ELSS-TAX PLANNING

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February and March..! The months that drives the investors, particularly salaried employees, to think about tax planning by making investments in various tax saving schemes i.e. schemes eligible to get deduction u/s.80C of The Income Tax act. This is because that the assessees have to estimate their tax liability and accordingly pay advance tax, if applicable, by 15th March [3rd Installment]. Salaried Employees will, any how, be governed by the provisions relating to the Tax Deducted at Source (T.D.S.). Further, any investments eligible for deduction U/s.80C of The Income Tax act made on or before 31st March 2007 will be considered while computing the taxable income for the previous year 2006-07.

Equity Linked Saving Scheme [ELSS] is a popular trend in mutual funds which plays key role in today's tax wise investment scenario. Investment in ELSS, more popularly known as Tax Saver Funds, offer tax benefits along with long term capital appreciation through investment in equity and equity related instruments.

Today several funds are continuously knocking the doors of retail investors through NFOs as well as open ended funds as the financial year is running towards the end of March. Also, there are several open ended tax saver funds which give the investors the option to enter those schemes by bearing load charges as per the terms of the schemes.

Any investment in ELSS will be kept in lock for a period of 3 years. This is the crucial factor to be considered. The 3 years time horizon will give the fund managers enough room to project for long term capital appreciation without being pressurized by the continuous changes in the fund size and this lock in period keeps away those investors with very short term speculative behaviour. Further the fund managers will have the scope of time to handle the favourable and unfavourable situations of the capital market in the long run by virtue of this lock in period of 3 years.

An individual investor can claim a maximum deduction of Rs.1,00,000/- u/s.80C of the Income Tax Act by investing in specified savings. As the sectoral caps have been removed by the Finance Act, 2005, the cap of Rs.10,000/- on an investment in ELSS does not apply. So, the investor can plan his portfolio according to his risk-return profile.

If he can take higher risk (i.e. with higher risk appetite) to earn higher return along with tax benefits at the time of investment, he can allocate a major portion of his portfolio to stocks i.e. Mutual funds in the form of ELSS. The various other tax benefits, apart from deduction u/s.80C, of investing in ELSS Schemes are discussed below.

Another benefit of investing in ELSS is exemption from long term capital gain u/s.10(38) of the income tax act at the time of redemption of units because it involves the transfer of a long term capital asset being a unit of an equity oriented fund chargeable to securities transaction tax. As any investment in ELSS will be kept in lock for a period of 3 years, any amount of gain realized at the time of exiting from the fund shall be termed as long term capital gain (as per the existing tax laws). As per Sec.10 (38) of the Act, equity oriented fund means a fund where the investible funds are invested by way of equity share in domestic companies to the extent of more than 65% of the total proceeds of such fund and which has been setup u/s.10 (23D) of the Income Tax Act. The percentage of share holding shall be computed with reference to the annual average of the monthly averages of opening and closing figures.

Also as per the existing tax laws, any dividend received from ELSS is exempt from income tax in the hands of the recipients u/s 10(35) of the Income Tax act. Further, no tax is required to be deducted at source where any income is credited or paid on or after 1st April 2003 by a Mutual Fund as per the provisions of sections 194K and 196A of the said act.

As per sec. 45 of the wealth tax act, wealth tax is not chargeable in respect of net wealth of a mutual fund provided it is registered u/s 10(23D) of the income tax act. As per CBDT Circular No:715 dtd.8/8/1995, no tax is required to be deducted at source from capital gains in the case of resident unit holders at the time of redemption of units. It should be noted that no tax would be required to be deducted from the redemption proceeds payable to non resident investors.

Systematic Investment Plan [SIP] is another good feature in ELSS Scenario which inculcates the disciplined behaviour of savings in the investors. By entering in to ELSS Scheme with SIP option the investor will make monthly payments of equal installments at a fixed date of every month. He can claim the total amount of investment he made through SIP from 1st April to 31st March in that respective previous year as a deduction u/s.80C of the Income Tax act. SIP also facilitates averaging effect in the volatile market.

SIP option also ensures that the entire investment in the ELSS is distributed evenly throughout the year without imposing burden on the wallet of the investor at the end of the financial year.

After making the investment, the investor will be allotted units based on the prevailing NAV subject to load charges, if any. However closed ended funds are not permitted to charge any load as per SEBI Circular dtd.4/4/06.

Example:

For ex:, if an open ended fund with NAV of Rs.12.5/- charges an entry load of 2.25%, an investment of Rs.10,000 will fetch the investor 782 units. He can Claim the investment amount of Rs.10,000 as deduction u/s.80C of the Income Tax Act. Assume, after 3 years, if the NAV of the said fund is 25/-, the investor will get Rs.19,550 as redemption proceeds by redeeming the units subject to Unamortized charges ,if any , as per the terms of the Scheme. *It should be noted that the figures used in this example is only for illustrative & understanding purposes of the readers and this is not to be taken as the indicative of the future performance of the ELSS FUNDS. Mutual fund investments are subject to market risk. One should read the offer document carefully before investing.*

Past performances have shown that ELSS Schemes have yielded remarkable returns though not assured as compared to the traditional investment avenues. Lock-in-period is also shorter when compared to the N.S.C. Or P.P.F.

Therefore, ELSS schemes give the opportunity to enter the stock market indirectly by investing in Mutual Funds along with tax benefits in various forms as discussed as above.

However before contributing to any ELSS Scheme, one should ensure that he studies the profile and investment objectives of the asset management company, the qualifications and experience of the fund manager, past performance of the earlier ELSS, if any, in the same fund family etc.,

ELSS concept it self offers the benefit of risk diversification. If the investor carefully selects the funds and makes his investments in different funds, he can better diversify the risk associated with his entire investment in ELSS Schemes along with other investment instruments and earn a reasonable return of income on his entire portfolio and can amass the wealth.