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Equity Linked Saving Schemes- a Smart Way for Tax Planning

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Abstract

Mutual funds in India are becoming an ideal investment choice compared to safe investments such as Fixed Deposits and postal which gives comparatively low returns. Since the year 2003 from which the present stage of bullrun in the Indian capital markets began, the mutual fund industry. ELSS Schemes provide benefit of tax exemption along with good returns. The main objectives of this article are to understand the concept of ELSS, as prevalent in the Mutual Fund Industry in India and to comparatively analyze ELSS with other tax saving instruments.

KEYWORDS: Mutual funds, Fixed Deposits, ELSS.

Introduction

In matters of savings and investments, an individual's first priority is usually investments designed to bring about tax savings. Investment options which offer tax benefits and an opportunity to create wealth are always a favourite of the investing community. While there are various tax savings options available out there under section 80C of the Income Tax Act, equity-linked savings schemes (ELSS) have emerged as one of the most popular options. ELSS is a tax-saving mutual fund with a three-year lock-in period, where investments are made in equity-related instruments. The Government of India, under Section 80C of the Income Tax Act, provides a list of investments / expenditures which offer tax deductions to people.

OBJECTIVES OF THE STUDY

In these terms the study has focused on following are:

- To compare the ELSS schemes with other traditional tax saving instruments on the basis on their Return
- To compare the selected top performed schemes with benchmark on the basis on the Return
- To explain some advantages of ELSS Schemes

REVIEW OF LITERATURE

The study of previous studies is an important part of any research. Mutual fund industry is an attractive field of research since decades. Several researchers have been contributed in this area. Some research studies that have influenced for this research are as follows:

Ramesh chander in his book entitled, ***Performance Appraisal of Mutual Funds in India***, studied the performance of selected mutual funds in terms of risk and return on the basis of fund characteristics. Besides, the study examined the portfolio construction, portfolio management, portfolio evaluation, disclosure practices and investor services. The researcher concluded that in terms of average returns, majority of the sample mutual fund schemes have recorded superior performance.

D.R Joshi in his book entitled, ***Mutual Funds and Hedge Funds***, explained the concept of Risk management through mutual funds. The author has also made an attempt to explain concept of hedge funds.

A.K Sharma and G.S Batra in their book entitled, ***Indian Stock Market***, offers detailed description about financial markets and their structure. The book also attempts to provide information on the regulatory environment and performance of primary and secondary market.

Gomathy Thyagarajan made comparative analysis of the performance of ICICI Prudential, HDFC and Franklin Templeton Mutual funds for the period 2002 to 2007. In his study he used Sharpe's Ratio method for performance evaluation and concluded that 20 sample schemes have outperformed their respective benchmark ratios and 4 schemes have shown negative performance.

R. Anitha, et. al, in her study analysed the performance of public-sector and private sector mutual funds for the period from 2005 to 2007 on the basis of Statistical tools like Mean, Standard Deviation and Co-efficient of Variation. The study concludes that the performance of all funds has shown volatility during the period of study making it difficult to earmark one particular fund which could outperform the other consistently.

Kalpesh P Prajapati and Mahesh K Patel, compared the performance of Indian mutual funds on the basis of performance index, risk-return analysis, Treynor's ratio, Sharp's ratio, Sharp's measure, Jensen's measure, and Fama's measure. The data used is daily closing NAVs from 1st January 2007 to 31st December, 2011 and concluded that most of the mutual funds have given positive return during the period of study.

Shivani Inder and Shikha Vohra, in her study has focused on long run performance i.e from (January, 2005 to December, 2011) evaluates the long run performance of the selected index fund schemes and make comparative analysis of the performance of these funds on the basis of the risk-return for the period of 6 years. The results indicate that follow the market. They try to capture market sentiments, good as well as bad, and thus perform as the market performs.

P Alekhya, in his study has evaluated the performance of equity mutual of public and private sector mutual fund schemes and has made comparative analysis during the period for past 3 years from 2009 to 2011. Funds were ranked according to Sharpes, Treynors and Jensons performance measure.

RESEARCH METHODOLOGY

Research Type: The research is analytical and exploratory research using convenience sampling.

The Universe: The universe of the study consists of the all the assets management companies (AMC).

Data Type: The Research Study is completely based on Secondary Data. To gain an overview of ELSS schemes and other tax saving Instruments secondary data has been collected from various sources like, the fact sheets, newspapers, journals, books, periodicals, websites, etc.

Data Source: Data has been collected from secondary sources. It's included the mutual fund fact sheet and magazine the —Mutual Fund Insight, and addition to others journals, magazines, articles, books, annual reports of company, Reports of RBI and other published and unpublished documents of the mutual funds have been consider in the research.

