CHAPTER

08

PUBLIC PROVIDENT FUND (PPF)

You saw in the previous chapter how EPF is a wonderful investment option that is available to employed Indians. The Public Provident Fund (PPF) is a similar option that is available to all Indian residents, irrespective of their employment status. Their similar sounding names can be confusing at times, with many people mistaking one for the other. The "Provident Fund" in both names, however, means the same: it's a fund that can be utilized during one's retirement years.

The Government of India introduced the Public Provident Fund scheme in 1968 to ensure that everyone could have some savings for their old age. The scheme was replaced by the Public Provident Fund Scheme, 2019, a modified version of the earlier scheme, effective December 12, 2019. PPF offers a healthy rate of interest, plus incentives such as tax deductions on the investment made, along with tax-free withdrawals on maturity, and complete security of the investment. Because of these attractive features, PPF has remained a highly popular scheme among different sections of society. Owing to the benefits it offers, PPF should definitely be part of your investment plan. Let's learn more about this scheme.

THE PUBLIC PROVIDENT FUND CONCEPT

For decades, PPF was the closest thing Indians had to a social security scheme until the launch of the National Pension Scheme (NPS). The key feature of PPF is its long maturity period: Once you start investing in PPF, you must wait 15 years before you can withdraw the corpus. If you wish to continue enjoying its benefits, you can extend the scheme beyond 15 years in five-year blocks, as many times as you want. Although the 15-year lock-in period might seem a turn-off initially, it is a necessary feature because time is a major factor in creating a meaningful amount for our retirement years. The fact that the amount received on maturity is entirely tax free makes it even more attractive.

Earlier, a PPF account could be closed before maturity only on the death of the account holder. However, with PPF 2019, the 15-year lock-in period has been relaxed for people who need this money for any critical need. You can now close your PPF account prematurely if it has been active for more than five years from the end of the year in which it was opened in the following circumstances:

• To pay for the higher education of the account holder or her children

• To pay for expenses related to treatment of a serious illness of the account holder, her spouse, dependent children, or dependent parents

• In case the residential status of the account holder changes to non-resident Indian (NRI).

In the case of such premature closure. a penalty of 1% is levied on all the interest earned during the preceding years.

For example, if the investor had started a PPF account on January 15, 2015, she can close her account on the completion of five financial years of investing (FYs 2016–17, 2017–18, 2018–19, 2019–20, and 2020–21). So, premature closure based on the three situations mentioned earlier can be done any day from April 1 2021 onwards. As per the rule, the interest earned will be reduced by 1% across all these years when the final corpus is withdrawn. For example, if the investor earned interest at the rate of 8.70% in 2015–16, it will get adjusted to 7.70% for that year. Similarly, since interest rates were 8.10% during April–September 2016 and 8% during October 2016–March 2017, the adjusted interest rates would be 7.10% and 7%, respectively, for those periods, and so on for the remaining periods. Do note that there is no such deduction in rates if the account is closed prematurely owing to demise of the account holder.

In addition to the option to close your PPF account prematurely after 5 years, the government has changed the way in which PPF accounts earns interest. Till 2016, the interest rate for PPF would be announced before the beginning of a financial year, which would then be applicable for that financial year. From FY 2016-17, interest rates are announced before the beginning of each quarter, that is, four times a year.

Once you open a PPF account, you must invest a minimum of Rs. 500 every financial year in your account while the maximum limit is Rs. 1,50,000 per year. You can make as many deposits in your PPF account every year, provided the total annual sum does not exceed Rs. 1,50,000 (if it does, you won't earn interest on the extra amount). The rate announced for PPF in a quarter is applicable only for those three months. This is unlike other investment schemes, such as the NSC, for example. In the case of NSCs, if you had invested at 8.10% in a 5-year certificate in FY 2016–17, your investment will earn interest at 8.10% throughout the five years, even if different interest rates are announced every quarter during the subsequent financial years. For PPF, however, the rate of interest announced every quarter will apply to the investments made during that quarter, as well as to the accumulated amount.

