Saving vs. Investing: What's the Difference?

Saving vs. Investing: An Overview

The words “saving” and “investing” are sometimes used interchangeably, but when it comes right down to it, we should be engaged in both to secure our financial future.

A shared characteristic of both saving and investing is the utmost importance that they play in our lives. If you are not doing either, the time to get started is now. This may require changes in spending, tracking, and in the utilization of your income, but it can and should be built into your plan. A general rule of thumb is saving should be short-term while investing should be long-term. Keeping that in mind, let’s review the differences. Also, keep in mind for both saving and investing that when risk goes down, liquidity goes up and vice versa.

Key Takeaways

- Saving money typically means it is available when we need it and it has a low risk of losing value.
- Investing typically carries a long-term horizon, such as our children’s college fund or retirement.
- The biggest and most influential difference between saving and investing is risk.

Saving

We save for purchases and emergencies. Saving money typically means it is available when we need it and it has a low risk of losing value. It is important to track your savings, putting a deadline, or timeline, and value to your goals. For example, if you are saving for your annual family vacation, you might want to target $3,000 to save in nine months to withdraw at the end of the year. You then know how much you need, how much to save monthly, and the ability to take the money out without fees to spend on that treasured vacation.

Investing

When investing, it is important to invest wisely. You will have a better return if you begin investing early. Understanding different investment vehicles, what they are for, and how to use them is imperative to being successful. We invest for long term goals, such as our children's college fund or retirement. We use specific vehicles that allow for growth. If our children have 10-plus years before they go to college, we can invest monthly in a vehicle like an education savings account (ESA) or a 529 plan. These allow for withdrawals when your child goes to college. Long-term college plans can help you successfully reach that goal.1

Key Differences

To start, the biggest and most influential difference between saving and investing is a risk. You save when you put money into a savings account like a money market account or Fixed Deposit (FD). It has little risk of loss of funds but also has minimal gains. When you save, you are usually able to pull that money out when you need it (or after a period of time). When you invest, you have the potential for better long-term gains or rewards, but also the potential for loss.

You risk more in investing for a larger return, but your potential loss can be large as well. It is important to review your goals to figure out which option is best for each one, saving or investing. Choosing incorrectly could cost you a lot of money in fees or loss of potential income earned through investing.

Another difference is interest, or money made. In investing, we want our investments to make us money, while the goal of saving is to keep our money safe, making very little return.

An FD is a popular savings tool. This tool can be relatively short-term, ranging from a few months to many (seven or more) years. While in the FD, your money is safe and grows at a slightly bigger interest rate than in a regular savings account, but accessing it before the term of the FD is over could mean paying fees and penalties. Make sure to find the best rate on a FD by comparing options from a number of institutions.

It is possible to be a wonderful investor, have growth in your FD and have investment properties, but be unable to make ends meet because you do not understand how to save your short term funds. You can save money each month, but long term, those savings will not pay in retirement and most likely will not pay for your children's college, making investing equally important. This should remind us how important both are, especially when done together.

Special Considerations

Generally speaking, short term is under seven years and long term is over seven years, but when it comes to saving and investing, those figures are based more on the specifics of the goal. Keep in mind when you will need funds, what your plan is for the funds, and the safety/risk associated with the goal.

In the end, do not wait to save or invest. Time is the greatest opportunity to grow your money and to meet your goals. With a relatively small amount of money, you can start investing and saving and get on the path to reaching all of your financial goals.

Here are a few reasons why it's important to have savings and investments:

Transaction Motive-People save cash to bridge the interval between receiving the income and expenditure. The amount depends on the interval at which money is received. Businessmen and entrepreneurs have to keep some part of the income to meet the current needs. Amount held in liquid will depend on the business turnover. Transaction demand for money stays constant at all levels.

Precautionary motive- This means taking precautions. People hold cash to deal with contingencies like unemployment, health issues etc. They want to keep a part of contingency liability aside to us it in case of an emergency.

Speculative motive- People also hold cash to use it in the financial market. They want to take advantage of the movement in the financial market regarding future changes in price and rate of interest. The ROI and people's tendency to spend money are inversely proportional.

Children's education- The most important thing for a person is to educate his children and send them to the best school and college. It's important to have savings for that so that you can provide your children with the best education.

Self reliance- When you save, you get a feeling of self reliance and power to do things. It gives you a feeling of independence.

For Family's security- If something happens to you, your family should be well taken care of. Having a savings and an investment portfolio ensures that.

THE POWER OF COMPOUNDING

-- THE CONCEPT AND ITS POWER!

Compounding is the greatest mathematical discovery of all times. This concept which is thought to have originated as early as the 17th century, has detailed equations which are used to compute it; but compound interest can simply be explained as "interest on interest".

