ELSS (Equity Linked Savings Scheme)

Introduction to Equity Linked Savings Scheme (ELSS)

Equity Linked Savings Scheme (ELSS) is a type of Mutual Fund scheme. Going by its name ELSS invests a majority of its corpus in equity and equity related products. An investment in ELSS comes with a lock in period and has tax benefits attached to it. It is suitable for investors having a high risk profile as returns in ELSS fluctuate depending upon the equity market and there are no fixed returns. ELSS schemes are open ended in nature, that is, investors can subscribe to the fund at any day. NAV or the price of the fund is declared on every business day.

Benefits / Features

3 years lock-in period (lowest compared to other select tax saving options)

Growth potential of equity

Tax free dividends

No tax on long-term capital gains

Tax Deduction under Section 80C

As per Section 80C and subject to provisions of the Income-tax Act, 1961, an individual/HUF is entitled to a deduction from Gross Total Income up to ₹1 Lakh (along with other prescribed investments) for amounts invested in Equity-Linked Savings Scheme.

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.

Options while making an investment in an ELSS

a. Growth option – In growth option income earned by the fund is not distributed to unit holders, Investor do not earn any dividend during the time it holds the fund. Any income/profit earned by the fund increases the NAV of the fund and vice versa. Whenever the investor sells its holdings he will realize long term capital gain/loss.

b. Dividend option – In this option the fund distributes income earned by the fund to the investors as dividends. The date of distribution is declared by the fund, however if the fund has negative income it will not distribute any dividend. Any dividend received by the investor is not liable for tax in the hands of investors.

c. Dividend reinvestments option – If the investors choose this option the dividends declared by the fund are reinvested. For example an investor is holding 10000 units of a fund and the fund declares dividend @ 1.5 per unit,

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Monthly investment in ELSS

Monthly investments on a pre specified date in mutual funds is possible through systematic investment plan (SIP). An investor has the option of investing monthly in equity linked savings schemes with a minimum investment based on respective schemes. This type of investment is better suited to small investors who cannot invest a lump sum amount. SIP has the benefit of averaging out the cost of investors. As the amount of investment is fixed the units purchases every month varies depending upon the NAV of the fund. At a higher NAV the investor gets fewer units and more number of units at a lower price thus averaging out the cost of investors

Points to remember

A – Equity linked savings schemes is a type of mutual fund with 3 years lock in period and tax benefits attached,

B - There are three types of options in ELSS, dividend option growth option and dividend reinvestment option.

C – Investors can opt for systematic investment plan. Minimum investment required depends on respective scheme. An investment through SIP has a disadvantage as every monthly investment carries a lock in period.

D - If an investor chooses dividend reinvestment plan the dividend reinvested is considered as a fresh purchase and has a lock in period of 3 years from the date of purchase so the dividend reinvested is further locked for a period of 3 years.

E – SIP helps in averaging out the cost of investors, however if the investor backs out from SIP when the markets are falling he won’t be able to average out his cost.