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May 2016

“Mauritius and Beyond” by S L Rao

Almost 25 years ago I brought up the issue of the Mauritius laundry. A double taxation agreement was tweaked to charge the same capital gains tax to investments from Mauritius in India as would have applied to them in Mauritius. The twist in the tale was that there was no capital gains tax in Mauritius while India had 10% for short-term (investments (held for less than one year) and 20% for long-term gains.

This resulted in Mauritius becoming a much larger investor in India than the U.S.A, U.K, etc. The investment funds were almost all by non-Mauritian entities with registrations there. Any office building in Mauritius has numerous solicitors ‘offices and each displays innumerable name plates of companies including the largest in the world. These foreign companies could now send funds to India for investment but as companies from Mauritius.

The investments in India would be in some cases for setting up manufacturing facilities. If the facility was sold later at profit, there would be no capital gains tax. But the majority of investors and funds were for investment in financial products, mainly in the stock market. For many years since, foreign investment into India was as institutional investments, and not as direct investments for setting up manufacturing. Apart from NRI funds it was the largest source of foreign funds.

Another result was that the Indian stock markets became exceedingly volatile. Investments would be liquidated usually at higher prices and the proceeds sent back to Mauritius, only to come back for new financial investments.

A hidden consequence was that this became the route for making Indian black (unaccounted) money into white by sending the money through havala to Mauritius and legitimately sending it back for investment, so that when it was remitted back it was clean. We can speculate that this route was created by powers in government mainly as a laundry to make their Indian black money white.

The new agreement with Mauritius initiated by the Prime Minister himself, will levy a capital gains tax at the Indian rate for two years. After that the rate will be as applicable in India. The clever part is that nameplate companies in Mauritius can no longer use the route. They must have a minimum expenditure on operations in Mauritius.

Many of us have criticized the Modi government as being one of mere rhetorical promises. But on controlling unaccounted money it has begun to go to the root of the problem. Thus there is a concerted move to produce defense products in India. This has been a source of huge corruption and unaccounted money for years. Banks are being made to reduce debts and companies are selling assets to do so, including illegal ones held abroad. There is more scrutiny of import and export prices, the source for under and over invoicing. Foreign banks both in India and abroad are under scrutiny for havala transactions. Names of Indian bank account holders abroad are now becoming available, the most comprehensive being from a law firm in Panama. A watchful media and investigating agencies of government are looking more closely at government transactions for illegal profits held in “black”. Lower tax rates have also reduced the temptation to generate black funds. Allowing Indians to legally remit fairly large sums abroad also have reduced the need to hold money abroad.

  Over the years, the people who have accumulated “black” money and assets in India and overseas, have developed the government system and procedures to enable them to do it more easily. Sectors like real estate and construction (roads, factories, etc) are major generators and the laws and tax policies for them must reduce the incentive to generate black money. The public distribution system has vast leakages from procurement, prices that enable leakage, transportation, storage and bogus ration cards. The vast social expenditures by the Sonia Gandhi led government generated huge leakages and consequent black money. Ministers and bureaucrats have designed schemes to ensure that much illegal money can be generated by siphoning off as much as 50 per cent or more of government expenditures. AAdhar, more bank accounts, direct benefits transfers, will reduce black money generation.

It is more important if we are serious about it to plug the loopholes created over the years. This has begun to happen. Thus: property taxes must be reduced; land transfers made simpler; investigations into economic crimes made speedier and with faster judgments and stiffer penalties including confiscation. The goods and services tax will cut evasion of indirect taxes and consequent accumulations of black moneys. The money laundering through Mauritius will now close; this must also apply to Cyprus. All ways to send black money out and bring it from there legally to India, laundered in Indian markets and sent back, must close. This must also be applied to participatory notes that enable Indians to invest anonymously in India through overseas banks.

The new double taxation agreement with Mauritius is a welcome sign that government is now tackling the roots of the problem. These must be closed: generation of black money in contracts, procurement, constructions, overseas purchase and sales; the havala route in which even “respectable” banks have become participants; in welfare schemes used for theft of funds. Our investigation and penalties for such wrong doing must be faster and more severe. (915)

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Surendra L RAO  
D1 Chartered Cottage, 8 Langford Road, Bangalore 560025 India; (91 80) 22275132; 41228450 ; Mobile 93431 98450  
  
<http://www.slrao.com/>

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