ALL ABOUT STOCKS & SHARES

MEANING:

1. SHARE: A share is a share in the share capital of a Company.
2. STOCKS: A bunch of different verities of shares of different companies with different value and quantity is called as STOCKS.
3. STOCK MARKET: A stock market or equity market is the aggregation of buyer and sellers of stocks; these are securities listed on a stock exchange as well as those only traded privately.

STOCK EXCHANGES:

A stock exchange is a place to trade stocks. Companies may want to get their stocks listed on a stock exchange. Other stocks may be traded "over the counter", that is, through a dealer. A large company will usually have its stock listed on many exchanges across the world.

Trade in stock markets means agreeing on a price in which both parties (buyer and seller) agree to deal for a product, in this case, the transaction of 'shares' which represents an equity or ownership interest in a particular company.

Participants in the stock market range from small individual stock investors to large hedge fund trade investors, who can be based anywhere in the world. Their orders usually end up with a professional at a stock exchange, who executes the order of buying or selling.

Actual trades are based on an auction market model where a potential buyer *bids* a specific price for a stock and a potential seller *asks* a specific price for the stock. Buying or selling at *market* means you will accept *any* ask price or bid price for the stock, respectively. When a bid price and ask price match, a sale takes place, on a first-come-first-served basis if there are multiple bidders or askers at a given price.

The purpose of a stock exchange is to facilitate the exchange of securities between buyers and sellers, thus providing a marketplace. The exchanges provide real-time trading information on listed securities, facilitating price discovery.

STOCK EXCHANGES IN INDIA:

There are many stock exchanges in India such as,

1. Bombay Stock Exchange – BSE, situated in then Bombay now Mumbai.
2. National Stock Exchange – NSE, situated in Delhi.
3. Calcutta Stock Exchange – CSE, situated in Kolkatta. Etc..

The popular and most stock trading in the country is done through the BSE and the NSE

STOCK INDEX:

Stock index is the barometer or an indicator of the Stock Market. It gives you a general idea about whether most of the stocks have gone up or most of the stocks have gown down.

Stock index is calculation is based on the Free-float Methodology.

INDICATORS OF INDIAN STOCK MARKET:

1. SENSEX is an indicator of all the major companies of the BSE.
2. NIFTY is an indicator of all the major companies of the NSE.

SENSEX:

For the premier Bombay Stock Exchange that pioneered the stock broking activity in India, 128 years of experience seems to be a proud milestone. A lot has changed since 1875 when 318 persons became members of what today is called The Stock Exchange, Mumbai by paying a princely of Re 1.

Since then, the country's capital markets have passed through both good and bad periods. The journey in the 20th century has not been as easy one. Till the decade of eighties, there was no scale to measure the ups and downs in the Indian Stock Market. The Stock Exchange, Mumbai in 1986 came out with a stock index that subsequently became the barometer of the Indian Stock market.

Sensex is not only scientifically designed but also based on globally accepted construction and review methodology. First complied in 1986, Sensex is a basket of 30 constituents stocks representing a sample of large, liquid and representative companies.

The base year of Sensex is 1978-79 and the base value is 100. The index is widely reported in both domestic and international markets through prints as well as electronic media.

The Index was initially calculated based on the "Full Market Capitalization" methodology but was shifted to the Free-float methodology with effect from September 1, 2003. The "Free-float Market Capitalization" methodology of index construction is regarded as an industry best practice globally.

Due to wide acceptance amongst the Indian investors; Sensex is regarded to be the pulse of the Indian stock Market. As the oldest index in the country, it provides the time series data over a fairly long period of time (from 1979 onwards).

Right from early nineties the stock market witnessed heightened activity in terms of various bull and bear runs. The Sensex captured all these events in the most judicial manner. One can identify the booms and busts of the Indian stock market through Sensex.

SENSEX CALCULATION METHODOLOGY:

Sensex is calculated using the "Free-float Market Capitalization" methodology. In this method the level of index at any point of time reflects the Free-float market value of 30 components stocks relative to a base period. The market capitalization of a company is determined by multiplying the price of its stock by the number of shares issued by the company. This market capitalization is further multiplied by the free-float factor to determine the free float market capitalization.

The calculation of Sensex involves dividing the Free-float market capitalization of 30 companies in the Index by a number called the Index Divisor.

Sensex is calculated once in every 15 seconds.

UNDERSTANDING FREE-FLOAT METHODOLOGY:

Free-float Methodology refers to an index construction methodology that takes into consideration only the free-float market capitalization of a company for the purpose of index calculation and assigning weight to stocks in Index. Free-float market capitalization is defined as that proportion of total shares issued by the company that are readily available for trading in the market.

