



Commodity Transaction Tax – A Panacea

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ABSTRACT

The 2nd biggest country in the world to introduce a tax on commodity futures trading is India. In 1993, Taiwan imposed a transaction tax of 0.05 percent on commodity futures contract. It was launched in India to bring commodity market on par with the securities market as well as to increase the Government Revenue. Apart from revenue potential, CTT would enable authorities track transactions and manipulative activities (Dabba Trading) that undermine market integrity. Hence, CTT plays a key role in Government revenue and tracking of manipulative activities. This paper focuses on the pros and consequences of Commodity Transaction Tax in Indian Commodity Derivative Market.

KEYWORDS : Derivatives, Commodity Market, Commodity Transaction Tax, Dabba Trading.

Introduction

Derivative is a financial asset the value of which depends on another underlying asset. It allows the efficient transfer of risk from one party to another. Commodity refers to any good that possesses a physical attribute. The word commodity comes from the French word "Commodite", which is used to refer to an object of utility that offers some convenience or useful service. The Forward Contracts Regulation Act (1952) defines goods as "every kind of movable property other than actionable claims, money and securities".

Commodity transaction tax (CTT) is a tax levied in India on transactions done on the domestic commodity futures exchanges. It is similar to a Financial Transaction Tax (FTT), which is commonly associated with transactions done in the financial sector.

The commodity futures markets have witnessed a rapid increase in trading volumes, market participation and the number of commodities traded (Commodity derivatives volumes increased 26% in 2015, exceeding 4.3 billion contracts traded). The commodity futures were initially permitted to trade in agricultural products but nowadays bullion, metals and energy products dominate the trading volume. (Bullion and base Metals accounted a share of around 56.7% in the total commodity derivative trading in India).

Two exchanges play a key role in Indian Commodity Derivative trading. Namely – 1. Multi Commodity Exchange of India (MCX – accounted an average share of 84% in the total volume from 2009-15) and 2. National Commodity & Derivative Exchange of India (NCDEX – contributed an average share of 12% from 2009-15).

Review of Literature

M. Thirumagal vijaya and D. Suganya¹ (2015) in his study titled "Marketing of Agricultural Products in India" Selling on any agricultural products depends on some couple of factors like the demand of the product at that time, availability of storage etc. The task of distribution system is to match the supply with the existing demand by whole selling and retailing in various points of different markets like primary, secondary or terminal markets. Most of the agricultural products in India are sold by farmers in the private sector to Money lenders or to village traders.

Akanksha Gupta and Poornima Varma² (2015) have investigated the impact of futures trading on spot markets of rubber in India. The study focuses on the price discovery role of futures, direction of volatility spillovers, and the relationship between the futures trading activity and the spot price volatility. The results show that there is a stronger flow from the futures to spot markets, indicating price discovery in futures. The results of Granger tests show the existence of bidirectional volatility spillover in the two markets and that the futures trading activity is both a cause and consequence of spot volatility.

Shamim Ahmad and Mohammed Jamshed³ (2014) in his study titled "Nurturing an Agriculture Friendly Commodity Derivatives Mar-

keting in India" examined the analysis and discussion leads to the creation of a new institutional design exclusively for governing, monitoring and regulating the spot, futures and derivatives markets in agricultural commodities. Central Government may pass an Inter-State Agriculture Produce Trade and Commerce Regulation Act under entry 42 Inter-State Trade and Commerce of agriculture produce at national level. They found the Government of India should empower spot exchanges to function on pan-India basis through integrated single window.

Mrs.Isha Chhajed and Mr.Sameer Mehta⁴ (2013) in his research paper "Market Behaviour and Price Discovery in Indian Agriculture Commodity Market" examined the price discovery mechanism is quite effective for most commodities, but may not be very effective for some commodities. They found several natural processes such as seasonal cycles based on harvests, monsoons, depressions, and other weather events would also be expected to have an impact on price discovery in commodity markets; this is another area that needs to be studied.

Research Gap

The above literature survey reveals that a lot has been done on Leadership in the Financial Markets, volatility in the Financial Markets and the study on the regulatory framework on the Commodity Derivatives Markets. A comprehensive study relating to Commodity Transaction Tax has not been done. Therefore, the study is undertaken to understand the applicability and impact of commodity transaction tax in India.

Objectives:

1. To put a light on the commodity derivative exchanges in India
2. To identify whether CTT can trigger a sharp fall in future trading
3. To study the revenue implications of CTT.

Commodity Transaction Tax

Commodity transaction tax (CTT) is a tax levied in India on operations relating to the domestic commodity futures exchanges. It is like a Financial Transaction Tax (FTT), which is commonly associated with transactions taken place in the financial sector.

