All about deduction under section 80C and tax planning

Background for Section 80C of the Income Tax Act (India) / What are eligible investments for Section 80C:

Section 80C replaced the existing Section 88 with more or less the same investment mix available in Section 88. The new section 80C has become effective w.e.f. 1st April, 2006. Even the section 80CCC on pension scheme contributions was merged with the above 80C. However, this new section has allowed a major change in the method of providing the tax benefit. Section 80C of the Income Tax Act allows certain investments and expenditure to be tax-exempt. One must plan investments well and spread it out across the various instruments specified under this section to avail maximum tax benefit. Unlike Section 88, there are no sub-limits and is irrespective of how much you earn and under which tax bracket you fall.

The total limit under this section is Rs 1 lakh. Included under this heading are many small savings schemes like NSC, PPF and other pension plans. Payment of life insurance premiums and investment in specified government infrastructure bonds are also eligible for deduction under Section 80C

Most of the Income Tax payee try to save tax by saving under Section 80C of the Income Tax Act. However, it is important to know the Section in toto so that one can make best use of the options available for exemption under income tax Act. One important point to note here is that one can not only save tax by undertaking the specified investments, but some expenditure which you normally incur can also give you the tax exemptions.

Besides these investments, the payments towards the principal amount of your home loan are also eligible for an income deduction. Education expense of children is increasing by the day. Under this section, there is provision that makes payments towards the education fees for children eligible for an income deduction

Sec 80C of the Income Tax Act is the section that deals with these tax breaks. It states that qualifying investments, up to a maximum of Rs. 1 Lakh, are deductible from your income. This means that your income gets reduced by this investment amount (up to Rs. 1 Lakh), and you end up paying no tax on it at all!

This benefit is available to everyone, irrespective of their income levels. Thus, if you are in the highest tax bracket of 30%, and you invest the full Rs. 1 Lakh, you save tax of Rs. 30,000. Isn't this great? So, let's understand the qualifying investments first.

Qualifying Investments

Provident Fund (PF) & Voluntary Provident Fund (VPF: PF is automatically deducted from your salary. Both you and your employer contribute to it. **While employer's contribution is exempt from tax, your contribution (i.e., employee's contribution) is counted towards section 80C investments**. You also have the option to contribute additional amounts through voluntary contributions (VPF). Current rate of interest is 8.5% per annum (p.a.) and is tax-free.

Public Provident Fund (PPF): Among all the assured returns small saving schemes, Public Provident Fund (PPF) is one of the best. Current rate of interest is 8% tax-free and the normal maturity period is 15 years. Minimum amount of contribution is Rs 500 and maximum is Rs 70,000. A point worth noting is that interest rate is assured but not fixed.

Life Insurance Premiums: Any amount that you pay towards life insurance premium for yourself, your spouse or your children can also be included in Section 80C deduction. Please note that life insurance premium paid by you for your parents (father / mother / both) or your in-laws is not eligible for deduction under section 80C. If you are paying premium for more than one insurance policy, all the premiums can be included. It is not necessary to have the insurance policy from Life Insurance Corporation (LIC) – even insurance bought from private players can be considered here.

Equity Linked Savings Scheme (ELSS): There are some mutual fund (MF) schemes specially created for offering you tax savings, and these are called Equity Linked Savings Scheme, or ELSS. The investments that you make in ELSS are eligible for deduction under Sec 80C.

Home Loan Principal Repayment: The Equated Monthly Installment (EMI) that you pay every month to repay your home loan consists of two components – Principal and Interest.The principal component of the EMI qualifies for deduction under Sec 80C. Even the interest component can save you significant income tax – but that would be under Section 24 of the Income Tax Act. Please read "Income Tax (IT) Benefits of a Home Loan / Housing Loan / Mortgage", which presents a full analysis of how you can save income tax through a home loan.

Stamp Duty and Registration Charges for a home: The amount you pay as stamp duty when you buy a house, and the amount you pay for the registration of the documents of the house can be claimed as deduction under section 80C in the year of purchase of the house.

National Savings Certificate (NSC): National Savings Certificate (NSC) is a 6-Yr small savings instrument eligible for section 80C tax benefit. Rate of interest is eight per cent compounded half-yearly, i.e., the effective annual rate of interest is 8.16%. If you invest Rs 1,000, it becomes Rs 1601 after six years. The interest accrued every year is liable to tax (i.e., to be included in your taxable income) but the interest is also deemed to be reinvested and thus eligible for section 80C deduction.

