

ACCESS to tax returns, audits, high-value transactions can help regulator build evidence

Sebi's Data Sharing Pact with CBDT to Bolster Insider Trading Probes

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Mumbai: The capital market regulator's investigation powers in insider trading and front running cases got a fillip following its recent mutual information-sharing agreement with the tax department.

As part of the pact, the Securities and Exchange Board of India (Sebi) will for the first time gain quicker access — in some cases automatic — to income tax returns, tax audits, data on agricultural income, high-value purchases and even network identity of market participants suspected of violating rules.

ET has reviewed select extracts of the agreement, which neither Sebi nor the tax department has made public.

This information sharing will help Sebi in establishing the financial links between various entities involved in insider trading or front running, said people with direct knowledge of the matter.

In the past, the regulator has encountered several cases wherein people with no knowledge of equities or connection to the markets were seen trading large quantities of shares before large institutions placed their orders. Sebi's investigations had linked such

Shot in the Arm

Sebi currently has access to basic information of investors captured while opening a demat account

I-T department has a more exhaustive database of information

TAX

The pact with the tax department help Sebi in establishing financial links between entities involved in insider trading or front running

Lack of this information has resulted in a low success rate for Sebi in proving insider trading or front running

people to officials at various institutions with access to insider information but it had been unable to act in the absence of evidence.

Email queries to Sebi and the Central Board of Direct Taxes (CBDT) seeking comments went unanswered until press time on Wednesday.

"The agreement will enable Sebi to ascertain material financial relationships with connected persons," said Moin Ladha, partner, Khaitan & Co. "Details of high-value transactions, income and investment patterns will help in investigation of a possible trade on behalf of an insider."

Before this arrangement, Sebi had access only to the basic information of

investors captured while opening a demat account. The tax department maintains a more exhaustive database of transactions by individuals.

The agreement is expected to improve the regulator's success rate in proving wrongdoings in the stock market which, lawyers say, has been mediocre.

A Sebi official, who spoke to ET, spoke of a case encountered three years ago where the regulator found that a group of investors were placing trades before a mutual fund placed its trades. Sebi's investigations revealed the trades were being done by farmers based out of Bihar and Jharkhand who had no knowledge of stock markets.

"At this stage, we suspected that farmers were just a front and someone from the fund management team of the MF was the actual beneficiary of these trades," said the Sebi official without identifying the asset manager. "However, we could not establish the financial link between both due to lack of data."

Sebi and CBDT have been clamping down on the use of stock market platforms for illicit purposes like money laundering or tax evasion.

In 2015, an extensive probe was conducted by both the regulators on stock exchange platforms being used for booking artificial losses and in turn escaping higher tax outgo. The cases also involved misuse of the long-term capital gains (LTCG) tax exemption available for listed companies, which was removed in 2018. In 2018-19, Sebi booked over 10,000 individuals for trading in illiquid stock options — another scheme devised for tax evasion.

"The idea behind the MOU is to act as a deterrent for those who engage in capital market activities and earn income but do not pay tax," said senior chartered accountant Dilip Lakhani. "While the MOUs may provide some crucial evidence, the regulators should ensure that genuine and small-time investors are not targeted."