

PPF- An Investment & Tax Saving Instrument

Introduction:

The stock market, despite the probability of giddy returns, can give you the heebie-jeebies due to the wild swings in share prices. Fixed deposits can be a turnoff because the interest earned is taxable. For investors seeking the best of both worlds, there is the Public Provident Fund (PPF). Wrapped in safety and free of tax, the PPF is almost a godsend for risk-averse investors.

PPF is a savings and tax-saving instrument. It also serves as a retirement planning tool for those who are not covered by any structured pension plan. The popularity of PPF as an investment avenue has been because of various reasons seldom found in other savings instruments - high rate of returns, compound interest, complete safety, no wealth tax, and tax-free interest.

Public provident fund (PPF) is an important long-term savings scheme. Further, annual contributions up to Rs 70,000 made under a PPF account are eligible for tax deduction u/s 80C of the Income-Tax Act, 1961 (the Act), and the interest income earned/accumulated in the PPF account is also exempt from tax.

“PPF is an excellent tool for long-term investment. It is risk-free as it is backed by the government,” Don’t think of your PPF account as a stodgy investment option where you put away something once in a year. With a little planning, it can be an important part of your financial portfolio. Here are a few tips that will help you make the most of this option:

PPF vs FDs

If ₹70,000 is invested every year in PPF and fixed deposits, the PPF account will be far bigger after 15 years



Calculation assumes that the year-end corpus of PPF and a fixed deposit is reinvested every year along with a fresh investment of ₹70,000. Fixed deposit earns 8% interest and its income is taxed at 30.9%.

So, if you invest ₹70,000 a year in a PPF, your annual tax savings in the 30% bracket will be

₹ **21,630**

In 15 years, you have a tax-free corpus of

₹ **22.92** lakh

With tax savings, the total gain in 15 years is

₹ **26.16** lakh

PPF-The wonder calculation:

The 8% compounding interest you earn on the balance can work wonders for you, especially because a PPF account is a long-term investment. There is an annual limit of

Rs 70,000 that one can invest in the PPF. You may feel it is a waste to be investing Rs 70,000 in this option when your Rs 1 lakh tax saving limit under Section 80C has already got exhausted. But don't let the tax savings alone guide your decision. Invest as much in PPF as you can afford to.

If you contribute Rs 70,000 a year to your PPF for 15 years, your investment would grow to a gargantuan Rs 22.92 lakh on maturity.

And remember, this is tax-free money. In the 30% tax bracket, this is equivalent to receiving almost 11.5% interest on a bank fixed deposit. "The PPF offers the highest post-tax returns among all fixed income options since no tax is levied on the investment, income and withdrawals,"

Distribute income:

PPF For Spouse:

There are benefits in store if you open a PPF account in the name of your spouse or child. Tax laws say that if any money gifted to a spouse is invested, the income from that investment is clubbed with the income of the giver. But since PPF income is tax free, it will not push up his tax liability. This way, you can invest more than Rs 70,000 a year in this tax-free haven and benefit from its various advantages.

PPF For children (Minor):

This strategy does not work in case of minor children though. You can open a PPF account in the name of a minor child but the combined contribution to your and your child's account cannot exceed Rs 70,000 a year.

PPF For children (Major):

However, if the child is over 18 years, up to Rs 70,000 a year can be invested in his name separately. The taxman insists on clubbing the income of minor children with that of the parent. But once they turn 18, they can have a separate income. "A PPF is an ideal way of building a fund for your child's educational needs instead of falling for all the 'high-commission-paying' child plans of insurers. In a child plan, you are not sure of the final returns."

PROCEDURE:

A/C OPENING

A PPF account can be opened at a head post office or at specified branches of some nationalised banks. Subscription can be made in cash or through a crossed cheque in favour of the accounts office, at the place at which that office is situated.

Deposits under PPF can be made for a period of 15 years and thereafter extended for a time period of 5 years each time.

ELIGIBILITY

Any individual may, on his own behalf or on behalf of a minor of whom he is the guardian, subscribe to PPF. The amount should not be less than Rs 100 and not more than Rs 70,000 in a year. An individual may also subscribe to the fund on behalf of a Hindu Undivided Family, an association of persons or a body of individuals.

