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ANNEXURE R-6

BLACK MONEY

WHITE PAPER

MAY 2012

MINISTRY OF FINANCE
DEPARTMENT OF REVENUE
CENTRAL BOARD OF DIRECT TAXES
NEW DELHI

PRANAB MUKHERJEE **FINANCE MINISTER**
INDIA

Foreword

In the past year the public discourse on the issue of corruption and black money has come in the forefront with the active participation of the civil society and our Parliamentary institutions. Two issues have been highlighted in this debate. First, several estimates have been floated, often without adequate factual basis on the magnitude of black money generated in the country and the unaccounted wealth stashed aboard. Secondly, a perception has been created that the Government's response to address this issue has been piecemeal and inadequate. This document seeks to dispel some of the views around these two issues and place the various concerns in a perspective.

The "White Paper on Black Money" presents the different facets of black money and its complex relationship with policy and administrative regime in the country. It also reflects upon the policy options

and strategies that the Government has been pursuing in the context of recent initiatives, or need to take up in the near future, to address the issue of black money and corruption in public life.

There is no doubt that manifestation of black money in social, economic and political space of our lives has a debilitating effect on the institutions of governance and conduct of public policy in the country. Governance failure and corruption in the system affect the poor disproportionately. The success of an inclusive development strategy critically depends on the capacity of our society to root out the evil of corruption and black money from its very foundations. Our endeavour in this regard requires a speedy transition towards a more transparent and result oriented economic management systems in India.

The steps taken in recent years for simplifying and placing the administrative procedures concerning taxation, trade and tariffs and social transfers on UID

based electronic interface, free of discretion and bureaucratic delays, are vital building blocks of the approach for tackling corruption and black money in our country. In this past year Government has brought five bills namely, the Lokpal Bill, the Judicial Accountability Bill, the Whistle Blowers Bill, the Grievance Redressal Bill and the Public Procurement Bill, which are at various stages of consideration by the Parliament. The institutionalisation and expansion of information exchange network at the international level is a major step in curbing cross-border flow of illicit wealth and in facilitating its repatriation. While these measures will set the tone for an equitable, transparent and a more efficient economy, there is much that we could do, both individually and collectively, to strengthen the moral fibre of our society.

I would have been happy if I could have included the conclusions of reports of three premier institutions that have been tasked to quantify the magnitude of black money. These reports are likely to

be received by the end of this year. However I have chosen to present this document now in response to an assurance given to the Parliament. Hopefully, it would contribute to an informed debate on the subject and a more effective policy response as we move forward.

New Delhi

16 May 2012

(Pranab Mukherjee)

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Introduction

1.1 The Context

Generation of black money and its stashing abroad in tax havens and offshore financial centres have dominated discussions and debate in public fora during the last two years. Members of Parliament, the Supreme Court of India and the public at large have unequivocally expressed concern on the issue, particularly after some reports suggested estimates of such unaccounted wealth being held abroad. The Finance Minister, while responding to an adjournment motion on the 'Situation Arising out of Money

Deposited Illegally in Foreign Banks and Action Being Taken against the Guilty Persons' in the Lok Sabha on 14 December 2011 gave an assurance that a white paper on black money would be prepared. This document is being presented to Parliament as a result.

1.2 The Objective of this Paper

The objective of this paper is to place in the public domain various facets and dimensions of black money and its complex relationship with the policy and administrative regime in the country. The paper also presents the framework, policy options, and strategies that the Government of India has been pursuing to tackle this issue, especially recent initiatives and developments. The paper is expected to contribute to the ongoing debate on the issue of black money and help develop a broad political consensus regarding the future course of action to address it.

1.3 The Problem and its Complexities

1.3.1 Black money is a term used in common parlance to refer to money that is not fully legitimate in the hands of the owner. This could be for two possible reasons. The first is that the money may have been generated through illegitimate activities not permissible under the law, like crime, drug trade, terrorism, and corruption, all of which are punishable under the legal framework of the state. The second and perhaps more likely reason is that the wealth may have been generated and accumulated by failing to pay the dues to the public exchequer in one form or other. In this case, the activities undertaken by the perpetrator could be legitimate and otherwise permissible under the law of the land but s/he has failed to report the income so generated, comply with the tax requirements, or pay the dues to the public exchequer, leading to the generation of this wealth.

1.3.2 A comparison of the two ways in which black money is generated is fundamental to understanding the problem and devising the appropriate policy mix with which it can be controlled and prevented by the

public authorities. At the very outset, it becomes clear that the first category is one where a strongly intolerant attitude with adequate participation of all state arms can produce results. It is the second category where the issue becomes far more complex and may require modifying, reforming, and redesigning major policies to promote compliance with laws, regulations, and taxes and deter the active economic agents of society from generating, hoarding, and illicitly transferring abroad such unaccounted wealth.

1.3.3 One of the reasons for the complexity of the problem of black money is the differences in perceived interests and objectives of taxpayers and the tax authority. Theoretically, one can postulate a particular level of regulation and tax that creates appropriate balance between the three different but related objectives, namely ensuring efficiency of a market economy, ensuring efficiency of the state with respect to its goals of providing requisite public goods and promoting equity, or what is often referred as

good governance, and ensuring that the incentives for compliance are not distorted in a self-defeating manner. However, in practice it may be difficult to bring about this balance and convergence in the interests of the stakeholders. It is therefore necessary to create awareness about these aspects and encourage understanding about the lack of any universal panaceas or magic remedies for this complex socio-economic problem.

1.3.4 Prevention of unacceptable aberrant behaviour needs strong policy deterrence. The need of the hour is to create effective administrative systems, using technology-based data processing, to generate actionable intelligence. In a federal structure of governance, this will require cooperation between agencies of the central and state governments. Moreover in an increasingly globalized environment, it would need strong initiatives on part of the Indian state to develop and strengthen mutual cooperation with the rest of the world.

Black Money and its Estimation

2.1 Defining 'Black Money'

2.1.1 There is no uniform definition of black money in the literature or economic theory. In fact, several terms with similar connotations have been in vogue, including 'unaccounted income', 'black income', 'dirty money', 'black wealth', 'underground wealth', 'black economy', 'parallel economy', 'shadow economy', and 'underground' or 'unofficial' economy. All these terms usually refer to any income on which the taxes imposed by government or public authorities have not been paid. Such wealth may consist of income generated from legitimate activities or activities which are illegitimate per se, like smuggling, illicit trade in banned substances, counterfeit currency, arms trafficking, terrorism, and corruption. For the purpose of this document, 'black money' can be defined as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession.

2.1.2 This definition of black money is in consonance with the definition used by the National Institute of Public Finance and Policy (NIPFP). In its 1985 report on Aspects of Black Economy, the NIPFP defined 'black income' as 'the aggregates of incomes which are taxable but not reported to the tax authorities'. Further, black incomes or unaccounted incomes are 'the extent to which estimates of national income and output are biased downwards because of deliberate, false reporting of incomes, output and transactions for reasons of tax evasion, flouting of other economic controls and relative motives'.

2.1.3 Thus, in addition to wealth earned through illegal means, the term black money would also include legal income that is concealed from public authorities:

> to evade payment of taxes (income tax, excise duty, sales tax, stamp duty, etc);

- to evade payment of other statutory contributions;
- to evade compliance with the provisions of industrial laws such as the Industrial Dispute Act 1947, Minimum Wages Act 1948, Payment of Bonus Act 1936, Factories Act 1948, and Contract Labour (Regulation and Abolition) Act 1970; and / or
- to evade compliance with other laws and administrative procedures.

2.2 Factors Leading to Generation of Black Money

2.2.1 Black money arising from illegal activities such as crime and corruption has an underlying antisocial element. The 'criminal' component of black money may include proceeds from a range of activities including racketeering, trafficking in counterfeit and contraband goods, smuggling, production and trade of narcotics, forgery, illegal mining, illegal felling of forests, illicit liquor trade,

robbery, kidnapping, human trafficking, sexual exploitation and prostitution, cheating and financial fraud, embezzlement, drug money, bank frauds, and illegal trade in arms. Some of these offences are included in the schedule of the Prevention of Money Laundering Act 2002. The 'corrupt' component of such money could stem from bribery and theft by those holding public office – such as by grant of business, leakages from government social spending programmes, speed money to circumvent or fast-track procedures, black marketing of price-controlled services, and altering land use regularizing unauthorized construction. All these activities are illegal per se and a result of human greed combined with declining societal values and inability of the state to prevent them. Factors leading to their generation are both social and administrative.

2.2.2 These illegal activities are punishable under various Acts of the central and state governments which are administered by various law enforcement agencies. Effective implementation of these Acts is

the responsibility of both state and central governments.

2.2.3 Significant amount of black money, however, is generated through legally permissible economic activities, which are not accounted for and disclosed or reported to the public authorities as per the law or regulations, thereby converting such income into black money. The failure to report or disclose such activities or income may be with the objective of evading taxes or avoiding the cost of compliance related to such reporting or disclosure. It may also be the result of non-compliance with some other law. For example, a factory owner may under-report production on account of theft of electricity which in turn leads to evasion of taxes. Generally, a high burden of taxation, either actual or perceived, provides a strong temptation to evade taxes and generate black money. Sometimes the procedural regulations can be such that complying with them may increase the probability of further scrutiny and thereby the incidence of the burden of compliance,

creating a perverse incentive not to report at all and remain outside the reported and accounted proportion of the economy. Culture and social practices may also play a vital role in deciding the preferences of citizens between tax compliance and black money generation. In a society where tax evasion and under-reporting of activities and income is perceived to be very common or the norm, such activities may be considered acceptable and honest tax compliance and paying one's due share to the public fund may not be considered a virtue. Studies indicate that countries with relatively poor implementation of regulations tend to have a higher share of unaccounted economy, whereas countries with properly implemented regulations and sound deterrence have smaller 'black' economies.

2.2.4 Thus the fight against generation and accumulation of black money is likely to be far more complex, requiring stronger intervention of the state, in developing countries like India than in developed countries. It needs a stronger legal framework,

commensurate administrative measures, and a very strong resolve to fight the menace. It also calls for political consensus as well as patience and perseverance.

2.3 Generating Black Money by Manipulation of Accounts

2.3.1 There can be two different modi operandi involved in the generation of black money. The first is the crude approach of not declaring or reporting the whole of the income or the activities leading to it. This is the likely approach in all cases of criminal, illegal, and impermissible activities. The sophistications in such an approach mostly get introduced subsequently for the purpose of laundering the money so generated with the objective of making it accountable and converting it into legitimate reported wealth that can be openly possessed and used.

2.3.2 The same approach of not declaring or reporting activities and the income generated

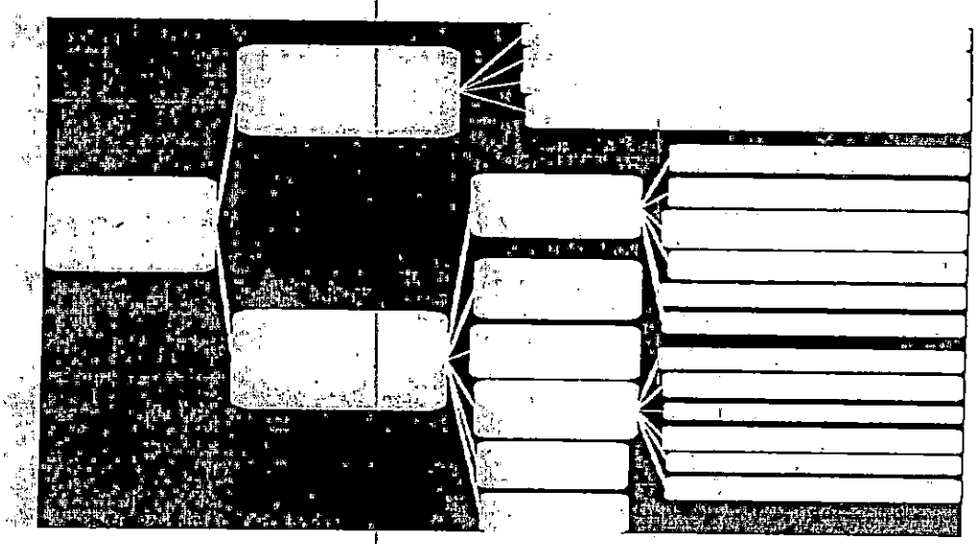
therefrom may also be followed in cases of failure to comply with regulatory obligations or tax evasion on income from legitimate activities. However, complete evasion or non-compliance may make such incomes vulnerable to detection by authorities and lead to consequent adverse outcomes for the generator. Thus a more sophisticated approach for generation of this kind of black money is often preferred, involving manipulation of financial records and accounting.

2.3.3 The best way of classifying and understanding the various ways and means adopted by taxpayers for the generation of black money would be the financial statement approach, elaborating different means by which the accounts prepared for reporting and presenting before the authorities are manipulated to misrepresent and underdisclose income, thereby generating unaccounted, undeclared, and unreported income that amounts to black money.

2.3.4 Any transaction entered into by the taxpayer must be reported in books of account which

are summarized at the end of the year in the form of financial statements. The financial statements basically comprise statement of income and expenditure which is called by different names such as 'Profit and Loss Account' or 'Income and Expenditure Account' and statement of assets and liabilities which is called 'Balance Sheet' or 'Statement of Affairs'. Tax evasion involves misreporting or non-reporting of the transactions in the books of account. Different kinds of manipulations of financial statements resulting in tax evasion and the generation of black money are summarised in Figure 2.1 and and some of these are elaborated in the following paragraphs

Figure 2.1 Manipulations of Accounts for Tax Evasion



2.3.5 Out of Book Transactions: This is one of the simplest and most widely adopted methods of tax evasion and generation of black money. Transactions that may result in taxation of receipts or income are not entered in the books of account by the taxpayer. The taxpayer either does not maintain books of account or maintains two sets or records partial receipts only. This mode is generally prevalent among the small grocery shops, unskilled or semi-skilled service providers, etc.

2.3.6 Parallel Books of Accounts: This is a practice usually adopted by those who are obliged under the law or due to business needs to maintain books of account. In order to evade reporting activities or the income generated from them, they may resort to maintaining two sets of books of account – one for their own consumption with the objective of managing their business and the other one for the regulatory and tax authorities such as the Income Tax Department, Sales Tax Department, and

Excise and Customs Department. The second set of books of account, which is maintained for the purpose of satisfying the legal and regulatory obligations of reporting to different authorities, may be manipulated by omitting receipts or falsely inflating expenses, for the purpose of evading taxes or other regulatory requirements.

2.3.7 Manipulation of Books of Account: When books of accounts are required to be maintained by taxpayers under different laws, like the Companies Act 1956, the Banking Regulation Act, and the Income Tax Act, it may become difficult for these taxpayers to indulge in out of books transactions or to maintain parallel books of accounts. Such parties may resort to manipulation of the books of accounts to evade taxes.

2.3.8 Manipulation of Sales/Receipts: A taxpayer is required to pay taxes on profit or income which is the difference between sale proceeds or receipts and expenditure. Thus manipulation of sales or receipts is

the easiest method of tax evasion. Other innovative means may include diversion of sales to associated enterprises, which may become more important if such enterprises are located in different tax jurisdictions and thereby may also give rise to issues related to international taxation and transfer pricing.

2.3.9 In case of use of a dummy / associated entity, there can be a plethora of possible arrangements entered into by such entities to aid generation of black money. In its simplest form, the associate entity may not report its activities or income at all. The main entity may show sales to such a dummy / associate entity at a lower price, thereby reducing its reported profits.

2.3.10 More complex scenarios can emerge if the dummy/ associated entity is situated in a low tax jurisdiction having very low tax rates. Thus the profit of the Indian entity will be transferred to the low tax jurisdiction and money will be accumulated by the

taxpayer in the books of accounts of the entity in the low tax jurisdiction.

2.3.11 Under-reporting of Production: Manipulation of production figure is another means of artificially reducing tax liability. It may be resorted to for the purpose of evading central excise, sales tax, or income tax.

2.3.12 Manipulation of Expenses: Since the income on which taxes are payable is arrived at after deducting the expenses of the business from the receipts, manipulation of expenses is a commonly adopted method of tax evasion. The expenses may be manipulated under different heads and result in under-reporting of income. It may involve inflation of expenses, sometimes by obtaining bogus or inflated invoices from the so called 'bill masters', who make bogus vouchers and charge nominal commission for this facility.

2.3.13 Any number of more sophisticated versions of manipulation of expenses can also be resorted to

by those intending to generate black money. Sometimes it can also involve 'hawala' operators, who operate shell entities in the form of proprietorship firms, partnership firms, companies, and trusts. These operators may accept cheques for payments claimed as expense and return cash after charging some commission. There have been instances of claims of bogus expenses to foreign entities. The payments can be shown to foreign entities in the form of advertisement and marketing expenses or commission for purchases or sales. The funds may be remitted to the account of the foreign taxpayer and the money can either be withdrawn in cash or remitted back to India in the form of non-taxable receipts. Such money may also be accumulated in the form of unaccounted assets of the Indian taxpayer abroad.

2.3.14 Other Manipulations of Accounts: Besides inflation of purchase / raw material cost, expenses like labour charges, entertainment expenses, and commission can be inflated or falsely booked to

reduce profits. In these cases, bogus bills may be prepared to show inflated expenses in the books.

2.3.15 Manipulation by Way of International Transactions through Associate Enterprises: Another way of manipulating accounted profits and taxes payable thereon may involve using associated enterprises in low tax jurisdictions through which goods or other material may be passed on to the concern. Intercorporate transactions between these associate enterprises belonging to the same group or owned and controlled by the same set of parties may be arranged and manipulated in a way that leads to evasion of taxes. This can often be achieved by arrangements that shift taxable income to the low tax jurisdictions or tax havens, and may lead to accumulation of black money earned from within India to another country.

2.3.16 Manipulation of Capital: The statement of affairs or balance sheet of the taxpayer contains details of assets, liabilities, and capital. The capital of

the taxpayer is the accumulated wealth which is invested in the form of assets or as working capital of the business. Manipulation of capital can be one of the ways of laundering and introduction of black money in books of accounts.

