Taxman hits the PN trail to check evasion

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THE income tax department is on course to track holders of participatory notes (PNs) in what is viewed as an attempt to assess possible tax implications.

According to official sources in Mumbai, the department has sought details from capital market regulator Sebi on the investments made in the stock market through the PN route since 2003. P-Notes, as they are popularly known, are derivative instruments comprising a basket of Indian stocks. These are issued by affiliates of foreign portfolio investors registered here to overseas investors who are not eligible to invest directly in Indian markets.

The holder of such an instrument can gain from the capital appreciation of the underlying shares. Close to 34 sub-accounts of foreign portfolio investors have issued P-Notes to hedge funds and other investors.

The tax department now wants to ascertain the list of those who have invested through P-Notes and has sought details from Sebi, top officials said.

According to sources, the IT department could also look at tracking the source of funds of PN holders. "If the identity of the PN holder is not known, it could give wide room for money laundering and tax evasion," reasoned an official.

Treaty with Mauritius gives FIIs some leeway

"THE holder of Indian securities — that is the FII — is subject to capital gains tax in India if he sells the shares and makes a profit from the sale of such shares. However, when the FII issues a PN to a hedge fund or other institutional buyers, the P-Note holder is not subject to Indian tax because the citus (issuance) of the P-Note is not in India," said head, International Tax Practice Group, Nishith Desai Associates, Shefali Goradia.

Foreign portfolio investors and other categories of investors pouring money into stocks listed on local bourses have to pay a short-term capital gains tax of 10% in India if they sell shares within a year of purchase. They are, however, exempt from paying long term capital gains tax just as local investors if they sell the shares after one year of purchase. But by routing their investments from Mauritius, foreign portfolio investors do not have to pay even the short-term capital gains tax by virtue of Indo-Mauritius tax treaty. Mauritius does not tax capital gains. Therefore, Mauritius-based foreign institutional investors are spared of paying any capital gains tax here. So is the case with Singapore based foreign institutional investors, subject to certain conditions.

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