Let's start to understand the power of compounding with a **small story** of the **'Peasant and the King'**. The peasant who won the praise of the King asked only for a single grain of rice as a reward for the first chess square and doubles it on every consequent one. The King granted the peasant's wish without much thinking and regarded it as a small wish. By going ahead from the first square to the 10th square, the peasant had made a 20 Digit Figure of rice grains. In the end, the King was forced to give his kingdom and all his possessions to the peasant, as he could not keep his promise. That is the power of compounding.

Compounding is also quoted by the great **Albert Einstein,** who is credited with the legendary quote: "Compound interest is the eighth wonder of the world. "He, who understands it, earns it; he who doesn't, pays it".

The concept of power of compounding is simplified here to help you understand better and gain maximum to your advantage.

HOW COMPOUND INTEREST WORKS?
There are two types of interest: simple interest and compound interest. While in simple interest, the first year's interest is not added to the principal amount, withcompound interest, the first year's interest is added to the principal.

HERE ARE 3 WAYS TO MAKE THE BEST USE OF POWER OF COMPOUNDING.

1. TIME LEFT TO GROW
Starting early facilitates a longer time horizon. The more time you give your money to build upon itself, the more it compounds.

2. CHOOSE OPTIONS TO INVEST WISELY
The interest rate you earn on your investment, or the profit you earn by investing in equity, mutual funds, total profit from capital gains and dividend.

3. INVEST REGULARY
You need to invest regularly to gain the maximum advantage of compounding. It can make a huge difference in the long-term.

LET US UNDERSTAND THIS BY AN EXAMPLE!
Let us say, you invest Rs.100,000/- at 8% on both simple or compound interest for the next 20 years. See the difference over time to your investments here. If you were able to invest in a product that earned 12% p.a., the Rs. 1 lakh investment would now be would worth a whopping Rs. 9.64 lakh with the power of compounding.

	Compound Interest	**Simple Interest**	**Compound Interest**	**Simple Interest**
Principal Amount	100000	100000	100000	100000
Rate of Interest	8%	8%	12%	12%
No. of Years	20	20	20	20
Total Value	**466096**	**260000**	**964629**	**340000**

FORMULE USED :-

- **Simple Interest = PRT/100 →(** Principle **X** Rate of Interest **X** Time**)/100**
- **AMT = Principle + SI (SI = Simple Interest)**
- **COMPOUND INTEREST**

$$A = P(1 + \frac{r}{n})^{nt}$$

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A = final amount

P = initial principal balance

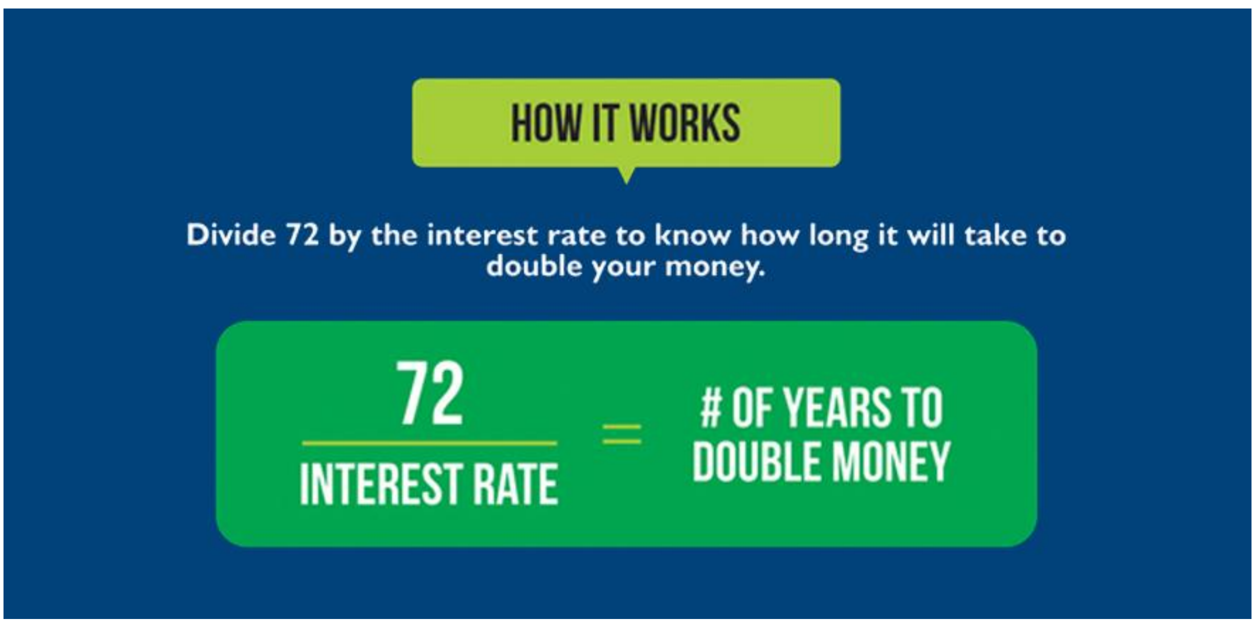
R = interest rate

N = number of times interest applied per time period

t = number of time periods elapsed

IMPORTANT NOTE :
If in the Question, "r=8%" then in the Formula we will Write "r" as 0.08 (i.e. when substituting values in the Formula)

FOLLOW THE 'RULE OF 72' OF COMPUNDING INTEREST TO DOUBLE YOUR WEALTH.



