Narrative Report on India

PART 1: NARRATIVE REPORT

Narrative India

India is ranked 47th in the 2020 Financial Secrecy Index, based on a relatively large scale weighting of 1.04 per cent combined with a secrecy score of 48.

India's affinity for informal finance is well documented. Agents move money, create companies or legitimise unaccounted transactions for a fee. Over the years, a concerted effort has been made by the government to curb malpractices and to formalise the economy. This document details the progress.

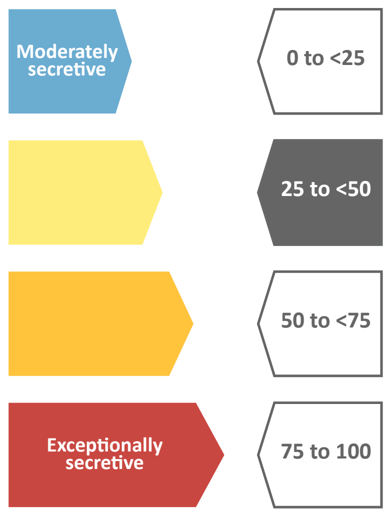
Benami: The unknown rich

India has its own term for financial secrecy - 'Benami'. When translated, benami means 'without name'. More precisely, benami entails the registration of assets in the name of a relative or employee. Dating back to the years prior to independence,[1] these transactions originated in India primarily for the purpose of safeguarding property titles from "hostile conquests and confiscations".[2] As a result, the early legal view was lenient enough to consider these 'quite unobjectionable'.[3] However, "concealment which formerly were a shelter from the strong hand of princes and adventurers"[4] in peaceful times turned into a "less ambitious but not less lucrative end of baffling creditors". Benami transactions became "court articulated institutions protecting unaccounted money".[5] High tax rates did not help the cause of financial transparency by ending this practice; until the 1970's the peak rate on personal income tax was 85 per cent with a wealth tax on top.

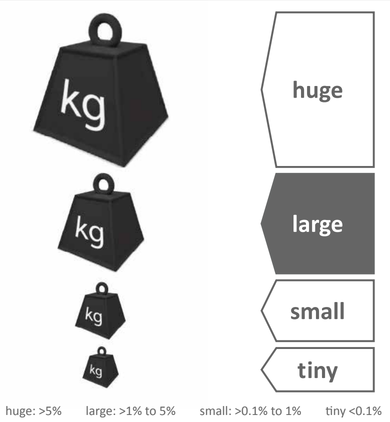
In the years following independence, these transactions posed a special challenge to the Tax Department. In one of the earliest reports on tax reform (1954), Nicholas Kaldor recommended that the disclosure of the beneficial owner should be made mandatory at the time of registration which would allow the Income Tax Department to screen all benami transactions. In spite of the fact that administrators recognised the problem, these transactions were not a punishable offence and were dealt with through three separate laws: section 281A of the Income Tax Act 196,1 defining a benami transaction; section 66 of the Code of Civil Procedure 1908; and the Transfer of Property Act, 1882. The matter came up for discussion when the select committee on Taxation Laws (Amendment) Bill 1969 recommended that the possibility of prohibiting these transactions be examined.[6] This was re-iterated in Parliament during the debate on Taxation Laws (Amendment) bill, 1971. Finally, to provide a considered view on the matter, the law commission in 1973 examined this issue in detail. Based on a thorough read of the law in India as well a survey of opinion of judges, the commission recommended that a separate law be enacted so that transactions would no longer be recognised by the law at the same time these would not be treated as an offence. Further, the commission in its report recommended that exceptions be made for past transactions. Nearly two decades have passed, and the benami Transactions Act had yet to see the light of day. In 1988 the President promulgated an ordinance that applied retroactively, thereby causing outrage. To finally bring into effect a law, the government again sought the Law Commission's opinion in order to

Rank: 47 of 133

How Secretive? 48



How big? 1.04%



India accounts for 1.04 per cent of the global market for offshore financial services. This makes it a large player compared to other secrecy jurisdictions.

The ranking is based on a combination of its secrecy score and scale weighting.

Full data is available here: http://www.financialsecrecyindex.com/database.

To find out more about the Financial Secrecy Index, please visit

http://www.financialsecrecyindex.com.

The FSI project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 727145.

