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## A Study On Futures And Options Market & Its Taxation

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### ABSTRACT

The futures and options (F&O) market plays a pivotal role in modern financial systems, offering investors tools for hedging, speculation, and portfolio diversification. This study examines the structure, functioning, and economic significance of the F&O market, with a particular focus on the taxation policies that govern it. Through a detailed analysis of regulatory frameworks and tax treatment of F&O transactions, the study explores how tax policies influence investor behavior, market participation, and compliance burdens. Drawing on empirical data and case studies, the research highlights the challenges of classifying F&O income, the implications of tax reporting requirements, and the effects of recent policy changes. The paper also assesses the adequacy of current tax regulations in promoting transparency and efficiency, while ensuring equitable tax collection. By bridging the gap between financial innovation and tax policy, this study provides actionable insights for policymakers, investors, and tax practitioners navigating the evolving landscape of derivative markets.

Futures and Options (F&O)

**Key words:** Derivative Markets, Financial Derivatives, Hedging Speculation, Portfolio Diversification Taxation Policies, Tax Treatment of Derivatives, Regulatory Framework

### INTRODUCTION

DERIVATIVES MARKET Instruments that help manage financial risk and enhance investment strategies. Among these instruments, derivatives—particularly Futures and Options(F&O)— play a crucial role in modern market dynamics. Futures and Options are contracts derived from underlying assets such as stocks, indices, or commodities. These instruments provide market participants with the ability to hedge risk, speculate on price movements, or gain leveraged exposure with relatively lower capital requirements. As trading in the F&O segment has expanded significantly. Both institutional and retail investors participate in these markets, contributing to liquidity and efficient price discovery.

In many jurisdictions, including emerging markets, tax rules for derivatives are still evolving. Governments and tax authorities often struggle to strike a balance between promoting market growth and ensuring proper tax compliance. One of the core issues in F&O taxation is the classification of income—whether profits are treated as business income, capital gains, or speculative income. Each classification has distinct implications for tax rates, deductions, and reporting requirements.

Moreover, the timing of income recognition, the allowance for expenses, and the treatment of carry-forward losses further complicate compliance. For active traders, maintaining proper books of accounts and audit requirements can be an added burden.

In India, for example, F&O income is generally treated as business income, subject to taxation under the Income Tax Act. This comes with audit requirements if turnover exceeds specified limits, along with eligibility for deductions under business provisions. In the United States, F&O contracts are taxed under Section 1256 of the Internal Revenue Code, offering a blended tax rate for certain regulated contracts. This treatment is considered more favorable than standard capital gains taxation. Regardless of the jurisdiction, proper documentation and understanding of tax obligations are essential for investors to remain compliant. Tax advisory services and automation tools are increasingly in demand due to the growing complexity.

## **DERIVATIVES MARKET**

Derivatives are financial instruments whose value is determined by the value of an underlying asset, such as financial securities or physical assets. Essentially, derivatives derive their price from the price movements of the underlying assets.

### **Derivatives market history**

Derivatives have a long history, dating back to ancient Mesopotamia around the second millennium BC, where early forms of futures contracts were used. However, they didn't gain widespread use until the 1970s, when new valuation techniques emerged, sparking rapid growth in the derivatives market. Today, derivatives are integral to modern finance.

Despite their utility, derivatives are complex and powerful financial instruments that have been central to various financial crises. The 2008 Global Financial Crisis is a notable example, where derivatives tied to the U.S. housing market and credit instruments led to the collapse of firms like Lehman Brothers and Bear Stearns, and the forced sale of Merrill Lynch.

## **CONTRACT PERIOD IN DERIVATIVES MARKET**

In the derivatives market, contract periods vary based on the type of contract and market. Common contract durations include specific lengths of time, which can differ depending on the underlying asset, market conditions, and the needs of the parties involved in the contract.

