

# Understanding the National Pension System & NPS Vatsalya Scheme: Exit Rules, Benefits, and Real-Life Insights for Investors



## Introduction

The National Pension System (NPS) is a government-backed, retirement-focused investment scheme designed to build long-term wealth through disciplined savings. It is a defined contribution system that is low-cost, tax-efficient, flexible, and portable, making it a suitable option for individuals seeking financial security after retirement.

Launched in 2009, NPS is open to all Indian citizens, including NRIs, and allows investors to accumulate savings over time and receive a combination of lump-sum withdrawals and pension (annuity income) at retirement.

## NPS operates through two types of accounts:

- Tier I Account (Primary retirement account) – Mandatory with a minimum annual contribution of ₹6,000
- Tier II Account (Voluntary savings account) – Optional with flexible withdrawals

### Subscribers can choose between:

- Active Choice – where they decide asset allocation
- Auto Choice – where allocation is done automatically based on age

The scheme offers exposure to multiple asset classes such as equity, corporate bonds, and government securities, enabling a balance between growth and stability. Historically, equity investments under NPS have delivered higher long-term returns, though with some volatility, while debt instruments have provided relatively stable returns.

From a tax perspective, NPS offers attractive benefits:

- Additional deduction of ₹50,000 under Section 80CCD(1B) over and above ₹1.5 lakh under Section 80C (under the old tax regime)
- Employer contributions are also eligible for deduction under Section 80CCD(2) (available under both old and new tax regimes)

At maturity, up to 60% of the corpus can be withdrawn tax-free, while the remaining portion is used to generate pension income. It is important to note that annuity income is taxable as per the individual's income tax slab.

Recently, the NPS Vatsalya Scheme was introduced to extend similar benefits to minors, enabling early financial planning for children. While both schemes offer attractive long-term benefits, it is important to clearly understand their exit rules, withdrawal conditions, and practical implications before investing.

## Who Can Open NPS Vatsalya?

The NPS Vatsalya Scheme can be opened in the name of a minor (child) and is managed by a parent or legal guardian. A minimum contribution of ₹250 is required to open an NPS Vatsalya account. Additionally, a minimum annual contribution of ₹250 is required to keep the account active. There is no upper limit on the maximum contribution.

## When is an NPS Vatsalya Account Converted to Regular NPS?

Upon attaining the age of 18, the subscriber has the option to either continue in the scheme for up to 3 years (i.e., until age 21) or transfer the entire accumulated corpus to a regular NPS account (under the All Citizen Model or any other applicable model) after completing the required KYC formalities.

If the subscriber does not exercise an option before age 21, the account is automatically transferred to a higher-equity scheme under the Moderate Life Cycle Fund (MLC). Thereafter, the account will be governed by the Pension Fund Regulatory and Development Authority (PFRDA) (Exits and Withdrawals under NPS) Regulations, 2015.

## Who Should Consider NPS / NPS Vatsalya?

- Individuals planning for retirement with discipline
- Salaried employees looking for additional tax benefits
- Parents wanting to build a long-term corpus for children
- Investors comfortable with long lock-in for higher compounding

## Who Should Avoid NPS investment?

- Investors looking for short-term liquidity
- Those planning for education or marriage goals
- Individuals needing flexible withdrawals

NPS is best suited for long-term, disciplined investors focused on retirement planning and tax efficiency.

It is ideal for those who can stay invested until 60. However, it may not be suitable for individuals seeking liquidity, flexibility, or funds for short-term goals like education, marriage, or emergencies.

### NPS vs Other Investment Options

Before investing, it is important to compare NPS with other popular investment options such as mutual funds and PPF. Each option differs in terms of returns, liquidity, tax benefits, and purpose. Understanding these differences helps investors choose the right mix based on their financial goals, risk appetite, and time horizon.

Feature	NPS	Mutual Funds	PPF
Liquidity	Low	High	Low
Returns	Market-linked	Market-linked	Fixed
Tax Benefit	High	Limited	High
Lock-in	Till 60	No lock-in	15 years
Pension	Yes	No	No

*Choose the right investment mix based on your financial goals, investment horizon, and risk appetite.*

Each investment option serves a distinct purpose, and the National Pension System (NPS) should ideally be viewed as a dedicated retirement tool within a diversified portfolio. All these investment options carry varying levels of risk and return potential. Based on your financial goals, investment horizon, corpus requirements, and risk appetite, you should choose the most appropriate combination of products.

#### a) Early Exit

Both NPS Vatsalya and the regular NPS provide an early exit option, subject to specified conditions. In the case of regular NPS, earlier rules required a minimum contribution period of 5 years to be eligible for premature exit. However, as per recent regulatory updates notified by the Pension Fund Regulatory and Development Authority (PFRDA), the mandatory 5-year lock-in period for premature exit has been removed for the All Citizen Model (effective December 2025), thereby offering greater liquidity and flexibility to subscribers.

In contrast, under the NPS Vatsalya Scheme, early exit can be exercised once the child attains the age of 18. In both cases, upon early exit, up to 20% of the total corpus can be withdrawn as a lump sum, while the remaining 80% must be mandatorily utilized to purchase an annuity (pension plan), subject to applicable conditions. As per the latest PFRDA guidelines, if the total accumulated corpus is ₹8 lakh or less, the subscriber is allowed to withdraw 100% of the corpus without any annuity requirement.

