VISION: Journal of Indian Taxation
Vol. 5(1), Jan-Jun 2018, pp. 91-103
DOI: 10.17492/vision.v5i1.13237
www.journalpressindia.com/vjit
© 2018 Journal Press India

Strengthening Financial and Taxation Regulatory Framework in India: A Review of Recent Legislations

*Sandeep Jain**

ABSTRACT

A number of legislations and institutional measures have been implemented in recent times by the government of India to ensure an efficient financial and taxation system. These measures focus on developing an unambiguous legal framework and transparent supervisory procedures. This paper reviews some of the recent legislations in this regard which are aimed at bringing our financial and taxation system in alignment with the changing environment. Some of the legislations reviewed include Prevention of Money Laundering Act, 2002; Credit Information Companies (Regulation) Act, 2005; Government Securities Act, 2006; Payment and Settlement Systems Act, 2007; Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and Financial Sector Legislative Reforms Commission (FSLRC), 2013. An overall assessment of these reforms shows that a number of effective legislations are being put in place for an efficient and transparent financial and taxation system and India remains committed to adoption of international standards and best practices wherever necessary.

***Keywords**: Financial system; Taxation; Money laundering; Black money; Credit information*

1.0 Introduction

An efficient financial and taxation system requires a regulatory framework with well-defined objectives, adequate and clear legal framework and transparent supervisory procedure. This, in turn, requires comprehensive legislations to enable the regulatory authorities to discharge their responsibilities effectively. The RBI has, therefore, been making constant efforts to upgrade and strengthen the legal framework in tune with the changing environment. This paper reviews some of the recent Acts enacted by the Parliament towards this objective so as to understand India's commitment towards adoption of best practices for an efficient financial and taxation system.

**FCA, Fellow Chartered Accountant, Delhi, India. (Email: caskcindia@gmail.com)*

2.0 Prevention of Money Laundering Act (PMLA), 2002

Money laundering is the process of transforming the proceeds of crime and corruption into ostensibly legitimate assets. In a number of legal and regulatory systems, however, the term money laundering has become conflated with other forms of financial and business crime, and is sometimes used more generally to include misuse of the financial system, including terrorism financing and evasion of international sanctions. Most anti-money laundering laws openly conflate money laundering with terrorism financing when regulating the financial system.

Some countries define money laundering as obfuscating sources of money, either intentionally or by merely using financial systems or services that do not identify or track sources or destinations. Other countries define money laundering to include money from activity that *would have been* a crime in that country, even if it was legal where the actual conduct occurred. This broad brush of applying money laundering to incidental, extraterritorial or simply privacy-seeking behaviours has led some to label it *financial thought crime*.

PMLA, 2002 was enacted in January 2003. The Act along with the Rules framed thereunder came into force with effect from July 1, 2005. Section 3 of PMLA defines offence of money laundering as whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering. It prescribes obligation of banking companies, financial institutions and intermediaries for verification and maintenance of records of the identity of all its clients and also of all transactions and for furnishing information of such transactions in prescribed form to the Financial Intelligence Unit-India (FIU-IND). It empowers the Director of FIU-IND to impose fine on banking company, financial institution or intermediary if they or any of their officers fails to comply with the provisions of the Act.

PMLA empowers certain officers of the Directorate of Enforcement to carry out investigations in cases involving offence of money laundering and also to attach the property involved in money laundering. PMLA envisages setting up of an Adjudicating Authority to exercise jurisdiction, power and authority to confirm attachment or order confiscation of attached properties. It also envisages setting up of an Appellate Tribunal to hear appeals against the order of the Adjudicating Authority and the authorities like Director FIU-IND.

PMLA envisages designation of one or more courts of sessions as Special Court or Special Courts to try offences punishable under PMLA and offences with which the

accused may, under the Code of Criminal Procedure, 1973, be charged at the same trial. PMLA allows Central Government to enter into an agreement with Government of any country outside India for enforcing the provisions of the PMLA, exchange of information for the prevention of any offence under PMLA or under the corresponding law in force in that country or investigation of cases relating to any offence under PMLA.

