This article illustrates how a profitable trade can become a loss making one due to delay in exit.

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# Off the kerb - Taxes More Than Gains? Yes, If You Don't Exit Your Options in Time

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Mumbai-based Chirag Gupta felt on the top of the world after trading hours on January 25, 2017, the expiry day of the month's futures and options contracts. The 27 year old trader had made a stupendous 5,300% gross returns betting on Nifty through options. But the celebrations were short lived after he received the contract note from his broker. The statement showed that Gupta owed the broker Rs18 lakh, which was 15,900% more than the money he had put in to initiate the trade.

The huge liability was no clerical error at the broker's back office. It was on account of the Securities Transaction Tax (STT) that he had to pay for allowing the Nifty options positions to expire, a rule that has the potential to trigger a systemic crisis. STT is a levy that investors and traders pay soon after they trade on the stock exchanges. In the case of options trading, the STT is around 0.05% on the premium. The STT on exercising an option is 0.125%.This is where the problem lies. When an option is exercised, the STT is paid on the entire value of the option. This is where Gupta had to face huge losses.

On the expiry day of the January contracts, Gupta bought 3,000 lots of 8,600 calls in the last few minutes of trading. One Nifty lot is currently 75 units. The premium he paid was five paise per lot, which cost him Rs. 11,250 (3000*75*0.05). Gupta's bet was that the Nifty would close above 8,600 based on the weighted average pricing estimates. In case his wager went awry, his losses would have been capped at Rs. 11,250 the total premium paid. The Nifty closed at 8602.75 that day that resulted in him making Rs. 6.18 lakh (3000*75*2.75). The gross profit in this trade was about Rs. 6.07 lakh. But

Gupta inadvertently made a mistake; he did not square off the position during trading hours. Instead he allowed it to expire, unaware of the enormous tax implications.

Since he allowed the Nifty options to be exercised, he had to pay STT on the full value of the options, which was almost Rs. 24.20 lakh ((8602.75*3000*75)*0.125%). If Gupta had sold the options before closing, the STT would have been 0.05% only, on the premium. As he made roughly Rs 6.18 lakh from the trade, his total liability was reduced to Rs 18 lakh. What was supposed to be a profitable trade for Gupta ended up being a loss making one.

Gupta might just be one of the many retail traders who had to pay the price for not understanding the tax rules before trading in options. In several cases, it has never come out in the open because retail traders usually buy smaller lots. In Gupta's case, he bought a bigger quantity, thereby amplifying the hit he took. One could blame him for the lack of knowledge of the tax rules but the bigger issue that authorities need to take note is the repercussions of such blundered trades on the system.

Hypothetically, if this happened to a trader, who built bigger positions in options and was unable to square off the trades before expiry, his broker would be wiped out. Brokers claim they send regular reminders to clients asking them to square off profitable positions in options on the expiry day, but most of them go unnoticed.

Temporarily , this problem could be solved by allowing options trading in the post market session between 3:40 PM and 4:00 PM. Currently , this is allowed only for shares. Brokers, after scanning their logs for such positions, could square them off in this window. Else, the government could step in to tweak the tax rules.