EVERYTHING YOU WANTED TO KNOW ABOUT ELSS

Top Performing Schemes:

Returns as on 10.10.2014			
ELSS Funds			
Fund	Rating	3-Year Return	5-Year Return
Axis Long Term Equity Fund	* * * * *	22.58	NA
Reliance Tax Saver Fund	* * * * *	21.42	21.89
ICICI Prudential Tax Plan - Regular Plan	* * * * *	17.53	21.44
DSP Black Rock Tax Saver Fund	* * * *	16.66	17.96

An ELSS is a diversified equity fund — a mutual fund that invests in stocks and is not concentrated in a sector or market category, and is thus a less risky way to invest in the market — with a three-year lock-in. Within the tax-saving set, it is the only one that offers a pure equity exposure. If you can take the risk of equity, an ELSS is the most attractive tax-saving vehicle today, and there are three reasons to eye it like never before.

What is an ELSS?

As the name of the scheme very clearly suggests, it is a savings scheme that's linked to equity. And these are the two most important facts to remember even after investing in an ELSS. A savings scheme must necessarily be for the long term, so it's of no use looking at short-term returns from an ELSS.

ELSS is a mutual fund similar to any diversified equity mutual fund that routes your investments into equity markets. However, it stands apart from a regular mutual fund in one major way. ELSS carries a tax benefit on the amount invested, and therefore you have to lock-in your investment in an ELSS for three years.

Features of ELSS?

- Proxy route to direct stock investments
- Lock-in feature provides long-term investing discipline
- Provides tax saving benefits and the potential for higher returns
- Flexibility to invest small amounts through an SIP

Who can buy?

Section 80C of the Income Tax Act provides tax benefits to a person who buys units of ELSS, either in his own name or jointly.

Individuals, HUF

What is the minimum & maximum amount of investment?

Investments can be made through a systematic investment plan (SIP) or lump sum. When markets are volatile, SIP is a better way to invest, save tax and create wealth over a long term.

Minimum Amount of investment is Rs.500. There is no limit for maximum amount of investment; however the tax advantage is only up to Rs.1.5 lakhs.

With SIP investor can take advantage of fluctuations in the stock market. So investor will get more units when the market is down and get fewer units when the market is up. For eg if you are investing Rs 1000 every month and you will get 100 units for when Net Asset Value (NAV) is 10 and will get 50 units when NAV is 20. So investing a fixed sum regularly helps to cover the market fluctuations by rupee costs averaging.
SIPs are a tried and tested method of minimizing risk and yet enjoying good returns, by regular, periodic investment, over a long horizon.

How is Tax saved?

Investments in ELSS plans are eligible for deduction from gross total income under Section 80C of Income Tax Act. Only Rs.1.5 lakhs of investments qualifies for tax benefits under the same section. Your gross income is reduced by the amount you invest in the scheme. If you are paying a tax of 30.9% you can save up to Rs.46, 350/- on an investment of Rs.1.5 lakhs or more in ELSS.

Tax Exemption twice in 6 years!!!
You can withdraw your Tax Saver Funds at the end of the 3 years and when you reinvest the same, you get Tax Exemption TWICE in six years compared to just once in the case of NSC.

Comparison with other options.

ELSS has a lower lock-in period compared to other tax saving options.

PPF, a tax-saver option is a 15year savings plan, while the National Saving Certificate carries a lock-in of 6years.

Benefits of ELSS

The three year lock-in stipulation might seem harsh, but it has its advantages, it induces discipline into your investing habits. You can lock yourself in low valuations, but also have to give your investment time to work for you. This lock-in keeps corporate money out, which means these schemes do not have to deal with sudden, large scale redemptions. Thus, ELSS tends to have more stable and optimum corpus size, which encourages good fund management.

Why ELSS :
1. Investors in ELSS under Dividend Payout Option have the advantage of getting Tax Free gains even during the lock-in period of 3 years.

2. Lowest Lock-in period of just 3 years, comparing favorably with maturity period of NSC (6yrs) and PPF (15 years).
3. Minimum investment is only Rs.500. very low entry barrier.
4. Investors in ELSS have the advantage of investing through Systematic Investment Plan.
5. Some ELSS schemes offer Free Life Insurance Cover and also Personal Accident Death Cover and even Critical Illness cover!!!
6. Historically, provided better returns than NSC, PPF and ULIPs.
7. Profits earned after the Lock-in Period is Completely Tax-Free.
8. Due to its 3 year lock-in period, the Fund Manager has the freedom to invest in Fundamentally Strong Shares with huge future potential and can afford to 'wait' to unlock the value. Thus, it has been observed that ELSS schemes do beat (in terms of returns) even Diversified Mutual Funds more often than not.

How to evaluate an ELSS?

One should look at the management style of ELSS Funds, whether they invest in value or growth stocks. The biggest advantage of ELSS is that it allows investors to choose products according to their risk appetite.

The suitability of a fund depends upon the compatibility of the fund’s strategy with the risk appetite of the investor.

How to choose?

Before selecting an ELSS, ensure that your investment takes into account your risk profile and the overall asset allocation of your portfolio. These schemes are suitable for investors willing to take a higher risk for better returns from their tax-saving investments.

The performance of the fund should be compared with that of its benchmark and peers. An investor should also assess risk and return strategy of the fund.

When to buy?

Timing entry into these schemes, to take advantages of dividend declarations or lower NAV, when markets fall is not a sustainable strategy. You may want to invest during market falls, but don’t wait till the year-end to do it.

How to invest?

Lump sum or SIP

You may either invest in lump sum or through SIP. Identifying the scheme and starting an SIP would ensure that the investor benefit from lower acquisition cost through rupee cost averaging in a volatile market. Investing periodically also spreads the burden.

Growth or Dividend option

Choosing the growth ensures compounding and capital appreciation in a mutual fund investment. However, in case of ELSS, the dividend paid out option provides a degree of liquidity even during the lock-in period. The dividend paid out can be invested in other investment options, whether equity or debt, depending upon the rebalancing needs of the investor's portfolio and thereby, reduce the risk in the overall investment plan. From the tax perspective, both options are equally efficient as dividends are tax-free.

Almost all equity-linked saving schemes have two fund options — growth and dividend. Unlike a growth plan, an investor gets annual payouts from the dividend schemes before the final redemption of units.

The trick here is to invest in the dividend plan of an ELSS. For instance, if one invests Rs 1.5 lakhs in an ELSS, One saves a tax outgo of Rs 46,350 (at the highest tax rate of 33.99 per cent) under section 80C.
Now consider this. An ELSS has announced a dividend of 50 per cent. The net asset value (NAV) per unit of the scheme is Rs 50. Suppose one invests Rs 1.5 lakhs in the fund before the record date for the dividend. After the record date, the investor will get a dividend of Rs 15,000 at the rate of Rs 5 per unit for 3,000 units that have been bought. Therefore, effectively the individual invests Rs 1, 35, 000 (Rs 1, 50,000 minus Rs 15,000) and saves Rs 46,350 in tax outgo.

In other words, on an investment of Rs 1,50,000 in the dividend plan of the ELSS, one gets a post-tax return of Rs 43,990 (Rs 46,350 plus Rs 15,000), or 40.90 per cent.