The black economy in india

It has been reported that, “ Black money today is created at every level of the Indian economy”. As the ‘ Parallel Economy’ is unaccounted for, the official National Income accounts do not represent the true state of the economy. In light of this statement, Give the future directives on the parallel economy and cite the practical obstacles faced on the way to fight the black economy.

INTRODUCTION

Parallel economy connotes the functioning of an unsanctioned sector in the economy whose objectives run parallel, rather in contradiction with the aroused social objectives. This is variously termed as ‘ black economy’, ‘ unaccounted economy’, ‘ illegal economy’, ‘ subterranean economy’, ‘ unsanctioned economy’ or ‘ hidden economy’.

A hidden economy in its broadest sense may consist of – a) illegal economy, such as money laundering, smuggling, etc; b) unreported economy including tax evasion; c) unregulated economy, ie economic activities outside regulations. The money laundering is a lack of transparency standards in bilateral and multilateral trade with flourishing offshore banking in tax havens has allowed it to grow unabated in past couple of decades. Experts estimate that around 50 per cent of GDP-or about Rs 33 lakh crore of black money-is generated every year through corruption at various levels. While black money which operates within the country can be productive, what goes overseas is seen as non-productive.

Impact of Black Money

The circulation of black money has adversely affected the Indian economy in several ways.

It leads to the misdirection of precious national resources.

It has enormously worsened the income-distribution. The fixed income salary class finds itself ever be the lower rung of the income-ladder as they pay taxes. They are not able to catch up with the people in business, or in professions, or many of those employed who make money by black activities. Many high placed official and honest employees earn much less than an average small shopkeeper in big cities like Bombay and Delhi.

The existence of a big-sized unreported segment of the economy is a- big handicap in making a correct analysis and formulation of right policies for it.

Black money results in transfer of funds from India to foreign countries through clandestine channels. Such transfers are made possible by violations exchange regulations through the device of under – invoicing of exports and over-invoicing of imports etc.

Black money requires for its protection, proliferation and expansion of a service organization composed of musclemen, touts and brokers to combat the forces of law and order on the one hand and on the other hand, there are income tax advisers, or chartered accountants in the pay of black money operators. There are contact men, liaison officers, Dallas , who negotiate favors from top bureaucracy and political bosses through bribes of black money.

Black money has corrupted our political system in a most vicious manner. At various levels, MLAs, MPs, Ministers, party functionaries openly go on collecting funds for party or elections. Ministers dole out favors of crores by accepting black money donations of a few lakhs from businessmen National policies are, therefore, being bent in favor of the big business under the pressure of black money.

Causes inflations- The politics of black money thus has corroded the moral fiber of Indian polity. Ministers dole out favors of crores by accepting black money donations of a few lakhs from businessmen. National policies are, therefore, being bent in favor of the big business under the pressure of black money.

Due to the pernicious impact of black money on the Indian economy and polity that the Wanchoo Committee concluded: “ It is, therefore, no exaggeration to say that black money is like a cancerous growth in the country’s economy which, if not checked in time, is sure to lead to its ruination”.

Survey on Bribery and Corruption

India lost a staggering $462 billion in illicit financial flows due to tax evasion, crime and corruption post-Independence, according to a report released by Washington-based Global Financial Integrity.

The document on the “ Survey on Bribery and Corruption” was released at the first annual fraud conference organized by the Association of Certified Fraud Examiners here on June 21, 2011. The report stated that 68% of India’s aggregate illicit capital loss occurred after India’s economic reforms in 1991, indicating that deregulation and trade liberalization actually contributed to or accelerated the transfer of illicit money abroad. Reports that wealth is stashed in offshore destinations and tax havens also goes to indicate the extent of the problem, the report said.

The KPMG India Fraud Survey 2010 suggested that today India is faced with a different kind of challenge. It is not about petty bribes, popularly known as ‘ bakshish’ anymore, but scams to the tune of thousands of crores that highlight political and industry nexus which if not checked could have far reaching impact on the economy. India has been facing governance challenges from within at various levels for a long time. “ Rigid bureaucracy, complex laws and long-drawn judicial process deter people from considering legal recourse in corruption cases. India has around 35 million court cases pending.

