

A STUDY ON
WIDENING OF TAX BASE AND TACKLING BLACK MONEY

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Federation of Indian Chambers of Commerce and Industry

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Introduction

The issue of widening of the tax base of the country has been a subject matter which has received considerable attention of the successive Governments over the years. There has been considerable debate on the subject.

In the recent past, the issue of unaccounted monies held overseas has been in the limelight and the matter has been a subject of PIL before the Supreme Court of India and is before the Special Investigation Team. The issue has resulted in the hold up of Parliament proceedings several times!! The estimates of the monies held overseas itself is matter of considerable speculation and estimates vary wildly.

Beyond the issue of unaccounted monies lying overseas, however, is the issue of unaccounted monies lying in India and what is perceived to be the parallel economy. There is, of course, this issue of widening the tax base by taxing exempt income like the agricultural income. Indeed, there is a strong case for taxing agricultural income particularly beyond a large threshold limit. This, however, is an issue which involves political hues and affects centre-state relationship. One easy fix here is to recommend the states to tax such income and ensure that this works as a part of the GST compensation regime. In this study, we have steered clear of overseas monies and taxation of agricultural income. What we have recommended here is that the Government implement simple measures as would ensure widening of the tax base. The appropriate use of IT infrastructure is at the heart of it. Also, we have suggested that to encourage use of cheques and other accountable means payment, there be an incentive both to the payers and payees. This would encourage them not to use cash as a basis of payment. We believe that this would be a better way of achieving compliance than use a stick approach. We do hope that our suggestions will help the Government formulate a policy which will enhance the tax base and remove the undue revenue pressures which currently fall on the shoulders of honest taxpayers.

We at FICCI have always believed that the way to progress is to have an effective partnership between the Government and other stakeholders. We have often heard from the Government that our suggestions are aimed at asking concessions rather than help revenue enhancement. This study and suggestions contained herein, hopefully, will address this issue

A team comprising of Ketan Dalal, Mukesh Butani, Ajay Vohra, T P Ostwal, S. Subramaniam, Ashok Tyagi, K. R. Sekar and Sachin Menon gave suggestions to help us put this together. Valuable inputs from Rajeev Dimri, Co-Chairman of the FICCI's Taxation Committee, helped the group fine-tune the proposals in this paper. Mrugen Trivedi coordinated this entire effort, led the initiative and prepared the draft text. I thank the team members and Mrugen in particular for their efforts but for which this study would not have been possible.

Mr Dinesh Kanabar
Chairman
FICCI's Taxation Committee

1. Background

State of the Indian Economy

GDP Growth

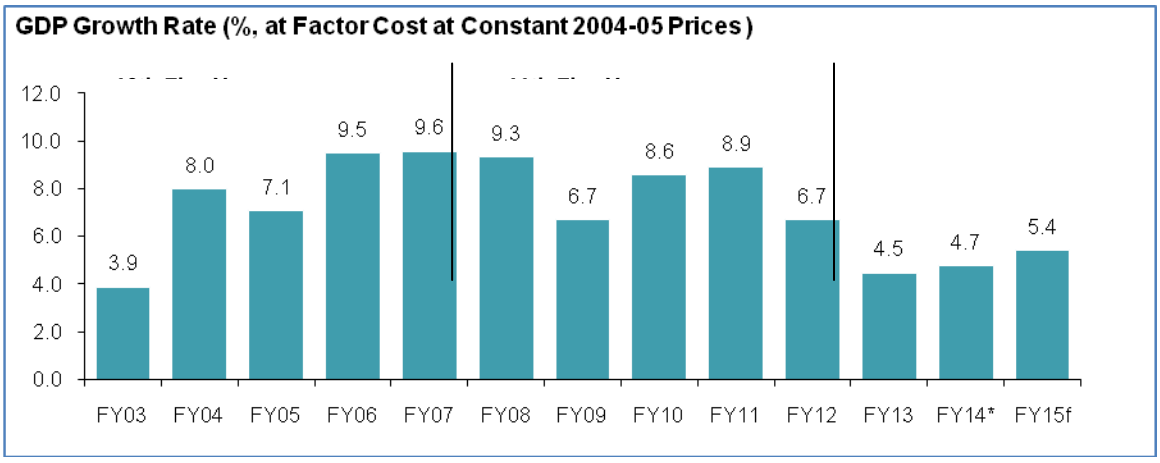
After achieving unprecedented growth of over 9 percent for three successive years between 2005 and 2008, the economy witnessed a slowdown to 6.7 percent in Financial Year (FY) 09, in the aftermath of the global financial crisis in 2008. The economy recovered quickly in FY10 and FY11 due to the same facilitating factors that fuelled its growth during the 10th Five Year Plan such as a growing services sector, strong domestic demand, higher investment, expanding infrastructure, among others.

However, post that, the economy has been going through a period of weakness, in the context of the decadal average of 7.9 percent during FY04 to FY13 – with Gross Domestic Product (GDP) growth having slowed down to 6.7 percent in FY12, followed by decade low growth of 4.5 per cent in FY13.[1] This was on account of sluggish industrial growth in the context of a tight monetary policy followed by the Reserve Bank of India (RBI) through most of FY12, and continued uncertainty in the global economy. The growth picked up marginally to 4.7 per cent in FY14.[2]

The Indian economy is now showing signs of recovery and is expected to further strengthen in FY15 (with the new government initiating measures to revive the economy and focussing on developing the manufacturing sector). To boost economic growth and overall investor sentiment, the Government of India (GoI) announced several measures during the Union Budget 2014-15 such as increase in Foreign Direct Investment (FDI) limits from 26 percent to 49 percent in defence manufacturing and insurance sector through the FIPB approval route and increasing investment limits in the construction sector.[3]

The Indian economy is likely to expand in the range of 5.4 to 5.9 percent in FY15, with better expected performance in mining and manufacturing, improved balance of payments, pick up in investment, improved external demand, stabilising global commodity prices and a modest global growth revival.[4] The country's GDP growth at factor cost at constant 2004-05 prices reached 5.7 percent in FY15 Q1, the highest in two-and-a-half years. Economic activities which registered significant growth in the quarter include 'electricity, gas and water supply' at 10.2 percent, 'financing, insurance, Real Estate and business services' at 10.4 percent and 'community, social and personal services' at 9.1 percent.[5]

[1] Planning Commission website, accessed 10 September 2014
[2] Planning Commission website, accessed 10 September 2014
[3] Union Budget 2014-15
[4] Economic Survey, 2013-14
[5] Central Statistics Office, Ministry Of Statistics & Programme Implementation, GoI

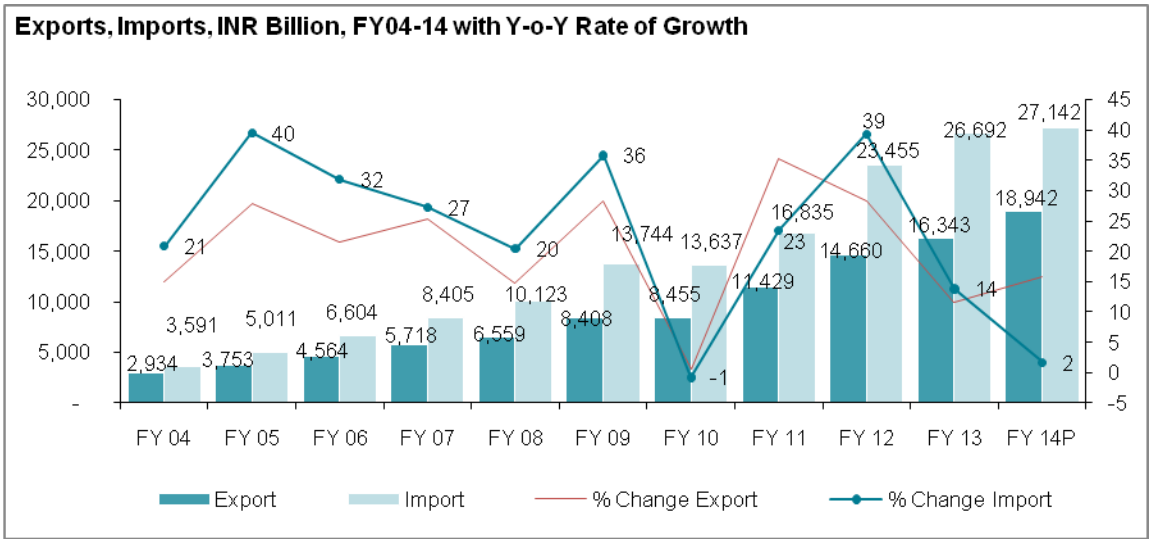


Source: Central Statistics Office, GoI; 'Economic Survey 2012-13,'GoI; Planning Commission

Note: *Denotes provisional estimates and f denotes forecast which has been projected between 5.4-5.9 percent

Trade

There has been a marked improvement in India's total merchandise trade to GDP ratio, from 21.8 percent in FY01 to 44.1 percent in FY14. India's trade deficit declined to INR 820 billion in FY14 from INR 10,348 billion during FY13 as a result of a sharp decline in imports and a moderate growth in exports. Merchandise exports reached INR18,942 billion (on customs basis) in FY14, registering a growth of 16 percent. Imports grew by only 2 percent in FY14, owing to a 12.8 percent fall in non-oil imports.[6]



Source: Central Statistics Office, GoI; Planning Commission

[6] Economic Survey, 2013-14

GDP ratio and black money generation

Over the past several decades, the Indian economy is facing a growing challenge with respect to black money generation and accumulation (which is hampering the government's revenue generation from taxation). There are various estimates of black money in India. India's black economy currently could be up to 75 percent of the GDP, as per a confidential report submitted by NIPFP in December 2013, accessed by The Hindu. The United Progressive Alliance (UPA) government had in March 2011 selected National Council for Applied Economic Research (NCEAR), National Institute of Public Finance and Policy (NIPFP) and National Institute of Financial Management (NIFM) to estimate the quantum of black money in the economy. The report is yet to be tabled in the Indian Parliament.

