How are gains from F&O to be taxed and declared in ITR

They are considered non-speculative business gains and taxed at the normal rates applicable to the taxpayer

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Filing income tax returns is easy if you have income only from salary and bank interest. But many taxpayers also have income from other sources, including gains from trading in futures and options (F&O) . Gains from F&O are not considered capital gains but business income. As these are considered non-speculative business gains, income tax is levied according to the applicable tax slab rates.

There are two ways to compute income from F&O trading:

- Normal system of computation:
  Income = sales – purchase – other expenses – depreciation
- Presumptive system of computation:
  Income = assumed percentage of sales

Normal system of taxation

This can be explained with an example.

During 2017-18, Mr A traded in Nifty many times. His purchases were worth ₹70 lakh and sales worth ₹80 lakh.
On the face of it, the income of Mr A would be: ₹80 lakh – ₹70 lakh = ₹10 lakh
But he also incurred several expenses related to this business, including:

- Subscription plan for receiving stock market tips: **₹3,000**
- Telephone and Internet bills: **₹20,000**
- Salary paid to employee(s): **₹2 lakh**
- Fee to CA for filing return: **₹10,000**
- Other business expenses: **₹15,000**

The total expenses were **₹2.48 lakh**
In addition, the depreciation on assets such as car, office furniture and computer during the year was **₹1.25 lakh.**
So, the total income of Mr A from the trading business would be computed as follows: ₹80 lakh – ₹70 lakh – ₹2.48 lakh – ₹1.25 lakh = ₹6.27 lakh

Under this system, the income is computed on actual basis and the taxpayer is required to maintain a record and invoice for each and every expense made. Moreover, he is also required to maintain all the books of accounts, profit and loss account as well as the balance sheet.

It can become very difficult for a small business owner to maintain so many records and to keep a copy of all the invoices.

Therefore, for small traders there is another option wherein no records are required to be maintained and the tax is to be paid on an assumed basis. This scheme is called presumptive tax and is explained below.

Presumptive taxation

Under the presumptive scheme of taxation, the law gives the small traders an option to declare his income as a percentage of total turnover.

The small trader can disclose his income at any level above 6% of turnover. Earlier, the minimum required to be disclosed was 8% but this was reduced to 6% from 2016-17 onwards. As the payment is always received in banks in case of F&O transactions, they can disclose the income as 6% of turnover.

In case the small trader feels that his income is less than 6%, he would have to shift to the normal scheme of taxation and prepare all books of accounts and keep copies of all invoices.

The presumptive scheme of tax is only applicable to traders whose annual turnover is less than ₹2 crore.

However, in case of F&O trading, as the value of contracts traded is huge and the manner of computation is a bit different.

Computation of turnover

In case of F&O transactions, the total of all contracts sold is not considered as the total turnover. The turnover is computed by taking into account the total of all favourable and unfavourable trades. This can be explained with the help of the following example:

Mr B enters into two transactions during the year.
He purchased one lot of Nifty for **₹8 lakh** and sold the same for **₹8.5** lakh, thereby earning a profit of **₹50,000**.
He purchased one lot of Reliance Industries for **₹9.5 lakh** and sold for **₹9.4 lakh**, thereby incurring a loss of **₹10,000**.
In the above case, the total turnover would be considered as **₹60,000**.

Which system is better?

The normal scheme of taxation may turn out to be better in some cases whereas presumptive scheme of taxation may turn out to be better in others. It actually depends on the trader and he should decide which system works best for him.

What to do about losses

F&O trading is a risky business which may result in losses as well. In case a person incurs a loss from trading, it can be set-off against any other income of that year (except salary income).

In case the person is unable to set-off this loss, the loss can be carried forward for up to eight financial years and set-off against business income only.

It is important to note that F&O losses can be set off against other incomes (except salary) in the financial year in which the loss was incurred. However, if this loss is carried forward to future years, it can only be set-off against business income of that year.

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