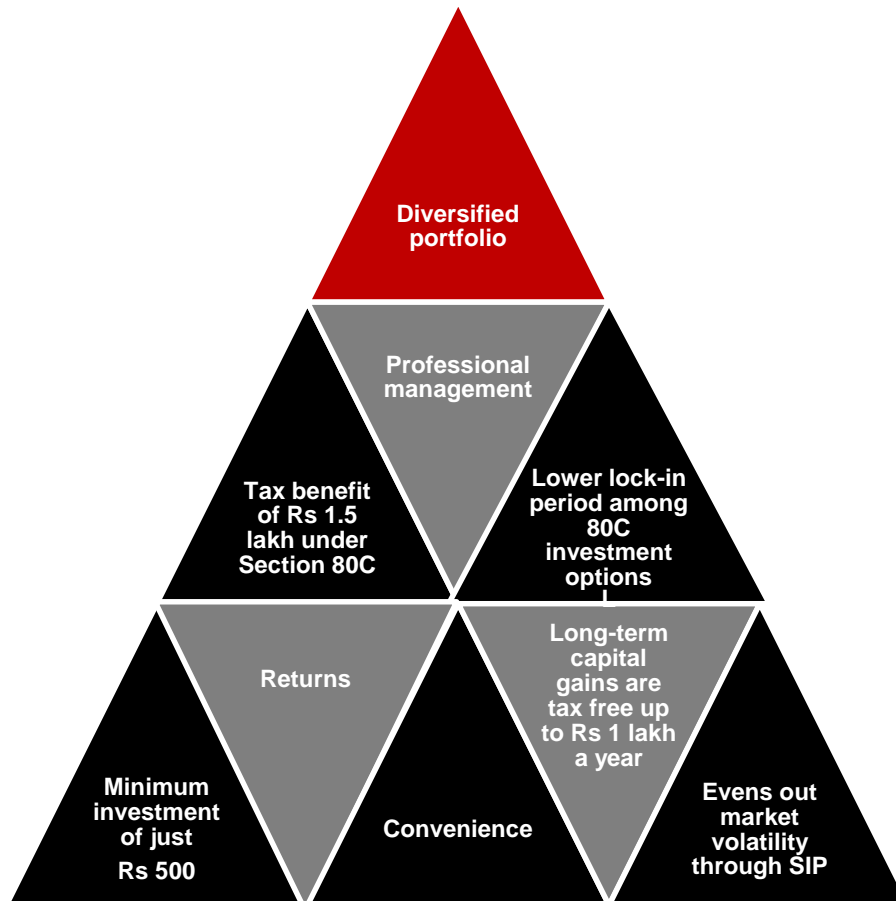
## SIPs through the year

- ◆ 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-19	18,000	26,080	25.61
5 years' SIP	02-Jan-17	30,000	45,823	16.96
7 years' SIP	01-Jan-15	42,000	70,796	14.65
10 years' SIP	02-Jan-12	60,000	132,414	15.12

Source – CRISIL For illustration purpose only, Data at December 2021, \* The ELSS category is represented by CRISIL-ranked ELSS funds  
 Performance of the ELSS is represented by a weighted averaged fund performance index created for ELSS funds, SIP returns are annualised  
 Past performance may or may not be sustained in the future.

# An ELSS offers many benefits including building a retirement kitty



- ◆ 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
- ◆ 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

Source – CRISIL

Past performance may or may not be sustained in the future. \* Based on 15-year annualized point to point returns as of December 31, 2021, of a weighted averaged fund performance index created for ELSS funds. Past performance may or may not be sustained in the future.



# Times are changing and we can't ignore retirement planning



## Rising expenses of lifestyle

If we assume a yearly inflation rate of 5%, Rs 1 lakh in expenses today will increase to ~ Rs 4.32 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

