

Get Back Money Illegally Deposited In Tax Havens

R. Vaidyanathan*

India should joins hands with different world bodies, including G-20, to address the issue of safe tax havens across the globe. If a deal comes through between the G-20 and different tax havens, particularly Switzerland, the efforts to recover Indian monies illegally stashed away abroad can be hugely successful. These illegal funds, if brought back to India, can tremendously boost our foreign exchange reserves and facilitate infrastructure investment. It is pertinent to mention here that the revenue generation efforts of countries like India are subverted by these deposits and that the gap between tax evasion and terror financing is getting narrower. Also, lesser the transparency in bank accounts, greater the threat to civilised society.

Barack Obama is concerned about them; Merkel is furious about them; and Sarkozy wants to regulate them. But the leaders of one of the most affected countries – India – are not saying or doing anything about them. They are the ‘tax havens’ or offshore financial centers where the ill-gotten wealth of tax evaders of many countries

is hoarded. These tax havens are now in the news since developed economies like the US, Germany and France etc. want them to return the ill-gotten wealth stashed away by their citizens.

The Tax Havens

The US government, as well its Congress, are most concerned about these tax havens due to the severe economic crisis faced by the country and also due to the pressure from sections of economists etc. to “clean up” the global financial system. There are also concerns regarding the financing of terror groups by some of the tainted money from these tax havens.

The detailed discussions on tax havens are provided

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There are more than 70 tax havens in the world, but as the Internal Revenue Service of the US reveals, around 40 of them aggressively market themselves. The popular ones include Switzerland, Luxemburg, Liechtenstein, Channel Islands and Bahamas.

by the Internal Revenue Service of United States Department of Treasury in a paper on “abusive Offshore Tax Avoidance schemes –Talking Points During 2008.”¹ I quote from this paper:

These are foreign jurisdictions that offer financial secrecy laws in an effort to attract investment from outside their borders. These jurisdictions are commonly referred to as “tax havens” because in addition to the financial secrecy they provide, they impose little or no tax on income from sources outside these jurisdictions.

It is difficult to quantify the amount of assets being held offshore or the rate at which the industry is growing. But it is estimated that some USD 5 trillion in assets is held “offshore” in tax havens. One authority estimates that the annual revenue loss to the USA at a minimum of USD 70 billion.

Tax haven service providers and their clients know their actions are veiled from tax authorities by banking and commercial secrecy laws and by lack of tax treaties or tax information exchange agreements. They create paper entities to disguise the

real parties to the transactions, and many are willing to create false documents to disguise the real nature of transactions. At least forty countries aggressively market themselves as tax havens. Some have gone so far as to offer asylum or immunity to criminals who invest sufficient funds. They permit the formation of companies without any proof of identity perhaps even by remote computer connections. Generally though such extremes are found in emerging nations where the stability and security of the financial, legal, political systems is questionable.

The largest concentrations of assets are attracted to the stable secure environments of the established tax havens – those that have existed for a number of years and enjoy the diplomatic protection of former colonial powers.

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Liechtenstein Affair

Recently, one of the tax havens – Liechtenstein – was in the news. Liechtenstein is a country as well as a convenient “letter box” for moneyed people all over the world to hide their ill-gotten wealth. It is a small principality where, if you jog a little longer, you may end up in the neighbouring country! The

crown prince, with a difficult-to-pronounce name – Alois von und Zu Liechtenstein (note that the Prince's surname is same as that of the country) – is angry with Germany for launching a massive tax-evasion investigation involving funds hidden away in his country's vaults. Germany's intelligence agency seems to have paid an unnamed informer more than USD 6 million for confidential and secret data about clients of LTG group, a bank owned by the prince's family. The revelations have already led to the resignation of the head of Deutsche Post – the former German mail service that is currently the world's largest logistics company. The Liechtenstein leaders are furious and have focused their ire at data theft rather than on the facts of the case.

The German government has announced that it would share information on accounts held in the tax haven with any government that wanted it. The spokesman for the German Finance Ministry, Thorstein Albig, has indicated that they would respond to such requests without charging any fees for the information. Finland, Sweden and Norway have expressed interest in the data obtained by the German intelligence.