If you are earning say 8% interest on an investment, you can expect your invested money to double in 72/8 i.e. 9 years. Similarly, if you want your investment to double in 6 years, the investment needs to grow at a compounded rate of 12% (72/6).

OBJECTIVES OF INVESTMENT

An investment is essentially an asset that is created with the intention of allowing money to grow. The wealth created can be used for a variety of objectives such as meeting shortages in income, saving up for retirement, or fulfilling certain specific obligations such as repayment of loans, payment of tuition fees, or purchase of other assets.

Investment may generate income for you in two ways. One, if you invest in a saleable asset, you may earn income by way of profit. Second, if Investment is made in a return generating plan, then you will earn an income via accumulation of gains. In this sense, 'what is investment' can be understood by saying that investments are all about putting your savings into assets or objects that become worth more than their initial worth or those that will help produce an income with time.

Objectives of Investment

Before you decide to invest your earnings in any one of the many investment plans available in India, it's essential to understand the reasons behind investing. While the individual objectives of investment may vary from one investor to another, the overall goals of investing money may be any one of the following reasons.

1. To Meet your Financial Goals

Investing can also help you achieve your short-term and long-term financial goals without too much stress or trouble. Some investment options, for instance, come with short lock-in periods and high liquidity. These investments are ideal instruments to park your funds in if you wish to save up for short-term targets like funding home improvements or creating an emergency fund. Other investment options that come with a longer lock-in period are perfect for saving up for long-term goals.

2. To Help Money Grow

Another common objective of investing money is to ensure that it grows into a sizable corpus over time. Capital appreciation is generally a long-term goal that helps people secure their financial future. To make the money you earn grow into wealth, you need to consider investment options that offer a significant return on the initial amount invested. Some of the best investments to achieve growth include real estate, mutual funds, commodities, and equity. The risk associated with these options may be high, but the return is also generally significant.

3. To Minimize the Burden of Tax

Aside from capital growth or preservation, investors also have another compelling incentive to consider certain investments. This motivation comes in the form of tax benefits offered by the Income Tax Act, 1961. Investing in options such as Unit Linked Insurance Plans (ULIPs), Public Provident Fund (PPF), and Equity Linked Savings Schemes (ELSS) can be deducted from your total income. This has the effect of reducing your taxable income, thereby bringing down your tax liability.

4. To Keep Money Safe

Capital preservation is one of the primary reasons people invest their money. Some investments help keep hard-earned money safe from being eroded with time. By parking your funds in these instruments or schemes, you can ensure that you don’t outlive your savings. Fixed deposits, government bonds, and even an ordinary savings account can help keep your money safe. Although the return on investment may be lower here, the objective of capital preservation is easily met.

5. To Earn a Steady Stream of Income

Investments can also help you earn a steady source of secondary (or primary) income. Examples of such investments include fixed deposits that pay out regular interest or stocks of companies that pay investors dividends consistently. Income-generating investments can help you pay for your everyday expenses after you’ve retired. Alternatively, they can also act as excellent sources of supplementary income during your working years by providing you with additional money to meet outlays like college expenses or EMIs.

6. To Save up for Retirement

Saving up for retirement is a necessity. It’s essential to have a retirement fund you can fall back on in your golden years, because you may not be able to continue working forever. Additionally, it would be unfair to depend on your children to support you later in life, particularly if they have children of their own to raise. By investing the money you earn during your working years in the right investment options, you can allow your funds to grow enough to sustain you after you’ve retired.

Risk and Returns: Concept of Risk and Returns

After investing money in a project a firm wants to get some outcomes from the project. The outcomes or the benefits that the investment generates are called returns. Wealth maximization approach is based on the concept of future value of expected cash flows from a prospective project.

So cash flows are nothing but the earnings generated by the project that we refer to as returns. Since fixture is uncertain, so returns are associated with some degree of uncertainty. In other words there will be some variability in generating cash flows, which we call as risk. In this article we discuss the concepts of risk and returns as well as the relationship between them.

CONCEPT OF RISK:

A person making an investment expects to get some returns from the investment in the future. However, as future is uncertain, the future expected returns too are uncertain. It is the uncertainty associated with the returns from an investment that introduces a risk into a project. The expected return is the uncertain future return that a firm expects to get from its project. The realized return, on the contrary, is the certain return that a firm has actually earned.

