Securities Transaction Tax-

Tax Treatment under Income Tax Act dymystified

Authored by:

M.K.Shah Adv,

Dr. Sushma Shah, FCA

CA. B.K. Shah, 9415017553

Q1: What is the STT (Securities Transaction Tax)?

A1: The salient features of STT are:

- The Securities Transaction Tax has been introduced by Chapter VII of the Finance Act (No.2) Act, 2004 w.e.f 1.10.2004.
- It applies to whole of India.
- It provides for a levy of a transaction tax on the value of certain transactions.
- These transactions include the
  - purchase and sale of equity shares in a company,
  - purchase and sale of units of an equity oriented fund,
  - sale of equity shares in a company or units of an equity oriented fund (non-delivery)
  - Sale of a derivative
  - sale of a unit of an equity oriented fund to the mutual fund

The transaction tax will be payable on all transactions that have taken effect from October 1, 2004. (A.Y. 2005-06)

Particulars	Transaction in recognised stock exchange in India				*Sale* of unit of an equity oriented fund to the mutual fund
	***Purchase* of equity shares, units of equity oriented mutual fund (delivery based)**	***Sale* of equity shares, units of equity oriented mutual fund (delivery based)**	***Sale* of equity shares, units of equity oriented mutual fund (non-delivery based)**	***Sale* of derivative**	
Whether securities transaction tax (STT) is attracted	Yes	Yes	Yes	Yes	Yes
Burden of STT on	Purchaser	Seller	Seller	Seller	Seller
Rate of STT					
from June 1, 2006	0.125%	0.125%	0.025%	0.017%	0.25%
-from June 1, 2005 to May 31, 2006	0.10%	0.10%	0.02%	0.0133%	0.20%
-during October 1, 2004 and May 31, 2005	0.075%	0.075%	0.015%	0.01%	0.15%
Tax treatment of long – term capital gain in the hands of seller-impact due to STT	NA	Exempt from tax under section 10(38) [long – term capital loss if any shall be ignored]	Income is generally treated as business income	Income is generally treated as business income	Exempt from tax under section 10(38) [long-term capital loss, if any, shall be ignored]

Tax treatment of short-term capital gain in the hands of seller-impact due to STT	NA	Taxable at the rate of 10% (+surcharge +education cess) under section 111A	Income is generally treated as business income	Income is generally treated as business income	Taxable at the rate of 10% (+surcharge +education cess) under section 111A
Tax treatment of business income in the hands of seller-impact due to STT	NA	If income is shown as business income, one can claim tax rebate under section 88E	One can claim tax rebate under section 88E	One can claim tax rebate under section 88E	If income is shown as business income One can claim rebate under section 88E
STT to be collected by- section 100	Stock exchange	Stock exchange	Stock exchange	Stock exchange	Mutual fund
Challan -rule 7 0f STT rules 2004	ITNS 282	ITNS 282	ITNS 282	ITNS 282	ITNS 282
Return of STT	Form 1 –see rule 7 of STT rules 2004	Form 1–see rule 7 of STT rules 2004	Form 1–see rule 7 of STT rules 2004	Form 1–see rule 7 of STT rules 2004	Form 2–see rule 7 of STT rules 2004
Due date of deposit of STT-section 100	Within 7 days from end of the calendar month in which STT is collected	Within 7 days from end of the calendar month in which STT is collected	Within 7 days from end of the calendar month in which STT is collected	Within 7 days from end of the calendar month in which STT is collected	Within 7 days from end of the calendar month in which STT is collected
Due date for filing of return-section	30th June immediately	30th June immediat	30th June immediatel	30th June immediately	30th June immediately

101	following the relevant financial year	ely following the relevant financial year	y following the relevant financial year	following the relevant financial year	following the relevant financial year
Return to be delivered to-section 101	The A.O. i.e. ITO, ACIT, DCIT, JCIT or ADDCIT-section 101	The A.O. i.e. ITO, ACIT, DCIT, JCIT or ADDCIT-section 101	The A.O. i.e. ITO, ACIT, DCIT, JCIT or ADDCIT-section 101	The A.O. i.e. ITO, ACIT, DCIT, JCIT or ADDCIT-section 101	The A.O. i.e. ITO, ACIT, DCIT, JCIT or ADDCIT-section 101

- **Surcharge:** Nil, Education cess: Nil on STT
- **Note:** STT is not applicable in case of government securities, bonds, debentures; units of mutual fund other than equity oriented mutual fund and in such cases, tax treatment of short-term and long-term capital gains shall be as per normal provisions of law.

