



BLACK MONEY OFFSETS INDIAN REAL ECONOMIC FUNDAMENTALS; A REVIEW

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Abstract

This research article aims at bringing out the impact of black money and the reasons for the growth of black money in India. The term, 'black money' denotes unaccounted income or black income, which leads to parallel economy or unofficial economy. It certainly becomes a major menace for any country and hence, it requires regulate at the earliest. Further, it attempts to review the different conduits of black money in India and they are Non Profits Organizations (NPOs), and real estate. This article therefore researches on these two areas and their roles in generating black money in India with my suggestions. Besides these, it reviews different legislations dealing with black money in India, as introspection.

INTRODUCTION

Since economic liberalization, a number of things have changed such as most of the licensing and controls have removed; tax rates and structures have been rationalized and made more comparable with competitive global level. But still the problems of expanding black money continue to haunt the Indian economy. It has been widely discussed and debated for a number of years. Magnitude of black money has been expanded through clandestine routes, non – profit organization and real estate are two of them. Apart from this, tax exemptions and evasions are responsible to expand the size of black money. In this context, country has to adopt various measures to overcome this menace further by analyzing the root causes of what creates corruption in our system.

OBJECTIVES OF THE STUDY

1. To analyse the role and impact of black money in India.
2. To analyse the role and method of tax evasion in creation of black money.
3. To provide suggestions to control black money.

THE RESEARCH METHODOLOGY

This research study is based on secondary data and collected from different reliable sources of working papers of different agencies of the government and manuals.

THE REVIEW OF LITERATURE

The black economy named with parallel economy, unaccounted economy, unsanctioned economy, or illegal economy in India has been a matter of discussion for a number of years. Thirteen years ago the Wanchoo Committee Report depicted the phenomenon as a "cancerous growth in the country's economy which, if not checked in time, will surely lead to its ruination". Since then numerous articles have been written pointing to the various deleterious consequences of the black economy, diagnosing its causes and suggesting a wide range of remedies. A number of efforts have also been made to estimate the quantitative dimensions of the problem by various committees and institutions. Wanchoo's committee, Kadlor's committee, O.P Chopra committee and National Institute of Public Finance and Policy (NIPFP) are some of them. Besides these, Income Tax Act 1961, of Indian government has been taken a number of measures from time to time in tackling the menace by instituting several machineries and by enacting new legislations both at state and central levels.

BLACK MONEY AND INDIAN ECONOMY

India is among the top 10 developing countries in the world with a black money outflow of \$1.6 billion in the year 2010 as per the report prepared by Global Financial Integrity (GFI) in December 2012. According to the latest report released by Swiss bank, India is topped in the list with almost \$1500 billion of black money, followed by Russia \$ 470 billion, UK \$390 billion, Ukraine \$100 billion and China with \$96 Billion. India's share of black money is larger than rest of the world and if it repatriates, then it will cover up her all external debts as India's external debt accounted at US\$ 305.9 billion (17.3 % of India's GDP) by the end of March 201. It is in this condition black money becomes a real menace for India to encounter with.

THE REASONS FOR BLACK MONEY IN INDIA

Both illegitimate activities and legitimate activities generate black money. The illegitimate activities comprise both crime and corruption. The 'criminal' components of black money may include proceeds from racketeering, trafficking in counterfeit and contraband goods; smuggling, illicit liquor trade, robbery, kidnapping, sexual exploitation and prostitution; and financial fraud. The corrupt component may comprise proceeds from bribery and theft by those holding public offices – such as by grant of business and leakages from government social spending programme.

Predominantly, increase in burden of taxation with ineffective and high compliance enforcement of tax laws in respective of income tax, sales tax, stamp duty etc provide a strong temptation to involve in the black economy. Lack of tax morality, or non – compliant attitude of the citizenry towards tax laws also increase the size of black money. Besides the above, various economic activities comprising real estate, bullion and jewelry market; financial market with a strong instrument participatory note, non – profit organization and external trade are also act as a thriving source of black money. In this context, study makes an attempt to analyze the role of Non Profit Institutions (NPIs) and Real estate activities in generating black money in India, since it appears to be the important conduits of thriving black money.