The realized return from the project may not correspond to the expected return. This possibility of variation of the actual return from the expected return is termed as risk. Risk is the variability in the expected return from a project. In other words, it is the degree of deviation from expected return. Risk is associated with the possibility that realized returns will be less than the returns that were expected. So, when realizations correspond to expectations exactly, there would be no risk.

i. Elements of Risk:

Various components cause the variability in expected returns, which are known as elements of risk. There are broadly two groups of elements classified as systematic risk and unsystematic risk.

Systematic Risk:

Business organizations are part of society that is dynamic. Various changes occur in a society like economic, political and social systems that have influence on the performance of companies and thereby on their expected returns. These changes affect all organizations to varying degrees. Hence the impact of these changes is system-wide and the portion of total variability in returns caused by such across the board factors is referred to as systematic risk. These risks are further subdivided into interest rate risk, market risk, and purchasing power risk.

Unsystematic Risk:

The returns of a company may vary due to certain factors that affect only that company. Examples of such factors are raw material scarcity, labour strike, management inefficiency, etc. When the variability in returns occurs due to such firm-specific factors it is known as unsystematic risk. This risk is unique or peculiar to a specific organization and affects it in addition to the systematic risk. These risks are subdivided into business risk and financial risk.

ii. Measurement of Risk:

Quantification of risk is known as measurement of risk.

Two approaches are followed in measurement of risk:

(i) Mean-variance approach, and

(ii) Correlation or regression approach.

Mean-variance approach is used to measure the total risk, i.e. sum of systematic and unsystematic risks. Under this approach the variance and standard deviation measure the extent of variability of possible returns from the expected return and is calculated as:

$$\sigma^2 = \sum_{i=1}^{n} [(X_i - \overline{X})^2 p(X_i)]$$

Where, Xi = Possible return,

P = Probability of return, and

n = Number of possible returns.

Correlation or regression method is used to measure the systematic risk. Systematic risk is expressed by β and is calculated by the following formula:

$$\beta_i = \frac{r_{im}\sigma_i\sigma_m}{\sigma_m^2}$$

Where, rim = Correlation coefficient between the returns of stock i and the return of the market index,

σm = Standard deviation of returns of the market index, and

σi = Standard deviation of returns of stock i.

Using regression method we may measure the systematic risk.

The form of the regression equation is as follows:

$$Y = \alpha + \beta X$$

It is used in the following form

or $$\alpha = \bar{Y} - \beta\bar{X}$$

and, $$\beta = \frac{n\sum XY - (\sum X)(\sum Y)}{n\sum X^2 - (\sum X)^2}$$

Where, n = Number of items,

Y = Mean value of the company's return,

X = Mean value of return of the market index,

α = Estimated return of the security when the market is stationary, and

β = Change in the return of the individual security in response to unit change in the return of the market index.

CONCEPT OF RETURN:

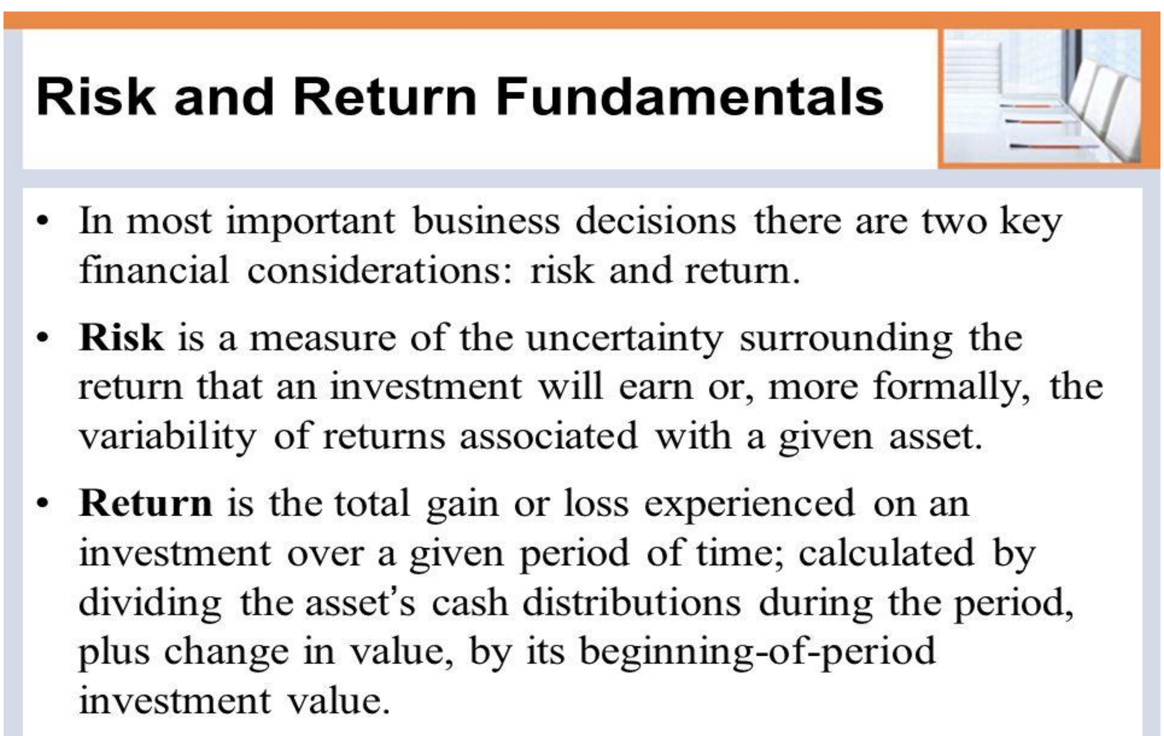
Return can be defined as the actual income from a project as well as appreciation in the value of capital. Thus there are two components in return—the basic component or the periodic cash flows from the investment, either in the form of interest or dividends; and the change in the price of the asset, commonly called as the capital gain or loss.

