ELSS Funds – what are they, how you save taxes, and why invest in them?

Tax planning may seem like a tedious exercise requiring lot of efforts that may make an ordinary investor nervous at the first glance. Equity Linked Savings Scheme (ELSS) offers a simple way to get tax benefits and at the same time get an opportunity to gain from the potential of Indian equity markets.

What is ELSS?

Simply put, ELSS is a type of diversified equity mutual fund which is qualified for tax exemption under section 80C of the Income Tax Act, and offers the twin-advantage of capital appreciation and tax benefits. It comes with a lock-in period of three years.

Why should one invest in an ELSS?

ELSS funds are one of the best avenues to save tax under Section 80C. This is because along with the tax deduction, the investor also gets the potential upside of investing in the equity markets. Also, no tax is levied on the long-term capital gains from these funds. Moreover, compared to other tax saving options, ELSS has the shortest lock-in period of three years.

BEYOND TAX SAVING

Parameter	PPF	NSC	ELSS
Tenure	15 years	6 years	3 years
Returns	(Compounded Annually) 8.80 % ^	(Compounded half-yearly) 8.60 to 8.90 % ^	Not assured dividends/ returns
Minimum investments	Rs.500	Rs.100	Rs.500
Maximum investments	Rs.100,000	No limit*	No limit*
Amount eligible for deduction under Section 80C	Rs.100,000	Rs 1,00,000	Rs 1,00,000
Taxation for interest	Tax free	Taxable	Dividends and capital gain tax free
Safety/ Rating	Highest	Highest	High Risk

* There is no upper limit on investments. However, investments of only upto Rs.100,000 per year are allowed to be claimed as deductions under Section 80C of IT Act.

SHORT Lock-in

Instrument	Lock-in Period
ELSS	3 Years from the date of allotment of the respective Units
Bank Fixed Deposit	5 Years
PO Time Deposit	5 Years
NSC	6 years
PPF	15 Years (Partial withdrawal after 6 years)

Source: Banks and Post Office

Pros and Cons

Like all investment options; ELSS too come with its share of advantages and disadvantages.

Advantages of ELSS over NSC and PPF

- Main advantage of ELSS is its short lock-in period. Maturity period of NSC is 6 years and PPF is 15 years.
- Since it is an equity linked scheme earning potential is high.
- Investor can opt for dividend option and get some gains during the lock-in period
- Investor can opt for Systematic Investment Plan

Disadvantages of ELSS

- Risk factor is very high compared to NSC and PPF

TAX ADVANTAGE

Particulars	Without ELSS/ 80C Tax Saving Investment	With ELSS / 80C Tax Saving Investment
Gross Total Income	Rs.7,50,000	Rs.7,50,000
Exemption Under Section 80C	Nil	Rs.1,00,000
Total Income	Rs.7,50,000	Rs.6,50,000
Tax on Total Income	Rs.80,000	Rs.60,000
Tax saved on Investment	Nil	Rs.20,000

Illustration of Tax exemption for a male person less than 60 years in receipt of salary income for the assessment year 2013-14 (FY 2012-2013)

Suitability

It is suitable for all types of investors who are not risk averse and need to invest in tax planning instruments. Though there is no age to get started on an ELSS, it is good investment to have for those who are just starting their careers as it can help them shed their inhibition about investing in equities through mutual funds in a big way.

Rates incorporates compounding wherever applicable.
Disclaimer: The comparison of ELSS Vs other tax savings instrument has been given for the purpose of the general information only. Investment in ELSS carry high risk and any investment decision needs to be taken only after consulting the Tax Consultant or Financial Advisor.