It generally excludes promoters' holding, government holding, strategic holding and other locked-in shares that will not come to the market for trading in the normal course. In other words, the market capitalization of each company in a Free-float index is reduced to the extent of its readily available shares in the market.

EXAMPLE FOR CALCULATION METHODOLOGY OF SENSEX:

Suppose company A has 1,000 shares in total, of which 200 are held by promoters, so that only 800 shares are available for trading to the general public. These 800 shares are the so-called 'free-floating' shares.

Similarly, company B has 2,000 shares in total, of which 1,000 are held by the promoters and the rest 1,000 are free floating.

Now suppose the current market price of stock A is Rs. 120. Thus, the 'total' market capitalization of company A is Rs. 1, 20,000 (1,000 x 120), but its free-float market cap is only Rs. 96,000 (800 x 120).

Similarly, suppose the current market price of stock B is Rs. 200. The total market capitalization of company B will thus be Rs. 4,00,000 (2,000 x 200), but its free-float market cap is only Rs. 2,00,000 (1,000 x 200).

So as of today the market capitalization of the index (i.e, stocks A and B) is Rs. 5,20,000 (Rs. 1,20,000 + Rs. 4,00,000); while the free-float market capitalization of the index is Rs. 2,96,000. (Rs. 96,000 + Rs. 2, 00,000)

The year 1978-79 is considered as base year of the index with a value set to 100. What this means is that suppose at that time the market capitalization of the stocks that comprised the index then was, say, 60,000 (remember at that time there may have been some other stocks in the Index, not A and B, but that does not matter), then we assume that an index market cap of 60,000 is equal to an index-value of 100.

Thus the value of the index today is 2,96,000 x 100 / 60,000 = 493.33

This is how the Sensex is calculated.

The factor 100/60,000 is called index divisor.

In other words, SENSEX = (Free-float market cap) x (Index divisor)

THE 30 SENSEX STOCKS:

The Sensex comprises of 30 prominent stocks derived from all key sectors which are traded actively in the exchange. These are,

	Name		Name		Name
1	Axis Bank	11	Hero Motor Corp	21	ONGC
2	Bajaj Auto	12	Hindalco Industries	22	Reliance Industries
3	Bharti Airtel	13	HUL	23	SBI
4	BHEL	14	ICICI Bank	24	Sesa Sterlite
5	Cipla	15	Infosys	25	Sun Pharma
6	Coal India	16	ITC	26	Tata Motors
7	Dr Reddys Labs	17	Larsen & Turbo	27	Tata Power
8	GAIL	18	Mahindra & Mahindra	28	Tata Steel
9	HDFC	19	Maruti Suzuki	29	TCS
10	HDFC Bank	20	NTPC	30	Wipro

TYPES OF STOCK TRADING:

A. BASED ON DURATION OF STOCK HOLDING:

The different types of stock trading based on duration of stock holding can be classified as;

1. DAY Trading:

It is a type of stock trading where both buying and selling of a financial instrument is done on the same day and all trading are closed before the market close for the day. Traders who participate in the day trading are called active traders or day traders. Day trading demands fast decision and fast action. This type of stock trading is not advisable for a beginner.

2. <u>SHORT Term Trading</u>:

A trade period of more than one day to a few weeks is considered as short term trade. A stock is bought and held in position from one day to a few weeks. A short trade is entered by creating a sell position, which is covered by buying after one day or in a few weeks.

3. <u>MEDIUM Term Trading</u>:

A trade period from a few weeks to a few months is considered as medium term trade. A trend is followed with tailoring stop loss.

4. <u>LONG Term Trading</u>:

In this type of stock trading, stocks is held for many months to many years. Investment decision is made by fundamental analysis of a stock. Profit from growth of the company, dividends and bonuses attract this type of stock trading.

B. BASED ON TREND:

The types of stock trading may also be classified in relation to a trend as,

1. <u>Trend FOLLOWING</u>:

Here a trader enters a trade by buying a stock in an *up trend* or by selling a stock in a *down trend,* anticipating that the trend will continue. The trade is continued using trailing stop loss, till the trend reverses.

2. <u>Contrarian Investing</u>:

Here a trader enters a trade by selling a stock in an up trend or by buying a stock in a down trend, anticipating that the trend will reverse.

3. <u>Range Trading</u>:

   Here a trader enters a trade by buying at lower level of a range and selling at a higher level of a range, anticipating that the trend continues to remain in a range.

<u>TAXATION ASPECTS:</u>

In connection with the stocks and shares, The Income Tax Act, 1961 has laid down some provisions and sections which describe the nature of income earned from trading of stocks and share and also its tax treatment and tax benefits.

