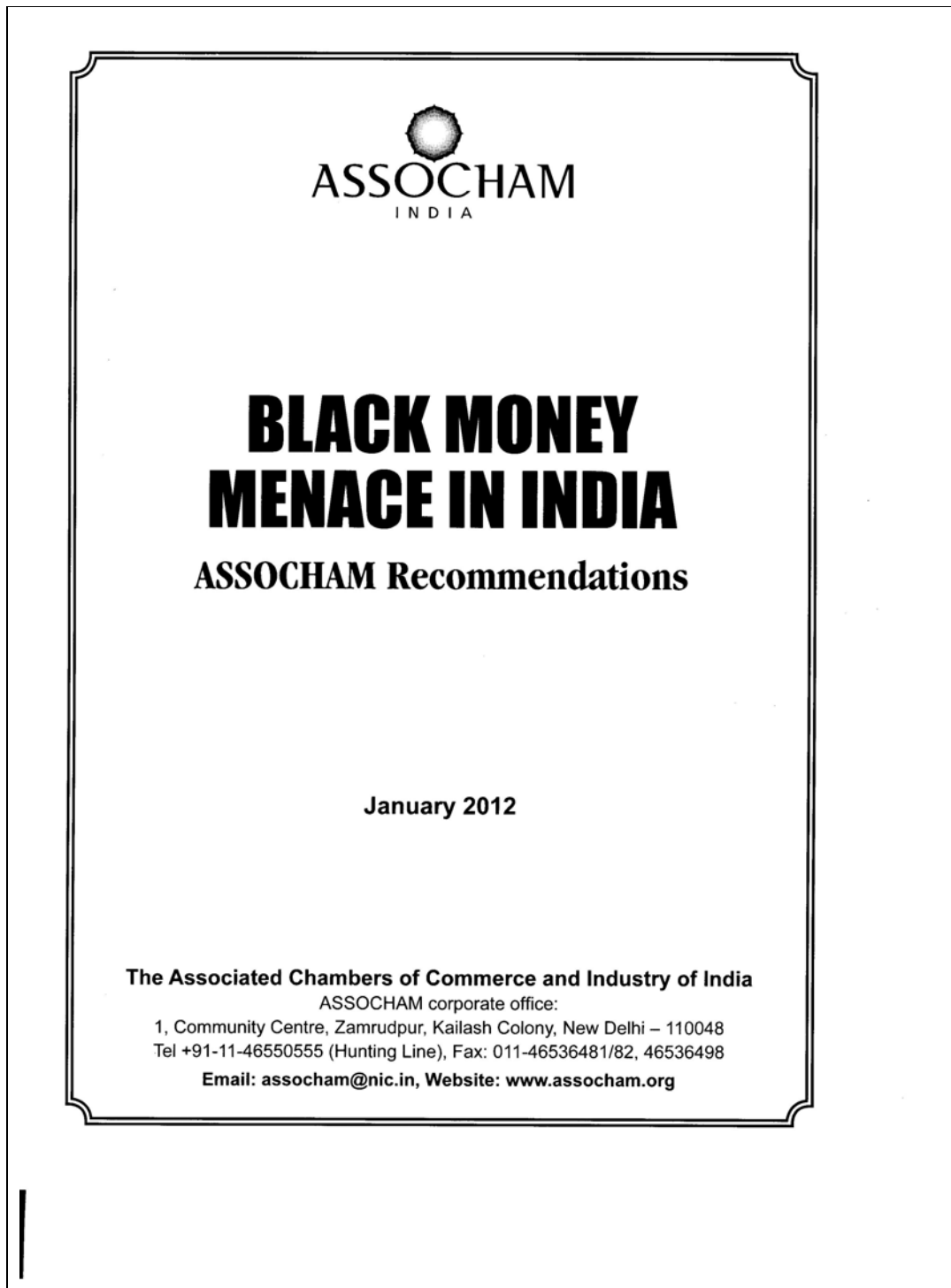


ANNEX-A2

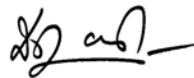


## ACKNOWLEDGEMENT

The ASSOCHAM President, Mr. Dilip Modi, in September 2011 appointed an expert committee to study and recommend realistic strategy to the Government of India on the issue of black money. The committee was chaired by Mr. Ved Jain, Chairman, ASSOCHAM National Council on Direct Taxes and former President, Institute of Chartered Accountants of India, and co-chaired by Mr. R. K. Handoo, Chairman, ASSOCHAM Legal Affairs Council and an eminent Supreme Court Advocate. The committee comprises of luminaries from industry, legal, professional and social sector as its members.

