

5 things you must know before investing in mutual fund ELSS for saving tax

Nikhil Walavalkar

Moneycontrol News

Tax saving mutual funds have emerged as one of the most sought after tax saving tool by individual tax payers in India. Thanks to the rising markets, these schemes rewarded investors with handsome returns and in turn attracted investors' money.

To put it in numbers, the [ELSS](#) - as they are termed in industry jargon - attracted Rs 10,613 crore till February 28, 2018, as per the data released by Association of Mutual Funds of India for FY17-18. In the previous year the number stood at Rs 7,191 crore for the same period.

As a category, the tax saving schemes have given 15.3% percent returns over past one year. For the uninitiated, an investment up to Rs 1.5 lakh in the tax saving funds fetches tax deduction under section 80C of the Income Tax Act.

If you are also contemplating an investment in tax saving schemes here are five things you must keep in mind.

There are risks attached

Most investors prefer to go by the returns offered by investment option. While the tax saving bank deposits offer in the range of 6.5% to 7% rate of interest the tax saving mutual fund schemes are offering higher teen. That makes many opt for the tax saving funds. However, you should always keep in mind that the tax saving schemes are expected to invest at least 80% of the money in shares. In most of the times, they are fully invested in shares to maximise the returns. This means you should also be prepared to stomach volatility. For example, over past one month tax saving funds have lost 2.8%.

Market volatility should not put you off. Instead invest as per your financial goal. If your investment in tax saving fund is mapped to a long term goal such as retirement, then the short term volatility should not bother you," says Suresh Sadagopan, founder of Ladder7 Financial Advisories.

As these schemes come with three years lock in period, you cannot sell them off just because the markets turn red. Intermittent volatility however, may cost you peace of mind. "If you are worried about volatility, you may want to opt for a weekly SIP or weekly STP. The arrangement should also extend in the new financial year so that you can plan your taxes early next year and you need not run around last minute again," says Vishal Dhawan, founder of Plan Ahead Wealth Advisors.

Past returns may not repeat

Do not go by the recent returns given by the best schemes in this category. There are two possibilities you should not ignore. The scheme that has emerged at the top of the chart need not remain there forever. And second the performance of the asset class may keep changing from time to time. Though over last three years these schemes have given 6.7% returns on an average, over five years the returns stand at 12.4%. Be realistic with your expectations, is all that experts say.

You may want to balance risk and reward with the help of scheme selection that suits your expectations. If you are keen to play a bit conservative you may go with large cap oriented schemes such as Franklin India Taxshield. For a bit more aggressive lot consider schemes such as IDFC Tax Advantage Fund which has allocation to mid cap stocks.

You can stay invested beyond lock in period

Though the schemes come with a lock in period of three years, there is no need to sell your holding after the completion of three years from the date of allotment of units. The schemes have the lowest lock in period of three years as compared to other investment options that fetch tax break. This is one more reason why they are seen as an attractive option. But do not sell in a hurry.

"Equities reward those who stay put for long term. Let your investment compound. Don't sell just because you are out of the lock in period," says Vishal Dhawan.

Returns are taxable

Till the end of FY2017-2018, the long term capital gains earned on the tax saving funds were tax free and so was the case with dividends earned on the tax saving schemes. Hereafter, the regime changes. Long term capital gains in excess of Rs 1 lakh will be taxed at the rate of 10%. The dividends too will be taxed at 10%. Hence it makes sense to embrace the growth option of the mutual fund and sell your investments when you need money.

You can recycle

All is well for those who have cash to invest and have a long term view. But what about those who are fully invested and have to run around to get some cash to invest at the last moment?

If you have been an investor for years in tax saving funds, you can simply sell your existing tax saving funds. The proceeds can be reinvested in tax saving funds. For time being, all such sell proceeds are tax free.

Though this year, you may be looking for some investment options in the last month, the experts advise to embrace discipline next year. "Decisions may go wrong if you want to take a call at the last minute. Instead start your tax planning early next financial year," says Suresh Sadagopan.