

Black Money in Balance Sheets

Executive Summary: -

Black money has always been a major issue in India's economy. One of the common ways to convert black money into white is through **fake deposits** in books of accounts. This practice allows people to hide their unaccounted money in a way that looks legal, but avoids paying taxes.

In this article, we'll discuss how fake deposits work, the legal consequences, and how a famous case involving Subrata Roy and the Sahara Group highlights the dangers of this practice.

What Are Fake Deposits?

A fake deposit is when a company or individual records money in their books that didn't actually come from a legitimate source. This could include:

- Loans from fake or non-existent people or companies,
- Share capital from shell companies (companies that only exist on paper),
- Payments for goods or services that were never provided, or
- Simple cash deposits that don't have a valid reason behind them.

People use these fake entries to make their financial records look clean, even though the money is unaccounted for and not taxed.

Legal Framework: Section 68 of the Income Tax Act

The Income Tax Act addresses this issue under Section 68, which states that if a person's financial records show a deposit, they must explain where that money came from. If they can't provide a satisfactory explanation, the tax authorities can treat that deposit as income, which will be taxed.

The person must prove:

- Who the creditor is,
- That the creditor can afford to lend the money, and
- That the transaction is real.

If they cannot prove these, the money will be treated as their income and taxed accordingly.

The Sahara Case: A Real-World Example

The **Sahara Group** case is one of the most high-profile examples of how fake deposits were used to launder black money. The case revolved around two companies, **Sahara India Real Estate Corporation Limited (SIRECL)** and **Sahara Housing Investment Corporation Limited (SHICL)**, which raised over **₹24,000 crore** from more than **30 million investors** in the form of **collective investment schemes (CIS)**. These funds were ostensibly raised for housing projects and real estate investments.

However, the **Securities and Exchange Board of India (SEBI)**, the regulatory body responsible for overseeing securities markets, began investigating the claims in 2011 after it found discrepancies in the investment documents and the lack of transparency regarding the investors. SEBI questioned the legality of these schemes, asserting that Sahara had raised money without registering the schemes with SEBI, as required by law.

Fake Investors and Untraceable Funds

The key issue in the Sahara case was the **suspicious nature of the investors**. Sahara claimed to have raised funds from millions of small investors across India. However, investigations revealed that many of these so-called investors were **non-existent** or **benami (proxy investors)**, meaning they were not real people but fake or shell companies used to create the appearance of legitimacy.

Sahara failed to provide **proper documentation** for these investors, such as identification proofs and address details, as required by law. The company's **audit trail** was highly irregular, and many of the investors allegedly had no idea that their names were being used in these schemes. Essentially, Sahara was using **paper investors** to show that the funds came from legitimate sources, when in reality, the money was sourced from unaccounted cash or black money.

Legal and Regulatory Impact

This case took a dramatic turn when SEBI issued orders for Sahara to refund the money raised from investors, along with **interest**. Sahara challenged these orders in court, arguing

that the funds were raised through legitimate means and that SEBI had no jurisdiction over their operations. The matter escalated to the **Supreme Court of India**, which in **2012** ordered Sahara to return the money to investors.

The **Supreme Court's ruling** in the Sahara case was significant because it directly addressed the use of **fake deposits and non-existent investors** as a mechanism for laundering money. The Court held that:

- The funds raised by Sahara were not legitimate investments, but instead constituted **unaccounted money**.
- Sahara was ordered to refund the money to investors, which was to be done in a way that could be tracked and verified.
- Subrata Roy, the founder of the Sahara Group, was ordered to appear in court and explain the company's failure to comply with the Court's orders.

Subrata Roy's Arrest and Jail Term

Subrata Roy's refusal to comply with the Supreme Court's order led to his **arrest** in **March 2014**, a move that made headlines across India. He was charged with contempt of court for failing to return the money to investors and for his role in the **illegal raising of funds**.

Roy's arrest highlighted the severe legal consequences of manipulating financial records and using fake deposits to launder black money. It also sent a strong message to businesses across India about the importance of adhering to regulatory standards and ensuring transparency in financial dealings.

Impact on the Financial System

The Sahara case was a wake-up call for regulators and tax authorities in India. It brought to light the ease with which unaccounted money could be introduced into the formal financial system using fake deposits. The case highlighted several key issues:

- The need for better **investor protection laws** to ensure that companies raising funds from the public are transparent and compliant with regulations.
- The role of **intermediaries** (like auditors, legal advisors, and financial professionals) in ensuring that funds raised by companies are legitimate and traceable.
- The importance of **comprehensive due diligence** by tax authorities to prevent the movement of black money through fake transactions and shell companies.

Aftermath and Reforms

In the aftermath of the case, the **Sahara Group** faced significant financial and legal challenges. The company was forced to sell off assets and restructure its operations to comply with the Court's orders. Subrata Roy's arrest and subsequent bail bond of **₹10,000 crore** also sparked a broader discussion about **corporate governance**, **financial transparency**, and **accountability** in India.

Additionally, the case prompted the Indian government and regulators to review and tighten existing laws around **collective investment schemes** and **financial disclosures**. In the years that followed, the Reserve Bank of India (RBI) and SEBI implemented stricter regulations to **monitor unregulated financial schemes** and prevent the misuse of fake deposits for laundering black money.

Challenges for the Tax Department

Detecting fake deposits is not easy. Some of the challenges include:

- Layering: Money is often moved through different companies to hide its true origin.
- Fake companies: Shell companies are used to create the illusion of real transactions.
- Uncooperative investors: Sometimes, people involved in these transactions refuse to provide any information when asked.
- Old deposits: Some deposits were made before demonetisation (2016), and these are still hard to trace.

What Happens if You Get Caught?

If tax authorities find that a deposit is fake, the consequences can be severe:

- The amount of the fake deposit will be added to your income and taxed.
- You could face a penalty of up to 200% of the tax due.
- In some cases, you could face criminal charges for tax evasion, which could result in jail time.
- The Benami Transactions (Prohibition) Act and Prevention of Money Laundering Act (PMLA) can also be used to seize property and punish offenders.

The Role of Professionals

As a tax professional, it is essential to ensure that all financial records are accurate and legitimate. If you are asked to certify accounts, make sure to:

- Verify the identity and financial status of any person or company involved in a transaction.
- If you suspect something is wrong, don't hesitate to ask for more information or decline the assignment.
- Always act in a manner that upholds the integrity of your profession.

Conclusion

Fake deposits are not just an accounting error—they are a way for people to avoid paying taxes and hide black money. As tax professionals and business owners, it's important to be aware of these tactics and to ensure that all financial records are honest and transparent. With improved technology and better regulations, tax authorities are increasingly able to catch these fraudulent practices. Let's make sure we are part of the solution, not the problem.