ASSOCHAM hopes that the Government will find the recommendations / suggestions of the committee very useful.

January 2012



D. S. Rawat  
Secretary General  
ASSOCHAM

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## BLACK MONEY MENACE IN INDIA

### I INTRODUCTION

Individuals and institutions globally are engaged in evading taxes and generating surpluses which do not get accounted for in the formal economy. These funds are generated from activities which may be legal or illegal by nature. However the mere fact that taxes have not been paid on such incomes, as per the rules of the land, converts such funds to form a part of the parallel economy or Black Money generation. The fund generated is normally held as currency notes and/or assets through investments in gold, jewellery, precious stones, art and artifacts, real estates and others. The literature revealed that strong parallel economies are created due to high level of corruption and weak hold of regulatory mechanism in developing regions of the world.

The Wanchoo Committee stated that 'the term Black Money is generally used to denote unaccounted money or concealed income and/or wealth as well as money involved in transactions wholly or partly suppressed'.

In India, Kaldor's estimates for black money generation in 1953-54 were about Rs. 600 crores (i.e. 6% of National Income then) on account of tax evasion only. Some other estimates further put the black money generated in India annually as Rs. 700 crore (1961-62); Rs. 1,000 crores (1965-66); Rs. 1,400 crores (1968-69). Estimates by Dr. Rangnekar for the same periods were Rs. 1,150 crore, (beginning of 1960s) Rs. 2,350 crore (mid 1960s) and Rs. 2833 crore by the late 1960s.

The Indian Institute of Finance study indicated that the growth rate of black money in 1991 has been at a rate of Rs. 60,000 crores per year. N. Vittal, Former Indian Chief Vigilance Commissioner in 2002, estimated that the yearly growth rate of Black money is a factor to the tune of 40-50 percent of GDP growth in the Indian economy on a year to year basis.



Another concept that has close proximity to Black money is the money laundering. The term laundering is referred to as investment or other transfer of money flowing from racketeering, drug transactions and other sources (illegal sources) into legitimate channels so that its original source cannot be traced. The traditionally known activities for laundering of money are via drugs, racketeering, kidnapping, gambling, procuring women and children, smuggling (alcohol, tobacco, medicines), armed robbery, counterfeiting and bogus invoicing, tax evasion and misappropriation of public funds.

Both black money and money laundering result in capital flight. Capital flight may be defined as transfer of assets denominated in a national currency into assets denominated in a foreign currency, either at home or abroad, in ways that are not part of normal transactions. One technique that can be used to move significant amounts of capital out of a country is the over-invoicing of imports and the under-invoicing of exports.

It may be noted that that illicit flows differ from the broadest definition of capital flight which also includes “normal” or “legal” outflows due to investors’ portfolio choices. Specifically, illicit flows are comprised of funds that are illegally earned, transferred, or utilized — if laws were broken in the origin, movement, or use of the funds then they are illicit. The transfer of these funds is not recorded anywhere in the country of origin for they typically violate the national criminal and civil codes, tax laws, customs regulations, VAT assessments, exchange controls, or banking regulations of that country.



II

**CORRUPTION AND CAPITAL FLIGHT:  
EMPIRICAL ASSESSMENT**

An important study conducted by Quan and Rishi (2006) empirically examined the role of corruption in impelling capital flight. Corruption was broadly defined as the abuse of public office for private gain. There is an implicit belief that popular mechanisms of capital flight, such as bribes and kickbacks on government contracts, trade misinvoicing, outright cash transfers, and smuggling are instances of corruption in the broadest sense. Identifying corruption as one dimension of poor governance, the empirical analysis explores direct linkages between corruption and capital flight in a broad sample of countries. The study hypothesized that: Does corruption impel capital flight by raising the risk of domestic investment, *ceteris paribus*? This hypothesis was tested for a panel of 69 countries over a seven-year period from 1995–2001. In this regard the study mentioned that,

- Political instability and poor governance contribute to a domestic environment that deters investment and induces capital flight.
- Corruption works as a regressive tax – the poor pay a disproportionate share of their income in the form of bribes to secure access to public services.
- Bribes and official extortion act as an extra tax and therefore deter potential foreign direct investment into developing countries. Corruption acts as a source of macroeconomic vulnerability and lower economic growth.

