

# **Futures & Options**

## **Tax, Accounting & Audit Issues Version 2.0**



**CA. PRAMOD JAIN**

**B. COM (H), FCA, FCS, FCMA, LL.B, DISA, MIMA, IP**

### **Namaste**

Lots of queries and issues have been raised on taxation, accounting and audit of Futures and Options transactions. A small note was prepared for the benefit of all, containing few specific issues including certain common questions shared with me over a couple of years which was published on 18<sup>th</sup> January 2022. Thereafter some changes were made in the definition of turnover by ICAI through its Guidance Note on Audit under section 44AB of the Income-Tax Act, 1961 – AY 2022-23. Considering the same it was thought that the document be revised as version 2.0.

### **Head of Income under which F&O transactions are taxable**

According to Proviso (d) and (e) of Section 43(5) of the Income Tax Act, 1961 trading in derivatives of the Securities carried out in a recognised stock exchange and trading in commodity derivatives carried out in a recognised stock exchange, respectively are not speculative transactions.

Hence, trading in Futures and Options being derivatives would not be a speculative business but a normal business income, which could either be a net gain or net loss and taxable under the head ‘Profits and Gains from Business’.

However, according to section 2(14)(b) of the Income Tax Act, 1961 any securities held by a Foreign Institutional Investor (FII) which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 is a capital asset. According to section 2(i) of the Securities and Exchange Board of India Act, 1992 “securities” has the meaning assigned to it in section 2 of the Securities Contracts (Regulation) Act, 1956 and as per section 2(h)(ia) of the Securities Contracts (Regulation) Act, 1956 securities include derivatives. Hence for FII derivatives being capital asset, any gain thereof would be taxable under the head ‘Capital Gains’.

### **Determination of Turnover**

In case, derivatives are taxable under the head ‘Profits and Gains from Business’, the method for determination of turnover is not provided under the Income Tax Act, 1961. However, as per generally accepted accounting practice and as per ICAI Guidance Note on Tax Audit revised for AY 2022-23, it should be as follows:

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- The total of favourable and unfavourable differences (Profit/Loss) shall be taken as turnover (In other words, all the differences, whether positive or negative are aggregated for calculating the turnover).
- Premium received on sale of options is also to be included in turnover. However, where the premium received is included for determining net profit for transactions, the same should not be separately included.
- In respect of any reverse trades entered, the difference thereon, should also form part of the turnover.

Example of calculation of Turnover of Futures:

<b>Future</b>	<b>Units</b>	<b>Buying Rate</b>	<b>Selling Rate</b>	<b>Total Sell Value</b>	<b>Total Buy Value</b>	<b>Gain / Loss</b>
<b>(A)</b>	<b>(B)</b>	<b>(C)</b>	<b>(D)</b>	<b>(E = B x D)</b>	<b>(F = B x C)</b>	<b>(G)</b>
Index A	75	18000	17100	Rs. 12,82,500	Rs. 13,50,000	Rs. - 67,500
Company B	6750	240	260	Rs. 17,55,000	Rs. 16,20,000	Rs. 1,35,000
Index C	100	38000	38000	Rs. 38,00,000	Rs. 38,00,000	Rs. 0
<b>Total Turnover</b>						<b>Rs. 2,02,500</b>

Example of calculation of Turnover of Options:

<b>Options</b>	<b>Units</b>	<b>Buying Rate</b>	<b>Selling Rate</b>	<b>Gain / Loss</b>	<b>Premium Received</b>	<b>Turnover</b>
<b>(A)</b>	<b>(B)</b>	<b>(C)</b>	<b>(D)</b>	<b>[E= (B) x (D-C)]</b>	<b>(F= D x B)</b>	<b>(G)</b>
Index A XX CE	100	300	210	Rs. -9,000	Rs. 21,000	Rs. 9,000
Company B XX PE	500	0	70	Rs. 35000	Rs. 35,000	Rs. 35,000
Index C XX CE	125	348	400	Rs. 6,500	Rs. 50,000	Rs. 6,500
<b>Total Turnover</b>						<b>Rs. 50,500</b>

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### **Accounting & Filing of financial statements in ITR**

Accounting of gains or losses in Futures & Options may be done gain-wise and loss-wise only. It has been also explained in the Tax Audit Guidance Note (Revised AY 2022-23) that though the contract notes are issued for the full value of the underlined shares or securities or commodities purchased or sold out, but entries in books of accounts are made only for the differences.

For example, in the example given in this document. F&O gain / loss account should be created and loss of Rs. 67500/- and gain of Rs. 135000/- should be entered in this account. It is the choice of the assessee to have a single account for gain and loss or separate account for gain and separate account for loss.

While filling the data in ITR in the Profit & Loss Account, assessee should fill the loss or gain accordingly, and nothing should be filled in the column of turnover. This is so, as the determination of turnover is only for the purpose of applicability of audit, TDS or any other similar purpose. Balance Sheet of only the F & O business should be filled in business head of the ITR.

### **Audit**

Audit under Income Tax Act would be required only if the business is covered under any of the clauses of section 44AB.