Q2: what do you mean by Recognized stock exchange?

A2: as per section 97(10) Ch VII of Finance (No. 2) Act, 2004 RSE shall have the meaning assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

"Recognized stock exchange" has the meaning assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

Section 2 (f) of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) reads as follows:

"Recognized stock exchange" means a stock exchange which is for the time being recognized by the Central Government under section 4.
The Central Government has recognized the following 22 Stock Exchanges:

(1) Bombay Stock Exchange
(2) Delhi Stock Exchange Association Ltd.
(3) Madhya Pradesh Stock Exchange (Indore)
(4) Ahmedabad Stock Exchange
(5) Madras Stock Exchange
(6) Calcutta Stock Exchange
(7) Uttar Pradesh Stock Exchange Association Ltd.

(8) Pune Stock Exchange Ltd.
(9) Bangalore Stock Exchange Ltd.
(10) Ludhiana Stock Exchange Association Ltd.
(11) Hyderabad Stock Exchange Ltd.
(12) Gauhati Stock Exchange Ltd.
(13) Cochin Stock Exchange Ltd.
(14) Mangalore Stock Exchange Ltd.
(15) Magadh Stock Exchange Association
(16) Bhubaneshwar Stock Exchange
(17) Saurashtra Kutch Stock Exchange
(18) Jaipur Stock Exchange
(19) Vadodara Stock Exchange
(20) Coimbatore Stock Exchange
(21) Over The Counter Exchange of India
(22) National Stock Exchange.

Q3: What is value of taxable securities transaction and how it shall be calculated?

A3: as per section 99 of Ch VII of Finance (No. 2) Act, 2004 value of taxable securities transactions shall be as follows:

a. **Option in securities:** The aggregate of the strike price and the option premium of such "option in securities";

As per section 97(8) “option premium” means the premium payable by the purchaser of any “option in securities” at the time of such purchase

As per section 97 (12) “strike price” means the price at which the “option in securities” may be exercised on the expiry date of such option.

b. **Futures:** Shall be the price at which such "futures" is traded; and
c. **In the case of any other taxable securities transaction it** shall be the price at which such securities are purchased or sold.

Calculations about futures:

The futures are subjected to STT only in the event of sell and the seller is the person responsible for payment of STT. The tax is collected by the broker at the time of raising invoice.

Suppose Mr. X has taken long position (purchase transaction) at the beginning of the deal on 31/12/2007.The name of the stock is FUTSTK HOTEL LEELA. His long position appears as follows:

Order no.	Trade no.	Trade time	Qty bought	Price	Brokerage (total)	Service tax	Amount (Rs.)
200712215025615	5898	9:56:20	3750	75.55	112.50	13.91	283438.91

The position is reversed (short position or sale position taken) on 31/12/2007 as follows:

Order no.	Trade no.	Trade time	Qty bought	Price	Brokerage (total)	Service tax	Amount (Rs.)
200712215128617	47097	10:10:11	3750	75.95	37.50	4.64	284770.36

Note:
Service is applicable only on brokerage @ 12.36%
STT is applicable only on sale amount @.017% which will come to
Rs. 2, 84,813.00 *.017%= Rs. 48.00 only. (Rounded off to nearest Rupee as per rule 4 of STT rules 2004)

About options:

There are only two kinds of options: Call Options and Put Options.

A ***Call option*** is an option to buy a stock at a specific price on or before a certain date. In this way, Call options are like ***security deposits.***

If, for example, you wanted to rent a certain property, and left a security deposit for it, the money would be used to insure that you could, in fact, rent that property at the price agreed upon when you returned.
If you never returned, you would give up your security deposit, but you would have no other liability. Call options usually increase in value as the value of the underlying instrument increases.
When you buy a Call option, the price you pay for it, called the option premium, secures your right to buy that certain stock at a specified price, called the strike price.
If you decide not to use the option to buy the stock, and you are not obligated to, your only cost is the option premium.