NON PROFIT ORGANIZATIONS; AN OVERVIEW

The Non Profit Organizations (NPOs) are the associations of charities, co-operatives, and other voluntary organizations formed for cultural, educational, religious, professional, or other public services. Their startup funding is provided by their members, trustees, or others who do not expect repayment, and who do not share in the organization's profits or losses which are retained or absorbed. The Registration of Societies Act of 1860, Section 25 of the Companies Act 1956, the Income Tax Act, 1961, and The Foreign Contributions Regulation Act, (FCRA) are the five main laws governing the non-profit sector.

THE GROWTH OF NPOS IN INDIA

According to the report published by National Accounts Division of Central Statistics Office 2012, there were 694186 Non Profit Organizations in India, of which 433,233 were in rural areas and 260,953 were in urban areas, which are 62.4% and 37.6% respectively. The below given table shows the same.

Table: 1 Total number of NPOs in India

| | Traced Societies | Rural | Urban |
|--------------------------------|-------------------------|--------------|--------------|
| Number of Societies | | | |
| Percentage distribution | 100 | 62.4 | 37.6 |

Source: National Accounts Division of Central Statistics Office -2012

NON PROFIT ORGANIZATIONS AND INDIAN TAX POLICIES; AN OVERVIEW

The Income Tax Act, 1961 is a central piece of legislation which affects all non-profit organizations uniformly throughout India. Out of 298 sections of the Act, only a few, namely sections 2(15), 10, 11, 12, 12A, 12AA, 35, and 80G are of special importance to non-profit organizations. The income tax Act 1961 grants the exemption to both the religious as well as the charitable trusts. Any trusts formed in order to encourage the religious activity can be understood as religious trust, whereas charitable trusts have formed to encourage charitable purpose. In both case status of a trust is an “individual” for the purpose of Income Tax Law.

Section 11&12 of IT Act deals with exemption to all charitable or religious institution subjected to some conditions. Section 2(15) of Income tax act provides the meaning of charitable purpose as it includes "relief of the poor, education, medical relief, and advancement of any other object of public utility not involving the carrying on of any activity for profit". The conditions are:

1. Income should be applied to charitable/religious purposes in India.
2. Trust should register under Section 12AA with the C.I.T. or D.I.T of exemption in prescribed format along with prescribed documents within a year. But the organizations recognized under Section 10 are free from such registration.
3. Trust should spend 85% of the total income for its purpose during the year it has been received.
4. A special resolution should be passed on income set apart for specific objectives to spend it in next 5 years.
5. Accumulated income can be applied only in India.
6. Short- term or long – term capital gain of trust, should be re - invested in to new capital asset.
7. Trust should file its income annually within the prescribed time limit.
8. Trust should run an annual audit whose income for the previous year falls within the tax bracket.
9. The funds of the organization should deposit according to the forms and modes specified u/s 11(5) of the Income Tax Act.
10. Trust should keep a separate account, if it has business income.

As cited above, a trust has to invest its fund as per the modes specified u/s 11(5) and has to use 85% of its income during the year it has been received to get exemption. However, a charitable hospital or medical institution approved under Section 10 (22 A) or an education institution approved under Section 10 (22) are not subjected to these provisions to get the same.



Sec 80G (5) provides a normal deduction of 50% to the donor in respect to the donation made by him to the registered charitable trust subject to the condition that amount donated should not exceed 10% of donor's gross total income. Besides the exemption u/s 80 G(5) a donor is also entitled to get a deduction of 100 & 175% respectively for the contribution made to an eligible project as per Sec 35AC and to the institution specifically working for social and scientific research. Further, a trust gets exemption on its business income a/s 11(4)/ (4A) of IT Act, if the business activity is incidental to the attainment of objects of the trust and separate books of account have been maintained by the trust.