Governance is understood to have six dimensions: voice and accountability; political stability and the absence of major violence; government effectiveness; regulatory quality; rule of law; and the control of corruption. The panel data analysis of corruption and capital flight indicated a positive and significant effect of corruption on capital flight. Especially, it suggests that an increase in corruption by one standard deviation induces an increase of almost 2 percent in capital flight.



## III

## HOW TO ESTIMATE CAPITAL FLIGHT

The World Bank method compares the sources of external finance (the change in external debt and net foreign direct investment), with the uses of finance (current account deficit and the change in official reserves). Sources of funds exceeding recorded uses of funds reflect unrecorded outflows. Sources of funds include increases in net external indebtedness of the public sector and the net inflow of foreign direct investment. Uses of funds include financing the current account deficit and additions to reserves. In this broad macroeconomic framework, illicit outflows (inflows) exist when the source of funds exceeds (falls short of) the uses of funds. Thus:

(Source of Funds) - (Uses of Funds)

$$\text{Illicit Outflow} = [\Delta \text{ External Debt} + \text{FDI (net)}] - [\text{Current Account Balance} + \Delta \text{ Reserves}]$$

The above model estimates are adjusted for trade mispricing, which has been long recognized as a major conduit for capital flight. The underlying rationale is that residents can shift money abroad illicitly by over-invoicing imports and under-invoicing exports. In order to capture such illegal transactions, a developing country's exports to the world (valued free on-board (f.o.b.) in US dollars) are compared to what the world reports as having imported from that country, after adjusting for the cost of insurance and freight. Similarly, a country's imports from the world net of freight and insurance are compared to what the world reports it has exported to that country.



**IV**

**THE CURRENT ISSUES**

**T**ax evasion is one of the major reasons for the creation of an underground economy. There are 70 tax havens and secrecy jurisdictions and that there are millions of dummy corporations that shield the owner's identity. Through transfer pricing, false documentation, fake corporations, tax havens and secrecy jurisdictions, Western banks and businesses handle \$ 1 trillion of illicit proceeds every year. Assets in tax havens are estimated at \$ 11.5 trillion and for every \$ 1 that poor countries receive in foreign aid, an estimated \$ 10 flows abroad through illicit transfers. There is capital flight from developing and transition countries to developed countries to the extent of \$ 500 billion every year. In December 2008, GFI produced a report that was even more specific. For this five-year period between 2002 and 2006, this study estimated that illicit financial flows from developing countries amounted to between \$ 850 billion and \$ 1.06 trillion a year. This capital flight occurred through trade mispricing, criminal and commercial smuggling (drugs, minerals, contraband goods) and mispriced asset swaps.

Thanks to OECD and G-20 pressure, several tax havens have now changed their policies. There is an OECD list of tax havens and financial centres that have already implemented the standards, or have committed to the standards, though they are yet to implement them. One example is in Switzerland. Swiss banks used to be bound by the Banking Law of 1934. Traditionally, Swiss law distinguished between tax evasion and tax fraud. The latter had direct criminal intent and international tax cooperation used to be provided only when there was tax fraud, not when there was tax evasion. But because of G-20 and OECD pressure, the Swiss have eliminated this.

All G20 governments have now agreed to a multilateral Convention to tackle tax evasion more effectively. The Multilateral Convention on Mutual Administrative Assistance in Tax Matters offers a wide range of tools for cross-border tax cooperation. It includes automatic exchange of information, multilateral simultaneous





tax examinations and international assistance in the collection of tax due. At the same time, the Convention imposes safeguards to protect the confidentiality of the information exchanged.