Do these regular changes in PPF interest rates affect your investment value? There are positives and negatives. The positive part is that the government will update PPF interest rates in line with the prevailing market rates of relevant government securities, so your investments will earn an interest rate that is at least 0.25% higher than the current market rates (historically, it's always been higher than 0.25%). The downside is that you wouldn't know how interest rates will change and, therefore, how much your corpus will be on maturity. For example, you may earn 8.10% this quarter, but rates could go down the next quarter, and you'll end up earning a lower interest until the rate changes in the following quarters.

PARTIAL WITHDRAWALS AND LOAN AVAILABILITY

Although PPF now allows you to close and withdraw your investment after a period of five years under certain conditions, you do not have to compulsorily close your account if you need money. PPF allows you to make partial withdrawals at any time after the completion of 5 years from the end of the year in which the account was opened. The withdrawal amounts can be up to 50% of the balance in your account at the end of the fourth year immediately preceding the year in which you want to withdraw or the amount at the end of the previous financial year, whichever is lower.

For example, if you've opened your account in FY 2019–20, the counting of five years will start from 2020–21 (after the end of FY 2019–20 in which the account was opened). Thus, withdrawals will be allowed from FY 2025–26 onwards. If you decide to make a partial withdrawal in FY 2025–26 itself, the amount you can withdraw will be 50% of the balance on March 31, 2022 or March 31, 2025, whichever is lower. See the following table to understand this clearly.

Year no.	Financial year	Amt. at end of FY	Withdrawals
Investment year	2019–20	Rs. 1,20,000	
Year 1	2020–21	Rs. 2,50,000	
Year 2	2021–22	Rs. 3,00,000	Rs. 1,50,000
Year 3	2022–23	Rs. 4,10,000	
Year 4	2023–24	Rs. 5,00,000	
Year 5	2024–25	Rs. 5,90,000	Rs. 2,45,000
Year 6 (with-drawal allowed from this year)	2025–26	Rs. 6,80,000	

Table 1

For a withdrawal applied in FY 2025–26, the preceding year for it will be FY 2024–25 and the preceding 4th year will be FY 2021–22. As you can see in Table 1, 50% of the account balances are Rs. 1,50,000 and Rs, 2,45,000, respectively, for those years. The amount eligible will be the lower of the two, which is Rs. 1,50,000. This amount will be tax free in your hands.

Thereafter, you can make a withdrawal once every year till maturity, provided you do not have any outstanding loan on your PPF account. The amount you withdraw need not be repaid and carries no penalty—the balance amount in your account continues to earn the applicable rate of interest.

If you need money but your account has not completed five years to be eligible for partial withdrawal, you can avail a loan any time after the completion of one year from the end of the year in which the account was opened. But it should also be taken before the completion of five years from the end of the year in which the account was opened.

For example, suppose you opened a PPF account and made an initial contribution in March 2020. The financial year will end on March 31, 2020. Then you need to wait for the entirety of 2020–21 (expiry of one year from the end of year 2019–20) before you can apply for a loan. You can avail a loan starting from April 2021 to March 31, 2025 (before the expiry of five years from the end of the year in which the initial investment was made).

Year no.	Financial year	Amt. at end of FY	Loan
Investment year	2019–20	Rs. 1,10,000	
Year 1	2020–21	Rs. 2,40,000	
Year 2	2021–22	Rs. 3,00,000	Loan available - Rs. 60,000
Year 3	2022–23	Rs. 4,20,000	Loan available - Rs. 75,0000
Year 4	2023–24	Rs. 5,00,000	Loan available - Rs. 1,05,000
Year 5	2024–25	Rs. 5,90,000	Loan available till end of this year - Rs. 2,50,000

Table 2

The loan amount can be a maximum of 25% of the amount in the account at the end of the second year preceding the year in which the loan is applied for. For example, if you apply for a loan in the third year (FY 2022–23), the loan amount can be up to 25% of the balance in your account at the end of the first financial year (March 31, 2021), which is Rs. 60,000. If you apply for a loan in the fourth year, your loan amount can be up to 25% of the balance at the end of the second financial year (in this example, Rs. 75,000), and so on. The principal amount of the loan needs to be repaid within 36 months of taking the loan.