2.3.17 Manipulation of Closing Stock: Suppression of closing stock both in terms of quality and value is one of the most common methods of understating profit. More sophisticated versions of such practice may include omission of goods in transit paid for and debited to purchases, or omission of goods sent to the customer for approval. A more common approach is undervaluation of inventory (stock of unsold goods), which means that while the expenses are being accounted for in the books, the value being added is not accounted for, thereby artificially reducing the profits.

2.3.18 Manipulation of Capital Expenses: Over-invoicing plant and equipment or any capital asset is an approach adopted to claim higher depreciation and

thereby reduce the profit of the business. As already stated, increase in capital can also be a means of enabling the businessman to borrow more funds from banks or raise capital from the market. It has been seen that such measures are sometimes resorted to at the time of bringing out a capital issue. At the same time, under-invoiced investments, indicating entry of undeclared wealth, may imply introduction of black money.

2.4. Generation of Black money in Some Vulnerable Sections of the Economy

2.4.1 While the source of generation of black money may lie in any sphere of economic activity, there are certain sectors of the economy or activities, which are more vulnerable to this menace. These include real estate, the bullion and jewellery market, financial markets, public procurement, non-profit organizations, external trade, international transactions involving tax havens, and the informal service sector.

2.4.2 Land and Real Estate Transactions: Due to rising prices of real estate, the tax incidence applicable on real estate transactions in the form of stamp duty and capital gains tax can create incentives for tax evasion through under-reporting of transaction price. This can lead to both generation and investment of black money. The buyer has the option of investing his black money by paying cash in addition to the documented sale consideration. This also leads to generation of black money in the hands of the recipient. A more sophisticated form occasionally resorted to consists of cash for the purchase of transferable development rights (TDR)[1].

2.4.3 Bullion and Jewellery Transactions: Cash sales in the gold and jewellery trade are quite common and serve two purposes. The purchase allows the buyer the option of converting black money into gold and bullion, while it gives the trader the option of keeping his unaccounted wealth in the form of stock, not disclosed in the books or valued at less than market price.

2.4.4 Financial Market Transactions: Financial market transactions can involve black money in different forms. Initial public offers (IPOs) offering equity shares to the public at large are also vulnerable to various manipulations that can generate black money for the promoters or operators. Rigging of markets by the market operators is one such means. This may involve use of shell companies and more sophisticated versions of such manipulation may involve offshore companies or investors in foreign tax jurisdictions who invest in shares offered by the IPO and through manipulated trading escalate their price artificially, only to offload them later at the cost of ordinary investors.

2.4.5 Public Procurement: Public procurement has grown phenomenally over the years – in volume, scale, and variety as well as complexity. It often includes sophisticated and hi-tech items, complex works, and a wide range of services. An OECD (Organisation for Economic Cooperation and

Development) estimate puts the figure for public procurement in India at 30 per cent of the GDP whereas a WTO (World Trade Organisation) estimate puts this figure at 20 per cent of the GDP.2 The Competition Commission of India had estimated in a paper that the annual public sector procurement in India would be of the order of Rs. 8 lakh crore while a rough estimation of direct government procurement is between Rs.2.5 and 3 lakh crore. This puts the total public procurement figure for India at around Rs. 10 to 11 lakh crore per year.

2.4.6 Non-profit Sector: Taxation laws allow certain privileges and incentives for promoting charitable activities. Misuse of such benefits and manipulations through entities claimed to be constituted for nonprofit motive are among possible sources of generation of black money. Such misuse has also been highlighted by the Financial Action Task Force (FATF), an intergovernmental body which develops and promotes policies to protect the global financial system against money laundering and financing of

terrorism. A Non-profit Organisation (NPO) Sector Assessment Committee constituted under the Ministry of Finance has reviewed the existing control and legal mechanisms for the NPO sector and suggested various measures for improvement.

2.4.7 Informal Sector and Cash Economy: The issue of black money is related to the magnitude of cash transactions in the informal economy. The demand for currency is determined by a number of factors such as income, price levels, and opportunity cost of holding currency. Factors like dependence on agriculture, existence of a large informal sector, and insufficient banking infrastructure with large un-banked and under-banked areas contribute to the large cash economy in India.

2.4.8 External trade and Transfer Pricing: More than 60 per cent4 of global trade is carried out between associated enterprises of multinational enterprises (MNEs). Since allocation of costs and overheads and fixing of price of product/services are highly

subjective, MNEs enjoy considerable discretion in allocating costs and prices to particular products/services and geographical jurisdictions. Such discretion enables them to transfer profit/income to no tax or low tax jurisdictions. Differing tax rates in different tax jurisdictions can create perverse incentives for corporations to shift taxable income from jurisdictions with relatively high tax rates to jurisdictions with relatively low tax rates as a means of minimising their tax liability. For example, a foreign parent company could use internal 'transfer prices' for overstating the value of goods and services that it exports to its foreign affiliate in order to shift taxable income from the operations of the affiliate in a high tax jurisdiction to its operations in a low-tax jurisdiction. Similarly, the foreign affiliate might understate the value of goods and services that it exports to the parent company in order to shift taxable income from its high tax jurisdiction to the low tax jurisdiction of its parent. Both of these strategies would shift the company's profits to the

low tax jurisdiction and, in so doing; reduce its worldwide tax payments. In this context transfer pricing has emerged as the biggest tool for generation and transfer of black money. In recent years, after the 9/11 incident in the USA due to intense scrutiny of banking transactions, enhanced security checks at airports and ports, and relaxation of exchange controls, transfer of money through hawala has reduced significantly but now transfer pricing is now being extensively used to transfer income/profit and avoid taxes at will across countries. Also, with the relaxation of exchange controls and liberalisation of banking channels, the popularity of the hawala system for legitimate transfers has reduced substantially. The increasing pressure on financial operators and banks to report cash transactions has also helped in curbing hawala transactions. Tax evasion through transfer pricing is largely invisible to the public and difficult and expensive for tax officers to detect. Christianaid5 estimates that developing countries may be losing

over US$160billion of tax revenues a year, primarily through transfer pricing strategies.

2.4.9 The illicit money transferred outside India may come back to India through various methods such as hawala, mispricing, foreign direct investment (FDI) through beneficial tax jurisdictions, raising of capital by Indian companies through global depository receipts (GDRs), and investment in Indian stock markets through participatory notes. It is possible that a large amount of money transferred outside India might actually have returned through these means.

Box 2.1: Characteristics of Tax havens

Various studies on tax havens have shown that tax havens are typically small countries/ jurisdictions, with low or nil taxation for foreigners who decide to come and settle there. They usually also offer strong confidentiality or secrecy regarding wealth and accounts, making them very attractive locations for safe keeping of unaccounted wealth. They also offer a

very liberal regulatory environment and allow opaque existence, where an entity can easily be set up without indulging in any meaningful commercial activity and yet claim to be a genuine business unit, merely by getting itself incorporated or registered in that jurisdiction. This makes them highly desirable locations for multinational entities wishing to reduce their global tax liabilities. These multinational entities consisting of a network of several corporate and non-corporate bodies may set up conduit companies in tax havens and artificially transfer their income to such conduit companies in view of the low tax regime there. There is increasing global awareness and concern about the role of tax havens and their facilitation of certain abusive and undesirable arrangements that result in significant fiscal challenges to other countries and also pose a threat in terms of potential financing of terrorism and other activities that threaten peace and security.

2.4.10 Trade-based Money Laundering (TBML): The FATF defines TBML as the process of disguising the

proceeds of crime and moving value through the use of trade transactions in an attempt at legitimizing their illicit origins. Factors that facilitate such manipulation include the enormous volume of international trade flow, the complexity associated with financing arrangements and currency exchanges as well as limited recourse to verification procedures between countries.

2.4.11 Tax Havens: The term 'tax haven' has been widely used since the 1950s. However, there is no precise definition of the term. The OECD initially defined tax havens as being characterised by no or very low taxes, lack of effective exchange of information, and lack of transparency about substantial activities. It listed 35 countries/ jurisdictions as tax havens in the year 2000. The list has changed over time as more tax havens have made agreements to share information.

2.4.12 Offshore Financial Centres: Some of the old tax havens have adopted the more benign

designation of 'offshore financial centre' (OFC) and tend to describe themselves as financial centres specializing in non-residential financial transactions. However, with their array of secrecy provisions that lack regulation, the zero or near zero taxation imposed by them, and lack of adequate capital controls, they are logical extensions of the traditional tax havens. The IMF has defined OFCs as centers where the bulk of financial sector transactions on both sides of the balance sheet are with individuals or companies that are not residents, where the transactions are initiated elsewhere, and where the majority of the institutions involved are controlled by non-residents. Thus, many OFCs have the following characteristics:

1. Jurisdictions that have financial institutions engaged primarily in business with non-residents;

2. Financial systems with external assets and liabilities out of proportion to domestic

financial intermediation designed to finance domestic economic; and

3. More popularly, centers which provide some or all of the following opportunities: low or zero taxation; moderate or light financial regulation; banking secrecy and anonymity.

International organizations including the BIS and IMF began to use the term OFC in a more restrictive manner to describe financial services that were evolving in tax havens.

Box 2.2: **Participatory Notes**

A Participatory Note (PN) is a derivative instrument issued in foreign jurisdictions, by a Foreign Institutional Investor (FII) / its sub-accounts or one of its associates, against underlying Indian securities. PNs are popular among foreign investors since they allow these investors to earn returns on investment in the Indian market without undergoing the significant cost and time implications of directly investing in India. These instruments are traded

overseas outside the direct purview of SEBI surveillance thereby raising many apprehensions about the beneficial ownership and the nature of funds invested in these instruments. Concerns have been raised that some of the money coming into the market via PNs could be the unaccounted wealth camouflaged under the guise of FII investment. SEBI has been taking measures to ensure that PNs are not used as conduits for black money or terrorist funding.

2.4.13 Investment through Innovative Derivative Instruments: With increasing sophistication of derivative instruments, new opportunities for investing and making profits without being subjected to taxes and regulations are also opening up. Such innovative means can also be misused by unscrupulous parties to generate unaccounted income. Some such instruments like participatory notes may not be adequately covered by regulatory mechanisms and their oversight and hence have potential for misuse.

2.5 Estimates of Black Money Generated in India

2.5.1 There are no reliable estimates of black money generation or accumulation, neither is there an accurate well-accepted methodology for making such estimation. By its very definition, black money is not accounted for, thus all attempts at its estimation depend upon the underlying assumptions made and the sophistication of adjustments incorporated. Among the estimates made so far, there is no uniformity, unanimity, or consensus about the best methodology or approach to be used for this purpose. There have also been wide variations in the figures reported, which further serves to highlight the limitations of the different methods adopted.

2.5.2 Analysis of individual methods used for estimation further exposes their limitations. One such method is the input / output method. It consists of using the input/output ratio along with the input to calculate the true output. It estimates black money as the difference between the declared output and

the output expected on the basis of the input/output ratio. This method is deceptively simple and, though it may have some utility if applied to a uniform industry or a specific sector of the economy, it is unlikely to be of much help if applied to economy as a whole. It also ignores structural changes in the economy including those related to technology.

2.5.3 Another approach, adopted by the monetarists, is based on the fact that money is needed to circulate incomes in both the 'black' and accounted for economies. As the official economy is known, the difference between that amount and the money in circulation could be assumed to be the circulating 'black' component. An estimate of the velocity of money (that is to say the average number of times currency changes hand in a year) enables an estimation of income circulated annually. A comparison of that with the income captured in the National Accounting System (NAS) gives the income which could be estimated as the black money in the economy. However, the assumption that the NAS

represents accounted incomes accurately is not always true. Large proportions of income, such as those falling in the unorganized sector, are not accurately captured in NAS, thus there may be upward bias in the estimate of black money so derived.

2.5.4 Yet another method of estimation of black money is the survey approach wherein sample surveys are carried out. They may be on the consumption pattern of a representative population sample, which is then compared to the total consumption of the country. In this method, the problems consist in getting a truly representative sample, unambiguous set of questions, and the willingness of persons in the sample size to reveal true facts. Often the comfort level with the interviewers is limited as people are unwilling to admit any illegality before strangers.

2.5.5 There is also the 'fiscal approach' method for estimating black income. The underlying basis of this approach is to view the economy as comprising

several sectors, each having its own sets of practices. The contribution of these sectors to black money generation is separately worked out, which when added would give the size of the 'black' economy. However, the manner of identifying the 'black component' in these sectors and the assumptions suffer from inherent subjectivity of the researcher and lack of uniform standards.

2.5.6 Attempts have been made in the past to quantify 'black' money generation in India. Broadly speaking, the estimates made so far have followed two distinct approaches:

(i) Kaldor's approach of quantifying non-salary incomes above the exemption limit of income tax; and

(i) The Edgar L. Feige method of working out transaction income on the basis of currency-deposit ratio and deriving from it the 'black' income of the economy.

2.5.7 N. Kaldor in his report (1956) estimated non-salary income on the basis of the break-up of national income into:

(i) Wages and salaries,

(ii) Income of the self-employed, and

(iii) Profit, interest, rent, etc.

Excluding wages and salaries from the contribution to net domestic product, he derived total non-salary income. An estimate of the actual non-salary income assessed to tax was made for each sector in order to arrive at the total non-salary income assessed to tax. The difference between the estimated non-salary income above the exemption limit and the actual non-salary income assessed to tax measures the size of 'black' income.

2.5.8 The Direct Taxes Enquiry Committee (Wanchoo Committee) followed the method adopted by Kaldor with some modifications. It estimated assessable non-salary income for the year 1961-62 at Rs. 2686 crore and non-salary income actually

assessed to tax to be of the order of Rs. 1875 crore. Accordingly the income which escaped income tax was of the order of Rs. 811 crore. After making rough adjustments for exemptions and deductions, the Wanchoo Committee found that 'the estimated income on which tax has been evaded (black income) would probably be Rs.700 crore and Rs. 1000 crore for the years 1961-62 and 1965-66 respectively'. 'Projecting this estimate further to 1968-69 on the basis of percentage increase in national income from 1961-62 to 1968-69, the income on which tax was evaded for 1968-69 was estimated as Rs.1800 crore.'

2.5.9 Rangnekar's estimate: Dr D.K. Rangnekar, a member of the Wanchoo Committee, dissented from the estimates made by the Wanchoo Committee. According to him, tax-evaded income for 1961-62 was of the order of Rs. 1150 crore as compared to the Wanchoo Committee's estimate of Rs. 811 crore. For 1965-66, it was Rs. 2,350 crore against the Rs. 1000 crore estimated by the Wanchoo

Committee. The projections for 1968-69 and 1969-70 were Rs. 2833 crore and Rs. 3080 crore respectively.

2.5.10 Chopra's estimate: Noted economist O.P. Chopra published several papers on the subject of unaccounted income. He prepared a series of estimates of unaccounted income for a period of 17 years, i.e. 1960-61 to 1976-77. Chopra's methodology marked a significant departure from the Wanchoo Committee approach and, as a consequence, he found a larger divergence in the two series from 1973 onwards when income above the exemption limit registered significant increase. The broad underlying assumptions of his methodology were:

i. Only non-salary income is concealed;

ii. Taxes other than income tax are evaded and the study is restricted to only that part of income which is subject to income tax. Thus tax evasion which may be due to (a) non-payment or under-payment of excise

duty, (b) sales tax,(c) customs duties, or (d) substituting agricultural income for non-agricultural income is not captured;

iii. The efficiency of the tax administration remains unchanged;

iv. The ratio of non-salary income above the exemption limit to total non-salary income has remained the same; and

v. The ratio of non-salary income to total income accruing from various sectors of the economy remains the same.

2.5.11 The crucial finding of Chopra's study was that after 1973-74, the ratio of unaccounted income to assessable non-salary income went up, whereas the Wanchoo Committee assumed this ratio to have remained constant. As a consequence, after 1973-74 there was wide divergence between the estimates of the Wanchoo Committee and those of Chopra. Chopra's estimates corroborated the hypothesis that tax evasion was more likely to be resorted to when

the rate of tax was comparatively high. His findings also supported the hypothesis that increase in prices lead to an increase in unaccounted income. Further, he gave a significant finding that funds were diverted to the non-taxable agriculture sector to convert unaccounted (black) income into legal (white) income. Chopra's study estimated unaccounted income to have increased from Rs. 916 crore in 1960-61, i.e. 6.5 per cent of gross national product (GNP) at factor cost, to Rs. 8098 crore in 1976-77 (11.4 per cent of GNP).

2.5.12 NIPFP Study on Black Economy in India: The NIPFP conducted a study under the guidance of Dr. S. Acharya (1985). The study defined 'black' money as the aggregate of incomes which were taxable but which were not reported to tax authorities. The study, however, gave a broader definition of 'black' income and called it 'unaccounted income' for purposes of clarity. As there was lack of sufficient data, the NIPFP study followed 'the minimum estimate approach'. That is to say, not

being able to ascertain the most probable degree of under-declaration or leakage, it used a degree of under-declaration which could safely be regarded as the minimum in the relevant sector. In several cases the study also made use of a range rather than a single figure of underestimation.

2.5.13 While preparing the estimate of 'black' income, the study excluded incomes generated through illegal activities like smuggling, black market transactions, and acceptance of bribes and kickbacks. To prepare a global estimate of black income, the study confined itself briefly to six areas:

i. factor incomes received either openly or covertly while participating in the production of goods and services,

ii. 'black' income generated in relation to capital receipts on sale of asset,

iii. 'black' income generated in fixed capital formation in the public sector,

iv. 'black' income generated in relation to the private corporate sector,

v. 'black' income generated in relation to export, and

vi. 'black' income generated through over invoicing of imports by the private sector and sale of import licences.

2.5.14. After aggregating the different components of 'black' income the study quantified the extent of 'black' money for different years as shown in Table 2.1.

Table 2.1 NIPFP Estimate of Black Money in India 1975-1983

Year	Estimate for Black Money (Rs.in crore)	Percent of GDP
1975-76	9,958 to 11,870	15 to 18
1980-81	20,362 to	18 to 21

	23,678	
1983-84	31,584 to 36,784	19 to 21

2.5.15 The NIPFP study concluded that total black income generation of Rs. 36,784 crore out of a total GDP at factor cost of Rs. 1,73,420 crore was on the higher side, although it turns out to be less than 30 per cent of GDP as against some extravagant estimates placing it at 50 or even 100 per cent of GDP. The study suggested with some degree of confidence that black income generation in the Indian economy in 1983-84 was not less than18 per cent of GDP at factor cost or 16 per cent of GDP at market prices.