India has 83 double tax avoidance agreements (DTAAs) and another 20 countries with which it has limited tax agreements. But the point is that DTAAs do not necessarily have clauses on the exchange of tax information. Therefore, India needs to sign tax information exchange agreements (TIEAs) urgently, especially because the global climate has changed in favour of such TIEAs. At present, India only has one TIEA, signed with Bermuda on 7th October 2010. Another 22 TIEAs are reportedly being renegotiated. The Finance Minister outlined a five-pronged strategy for handling the problem of black money: (1) Join the global crusade against black money; (2) Create an appropriate legislative framework; (3) Setting up institutions for dealing with illicit funds; (4) Developing systems for implementation; and (5) Imparting skills to manpower for effective action. This strategy, with the inclusion of the TIEAs, is unexceptionable. But it is preventive. Even when a TIEA is signed, it is likely to be prospective, not retrospective. That is, such a strategy handles the problem of future flows of illicit capital flight. It doesn't address the problem of Indian money that is already abroad. Those are valuable resources and, if brought back, can be used to fund India's physical and social infrastructure needs.



**V THE EVOLVING GLOBAL FRAMEWORK**

Several countries are currently operating voluntary compliance programmes. Such rules or programmes provide an opportunity to facilitate compliance in a timely and cost effective manner, saving costly and contentious audits, litigation and criminal proceedings. Voluntary compliance initiatives must walk a fine line between providing sufficient incentives for those engaged in noncompliance to come forward and not rewarding or encouraging such conduct. Offshore voluntary compliance programmes offer the opportunity to maximize the benefits of improvements in transparency and exchange of information for tax purposes, to increase short-term tax revenues and improve medium-term tax compliance.

The increase in the risk of detection through improved international tax co-operation coupled with the availability of voluntary disclosure programmes has lead to a large number of taxpayers coming forward and significant amount of tax being collected. For instance, more than 14,700 taxpayers took advantage of a recent US initiative and in Germany more than 20,000 taxpayers made a voluntary disclosure resulting in reported additional revenue to the German government in the range of 4 billion Euros.

Table 1 gives a bird's eye view of the recent initiatives taken by different countries to improve offshore compliance and their results.

**Table 1  
Recent Country Initiatives to Improve Offshore Compliance**

Country	Action taken to build on the G20 initiative	Amount Disclosed and Taxes Paid
Argentina	Voluntary Disclosure Initiative (2009)	EUR 146 million additional revenue yield.
Australia	Offshore Voluntary Disclosure Initiative (2010/2011)	EUR 150 million (AUD 210 million) additional revenue assessed. More than 8 000 taxpayers involved.



Brazil	Voluntary Compliance Initiative (2009)	Estimated EUR 315 million additional revenue yield.
Canada	On-going Voluntary Disclosures Program (fiscal years ending in 2009-2011)	EUR 620 million (CAD 860 million) total unreported income disclosed. 8,700 disclosures.
China	Broadening the network of tax information exchange agreements and increasing numbers of requests.	EUR 80 million (CNY 690 million) additional revenue yield (in 2010), expected to grow significantly.
Denmark	"Project havens" aimed at uncovering hidden wealth and income abroad.	More than EUR 50 million additional revenue yield so far.
France	Offshore Voluntary Disclosure Initiative (2009)	EUR 1.2 billion additional revenue yield. More than 4 700 taxpayers involved.
Germany	Voluntary Disclosures (2010/2011)	Estimated additional revenue yield of EUR 1.8 billion. Between 25 000 and 30 000 taxpayers involved.
India	Increase of staff number, greater co-operation with G20 partners, increase in exchange of information agreements.	Significant additional revenues expected over next two years.
Ireland	Voluntary Disclosures (since 2009)	EUR 70 million additional revenue yield. Around 400 taxpayers involved. An earlier initiative yielded over EUR 1 billion.



