How investing in NPS can help you save tax

Although the National Pension System comes with exempt-exempt-exempt (EEE) tax status, there is a catch.

The National Pension System (NPS) is one of the financial products you can use to reduce your tax outgo. You can invest in NPS to save for your retirement as well.

Although the NPS comes with exempt-exempt-exempt (EEE) tax status, there is a catch. If you are planning on investing in NPS to save on tax, here are a few important points you should keep in mind.

- **Tax-saving benefit under NPS at the time of investing**

At the time of investment, tax-saving benefit of NPS can be claimed under three sections of the Income-tax Act, 1961. These sections are: - (i) Section 80CCD (1), (ii) 80CCD (2), and (iii) 80 CCD (1b).

- **Section 80CCD (1)**

Tax-benefit under section 80CCD (1) is available on an individual's self-contributions to the NPS Tier-I account. Currently, an individual can claim tax benefit on a maximum self contribution of Rs 1.5 lakh in a financial year to the Tier-I account. The amount so deposited up to Rs 1.5 lakh can be claimed as deduction from gross total income before tax, thereby reducing the tax liability.

Therefore, if you have deposited more than Rs 1.5 lakh, say Rs 2 lakh, in your Tier-I NPS account, then you will be able to claim tax benefit on Rs 1.5 lakh only as per income tax laws. Remember, there is no limit on the maximum amount that can be deposited in the Tier-I NPS account.

This deduction comes under the overall limit of section 80C of the Income Tax Act. Current income tax laws allow maximum deduction of Rs 1.5 lakh on aggregate basis for the investment and expenditure inccurred under sections 80C, 80CCC and 80CCD (1). Therefore, if you claim deduction of Rs 1.5 lakh under section 80CCD (1) , then you cannot claim deduction of Rs 1.5 lakh under section 80C simultaneously.

- **Section 80CCD (2)**

Tax benefit under 80CCD (2) can be claimed by the individual when the employer deposits the money on behalf of the individual in his/her NPS Tier-I account. According to current income tax laws, the employer can deposit a maximum of 10 per cent of the individual's salary. Salary here means basic salary plus dearness allowance. Remember, there is no maximum restriction on how much can be deposited as long as it does not breach the 10 percent limit.

Here also, the amount deposited by the employer can be claimed as deduction from gross total income before tax thereby reducing taxable income and consequently the tax payable. Remember, the tax benefit under section 80CCD (2) is over and above the section 80CCD (1).

- **Section 80CCD (1b)**

  Apart from the above mentioned tax-saving benefits, an individual can claim deduction under 80CCD (1b) for a maximum of Rs 50,000 in a financial year. This additional deduction was introduced in the financial year 2015-16.

  The additional tax benefit of Rs 50,000 is over and above tax-break under section 80CCD (1) and 80CCD (2). The amount despoited can be claimed as deduction from gross total income before computing the tax liability.

  Tax-saving benefits in NPS

Income tax benefit under	Tax benefit on maximum investment/contribution in NPS
Section 80CCD (1)	Of Rs 1.5 lakh under the overall limit of Section 80C
Section 80 CCD (1b)	Of Rs 50,000 which is over and above Rs 1.5 lakh of section 80CCD (1)
Section 80 CCD (2)	Maximum 10% of (basic salary + DA) deposited by the employer

- **For Government employees**

  From FY 2019-20 onwards, government employees have an option to invest in NPS Tier -II account with a lower lock-in period. A government employee can invest maximum of Rs 1.5 lakh in the Tier-II account of NPS to claim tax benefit under section 80C. Unlike lock-in period till the age of retirement, the investment made in Tier-II account of NPS under section 80C comes with a lock-in period of three years.

  The tax benefit for Tier-II NPS account is not available for non-government employees.

- **Lock-in period of NPS and partial withdrawals**

  NPS comes with a long lock-in period. The scheme matures once the individual turns 60 years. However, during the duration of the scheme account, partial withdrawal is allowed subject to certain terms and conditions.
  For instance, partial withdrawal from NPS is allowed for higher education of children, marriage of children, purchase or construction of residential house or flat etc., if the Tier-I account has completed three years.

  The maximum amount that an individual can withdraw from Tier-I account is 25 per cent of his/her own contribution. Also, according to current income tax laws, maximum 25 per cent withdrawal from subscriber's own contribution will be exempted from tax. Therefore, the maximum amount of partial withdrawal and tax-exempted amount are equal.

- **At the time of maturity**

As mentioned above, NPS will mature when the individual turns 60 years of age. To make the scheme attractive, in the July 2019 Budget, the government made some changes in the taxation of the scheme at the time of maturity.

According to the new laws, maximum sixty percent of the corpus accumulated at the time of maturity can be withdrawn as tax-free. However, remaining 40 percent of the corpus, which is tax-exempt, has to be compulsorily used to buy an annuity plan.

This has made NPS technically exempt-exempt-exempt from tax. But remember, the annuity received under the pension plan is taxable in your hands in the year of receipt at the tax rates applicable to your income.

Conclusion

Section 80C of the Income Tax Act offers choice of various specified investment products in which one can invest and save tax. However, while making investments to save tax, one should link their tax-saving investments to their money goals.

NPS comes with a long lock-in period and certain conditions regarding partial withdrawal. In case an urgent monetary need arises, then you might not be able to withdraw from your NPS account except in the specified cases. However, on the other hand, if your goal is saving for retirement, then NPS is one option, apart from EPF that can be looked at.

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