Put options are options to sell a stock at a specific price on or before a certain date. In this way, Put options are like ***insurance policies.***
If you buy a new car, and then buy auto insurance on the car, you pay a premium and are, hence, protected if the asset is damaged in an accident. If this happens, you can use your policy to regain the insured value of the car. In this way, the put option gains in value as the value of the underlying instrument decreases.

If all goes well and the insurance is not needed, the insurance company keeps your premium in return for taking on the risk.
With a Put option, you can "insure" a stock by fixing a selling price.
If something happens which causes the stock price to fall, and thus, "damages" your asset, you can exercise your option and sell it at its "insured" price level.
If the price of your stock goes up, and there is no "damage," then you do not need to use the insurance, and, once again, your only cost is the premium.
This is the primary function of listed options, to allow investors ways to manage risk.

Types Of Expiration
There are two different types of options with respect to expiration. There is a European style option and an American style option. The European style option cannot be exercised until the expiration date. Once an investor has purchased the option, it must be held until expiration. An American style option can be exercised at any time after it is purchased. Today, most stock options which are traded are American style options. And many index options are American style. However, there are many index options which are European style options. An investor should be aware of this when considering the purchase of an index option.

Options Premiums
An option Premium is the price of the option. It is the price you pay to purchase the option. For example, an XYZ May 30 Call (thus it is an option to buy Company XYZ stock) may have an option premium of Rs.2.

This means that this option costs Rs. 200.00. Why? Because most listed options are for 100 shares of stock, and all equity option prices are quoted on a per share basis, so they need to be multiplied times 100.
Strike Price
The Strike (or Exercise) Price is the price at which the underlying security (in this case, XYZ) can be bought or sold as specified in the option contract.

For example, with the XYZ May 30 Call, the strike price of 30 means the stock can be bought for Rs. 30 per share. Were this the XYZ May 30 Put, it would allow the holder the right to sell the stock at Rs. 30 per share.

Expiration Date

The Expiration Date is the day on which the option is no longer valid and ceases to exist. The expiration date for all listed stock options in the U.S. is the third Friday of the month (except when it falls on a holiday, in which case it is on Thursday).
In India Options contracts on individual securities shall expire on the last Thursday of the expiry month. If the last Thursday is a trading holiday, the contracts shall expire on the previous trading day.

For example, the XYZ May 30 Call option will expire on the third Friday of May or last Thursday of May.

The strike price also helps to identify whether an option is in-the-money, at-the-money, or out-of-the-money when compared to the price of the underlying security. You will learn about these terms later.

Exercising Options
People who buy options have a Right, and that is the right to Exercise.
For a Call exercise, Call holders may buy stock at the strike price (from the Call seller).
For a Put exercise, Put holders may sell stock at the strike price (to the Put seller).
Neither Call holders nor Put holders are obligated to buy or sell; they simply have the rights to do so, and may choose to Exercise or not to Exercise based upon their own logic.

Assignment of Options
when an option holder chooses to exercise an option, a process begins to find a writer who is short the same kind of option (i.e., class, strike price and option type). Once found, that writer may be Assigned.
This means that when buyers exercise, sellers may be chosen to make good on their obligations.
For a Call assignment, Call writers are required to sell stock at the strike price to the Call holder.
For a Put assignment, Put writers are required to buy stock at the strike price from the Put holder.

Strike price
The predetermined price upon which the buyer and the seller of an option have agreed is the strike price, also called the exercise price or the striking price. Each option on an underlying instrument shall have multiple strike prices.

In the money:
Call option - underlying instrument price is higher than the strike price.
Put option - underlying instrument price is lower than the strike price.

Out of the money:

Call option - underlying instrument price is lower than the strike price.
Put option - underlying instrument price is higher than the strike price.

At the money:
The underlying price is equivalent to the strike price.

