Taurus Tax Shield is amongst the best 3 ELSS and a 5 star rated fund by Value Research

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CATEGORY WATCH

Tax-saving funds

They may be on death row but still make for a lucrative bet. Renu Yadav tells you why and which funds to opt for

The clock is ticking. Not only is the calendar year fast coming to an end, the end of the financial year is round the corner too. That means if you have been dithering on your tax planning, you really do not have much time left. But surprisingly, the choices this time are quite beckoning. And, if the Direct Tax Code (DTC) gets cleared in the winter session of parliament, then most of these options will no longer be available.

Those interested in fixed return products, would be quite happy this year. The government has linked the ...lic Provident Fund (PPF) rate to the market. The ... of return has been enhanced from 8 per cent to ... per cent. But this will not be the case every year ...eafter. This rate is no longer fixed for the entire ...n of the instrument. The 8.6 per cent rate is on ...r just for this year. Next year, it will be different ... will depend upon the then existing interest rate ...ironment. And so on for the future.

...o every year in April, the rates will be reset ...ording to what the market yield for government ...t is.

...his shift to market-linked returns coincides with ...ernment bond yields hitting three-year high levels. If the government bond yields continue to remain at the current high levels till the cut-off date in April 2012, investors in long-term options, such as the PPF, can expect a return of more than 9 per cent in the next financial year. But it is a double-edged sword. If interest rates were to drop in the coming year to less than 8 per cent, then PPF could well yield much lower. So investors who are thrilled with the current rate and want to cast their lot with this instrument would be

Emerging Bluechip

Annual Returns (%)

Category	2006	2007	2008	2009	2010
Equity: Large Cap	40.45	50.54	-50.66	73.27	17.84
Equity: Large & Mid Cap	36.47	55.65	-52.47	80.24	16.99
Equity: Multi Cap	34.93	61.56	-54.79	83.07	18.75
Equity: Mid & Small Cap	28.34	60.77	-60.09	98.14	20.30
Equity: Tax Planning	30.18	59.25	-55.56	81.79	18.78
Indices					
BSE Sensex	46.70	47.15	-52.45	81.03	17.43
BSE Mid Cap	31.13	68.63	-66.95	107.66	16.15
BSE Small Cap	15.97	93.67	-72.41	126.92	15.71

Investment avenues that qualify for the ₹1 lakh deduction under Section 80C

Public Provident Fund (PPF)
Return: 8.6 per cent per annum
Lock in: 15 years
Risk: Guaranteed return
Maximum Investment: ₹1 lakh
Tax: No tax on interest earned

National Savings Certificate (NSC)
Return: 8.4 per cent per annum
Lock in: 5 years
Risk: Guaranteed return
Maximum Investment: None*
Tax: On interest earned

** Tax benefit is only available on investments up to ₹1 lakh*

5-year Fixed Deposits
Return: 9.25% from State Bank of India for general public. 9.75% for Senior Citizens. Deposit rates may vary for other banks.
Lock in: 5 years
Risk: Guaranteed return
Maximum Investment: None*
Tax: On interest earned

** Tax benefit is only available on investments up to ₹1 lakh*

Equity Linked Savings Schemes (ELSS)
Return: 22.66% 3-Year annualised return as on 9/12/2011. Variable and market linked
Lock in: 3 years
Risk: Return not guaranteed
Maximum Investment: ₹1 lakh
Tax: Since the lock-in is three years, long-term capital gains tax is nil

Pension Funds
Return: 12.87% 3-Year annualised return as on 9/12/2011. Variable and market linked
Lock in: 3 years
Risk: Return not guaranteed
Maximum Investment: ₹1 lakh
Tax: Taxed as a debt fund

UTI Retirement Benefit Pension Fund and Templeton India Pension Plan are two such funds

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happy to know that the limit is no longer ₹70,000 but enhanced to ₹1 lakh.

In the case of National Savings Certificate (NSC), the rate is also hiked from 8 per cent to 8.4 per cent. The government has gone one step ahead and introduced a 10-year duration for NSC. The interest rate on a 10-year NSC will be 50 bps more than the benchmark and fetch 8.7 per cent.