Italy	Offshore Voluntary Disclosure Initiative (2009/2010)	EUR 5.6 billion additional revenue yield. Total undisclosed assets: EUR 104.5 billion. Representing five times the amount from the 2002/2003 initiative.
Korea	Establishment of the Offshore Compliance Enforcement Centre (2009) and offshore tax evasion cases uncovered through tax audits (since 2009)	EUR 510 million (KRW 810 billion) additional revenue assessed.
	Foreign Financial Accounts Reporting Program (2010)	More than 500 taxpayers involved.
Mexico	Offshore Voluntary Disclosure Initiative (2009)	EUR 58 million (MXN 1,057 million) additional revenue yield. Total undisclosed assets: EUR 1,073 million (MXN 19,436 million).
Netherlands	Voluntary disclosure program on offshore accounts	EUR 475 million additional revenue yield so far. More than 9 000 taxpayers involved.
	Tackling the diversion of profits resulting from the transfer of intangibles by individuals and SMEs to no or nominal tax jurisdictions	EUR 20 million additional revenue yield so far and expected to raise EUR 150 million over a 10 year period.
Norway	Voluntary Disclosures	EUR 30 million additional revenue
Portugal	Exceptional Regime of Tax Regularization of Assets (2009)	EUR 83 million additional revenue collected. Around 1 000 taxpayers involved.



South Africa	Voluntary Disclosure Program (2010)	EUR 22 million additional revenue yield (ZAR 229 million)
Spain	Compliance Initiatives focused on Individuals	EUR 260 million additional revenue yield
Turkey	Offshore Voluntary Disclosure Initiative (2009)	EUR 225 million additional revenue yield (TRY 558 million). Total undisclosed assets: EUR 11.25 billion (TRY 27.9 billion).
United Kingdom	Liechtenstein Disclosure Facility	EUR 160 million additional revenue yield (GBP 140 million). More than 1 350 taxpayers involved.
	New Disclosure Opportunity	EUR 100 million additional revenue yield (GBP 85 million). Approximately 5 500 disclosures.
United States	Offshore Voluntary Disclosure Initiatives (2009 and 2011)	EUR 2 billion additional revenue yield (USD 2.7 billion) recovered thus far from the 2009 and 2011 initiative. More than 30 000 taxpayers involved.
	Switzerland Disclosure (2009)	Disclosure of 4 450 accounts.

Source: Organisation for Economic Development (2011) 'The Era of Bank Secrecy is Over', October 26,



VI

## ESTIMATES OF ILLICIT FINANCIAL FLOWS FROM INDIA

There are no official estimates of black money in India. All the estimates made by the non-government sources though indicate generation of large amounts of black money in India, there exists a large variation about the amount of black money. For instance, the Bureau of International Narcotics and Law Enforcement Affairs of United States Department of State in its Report on 'Money Laundering and Financial Crimes' Vol.2, published in March 2010, observed that private analysts estimate India's black market to range from \$2.1 - \$2.5 trillion.

Prof. R.Vaidyanathan, Professor of Finance, Indian Institute of Management, who worked on the subject of 'Tax havens and Illegal Funds of India', quoted that the amount of the Indian money stashed abroad may be of the order of \$1.4 trillion.

Agarwal and Agarwal observed that during the period 1995-2009, illicit financial flows from the Indian non-bank private sector into developed country banks and offshore financial centers (OFCs). Indian private sector shifted away from bank deposits to deposits in OFCs. As the share of OFC deposits increased from 36.4 percent of total deposits in 1995 to 54.2 percent in 2009, deposits in banks fell commensurately to 45.8 percent in the last year. As OFCs are subject to even less oversight than banks and typically hold a larger share of illicit funds, the increasing recourse to OFC deposits relative to banks could be symptomatic of the burgeoning underground economy in India from which such funds emanate.

A more recent study, Kar, Dev and Cartwright-Smith (2008), India lost between US\$23.7-\$27.3 billion annually in illicit financial flows (IFFs) during 2002-2006.

Shankar Acharya and his colleagues at the National Institute of Public Finance and Policy (NIPFP) undertook what is still the most comprehensive study on the size of the black economy in India. Stated simply, this study found that the size of the black economy in India was less than 30% of GDP and was more like 21%. A



subsequent study by Arun Kumar placed it at 35%. There are estimates of around 50% that also float around.

“All these estimates are based on various unverifiable assumptions and approximations. Government has been seized of the matter and has constituted a multidisciplinary committee to get studies conducted to estimate the quantum of illicit fund generated by Indian citizens.” This is a statement from the Finance Minister’s Press Conference on 25th January 2011.