The interest amount needs to be paid in a maximum of two instalments at a rate of 1% for the period it took to repay the loan.

If you are unable to repay the entire principal amount of the loan within 36 months, an interest of 6% per year is charged on the outstanding amount. Do note that the account does not earn any interest on the loan amount taken until the loan is repaid. Therefore, the longer you delay repayment, the longer you lose interest on your investment. Because you don't earn interest on the loan amount till it is repaid, the effective rate of interest for your loan is 1% plus the loss of PPF interest. For example, if your account had Rs. 5 lakh, and you took a loan of Rs. 1 lakh, you will receive PPF interest (assume 7.5%) only on Rs. 4 lakh. You will have to pay an interest of 1% on the remaining Rs. 1 lakh that you borrowed. However, because you are losing the PPF interest (assumed 7.5%), the effective interest cost on your loan becomes 8.5% (1% + 7.5%).

OTHER CONDITIONS

Investments of up to Rs. 1,50,000 per year are eligible for tax benefits under Section 80C of the Income Tax Act in the old tax regime. At the end of 15 years, you'll get the entire amount that is accumulated, tax free. Along with the flexibility to withdraw money and take loans, as well as the tax benefits, you also have the freedom to invest at your own pace. The money you are able to keep aside can be deposited in your PPF throughout the year. For example, you could deposit Rs. 2,000 one month, Rs. 5,000 the next month, nothing the following month, and so on. Alternatively, you can make a single lump sum deposit in a year. You need to invest a minimum of Rs. 500 per year to keep your account active. If you neglect to pay this, you'll have to pay a penalty of Rs. 50 in the next year to reactivate your account (a total of Rs. 550 for each missed year).

AT THE END OF 15 YEARS, YOU HAVE TWO OPTIONS

- Withdraw the entire amount accumulated in your PPF account.

- Extend it in blocks of five years at a time with additional contributions. The extensions can be carried out indefinitely in blocks of 5 years.

- Extend it for another five years without making deposits. Again, you can extend it indefinitely.

When you withdraw the amount after the completion of 15 years, the entire amount you receive is tax free. You could start a fresh PPF account by investing a part of the money you withdrew into the new account.

If you choose to contribute deposits, you'll have to fill Form 4 (earlier it was Form H) within one year from the end of the maturity period. If you do not submit Form 4, by default, your account will be continued without further deposits.

EXTENDING PPF WITH THE OPTION TO DEPOSIT

If you submit Form 4 and decide to make further deposits, the same investment limits of a maximum of Rs. 1,50,000 and minimum of Rs. 500 per year will apply. On extending the account, you can withdraw up to a maximum of 60% of the amount that is in your account. The withdrawal can be made in one lump sum or once every year over the 5-year period. For example, if the amount in your account at the end of 15 years was Rs. 30 lakh, you can withdraw up to Rs. 18 lakh in a maximum of five instalments over the extended five-year period (but only one withdrawal per year). For example, you could withdraw Rs. 2 lakh in the first year, Rs. 5 lakh in the next couple of years, and so on. Or you could withdraw the entire Rs. 18 lakh at any time during the five-year period.

No.	Objective	New form
1	Open a PPF Account/Contribution Form	Form 1
2	Application for loan/withdrawal	Form 2
3	Application for closure of account	Form 3
4	Application for extension of account	Form 4
5	Application for premature closure of PPF account	Form 5
6	Nomination Form	Form 1

Table 3

EXTENDING PPF WITHOUT DEPOSIT

If you decide to extend your PPF but not make any deposits, there is no limit to the amount you can withdraw (you can even withdraw the entire amount in your account, although you'll still be allowed to withdraw only once a year). This is the default option if you neither close your account nor submit Form 4 within one year from the end of the maturity period. Note that once the PPF account is continued without deposits for more than a year post maturity, the account holder cannot make deposits in the following years till the passage of five years. The account will continue to earn interest at the applicable rates. Once the five-year period is over, all the three options are open to you again.