The term yield is often used in connection to return, which refers to the income component in relation to some price for the asset. The total return of an asset for the holding period relates to all the cash flows received by an investor during any designated time period to the amount of money invested in the asset.

It is measured as:

Total Return = Cash payments received + Price change in assets over the period /Purchase price of the asset. In connection with return we use two terms—realized return and expected or predicted return. Realized return is the return that was earned by the firm, so it is historic. Expected or predicted return is the return the firm anticipates to earn from an asset over some future period.

REVISION :



The Impact of Inflation on Your Savings & Investments

Understanding how market forces can influence your assets is the first step toward protecting yourself against potential adverse effects.

What Is Inflation?

Inflation is when average prices in the entire country go up. In other words, the buying power of an individual dollar decreases when the price of everything has increased. For example, imagine that it costs Rs100 to buy a Kg of Apple today, and the current inflation rate is 6%: Next year, the price of the same one Kg of Apple will be Rs.106, assuming that price increases in step with inflation.

The retail inflation rate in India, which has been on the rise since September last year, touched **6.07 per cent in February this year**, according to the data released by the National Statistical Office (NSO). In January this year, the retail inflation was at 6.01 per cent.

How Can It Impact Savings?
Over time, inflation can reduce the value of your savings, because prices typically go up in the future. This is most noticeable with cash. If you keep Rs.10,000 under your bed, that money may not be able to buy as much 20 years into the future. While you haven't actually lost money, you end up with a smaller net worth because inflation eats into your purchasing power.
When you keep your money in the bank, you may earn interest, which balances out some of the effects of inflation. When inflation is high, banks typically pay higher interest rates. But once again, your savings may not grow fast enough to completely offset the inflation loss.

How Can It Impact Investments?
The impact of inflation on investments depends on the investment type. For investments with a set annual return, like regular bonds or bank certificates of deposit, inflation can hurt performance — since you earn the same interest payment each year, it can cut into your earnings. If you receive a payment of Rs1000 per year, for instance, that payment would be worth less and less each year given inflation.
For stocks, inflation can have a mixed impact. Inflation is typically high when the economy is strong. Companies may be selling more, which could help their share price. However, companies will also pay more for wages and raw materials, which hurts their value. Whether inflation will help or hurt a stock can depend on the performance of the company behind it.

On the other hand, precious metals like gold historically do well when inflation is high. As the value of the dollar goes down, it costs more dollars to buy the same amount of gold.
Finally, there are some investments that are indexed for inflation risk. They earn more when inflation goes up and less when inflation goes down, so your total earnings are more stable. Some bonds and annuities offer this feature for an additional cost.

How Can You Plan for Inflation?
Inflation is one reason many people don't put all their money in the bank — over time, that inflation can erode the value of those savings. For that reason, some prefer to keep some of their money in potentially higher-growth investments like stocks or mutual funds, because on average these investments earn more per year than the inflation rate (although they also carry a risk of lower earnings or loss).
You may also want to consider inflation risk as you figure out what kind of asset allocation to have in your portfolio. Fixed investments, like bonds or fixed annuities, can be adversely affected by inflation. To diversify, some investors choose to add gold or inflation-indexed investments to their portfolios.
Inflation is a market force that is impossible to completely avoid. But by planning for it and putting a strong investment strategy in place, you might be able to help minimize the impact of inflation on your savings and long-term financial plans.

How inflation will impact investing in different asset classes

With that understanding of the Concept of INFLATION now in place, let us look at how inflation impacts multiple asset classes.

Fixed Income
Inflation impacts fixed income investments the most due to its inverse relationship with interest rates. As inflation inches higher, investors expected returns to also move higher to beat inflation. But as interest rates on debt instruments are fixed over their term, the prices of these instruments fall as investors sell the existing lower yielding products and move into higher yielding ones. So, in a rising inflation environment, fixed rate debt investments stand to lose the most. At times, central banks could take actions around monetary policy and systemic liquidity to manage interest rates or yields on debt products but eventually fundamentals would catch up. Inflation Protected Securities are a

category of bonds that adjust yields to inflation which could be considered in times of rising inflation. Similarly, floating rate bonds could also be looked at in times of rising interest rates.