On 28th February, 2013, India introduced a CTT on the commodity futures trading under the direct tax provisions in the Union Budget of India 2013-14. CTT is imposed at 0.01 percent (Rs.10 for transaction worth Rs.1 lakh). Commodity Transaction Tax is imposed only on non-agricultural commodities futures contracts (e.g., gold, copper and oil) traded in the Indian markets. The agricultural futures contracts are relaxed from Commodity Transaction Tax. The tax is payable by the seller of commodity futures contract. The finance ministry introduced CTT to bring commodity markets on par with the securities market. A securities transaction tax is being imposed since 2004.

India is the 2nd largest Country in the world to introduce the commodity transaction tax on commodity futures trading. Taiwan levied a transaction tax of 0.05 percent on the total value of the commodity futures contract, in 1993.

Benefits???

Based on the current trading value of non-agricultural derivative commodities in the Indian exchanges, a study calculation suggests that CTT (at 0.01 percent) could fetch Rs.15, 950 million (about \$300 million) each year. This is a useful amount in the present times when tax revenues are under severe oppression and the government's attempts to reduce fiscal deficit through other measures are not producing positive results.

The income elevated through this can be utilised in many ways. Commodity Transaction Tax use a part of this tax revenue to reduce fiscal deficit. Equally important, a portion of proceeds of CTT should be utilized to enhance the regulatory and supervisory capacities of the Forward Markets Commission (FMC), which is grossly understaffed and underfunded. A part of proceeds could also be deployed to install price ticker boards at local markets and post offices across the country for demonstrating commodity futures prices. This would assist farmers and producers to get information on a real-time basis in their local languages and interest from the futures price fluctuations.

Apart from revenue potential, CTT would enable authorities track dealings and conniving activities that weaken market stability. Presently, huge information pause exist and a centralized database of currency flows is virtually nonexistent. With the execution of CTT, the government would be better supplied to orbit the inflows and outflows of money into the commodity derivatives markets. This could be particularly valuable to the Indian tax authorities as there are no effective instrument in place to deal the flow of illegal money that is discovering its way into the commodity markets. The audit course is reviewed to be a crucial factor behind the overcoming criticism against CTT.

Another key benefit of CTT lies in its progressive outlook. It would only affect speculators and non-commercial players who often use algorithmic trading to deal a significant number of commodity futures derivatives agreements at very rapid speeds. In opposite, a sales tax is typically remembered to be retrogressive since it disproportionately burdens poor people.

Also Besides, the CTT would be a more efficient revenue source than other taxes. It would be composed by the commodity futures exchanges from the brokers and advanced on to the exchequer, thereby allowing the authorities to generate revenue in a pellucid and efficient manner.

CTT - Triggers a sharp fall in futures trading?

It is too early to conclude the impact of CTT on the trading volumes as the tax came into force only on July 1, 2013. There is no contesting that the accumulative volume of trade during April-December 2013 is lesser than the compatible period of the precursory year but it would be fallacious to onus CTT for it as other dominant factors such as poor domestic market beliefs, the NSEL payment disaster including the MCX, and unfavorable price fluctuations in the overall commodity markets cannot be ignored.

During April-December 2014, CTT collection was Rs.3,750 million at the MCX, the country's largest commodity exchange, despite the drastic decline in futures trading volume during this period.

The primary market trends suggest that CTT had no significant negative impact on real hedgers – existing of producers, processors and consumers of the underlying commodity – who use futures markets primarily for hedging purposes.

Closely, there is no proof to evince that CTT has shifted futures trading to an illegal platform (popularly called 'Dabba' trading), as anticipated by many market participants.

Revenue Implications

Making revenue from CTT is a short -sighted move and it is evident from the below table.

Table: 1 Estimated total Income Tax Revenue from the 3National Commodity Exchanges for the Financial Year 2007-08: The Base Case (in Rs. Crore)

Tax from brokerage income	196.35
Tax from exchange income of transaction fees	13.09
Tax from profits of intra-day traders	1570.79
Tax from profits of long-term players	654.5
Total tax revenue	2434.72

CTT- a panacea?

In spite of number of benefits, a levy of 0.01 percent alone cannot the problems of Indian commodity futures markets. It should not be considered as a proxy regulation and supervision of futures markets.

CTT should be used in concurrence with other weights as it does offer an attractive mechanism to reform the Indian commodity derivatives markets. Hence, it should be part of policy measures to ensure that commodity futures markets function in a fair and orderly manner. In the larger interest of the macro economy, the economic and developmental gains of taxing speculative investments in the commodity futures markets are more than the private gains of speculators and day traders.

Conclusions

Market players anticipate fall in trading volumes by 65-75 percent. An anticipation of 90 percent reduction in volumes is expected after the execution of CTT. Hence, it is indicating to increase in the revenue loss. In nutshell, it is a discouraging element in Indian commodity derivative trading in India and will be a recipe of disaster even to government.

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