A PLAIN-LANGUAGE INVESTOR'S GUIDE

ETFs vs Mutual Funds

VS

Understanding every difference that matters, who should choose what, the key factors to weigh, and the pros and cons of each — explained simply

Structure • Costs • Taxation (updated for FY 2025-26) • Liquidity • Suitability • Investment Factors

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Prepared for general investor education | Reflects regulatory and tax provisions applicable as of mid-2026

1 Introduction

Mutual Funds (MFs) and Exchange Traded Funds (ETFs) are often spoken of in the same breath, and it is easy to see why — both pool money from many investors and put it into a basket of stocks, bonds, or other assets, both are regulated by SEBI, and both are managed by professional Asset Management Companies (AMCs). Yet beneath this similarity lie real, practical differences in how you buy them, what they cost, how they are taxed, and how much hand-holding they need from you as an investor.

This guide lays out every meaningful difference between the two, without skipping the fine print, so that you can decide — with full clarity — which one fits your particular need, or how to use both together in a single portfolio, which is what most seasoned investors eventually do.

What is a Mutual Fund?

Mutual Fund — In Short

A Mutual Fund collects money from many investors and invests it in stocks, bonds, or a mix of both, as per the fund's stated objective. You buy and sell units directly with the fund house (AMC) at a price called the Net Asset Value (NAV), declared once at the end of each business day. You do not need a demat account to invest in regular mutual funds.

ETF — In Short

An Exchange Traded Fund is also a pooled investment, usually built to mirror an index such as the Nifty 50, Sensex, a sector, gold, silver, or a bond index. Unlike a mutual fund, its units are listed and traded on the stock exchange throughout market hours, just like shares of a company. You need a demat and trading account to buy or sell an ETF.

Why This Comparison Matters Today

India's mutual fund industry has grown to an Assets Under Management (AUM) of roughly ₹82 lakh crore as of February 2026, while ETF assets crossed ₹10 lakh crore in 2025 — a category that barely existed for retail investors fifteen years ago. With SEBI tightening expense-ratio rules from April 2026 and capital gains tax rules having changed materially after the July 2024 Budget, the cost and tax math between ETFs and MFs has shifted meaningfully. An informed choice today is not the same as an informed choice five years ago, which is exactly why this guide has been freshly written.

2 Point-by-Point Differences

Factor	Mutual Fund	ETF
Trading Mechanism	Bought and sold directly with the AMC / registrar (or via a distributor / app); not traded on a stock exchange.	Bought and sold on a stock exchange (NSE/BSE) through a broker, exactly like a company's share.
Pricing	Transacted at NAV, calculated and declared once at the end of each trading day. You do not know the exact price at the moment you place the order.	Price changes continuously during market hours based on real demand and supply; you see and lock in the price the moment you transact.
Demat Account	Not required for regular mutual fund units (though folios can optionally be held in demat form).	Mandatory — along with a trading account, since units exist only in dematerialised form.
Minimum Investment	Very low entry point; SIPs can start from as little as ₹100–₹500 per month.	Price of one unit (can range from under ₹50 to a few thousand rupees) plus brokerage; you cannot buy a fraction of a unit.
SIP Facility	Well-established, automated SIP/STP/SWP facilities directly with the AMC — fully hands-off once set up.	No default SIP with the AMC; some brokers now offer a manual or semi-automated recurring order facility, but it is less standardised and less widely available.
Liquidity Source	The AMC itself stands ready to redeem units at NAV — guaranteed liquidity (subject to exit load, if any).	Depends on buyers and sellers being present on the exchange at that moment, supported by designated market makers; thinly traded ETFs can have wide bid-ask spreads.
Premium / Discount to NAV	Not applicable — you always transact at the actual NAV.	Can trade slightly above (premium) or below (discount) its indicative NAV (iNAV) during the day, especially in low-volume ETFs.
Management Style	Available in both active (fund manager picks stocks to beat the benchmark) and passive (index-tracking) varieties.	Predominantly passive, built to replicate an index; actively managed ETFs are only just beginning to emerge globally and remain rare in India.
Choice / Variety	Very wide universe — equity (large/mid/small-cap, sectoral, thematic), debt, hybrid, solution-oriented, international, and more.	Narrower set, concentrated in broad index ETFs (Nifty, Sensex), sector/thematic indices, gold, silver, debt/bond ETFs, and a few international feeder ETFs.

