ELSS

Alternative investment avenue

Equity linked investment schemes are here to stay

Almost coinciding with the onslaught of the global recession, and due to various other reasons such as a dismal growth rate and a gloomy investment environment back home, retail participation in the stock market has declined drastically over the last few years. This could possibly be the reason that prompted the government to bring out such attractive schemes as the equity linked saving schemes (ELSS), through which small investors can invest in the market and earn tax free returns while being able to use it as a tool for saving tax up to ₹1.5 lakh under Section 80C of the Income Tax Act.

Basically, ELSS is an equity-based mutual fund scheme in which the investment is mainly in equity. "Up to 35 per cent of the fund can be invested in non-equity investments such as debt instruments in order to provide more balance to the fund. However, the majority of the allocation is in equity and therefore it is highly volatile in nature and returns are dependent on market performance. As a result, the price of the units keeps fluctuating in tune with the ups and downs of the equity market. Fund managers usually resort to a diversification of funds in equities across sectors, which can reduce the risk to some extent. Further, it is an open-ended fund and thus can be subscribed to at any point of time. The funds have their net asset value (NAV) which changes according to the market scenario. The investor uses the NAV for the purchase or sale of the units," explains Lalit Kumar Dangi, chairman of the Libord group, strongly advocating retail investors to use this route for investing in the stock market.

The most important point for investment under ELSS is that being equity-related instruments these are termed equity funds. "The advantage is that when investors invest in ELSS, it is tax free, as they get deduction under Section 80C, thus being known as an exempt-exempt-exempt policy. The prospect in today's market is good as the Indian capital market is expected to remain buoyant for the next few years. ELSS is probably the best option this year for tax savings purposes. The buoyant equity market will help the investor reap excellent returns over a period of time through ELSS," says Sudip Bandyopadhyay, MD & CEO, Destimoney.

Among other immediate alternatives viz, PPF and NSS, ELSS emerges as the best choice for an investor who has a good appetite for risk taking as the ELSS has outperformed both with a massive 27.34 per cent returns on an average in the past three years compared to 8.70 per cent on PPF compounded annually and 8.5-8.8 per cent on NSS compounded half yearly. "Not only are the returns high but they have the shortest lock-in period of three years compared to 15 years in PPF (even partial withdrawal is possible after only six years) and six years for NSS. While dividend income is tax free, the investor can invest up to any amount even though he is entitled for deductions upto ₹1,50,000 under Section 80C," explains V.V.L.N. Sastry, MD, Firstcall Equity. "A lock-in of only three years vis-à-vis other instruments, and systematic investment on a monthly basis can also be done on a regular basis," adds Deven Choksey, MD, KR Choksey.

Though ELSS is more emphatically advertised as a tax saving instrument by the mutual funds, there are reasons why one should opt for them as a good investment choice for an average investor who wants to have an equity investment portfolio. "Most of the investors who want to invest in the stock market find themselves in a state of confusion regarding what scrips to buy and when to sell them so as to maximise their returns. Often they lack confidence as they may not possess in-depth knowledge about the movement of stock prices based on fundamental or technical analysis and particularly the prices of individual stock," adds Dangi.

"Practically, ELSS enjoys all the benefits that an institution like mutual funds can offer to its clients. The mutual funds can help small investors to invest in select units handpicked by them based on proper research and thorough due diligence of the stock of any company under a given set of industry and macro conditions with a fair degree of foresight about likely movements in the

Best performing ELSS

Scheme	Rank	AUM Dec 2014	1 Year return	2 Years return	5 Years return
SBI Magnum Tax Gain	3	4,694	64.3	29.9	15.2
HDFC Tax Saver	4	4,910	70.5	28.9	15.8
Reliance Tax Saver	1	3,210	105.2	41.7	20.8
Axis Long Term Equity Fund	1	2810	81.2	42.1	24.6
ICICI Pru Tax Plan	3	2120	64.6	30.3	17.8
Birla SL Tax Relief 96	2	1695	75.1	34.1	15.9
UTI Master Equity Plan	–	1510	54.6	23.2	13.9
L&T Tax Advantage	4	1437	60.8	25.8	15.6
Franklin India Tax Shield	2	1392	72.3	30.4	18.9
Sundaram Tax Saver	5	1176	63.4	22.9	13.1
HDFC Long Term Advantage	5	1078	55.7	26.8	15.9
DSP-BRTax Saver Fund	3	988	67.2	29.7	16.7

future," recommends Sastry.

