TRANSACTION TAX to Hit Volume in Base Metals on Futures Exchanges

- Metalworld Research Team

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Trading in base metals in domestic commodity futures exchanges has become costlier with the Finance Minister P. Chidambaram leving 0.01 percent commodity transaction tax (CTT) in the recent budget effective next financial year. Experts believe that the commodity derivatives market was not ready with this tax which would drive volume from Indian exchange to overseas platform including the London Metal Exchange (LME), Shanghai and COMEX where base metals are widely traded even by Indian multinationals.

What is CTT ?

The CTT is a tax to paid by the buyers on the exchange platform. The CTT was announced by the Finance Minister in the Union Budget 2009-10 but, was kept on hold due to the pre-mature of commodity derivatives market at that point of time. The Finance Minister levied 0.01 per cent transaction tax on the buyer side on non-agri commodities affecting thereby, the interest of base metals traders including copper, aluminium, lead and zinc to name a few. This resulted into around five times increase in increase in the cost of transaction on Indian futures exchanges. The levy has made India as the costliest place for transaction business in commodity futures. Currently, the exchanges charge hardly 0.002 per cent from traders in addition to membership fee which made India as a competitive place for domestic traders and corporate for hedging. Indian corporate, meanwhile, are allowed to hedge their risk on overseas platforms for which they require to obtain necessary permission from the Reserve Bank of India which they feel, is a cumbersome process. Since, they do not want to pass through all these government procedures; they hedge their raw material risk on domestic exchanges.

According to Shreekant Javalgekar, managing director (MD) of the Multi Commodity Exchange: "CTT will increase the transaction cost by 300 per cent on an average, which will drive the trades towards dabba trading (not part of the stock exchange platform) or international markets. The commodity futures markets have created nearly 10 lakh jobs in non-urban areas, which might now come under threat. This is also expected to be inflationary, as the spot market and futures market move together."

Rising Volume

Domestic commodity exchange expanded their horizon through a number of awareness programmes in remote villages to attract participation from hedgers and speculators from tier III, IV and V cities. According to trade sources, FMC in association with

NIFTY FUTURES - AVERAGE DAILY TURNOVER FOR THE YEAR (RS CRORE)				
Year	SGX	Change (%)	NSE	Change (%)
2008	700.69	883.22	15536.36	15.89
2009	358.03	(-)48.90	13771.81	(-) 11.36
2010	978.67	173.35	13909.65	1.00
2011	1393.18	42.35	13262.28	(-) 4.65
2012	1658.59	19.05	8618.15	(-) 35.02
2013*	1591.95	(-)4.02	5732.88	(-) 33.48

**Till Feb 05, 2013, Source : Bloomberg*

commodity exchanges, farmers' organizations and associations, conducted around 1000 capacity building programmes which in an effort attract participation from rural potential traders. Although, all national level exchanges including Multi Commodity Exchange (MCX), National Commodity & Derivatives Exchange (NCDEX), Indian Commodity Exchange (ICEX), Ace Derivatives & Commodity Exchange (Ace) and National Multi Commodity Exchange (NMCE) reported a marginal 5.17 per cent decline in their cumulative turnover between April 1, 2013 and February 15, 2013. Data compiled by the FMC showed accumulative turnover at Rs15109155.68 crore between April 1, 2013 and February 15, 2013 as compared to Rs 15932497.90 crore in the corresponding period last year.

Base metals, however, showed a staggering increase in its turnover during the period under comparison. Total turnover in base metals across all commodity exchanges went up sharply by 15.22 per cent to Rs 2844364.66 crore between April 1, 2013 and February 15, 2013 as compared to Rs 2468560.47 crore in the same period last year.

Past Experience

With the finance minister P Chidambaram introducing securities transaction tax (STT) of 0.125 per cent on delivery and 0.025 per cent on intraday equity trade effective the financial year 2005-06 making, thereby, India as the costliest country for equity trading, the DAT of Nifty futures started gradually declining. At the same time, however, DAT of Singapore Exchange (SGX) steadily shot up. In the last six years, DAT of Nifty futures fell sharply on the NSE to Rs 5732.88 crore in 2013 compared to a staggering Rs 15536.36 crore. In contrast, DAT of SGX shot up to 1591.95 crore in 2013 from the level of Rs 700.69 crore in 2008. Traders believe that the incremental volume, in addition to existing volume, has shifted to SGX where a negligible 20 bps of STT is levied. In India, however, total transaction charges work out to 0.469 per cent of which STT works out to 26.64 per cent.