If you have any feedback or comments on this report, contact us at info@taxjustice.net replace the ordinance with a bill.

On examining the matter, the commission thought it right to expand the definition of benami properties beyond immovable property, to patents and copyright. Thus, with the recommendation of the law commission and the subsequent enactment, benami transactions that had for decades been a part of Indian law, were finally called an offence, attracting penal actions such as confiscation. Notwithstanding such legal change and the reduction in tax rates, these transactions continued unfettered and the Act, though in statute, could not be operationalized for 28 years due to defects in the drafting of the law.[7] Ultimately, in 2016, the incumbent government enacted the Benami Transactions (Amendment) Act of 2016. The law finally empowered institutions, primarily the tax department, to implement the legislation. With the implementation of the Act, the authorities now have the means to uncover information on beneficial ownership. If statistics are a proof of success, post enactment the government has served notice for the provisional attachment of 140 properties for a total value of INR. 2000 million or US $30.5 million.

Shell Companies: Corporate hoodwinking

Much like benami transactions, shell companies allow beneficiaries to hide their identity. These are used by corporate entities to construct complex structures that make it difficult to trace back the ultimate owner. Such entities have existed for a while in India, with evidence of them dating back to the 1980s.[8] The city of Kolkata is among those known for the preponderance of shell companies.[9] In fact, in a recent crackdown, the Income Tax Department found that a dilapidated building, once a bustling warehouse used by the British, was the registered office to more than 90 per cent of the 300 shell companies based in the city.[10]

Over the years it is observed that on an average only 60 per cent of the registered companies filed their tax returns,[11] implying that a sizeable number of companies are registered but do not file their income tax returns. Even assuming that some of these may have turned unviable, the gap in the numbers provides some indication of shell companies in India.

Even though the use of shell companies is well known, only recently have their operations been investigated. Unaccounted incomes took centre stage in the years leading up to the 2014 elections in India. To respond to mounting political pressure, a Special Investigation Team (SIT) was set up to probe the various aspects of black money. As a part of the recommendations, the SIT, in its 3rd report, recommended the proactive detection of shell companies and punitive actions against such identified companies.[12] To anyone familiar with how these companies operate, sifting them out is comparable to finding a needle in a hay stack. Nevertheless, to make identification of shell companies easier, the government began striking off inactive companies- a recommended practice (Pieth and Stiglitz, 2016).

Legal measures have been introduced to prevent the use of shell companies as a means of hiding money. In 2013 India amended the Companies Act with sections 89 and 90 which require mandatory disclosure of beneficial interests and extend the government's right to probe the beneficial interest of companies. The amendments also adopted a definition of beneficial interest in line with that adopted by the EU and UK.[13] In addition, companies are required to maintain a register of beneficial interest which is open to inspection by any member of the company upon payment of fee. The legal changes tie in with the government's proactive stance and offer the possibility to finally tackle shell companies. In fact, various regulatory agencies considered the introduction of a definition of 'shell companies' to the respective laws. Operationalising the law through the rule, in 2019 the disclosure of significant beneficial owners was made even stricter. Any significant beneficial owner (SBO) must now provide this information to the company within 30 days of any change. Once such declaration is received, the company must file a return within 30 days. Any company with information or reason to believe that the individual is an SBO can ask for the information. If the SBO does not furnish details on request, then the company can refer the issue to National Company Law Tribunal who can in turn impose restrictions on transfers and suspend the right to receive dividends or to vote. Furthermore, failing to file declarations, wilfully furnishing false information, or suppressing material information is now punishable with imprisonment and/or a fine.[14] The Securities Exchange Board of India (SEBI) also mandates a similar disclosure by listed companies on SBO on a quarterly basis in the prescribed format as part of the shareholding pattern. This marks a significant change in disclosure norms for corporates.

Secrecy is not confined to transactions within the economy, but can be useful to those seeking to cover the trail of money slipping in and out of the economy. The illicit flows through trade misinvoicing attributable to India were estimated at US $27.5 billion in 2014, up from $142 million in 2000.[15] Evidently, illicit flows through this route have been increasing. These, however, represent only one channel. There are other alternatives such as the Hawala to move money, Swiss bank accounts to hoard unaccounted balances, as well as Mauritius to avoid tax through conduit arrangements. Each of these with their peculiarities, pose a separate challenge for the administration.

