

## Reasons of Investors' Preferences for ELSS (Equity Linked Saving Schemes) for Taxation Planning: A Quantitative Investigation

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### Abstract

The tax-saving season starts on April 1st for both salaried individuals as well as businessmen. It's crucial for investors to seek out tax-saving opportunities that not only provide exemptions but also generate tax-free income. With numerous of investment options available, selecting the right one can be difficult. Unfortunately, many investors tend to delay on tax planning. However, tax-saving is a genuine means to reduce tax liabilities, and all taxpayers should consider it to build their wealth. However, ELSS investments involve higher risks due to their equity exposure, making them suitable for investors with a high-risk tolerance. Tax-saving investments serve as an excellent way to diversify tax burdens and enhance wealth. Despite the abundance of options in the market, choosing the most suitable investment remains a challenge. A sample of 239 respondents was collected from different investors with different income level. The factors that identify the Reasons of Investors' Preferences for ELSS (Equity Linked Saving Schemes) for Taxation Planning are Tax Benefits, Lock-in Period, Potential for Capital Appreciation, and Systematic Investment Plans.

**Keywords:** Mutual fund, ELSS, Investor's behaviour, Investor's preference, tax saving

### Introduction

Investors opt for tax-saving mutual funds to alleviate their tax burdens, often favoring long-term investments. They typically prefer to monitor their fund's performance periodically rather than monthly. When making investment decisions, investors believe that Equity Linked Savings Schemes (ELSS) offer average returns aligned with their long-term financial goals. ELSS investments are perceived as riskier compared to other tax-saving options and are not expected to yield returns as high as bank fixed deposits. However, most respondents consider ELSS to be an appropriate tax-saving investment due to its liquidity and value the liquidity factor highly. The lock-in period of ELSS is seen as advantageous, as it encourages long-term investments with its relatively low lock-in requirement. Overall, investors express satisfaction with the performance of their ELSS investments (**Badrinath & Surulivel, 2024**). When Equity Linked Savings Schemes (ELSS) were introduced, investors initially received tax rebates under Section 88 of the Income Tax Act. With the dual objectives of wealth creation and tax reduction through tax-saving instruments, ELSS emerged as a viable option offering both benefits. As the mutual fund industry matures, it becomes crucial to comprehend investors' perceptions and preferences regarding ELSS compared to other tax-saving instruments in this evolving regime (**Sawant & Melo, 2022**). Mutual funds are increasingly becoming the preferred choice for investors due to their potential for better returns and flexibility. They

cater to small investors by offering options like Systematic Investment Plans (SIPs). Mutual funds are recognized as a vehicle for long-term wealth creation and also provide tax-saving schemes with shorter investment horizons tied to the stock market. Equity Linked Savings Schemes (ELSS) present an opportunity for capital appreciation through equity investments while simultaneously offering tax benefits. Additionally, the long-term capital gains from ELSS schemes are tax-efficient. Even during the lock-in period, dividend options for such funds enable capital gains (**Puranik & Dave, 2021**). The satisfaction level of mutual fund investors improves when mutual fund management adapts their strategies according to the demographic changes and needs of tax-saving investors. These factors significantly contribute to investor satisfaction and should be considered by management. Based on these findings, it's imperative for management to offer skill enhancement and comprehensive orientation programs to appeal more savings into tax-saving investment avenues. Furthermore, the variety of investors in terms of demographic factors can be combined into such programs. This approach aims to enhance participants' understanding of tax-deferred investment vehicles and cater to the specific needs of various investor demographics (**Reddy & Ram, 2022**). ELSS has proven to be advantageous by offering opportunities for capital accumulation along with tax benefits under Section 80(C) of the Income Tax Act, 1961. It stands out as a lucrative option for earning better returns, particularly with tax-free dividends for investors, as tax is deducted at the source. Additionally, combining ELSS with SIP enables investors to mitigate market fluctuations, making it an attractive option. ELSS is also beneficial for investors with limited knowledge, as it allows them to maximize returns while availing tax benefits (**Vinod, 2020**). Tax planning is an integral component of financial planning, aiming to reduce the tax burden on taxpayers. Efficient tax planning involves identifying sources of tax deductions and allocating investments to minimize tax liabilities. Tax exemptions, rebates, and allowances ensure that investments align with long-term goals. Mutual fund investments pool retail investors' funds and are managed by professional asset managers. Recognizing the importance of savings from retail investors, the Government of India introduced Equity Linked Savings Schemes (ELSS) to encourage and promote retail investor participation in mutual funds. Taxpayers' investment patterns in mutual funds often lean towards tax-saving ELSS schemes provided by mutual fund companies to benefit from tax deductions at the source of investment (**Dhandayuthapani & Katharbatsha, 2017**). ELSS Tax Saving Mutual Funds offer the potential for higher returns compared to other tax-saving instruments such as PPF, NPS, and Tax Saving FDs. However, they come with a longer lock-in period of three years, which restricts investors from withdrawing their investment before maturity. Early withdrawal may result in significant penalties. To safeguard investors' interests, some part of fund is saved as cash, which doesn't earn any interest but serves as compensation in case of premature withdrawals (**Narang et al. 2022**).

