Why Commodity Transaction Tax Must Go

(This editorial is based on the article "Why commodity transaction tax must go" which appeared in The Hindu on 17th December.)

Commodity Transaction Tax (CTT) is claimed as a tax that harmed more than doing good in India. It is argued that it was introduced for the wrong reason. While typically such taxes are levied to curb excessive speculation or to garner tax revenue, the Centre used CTT as a tool to make trading shift from commodity to equity futures.

A commodity futures contract is an agreement to buy or sell a predetermined amount of a commodity at a specific price on a specific date in the future. Buyers use such contracts to avoid the risks associated with the price fluctuations of a futures' underlying product or raw material. Sellers use futures contracts to lock in guaranteed prices for their products.

Stock Futures are financial contracts where the underlying asset is an individual stock. Stock Future contract is an agreement to buy or sell a specified quantity of underlying equity share for a future date at a price agreed upon between the buyer and seller.(A stock is a share in the ownership of a company).

What is Commodity Transaction Tax?

> It is introduced to tax commodity trading in India where both parties—buyer & seller of contract—will be taxed depending on the amount of the contract size. CCT is similar to the securities transaction tax (STT)-(a tax payable in India on the value of securities (excluding commodities and currency) transacted through a recognized stock exchange) levied on the purchase and sale of equities in the stock market.

Background

- **In the Union Budget of 2008-09, P Chidambaram first mooted the idea of CTT.**
- At that time, the intention appears to have been to garner revenue from a section of the market that was growing at a brisk pace.

- The Budget proposal was not implemented due to ardent opposition of the commodity exchanges and traders.
- However, in 2013, lobbying by stock exchanges drowned the protests of commodity exchanges in the corridors of power. The stock exchanges argued that Securities Transaction Tax levied on equity derivatives had made transacting in stock futures and options more expensive and an unfair advantage was being given to commodity derivatives that were free from transaction tax until then. They were of the view that this was resulting in shifting volumes from equity to commodity futures.

Commodity derivatives are financial instruments whose value is based on underlying commodities, such as oil, gas, metals, agricultural products, and minerals.

> In 2013 CTT was imposed on non-agricultural commodities futures contracts at 0.01 per cent of the contract price. While most agri commodities were exempt from this tax, some processed commodities were brought under the purview of this taxation. In 2018, CTT has been imposed on commodity options too.

Impacts

- A lot has changed with the introduction of the CTT by the Government in 2013.
- The reason why CTT was introduced during financial year 2013-2014 (for non-agricultural commodities) was to bring parity between the equity and commodity derivative markets.
- However, with CTT, transaction cost for a trader increased five times, causing the trader to rethink his/her options as the proposed rate does not reflect the volatility conditions of the commodity vis-à-vis equity derivative markets (equity markets are more volatile/unstable as compared to commodities).
- This resulted in CTT having a significant negative impact on the trading volumes of all commodities, leading to India's global ranking dropping to lower levels.
- By 2025, the Government potentially stands to lose about ₹4,300 crore in aggregate if CTT remains in force. Due to the lower volume, the revenue from CTT collection has been so meager that it is clubbed with other income taxes in the Union Budget.
- Financial participants in non-agri segments were also affected. There is some increase in market volatility in the last year for bullion contracts (copper, gold, and silver) also.
- Introduction of CTT has, therefore, dealt a severe blow to the volume of bullion, energy and base metal contracts traded on commodity exchanges while causing an unnecessary spike in stock futures trading.

Way Forward

- Financial participants such as arbitrageurs [someone who engages in arbitrage i.e purchases securities in one market for immediate resale in another in the hope of profiting from the price differential] and traders, who have moved away due to the CTT levy, are needed to impart liquidity in any market. The Centre therefore needs to seriously consider removing the transaction tax on commodity derivatives.

- The commodity derivative segment is more important than equity because it helps commodity producers and other manufacturers manage their price risk.
- Since this segment is still at a nascent stage, burdening it with additional transaction taxes, which yield paltry sums to the exchequer, makes very little sense.
- The Government could also consider a reduction in this transaction tax (in line with other international exchanges) if not removal, as this would make Indian exchanges globally competitive, thereby increasing trading volumes significantly leading to higher revenues through taxation on profits made by each stakeholder in the system.