2.5.16 While the NIPFP report estimated the 'black' economy (not counting smuggling and illegal activities) at about 20 per cent of the GDP for the year 1980-81, Suraj B. Gupta, a noted economist, pointed out some erroneous assumptions in NIPFP study and estimated 'black' income at 42 per cent of

GDP for the year 1980-81 and 51 per cent for the year 1987-88. Arun Kumar pointed out certain defects in Gupta's method as well as in the NIPFP study. He estimated 'black' income to be about 35 per cent for the year 1990-91 and 40 per cent for the year 1995-96.

2.5.17 The last official study for estimating black money generation was conducted at the behest of the Ministry of Finance by the NIPFP in 1985. The alternative estimates of 'black' income for the decade prior to 1985, compiled in the NIPFP Report, as shown in Table 2.2, show the extent of variation in estimates.

Table 2.2 Variations in Estimates of Black Income

Year	Chopra's estimate		Gupta & Gupta's estimates	Gupta & Mehta estimates	Ghosh et.al's estimates	Rangnekar's estimates
	Wanchoo Method	Own Method				
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1970-71	4.8	5.2	22.3	—	7.6	—
1971-72	5.1	3.2	28.7	—	7.8	—
1972-73	4.0	3.8	31.9	—	7.8	—
1973-74	4.9	8.1	27.1	—	7.4	9.9
1974-75	5.9	12.4	20.9	13.8	8.1	9.3
1975-76	5.6	9.9	25.0	—	8.4	10.0
1976-77	5.7	10.2	37.6	—	8.7	11.3
1977-78	—	—	38.4	—	8.7	12.1

1978-79	—	—	48.1	19.8	—	13.5
1979-80	—	—	—	—	—	14.4

2.5.18 It may be useful to see how India compares with other countries in the world on estimates of black money or black or shadow economy. The World Bank Development Research Group on Poverty and Inequality and Europe and Central Asia Region Human Development Economics Unit in July 2010 estimated 'Shadow Economies' of 162 countries from 1999 to 2007.6 It reported that the weighted average size of the shadow economy (as a percentage of 'official' GDP) of these 162 countries in 2007 was 31 per cent as compared to 34 per cent in 1999. For India, these figures were 20.7 per cent and 23.2 per cent respectively, comparing favourably with the world average. Shadow economy for the purposes of the study was defined to include all market-based legal production of goods and services that are deliberately concealed from public authorities for any of the following reasons:

> to avoid payment of income, value added or other taxes,

- to avoid payment of social security contributions,
- to avoid having to meet certain legal labour market standards, such as minimum wages, maximum working hours, and safety standards; and
- to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms.

2.5.19 The studies discussed here for estimating the extent of Black Money in the economy have followed different methods and have been criticized for their numerous assumptions and approximations. Further, they have arrived at different figures of black money even for the same year. There have also been media reports in recent years that have extended several estimates of black money, especially the unaccounted money held abroad by Indians.

2.6 Estimates of Black Money Stashed Abroad

2.6.1 A chain Email, which first started circulating on the Internet in early 2009, states that Indians have more money in the Swiss banks than all other countries combined. It claims that as per a Swiss Banking Association report in 2006, bank deposits in the territory of Switzerland by nationals of a few countries are as under: India, US$1456 billion, Russia, US $470 billion, UK, US$390 billion, Ukraine, US$100 billion, China, US$96 billion.

2.6.2 It is now evident that there is no organization by the name of Swiss Banking Association,7 although there is a Swiss Bankers Association (SBA). On 13 September 2009 Zeenews.com reported a statement from James Nason, Head of International Communications of the SBA, in which, referring to figures being quoted based on the alleged SBA report, he asserted that the SBA had never published any such report and that the story about Indian deposits was a complete fabrication. Thus these figures appear to be a figment

of the imagination and the email circulating them baseless and mischievous in intent.

2.6.3 Another report which was circulated in the media stating that Indian nationals held around US$ 1.4 trillion abroad in illicit external assets was based on the 2008 report of Global Financial Integrity (GFI), 'Illicit Financial Flows from Developing Countries: 2002-2006'. In its November 2010 report, 'The Drivers and Dynamics of Illicit Financial Flows from India: 1948-2008', however, it accepted on page 9 that the back-of-the-envelope method used to derive the figure was flawed – the figure was based on GFI's estimated average illicit outflows of US$ 22.7 billion per annum (over the period 2002-06) multiplied by the 61 years since independence and it is erroneous to apply annual averages to a long time series when illicit flows are fluctuating sharply from one year to the next.

2.6.4 It is however useful to mention here one estimate of the amount of Indian deposits in Swiss

banks (located in Switzerland) which has been made by the Swiss National Bank. Its spokesperson stated that at the end of 2010, the total liabilities of Swiss Banks towards Indians were 1.945 billion Swiss Francs (about Rs. 9,295 crore). The Swiss Ministry of External Affairs confirmed these figures when a reference was made by the Indian Ministry of External Affairs to them. Since the information was publicly available on the website of the Swiss National Bank, the figures of earlier years were also taken and are tabulated in Annexure Table 1. From this Table, it can be seen that bank deposits of Indians in Swiss banks have decreased from Rs. 23,373 crore in year 2006 to Rs. 9,295 crore in year 2010.

2.6.5 In Annexure Table 2 the liabilities of Swiss banks towards nationals of various countries have been listed. It can be seen that the deposits of Indians in Swiss banks constitute only 0.13 per cent of the total bank deposits of citizens of all countries. Further, the share of Indians in the total bank deposits of citizens of all countries in Swiss banks has

reduced from 0.29 per cent in 2006 to 0.13 per cent in 2010.

2.6.6 These figures are the only authentic information available at this stage about Indian money lying in foreign banks. From these figures, it can be safely concluded that the common belief that Indians hold the maximum deposits in Swiss banks is not correct.

2.7 Illicit Money transferred outside India: Reports of the IMF and GFI

2.7.1 An IMF study as reported by Rishi and Boyce (1990)9 estimated the flight of capital from India during the period 1971-86 at US$20-30 billion, or US$1-2 billion every year. This estimate was later revised in 200110 to US$ 88 billion over the 1971-97 period, a sum that is roughly equivalent to 20 per cent of net real debt disbursements to the economy from 1971 to 1997. In other words, for every dollar of external debt accumulated by India from 1971 to 1997, private Indian residents accumulated 20 cents of external assets.

2.7.2 The method followed to arrive at these estimates was the World Bank residual method which estimates capital flight as follows:

Capital Flight = Change in External Debt Outstanding + Current Account Surplus + Change in Official Reserve + FDI

The underlying rationale of the method is that the sources of funds exceeding recorded use of funds reflect unrecorded outflows. This unrecorded outflow may involve capital earned through legitimate means such as the profits of a legitimate business or it may involve capital earned through illegitimate business.

2.7.3 Capital flight is further adjusted through trade mis-invoicing which arises when transactions are reinvoiced when goods leaving the country of export under one invoice are reported under a different invoice in the country of import. The underlying rationale is that residents can acquire foreign assets illicitly by over-invoicing imports and under-invoicing exports. This is estimated by comparing

exports/imports of goods from/to India with what the other countries are reporting as importing/exporting from/to India. The adjusted capital flight was thus estimated at US$ 87,881 million.

2.7.4 GFI used similar methodology, with certain modifications, for estimating illicit outflows and on other related topics in a series of reports:

(a) December 2008: Illicit Financial Flows from Developing Countries: 2002-2006, which estimates that illicit financial flows out of developing countries are US$ 850 billion to US$ 1 trillion per year.

(b) February 2010: The Implied Tax Revenue Loss from Trade Mispricing, which estimates that the developing world is losing roughly US$ 100 billion per year in tax revenue loss from illicit financial flows.

(c) March 2010: Privately Held, Non-Resident Deposits in Secrecy Jurisdictions, which estimates that such deposits are currently

approaching US$ 10 trillion and have been growing at a compound rate of 9 per cent annually over the last 13 years, much faster than the growth in world GDP at 3.9 per cent per year.

(d) March 2010: Illicit Financial Flows from Africa: Hidden Resource for Development, which estimates that Africa lost US$854 billion in illicit financial outflows from 1970 through 2008.

(e) May 2010: The Absorption of Illicit Financial Flows from Developing Countries: 2002-2006, which examines where trillions of dollars in illicit outflows from the developing countries, being proceeds of crime, corruption, and tax evasion, are being deposited. It has been reported that the greater part of illicit flows departing from one country and arriving in another are transferred as cash through the shadow financial system, resulting in deposits in accounts outside countries of origin. It has been demonstrated that developed countries are the largest

absorbers of cash coming out of developing countries and developed country banks absorb between 56 per cent and 76 per cent of such flows, considerably more than the OFCs.

(f) November 2010: The Drivers and Dynamics of Illicit Financial Flows from India: 1948-2008, which estimates that between 1948 and 2008,a total amount of US$ 213.2 billion has been shifted out of India through illicit outflows. After taking into consideration the rate of return on external assets, it is estimated that the adjusted gross transfer of illicit assets by residents of India amounts to about US$ 462 billion as of end-December 2008. It has been further stated that if the size of India's underground economy is estimated at 50 per cent of the GDP (US$ 640 billion based on a GDP of US$ 1.28 trillion in 2008), roughly 72.2 per cent of the illicit assets comprising the underground economy is held abroad.

(g) January 2011: Illicit Financial Flows from Developing Countries: 2000-2009, which estimates that illicit outflows from the developing world from 2000 to 2008 were approximately US$ 6.5 trillion.

(h) February 2011: Transnational Crime in the Developing World, which evaluates the overall size of criminal markets in 12 categories: drugs, humans, wildlife, counterfeit goods and currencies, human organs, small arms, diamonds and other gems, oil, timber, fish, art and cultural property, and gold. Of the 12 illicit activities studied, trade in drugs ($320 billion per year) and counterfeiting ($250 billion per year) are ranked first and second in terms of illicit funds generated.

(i) December 2011: Illicit Financial Flows from the Developing World over the Decade Ending 2009, which finds that illicit outflows from the developing world during the year 2009 were US$

903 billion which is a major drop from the US$ 1.55 trillion recorded in the year 2008. The report also finds that from 2000 to 2009, developing countries lost US$ 8.44 trillion to illicit financial flows. As in the January 2011 report, countries are ranked according to the magnitude of outflows as shown here in Annexure Table 3.

2.7.5 In these reports, the illicit financial flows (IFFs) have been estimated by adding the change in external debt (CED) to trade mispricing based on the gross excluding reversals (GER) method. The CED is computed as source of funds (change in funds plus net FDI) minus use of funds (current account balance plus change in reserves) on the underlying principle that source of funds exceeding recorded use of funds reflects unrecorded outflows. The GER is computed by comparing a country's export/import to the world (free-on-board.) as compared to what the world reports as having imported/exported from/to that

country, after adjusting for cost of insurance and freight (10 per cent of f.o.b.).

2.7.6 However, both the CED and GER adjustments only consider illicit outflows. Thus, when the use of funds exceeds the source, that is when there are inward transfers of illicit capital, the CED or GER, as the case may be, is set to zero. Illicit inflows have been excluded mainly on the grounds that since illicit flows are unrecorded, they cannot be taxed or utilised directly by the government for economic development. Further, these inflows are themselves driven by illicit activities such as smuggling to evade import duties or value-added tax (VAT) or through over-invoicing of exports.

2.7.7 By not considering illicit inflows even if the reasons given are valid, it is apparent that the estimate given in GFI's November 2010 report of a total of US$ 213.2 billion being shifted out of India from 1948 to 2008 appears to be on a higher side.

2.7.8 Further, the GFI reports do not consider the net effect of illicit outflows which have come back to the country through legal channels such as FDI and investment through P-Notes. It recognises that while outward transfers of illicit capital could come back to a country through a process known as 'round tripping', as the Indian and Chinese experience shows, these inflows would not be captured and would show up as an uptick in recorded FDI. It further states that while intuitively it may make sense to net out the return of flight capital from outflows, it would be practically impossible to implement because it would not be possible to apportion recorded aggregate inflows between new investments and the return of capital flight. This recognition further reduces the estimate of outflow from India.

2.7.9 Moreover the GFI (and World Bank)models do not capture significant illicit outflows, such as through

- Mispricing occurring through trade in services and intangibles as the same are not addressed in IMF Direction of Trade Statistics
- Trade mispricing that occurs within the same invoice through related or unrelated parties
- Smuggling
- Hawala-type swap transactions

2.7.10 It is therefore reasonable to suggest that although the estimates of illicit outflows outside India made by the IMF and GFI gives useful insights, they are incomplete and further studies are required to get a correct estimate.

2.8 Has Money transferred abroad illicitly returned?

2.8.1 In 'The Drivers and Dynamics of Illicit Financial Flows from India: 1948-2008', GFI has estimated that from 1948 to 2008 a total of US$ 213.2 billion has been shifted out of India through illicit outflows. It further estimates that after taking into consideration the rate of return on external assets,

the adjusted gross transfer of illicit assets by residents of India amounts to about US$ 462 billion as of end-December 2008. It needs to be ascertained whether such an amount is stashed abroad in offshore bank accounts or whether this money has at least partly already returned to India.

2.8.2 FDI statistics perhaps point to this fact. As per data released by the Department of Industrial Policy and Promotion (DIPP), from April 2000 to March 2011 FDI from Mauritius is 41.80 per cent of the entire FDI received by India. In Annexure Table 4 the FDI equity inflows country-wise have been listed. It can be seen from this table that the two topmost sources of the cumulative inflows from April 2000 to March 2011 are Mauritius (41.80 per cent) and Singapore (9.17 per cent). Mauritius and Singapore with their small economies cannot be the sources of such huge investments and it is apparent that the investments are routed through these jurisdictions for avoidance of taxes and/or for concealing the identities from the revenue authorities of the ultimate

investors, many of whom could actually be Indian residents, who have invested in their own companies, though a process known as round tripping.

2.8.3 Investment in the Indian Stock Market through PNs is another way in which the black money generated by Indians is re-invested in India. PNs or overseas derivative instruments (ODIs) are issued by FIIs against underlying Indian securities, which can be equity, debt, derivatives, or even indices. The investor in PNs does not hold the Indian securities in her/his own name. These are legally held by the FIIs, but s/he derives economic benefits from fluctuation in prices of the Indian securities, as also dividends and capital gains, through specifically designed contracts. Thus, through the instrument of PNs, investment can be made in the Indian securities market by those investors who do not wish to be regulated by Indian regulators due to a variety of reasons such as not meeting the eligibility criteria for investment in Indian securities market, cost and time considerations, or the desire to keep their identity anonymous, which is

possible also for the reason that PNs/ODIs can be freely traded and easily transferred without disclosing the identity of the actual beneficiaries. ThePNs can only be issued to persons who are regulated by an appropriate foreign regulatory authority and after satisfying know your customer (KYC) norms. Further, the FIIs are required to report to SEBI on a monthly basis, the name and location of the person to whom the PNs/ODIs have been issued. However, in view of the fact that the jurisdictions in which the persons to whom PNs are issued are not only countries such as the UK or USA but also well-known OFCs such as the Cayman Islands, British Virgin Islands, Switzerland, and Luxembourg, it is possible to hide the identity of the ultimate beneficiaries through multiple layers which is also evident by going through the orders passed by SEBI in some cases.11 The ultimate beneficiaries/investors through the PN Route can be Indians and the source of their investment may be black money generated by them.

2.8.4 In the recent past, instances have come to the notice of SEBI that the GDRs issued by some Indian companies, which are listed on the Luxembourg Stock Exchange, are used for manipulation of markets. On going through a 21 September 2011 order passed by SEBI,12 it can be seen that surprisingly mysterious 'initial investors' were found ready to invest in GDRs issued by companies which were either start-ups or having shares with very little trading and after two-three years sold the GDRs at deep discounts taking heavy losses. These instances suggest this as another possible route for reinvestment of black money.

2.8.5 Charitable organisations, non-government organisations (NGOs), and associations receiving foreign contributions are required to file an annual return to the Ministry of Home Affairs in Form FC-3. In the said form, only the name and address of the foreign donors are mentioned, with no further details of the beneficial owners. It is possible that in many such cases, the black money generated by Indians is being routed back to India.

2.8.6 While GFI recognizes in its various reports that the outward transfers of illicit capital could come back to a country through 'round tripping', it has not taken the same into consideration in view of the practical difficulty of doing so. However, the foregoing examples do suggest that a large part of the illicit flows from India may have returned. They also highlight urgent need of proper investigations by the International Taxation Division, strengthening of the legislative framework consisting of double taxation avoidance agreements (DTAAs) and tax information exchange agreements (TIEAs), and streamlining of exchange of information from various jurisdictions, including OFCs.

2.9 Misuse of Corporate Structure

2.9.1 Corporate structuring is a legitimate means of bringing together factors of production in a way that will facilitate business and enterprise and help the economy. However, an artificial personality can also be created of a corporate entity to conceal the

real beneficiaries. Opaque structuring through creation of multiple entities that own each other and the secrecy granted by certain jurisdictions facilitate such misuse.

2.9.2 A World Bank Report of 2011 titled 'The Puppet Masters' investigated 150 big corruption cases and in almost all such cases, misuse of corporate vehicles, such as companies and trusts, was found to the tune of US$ 50 billion. As a response to such blatant misuse of legal privileges, many countries are now demanding meaningful information about beneficial ownership. The FATF has also taken a strong stand on this issue and is in the process of revamping its recommendations to tighten the rules. It is expected that there will be a shift towards identifying real rather than merely legal ownership and global efforts will plug the loopholes existing in the form of such unethical practices prevalent today.

2.9.3 The Vodafone tax case provides an instance of the misuse of corporate structure for avoiding the

payment of taxes. In this case, the Hutchison Group had made investments in India from 1992 to 2006 through a number of subsidiaries having 'separate corporate personality' but which were essentially post box companies based in the Cayman Islands, British Virgin Islands, and Mauritius. The Hutchison Group sold its entire business operation in India in February 2007 to the Vodafone Group for a total consideration of US$ 11.2 billion and the same was effected through transfer of a solitary share of a Cayman Islands company. When the tax authorities requested the accounts of the said company, the answer given was that as per Cayman Islands law, the company was not required to prepare its accounts.