In common parlance, 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.

NIPFP in its report of 1985 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'.

Further the white paper on 'black money' published by the Ministry of Finance states that 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.

A Business Standard report in January, 2013 estimated it at 30 percent of GDP, or INR 28 lakh crore. A report by NIPFP in December 2012, estimated black money at above INR 10 lakh crore or 10 percent of the GDP. An earlier report by NIPFP in 1984 had estimated black money generated in the country to 19 percent to 21 percent of GDP or INR 36,000 crore.

Year	Estimates for Black Money (INR Crore)	Percent of GDP
1975	9,958 to 11,870	15 to 18
1980	20,362 to 23,678	18 to 21

1983	31,584 to 36,784	19 to 21
2012	>10,00,000	10

Source: NIPFP Estimate

Tax payers Base

The number of income-tax payers in India has historically been low. According to the Ministry of Finance, the number of taxpayers account for ~2.9 percent of the total population, which equates to ~ 35 million taxpayers, out of which only about 0.1 percent i.e., 42,800 persons admit to having a taxable income exceeding INR 1 crore.

An estimated 90 percent of India's individual taxpayers fall in the category of people earning taxable income of up to INR 5 lakh a year; however, this category accounts for only 10 percent of the total income-tax collected by the revenue department. In contrast, less than 2 percent of taxpayers fall in the category of individuals earning taxable income of above INR 20 lakh, but account for over 63 percent of actual tax collected in a year.

The number of multi-millionaires in India (those with net assets of at least INR 60 crore) increased from 13,700 in 2013 to 14,800 in 2014, a rise of ~8 percent, while the number of millionaires (with net assets of at least INR 6 crore) increased by ~6 percent in this period, reaching 226,800 in 2014 from 214,000 in 2013.[7] This brings out an interesting observation that a country with 226,800 millionaires (with net assets of over INR 6 crore) has less than 50,000 taxpayers earning taxable income of over INR 1 crore.

All of the above statistics indicate that tax evasion is widespread in the economy and hence it becomes necessary for the government to increase the number of high-end taxpayers.

Tax Collection

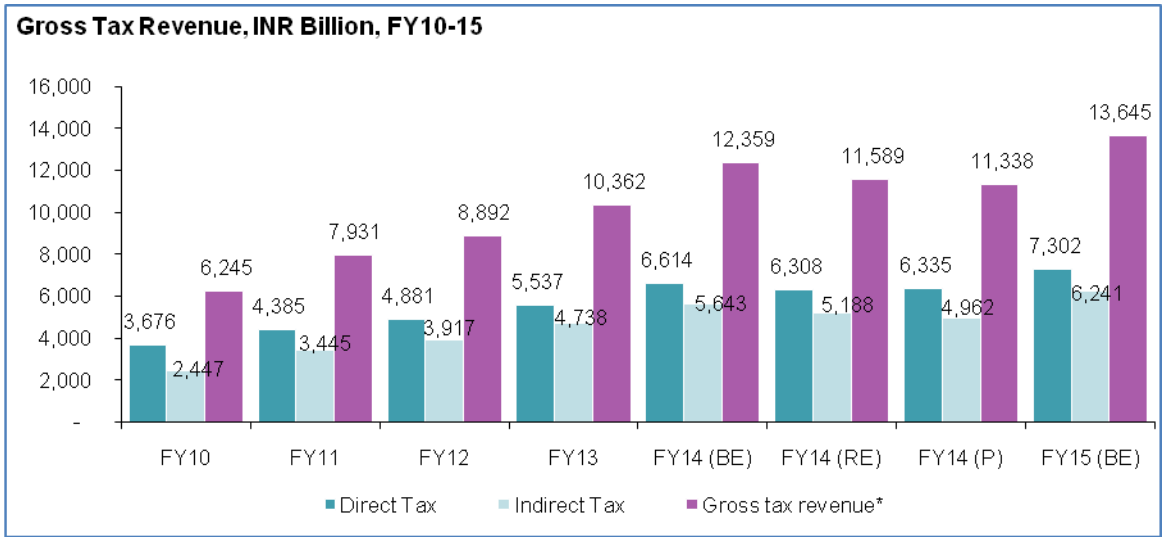
Tax collection in the country has been low, at about 10 percent of GDP, a quarter of the average in the Organisation for Economic Co-operation and Development (OECD) group of developed nations. The government has mostly registered a shortfall in tax revenues from what it estimates in the budget each year.

Although the gross tax revenue target for FY14 recording a deficit of ~6.2 percent over the budgeted level, gross tax revenue grew by 9.4 percent in FY14 to reach INR11,338 billion, as compared to INR10,362 billion in FY13.

Direct Tax revenues increased 14.4 percent and Indirect Tax collection improved by 4.7 percent, during the same period.[8] Indirect Tax revenues increased by 3.9 percent during April–July FY15, lower than 25 percent of the annual increase envisaged in the FY15 budget.[9]

[7] "The Multi-Millionaire Phenomenon 2014", New World Wealth
[8] Union Budget documents and Controller General of Accounts, Ministry of Finance, GoI
[9] Ministry of Finance, GoI

The government has estimated Indirect Tax collection of INR 6,241 billion in FY15, up 20.3 percent over the collection in FY14 (revised estimates). The government has set a Direct Tax collection target of INR 7,302 billion, an increase of 15.8 percent from the collection in FY14.[10] Most of the budgeted revenue in Indirect Taxes is expected from excise duty hike in cigarettes and pan masala announced in the 2014-15 Union Budget.

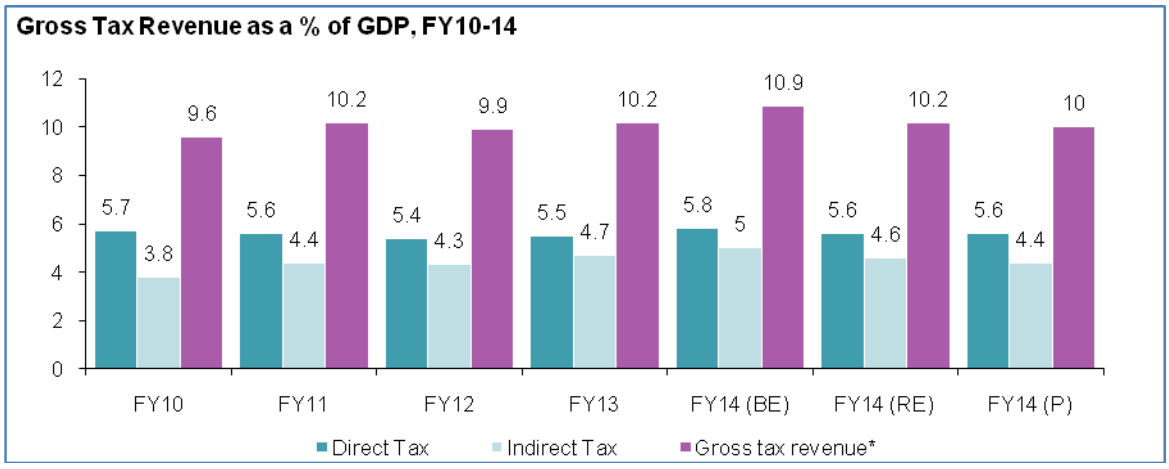


Source: Union Budget documents and Controller General of Accounts, Ministry of Finance, GoI

Notes: BE-Budget Estimates RE-Revised Estimates P: Provisional Actuals (Unaudited)

* includes Direct and Indirect Taxed and Taxes of Union Territories and 'other' Taxes

1. Direct Taxes also include taxes on expenditure, interest, wealth, gift, and estate duty



Source: Union Budget documents and Controller General of Accounts, Ministry of Finance, GoI

[10] Union Budget documents and Controller General of Accounts, Ministry of Finance, GoI

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* includes Direct and Indirect taxed and Taxes of Union Territories and 'other' taxes

1 .Direct Taxes also include taxes on expenditure, interest, wealth, gift, and estate duty

2. The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series

Need for expansion of tax base

The present tax payer base in the country is minuscule and expansion of this base is critical for several reasons. Firstly, a wider tax base is imperative for the government to achieve fiscal consolidation and a higher tax-GDP ratio. Secondly, in view of the continuing shortfall in tax collections compared with budget estimates and to meet the target of 17.7 percent growth in tax collections in FY15, it is necessary for the government to take steps in broadening its tax base.

Thirdly, expansion of the tax payer base will enable the government to undertake planned investments in infrastructure and other areas that are important for growth and development of the country. Lastly, to lower the burden on existing tax payers, the government needs to find avenues to bring in more individuals and their unreported income under the ambit of taxation.

To enhance the tax base and augment tax collection, it is pivotal for the government to focus on non-filers and uncover black money in the economy. The Income-Tax (IT) department should implement stronger mechanisms to identify persons who resorted to tax evasion and bring them under the tax net.

The newly formed government is focusing on unearthing black money within the country and that parked abroad and has announced the formation of a Special Investigation Team (SIT) for this. The IT department plans to widen the tax base by identifying non-filers, using annual information returns, capturing new information sources such as under-reporting of immovable property, etc. It also plans to track advance tax payments by top taxpayers, Tax Deducted at Source (TDS) payments by top deductors and monitor payments by entities covered under minimum alternate tax provisions.

In addition, the proposed dual Goods and Services Tax (GST) is expected to expand the tax base and simplify and harmonize the tax systems presently levied at both central and state levels. Further, the Union Budget for 2014-15 widened the service tax base to include radio- cabs and online ads, and withdrew exemptions given to services of air-conditioned contract carriages and testing of new drugs on human participants (to broaden the tax base).

