I-T scanner on end-beneficiary details of P-notes

The international taxation arm of the income tax (I-T) department has sought details of end-beneficiary subscribers of participatory notes (P-notes) from some leading offshore derivative instrument (ODI) issuers in the country.

According to a senior official, the I-T department suspects that these instruments are being used to legalise unaccounted money.

The issue came up when taxmen found certain discrepancies in the disclosures made by ODI issuers. Nearly half a dozen P-note issuers could come under scrutiny.

"Details mentioned in the Know Your Customer (KYC) disclosures were not tallying with the tax authority's database. We need more information from the issuers to ascertain if any law has been violated. We will get the data in the next few weeks," the official said.

The move comes in the wake of amendments in tax treaties with Mauritius and Singapore. Till now, all the investments coming from these countries were exempt from short-term capital gains (STCG) tax.

However, the STCG tax will be levied even on these transactions. Exploiting the tax arbitrage, investors from around the world invested in Indian equities through shell entities in these countries.

Besides, the tax department is also keeping an eye on those entities that recently shifted or are in the process of shifting their base to countries that have a double-taxation avoidance treaty or special tax treaties, such as France, Sweden, or the Netherlands, allowing investors to avoid paying tax in India.

Routing investments through these countries would negate the impact of the General Anti-Avoidance Rule (GAAR) — which came into effect from April 1.

"Shifting base to other countries is one of the concerns that has created ripples with the tax authorities. Investing in India via these countries which have special treaties could derail the government's tax target," said Amit Maheshwari, partner at Ashok Maheshwary and Associates LLP.

P-notes have been under the radar of various Indian regulatory and enforcement authorities because of lack of transparency.

P-notes are essentially ODIs issued by brokerages registered as foreign portfolio investors (FPIs) with the Indian market regulator market regulator the Securities and Exchange Board of India (Sebi).

These are considered a way to take indirect exposure to Indian markets and are typically taken up by investors whose exposure is low and they want to minimise compliance cost. However, the absence of enough checks and balances in terms of disclosures led to the misuse of the route, as investors channelised their unaccounted money into equities through ODIs. Sensing the abuse, a special investigation team (SIT) urged the government to tighten the regulatory framework for p-notes.

In 2016, Sebi tightened the regulations for p-notes. Under the new rules, Sebi had increased the KYC requirements, issued curbs on transferability, and prescribed more stringent reporting for p-notes issuers and holders. It also mandated issuers to follow Indian anti-money laundering laws instead of norms prevalent in the jurisdiction of the end beneficial owner.

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