What is Commodities transaction tax?

Heads of India's five commodity futures exchanges have been vehemently opposing the idea of a transaction tax on commodity trades similar to that on stock and equity derivatives trades. They say a commodity transaction tax will sound the death knell for the organised commodity futures market as the cost of trading will shoot up eight-fold from around 2 per lakh now.

Their arguments followed comments by a leading stock exchange and a few bankers, the latter during pre-budget talks with Finance Minister P Chidambaram, that such a tax should be imposed on commodity futures trades to stem the flow of investor funds from equity markets to unproductive commodity trades.

WHAT IS A COMMODITIES TRANSACTION TAX OR CTT?

CTT is a tax levied on exchange-traded commodity derivatives in India on the lines of the Securities Transaction Tax or STT — a tax imposed on the purchase and sale of securities and their derivatives traded on stock exchanges in the local market.

WHY HAS SUCH A TAX BEEN PROPOSED?

In the 2008-09 Budget, Finance Minister P Chidambaram proposed the introduction of CTT on the same lines as STT on options and futures, saying that transactions in commodity futures have come of age. Subsequently, the proposal was dropped after the Prime Minister's Economic Advisory Council or PMEAC cautioned against the levy.

WHY HAS DEMAND FOR THE TAX BEEN RENEWED?

Currently, transaction tax is levied only on equity cash and equity derivatives transactions . The argument is that since transaction charge is a well established tax system in the equity market, the same should be replicated in commodity futures trading too. Proponents of the tax further point out that imposing a transaction tax on commodity derivatives will provide a level playing field between equity and commodity trading markets.

The Bombay Stock Exchange pitched for it, saying that a transaction tax on equities was forcing traders to move to the commodities segment.

WHY ARE COMMODITY EXCHANGES OPPOSING CTT?

According to commodity exchanges, exchange traded commodity derivatives are risk management platforms for hedging against adverse price movement. CTT on commodity derivatives could increase the cost of hedging transactions, impair hedging efficiency and drive out hedgers, they say. They also fear that imposing CTT will boost illegal dabba trading.

Dabba trading is an illegal market in which participants do not have to pay margin requirements , mark-to-market margins, transaction fee and taxes. They point to the fact that no less a body than PMEAC had warned against such a levy and that trades have in fact shifted from equity futures to equity options as tax on the latter is on the option premium, which is much less.

WHAT ARE STT RATES CURRENTLY?

An STT of 100 per lakh, or 0.1% of the transaction amount, is levied on buyer and seller in the equity cash market. A seller of an equity futures or options contract, which is cash settled, pays an STT of 17 per lakh (0.017%) each. If an option is exercised by a buyer, (s)he pays 125 a lakh, or 0.125%. However, since STT on options is calculated on the premium , the figure tends to be much smaller.

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