Equity

When it comes to equities, inflation can be good or bad depending on the level of inflation, nature of inflation (transient or persistent), the external macro environment, and each corporates' sector exposure, balance sheet structure and pricing power. Low to moderate inflation at levels of 2-6 per cent is generally healthy for equities whereas hyperinflation of 10-14 per cent is bad. Rising raw material prices does pinch corporates operating margins, but if competitive dynamics enable the corporate to raise prices of its final products in-line, then it is said to have pricing power. In this case, the final consumer bears the brunt of inflation and the corporate maintains its margins. Capital markets reward such companies which gets reflected in rising stock prices. But if the demand is suppressed due to weaker consumer sentiments, high unemployment, sector disruption or any other reason, then corporates would find it difficult to pass on the raw material price rise to final product price hikes. This would lead to contraction in profits and consequent impact on stock prices.

Commodities

Commodities are real, physical assets and a strong hedge against inflation as their prices define the underlying inflation. Their prices are an indicator of inflation to come. Inflation is a weighted index of prices of different goods and services - raw materials (wholesale inflation) and final products (consumer inflation) - combined in a basket. The proportion of these items is determined by the respective country's government agencies. So, commodities (basic resources, metals, energy, agricultural produce) tend to do very well under a rising inflation scenario and vice versa.

Gold

The same relationship holds true for gold as well because it is also a precious metal – a commodity after all. Gold is the best inflation hedge as it tends to protect the value of your portfolio in times of rising inflation and hence it is also called a 'premium store of value'. But if central banks raise interest rates under inflationary pressure, then non-yielding assets like gold could become relatively unattractive for some investors. The other attributes of gold that make it a valuable strategic asset in investment portfolios are – return-generating ability over long-periods, great diversifier due to its low correlation with other asset classes in both expansionary and recessionary periods leading to better risk-adjusted returns, liquid as other mainstream financial assets and no credit risk. Investors also look at gold as an 'alternative currency' or 'currency of last resort' especially in countries where local currency is losing value.

Real Estate

Property prices and rentals tend to rise when inflation rises as property owner or landlord demands higher returns to offset rising input and consumption costs. Thus, real estate is also a physical asset which has a high correlation with inflation. REITs and Real Estate ETFs invest in a pool of real estate assets and are a better way to gain exposure to this asset class rather than investing in tangible physical land, residential, commercial, retail, or industrial property.

INVESTORS AGE AND ASSETS ALLOCATION

When you create your investment portfolio, one of the most important parameters that will affect your returns is the asset allocation. Meaning, the proportion you invest in different asset classes – equity, debt, gold, and so on. Ideally, you should focus on investing in such a way that your risks are minimized, and returns maximized. But, should this be a factor of your age? Does it make sense to think about asset allocation as per age? Let's find out.

Should asset allocation change with age?

Yes, absolutely. When you make an investment, you're looking to buy something that will appreciate in value with time. Each asset behaves differently over time and also accompanies a different level of risk. Your time horizon is an important determinant of risk tolerance – the longer the horizon, the more time you have to ride out the ups and downs of the market. Thus, the higher your risk tolerance. Similarly, a short time frame reduces your risk tolerance levels.

Additionally, one's risk appetite decreases over time since expenses and financial obligations increase. As investors near retirement, their risk tolerance decreases even further because of the absence of a steady source of income. Thus, it only makes sense to strategize asset allocation as per age.

What is the rule of thumb for asset allocation with age?

Investment in stocks

Stocks or equity shares of a company offer the most potential for long-term wealth creation. However, they are also subject to market changes. Now, when you’re young, your long-term growth potential outweighs the risks involved. It is highly unlikely for young investors to cash out stocks when the market is down. But, as you age, the scenario will gradually reverse. Thus, it is advisable to invest in equities and equity mutual funds when you’re in your prime. With time, decrease your investments in equity and related funds.

Investment in bonds

Bonds or debt-based funds offer lower long-term returns compared to equity. However, they promise a steady stream of income and are ideal for a low risk tolerance level. Therefore, as you near your retirement, your asset allocation as per age should incline more towards fixed-income assets such as debt mutual funds. You can still make investments in this asset class when you’re young, depending on your risk appetite.

Thinking about asset allocation according to age

Investors have a handy formula to deduce the right asset allocation as per age. Simply deduct your age from 100 to calculate the percentage of your portfolio that should be invested in stocks. Meaning, a 40-year old would invest 60% of their portfolio in stocks, whereas a 60-year old would invest 40%.

Finally, it’s during your peak-earning years that you should invest the most in stocks and the least in bonds – in your 35s to 50s. Then, as you age, you might want to bring stability to your portfolio with more debt investments and fewer equity ones.