The Union Budget of 2013 had announced voluntary compliance scheme for service tax defaulters and has proposed a 10 percent surcharge on those whose annual income exceeds INR 1 crore. The measure was likely to impact about 42,800 taxpayers and contribute about 1

percent additional revenue to the government. To check tax evasion, the IT Department in 2013 also issued letters to about 1.2 million non-filers[11].

Tax Administration Reform Commission (TARC) chaired by Dr. Parthasarathi Shome has released its third report which recommends measures for deepening and widening of taxpayer base. It has also been pointed out in the report that it is possible to increase the number of income tax payers from the present 35 million to at least 60 million.

[11] http://www.rediff.com/business/report/tax-dept-will-continue-sending-letters-to-non-filers-finmin/20130325.htm

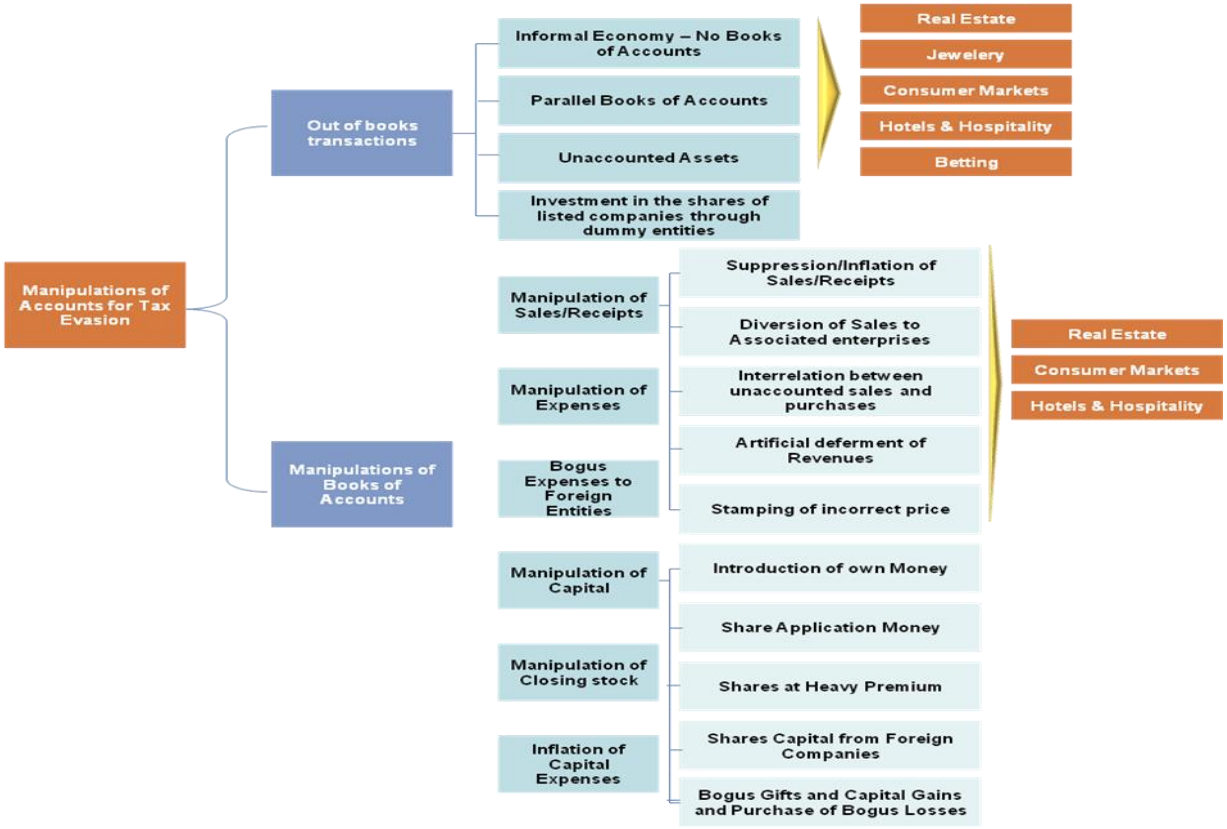
2. Generation of Black Money in various sectors of Indian Economy

Black money is a cause of concern for the Indian economy and results in huge losses in tax revenues for the government. India is the fifth leading county among the developing nations in the world with total illicit financial flows of USD 344 billion from 2002 till 2011[12].

Methods of Black Money generation

Black money generation in India primarily takes place through two sources. The first source includes those activities which are not permitted by the law, such as crime, drug trade, terrorism and corruption. The second is through a legally permissible activity but not accounted for and/or reported to public authorities which may result in tax evasion.

Tax evasion involves misreporting or non-reporting of the transactions in the books of account. The manipulation of financial statements results in the generation of unaccounted income that amounts to black money. Different kinds of manipulations of financial statements resulting in tax evasion and the generation of black money, and the likely sectors impacted, are summarized in the table below.



Source: "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012

[12] "Illicit Financial Flows from Developing Countries: 2002-2011", Global Financial Integrity report, December 2013

Manipulation of Financial Statements can take place through two different methods:

Out of Book Transactions: One of the most widely adopted methods of tax evasion, generally prevalent among the small shops, unskilled or semi-skilled service providers, etc. Transactions that may result in taxation of receipts or income are not entered in the books of account by the taxpayer who either does not maintain books of account or maintains two sets or records partial receipts only. This method is a likely source of generation of black money across Real Estate, Hotels, Consumer Markets, Retailers, Betting, etc.

Manipulation of Books of Account: In case of mandatory requirement to maintain books of accounts by taxpayers under different laws, manipulation of the books of accounts such as suppression or inflation of sales/receipts, manipulation of expenditure, capital, etc, is done to evade taxes. This method is a likely source of generation of black money across Real Estate, Hotels, Retailers and Consumer Markets.

Key sectors Impacted

About a third of India's black money transactions are believed to be in Real Estate, followed by Manufacturing, and purchase of Jewellery and Consumer Goods.[13]

The IT department detected undisclosed income worth INR 10,791.6 crore in search operations during FY14, and found unreported income of INR 90,390.7 crore in survey operations, the total figure of INR 1,01,181 crore from search and survey being more than double the figure arrived at in FY13. Seizure of Jewellery, fixed deposits and cash during the search operations was about INR 808 crore as the IT department executed 4,503 warrants and launched searches on 569 entities during this period. The number of search warrants in FY13 stood at 3,889. Real Estate emerged as the top tax evader[14].

Real estate

The Real Estate sector in India constitutes for about 11 % of the GDP[15] of Indian Economy, as these transactions involve high transaction value. In the year 2012-13, Real Estate sector has been considered as the highest parking space for black money[16].

Due to rising prices of Real Estate, the taxes applicable on Real Estate transactions in the form of stamp duty and capital gains tax may result into tax evasion through under-reporting of transaction price. This leads to both generation and absorption of black money. The buyer has the option of using 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.[17]

On indirect tax front, the State Governments levy Value Added Tax (VAT) at varying rates and Stamp duty @ 5% or more whereas the Central Government levies Service tax in the range of 3-

[13] "Black Money In India – A Conceptual Analysis", Research Paper, January 2014
[14] "Business Today Article, July 2014
[15] White Paper on Black Money, Ministry of Finance, May 2012
[16] http://businesstoday.intoday.in/story/buy-gold-with-white-cash-to-claim-refund/1/23467.html
[17] "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012

5% Service tax. The incidence of multiple taxation provides the incentive to under report/under value the transactions.

The cash generated is also absorbed by various avenues. Generally, the sub-contractors are usually hired for the job of painting or civil construction, etc. and are generally not registered with the Service tax or VAT Department. Therefore, the Real Estate seller finds it easier to dispense its black money in paying such sub-contractors in cash.

Between January and June 2012, 30 percent of total transactions in the property sector in the country were executed using black money, according to consultancy firm Liases Foras. ~80 Real Estate players were identified with INR 2,250 crore of unaccounted money in FY10, compared to 123 Real Estate groups with INR 1,950 crore of black money in FY09. [18]

Jewellery

India is one of the leading gold markets in the world and holds over 18,000 tonnes of above ground gold stocks, worth about 2/3rd of India's current GDP and represents 11 percent of global stock.[19] Therefore, Bullion and Jewellery becomes a large segment for generation of black money. The black money holders invest in bullion and Jewellery to protect the value of their black money from inflationary depreciation. Cash sales in the gold and Jewellery trade gives the buyer an option to convert black money into gold and Jewellery, 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.[20]

Nearly 70-80 % of the transactions involving Jewellery are made using cash (black money). Apart from unreported cash transactions that lead to black money, jewelers (specifically small jewelers) often sell ornaments that are made using adulterated gold. This practice also contributes to black money, as the jeweler typically does not report the full profit made by selling ornaments at premium rates (when they were made using adulterated gold, which is cheaper).[21]

Undisclosed sale of gold, silver etc. results in escapement of applicable tax liabilities

Tax authorities have estimated purchases of gold bullion and Jewellery as the second-largest parking space for black money, next to Real Estate[22]. Currently, import of gold and silver attracts a customs duty at the rate of 10%. This sector is also subject to Excise duty and VAT liability payable at the time of their sales.

In order to escape payment of customs duty at time of import, smuggling of gold, silver, etc. takes place that again requires payment in cash, which in turn is generated through the channels of unaccounted transactions.

[18] "Reuters Article, November 2012
[19] "Heart of Gold Revival", World Gold Council (WGC) report, 2010
[20] "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012
[21] "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012
[22] http://businesstoday.intoday.in/story/buy-gold-with-white-cash-to-claim-refund/1/23467.html

Further, as the smuggled items are not imported through legal mediums, the smugglers also have to make the payment illegally to their suppliers in cash. This leads to emergence of an organised payment mechanism through black money to the foreign suppliers without being tracked by the Tax Departments.