Sampling Frame: Various Equity Linked Saving Schemes of leading mutual fund companies and some traditional tax saving instruments are selected on the basis of their performance. ***Sampling Unit:*** The sample unit includes schemes of HDFC Mutual Fund.

Sample size: Following schemes are considered as sample for the study:

1. Birla Sunlife Tax Plan (G)

2. Birla Sunlife Tax relief 96 (G)

3. DSP Black Rock tax Saver Fund (G)

4. Franklin India Tax Shield (G)

5. ICICI Pru Long Term Equity Fund (G)

Other Popular Tax Saving Instruments under 80 C

Table 1

. Life insurance policy premium
. Contributions made under Employees' Provident Fund Scheme
. Contribution to Public Provident Fund Account / any recognised provident fund
. Contribution to an approved superannuation fund
. Subscription to any notified security or notified deposit scheme of the Central Government like Sukanya Samriddhi Account Scheme.
. Subscription to National Savings Certificates
. Contribution for participation in unit-linked Insurance Plan
. Tuition fees (excluding development fees, donations, etc.) for full time education of any 2 of his/her children
. Certain payments for purchase/construction of residential house property
. Sum paid towards notified annuity plan
. Contribution to any pension fund set up by any mutual fund which is referred to in section 10(23D)
. Subscription to equity shares or debentures forming part of any approved eligible issue of capital made by a public company or public financial institutions
. Subscription to any units of any approved mutual fund referred to in section 10(23D)
. Term deposits for a fixed period of not less than 5 years with a scheduled bank, and which is in accordance with a scheme 11 framed and notified.
. Subscription to notified bonds issued by the NABARD.
. Deposit in an account under the Senior Citizen Savings Scheme Rules, 2004
. 5-year term deposit in an account under the Post Office Time Deposit Rules, 1981

Some Features of ELSS

With such a long list of options, choosing the right investment can be a daunting task, to say the least. ELSS funds have been the most preferred option in recent years for the following reasons:

Save tax and earn high returns

ELSS funds offer a tax deduction of up to ₹150,000 under Section 80C of the Income Tax Act. These funds offer the EEE benefit – tax exemption, wealth accumulation and zero exit_load. Further, these funds invest primarily in the equity market in a diversified manner, which gives investors a good opportunity to earn inflation-beating returns.

Lowest lock-in period

Of all the investment options available under Section 80C, ELSS funds offer the lowest lock-in period of only 3 years.

Also, these funds do not have a maximum investment period like PPF (15 years) or FD (10 years) has. The capital gain on these investments will be counted as Long-term Capital Gains (LTCG), which is tax-free. Post the lock-in period, the investor can choose to liquidate the investment or stay invested, based on the fund performance.

Comparison of ELSS with Other Tax saving Instruments

Here is a quick glimpse at how ELSS compares with the other commonly used tax-saving investments:

Table 2

Investment	ELSS	PPF	FD	NSC	NPS
Approximate returns	12-14%	7-8%	6.5-7.5%	7-8%	7-8%
Lock-in period	3 years	15 years	5 years	5 years	Till retirement
Tax on returns	No	No	Yes	Yes	Yes (partially)

Performance of top 5 Best ELSS tax Saving Mutual Funds

Performance of top 5 Best ELSS tax Saving Mutual Funds (Values as on December 2017)

Table 3

Birla Sunlife Tax Plan (G)

Years	Fund Return	Benchmark	Benchmark Return	Difference
1 Year Return	37.73%	S&P BSE Sensex	25.58%	12.15%
3 Year Return	14.74%	S&P BSE Sensex	4.99%	9.75%
5 Year Return	20.70%	S&P BSE Sensex	11.14%	9.56%
10 Year Return	9.25%	S&P BSE Sensex	5.13%	4.12%

Source: Fact sheets of company

Table 4

Birla Sunlife Tax relief 96 (G)

Years	Fund Return	Benchmark	Benchmark Return	Difference
1 Year Return	38.36%	S&P 200 BSE Sensex	28.45%	9.91%
3 Year Return	15.37%	S&P 200 BSE Sensex	8.58%	6.79%
5 Year Return	21.47%	S&P 200 BSE Sensex	13.28%	8.46%
10 Year Return	8.41%	S&P 200 BSE Sensex	5.80%	2.61%