2.9.4 With increasing realisation about the harmful effect of ownership being concealed behind complicated corporate ownership structure, such structure is coming under scrutiny. In the Indian context, it is one of the reasons for the fact that tax authorities are not able to take action in cases where money is prima facie brought back to India through

round tripping and other legitimate means and it is expected that efforts taken by India in this regard as also global pressure will provide a check on these tendencies.

2.10 Need for more research

2.10.1 The need for more reliable estimates of the extent of black money both inside and outside the country arrived at through rigorous research and examination has been already recognised. This is needed for purposes of policy formulation as well as to prevent wild speculations. To achieve these objectives, a memorandum of understanding has been signed between the Central Board for Direct Taxes (CBDT), the NIPFP, the National Council for Applied Economic Research (NCAER), and the National Institute of Financial Management (NIFM) on 21 March 2011 for completing a study within a period of 18 months with the following terms of reference:

- To assess/survey unaccounted income and wealth both inside and outside the country.
- To profile the nature of activities engendering money laundering both inside and outside the country with its ramifications for national security.
- To identify important sectors of the economy in which unaccounted money is generated and examine causes and conditions that result in generation of unaccounted money.
- To examine the methods employed in generation of unaccounted money and conversion of the same into accounted money.
- To suggest ways and means for detection and prevention of unaccounted money and bringing the same into the mainstream economy.
- To suggest methods to be employed for bringing to tax unaccounted money kept outside India.
- To estimate the quantum of non-payment of tax due to evasion by registered corporate bodies.

2.10.2 The issue of generation of black money and its illicit transfer abroad has gained prominence in the last two years due to the resolve of world leaders, including Indian leaders, to address it effectively. Some of the widely circulated figures about black money of Indians stashed abroad have been, as discussed earlier, baseless exaggerations and there is strong likelihood that substantial amount of such money transferred abroad illicitly might have returned to India through illicit means. Thus a multi-pronged strategy, including joining the global crusade against black money, creating an appropriate legislative framework, setting up institutions for dealing with illicit money, developing systems for implementation, and imparting skills for effective action, is required to deal with the issue of generation of black money and its illicit transfer outside the country, and for bringing it back to India. This will be subsequently discussed in this document.

INSTITUTIONS TO DEAL WITH BLACK MONEY

3.1 Introduction

The responsibility of dealing with the challenge of unaccounted wealth and its consequences is jointly and collectively shared by a number of institutions belonging to the central and state governments. These include various tax departments which are assigned the task of enforcement of tax laws. Among them the important ones are the CBDT and the Central Board of Excise and Customs (CBEC). However, there are various other regulatory authorities undertaking supervision and policing. They include the Enforcement Directorate (ED), Financial Intelligence Unit (FIU), Economic Offences Wing of the State Police, Central Bureau of Investigation (CBI), Serious Frauds Investigation Office (SFIO), and Narcotics Control Bureau (NCB). In addition, there are coordinating agencies such as the Central Economic Intelligence Bureau (CEIB), National Investigation Agency (NIA), and the High Level Committee (HLC), which also play an important role in fighting the menace of black money. This

chapter discusses the role and responsibilities of these institutions and their administrative framework.

3.2 Central Board of Direct Taxes

3.2.1 The CBDT, New Delhi, is part of the Department of Revenue in the Ministry of Finance. While the CBDT provides essential inputs for policy and planning of direct taxes in India, it is also responsible for administration of direct tax laws through its Income Tax arm. The CBDT is a statutory authority functioning under the Central Board of Revenue Act 1963. The officials of the Board in their ex-officio capacity also function as a Division of the Ministry dealing with matters relating to the levy and collection of direct taxes. The CBDT is headed by a Chairman and comprises six Members besides. Various functions and responsibilities of the CBDT are distributed amongst the Chairman and Members, with only fundamental issues reserved for collective decision. In addition, the Chairman along with each Member is responsible for exercising supervisory

control over definite areas of the field offices of the Income Tax Department, spread all over India, known as Zones and administered by eighteen cadre-controlling Chief Commissioners. Eight Directorates,13 headed by the Director General of Income Tax, are attached to the CBDT and play the vital role of liaising between the field offices and the CBDT. The Investigation Wings are headed by the Director General of Income Tax (Investigation) . The Director General of Income Tax (International Taxation) is in charge of taxation issues arising from cross-border transactions and transfer pricing. The Income Tax Department has offices in more than 740 buildings spread over 510 cities and towns across India and has over 55,000 employees.

3.2.2 The vision of the Income Tax Department is to be a partner in the nation-building process through progressive tax policy, efficient and effective tax administration, and improved voluntary compliance. This is achieved by creating an enabling policy environment and by augmenting the revenue

mobilization apparatus for optimum revenue collection under the law while maintaining taxpayer confidence in the system.

3.2.3 The Income Tax Department is primarily responsible for combating the menace of black money. For this purpose, it uses the tools of scrutiny assessment as well as information-based investigations for detecting tax evasion and penalising the same as per provisions of the Income Tax Act, with the objective of creating deterrence against tax evasion. In doing so, it plays one of the most important roles in preventing generation, accumulation, and consumption of unaccounted black money. Some of its important functions are as follows:

Institutions to Deal with Black Money

a) Policy making: The CBDT is responsible for assisting the central government in all policy matters related to direct taxation, including amendments of the law, making

rules and procedures, and facilitating compliance with them. The Foreign Tax and Tax Research (FT&TR) Division in the Board, is responsible for all policy issues relating to international taxation and transfer pricing. The officers of the FT&TR Division negotiate and renegotiate the DTAAs and TIEAs. The Division also coordinates with various international organizations such as the OECD, United Nations, Global Forum on Transparency and Exchange of Information for Tax Purposes, Inter American Centre of Tax Administrations (CIAT), and South Asian Association for Regional Cooperation (SAARC). Other divisions of the CBDT deal with policy matters related to investigations, legal amendment, litigations, audit, and administrative matters.

b) Assessment: Determination of a person's income is referred to as 'assessment'. The

primary onus of declaring one's true income is on the taxpayer herself/himself by way of filing of a 'return' of income. The return is then processed for prima facie errors and on the basis of computerised selection and definite criteria. Some returns are selected for detailed scrutiny and verification by officers of the Income Tax Department. Such assessment is carried out by the field offices and also covers refunds, rectifications, penalties, and prosecution.

c) Investigation: The Investigation Wing of the Income Tax Department deals with investigations to detect tax evasion and carries out operations like surveys and searches to collect evidence of such evasion. Such operations are usually carried out after detailed preliminary investigations and in cases involving substantial evasion of taxes.

d) Collection of Information: There are various reporting mechanisms as part of the compliance strategy whereby the Income Tax Department receives data for the purpose of detecting cases of evasion of taxes. Data in respect of cash transactions in bank accounts, registered immovable property below the circle rate, and capital market transactions, etc. is received in the form of annual information returns (AIR). Collected data is then analysed to help identify clandestine transactions. An integrated taxpayer data management system (ITDMS) is also an effective tool for analysing the data gathered from AIRs, permanent account number (PAN) database, Income Tax Department (ITD) applications, and telephone operators to unearth unscrupulous transactions.

e) Collection of Information Involving Cross-border Transactions: The Income Tax

Department also receives information from foreign tax authorities under the instruments of exchange of information, that is DTAAs, TIEAs, and Multilateral Conventions, which are used by the tax administration for purposes of investigation and assessment.

3.2.4 There are a number of other enforcement and regulatory agencies working in different ministries that are also involved directly or indirectly in prevention of the accumulation of black money. The primary responsibility of these agencies is the regulation of certain transactions or entities so as to check unlawful activities but in the process they have an important role in preventing accumulation of black money. The Income Tax department coordinates with these agencies to consolidate the efforts in the direction of combating the menace of black money and tax evasion.

3.3 **Enforcement Directorate**

3.3.1 The ED was established in 1956 to administer the provisions of the Foreign Exchange Regulation Act 1973 (FERA). However, FERA was repealed on 31 May 2000 and replaced with the Foreign Exchange Management Act 1999 (FEMA) which came into force with effect from 1 June 2000.

3.3.2 The ED has currently been entrusted with the investigation and prosecution of money-laundering offences and attachment/confiscation of the proceeds of crime under the Prevention of Money Laundering Act 2002 (PMLA). The officers of the ED undertake multifaceted functions of collection, collation and development of intelligence, investigation into suspected cases of money laundering, attachment/confiscation of assets acquired through the commission of scheduled offences, and the criminal prosecution of the offenders in the court of law. The ED also enforces the provisions of FEMA, aimed at promoting the development and maintenance of India's foreign

exchange market and providing, inter alia, for action against persons/entities involved in international hawala transactions.

3.3.3 The ED has a pan-Indian character with field offices spread over various states and regions. There is a separate legal wing headed by a Prosecutor, with two deputy legal advisers and 10 assistant legal advisers. The Directorate was restructured in March 2011 increasing the number of offices from 22 to 39 and the total strength of officers and staff to 2063. After the process of restructuring is completed, the Directorate will have headquarters in New Delhi, five regional offices at New Delhi, Mumbai, Kolkata, Chennai and Chandigarh, besides 11 zonal offices and 22 sub-zonal offices at various places.

3.3.4 The Directorate initiates investigations under FEMA for contraventions relating to foreign exchange transactions generally by resident Indians, including maintenance of bank accounts abroad with

unauthorized holdings, on the basis of specific intelligence/information and takes appropriate action as per the provisions of FEMA.

3.3.5 The ED also administers the PMLA. The PMLA contains provisions related to investigation into the cases of money laundering and powers of search, seizure, collection of evidence, prosecution, etc. for which the ED is the competent authority. Under the PMLA, 'money laundering' is a criminal offence and extends to any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence (as per Annexure-1). After a 2009 amendment, predicate offences for money laundering also extend to conduct that occurred in another country which constitutes an offence in that country and which would have constituted a predicate offence had it occurred domestically. The ED initiates investigations only after a law enforcement agency registers a case under any one of the offences listed in the Schedule to the Act.

3.4 Financial Intelligence Unit

3.4.1 The FIU-IND was established by the Government of India vide an Office Memorandum dated 18 November 2004 for coordinating and strengthening efforts for national and international intelligence by investigation and enforcement agencies in combating money laundering and terrorist financing. FIU-IND is the national agency responsible for receiving, processing, analysing, and disseminating information relating to suspect financial transactions. It is an independent body reporting to the Economic Intelligence Council headed by the Finance Minister. For administrative purposes, the FIU-IND is under the control of the Department of Revenue, Ministry of Finance.

3.4.2 Under the Rules issued under the PMLA, the following types of reports have been prescribed for the reporting entities:

- Cash Transaction Reports (CTRs),
- Suspicious Transaction Reports (STRs),

> Counterfeit Currency Reports (CCRs), and

> Non-Profit Organizations Transaction Reports (NTRs)

3.4.3 CTRs and NTRs are threshold-based (Rs. 10 lakh and above in a month) reports and are submitted on a monthly basis. STRs and CCRs are transaction-based reports and are submitted when such a transaction takes place. The FIU-IND receives over 7 lakh CTRs and 1500 STRs every month.

3.4.4 The FIU-IND's functions are defined under the PMLA. The Director, FIU-IND is empowered under Sections 12, 13, and 66 of the PMLA for exercise of powers relating to collection and dissemination of information. Powers relating to search and seizure are exercised by the ED. Notification No. 5/2005, dated 1 July 2005 confers various powers under the PMLA on the Director, FIU-IND.

3.4.5 For ensuring the availability of information with the FIU, section 12 of the PMLA requires every banking company, financial institution, and

intermediary (the reporting entities) to furnish information to the FIU and verify the identity of their clients in the manner prescribed. The reporting entities are also required to maintain and preserve records of transactions and identity of clients for a period of ten years from the date of cessation of transactions. Section 13 of the PMLA empowers the Director, FIU to call for records maintained by a reporting entity and enquire into cases of suspected failure of compliance with the provisions of the PMLA and also to impose fine.

3.4.6 Prior to Notification No. 13/2009 dated 12 November 2009, the 'regulator' for purposes of issue of guidelines for the client identification requirements and reporting to the FIU were the Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA), and SEBI. After the Notification, however, the definition of regulator has been changed to mean a person or an authority or a government which is vested with the power to license, authorise, register, regulate, or supervise the

activities of banking companies, financial institutions, or intermediaries, as the case may be. Accordingly, at present, various 'regulators' have issued KYC Norms for identifying clients and reporting to the FIU. They are also mandated to prescribe enhanced measures for verifying the client's identity taking into consideration type of client, business relationship, or nature and value of transactions. These regulators have issued circulars for the KYC norms.

3.5 Central Board of Excise and Customs and DRI

3.5.1 The CBEC is a part of the Department of Revenue under the Ministry of Finance, Government of India. It deals with the tasks of formulation of policy concerning levy and collection of customs and central excise duties, prevention of smuggling, and administration of matters relating to customs, central excise and narcotics to the extent under the CBEC's purview. The Board is the administrative authority for its subordinate organizations, including Custom

Houses, Central Excise Commissionerates, and the Central Revenues Control Laboratory.

3.5.2 The Directorate General of Central Excise Intelligence (DGCEI) is the apex intelligence organization functioning under the CBEC. It is entrusted with the responsibility of detecting cases of evasion of central excise and service tax. The Directorate develops intelligence, especially in new areas of tax evasion through its intelligence network across the country and disseminates information in this respect by issuing Modus Operandi Circulars and Alert Circulars to apprise field formations of the latest trends in duty evasion. Wherever found necessary, DGCEI on its own, or in coordination with field formations, organises operations to unearth evasion of central excise duty and service tax.

3.5.3 The Directorate of Revenue Intelligence (DRI) also functions under the CBEC. It is entrusted with the responsibility of collection of data and information and its analysis, collation, interpretation

and dissemination on matters relating to violations of customs laws and, to a lesser extent, anti-narcotics law. It maintains close liaison with the World Customs Organisation, Brussels, the Regional Intelligence Liaison Office at Tokyo, INTERPOL, and foreign customs administrations. It is headed by a Director General in New Delhi and is divided into seven zones all over India.

3.5.4 Thorough scrutiny and enquiry of cases of Suspected Transaction Reports (STRs) forwarded by the FIU is conducted by the DRI (Headquarters) and its zonal units which helps in the identification of cases of unaccounted money both within and outside the country.

3.6 **Central Economic Intelligence Bureau**

3.6.1 The CEIB functioning under the Ministry of Finance is responsible for coordination, intelligence sharing, and investigations at national as well as regional levels amongst various law enforcement agencies. The existing coordination mechanism in the

CEIB consists of Regional Economic Intelligence Councils (REICs) at regional level and the Group on Economic Intelligence and meetings of the heads of investigating agencies under the Department of Revenue at the centre. While the Group on Economic Intelligence is focused on matters relating to intelligence sharing, the REICs and heads of agencies meetings cover both intelligence and investigations.

3.6.2 As per the charter of the CEIB, it has been assigned the responsibility of acting as the 'think tank' on issues relating to economic offences including data collection and collation policies and preparation and maintenance of dossiers of tax evaders, violators of economic laws, white collar operators, etc. It also examines emerging trends and changing dynamics of economic offences. It takes note of the nexus among various stakeholders of these activities, their modi operandi and suggests measures for effectively dealing with them. It also analyses the macroeconomic impact of such activities and is the nodal agency for coordination at

international level. It coordinates with the National Security Council Secretariat on matters having a bearing on national and economic security.

3.6.3 Human intelligence continuous to be the most important source of gathering information about evasion of various taxes and duties and generation of black money. During the course of investigation of customs offence cases, the CEIB comes across information relating to generation and parking of black money. All such information is shared with the relevant departments/agencies for further investigation and necessary action as may be warranted. In such matters inter-agency cooperation and sharing of information play a vital role.

3.6.4 Any information on black money or money laundering or hawala transactions is regularly shared with the ED and Director General of Income Tax so that proper action on all accounts is initiated in the matter. Evidence is shared with the ED to help establish cases of money laundering and hawala operations by unscrupulous importers / exporters and

hawala operators. Cases of unaccounted cash recovery are reported to the DGIT (Investigation), CBDT to establish the source of the money and its proper accounting.

3.6.5 The CEIB maintains constant interaction with its Customs Overseas Investigation Network (COIN) offices to share intelligence and information on suspected import / export transactions. The COIN offices gather evidence through diplomatic channels from the foreign custom offices and other foreign establishments to establish cases of mis-declaration which are intricately linked with tax evasion and money laundering.

3.7 **Other Central Agencies**

3.7.1 The NCB, which functions under the Ministry of Home Affairs, was established on 17th March 1986 and its functions include co-ordination of actions by various offices, state governments, and other authorities under the Narcotics Drugs and Psychotropic Substances (NDPS) Act 1985, Customs

Act, Drugs and Cosmetics Act, and any other law for the time being in force in connection with the enforcement provisions of the NDPS Act. It is assigned the task of counter measures against illicit drugs traffic under the various international conventions and protocols, and also assists concerned authorities in foreign countries and concerned international organisations dealing with prevention and suppression of this traffic. The Central Bureau of Narcotics (CBN) supervises the cultivation of opium poppy in India and issues necessary licences for manufacture, export and import of narcotics drugs and psychotropic substances. It monitors India's implementation of the United Nations Drug Control Conventions and also interacts with the International Narcotics Control Board (INCB) in Vienna and the competent authorities of other countries to verify the genuineness of a transaction prior to authorising shipments.

3.7.2 The SFIO functions under the Ministry of Corporate Affairs and takes up for investigation

complex cases having inter-departmental and multidisciplinary ramifications and substantial involvement of public interest, either in terms of monetary misappropriation or in terms of persons affected. It also takes up cases where investigation has the potential of contributing towards a clear improvement in systems, laws, or procedures.

3.7.3 The Registrar of Companies (ROC) is the Registry for companies and limited liability firms and is established under the Ministry of Corporate Affairs. The Ministry of Corporate Affairs has a three-tier organisational set-up consisting of a Secretariat in New Delhi, Regional Directorates in Mumbai, Kolkata, Chennai and Noida, and field offices in all states and union territories.