Voicing Concerns

"The equity volume which India lost because of STT is yet to recover because of alternative options available for foreign institutional investors (FIIs) where transaction charges costs are much lower," said Priti Gupta, Executive Director of Anand Rathi Commodities. Now, the finance minister's decision to levy the same in commodity futures is set to raise commodity futures transaction cost. Priti believes that the volume which commodity exchanges and the markets regulator the Forward Markets Commission (FMC) have built over the last several years would be lost to overseas platforms. Small time investors and hedgers would be affected the most from this levy. "The retail portion constituting around 40 per cent of daily exchange turnover would either be shifted to the unorganized (dabba) market where the finance minister would have no control, or, they would go out of the market permanently. Similarly, corporate hedgers who can take the cumbersome process to get clearance from the Reserve Bank of India (RBI) for trading on overseas commodity exchanges would do so or they would also go out of the market. The third type of traders, intraday arbitrageurs would completely shut down their shops to opt for alternative business model," said Priti.

D R Dogra, MD of CARE Ratings, said: "Overall, the budget is positive for the farm sector." He commends three aspects. First, targeting a higher level of credit for the sector, enabling farmers to seek loans for cropping. Second, continuation of the interest subvention for the community, with farmers under pressure since last year on account of a poor monsoon in some areas. The third is inclusion of private banks in this scheme. So far, it was the public sector, cooperative and regional rural banks which were covered. The finance minister was silent, though, on sugar decontrol, despite several committees recommending this. Also, on the issue of raising the import duty on edible oil, despite record imports.

Said Ajay Kedia, Managing Director of Kedia Commodity, a Mumbai-based commodity broking firm, "Finance Minister introduced a tax on transaction of non-agricultural commodities on exchanges so as to facilitate a more open and transparent trading process, especially in gold contracts. However, it is belief that this move will reduce liquidity in the market, and widen the bid-ask price spread. This move could also reduce demand for trading of commodities on derivative exchanges Commodity transaction tax, or CTT, was originally proposed in Union Budget 2008 but abolished in the Budget of 2009 based on the recommendation of the Prime Minister's Economic Advisory Council."

By introducing CTT on non-agri commodity government can fetch near Rs 1500 crore as per last second years data, this will be a setback for the commodity market as it will help to grow Dabba trading more due to the cost which will be spicked by almost 485%.

Added Javalgekar, with respect to commodities transactions tax (CTT), the discrimination is glaring between agri and non-agri commodities; which is not the case as regards STT. This treatment is like having STT on shares of 'Company A' and no STT on 'Company B'. Further, currency markets are 500% bigger than the commodities markets, yet there is no transaction tax levied on them, which is again discriminatory. Gold ETFs too have been charged at 0.001 % as against 0.01% for Gold futures traded on commodity futures markets. Gold

ETFs is 100% backed by physical gold.

Meanwhile, R Ramaseshan, managing director of NCDEX lauded FM's CTT levy. "The Finance Minister has taken a much nuanced stand on the issue of taxes on commodity derivatives. By removing the tag of 'speculative income' on gains made from trading in commodity derivatives the FM has extended a hand of support to the market participants which will strengthen commodity markets. He has also taken a calibrated approach with respect to Commodity Transaction Tax (CTT) by proposing a 0.01% tax only on transactions in non-agricultural commodities at this point of time. Coming as this does with the renewed support for agricultural sector as a whole, it will further strengthen the agricultural commodity derivatives market in India," he said.

Experts believe that global commodity futures trading platforms including the London Metal Exchange (LME), New York Mercantile Exchange (NYMEX) and Chicago Mercantile Exchange (CME) and Bursa Malaysia have been working hard to grab Indian corporates' hedging business. Levying

CTT would be a readymade tool for them to grab business from Indian corporate without any effort. For hedging in edible oil group, traders would shift to Bursa Malaysia while for base metals people would opt for LME. Similarly, for the crude oil and agri commodities basket, traders would have option for Nymex and CME respectively. "On most of global exchanges, however, traders do not require to pay exposure-free margins upfront commencing trade. The credit line provided by brokers is enough to start trading. Hence, commodity trade volume would move to overseas exchanges as experienced in the case of equity," said an analyst.

A report from Dun & Bradstreet, said, "Levy of CTT on non-agricultural commodities futures contracts at the same rate as on equity futures, at 0.01% of the price of the trade. Agricultural commodities will be exempted." The measures undertaken by the Government to boost the capital market are positive as they aim to enhance activity in the market. Reduction of STT will reduce transaction cost, revive intra-day trading, promote retail participation and boost the equity market. Further, levy of CTT on nonagricultural commodities to bring derivative trading in the securities market at par with derivative trading in the commodities market will further boost the equity market, it added. ❍❍❍