

Operation Clean Money- Towards a Tax Compliant Society



The Government has been taking a number of initiatives to eradicate black money from the Indian economy and work towards building a tax compliant society, demonetisation being one of the most prominent steps in this regard. In the wake of demonetisation, the Government has also introduced a number of ancillary initiatives to make demonetisation a success. These initiatives along with the challenges faced by the Government in implementing these initiatives have been discussed in detail in this article. Read on to know more....

Background

On 8th November 2016, the Government announced cancellation of legal tender character of all ₹500 and ₹1,000 banknotes except for a few specified transactions. The two high value denomination notes, constituted nearly 86% of cash in circulation on that date. The aim of the action was fourfold¹: to curb corruption; counterfeiting; use of high denomination notes for terrorist activities; and accumulation of “black money” generated by income that has not been declared to the tax authorities. The action has been popularly referred to as demonetisation.

Demonetisation is one of the several measures taken by the Government in the last three and a half years to tackle the issue of black money. Some major initiatives in this regard, include the following:

- Constitution of the Special Investigation Team (SIT) on Black Money in May 2014

- Enactment of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015
- Comprehensive amendment of the Benami Transactions (Prohibition) Act, 1988
- Information Exchange Agreements with Switzerland
- Changes in the Tax Treaties with Mauritius, Cyprus and Singapore
- The Income Disclosure Scheme, 2016
- The Taxation Laws (Second Amendment) Act, 2016 and the Pradhan Mantri Garib Kalyan Yojna, 2016

Opportunities and Challenges

One of the four objectives of demonetisation was to curb the accumulation of “black money”, generated by income that has not been declared to the tax authorities.

With demonetisation of high value currency notes, large amount of cash entered the formal

(Contributed by Income Tax Department. Comments can be sent to dtc@icai.in.)

¹ Economic Survey 2016-17

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banking system, which could be tracked through use of the know your customer (KYC) norms under the existing anti-money laundering regime. This was an unprecedented opportunity for the Income-tax Department.

To enable tracking of these cash deposits, Rule 114B of the Income-tax Act was amended in November, 2016 requiring all persons and entities to furnish their permanent account number (PAN) or Form No.60 for all accounts other than specified basic deposits/accounts. The consequent linking of PAN with the bank accounts significantly enhanced ITD's ability to match the financial assets with the information received by the tax authorities post demonetisation and later disclosed in the income tax returns.

The major challenge, however, has been tracking of the entities which managed to quickly move funds across multiple layers of bank accounts to obfuscate the source of funds.

The table below presents the unique opportunities and challenges before the Income Tax Department (ITD) in identification of the fund trails.

Measure	Opportunity
Demonetisation of high value denomination notes	Identification of persons depositing large amount of cash
Linking of PAN with bank accounts	Matching of financial asset with the information disclosed in the Income tax Returns
Restriction on cash withdrawals	Tracking of funds and identification of layering accounts and entities

Investigations have shown that persons having unexplained old high denomination currency notes adopted a range of methods for conversion of such unaccounted cash into legal tender. Some such methods are:

- Splitting of cash deposit in multiple accounts
- Opening of new accounts to deposit cash
- Purchase of bullion, jewellery, luxury goods in cash
- Repayment of loan in cash
- Back-dating of cash sale transactions
- Inflation of cash-in-hand
- Exchange of notes before depositing in bank account
- Routing of funds through multiple accounts (using RTGS) through use of shell entities.

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As the nature of cash as black or white is fluid (e.g. sale of bullion, jewellery, luxury goods in cash converts unaccounted cash of purchaser as accounted cash in the books of accounts of the seller), investigation into all such cases require considerable effort and time.

Black or White: Fluid Categories

Cash can be used as a medium of exchange (for transactions) or as a store of value like other forms of wealth such as gold and real estate. In terms of nature, cash can be illicit or otherwise. Function and nature are quite distinct. For example, cash used as a store of value could be white (the savings that all households keep for an emergency), while cash used for transactions could be black (if it was earned through tax evasion and/or corruption). Moreover, these categories are fluid. Cash held as black money can be converted to white through laundering and other means, or by declaring it to the authorities and paying the associated tax/penalty.

(Reference: Economic Survey 2016-17)

Immediate Response

The Income Tax Department (ITD) took a series of steps between November 2016 and January 2017 for achieving the objectives of demonetisation. These included strengthening of the data collection mechanism, collection of information on high value cash transactions from FIU-IND, preponement of the submission date to report Statement of Financial Transactions (SFT) to January 31, 2017 and focused enforcement actions.

