Opt for ELSS and Bank FD combo to save on tax, preserve capital

Many individuals are excluding tax-saving mutual fund schemes (equity-linked savings schemes, or ELSS, in industry parlance) in their annual tax-planning exercise this year.

This is mainly because most of them don't see the market moving further up from the current, near historical high, and many of them are happy with the risk-free 8.5-9% interest offered by tax-saving bank fixed deposit (TSBFD) and public provident fund(PPF).

Some financial advisors are asking these investors to invest in a combination of ELSS and TSBFD to tide over the tricky situation. "Such investors can go for a combination of ELSS and TSBFD. It will help them save income tax, invest some money in stock market and preserve capital," says Vishal Dhawan, founder, Plan Ahead Wealth Advisors.

Experts like him ask these investors to invest 60-70% of the money in TSBFD or PPF and the remaining 30-40% in ELSS. "If they want to reduce risk further, instead of ELSS, they can consider investing in pension products that invest up to 40% of the corpus in equities," Dhawan adds.

Disenchanted with Markets Many investors have been dumping their equity investments for some time now. As per Association of Mutual Funds in India (Amfi) data, both ELSS and equity fund universe saw outflows of Rs 1,547 crore and Rs 7,652 crore, respectively, from April 2013 to November 2013.

However, most financial advisors say "shunning equities altogether does not help in a high inflationary environment". They argue that though bellwether indices such as the Nifty are quoting at their all-time highs, equity markets have a better future in the next couple of years.

"Markets expect about 15% growth in corporate earnings in FY15. We may see equities delivering above average returns due to earnings growth and re-rating of the equities as the economy gradually recovers from the current slow growth phase," says Sadanand Shetty, V-P and senior fund manager, Taurus Mutual Fund.

Broader markets offer hope due to attractive valuations, and ELSS schemes with three-year lockin period can be a good entry point for investors. ELSS category has offered an average 1.57% return in the last three years ended January 3, according to Value Research, a mutual fund tracking entity.

How the Strategy Works Betting on equities through ELSS without risking your capital may sound a bit fantastic, but consider this scenario before dismissing it.

For example, a person is planning to invest Rs 1 lakh under section 80C, and he invests Rs 70,000 in TSBFD and the rest in a tax-saving mutual fund scheme. At 8% interest rate, he will get back Rs 1 lakh from his TSBFD at the end of the fifth year. In other words, the investor has succeeded in preserving his capital.

The remaining Rs 30,000 invested in ELSS will offer market-lined returns. "This works the best for investors in the lower income tax bracket. If you are in the higher income tax bracket, consider investing in PPF instead of TSBFD. Interest on PPF is tax-free," says Nikhil Kothari, chief financial planner, Etica Wealth Management.
Though a new PPF account comes with a 15-year time frame, it can be looked at as a means to plan longterm goal such as retirement while saving tax, he adds. Though the payoff from ELSS is market-linked, the proceeds are tax free.

Most experts advise investors to be careful while choosing an ELSS. Nikhil Kothari recommends Franklin India Taxshield, an ELSS with a large-cap bias. He recommends HDFC Tax saver and DSPBR Taxsaver to those with higher risk appetite.

Vishal Dhawan recommends Franklin India Taxshield and ICICI Prudential Tax Plan. "If investors are not comfortable with the risks associated with ELSS , they may consider pension plans launched by mutual funds as these schemes invest approximately 40% in equities and rest in debt," adds Vishal Dhawan.

(Economic Times)