The investment in ELSS can be made with a minimum amount of ₹500 either on a lump-sum basis or through systematic investment plans (SIPs). In case of SIPs, a specified amount is invested every month on a particular date but a lock-in period for three years becomes applicable for each investment made therein. There is no upper limit for the investment in ELSS. This clearly shows that it is to the advantage of the investors to invest in such schemes since if they individually invest in the share market they may not get better returns than what they get on ELSS. No wonder, these factors have prompted many investors to invest in these schemes.

Good performance

In 2013, it almost felt like the retail investors fled the markets resulting in the shrinkage of trading volumes in the cash segment of the Bombay Stock Exchange and National Stock Exchange, which reached their lowest level in seven years. However, in recent months with the glitter coming back to the stock market, the average daily turnover in the retail segment of the two exchanges increased substantially over the previous years' levels. "But the most important aspect of increased retail participation is that it is substantially coming through mutual funds that are probably being seen as a safe bet to hit the right scores. This is reflected not only in the increase in the number of mutual fund folios but also the amount of investments in mutual funds particularly in their equity schemes," says Dangi.

For instance, the asset under the management (AUM) as on December 2013 was ₹8,76,921 crore (equity: ₹1.58 lakh crore) which has now, as on December 2014, gone to ₹11,06,279 crore (equity: ₹2.83 lakh crore). It clearly shows that investors' inclination towards equity market has increased. As on December 2014 the total AUM of ELSS equity was ₹36,257 crore as against ₹24,265 crore in December 2013, which shows a more than 50 per cent increase in investment. The stock market index has increased by 30 per cent from January 2014 to December 2014 and there are indications that it will go upwards and in such a situation there is an increase in money under management of mutual funds. "The scope of ELSS is going to widen in the coming days due to the opening up of the economy, increase in savings rates, desire to invest in the stock market, understanding the fundamentals of the mutual funds, past track records and awareness about sectoral investment by mutual funds," adds Sastry.

Numbers tell a story. Reliance Tax Saving, Axis Long Term Equity Fund and many others have given mind boggling returns ranging from 60-85 per cent. Axis Long Term Equity Fund, Reliance Tax Saving (ELSS), HDFC Tax Saving, SBI Magnum Tax Gain, Birla ELSS Tax Relief 96 have all given more than 50 per cent returns in the last one year and more than 12 per cent in average the last five years whereas the average Sensex returns from this year is 43 per cent and the five-year average is 12.5 per cent. It clearly shows that ELSS funds are outperforming even the Sensex.

However, quite ironically, despite the outstanding show put up by some of the top ELSS, investors are not investing much – maybe due to a lack of awareness about the scheme or a low risk appetite for equity markets. Though they do carry a high risk under volatile equity market conditions, investors can immensely benefit from these schemes provided they adopt a research-based cautious approach. Most risk factors in making ELSS an investment choice are similar to those that apply to equity markets. "Investors should always remember to do thorough research before they invest in any ELSS fund. They should carefully evaluate the ELSS of different mutual funds on the basis of the following decision parameters: large assets under management, promoted by a reputed group, right investment approach of the fund manager, portfolio of the fund, past track record of the fund managers, see how volatile the fund has been in the past, the expense ratio of the fund, good ranking by credit rating agencies, etc.

Recently, the Association of Mutual Funds in India (AMFI) upon consultation with SEBI, asked asset management companies (AMCs) to stop offering the dividend reinvestment option wherein the dividend amount reinvested is also subject to a lock-in of three years from the date of reinvestment. One of the important reasons could have been the rising complaints during withdrawals. Prior to this, the ELSS products provided for growth options and dividend options which included the 'Dividend Reinvestment Sub-Option' wherein the dividend amount could be reinvested, subject to a lock-in period of three years from the date of reinvestment. "It was observed that quite often investors forget to tick the 'Dividend Payout Sub-Option', resulting in reinvestment of the dividend by default. Since the original amount invested qualifies for deduction under Section 80C, even though the dividend reinvested does not qualify for any such deduction, the lock-in period rule is often misconstrued by investors, who expect to withdraw the entire balance of units (including dividend reinvested) at the time of redemption, after a three-year lock-in period of the original investment which they were not able to get due to lock-in of each transaction of dividend reinvestment, leading to investor grievances," says Dangi, recommending that the dividend reinvestment sub-option under ELSS products be withdrawn, to avoid any confusion among investors. For existing investors, it means the dividend reinvestment option will be converted to a dividend payout. According to the new guidelines, investors who do not wish to receive dividend pay-out could opt for the 'Dividend Transfer Plan (DTP)', wherein the dividend amount could be reinvested in any other open-ended scheme of the mutual fund. However, it is unlikely to have any major impact over the popularity of ELSS as a tax saving instrument for a taxpayer with a risk appetite to opt for higher returns.

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