Where you invest to claim your Rs 1 lakh Section 80C tax break should be a matter of choice, not default or desperation

My work requires me to look at money choices made by individuals all the time. A good chunk of these choices are made close to the March 31 deadline for making tax-based investments, as people rush to make up in two months what they didn't pay much attention to in the past 10 months. In those rushed, often uninformed decisions, I see the fallout of desperation: wrong investment choices, which maximise tax savings, but don't maximise returns.

Know your choices

The first step to maximising returns is understanding the options to save tax through Section 80C, which can reduce your taxable income by up to Rs 1 lakh. These can be classified into three:

Expenses. Repayment of home loan principal and tuition fees of two school-going children. These are expenses you are already making.

Investments by default. These are investments in which you either have no choice (EPF, which comes out of your salary) or don't have to invest anything more (interest accrued from National Savings Certificates bought in previous years).

Investments by choice. Investments selected by you in designated debt instruments (PPF, NSC, five-year bank fixed deposits), equity funds (equity-linked savings schemes, or ELSS) and life insurance plans.

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Follow the order

There are ways and ways to reach the limit of Rs 1 lakh for the year. There is such a thing as the right way for you. Rule number one: allocate what you can't avoid and invest the balance. All Section 80C investments have oppressive terms and conditions. Most of them have a lock-in period, starting from three years (for example, ELSS) and going up to five years (PPF). Others like Ulips (unit-linked insurance plans) require you to stay invested for at least 15-20 years to realise returns that can be considered decent.

Invest all you can, but keep as much as possible outside the ambit of Section 80C, as the universe of open instruments provides better returns, liquidity, flexibility and other benefits. Therefore, claim the expenses and default investments, and invest the balance.

Say, in a given year, you have repaid Rs 40,000 principal on your home loan, are paying Rs 20,000 as tuition fee for your kids' education and have invested Rs 60,000 in Section 80C instruments. If you took the benefit of just the Rs 40,000 principal repayment, you would have had to invest Rs 60,000 in Section 80C instruments. But had you also included the Rs 20,000 tuition fee, your shortfall would have been only Rs 40,000. The balance 20,000 could have then been invested in schemes outside the purview of Section 80C, or used to repay credit card loans or create emergency fund, among other things. That is the ideal. However, if you are an undisciplined investor, put in as much as you can in Section 80C instruments if that is the only way to get you to save.

> **Treat tax-based investing as an ongoing, wealth creation exercise, not a year-end chore**

Create wealth

The next level of choice is how to break-up your discretionary Section 80C investments. Proper allocation, tailored to your needs and risk appetite, supplements your overall financial planning. Which brings us to rule number two: unless you are nearing the end of your working life, look at tax saving as an active, aggressive wealth-creation tool, not a defensive, end-of-year exercise. That difference in approach can make a big difference to your maturity amount over long periods of time.

It's especially true for those in the age bracket of 25-35, who should maximise their allocation to ELSS. In the tax-saving investment set, their performance has been peerless. Their returns are market-linked, which scares away many, but that risk can be managed by staying invested for long periods (five years at least) and by choosing good funds. If you invested Rs 10,000 every year for 25 years, and earned 12 per cent a year in ELSS and 8 per cent in NSC, the difference in amounts will be about Rs 6 lakh — Rs 13.3 lakh from ELSS compared to Rs 7.3 lakh in NSC.

Along with the do's, there are some don'ts as well. The most important: don't commit to something you can't meet. Many investors buy life insurance policies with high premiums so as to get the tax benefit for that year. What they don't realise is that they need to pay that premium through the policy tenure. Often, in subsequent years, they are struggling to pay that premium. Even if they are not struggling, they have lost the option, or are left with a smaller corpus, to make alternative investments. Whichever way you look at it, investments and allocation under Section 80C should be a matter of choice, not default. ■

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TAX-SAVING STRATEGIES

IN YOUR 20s

WHO YOU ARE

Single, without dependants, early working years, rising income surplus

DO'S AND DON'TS

- Invest in ELSS as much as possible. Since you don't need the money, you can put up with temporary dips in value to reap long-term benefits
- Start a PPF account
- If you don't have dependants, don't buy life insurance — you will be paying for something you don't need

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