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Don't tax CDM before it takes off

by invitation

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THE commodity derivatives market (CDM) is at a nascent stage in the country. It's only 4 years old. Participation of banks, mutual funds, FIs, FIIs is still not allowed. Options contracts, index futures and futures based on intangibles are still to come. Therefore, the correct approach would be to let the market grow properly after enabling all types of instruments and participants, and letting the market attain its full potential. Don't tax it before it properly takes off. When STT was applied on stock exchange, it was grown to its size and all types of contracts were available on its platform.

Fundamentally, the stock market and the commodity market are different. Stock derivative is based on local underlying assets, while commodity derivatives are based on global underlying assets — gold, soya, cotton, etc. If an investor has to buy/sell Indian stocks, he has to trade on Indian stock exchange but if a trader has to trade in gold futures, he can trade on MCX, COMEX, TOCOM or Shanghai, depending upon the respective cost of transaction. Cost of transaction at Indian commodity exchanges has to be on par with international markets. Otherwise, the entire volume will just shift to international exchanges, which was the status before the government lifted the ban in 2003.

While the stock market is a place for investment and capital formation, commodity derivatives market is a places for hedging and insurance against price fluctuation. While stock derivatives are based on underlying assets, commodity derivatives are based on consumables. All stock F&O contracts are cash settled contracts, but commodity derivative contracts are based on physical deliveries. Thus, existence of STT does not justify imposition of CTT.

Profit/loss arising out of transactions in stock F&O are treated as business income/loss, which can be set off against any other business loss/profit. But, profit/loss arising out of commodity derivatives is treated as speculative profit/loss, which is not allowed to be set off against other business loss/profit. Treatment of profit/loss relating to commodity derivatives as normal business income/loss is a long pending justified demand of the industry — to get it on par with global commodity markets.

In many countries STT exists but CTT is not applicable. Hence, there is no rationale for applying the same in Indian commodity derivatives market. In the stock market, both spot and futures are well-regulated and conducted under the umbrella of electronic exchanges. In commodity market, physical market exists outside the purview of electronic exchanges. Thus the imposition of CTT on futures, while spot continuing outside its purview, will create distortion in prices, divergence of spot and futures at maturity and wrong price signals.

CTT will also create a regulatory arbitrage between national electronic commodity exchanges and regional ring-based exchanges. Apart from three national exchanges, there are 22 regional commodity exchanges and as per the policy followed by regulator, they are not under any compulsion to implement online trading. Under-reporting of transactions is the perennial problem in all out cry markets. Imposition of CTT will aggravate this problem and will lead to regulatory arbitrage between regional exchanges and national exchanges.

Commodities are subject to many taxes like mandi fee, sales tax /VAT, CST, excise, custom, octroi, etc., but stocks are not subject to any such taxes. Therefore, CTT should not be applied on commodity market which already suffers from so many taxes. Any additional tax will impact the consumer-paid price and lead to price inflation, which is already a cause of concern. Last year, stamp duty was made applicable in this market.