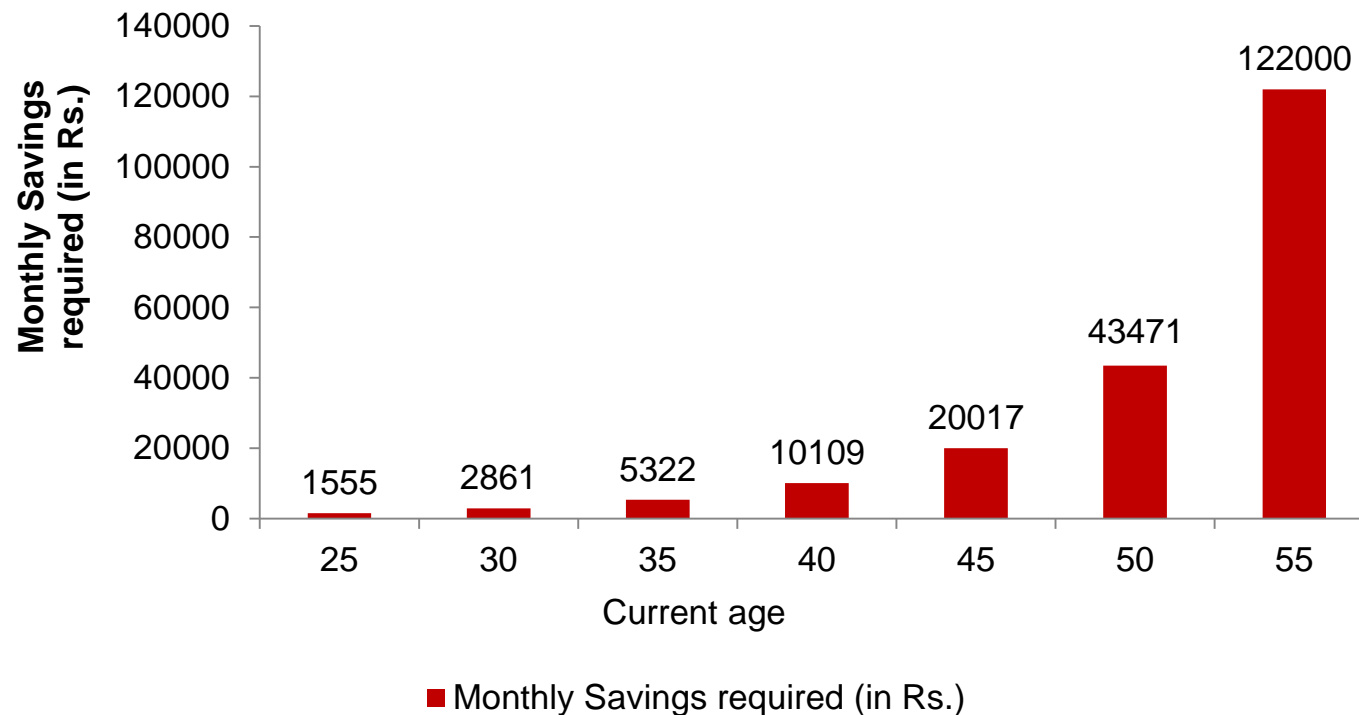
Source – CRISIL, \*\* According to Census 2011 data  
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# A ready reckoner on retirement planning

- ◆ 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

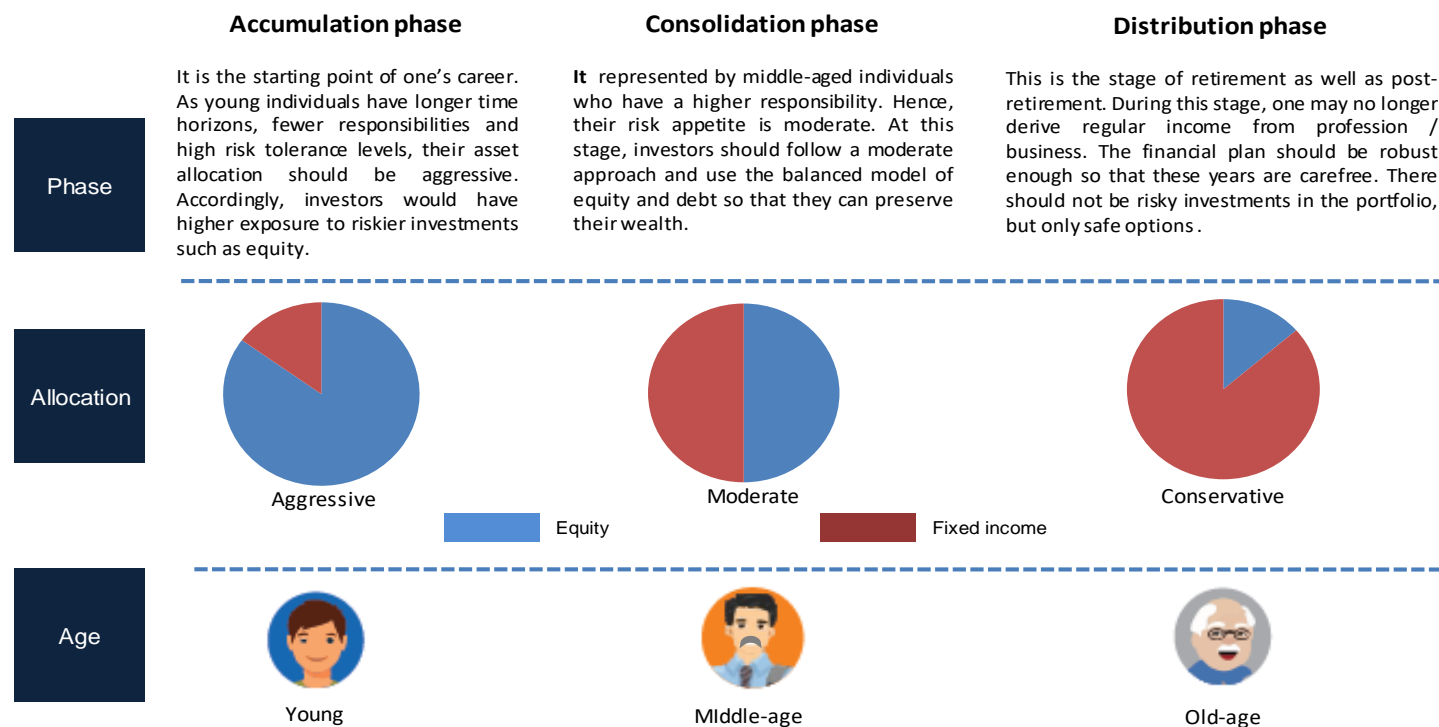
- ◆ Amit and Isha, both professionals, wish to have a retirement kitty of Rs 1 crore when they retire at the age of 60
- ◆ Amit is 45 years old and is 15 years away from retirement. Isha is 25 and has just begun her career. Assuming both can deploy their monthly savings in an investment scheme that provides 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



