**3. BLACK MONEY, FINANCIAL TRANSPARENCY AND INTERNATIONAL TAXATION**

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| **Highlights**   * The Union Budget has limited cash donations made to political parties to Rs. 2,000. Donations larger than Rs. 2,000 are to be made by cheque, digital modes, or through electoral bonds. * Cash transactions have been limited to Rs. 3 lakh. Transactions above this limit should be made through cheque and other digital forms of payment. * The Income Tax Department has been taking several measures such as amendment of Double Tax Avoidance Agreements and implementation of General Anti-Avoidance Rules, that have not found mention in the Union Budget 2017-18. * New laws have been announced to confiscate property of economic offenders and to address illicit deposit schemes. |

**Political Party Financing**

The Union Budget, for the first time, acknowledged the significance of transparency in funding of political parties in a democracy. With regard to this, the Union Budget proposed the adoption of Election Commission’s recommendation, capping the maximum amount of cash donation that a political party can receive from one person at Rs. 2,000. This is a decrease from the previous limit of Rs. 20,000. Political parties shall continue to receive donations larger than Rs. 2,000 by cheque or other digital modes from their donors.

The Union Budget has also proposed an amendment to the Reserve Bank of India Act to enable the issuance of ‘electoral bonds’ that may be purchased by donors from authorised banks against cheques and digital payments. These electoral bonds shall be redeemable only in the designated account of a registered political party.

This is a welcome move toward transparency in political funding in India. However, a few concerns must be addressed to further enhance transparency in the funding of political parties, thereby curbing the further generation of black money:

* In line with the Union Budget’s announcements, political parties must be required to submit details of all donations above Rs. 2,000 received to the Election Commission.
* Full details of donors should be made available in the public domain. This is done in countries such as Bhutan, Brazil, Bulgaria, France, Germany, Italy and Nepal.
* This initiative must pave the way toward state funding of elections, which will contribute significantly toward fair elections and the strengthening of democracy.

**Limits on Cash Transactions**

The Union Budget has proposed the adoption of the recommendation of the Special Investigation Team on Black Money to limit all cash transactions to Rs. 3 lakh. This proposes that a person may not receive an amount of over Rs. 3 lakh in cash from a person in one day, with respect to a single transaction, or with respect to transactions relating to one event or occasion from one person.

However, effective implementation of this proposal is key. Tracing cash transactions above the prescribed limit of Rs. 3 lakh remains difficult, and it remains to be seen whether larger cash transactions can be monitored.

**Demonetisation**

In November 2016, high denomination currency notes of Rs. 1,000 and Rs. 500 were declared illegal, with the stated aim of eliminating black money, tackling counterfeit currency and curbing terrorist financing. There is little data or indicators available in the public domain regarding its impact on black money. The Union Budget 2017-18 was expected to provide data regarding the impact that demonetisation had on the stated objectives of the announcement. The Union Government should make the data on total currency that has not been deposited in banks or exchanged, number and value of declarations made under the Income Declaration Scheme announced after demonetisation, and the impact on the tax base of the country and on black money.

In this context, the Income Tax Department has launched Operation Clean Money on January 31, 2017. The Department has identified Permanent Account Numbers against which cash deposits were found to be disproportionate with declared income. The Central Board of Direct Taxes expects such citizens to provide an explanation online. This may encourage the widening of the tax net and avoid underreporting of taxable income.

**Tax Avoidance**

Tax avoidance by multi-national corporations (MNCs) has been a grave issue faced by India. The Union Government and the Income Tax Department, Ministry of Finance have taken a number of steps through 2016 to address domestic and international tax avoidance. However, these measures did not find mention in the Union Budget 2017-18, including:

* Amendment of Double Tax Avoidance Agreements (DTAAs) and Bilateral Investment Treaties (BITs): DTAAs and BITs have been misused to avoid taxes, round tripping of black money and reinvestment in India using tax havens, and treaty shopping. To address these gaps in the existing DTAAs and BITs, several agreements have been amended, for instance, with Mauritius, Cyprus, Singapore, etc. Negotiations are underway for amending more agreements.
* Implementation of General Anti Avoidance Rules (GAAR): GAAR did not find mention in the Union Budget 2017-18. However, GAAR will come into effect from April 1, 2017. GAAR may be invoked in any financial transaction which is deemed to have been carried out primarily  to avoid tax. Due to its wide scope, it is expected to plug the gaps where the existing regulation are not able to deal with particular instances of tax avoidance.
* Income Disclosure Schemes: Several windows were provided under Income Disclosure Schemes to citizens, allowing them to voluntarily disclose their previously undeclared income and pay tax along with stipulated penalty. These windows were offered to encourage tax compliance, simultaneously collecting taxes due on previously undisclosed income.

**Financial Regulations**

The past few years have witnessed a number of revelations of financial crimes, exposing the underbelly of financial secrecy, including the Panama Papers, fraud deposit schemes, chit fund scams, wilful defaulters, etc. The Union Budget 2017-18 has announced a new law for confiscation of property of economic offenders, and a new law to deal with illicit deposit schemes. These two announcements are welcome. However, even with the required legislation in place, there is scope for improved efficiency on part of law enforcement agencies and the judiciary. Hence, for successfully curtailing current and future case of such financial crimes, the Union Government must initiate necessary reforms related to law enforcement agencies and the judicial system.

