

Black Economy of India

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Abstract

Black money refers to a certain sector of economy where some private cash transactions go unreported to the Government and on which taxes are not paid. It involves illegal economic activities like buying and selling of drugs. The size of black economy is estimated between five and 48 percent of GDP. In a petition filed recently with the Supreme Court by some prominent citizens of India, the Government has been asked to bring back the unaccounted for wealth hoarded and concealed by Indians in Swiss Banks and other offshore tax havens. There are many sources of black money viz. overstated cost, under invoiced revenue, kick back from major defence / civilian contracts, hawala funds, etc. Well established doctors, lawyers and other self-employed professionals are the biggest tax evaders. Such unaccounted for money is moved across states and national borders through Hawala route. Black money launderers constantly contrive new routes of fund movement and make money white. A recent development in this regard is that of investing hidden funds in paintings and art collections, massive profits earned through trading in stock markets etc. Major portion of the ill-gotten wealth of the country has been taken away abroad and kept in the bank accounts in some of the world's best known tax havens.

Various committees and commissions have been set up by the Government to suggest ways and means to curb black money. Many recommendations have been made by them with no effect. The left parties hold the view that there is no political will to tackle the issue. There are too many enforcement agencies like Enforcement Directorate, CBI, Intelligence Bureau, Income Tax Dept. etc. There are no clear guidelines about their role and jurisdiction, nor there is proper coordination. Many suggestions have been made for curbing black money. Some of them are renegotiation of existing tax treaties with an accent on exchange of information, prescribing procedures for confiscation of benami properties etc. Meanwhile, Government has identified 20 countries with whom it would enter into agreement in the form of information exchange and general assistance for the return of black money. Government has sought comprehensive review of the tax treaties with 25 countries. The Finance Ministry has also ordered for renegotiation of 77 double tax avoidance pacts. Any measure initiated by the Government and RBI to check inflation may not be effective so long as huge amount of black money exists in the economy. Therefore, the only solution lies in checking the generation of black money.

Keywords: *Black money, Parallel economy, Tax havens, Unaccounted for wealth, Agreement in the form of information exchange and general assistance for the return of black money, Double Tax Avoidance Pacts, Swiss Bank, Financial Intelligence Unit -India, Swiss Bankers Association, Foreign Institutional Investment (FII), Non Resident Indians (NRIs)*

Introduction

Black economy may be defined as a hidden sector of the economy where private cash transactions go unreported. It is the sector of economic activities which involve illegal economic transactions like buying and selling of drugs, capital gains and bribes. This part of the economy is hidden from the Government and taxes are not paid on incomes earned from these illegal activities.

Black money in India has been variously estimated by different economists. Economist Shankar Acharya estimated it at 20percent of the GDP, while Prof. Arunkumar of JNU put the figure at 40 percent. Some other experts estimated that the amount of such undeclared income varies from 5% to 20% of GDP. According to some calculations, India's black money abroad is believed to be more than its foreign exchange reserves. Indians have stashed away no less than dollar 1.4 trillion in black money in Swiss Banks, according to Swiss Association's Document (source: The Telegraph March 6,2010)

The issue has come to prominence recently with the Supreme Court admitting a petition asking the Govt. of India to bring back unaccounted for wealth hoarded and concealed by Indians in Swiss Banks and other offshore tax havens. The NDA working Chairman L. K. Advani demands that the Govt. should come out with a white paper containing its efforts to bring back the black money illegally kept abroad by Indian citizens. In the petition filed with the Supreme Court the petitioners said that over 1.45 trillion dollar belonging to Indians has been lying unreported in Swiss banks alone. The petitioners also say that "huge untold" wealth has been siphoned off to around 70 banks in other tax havens. This amount is sufficient enough to wipe out India's total external debt of about \$222 billion (source : The Economic Times dt. 25th Mar.2010). The petitioners cited that US Govt. has taken a drive against Swiss Bank UBS and compelled the Bank to reveal names of American citizens who held illegal accounts with it. The US Govt. had also imposed a penalty of \$769 billion for the Internal Revenue Service of the US. In the petition, the petitioners have also cited the recent LGT Bank(Liechtenstein) episode. A former employee of the Bank had sold data of 1400 account holders to German Authorities, on the basis of which, the German Authorities took action against 500 of its tax payers. The petition also pointed out the recent episode of Pune based Hasan Ali Khan who was probed by the Income Tax Department and also by the Enforcement Directorate. However, the Govt. did not initiate any criminal action against him and let him off after making a demand for certain amount under the Income Tax Act.