## Literature Review

**Rajitha (2023)** states that preferences of investors towards different investment options that vary based on individual factors like income and age of investors. Young investors are often ready to take on some level of risk, while some prioritize the safety of principal and investment returns. Every investor looks for options where their money is more secured as well as give moderate returns. Perception of investors play a significant part in their decisions of investment. Nowadays, investors are increasingly turning to avenues like mutual funds, bonds, shares, debentures, and other stock market products to achieve higher returns.

**Singal & Manrai (2018)** focused on comparing the ELSS offerings of public sector and private sector mutual funds within the capital market. The primary aim is to analyse and compare the ELSS schemes of both sectors and assess the market timing abilities of fund managers associated with ELSS. ELSS and similar schemes primarily invest in equity for long-term capital gains, featuring a minimum lock-in period of three years and tax advantages under "Section 88 of the Income Tax Act". Factors such as tax benefits, return potential, liquidity, low cost, and transparency serve as major motivators for retail investors to invest in mutual funds. Additionally, economies of scale play a role in motivating investors to a certain extent.

**Dwivedi & Khare (2023)** found that managing investments requires substantial financial and market knowledge, thorough analysis, and understanding of the various available avenues and their respective pros and cons. The preferences of investors are closely tied to several benefits including safety, uniform returns or dividends, tax advantages, and preparing for future contingencies. Despite the limitations inherent in sample size, this study effectively identifies investment patterns across different demographics such as age, gender, income, and marital status. Mutual fund firms gather funds from willing investors and invest them in the stock market. Similar to the stock market, mutual fund investments are exposed to various market risks but also offer potential profits.

**Sundari, Vidhyapriya, Venmathi (2016)** revealed that taxation concerns individuals for various reasons; while some aim to avoid taxes altogether, others seek to minimize their tax liability through legal means known as tax planning. Tax planning is a complex process involving various measures to reduce one's tax burden. With numerous investment options available, it's crucial to select the most suitable one. Those engaged in tax planning must be well-versed in the array of investment choices and how they can be utilized to achieve overall objectives. This includes understanding the process of making investments, as well as how to maintain and manage them. Additionally, it's essential to comprehend investors' expectations, perceptions of different products and investment avenues, and their current investment patterns to provide suitable solutions. Equity Linked Savings Scheme (ELSS) funds offer significant potential, high liquidity, and enhanced transparency for better performance. Accessing details about the fund's portfolio is straightforward. Moreover, mutual fund houses simplify the investment process, allowing for online investments if KYC requirements are met. Even new investors receive assistance, with fund houses facilitating document collection and guiding through the KYC screening process. ELSS funds carry market risks similar to other diversified funds, given their equity nature.