3.7.4 The Registrar of Societies (ROS): The Registrars of non-profit societies are within state government's purview and most of the states have an ROS office. The Society Registration Act is a central Act but many states have adopted it with some state

amendments and are registering non-profit societies under their respective Acts. Some state assemblies have enacted completely separate legislation on the subject. The ROS offices are reservoirs of data on societies and also function as their regulator.

3.7.5 The Bureau of Immigration (BOI): There are 78 immigration check-posts (ICPs) in the country of which 26 are at airports, 20 at seaports, while 32 are land ICPs. Of these 78 ICPs, 12 are controlled by the BOI, while the remaining 66 are managed by state governments on behalf of the Government of India. Immigration checks are conducted at the ICPs for all passengers, Indian and foreign, both at the time of arrival and departure. All passengers coming to India or departing from India are also required to complete Disembarkation and Embarkation Cards on arrival and departure respectively.

3.7.6 The Economic Intelligence Council (EIC), which came into existence in 2003, is chaired by the Finance Minister and comprises senior functionaries of

various ministries and intelligence agencies, including the Governor of the RBI and the Chairman of SEBI. The EIC meets at least once a year to discuss and take decisions regarding trends in economic offences and strategies on intelligence sharing, coordination, etc. The implementation of decisions taken by the EIC is monitored by the Working Group on Intelligence Apparatus, set up for this purpose within the EIC.

3.7.7 The Inter-Ministerial Coordination Committee on Combating Financing of Terrorism and Prevention of Money Laundering (IMCC) has been set up in 2002 to ensure effective coordination between all competent authorities and strengthen India's national capacity for implementing AML/CFT measures which meet international standards. The IMCC is chaired by the Additional Secretary of the Department of Economic Affairs within the Ministry of Finance. At present the committee consists of 14 agencies with substantial role in AML/CFT.

3.7.8 The National Crime Records Bureau (NCRB) has been set up with the objective of empowering the Indian police services with information technology and criminal intelligence with a view to enabling them to effectively and efficiently enforce the law. It therefore creates and maintains a secured national database on crimes, criminals, property, and organised criminal gangs for use by law enforcement agencies. The NCRB also processes and disseminates fingerprint records of criminals, including foreign criminals, to establish their identity.

3.7.9 The National Investigation Agency (NIA) is a specialised and dedicated investigating agency set up under the National Investigation Agency Act to investigate and prosecute scheduled offences, in particular offences under the Unlawful Activities (Prevention) Act, including Financing of Terrorism. The NIA has concurrent jurisdiction with the individual states, thereby empowering the central government to probe terror attacks in any part of the country. Officers of the NIA have all powers,

privileges, and liabilities which police officers have in connection with investigation of an offence. The central government has the power to suo moto assign a case to the NIA for investigation. The NIA Act also provides for setting up of special courts and trials to be held on a day-to-day basis. The NIA Act can investigate offences under the specific Acts mentioned in the Schedule to NIA Act, including the Atomic Energy Act 1962, Unlawful Activities (Prevention) Act 1967, Anti-Hijacking Act 1982, Suppression of Unlawful Acts against Safety of Civil Aviation Act 1982, SAARC Convention (Suppression of Terrorism) Act 1993, Suppression of Unlawful Acts against Safety of Maritime Navigation and Fixed Platforms on Continental Shelf Act 2002, Weapons of Mass Destruction and Their Delivery Systems (Prohibition of Unlawful Activities) Act 2005, and offences under chapter VI and sections 489-A to 489-E of the Indian Penal Code.

3.7.10 A High Level Committee headed by the Revenue Secretary and with representatives of the

RBI, Intelligence Bureau (IB), ED, CBI, CBDT, NCB, DRI, FIU and the Foreign Tax Division has been constituted with the joint secretary (FT&TR-I) as Member-Secretary. This Committee is entrusted with the responsibility of coordinating investigations under different laws into matters concerning the illicit generation of funds within the country and their flow for illegal parking in foreign jurisdictions by Indian citizens.

3.8 CBI and Police Authorities

3.8.1 The CBI, functioning under the Department of Personnel, Ministry of Personnel, Pension and Public Grievances, Government of India, is the premier investigating police agency in India. It handles a broad category of criminal cases including cases of corruption and fraud committed by public servants, economic crimes, and other specific crimes involving terrorism, bomb blasts, sensational homicides, kidnappings and the underworld. The CBI plays an important role in international cooperation relating to

mutual legal assistance and extradition matters. The Ministry of Home Affairs is the central authority for mutual legal assistance in criminal matters and the Ministry of External Affairs the nodal agency for extradition matters.

3.8.2 State Police Agencies: Under the Constitution of India, police and public order are state (provincial) subjects. Every State/Union Territory has its own police force, which performs not only normal policing duties but also has specialised units to combat economic offences. The Economic Offences Wing (EOW) of the Police functioning under the administrative control of states (provinces) is entrusted with the responsibility of investigation of serious economic offences and offences having inter-state ramifications. It is also mandated to interact, assist, and guide the district police on matters related to financial crimes and preventive and detection measures.

3.8.3 The various divisions of the EOW in states typically include the following sections:

- Anti Fraud and Cheating Section: Company frauds, Bank frauds, Frauds by Non-banking financial companies, Sales tax frauds, Income tax-related frauds
- Anti Land & Building Racket Section: Co-operative group housing frauds, Cases against land mafia, Frauds by Builders, Land-related bank frauds involving double mortgage, fake documents, etc., Frauds related to pre-launch schemes, Illegal sale of government lands, etc.
- Anti Forgery Section: Forgery of documents, Wills admission-related frauds, Visa-related frauds, Job rackets, Manpower export rackets
- Anti Criminal Breach of Trust Section: Multi level marketing frauds, Export/import related frauds, Chit fund frauds, Tax evasion frauds, Share trade frauds,

Corporate frauds involving criminal breach of trust

- Intellectual Property Rights (IPR)and Trademark Section: Infringement of copyrights, Audio- Video piracy, Software piracy, Spurious drugs and fast-moving consumer goods (FMCG), Book piracy, Trademark offences, Violation of trademarks in the manufacturing sector
- Anti Cyber Crime Section: Data theft, Identify theft, Credit card frauds, Online obscenity and pornography, Phishing hacking, Social networking- related complaints.

3.8.4 These various organisations of central and state governments closely monitor violation of laws regulating economic activities and their links with other criminal activities and in doing so provide a comprehensive network of checks and balances against generation of black money too. However, the federal structure of governance and their vertical

reporting systems within their respective ministries and departments may have resulted in less than optimum coordination of data, information, and actions and a strengthening of this aspect may be an important way forward in the fight against generation and accumulation of black money.

Tackling the Menace of Black Money: The Framework

4.1 Evolution of Strategies to Control Black Money in India

4.1.1 The problem of tax evasion and generation of Black Money is not new. As far back as 1936, the Ayers Committee, while reviewing the income tax administration in India suggested large-scale amendments to secure the interests of the honest taxpayer and effectively deal with fraudulent evasion. An Income-tax Investigation Commission was appointed in 1947 to investigate tax evasion and suggest measures for preventing it in future. A Taxation Enquiry Commission (1935-54) also went

into the question of tax evasion and recommended several legal and procedural changes. In 1956, Nicholas Kaldor made a specialized study of the Indian tax system, that also included prevalence of tax evasion, and his recommendations resulted in several amendments and new legislations like the Wealth Tax Act. A Direct Taxes Administration Enquiry Committee formed in 1958 suggested an integrated scheme of taxation for facilitating compliance and preventing tax evasion. It also made substantial contribution to the reorganization of tax administration. Important reforms based on the reports of various committees as well as the Administrative Reforms Commission have been made from time to time to strengthen tax compliance and plug tax evasion.

4.1.2 One of the main thrusts of these reforms consists of optimising the tax rates. The income tax rates were in the range of 25-30 per cent till the early 1960s, but gradually increased to reach a peak of 85 per cent with a 15 per cent surcharge during

the 1970s. These high rates, necessitated by contingencies like drought and war, when combined with the prevailing shortages, resulted in controls and licences, and thereby provided further incentives for evasion of taxes. It was largely in this economic environment that generation of black money became highly prevalent and acquired serious proportions. The Wanchoo Committee was appointed in 1971 to examine and suggest legal and administrative measures for unearthing black money and countering evasion and checking avoidance. It comprehensively dealt with the causes of and methods of tackling tax evasion and made a number of recommendations for strengthening tax administration.

4.1.3 In the past, the government has also resorted to voluntary disclosure schemes providing amnesty to tax evaders if they declared their unaccounted income and paid due taxes on the same. These voluntary schemes have been criticized on the grounds that they provide a premium on dishonesty and are unfair to honest taxpayers, as well as for

their failure to achieve the objective of unearthing undisclosed money.

4.1.4 The high marginal tax rates of over 90 per cent in the early 1970s, often considered a major reason for tax evasion and generation of black money, were brought down subsequently and have been at around 30 per cent since 1997. In the meantime, liberalisation of tariff and non-tariff barriers also removed some of the underlying reasons for black money. However, with liberalisation of restrictions on cross-border flow of goods and services and relaxation of foreign exchange control, new opportunities opened up for tax evasion through tax havens, misuse of transfer pricing, and other sophisticated methods. Globalisation reduced the cost of these sophisticated methods thereby facilitating generation of black money and its transfer across the border. These changes required new strategies to curb black money.

4.1.5 The role of tax havens has gradually come under scrutiny globally. With near-zero tax regimes, banking secrecy, and weak financial regulations, these tax havens facilitate hiding of money accumulated through tax evasion and other illegal means in addition to creating risks of terrorist financing and money laundering. At the G-7 summit in Lyons in 1996, a call was given to the OECD to prepare a report to address these issues with a view to establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices. The OECD came up with a report in 1998 and called for action against tax havens. The report envisaged blacklisting of and internationally coordinated sanctions against havens that persisted in luring other states' tax bases.

4.1.6 Countries have now realised that transparency and cooperation are essential for protecting their tax revenue. Such pressure has increased in recent times in view of the fiscal challenges faced by countries

across the world and public resentment against unethical financial practices.

4.1.7 The G20 summit in London in April 2009 proved to be an important milestone when just before the summit, countries like Switzerland, Liechtenstein, Luxembourg, and Monaco announced their preparedness to accept OECD standards of transparency and exchange of information. As an equal member of the G20, India played a vital role in sending out a strong message to various countries that if they did not comply with international standards of transparency, they should be ready to face sanctions from the 20 largest economies. The G20 countries, including India, declared, 'We agree to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over.'

4.1.8 With increased globalisation and economic liberalisation, there has been a manifold increase in

cross-border transactions. This has also resulted in increased opportunities for sophisticated schemes for avoiding tax payment using the different tax rules of different countries and use of tax havens. Global trade amongst various arms of MNEs has also increased substantially and accounts for a significant proportion of global trade. It also means increasing misuse of transfer pricing, leading to estimations that developing countries might be losing significant resources due to transfer-pricing manipulation. One of the difficulties in preventing abuse of such transfer-pricing arrangements is the large disparity between resources deployed by these multinationals and those available with tax administrators, particularly of developing countries. This requires enormous reforms for improving the capacity of tax administrations and equipping them with the necessary resources to deal with such modern challenges.

4.1.9 In the wake of such dramatic transformation of the factors that lead to the

generation of black money and the globalized development that facilitates them, the Government of India has resorted to a five-pronged strategy, which consists of the following:

(a) Joining the global crusade against black money;

(b) Creating appropriate legislative framework;

(c) Setting up institutions for dealing with illicit money;

(d) Developing systems for implementation; and

(e) Imparting skills to personnel for effective action.

4.2 Joining the Global Crusade against Black Money

A. India's actions through the G20

4.2.1 The financial crisis of 2008 and the resultant need for protecting revenues further strengthened the need for coordinated global efforts to tackle the challenges posed by tax haven-mediated

arrangements for evading tax. India has been a strong proponent of transparency and exchange of information for tax purposes and has pushed the G20 forum to exert pressures on countries that do not conform to the international standards of transparency.

4.2.2 At the London summit in April 2009, India played a major role in developing international consensus for taking action against tax havens. In its September 2009 summit at Pittsburg, the G20 gave a call for developing a toolbox of counter measures against non-cooperative jurisdictions. The G20 leaders envisaged a 'toolbox' with possible sanctions, suggesting the following measures:

- increased disclosure requirements on the part of taxpayers and financial institutions to report transactions involving non-cooperative jurisdictions;
- withholding taxes in respect of a wide variety of payments;

- denying deductions in respect of expense payments to payees resident in a non-cooperative jurisdiction;
- reviewing tax treaty policy;
- asking international institutions and regional development banks to review their investment policies; and
- giving extra weight to the principles of tax transparency and information exchange when designing bilateral aid programmes.

4.2.3 It was on India's initiative in November 2010 at the Seoul Summit that the G20 gave a call for concluding the TIEA. Prior to this, some countries were not willing to enter into TIEAs and were insisting on entering into DTAAs. Both the DTAA as well as TIEA are effective tax information exchange mechanisms. Since negotiation of a DTAA takes time, which can delay development of the mechanism for effective exchange, India has taken the plea that a country cannot refuse signing a TIEA if it has been requested by other countries. It was again at India's

initiative that this position was accepted and now global consensus has emerged that a country cannot insist on a DTAA and must conclude a TIEA if requested by other countries. After this development, many countries that were earlier insisting on DTAAs, have now agreed to conclude TIEAs with India as well other countries of the world.

4.2.4 Some countries have been unwilling to share past banking information. The issue of sharing even past information was taken up by the Finance Minister of India at the meeting of G20 Finance Ministers at Paris in February 2011. The issue was again raised at the G20 meet at Washington in April 2011, pursuant to which, the G20 issued a communiqué asking the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum hereafter) to suggest ways of improving the effectiveness of exchange-sharing mechanisms. The Finance Minister again raised this issue at the G20 Finance Ministers meeting at Paris in October 2011, while the Prime Minister raised it at

the G20 Summit at Cannes in November 2011. India is committed to working with other countries to evolve global consensus on this issue in order to achieve complete transparency even with respect to past banking information.

4.2.5 India has also been raising the issue of automatic exchange of tax information, i.e. sharing of information without a request, between countries. The DTAAs and TIEAs so far provide for automatic exchange of information only on voluntary basis. India believes that automatic exchange of information is essential for promoting voluntary compliance and achieving transparency. The Indian Prime Minister and Finance Minister have repeatedly raised this issue. Indian efforts have contributed to the Cannes declaration that encourages countries to exchange information automatically.

4.2.6 The text of the communiqué issued at the G20 summit on the issue of transparency and exchange of

information for tax purposes is enclosed here as Annexure 2.

B. Global Forum

4.2.7 The Global Forum was reconstituted in the wake of the global financial crisis. G20 leaders gave it a renewed mandate in 2009 and called on it to help secure the integrity of the financial system through the uniform implementation of high standards of transparency. Its mandate reflects the increasing need for international cooperation between tax administrations in the globalized era. At present, it has 108 jurisdictions as members, with the European Union and nine international organisations as observers.

4.2.8 India is vice chair of the Peer Review Group of the Global Forum which carries out monitoring and peer review of the member and relevant jurisdictions. Peer Review is carried out in two phases. Phase 1 deals with a jurisdiction's legal framework, while Phase 2 deals with the practical application of that

framework. The peer review ensures that every jurisdiction in the world adheres to a minimum standard on transparency and exchange of information for tax purposes. This minimum standard embraces three basic components: availability of information, appropriate access to the information and the existence of exchange of information mechanisms. Till date, peer review reports of 70 jurisdictions have been accepted by the Global Forum. India's initiative in these meetings has resulted in many jurisdictions changing their laws and administrative procedures in order to conform to international standards. Indian assessors nominated by the government have also contributed significantly to achieving this result.

C. Multilateral Convention on Mutual Administrative Assistance in Tax Matters

4.2.9 The Multilateral Convention on Mutual Administrative Assistance in Tax Matters was developed jointly by the Council of Europe and the

OECD and was opened for signature by the member states of both organizations on 25 January 1998. This multilateral instrument, which was initially signed by 15 countries, provides for all possible forms of administrative cooperation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. In response to the April 2009 call by the G20 for a global instrument to fight international tax evasion and avoidance, the Convention has been brought up to the internationally agreed standard on information exchange for tax purposes, in particular by requiring the exchange of bank information on request through an amending Protocol, which entered into force on 1 June 2011. The amended Protocol also provides for the opening of the Convention to all countries. India signed the Convention on 26 January 2012 and ratified it on 2 February 2012, thus becoming the first country outside the OECD and European countries to join it. There are at present 33 signatories to the

Convention and 13 of them have ratified it as shown in Annexure Table 5.

4.2.10 This Convention provides many advantages. As more countries sign it, the task of information exchange will get increasingly facilitated. It is likely to be an important instrument for cooperation in the area of assistance in tax collection. By enabling development of automatic exchange of information, this convention supports India's call for standardising automatic exchange as a global standard. A unique feature of this convention is the facility for serving of notices issued by one tax administration through another tax administration. It is also hoped that the convention will facilitate tax examination abroad, which is being included in all TIEAs. The Convention also supports India's demand for sharing of past banking information. As more and more countries join this Convention without reservation, the instrument has the potential of becoming an effective tool for tax cooperation. However, it has provision for reservations. India will continue to work with other

countries in order to build consensus against reservations.

D. Financial Action Task Force

4.2.11 India, having met the strict evaluation norms of the FATF, was granted full-fledged membership (34th Member) in June 2010. Further, in recognition of India's efforts in this regard, the Asia Pacific Group (APG) on Money Laundering and Terrorist Funding chose India as Co-chair of the Group at its annual meeting in Singapore in July 2010. For furtherance of the objectives of joining the global efforts against money laundering and bolstering the national programme, India successfully hosted the annual meeting of the APG between 18 and 22 July 2011 at Kochi, Kerala. India is fully committed to following the FATF norms of KYC and customer due diligence, illegal transfer of funds and their recovery, and international cooperation.

E. United Nations Convention Against Corruption

4.2.12 On 9 May, 2011 India became the 152nd country to ratify the United Nations Convention against Corruption, which was signed on 9 December 2005. The purposes of this Convention are: (a) to promote and strengthen measures for preventing and combating corruption more efficiently and effectively; (b) to promote, facilitate, and support international cooperation and technical assistance in the prevention of and fight against corruption including in asset recovery; (c) to promote integrity, accountability measures, and the criminalisation of the most prevalent forms of corruption in both public and private sectors.

