Members present are:

1. Dr. A. Bijikumari Amma.
   Joint Commissioner (A & I),
   Office of the Commissioner of Commercial Taxes, Thiruvananthapuram.

2. N. Thulaseedharan Pillai.
   Joint Commissioner (General),
   Office of the Commissioner of Commercial Taxes, Thiruvananthapuram.

3. S. Anil Kumar.
   Deputy Commissioner (Internal Audit),
   Office of the Commissioner of Commercial Taxes, Thiruvananthapuram.

Sub :- KVAT Act, 2003 – Clarification U/s 94 – Whether the turnover in the futures market and market margins comes within the purview of taxable turnover under the KVAT Act – Orders issued.

Read :-


2. Judgement of Hon’ble High Court of Kerala in WP(C) No. 15211 of 2016 (B)

ORDER No.C3/12215/16/CT DATED 06/10/2016.

1. Sri. Joshy Varghese, Mankada Trading Company has preferred an application U/s 94 of the Kerala Value Added Tax Act, 2003, seeking clarification as to whether the turnover in the futures market and market margins received by the participants in the future market comes under taxable turnover or the said transaction comes within the purview of explanation VIII(a) to the definition of sale in section 2(xliii) of the KVAT Act.

2. The applicant is a dealer registered on the rolls of the Commercial Tax Officer, Perinthalmanna. The applicant is doing business in future trading. The applicant has submitted that he is proposed to enter into future contracts with other similar dealers by executing agreement to buy commodity like Rubber, Pepper, Areca nut etc. to sell at a future date. The applicant would submit that future trading takes place in respect of goods which is not in existence as on the date on which the transaction takes place. The system works as per the rules and regulations made by the Forward Marketing Commission functioning under the Ministry of Consumer Affairs, Food and Public Distribution, Government of India.
Under the said Commission there are so many exchanges like the National Multi-commodity Exchange of India Ltd.

3. The applicant explains how the system works, as follows.

On a particular day, say 20th July, 2016, a dealer say A (buyer) agrees to buy one Metric Ton of rubber at Rs. 150/- per kg for 15th October 2016. This date is known as the “Contract Expiry” date. On the same day another dealer B (seller) may agree to sell rubber of the same quantity for Rs. 150/- per kg also for 15th October, 2016. A & B do not pay/receive any consideration at the time when they enter into the contract, but only have to deposit a margin amount (which varies from 4% to 15%) to the exchange. As far as A is concerned, the seller remains anonymous. Similarly in the case of B, the buyer remains anonymous. Suppose, on 21st July, the market price of the commodity increases to Rs. 160/- per Kg. Then the commodity exchange will debit B by the differential amount (Mark to Market – MTM), i.e., Rs. 10/- per KG and credit A by the same amount. If on the next day the price falls to Rs. 140/-, the exchange will credit B, the seller with Rs. 20/- and debit the buyer A by Rs. 20/-. This debit and credit goes on till the date the contract matures and A either takes delivery of the goods or squares off his position, since he has the liberty to square off his position agreed to be bought by him on any day before the contract expiry date. In such instances there is no physical sale. Similarly, it is also not necessary that B, the seller in the present case should have any stock of rubber to enable him to participate in future trading. He need possess the stock only if he has to deliver the goods on expiry of contract. In these instances, when either A or B exit, C will take their place. It is not possible even for the Commodity Exchanges to exactly earmark each buyer to seller though the total number of buyers and sellers will always remain equal. Any dealer, anywhere in India, who is not even registered, can participate in future trading and earn or lose money. A dealer is required to have registration only if he, as a buyer, has to take delivery of the goods on the contract expiry day. So, for participating in futures trading the participant need not possess any goods at all and hence he need not be a registered dealer (not even a dealer).

On the expiry of the contract all participants who have an outstanding sell position are required to deliver the goods. This is done at the settlement price of the contract which is the closing price at the expiry of the contract on the last day, irrespective of whether such price is lower or higher than the price of the commodity on the date on which the agreement to sell/buy was entered into. Invoice will be raised for the price on the date of delivery. The buyer does not know in advance as to who is the person who will raise the invoice on contract expiry and vice-versa. An actual sale/purchase takes place, wherein there is a transfer of ownership and movement of consideration, only on contract expiry. The price charge on the goods actually handed over to the buyer will be turnover of the seller.

The amount standing to the credit of the buyer or seller on account of the working of the system, without any transfer of goods, will be his gain on account of the operation of the system of future trading. This amount does not have any relation to the goods bought or sold. The buyer will be paying the tax on the basis of the bill issued at the time of physical delivery of the goods. If the seller realizes any amount more than that, it will amount illegal collection of tax. The profit on future trading is given by the agency which undertakes the “future trading” by maintaining a ledger account for dealers who participate in the future trading. The agency or the recipient will not be in a position to pin point whether the amount received by a dealer at the end of a specific period due to the operation of the system of future trading relates to a particular sale or not. The amount received need not have any relation at all to any goods as the system works even without any goods in the possession of the seller, except in the case of actual physical delivery of goods.
The Exchanges clearly define Cash/physical market separate from derivative market. There are Spot Exchanges and Derivative Exchanges. In Derivative Exchanges physical delivery of goods takes place only when the contract expires.

4. The applicant would contend under section 6 of the KVAT Act, liability to pay tax is on the taxable turnover. “Taxable turnover” is defined to mean the turnover on which a dealer shall be liable to pay tax as determined after making such deductions from his total turnover in the prescribed manner. As per clause (iii) of section 2 of the Act, the term “turnover” is defined as follows.