**Godhwani (2024)** studied that taxpayers seeking higher returns compared to traditional tax-saving avenues are drawn to mutual fund ELSS schemes. When compared to traditional tax-saving instruments, ELSS funds offer superior returns with a shorter lock-in period, making them an attractive option for wealth accumulation while saving taxes. Equity Linked Saving Schemes (ELSS) not only allow participation in equity markets but also provide tax benefits. These schemes offer tax rebates to investors as per the provisions of Indian tax laws. While tax planning may seem daunting at first, ELSS is a simple way to obtain tax saving while also benefiting from Indian equity markets. ELSS is a varied equity mutual fund eligible for tax exemption under "Section 80C of the Income Tax Act." In the current scenario, investors with surplus funds seek highly diversified instruments for better returns with lower risk, making mutual funds significant in the Indian capital market. Mutual funds present an efficient option for investors with limited finances.

**Singh (2022)** stated that ELSS, a mutual fund product, serves as a tax-saving tool for investors. Typically invested in the stock market, ELSS enables investors to capitalize on stock price appreciation, leveraging the potential of the market to their advantage. Equity Linked Saving Schemes (ELSS) offer tax benefits under section 80C while also facilitating capital appreciation through mutual fund investments. While ELSS presents an opportunity for tax-saving and capital growth, risk-averse investors may express concerns about its volatility, coupled with the mandatory three-year lock-in period. However, it's noteworthy that long-term capital gains from ELSS investments are tax-free. Additionally, dividends earned through ELSS plans remain tax-free in the hands of investors.

**Sahu (2016)** revealed that individuals often seek sources of income that can increase their incomes in a short timeframe, and diverse investment avenues offer appropriate avenues for a wide-ranging investor. Investment in equity funds, particularly at opportune moments, can prove to be a lucrative income source. While equity investments carry inherent risks, they typically yield better results compared to other alternatives. This study delves into the performance of a sample of ELSS mutual funds, which primarily invest in the stock market. ELSS funds' performance is closely tied to stock market movements, given their significant exposure to equities. Despite their inherent volatility, ELSS funds have a track record of delivering superior long-term returns compared to more conservative options, thanks to their focus on stocks which offer high potential returns albeit with higher volatility. Equity mutual funds, being predominantly traded on the stock market, are susceptible to market fluctuations, influencing their returns. Making sound financial decisions is paramount for investors to preserve and grow their savings effectively, opting for programs that offer optimal results. For risk-averse investors seeking safety without compromising returns, exploring options like Public Pension Funds could be beneficial. Additionally, investors with specific long-term financial goals, such as funding a wedding or a child's education, can consider targeted investment strategies. For those prioritizing tax planning alongside investment growth, ELSS presents a viable option, provided they are comfortable with the associated risks.

**Gahlot (2019)** found that the Equity Linked Saving Scheme (ELSS) falls under the category of equity mutual funds, where investments are eligible for tax deductions of up to Rs 1.5 lakh per fiscal year under section 80C of the Income Tax Act. ELSS funds allocate at least 80% of their Assets Under Management (AUM) towards equities and equity-related instruments. Investors have the option to invest either through Systematic Investment Plans (SIPs) or lump sum investments in ELSS. A mutual fund functions as a trust or a collective investment scheme wherein investors pool their resources to achieve a common financial objective. Key factors that attract investors to mutual funds include the potential for better returns, portfolio security, and tax benefits. Despite the benefits of mutual funds, many individuals possess only partial knowledge about them and may not be fully aware of their advantages and workings.

### Objective

For identifying “Reasons of Investors' Preferences for ELSS (Equity Linked Saving Schemes) for Taxation Planning”.

### Study’s Methodology

239 respondents are considered for this study which was collected from different investors with different income level. Random sampling method was used to collect data and examined by “Explanatory Factor Analysis” for results.

### Findings of the Study

Below table shows demographic details of participants it shows that 54.39% are male, and 45.61% are female participants. Regarding age of the respondents, 33.05% are between 26 to 30 years, 25.52% are 30 to 35 years, and 41.43% are above 35 years of age. About Income level, 35.56% are Less than 5 lacs, 29.71% are 5 lacs to 10 lacs, and 34.73% are More than 10 lacs.