It appears that the Indian laws dealing with such issues are not strong enough to take a preventive measure. Tax evasion in India is not a criminal offence, therefore, the culprits can get away with lighter punishments like paying a penalty.

Sources of Black Money

There are many sources of black income viz.

- A. Overstated cost
- B. Under-invoiced revenue

- C. Kick back from major defence /civilian contracts
- D. Not bringing back the earnings abroad.
- E. Gold smuggling
- F. Income from illegal economic activities
- G. Transactions done abroad and not reported in India
- H. Hawala funds
- I. Funds earned by artists/entertainment industry/ sports people and kept concealed in bank accounts abroad.

Transparency International has ranked India as one of the most corrupt countries of the world. Therefore, tracking illegal wealth becomes a constant challenge for India. It is believed that tax amnesty schemes treat the symptoms rather than the roots of the disease. There is therefore a need for changing the outlook with regard to the problem of black money.

How Black Money is Created

Service providers such as well-established doctors, and lawyers are the biggest tax evaders. Owning a mobile phone is one of the criteria for filing income tax returns. India is reported to be having more than 120 million mobile phone users. Owning a car is another criteria for filing income tax returns. The car owners in India buy more cars but their number is around one lakh. This gives an idea about the extent of tax evasion and volume of black money.

Hawala, is the south Asia's biggest illegal money transferring route. Funds are moved across states and national borders through this non-banking method. In two of India's wealthiest states, Maharashtra and Gujarat alone, Hawala transactions are known to run into billions of rupees evading income taxes. Black money launderers in India are constantly devising new routes of fund movement. A recent development in this regard is that of investing hidden funds in paintings and art collections. The Income Tax Department found that a small business man had invested large amount in purchasing a piece of painting. This raised their suspicion and they raided some of the rich city-builders and found crores of undeclared income invested in paintings bought from local art galleries.

Purchasing luxury cars, real estate and jewellery are other gateways of money laundering. India is one of the world's largest consumer's of gold. Stock market could be the biggest and easiest money laundering avenue. Black money can be turned into white through massive profits earned from trading in stock market by paying a mere 10 percent capital gain tax. In a recent IPO offering, it was revealed that a woman in Gujarat reportedly opened more than ten thousand fake demat accounts for cornering a major portion of the shares.

It is unfortunate that a major portion of the ill-gotten wealth of the country has been taken away abroad and kept in secret bank accounts in some of the world's best known tax havens and the Indian economy has been stripped of its wealth. The NRIs also contribute to increasing the quantum of black money. Indian workers in Arab countries cannot transfer money back home due to local laws. Hawala is

the only route – they deliver cash to local agents for delivery to their families in India. The other method is buying gold and bringing it to India. NRIs in eastern Africa experienced tight exchange control regulation until mid 1990s. They used to send their cash to Britain and the US. NRIs from Britain used the hawala route to send money to their families in India for a better exchange rate and less hassles than sending through the bank.

A new element of financing terrorist operation has crept in during the past few years. Terror groups are using wire money transfer channels and credit cards to send money for terror strikes in India.

With the opening up of the economy, cross border movement of funds has become easier. About 75 percent of black money in India goes abroad through hawala channels. The money which Indians sent abroad in the 1970s and 1980s is now coming back to India, a kind of reverse hawala flow. As India is now growing very fast and the rupee is appreciating, it makes sense for Indians to bring their money back. A most popular route is a dummy software company. Software has no material value. Cartons of empty floppies are being shipped to foreign buyers and earnings therefrom are being shown as export earnings. Another old fashion tool is the briefcase. Over the past few years more than 200 Nigerians have landed at Indian airports with suitcases with huge amounts of money and declared at the airports. According to the present Indian Regulations, Foreign Nationals can import any amount of money, if they declare it. The Reserve Bank of India is trying to curtail the massive flow of cash and the resultant inflation by raising interest rates. RBI appears to have a feeling that reverse hawala is a good thing and has allowed the use of participatory notes to allow money to come to India anonymously.