4.2.13 The Convention requires the state parties to criminalise bribery of national public officials, foreign public officials and officials of public international organizations, embezzlement, misappropriation or other divisions of property by a public official, laundering of proceeds of crime, obstruction of justice, and illicit enrichment. Under the Convention

countries should have mechanisms for freezing, seizure, and confiscation of the proceeds of crime and cooperate in criminal matters by extradition and mutual legal assistance to the greatest possible extent. The return of assets is a fundamental objective of this Convention and countries are to afford one another the widest measure of cooperation and assistance in this regard. It prescribes mechanisms for recovery of property through international cooperation for purposes of confiscation. This Convention can help prevent perpetrators of corruption from illegally transferring their wealth abroad and will be an important tool for tackling this menace.

F. United Nations Convention against Transnational Organized Crime

4.2.14 On 5 May 2011, India ratified the United Nations Convention against Transnational Organized Crime (Palermo Convention), which was signed on 12 December 2002. The purpose of this Convention is to

promote international cooperation in preventing and combating transnational organized crime more effectively. Under the Convention countries are to take measures against smuggling of migrants by land, sea, and air as well as manufacturing and trafficking of firearms and ammunition. The Convention will help India get international cooperation in tracing, seizure, freezing, and confiscation of the proceeds of crimes under a wide range of mutual legal assistance clauses, even with countries with which it has no mutual legal assistance treaties.

G. International Convention for the Suppression of the Financing of Terrorism

4.2.15 India has signed the International Convention for the Suppression of the Financing of Terrorism on 8 September 2000 and ratified it on 22 April 2003. It requires each state party to take appropriate measures, in accordance with its domestic legal principles, for the detection and freezing, seizure, or

forfeiture of any funds used or allocated for the purposes of committing the offences described, as well as take alleged offenders into custody, prosecute or extradite them, cooperate in preventive measures and countermeasures, and exchange information and evidence needed in related criminal proceedings. The offences referred to in the Convention are deemed to be extraditable offences between state parties under existing extradition treaties and under the Convention itself. It will not only strengthen India's reach against those financing terrorism but also act as a check against generation and accumulation of black money through terrorism or organised crime.

H. United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances

4.2.16 India has also joined the United Nations Convention against Illicit Traffic in Narcotic Drugs And Psychotropic Substances on 27 March 1990.The purpose of this Convention is to promote cooperation

among the parties so that they may more effectively address the various aspects of illicit traffic in narcotic drugs and psychotropic substances having an international dimension. The Convention also calls for criminalisation of money laundering, the freezing, seizure and confiscation of the proceeds of crime, and international cooperation.

4.2.17 Indian Customs is represented in matters relating to international cooperation in enforcement by the Department of Revenue Intelligence. It coordinates cooperation under various bilateral agreements or the International Convention on Mutual Administrative Assistance for the Prevention and Repression of Customs Offences (Nairobi Convention 1977). India has signed bilateral cooperation agreements/ memoranda of understanding with 20 countries. This arrangement helps in dealing with customs offences which can have direct linkages with the generation of black money.

I. Egmont Group

4.2.18 Egmont group is a group of FIUs for international cooperation and free exchange of information. FIU-IND was admitted as a member of the group in May 2007 and since then India has been playing an important role in facilitating cooperation amongst FIUs through this Group. At the Group's plenary meeting in June 2010, India was elected co-chair of the Asia group which has given Indian representatives an opportunity to participate in the meetings and deliberations of the Egmont Committee which is the policymaking body of the Group.

4.2.19 The foregoing discussion demonstrates that India has been in the forefront of the global crusade against black money by effectively raising the issues of transparency in global forums, has joined various international conventions, and is promoting full flow of information amongst jurisdictions.

4.3 Creating an appropriate legislative framework

4.3.1 The international consensus on the need for coordinated action in the fight against the menace of black money requires parallel action at country level. Accordingly, a number of proactive steps have recently been taken in order to create an appropriate legislative framework for preventing the generation of black money and for its detection.

A. Strengthening Direct Taxes provisions including those relating to International Taxation and Transfer Pricing

4.3.2 A number of significant changes were brought about through the Finance Act 2011 to check the menace of black money and in line with our joining the global crusade, which are summarised as follows:

(a) A new section 94A was introduced in the Income Tax Act to discourage transactions between residents and persons located in jurisdictions which do not effectively exchange information with India (non-

cooperative jurisdictions). The section provides that if an assessee enters into a transaction with a person in a non-cooperative jurisdiction, then all the parties to the transaction shall be treated as associated enterprises and the transaction treated as an international transaction resulting in application of transfer-pricing regulations. Further, no deduction in respect of any payment made to any financial institution shall be allowed unless the assessee furnishes an authorization allowing for seeking relevant information from the said financial institution. Similarly, no deduction in respect of any other expenditure or allowance arising from the transaction with a person shall be allowed unless the assessee maintains and furnishes the prescribed information. If any sum is received from a person located in such jurisdictions, then the onus is on the

assessee to satisfactorily explain the source of such money in the hands of such person or in the hands of the beneficial owner, and in case of his failure to do so, the amount shall be deemed to be the income of the assessee. Any payment made to a person located in such jurisdictions shall be liable for withholding tax at 30 per cent or rate higher than that prescribed in the Income Tax Act.

(b) To facilitate prompt collection of information on requests received from tax authorities outside India under the provisions of DTAAs/TIEAs, the powers under section 131 and 133A of income tax authorities have been extended

(c) The time limit for completion of assessments if a request is made to foreign tax authorities has been extended to six months through the Finance Act 2011,

which has been further extended to one year through the Finance Bill 2012.

4.3.3 A number of other significant changes have been proposed in the Income Tax Act through the Finance Bill 2012 which include the following:

(a) General Anti Avoidance Rules (GAAR) have been introduced with effect from 1 April 2014 to check aggressive tax planning with the use of sophisticated structures. With adequate safeguards to prevent the misuse of the provisions, it will ensure that the real substance of transactions will be taken into account for determining tax consequences.

(b) With a view to providing objectivity in determination of income from related domestic party transactions and determination of reasonableness of expenditure between related domestic parties, provisions relating to transfer

pricing regulations have been extended to specified domestic transactions.

(c) In order to reduce the quantum of cash transactions in the bullion and jewellery sector and for curbing the flow of unaccounted money in the trading system in the sector, the seller of bullion and jewellery is now required to collect tax @1 per cent of sales consideration from every buyer of jewellery and bullion if sales consideration is above Rs. 500,000 and Rs. 2,00,000 respectively.

(d) In order to facilitate tax collection and improve the reporting mechanism for transactions in the mining sector, provision of collection of tax at source @1 per cent, in certain circumstances, has been introduced.

(e) To check the introduction of black money in the accounts, it has been provided that the

nature and source of any sum credited as share capital, share premium, etc. in the books of a closely held company shall be treated as explained only if the source of funds is also explained by the said company in the hands of the resident shareholder.

(f) To create greater deterrence against black money, unexplained amounts deemed as income of a taxpayer under sections 68, 69, 69A, 69B, 69C and 69D of the Income Tax Act 1961 are proposed to be taxed at the maximum marginal rate without any allowance or deduction.

(g) To improve incentives for disclosure, in case of search operations, it has been provided that if the undisclosed income is declared during the time of search, there will be penalty of 10 per cent, if disclosed during the time of filing of return, the penalty will be 20 per cent, and if detected

during post search assessment, the penalty will be 30 to 90 per cent of the undisclosed income.

(h) To facilitate the launch of prosecution in cases of evasion of taxes and speedy trial and early conclusion, provisions for constitution of special courts, summons trials, and appointment of public prosecutors have been included.

(i) To check introduction of black money in the share capital of a company in which the public is not substantially interested, it is provided that consideration received for issue of shares exceeding the face value of such shares will be deemed the income of the company. The provisions will not apply if the company substantiates that the fair market value has been determined on the basis of the value of its tangible and intangible assets.

(j) It has been provided that in the case of a transfer, if consideration for the transfer of a capital asset(s) is not attributable or determinable, then for the purpose of computing income chargeable to tax as gains, the fair market value of the asset shall be taken to be the full market value of consideration.

(k) The return forms have also been modified so that every taxpayer is required to disclose the name and PAN of the joint owner, if he has income/loss from a jointly owned house property.

(l) It has been provided that deduction on donations to charitable institutions, etc. will be allowed in excess of Rs. 10,000 only if they are made in a mode other than cash. The return form has been modified and if a person claims deduction for charity and

donation, he has to provide the details such as name, address, and PAN of the donor.

(m) Sections 90 and 90A of the Income Tax Act have been amended to provide that submission of Tax Residency Certificate will be a necessary but not sufficient condition for availing the benefits of DTAAs. The return form has been modified to provide that if a person claims relief under a DTAA for taxes paid in a foreign country, then the details such as country name, tax identification number in that country, income, and taxes paid in that country need to be furnished.

(n) The reporting mechanisms for those operating assets and banking accounts abroad is strengthened by making filing of return of income mandatory for every resident (excluding person who is not ordinarily resident in India) having any

assets or banking accounts located outside India even if s/he does not have taxable income. The return forms have been modified whereby every person except a person not ordinarily resident is required to submit details of foreign bank accounts, financial interests, immovable properties or other assets outside India. Any false information makes the filer liable for prosecution.

(o) The time limit for reopening of assessments, where income in relation to any asset located outside India that has escaped assessment, has been extended from six years to sixteen years.

(p) The electronic filing of tax returns has been made mandatory for individuals having total income more than Rs. 10 lakh and for resident individuals having any assets outside India.

4.3.4 In view of the report of GFI relating to mis-pricing, a committee was constituted by the Finance Minister to strengthen the transfer-pricing provisions in the Income Tax Act 1961. Various recommendations made by the committee have been implemented by way of legislative amendments through the Finance Acts 2011 and the Finance Bill 2012.

4.3.5 Simultaneously, the procedural aspects are also being modified to ensure that the creation of deterrence against black money generation is strengthened while ironing out aspects that can cause inconvenience for taxpayers. Clause (iv) of Rule 6DDA of the Income Tax Rules 1962 requires a recognized stock exchange to ensure that transactions once registered in the system cannot be erased or modified. However, in case of genuine human errors, modification of a registered transaction is permitted by SEBI. On analysis of National Stock Exchange (NSE) data for March 2010, it was observed that about 713 members had carried

out changes, the total volume of which was more than Rs. 56,000 crore. In 19 of these cases, the changes were made more than 5000 times, amounting to more than Rs. 22,000 crore. Such frequent changes are vulnerable to tax manipulation and misuse, while absolute restriction can cause hardships in case of genuine errors. To balance the two considerations, Rule 6DDA of the Income Tax Rules 1962 has been amended to provide that stock exchanges shall send a monthly statement of such transactions in which client codes were modified.

4.3.6 To facilitate allotment of PAN numbers to foreign investors, new Forms No. 49 A and 49AA have been devised for Indian and foreign entities respectively. Simultaneously, Rule 114 of the Income Tax Rules has also been amended to ensure acceptance of a copy of National/Citizenship/Taxpayer Identification Number in the case of individuals not being citizens of India, as proof of identity and address, if duly attested by an apostille of the country where such an applicant is

resident. These measures are expected to improve compliance while minimising inconvenience and thereby contribute to regulatory improvement.

B. Creating network of DTAAs and TIEAs as per International Standard

4.3.7 DTAAs promote international trade by allocating taxation rights between the country of source and the country of residence, avoiding double tax, and enabling corresponding adjustments in the face of transfer-pricing adjustments in the other country. In addition, DTAAs can also enable mutual assistance in collecting information, tax investigation, and collection of taxes between the respective countries as well as help in resolution of tax disputes.

4.3.8 Where a DTAA does not exist for whatever reason, the countries can choose to enter into a TIEA which is focused primarily on mutual facilitation of sharing tax information. The development of this network of DTAAs and TIEAs has been an important development in our capacity to prevent misuse of

international transactions and transfer pricing for evading tax and generating black money.

4.3.9 After 2009, a global consensus was developed that jurisdictions should exchange banking information as well as other information in which the supplying country has no domestic interest. The international standards for exchange of information for tax purposes have accordingly been modified. Since most of the Indian DTAAs that came into existence prior to 2009 were not as per the latest international standards, negotiations were started, and in many cases have been completed, with different countries to bring them up to those standards.

4.3.10 One of the old DTAAs which was brought up to international standards was that with Switzerland. In March 2009, in view of the stand taken by the G20 countries, Switzerland announced that it was willing to adopt the international standards on administrative assistance in tax matters and withdrew its

reservations about sharing banking information and sharing of information in the absence of domestic interest. After this change of policy, India moved swiftly and signed a Protocol for amending the DTAA on 30 August 2010, which came into force on 7 November 2011. As per the revised DTAA, Switzerland is obliged to provide banking and other information in specific cases that relate to the period starting from 1 April 2011, with limited retrospective application. It is pertinent to note that with this change in policy of Switzerland, many other countries have entered into Protocols with it for bringing provisions relating to exchange of information up to international standards. In most such Protocols, Switzerland has agreed to share information prospectively only and has accepted limited retrospectivity only in case of some countries, such as India (Annexure Table 6).

4.3.11 In addition to bringing the existing DTAAs up to international standards on exchange of information, India has also started negotiations for

new DTAAs with several countries. Many of these negotiations have been finalized and in all these new treaties there are provisions for exchange of information as per international standards, including exchange of banking information.

4.3.12 Before 2009, many countries were not willing to enter into TIEAs and insisted instead on DTAAs. Since it may not always be in its interest to conclude DTAAs with those countries and in view of the fact that negotiations for a DTAA take far longer, India prevailed upon these countries to enter into TIEAs with it and started negotiations with them.

4.3.13 As per international standards, if information is originally regarded as secret in the transmitting state, it shall be used only for tax-related purposes, but may be disclosed in public court proceedings or in judicial decisions. The Government of India has taken up the issue of relaxing the confidentiality clause with several countries. In all the new agreements being negotiated, attempts are

being made to provide for sharing of information among the investigating agencies with the consent of the concerned country. This will strengthen India's capacity to prevent generation of black money through use of offshore entities and international transactions.

4.3.14 In 30 out of India's 82 DTAAs, there is provision for assistance in collection of taxes which facilitates repatriation of assets located outside India to the extent of the outstanding tax demand which cannot be collected in India. The Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which will come into force on 1 June 2012, has provisions for assistance in collection of taxes. Thus those signatories to the Convention who have not placed reservations are obliged to provide such assistance for collection of taxes and repatriation of assets. It may, however, be noted that there is no Article on Assistance in Tax Collection with Switzerland as it has not agreed to have such a

provision with any country and has not yet joined this Convention.

4.3.15 All the TIEAs signed by India have provisions for tax examination abroad. Further, as per the revised standards, under the DTAAs, countries are obliged to provide assistance in tax examination under the Article on exchange of information. In addition, India has included specific Articles on Tax Examination Abroad with a number of countries. Most of the TIEAs signed by India also contain provision for obtaining past information either in all cases or at least in criminal cases.

C. Prevention of Money Laundering Act

4.3.16 The Prevention of Money Laundering Act 2002 was enacted to prevent money laundering and provide for confiscation of property derived from, or involved in, money laundering and for matters connected therewith or incidental thereto. The Act also addressed international obligations under the Political Declaration and Global Programme of Action

adopted by the General Assembly of the United Nations to prevent money laundering.

4.3.17 To strengthen the provisions of the PMLA, amendments were carried out in 2009. These amendments have introduced new definitions to clarify and strengthen the Act and strengthened provisions related to attachment of property involved in money laundering and its seizure and confiscation. More offences have been added in Parts A and B of the Schedule to the Act, including those pertaining to insider trading and market manipulation as well as smuggling of antiques, terrorism funding, human trafficking other than prostitution, and a wider range of environmental crimes. A new category of offences with cross-border implications has been introduced as Part C.

4.3.18 The problem of black money is no longer restricted to the geopolitical boundaries of any country. It has become a global menace that cannot be contained by any nation alone. In view of this,

India has become a member of the FATF and APG on Money Laundering, which are committed to the effective implementation and enforcement of internationally accepted standards against money laundering and the financing of terrorism. Consequent to the submission of an action plan to the FATF for bringing India's antimoney- laundering legislation on par with international standards and to address some of the deficiencies of the Act that have been experienced by the implementing agencies, PMLA 2002 is further proposed to be amended through the Prevention of Money Laundering (Amendment) Bill 2011, which is under consideration of Parliament. The Bill seeks to introduce the concept of 'corresponding law' to link the provisions of Indian law with the laws of foreign countries and provide for transfer of the proceeds of the foreign predicate offence in any manner in India. It also proposes to enlarge the definition of the offence of money laundering to include therein activities like concealment, acquisition, possession, and use of

proceeds of crime as criminal activities and remove the existing limit of Rs. five lakh for imposition of fine under the Act. It also strengthens provisions for attachment and confiscation of the proceeds of crime and widens the investigative powers of the Director and clubs offences listed under Schedules A and B into a single Schedule.

D. Prevention of Benami Transactions

4.3.19 One of the important initiatives taken by the Government is the introduction of the Benami Transaction (Prohibition) Bill 2011. This comprehensive legislation was introduced in the Lok Sabha on 18 August 2011 and is currently being examined by the Standing Committee on Finance. It will iron out the infirmities in the Benami Transaction (Prohibition) Act enacted in 1988 and formalise the procedure for implementing the benami law, including the procedure for determination, confiscation, prosecution, and miscellaneous requirements.

4.3.20 This Bill defines benami property and a benami transaction in terms of a transaction or agreement where a property is transferred to or held by a person for a consideration provided or paid by another person. Such a property is held for the immediate or future benefit, direct or indirect, of the person providing the consideration. A transaction or arrangement in respect of a property carried out or made in a fictitious name or where the owner of the property is not aware of or denies knowledge of such ownership is also included in the definition of benami transaction. The Bill specifies the consequences of benami transactions in the form of confiscation of the benami property and imprisonment up to two years in addition to a fine. This Bill also provides the procedure for enquiry and determination of benami property and its consequences as well as the authorities empowered to act for this purpose, including the appellate authorities. Once the report of the Standing Committee is received, the Benami Transactions (Prohibition) Bill 2011 will be moved for

passage in Parliament and the relevant rules notified thereafter.

