70% of P-Notes come via Singapore, Mauritius

Some 36.5% of the total offshore derivative instruments have been channelled through Singapore and 30% through Mauritius

As of 29 February, there were 37 FPIs with outstanding ODI positions of `2.17 trillion, according to the Sebi website. Photo: Mint

Mumbai: More than two-thirds of foreign fund flows through Participatory Notes, or offshore derivative instruments (ODIs), have been routed through Singapore and Mauritius, which have tax treaties with India that are advantageous for investors in these instruments.

Some 36.5% of the total ODIs have been channelled through Singapore and 30% through Mauritius, according to data compiled by the capital markets regulator, a copy of which has been reviewed by *Mint*.

Participatory Notes, or P-Notes, are instruments issued by registered foreign portfolio investors (FPIs) to overseas investors, who wish to invest in Indian stock markets without registering themselves with the Securities and Exchange Board of India (Sebi).

“One of the reasons why a majority of the P-Note investment comes from Singapore and Mauritius could be that the FPI, which is the P-Note holder does not have to pay any Indian capital gains tax if it is based in Singapore or Mauritius under these treaties,” said Rajesh Gandhi, Partner-Tax, Deloitte Haskin & Sells. FPIs based in few other countries including the Netherlands, France, Cyprus and South Korea also get capital gains tax exemption under their respective treaties with India, he said.

The tax treaty with Mauritius prevents India from taxing capital gains of investors based out of Mauritius.

Since there is no capital gains tax in Mauritius, these investors pay no capital gains tax in either country. Singapore has a similar treaty with India. Singapore also does not have a capital gains tax regime.

As of 29 February, there were 37 FPIs with outstanding ODI positions of `2.17 trillion, according to the Sebi website. Outstanding ODI value is 10.7% of the assets under custody of FPIs. While the aggregate data is released by the regulator, the break-up of ODI holdings is not.

An email sent to Sebi to confirm these figures on Monday remained unanswered.

Sebi data accessed by *Mint* shows that Morgan Stanley Asia (Singapore) has the highest market share at 14.35% of all ODIs valued at `31,246 crore. The second-largest outstanding ODI position of `24,161 crore is held by Copthall Mauritius Investment Ltd, a unit of JP Morgan Chase & Co. The market share of this Mauritius-based unit of the bank is 11.26%.

Goldman Sachs (Singapore) Pte is the third largest with outstanding ODIs of `19,360 crore. The Singapore branch of Zurich-based Credit Suisse Group AG has a 7.64% market share with outstanding P-notes valued at `16,638 crore. The only unexpected jurisdiction to figure in the list is Spain. Merill Lynch Capital Markets Espana held P-notes valued at `12,258 crore.

“The market share numbers provided by you are correct and their activity in the Indian equity markets is simply a reflection of client demand,” Credit Suisse said in an e-mailed response to a query. Bank of America Merrill Lynch declined to comment on the story. Emails sent to Goldman Sachs, Morgan Stanley and JP Morgan Chase on Friday and subsequent reminder on Tuesday did not elicit a response.

Rules related to ODIs were tightened in 2014 by Sebi. These rules now put the burden on the FPIs to make sure that the instruments are not sold to anyone who is not regulated by an appropriate foreign regulatory authority.

P-Notes also cannot be issued to a resident of a country identified by the inter-governmental Financial Action Task Force as being lax on money laundering and terror financing regulations. Sebi has powers to obtain information regarding the final holder or beneficiaries.

Sebi chairman U.K. Sinha has said that strong measures have been put in place to check misuse of instruments like P-Notes, *PTI* reported on 13 March.

“P-Note issuers purchase underlying Indian security as hedge. It is logical for them to operate out of jurisdictions that afford investment protection for the underlying investment and eliminate double taxation. Issuers otherwise may pass on the costs and liability to the P-Note subscriber which could impact the overall business,” said Richie Sancheti, head, investment funds, Nishith Desai Associates. “Under the law, ODIs can be issued to those regulated by an ‘appropriate foreign regulatory authority’. This addition to the eligibility criteria allows Sebi to gather relevant information about such ODI subscribers from their regulators,” he added.