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It is common knowledge that illegal money of India amounting to trillions of dollars is parked in various tax heavens like Antigua, Switzerland, Bahamas, Liechtenstein, Isle of Man and St. Kitts etc. Throughout the Nehruvian socialistic period, under-invoicing of exports and over-invoicing of imports was very common and the funds were siphoned off to these tax havens. In a socialistic way, all leaders – be they from business, politics, films, sports or bureaucracy – participated in creating what we may call 'Secular Ill-gotten Wealth' that cut across any caste or creed distinctions.

In the domestic capital market, substantial inflow of money comes from these tax havens by shell companies or by entities that do not want to be registered. In 2007, more than half of the FII investments were through anonymous PNs. The sub-accounts created by the FIIs for these nameless entities are fraught with dangerous consequences and security risk.

Foreign Institutional Investment Flow in India

In the domestic capital market, substantial inflow of money comes from these tax havens by shell companies or by entities that do not want to be registered. India knows that these tax havens distort global resource allocation as well as domestic initiatives in enhancing government coffers. They encourage venality and are also possible sources of substantial drug and terror money. For instance, Securities and Exchange Board of India took stringent action in 2007 to phase out Participatory Notes (PNs), not registered by FIIs, from the Indian share markets since most of these exotic instruments were issued to/by anonymous entities not regulated by SEBI. The Board pointed out that nearly

50 per cent of the funds flowing in were through entities not registered under it.

The PNs had become the most preferred instrument of investment, with the largest investments from abroad in the Indian stock market routed through them. The amount invested through PNs in Indian stock market increased by several times after the UPA government assumed office. The notional value of investment in PNs, which aggregated Rs 31,875 crore in over 10 years up to March 2004, burgeoned to Rs 3,53,484 crore by August 2007, i.e. increased by over 11 times in just 40 months! Investments through PNs constituted 20 per cent of all FII investments in 2004. This increased to over 51.6 per cent in August 2007. This data is available on the SEBI website. Thus, in 2007, more than half the FII investments were through anonymous PNs. The sub-accounts created by the FIIs for these nameless entities are fraught with dangerous consequences and security risk. The sources of these funds are unknown; the investors are nameless; and billions of dollars invested through PNs are address-less. “Know Your Customer” norms, which the law makes it mandatory for opening simple banks accounts by Indians in this country, are not followed while allowing investment of billions of dollars in the Indian stocks market. The PN mechanism – through which unnamed investors

participate in our markets, invest and disinvest stocks worth billions of dollars and make and repatriate profits – is thus a mystery wrapped in a puzzle, packed in an enigma, crammed inside a conundrum and delivered through a riddle. The clamour for this form of investments is intriguing, if not outright suspicious. Many experts felt that PNs were Weapons of Mass Destruction – WMD – of our stock markets. Actually, SEBI had proposed that FII and their sub-accounts not be allowed to issue or renew offshore derivative instruments. It also wanted them to wind up their current positions over the next 18 months, but these restrictions were revoked under pressure from the Central government. It was generally believed that PNs are not to be issued to Indians,

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namely Indian residents/NRIs/PIOs/OCBs etc, essentially to deny Indian entities investing in our share market by using anonymous PN route under Foreign Institutional Investors scheme. But something else was perhaps happening. Indian entities were perhaps funneling funds from tax havens back to India through the FII route. This is, to some extent, borne out by the revelations made in a Security Appellate Tribunal order in the Goldman Sachs case on anonymous entities.

The order clearly says that since there were no bar on FIIs and their sub-accounts to issue/subscribe/purchase any PNs to/from Indian residents or NRIs/PIOs/OCBs, it would be “reasonable to presume” that many of them must have dealt with such persons in the course of their business activities. The SAT concurred with the observation of Goldman Sachs that there was no provision till that date either in the Act or in the Regulations to debar FIIs or their sub-accounts from dealing in PNs with Indian residents/NRIs/PIOs/OCBs.