### **What are the most actively traded futures and options contracts in India Index Futures:**

**NIFTY:** With 108,118 contracts and a traded value of ₹186,931,129,660.50, expiring on April 24, 2025.

**BANKNIFTY:** With 56,803 contracts and a traded value of ₹88,134,052,241.70, expiring on April 24, 2025.

**MIDCPNIFTY:** With a contract expiring on April 24, 2025.

**Stock Futures:**

HDFCBANK: With 40,117 contracts and a traded value of ₹40,307,595,867, expiring on April 24, 2025.

RELIANCE: With 44,581 contracts and a traded value of ₹26,963,480,420, expiring on April 24, 2025.

BAJFINANCE: With 22,627 contracts and a traded value of ₹24,655,510,550, expiring on April 24, 2025.

ICICIBANK: With 23,901 contracts and a traded value of ₹22,332,138,360, expiring on April 24, 2025.

TATAMOTORS: With 54,407 contracts and a traded value of ₹18,593,782,674.50, expiring on April 24, 2025.

**Index Options:**

NIFTY-24-APR-25: With a volume of 64,204 and open interest of 12,604,950. BANKNIFTY-24-APR-25:

With a volume of 38,627 and open interest of 2,207,520.

**REVIEW OF LITERATURE**

**Sharma & Gupta (2020)** Found that many Indian traders lack awareness of the taxation rules related to F&O trading, leading to common issues in income classification and audit requirements.

**Joshi & Patel (2021)** Concluded that tax compliance in F&O trading is low due to the complex and unclear tax structure, particularly concerning treatment of profits and losses.

A study by **Dr. T.V.S.S. Swathi and M. V. Sai Priya (2021)** examined futures and options in the Indian stock market, focusing on a specific company's derivatives. The study found that derivatives can mitigate stock market risks. In futures, investors can offset losses in near-month contracts using mid-month contracts. Options, meanwhile, offer potential for greater growth than futures and allow investors to set a margin of safety, determining optimal buy and sell points.

**RESEARCH METHODOLOGY****Secondary Data:**

The secondary data for this study was gathered from existing sources, including: National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) websites

- Internal records
- Textbooks and journals focused on derivatives, the Indian stock market system, and financial derivatives.

**SCOPE OF THE STUDY**

The scope of the study is limited to DERIVATIVES with the special reference to Indian context & the National stock exchange has been taken as representative sample for the study. The study includes futures and options.

**STATEMENT OF THE PROBLEM:**

The trading of Futures and Options has become increasingly common among investors. Despite this, many traders are unaware of the specific tax rules that apply to such transactions. The existing tax system for F&O is complex, involving rules on income classification, audit limits, and loss treatment. This lack of clarity can result in errors and non-compliance. Therefore, a focused study is needed to understand the F&O market and its taxation structure to guide investors better.

## OBJECTIVES

- To understand the meaning of financial derivatives.
- To analyze the futures and options market in Indian financial markets.
- To assess the taxation framework for futures and options.

## RESEARCH DESIGN

This study follows a descriptive research design to understand the structure and taxation of the Futures and Options (F&O) market. It aims to collect data on how F&O trading works, how it is taxed, and how well traders understand these aspects. Both primary and secondary data sources are used. Primary data is collected through questionnaires and interviews with traders, investors, and tax professionals. Secondary data includes information from books, articles, official reports, and government tax guidelines. The collected data is analyzed to identify trends, knowledge gaps, and compliance issues in F&O taxation.

## DATA ANALYSIS

year-by-year capital gains and LTCG tax using an initial investment of ₹10,00,000 (₹10 lakhs) in April 2020 and sold fully in March 2025, using the same NIFTY 50 5-year growth data.