Under the Statement of Financial Transactions (SFT), the banks and post-offices were required to report aggregating deposits of ₹12.50 lakh or above in case of current account and ₹2.50 lakh or above in case of accounts other than current accounts, for the period between November 9, 2016 and December 30, 2016. For such reporting entities, similar cash deposits for the period April 1, 2016 to November 8, 2016 were also to be reported.

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The Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY) was launched on 17th December 2016. Declaration under the Scheme could be made by any person in respect of undisclosed income in the form of cash or deposits, in an account with bank or post office or specified entity. Such declarations followed by payments of specified taxes/deposits entitled the declarants to immunity from penal consequences including criminal prosecutions.

Broad Approach

Traditionally, the tax administration has emphasised on enforcement as a tool for ensuring compliance with the tax law. With the advent of information technology and the quantum leap in the number of taxpayers, tax administrations across the world have reformulated this strategy. The new strategy consists of a risk-based compliance management. Under this approach, the total taxpayer population is segmented into two broad categories, namely (i) those who intend to fulfill their legal obligations but do not have access to information and facilities to fulfill their legal obligations, and (ii) those who have access to information and facilities but do not intend to fulfill their legal obligations.

It has been recognised that non-compliance amongst the first category of taxpayers can be significantly reduced by merely providing quality taxpayer services and facilitation, which do not require deployment of large resources. This allows the tax administration to release large resources for tackling a relatively small number in the second category (i.e. high risk persons). Use of new data-driven and intelligence led technologies can help tax administrations fine tune compliance approaches to incorporate appropriate interventions and develop new capabilities to address tax risks including tax avoidance, evasion and fraud.

In line with global experience, the Income-tax Department has adopted a multi-pronged strategy

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to achieve its objectives by launching numerous E-governance initiatives for–

- i. providing tax payer services and facilitation;
- ii. establishing a robust risk management strategy to detect and penalise non-compliance; and
- iii. building internal capacity for efficient and faceless interface with all stakeholders.

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In line with the changing approach to ensure compliance, the Income-tax Department (ITD) initiated Operation Clean Money on 31st January 2017 with the launch of e-verification of large cash deposits made from 9th November to 30th December 2016.

The mission of Operation Clean Money (OCM) is to *“Create a tax compliant society through a fair, transparent and non-intrusive tax administration where every Indian takes pride in paying taxes”*.

The experience and learning of the initial phase of Operation Clean Money made it clear that a comprehensive strategic planning approach was needed to leverage the opportunities of demonetisation and other measures for creating a tax compliant society.

The OCM Strategic Plan² identifies action points under following focus areas:

- OCM Focus Area 1: Citizen Engagement and Taxpayer Awareness
- OCM Focus Area 2: Quality Taxpayer Service Delivery
- OCM Focus Area 3: Timely Collection and Integration of Information
- OCM Focus Area 4: Leverage Data Analytics in Tax Administration
- OCM Focus Area 5: Supporting Voluntary Compliance
- OCM Focus Area 6: Transformation of Verification and Assessment Function
- OCM Focus Area 7: Effective Deterrence for Habitual Offenders
- OCM Focus Area 8: Comprehensive IT enablement of Business Processes
- OCM Focus Area 9: Build and Strengthen Organisational Capacity
- OCM Focus Area 10: Develop Sustainable Compliance Ecosystem.

e-Verification of Cash Deposits

The cash deposit data was analysed to identify

² Operation Clean Money Strategic Plan 2017-2022

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A comprehensive and whole of the government approach was adopted to detect and punish those found involved in misuse of the scheme of demonetisation. The enforcement actions intensified by the ITD led to significant incremental outcomes in terms of searches, surveys, and references of cases to the Enforcement Directorate and the CBI for further action.

persons whose cash transactions did not appear in line with the tax payer's profile. Preliminary assessment was undertaken to analyse distribution of large cash deposits across various taxpayer segments (e.g. Business, Non-business etc.). This analysis resulted in identification of about 17.92 lakh persons for verification process in the first phase.

