All about Investing in an ELSS

While tax planning may seem to be a difficult process, Mutual Funds offer you a simple way to get tax benefits, while aiming to make the most of the potential of the equity markets. An Equity Linked Savings Scheme (ELSS) is an open-ended Equity Mutual Fund that doesn't just help you save tax, but also gives you an opportunity to grow your money. It qualifies for tax exemptions under section (u/s) 80C of the Indian Income Tax Act up to Rs. 1,50,000/. This diversified equity fund is ideal for your long-term financial goals such as planning your retirement or buying a new home.

ELSS funds have a lock-in period of three years, though we would suggest investing for a longer duration or until you have enough to achieve your goal. Remember that these funds give you higher returns than any other tax-saving schemes out there. Besides, you don’t have to invest a lump-sum amount, you can invest in these funds through a Systematic Investment Plan (SIP).

Why should you invest in an ELSS?

Along with the tax deductions, an ELSS offers you the following benefits:

- An opportunity to grow your money by investing in the equity market.
- Long-term capital gains from these funds are tax free in your hands.
- The lock-in period is only 3 years.
- You can also opt for a Dividend Pay-out option, thereby realizing some potential gain during the lock-in period.#
- You can invest through a Systematic Investment Plan and bring discipline to your tax planning

However, it must be noted that any dividend payment will be from the NAV of the Scheme and therefore the NAV of the scheme will fall to the extent of dividend payment. Also dividend payment is subject to availability of distributable surplus and approval from Trustees.

Features of ELSS & other Tax Saving instruments u/s 80C of Income Tax Act, 1961?

Particulars	PPF	NSC	ELSS
Tenure	15 years	6 years	3 years
Returns	8.70 % * (Compounded Annually)	8.50 to 8.80 % * (Compounded half-yearly)	Returns / Dividends are Market linked and not assured
Minimum Investment	Rs.500	Rs.100	Rs.500
Maximum Investment	Rs.150,000	No limit^	No limit^
Amount eligible for deduction u/s 80C	Rs.150,000	Rs.150,000	Rs.150,000
Taxation for interest	Tax free	Taxable	Dividends and capital gain tax free

Safety/ Risk	Highest Safety	Highest Safety	High Risk
Lock-in Period	15 Years - Partial Withdrawal after 6 years is permitted	6 Years	3 years

*Source: http://finmin.nic.in - All rates shown above have been compounded wherever applicable. *There is no upper limit on investments. However, investments of only up-to Rs.1,50,000/- per year are allowed to be claimed as deductions under Section 80C of Income Tax Act, 1961.

How to invest?

Understand your financial goals

First and foremost, you need to assess your financial goals. You can start by listing down all your financial goals. These goals can be planning for your retirement, kid's education, buying a house or a car, etc. Next, you need to make a rough estimate of the amount of money you'll need to meet each of your goals. Based on the estimate, you'll need to define the amount of money that you need to invest to achieve each of your goals.

Choosing the right scheme

A crucial part of investing in ELSS funds is selecting the right fund. A person who is well-versed with ELSS investments will know of the high variation among the different ELSS funds available in the market. It is not necessary that a top-performing fund is the best one, there are other factors such as volatility, a consistent fund manager, reputation of the management company and other factors that come into play. You could always approach a financial advisor to help you with your investment.

Let's take a closer look at some of the common ELSS terms:

§ **Expense Ratio –** While selecting an ELSS fund, you should look at the expense ratio of the fund. This is basically the amount of money that the fund management company charges an investor for managing the fund. This varies from fund to fund. The formula is total expenses incurred by the fund divided by its Assets under Management (AUM).

§ **Past Performance –** Another important selection criteria is the past performance of the fund. Assessing a fund's historical performance will give your insight into its probable future performance. A fund that has performed consistently is a good bet.

§ **Age of the scheme –** Since Mutual Funds are subject to market conditions, it is better to opt for the older schemes. A scheme that has a history of 5 to 10 years would have gone through various market phases – bull, bear and stagnant. So, these are generally considered better options than the other schemes.

§ **Size of the corpus –** Yes, bigger is better! Get to know the corpus of the scheme you're planning to invest in and compare this with the other schemes available in the market. A bigger corpus means the particular scheme is trusted by a lot of other investors.

There are two different avenues for investing in ELSS funds -regular and direct. The regular route comes with a higher expense ratio than the direct one as the investor is expected to pay the fund distributor. Taking the direct route is considered to be a better option to invest in because of the lower expense ratio.

Intermediary selection – Once you've selected your ELSS fund, you'll have to invest in it. This can be done either via a Mutual Fund distributor, an online distributor or directly through the fund company.

Mutual Fund Distributor

- Easily accessible
- Does all the work for you – paperwork, investments
- Gets their commission from the fund house

Online Distributor

- Easily accessible
- Easy to track the performance of your funds
- Doesn’t sell direct plans
- Most charge a fee per transaction
- Ease of investing online

Direct Investment

- You’ll need to visit the fund company for investing.
- You can also invest online via the fund company’s website.

ELSS is the way to go if you’re looking to create wealth while saving on taxes. Caution, due diligence and proper risk assessment are necessary if you want to gain from your ELSS investments.

Here’s a tip for investing in ELSS funds – always invest via SIP instead of a lump-sum investment. This way, you average out the cost of investment. **Mutual Fund investments are subject to market risks, read all scheme related documents carefully before investing.**

Do you have a better strategy for investing in ELSS funds? Feel free to write me back at siddhantc3@gmail.com!