PMLA seeks to combat money laundering in India and has three main objectives:

1. To prevent and control money laundering.
2. To confiscate and seize the property obtained from the laundered money.
3. To deal with any other issue connected with money laundering in India.

Special Courts have been set-up in a number of States/UTs by the Central Government to conduct the trial of the offences of money laundering. The authorities under the Act, like the director, adjudicating authority and the appellate tribunal, have been constituted to carry out the proceedings related to attachment and confiscation of any property derived from money laundering.

In order to enlarge the scope of this Act and to achieve the desired objectives, the Act provides for bilateral agreements between countries to cooperate with each other and curb the menace of money laundering. These agreements shall be for the purpose of either enforcing the provisions of this Act or for the exchange of information which shall help in the prevention in the commission of an offence under this Act or the corresponding laws in that foreign State.

In certain cases the Central Government may seek/provide assistance from/to a contracting State for any investigation or forwarding of evidence collected during the course of such investigation. The Act provides for reciprocal arrangements for processes/assistance with regard to accused persons.

The Government constituted the Financial Intelligence Unit-India, in November, 2004. The organization has started receiving Cash Transaction Reports and Suspicious Transaction Reports from the banking companies etc. in terms of Section 12 of the PMLA.

3.0 Credit Information Companies (Regulation) Act, 2005

It is aimed at providing for regulation of credit information companies and to facilitate efficient distribution of credit. No company can commence or carry on the business of credit information without obtaining a certificate of registration from the RBI. The Act sets out procedures for obtaining certificate of registration, the requirements of minimum capital and management of credit information companies. The Act also empowers the RBI to determine policy in relation to functioning of credit

information companies and to give directions to such companies, credit institutions and specified users.

The Act also lays down the functions of credit information companies, powers and duties of auditors, obtaining of membership by credit institutions in credit information companies, information privacy principles, alterations of credit information files and credit reports, regulation of unauthorised access to credit information, offences and penalties, obligations as to fidelity and secrecy.

Other salient features of the Act include settlement of disputes between credit institutions and credit information companies or between credit institutions and their borrowers. The Act also provides for amendment of certain enactments so as to permit disclosure of credit information.

4.0 Government Securities Act, 2006

This Act was enacted by the Parliament with a view to consolidating and amending the law relating to Government securities and its management by the Reserve Bank of India. The Act applies to Government securities created and issued, whether before or after the commencement of the Act, by the Central or a State Government. Accordingly, the Public Debt Act, 1944 ceased to apply to the Government securities. The Indian Securities Act, 1920 was repealed.

The new Act would facilitate widening and deepening of the Government securities market and its more effective regulation by the Reserve Bank in various ways, such as:

1. Stripping or reconstitution of Government securities.
2. Legal recognition of beneficial ownership of the investors in Government securities through the constituents' subsidiary general ledger (CSGL).
3. Statutory backing for the Reserve Bank's power to debar subsidiary general ledger (SGL) account holders from trading, either temporarily or permanently, for misuse of SGL account facility.
4. Facility of pledge or hypothecation or lien of Government securities for availing of loan.
5. Extension of nomination facility to hold the securities or receive the amount thereof in the event of death of the holder.
6. Recognition of title to Government security of the deceased holder on the basis of documents other than succession certificate such as will executed by the deceased holder, registered deed of family settlement, gift deed, deed of partition, etc., as prescribed by the Reserve Bank of India.

7. Recognition of mother as the guardian of the minor for the purpose of holding Government Securities.
8. Statutory powers to the Reserve Bank to call for information, cause inspection and issue directions in relation to Government securities.