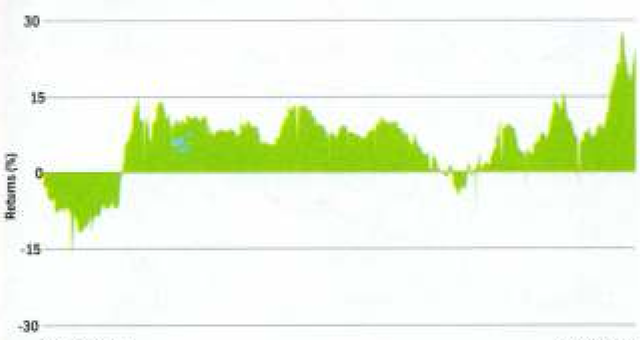
Under the DTC, equity mutual funds will not qualify for deduction under Section 80C. So what will happen to your existing investment? It is not going to fly away. In fact, you should make hay while the sun shines. As long as the tax benefit is available, use it. This is the only tax-saving instrument that is equity oriented and has the least number of years as the lock-in period. To add to it, it is probably the best time to enter such funds.

Equities are getting as bad a press as there possibly can be. It's now been more than three years since the stock markets have given any meaningful and sustained gains. What's more, with the shadow of slowing economic growth, declining corporate profits and the threat of economic doom emanating from Europe, it's hard to consider ELSS mutual funds as a serious alternative. But it is time to actually act contrary to instincts.

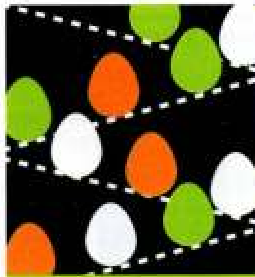
You will be investing with a three-year lock-in, so your time horizon is not a few months down the road. Investing in equity always makes sense when you do not need the money for a few years and when the markets are as beaten down and pessimistic as they are now. Sure, they could still decline sharply over the next few months, and most probably will, but the solution to that is cost-averaging.

Here's the best recipe for this year's tax-saving investments. Whatever amount you have left over after deductions so far, divided it by four. Invest each part in a good ELSS at a one-month gap over the next four months. This will give you a good average entry

How ELSS funds have delivered over the past 3 years



The above graph shows the daily average three-year annualised return delivered by tax planning funds over the past three years.



How to plan your investments under Section 80C

1) Take into account mandatory payments
   - Payment towards the principal amount of your home loan
   - Education fees towards your children's education
   - Premium paid on all life insurance policies towards yourself, your spouse and children
   - Premium paid on your Unit Linked Insurance Plan (ULIP)
   - Contribution towards your Employees Provident Fund (EPF)
2) From ₹1 lakh, deduct all of the above. The balance, if any, will tell you how much you need to invest in Section 80C instruments.
3) Once you max your limit of ₹1 lakh, you still have an additional window of a tax deduction up to ₹20,000 specifically in infrastructure bonds. These bonds are not issued by the government. Specific companies such as IFCI, Power Finance Corporation (PFC), Infrastructure Development Finance Company (IDFC) and L&T Infrastructure Finance Company (L&T Infrastructure) issue these bonds. Currently, they are available at 9 per cent per annum.

The chosen ones

We have selected and analysed seven of the best tax planning funds on the basis of their rating scores over three- and five-year periods

Fund	Market-cap tilt
Canara Robeco Tax Saver	Multi Cap
Fidelity Tax Advantage	Large & Mid Cap
Franklin Taxshield	Large & Mid Cap
HDFC Taxsaver	Multi Cap
ICICI Prudential Tax Saver	Multi Cap
Religare Tax Plan	Multi Cap
Taurus Tax Shield	Multi Cap

Capitalisation break-up of tax planning funds

point no matter what happens in the equity markets during the period.

Another point to note, do not opt for the dividend scheme. Normally, it is what we would recommend since the money is locked-in, but this time we suggest the growth options. Once the DTC comes into play, dividend from the funds will attract a Dividend Distribution Tax (DDT) of 5 per cent.

Should you invest in an ELSS now, you will get the benefits under Section 80C and the lock-in will still be three years. What will happen after DTC? You will not get this option again but your current investments will stay and the money you make will still be tax free.