<u>Nature of INCOME:</u>

1. Speculation Gain.
2. Short Term Capital Gain.
3. Long Term Capital Gain.

SPECULATION GAIN:

1. Income from inter-day trading is considered as speculation income and is taxable under the head 'Profits and Gains of Business or Profession'.
2. As per Section 43(5) of the Income Tax Act, 1961, *"Speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.*
3. Income from speculation gains is taxed at the normal rates.
4. Speculation losses can be set off only against speculation gains and not against any other head of income or non-speculation business income.
5. Speculation losses can be carry forward for '4' Assessment years u/s 73.

NOTE: Trading in derivatives (future and options) is treated as non-speculation business even though delivery is not affected in such transactions.

CAPITAL GAINS:

As per Section 2(42A) **o**f the Income Tax Act, 1961, *Any Equity or Preference Shares, Any Units of UTI or Mutual funds, Any Zero Coupon Bonds and other securities like debentures, government securities etc, if listed in stock exchange, will be considered as Short term capital gain (STCG) if it was held for not more than 12 months prior to date of transfer.*

As per Section 2(29A) of the Income Tax Act, 1961, *Any Equity or Preference Shares, Any Units of UTI or Mutual funds, Any Zero Coupon Bonds and other securities like debentures, government securities etc, if listed in stock exchange, will be considered as Long term capital gain (LTCG) if it was held for more than 12 months prior to date of transfer.*

TAX TREATMENT ON CAPITAL GAINS:

1. In case of listed shares chargeable to Security Transaction Tax (STT) in Recognized Stock Exchange (RSE), LTCG is exempt u/s 10(38).
2. In case of listed shares chargeable to STT in RSE, STCG is taxable at 15% flat rate u/s 111A.
3. In case of listed shares not traded through RSE, LTCG is taxable at an option of 20% after indexation or 10% without indexation, whichever is beneficiary to the assessee u/s 112.
4. In case of unlisted shares & other LTCA's, LTCG is taxable at 20% flat rate u/s 112.
5. In case of unlisted shares & other STCA's, STCG is taxable at normal rates with all other incomes.
6. In case of debt mutual funds chargeable to STT, STCG's are added to the income and taxed as per the individual's income tax slab.
7. In case of debt mutual funds traded through RSE, LTCG is taxable at an option of 20% after indexation or 10% without indexation, whichever is beneficiary to the assessee.
8. In case the basic exemption is not exhausted by any other income, then LTCG &/or STCG shall be reduced to that extent and only the balance is taxed at flat rate.
9. In case of loss from any head which is eligible for set off then it shall be set off with LTCG & the balance will be taxed.
10. Deduction under chapter VIA is not available for LTCG.

11. LTCL can be set-off only with LTCG whereas, STCL can be set-off with STCG or LTCG.
12. Carried forward for 8 Assessment Years.

SPECIAL CASES:

1. Tax implications of a bonus / rights issue on equity shares?

   Under section 55(2)(AA), bonus / rights issue on equity shares has a zero (nil) cost of acquisition. The holding period is calculated from the date of allotment of equity shares. The net sales proceeds are treated as the capital gain. The period of holding of such issue is reckoned from the date of the allotment of such issue.

2. Tax implications of Split shares?

   The split shares represent the sub-divided shares of a lot of shares. The cost of such shares gets proportionately divided and the period of holding also continuous to be the same as that of the original lot.

3. Basis for Stocks of multiple demat account?

   In case of multiple demat accounts, the capital gains on sale of shares has to be computed on the basis of the 'first-in-first-out' – FIFO with reference to the particular account from where the shares are sold.

TAX BENEFITS:

1. Deduction under section 80C :

   Under *section 80C*, any subscription to equity shares or debentures forming part of any eligible issue of capital, approved by the court or an application made by a public company or subscription to such eligible issue by a public finance institution in a prescribed form, would be eligible to deduction subject to the condition of this section. Also, subscription to any unit of a mutual fund, approved by the board in respect of any mutual fund, referred to the Clause (23D) of section 10, would also be entitled.

2. Rebate under section 80CCG:
   Section 80CCG is also called Rajiv Gandhi Equity Savings Scheme, 2012. Any resident individual with income less than Rs 12 lakhs who use demat account for the first time to buy notified shares, mutual funds can claim 50% deduction on the invested amount subject to the maximum of Rs. 50,000. This deduction can be availed for three consecutive years, based on investments you make in those years, complying the RGESS requirements.

3. Rebate under section 88E:
   'Rebate in respect of securities transaction tax. – (i) where the total income of an assessee in a previous year includes any income, chargeable under the head "Profits and gains of business of profession", arising from taxable securities transactions, he shall be entitled to a deduction, from the amount of income-tax on such income arising from such transactions, computed in the manner provided in sub-section (2), of an amount equal to the securities transaction tax paid by him in respect of the taxable securities transactions entered into in the course of his business during that previous year.

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