The PPF is not an investment option for those looking for liquidity or short-term returns. Instead, you should view it as a steadily growing, tax-free investment for your retirement years, and you won't go wrong.

HOW TO INVEST IN PPF

• You can open a PPF account with any post office, public sector bank, or a few private banks, as specified by the government from time to time.

• You can open only one PPF account where you can deposit a maximum of Rs. 1,50,000 per year. You need to deposit a minimum of Rs. 500 every year to keep your account active.

• There is no age limit for opening an account. You can even open an account in the name of a minor.

• You can invest any amount ranging from Rs. 500 to Rs. 1,50,000 in a year in multiples of Rs. 50. For example, you can invest Rs. 500 or Rs. 550, but not Rs. 552.

• Non-resident Indians (NRIs) cannot open a PPF account. However, if you have already opened a PPF account before becoming an NRI, you can continue to invest in it till it matures at 15 years.

POINTS TO CONSIDER BEFORE INVESTING

• What is your financial goal 15 years down the line? The younger you are, the better it is to start a PPF account. For example, if you are 50 years old, it may be better to opt for an investment with a shorter maturity period because you will be 65 years by the time your account reaches maturity.

• Can you afford not to withdraw the amount till five years after opening the account?

ADVANTAGES

• The benefits under Section 80C reduce your tax liability by the amount you invest. For example, if you invest Rs. 50,000 in a year, your taxable income will be reduced by Rs. 50,000. The maximum amount you can invest is Rs. 1,50,000 per year.

• There is no age limit for opening a PPF account. An account can be opened for even the youngest member of your family. For more details, you can read the section on rules for investing on behalf of minors at the end of this chapter.

• You can make multiple deposits in a year. Earlier there was a limit of only 12 deposits per year, which is no longer applicable.

• In a specified emergency, such as medical treatment or higher education, you can close the account and withdraw the amount after five years. Around 50% of your deposit can be withdrawn after five years, subject to specified conditions.

• The entire amount you get on maturity is tax free.

DISADVANTAGES

• There is a lock-in period of 15 years, and you can only make partial withdrawals during this period. If you close your account and withdraw the entire amount after the completion of five years, you lose 1% from the interest you've earned every year.

• The interest rate can change on a quarterly basis. It could, therefore, be lower than the year in which you opened the account. This could affect your earnings from PPF.

• You can only operate one account per person. If you shift residence, you can request your bank branch/post office branch to move your account to a branch closer to your new residence.

• Premature closure may be allowed only in the event of a genuine emergency and that too only at the end of five years from the end of the year in which the account was opened.

INVESTMENT METER

Safety: * * * * *
Liquidity: ***
Returns: * * * *

(5 stars indicate Excellent and 1 star indicates Poor)

TAX IMPACT

Deposits made every year are eligible for tax deduction under Section

80C up to a limit of Rs. 1,50,000 under the old tax regime. The interest income and the total amount received on maturity are tax free.

PPF INVESTMENT TABLE

Table 4 shows how PPF interest is calculated if you deposit multiple times during a year. Note that in this example, the amounts being deposited every month are not the same. While interest is calculated every month, it is credited to your account only at the end of the year. An important point about the interest you earn is that it is not calculated on the amount you have at the end of the month. Instead, it is calculated considering the lowest amount in your account between the 5th and the last day of the month. For the month of April, the interest will be = (10,000 x 7.10/100)/12 = 710/12 = 59.16

While interest is calculated every month, it is credited to your account only at the end of the year. An important point about the interest you earn is that it is not calculated on the amount you have at the end of the month. Instead, it is calculated considering the lowest amount in your account between the 5th and the last day of the month