Online verification of cash transactions was enabled and the information in respect of the identified cases was made available in the e-filing window of the PAN holder (after log in) at the portal <https://incometaxindiaefiling.gov.in>. The taxpayer was able to submit online explanation without any need to visit Income Tax office. Detailed user guide, quick reference guide and Frequently Asked Questions (FAQs) were published to assist the taxpayer in submitting online response. Email and SMS were sent to the taxpayers for submitting online response on the e-filing portal. ITD also released advertisements to educate taxpayers about registration and submission of online response. There was an overwhelming response to the online verification process and nearly 11 Lakh persons submitted online response. More than 5.27 Lakh taxpayers submitted their response within 12 days.

Identification of High Risk Cases

ITD on-boarded two specialised data analytics agencies and a business process management agency to augment departmental capability in analysing large volume of cash deposit data, and track the compliance status of taxpayers and reporting entities. Data analytics was used to identify high risk cases such as:

- Persons/groups splitting cash deposits in multiple accounts to avoid reporting
- High value cash deposit and purchase of property after demonetisation
- High value cash deposit and outward foreign remittances after demonetisation

- Clusters of non-PAN accounts with similar name and address
- Clusters of non-PAN accounts with similar name and mobile number

Targeted Enforcement Actions

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Supporting Voluntary Compliance

The Portal of Operation Clean Money (<https://www.cleanmoney.gov.in>) was launched on 16th May 2017.

The salient features of the OCM portal are:

- **Providing comprehensive information at one place** consisting of Step by Step Guides, Frequently Asked Questions, User Guides, Quick Reference Guides and Training Toolkits related to verification process and other issues.
- **Enabling Citizen Engagement** for creating a tax compliant society where every Indian takes pride in paying taxes. Citizens would be able to support the operation clean money by taking pledge (इमानदारी का उत्सव), contribute by engaging and educating fellow citizens (जन भागीदारी), and share their experiences and provide feedback (सुखद अनुभव).
- **Enabling Transparent Tax Administration** by sharing status reports (including sanitised cases and explanation of verification issues) and thematic analysis reports (e.g. taxpayer segment analysis of cash deposit data).

The web portal provides a platform for the citizens of India and Income-tax Department to come together for the common cause of building a proud nation, which runs on the strength of the honest taxpayer. Going forward, the portal is being leveraged as a tool to promote various programs and campaigns launched under OCM.

Targeted Electronic Campaign

One of the pillars of Operation Clean Money is fair, transparent and non-intrusive tax administration. Keeping in view the large number of persons depositing cash, it was important to facilitate the taxpayers who intend to fulfill their legal obligations.

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The Income Tax return for the Assessment Year 2017-18 (Financial Year 2016-17) was modified to enable taxpayers to voluntarily provide the details of cash deposited in bank accounts aggregating to 2 lakh or more.

Targeted electronic communication and advertisement campaign were used to communicate to the target segment that they should:

- File the return by due date
- Mention the bank account in the Income Tax Return
- Consider the amounts so deposited while computing income and paying taxes.

Collection and Integration of Information

The Income-tax Department collects taxpayers' financial transaction information from other entities under two broad categories i.e., Third party reporting obligation (under Section 285BA of the Income-tax Act) and Tax Deduction/Collection at Source (TDS/TCS). The following transaction types are collected under Statement for Financial Transactions (SFT) in Form 61A (Rule 114E).

- SFT- 001: Purchase of bank drafts or pay orders in cash
- SFT- 002: Purchase of pre-paid instruments in cash
- SFT- 003: Cash deposit in current account
- SFT- 004: Cash deposit in account other than current account
- SFT- 005: Time deposit
- SFT- 006: Payment for credit card
- SFT- 007: Purchase of debentures
- SFT- 008: Purchase of shares
- SFT- 009: Buy back of shares
- SFT- 010: Purchase of mutual fund units
- SFT- 011: Purchase of foreign currency
- SFT-012: Purchase or sale of immovable property
- SFT- 013: Cash payment for goods and services
- SFT- 014: Cash deposits during specified period (9th Nov to 30th Dec, 2016).

The effectiveness of utilisation of third party reporting relies heavily on the quality of the data. Data errors and defects not only result in defects and errors during data analysis but also increase the compliance cost for a taxpayer. To overcome this, the department has provided a utility which allows the reporting entities to validate the information and identify errors before submission.

ITD is also developing a seamless system under **Project Insight** to assess the quality of data and identify the sources of error in it. The data quality issues can then be communicated to the reporting entities in a Data Quality Report (DQR). The feedback loop would enable the reporting entities to improve their internal data management process which would improve the data quality over time.