Tax Saving Schemes – Government Schemes

How to save tax or rather how to plan your investment is a question that bothers each one of us. While tax planning is crucial, tax saving schemes are also essential. You can save tax and earn returns with the best tax saving schemes in India. The ideal time to plan for tax saving investments is the beginning of the financial year. This will ensure you don't pay more taxes and save taxes in India along with year-long returns on tax saving investment.

While we all aim to save taxes in India why only a few of us succeed. The answer could be a lack of knowledge or struggles in fitting the best-suited choice in your investment planning. In this article, we have listed each of the best tax saving investment options in India to help you compare and make a well-informed investment decision.

While planning on how to save tax in India, you must also ensure that your goal is not just tax saving. The goal must be to invest in the best-suited investment option along with income tax saving.

1. Unit Linked Insurance Plan (ULIP)

ULIP Life Insurance Plan is one of the most important investment plans in India. It ensures that one's family is financially balanced in the case of an event of death. By purchasing a life insurance policy, the taxpayer can avail of the benefit under the income tax act.

Under section 80C of the income tax act 1961, the premium paid towards the purchase of a life insurance policy qualifies for deduction up to Rs. 1.5 lakh. Furthermore, as per section 10(10D) income on the maturity of the policy is tax free. The income is tax-free if the premium is not more than 10% of the sum assured. In the case wherein the money goes to the nominee's of the person insured, the same remains as a tax exemption in the hands of the nominee.

In terms of the deduction under section 80C 1961, the taxpayer can claim 20% of tax deduction on the premium paid.

The following conditions also apply:

1. The taxpayer purchases a life insurance policy on or before 31st March 2012

2. The policy is in his own name or in the name of their spouse or child

If the life insurance policy is purchased after 1st April 2012, then the premium paid is eligible for tax deduction up to 10% of the sum assured.

2. ELSS Mutual Funds

Equity Linked Savings Schemes are mutual fund investment schemes that invest a large percentage of their portfolio in equity. Furthermore, the fund has a mandatory lock-in period of 3 years which is the shortest amongst all the investment products.

Investment in ELSS funds qualifies for deduction under section 80C of the income tax act up to a maximum of Rs. 1.5 lakh. Both lump sum investment and the amount invested through a systematic investment plan (SIP) qualifies for the deduction. Since ELSS funds invest a large amount in equity, there is always some inherent risk.

ELSS funds provide the dual benefit of capital appreciation and tax-savings. This makes it one of the most popular tax saving schemes amongst investors.

In general, taxpayers who want to claim tax deductions of up to Rs 1.5 lakh under Section 80C provisions and are willing to take some risk should consider investing in ELSS. These mutual funds are equity-oriented, and they invest a minimum of 60% of their portfolio in equity and equity-linked instruments. This makes it crucial to be invested in the funds for a long period of time in order to reap the benefit of the returns.

3. Public Provident Fund (PPF)

The Public Provident Fund has always been a popular tax saving schemes amongst the taxpayer. One of the major reasons for this popularity is the fact that PPF falls under the category of exempt–exempt–exempt tax status. You can open your PPF accounts with a bank or post office.

Taxpayers can claim a deduction under section 80C of the income tax act for the amount invested by them during the financial year. The maximum amount eligible for deduction is Rs. 1.5 lakhs. Since PPF falls under the exempt category, the interest and maturity amount are exempt from tax.

PPF account comes with a lock-in period of 15 years and it allows the investors the below options at the end of the maturity period:

1. Withdrawal of proceeds from the account
2. Continue for another 5 years

4. Sukanya Samridhi Yojana (SSY)

Sukanya Samriddhi Yojana has become one of the most important tax saving schemes. It was launched in 2015 by the government of India as a part of the Beti Bachao Beti Padhao campaign. It had a major impact on the general public. The scheme allows a fixed income investment through which the taxpayer can invest regular deposits and at the same time earn interest on it. Investing in Sukanya Samriddhi Yojana also qualifies as an eligible deduction under section 80C of the income tax act.

The government of India determines the rate of interest on the scheme on a quarterly basis and is payable on maturity. The scheme comes with a lock-in period of 21 years and will mature after the expiry of 21 years. A minimum deposit of Rs. 250 is required to be made per year for 15 years. Failure to pay the minimum amount in a year will lead to disconnection of the account. To re-activated the account, you need to pay a penalty of Rs. 50 along with the original Rs. 250 deposit.

In order to open a Sukanya Samriddhi account, below is the eligibility criteria for this tax saving option:

1. Only girl children can claim the benefits of this scheme.
2. The girl child cannot be more than 10 years of age. A grace period of one year is provided which allows the parent to invest with 1 year of the girl child being 10 years of age.
3. The investor must submit age proof of the daughter.

5. National Savings Certificate

A government of India initiative, a national savings certificate is a fixed income investment scheme that aims at the small and middle-income investors to invest and earn handsome returns. It is considered a low-risk investment and as secure as the Provident Fund. The investors can invest as per their income profile and investment habits.