Finally, there are just two options that the fund houses will resort to with regards to tax-saving schemes. Either they will eventually merge these schemes with existing equity diversified schemes. Or, they may keep them running as regular equity diversified funds without any lock-in or tax benefit. They would probably just change the name of the scheme to ensure that the word "tax" no longer features in them.

So if you are on the look-out for a fixed return instrument, you can consider PPF and NSC. Or maybe even the five-year deposits offered by banks or the post office. For those who have maxed the limit under Section 80C and would like to even tap into the ₹20,000 additional limit, they can lock their money at 9 per cent rates. But for the best long-term returns, we still suggest you give tax saving funds a shot, it may be your last chance. Once the DTC comes into play, the only way to save tax with equity instruments would be through the New Pension Scheme (NPS), where the money will be locked in till retirement. While the premium paid in Unit Linked Insurance Plans (ULIPs) also currently qualifies for a deduction under Section 80C, we did not mention it earlier. That's because we do not consider it to be a wise investment and advice against it. ■

The market cap exposure of tax-saving funds

Category of equity funds	Count of ELSS	Exposure to large-cap stocks taking into account the half-yearly portfolios over the past three years
Large Cap	2	>80%
Large & Mid Cap	18	>60% <80%
Multi Cap	14	>60% <40%
Mid & Small Cap	2	<40%

Large-cap stocks - Those which account for the top 70% of the market capitalisation of stocks listed on the BSE. The next 20% are mid-caps and the remaining 10% are small caps.

Those familiar with our classification of equity mutual funds would be aware that it is done on the basis of market cap exposure. When we come to this category of funds, since the classification is done purely on the basis of the tax benefit, there is no "one type" of fund here. In fact, the schemes that are classified as ELSS all have their own varying exposure to various market cap stocks.

What is most interesting is that just two funds fall in the 'Equity: Large Cap' category and the same number in the 'Equity: Mid & Small Cap' one. Ironically, if this classification was done at the end of 2007, when the bull market was on full throttle, most would have fallen in the 'Equity: Mid & Small Cap' category. It is the large-cap exposure post the 2008-crash that has pushed them in the 'Equity: Large & Mid Cap' slot.

The median weighted average market capitalisation of the funds in this category was ₹14,800 crore in December 2007. There were five funds in the category with an allocation of over 40 per cent to small caps. In fact, if we go back further in time to 2004, some of the funds like ICICI Prudential Tax Plan and Taurus Tax Shield looked like pure small-cap funds with over half the portfolio in such stocks.

Currently, Sahara Tax Gain is the only fund with an allocation of close to 20 per cent to small caps and has the lowest weighted average market capitalisation in the category of close to ₹14,789. Just one fund (Reliance Tax Saver) has an allocation of less than 50 per cent to large caps. The number of stocks held by funds in this category range from 14 (JP Morgan India Tax Advantage) to 80 (DSPBR Tax Saver).