2 Point-by-Point Differences (continued)

Factor	Mutual Fund	ETF
Total Expense Ratio (TER)	Generally higher, especially in regular plans (which embed distributor commission). Direct plans narrow the gap considerably.	Usually the lowest-cost option available — direct-plan index funds and ETFs alike often carry a TER below 0.10%, since there is no distributor commission and minimal active management cost.
Brokerage / Demat Charges	None — no brokerage or annual demat maintenance charge applies.	Brokerage is charged on every buy/sell order, plus annual demat account maintenance charges apply — a real, recurring cost to factor in.
Entry / Exit Load	Entry load is abolished industry-wide; exit load may apply if redeemed before a specified period (commonly within 1 year for equity funds).	No entry or exit load charged by the AMC; you only pay brokerage and applicable statutory charges on the exchange transaction.
Tracking Error	Applicable only to passive/index mutual funds; actively managed funds are not measured this way.	A key metric for every ETF — measures how closely the ETF's returns mirror its benchmark index; lower is better.
Portfolio Transparency	Full portfolio holdings disclosed monthly (and a simplified factsheet more frequently).	Underlying basket and indicative NAV (iNAV) are published in near real-time through the trading day — marginally more transparent.
Intraday Flexibility	Not possible — only one transaction price (NAV) per day, you cannot time an intraday move.	Full flexibility — limit orders, stop-loss orders, and intraday buying/selling are all possible, just like trading a stock.
Dividend / IDCW Option	Growth and IDCW (Income Distribution cum Capital Withdrawal) options widely available, along with automated reinvestment.	Most ETFs follow the growth structure by default; a few may offer IDCW, but reinvestment is not automatic and has to be done manually by buying more units.
Systematic Withdrawal (SWP)	A well-established, automated facility — ideal for retirees needing a regular monthly payout.	No standard SWP facility; withdrawals require manually selling units on the exchange each time.
Regulatory Oversight	Regulated by SEBI under the SEBI (Mutual Funds) Regulations, 1996; industry body — AMFI.	Also regulated by SEBI, with the additional oversight of the stock exchanges (NSE/BSE) on which the units are listed.

3 Taxation — The Most Misunderstood Difference

This is the area where investors make the most costly mistakes, simply because the rules changed significantly after the Union Budget of July 2024, with further fine-tuning effective FY 2025-26. Here is the position as it currently stands.

Category	Short-Term Capital Gains (STCG)	Long-Term Capital Gains (LTCG)
Equity-oriented MF / Equity ETF (>65% in domestic equity)	Held ≤ 12 months: taxed flat at **20%** under Section 111A.	Held > 12 months: taxed at **12.5%** (no indexation) on gains exceeding **₹1.25 lakh** in a financial year; gains up to that threshold are tax-free.
Debt-oriented MF / Debt ETF (>65% in debt & money market, bought after 1-Apr-2023)	Taxed entirely at your applicable income-tax slab rate, regardless of how long you hold the units — there is no separate long-term concession (Section 50AA).	
Gold / Silver ETF (no longer covered under Sec 50AA from FY 2025-26)	Held ≤ 12 months: taxed at slab rate.	Held > 12 months: taxed at **12.5%** without indexation; the ₹1.25 lakh exemption does **not** apply here (that is only for equity-oriented funds).
International ETF / Fund (also excluded from Sec 50AA from FY 2025-26)	Held ≤ 12 months: taxed at slab rate.	Held > 12 months: taxed at **12.5%** without indexation, for international ETFs listed on Indian exchanges.

Other Tax-Related Charges

- **Securities Transaction Tax (STT):** Applies only to equity-oriented funds — at the rate of 0.001% on the sale/redemption value, whether you redeem mutual fund units with the AMC or sell ETF units on the exchange. Debt funds, gold ETFs, and silver ETFs do not attract STT.
- **Stamp Duty:** Mutual fund purchases (lumpsum, SIP, STP, or switch-in) attract stamp duty of 0.005% of the amount invested; transfer of units between demat accounts attracts 0.015%. ETF purchases on the exchange attract stamp duty at rates applicable to delivery-based equity transactions.
- **IDCW / Dividend Taxation:** Since the Dividend Distribution Tax was abolished in the 2020 Budget, any IDCW payout — from either an MF or an ETF — is added to your taxable income and taxed at your slab rate.
- **GST on Expense Ratio:** Continues to apply on the management-fee component of TER for both MFs and ETFs.

Quick Note on Indexation

The benefit of indexation (adjusting your purchase cost for inflation before computing LTCG) has been removed for units purchased on or after 23 July 2024, across both mutual funds and ETFs. This was one of the more significant — and less publicised — changes from the July 2024 Budget.

