Tax and Retirement Planning

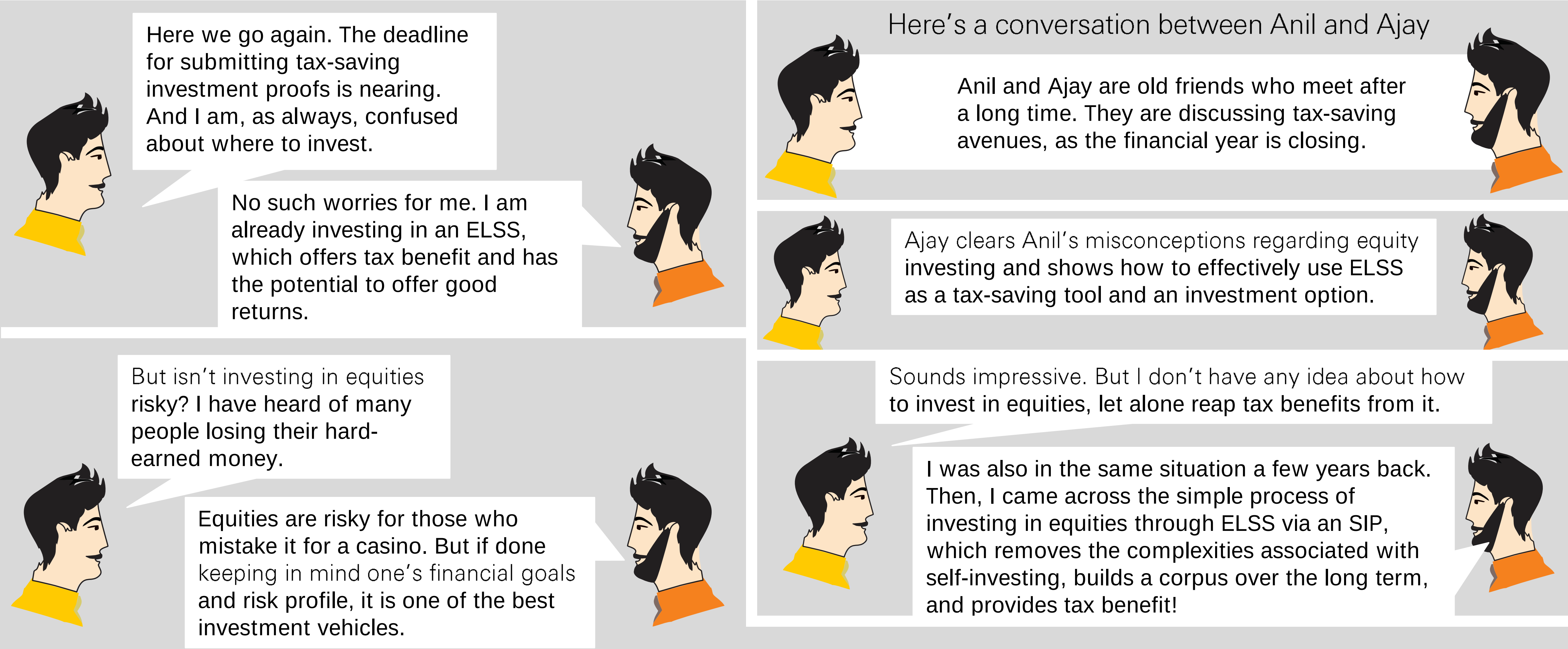
Explore tax-efficient avenues that match your financial goals

An Investor Education and Awareness Initiative

HSBC Mutual Fund | Opening up a world of opportunity

September 2023

Simplify tax planning by investing in ELSS



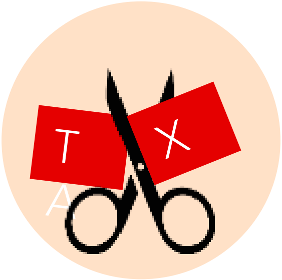
Systematic investment in ELSS helps build wealth over the long term with tax benefits

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

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

For illustration purpose only, Source - CRISIL
It is recommended to consult a financial advisor before making an investment decision

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
Investment-linked		
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)
Non-investment-linked		
80D	Medical insurance	Rs 25,000
80E	Education loan interest	No limit
24B	Payment of interest on home loan	Rs 200,000

