Economic Times

Best way to invest in ELSS

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Clip: 1 of 1

Best way to invest in ELSS

Even as you save tax through an ELSS fund, find out the approach that will help optimise your returns.

SANKET DHANORKAR

As a financial year draws to a close, people rush to make tax-saving investments and the haste often results in flawed decisions. Take the investments in tax-saving equity mutual funds. While these funds offer a good avenue to save tax and grow one's money, investors often approach these in the wrong manner. Given that these are essentially equity products, they should be treated differently from other Section 80C alternatives, such as the Public Provident Fund, life insurance, tax-saving fixed deposits, etc. So, if you are planning to invest in an ELSS fund, here are the things you should keep in mind to make the most of this option.

Start early

Unlike a tax-saving fixed deposit or a traditional insurance policy, where investors can shell out the entire money as a lump sum, this product requires a different approach. Being an equity investment, it is exposed to market risks and its performance depends to a large extent on the points of entry and exit. When you are investing a lump sum in the scheme, the timing of entry will have a bearing on the returns. If you invest when the market is at a peak, you could end up with erosion of capital. The loss could even offset any tax saving you achieved at the time of making the investment. Even if you spread your investment over the last three months of a financial year, it will not reduce the risk greatly.

Instead, investors should start doing so regularly through an SIP from the beginning of the financial year, spreading their investments over 12 months. "If you invest towards the end of the year, you will end up timing the market. It makes more sense to stagger the investment over the entire year," says Vidya Bala, head of research, *FundsIndia.com*. It will help you mitigate the market risk, and as Suresh Sadagopan, Founder, Ladder 7 Financial Services, says, "This approach will help you avoid a cash flow crunch later in the year."

Top rated ELSS funds

SCHEME	RATING	RETURN (%)		
		1-YR	3-YR	5-YR
Axis Long Term Equity Fund	*****	35.4	15.54	-
BNP Paribas Tax Advantage Plan Fund	*****	22.62	11.96	21.12
Franklin India Taxshield Fund	*****	21.41	9.25	23.22
IDFC Tax Advantage (ELSS) Fund - Regular Plan	*****	23.55	9.22	20.36
Edelweiss ELSS Fund	****	20.03	8.55	18.15
HDFC Long Term Advantage Fund	****	24.05	8.54	24.58
HSBC Tax Saver Equity Fund	****	23.22	9.78	21.24
ICICI Prudential Tax Plan - Regular Plan	****	29.01	9.87	26.86
Principal Tax Savings Fund	****	26.2	9.44	19.03
Quantum Tax Saving Fund	****	23.41	9.73	24.31
Religare Invesco Tax Plan	****	23.52	9.87	23.86
SBI Magnum Taxgain	****	23.57	8.79	20.12

Data as on 31 Mar 2014. The 3-year and 5-year returns are annualised.
Source: Value Research

Invest within limits

Some investors put money across multiple ELSS funds at the same time. However, this will neither enhance the tax saving, nor will it lend diversification to the portfolio. Since an ELSS is a Section 80C investment, you can claim a maximum tax deduction of ₹1 lakh even though you can invest a higher amount. Besides, if you have alread made other Section 80C investments, such as those in the Employee Provident Fund, life insurance, tuition fees for your children, or principal component of the housing loan, it will leave little room to claim tax deduction on the ELSS. If you are keen for a higher equity exposure, it would be better to opt for a traditional diversified equity fund instead.

Check out the best mutual funds **Page 22**

It is also not a good idea to opt for a new ELSS every year, says Shilpi Johri, head, Arthashastra Consulting. As this is unlikely to lend any substantial diversification to your portfolio, limit it to two ELSS funds. Bala asserts, "It is enough to hold 1-2 tax-saving equity funds. As you would also be holding a few traditional diversified equity funds, having more ELSS funds will only duplicate your portfolio."

Don't opt for dividend reinvestment

While investing in an ELSS, it is better to opt for the growth or dividend option, not the dividend reinvestment option. Remember that each instalment of the ELSS will be locked in for a period of three years. If you choose the reinvestment option, any dividend that the fund declares at any point will be reinvested in the scheme and the units will, in turn, come with a lock-in period of three years. Assuming that the fund declares dividend regularly, there is a possibility of some units remaining locked-in forever. Johri says, "Under dividend reinvestment, you run the risk of leaving some money stuck with the scheme, limiting your flexibility to take out the entire money at any time."

Redeem gradually

Don't be in a hurry to redeem your investment after the three-year lock-in period. Sadagopan feels that they should look beyond the tax-saving angle. "There is no compulsion to redeem the investment at the end of three years. Apart from saving tax, these funds help achieve your financial goals," he says. He suggests staying with the fund for as long as one can, if there is no immediate need for money, and if the performance is strong enough.

Also, remember that if you have an SIP in an ELSS, you need to hold each instalment for three years to be able to redeem the money. Such redemption is on a first-in, first-out basis, which means that the units allotted first will be redeemed first. When you are taking out money in an ad hoc manner, you have to check the latest account statement to know how many units are eligible. If the request is for more than those eligible, it may be rejected.

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