Hawala: fund flows with no paper trails

The Hawala market is an informal channel for the transfer of money. In some countries Hawala is a regulated industry, but in India it is banned under the Foreign Exchange Management Act (FEMA), 2000 and the Prevention of Money Laundering Act (PMLA), 2002.

Hawala evolved as a cheaper or swifter alternative to remit money. The beginning of this institution can be traced back to the Middle Ages where the absence of a legal framework meant that money exchanges had to rely on trust. The origins of this financial arrangement are often associated with the hundi which were the medieval equivalents of debit or credit cards.[16] These were used to transact within India and by those travelling to East Africa or by foreigners making payments for purchases of spices and clothes. The earliest evidence of the practice dates back to 1030 AD, and it continued as a medium of exchange until the British set up their own banking system and declared these as illegal in the 1830s. The hundi system thereafter went underground only to re-emerge as Hawala in the 1900s.[17] Given that it thrived in the absence of regulation, even after the institutional substitutes of formal banking emerged, Hawala did not lose its appeal. Its continued appeal can be contributed to better rates of transfer and the absence of a paper trail, making it the preferred medium for transferring illegal proceeds from crime or to launder money.

Typically, in a transaction carried out through hawala the person seeking to transfer money contacts a local agent who then contacts a corresponding agent in the recipient's country. Once the person transfers the money to the hawala agent he receives a code which he must provide to the recipient so that the cash can be retrieved from the hawala agent in his country. The agent in the recipient's country delivers the money to an agreed location upon receipt of the code. In this process money does not move across borders, and an outstanding balance exists between the hawaladars. Because Hawala is unlawful in India, the balance is often settled through illicit transactions such as misinvoicing of trade or smuggling.[18]

In the post -independence years leading up to liberalisation, strict foreign exchange controls were imposed through the Foreign Exchange Regulation Act (FERA). However, contrary to the intent, these controls led to an expansion in activity through the hawala channel. The infamous 'Jain Hawala Scandal' in 1991, led the authorities to discover diaries that contained evidence of payments amounting to INR 654.7 million made to 115 people between 1988 and 1991, including politicians and government officials.

In keeping with the mood, the liberalisation of the Indian economy in the 1990s was accompanied by a change in regulatory regime. In 1999, the Foreign Exchange Management Act (FEMA) replaced the Foreign Exchange Regulation Act (FERA). Although the new Act carried the same provisions its predecessor, the penalty became a fine equivalent to three times the proceeds, if quantifiable, or INR 200,000[19] as opposed to imprisonment as it was under the Conservation of Foreign Exchange and Prevention of Smuggling Act.[20] With the easing of exchange controls, reduction in tariffs on gold imports, and the enactment of the PMLA in 2005 the activity in the Hawala market did cool off, but the market did not disappear. In 2014, it swung back in action with the imposition of higher tariffs on gold, observed through the reported spike in hawala margins.[21]

The nearly invisible operations of the hawala agents make it impossible to quantify the volume of transactions that pass through this channel. However, as per some estimates these could be close to 30 to 40 per cent of the recorded remittance transfers.[22] Over the years, the policies adopted have sought to throttle the illegal markets, but as is evident the markets continue to exist.

Swiss Bank Accounts: Keepers of secrets

Financial as well as political scams have often led investigators to the doors of Swiss banks. In 1983, the matter of a politician having stashed proceeds from corruption in a Swiss bank account came up for a discussion in the Parliament.[23] In 2001, a Joint Parliamentary committee was set up to inquire into a stock market scam, associated with closure of banks and widespread default by brokers. Investigations revealed that an account in Credit Suisse in Zurich was operated by a company called Elista Limited registered in Nassau, Bahamas. The primary suspect in the scam-Ketan Parekh- was revealed as the beneficial owner of the company.[24]

India

With the veil of secrecy guarding such money it is difficult to be certain of the amounts held in these accounts. However, in 2010 the Swiss National Bank provided data on the value held in Swiss bank accounts by Indian nationals. According to these figures, Indian account holders had deposits totalling 1.945 billion Swiss Francs.[25] Further, in 2015, the data revealed in the Swiss Leaks scandal showed that India ranked 16th in terms of the value of bank accounts held in HSBC, Geneva.[26] On further investigation by the Indian government it was found that of the 628 cases, revealed in the scandal, the Ministry of Finance was able to take action in 427. The remaining 201 accounts were found to belong to non-residents or were untraceable. As a result of these investigations, the Indian revenue authority levied INR 29,260 million in taxes and penalties.[27] In response, the government enacted the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act in 2015. The Act targets undisclosed assets and incomes held abroad as well as the wilful evasion of tax.[28] By excluding the undisclosed foreign income and assets from total income under the Income Tax Act 1961 as well as imposing higher fines on undisclosed sums.

