

ELSS Mutual Fund – a wealth generator

Most of the tax saving instruments under Section 80C are savings oriented instruments with returns after adjusting for inflation either in the negative or slightly positive. The exceptions to this are the ULIPs (Life and Pension Funds) and the ELSS Mutual Funds. The advantage with ELSS compared to the ULIPs is the frequency (mostly a single investment or a monthly investment for a year) and term for investment, for getting good returns.

Does ELSS diversify?

An ELSS (Equity Linked Savings Scheme) is a mutual fund that has to invest a minimum of 80% in Equity Shares. The balance 20% can be in debt, money market instruments, cash or even more equity. There is a 3 year lock-in period for the ELSS mutual funds. Post the 36 months, the funds remain invested and work like any other open-ended mutual fund.

Why an ELSS?

It has been an established fact that in the long run equity gives a much higher inflation adjusted returns when compared to any other investment except for maybe real estate. The top 5 ELSS funds have given returns from 22% to 26% compounded annually over the past 5 years. This is again higher than the market (Nifty) returns over the past 5 years which is at 19%.

ELSS is part of the Section 80C instruments which are cumulatively eligible for a deduction from income up to Rs.1L . This gives the tax payers benefits from 10% to 30% (excluding the educational cess) based on their current tax slab.

The return (maturity and the dividend [(if opted for)] from the ELSS is also tax free under the present EEE (Exempt - Exempt - Exempt) regime. However, with the DTC regime tax benefits could be phased out and is under debate.

The 3 year lock-in period makes sure one stays invested. Otherwise in a normal mutual fund one tends to withdraw in case of any monetary requirement. The lock-in period also helps the fund managers to plan their investments better and also to hold on to valuable investments as they do not have to worry about sudden redemption pressures. The above logic is proved in the higher returns achieved by the ELSS funds when compared to the market returns. Wealth creation because of this is much better than most of the other mutual funds. Only some sector based mutual funds have given better returns than the ELSS fund in the past 5 years.

Options with the ELSS

Salaried people with a tight budget can opt for a monthly investment (SIP using ECS). The automatic investment from the bank through ECS makes it an easy way to invest.

Those who want an income in between can opt for the dividend option. This is particularly suitable for senior citizens. Also, the ELSS gives a tax free return compared to a bank or company deposit, which is taxable.

Limitations with ELSS

The investment in an ELSS cannot be switched or closed before the 3 years are completed from the date of investment. During market downturns, this becomes a limitation as one can only sit and watch the funds go down. One has the option of averaging when the market goes down, but an investment to save tax may not be required in the year in which the market is going down.

The lock-in works negatively also for the monthly investment because the lock-in is calculated from the date of the investment and not from the date the scheme was started. This means that the 12th month's investment can be withdrawn only on the 48th month. This is a disadvantage compared to ULIPs, where the lock-in is from the date of start of the scheme.

In summary

Most fund houses start an ELSS regular investment at Rs.500/- per month. Single investments start generally at Rs.5000/-. This makes ELSS accessible to all tax payers. With the compulsory lock-in giving better returns than other investments, even the most risk averse can look at an exposure to the ELSS fund for their tax benefits.