## VII ASSOCHAM VIEWS & RECOMMENDATIONS

In view of the current relevance of the subject, ASSOCHAM organized a series of internal meetings. The outcomes of these meetings are as follows:

A. ASSOCHAM is of the view that the generation of the black money in the country is mainly due to the following factors:

**i. Real Estate Transactions:**

It is a common knowledge that most of the real estate transactions are understated. There are several reasons for the same. However, the main reason for understatement of the real estate transactions is the high rate of stamp duty levied on registration of the property. Further at the time of the resale there is no system of allowing credit of the stamp duty paid at the time of purchase.

**Suggestions:**

- (a) Therefore, there is a need to introduce a uniform stamp duty rate applicable across the country. ASSOCHAM is of the view that a stamp duty rate of 3% is fair and reasonable rate with the benefit of allowing credit of the stamp duty paid at the time of the purchase.
- (b) It is further recommended that the mechanism of determination of circle rate being notified by each of the States also be streamlined. The circle rate needs to be notified every year on the basis of the data input for the preceding year so as to make sure that the circle rates are as good as the prevalent market rate.
- (c) ASSOCHAM is of the view that reduction in the stamp duty rate with credit of the stamp duty paid at the time of the purchase will not have any impact on





revenue collection of the State Governments and will go a long way in curbing the menace of black money.

**ii. Expenditure on Elections:**

One of the main factors contributing to the parallel economy in the form of black money is the huge expenditure required to be incurred on elections. In the country, we have elections not only for the Parliament but also for the State Assemblies, Municipal Corporations, Panchayats as well. It is a common knowledge that candidates spend huge amount of money in the elections and most of such money is unaccounted money. The reason for this unaccounted expenditure are two fold – i) the restriction on the total amount of the expenditure a candidates is legally allowed to spend, and ii) absence of legitimate source of income in the hands of the candidates contesting elections.

Addressing these issues and ensuring transparent way of financing the democracy has long been part of the public debate. Country has remained a distant onlooker debating the issue. A vague idea of how big this problem is, can be had from the fact that on an average about Rs.10 Crore per Parliament seat is the expenditure incurred by the candidates contesting the elections and about Rs.5 Crore is the expenditure incurred by the candidates contesting the State Assembly elections. Assuming that elections are being held once in five years, the total expenditure being incurred by the candidates for Parliament and Assembly Elections itself will be more than Rs.25,000 Crore. Besides this a huge amount of expenditure is being incurred on elections to the Municipal Corporations and Panchayats also.

The Election Commission has fixed unrealistic Cap of Rs. 40 lakhs per parliament seat and Rs.16 lakhs per Assembly seat.

The world's leading democracies such as US, UK and Germany have enacted laws relating to public funding of the elections.



Chamber is of the view that it is high time that the country enacts laws relating to public funding. Further there is a need to consider the ground realities while fixing the ceiling of expenditure a candidate can spend in the elections.

**iii. Misuse of discretion by the public authorities:**

There's a lot of hue and cry in the country on account of corruption, which is due to the misuse of discretion by the public authorities. This misuse of discretion by public authorities has led to the generation of a lot of black money in the system, which cannot be accounted for by the public authorities and which either gets stashed abroad or finds its way in the undervalued properties and gems and jewellery.

The Chamber is of the view that the discretion of the public authorities can be controlled by infusing extreme accountability in the system where the public authority would be liable to pay penalty/fine for any misuse of discretion.

**iv. Import of gold and consumption in the country thereof:**

India is the biggest consumer of gold in the world. The import of gold is on payment of hard earned foreign exchange while the sale of gold at the grassroots level is mainly in cash, leading to generation of huge black money. Therefore, there is an urgent need for a mechanism to curb it.

**v. Tax Haven Countries:**

One of the reasons of generation of black money is the easy parking of such funds in tax haven countries. Post-independence India has passed through toughest tax laws and foreign exchange regulations. The extreme high rate of taxation, may it be income tax, excise duty, customs encouraged per force more and more people to carry out the transactions outside the books of account and in the result generate black money. The black money so generated over the period has been parked either in the tax haven countries or the countries where the secrecy laws ensure that money so parked will not be detected.