Source: Fact sheets of company

Table 5

DSP Black Rock tax Saver Fund

Years	Fund Return	Benchmark	Benchmark Return	Difference
1 Year Return	29.33%	Nifty 500	30.58%	-1.25%
3 Year Return	14.25%	Nifty 500	9.45%	4.8%
5 Year Return	19.90%	Nifty 500	14.01%	5.89%
10 Year Return	11%	Nifty 500	6%	5%

Source: Fact sheets of company

Table 6

Franklin India Tax Shield (G)

Years	Fund Return	Benchmark	Benchmark Return	Difference
1 Year Return	24%	Nifty 500	30.58%	6.58%
3 Year Return	10.45%	Nifty 500	9.45%	1%
5 Year Return	18%	Nifty 500	14.01%	4%
10 Year Return	10.96%	Nifty 500	6%	4.96%

Source: Fact sheets of company

Table 7

ICICI Pru Long Term Equity Fund (G)

Years	Fund Return	Benchmark	Benchmark Return	Difference
1 Year Return	21.58%	Nifty 500	30.58%	9%
3 Year Return	8.81%	Nifty 500	9.45%	0.64%
5 Year Return	17.23%	Nifty 500	14.01%	3.22%
10 Year Return	11%	Nifty 500	6%	5%

Source: Fact sheets of company

The above tables shows that most of the times ELSS schemes have generated positive returns.

Advantages of Investing in Mutual Fund

Some advantages of investing in an ELSS mutual fund:

1. **Has Short Lock-in period**

In comparison to other tax savings instruments like the National Savings Certificate (NSC), tax savings bank deposit or Public Provident Fund (PPF), the lock-in period is much lower for an ELSS fund. While NSC, tax-saving FD and PPF require a lock-in timeframe of 6 years, 5 years and 15 years respectively, an ELSS fund has a lock-in period of only 3 years. In comparison, ELSS funds are far more convenient as you have faster access to the funds for re-investment or spending purposes as these investments can be made and redeemed online.

2. **Yields High return on investment (ROI)**

As ELSS is an investment which is made in the equity markets, you can expect higher returns in comparison to many other tax-saving investment options, from the perspective of a long-term investor. Thus, not only do they help save tax, but they also enable you to make a bigger profit on your investment. It is however recommended that investments in an ELSS fund be made over the medium to long term in order to derive maximum benefits from your investment. While fixed deposits and PPF provide returns in the range of around 8%, ELSS schemes have historically generated returns of 12% and higher over a 10-year period.

3. **Offers Tax Benefits**

ELSS funds qualify for tax exemptions under 80C of the IT Act where investments of up to Rs.150,000 can be claimed as tax deduction in each financial year. Furthermore all capital gains earned through ELSS funds are tax-free i.e. there is no tax imposed on the maturity amount or the earnings accrued through ELSS investments. This is why ELSS is a much-preferred savings option, and not only from the tax-savings perspective.

4. **Inculcates Financial Discipline Through SIP**

Mutual funds generally offer a systematic investment plan (SIP) facility, wherein, you can invest a fixed amount every month, just as you would in case of a recurring deposit. ELSS funds also provide this facility, where your earnings can be deployed into your ELSS fund periodically (weekly/monthly). This proves to be a great advantage as it reduces the strain of having to invest a lump sum amount at a time, thus reducing the strain on your monthly budget.

5. **Protects from Inflation**

ELSS funds also help earn returns that are able to beat inflation. While bonds and fixed deposits might offer returns that may be in line with the pace of inflation over a period of time, in reality, the real returns are quite low. Since ELSS funds are equity-based and returns are tax-free, they provide higher gains as compared to other investment options, which are in line with the increase in inflation.

6. **Is a Long-Term investment option**

There is a general misconception that in case of ELSS, funds need to be withdrawn or re-invested elsewhere, once the lock-in period has been crossed. This is not the case with ELSS funds, there is no need to do so if the fund is performing well. ELSS funds provide investors with the choice of continuing to stay invested beyond the lock-in period, if they desire. If the ELSS fund is a well-diversified scheme, it is in fact advised that it be considered more as a long-term investment.

7. **Is Affected Minimally by Market Volatility**

Traditionally, ELSS mutual funds have shown themselves to be considerably less volatile as compared to other equity investments. Thus many experts suggest that investors make ELSS investments in order to prevent being affected by the volatility of traditional stock market investments.

Conclusion

Due to the above as well as other benefits of ELSS funds, financial planners recommend that they be considered for reasons over and above the tax-savings benefits they provide. Though it is always suggested that one should ideally have a diversified portfolio, with investments made across the entire gamut of tax-savings and profit-maximisation schemes, one should definitely include ELSS funds in their investment portfolio. This is because the risks they come with given that they are equity-based schemes are more than compensated for by their numerous advantages.

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