KEY OBSERVATIONS AND FINDINGS:

1. NPO has to file its income from different sources to claim exemptions u/s 11&12 of IT Act. Each NPO following the same to get exemption. But the quantum of income filed is suspected, because there is a propensity for manipulating the income to truncate the very intention of the provision cited above by using the unscrupulous approaches of non - declaration and under reporting which act as a strong conduit for generating black money in the official economy.
2. NPO has to invest its fund as per the modes specified u/s 11(5) and investment in shares of private company is strictly prohibited. But many NPO has been investing their funds in the shares of private companies, more over in unorganized financial sector which do not keep the record of transaction; as such investment offers mutual benefit to both investors and the issuer of securities.
3. NPO in India can be registered under a plethora of Acts. There is no central Act for registering or regulating public charitable trust. Further each state has its own Act in dealing with charity. The multiplicity of law governs charity is one of the reason behind the growth of black money in India.
4. NPO is deemed to utilize 85% of income in any financial year to get tax exemption a/s 11. This provision seems most favorable to NGO's as the income on which taxes are payable is arrived at after deducting the expenses of business from the receipts.
5. Section 10 of the IT Act states that, "the exemption would not be denied if profits are incidentally earned". This provision makes the assessee to engage in profitable activities under the name of charity because, truncation of the same is very easy if the assessee has a strong advocate to title all such profitable activities in to incidental profit.
6. A charitable hospital or medical institution approved under Sec 10 (22A) or an education institution under Sec 10 (22) need not invest its fund only in the form and mode specified under Section 11 (5). There is more chance to exploit this provision by making more investments in unorganised sector and investments may reach abroad by crossing the country's border. Later the money invested abroad may turn back to India under the name of Participatory Notes which act as a strong conduit of black money.
7. A donor is entitled to get 50% to 175% of tax exemption on total income under the various provisions in the Section 80 (G) and 35 of IT Act, because the government recognizes that these organizations performing a useful function. Truncation of this provision is also possible by generating receipts of bigger amount than actual donations to mobilize fund from public. So this provision decreases the income of an official economy and act as a "fertilizer" to the growth of parallel economy.
8. Sec 80G (5) provides a normal deduction of 50% to the donor in respect to the donation made by him to the registered charitable trust subject to the condition that amount donated should not exceed 10% of donor's gross total income. If the donation is in excess of 10%, the amount in excess of 10% cannot be considered for deduction. The provision cited above is strong enough to control the quantum of donations and there by tax exemption.
9. NPO s are allowed to run business under the conditions stipulated from time to time but separate accounts should be maintained for both and nor do they allow in cross utilizing their income. But the propensity to cross utilize the income is very high as it offers tax benefits.

SUGGESTIONS WITH RECOMMENDATIONS

1. There are a multiplicity of laws or agency governing charity for different religions, organizations, and for states, with no uniformity in the laws across states, and no consistency between laws. This makes a person to understand a complex set of legal issues, especially if an organization works across several states in India. To overcome this, study recommends the enactment of a comprehensive central law for legal incorporation of NPO.
2. Income Tax Exemptions Directorate should create a database of charitable organizations registered with it, according to size of assets, annual income, and whether the organization is receiving funds, or donating funds or both. The Annual return form could have columns to indicate this, as is being done in Canada and other countries.
3. A monitoring and evaluation system should be put in place whose objective is to improve performance, and not mere inspection. There must be more thorough monitoring, with a certain percentage of organizations being regularly visited and scrutinized.



4. A minimum number of audits, which could be determined as a proportion of the total number filing returns, must be conducted in a year, both randomly and specifically selected. For the purpose, NPOs could be put into different categories based on size of assets and annual income.
5. Recruit the adequate number of human capital in different agencies dealing with governance of NPO to curb the menace of black money through NGOs route.
6. Income Tax Exemptions Directorate should conduct operations to control the non-payment of taxes through the manipulation of expense and receipt since it has been used as a major route to get tax exemption under various provisions of IT Act. The study suggest “operation bogus voucher” to attack “bill masters”, who make inflated voucher for commission.

REAL ESTATE: AN OVERVIEW

In India, real estate sector is one of the most globally recognized sectors. It is the second largest sector employing people in India, next only to agriculture. The sector comprises of four sub sectors – housing, retail, hospitality, and commercial. Among these housing contributes 5-6 % of the country’s GDP. Real estate contributed about 6.3% to India’s GDP in 2013. And the market size of the sector is expected to touch 180 billion US \$ in 2020.