4 Pros and Cons of ETFs

✓ Advantages

- Among the lowest-cost investment vehicles available, with TER often under 0.10%.
- Real-time pricing gives full control over the exact price at which you buy or sell.
- No exit load and no lock-in (other than the standard T+1 settlement) in most ETFs.
- High transparency — underlying basket and iNAV visible throughout the trading day.
- True, low-bias passive replication of an index, free of fund-manager judgement calls.
- Useful for tactical or short-term allocation shifts due to intraday liquidity.
- No distributor commission embedded — what you see in the TER is essentially the cost.

✗ Disadvantages

- Mandatory demat and trading account, with associated annual maintenance and brokerage charges.
- No default SIP discipline — requires the investor to actively place orders, increasing the chance of irregular or emotion-driven investing.
- Liquidity risk in low-volume ETFs — wide bid-ask spreads can quietly erode returns.
- Can trade at a premium or discount to actual NAV, particularly during volatile sessions.
- Very limited choice of actively managed strategies; almost entirely passive products.
- No automated SWP — retirees seeking steady payouts must sell units manually each time.
- Requires a degree of market awareness and hands-on monitoring that not every investor wants.

5 Pros and Cons of Mutual Funds

✓ Advantages

- No demat account needed — simple, paperwork-light entry for first-time investors.
- Automated SIP, STP, and SWP facilities build investing discipline without effort.
- Enormous variety — active and passive, equity, debt, hybrid, solution-oriented, sectoral, and international — to match any goal or risk appetite.
- Professional active management gives a genuine chance of beating the benchmark, not just matching it.
- Single end-of-day NAV removes intraday price stress and impulsive trading temptation.
- Very low minimum investment, making it accessible to nearly every income level.
- Strong, well-established investor grievance redressal mechanism through AMFI and SEBI.

✗ Disadvantages

- Regular plans carry distributor commission, which quietly raises the TER and dents long-term returns.
- Active funds carry fund-manager risk — performance depends on the manager's skill and can lag the benchmark in weaker years.
- Exit load may apply on early redemption, typically within the first year.
- Only one transaction price (NAV) per day — no ability to time an intraday move.
- Generally higher expense ratio than a comparable ETF, even on direct plans in some active categories.
- Portfolio holdings disclosed only monthly, somewhat less frequent than an ETF's real-time transparency.
- Redemption proceeds can take 1–3 working days to actually reach your bank account.

6 Who Should Choose What?

There is no single "better" product — the right choice depends entirely on your circumstances, habits, and how much time you want to spend monitoring your investments.

Investor Profile	Better Suited To	Why
First-time / beginner investor	**Mutual Fund**	No demat account hassle, low minimum, guided SIP discipline.
Busy professional with little time to track markets	**Mutual Fund (SIP)**	Fully automated; no need to watch intraday prices.
Cost-conscious investor already holding a demat account	**ETF**	Lowest TER available; ideal for long-term, low-cost index exposure.
Active trader / tactical allocator	**ETF**	Intraday liquidity, limit orders, and stop-losses suit a trading approach.
Investor seeking to beat the market, not just match it	**Active Mutual Fund**	Most ETFs are passive; active stock-picking is a mutual fund domain.
Investor wanting very small, regular monthly investments	**Mutual Fund (SIP)**	SIPs start from ₹100–₹500; ETFs need at least one full unit's price each time.
Gold/commodity exposure seeker without a demat account	**Gold Mutual Fund (FoF)**	Gives the same gold-price exposure as a Gold ETF without needing demat.
Gold/commodity exposure seeker with a demat account	**Gold ETF**	Lower cost and easier exit on the exchange compared to a Gold FoF.
Retiree needing a steady monthly payout	**Mutual Fund (SWP)**	Automated systematic withdrawal is well-established only in mutual funds.
Large lump-sum, long-term, set-and-forget investor	**Either**	A low-cost index fund and an equivalent ETF are economically near-identical here.

7 Factors to Consider Before Investing in an ETF

- **Expense Ratio:** Compare the TER across all ETFs tracking the same benchmark — even a 0.05% difference compounds meaningfully over the long term.
- **Tracking Error and Tracking Difference:** A lower tracking error means the ETF is doing its one job — mirroring the index — efficiently. Always check this in the fund's factsheet.
- **Liquidity and Trading Volume:** Look at the average daily traded volume and the bid-ask spread. An ETF with poor liquidity can cost you more on entry/exit than its low TER would suggest.
- **AUM Size:** Larger ETFs generally attract more market-maker support, translating into tighter spreads and better liquidity.
- **Premium/Discount to iNAV:** Check the ETF's live indicative NAV before placing an order, especially during volatile market sessions.
- **Brokerage and Demat Costs:** Factor in per-transaction brokerage and annual demat maintenance charges — these are real, recurring costs absent in mutual funds.
- **Suitability of the Underlying Index:** Make sure the index the ETF tracks actually matches your investment goal — a sectoral or thematic ETF carries concentration risk that a broad-market ETF does not.
- **Tax Category:** Know whether the ETF is equity-oriented, debt-oriented, gold/silver, or international, since each carries a different tax treatment, as detailed earlier in this guide.
- **Need for Active Monitoring:** Be honest about whether you have the time and inclination to place orders yourself, since ETFs do not offer the hands-off SIP experience by default.