E. Public Procurement Bill

4.3.21 The Public Procurement Bill 2012 was approved by the Union Cabinet on 12th April 2012 for introduction in Parliament. The Bill seeks to regulate procurement by ministries/ departments of the central Government and its attached/subordinate offices, central public sector enterprises (CPSEs), autonomous and statutory bodies controlled by the central government and other procuring entities with the objectives of ensuring transparency, accountability and probity in the procurement process, fair and equitable treatment of bidders, promoting competition, enhancing efficiency and economy, safeguarding integrity in the procurement process, and enhancing public confidence in public procurement.

4.3.22 The Bill is based on broad principles and envisages a set of detailed rules, guidelines, and

model documents. It builds on national and international experience and best practices as appropriate for the needs of the Government of India. It will create a statutory framework for public procurement which will provide greater accountability, transparency, and enforceability of the regulatory framework. The Bill codifies the essential principles governing procurement required for achieving economy, efficiency, and quality as well as combating corruption. It legally obligates procuring entities and their officials to comply with these principles. It also ensures that competition will be maximised in procurement, while providing for adequate flexibility for different types of procurement needs. It puts in place a strong framework of transparency and accountability through a public procurement portal and a grievance redressal system in which an independent mechanism, chaired by a retired High Court Judge, will review grievances.

F. Prevention of Bribery of Foreign Public Officials Bill

4.3.23 The Prevention of Bribery of Foreign Public Officials and Officials of the Public International Organisations Bill 2011 was introduced in the Lok Sabha on 25 March 2011 and is under consideration of the Standing Committee. The Bill seeks to prevent corruption relating to bribery of foreign public officials and officials of public international organisations and to address matters connected therewith or incidental thereto. The proposed legislation prohibits acceptance of gratification by foreign public officials or officials of public international organisations as well as the act of giving such gratification or its abetment. The bill also empowers the central government to enter into agreements with foreign countries for enforcing the provisions, makes offences under the proposed act extraditable, and provides for attachment, seizure and confiscation of property in India or the respective country and mutual assistance in this regard.

G. Lokpal and Lokayukta Bill

4.3.24 The Lokpal and Lokayukta Bill 2011, which after being passed by the Lok Sabha is now under consideration of the Rajya Sabha, provides for the establishment of the institution of Lokpal to inquire into allegations of corruption against certain public functionaries and for matters connected therewith or incidental thereto. The Bill envisages setting up of the institution of Lokpal consisting of a Chairperson and eight Members with the stipulation that half of the Members shall be Judicial Members. It shall have its own Investigation Wing and Prosecution Wing with such officers and staff as are necessary to carry out its functions. The Lokpal shall inquire into allegations of corruption made in respect of the Prime Minister after he has demitted office; a Minister of the union; a Member of Parliament; any Group 'A' officer or equivalent; Chairperson or member or officer equivalent to Group 'A' in any body/ board/ corporation/ authority/ company/ society/ trust/ autonomous body established by an Act of Parliament or wholly or partly financed or controlled by the

central government; and any director, manager, secretary or other officer of a society or association of persons or trust wholly or partly financed or aided by the government or in receipt of any donations from the public and whose annual income exceeds such amount as the central government may by notification specify. However, organisations created for religious purposes and receiving public donations shall be outside the purview of the Lokpal. The Lokpal shall not require sanction or approval under Section 197 of the Code of Criminal Procedure 1973 or Section 19 of the Prevention of Corruption Act 1988 in cases where prosecution is proposed. The Lokpal shall also have powers to attach the property of corrupt public servants acquired through corrupt means.

H. Citizens' Grievance Redressal Bill

4.3.25 The Right of Citizens for Time Bound Delivery of Goods and Services and Redressal of their Grievances Bill, 2011, which is presently under

consideration of the Lok Sabha outlines the responsibilities of government departments towards citizens and how someone who is denied the service due to him can seek redressel. It mandates that every public authority or government department has to publish a citizen's charter listing all services rendered by that department along with a grievance redressal mechanism for non-compliance with the citizen's charter. It also sets up a Central Public Grievances Redressal Commission, with an equivalent in every state, and provides for a designated authority from a department other than the one against which the complaint has been filed to address the complaint. The other features of the Bill are:

> The Citizen's charter has to clearly explain the complaint redressal system for that office, like which officer in that department the complaint should be registered with.

> Every government department or public authority shall create an 'information and facilitation centre' that could include a

customer helpline or help desk to deliver services and handle complaints.

> Every public authority will appoint or designate Grievance Redressal Officers whose contact information will be clearly shared with the public. The Grievance Redressal Officer shall provide the public with all necessary assistance in filing complaints. Within two days of the complaint being registered, the citizen who has filed a complaint will receive - by SMS or mail - a unique complaint number and a time frame within which the complaint will be handled. That time frame cannot exceed 30 days from when the complaint was received.

> The Grievance Redressal Officer has to ensure that the person who made the complaint is informed in writing with an Action Taken Report on how his/ her complaint was handled. If this does not happen, the citizen

can appeal to a designated authority. This officer can summon others and ask them to testify under oath.

> The designated authority has to ensure that the appeal is acted upon within 30 days. S/he can fine the officer concerned and compensate the citizen, if appropriate.

> If a citizen is not happy with the designated authority's response or decision, s/he can take her/his complaint to the State Public Grievance Redressal Commission (assuming that the complaint is against a government department that is under the jurisdiction of a state government). Each state shall set up this body. It will have a Chief Commissioner and a maximum of ten other commissioners. They will be appointed by a committee consisting of the Chief Minister, the leader of opposition in that state, and a sitting judge of the High Court. The

commissioners will have a term of five years.

> For citizens who are unhappy with a service provided to them from a government office that is under the jurisdiction of the central government, they can finally appeal to the Central Public Grievance Redressal Commission. This body will have a Chief Commissioner and a maximum of ten commissioners who will be appointed by the President after they are chosen by a committee comprising the PM, the leader of opposition, and a sitting judge of the Supreme Court.

> If citizens are unhappy with the decision of the Central or State Commissions, they can appeal to the Lokayukta or Lokpal.

I. Judicial Standards and Accountability Bill

4.3.26 The Judicial Standards and Accountability Bill 2010 was passed by the Lok Sabha and is under

consideration of the Rajya Sabha. The Bill provides a mechanism for enquiring into complaints against judges of the Supreme Court and High Courts, lays down judicial standards, and requires judges of the Supreme Court and High Courts to declare their assets and liabilities. The Bill seeks to replace the Judges (Inquiry) Act 1968 while retaining its basic features. The enactment of the Bill will address the growing concerns regarding the need to ensure greater accountability of the higher judiciary by bringing in more transparency and will further strengthen the credibility and independence of the judiciary. The Bill seeks to lay down enforceable standards of conduct for judges. The main features of the Bill are:

- It requires judges to declare their assets, lays down judicial standards, and establishes processes for removal of judges of the Supreme Court and High Courts.

> It requires judges to declare their assets and liabilities and also those of their spouses and children.

> The Bill establishes the National Judicial Oversight Committee, the Complaints Scrutiny Panel, and an investigation committee. Any person can make a complaint against a judge to the Oversight Committee on grounds of 'misbehaviour'.

> A motion for removal of a judge on grounds of misbehaviour can also be moved in Parliament. Such a motion will be referred for further inquiry to the Oversight Committee.

> Complaints and inquiries against judges will be confidential and frivolous complaints will be penalised.

> The Oversight Committee may issue advisories or warnings to judges and also recommend their removal to the President.

J. Whistleblower's Bill

4.3.27 The Public Interest Disclosure and Protection to Persons Making the Disclosure Bill 2010, (commonly known as the Whistleblowers' Bill) was passed by the Lok Sabha and is under consideration of the Rajya Sabha. The Bill seeks to provide 'adequate protection to persons reporting corruption or willful misuse of discretion which causes demonstrable loss to the government or commission of a criminal offence by a public servant'. While the measure sets out the procedure to inquire into disclosures and provides adequate safeguards against victimisation of the whistleblower, it also seeks to provide punishment for false or frivolous complaints.

K. Direct Payment into Bank Accounts of Payees

4.3.28 As part of the Government's commitment to good governance and elimination of corruption, the Ministry of Finance has amended the relevant rules to enable all ministries and departments to facilitate payments by direct credit to the bank accounts of

payees. Orders have also been issued by the Controller General of Accounts (CGA) that, with effect from 1 April 2012, all payments above Rs. 25,000 to suppliers, contractors, and grantee and loanee institutions shall be directly credited to their bank accounts. While government servants will continue to have the option of receiving their salary by cash or cheque, they may also opt for it to be directly credited to their bank accounts. However, all other payments to government servants of an amount above Rs. 25,000 shall be credited directly to their bank accounts. Further, all payments towards the settlement of retirement/terminal benefits of government servants shall also be directly credited to their bank accounts. The Finance Minister has also inaugurated a 'Government e-payment gateway' set up by the CGA which will be used by the Pay and Accounts Officers (PAOs) of the central civil ministries/ departments for implementing these measures. The Controller General of Defence Accounts (CGDA) will also be progressively using this

e-payment gateway. The measure is expected to streamline the process of making payments by government departments while minimising the interface of payees with government offices for receiving their dues. This e-payment gateway will enhance transparency and accountability in public dealings of the central government and also usher in green banking by the government.

L. Unique Identity (UID)-Aadhaar

4.3.29 As announced by the Finance Minister in his Budget speech, enrolments into the Aadhaar system have crossed 20 crore and the Aadhaar numbers generated up to date 14 crore. Adequate funds have been allocated for completing another 40 crore enrolments starting from 1 April 2012. The Aadhaar platform will facilitate payments under the Mahatma Gandhi National Rural Employment Guarantee Act (MG-NREGA); old age, widow and disability pensions; and scholarships to be made directly into beneficiary accounts in selected areas. This initiative will cut

down corruption and the generation of black money in India.

M. Amendments to the NDPS Act

4.3.30 On 8 September 2011, the Government introduced the Narcotic Drugs and Psychotropic Substance (Amendment) Bill 2011 in the Lok Sabha, which is presently under consideration of the Standing Committee. The Bill seeks to amend a number of provisions of the NDPS Act including modification of the definitions of 'small' and 'commercial' quantities, standardisation of punishment for consumption of drugs, and transfer of the power to regulate 'poppy straw concentrate' from the state governments to central government. It also widens the scope for forfeiture of illegally acquired property, wherein any property of a person who is alleged to be involved in illicit traffic and the source of which cannot be proved constitutes 'illegally acquired property' and is liable to be seized.

4.4 Setting up Institutions for Dealing with Illicit Money

4.4.1 The third limb of the five-pronged strategy to deal with the menace of black money, particularly to check cross-border flows, is setting up institutions to deal with the problem. Some of the initiatives taken by the Government of India in this regard are described in the following paragraphs.

A. Directorate of Criminal Investigation

4.4.2 Till recently, the tax administration in India did not have a separate set-up for targeted investigation into criminal cases. On 30 May 2011, a notification has been issued by the Government of India for creation of a Directorate of Income Tax (Criminal Investigation) or DCI in the Central Board of Direct Taxes, Department of Revenue, Ministry of Finance. The DCI is mandated to perform functions in respect of criminal matters having any financial implication punishable as an offence under any direct taxes law. The DCI, in discharge of its responsibilities

under the direct tax laws, is required to perform the following functions:

- Seek and collect information about persons and transactions suspected to be involved in criminal activities having cross-border, inter-state, or international ramifications that pose a threat to national security and are punishable under the direct tax laws;
- Investigate the sources and uses of funds involved in such criminal activities;
- Cause issuance of show cause notices for offences committed under any direct tax law;
- File prosecution complaints in the competent court under any direct tax law relating to a criminal activity;
- Hire the services of special prosecutors and other experts for pursuing a prosecution complaint filed in any court of competent jurisdiction;

- Execute appropriate witness protection programmes for effective prosecution of criminal offences under the direct tax laws, i.e. to protect and rehabilitate witnesses who support the state in prosecution of such offences so as to insulate them from any harm to their person;
- Coordinate with and extend necessary expert, technical, and logistical support to any other intelligence or law enforcement agency in India investigating crimes having cross-border, inter-state or international ramifications that pose a threat to national security;
- Enter into agreements for sharing of information and other cooperation with any central or state agency in India;
- Enter into agreements for sharing of information and other cooperation with such agencies of foreign states as may be

permissible under any international agreement or treaty; and

> Any other matter relating to the above. The DCI is headed by a Director General of Income Tax (Criminal Investigation) and functions under administrative control of the CBDT. The head office of the DCI is located at New Delhi and it has eight regional offices all over India.

B. Cell for Exchange of Information

4.4.3 The Government of India has set up an Exchange of Information (EOI) Cell in the FT&TR Division of the CBDT. The EOI works on the basis of mutual cooperation. The competent authorities of different countries provide different forms of administrative assistance to each other based on the provisions of DTAAs/TIEAs or the Multilateral Convention for Mutual Administrative Assistance. Administrative assistance under these instruments of EOI, depending on the terms of the agreement, may

take the form of (a) specific exchange of information, (b) spontaneous exchange of information, (c) automatic exchange of information, (d) tax examination abroad, (e) simultaneous exchange of information, (f) service of documents, and (g) assistance in collection of tax.

C. Income Tax Overseas Units

4.4.4. With increased scope for international cooperation in areas of exchange of information, transfer pricing, and taxation of cross-border transactions, Government of India decided to create a network of Income Tax Overseas Units (ITOUs). In addition to the existing two ITOUs at Singapore and Mauritius, eight more have been opened. The objectives of these ITOUs are > Monitor DTAA-related issues;

> Assist the authorities in handling issues arising out of international taxation and transfer pricing;

- Assist the authorities in frequent revision of existing DTAAs;
- Assist the authorities in negotiation of TIEAs;
- Expedite the exchange of information by the competent authorities (as per DTAAs and TIEAs) of these countries as required by the competent authority in India;
- Assist the authorities in collection of taxes;
- Assist the authorities in work relating to Mutual Agreement Procedure under DTAAs;
- Maintain liaison with various departments of the respective countries especially Income Tax Department, Registrar of Companies, Department of Banking Services, and Administrators of Financial Services;
- Maintain liaison with investors investing in India from these countries;
- Impart information about domestic laws of India to foreign investors;

- Maintain liaison with Indian investors in these countries to assess any tax-related problems arising for these investors;
- Assist the Mission in any other commercial/economic work assigned to the officer by the Head of the Mission; and
- Any other work assigned to the officer by the CBDT, Department of Revenue.

4.4.5 The ITOUs at Mauritius and Singapore have been very useful in discharging the functions outlined in para 4.4.4. So far, 49 pieces of information have been received from these countries. It may also be pointed out that the activities listed in para 4.4.4 have assumed great significance in the past few years. Opening of the new ITOUs and presence of tax officers in the ITOUs also acts as effective deterrence against tax evasion.

D. Strengthening the FT&TR Division in the CBDT

4.4.6 The FT&TR Division of the CBDT has been playing a pivotal role in negotiating DTAAs and TIEAs and bringing them up to international standards, exchanging of information with foreign tax administrators under these DTAAs/TIEAs through the competent authority, settling of disputes under DTAAs/TIEAs, participation in international forums for strongly putting across the views of the Government of India, administration of Advanced Pricing Agreements, in addition to advising the government on all policies relating to international taxation and transfer pricing.

4.4.7 The FT&TR Division has been strengthened by creating 4 new posts of Director, 7 new posts of Under Secretary, and 9 new posts of Section Officer (SO) along with supporting staff.

E. Strengthening of Investigation Division of the CBDT

4.4.8 The Investigation Division of the CBDT has also been enlarged from the existing 2 to 5 branches

and 3 posts of Director, 3 of Under Secretary, and 5 of Officer on Special Duty (OSD) (SO-level), have been created to deal with the increasing workload relating to black money. The Directorates of Income Tax (Central Information Branch) have been redesignated Directorates of Income Tax (Intelligence) and given powers under the Income Tax Act 1961 to collect as well as verify information.

4.5 Developing Systems for Implementation

Some of the steps taken under the fourth limb of the five-pronged strategey are listed below:

A. Integrated Taxpayer Data Management System (ITDMS) and 360-degree Profiling:

4.5.1 The information collected by the Income Tax Department from various sources such as AIR, tax deduction at source (TDS), the Central Information Branch, OLTAS, etc. is collated in a computerized environment to create a 360-degree profile of the high net-worth assessees, termed

ITDMS. The ITDMS is utilized for investigation of tax evasion complaints and for developing cases for search and seizure actions.

B. **Setting up Cyber Forensic Labs and Work Stations:**

4.5.2 During the course of search and seizure operations, specialized skills are required for identifying and safely retrieving relevant data so that the integrity of the data can be protected and its evidentiary value established in a court of law. Excellent results have been achieved in many search and seizure cases by availing of the expertise of forensic labs in Delhi and Mumbai. Apart from protecting the evidentiary value of data seized in the course of search and seizure operations, cyber forensic labs aim at retrieving hidden, password-protected, and deleted files and at giving protection against advanced software tools (logic bombs) which get activated if the system is not shut down/started with a particular set of keystrokes.

C. CAIT for Focused Investigation:

4.5.3 The Investigation Wing of the CBDT has developed a software audit tool to analyse computerized books of accounts so as to assist tax officers in tax assessments. The computer-assisted investigation tool (CAIT) can analyse accounts maintained on various accounting software available in market - such as Tally, ERP, and SAP -and thus help officers of the Income Tax Department conduct audit and investigation on a number of parameters. An MOU & SLA (memorandum of understanding and service-level agreement) was signed between the Department and the vendor M/s Audi Time Information System (I) Ltd. CAIT has been implemented in 25 locations across the country in the first phase during financial year 2011-12 and thus equipped the department with an effective software tool for detecting under-reporting or mis-reporting of income and tax evasion.