Key Statistics

Linking of high value transaction with PAN

- Nearly 3 times jump in PAN allotments after demonetisation (PAN allotments in April to October 2017 was approximately 7.50 lakh per month as compared to around 2.5 lakh for corresponding period last year)
- Nearly 3 times increase in high value transactions reported to ITD

Widening of tax base

- 84.2 lakh new ITR filers in FY 2016-17 compared to 66.5 lakh such filers in 2015-16—Growth of 26.6%
- During FY 2017-18 (till 7th November), increase of 63.45 lakh (19.5%) in number of e-returns
- Returns under the presumptive scheme grew by 50.5%

Improved Tax compliance

- The advance tax on Personal Income Tax has grown by 29.6% upto October 2017
- Substantial increase in Gross Total Income reported by individuals depositing cash as compared to non-cash depositing individuals.

Roadmap Ahead

The approach for utilisation of demonetisation data is to use Department's resources in a focused manner to ensure that the taxpayers comply with their primary obligations i.e. file Income Tax Return; show correct income in the Income Tax Return; and pay all due taxes on time.

Notices under Section 142(1) of the Income-tax Act are being issued to persons who have not filed their returns of income though they have deposited substantial cash in their bank accounts. A wide range of coordinated actions are proposed to be taken to target non-filers and untraceable cases. Indicative action points to ensure compliance by this segment may include communicating the list of such persons to the reporting entities (e.g. banks) for conducting enhanced customer due diligence and collecting additional information (KYC details and transaction details) of such persons from the reporting entities.

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High risk cases will be selected for scrutiny and further investigation in a phased manner based on the risk management strategy. This selection will consider the following:

- Whether taxpayer filed the return
- Whether taxpayer mentioned the bank account in the Income Tax Return
- Whether taxpayer has broadly considered the cash deposits while computing income and paying taxes
- Whether the explanation of source of cash deposit submitted by the taxpayer is in line with the taxpayer profile.

Scrutiny and targeted enforcement actions will be used to collect additional information and ensure compliance in high risk cases. Online system will be used to capture results of enforcement and investigation for effective monitoring. Penalties will be levied and prosecution will be initiated in appropriate cases to deter tax evaders and habitual offenders.

Sustainable Compliance Ecosystem

The tax intermediaries (accountants, advisors, practitioners etc.) have a significant impact on the administration of taxes. In addition to tax intermediaries, following stakeholders have an indirect impact on tax compliance:

- Government Bodies and Industry Bodies
- Civil Society (Media, academia, training institutions, civil society organisations)
- Service Providers (Providers of accounting software, cash registers, POS etc.)
- Business Partners (Banks, investors, contractors, suppliers, customers, staff)

Implementation of Goods and Service tax (GST) and introduction of new technologies has provided new opportunities in promoting tax compliance by businesses. These new technological options may help in reducing complexity and improving customer experience.

ITD is shifting towards a more systematic approach where tax administration engages and involves taxpayers and stakeholders in the compliance process. If tax compliance requirements are in-built into the technology systems and processes used by the taxpayer for the purpose of managing the business, it will make it impossible or difficult for them to manipulate or erase information (or make such attempts easy to detect). Increased co-

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operation with tax service providers and industry organisations, therefore, plays an important role in promoting compliance. The three main categories of tax related services are as under:

- Compliance: activities focused on delivering tax returns or other reports to meet legal obligations.
- Accounting: bookkeeping, payroll services and preparing financial statements.
- Advisory: providing tax advice and representing clients in tax affairs.

There is a need to develop strong partnerships with the stakeholders to create a sustainable compliance ecosystem.

Role of ICAI and Chartered Accountants

ICAI, as a partner in nation building, has always been proactive in bridging the gap between the taxpayers and the Department. ICAI has played the role of a catalyst, to create awareness about the necessity of being a tax compliant society. For this purpose, an email with subject “Help in building a tax-compliant nation, Support Operation Clean Money” was sent out to the members of ICAI.

The Chartered Accountants have an important role in Operation Clean Money, which includes:

- Creating awareness about Operation Clean Money
- Pledging their “Support” on the Clean Money Web Portal by using the “I Support” link on OCM portal or ICAI web portal
- Supporting voluntary compliance by encouraging taxpayers to file Income Tax Return showing correct income.
- Providing suggestions and feedback to the Department.

This collaborative approach will go a long way in achieving the mission of Operation Clean Money i.e. to “Create a tax compliant society through a fair, transparent and non-intrusive tax administration, where every Indian takes pride in paying taxes”. ■