The use of unaccounted money in the real estate market in urban India has appeared as a major problem in recent years. While its dimension is not known exactly, the growing pressure of black money in many transactions of real estate is generally accepted. The incentive to evade tax is partly an offshoot of the heavy tax pressure and attendant procedures imposed on the conveyance and registration of property for real estate by a multiplicity of Central, State and local authorities. On the other hand, disruption of the functioning of land and housing market due to the Urban Land (Ceiling and Regulation) Act and the Rent Control Acts along with the insufficient information on real estate to the public seems to have substantiated the influence of black money.

The generation of black money in real estate in India is characterised, largely, to an unintended consequence of the fiscal policy implemented under the regulatory regimen encompassing also control on ownership and use of land (see, Government of India, 1979 and 1985). One of the important findings of the studies that have gone into the policy evaluation points to high incidence of tax on the real estate properties as a factor accountable for compelling the tax payers to adopt extra legal or illegal routes of avoiding or evading taxes.

REAL ESTATE TAXES/LEVIES AND BURDEN:

There is a multiplicity of taxation authorities at Centre, State and local levels. The State governments levy stamp duty, registration fees and transfer duty, urban land tax in some States, and some development authorities levy a charge on the unearned increment realized by the seller on leasehold property. The Income Tax Department of Central Government, collects the wealth tax on the assessed market value of the land and property beyond prescribed values every year, capital gains tax on the realization of profit on sale of the property according to prescribed formulae, and gift tax on gifts beyond a prescribed value; finally, the local governments impose property taxes or development charges and special levies on land and buildings. Apart from these taxes, income earned from real estate properties through rents and deposits is taxed under the personal and corporate income tax. Thus, property is subject to one-time levies like stamp duty, registration fees, gift tax, unearned increment fee, development charges etc., and recurring levies like the wealth tax, income tax, property tax and other local taxes resting on individual valuation bases.

REAL ESTATE AND INDIAN TAX POLICIES; AN OVERVIEW

Real estate transactions are one of the paramount sources for propagation and employment of black money. The Government is regularly trying to plug loop holes in such transactions by introducing various provisions from time to time in the Income Tax Act and for this, number of amendments have been implemented in the Income Tax Act in recent years. The most critical amendments in this regard are sections 56(2) (vii), section 50C and section 43CA which covers more or less all types of transactions related to transfer of immovable property. The Finance Act, 2013 has also introduced section 194IA for deduction of tax at source in case of sale of immovable property.

Section 56(2) (vii) of the Income Tax Act, 1961 deals with transmit of an immovable property being obtained by an assessee as capital assets. Section 50C of the Income Tax Act, 1961 deals with consideration sum received on transfer of immovable property held as Capital Assets. Section 43CA of the Income Tax Act, 1961 deals with consideration sum received on transfer of immovable property other than Capital Assets. Section 50C of the Income Tax Act, 1961 is applied in case of Capital Gain whether Short Term or Long Term. Section 43CA of the Income Tax Act, 1961 has been introduced in the Income Tax Act, 1961 by the Finance Act 2013 w.e.f. 1-04-2014. This section has made all the hue and cry among the real estate dealers.

There are two visible reasons for the real estate to have become the nerve centre of black money. First, the real estate properties such as land and buildings have become increasingly attractive for transaction through unlawful modes of concealment like the understatement of actual value. Second, once black money enters into the real estate market it is finding a safe haven from being caught by the tax enforcement authorities. Apart from this absence of unified method of valuation among the tax administering authorities at Centre, State and local levels and Variance in the tax rate among states also enlarge the amount of black money in real estate sector.