An option is said to be 'at-the-money', when the option's strike price is equal to the underlying asset price. This is true for both puts and calls.

A call option is said to be 'in the money' when the strike price of the option is less than the underlying asset price. For example, a Stock A' call option with strike of 3900 is 'in-the-money', when the spot price of Stock 'A' is at 4100 as the call option has a positive exercise value. The call option holder has the right to buy the Stock 'A' at 3900, no matter by what amount the spot price exceeded the strike price. With the spot price at 4100, selling Stock 'A' at this higher price, one can make a profit.

On the other hand, a call option is out-of-the-money when the strike price is greater than the underlying asset price. Using the earlier example of Sensex call option, if the Sensex falls to 3700, the call option no longer has positive exercise value. The call holder will not exercise the option to buy Sensex at 3900 when the current price is at 3700 and allow his 'option' right to lapse.

	CALL OPTIONS	**PUT OPTIONS**
In-the-money	Strike Price < Spot Price of underlying asset	Strike Price > Spot Price of underlying asset
At-the-money	Strike Price = Spot Price of underlying asset	Strike Price = Spot Price of underlying asset
Out-of the-money	Strike Price > Spot Price of underlying asset	Strike Price < Spot Price of underlying asset

A put option is in-the-money when the strike price of the option is greater than the spot price of the underlying asset. For example, a Stock 'A' put at strike of 4400 is in-the-money when the spot price of Stock 'A' is at 4100. When this is the case, the put option has value because the put option holder can sell the Stock 'A' at 4400, an amount greater than the current Stock 'A' of 4100. Likewise, a put option is out-of-the-money when the strike price is less than the spot price of underlying asset. In the above example, the buyer of Stock 'A' put option won't exercise the option when the spot is at 4800. The put no longer has positive exercise value and therefore in this scenario, the put option holder will allow his 'option' right to lapse

Expiration day

Options have finite lives. The expiration day of the option is the last day that the option owner can exercise the option. American options can be exercised any time before the expiration date at the owner's discretion.

Thus, the expiration and exercise days can be different. European options can only be exercised on the expiration day.

Example 1st: at kotak securities as on 9/5/2008

http://kotaksec.cmlinks.com/Derivatives/FoMarketWatch.aspx?Opt=5&InstName=OPTSTK&Sort=VOL&pnav=PI1_PI5

Instrument Type	Symbol	Expiry Date	Option Type	Strike Price(Rs.)	High Price	Low Price	Prev Close	Current Price(Rs.)	Contracts Traded(Nos.)	Turnover (Rs. in Cr)
OPTSTK	RELIANCE	29/05/2008	CA	2700.00	61.00	21.00	61.70	55.00	4774.00	903771907.50
OPTSTK	RELIANCE	29/05/2008	CA	2600.00	121.95	48.30	120.75	110.00	3026.00	572855842.50
OPTSTK	RPL	29/05/2008	CA	200.00	7.00	2.90	7.75	7.00	1448.00	437178350.00
OPTSTK	RPL	29/05/2008	CA	190.00	12.75	5.40	13.05	12.75	1190.00	359283312.50
OPTSTK	RELIANCE	29/05/2008	PA	2600.00	112.00	36.10	40.45	43.90	1368.00	258977790.00
OPTSTK	RELIANCE	29/05/2008	CA	2800.00	27.65	9.00	26.55	26.35	1292.00	244590135.00
OPTSTK	TATASTEEL	29/05/2008	CA	840.00	41.80	26.10	34.05	32.00	707.00	228185522.60
OPTSTK	RPL	29/05/2008	CA	210.00	3.60	1.50	4.15	3.60	727.00	219494931.25
OPTSTK	IFCI	29/05/2008	CA	65.00	4.80	3.10	3.60	3.75	1543.00	180406788.50
OPTSTK	IFCI	29/05/2008	CA	70.00	3.00	1.85	2.15	2.25	1341.00	156789049.50
OPTSTK	TATASTEEL	29/05/2008	CA	860.00	29.40	16.50	23.70	23.00	462.00	149111331.60
OPTSTK	IFCI	29/05/2008	CA	60.00	7.00	4.60	5.45	5.25	1267.00	148137006.50
OPTSTK	RELIANCE	29/05/2008	CA	2650.00	87.50	32.70	86.55	80.00	756.00	143119305.00
OPTSTK	RPL	29/05/2008	PA	190.00	13.00	5.35	4.80	5.35	454.00	137071112.50

OPTSTK	RPL	29/05/2008	PA	180.00	7.00	2.75	2.35	2.80	383.00	115634881.25
...										