The crucial SAT observation was that when the FIIs and their sub-accounts were not debarred from dealing in PNs with Indian residents/NRIs/PIOs/OCBs and “many of them would have dealt with the latter, they could not be asked to furnish the undertaking. We could have appreciated the requirement of the

undertaking being given by FIIs and their sub-accounts only if they had first been debarred from dealing with the aforesaid persons. In other words, the bar must necessarily precede the undertaking demanded from the FIIs and their sub-accounts”.

After these observations, the FIIs are required to give undertakings regarding percentage of assets under management in such instruments and also a declaration that they have not issued any to Indian residents or NRIs. Unfortunately, the government does not reveal the nature and identification of Foreign Institutional Investors investing in the market nor the nature of origin of these entities.

The Indian attitude to this serious issue is in contrast to that of the US. The UBS recently paid a penalty of over \$800 millions in the US and also disclosed the secret account details of 300 Americans as per the US government wish. But in India, the same UBS paid a paltry penalty of a few lakh rupees to the SEBI for not – yes, not – disclosing the names of secret PN holders whose funds it had invested, and settled the case just a couple of weeks back!

Outflow of Funds from India

On the other hand, we find more disturbing issues pertaining to outflow of funds from India. Statistics available on Union Finance Ministry website on the

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country-wise approvals for Direct Investments in JVs and wholly-owned subsidiaries during 1996-2007 reveal that more than one- third of outflows out of a total of around 31,000 million USD is to many well known tax havens like Channel Island (5,400 million USD), Mauritius (2,600 million USD), Virgin Islands (1,008 million USD), Cyprus (1,361 million USD) and Cayman Islands (104 million USD). Indian businessmen, howsoever capable, cannot think of investing 5,400 million USD or around Rs 21,000 crore in Channel Island. Data are not available for FIIs, nor in terms of who are the corresponding investors.

Why are we very frugal/discreet in providing data when it comes to our foreign inflows and outflows?

Under pressure from US federal authorities, Swiss bank UBS is closing down hidden offshore accounts of its well-heeled American clients, potentially allowing their secrets to spill out into the open. In a step that would have been unthinkable at one point in the rarefied world of Swiss banking, UBS will shut about 19,000 accounts that prosecutors suspect have gone undeclared to the Internal Revenue Service.

Unfortunately, our parliamentarians rather than being nose-y are increasingly being noisy in putting out probing questions on what is happening in our own markets.

The issue is of paramount importance due to many reasons. Any expert on Indian stock markets knows that our markets are increasingly being moved by global flows – both inflows and outflows of funds. Secondly, such flows may be of ill-gotten wealth of Indians kept abroad in tax havens or domestic funds sent out and brought back to facilitate some activities. This has to be seen in context of concerns expressed by our own National Security Advisor M.K. Narayanan regarding the possibility of terror funds coming through financial

markets.² With parliamentary elections around the corner, the issue becomes most important since we all know that huge funds – not always accounted for – are used during the electoral process.

Tax Havens and Developed Economies

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The clients now face stark choices: they can encash their cheques and, thereby, alert the authorities to any potential wrongdoing, or not encash them and effectively lose their money. Or, they can transfer the money to new banks, a procedure which, in case of foreign banks, requires depositors of more than \$10,000 to report the new account to the Treasury Department.

UBS – the largest banking institution in Switzerland – has also committed to provide names of top 250 persons who have kept money in offshore accounts out of 19,000 accounts to the US authorities. UBS has also committed to pay a fine of 780 million USD to settle claims that it has defrauded US Internal Revenue Service. Now, the US State Department is compelling the disclosure of 52,000 American accounts kept with UBS. The original charges are that the UBS offshore accounts have helped Americans to hide 18 billion USD in 19,000 accounts. As of now, it has been settlement that anyone who wishes to open offshore account has to do it through US regulatory bodies.

Traditionally, Swiss authorities argued that if no criminality was committed under the Swiss laws (which do not recognise currency violations and tax evasion as offences), information on offshore

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accounts could not be divulged. A similar position was taken in the infamous Bofors case also. Now that wall has been breached by this US agreement with Swiss authorities.

UBS, the world's largest private bank, also assured that it would stop offering to American clients offshore private banking services not declared to the IRS.