8 Factors to Consider Before Investing in a Mutual Fund

- **Fund Category and Objective:** Match the fund's category — large-cap, mid-cap, debt, hybrid, sectoral, and so on — to your specific financial goal and time horizon.
- **Risk Profile (Riskometer):** Every scheme carries a SEBI-mandated riskometer; ensure it aligns with your own risk appetite before investing.
- **Direct vs Regular Plan:** A direct plan carries a meaningfully lower expense ratio than a regular plan over the long run, since it excludes distributor commission.
- **Expense Ratio:** Compare TER within the same category and plan type (direct vs direct, regular vs regular) for a fair comparison.
- **Fund Manager Track Record:** For actively managed funds, the manager's consistency across market cycles matters more than a single good year.
- **Past Performance vs Benchmark:** Useful context, but never a guarantee — always check performance against both the benchmark and category peers over multiple time frames.
- **Exit Load and Lock-in:** Note any exit load period, and remember that tax-saving ELSS funds carry a mandatory 3-year lock-in.
- **AUM and Fund House Pedigree:** Very large or very small AUM can each bring its own challenges (liquidity constraints at the small end, agility constraints at the large end).
- **Portfolio Concentration and Overlap:** If you hold multiple funds, check for overlapping stocks to avoid unintentionally concentrated exposure.
- **SIP vs Lump Sum Suitability:** Choose based on your cash-flow pattern and market timing comfort — SIP suits regular income, lump sum suits windfall amounts with a long horizon.

9 Latest Regulatory and Tax Updates (2024–2026)

1. SEBI's New Expense Ratio Framework — Effective 1 April 2026

SEBI has unbundled the Total Expense Ratio into three distinct parts: the Base Expense Ratio (BER — the AMC's actual management fee), brokerage and transaction costs (now disclosed separately), and statutory charges (GST, STT, CTT, stamp duty, and exchange/SEBI charges — now moved entirely out of the TER calculation). Maximum BER caps have also been reduced across AUM slabs, by up to 15 basis points in some categories — for instance, the highest BER for open-ended equity schemes with AUM below ₹500 crore has been cut from 2.25% to 2.10%. This is intended to bring greater transparency and a like-for-like comparison of true management costs across schemes.

2. Capital Gains Tax Overhaul — Union Budget, July 2024 (applicable FY 2025-26 onward)

Equity-oriented STCG rose from 15% to 20%; equity-oriented LTCG rose from 10% to 12.5%, though the annual tax-free exemption was simultaneously raised from ₹1 lakh to ₹1.25 lakh. Indexation benefit was withdrawn for units purchased on or after 23 July 2024. Holding periods were also standardised — 12 months for listed securities including equity ETFs, gold ETFs, and silver ETFs.

3. Narrowing of Section 50AA — Effective FY 2025-26

The "specified mutual fund" deeming provision (which forces short-term tax treatment regardless of holding period) now applies only to funds investing more than 65% in debt and money-market instruments. Gold ETFs and international ETFs/funds, which were earlier inadvertently caught under this rule, are now excluded and instead follow the standard listed-security holding-period rules.

4. Continued Growth of the ETF Category

ETF assets in India crossed ₹10 lakh crore during 2025, helped significantly by sustained EPFO allocations into equity ETFs and growing retail awareness of low-cost index investing. The overall mutual fund industry, in parallel, has grown to roughly ₹82 lakh crore in AUM as of February 2026 — both categories continue to expand, not compete each other out.

10 Conclusion

ETFs and Mutual Funds are not really rivals fighting for the same seat in your portfolio — they are two different tools designed for slightly different jobs. If you want the lowest possible cost, real-time pricing, and you are already comfortable operating a demat account, an ETF tracking a broad index can be a very efficient core holding. If you want the discipline of automated SIPs, the option of professional active management, systematic withdrawal in retirement, and a far wider menu of fund categories, a mutual fund remains the more practical everyday vehicle for most Indian investors.

In practice, a great many well-built portfolios use both — a mutual fund SIP for disciplined monthly accumulation, alongside an ETF for a low-cost, liquid, tactical sleeve. The "right" answer is rarely either-or; it is choosing the right tool for each specific goal, and reviewing that choice periodically as your needs, and the rules, continue to evolve.

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