CA: call American; PA= Put American

F&O Underlying Asset Details

Scrip Code: 500325 **ISIN No.:** INE002A01018

Scrip Name: RELIANCE INDUSTRIES LTD.

Listing Details	Capital Details	Shareholding Details as on 30 June, 2007
Date of Listing	Issued & Paid-up Capital (number of shares)	Promoter (%)
Monday, January 23, 1978	1393508041	52.79

Derivatives Details
New Lot size for the F&O contract (number of shares)
150

Trading Details	
Average Market Capitalisation for six months ended on 30 June, 2007 (Rs. Crores)	Average Daily Trading Volume for six months ended on 30 June, 2007 (numbers of shares)
236,938.17	791562.85

S.O.1059 (E) dated 28th September 2004

In exercise of the powers conferred by sub-section (1) read with subsection (2) of section 114 of the Finance (No.2) Act, 2004 (23 of 2004), the Central Government has made the following rules for carrying out the provisions of Chapter VII of the said Act relating to securities transaction tax, namely:

- For the purposes of clause (c) of section 99 of the Act, *the value of a taxable securities transaction, being a purchase or sale of an equity share in a company or a unit of an equity oriented fund, entered into in a recognised stock exchange, shall be determined in the following manner, namely:*

(a) where the equity share or unit is purchased or sold by a person on a trading day in the netted settlement mode (intra day trading),-

- the quantity of shares or units purchased or sold in each trade in that equity share or unit executed by the person on that day, shall be multiplied by the price at which the trade is executed, to determine the trade value of each such trade;
- The aggregate trade value of all trades in the equity share or unit by the person on that day shall be arrived at by totaling the trade values determined under sub-clause (i);
- the aggregate trade value arrived at under sub-clause (ii), shall be divided by the total quantity of the equity share or unit traded by the person on that day, to determine the volume weighted average price of that equity share or unit for that person for that day;
- Such volume weighted average price (rounded off to the nearest paisa) shall be taken to be the value of the taxable securities transaction relating to the equity share or unit.

Explanation: Where the equity share or unit is purchased or sold through a member of the stock exchange shall be made with reference to the trades executed in the equity share or unit under a particular client Code through that member;

(b) where the equity share or unit is purchased or sold by a person in the trade-for trade settlement mode, the value of the taxable securities transaction shall be the price at which the equity share or unit is purchased or sold;

(c) where the equity share or unit is purchased in the auction settlement mode, the value of the taxable securities transaction shall be the volume weighted average price of the equity share or unit, determined in the manner specified in clause (a), in respect of all trades in that equity share or unit carried out in the auction session;

(d) where the equity share or unit is sold in the auction settlement mode, the value of the taxable securities transaction shall be the price at which the equity share or unit is sold.

Explanation.- For the purposes of this rule,–

(i) "netted settlement mode" means a mode of settlement of transactions in a recognised stock exchange where the quantity of an equity share or unit purchased by a person on a trading day is set off against the quantity of that equity share or unit sold by him on that day and actual delivery is required to be taken or given by him as the case may be, only in respect of the net quantity purchased or sold as has not been so set off;

(ii) "trade-for-trade settlement mode" means a mode of settlement of transactions in a recognised stock exchange where each trade is compulsorily required to be settled by actual delivery;

(iii) "auction settlement mode" means a mode of settlement, in a stock exchange, of transactions carried out in the auction session, being a trading session in which the stock exchange makes purchases of equity shares or units through an auction process initiated by it, so as to settle transactions where there has been a failure to deliver such equity shares or units which were required to be delivered.