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Please consult your financial advisor for any tax related information as applicable to your investments

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 lock-in 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

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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

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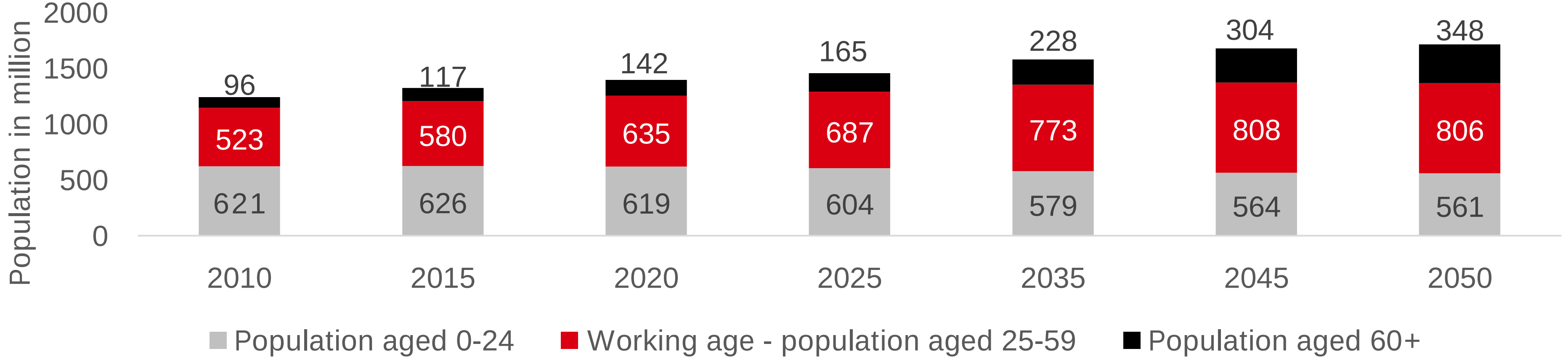
Invest as per your risk appetite and age

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 safe
- 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 minimal 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 aim to realize this by investing Rs 73,000 annually in a five-year FD. This way, he may 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 6.50%*
Year 1	73,000	21900	Year 6	100,016
Year 2	73,000	21900	Year 7	100,016
Year 3	73,000	21900	Year 8	100,016
Year 4	73,000	21900	Year 9	100,016
Year 5	73,000	21900	Year 10	100,016

Source – CRISIL, *SBI fixed deposit rate for 5 years, with effect from August 31, 2023
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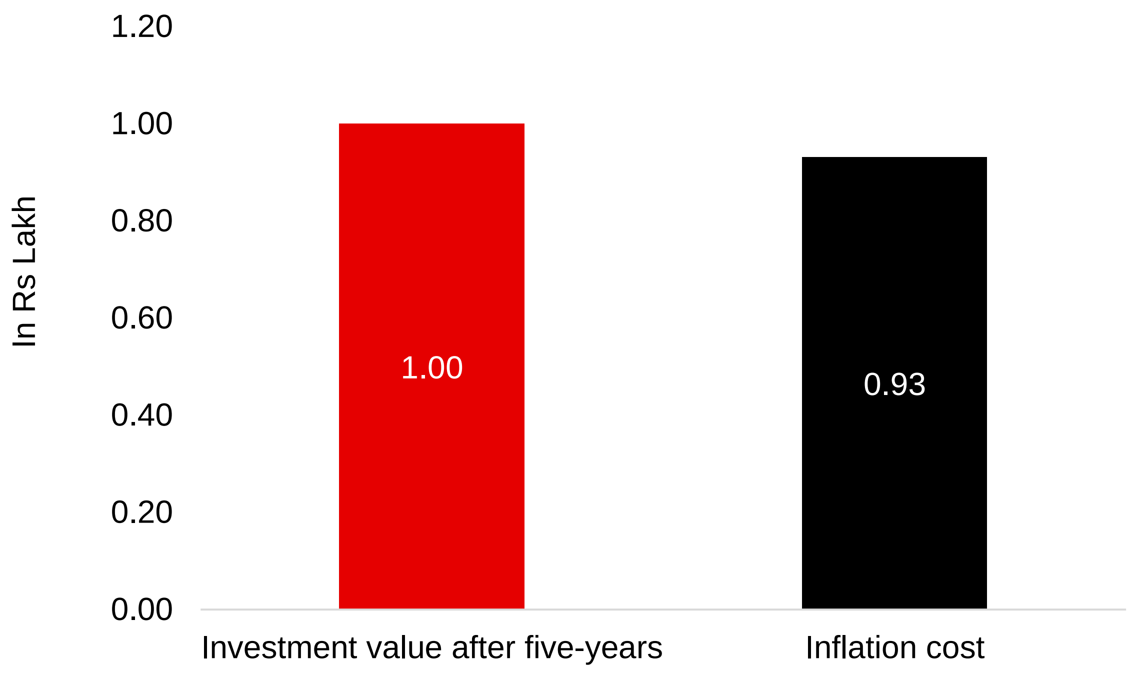
Traditional instruments – cons