Infrastructure Bonds: These are also popularly called Infra Bonds. These are issued by infrastructure companies, and not the government. The amount that you invest in these bonds can also be included in Sec 80C deductions.

Pension Funds – Section 80CCC: This section – Sec 80CCC – stipulates that an investment in pension funds is eligible for deduction from your income. Section 80CCC investment limit is clubbed with the limit of Section 80C – it maeans that the total deduction available for 80CCC and 80C is Rs. 1 Lakh.This also means that your investment in pension funds upto Rs. 1 Lakh can be claimed as deduction u/s 80CCC. However, as mentioned earlier, the total deduction u/s 80C and 80CCC can not exceed Rs. 1 Lakh.

5-Yr bank fixed deposits (FDs): Tax-saving fixed deposits (FDs) of scheduled banks with tenure of 5 years are also entitled for section 80C deduction.

<u>Senior Citizen Savings Scheme 2004 (SCSS)</u>: A recent addition to section 80C list, Senior Citizen Savings Scheme (SCSS) is the **most lucrative scheme among all the small savings schemes but is meant only for senior citizens**. Current rate of interest is 9% per annum payable quarterly. Please note that the interest is payable quarterly instead of compounded quarterly. Thus, unclaimed interest on these deposits won't earn any further interest. Interest income is chargeable to tax.

<u>5-Yr post office time deposit (POTD) scheme:</u> POTDs are similar to bank fixed deposits. Although available for varying time duration like one year, two year, three year and five year, only 5-Yr post-office time deposit (POTD) – which currently offers 7.5 per cent rate of interest – qualifies for tax saving under section 80C. Effective rate works out to be 7.71% per annum (p.a.) as the rate of interest is compounded quarterly but paid annually. The Interest is entirely taxable.

NABARD rural bonds: There are two types of Bonds issued by NABARD (National Bank for Agriculture and Rural Development): NABARD Rural Bonds and Bhavishya Nirman Bonds (BNB). Out of these two, only NABARD Rural Bonds qualify under section 80C.

Unit linked Insurance Plan : ULIP stands for Unit linked Saving Schemes. ULIPs cover Life insurance with benefits of equity investments.They have attracted the attention of investors and tax-savers not only because they help us save tax but they also perform well to give decent returns in the long-term.

<u>Others:</u> Apart form the major avenues listed above, there are some other things, like children's education expense (for which you need receipts), that can be claimed as deductions under Sec 80C.

<u>So, where should you invest?</u>

Like most other things in personal finance, the answer varies from person to person. But the following can be the broad principles:

Provident Fund: This is deducted compulsorily, and there is no running away from it! So, this has to be the first. Also, apart from saving tax now, it builds a long term, tax-free retirement corpus for you.

Home Loan Principal: If you are paying the EMI for a home loan, this one is automatic too! So, it comes as a close second.

Life Insurance Premiums: Every earning person having dependents should have adequate life insurance coverage. (For more on this, please read “Life after life – Why you should buy Life Insurance”) Therefore, life insurance premium payments are the next.

Voluntary Provident Fund (VPF) / Public Provident Fund (PPF): If you think that the PF being deducted from your salary is not enough, you should invest some more in VPF, or in PPF.

Equity Linked Savings Scheme (ELSS): After the above, if you have not reached the limit of Rs. 1,00,000, then you should invest the remaining amount in Equity Linked Savings Scheme (ELSS).

Equities provide the best, inflation-beating return in the long term, and should be a part of everyone’s portfolio. After all, what can be better than something that gives great return and helps save tax at the same time?

When to Invest?

Many of us start looking for investment avenues only in February or March, just before the Financial Year is getting over. This is a big mistake! One, you would end up investing your money without putting proper thought to it. And secondly, you would end up losing the interest / appreciation for the whole year. Instead, decide where you want to make the investments, and start investing right from the beginning of the financial year – from April. This way, you would not only make informed decisions, but would also earn the interest for the full year from April to March.

Tags: 1 lakh, education fees, eligible investments, government infrastructure, Home Loan, income tax act, income tax act india, infrastructure bonds, investment mix, life insurance premiums, maximum tax, nsc, pension scheme, PPF, tax benefit, tax bracket, tax exemptions