Besides lack of manpower and poor infrastructure facilities, other factors hindering the anti-corruption drive include lack of teeth in the legal framework,” the study said.

“ A large number of respondents stated that organizations pay bribes to win and retain businesses. This is a typical scenario where organizations tend to overlook the implications of encouraging these practices and often look only at short term benefits achieved. They fail to realize that what has worked in their favor could also land into trouble later and lead to adverse consequences for them,” the report said.

The study noted that another key area where business is impacted is in the area of mergers and acquisitions. “ Nearly 37% respondents opined that the corruption could impact the valuation of a company thereby denying shareholders of a fair price. Moreover, it could also make it difficult for them to find a suitable business partner, thereby seriously impacting the growth prospects of the business," the study said.

MEASURES TAKEN BY GOVERNMENT TO TACKLE BLACK MONEY

There is no reliable information about the money of Indians in undisclosed bank accounts outside the jurisdiction of the country. There are various estimations based on various assumptions and presumptions which may not be correct. Further there is a marked difference in the amount of these estimates.

A proposal for getting a study conducted to estimate the quantum of black money both inside and outside the country has already been approved by Union Finance Minister. The following Government institutes have been approved in March, 2011 for conducting separate studies on black money:

National Institute of Public Finance and Policy (NIPFP);

National Institute of Financial Management (NIFM);

National Council of Applied Economic Research (NCAER).

Memorandum of understanding has been signed between CBDT and each of three institutes on 21. 03. 2011. The study will be completed within a period of 18 months from the date of MOU.

Government has formulated a five pronged strategy to tackle the menace of black money which is as below:

Joining the global crusade against black money,

Creating an appropriate legislative framework,

Setting up institutions for dealing with Illicit Funds,

Developing systems for implementation (new manpower policy);

Imparting skills to the manpower for effective action (constant training for skill development).

In line with above strategy, the Government has taken several steps in the last two financial years, the details of which are discussed in the following paragraphs.

Joining the global crusade against black money:

Black money does not limit itself to the geo- political boundaries. It transcends borders and has become a global problem. The countries across the world have started a concerted global effort and as a part of global effort against black money, India has played a proactive role in pointing out deficiencies in the assessment of various countries by the Peer Review Group of the Global Forum. Government is also playing an active role in ensuring that these countries remove the deficiencies to bring more transparency. India has joined the Task Force on Financial Integrity and Economic Development in order to bring greater transparency and accountability in the financial system. India has joined as the 34thmember of Financial Action

Task Force (FATF) on 25th June 2010. FATF membership is important as it will help India to build the capacity to fight terrorism and trace terror funds and to successfully investigate and prosecute money laundering and terrorist financing offences. India has joined the Asia Pacific Group (APG)against Money laundering. The 14th annual Plenary of Asia Pacific Group (APG) was held in Kochi from 18-22 July, 2011. More than 320 delegates from 41 jurisdictions, observers and various organizations attended the Plenary which was inaugurated by the Union Finance Minister. India is the co-chair of this forum till July 2012. India has gained Membership of the Eurasian Group (EAG)in December 2010.

India has joined the Egmont Groupwhich is an international network fostering improved communication and interaction among Financial Intelligence Units (FIU). India is an active member of G 20 and has played a key role both in identifying issues and drafting communiqués. In the G 20 Seoul Summit, November 11-12, 2010, a clause “ countries to further enter into Tax Information Exchange Agreements wherever required by the partner country” was incorporated in the communiqué at the instance of India.

