

## P-Notes make a comeback under GAAR

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Participatory notes (P-Notes) have been long vilified for the anonymous nature of their investors and suspected as a route for money laundering. Photo: Hemant Mishra/Mint

**Mumbai:** Participatory notes (P-Notes), long vilified for the anonymous nature of their investors and suspected as a route for money laundering, are seeing rising interest among short-term foreign investors as the general anti-tax avoidance rule (GAAR) became applicable from 1 April.

Foreign portfolio investors, especially those from countries which don't have any tax treaties, typically route their investments through so-called special purpose vehicles in Mauritius and Singapore to save on taxes. Mauritius and Singapore have tax avoidance treaties with India. This is a favoured route, especially for hedge funds, while trading in futures and options or investing for the short term.

Under GAAR, foreign investors would need to prove that such structures are not aimed at evading taxes. GAAR gives the tax department powers to scrutinize transactions structured in such a way as to deliberately avoid paying tax. Failure to show that a transaction was not structured to evade levies means investors will have to cough up 15% tax on equities and 30% on equity derivatives. Investing via P-Notes has a lower tax liability of 7.5-8%.

"Many of the SPV (special purpose vehicle) structures coming from Mauritius and Singapore may not be able to pass the GAAR test. Those investors appear to be interested in accessing the Indian market through the P-Note route," said Suresh Swamy, a partner at consulting firm PwC in India.

Investment bankers, who are also P-notes issuers, are coming out with new products such as one which will allow foreign investors to set off losses against taxes.

"Hedge funds are drawing comfort from the fact that the tax rules clearly provide that GAAR provisions do not apply to a person who has invested in ODI (off-shore derivative instruments)/ P-Notes. P-Note issuer should also not ordinarily face a challenge in meeting the GAAR threshold," said Swamy.

Data from the Securities and Exchange Board of India showed that as of February, about 6.6% of all foreign investments in India come through the offshore derivative instrument route. This has fallen from a peak of 55.7% in June 2007 as the capital markets regulator increased its scrutiny on these instruments and P-Notes became less lucrative owing to the renegotiated tax treaties with Mauritius and Singapore.

"Structures could be scrutinized if they are designed to primarily avoid taxes. Choice of entity can however be driven by several non-tax considerations too," said Richie Sancheti, head of investment funds practice at Nishith Desai Associates.

"P-Notes respond to the need of investors who seek a streamlined basis for accessing several markets while dealing with very limited number of counterparties. In Indian context, if the participation is not intended to be deep but particular portfolio specific, it would be disproportionate to undergo tax and administrative compliances as a foreign portfolio investor," he added.