For example, if a subscriber invests ₹1,000 per month under the NPS Vatsalya Scheme, the corpus at age 18 may grow to approximately ₹6,00,000, assuming an average annual return of 10%. Since the total corpus is below ₹8 lakh, the subscriber can withdraw the entire amount of ₹6,00,000 without purchasing an annuity.

To summarise, although recent amendments have improved flexibility—especially for smaller corpus sizes—early exit in both NPS and NPS Vatsalya generally leads to restricted liquidity, as a significant portion (up to 80%) is typically required to be allocated towards annuity. This reinforces that NPS is primarily designed as a long-term, retirement-oriented investment vehicle. Therefore, early exit should be considered only in exceptional situations.

### Partial Withdrawal (Without Closing the Account)

Under the National Pension System (NPS), partial withdrawal is permitted after the completion of at least 3 years from the date of account opening. A subscriber can withdraw up to a maximum of 25% of their own contributions (excluding employer contributions and investment gains), and not 25% of the total corpus at the time of withdrawal.

Such withdrawals are allowed only for specified purposes, including higher education, marriage, purchase/construction of a house, and medical treatment of specified illnesses. A maximum of three partial withdrawals is permitted during the entire tenure of the account. Importantly, the NPS account continues even after the withdrawal.

### Partial Withdrawal under NPS Vatsalya

Under the NPS Vatsalya Scheme, partial withdrawal provisions are structured based on the age of the subscriber:

- From age 0–18 years: A maximum of two withdrawals allowed
- From age 18–21 years: Two additional withdrawals allowed

The permitted purposes for partial withdrawal include:

- Education of the subscriber
- Treatment of specified illnesses
- Disability of 75% or more

Similar to regular NPS, partial withdrawal is allowed up to 25% of the subscriber's own contributions (excluding returns).



### Tax Treatment

Partial withdrawals up to 25% of own contributions are exempt from tax under Section 10(12BA) of the Income Tax Act. This exemption is available under both the old and new tax regimes, including cases where the amount is received by the parent or guardian on behalf of the minor under NPS Vatsalya.



## b) Exit & Withdrawal Options in NPS & NPS Vatsalya

Under the National Pension System (NPS), at the age of 60 (normal exit), a subscriber can withdraw up to 60% of the total corpus as a tax-free lump sum, while the remaining 40% must be used to purchase an annuity (pension).

As per recent guidelines, additional flexibility has been introduced, allowing withdrawal of up to 80% of the corpus.

However, only 60% remains tax-free, and any additional withdrawal (up to 20%) is taxable as per the applicable income tax slab. In such cases, the minimum annuity requirement reduces to 20%. From a financial planning perspective, the 60% lump sum + 40% annuity option remains the most balanced approach, providing both liquidity and stable retirement income.

Further, for non-government subscribers (All Citizen/Corporate), if the total corpus at normal exit is ₹8 lakh or less, 100% withdrawal is permitted, which is fully tax-free. If the corpus is between ₹8 lakh and ₹12 lakh, the subscriber can withdraw up to ₹6 lakh as a lump sum, and the balance can be allocated either towards annuity or a phased withdrawal option known as Systematic Unit Redemption (SUR), to be taken over a minimum period of six years. These provisions are applicable from December 2025, as per updates by the Pension Fund Regulatory and Development Authority (PFRDA).

### NPS Vatsalya – Exit Options

Under the NPS Vatsalya Scheme, exit is permitted between the ages of 18 and 21 years:

- If the total accumulated corpus is **below ₹8 lakh** → 100% withdrawal allowed (no annuity requirement)
- If the corpus is **₹8 lakh or above** → **Up to 80% can be withdrawn as a lump sum**, and at least 20% must be utilised for annuity purchase

### Risks & Limitations:

- Lock-in till age 60
- Mandatory annuity (low return ~5–7%)
- Limited liquidity (only 20% in early exit)
- Annuity income is taxable

NPS is a long-term retirement product with limited liquidity and mandatory annuity requirements. While it offers tax benefits and disciplined savings, investors must be comfortable with lock-in until retirement and relatively lower annuity returns.

It is important to align NPS investments with long-term goals rather than short-term financial needs.

## Conclusion

NPS and NPS Vatsalya are powerful long-term retirement planning tools; however, they come with structured exit rules. While early exit is permitted, liquidity remains limited due to mandatory annuity requirements. That said, the ₹8 lakh relaxation rule provides meaningful flexibility for small investors.

From an intergenerational perspective, NPS Vatsalya can help build disciplined long-term wealth. For instance, a monthly investment of ₹1,500 starting at age 1 can grow to approximately ₹12.88 lakh by age 21 (assuming an average annual return of 10%). Even after annuitization, the resulting income can support long-term financial planning or be reinvested for future generations.

Thus, NPS Vatsalya not only supports retirement planning but also serves as a disciplined and structured approach to building intergenerational wealth—provided investors clearly understand its structure, benefits, and limitations.

## Disclaimer

The information contained in this document is for general informational purposes only and should not be construed as investment advice. While care has been taken to ensure accuracy, the author does not guarantee completeness or reliability. Investors are advised to consult their financial advisor before making any investment decisions.



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