Tax-saving funds

Fund	Rating	SIP Returns (%) 3 year	SIP Returns (%) 5 year	Trailing Returns (%) 1 year	Trailing Returns (%) 3 year	Trailing Returns (%) 5 year	Top 10 Stocks (%)	Total Stocks	Assets (₹ Cr)	Style Box	Performance Graph 2008 2009 2010 2011
Canara Robeco Equity Tax Saver	★★★★★	10.92	12.13	-12.27	33.07	12.52	34.22	52	302.14		
Fidelity Tax Advantage*	★★★★★	9.10	9.08	-15.53	28.17	9.85	41.75	65	1182.87		
Taurus Tax Shield	★★★★★	5.13	8.17	-18.69	27.28	12.25	49.66	43	68.35		
Franklin India Taxshield	★★★★	11.19	9.74	-9.47	27.20	9.15	43.32	49	803.51		
HDFC Taxsaver	★★★★	8.85	8.55	-17.90	30.47	6.67	45.12	38	3032.10		
ICICI Prudential Tax Plan	★★★★	9.56	8.60	-16.24	33.82	5.97	42.64	53	1259.35		
Religare Tax Plan	★★★★	9.17	-	-13.66	28.13	-	40.35	50	108.14		
Sahara Tax Gain	★★★★	6.89	8.64	-16.55	26.32	9.84	27.53	44	10.94		
Sundaram Taxsaver	★★★★	1.61	4.13	-19.18	19.17	7.26	40.57	47	1406.67		
Birla Sun Life Tax Relief 96	★★★	0.30	1.02	-23.47	24.22	2.94	41.16	54	1417.29		
DSPBR Tax Saver	★★★	3.02	-	-21.62	23.27	-	34.07	76	770.22		
HDFC LT Advantage	★★★	8.17	7.00	-18.63	27.90	5.91	66.00	21	884.40		
HSBC Tax Saver Equity	★★★	2.70	-	-20.09	20.90	-	47.43	34	218.18		
ING Tax Savings	★★★	9.23	4.42	-15.91	29.40	0.31	45.06	43	32.76		
Kotak Tax Saver	★★★	2.33	1.44	-19.90	21.01	2.86	41.05	61	467.47		
Magnum Taxgain	★★★	2.47	2.75	-17.52	22.61	3.86	35.47	60	4923.06		
Principal Personal Tax Saver*	★★★	-0.11	0.11	-22.93	21.55	3.58	39.08	47	519.48		
Reliance Tax Saver	★★★	4.97	5.55	-18.67	24.09	4.96	48.94	32	2026.56		
Tata Tax Saving	★★★	7.17	5.53	-13.16	25.12	5.10	41.17	41	130.48		
Baroda Pioneer ELSS 96	★★	-0.69	0.21	-21.50	20.81	1.51	56.83	43	20.44		
Birla Sun Life Tax Plan	★★	2.67	1.85	-15.50	21.01	2.01	44.15	47	135.12		
BNP Paribas Tax Advantage Plan	★★	7.29	2.75	-9.31	22.18	-0.72	34.71	52	55.85		
DWS Tax Saving	★★	-2.05	-1.16	-23.65	16.40	1.25	46.78	33	65.62		
L&T Tax Saver	★★	0.13	0.43	-23.61	23.66	-0.98	51.70	36	28.33		
UTI Equity Tax Savings*	★★	2.73	2.36	-16.03	19.81	2.30	43.33	47	475.47		
JM Tax Gain	★	-6.65	-	-24.44	12.39	-	58.15	21	44.44		
LIC Nomura MF Tax Plan	★	-1.62	-1.27	-19.62	16.43	-0.95	55.25	47	35.42		
Principal Tax Savings*	★	-2.39	-3.60	-24.23	16.33	-1.82	33.30	55	230.39		
Axis Long Term Equity	Not Rated	-	-	-7.43	-	-	40.94	41	126.31		
Bharti AXA Tax Advantage Eco	Not Rated	-	-	-18.45	-	-	50.62	43	36.01		
Bharti AXA Tax Advantage Reg	Not Rated	-	-	-18.64	-	-	50.62	43	36.01		
Edelweiss ELSS*	Not Rated	-	-	-15.44	-	-	35.10	56	4.69		
Escorts Tax Plan**	Not Rated	-10.24	-8.44	-32.34	7.59	-4.18	52.35	39	4.33		
IDFC Tax Advantage (ELSS)	Not Rated	-	-	-17.54	-	-	48.54	30	128.82		
JP Morgan India Tax Advantage	Not Rated	-	-	-15.98	-	-	54.31	-	3.99		
Quantum Tax Saving	Not Rated	-	-	-15.81	-	-	50.98	27	4.13		
Union KBC Tax Saver	Not Rated	-	-	-	-	-	-	-	-	-	-

Quarterly Performance: Top Quartile = (Among top 25% in the category) Second Quartile = (Among top 50-75% in the category) Third Quartile = (Among bottom 25-50% in the category) Bottom Quartile = (Among bottom 25% in the category)

The left-most bar in a series represents the fund's performance in the first quarter of a calendar year. Similarly, subsequent bars represent the fund's performance in 2nd, 3rd & last quarter of the calendar year

STYLE BOX

Funds marked in this colour are our recommended funds; All data as on November 30, 2011; *Portfolio data as on October 31, 2011, **Portfolio data as on September 30, 2011