As the smuggled Jewellery is not supported by any legal documentation, any subsequent sale would also go unaccounted and thereby, would lead to generation of black money by the purchaser. These being high value transactions the amount of black money involved is also enormous.

Due to all these unaccounted transactions, the Tax Departments lose their revenue in every form of duties and taxes i.e., in the form of Customs duty at the time of smuggling, VAT and Income tax due to unaccounted sales, etc.

Consumer Goods

The Fast Moving Consumer Goods (FMCG) sector deals in a variety of products, such as soft drinks, toiletries, toys, processed food and other consumable items. In general, these goods are sold over the counter to the ultimate consumers. This sector primarily attracts Excise duty at the time of their manufacture and VAT in the event of their subsequent sales at regular intervals.

According to FICCI's study, counterfeit brands in India have resulted in a loss of over INR 16,546 Crores to the Exchequer in 2012[23]. FMCG sector is most vulnerable to these counterfeiters, as the buyers are generally average household consumers, who are ignorant of such malpractices. These counterfeiters merely copy the packaging style of a renowned brand to increase the sale of their products. Since, these products are fake in nature, the counterfeiters do not register themselves under any of the tax laws.

Even though these counterfeit products are merely copies of a branded product, its industry requires manpower, machinery and capital to manufacture these products along with other auxiliary services, such as transporters, job workers for packaging, etc. Since, the industry is not registered, it results in tax evasion of Excise Duty on manufacture and job work, Service tax on services such as transporters, VAT on sale of products.

Due to a chain of illegal transactions, the entire industry functions on black money. There is infusion, generation, investment and distribution of black money. Further, these counterfeiters are generally small manufacturers but are large in numbers. Hence, putting an end to such a practice again becomes a challenge for the Tax Departments and Government. Further, due to the region specific distribution of products, their existence also doesn’t get highlighted at a larger scale, which again creates hindrance in their identification.

In another instance, some assessees manipulate with the disclosure requirements on the products. An increase in price or reduction in volume or weight of the products is also a kind of

[23] Indian Risk Survey 2014 by FICCI at http://www.ficci.com/SEdocument/20276/report-India-Risk-Survey-2014.pdf



malpractice which creates a deviation in the information shown for taxation purpose and the actual product being sold. Due to such deviation and lack of adequate surveillance, this activity results in reduction in collection of Excise Duty on manufacture and VAT at the time of sale of products; and lead to generation of black money.

FMCG sector largely functions with the unorganised sectors that are primarily dealing in cash such as grocery stores, etc. Further, their customers are also large household consumers. Therefore, it is implied that the transactions with the end customers would be in cash, most of which would get unaccounted. This practice results in reduction in collection of duty and generation of black money. Further, the end customers are household consumers, who are not required to get registered under any of the tax laws or maintain any documentation for their purchases. Hence, cross-verification to confirm whether the entire sales have been booked becomes practically impossible.

Purchase of consumer packed goods and consumer durables from the unorganized retail channels and small consumer goods shops, without a proper bill results in the generation of black money in the industry. About 80% of grocery transactions involve black money. This is due to the large amount of cash transactions which are not reported by owners due to the unorganized nature of the industry.[24] In the absence of a bill, no local VAT is raised on the goods, and the transaction disappears from any accounting book.

E-Commerce transactions are also becoming an important source of black money generation with the growth of online retailers in India. The Cash on Delivery payment option on the online transaction is fuelling the consumption of black money. About 50% of e-commerce sales could be in black. This is because of the cash-on-delivery facility that is being offered on online shopping.[25]

Overall, about half (or nearly US$5-6 billion i.e. INR 300 – 350 billion) of the Indian consumer market revenue is unreported.

Hotels & Hospitality

The incidence of tax evasion in small and midsized hotels and restaurants/banquets is large. These institutions convince the customers to pay a part amount of the bill by way of cash, to save the applicable service and other related taxes on the transaction, thereby making some or whole of the transaction black income for them and untraceable for the tax authorities.

Restaurant sector / outdoor catering service providers for marriage, parties etc. primarily deal with preparation and serving of food as per the orders received from customers. These services / sector generally attract both VAT and Service tax.

The customers are large in number and not registered under any law, being the general consumer. Lot of dealings are in cash. Therefore, provision of food and services without raising

[24] "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012
[25] "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012

any invoice or accounting in the books is a common practice. In this way, the black money is easily utilised escaping the tax net.

Betting

Betting in sports is illegal in the country, and hence, creates a wide scope for black money generation. In India, only betting on horse racing, lotteries conducted by state governments and casinos in certain states are permissible.

According to 2012 FICCI and KPMG report, betting in India is a INR3,00,000 crore market and if taxed at a rate of 20 percent, the exchequer can earn revenue of INR12,000 crore to INR19,000 crore every year.

Betting market in India	INR3,00,000 crore
Possible rate of tax	20% of the profits
Possible revenue to the Government	INR12,000 crore to INR19,000 crore

Source: KPMG report on "Online Gaming: A Gamble or a Sure Bet", June, 2012

Cricket betting is widespread in the country and the government is losing a huge amount of tax revenue through money lost into the illegal gambling black-market. As there are no legitimate means on placing bets, hence, people resort to illegal channels such as bookies/bookmaker that facilitate gambling by setting odds, accepting and placing bets and paying out winnings on behalf of other people. Illegal betting leads to malpractices such as match-fixing or spot-fixing wherein the bookie fixes the outcome of the event in his favor by having an illegal agreement with the sportsperson. This leads to bettors being cheated at the hands of bookmakers, thereby enabling them to earn huge sums of black money.

The Indian Premier League (IPL) has been marred by betting and spot fixing scandals and involvement of huge amount of black money. As per news reports, some of the players are paid more than the payment slabs prescribed by the Board of Control for Cricket in India (BCCI), with certain amount paid through legitimate means and some in black. During the IPL 2013 season, in a sport fixing scam, several cricketers were arrested for accepting money from bookies to throw away matches.

Legalizing sports betting in the country can be seen as an effective measure to reduce the element of black money and help the government raise the tax revenue receipts. This may curtail the cases of match fixing, money laundering and crimes. An illustration of countries where betting is legalized along with the mechanism prevailing is given below:

Sr. No.	Country	Mechanism
1	USA	In the US, it is legal to bet on outcomes of sporting events, as long as the bets are placed through a registered betting

		agency. However, a few states prohibit betting. The bets are placed through a bookmaker (betting agency) who offers different odds based on the outcome of a sporting event. Bets can be placed online or in-person. Depending on the odds, payouts are made to winners. Winnings from betting are fully taxable in the US.
2	UK	Betting on outcomes of sporting events is legal in the UK. The bets are placed with a bookmaker. For an individual, winning from betting is non-taxable.

Others

Financial Market Transactions

Financial market transactions also involve black money. Black money generation can take place in Initial public offers (IPOs) through manipulations such as rigging of markets by market operators that can generate illegal money for the promoters or operators. This may involve use of shell companies and 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.[26]

Non-profit Sector and Education

Misuse of the tax incentives available for indulging in charitable activities, and manipulations through entities claimed to be constituted for nonprofit motive is among the sources of generation of black money in the non-profit sector.

The Indian education system generates about INR 48,400 crore of black money every year.[27] The major source of unaccounted money is the capitation fee used for getting admission to UG, PG, medical, engineering and other professional courses. IT authorities detected INR 288 crore of black money with educational institutes in FY10, a growth of 550 percent from FY09.

[26] "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012
[27] Investigative research report on Black money generation in Education, Centre for Research and Prevention on Computer Crimes, June 2014

3. Present Administrative system of Government to trace black money transactions[28]

With black money generation rampant across various sectors of the economy, the government has set up various administrative agencies to tackle its generation, the principal agencies being the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC).

Central Board of Direct Taxes: The CBDT and the I-T Department use tools of scrutiny assessment and information-based investigations for detecting tax evasion.

The Investigation Wing of the I-T Department carries out surveys to collect evidence of tax evasion. The department receives data relating to cash transactions in bank accounts, registered immovable property below the circle rate, and capital market transactions in the form of Annual Information Returns (AIR), which is analyzed to identify cases of tax evasion. An Integrated Taxpayer Data Management System (ITDMS) is used for analyzing data gathered from AIRs, permanent account number (PAN) database, I-T Department (ITD) applications, to unearth illegal transactions.

Central Board of Excise and Customs: CBEC, including Commissionerates of Customs, Central Excise and Service Tax; Directorate of Revenue Intelligence (DRI); Directorate General of Central Excise Intelligence (DGCEI), etc., are all engaged in the administration of matters relating to Customs, Central Excise, Service Tax, etc.

DGCEI is responsible for 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 necessary, DGCEI on its own, or in coordination with field formations, organizes operations to unearth evasion of Central Excise Duty and Service Tax. DRI is responsible for handling matters relating to violations of customs laws and anti-narcotics law.

Other regulatory agencies undertaking supervision include the Directorate of Enforcement (ED); Financial Intelligence Unit (FIU-IND); Economic Offences Wing of the State Police, Central Bureau of Investigation (CBI), Serious Frauds Investigation Office (SFIO), and Narcotics Control Bureau (NCB).

Additionally, there are co-ordinating 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.

