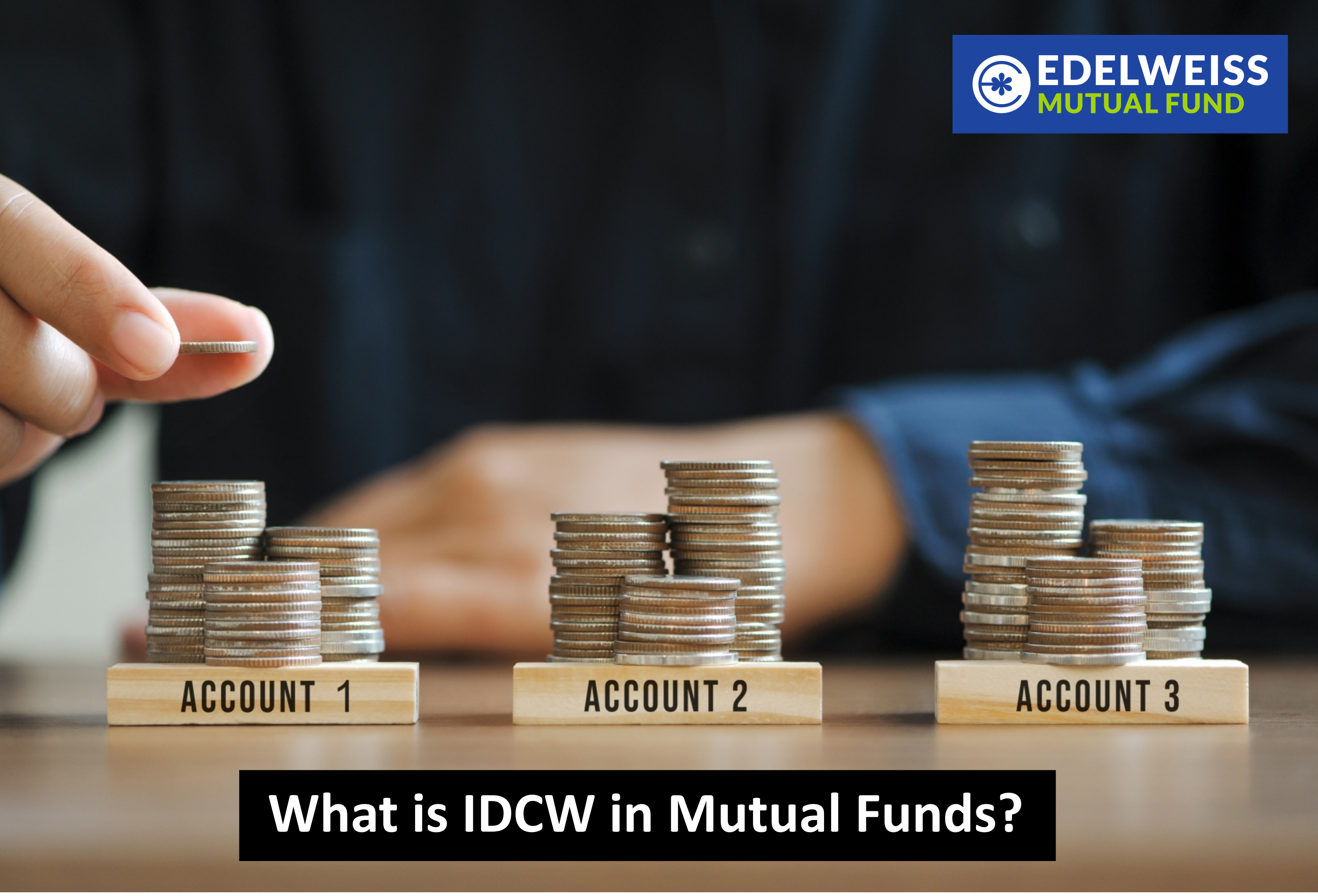

What is IDCW in Mutual Funds?

Introduction

The world runs on abbreviations today. Whether it is your email or message inbox, you are bound to encounter the occasional PFAs, LOLs, and FYIs. The realm of mutual funds also has a few abbreviations you must know and keep track of. IDCW is one of them and was introduced by the Securities and Exchange Board of India (SEBI) in place of the term' dividend option' in April 2021. Find out all about the IDCW option in mutual funds in this article.

What is the meaning of IDCW in mutual funds?

There are two types of mutual funds with respect to profit distribution - dividend and growth. The growth option reinvests your profits back into the market and offers capital appreciation. On the other hand, the dividend option offers your investment returns as regular income. This option is known as the Income Distribution Cum Capital Withdrawal (IDCW) option.
SEBI changed the term from dividend to IDCW in 2021 through Circular no SEBI/HO/IMD/DF3/CIR/P/2020/194 to clearly convey that the dividend distributed to investors comes from their investment and is taken from a portion of their capital.

Here's an example to understand IDCW in mutual funds:

Consider an example where you own 100 units of a mutual fund with a Net Asset Value (NAV) of Rs 10. You will have an investment value of Rs 1,000. Say, the dividend per unit is Rs 1. So, you will receive a total dividend of Rs 100. This Rs 100 will be paid from your total investment value of Rs 1,000. Therefore, your investment value after the dividend payment will be Rs 900.
There are several misconceptions about mutual fund dividends. Find out what these are and whether or not there is any truth to them.

Common misconceptions about mutual fund dividends in India

Myth 1: The dividend is given over and above the profits earned by the fund.
The dividend paid in mutual funds is taken from the investor's investment value. It is not an additional payment but your own money being given to you after it earns returns in the market.

Myth 2: The dividend is generated from the underlying stocks in the portfolio.
Publically-listed companies may reward investors with a dividend from their profits. You may receive the dividend from here or

from the profits earned by buying and selling the underlying stocks in the mutual fund portfolio.

Myth 3: There is no difference between mutual fund dividends and dividends declared by companies.
The dividend paid in mutual funds is not the same as the one declared by a publically-listed company. Dividends declared by companies are a share of their profits distributed to their shareholders, while a mutual fund only pays a percentage of the investor's capital. In fact, the new name, IDCW, was introduced to distinguish mutual fund dividends from stock dividends.

Growth or IDCW – is one better than the other?

In the growth option, the mutual fund does not distribute any dividends. Instead, it reinvests the returns generated by the fund. As a result, the fund's NAV increases, leading to capital appreciation. This is suitable if your goal is to accumulate capital for a future financial goal, such as retirement or a house purchase.
In the IDCW option, the mutual fund distributes dividends at regular intervals. The NAV of the fund reduces by the amount of the dividend distributed, as explained in the example above. This option is suitable if you want regular income from your investments, such as after you retire.
In addition to the above, it is also essential to understand the taxability of each of these options. Gains from growth funds are levied with short and long-term capital gains tax. Equity funds incur a 15% tax on profits from funds held for less than 12 months and 10% on gains exceeding Rs 1 lakh from funds held for more than 12 months. Debt funds are taxed as per your income tax slab on gains from funds held for less than 36 months and a flat 20% (plus indexation or the cost adjustment of your investment as per the inflation rate) on profits from funds held for more than 36 months.
In the case of IDCW, the dividend is simply added to your gross taxable income and taxed as per the income tax slab rate you fall into.

Conclusion
Neither growth nor IDCW option is inherently better than the other. The choice between them depends on your investment goals. However, it is important to understand the pros and cons of both options before making a decision.