- While fixed-income investments aims to provide the benefit of capital protection and relatively 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 73,000 investment in FD grew 6.50% to Rs 1 lakh, the inflation, considering the same amount, grew about 5% to Rs 93,000, resulting in a meagre inflation-adjusted return of Rs 7,000



Fort illustration purpose only Source – CRISIL, Assuming inflation of ~5% (5-year average inflation rate for fiscals 2017-23 CPI)
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ELSS – A good combo to save tax and build potential 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

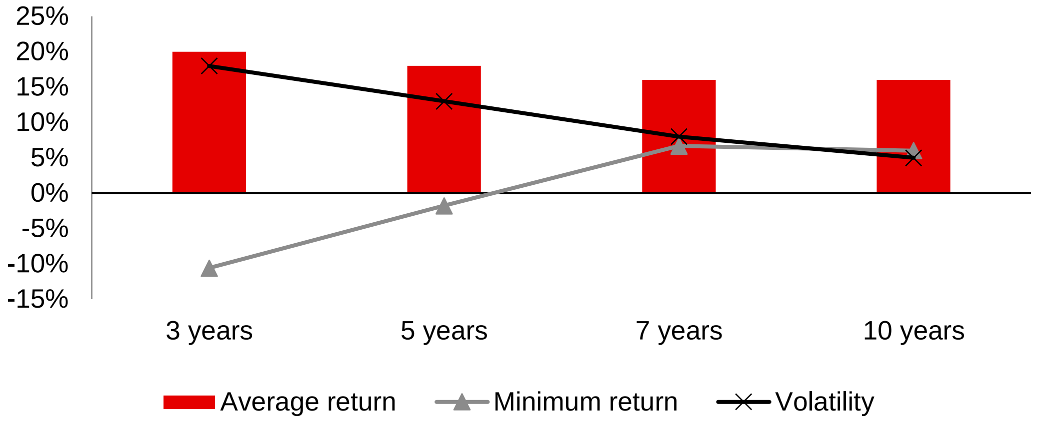
Source – CRISIL, Past performance may or may not be sustained in the future. Mutual Fund investments are subject to market risks, read all scheme related documents carefully

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 *	22.46	12.07	12.93	16.99
Nifty 50	19.13	10.51	11.85	13.40
Nifty 500	21.78	11.11	12.34	15.01

Annualised returns as of August 31, 2023



Data as of March 31, 2023, for calendar year
Returns are annualized, calculated on a daily rolling basis of a weighted average index of CRISIL-ranked ELSS funds from June 2001 till August 2023.
Volatility represented by standard deviation

For illustration purpose only , Source - CRISIL
The ELSS category is represented by CRISIL-ranked 35 ELSS funds. Returns for ELSS schemes are based on average of CRISIL-ranked ELSS funds.
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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 throughout the year

ELSS funds*				
Period	SIP start date	Total amount invested (Rs)	Market value (Rs)	SIP returns (%)
3 years' SIP	30-Sep-20	18000	21902	14
5 years' SIP	1-Oct-18	30000	43535	15
7 years' SIP	30-Sep-16	42000	66046	13
10 years' SIP	30-Sep-13	60000	114570	13

* The ELSS category is represented by CRISIL-ranked 35 ELSS funds. Performance of the ELSS is represented by a weighted averaged fund performance index created for ELSS funds, SIP returns are annualized. Past performance may or may not be sustained in the future.