Prosecutors contend that the UBS helped wealthy Americans hide about 18 billion USD, thereby evading taxes of 300 million USD each year. The UBS is struggling to maintain its centuries-old tradition of Swiss banking secrecy amid mounting legal pressure from the Justice Department to turn over client records. It began handing over some records last summer, causing consternation in the Swiss banking circles.

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Recent Developments

It is important to note the following fast-paced developments that have taken place recently:

- In the third quarter of 2008, the

Organisation for Economic Cooperation and Development (OECD), of which Switzerland is one of the 17 members, threatened to blacklist Switzerland for protecting tax evaders.

- In a preparatory meeting held in February 2009 in Berlin for the April summit of G-20 nations, which includes India, the European leaders vowed to launch a crusade against tax havens at the G-20 meet. They also hinted at sanctions to “punish non-cooperative tax havens”. They were reported to have prepared a list of some 30 such tax shelters and secret havens which they want to name at the summit.
- When Switzerland, stunned at this development, requested that it be given an opportunity to present its case at the G-20 summit, in an extraordinary show of toughness, they bluntly rejected that plea.
- A week later on February 18, UBS was forced by the US tax administration to reveal the names of some 300 presumed tax evaders. The US threatened to sue the UBS. Fearing that the action would lead to the bank’s demise, the Swiss authorities invoked an emergency clause in their banking law and furnished the required data to the US before Swiss Federal Court, which was moved by the account holders.
- In less than a week, the Obama

The sudden eruption of indignation and anger against banking secrecy and illegitimate money it breeds and protects seems to have shaken the Swiss government. While the Swiss government used to stress in the past that its banks’ secrecy was “non-negotiable”, it can no more stick to that stand.

administration announced a statute to uncover all secretive tax havens, including Switzerland.

- The sudden eruption of indignation and anger against banking secrecy and illegitimate money it breeds and protects seems to have shaken the Swiss government. While the Swiss government used to stress in the past that its banks’ secrecy was “non-negotiable”, it can no more stick to that stand. It has now acknowledged that it would have to “compromise”. The Foreign and Justice Ministers of Switzerland have hinted that the country would have to give up protection to foreign tax evaders. The Swiss government has also indicated that it would change its present laws that regard tax evasion as a ‘civil offence’ and make it a ‘criminal offence’. We in India know how Swiss

laws were misused to manipulate and cover up the Bofors kickback case.

- British Prime Minister Gordon Brown, who was severely criticised for not immediately supporting Germany and France on their stance against banking secrecy in the Berlin preparatory meet, soon came out in support of the move against tax havens and banking secrecy while addressing the US Congress later in February.

In contrast, twice in the last one year, India has shown marked disinclination to lay its hands on the data pertaining to illicit money kept by Indian nationals in secret Swiss bank accounts and to strive to get back the Indian wealth hoarded in Swiss banks.

While things were moving at a fast pace and the very Western nations which had once encouraged the Swiss banks' secrecy but were now against secret banking, the Indian representative at the G-20 preparatory meeting in Berlin did not utter any word of support for the move.

One of the most important agenda for the G-20 summit now is the issue of tax havens and banking secrecy but the Indian Prime Minister is still maintaining a deafening silence. Considering the enormous Indian monies believed to be hoarded in secret accounts in Switzerland, the Indian government is duty bound to support the move to unlock the banking secrecy and take a proactive

position.

India's Money and India's Role

In all these discussions, one critical aspect ought not to be forgotten but brought to the surface is the wealth hoarded by Indians in foreign banks for the last five to six decades. The recent developments pertaining to such tainted money should alert us to our own wealth stashed away abroad.

Addressing a press conference to commemorate 60 years of Indo-Swiss Friendship Treaty, the Swiss Ambassador to India said, "Switzerland was accused of giving shelter to black money and there

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has been a lot of inflow of such wealth from India and other countries of the world. I would not say it would be stopped 100 per cent (under a new law). But through this measure, it would be controlled up to a certain limit.”³

The Swiss Ambassador was at least forthcoming about the venality of the Indian elite.

