STASHING THE CASH: BOOK REVIEW

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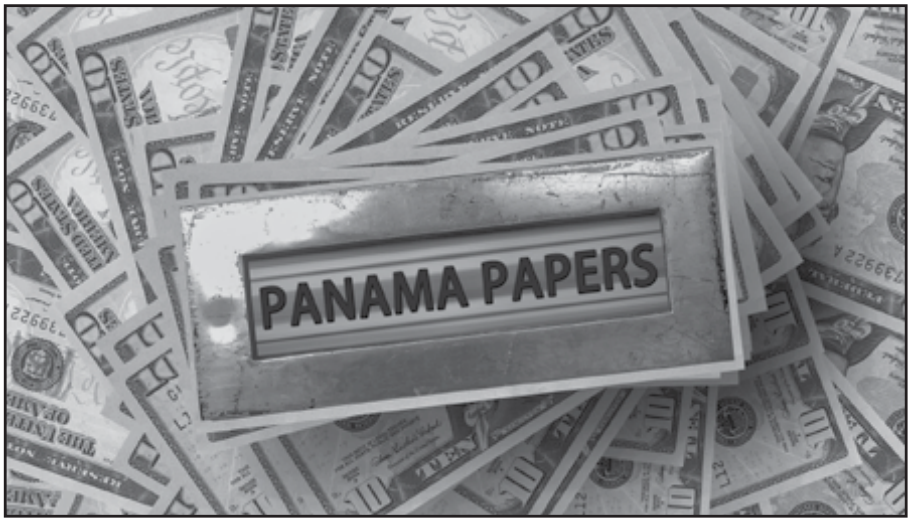

Black Money and Tax Havens

Author: Prof. R. Vaidyanathan, Publisher: westland publications ltd., First published in 2017, Price: ₹ 350, Pages: 184

Whitney Milam in her article, *The Global 1% Is Destroying Democracy: Unraveling a web of dark money,* notes that, "Weak transparency measures in the West allow elites from corrupt authoritarian countries to construct a mask of legality and respectability so that their illicit cash can circle the globe incognito." She then goes on to explain this phenomenon and estimate the worth of this illicit cash: "After all, offshore banking and anonymous shell corporations are perfectly legal, and in a digitized world that's more interconnected than ever before, these methods have never been easier. Estimates of total offshore wealth vary, but they're in the trillions, with *Forbes* estimating last year that a full 10 percent of global GDP is kept offshore."[1]

There is no doubt that transparency of money across the world is lower than ever before and it is affecting both citizens and democracies. *Black Money and Tax Havens* offers to plug our awareness gap on hidden wealth by offering both theoretical perspective as well as evidence-based research (viz. case studies) on a variety of interlinked fields like black money, round-tripping of illicit funds and role of tax havens under modern day capitalism. Written lucidly and heavily referenced, Prof. R. Vaidyanathan's work can serve journalists, researchers and policy-makers in understanding the complex world of black money and how it travels to various tax havens and offshore financial centres like Antigua, Switzerland, Bahamas, Liechtenstein, Isle of Man, St. Kitts etc.

After consulting different definitions as provided by international experts in their studies and reports, the author defines black money as assets or resources that have neither been reported to official agencies at the time of their creation nor revealed at any point of time during their possession. People do not report black money for a variety of reasons, chief among which is high tax rates. They also shield their wealth from home governments when black money is generated from corruption and payment of bribes, on account of over-invoicing of expenditure and under-invoicing of receipts and when the rule of law (including tax laws) is ineffective in a country.

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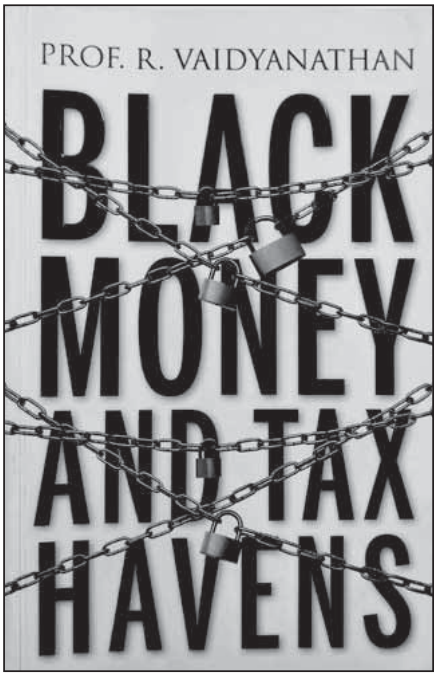

There are numerous processes through which illicit cash is generated. Transactions related to real estate, financial markets, bullion and jewellery, as well as cash also contribute to unreported income. The problem is exacerbated with a greater proportion of high-denomination currency notes, infusion of counterfeit currency and trade-based money laundering (in which trade misinvoicing plays a role).

The author, retired professor at IIM Bangalore and committee member of regulatory bodies such as Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI), has expertise in domains of finance, especially in banking, insurance and capital markets. Not surprisingly, he has provided various estimates of the black money volume in India, as has been calculated by various committees and eminent economists at different time points since the early 1960s. Based on media reports about the unreleased study by the National Institute of Public Finance and Policy (NIPFP), the author has stated here that black money constituted nearly 42 percent of total GDP or about 71.5 percent of 'reported' GDP (as mentioned in the NIPFP study).