#### Details of Participants

Variable	Participants	% age
<b>Gender of Participants</b>		
Male	130	54.39%
Female	109	45.61%
<b>Total</b>	<b>239</b>	<b>100</b>
<b>Age in years</b>		
26 to 30	79	33.05%
30 to 35	61	25.52%
Above 35	99	41.43%
<b>Total</b>	<b>239</b>	<b>100</b>
<b>Income Level</b>		
Less than 5 lacs	85	35.56%
5 lacs to 10 lacs	71	29.71%
More than 10 lacs	83	34.73%

<b>Total</b>	<b>239</b>	<b>100</b>
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**“Factor Analysis”****“KMO and Bartlett's Test”**

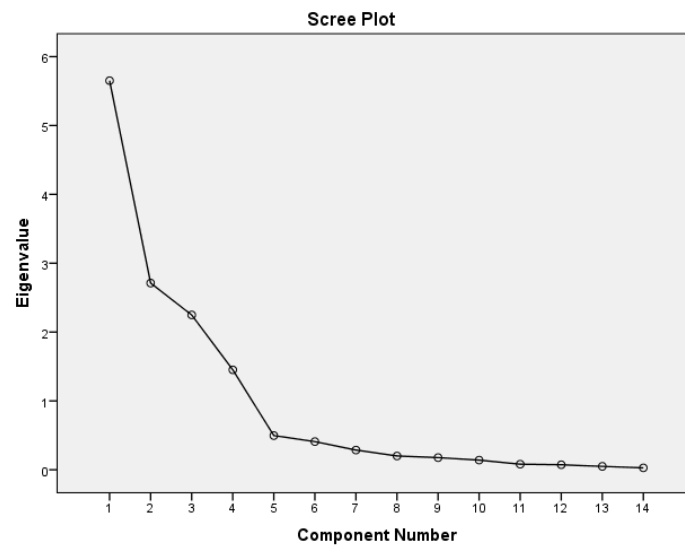
“Kaiser-Meyer-Olkin Measure of Sampling Adequacy”		.770
“Bartlett's Test of Sphericity”	“Approx. Chi-Square”	3712.263
	df	91
	Significance	.000

“KMO and Bartlett's Test”, value of KMO is .770

**“Total Variance Explained”**

“Component”	“Initial Eigenvalues”			“Rotation Sums of Squared Loadings”		
	“Total”	“% Of Variance”	“Cumulative %”	“Total”	“% Of Variance”	“Cumulative %”
1.	5.651	40.365	40.365	<b>3.700</b>	26.428	26.428
2.	2.711	19.366	59.731	<b>3.648</b>	26.056	52.484
3.	2.248	16.059	75.790	<b>2.390</b>	17.074	69.557
4.	1.451	10.367	86.158	<b>2.324</b>	16.600	<b>86.158</b>
5.	.496	3.545	89.702			
6.	.408	2.918	92.620			
7.	.286	2.044	94.664			
8.	.200	1.427	96.091			
9.	.176	1.259	97.350			
10.	.140	1.003	98.353			
11.	.081	.577	98.930			
12.	.072	.518	99.448			
13.	.049	.351	99.799			
14.	.028	.201	100.000			

All the four factors are making contribution in explaining total 86.158% of variance. The variance explained by Tax Benefits is 26.428%, Lock-in Period is 26.056%, Potential for Capital Appreciation is 17.074%, and Systematic Investment Plans is 16.600%.