However, the worst part of the story is loss of money deposited in Swiss banks after the death of some depositors who failed to pass on the account information to their kin. The Swiss banks appropriate such money after some years (seven to ten) after the death of the beneficiary if there are no claimants. Swiss accounts are operated through codes but most require passport and its number as proof. That is the reason why some persons travel to Switzerland with all expired passports. Zurich is the only European town with trams sporting Hindi slogans on their sides. Of course, it is supposedly linked to Bollywood, but the Indian traffic to Zurich has to be seen to believe. It is suggested that at least 60,000 Indians visit Switzerland – not all going there for skiing!!! The estimate of Indian money in tax havens varies from 500 billion USD to 1.4 trillion USD.

The estimates of the money stashed abroad can be inferred from a pioneering study sponsored by the Ford Foundation, ‘Illicit Financial Flows from Developing

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Countries: 2002-2006 – Global Financial Integrity – By Dev Kar and Devon-Cartwright Smith.⁴

Financial flows in the context of this report includes the proceeds from both illicit activities such as corruption (bribery and embezzlement of national wealth), criminal activity and proceeds of licit business that become illicit when transferred across borders in contravention of applicable laws and regulatory frameworks (most commonly to evade payment of taxes).

It is pertinent to keep in mind the following points:

- a) In 2006, the most recent year of the Global Financial Integrity study, developing countries lost an estimated \$858.6 billion to \$1.06 trillion in illicit financial outflows.
- b) Even at the lower end of the range of estimates, the volume of illicit financial

Money gets to tax havens through under- and over-invoicing of exports and imports and stashing the balance abroad; kickbacks from major defence/civilian contracts; smuggling of gold in the past; transactions done abroad but not reported in India; *hawala* funds; and funds earned by artistes/entertainment industry/sportspersons but stashed abroad.

flows leaking out of developing countries increased at a compound rate of 18.2 per cent over the five-year period analysed for the study.

- c) On an average, for the five-year period of this study, Asia accounts for approximately 50 per cent of overall illicit financial flows from all developing countries.
- d) This study shows that the average money taken away from India annually during 2002-06 is \$27.3 billion. It means that during the five-year period, the amount stashed away equals 136.5 billion dollars. It is not that all this money went to the Swiss banks but other tax havens as well. The share of Swiss banks in the dirty money equals one-third of the global aggregate, some \$ 45 billion of the 136.5 billion stashed away from India.⁵

e) Another important point is that the study pertains to only five years. More money was stashed away during the Nehruvian socialist regime. So the loot for 55 years would be several times the about-mentioned amount. In fact, in those days, the Indian rupee commanded a better price per dollar. In other words, a fewer rupees could get more dollars. Estimates are that the Indian money stashed abroad may be of the order of \$1.4 trillion.

f) This 1.4 trillion USD equals Rs 70 lakh crore. Compare it to our national income of around Rs 50 lakh crore.

How did the money get to tax havens in the first place? There are several methods/reasons: under- and over-invoicing of exports and imports and stashing the balance abroad; kickbacks from major defence/civilian contracts; smuggling of gold in the past; transactions done abroad but not reported in India; *hawala* funds; and funds earned by artistes/entertainment industry/sportspersons but stashed abroad. If you opt to indulge in *adharma*, hundred ways open up!

We need to take steps to bring back to India all the illegal money stashed away in these tax havens. It has been successfully demonstrated by countries which tried to recover assets stashed abroad by their corrupt leaders and businessmen, that this can be

accomplished. Consider these examples:

- Philippines slogged for 18 years but finally succeeded in getting back the bribe money of its former President Ferdinand Marcos (\$ 624 million) held in Swiss Bank accounts.
- Between 2001-2004, Peru recovered \$180 millions stashed away in tax havens by Vladimiro Montesinos.
- Between 2005-2006, Nigeria recovered 505 million USD of Sani Abacha, otherwise frozen and forfeited by Swiss authorities.

If India joins hands with the OECD and G-20 nations and a deal comes through between the G-20 and different tax havens, particularly Switzerland, the process to recover Indian monies can be much shorter and hugely successful.

