

CONSEQUENCES OF MONEY LAUNDERING IN REAL ESTATE

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Abstract: Chennai is the capital city of the Tamil Nadu state in India. It is considered to be the entry point of south India. It is named for its commercial, economic and educational center. It is also known as the "Cultural Capital of South India" with several intercultural activities. Due to its popularity and growth Chennai's real estate market is determined by black money. Money Laundering is the proceeds of an "unlawful activity", unlawful activity can be any activity which is related, directly or indirectly to any crime or illegal activity. Money laundering is the process of making dirty money look clean. The real estate market is volatile in nature when it comes to pricing. Due to this, many unscrupulous elements find this as a perfect form of investment, where illegal revenue can be concealed.

INTRODUCTION

Land is one of those essential commodities in the world which cannot be manufactured to fulfil the supply and demand of the increasing population. Real Estate industry is probably the oldest form of business in the world and has proven to be the only business which has never lost its glamour since the ancient period. It has the nature of increasing except in times of severe economic downtrends. Buying or selling of a property is considered to be one of the largest financial dealing for an average family. Variations in property prices will be impacting on family's decisions like where to live, children education and work.

Until 19th century the concept of real estate did not undergo much change. Although in last two decades, it has undergone major changes which made this industry vulnerable towards Money Laundering that benefits anti-social elements throughout the world. Various reports produced by the Financial Action Task Force (FATF) and International Monetary Fund (IMF) over the last few years have made reference to the fact that the real-estate sector may be one of the vehicles used by criminal organizations to launder their illicitly obtained money. As huge amount of funds and several parties involved in every single real-estate transaction, it is extremely difficult to identify property dealings and transactions associated with money laundering.

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MONEY LAUNDERING

Money Laundering is the proceeds of an “unlawful activity”, unlawful activity can be any activity which is related, directly or indirectly to any crime or illegal activity. Money laundering is the process of making dirty money look clean. Organized crimes like arms transportation, smuggling, human trafficking, embezzlement, tax fraud, bribery, drug trafficking and prostitution will generate a huge amount of money. Hence criminals need to find a way to convert the origin from illegitimate to a legitimate source before the authorities determine the true origin of money. Con artists do this by concealing the sources, converting the form and transfer of money to different spaces where it is less likely to attract attention of the authorities. Money laundering has three states 1. Placement: introduction of illegal proceeds into the fiscal system, 2. Layering: separation of illicit money from their source by layers of financial transactions and 3. Integration: providing legitimacy to illicit wealth by the re-entry into the economy.

The Financial Action Task Force (FATF) – a Paris-based inter-governmental body defines money laundering as:

- The conversion or transfer of property, knowing it is derived from a criminal offense
- The concealment or disguising of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property
- The acquisition, possession or use of property, knowing at the time of its receipt that it was derived from a criminal offense or from participation in a crime.

Rise in Real Estate Demand

In the last two decades, market value of the property has started to change on a weekly / monthly basis and some times daily especially in the peak commercial and residential areas. Even though Government hiked the guide line value by a little margin with the intension of helping poor and middle class people to buy a piece of land, sellers and their agents have started hiking the value of the property with the reasons that are not connected to the property.

The demand for residential properties has skyrocketed due to the increase in urbanization & working population. Individual’s aspiration levels have gone miles ahead. Processing of loans by Banks has become simple and quick with adjustable interest rates. Office and commercial space prices have also increased considerably as India is considered to be the most attractive destination for IT & BPO services.