Creating an appropriate legislative framework:

The Government has been constantly trying to strengthen the legislative frame work to control generation of black money in the country as well as control the flight of such illicit fund to foreign shores. In pursuance of this India has so far completed negotiations of 22 new Tax Information Exchange Agreementswith various tax heavens. Nine of these agreements have also been approved by the cabinet. India has initiated process of negotiation with 75 countries to broaden the scope of Article concerning Exchange of

Information to specifically allow for exchange of banking information and information without domestic interest. As on date, it has completed negotiation with 18 existingDouble Tax Avoidance Agreement (DTAA) countries to update this Article. These agreements have also been initialed. 22 new DTAAs have also been finalized where the Exchange of Information Article is in line with the international standards. In short negotiations/renegotiations of DTAAs with 40 countries have been completed. DTAAs with Switzerland (amendment), Norway (revised), Mozambique (new), Colombia (new), Ethiopia(new), Georgia(new), Taipei(new), Lithuania(new) and Tanzania(revised) have been signed.

The protocol amending our tax treaty with Switzerland was signed on 30th August 2010 and has been approved recently by the Swiss Parliament (on 17thJune 2011). After following the mandatory constitutional process the DTAA will become operational. It will enter into force when Switzerland completes its internal process. Upon entry into force it will allow India to obtain banking information (as well as information without domestic interest) from Switzerland in specific cases for a period starting from 1st April 2011. There are certain countries or territories outside India which do not effectively exchange information with India as an anti-avoidance measure. The Government has enacted legislation to prescribe a tool box of counter measures against these non-cooperative jurisdictions. For this purpose, section 94A has been inserted into the Income-tax Act through Finance Act, 2011. This section gives an enabling power to the Central Government to notify any country or territory outside India, having regards to lack of effective exchange of information by it with India, as a notified jurisdictional area. Once the country/territory as such is notified as a non-cooperative jurisdiction, transactions with residents of such country/territory are subject to higher withholding, certain disallowances and the transactions are also subject to transfer pricing regulations. The Government has proposed the following specific new measures for unearthing black money in the Direct Taxes Code Bill: For the purpose of levy of wealth tax, taxable assets have been defined to include deposits in banks located outside India in case of individual, unreported bank deposits in case of others, interest in a foreign trust or any other entity (other than foreign company) and any equity or preferential shares held in a controlled foreign company.

The General Anti Avoidance Rule (GAAR)has been incorporated to deal with aggressive tax planning devices used to circumvent tax laws. Specific Controlled Foreign Company (CFC) rules have been incorporated to bring to tax passive income earned by residents from substantial shareholding in companies situated in low tax jurisdictions. A reporting requirement has been introduced making it obligatory on the part of resident assesses to furnish details of their investment and interest in any entity outside India in the form and manner as may be prescribed.

According to the Global Financial Integrity Report, major channel for illicit outflow is transfer of funds through mispricing which accounts for 77. 6% of total illicit outflows. The existing transfer pricing provisions of the government, which were introduced in the year 2001 are not detailed provisions as compared to transfer pricing provisions of developed countries. It was felt that there is need to upgrade these transfer pricing provisions to meet the challenges of growing intangible economy and various complex cost sharing arrangements. As per directions of FM, DGIT (International Taxation) has constituted a committee to look into the issue of revising the transfer pricing provisions. The committee has already submitted its interim report which is under consideration. The Prevention of Money Laundering Act (PMLA)was amended on 1st June 2009, whereby the predicate offences listed in the Schedule of the Act were substantially increased. This amendment has tremendously widened the scope of Money Laundering Investigations.

Setting up institutions for dealing with Illicit Funds;

Government has decided to set up Exchange of Information (EoI) Cell for an effective exchange of information to curb tax evasion. Efforts are on to put the cell in place under Foreign Tax Division of CBDT. Government has approved the creation of the Directorate of Income Tax (Criminal Investigation), in the Central Board of Direct Taxes. The DCI will perform functions in respect of criminal matters having any financial implication punishable as an offence under any direct tax law. Government has set up Income tax Overseas Units in two Indian Missions abroad. Eight more such units are being setup in the current Financial Year to strengthen information exchange mechanism. In order to augment the reach of the Directorate of Enforcement, the Government has approved upgradation of five existing Zonal offices as Regional offices and five existing Sub Zonal offices as Zonal offices. It has also approved creation of a new Zonal office and 16 new Sub zonal offices of Enforcement Directorate across the country. The Process of filling up the additional posts sanctioned by the Government as also for upgradation of the existing offices and setting up of new offices of

Enforcement Directorate has started. As per the Action Plan, the Ministry of Finance is filling up the Group A posts of the Directorate in three phases.

