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The Retail Investor's Dilemma

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I am 32 years old, working for the last seven years now. However, I fall under the highest tax bracket. After all my expenses I can save up to ₹15,000 per month. I am looking for an investment vehicle which provides efficient tax saving for long-term horizon. I am a bit confused as to whether I should choose PPF or ELSS. Can you help me out on the above?

- Pradeep Rane, Thane

S Your financial concern at an early age is appreciable. Your surplus income is ₹1,80,000 per annum out of which you can save a maximum of ₹1,50,000 from tax under section 80C of the Income Tax Act. So the remaining ₹30,000 is anyway taxable. A PPF (Public Provident Fund) is government-backed debt security which has been giving a return of 8.7 per cent per annum for the current financial year, with a lock-in period of 15 years. An ELSS (Equity Linked Saving Scheme) on the other hand is a mutual fund which invests its major part of corpus in equity with different underlying strategies. The lock-in period for ELSS is three years. So before deciding which product will suit your requirement, one needs to examine the two products in detail.

Asset Class: A PPF belongs to the debt asset class where the money will be invested in instruments offered by the central/state government and public sector financial institutions. An ELSS comes under the equity asset class where the underlying asset is in shares of companies.

Risk: This is a key parameter which you should consider before investing. The investment choices vary from person to person based on one's risk appetite. PPF can be taken as low-risk investment which is invested in government instrument. This gives steady returns with low volatility. In contrast, an ELSS comes with high risk since the equity markets are volatile in the short term. But the payoffs from ELSS are also proportionate to the risk taken! You should also consider the other parameters of ELSS such as the expense ratio of the fund, the fund manager's underlying strategy, and the quality of the fund house before you choose this option.

Liquidity: Both these products are subject to lock-in with a close-ended tenure; hence liquidity is a constraint! This implies that you can't redeem your investments until the lock-in period is over. However an ELSS weighs better over a PPF account since the lock-in period is only three years vis-a-vis 15 years for PPF, although PPF provides for a premature partial withdrawal after completion of the fourth financial year, subject to certain conditions. You may choose to opt for a dividend pay-out option in an ELSS during the investment tenure for recurring cash flow, but interest pay-out option is not allowed in a PPF account. You need to consider all your liquidity requirements before making a choice.

Returns: Coming to the returns' part, ELSS always outperforms the PPF. PPF gives steady CAGR (compounding annual growth rate) returns of around 8.5 per cent while ELSS is meant for long-term investors who can ride volatility in equity markets. The table below indicates the behaviour of a typical ELSS scheme.

CAGR- Returns	Investment Period			
Scheme Name	3 Years	5 Years	7 Years	10 Years
Franklin India Taxshield(G)	22.2398	17.4745	12.5323	20.8200
HDFC TaxSaver(G)	21.2396	15.8677	11.5608	22.4820
Reliance Tax Saver (ELSS) Fund(G)	29.0797	20.9003	13.5213	NA
Escorts Tax(G)	8.2457	3.1932	-2.6329	10.0392
LIC Nomura MF Tax Plan(G)	19.6592	9.6304	5.5470	11.5270
Principal Personal Tax saver Fund	20.0333	11.1060	5.7928	16.8781

If you look at the returns of the ELSS funds, they have the potential to deliver more than two times that of PPF returns in the long term. However, you need to choose the right fund as the differential between the best and the worst fund is high. Except during brief and short periods, ELSS funds create more value for investors in the long run.

Taxation: From the tax angle both PPF and ELSS are very efficient. You can have complete exemption of ₹1,50,000 under either of these or a combination of both. In addition to this, the recurring income from each of this in the form of interest/dividend is also exempt from taxes and the maturity proceeds are also tax-free from these products.

Parameter	PPF	ELSS
Returns	Moderate	Superior
Risk-Volataility	Low	High
Liquidity- Lock in Period	15 Years	3 Years
Taxation	Tax- efficient	Tax- efficient
Redemption Before Lock-in	Available	Not Available

In conclusion you can go for a mix of these products to match your long-term horizon and taking into consideration the liquidity requirement, returns' perspective, and risk appetite. It's always advisable to invest in a product which matches your risk appetite and financial advisors will assist you in doing that.

PPF can be taken as low-risk investment which is invested in government instrument. This gives steady returns with low volatility.

Disclaimer: Past performance does not guarantee future returns. The mutual funds which have been mentioned are indicative of historical performance only. Please consult your financial advisor before investing in mutual funds.