5.0 Payment and Settlement Systems Act, 2007

This Act, along with Payment and Settlement Systems Regulations, 2008, stipulates that no person other than the Reserve Bank of India (RBI), shall commence or operate a payment system except under and in accordance with an authorisation issued by the RBI under the provisions of the Act.

All persons currently operating a payment system or desirous of setting up a payment system, as defined in Section 2(1)(i) of the Act should apply for authorisation to the Reserve Bank, unless specifically exempted in terms of the Act. Existing payment systems will cease to have the right to carry on their operations, unless they obtain an authorisation within six months from the commencement of the Act (i.e. August 12, 2008).

The Payment and Settlement Systems Regulations, 2008 detail the form and manner in which the application is to be made to the Reserve Bank for grant of authorisation.

6.0 Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

Individuals and institutions globally are engaged in evading taxes and generating surplus which do not get accounted for in the formal economy. These funds are generated from activities which may be legal or illegal by nature. However, the mere fact that taxes have not been paid on such incomes, as per the rules of the land, converts such funds to form a part of the parallel economy or black money generation. The Government has been focused on the black money peril both within the confines of India and the sums of money parked abroad. To tackle the complex issue of black money abroad which has been in the headlines, a separate regime for taxation of The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 has been introduced.

The Act was passed by Lok Sabha on May 11, 2015 and by the Rajya Sabha on May 13, 2015. It received President's assent on May 26, 2015 and came into force on July 1, 2015. The Act extends to the whole of India.

The Act makes provisions to deal with the problem of the black money (i.e.

undisclosed foreign income and assets), to frame procedures for dealing with such income and assets and to provide for imposition of tax on any undisclosed foreign income and asset held outside India and for matters connected therewith or incidental thereto.

7.0 Benami Transactions (Prohibition) Amendment Act, 2016

It came into force from November 1, 2016. The new law seeks to give more teeth to the authorities to curb benami transactions and hence black money. The Act is an amendment of the existing Benami Transactions (Prohibition) Act, 1988. After coming into force, it was renamed as Prohibition of Benami Property Transactions Act, 1988 (PBPT Act). The Act defines *benami* transactions and also provides imprisonment up to 7 years and fine for violation of the Act. The earlier law provided for up to 3 years of imprisonment or fine or both.

The PBPT Act prohibits recovery of the property held benami from benamidar by the real owner. Properties held benami are liable for confiscation by the government without payment of compensation. The new law also provides for an appellate mechanism in the form of an adjudicating authority and appellate tribunal.

The amendments aim to strengthen the Act in terms of legal and administrative procedure. The *benami* (without a name) property refers to property purchased by a person in the name of some other person. The person on whose name the property is purchased is called the *benamdar* and the property so purchased is called the *benami* property. The person who finances the deal is the real owner.

The PBPT Act prohibits recovery of the property held benami from benamdar by the real owner. As per the Act, properties held benami are liable for confiscation by the government, without payment of compensation. An appellate mechanism has been provided under the act, in the form of an adjudicating authority and appellate tribunal.

The four authorities who will conduct inquiries or investigations are the Initiating Officer, Approving Authority, Administrator and Adjudicating Authority.

In the case of charitable or religious organisation properties, the government has the power to grant exemption.

8.0 High Level Committee on Financial Sector Reforms, 2008

With a view to outlining a comprehensive agenda for the evolution of the financial sector—indicating especially the priorities and sequencing decisions which the Government of India must keep in minds—a High Level Committee on Financial Sector Reforms was set up by the Planning Commission of India in August 2007. The

Committee (Chairman: Raghuram G. Rajan) submitted its report in September 2008, and made the following main recommendations:

1. Allow more entry to private well-governed, deposit-taking small finance banks.
2. Liberalise the banking correspondent regulation so that a wide range of local agents can serve to extend financial services. Use technology both to reduce costs and to limit fraud and misrepresentation.
3. Offer priority sector loan certificates (PSLC) to all entities that lend to eligible categories in the priority sector. Allow banks that undershoot their priority sector obligations to buy the PSLC and submit it towards fulfilment of their target.
4. Sell small under-performing public sector banks, possibly to another bank or to a strategic investor, to gain experience with the process and gauge outcomes.
5. Create stronger boards for large public sector banks, with more power to outside shareholders (including possibly a private sector strategic investor), devolving the power to appoint and compensate top executives to the board.
6. After starting the process of strengthening boards, delink the banks from additional government oversight, including by the Central Vigilance Commission and Parliament, with the justification that with government-controlled boards governing the banks, a second layer of oversight is not needed.
7. Be more liberal in allowing takeovers and mergers, including by domestically incorporated subsidiaries of foreign banks.
8. Free banks to set up branches and ATMs anywhere.

9.0 Committee on Financial Sector Assessment (CFSA), 2009

In March 2009, the Government and RBI jointly released the report of the Committee on Financial Sector Assessment (CFSA) that was co-chaired by Deputy Governor Rakesh Mohan and Finance Secretary Ashok Chawla. The report is the culmination of work started in September 2006 to undertake a comprehensive self-assessment of India's financial sector, particularly focusing on stability assessment and stress testing and compliance with all financial standards and codes.

CFSA owed its origins to the Financial Sector Assessment Programme (FSAP) that was initiated in 1999 and carried out jointly by the IMF and the World Bank after the Asian crisis. Several countries, including India, participated in this long- drawn and resource-intensive exercise. This programme so far has been conducted by the IMF and the World Bank using experts from around the world to carry out the assessment with participation from the host country.

The CFSA followed a forward-looking and holistic approach to self-assessment, based on three mutually reinforcing pillars:

1. Financial stability assessment and stress testing.
2. Legal, infrastructural and market development issues.
3. Assessment of the status of implementation of international financial standards and codes.

The first pillar is essentially concerned with stability assessment. Taking into account the legal, regulatory and supervisory architecture in India, the CFSA felt the need for involving, and associating closely, all the major regulatory institutions in the financial sector—RBI, SEBI and IRDA[1], besides the relevant government departments. Direct official involvement at different levels brought about enormous responsibility, ownership, and commitment to the process, ensuring constructive pragmatism when faced with contentious issues.

Since the assessment required comprehensive domain knowledge in the various technical areas examined, the CFSA initially constituted Technical Groups comprising officials with first-hand experience in handling the respective areas from the regulatory agencies concerned as well as the government to undertake the preliminary assessment and to prepare technical notes and background material in the concerned areas. This ensured that officials who are well-conversant with their own systems and are aware of the existing strengths and weaknesses could identify the best alternative solutions.

To ensure an impartial assessment, the CFSA constituted four external independent advisory panels, comprising non-official experts drawn from within the country. These Panels made their assessments after thorough debate and rigorous scrutiny of inputs provided by the technical groups. To further strengthen the credibility of this assessment, the advisory panels' assessments were reviewed by eminent international experts.

The CFSA then drew up its own overview report at the final stage, drawing upon the assessments, findings and recommendations of the advisory panels and the comments of the peer reviewers. The assessments and recommendations comprise six volumes.

Overall, the CFSA found that India's financial system is essentially sound and resilient, and that systemic stability is by and large robust. India is broadly compliant with most of the standards and codes though gaps were noted in the timely implementation of bankruptcy proceedings.

Of immediate interest, and related closely to the current macroeconomic conditions, the CFSA also carried out single-factor stress-tests for credit and market risks and liquidity ratio and scenario analyses. These tests show that there are no significant vulnerabilities in the banking system. This does not mean that NPAs will not rise in this

economic slowdown. NPAs may indeed rise. However, given the strength of the banks' balance sheets, that rise is not likely to pose any systemic risks, as it might in many advanced countries.

Risk assessment, however, is a continuous process and the stress tests need to be conducted taking into account the macroeconomic linkages as also the second round and contagion risks.