<u>Example 1st:</u>
Mr. X has performed the following day trading on 9.5.2008 in RQL Shares

Time	**Nature of trans.**	**No. of shares**	**Rate**	**value**
11:00 a.m.	**Sale**	**200**	**@800.00**	**1,60,000.00**
12.00 a.m.	**Purchase**	**500**	**@750.00**	**3,75,000.00**
1.00 p.m.	**Sale**	**700**	**@850.00**	**5,95,000.00**
2.00 p.m.	**Purchase**	**800**	**@600.00**	**4,80,000.00**
	total	**2200**	**Total**	**16,10,000.00**

Net volume weighted average price: RS. 731.82 per share
Net position is

Sold	**Purchase**	**Net purchase (del based)**

900 shares	**1300 shares**	**400 shares**

Transaction value and STT= non delivery sale on 900 shares X 731.82 = 6,58,638 X 0.025%= 165 INR
Transaction value and STT= delivery purchase on 400 shares X 731.82 = 2,92,728 X 0.125%= 366 INR

<u>Example 2nd:</u>
Mr. X has performed the following day trading on 9.5.2008 in RQL Shares

Time	Nature of trans.	No. of shares	Rate	value
11:00 a.m.	purchase	200	@800.00	1,60,000.00
12.00 a.m.	Sale	500	@750.00	3,75,000.00
1.00 p.m.	purchase	700	@850.00	5,95,000.00
2.00 p.m.	Sale	800	@600.00	4,80,000.00
	total	2200	Total	16,10,000.00

Net volume weighted average price : RS. 731.82 per share
Net position is

Sold	Purchase	Net sold (DLY Based)
1300 shares	900 shares	400 shares

Transaction value and STT= non delivery sale on 900 shares X 731.82 = 6,58,638 X 0.025%= 165 INR
Transaction value and STT= delivery sale on 400 shares X 731.82 = 2,92,728 X 0.125%= 366 INR

Q4***: Can I claim set-off of STT from tax payable by me?***
A4: As per sec 88E of the Income Tax Act, 1961. STT can be set-off only if the following conditions are satisfied:

- Assessee is running a business income of which is taxable under the Head PGBP
- Such income arises out of ***taxable securities transactions.***
- *The assessee has paid STT.*
- *The assessee furnishes proof of payment of STT in the prescribed format. (Form 10DB or 10DC)*
- *Then the set-off will be allowed to the following extent:*
    - *Actual STT paid; or*
    - *Average rate of tax X Business income from such taxable Security transaction; which ever is lower.*

    (Average rate of tax means= Total Tax/Total Income X 100)

Q5: what is the proof of payment of STT?

A5: as per Income Tax (FIRST AMENDMENT) rules 2004 dated 6/1/2005 the evidence of payment of security transaction tax for claiming deduction under section 88E shall be as follows:

The evidence of payment of securities transaction tax which is required to be furnished along with the return of income by the assessee under first proviso to section 88E,–
(i) On value of transaction entered into by him in a recognised stock exchange, shall be in Form No. 10DB and shall be verified in the manner indicated therein;
(ii) On value of transaction of sale, by him, of a unit of an equity oriented fund to the Mutual Fund, shall be in Form No. 10DC and shall be verified in the manner indicated therein.'

Q6: What changes have been proposed regarding STT in the budget 2008?

A6: Finance Minister P Chidambaram proposed changes in the Securities Transaction Tax,

- This will now be treated like any other deductible expenditure against business income.
- The finance minister has further proposed that in case of sale of an option in securities, the levy of STT would be only on the option premium, where the option is not exercised and the liability would be on the seller.
- STT would be levied at the rate of 0.017 per cent of the option premium and shall be paid by the seller. However, where the option is exercised, the levy would be on the settlement price and the liability would be on the buyer. STT on such a transaction would be levied at the rate of 0.125 per cent of settlement price and would be paid by the purchaser.
- In case of the sale of a future in securities, STT would be levied at 0.017 per cent and is to be paid by the seller.
- Meanwhile, there would be no changes in the present rates. The finance minister has also introduced Commodities Transaction Tax (CTT) on the lines of STT on futures and options.