### Base Information

START DATE	END DATE	INVESTED	FINAL VALUE	TOTAL GAIN	LTCG EXEMPTION	LTCG TAX RATE
APR 2020	MAR 2025	₹10,00,000	₹23,74,100	₹113,74,100	₹1,00,000	10% on excess

### PORTFOLIO OF 2021

Description	Amount
Initial Investment	1000000
Final Value	less 1490000
Total LTCG	490000
Exempted LTCG	less 100000
Taxable LTCG	390000
LTCG @ 10%	39000
H & ES 4%	40560
Net after Tax value	1449440 (1490000 – 40560)

## INTERPRETATION

Initially invested ₹10,00,000 in an asset, and its value increased to ₹14,90,000, resulting in a long-term capital gain of ₹4,90,000. Under Indian tax laws (Section 112A), the first ₹1,00,000 of LTCG is exempt from tax, leaving a taxable gain of ₹3,90,000. This taxable gain is subject to a 10% tax, amounting to ₹39,000. Additionally, a 4% Health and Education Cess is applied to the tax, resulting in a cess of ₹1,560. The total tax payable is ₹40,560. After deducting this tax from the final sale value, you're left with a net after-tax amount of ₹14,49,440.

**PORTFOLIO PF 2022**

Description	Amount
Initial Investment	1000000
Final Value less	1770120
Total LTCG	770120
Exempted LTCG less	100000
Taxable LTCG	670120
LTCG @ 10%	67012
H & ES 4%	69692
Net after Tax value	1700428 (1770120 – 69692)

**INTERPRETATION**

Initially invested ₹10,00,000 in an asset, and its value increased to ₹1770120, resulting in a long-term capital gain of ₹770120. Under Indian tax laws (Section 112A), the first ₹1,00,000 of LTCG is exempt from tax, leaving a taxable gain of ₹670120. This taxable gain is subject to a 10% tax, amounting to ₹67012. Additionally, a 4% Health and Education Cess is applied to the tax, resulting in a cess of ₹2680. The total tax payable is ₹69692. After deducting this tax from the final sale value, you're left with a net after-tax amount of ₹1700428.

**PORTFOLIO OF 2023**

Description	Amount
Initial Investment	1000000
Final Value less	1759500
Total LTCG	759500
Exempted LTCG less	100000
Taxable LTCG	659500
LTCG @ 10%	65950
H & ES 4%	68588
Net after Tax value	1690912 (1759500 – 68588)

**INTERPRETATION**

Initially invested ₹10,00,000 in an asset, and its value increased to ₹1759500, resulting in a long-term capital gain of ₹759500. Under Indian tax laws (Section 112A), the first ₹1,00,000 of LTCG is exempt from tax, leaving a taxable gain of ₹659500. This taxable gain is subject to a 10% tax, amounting to ₹65950. Additionally, a 4% Health and Education Cess is applied to the tax, resulting in a cess of ₹2638. The total tax payable is ₹68588. After deducting this tax from the final sale value, you're left with a net after-tax amount of ₹1690912.

**PORTFOLIO OF 2024**

Description	Amount
Initial Investment	1000000
Final Value less	2262180
Total LTCG	1262180
Exempted LTCG less	100000
Taxable LTCG	1162180
LTCG @ 10%	116218
H & ES 4%	4648
Net after Tax value	2141312 (2262180 - 120866)

**INTERPRETATION**

Initially invested ₹10,00,000 in an asset, and its value increased to ₹2262180, resulting in a long-term capital gain of ₹1262180. Under Indian tax laws (Section 112A), the first ₹1,00,000 of LTCG is exempt from tax, leaving a taxable gain of ₹1162180. This taxable gain is subject to a 10% tax, amounting to ₹116218. Additionally, a 4% Health and Education Cess is applied to the tax, resulting in a cess of ₹4648. The total tax payable is ₹120866. After deducting this tax from the final sale value, you're left with a net after-tax amount of ₹2141312.