In case an assessee has no other business activity, then audit in case of Futures & Options would be required only where his turnover (as determined above in this document) exceeds Rs. 10 Crores in a financial year. This is so, as transactions in F&O are always through proper banking channels mainly online through RTGS / NEFT / IMPS, etc. hence as per proviso to section 44AB(a), the limit for getting the audit done would be Rs. 10 Crores.

### **Few commonly asked questions**

Below are few questions, which have been commonly asked:

<b>S. No.</b>	<b>Question</b>	<b>Answer</b>
1	F&O Turnover is Rs. 3 Crores in AY 2023-24, is tax audit	No, as there being no cash transactions, the limit for tax audit is Rs. 10 Crores.

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	required?	
2	F&O Turnover is Rs. 80 Lacs & there is a net loss from it, is tax audit required?	No, as the assessee never availed s. 44AD earlier, hence provisions of s. 44AB(e) are not applicable.
3	Assessee being salaried employee who has no other income, F&O loss is disallowed by CPC, why?	This is so as under section 71(2A) loss from business is not allowed to be set-off against salary income.
4	Salaried Individual, having F&O loss, which ITR would be filed?	ITR -3, filing the profit & loss and balance sheet of F&O business.
5	Can an individual claim benefit of s. 44AD in F&O trading?	Yes, there is no restriction, however, disclose the actual profits which may be more than 6%.
6	Can an assessee claim expenses against F&O gains?	Yes, actual expenses can be claimed which would include STT, brokerage, cess, etc.

I hope this document is of use to you. I thank *CA. Shreya Jain* and *Mr. Jatin Arora* in assisting me to compile the original document. Your suggestions and comments would be highly appreciated.

Best Regards

**CA. PRAMOD JAIN**

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(Disclaimer: Though full efforts have been made to state the interpretations correctly, yet the author is not responsible / liable for any loss or damage caused to anyone due to any mistake / error / omission)

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### **ABOUT CA. PRAMOD JAIN**

He is a commerce graduate [B. Com (H)] from Shri Ram College of Commerce (SRCC). He is a fellow member of the Institute of Chartered Accountants of India (FCA). He is a fellow member of the Institute of Companies Secretaries of India (FCS). He is a fellow member of the Institute of Cost Accountants of India (FCMA). He is a Bachelor of Law (LL.B). He has qualified Information System Auditor [DISA (ICAI)]. He is also a member of All India Management Association (MIMA). He is also an Insolvency Professional (IP). He has also passed the Proficiency Self-Assessment Test for Independent Director's Databank. He has passed certification course NCFM of National Stock Exchange of India (NSE). He has also done certification course CAAT of ICAI. He has also done post qualification certificate course on Valuation of ICAI.

He is elected as Central Council Member of ICAI for the period 2019 to 2022 and from 2022 to 2025. Apart from being member in more than 25 committees / groups / directorates of ICAI, and other Bodies he is / was:

- Chairman of Accounting Standards Board (ASB) of ICAI for Year 2022-23 and 2023-24
- Convenor - Members & Students (Grievances Handling & e-Sahayata) Directorate for 2023-24
- Chairman of Accounting & Finance Services Sectional Committee SSD-12 under the Services Sector Division Council (SSDC) of Bureau of Indian Standards (BIS) for 2023-24
- Chairman of Expert Advisory Committee (EAC) of ICAI for Year 2022-23
- Co-Chairman of Corporate Affairs Committee of PHDCCI for the year 2022-23
- Chairman of Committee on International Taxation (CITAX) of ICAI for Year 2021-22
- Chairman of Taxation Audit Quality Review Board (TAQRB) of ICAI for the year 2021-22.
- Member of Quality Review Board (QRB) for 3 years from 2020 to 2023.
- Member of SME Implementation Group (SMEIG) of IFRS Foundation, UK from 2023 to 2026.
- Chairman of Valuation Standards Board (VSB) of ICAI for the year 2020-21.
- Chairman of CSR Committee of ICAI for year 2020-21.
- Vice-Chairman of Committee on MSME & Start-up of ICAI for the year 2021-22.
- Vice-Chairman of Women Members Empowerment Committee (WMEC) of ICAI for 2021-22.
- Vice-Chairman of Direct Tax Committee (DTC) of ICAI for year 2019-20 and 2020-21.
- Vice-Chairman of Committee on International Taxation (CITAX) of ICAI for Year 2019-20.
- Member of ICAI Disciplinary Committee for the year 2020-21.

He is the conceptualizer of the portal [www.expertspanel.in](http://www.expertspanel.in) which is a one stop solution for all professional queries which has given more than 35000 answers since its launch in mid of year 2018.

He has delivered more than 1600 lectures and articles on various topics of Income Tax, Corporate Laws, LLP, Audits, Peer Review, Quality Review, etc. at more than 200 forums throughout the country. Most of his presentations and articles since 2013 are available for free download from [www.lunawat.com](http://www.lunawat.com) and from 2018 at [www.expertspanel.in](http://www.expertspanel.in) also.

He has authored more than books 13 books including "Chartered Accountant's Documentation and Compliance for Audits and Reviews", Limited liability Partnership – A Complete Resource Book", and "Accounting Standards and CARO".