The illegal funds, if brought back to India, can tremendously boost our foreign exchange reserves and facilitate infrastructure investment. The entire tax efforts of countries like India are subverted by these deposits. The gap between tax evasion and terror financing is getting smaller. Lesser the transparency in bank accounts, greater the threat to civilised society. From this point also, it is imperative for us to get these vaults opened. The issue should also become a major issue for world trade and financial negotiations. The entire issue of global financial flows and cross-country free flows becomes meaningless due to

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presence of these tax heavens. An Indian lead will shake the world and help a large number of African and Latino countries in the process. Even spiritual leader like Baba Ramdev has demanded that steps be taken to bring back the stashed money. Another important is whether there is a political will among the India's ruling class to put the issue of tax havens on global agenda and compel developed countries to facilitate burial of this anachronism in the 21st century? These tiny islands have had their time, crooked purpose and place in history. But not now in a globalising world where compliance is the motto and transparency the *mantra*. India will bring sanity to global financial markets and joy to millions of pauperised persons in Latin America, Asia and Africa if it takes up

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To start with, we can add a column in affidavits to be submitted by electoral candidates, regarding wealth accumulated abroad. Of course, politicians are not going to declare their ill-gotten wealth but the column may come in handy in future to formulate charge of submission of false affidavits. Second issue is with regards to link between globalisation and ill-gotten wealth. India as a responsible member of world forums can and should demand transparency from these tax heavens to provide information regarding illicit wealth, its source and time. These funds are as dangerous to the global welfare as global warming or carbon toxins. It is for the G-20 leaders to address the issue to bring orderly growth in the global financial markets. The entire revenue generation efforts of countries like India get subverted by these illegal deposits abroad.

Therefore, India should raise the issue at G-20/WTO/IMF/UN and also as a member of Egmont Group, which is an international body to stimulate cooperation amongst Financial Intelligence Unit (FIUs) across the globe. More than 100 countries are its members. FIU-India was made a member of the Egmont Group at its recent Plenary Session at Hamilton, Bermuda after verification of the FIU-India's operational status and ability to share information with foreign FIUs. The Egmont Group membership, apart from meeting an important requirement of Financial Action Task Force (FATF), will facilitate and enhance the exchange of information by FIU-India with other FIUs. Admission of FIU-India into the Egmont Group is a major step forward for India to join the international community in its fight against money laundering and financing of terrorism. On its part, the Indian government continues to remain committed to fight the menace of money laundering and financing of terrorism with full might. India has enacted the Prevention of Money Laundering Act, 2002 (PMLA) which was brought into force from July 1, 2005. Financial Intelligence Unit-India has also been set up to receive information relating to large cash and suspicious transactions under PMLA from various entities in financial sector and disseminate information in appropriate cases to

relevant intelligence/law enforcement agencies. FIU-India has, till now, received more than 27 lakh Cash Transaction Reports and more than 1,100 Suspicious Transaction Reports from various entities in the financial sector. FIU-India is also authorised to share information relating to suspect financial transactions with other FIUs. Hence, it is important that India takes the lead and encourage other African and Latin American and Asian countries to join in this effort.

In Bofors case, it was the government of the day versus opposition parties. But now, a mass movement has to be built against all tainted leaders. The citizens of India should fight to uphold the values of our Republic, which is not just a market or museum piece but a living civilisation wounded by colonialists and looted by current *thanedars* ruling the roost in the corridors of power. If the leaders keep

quiet on this burning issue, we can conclude that the elite of the country have failed us. Of course, the mainstream media – both electronic and print – will campaign to “fill up pubs” in the name of freedom rather than take up any serious issue. Our media has become a mere entertainer and is not interested in any important issue.

Let us remember that the past history suggests that our elite failed India and helped in the plunder and devastation of this country. The silence of our elite in politics/media/business/bureaucracy and arts speaks volumes about our collective guilt. ‘No criminals in politics’ is a good campaign, but can we afford leaders who stash funds abroad? Black money stashed abroad is the Gangotri of all crimes. It shows our distrust for our motherland and contempt for *dharma*. Let us deal with it first.

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On Socialists

There are 84 castes among the Brahmins, whereas it would seem there are 85 different types of socialists.

Sardar Vallabbhai Patel