Central Vigilance Commission (CVC) is the principal Central Government anti-corruption watchdog; with anti-corruption units of the Central Bureau of Investigation (CBI) as its principal implementing arm. The Comptroller and Auditor General of India (CAG) also provides oversight for the Central Government and central PSUs, while the State Auditor General (AG) oversees the state government and its organizations. CAG established by the Constitution of India under

[28] "Measures to Tackle Black Money in India and Abroad", Government of India, Ministry of Finance, 2012; "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012; Press search

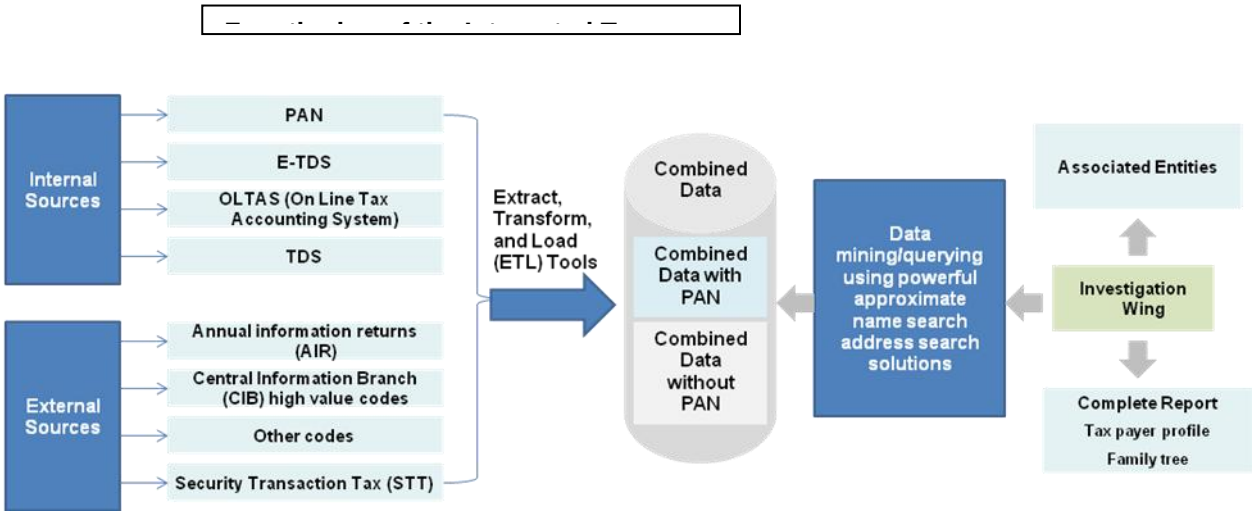
Chapter V, audits all receipts and expenditure of the central and state governments, including those of bodies and authorities substantially financed by the government. Of late, the role of CAG has come in the limelight as a result of its audit reports on the 2010 Commonwealth Games and allocation of licenses for 2G telecom spectrum and coal mining blocks.

The newly formed government has also constituted a Special Investigation Team (SIT) for unearthing black money.

In its efforts to track black money in the economy, the I-T department is gradually moving from regular search and survey operations to non-intrusive methods of data mining through electronic databases and information available through electronic portals of banking and other financial intermediaries. The department has also developed cyber forensics labs and various software tools for tracking black money.

Integrated Taxpayer Data Management System: The ITDMS is a data mining tool implemented by the I-T department that is used for detection of potential cases of tax evasion. The tool assists in generating a 360-degree profile of the high net-worth assesses by compiling information from all internal and external data sources such as AIR, TDS, and the Central Information Branch.

It has an identity search tool, 'PrimeMatch' that can handle possible variations in identification parameters such as name, address and date of birth while dealing with large data volumes. In case of an individual, the family tree of the person is also created by relating the names and addresses, and also links the information to all the related entities in which a person being investigated has interest as a partner or director. The government has implemented the tool in all 20 Directorate General of Income Tax (Investigation).



Source: Department of Administrative Reforms & Public Grievances, Ministry of Personnel, Pensions & Public Grievances, (GoI) Website



Cyber Forensic Labs and Work Stations: Cyber Forensic labs, set up in Delhi and Mumbai by the Directorate of Income Tax Investigation (DITI) with the help of Centre for Development of Advance Computing (CDAC), are equipped with advance ICT tools for gathering and analyzing electronic data and digital evidences, and helping speed up investigation of tax evasion cases. The labs help in identifying and safely retrieving relevant data found in the course of search and seizure operations and help protecting its evidentiary value. The labs also enable retrieving hidden, password-protected, and deleted files and emails from assessees' computers and giving protection against advanced software tools which get activated if the system is not shut down/started with a particular set of keystrokes.

CAIT for Focused Investigation: The Investigation Wing of the CBDT has developed a software audit tool called, Computer-assisted investigation tool (CAIT) to analyze computerized books of accounts maintained on various accounting softwares such as Tally, ERP, and SAP. The tool assists officers of the I-T Department for detecting under-reporting or mis-reporting of income by scrutinizing computerized books of digital evidence seized during search and survey operations. CAIT was implemented in 25 locations across the country in the first phase during FY12.

Data Warehousing and Business Intelligence: As part of its efforts to track black money in the country, the I-T department is implementing a new project, 'Data Warehousing and Business Intelligence', wherein a new warehouse of business related intelligence and income data would be created to enable the taxman check multiple trends of expenses made by individuals and entities. The database would collate all electronic and manual intelligence and other information collected by the investigation wings of the department. The warehouse, in addition to storing the information contained in the I-T database such as PAN card information, tax returns and banking related information will also have the ability to generate information from the open source available on the Internet.

The department, through this new data warehouse, aims to bring the portals of both its investigation and criminal investigation units on one platform, to widen the tax base and check undisclosed income. The project seeks to strengthen the non-intrusive surveillance capabilities of the I-T department and will be operational by 2015.

Database on suppression of property sales amount: Government is also contemplating forming a database of instances of suppressed property sales proceeds detected by the I-T department, to help the Controller of Stamps department arrive at an appropriate price for land in an area and discourage black money transactions[29].

In addition to the administrative systems, the government has also created a strong legislative framework for preventing the generation of black money and for its detection. Some of the government policy instruments in this regard include the Income Tax Act, 1961, Wealth Tax Act, 1957, Benami Transactions (Prohibition) Act, Foreign Exchange Management Act (FEMA), 2002, Prevention of Money Laundering Act (PMLA), 2002, Customs & Narcotic Drugs and Psychotropic

[29] The Economic Times Article – September 2014

Substances (NDPS) laws, Prevention of Corruption Act & United Nations Convention Against Corruption (UNCAC), Prevention of Bribery of Foreign Public Officials Bill, Lokpal and Lokayukta Bill, Unique Identity (UID)-Aadhaar, etc.

Goods and Services Tax Network (GSTN): 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 would include taxpayer utility, common return submission along with tracking mechanism for inter-state trade, common tax payment gateway, common registration for states VAT and Central Sales Tax [CST]) and central levies (central excise and service tax) and building interface between the GSTN Common Portal and state/centre tax systems. This system is expected to reduce cases of tax evasion.

The GSTN SPV would be substantially funded through a one-time non-recurring grant of INR315 crore from the central government towards expenditure for setting up and functioning of the SPV for a three-year period after incorporation.

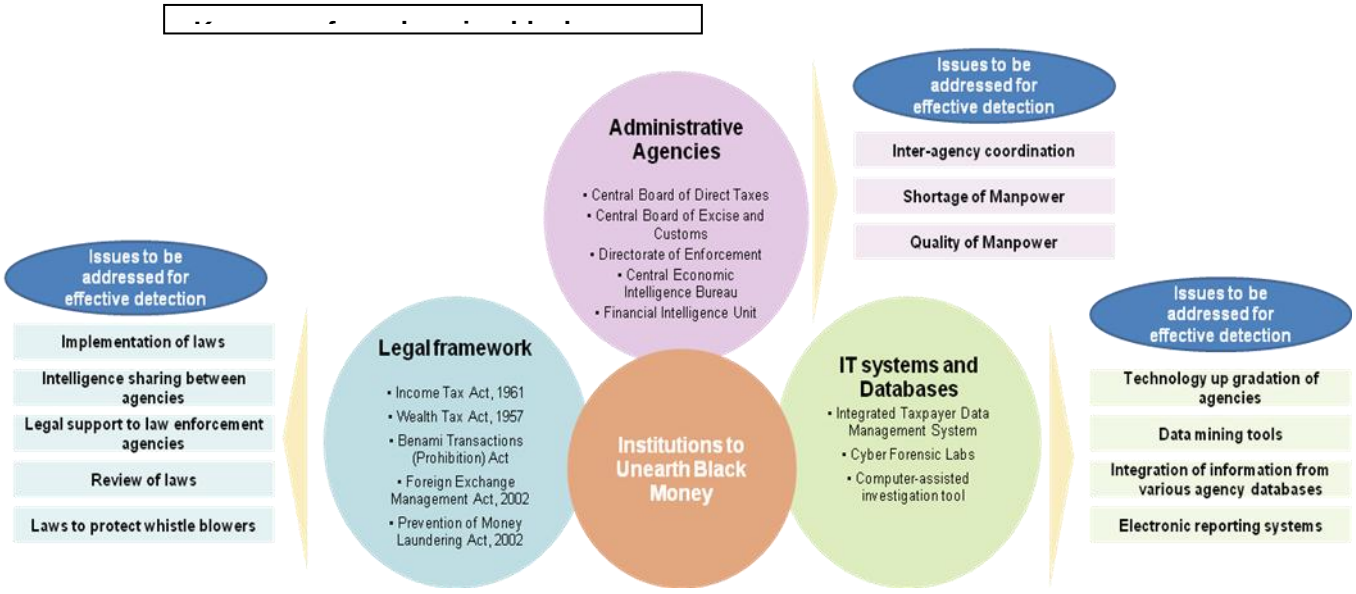
4. Why black money does not get captured[30]

The existing legal and administrative framework to deal with black money has proved to be largely ineffective, resulting in significant amounts of illicit money not being reported, or even detected. Historically, polices that have been established to curb accrual of black money have not been enforced by the agencies. In addition, systems and processes in place have been circumvented, rendering them unproductive or even obsolete in most scenarios.