For a layperson, a country can be termed as a tax haven if it imposes little or no tax on individuals and corporations. The literature survey done by the author reflects that it is difficult to define tax havens. In short, there cannot be a universal definition for tax havens. For example, after finding it difficult to define a tax haven in its December 2008 report, the United States Government Accountability Office has regarded certain characteristics as indicative of it. The broad markers of these havens are no or low tax rates, lack of transparency in the operation of legislative, legal or administrative provisions, dearth of effective exchange of tax information with foreign official agencies, lax regulations regarding a substantive local presence and self-promotion as an offshore financial centre.

Prof. Vaidyanathan has outlined tax havens on the basis of their various functions such as scope, exemption rules, business model and secrecy. Illicit financial flows from high tax rate countries like China Mainland, Thailand, Brazil, Malaysia and India to low or no tax rate countries or tax havens such as the Cayman Islands, British Virgin Islands, Mauritius, Monaco etc. have compelled governments around the world to sign tax treaties. However, the author believes that tax treaties do not really have an impact on the complex high-risk financial structures of tax havens; instead tax treaties make offshore financial centres more sought after locations by high net worth individuals and multinational corporations (MNCs).

Once vast flows of black money are channelled out from the origin country (through methods like over-invoicing of imports and under-invoicing of exports), they are invested back by a secret company or entity located in some tax haven (preferably a country like Mauritius with whom India has Double Tax Avoidance Agreement—DTAA) in the form of portfolio investment.

Foreign portfolio investors who are registered with SEBI issue

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Participatory Notes or p-notes to overseas investors (secret companies owned by an Indian citizen or corporation, which is located in some tax haven). These investors want to purchase Indian equity apart from debt instruments (with short-term investment horizon so that funds can move in and out of the country quickly) in the stock exchange without undergoing the rigorous process of registering themselves with the regulator viz. SEBI. P-notes help in hiding the identity of its beneficial owner by facilitating the secret companies located in tax havens maintain anonymity. This process is called round tripping and is often alleged to be used for stock price manipulation.

The author alleges that although civil society organisations and public-spirited individuals have demanded bringing back black money in the country from offshore financial centres since late 2000s, the ruling UPA government at the Centre remained non-cooperative most of the time. He cites media reports and research findings to reinforce his argument that the government could have learnt a lesson or two from the efforts of other countries such as the United States or Germany to identify individuals who kept their illicit money in offshore banks and tax havens. He has also proposed to publicly reveal the names of individuals or corporations who keep their illicit money abroad.



Myriad issues related to the complicated framework around tax havens in the contemporary financial world have been explored in the book's 12 chapters. While the discussion begins with black money and corruption, it is carried forward and brought alive with details of various estimates of the extent of black money in India. To shed light on the current global conversation on capital flight, elite wealth, corruption and tax avoidance, the author provides accounts of the history and functions of tax havens, as well as funds flow, benefits and rankings of tax havens and offshore financial centres. Another highlight of the book is an analysis of 'blood money,' where the reader is enlightened about how illicit money is not just about tax evasion, but also concerns trade in drugs, arms and ammunitions as well as human trafficking.

Other allied issues that find a mention in this comprehensive narrative on shady finance, black money and tax evasion are the relationship between multinational corporations and tax havens, as well as country specific experiences in black money creation.

For a reader, any examination of corruption and tax scandal is incomplete without a mention of the recent outrage against the leak of millions of documents from tax haven law firm Mossack Fonseca. The author taps into this sentiment to analyse the Panama Papers leak and how

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that affects India. Finally, he ties up the various threads around the financial conduct of the rich and powerful with suggestions on reforms required to curb black money and ways to deal with tax havens.

The book can be criticised for making two broad assumptions – (a) that the prevalence of cash contributes to black money; and (b) cross-border movement of capital or money takes place to escape higher tax rates. A study published in *BIS Quarterly Review* – a peer-reviewed research journal from Bank for International Settlements – shows that the value of payments made in cash as a proportion of GDP was lower in India (8.8 percent) as compared to countries like Japan (20.0 percent) or Switzerland (12.3 percent) in 2016.[2] Despite demonetisation of Rs. 500 and Rs. 1000 notes to curb black money, cash in circulation during the end of May 2019 was almost 22 percent higher than the pre-demonetisation level.[3]

International flow of capital depends on various factors, such as differences in real interest rates between countries, war within a country, macroeconomic stability of an economy, etc. apart from tax rate differences across nations.

(Endnotes)

1. Milam, Whitney (2018, August 12). The Global 1% Is Destroying Democracy. *Medium*. Retrieved June 3, 2019, from https://bit.ly/2MA7xlf

2. Bech, Morten L., Umar Faruqui, Frederik Ougaard, and Cristina Picillo, "*Payments are a-changin'but cash still rules*," BIS Quarterly Review, March (2018) from https://bit.ly/2XHuSMB

3. PTI (2019, June 25) Currency in circulation rises 22% in May over pre-demonetisation level, *Livemint*, Retrieved June 25, 2019, from https://bit.ly/2LRkmLA

> At his best, man is the noblest of all animals; separated from law and justice he is the worst.
>
> *Aristotle*