D. Goods and Services Tax Network (GSTN)

4.5.4 The Cabinet has approved a proposal to set up a special purpose vehicle -GSTN (GSTN SPV) for providing shared IT infrastructure and services to central and state governments, taxpayers, and other stakeholders for implementation of the goods and services tax (GST), both before and after the rollout of GST. During the pre-GST stage, the services on offer would include taxpayer utility, common return submission along with tracking mechanism for inter-state trade, common tax payment gateway, common registration for states (value-added tax [VAT] and central sales tax [CST]) and centre (central excise and service tax) and building interface between the GSTN Common Portal and state/centre tax systems. The GSTN SPV would be substantially funded through a one-time non-recurring grant-in-aid of Rs. 315 crore from the central government towards expenditure for setting up and functioning of the SPV for a three-year period after incorporation.

E. Committee on Black Money

4.5.5 A Committee headed by the Chairman of CBDT was constituted on 27th May, 2011 for examining ways to strengthen laws to curb the generation of black money in the country, its legal transfer abroad and its recovery. The Committee has submitted its report to the Ministry of Finance in March, 2012 and the recommendations are summarised at Annexure 3.

4.6 Imparting Skills to the Personnel for Effective Action.

The fifth limb of the five pronged strategy to deal with the menace of Black Money is imparting skills to the personnel dealing with black money and some of the steps taken in this regard are summarised below.

4.6.1 Capacity building by imparting skills to augment the capacity of the manpower resources of the Income Tax Department is an important limb of the five-pronged strategy formulated by the government for effectively tackling the menace of

black money. To this end, efforts have been made to regularly upgrade the skills of officers and staff and provide them exposure to the international experience and global best practices in effectively dealing with black money through various training modules.

4.6.2 The Income Tax Department has, in recent times, aspired to become a facilitator of voluntary compliance in addition to being an enforcement agency and accordingly efforts have been undertaken to widen the induction-training process from just imparting knowledge and skills in the area of tax laws to inculcating attitudes and skills required for quality taxpayers' service and enhancing understanding of compliance behaviour.

4.6.3 To further streamline and systematise the process of training needs analysis and optimise skill upgradation, the Department is also setting up a Human Resource Management System (HRMS) to, inter-alia, identify officers who require specialized training as also the training requirements of all

personnel. The HRMS will assist in training needs analysis by maintaining a database containing all information regarding the officer and job profile of the various posts in the Department to dovetail with the career-wide training, job exposure, skill upgradation, and performance management of all the employees. Thereafter officers could be selected for specialized training both on the basis of job requirements and performance in various areas of activity. Training to be imparted would be identified both for performance improvement and also for imparting specialised skills to enable handling of certain specialised assignments. The HRMS also provides for competency mapping of such trained personnel so that the most appropriate persons are picked up for various functions, including sensitive assignments such as unearthing of black money.

4.6.4 Steps are also being undertaken for capacity building and improvement of the quality of manpower in other agencies dealing with black money. For instance, the FIU-IND makes proactive

efforts to regularly upgrade the skills of its employees by providing them opportunities for training on anti-money laundering, terrorist financing, and related economic issues. FIU-IND officials regularly attend domestic as well as international training programmes on relevant subjects including securities markets investigations, commodity markets investigations, corporate frauds, abuse of charitable and non-profit organizations, cyber-crimes, intelligence trade craft, counter-terrorism, tactical analysis, insurance frauds, financialsector supervision, and AML policy development. The Directorate has initiated the process of imparting training to officers on their joining the Directorate, whether on deputation or through direct recruitment. The officers of the Directorate also participate in training programmes being conducted by other agencies.

4.7 Results Achieved

4.7.1 The five-pronged strategy adopted by the government has already yielded good results.

A. Large Network of DTAAs and TIEAs

4.7.2 In the last two years or more, India have completed negotiation of 62 DTAAs/TIEAs (29 existing DTAAs, 16 new DTAAs, and 17 TIEAs) and have signed 33 DTAAs/TIEAs (23 DTAAs, 10 TIEAs). As a result today India has a large DTAA (82) and TIEA (6) treaty network . These are listed in Annexure Table 7.

B. Information Received from Abroad under DTAAs and TIEAs

4.7.3 Indian competent authority has received some useful information from competent authorities of other countries through DTAAs/TIEAs. On 18 March 2009, India was able to obtain information from the German government regarding Indian taxpayers having accounts with LGT Bank in Liechtenstein. The information was immediately

passed on to the Income Tax Department for appropriate action under the Income Tax and Wealth Tax Act. Feedback in this regard from the Chief Commissioners of Income Tax reveals that on the basis of information received regarding certain trusts/ entities in the LGT bank, Liechtenstein, and beneficiaries therein, assessment proceedings were reopened and cases centralized in different central charges in Chennai, Delhi, Mumbai, and Kolkata. This resulted in assessments being made in a total of 18 individual cases, being beneficiaries of the said trusts/entities, as per the provisions of the Income Tax Act 1961. The total assessed income in these cases was Rs. 39.66 crore and a total demand of Rs. 24.26 crore was raised. Penalty proceedings for concealment of income have separately been initiated in all these cases and penalty amounting to Rs. 11.94 crore has been imposed in nine of the cases. Out of the 18 taxpayers one has passed away while prosecution has been launched against all 17 other taxpayers.

4.7.4 The information obtained from Germany is subject to the confidentiality provisions of the DTAA and may only be used for the tax purposes specified therein. Thus the contents of the information received from German tax authorities cannot be disclosed to persons other than those involved in income and wealth tax proceedings. This confidentiality provision is in line with similar provisions contained in both OECD and UN Model Tax Conventions. Notwithstanding this, names of the taxpayers against whom prosecution has been initiated have already become public. This is in accordance with the DTAA.

4.7.5 When it came to notice of the Government that information regarding Indians having bank accounts in other countries may be available with French tax authorities, the matter was taken up with them. The Indian Finance Minister later on took up the matter with the then French Minister of Finance and only because of discussions at the highest level the information made available to India under the

provisions of the India-France DTAC. The information was made available to India under Article 28 of the India-France Convention. Under the DTAC, the source of information is not material. Once the information is shared under the DTAC, it is protected by the confidentiality clause of the DTAC. France also took a written undertaking from India about maintaining the confidentiality of the information before handing it over.

4.7.6 On the basis of information received from France so far in 219 cases, the department has detected undisclosed income totalling Rs. 565 crore and tax amounting to Rs. 181 crore has already been realized.

4.7.7 In addition to these two specific instances, the EOI mechanism with foreign tax authorities has expanded significantly due to the following reasons:

> The time limit for completion of assessment under Sections 153 and 153B of Income

Tax Act has been extended by one year by the Finance Bill 2012.

> International developments in recent years have contributed significantly towards increasing the pace of exchange of information. Countries worldwide are now recognising that transparency is required not only for detecting tax evasion but also for preventing money laundering and terror financing.

> The infrastructure of the EOI Cell in India has improved significantly. The entire system and work flow has been automated and the responses to the enquiries are being closely monitored. With communication through the internet, the time lag in exchange of information has reduced significantly.

4.7.8 Thus, a large number of information has started flowing in from foreign countries which are being forwarded to the field authorities for further

investigation. In the last few years, more than 12,500 pieces of information regarding details of assets and payments received by Indian citizens in several countries including banking information have been obtained and are now under different stages of processing and investigation. Table 4.1 gives a year-wise break-up.

Table 4.1 Tax-realted information about Indian Taxpayers from Abroad

Information received	during Pieces of Information
2008-10(disseminated in January 2011)	7,704
Jan to June 2011	480
July to December 2011	1,006
January to May 2012	3,339

4.7.9 Further, there has been significant increase in the requests for administrative assistance to foreign tax authorities sent by field authorities as shown in Table 4.2.

Tabel.4.2 Requests from Field Officers to Foreign Tax Authorities

Financial Year	No. of requests received from field authorities
2008-09	39
2009-10	46
2010-11	92
2011-12	386

4.7.10 India has also started sending information to foreign tax authorities under Automatic EOI. More than 58,000 pieces of information were sent to eight countries last year.

4.7.11 Boxes 4.1-4.3 detail some instances where black money has been unearthed due to enhanced exchange of information in the last year.

Box 4.1 Information from Canada on Gifts

Taxpayer (A) received gifts from taxpayers B, C, and D who are resident of Canada. The taxpayer was asked to explain the source of the gifts in the course

of assessment proceedings. S/he submitted the returns of income filed by B, C, and D with Canadian tax authorities as proof of their sources of income. Indian tax authorities sought the following information from the Canadian competent authority:

a) Whether B, C, and D have the resources to make gifts as mentioned in the annexure.

b) Whether the transactions are bona fide.

c) Whether B, C, and D are assessed to income tax or any other tax applicable in Canada.

d) Whether such details have been disclosed in their returns filed before the Canadian authorities.

e) Whether the bank accounts from which the monies were drawn to effect gifts were maintained continuously, if so, copy of such accounts.

The Canadian tax authority gave the information that the income tax returns filed by these individuals indicate that none of them was reporting sufficient income to be able to give gifts in the amounts noted. Enquiries revealed that B was known to the Canadian authorities as Mr X. The Canadian authorities attached the bank statements of the taxpayer. The late C was known to Canadian authorities as Mr Y. The income reported by C/Y did not support the ability to give a gift to the Indian taxpayer.

The enquiries made by the EOI Cell revealed that the return details filed by taxpayer A before the assessing officer were fictitious / forged and the income returned as per the records of the Canadian tax authority was far below his claims. Consequently, it was seen that the foreign tax credit claimed by the taxpayer in his Indian return was also false and amounted to defrauding government tax.

Box. 4.2 Evidence Found during Search Operations Supplemented by Information Received from Abroad

A search and seizure operation was conducted on the Indian company G Ltd. In the course of the operation, evidence was collected that indicated the use of international entities for tax evasion. G Ltd was a private Ltd company with Mr X being its Managing Director and major decision maker. G Ltd was engaged in the pharmaceuticals business with exports to the Ukraine, Cyprus, and Russia. G Ltd claimed bogus marketing expenses through dummy companies in the Ukraine, Cyprus, and the UK. It claimed the payments to be made to the Cyprus and UK companies as reimbursements of the expenses of the Ukraine company. These funds were diverted to the personal accounts of Mr X who accumulated wealth in foreign countries. In the course of search and seizure operation, the marketing/ business promotion expenses were found to be unusually high at 50 per cent of the turnover. The Cyprus and Ukraine based companies had previously been owned by Mr X. The seals and stamps of these companies were found on the premises of G Ltd. Some of the

employees of G Ltd were found to be closely linked with the Ukraine and Cyprus companies. Details of huge investments in the name of Mr X and his family members were found on the premises. Enquiries were made from the UK, Germany, Switzerland, Cyprus, and the Ukraine for the following:

- The ownership structure of these companies
- Details of the shareholders, ultimate beneficial owners of these companies
- Copy of incorporation documents
- Nature of business by these concerns
- Details of the bank statements and the sources of funds in the bank accounts of Mr X
- Source of funds from which the properties in foreign countries have been purchased by Mr X and family members
- Source of funds from which the properties in foreign countries have been purchased by Mr X and family members.

Enquiries into the whereabouts of the Ukraine companies revealed the following facts:

As per the local tax database, one of the companies was not registered at the address mentioned in the documents seized. As per the statement of a legal representative of the company, no relationship existed with the UK and G Ltd claimed that these Ukraine companies had raised invoices in the name of Cyprus and UK companies which in turn raised invoices in the name of G Ltd. Enquiries revealed no such relation between the Ukraine and UK/ Cyprus companies. The UK enquiries revealed that Mr X and his wife used to be directors of the UK-based companies. No expenses for office premises and wages/ salaries were incurred by these concerns. The balance sheets of these companies did not have any property and the registered office address was the residential address of the accountant. This supported the conclusion of these companies being paper companies. Enquiries revealed flow of funds into the bank accounts of Mr X and his wife from the

bank accounts of the Cyprus companies in whose nam, the expenses had been claimed. Enquiries from the UK into the properties of Mr X and his wife revealed huge investments. A detailed statement of the taxpayer was recorded and he failed to explain the transactions. Based on the EOI enquiries and documents seized in the course of action u/s 132, the taxpayer was denied the bogus claim of expenses of around Rs. 150 crore.

Box 4.3 Spontaneous Exchange of Information from Japan

The National Tax Agency Japan passed on information about remittances to the extent of US$ 48,37,714 in the bank accounts of an Indian taxpayer by a Japanese entity maintained in Hong Kong. The information was received by the EOI Cell under spontaneous EOI and the same was passed on to the income tax authorities. Based on the information received, the income tax authorities carried out a survey on u/s 133A at the business premises of Indian taxpayer. During the course of survey, Rs.

1,12,64,984 of unexplained cash was found. When confronted, the taxpayer admitted that the cash was not accounted. Hence the survey action was converted into a search and seizure action u/s 132 of the Income Tax Act and Rs. 1.13 crore of unexplained cash was seized along with incriminatory documents.

During the course of the search, when confronted with the information received from the National Tax Agency, Japan, the Managing Director of the taxpayer company admitted that the two accounts in Hong Kong were maintained in the name of Taxpayer Company and its directors. She also admitted that the difference in sale consideration from export of iron ore according to the original contract and addendum agreement was deposited in the bank accounts in Hong Kong. She admitted the undisclosed income of Rs. 21.61 Crore including foreign exchange fluctuation gain.

C. Action by the Investigation Wing

4.7.12 In search and seizure action under section 132 of Income Tax Act, the Investigation Wing of the CBDT has detected concealed income of Rs. 19,938 crore in the last two financial years. Focused searches have been conducted in a number of cases in the current year on the basis of information received from foreign jurisdictions under the provisions of DTAA. Search and seizure statistics for the last few years are given in Table 4.3.

Table 4.3 Search and Seizure Statistics 2006-2012

Financial Year	No. of Warrants Executed	VALUE OF ASSETS SEIZED (In Crore)				Total Undisclosed Income Admitted (In Crore)
		Cash	Jewellery	Other Assets	Total	
2006-07	3,534	187.48	99.19	77.9	364.64	3,612.89

				6		
2007-08	3,281	206.35	128.07	93.39	427.82	4,160.58
2008-09	3,379	339.86	122.18	88.19	550.23	4,613.06
2009-10	3,454	300.97	132.2	530.33	963.5	8,101.35
2010-11	4,852	440.28	184.15	150.55	774.98	10,649.16
2011-12	5,260	499.91	271.4	134.3	905.61	9,289.43

4.7.13 Surveys under section 133A of Income Tax Act are an important tool for ensuring that businesses are carried out according to the rules and taxes are paid in time, particularly in the micro, small and medium enterprises (MSME) and unorganized sector.

Since April 2009,the Income Tax Department has detected under-reporting of income to the tune of Rs. 11,800 crore in surveys, and collected due taxes thereon. Table 4.4 indicates the number of surveys conducted and under-reported income detected over the last few years.

Table 4.4 Number of Surveys Conducted and Undisclosed Income Detected 2006-2012

Financial Year	No. of Surveys Conducted	Undisclosed Income Detected (In Crore)
2006-07	6,207	2,612.77
2007-08	6,071	3,581.77
2008-09	5,777	3,059.89
2009-10	4,680	4,857.10
2010-11	3,911	5,894.44
2011-12	3,706	6,572.75

D. Prosecution under Income Tax Act

4.7.14 The Income Tax Department launches prosecutions against tax offenders under Chapter

XXII of the Income Tax Act 1961. Prosecutions are launched for tax evasion (section 276C), non-filing of tax returns (section 276CC), failure to deposit taxes deducted / collected at source (sections 276B and 276BB), false statement in verification (section 277), abetment of false return (section 278), contravention of prohibitory orders (sections 275A and 275B), etc. Sentences vary from a minimum of 3 months to a maximum of 7 years imprisonment with fine.

4.7.15 Although sparingly used, the department has utilized these provisions successfully to enhance tax compliance, with a success rate of about 48 per cent convictions or fiscal compounding in the last six years, one of the highest amongst all law enforcement agencies in India. Table 4.5 indicates the number of complaints filed, cases decided, convictions and compounding of offences, and the success rate.

Table 4.5 Number of Complaints Field, Convictions, Compounding of Offences, and Success Rate 2005-2012

PROSECUTION DATA

YEAR	COMPLAINTS FIELD	CASES DECIDED*	CASES COMPOUNDED	CASES SUCCESSFUL CONVICTED	SUCCESS CASES	COMPLAINTS RATE
2005-06	326	125	84	1	85	68.0
2006-07	73	100	57	2	59	59.0
2007-08	263	280	13	11	24	8.6
2008-09	162	146	13	14	27	18.5
2009-10	312	599	291	32	323	53.9

2010-11	244	356	83	51	134	37.6
2011-12	105	471	342	12	354	75.2
TOTAL	1,485	2,077	883	123	1,006	48.4

* Cases decided have no direct correlation with complaints filed.

E. International Taxation and Transfer Pricing

4.7.16 The Directorate of Transfer Pricing has detected mispricing of Rs. 67,768 crore in the last two financial years (Table 4.7) (Rs. 44,531 crore in the current financial year). This has effectively stopped transfer of equivalent amount of profits out of the country.

4.7.17 The Directorate of International Taxation has collected taxes of Rs. 48,951 crore from cross-border transactions in the last few financial years as can be seen from Table 4.6.

Table 4.6 Collection from Cross-border Transactions 2002-2012

Financial Year	Collection of International Taxation Directorate
2002-03	Rs. 1,356 crore
2003-04	Rs. 1,729 crore
2004-05	Rs. 4,418 crore
2005-06	Rs. 8,049 crore
2006-07	Rs. 9,147 crore
2007-08	Rs. 11,790 crore
2008-09	Rs. 15,740 crore
2009-10	Rs. 16,198 crore
2010-11	Rs. 21,509 crore
2011-12	Rs. 27,442 crore

Table 4.7 Transfer-pricing Adjustments 2004-2012

Financi	Number	Number	% of	Amount

al Year	of TP Audits Completed	of Adjustment Cases	Adjustment Cases	of Adjustment (In Crores)
2004-05	1,061	239	23	1,220
2005-06	1,501	337	22	2,287
2006-07	1,768	471	27	3,432
2007-08	219	84	39	1,614
2008-09	1,726	670	39	6,140
2009-10	1,830	813	44	10,908
2010-11	2,301	1,138	49	23,237
2011-12	2,638	1,343	52	44,531

F. Information disseminated by the FIU