Lack of effective data mining tools (used by the government) that can analyze possible cases of non-disclosure or tax evasion, is another factor acting as an impediment to reporting illegal money. For instance, the government does not have a robust database which contains information from all agencies and departments on monetary transactions and wealth generation.

Further, a large part of the Indian economy is unorganized and involves heavy use of cash transactions, which do not leave audit trails. The efforts aimed at regulating and controlling cash transactions have been in vain, largely due to a significant segment of the population being poor and hence deal in cash, particularly in rural parts of the country. Non-usage of mainstream banking channels (credit and debit cards and other instruments) for transactions hinders the tracking of illegal money exchange.

It has also been argued that auditors lack accountability when assessing income and reporting discrepancies. This effectively prevents the tracing of black money at source.



Source: KPMG in India analysis

[30] "Measures to Tackle Black Money in India and Abroad", Government of India, Ministry of Finance, 2012; "White paper on Black Money", Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, May 2012; Press search; KPMG in India analysis

The key factors that prevent tracking and reporting of black money are discussed below:-

LACK OF ADEQUATE IT INFRASTRUCTURE

Economic Intelligence agencies technologically inept: Intelligence sharing among different central economic intelligence and law enforcement agencies through the Central Economic Intelligence Bureau (CEIB) and the Regional Economic Intelligence Committees (REICs) is ineffective as the agencies are not technology-savvy and lack a common platform for information exchange. The intelligence gathering mechanisms need to be more broad-based so that the entire gamut of economic activity is captured electronically, mined and analyzed.

Lack of sufficient data mining tools and electronic reporting mechanisms: Dearth of sufficient electronic reporting mechanisms, data-mining and analysis tools hamper detection and reporting of black money. As a first step, the third-party reporting mechanism of the I-T Department needs to be computerized and cover most high-value transactions. High value transactions are reported to I-T department by the property registrars, banks, RBI, mutual fund companies, etc., through third-party reports or annual information reports. The department uses these reports to verify the information disclosed by the individual in his income tax returns.

Absence of databases to capture foreign remittances, property and Jewellery transactions: The reporting and monitoring systems to trace dealings in bullion/Jewellery through the Income Tax /Customs/Sales Tax Acts are ineffective. There is no computerized database maintaining the revenue records indicating the ownership of all property, due to which it becomes difficult to reduce the element of black money in transactions relating to immovable property. Similarly, there is no central database to capture transactions in bullion and jewellery.

Lack of a central database integrated with information from all agency databases: There is a lack of seamless integration of the systems and databases of all departments and agencies on real-time basis into a single central database. The IT department compiles information from various returns filed by tax payers such as returns of income and wealth tax, TDS, international remittances, tax audit reports, and international transactions. Information collected from different agencies such as banking and financial institutions, registrars of immovable properties, mutual fund organizations, and credit card agencies is also stored in the database of the department. Similar systems and databases are maintained by other government agencies such as the Customs and Excise Department, etc. This wealth of information from various agencies needs to be integrated into a single database. The Exchange of Information (EOI) Cell also needs to be fully integrated with the IT Department and other investigation agencies.

There is also further scope for development of electronic and net-based services and for improving the resources of tax administration, which would help in reducing the cost of compliance for the taxpayer.



INEFFICIENT LEGAL FRAMEWORK

Lack in effective implementation of existing laws: There is ineffective implementation of relevant laws like Excise, Sales tax, Anti-Corruption and Electoral laws by the concerned agencies that can curb generation of black money. Law enforcement is ineffective due to lack of close inter-agency coordination to identify the laws violated and the violators, and inefficient intelligence sharing among different law enforcement agencies.

Lack of strong legal support to agencies: The CBDT and CBEC lack complete administrative and financial autonomy in formulating tax policies for better tax administration. The legal support to various law enforcement agencies needs to be enhanced with specialized judicial machinery and speedier trials.

Money laundering laws not reviewed regularly: The existing laws dealing with violations are not comprehensively reviewed by the concerned administrative ministries on a regular basis, in view of the changing economic scenario. This results in archaic laws affecting the effective detection of black money.

Moderate regulatory and implementation laws for KYC: Lack of an effective regulatory framework by the RBI, state and central governments, and inability in ensuring stricter adherence to KYC norms leads to non compliance by banks, financial institutions and cooperatives. The non compliance in turn leads to opening of fictitious fraudulent bank accounts which are ultimately used as a source of generating and storing of illicit money.

Absence of laws: The country does not have strict laws on reporting all global transactions above a threshold limit by the entities operating in India. Absence of a law to protect whistle-blowers as well as an effective witness protection program results in loss of credible information and non-cooperation by witnesses.

LACK OF TRAINING TO THE STAFF TO IDENTIFY OR SCRUTINISE BLACK MONEY

Generally, tax evasion takes place due to the loopholes in the taxation systems. For example, a person may not show the same amount of sales in its service tax return as has been shown in the income tax return. A black money holder takes undue advantage of this situation, knowing that his chance of being caught would be the slimmest. Therefore, due to lack of training to identify such transactions, the tax officers do end up overlooking these instances.

Further, due to lack of implementation of a standard procedure and training thereon to handle concurrent transactions, tax officers adopt dissimilar approaches for similar instances of tax evasion, creating a grave possibility of skipping important issues. These trainings would enable the tax officers to have a harmonious and comprehensive approach towards identification of transactions, ensuring that none of the discrepancy in a standard is missed out.

Lack of training to adapt and handle the Information Technology Infrastructure also makes a tax officer vulnerable to a situation of tax evasion. He may not be in a position to identify the cases of apparent defaults. An inadequately trained officer finds it difficult to extract the requisite information from the system and accordingly, analyse thereafter. This approach also gives

handle to the black money holders to take advantage of this situation and carry on their activity of tax evasion without much of a concern.

The tax laws are invariably complex and constantly evolving in nature, due to amendments and judicial pronouncements. A regular and intensive training is imperative for a tax officer to be abreast with such changes and their implications. Due to such training modules and sessions, the tax officers would focus their time and energy on the issues which are relevant as per the current laws and not on the issues that have already been decided by various judicial forums. Due to lack of training, the tax officers tend to overlook the instances of tax evasions arising out of different and incorrect tax related interpretations adopted by an assessee and accordingly, this gives boost to the black money holders to invariably act in the same manner.

INEFFICIENCY IN THE FUNCTIONING OF ADMINISTRATIVE AGENCIES

Dearth of manpower: Shortage of manpower, especially in the CBDT and CBEC affects the effective functioning of these bodies. The shortage reflects in the table below.

Sl.	Name of Agency	Sanctioned Staff	Working Staff	Shortage
1	Central Board of Direct Taxes (CBDT)	57,793	42,791	15,002
2	Central Board of Excise and Customs (CBEC)	69,164	55,419	13,745
3	Central Bureau of Narcotics (CBN)	1,245	777	468
4	Directorate of Enforcement (ED)*	2,064	571	1,493
5	Central Economic Intelligence Bureau (CEIB)	113	78	35
6	Financial Intelligence Unit (FIU)	74	28	46

Source: Performance Budget, 2011

* The figures are not as per Performance Budget, 2011, but after sanction of additional manpower

Quality of Personnel: Additionally, the quality of manpower in the IT department and other agencies dealing with black money is not up to the mark – there is a lack of training on knowledge of tax laws and domain knowledge of financial investigation, IT skill sets as well as global best practices to effectively deal with black money. To address the training needs of personnel, the department is setting up a Human Resource Management System (HRMS) which would contain all information of the officers and job profile of the various posts in the department, to identify officers who require specialized training and the training requirements of all personnel.

Limited reach of Agencies: The Directorate of Revenue Intelligence (DRI) maintains constant interaction with its Customs Overseas Intelligence Network (COIN) offices to share intelligence and information through diplomatic channels on the suspected import/export transactions to establish cases of mis-declaration, which are linked with tax evasion. The scope and reach of COIN offices is limited and hence, cases of money laundering are not reported in full.

5. Suggestions to unearth black money

A. AREA/INDUSTRY WISE SUGGESTIONS

The consumer markets and the real estate sector emerge as the top sectors that witness the generation of black money in India. Suggestions to tackle the challenges of unearthing black money in each of these sectors are as follows:

1. Consumer Markets/Jewellery

A majority of the Indian consumer market is unorganized due to the presence of small businesses which largely deal in cash, both, when buying products and selling them. While FMCG companies issue invoices to such businesses at the time of selling products, an equivalent amount of sale is not reported by these entities. Moreover, this is easily concealed by such businesses as bills are generally not provided to customers, who also tend to pay for purchase using cash.

Secondly, the presence of such small shops in all corners of the county makes it a challenge for authorities to monitor them and enforce tax payments.

However, authorities can assess the amount of sales made by such entities by tracking the goods purchased by them from FMCG companies, as FMCG companies have to present an invoice to them when selling goods. The invoices can be studied to evaluate the possible sales of such stores and the amount that is unreported.

To facilitate this, a central database can be established, for the sole purpose of storing invoices issued by FMCG companies to small businesses across the country. The timely and accurate updation of the database will be the responsibility of the FMCG companies, who have the necessary resources (IT and manpower) to feed into the database. Authorities can then make use of this database to effectively monitor the purchases made by these stores and the sales reported by them. The database can then be automated to provide analysis of the invoice values reported by FMCG companies for each of the stores that they are selling to, and the sales reported by those stores. As a result, discrepancies can be quickly caught and investigated. More such tools can be developed to maximize the utility of the database, which will result in significant increase in the tax receipts from this segment.

