

Black Money [UPSC Notes for Indian Economy]

Black money is a term frequently used in the Indian media. It is a huge problem in the Indian economy. Hence, the topic is very important for the [UPSC exam](#) GS III paper, which includes Indian Economy. In this article, you can read all about the important issues related to black money.

Black Money - Definition

There is no one definition for black money in economics. In layman's language, it is money that has been acquired through illegitimate means or money which is unaccounted for, that is, for which tax is not paid to the government.

Spurious notes or counterfeit money is generally not counted as black money. Counterfeit notes are currency notes that are illegally printed by unauthorised agents.

Black money is hidden from government authorities and is not reflected in the country's GDP, national income, etc.

- White money is money that is earned through legitimate means and is accounted for, for which income or other tax is paid.
- In an ideal economy, all money that is transacted should be accounted for. This would help the government to collect taxes.
- Cash transactions without proper accounting is black money.

How is black money generated?

Black money is generated by any of the following three ways:

1. Illegitimate activities: The illegal activities that can lead to black money generation are:
 1. Crime
 2. Corruption
 3. Non-compliance with tax requirements
 4. Complex procedural regulations
 5. Money laundering
 6. Smuggling
2. Tax evasion: This is where an entity wilfully does not pay taxes that are due to the government.
3. Tax avoidance: This is where an entity takes advantage of the existing loopholes in the system and avoids paying taxes. This is not illegal though.

Sources of Black Money in India

Some of the chief sources of black money are described below.

- Sellers or traders who do not give bills or receipt creates black money.
- Many people invest in bullion or jewellery to hide their actual income from the authorities.
- In the real estate sector, many people undervalue their real assets to refrain from paying the rightful tax. They cheat the government of the correct amount of property tax.
- Some NGOs and trusts do not provide proper sources for their funds and donations received.
- Tax havens: Tax havens are generally small countries where foreigners don't have to pay taxes. These countries generally have very liberal regulatory frameworks, which big corporations take advantage

of. They set up shell companies there and redirect all their profits to this entity, by which they can reduce their tax liabilities by a huge margin.

- Hawala: Hawala is an informal method by which money can change hands without the use of banks. This works through codes, contacts and trust with no paperwork at all.
- Investments through innovative derivative instruments like participatory notes also is a means to hide black money.

Size of the problem

- A Bank of Italy calculation reveals India's share in tax havens globally to be \$152-181 billion or Rs. 10 lakh crore.
- India is ranked eight in the world in black money generation by the Global Financial Integrity Report.
- A former director of the [CBI](#) has said that the total black money in India is around USD 500 billion.

Money Laundering

Money laundering is the process by which black money is converted into white money.

People who possess black money cannot spend it publicly. They should either hide it or spend it on the underground economy. Through money laundering, they convert it into white money. It is a method by which criminals mask their accumulated wealth.

Through money laundering, people separate the money earned (illegally) from its source, mix it with white money, and then funnel it back into the source.

Another commonly heard related term is round tripping. Here, people send money to a tax haven like Mauritius or Cayman Islands (to avoid paying tax), and then invest that money into India, thus becoming foreign investment.

Effects of Black Money

Black money has some serious consequences on the economy of a country. Some of them are discussed below.

- It affects the financial system of the country. The central bank is not able to control money supply in the economy causing a higher inflation. This will lead to a fall in the value of the currency.
- Black money affects the credibility of a country negatively.
- Black money is most often used for illegal activities such as drugs and narcotics dealing, terrorism, etc. which is detrimental to the health of the country.
- The government suffers a big loss in the form of taxes because of black money.
- Black money creates a parallel economy in the country, which is completely underground. For example, in Mexico, there is a thriving parallel economy because of illegal trafficking of drugs. This leads to governance problems.
- Black money can also cause real estate prices to go up, which may lead to an asset bubble.

Measures taken by the Government to Curb Black Money

The government has undertaken many measures to curb black money. They are discussed below.

1. Tax reforms have been initiated with a view to resist black money. Tax base has been increased and rates have been slashed. Reforms are being made to incorporate tax deduction at source itself.
2. Through the Black Money Bill, the government has allowed the reporting of black money generated through tax evasion in a given time frame.

3. Demonetisation of Rs.500 and Rs.1000 was carried out in 2016 with the primary view of making black money useless. To know more about [demonetisation](#), click on the linked article.
4. The government is encouraging cashless/digital transactions with a view to making things more transparent.
5. Electoral reforms are also intended to curb black money as much of the black money generated in India is used in elections.

Legislative Framework to deal with Black Money

1. Prevention of Corruption Act, 1988
2. Benami Transactions Prohibition Act, 1988
3. Prevention of Money Laundering Act, 2002
4. The Undisclosed Foreign Income and Assets (Imposition of Tax) Bill, 2015
5. Lokpal and Lokayukta Act

UPSC Questions related to Black Money

What is the meaning of Hundis?

A Hundi is an unconditional order in writing made by a person directing another to pay a certain sum of money to a person named in the order. Hundis, being a part of the informal system, have no legal status and are not covered under the Negotiable Instruments Act, 1881.

What are the institutions to deal with black money in India?

The institutions to deal with black money in India are:

1. Enforcement Directorate (ED)
2. Central Board of Direct Taxes (CBDT)
3. Financial Intelligence Unit
4. Central Board of Excise and Customs
5. Directorate of Revenue Intelligence (DRI)
6. NIA
7. Central Economic Intelligence Bureau
8. CBI
9. Police authorities