**International Taxation**

With increasing globalisation and integration of India’s economy with the rest of the world, the role of international taxation has become important. Loopholes in domestic and international tax laws are often exploited by MNCs to avoid paying their fair share of taxes. Strengthening the government’s commitment towards the Base Erosion and Profit Shifting (BEPS) project led by G20 and the Organisation of Economic Co-Operation and Development (OECD), there were two announcements in the Union Budget on these issues:

* Alignment of the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices
* Capping the interest payment to a related entity at 30% of earnings before interest, taxes, depreciation and amortization

In addition, there are a few global policy measures regarding international taxation that have been considered or adopted in India, including:

| Issues Relating to International Taxation | Global Standard | Status of Implementation in India | Key Policy Asks |
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| Automatic Exchange of Tax and Financial Information between Jurisdictions:  Criminals and tax evaders take advantage of a porous financial system, and illicit money can transcend borders with the click of a button. Efforts on part of government authorities however, continues to be constrained by national borders. Existence of tax havens and an army of tax lawyers and bankers facilitate financial secrecy and enable people to move their assets offshore. | The OECD and the G20 have devised the standard for exchanging tax information automatically, under the Common Reporting Standard. This measure is termed Automatic Exchange of Information, allowing exchange of financial information like names, addresses, tax identification numbers and account balance at regular intervals with the account holder's country’s government. | India joined the standard of Automatic Exchange of Information in June 2015. One of the early adopters of the standard, India will start exchanging information with other countries, and receive information regarding Indian citizens' assets abroad starting September 2017, on an automatic and periodic basis. This is an improvement over the previous standard, where the Indian tax authorities had to request information on a case-by-case basis. | 1) All jurisdictions, including India, should collect and publish aggregate statistics of foreign assets they hold, regardless of whether the account holders' home country has joined the standard for Automatic Exchange of Information. Such data would not breach confidentiality. Rather, it would enable a better understanding of the size and composition of offshore financial centres and how it is changing over time.   2) The information received should be shared between different enforcement agencies within India, to fight corruption and money laundering. |
| Registry of Beneficial Owners (True Human Owners) of Companies:  In most countries across the world, company registration laws do not require ownership information. This results in a spider web of anonymously held companies, enabling embezzlers, arms traffickers and drug dealers to be business owners, without being identified as the ones ultimately controlling or profiting from such companies. Anonymous companies, perfect for hiding ill-gotten money, more often have few employees and do not conduct any real business. | In 2016, the United Kingdom became the first country to create a fully public registry of beneficial owners of companies incorporated there, in open data format. This registry identifies the true human owners of all companies registered in the U.K. Afghanistan, Austria, Denmark, France, Kenya, Netherlands, Nigeria and Ukraine have signalled their support for public registers of beneficial owners. The European Union has also ruled on creation of national-level beneficial ownership registries throughout the Union. | India has introduced a provision for creating a registry of beneficial owners of companies registered in India, in the Companies (Amendment) Bill, 2016. The provision requires all companies to file a return of their ‘significant beneficial owners’ who own 25 percent of shares, with the Registrar of Companies. This bill was then referred to the Parliamentary Standing Committee on Finance, which has in its report retained the provision on creating the registry of beneficial owners. The Bill is yet to be passed in Parliament. | 1) The Indian registry of beneficial owners should be available in the public domain, for citizens to have information regarding the persons who ultimate control and profit from companies.  2) There is a need to lower the current threshold of 25 percent ownership of shares in a company to be recognised as a beneficial owner. An individual wishing to remain anonymous would only need to appoint three individuals to represent themselves as beneficial owners. The presence of a 25 percent threshold is vulnerable to abuse and should be lowered to 10 percent. |
| Country-by-Country Reporting of Multi-National Corporations' Operation and Tax Data:  There is a lack of clear and transparent information about the operation of MNCs. Currently, MNCs are able to exploit loopholes in domestic and international tax laws to shift their profits from one country to another, often through tax havens, with the goal of avoiding paying their taxes in jurisdictions where they create value. MNCs report on their profits, revenue, taxes paid and number of employees in an aggregate manner, which does not clarify a corporation’s operations in a specific country. | The G20-OECD BEPS project requires MNCs with an annual consolidated revenue of over 750 million Euros (about Rs. 5,300 crore) to report information regarding revenue accrued, profits, taxes paid, number of employees, assets, etc. in a disaggregated, country-by-country basis. This greatly enables governments across the world to ensure that MNCs operating in their jurisdictions pay their fair share of taxes, spot irregular information and activity that needs further investigation. | India announced the adoption of Country-by-Country Reporting requirements for MNCs in the Union Budget 2016-17. The new documentation regime applied from April 1, 2016 with the first filing due by November 30, 2017. There were also penalties attached with non-disclosure or inaccurate information. | 1) The threshold of Rs. 5,300 crore required to report MNCs’ operation details is extremely high, resulting in only 45-47 companies in India being required to report their data on a country-by-country basis. There is therefore a need to lower the reporting threshold to include more MNCs in the net.  2) Country-by-country reports should be available in the public domain, providing information to a wide range of stakeholders, helping strengthen efforts to monitor corrupt practices, corporate governance and responsibility. Transparency in the operation of MNCs would facilitate an equitable financial system. |

However, the BEPS project does not adequately address developing countries’ differentiated concerns regarding the various ways in which they lose revenue. Particularly, the transfer pricing guidelines suggested by BEPS through its Country-by-Country Reporting guidelines are complicated and expensive for developing countries to implement. The standards that the BEPS project seeks to implement in countries across the world have been shaped by 35 rich and powerful OECD member countries. This also raises the question of the design of international institutions that form the norms of international taxation, as this runs the risk of benefiting rich countries and leaving developing countries out of the process.