To ensure the accuracy of invoice values fed into the database by FMCG companies, the invoices can be compared against their financial statements and reports. Discrepancies can be easily uncovered, as it is relatively easier to track the financial statements of the FMCG companies. Not only will this help authorities in tracking the sales made by small businesses, but also add another layer of scrutiny to sales reported by FMCG companies.

This approach may not work for items especially in rural areas, which generally do not involve bills/invoices, making them almost impossible to track.

Similarly, the jewellery market can also be covered more comprehensively using a similar system. Jewellers purchase raw gold against invoices, which can be tracked through a database



to assess actual sales against reported sales. Such a system can reveal the sales made by jewellers, which can be compared to sales reported by them. However, this would still leave out jewellery made out of recycled gold.

Most of the jewellers discourage use of credit cards / debit cards by levying an additional charge upto 2% for payments made against such cards vis-à-vis cash transaction. Government may provide some incentives so that dealers are encouraged to accept payments through credit card / debit card and other banking instruments. These incentives could take the form of an additional deduction from income relatable to the transaction value for calculating the tax liability or a reduced VAT.

This will create appropriate audit trails that can build strong deterrence against evasion as well as help trace black money generation.

2. Reforms in real estate

One of the major reasons for buyers and sellers to indulge in unreported cash transactions related to property is the extent of taxes that are applicable on transactions, directly or indirectly. Moreover, tax rates are considered to be high, which encourages the parties involved to withhold accurate reporting (in a bid to save money).

Therefore, a suggestion to simplify the tax structure, and possibly reduced tax rates, may discourage black money generation. If a simplified tax structure can be implemented, the parties involved will not be inclined to avoid taxation; in addition, there will also be higher incidence of reporting of full transaction value.

The tax structure can be simplified by reducing the types and forms of payment a buyer has to make during registration of a purchased property. As the registration charges and taxes are dependent on the value of the transaction, buyers under report the value to avoid paying higher taxes and charges (by making a portion of the payment in cash). This enables the parties involved to declare lower transaction values.

To overcome this method of tax avoidance, taxes and charges at the time of registration can be split into two parts — a fixed component and a variable component. Irrespective of the reported value of the property a fixed component has to be paid to civic authorities, while the variable component will be dependent on the current market prices of the property. The market price of a property will be determined by an independent government approved agency. The value of the property reported by the agency will form the basis for calculating the taxes and charges to be paid by the buyer.

Such a practice will render buyers and sellers incapable of underreporting the transaction price. As a result taxes will be paid in full. This will significantly reduce use of cash in real estate transactions. A simplified tax regime applicable to the real estate sector will also enable authorities to better detect instances of avoidance.

The Real Estate Regulation Bill is a step in the direction to make the process of approvals transparent and automated which will also reduce the scope for generation of black money.

Further the Government can also incentivize first time buyers to boost the housing sector and generate further growth of the economy.

B. DIRECT TAX SUGGESTIONS

1. Tax Collected at Source

With a view to combating large scale tax evasion by persons deriving incomes from specified business and with a view to facilitating collection of taxes from such taxpayers, the Finance Act, 1988 inserted a new Section 206C of the Act to provide for collection of such tax at source. Section 206C requires tax to be collected at source by the seller at the specified rate on certain goods like alcoholic liquor, scrap, specified minerals etc. at the time of sale of such goods. This is done in order to collect tax at the earliest point of time and to ensure more transparency in the system. Such tax has to be collected at the time of debiting of the amount receivable from the buyer or at the time of receipt of such amount from the said buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

The government introduced these provisions in the Act since a difficulty arose in assessing the income of persons who took contracts for sale of liquor, scrap, etc. In these businesses individuals, firms or associations of persons took contracts in 'benami' names by floating undertakings or associations for short periods. Moreover, at the time of assessment in these cases, either the accounts were not available or they were mostly incorrect or incomplete[31]. Thus, it became impossible to collect the tax found due, either because it was difficult to establish the identity of the persons and trace them or because of the fact that the persons in whose names contracts were taken were men of no means.

The Finance Act 2012[32] has introduced the collection of tax at source at 1 per cent by the seller in case of jewellery, if the cash sale consideration exceeds INR 0.5 million and Tax Collected at Source (TCS) on the cash sale of bullion if the cash sale consideration exceeds INR 0.2 million. The memorandum explaining the provisions of the Finance Bill 2012, provided that the provisions of TCS would apply irrespective of the fact whether buyer is a manufacturer, trader or purchase is for personal use.

Further the Finance Act, 2013 introduced withholding tax provision under Section 194-IA, which provides for tax deduction at source at 1 per cent on transfer of immovable property where the property value exceeds INR 5 million. This provision has been introduced to bring the property related transactions within the tax net which are usually undervalued and under-reported.

With a view to create an audit trail, it is recommended that the scope of Section 206C be expanded to include some more sectors where black money gets generated. Further, in line with Section 194-IA, a similar provisions should be introduced to cover more sectors where black money gets generated. However, the tax rate can be as low as Securities Transaction Tax

[31] CBDT Circular 528/1988, dated 16 December 1988
[32] With effect from 1 July 2012



(STT) or erstwhile Banking Cash Transaction Tax (BCTT) because the main aim of such type of provision is to report these transactions in the system and not to collect taxes.

2. **Expanding the scope of presumptive taxation**

Sections 44AD and 44AE of the Act are deeming provisions for the purpose of computing profits of certain specified businesses on a presumptive basis. All these presumptive taxation provisions are optional at the discretion of the taxpayer. Currently, these provisions are applicable to taxpayers engaged in the business of plying, hiring, or leasing of goods carriage and in any other eligible business.

The threshold limit for applicability of section 44AD is INR 10 million, and for 44AE applicable to taxpayers who are engaged in the business of plying, hiring, or leasing of goods carriage is on the basis of goods carriage

The rationale for introduction of presumptive based taxation is to capture more number of small businesses within the tax net and to avoid revenue leakages. There are still a large number of professionals who operate through transactions in cash and stay out of the tax net. The Kelkar Committee had identified professionals like lawyers, doctors, accountant, architects as “the missing middle”. The third report of TARC highlights the above and suggests that for these professionals, a presumptive profit estimation scheme could also be considered by the Government.

Under the presumptive taxation regime, the government may introduce slab method of tax rates to capture more number of small taxpayers for e.g. slab of up to INR 4 million – where 5 per cent may be treated as the deemed income, Up to INR 10 million – where 6 per cent may be treated as the deemed income, above INR 10 million – where 8 per cent may be treated as the deemed income.

3. Cash Economy

Cash plays an important role in generation of black money. It has always been a facilitator of black money since transactions made in cash do not leave any audit trail. Most of the economically backward sections of the society deal in cash, particularly in the rural sector, and accordingly payments on account of labour wages or those made to rural artisans and institutions need to be made in cash. Further, the costs of transaction imposed by any regulations are likely to spread across the economy and affect both consumers and producers, thereby leading to resistance and lack of support for such a move. However, given the primary importance of cash in relation to both generation and use of black money, there is no alternative but to target cash transactions in a way that will not affect those complying with the law, while making it difficult for those intending to generate and utilise black money.

It is necessary to limit high transaction and exempting those with a reasonable audit trail at either end of the transactions. Further, work needs to be done in this regard in future by way of legal curbs and regulations, that can restrict the generation and flow of black money within the economy. Another important measure in this regard could be the promotion of banking



channels including use of credit and debit cards, since they leave adequate audit trails and hence disincentivise black money generation.

With electronic transfer facilities being available to trade, one can foresee this as one of the major thrusts towards strengthening accountability and discouraging unaccounted activities. It is imperative that payment of wages and salaries in the private sector should also be through banking channels and should become cashless, in line with the government objective of financial inclusion. Government can also deliberate in providing tax incentives for use of credit/debit cards as practiced in Republic of Korea.

4. Tax on Agriculture Income

Under the existing constitutional provisions, only the State Governments are permitted to levy a tax on agricultural income which, in the existing state of affairs, is often limited in scope and is not consistently enforced in the country in the wake of different State legislations. In our view this position requires to be revisited (a) given the fact that the introduction of the GST regime will usher in a new approach to levy taxes in the country and (b) in the background of the compensation obligation undertaken by the Central Government to the States.

In our view the rural and agricultural sector is a large contributor to the cash-economy. It often becomes difficult to deal with issues of parallel economy without an effective solution to agri-economy. Taking cue from the successful partnership evolved by the Central Government with the States leading to the proposed GST regime, we propose that the State Governments be encouraged to usher suitable mechanism (while providing reasonably high level of thresholds to avoid small farmers being burdened) for increasing the scope and quantum of agricultural income tax. The increased collections will ensure that the compensation burden of the Central Government stands reduced, thereby leveraging its financial position without comprising the interests of the States. The levy would also be in line with the ability-to-pay principle as the richer farmers should not be an exception to the universally recognized principle. This may be the most effective way of migrating agri-economy related cash transactions to main stream.

C. INDIRECT TAXES SUGGESTIONS

1. Creating IT Infrastructure to track tax evasion

It is imperative that a platform is created to consolidate information pertaining to different streams of taxes i.e., Income tax, Service tax, Sales tax, Excise duty, etc., by using common means such as PAN of an assessee, etc. By using this platform as a tool, a tax officer can cross verify the information available with any other streams of tax. For e.g., identification of those assessees who are showing substantial service income in their income tax returns but are not registered with the Service tax department or are showing lesser service income in their Service tax returns.

An example of successfully deploying IT infrastructure effectively is the State of Maharashtra. Due to improved IT infrastructure, the Maharashtra VAT department has been able to identify the dealers that merely existed on paper and were only issuing fictitious invoice (also known as

Hawala Dealers). The customers were claiming credit on the strength of such fictitious invoice and utilised to discharge their tax dues. The State department cross verified the sales submitted by such Hawala Dealers against the corresponding information of purchases shown by the other dealers. This has been made possible due to recent development in IT Infrastructure by the Maharashtra VAT department. However, such facility is not available in all the States across India.