10.0 Financial Sector Legislative Reforms Commission (FSLRC), 2013

The Indian financial system is increasingly out of touch with the requirements of the economy today and the even greater requirements of the economy in the future. Most changes in the framework of financial regulation in India have been made in response to the need of the hour. This has meant piecemeal changes to the various laws that give powers to regulators to regulate finance.

In recent years, a consensus has emerged about the direction of reforms through a series of expert committees, which have drawn on hundreds of independent experts and a body of research on the failings of Indian finance. However, many of the changes proposed are incompatible with the basic structure of existing laws.

With a view to revamping financial sector laws to bring them in tune with current requirements, the Government set up the FSLRC (Chairman: B.N. Srikrishna) on March, 24, 2011.[2] FSLRC in its Report, submitted in March 2013, gave wide-ranging recommendations, both legislative and non-legislative, on the institutional, legal, and regulatory framework and operational changes in the Indian financial sector. The draft Indian Financial Code (IFC) was proposed by FSLRC has provisions that aim at replacing a large numbers of existing financial laws. FSLRC has designed a modified financial regulatory architecture which would increase accountability by achieving clarity of purpose for each organization and avoid conflicts of interest. The modified arrangements also facilitate achieving economies of scope and scale of related activities, for the private sector and for the government.

The FSLRC was set up to review and redraft the laws so that Indian finance can be reformed to prepare India for growing into a modern economy, without having to constantly amend existing laws to incorporate each new step for the financial system.

The task for FSLRC was to question the fundamental arrangements between regulators, the Government, the regulated, and the consumer for whose protection regulation is ultimately being done. FSLRC proposed a new draft law, viz. the Indian Financial Code. This law puts consumer protection at the heart of all financial regulations. In order to protect the consumer without putting a burden on the taxpayer,

regulators do micro-prudential regulation and reduce the risk of failure of financial firms. They protect policy holders and prevent unsuitable products from being sold through regulations about consumer protection and through redressal forums. When financial firms fail, shareholders should bear the full brunt of the failure, but consequences for consumers and the economy should be blocked using a resolution corporation. Through systemic risk regulation, the regulators and the government prevent a large-scale disruption of financial services. This adds up to a rational approach to interventions by financial agencies in the financial system, as opposed to the existing approach of command and control.

A major theme of many of the recommendations of previous committee reports in India has been the impediments placed by financial agencies against progress. This issue has been addressed by FSLRC by giving regulators clear objectives and enumerated powers. The regulator in this scenario needs to demonstrate that the regulation is required to meet the objectives assigned to him, and it lies within his powers, and that a cost-benefit analysis of the regulation shows that the additional cost, monetary or otherwise, of complying with this regulation is going to bring clear benefits to the economy.

11.0 Indian Financial Code (IFC)

The Report of FSLRC contained the Draft Indian Financial Code. IFC replaces most existing Indian financial laws. It seeks to address present weaknesses of the Indian financial system, and meet the requirements of the Indian economy over the coming 30 years.

IFC articulates clear objectives for financial regulation where Government intervention is required. These include (a) consumer protection, (b) micro-prudential regulation, (c) systemic risk reduction, (d) market abuse in organized financial trading, (e) consumer redress, (f) debt management, (g) capital controls, and (h) monetary policy. In each area, precise objectives are stated and precise powers given to financial agencies.

IFC lays great emphasis on the formal process through which the legislative, executive, and judicial functions take place in financial regulation. The principles of rule of law and accountability are emphasized to create a better environment of checks and balances around regulators.

The present financial regulatory architecture has come about through numerous episodes in the past decades, without a coherent design. FSLRC has designed a modified financial regulatory architecture, which would increase accountability by achieving clarity of purpose for each organization and avoid conflicts of interest. The modified arrangements also facilitate achieving economies of scope and scale.