## vi. Foreign Exchange Restrictions

The strict restriction on allowing foreign currency in case of need had also encouraged people to park funds outside the country in foreign currency so as to meet the requirements or the obligations may it for business, education, health and other personal purposes.

- B.** Post-liberalization, however, there have been substantial reforms in the taxation laws and the tax rates have been moderated to a reasonable level. The foreign exchange laws have also been liberalized so that one does not have much difficulty in obtaining foreign currency in case of need be, may it for business, education, health or for any other purposes. Thus, as on date there is not much incentive to park funds outside the country.

### **C. How to Bring Back the Money Parked Outside**

The main issue is how to bring back the funds a substantial part of which got parked outside India during the pre-liberalization regime. The persons who have parked these funds outside India will not bring it back because of the penal actions which they may have to face. At the same time the Government cannot detect such funds in the absence of any information though discussions have been going on with the various countries and agreements have been entered into to exchange information under the Double Taxation Avoidance Agreements. Further the fact remains that such exchange of information will be perspective and practically as well as legally it will not be possible to get information about the past activities and the funds stashed away abroad in the past.

In view of these ground realities it will be prudent that Government of India opens a window so that this money can be brought back to India. In this context, following measures are suggested:

- (i) ASSOCHAM is of the view that while opening this window it will be important to provide immunity to the person declaring such assets which



can be in the form of bank deposit, investment in shares/debentures, mutual funds, property, etc.

- (ii) The immunity needs to be provided under Direct Tax and Indirect Tax Laws, Companies Act, Foreign Exchange Management Act including Money Laundering Act etc.
- (iii) As regards the tax to be paid on such disclosure of money, the Chamber is of the view that a flat rate of 40% be levied on the present value of such money or the asset.
- (iv) The cutoff date for valuation be fixed may be 1.1.2012 or 1.4.2012. Foreign currency and deposits to be valued by applying the notified exchange rate as on the valuation date.
- (v) Further 10 % of the amount be asked to be invested in Infrastructure Bonds of 7 years tenure.
- (vi) The funds so collected to be earmarked and used by the Government only for the development of the Infrastructure.
- (vii) This high rate of tax (at the rate of 40%) with further investment of 10 per cent in Infrastructure Bonds as compared to present maximum tax rate of 30% will help ensuring that there is no misuse of the scheme by unintended persons.
- (viii) Further charging tax on the present value of the foreign assets by applying the current exchange rate will also ensure that this amnesty scheme is not exploited by unscrupulous people by converting black money in to white by paying nominal taxes.

These two measures, the Chamber is of the view, will address all those issues which have arisen in the earlier voluntary disclosure scheme.

ASSOCHAM while making this proposal of amnesty is conscious of the fact that tax evaders should not get away and be shown any leniency. However



at the same time the ground realities cannot be ignored. The fact remains that as on date it may not be possible to get hold of these persons who have stashed money abroad that is why the scheme is an invitation to these people to come forward and pay taxes.

- Further this scheme shall not be applicable in respect of those persons where the authorities have detected unaccounted money and proceedings have been initiated before the date when such scheme is notified.
- That the objective of this amnesty scheme is to get back the money stashed abroad but considering the fact that there may be frequent cross and inter linked transactions and it may not be possible to isolate the transactions with respect to foreign bank account or the foreign assets, the scheme be made open for money being kept abroad as well as in India.
- Further there may be instances where money remitted abroad has been utilized and not available for repatriation. As such there should be no insistence in such cases to bring money back.
- This window may be kept opened for a minimum period of six months.

ASSOCHAM is of the view that looking to the conscious and the debate which has arisen in the last few years and the efforts being put in by the Government to collect information about the foreign assets help the public, there will be a large number of people who will like to come forward voluntarily and to make such disclosures and bring back the money in the country.

The Chamber is also of the view that if the above scheme is implemented in right earnest then a substantial part of the funds parked abroad for which the estimate ranges from few hundred billion dollars to few thousand billion dollars may get covered in the Scheme which will help the country not only meet its Revenue deficits but also help in meeting the Balance of Payment (BOP).

ASSOCHAM on its part assures that it will put all its efforts to make the scheme successful.