Developing systems for implementation:

Government has doubled the strength of Foreign Tax Division, which deals with the work of exchange of information. The Directorate of International Taxation and Transfer Pricing in the Income Tax Department have also been strengthened as major part of the flow of illicit money outside of India takes place through mispricing of international transaction. In a bid to strengthen the Enforcement Directorate, the Government has approved creation of 1318 new posts at various levels. The process of filling up of these posts has already been started by the Deptt. of Revenue.

Imparting skills to the manpower for effective action:

As a part of capacity building and skill development, 51 senior Officers were sent abroad for specialized training in the field of International Taxation and Transfer Pricing in F. Y. 2010-2011. Since skill up gradation in international tax and transfer pricing require substantial time and resource, a posting policy has been approved which provides that officers may be posted in the Directorate for the period not less than five years. Apart from the above the Government has also taken the following measures-

The Government has constituted a Committee on 27th May, 2011 under the Chairmanship of Chairman, Central Board of Direct Taxes (CBDT) to examine ways to strengthen laws to curb the generation of black money in the country, its illegal transfer abroad and its recovery. The Committee include Member (L&C), CBDT, Director Enforcement (ED), Director General of

Revenue Intelligence (DRI), Director General (Currency), Joint Secretary (FT&TR), CBDT; Director,(FIU-IND) as Members.

The Committee will examine the existing legal and administrative framework to deal with the menace of generation of black money through illegal means including, inter alia, (a) Declaring wealth generated illegally as national asset; (b) Enacting/amending laws to confiscate and recover such assets; and (c) Providing for exemplary punishment against its perpetrators. The Committee will also consult all stakeholders and submit its report within a period of six months. 6. 1 The second meeting of the Committee on the Black-Money was held on 29th July, 2011 and it has been decided that the Committee would hold its next meeting in September 2011 and in the meanwhile; (i) Letters have been written to various Industry Associations, Voluntary Organizations, ICAI, ICWAI and NASSCOM requesting them to give suggestions/views on existing legal and administrative framework available under the various laws to deal with the menace of generation of black money through illegal means, (ii) More than 3300 comments on the issue of black money have been received from the public via-e-mail which are being examined. (iii) Suggestions for improving the respective laws sent by the organizations, as well as gist of useful suggestions received through email, would be compiled and circulated. (iv) Reminders will be sent to industry and trade associations, ICAI and ICWAI for expediting their suggestion. (v)Letters have also been issued to Chief Commissioners of Income Tax (Cadre Controlling Authorities), Director Generals of Income Tax (Training), National Academy of Direct Taxes, requesting them to give suggestions/views on existing legal and administrative framework available under the various laws to deal with the menace of generation of black money through illegal means.

PRACTICAL OBSTACLES FACED ON THE WAY TO FIGHT THE BLACK ECONOMY

Pricing

Goods acquired illegally take one of two price levels:

They may be cheaper than legal market prices. The supplier does not have to pay for production costs or taxes. This is usually the case in the underground economy. Criminals steal goods and sell them below the legal market price, but there is no receipt, guarantee, and so forth.

They may be more expensive than legal market prices. The product is difficult to acquire or produce, dangerous to handle or not easily available legally, if at all. If goods are illegal, such as some drugs, their prices can be vastly inflated over the costs of production.

Black markets can form part of border trade near the borders of neighboring jurisdictions with little or no border control if there are substantially different tax rates, or where goods are legal on one side of the border but not on the other. Products that are commonly smuggled like this include alcohol and tobacco. However, not all border trade is illegal.