**PORTFOLIO OF 2025**

Description	Amount
Initial Investment	1000000
Final Value less	2374100
Total LTCG	1374100
Exempted LTCG less	100000
Taxable LTCG	1274100
LTCG @ 10%	127410
H & ES 4%	5096
Net after Tax value	2241594 (2374100 – 132506)

**INTERPRETATION**

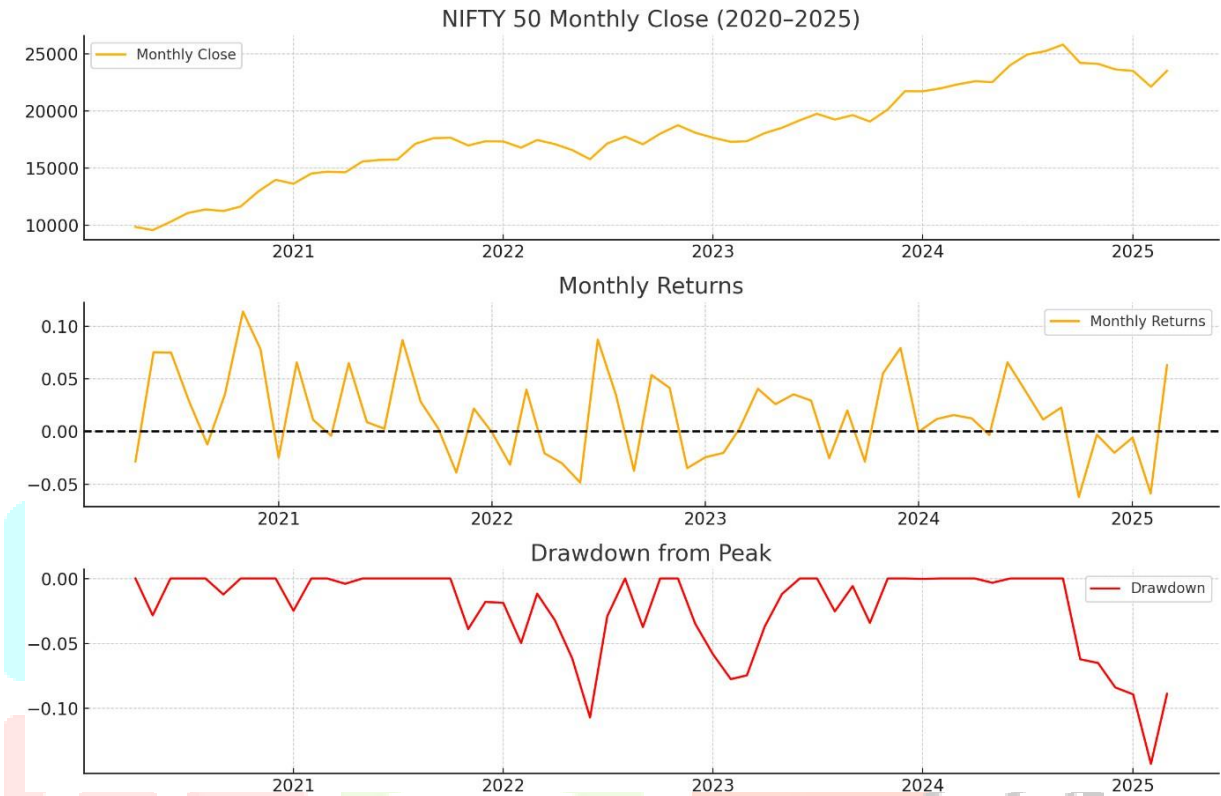
Initially invested ₹10,00,000 in an asset, and its value increased to ₹2374100, resulting in a long-term capital gain of ₹1374100. Under Indian tax laws (Section 112A), the first ₹1,00,000 of LTCG is exempt from tax, leaving a taxable gain of ₹1274100. This taxable gain is subject to a 10% tax, amounting to ₹127410. Additionally, a 4% Health and Education Cess is applied to the tax, resulting in a cess of ₹5096. The total tax payable is ₹132506. After deducting this tax from the final sale value, you're left with a net after-tax amount of ₹2241594.