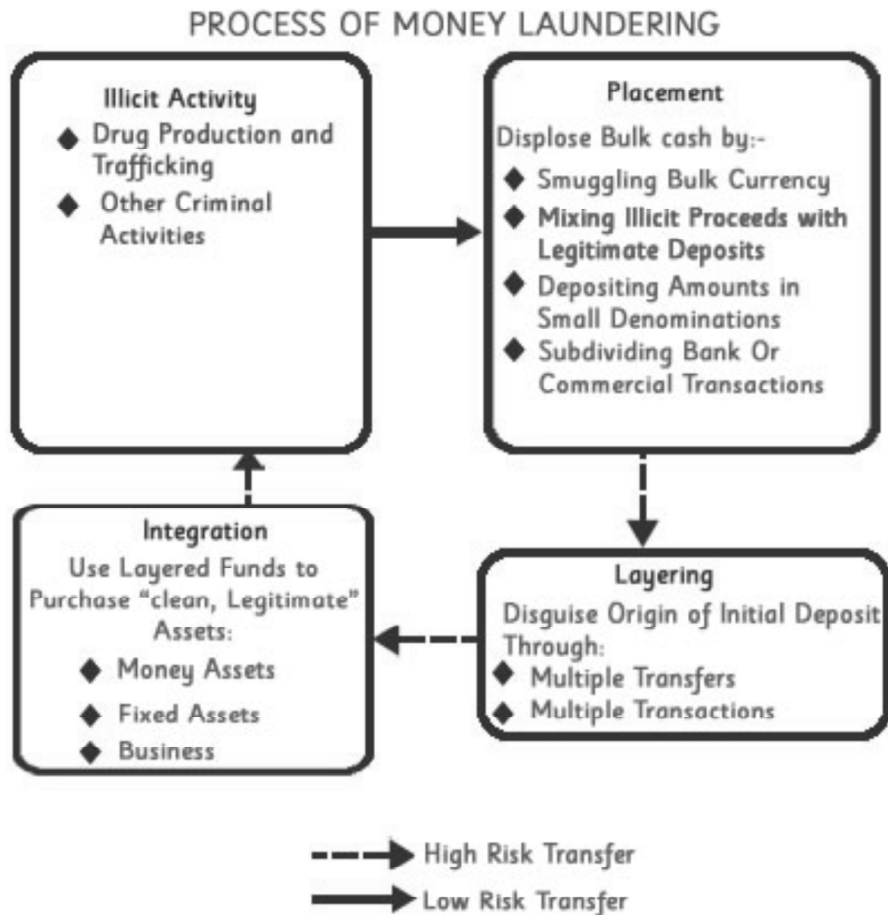
Money Laundering in Real Estate

In 1998, the International Monetary Fund estimated that the aggregate size of money laundering is between 2% and 5% of the world’s Gross Domestic Product

(GDP) ranged between USD 590 billion and USD 1.5 trillion. Money generated by criminal activities is processed into legal forms of investment without drawing the attention of legal authorities. One of the forms of legal investment, where there is high probability of presence of laundered money is "Real Estate".

The following example will illustrate one of the effective ways to understand how the real estate sector is abused by money launderers. A money launderer would like to buy a property with 25% legal funds paid through bank account and 75% illegal funds paid to the seller in the form of cash. After a stipulated period of time the launderer sells the property with the same amount or some amount of profit. During the time of selling money launderer would request the buyer to pay the property value through bank account, cheque or demand draft so that all his money gets legitimate appearance.

Figure 1: Bird Eye View of Money Laundering in Chennai Real Estate



The purpose of this paper is to understand the consequences of money laundering in the Chennai real estate world through applied research methodology. It is very evident that awareness on capital gain tax is very less among all categories of people when it is compared with the guideline value fixed by the government. The probable reason could be that the guideline value is collected at the time of registering real estate transaction in registration office, while capital gain tax is collected by income tax office at the financial year end. Awareness has to be increased widely to raise capital gain tax collected for the government by the income tax office.