As is evident, the government has grappled with the misuse of Swiss bank accounts for some time. For many years, limited legal recourse was available. In case of proceeds from illegal activities such as bribe money, the Mutual Legal Assistance Treaties (MLAT) could be used to repatriate assets. India signed a MLAT with Switzerland in 1989, which could be used for cases specific to corruption. Recently, Switzerland committed to begin the exchange of information by 2018.[29] This has been a remarkable change and in 2019 India exchanged the first tranche of information on swiss bank account details of nationals.

Mauritius: A haven for seekers

In the world of offshore companies, Mauritius is a preferred route by Indian clients to move money. In 1983, India signed a double tax avoidance agreement with Mauritius. The main provision of this treaty was that the no resident of Mauritius would be taxed on capital gains arising from the sale of securities in India.[30] With the liberalisation of the economy post 1991, which was followed by relaxed rules for foreign investment inflows, substantial sums of money began to flow through Mauritius. In fact, between 2000 and 2017, Mauritius accounted for 34 per cent of the inward direct investment flows.[31] The treaty provisions made it lucrative to invest in India through Mauritius. It is known that many OECD countries routed their investment flows through India via Mauritius.[32]

The use of a Mauritian conduit company offered a sweet deal since the company was not subject to tax on sale of shares in an Indian company, resulting in no tax being liable in either India or Mauritius on investment returns from Indian companies.[33] In the famous Union of India vs. Azadi Bachao (2003) case, the Supreme Court ruled in favour of the taxpayer, stating that treaty shopping was lawful on economic as well as legal grounds. The latter was substantiated through a comparison with the India-US treaty wherein there existed an elaborate Limitation of Benefit clause.[34] Therefore, Mauritius became the perennial haven for funds looking to avoid taxes in India. Setting up companies that merely allowed the transfer of funds was a lucrative business strategy, allowing businesses in India to round-trip financial flows through Mauritius.[35] Thirty three years later, this very loophole was finally plugged through an amending protocol to the Mauritius Indian tax treaty.[36] Two major changes that took care of this problem were the source based taxation of capital gains and introduction of the limitation of benefits. The amending protocol reflects the government's commitment to bring about greater transparency in taxation.[37] Further, the implementation of the new country-by-country reporting requirements may help in identifying complex arrangements.

Hawala, Swiss Bank Accounts and offshore financial companies are all alternatives used to avoid and evade taxes in India. The secrecy of these transactions can be tackled through two important legal changes that are accepted as best practice: the Prevention of Money Laundering Act and the automatic exchange of information. In both these regards India has made progress.

Prevention of Money Laundering Act

Some studies suggest that India was probably among the first countries to introduce anti-money laundering legislation.[38] The Prevention of Money Laundering Act was enacted in 2002, finally taking force in July 2005. The enactment of PMLA was accompanied by the setting up of the Financial Intelligence Unit (FIU) in 2004. The unit is an independent body reporting to the Economic Intelligence Council headed by the finance minister. Its main responsibilities include receiving, processing, analysing and disseminating information relating to suspect financial transactions. The grounds for suspicion have been laid out in detail and include transactions lacking economic rationale or showing a sudden spurt in activity or possible link to illegal activities. The FIU is also responsible for coordinating and strengthening the efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. Although, India did make progress with the enactment of the PMLA, the peer review by the Financial Action Task Force (FATF) in 2010 did point out flaws. For example, dealers in gems and metals, lawyers, and real estate agents did not report transactions. In fact, the "know your customer" norms are still relatively lax for those operating in the gems and jewellery sector. Further the FATF noted that the list of predicate offences for money laundering excluded those related to fraud and organised crime. It also does not include certain offences under the Immoral Traffic (Prevention) Act, 1956. To address some of the concerns, amendments were made to the PMLA in 2009, 2012 and 2016. In 2009, definitional clarity was introduced along with an expansion in the inclusion of offences. With such improvements, the 2013 peer review by FATF rated India as compliant.