**ScreePlot****“Rotated Component Matrix”**

“S. No.”	“Statements”	“Factor Loading”	“Factor Reliability”
	<b>Tax Benefits</b>		<b>.970</b>
1.	ELSS qualifies for tax deductions under Section 80C of the Income Tax Act, 1961 in India	.955	
2.	Offers a deduction of up to ₹1.5 lakh per financial year, which helps in reducing the taxable income	.948	
3.	ELSS provides an opportunity for capital appreciation through equity investments and offering tax benefits	.928	
4.	It is beneficial for investors with limited knowledge, allowing to maximize returns and tax benefits	.924	
	<b>Lock-in Period</b>		<b>.955</b>
1.	It has mandatory lock-in period of three years, which is shorter compared to other tax-saving instruments	.959	
2.	This feature is attractive who seek tax benefits without committing their funds for an extended period	.913	
3.	Lock-in period of ELSS is seen as advantageous, as it encourages long-term investments	.897	
4.	Even during the lock-in period, dividend options for such funds enable capital gains	.893	
	<b>Potential for Capital Appreciation</b>		<b>.867</b>

1.	Due to its equity-oriented nature, ELSS has the potential for capital appreciation over the long term	.889	
2.	ELSS are exposed to market risks, investors can benefit from higher returns	.844	
3.	Facilitating capital appreciation through mutual fund investments	.819	
	<b>Systematic Investment Plans</b>		<b>.838</b>
1.	It allows investors to invest through SIPs, enabling them to stagger their investments	.923	
2.	They cater to small investors by offering options like Systematic Investment Plans (SIPs)	.905	
3.	It gives option to invest either through Systematic Investment Plans or lump sum investments	.725	

#### Factors and the associated variables

The first factor of the study is Tax Benefits, the variables that falls under this factor are ELSS qualifies for tax deductions under Section 80C of the Income Tax Act, 1961 in India, offers a deduction of up to ₹1.5 lakh per financial year, which helps in reducing the taxable income, ELSS provides an opportunity for capital appreciation through equity investments and offering tax benefits, and Beneficial for investors with limited knowledge, allowing to maximize returns and tax benefits. Second factor is Lock-in Period, that variables under this factor are Mandatory lock-in period of three years, it is shorter compared to other tax-saving instruments, It is attractive who seek tax benefits without committing their funds for an extended period, Lock-in period of ELSS is seen as advantageous, as it encourages long-term investments, and Even during the lock-in period, dividend options for such funds enable capital gains. Potential for Capital Appreciation is the third factor, the variables under this factor are Due to its equity-oriented nature, ELSS has the potential for capital appreciation over the long term, ELSS are exposed to market risks, investors can benefit from higher returns, and Facilitating capital appreciation through mutual fund investments. Fourth and last factor is Systematic Investment Plans, the variables are Allows investors to invest through SIPs, enabling them to stagger their investments, cater to small investors by offering options like SIPs, and Option to invest either through Systematic Investment Plans or lump sum investments.

#### “Reliability Statistics”

“Cronbach's Alpha”	“Number of Items”
.875	14

“Total reliability” of 14 items includes variables for Reasons of Investors' Preferences for ELSS (Equity Linked Saving Schemes) for Taxation Planning is 0.875

#### Conclusion

In today's competitive investment landscape, investors are presented with a plethora of avenues, each with its own set of advantages and disadvantages. Before making investment decisions, individuals strive to weigh these pros and cons to find a suitable balance. Among these avenues, Mutual Funds emerge as the most fitting choice for the average individual. They offer the opportunity to invest in a diversified and professionally managed portfolio at a relatively low cost. Mutual Funds

serve as a platform for common investors to engage in the Indian capital market, benefitting from professional fund management regardless of the invested amount. The Indian mutual fund industry is experiencing rapid growth, evident from the increasing Assets Under Management (AUM) of various fund houses. Compared to direct stock investment, mutual fund investment entails lower risk, making it a safer option for risk-averse investors. The findings of such studies aid mutual fund companies in identifying areas for improvement and refining their marketing strategies. This understanding enables companies to innovate and develop new products tailored to investors' preferences. Tax-saving schemes, particularly popular among investors, have seen a surge in demand as individuals seek to leverage tax benefits under section 80C. Consequently, various Mutual Fund asset management companies are introducing their own tax-saving schemes to meet this growing demand.

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