Table 1
Awareness About Money Laundering among Various Classes of People in Tamil Nadu

<i>Type of People</i>	<i>No of People</i>	<i>People's Intention to Invest Accounted funds</i>	<i>Interested to use Banks for Real Estate Transactions</i>	<i>Awareness of Capital Gain Tax</i>	<i>Awareness of Guideline Value</i>
Salaried Workers (Tax payers)	270	91%	95%	15%	100%
Salaried Workers (Non tax payers)	216	65%	54%	10%	98%
Business people (Tax payers)	234	67%	65%	75%	100%
Business people (Non tax payers)	252	27%	39%	12%	100%

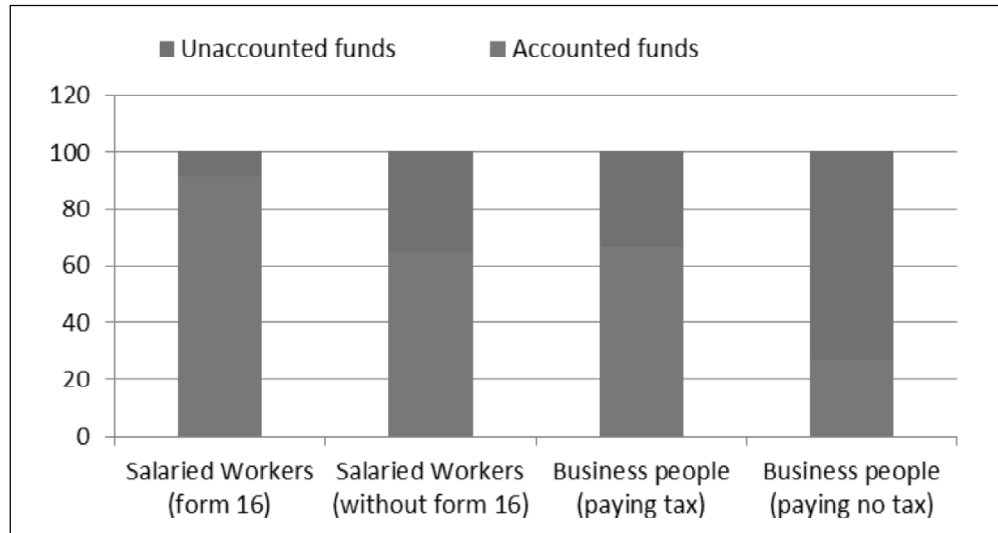
91% of the salaried workers (Tax payers) feel their income and expenditures on real estate have to be made through accounted funds and they are interested to use Financial Institutions for the mode of payment as their earnings are audited for tax purpose. At the same time, 54% of the salaried workers (Non tax payers) are willing to use Financial Institutions for the mode of payment for the safety purpose and others are willing to pay the transaction proceeds in the form of cash.

65% of the business people (Tax payers) are willing to use Financial Institutions for the mode of payment and all other business people are willing to pay / receive funds in the form of cash as they have both accounted and unaccounted funds. At the same time, 39% of the business people (Non tax payers) are willing to use Financial Institutions for the mode of payment and most of them are ready to pay

Table 2
Paying Mode in Real Estate Transaction

	<i>Accounted funds</i>	<i>Unaccounted funds</i>
Salaried Workers (form 16)	91%	9%
Salaried Workers (without form 16)	65%	35%
Business people (paying tax)	67%	33%
Business people (paying no tax)	27%	73%

Figure 2: Graph Showing the Intention to Invest Accounted Funds and Unaccounted Funds



/ receive funds in the form of cash as they are used to do transactions in unaccounted funds.

In general, it is found that most of the people who are paying tax are interested to buy or sell their property with accounted funds however people who are not paying tax prefer to pay or receive unaccounted cash. As foggy money is getting funneled into the real estate for last two decades, market value of the property has started to change on a weekly / monthly basis and sometimes daily especially in the peak commercial and residential areas. Investing black money in Real Estate might happen at any of these three stages but most of the time it happens in the Integration stage. Money laundering transactions can be easily masked within the genuine transactions as the huge number of real estate transactions is very high and amount of money moved is mind-boggling.

Recently real estate has gradually widespread as speculating investment. Purchase of more than one property for the purpose of asset is becoming more popular. This era has witnessed enormous off-take in the real estate sector with the increase in incomes. There are abundant factors which will shape the price of real-estate and they are segmented regionally.