Source – CRISIL, \* Based on 15-year annualised point-to-point returns as of December 31, 2021, of a weighted averaged fund performance index created for ELSS funds  
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# Follow a glide path

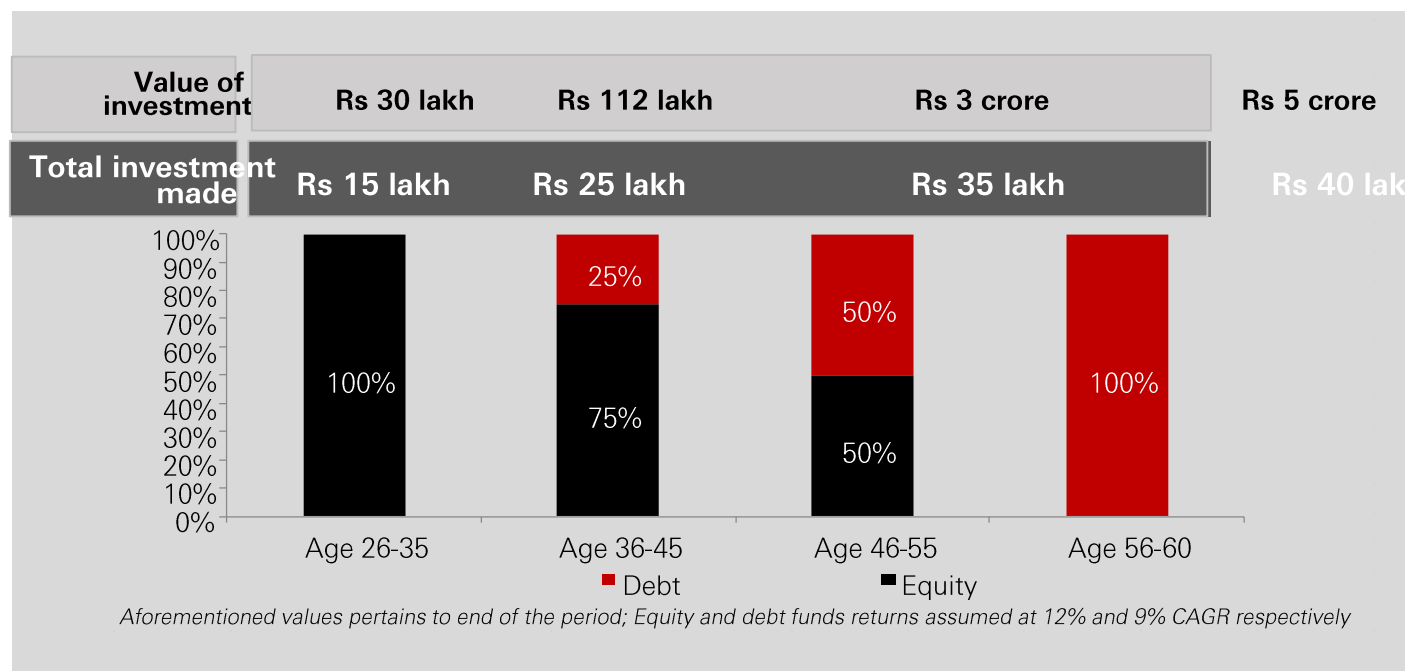
- ♦ To optimise the retirement planning process, investors must follow a glide path wherein allocation to equities is gradually reduced with the advancement of age. This maps the reduction in risk appetite accurately with the change in invested asset class
- ♦ This is also known as lifecycle-based investment,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



Source – CRISIL, For illustration purpose only, It is recommended to consult a financial advisor before taking any investment decisions  
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# 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



Source – CRISIL, 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, 2021 of a weighted averaged fund performance index created for ELSS funds  
 Fixed income fund returns are based on average 1-year FD index returns between October 1999 and December 2021  
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