The FIU has been actively gathering and exchanging information. In 2017-18, India received 14,36,340 suspicious transaction reports compared to 4,409 in 2008-09. Further, the FIU processed 82,595 STRs as compared to 35,696 in 2008-09.[39] Not only is there more information now available to the authorities, but the law has also enabled the authorities to apprehend launderers. However, the success has been dismal when measured in prosecutions and convictions. As stated by the Finance Minister, in the 10 years following its enactment, 2,260 cases have been registered under the Prevention of Money Laundering Act. Out of the above-mentioned cases, the prosecution has been filed in 370 cases and two persons in two cases have been convicted for the offence of money laundering.[40]

Exchange of Information

As for the exchange of information, India made early progress. With the first Double Tax Avoidance Agreements (DTAAs) signed in 1965, with Greece, India has been actively establishing exchange of information mechanisms and exchanging information for over 40 years.[41] There are often barriers to the exchange of information that may exist in the domestic laws of partner countries. For example, the DTAAs with countries that allow for banking secrecy will not be useful since they limit the supply of information to that which is obtainable under the laws of the other contracting jurisdiction.[42]

Keeping with the international best practice and in order to overcome the limitation on the exchange of information, India signed the OECD's Multilateral Competent Authority Agreement (MCAA) for Automatic Exchange of Information (AEOI) in 2015.[43] The exchange of information relationships have already been activated with 53 countries which include Austria, Belgium and Singapore.[44] The agreement took effect starting in 2018 and will ensure the exchange of financial information[45] of individuals and entities collected from financial institutions, including information of ultimate controlling persons and beneficial owners.[46] The gathering of the information to be exchanged is regulated by section 285 BA of the Income Tax Act, 1961. The section lays down the requirements for the financial reporting of various transactions,[47] including high value cash transactions. With the exchange of information in place, it now remains to be seen what is the extent and timing of information exchanged.[48]

The administrative infrastructure has been upgraded to keep pace with such reforms. India officially set up the exchange of information cell in October 2010. This became fully operational by January 2012. Further, sections 131 and 133 of the Income Tax Act were amended in 2011 to give powers to the EOI cell.[49] India received 97 EOI requests from July 2009 till June 2012 from 22 partners. India's main EOI partners in respect of requests received are the UK, Ukraine, USA and Japan. India sent 563 requests.[50] Between 2009 and 2012 India transmitted 2 million pieces of information.[51]

Turning on the heat on auditors

After a series of banking sector scams, particularly the Punjab National Bank scam[52] originating primarily from a lapse on the part of auditors, the Indian government turned its focus on auditors. In response to the need for regulating the sector, the National Financial Reporting Authority was founded in 2018. The oversight agency can investigate chartered accountants and can take penal actions against an auditor for misconduct. This move is expected to augment financial transparency in India.

Conclusion

Secrecy is inimical to the flow of information, the necessary pre-condition for well-functioning markets. Countries in the business of secrecy break down this network of exchange, thereby frustrating the administrative efforts in other countries to clamp down illicit financial flows. India does not legitimise secrecy. In fact, the confidentiality of bank accounts prescribed in the RBI Act can be dispensed with where the law requires such disclosure.

However, India developed its own methods of disguising financial transactions through the long history of hawala and benami. The government has responded from time to time with the appropriate legislations and institutional reforms to improve enforcement. These changes were often met with resistance and took time before finally taking effect. Some success has accrued in recent times, however. The fact that sizeable unaccounted assets and incomes have been unearthed is a sign of progress. However, the threat of financial secrecy still looms. In 2016, the currency swap commonly referred to as 'demonetisation' uncovered that illicit transactions through hawala or shell companies were still thriving.

One measure that can effectively tackle financial secrecy within the economy is the effective reporting of financial information. India has introduced reforms to this effect in the past, where the Permanent Account Number (PAN), a unique ID issued by the tax department, was made mandatory to fulfil Know Your Customer requirements and would have to be quoted for specific transactions[53] such as cash deposits. However, administrative capacity remains an important challenge to the success of such an initiative. The collection of information is not enough; processing it is also necessary. The workload is overwhelming, taking for example just one agency- the Income Tax Department – the number of cases it must deal with are far too many for the officers available. In 2014, the number of officers deployed on assessment duty was 6,576[54] while the number of scrutiny assessments due for disposal was 19.96 million. While there are multiple agencies involved, there is a shortage of manpower.