How to Curb Black Money?

Over 40 committees and commissions have been set up so far to suggest ways and means to curb black money. They have come out with hundreds of recommendations leading to nowhere. The left parties hold the view that there is no political will to tackle this issue. Enforcement agencies are loaded with huge volume of information about black money but they are not equipped to handle it. The Financial Intelligence Unit, set up in November 2004, to build a net work of Financial Intelligence received more than two million cash transaction reports. They shortlisted about 800 as suspicious and forwarded them, to various investigation agencies like the Enforcement Directorate, various Income tax Departments, the CBI and the Intelligence Bureau but perhaps none of them is equipped to follow up such a huge number of suspicious leads.

Too many agencies create another problem. There are no clear cut guidelines when one agency's work is over and another's starts. There is also lack of coordination among the agencies. Some time one agency works against the other. This also makes it impossible to hold anyone accountable for failure or non-conclusion of a case. The whole administrative set up needs a critical review. The question of setting up one single authority to deal with all the issues relating to unaccounted for wealth, both domestic and that stashed by Indians in Swiss Banks and other offshore tax havens needs a serious consideration.

The petitioners to the Supreme Court include many prominent personalities of India like the former Chief Election Commissioner, J M Lyngdoh, former Mumbai Police Commissioner Juliot Reberio, Former UGC Chairman Hari Gantra and former Union Minister Ram Jethmalani. They have suggested slew of measures which the Govt. can adopt. Some of them are

- a. Renegotiation of existing tax treaties with an accent on exchanging information.
- b. Prescribing procedures for confiscation of benami properties.
- c. Publishing names of individuals having accounts with Swiss banks and other banks in the offshore tax havens.
- d. Indian laws dealing with such issues are not strong enough to deter such crimes. For example, tax evasion in India is not a criminal offence. Therefore, there is a need to provide teeth to the existing laws so that exemplary punishment can be imposed on people involved in such malpractices.

Measures initiated by the Govt.

In a recent statement on the subject, in the Lok Sabha the Prime Minister, Dr. Man Mohan Singh said that the Govt. has identified 20 countries with whom it would enter into agreements on information exchange and general assistance for the return of black money stashed away by Indians abroad. Negotiations have been completed with Bahamas and Bermuda and steps are being taken for the signing of Agreements. The Govt. has also approached Switzerland for the renegotiation of the Tax Treaty so that Govt. can have access to information.

India has signed double tax avoidance agreements with as many as 85 countries and has sought comprehensive review of the tax treaties with 25 countries. The Finance Minister has also ordered renegotiation of 77 double tax avoidance pacts.

Conclusion

It is difficult to define and estimate the size of black money. It includes money generated and deployed in illegal activities like drug smuggling, kickbacks in various international deals like defence purchases and the money generated by legal business on which tax has not been paid e.g. sale of goods from a factory to avoid excise duty etc.

In 1970s, there were certain known sources of creating black money namely, unemployed youth turned petty criminals engaged in illegal country liquor manufacture and sale, white collar tax evasion of small amounts and hard core criminal politicians nexus. Almost all sections of the economy generate some black money. Simplification of tax laws and reduction in tax rates have failed to make any significant impact on the creation of black money.

The Reserve Bank of India, at the instance of the Govt. of India, is trying to tackle the problem of current inflation by raising interest rates and tightening money supply. But this may not produce the desired result because of the huge amount of black money being generated here and also coming from overseas. This is raising the prices of everything from necessities of life to luxurious cars and houses. If the Govt. could effectively tackle the issue of black money and parallel economy, there

might not have been any need to raise interest rates. If the Govt. could do so, it could get huge revenues, perhaps much more than those collected from direct tax revenues by tinkering with the tax collection administration. In the words of NCAER's Bhide, "in the long run, the only solution is to check the generation of black money and move gradually away from cash economy". Until this is done, investigation, detection, amnesty schemes etc. are unlikely to curb the black and booming economy.

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