No.	Month	Amount deposited on or before 5th of every month	Amount in your account	Interest (amt. x interest rate)/12
1	April	10,000	10,000	59
2	May	12,000	22,000	130
3	June	Nil	22,000	130
4	July	5,000	27,000	160
5	August	Nil	27,000	160
6	September	1000	28,000	166
7	October	Nil	28,000	166
8	November	5,000	33,000	195
9	December	10,000	43,000	254
10	January	10,000	53,000	314
11	February	0	53,000	314
12	March	25,000	78,000	462
				2,510
Balance at the end of the financial year: 78,000 + 2,510 = 80,510				

Table 4

In this example, assume you had deposited Rs. 10,000 on April 31 and then another Rs. 12,000 on May 5. In this case, the account would look like this:

Deposited on April 31: Rs, 10,000
Deposited on May 5: Rs. 12,000
Total amount on May 5: Rs, 22,000
Total amount on May 31: Rs, 22,000

Since the lowest amount between May 5 and May 31 was Rs. 22,000, the interest for May will be calculated on this amount as Rs. 130 (22,000 x 0.071/12). But if you had deposited Rs. 12,000 after May 5, say on May 15, then your account would look like this:

Deposited on April 31: Rs. 10,000;
Deposited on May 15: Rs. 22,000;
Total amount on May 5: Rs, 10,000;
Total amount on May 31: Rs. 22,000

Here, the lowest amount between May 5 and 31 is Rs. 10,000. In this case, although your account will have Rs. 22,000 at the end of May, only Rs. 10,000 will be considered in the interest calculation because it is the lowest amount between May 5 and May 31. Thus, the interest you would have earned for May would be Rs. 59.16 (10,000 x 0.071)/12).

At the end of the financial year, the entire interest would be credited to your account, and the total amount in your account would be: 78,000 + 2,510 = 80,510.

What happens when you invest the maximum amount of Rs. 1,50,000 for 15 years? See the following table. Assume interest is constant at 7.10%, and the yearly investments are made before April 5 every year.

As seen in the table, you'll end up with a corpus of Rs. 40.68 lakh that you can claim tax free. You can also extend the account and continue to invest in it in blocks of five years as explained earlier.

No.	Max investment	Interest at 7.10%	Closing balance	Max withdrawal limit	Max loan possible
1	1,50,000	10,650	1,60,650	-	-
2	1,50,000	22,056	3,32,706	-	-
3	1,50,000	34,772	5,16,978	-	83,177
4	1,50,000	47,355	7,14,334	-	1,29,445
5	1,50,000	61,368	9,25,701	-	1,78,583
6	1,50,000	76,375	11,52,076	-	2,31,425
7	1,50,000	92,447	13,94,524	2,58,489	-
8	1,50,000	1,09,661	16,54,185	3,57,167	-
9	1,50,000	1,28,097	19,32,282	4,62,851	-
10	1,50,000	1,47,842	22,30,124	5,76,038	-
11	1,50,000	1,68,989	25,49,113	6,97,262	-
12	1,50,000	1,91,637	28,90,750	8,27,092	-
13	1,50,000	2,15,893	32,56,643	9,66,141	-
14	1,50,000	2,41,872	36,48,515	11,15,062	-
15	1,50,000	2,69,695	40,68,209	12,74,556	-

Table 5

PPF RULES FOR INVESTING ON BEHALF OF MINORS

• A parent can open one PPF account for each of his/her minor children.

• The account can be owned and operated by only one of the parents. Both parents cannot open an account for the same child.

• A legal guardian, for example, an uncle, aunt, or grandparent, can open an account for minors only if the parents of the children are no longer alive.