- An individual can open only one account.
- A person having a GPF, EPF, or CPF accounts can also open a PPF account.
- More than one account/joint accounts are not permitted.
- Both, the parents and the child, can contribute out of their respective incomes chargeable to tax and earn tax breaks under Section 80C.
- An individual may open one PPF account on behalf of each minor child of whom he is the guardian.
- If a guardian opens an account on behalf of a minor child, the other guardian cannot open an account on behalf of the same minor child.
- Investments in a PPF account can be made in multiples of Rs 5, either lump sum, or in installments (not exceeding 12 in a year).

INTEREST RATE

Over the past few years, the interest rate on PPF accounts has also been reduced and has come down from 12% to 8%. Still, considering the other instruments available in the market, PPF is among the best options. Considering the tax advantages on the interest income, the effective rate of returns is quite high as compared to other saving instruments.

The interest rate on PPF has been following market rates. Starting from 4.8 per cent in 1968-69, it went upto 12 % in 1986-87. The 12% interest remained for almost 14 years till 1999-00. From the year 2000, then decent began, and the rate has touched the prevailing 8%.

Interest at the rate notified by the Central Government will be allowed for a calendar month on the lowest balance at credit of an account between the close of the fifth day and the end of the month. It will be credited to the account at the end of each year.

The present rate is 8% compounded annually.

INCOME TAX BENEFITS:

The balance to the credit of a subscriber in his account is not subject to attachment. The PPF Act gives the account holder immunity from attachment. Contributions paid out of the assessee's taxable income into his PPF account, his children (minor or major) and spouse's accounts qualify for rebate under the Income Tax Act. In the case of a Hindu Undivided Family, any member of the family will qualify for rebate. The interest credited to the fund and withdrawals from the fund are exempt from income tax.

WEALTH TAX:

The balance held in a PPF account is completely free from wealth tax.

RECENT GOVERNMENT CLARIFICATIONS

1. Deposit date in Cheque payments

Till recently, in case of a PPF when a subscriber used to make deposits by local cheque or demand draft, the date of tender of cheque or draft at the accounting office was treated as the date of deposit of PPF, provided the said cheque was duly honoured on presentation for encashment.

In contrast, in case of other small savings schemes like Post Office Savings Scheme (POSS), Senior Citizen Savings Scheme 2004 (SCSS) any money deposited in these accounts by means of a cheque, the date of encashment of the cheque is treated as the date of deposit.

Thus, in order to remove inconsistency between PPF and other small savings schemes and to bring in uniformity in the reckoning of the date of deposit of all the schemes, the government has issued necessary instructions through the circular to banks / other intermediaries which hold PPF accounts for the individuals to treat the date of realisation of the cheque or demand draft by the subscriber as the date of deposit.

This issue becomes particularly relevant in respect of deposits made towards the end of the financial year by cheque / demand draft because if the same is not realised by March 31, then the same will be treated as deposits for the following financial year. This would also have ramifications in respect of the tax deduction being claimed by the individuals in a particular tax year.

2. Opening an account for a minor :

There have been certain practical hurdles in respect of opening of accounts for minor vis-à-vis some intermediary agencies. This clarification reiterates that as per the rules under PPF scheme, an individual may on his own behalf or on behalf of a minor of whom he is a guardian, open a PPF account. Further, either father or mother can open PPF account on behalf of his / her minor child, but both cannot open the account for same child.

SPECIAL FEATURES:

1) You can have only one PPF account, either in your name, your spouse's name or your minor child's name. This applies across post offices and banks that open such accounts.

2) If you opened two PPF accounts long ago, close the second. Your bank or post office will return the principal invested without interest on your second PPF account.

3) There is no concept of joint holding in a PPF account. It has to be in a single name only. You can however nominate your dependents to your PPF account.

4) Interest is computed on the minimum balance between the 5th and end of a month. If you are investing a lump sum to save tax, deposit the amount before March 5 of the year.

5) You cannot offer the balance in your PPF account as collateral to take a loan. Ensure that PPF is not your only investing vehicle.

6) Nominees can claim the balance in the PPF account with interest on the death of the account holder. They cannot continue the account or make additional contributions.

Caution point –DTC:

As of now, PPF falls under the Exempt, Exempt, Exempt (EEE) regime. Under the proposed Direct Tax Code (DTC), all small savings schemes, including PPF, are proposed to be under EET regime, which effectively means that the withdrawals from the scheme may be taxable once the DTC is implemented. The silver lining over here is that it is likely that deposits made and the interest accumulated in the account till the date of implementation of DTC may continue to be exempt and only subsequent contributions and the interest account may be subject to tax. The revised draft of DTC is awaited which would throw more light and clarify taxability of PPF scheme on a go-forward basis

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