Hence, there is an urgent need for implementation of such systems across all the States in India and the information is not only freely shared within the VAT departments but interchangeably with other departments such as Excise, Service tax etc. In this way, a works contractor, whose transaction is taxable under both the levies i.e., VAT and Service tax, can be tracked down without much difficulty.

Further, there should be a system of sharing of information by the tax department governed by Central Government such as Customs, Excise and Service Tax departments with the Tax departments that are governed by the State Governments such as VAT, Entry Tax, etc. For example, a tax evasion on account concealed income should be shared with the Excise, Service tax and Sales tax department, so that an appropriate action can be taken by these Tax departments.

Implementation of IT Infrastructure also results in speedy analysis of information and ensures tracking of almost all the cases with apparent non-compliances. The speed in information processing would create facility to tackle more cases with ease. In this way, cases pertaining to tax evasion resulting in accumulation of black money can be reduced.

2. Minimising taxation on online money transfers through banking channels

Recently, the Government has clarified the levy of Service tax on Indian banks / agents engaged in money transfers / foreign exchange remittances. The Money Transfer Service Operators (MTSO) appoints Indian banks to facilitate online remittances to the beneficiaries in India. It has been clarified that the Indian banks should be considered as a service provider in India and be liable to Service tax. To recover the cost of such Service tax, the Indian banks tend to pass on this burden to the Indian beneficiaries, receiving the funds from outside India.

The additional cost of remitting funds tends to encourage proliferation of non banking channels. Hence, the Indian beneficiaries may prefer the non-banking channels for receiving the foreign remittances to escape the burden of such Service tax. These non-banking channels unofficially work parallel to the current banking system but entirely run in cash, i.e., unaccounted money. Thus, the tendency to opt for non-banking channels by Indian beneficiaries, gives rise to increase in accumulation of black money in India.

The collection of service tax may not be a substantial sum but the leakages that can be perpetrated by diverting the trade to non banking channels can have far reaching implications. Therefore, the Government should eliminate the levy of Service tax imposed on banking channels so that the beneficiaries do not hesitate to transact or receive foreign remittances in



their Indian bank accounts. In this fashion, the Government can encourage the Indian beneficiaries to opt for cost friendly Indian banking channels and enhance accountability of cash inflows within the country.

3. Verification of Electricity consumption records

Filing of electricity consumption statements by SSI units

There are instances, wherein the assessees take benefit of exemption from Excise duty available to the small scale units claiming that their production is below the threshold limit prescribed under law. Due to deficient manpower such cases are seldom scrutinised and therefore there is a high propensity to evade tax in such cases. These units are often at the lower end of the pecking order and the cost benefit analysis i.e. effort spent to recover tax vis-a-vis tax collected discourages the department to go behind such tax offenders. Therefore, there is a need to develop a mechanism which can produce tangible results with minimum efforts.

One option can be to scrutinise the electricity consumption records of such SSI units to cross verify the declared production of finished goods. In this way, the Excise department would be in a position to broadly estimate the production of finished goods and compare with the declarations made to them.

Payment of electric bills only by cheque / requirement of PAN for commercial connections

Another area to ensure accountability would be to make it compulsory for industrial units to provide their PAN numbers to the Electricity department and make payment of electricity charges compulsory by banking channels. This would bring accountability and transparency in the manufacturing / service sector. This information can be collected and analysed in case of significant discrepancy in production declaration. Further, manufacturing units which are completely outside the banking net can be brought within the ambit and made accountable. The tax evasions identified will have a cascading effect not only from Income tax but also Excise, Service tax, VAT laws perspective. Correspondingly, it may also help in identifying theft of electricity if the production data do not reconcile with the consumption of electricity required to meet the production numbers.

Sharing of electricity theft record with the tax departments

The Electricity department should also share the information of electricity theft committed by a defaulter with the tax departments which will help identify tax evaders as production and sales records are likely to be concealed in such cases.

4. **Scrutiny of companies claiming exemption from Customs Duty on import of machineries, etc.**

Certain industries like power generation, etc. have been granted exemption from Customs Duty on import of machineries required for their initial set-up. In their books of accounts, such industries claim these imports as expenditure or claim depreciation after capitalising these



expenditure. There have been instances of over valuation of machineries which enables claim of higher expenditure in their books of accounts, which in turn results a substantial reduction in Income tax liability.

As there is no inflow of Customs Duty, Customs department may not scrutinise such over-valued imports in detail. Further, even Income Tax department may allow such expenditure based on documents such as invoices, etc. In this way, these industries walk away without being noticed by any of these departments and escape huge Income tax liabilities.

Therefore, the Customs department should conduct a detailed scrutiny of parameters adopted for valuation of these exempt imports and can also share information for any discrepancy found therein with the Income Tax department. Such sharing of information, amongst the tax departments, would result in closing the loophole which enables tax evasion.

D. SUGGESTIONS ON IMPROVEMENT OF IT AND DATA/ANALYTICS INFRASTRUCTURE OF GOVERNMENT

Technology Enablement

Revenue Authorities have to ensure that taxpayer and other parties fully understand their obligations under the revenue laws. Inability of taxpayers and other parties to discharge their obligations appropriately is due to ignorance, carelessness, recklessness, and sometimes deliberate evasion.

Black money generation can be categorized into three areas:

a) Non-deliberate actions/ ignorance towards tax laws

b) Deliberate actions like misuse of tax provisions, aggressive tax planning, etc.

c) Criminal activities and fraud

Most of the non-compliance which is due to ignorance or carelessness can be addressed by educating the taxpayers and providing help to the taxpayers at lower costs. Simplification of laws in terms of reporting, and calculation of tax liability would be beneficial as well.

For the other two areas wherein the taxpayers deliberately avoid complete reporting or misuse the provisions under the laws which are primarily to benefit the industry; technology can be very helpful.

Although most revenue departments both at central and states level have been computerized long ago, but they are not able to address the issue of tax evasion and black money effectively. Most of these departments have addressed key areas like registration, reporting, filing and payments but their approach to the use of technology has been mostly myopic, as they are only targeting the population which is registered and what they report to the departments. Tax authorities in India are not effectively able to address the non-filers, under reporters of income, and areas such as crime and fraud.



Technology can be effective in these areas if we can deploy it innovatively and effectively. Technology can be very effectively deployed to do large number crunching and data analysis very quickly and effectively. Every industry has a defined value chain, and by linking the sales reported by the providers to the consumers and comparing data from other stakeholders, one can create a larger view on the actual income of a taxpayer and possibility of non-compliance if any. To be able to effectively utilize technology revenue departments must ensure that there is standardization across the country and at international level in terms of capturing of information, reporting and record keeping. Also, one needs to ensure that data from different departments can be interlinked so that if all the data is collected into one bucket it can be clearly segregated on the basis of entity/taxpayer.

Key suggestions which can be effective in detection of tax evasion and black money are:

1. Standardization of Data and Reporting Formats

The way data is captured and recorded today, across departments and across states is different. We need to define metadata standards for most of the common elements like entity, person, taxpayer, invoice etc. Also all the reporting formats should be common and standardized. This will go a long way in matching data from different sources, as most businesses operate across multiple geographies, and report to multiple departments. Also consumption data on various counts like raw material, labour cost, payments to service providers, electricity cost etc. can be used to understand the actual income and profitability of a business.

2. Electronic Book Keeping

All business activities of financial nature should be appropriately recorded and book keeping should be standardized across professions including service sectors like doctors, lawyers, etc. An environment should be developed in the country wherein various accounting software vendors like Tally, SAP, Oracle and other smaller players use these standards and get certified by some central authority. Also, there is a need to develop a low cost IT system which may be enabled through cloud computing for small businesses for use. This may be subsidized or enabled by government. Further to this, government should make enough provisions that all businesses must mandatorily use a certified software or online system for book keeping, and there should be enough controls in the systems that the reports and forms generated from these tools cannot be manually manipulated. All forms and reports which are required for compliance should get automatically generated by the accounting software without a need for any manual intervention.

3. Cross seeding of unique Identifiers like PAN, CIN, VAT number, etc.

Different revenue departments should use a common identifier for identifying an entity or taxpayer. Currently each department issues a separate unique identifier like PAN by Income Tax, VAT or Sales Tax registration number by Sales Tax department, CIN number by MCA. As of today there is no mechanism to link these. These numbers should be cross seeded across different departments so that they could link and aggregate the data and information.



4. Book Keeping of public projects through a common central IT system

The government of any country is typically also the largest employer and procurer of goods and services. We need to ensure transparency in public procurement, and their execution. There is a need to develop a central book keeping system to record all financial activities for all public projects. All goods and services procured should be recorded on the central system and all invoices generated. Transaction level data recorded in this system would be very helpful to identify cases of tax evasion and generation of black money.

5. Dematerialization of land records and property (commercial/residential/others)

Property is one of the largest generator and consumer of black money in the country. The Finance Act, 2013 introduced withholding tax provisions (Section 194-1A) with respect to transfer of immovable property. The transferee is responsible to deduct 1% tax while making payment or while crediting the sum to the account of the transferor in the books of accounts. These provisions may generate some data on immovable property related transactions, however; the same may not be sufficient. All land records and property should be dematerialized in a similar way as company shares. The same system may also be used to record all buy-sell transactions. This would help clearly establish ownership of all real estate available in the country and if required this information can be subtly made public in the form of property index.

6. Centralize documentation generation and reporting for exports and imports including banking transactions

All export and import of goods and services involves cross border transactions and is often used as channel for moving black money out of the country. All documentation that is required should be generated/ reported at a central system including the transfer of money across banking channels. Appropriate codification of goods and services along with some intelligence can help identify fake/ dubious transactions.