Financial Stability and Development Council (FSDC) decided that while the

draft IFC is a bill that requires Parliamentary action, a number of changes proposed by the FSLRC can be implemented voluntarily, without any legislative changes. To provide examples of best practices, and to guide regulators on compliance with the measures recommended by the FSLRC, the Ministry of Finance has published a handbook on adoption of governance enhancing and non-legislative elements of the draft Indian Financial Code.

IFC is on the legislative agenda. This legislative and non-legislative work is now the centrepiece of financial reforms in India.

12.0 Financial Stability and Development Council (FSDC)

Following the recent global financial crisis, several nations have been revisiting their regulatory architecture. India has also been prompt to act on this front. In pursuance of the announcement made in the Budget 2010-11, an apex-level Financial Stability and Development Council was set up under the Chairmanship of the Finance Minister for strengthening and institutionalizing the mechanism for maintaining financial stability and enhancing inter-regulatory coordination. FSDC is a non-statutory apex council for coordination among various regulatory bodies, since in India's increasingly complex economy, issues arise that straddle multiple financial jurisdictions.

FSDC monitors macro-prudential supervision of the economy, including functioning of large financial conglomerates, and addresses inter-regulatory coordination and financial-sector development issues. It also focuses on financial literacy and financial inclusion.

A sub-committee of the FSDC has also been set up under the chairmanship of the Governor of Reserve Bank of India (RBI). Under the aegis of the FSDC, two empowered technical groups (i.e. Technical Group on Financial Literacy and Financial Inclusion and Inter-Regulatory Technical Group) have been formed.

13.0 Financial Action Task Force (FATF)

FATF is an inter-governmental policy-making body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a *policy-making body* which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

The FATF has a ministerial mandate to establish international standards for

combating money laundering and terrorist financing. India joined the FATF as its 34th member in June 2010. At present the FATF has 36 members comprising 34 countries and two organizations, namely the European Union and Gulf Cooperation Council. India participated in the FATF plenary and Working Group Meetings held in Mexico from June 20-24, 2011.

FATF has developed a series of Recommendations that are recognised as the international standard for combating of money laundering and the financing of terrorism and proliferation of weapons of mass destruction. They form the basis for a co-ordinated response to these threats to the integrity of the financial system and help ensure a level playing field. First issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003 and most recently in 2012 to ensure that they remain up to date and relevant, and they are intended to be of universal application.

FATF monitors the progress of its members in implementing necessary measures, reviews money laundering and terrorist financing techniques and counter-measures, and promotes the adoption and implementation of appropriate measures globally. In collaboration with other international stakeholders, the FATF works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse.

FATF's decision making body, the FATF Plenary, meets three times per year.

14.0 Financial Stability Board (FSB)

FSB was established in 2009 under the aegis of the G20 bringing together the national authorities, standard-setting bodies, and international financial institutions to address vulnerabilities and to develop and implement strong regulatory, supervisory, and other policies in the interest of financial stability. India is an active Member of the FSB. Financial Stability and Development Council (FSDC) Secretariat in the Department of Economic Affairs, Ministry of Finance coordinates with the various financial sector regulators and other relevant agencies to represent India's views with the FSB. As a member of the FSB, Basel Committee on Banking Supervision (BCBS), and International Monetary Fund (IMF), India actively participates in post-crisis reforms of the international regulatory and supervisory framework under the aegis of the G20. India remains committed to adoption of international standards and best practices, in a phased manner and calibrated to local conditions, wherever necessary.

Endnotes

1. The supervisory control of insurance companies is exercised by Insurance Regulatory and Development Authority (IRDA) and these powers flow from Insurance Act, 1938 as well as

from IRDA Act, 1999. IRDA Act 1999 states: "Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of insurance business and reinsurance business". Regulatory and supervisory powers of the IRDA are wide and pervasive.

2. Government of India, Ministry of Finance, *Report of the Financial Sector Legislative Reforms Commission* (Chairman: B.N. Srikrishna), March 2013.