**STATISTICAL ANALYSIS CORRELATION**

Year-wise Portfolio Value (Using NIFTY % Growth Each Year)	NIFTY Return	Portfolio Value (₹)	Gain from Initial (₹)
Financial Year			
Mar-21	49.00%	₹14,90,000	₹4,90,000
Mar-22	18.80%	₹17,70,120	₹7,70,120
Mar-23	-0.60%	₹17,59,500	₹7,59,500
Mar-24	28.60%	₹22,62,180	₹12,62,180
Mar-25	5.40%	₹23,74,100	₹13,74,100



	NIFTY RETURNS	PORTFOLIO VALUE	GAIN FROM INTIAL
NIFTY RETURNS	1		
PORTFOLIO VALUE	-0.729422014	1	
GAIN FROM INTIAL	-0.431698593	0.86341334	1



INTERPRETATION

The NIFTY 50 index demonstrated remarkable growth between 2020 and 2025, surging from approximately 10,000 to over 22,000. Although this upward trajectory wasn't smooth, with intermittent corrections, the overall trend remained positive. Investors encountered periods of market stress, particularly in early 2022 and late 2024, which led to significant drawdowns. Despite these fluctuations, the long-term outlook appears promising, underscoring the importance of navigating short-term volatility.

Year Wise portfolio value Year (Using NIFTY % Growth Each Year)

Financial Year	NIFTY Return	Portfolio Value (₹)	Gain from Initial (₹)
Mar 2021	+49.0%	₹14,90,000	₹4,90,000
Mar 2022	+18.8%	₹17,70,120	₹7,70,120
Mar 2023	-0.6%	₹17,59,500	₹7,59,500
Mar 2024	+28.6%	₹22,62,180	₹12,62,180
Mar 2025	+5.4%	₹23,74,100	₹13,74,100

**Final Capital Gains Tax Calculation (at time of redemption in Mar 2025)**

Description	Amount (₹)
Initial Investment	₹10,00,000
Final Value (Mar 2025)	₹23,74,100
<b>Total LTCG</b>	₹13,74,100
Exempt LTCG	₹1,00,000
<b>Taxable LTCG</b>	₹12,74,100
<b>LTCG Tax @10%</b>	<b>₹1,27,410</b>
<b>Net After Tax Value</b>	<b>₹22,46,690</b>

**Final Summary (2020–2025):**

Metric	Amount (₹)
Invested	₹10,00,000
Gross Value (Mar 2025)	₹23,74,100
Capital Gain	₹13,74,100
LTCG Tax Paid	₹1,27,410
<b>Net Value After Tax</b>	<b>₹22,46,690</b>
<b>Net Profit</b>	<b>₹12,46,690</b>

**FINDINGS**

- There has been a steady increase in retail and institutional participation in the F&O segment, driven by increased awareness, digital trading platforms, and leverage opportunities.
- The majority of trades in the F&O market are speculative, with very few leading to actual delivery. This indicates a strong speculative interest rather than hedging or investment.
- Many retail investors remain unclear about the tax treatment of F&O transactions, especially regarding classification under business income and the implications for ITR filing.

**SUGGESTIONS**

- The tax framework for F&O should be simplified for small and retail traders. Clear and concise guidelines from the Income Tax Department can help prevent errors in filing.
- Regulatory bodies like SEBI and exchanges (NSE/BSE) should initiate investor education on taxation norms, record-keeping, and audit requirements for derivatives.
- Consideration should be given to introducing a separate taxation regime for F&O traders with thresholds and tax rates, similar to presumptive taxation schemes.
- The method of computing turnover in F&O trading should be standardized across

**CONCLUSION**

The Futures and Options (F&O) market plays a vital role in the modern financial ecosystem by offering instruments for hedging, speculation, and portfolio diversification. Over the past decade, this segment has witnessed exponential growth, particularly with increased participation from retail investors.

To ensure the sustainable growth of the F&O market, a balanced approach is necessary—one that encourages participation while ensuring transparency and tax compliance. Simplified tax norms, improved



investor education, and better tools for tracking and reporting F&O trades can go a long way in bridging the current gaps. Regulatory bodies, brokers, and the government must work together to create a more investor-friendly environment that promotes responsible trading and accurate tax disclosure.

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