KEY OBSERVATIONS AND FINDINGS

- Not reporting the correct value of the property is the most prominent way of tax exemption under real estate transaction. Both buyers and sellers are benefiting from such a strategy by way of evading capital gains tax, stamp duty and registration fees. The burden arising out of imposts like high stamp duty and registering fee seem to be responsible for undervaluation of land and buildings in the documents presented for registration. To deal with such cases, the government had used to take help of provisions of the Chapter XXC of the Income tax Act, 1961 by purchasing all such suspected under-reported properties valued more than Rs 10 lakh entering the market for transfer by an appropriate authority. At present, government has been taking help of provisions of sections 56(2) (vii), section 50C and section 43CA which covers more or less all types of transactions related to transfer of immovable property.
- Splitting the transacted property to a non-reporting level is one of the most vigorous techniques of tax evasion. Process of splitting converts the property within a tax bracket in to outside the tax bracket, by dividing the transacted property under the multiple ownership of real or fictitious name. This process generates more black money in the hands of tax payer by evading it. And further this accumulated money creates a parallel economy.
- Sec 45(1) of the Income Tax Act, 1961 deals with capital gain tax. Under this provision land and buildings are treated as capital assets subjects to capital gain tax. For the purpose of the Income tax Act, capital gain is the amount by which a capital asset is sold; similar to that of stamp duty and registration fees, capital gains tax in India has given rise to the problem of under-valuation of land and buildings in the document of transfer presented for registration. Moreover, Indian experience of the tax indicates very little capital gains tax being paid after taking the advantage of many provisions of exemptions. Tax payers make it possible by keeping non – transparent share of capital gain.
- Purchase of many houses under the fictitious names so as to avoid taxes on income from house properties is one of the significant modes associated with real estate taxation. The interesting fact is that input and output of such acts are black money.
- Under reporting of rent so as to avoid taxes on income from house properties is a common mode of tax evasion by non registration of rent agreements, and non – issue of receipts by landlords.

SUGGESTIONS WITH RECOMMENDATIONS

- It is envisaged that the incentive to greater reporting of transactions and the lesser use of black money will be itself compensated for the loss of revenue due to reduced rates and simplified procedures. So the present rates of central, state and local taxes on real estate could be brought down in aggregate in order to reduce the incentive of evasion and overhaul the administrative structure dealing with real estate transactions and their registration with a view to minimize the loss of time and harassment of tax payers.
- The Registration Department could be incorporated in a single window process for the collection of stamp duties, registration charges etc. payable for the property at the time of registration of the deed. And the department should create a data base for its efficient function.
- Raising the ceiling value for declaration and increased probability of detection on under-reporting of value by adopting a uniform base of valuation for all Central and state taxes and improved coordination with Registration Department.
- Some of the state governments are revising value of stamp duty continuously and also without looking at real market value in the particular locality. The market price in a particular locality of immovable property may differ due to various factors but the stamp duty value remains the same in a particular locality. The state Government should not think about its own revenue but should also take other factors in to account regarding location of the property.
- A regular publication of area-wise property values, availability of rental housing along with rent-price and ownership housing would serve a useful purpose for reducing the price setting role of real estate agents.
- The role of small real estate developers and builders who concentrate in 'near city-centre' pockets needs to be monitored closely.

CONCLUSION

In India, amount of black money is rapidly increasing, which badly impacts the economic growth of the nation. It has debilitating effects on growth of institutional governance system in many respects. Such money became the new challenge



for Indian economy. It is also an originator of big loss in tax revenues for the government of India. To tackle and fight against this menace is extremely difficult.

In this study, an attempt has made to understand how the various provisions of Income Tax Act, 1961 relating to tax exemption on Real estate and NPO helps to accumulate the black money. Besides this, study has put an effort to examine the magnitude and impact of black money. NPO and Real estate becomes responsible for the growth black money, since it provides number of tax exemptions and it largely account for tax evasion. Multiplicity of law governing charity, multiplicity of taxation authority on real estate is act as the major problems in this respect. Moreover, India lacks a strong database for efficient functioning.

The major observation of the study is that, tax payers at NPO and Real estate follows common approaches to evade tax in the form of non reporting of income, manipulation of expenses and revenues in tax heavens, maintenance of two books of accounts and non- entering of transactions. This kind of measures can attract a number of penalties under Income Tax Act, 1961. These penalties are imposed under section 276C and 278. Penalties include fine and, or, imprisonment ranging from three months to seven years. But these penalties have to prove to be a deterrent. Study strongly suggests that exemptions need to be carefully designed and justified with sound social system and economic reasons.

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