Source – CRISIL. The above data is for information only.
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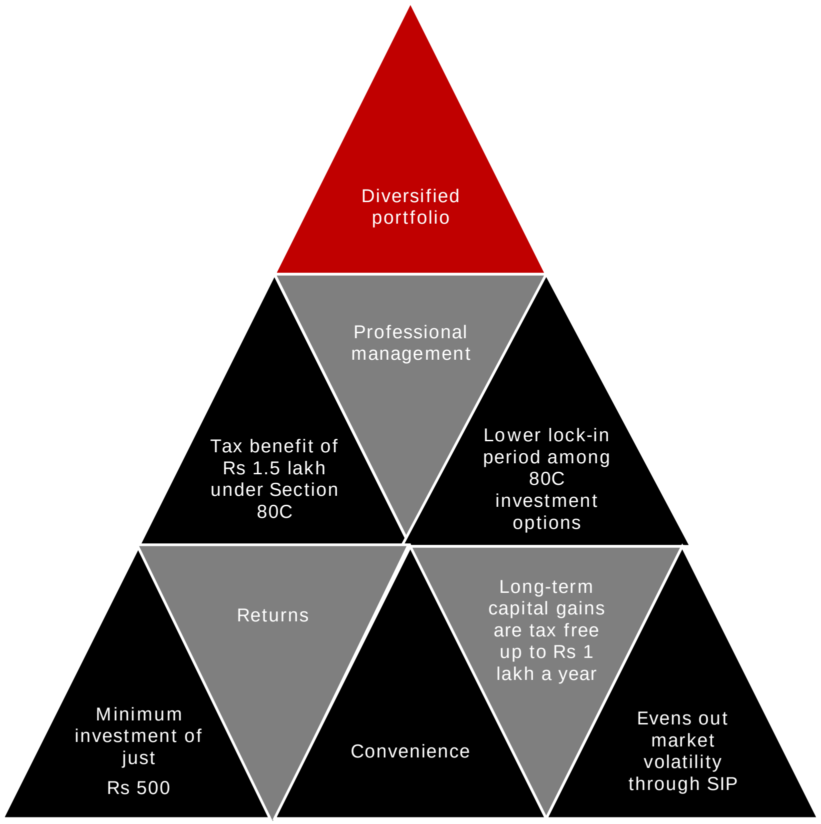
An ELSS offers many benefits including building a retirement kitty

- 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, you can aim to effectively meet it by investing in an ELSS
- If Amish wants to build a retirement kitty of some amount at the retirement age of 60, he can achieve it by investing certain money on a monthly basis in an ELSS for the next 30 years



Source – CRISIL
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Times are changing and we can’t ignore retirement planning

Rising expenses of lifestyle

Considering yearly inflation rate, certain amount of expenses today is expected to increase to a new higher amount in future. 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

Source – CRISIL

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

Phase

Accumulation 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.

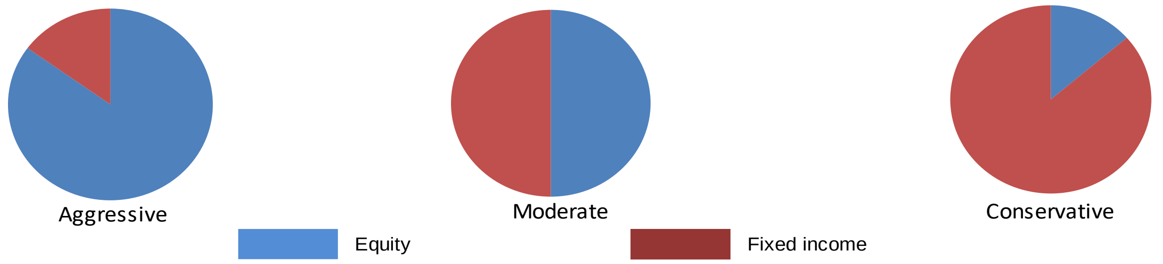
Consolidation phase

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.

Distribution phase

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


Young


MIddle-age


Old-age

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