India has come a long way in legally addressing various forms of financial secrecy. The preliminary evidence offers hope that light will finally shine on secrecy.

With thanks to Suranjali Tandon

Endnotes

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> *"every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of **not less than twenty-five per cent** or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (27) of section 2, over the company"* [emphasise added, S.T]

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51 CBDT manual for Exchange of Information, p.42, available at: http://www.taxindiainternational.com/pdfdocs/Manual_EoI_1.pdf; 03.07.2019.

52 https://www.livemint.com/Politics/0DcEXOEB6q7o822fWBuCbM/Cabinet-clears-setting-up-of-National-Financial-Reporting-Au.html; 04.02.2020.

53 Section 114B in the Income Tax Act, 1961 was introduced in November 1998 and has been modified since.

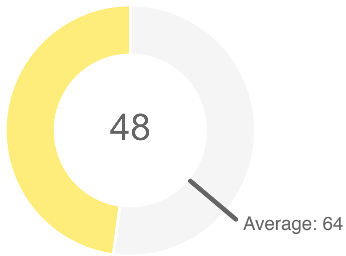
54 Union Government Department of Revenue-Direct Taxes, Report of the Comptroller and Auditor General of India, Rreport No. 3, 2016, p.83, available at: http://www.cag.gov.in/sites/default/files/audit_report_files/Union_Direct_Tax_Compliance_Revenue_Report_3_2016_Department_Revenue.pdf; 03.07.2019.

India

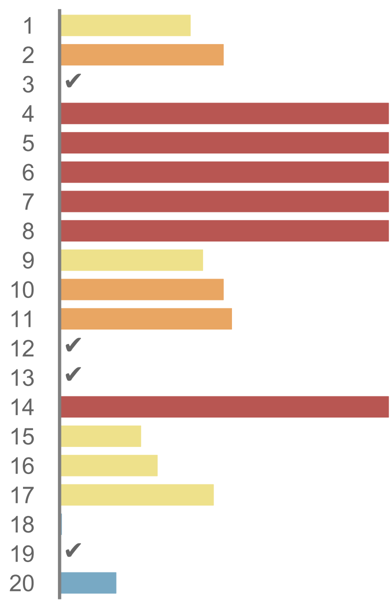
PART 2: SECRECY SCORE

OWNERSHIP REGISTRATION	40	1. Banking Secrecy
	50	2. Trust and Foundations Register
	0	3. Recorded Company Ownership
	100	4. Other Wealth Ownership
	100	5. Limited Partnership Transparency
LEGAL ENTITY TRANSPARENCY	100	6. Public Company Ownership
	100	7. Public Company Accounts
	100	8. Country-by-Country Reporting
	44	9. Corporate Tax Disclosure
	50	10. Legal Entity Identifier
INTEGRITY OF TAX AND FINANCIAL REGULATION	53	11. Tax Administration Capacity
	0	12. Consistent Personal Income Tax
	0	13. Avoids Promoting Tax Evasion
	100	14. Tax Court Secrecy
	25	15. Harmful Structures
	30	16. Public Statistics
INTERNATIONAL STANDARDS AND COOPERATION	47	17. Anti-Money Laundering
	1	18. Automatic Information Exchange
	0	19. Bilateral Treaties
	18	20. International Legal Cooperation

Secrecy Score



Key Financial Secrecy Indicators



Notes and Sources

The FSI ranking is based on a combination of a country's secrecy score and global scale weighting (click here to see our full methodology).

The secrecy score is calculated as an arithmetic average of the 20 Key Financial Secrecy Indicators (KFSI), listed on the right. Each indicator is explained in more detail in the links accessible by clicking on the name of the KFSI.

A grey tick in the chart above indicates full compliance with the relevant indicator, meaning least secrecy; red indicates non-compliance (most secrecy); colours in between partial compliance.

This report draws on data sources that include regulatory reports, legislation, regulation and news available as of 30 September 2019 (or later in some cases).

Full data is available here: http://www.financialsecrecyindex.com/database.

To find out more about the Financial Secrecy Index, please visit http://www.financialsecrecyindex.com.