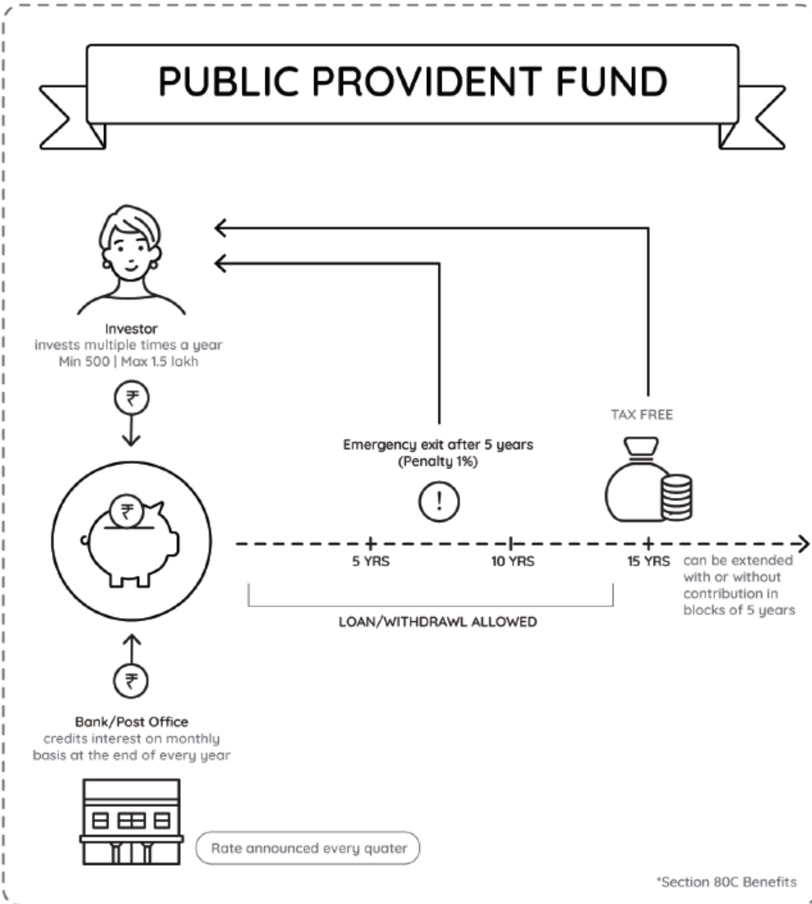
• As a parent, you can claim tax deduction on the investments made in your account and your minor child's account. However, the combined tax benefit for investments in both accounts cannot exceed Rs. 1.5 lakh.

• Your total investment in all accounts (self and minor children) cannot exceed Rs. 1.5 lakh. For example, you could invest Rs. 1,00,000 in your account and Rs. 50,000 in your minor child's account.

COMPARISON OF PPF, EPF, AND VPF

Features	Public Provident Fund	Employee's Provident Fund	Voluntary Provident Fund
Eligibility	All Indian residents, including minors	Only employed Indian residents	Only employed Indian residents
Period of investment	Minimum 15 years with the option to extend it in tranches of 5 years at a time	Up to retirement or job change.	Up to retirement or job change
Contribution	Minimum Rs. 500 up to Rs. 1.5 lakh annually	12% of basic salary	Voluntary (up to 100% of basic + DA)
Other contributions	N.A.	12% of basic salary by employer and 1.16% by Government	N.A.
Taxation	Tax free on maturity. Partial withdrawals are also tax free.	Tax free after 5 continuous years of investment. From FY 2021-22, the returns are tax-free only for employee annual contributions of up to Rs. 2.5 lakhs.	Tax free after 5 continuous years of investment. From FY 2021-22, the returns are tax-free only for annual employee contributions of up to Rs. 2.5 lakhs.
Tax deduction during investment	As per Section 80C	As per Section 80C	As per Section 80C

Table 6



PROS | CONS

Pros

- Section 80 C benefits. Interest is tax free
- No age limit to start PPF

Cons

- Long lock-in period of 5 years
- Interet varies every quater

TIP

Can be a great option for creating retirement corpus. Entire amount is tax free.