Consequences of Money Laundering in Real Estate

(i) *Common man:* Money laundering in Chennai real estate has affected every single individual’s lifestyle in our city as it determines the economic growth and stability directly or indirectly. It made impossible for the individuals to invest in

real estate as prices are skyrocketed. It busted the dream of every single family. In a larger perspective, the consequences of money laundering is very huge than anything else. From the research it is also understood that, money laundering made extremely impossible to explain differences in property prices due to several factors like lack of reliable, uniform information, real estate markets are geographically segmented and numerous factors shape the local price of real-estate.

(ii) Increases Illegal activities and Corruption resulting in Economic Instability: Money laundering helps to increase the profitable aspects of illegal activities. If a country is identified as destination for money laundering, it will attract money launders and con artists. Through Benami transactions con artist will be able to invest their illegal funds into real estate transactions. Corruption will be predominant if money launderers increase in a country as they will corrupt government officials, employees of financial or non-financial institutions, politicians, judicial system so that they can continue to do money laundering. It will make the government to lose its control on the decisions made regarding the economic policy by providing incorrect figures. It lays path to the economic distortion and volatility. Loss of tax revenue makes the biggest setback to the countries' growth in all possible ways.

(iii) Reputation Risk for the Country and Financial Institutions: Money Laundering reduces legitimate global opportunities for the country as foreign financial institutions may decide to limit their transactions. If a country's financial reputation is damaged, stimulating is very difficult. Money laundering will be able to damage the reliability, security, and consistency of financial sector in a country. It can harm individual banks and other financial institutions, such as stock brokerage and insurance industry. Certainly, criminal activity has been the reason for the failure of banks like first Internet bank, BCCI etc.

COMBATING MONEY LAUNDERING PREVAILING IN REAL ESTATE

Combating money laundering in real estate market is one of the biggest challenges faced by the union government and state government as the typologies varies from time to time and case to case. Few measures and continuous auditing from the government will bring down the influence and effects of black money in real estate.

- Recognize the importance of identification, due diligence, record-keeping and reporting requirements in the real estate sector.
- All the payments pertaining to real estate transactions to be routed through bank accounts, cheque or demand draft.
- Fixation of threshold limit and will help the government to bifurcate the large value transaction, which will be useful while verifying the source of funds in real estate transactions.

- Understanding the “paper trial or money trial” will create tremendous opportunities in terms of identification and ability to find the originators of illegal funds and organized crimes.
- If the buyer / seller is unable to explain the source of fund / property then Suspicious Activity Report (SAR) has to be filed with Financial Intelligence Unit (FIU) for further investigation.

In recent years the real estate sector in India has undergone various regulatory and legal reforms. These reforms include the following:

- The Prevention of Money Laundering Act 2002 (Bill 1999) to cover Income Tax, Customs, Excise and Sales Tax; The Income Tax Act 1961, the Customs and Excise Acts 1962.
- Government of India supporting the repeal of the Urban Land Ceiling Act, with nine state governments having already repealed the Act.
- Rationalization of property taxes in a number of states.
- The proposed computerization of land records.
- Benami Transaction Prohibition Act 1988.

CONCLUSION

The real estate market is volatile in nature when it comes to pricing. Due to this, many unscrupulous elements find this as a perfect form of investment, where illegal revenue can be concealed. To combat money laundering channeled through real estate, government has to act fast before the black money starts ruling the whole real estate industry. People are expecting transparent processes which will assist them to evaluate the reasonable price of the property with the help of domain experts. Within the large number of genuine real estate transactions, money laundering transactions are getting mingled. To overcome the issues raised by money laundering several countries have started extreme measures to combat money laundering as it is a serious threat to their economy and reputation. By emphasizing the importance of accurate pricing along with buyer and seller’s documentation for identification, record-keeping and reporting requirements, government can bring down the consequences of money laundering in real estate.

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Financial Intelligence Unit of India (<http://fiuindia.gov.in/>)