Investment in NSC qualifies for deduction under section 80C of the income tax act up to Rs. 1.50 lakh. Apart from providing the benefit of tax exemption, it provides the investor with complete capital protection and guaranteed interest. Some of the features of the NSC, tax saving option are as follows:

- 6.8% annual interest as a guaranteed return.
- You can claim a tax benefit under section 80C up to Rs. 1.5L

- You can invest as low as Rs. 1,000 (or multiples of Rs. 100). You can increase the investment amount as per your convenience.
- On maturity, the entire maturity value will be received by the investor and the same will be taxed in the hands of the taxpayer.
- An early exit is not available. You can use the same as collateral security in case of loans from Bank or NBFC.

6. Tax-savings fixed deposit

Fixed deposits are considered one of the safest tax savings schemes. It’s safer than equity investments in terms of risk and returns. The banks decide the interest rates and it depends on several factors. Below are some of the features of a tax-saving fixed deposit:

1. Investment in tax saver fixed deposit eligible for deduction under section 80C while calculating the taxable income.
2. A minimum lock-in period of 5 years
3. The Senior citizens can get a higher interest rate on investment
4. In the case of a joint account, the primary holder can avail the benefit of tax deduction while calculating the taxable income
5. Tax saver fixed deposits do not allow any premature withdrawal. However, after the expiry of the 5 year lock-in period, investors get access to premature withdrawal. The terms and conditions for premature withdrawal vary from bank to bank.

7. Senior Citizen Savings Scheme

A Senior Citizen Savings Scheme is an income tax saving schemes available to senior citizens who are residents in India. The scheme is available for investment through banks and post offices and offers one of the highest rates amongst the various savings schemes.

Depositors can make an investment with a minimum amount of Rs. 1000 and in multiples thereof. The scheme also provides the facility of investment through cash provided the investment amount is less than Rs. 1 lakh. The deposits made into the scheme matures after a period of 5 years. The depositors also have the option to further extend the maturity period by another 3 years.

Investment in the Senior Citizen Savings Scheme qualifies as a deduction under section 80C up to Rs. 1.5 lakhs from the taxable income. The interest on such deposits is fully taxable and liable for a tax deduction if the interest is above Rs. 50,000. Deposits made into a Senior Citizens Savings Scheme account are compounded and paid out annually.

8. School Tuition Fees:

The income tax act 1961 provides a deduction under section 80C of the income tax act for payment for school fees of children. This tax saving option is available under section 80C in addition to other investments like PPF, NSC, ELSS etc. Tuition fees paid to any registered university, college, school, or educational institution qualifies for deduction up to Rs. 1.5 lakh.

Moreover, only the tuition fees qualify for deduction under the income tax act. Any other fee like donation, development fee, etc. even if paid to such an institution does not qualify for the deduction.

The income tax act allows both the parents to claim the deduction to the extent of the amount paid by them. So if the total fee paid by the parents is Rs 1 lakh, of which the father has paid Rs 40,000, while the mother has paid Rs 60,000, both can claim the amount individually as per the payment made by them.

9. National Pension Scheme (NPS)

NPS or National Pension Scheme has become a popular income tax saving investment product. It is a tax saving option that is available to both government and private employees. It enables the depositor to build a corpus for their retirement along with a regular monthly income. The amount invested by the depositor is invested in several schemes including the equity markets.

There are two types of NPS accounts, Tier-1 & Tier-2. A tier-1 account has a lock-in period until the subscriber reaches the age of 60 years. The contributions made by the subscriber to tier-1 are tax-deductible under section 80CCD(1) and 80CCD(1B). Tier-2 accounts are voluntary in nature which allows the subscriber to withdraw the money when they like. However, contributions under tier-2 accounts are not eligible for a tax deduction.

As per the provision of section 80CCD, an individual can claim a deduction up to Rs. 1.5 lakh by investing in NPS. Additionally, a new sub-section 1B was also introduced, which offered an additional deduction of up to Rs. 50,000/-for contributions made by individual taxpayers towards the NPS.

10. Health Insurance premium under section 80D:

You can claim a tax benefit up to Rs. 25,000 in respect of the below contributions:

1. Premium paid to keep in force health insurance covering self, spouse, or dependent children.
2. Any contribution to Central Health Government Schemes.
3. Any other scheme may be notified by the central government as eligible for deduction.

In order to take care of one’s medical emergencies, medical insurance is considered as the safest investment option. This allows the taxpayer to avail of the benefits on two fronts. Firstly, being taken care of by the insurance policy in the case of a medical emergency. Secondly, the tax benefit under the income tax act for investing in an investment product.

Apart from the above, an additional deduction for the insurance of the parents is available to the extent of Rs. 25,000 if they are less than 60 years of age or Rs. 50,000 if they are more than 60 years of age. If the individual and the parent are both above 60 years of age, the maximum deduction available under this section will be Rs. 1,00,000.

REFERENCE & CREDITS

1. Various educational Websites.

2. https://indiafreenotes.com/

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