Consumer Issue

Even when the underground market offers lower prices, consumers still have an incentive to buy on the legal market when possible, because:

They may prefer legal suppliers, as they are easier to contact and can be held accountable for faults;

In some jurisdictions, customers may be charged with a criminal offense if they knowingly participate in the black economy, even as a consumer;

They may feel in danger of being hurt while making the deal;

They may have a moral dislike of black marketing;

In some jurisdictions (such as England and Wales), consumers in possession of stolen goods will have them taken away if they are traced, even if they did not know they were stolen. Though they themselves commit no offense, they are still left with no goods and no money back. This risk makes some averse to buying goods that they think may be from the underground market, even if in fact they are legitimate (for example, items sold at a car boot sale).

However, in some situations, consumers can actually be in a better situation when using black market services, particularly when government regulations and monopolies hinder what would otherwise be a legitimate competitive service. For example:

Unlicensed taxicabs. In Baltimore, it has been reported that many consumers actively prefer illegal taxis, citing that they are more available, convenient, and priced fairly.

Illegal Drugs

From the late 19th and early 20th centuries, many countries began to ban the keeping or using of some recreational drugs, such as the United States’ war on drugs. Many people nonetheless continue to use illegal drugs, and a black market exists to supply them. Despite law enforcement efforts to intercept them, demand remains high, providing a large profit motive for organized criminal groups to keep drugs supplied. The United Nations has reported that the retail market value of illegal drugs is $321. 6 billion USD.

Although law enforcement agencies intercept a fraction of the illegal drugs, and incarcerate hundreds of thousands of wholesale and retail sellers, the very stable demand for such drugs and the high profit margins encourages new distributors to enter the market without an increase in the retail price. Many drug` legalization activists draw parallels between the illegal drug trade and the Prohibition of alcohol in the United States in the 1920s.

In the United Kingdom, it is not illegal to take drugs, but it is illegal to possess them. This can lead to the unintended consequence that those in possession may swallow the evidence; once in the body they are committing no crime.

Prostitution

Prostitution is illegal or highly regulated in most countries across the world. These places form a classic study of the underground economy, because of consistent high demand from customers, relatively high pay, but labor intensive and low skilled work, which attracts a continual supply of workers. While prostitution exists in every country, studies show that it tends to flourish more in poorer countries and in areas with large numbers of unattached men, such as around military bases.

Prostitutes in the black market generally operate with some degree of secrecy, sometimes negotiating prices and activities through codewords and subtle gestures. In countries such as the Netherlands, where prostitution is legal but regulated, illegal prostitutes exist whose services are offered cheaper without regard for the legal requirements or procedures- health checks, standards of accommodation, and so on.

In other countries such as Nicaragua where legal prostitution is regulated, hotels may require both parties to identify themselves, to prevent the rise of child prostitution.

Learning from the Article

Through this Article we learn that:-

Introduction to Black Economy in India.

The Measures taken by Government to curb Black Economy.

The Challenges faced while tackling Black Economy

CONCLUSION

Parallel economy is a new threat for the Indian economy. In India parallel economy is expanding very rapidly. Government of India introduced commissions under Kaldor, Wanchoo, Rangnekar, Chopra, and Gupta for estimating black economy. There are many factors like Controls and Licensing System, Higher Rates of Taxes, Ineffective Enforcement of Tax Laws, Inflation, Funding of political parties etc. that influence its growth. In India amount of black money are increasing continuously which badly impacts the economic growth of the nation. Such money is a new challenge for Indian economy. Indian economy is badly affected by black money as it is underestimating GDP, increasing inequality of income, increasing illegal activities etc. Over the past 50 years, the government has at various times announced several schemes offering opportunities to bring black money overboard but the result are not so effective. Some of these schemes are: introducing the scheme of Special Bearer Bonds, demonetizing high denomination currency notes, stringent raids and scheme of voluntary disclosures. These instruments are expected to reduce the volume of the black economy.