(iii) “Turnover” means the aggregate amount for which goods are either bought or sold, supplied or distributed by a dealer, either directly or through another, on his own account or on account of others, whether for cash or for deferred payment or for other valuable consideration, provided that the proceeds of the sale by a person not being a Company or Firm registered under the Companies Act, 1956(Central Act 1 of 1956) and Indian Partnership Act, 1932 (Central Act 9 of 1932) or society including a co-operative society or association of individuals whether incorporated or not of agricultural or horticultural produce grown by himself or grown on any land in which he has an interest whether as owner, usufructuary mortgagee, tenant or otherwise, shall be excluded from his turnover.

5. The applicant would also contend that as per rule 9, the total turnover of a dealer for the purposes of the rules shall be the aggregate of the amount for which goods are sold by a dealer and amount for which goods taxable under sub-section (2) of section 6 are purchased by a dealer. As per clause (xliv) of section 2 of the Act,

Sale price means the amount of valuable consideration received or receivable by a dealer for the sale of any goods less any sum allowed as cash discount, according to the practice normally prevailing in the trade, but inclusive of any sum charged for anything done by the dealer in respect of the goods or services at the time of or before delivery thereof, excise duty, special excise duty or any other duty or taxes except the tax imposed under this Act.

The term sale is defined as under.

(xliii) “Sale” with all its grammatical variations and cognate expressions means any transfer whether in pursuance of a contract or not of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or for other valuable consideration, but does not include a mortgage, hypothecation, charge or pledge;

Explanation VIII:- (a) The sale or purchase of goods shall be deemed, for the purposes of this Act, to have taken place in the State where the contract of sale or purchase might have been made, if the goods are within the State,-
(i) in the case of specific or ascertained goods at the time the contract of sale or purchase is made; and

(ii) in the case of unascertained or future goods, at the time of their appropriation to the contract of sale or purchase by the seller or by the purchaser, whether the assent of the other party is prior or subsequent to such appropriation;

(b) Where there is a single contract of sale or purchase of goods situated at more places than one, the provisions of clause (a) shall apply as if there were separate contracts in respect of the goods at each of such places;

(c) For the purpose of this Act, the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract shall be deemed to have taken place in the State, if the goods are within the State at the time of such transfer irrespective of the place where the agreement of works contract is made, whether the assent of the other party to the contract is prior or subsequent to such transfer;

6. The applicant would further contend that a particular transaction should amount to “sale” and the consideration there for should amount to “turnover”, there should be two parties, who should enter into a contract of sale in pursuance of which the seller should deliver and the buyer should accept the specified goods, which is the subject matter of such sale, i.e. the goods should be appropriated to the contract of sale. In the case of future trading, trading takes place in respect of future goods. So even without the physical existence of goods, a dealer offers to sell, without knowing who the buyer is, and another dealer offers to buy without knowing who the seller is, goods which may come into existence on a future date. Also, the amount (MTM) received by a dealer on account of the operation of the system of future trading, which is independent of the goods ultimately sold, from the agency working under the NMCE/NCDEX/MCX, cannot, by any stretch of imagination be termed as “turnover” for the purposes of section 6 of the Act. On the said amounts, the recipients are subject to income tax. All along the said amount was regarded as income of the recipient and was never included in the turnover of the recipients.

7. The applicant has placed his reliance on the judgement of the Hon’ble Supreme Court in the Sales Tax Officer, Pilibhit vs. M/s. Budh Prakash Jai Prakash and would contend that the amount received by the applicant as gain from future trading will not come under the purview of “turnover” of the appellant. The observation of Hon’ble of Supreme Court in the above case is as follows.

“The position therefore is that a liability to be assessed to sales tax can arise only if there is a completed sale under which price is paid or is payable and not when there is only an agreement to sell, which can only result in a claim for damages. It would be contrary to all principles to hold that damages for breach of contract are liable to be assessed to sales tax on the ground that they are in the same position as sale price. The power conferred under entry 48 to impose a tax on the sale of goods can therefore be exercised only when there is a sale under which there is a transfer of property in the goods, and not when there is a mere agreement to sell. The State Legislature cannot, by enlarging the definition of “sale” as including forward contracts,
arrogate to itself a power which is not conferred upon it by the Constitution Act, and the definition of “sale” in section 2(h) of Act XV of 1948 must, to that extent, be declared ultra vires.”

And held that the receipt from forward contract will not form part of the turnover.

8. The applicant has also referred to a communication issued vide D.O.No. 3/8/2010-MKT-II dtd. 02-03-10 by Forward Markets Commission [constituted under the provisions of the Forward Contract (Regulation) Act, 1952] to the Chief Secretary to Government stating inter alia, that –

“VAT is payable on such actual delivery which happens after the contract is settled. If the contract is settled other than by delivery, no VAT would be payable because VAT is leviable only on actual sale of goods.”

9. The authorised representative of the applicant was heard in the matter and the contentions raised were examined.

10. The matter had been examined earlier and vide this office letter C1-36674/08 dtd. 25.05.2010, instructions were given to all DCs and DC(I)s that as per the procedure of future trading, the goods are not ascertained when the contracts are entered into and there is only an agreement to sell. So, in respect of unascertained or future goods, the sale takes place only at the time of their appropriation to the contract of sale. Hence, only those contracts which result in actual physical delivery of goods alone will be exigible to Value Added Tax as per the definition of sale in KVAT Act, 2003.

11. In the light of the above, it is clarified that turnover relating to market margins received by the participants in the future market would not come under the purview of the taxable turnover under the KVAT Act.

The issues raised above are clarified accordingly.

Dr. A. Bijikumari Amma
Joint Commissioner (A&I)
O/o CCT

N. Thulaseedharan Pillai
Joint Commissioner (General)
O/o CCT

S. Anil Kumar
Deputy Commissioner (Internal Audit)
O/o CCT

To

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