



DEMONETISATION

धर्मयुद्ध...

FOR A BETTER TOMORROW



A Compendium Featuring Opinions
by Diverse Indian Voices

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DEMONETISATION : THE STRATEGY FOR CORRUPTION FREE AND TRANSPARENT ECOSYSTEM

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Demonetisation has unleashed a storm of crisscrossed debate. There are different schools of thought advocating or opposing and questioning the purpose of demonetisation. However, one needs to know history of the theme of demonetisation and its implementation. Prime Minister Shri. Narendra Modi is the first author of the theme of effective demonetisation in India. The article deals in a brief history of demonetisation in India and elsewhere in the world as a matter of strategy to create a corruption free and transparent ecosystem in India.

The sudden announcement on demonetisation of high-value notes on 8th November, 2016¹ by the Prime Minister

Shri. Narendra Modi created a disruption in the economic ecosystem of the country. There is a debate in the country, whether it helped us in curbing corruption and eliminating black money in circulation. What was its impact on the economy in the short, medium and long term; particularly in the important segments, like rural and agriculture sectors; micro, small and medium enterprises and unorganized sectors like small traders, shop owners and daily wagers etc.; whether 'Big Bang' reforms require this? Are we moving towards 'Digital Economy'?

The first quarter (2017-18) fall in GDP² rate to 5.7% is a cause of concern. But the government has a well chalked out plan for economic revival. Job creation, doubling of farmers' income, building infrastructure in rural areas and irrigation, fast and amicable resolution of NPA problem and ease of doing business for manufacturing sector are very much going on. Government believes that the economy has bottomed out and we will see a turnaround in next quarter. With macroeconomic parameters well entrenched, we will see falling interest rate, firming up of dollars in terms of rupee. Direct tax collection in April-July is up by 19% YOY, indicating expanding tax base is a sign of success of demonetisation and GST.

Demonetisation and GST are to be seen as Prime Minister Shri. Narendra Modi led government's drive to end black money. Government in a renewed zeal has de-registered about 3,00,000 companies³ for non-compliances and has identified more than 2,00,000 companies for investigation. It states that 37,000 shell companies were shielding and participating in 'hawala' transaction. The finance ministry and Central Board of Direct Taxes (CBDT) will undertake data mining to track money laundering. Demonetisation has been instrumental in moving

large part of informal economy to formal ecosystem.

To properly analyze demonetisation and roadmap ahead we have to understand what was the scenario and what the Union Government wanted to accomplish. Reviving economic growth, curbing corruption and elimination of black money were the two important mandates on which Prime Minister Shri. Narendra Modiji's government came to power. It must be remembered that the circumstances under which the present government was voted to the power.

The economic scenario pointed towards a very dismal ecosystem

- According to World Bank Report⁴, about 20% of illegal wealth is stashed across the assets classes in real estate, gold and cash currency in India.
- Global Wealth Report 2016⁵ shows that 1% of our population has more than 58% of the total wealth of the country. In the terms of concentration of wealth, India ranks 2nd after Russia across globe.
- 96.2% of our population has a total wealth⁶ of less than \$10,000 i.e. approximately Rs.7,00,000.
- Cash currency ratio to GDP in India⁷ was 14%, which is high compared to the international standards.
- Budgetary resources of the government are limited. Annual planned expenditure of the government of India⁸ for 2015-16 was approximately Rs.5.78 lakh crores and is not enough for the government to undertake massive infrastructure developments and insufficient to meet the social security requirements of the country.

- Every citizen of the country is paying taxes in the form of indirect tax, but if these business transactions are not properly accounted for, this tax does not reach the government revenue. Proper recording and audit trail of every transaction in the system is very important.
- CAG in its audit report⁹ on various social security schemes of the government has pointed out large-scale leakages in the delivery mechanism; it also talks about subsidies not reaching the targeted groups.
- There was large-scale hawala transaction through shell companies and also round tripping through the 'Tax Havens'.

When the present government assumed power, corruption and black money were the part of the 'normal'. This established 'normal' had to be disrupted. Demonetisation cannot be analyzed in isolation. It is a part of the series of measures undertaken by Narendra Modi's government since its inception, to implement its firm resolve to end corruption.

Corruption at high places is not the plain vanilla 'cash-under-the-table' variety that can either be recovered as such by the anti-corruption watchdogs or converted to real estate/ gold and other precious items in the name of extended family members, which can still be traced. Genius minds were involved in devising payoffs to cover the tracks for top ministers and bureaucrats when the latter were on the take and it became virtually impossible for the investigative agencies to establish the quid-pro-quo.

For the first time in the last few decades, we see real fear in the eyes of the corrupt. One of the most important dimensions of the fight against corruption by the present government is to

unravel the anonymity of ill-gotten wealth.

The very next day Shri. Narendra Modi came to power, a Special Investigation Team (SIT) in accordance with the pending order of the Hon. Supreme Court was set up to suggest steps to curb corruption from the country. Starting that day, several steps have been taken by the government to achieve these objectives.

Steps taken by Modi Government to curb corruption and black money

- 1) Foreign illegal assets declaration scheme¹⁰ – The 'Undisclosed Foreign Income and Assets (Imposition of Tax) Bill, 2015', provides for separate taxation of any undisclosed income in relation to foreign income and assets. Such income will henceforth not be taxed under the Income-tax Act but under the stringent provisions of the proposed new legislation.
- 2) Renegotiation of bi-lateral treaties with Mauritius, Cyprus and Singapore where most of the hawala transaction take place.
- 3) Treaty with America for sharing of financial information under FATCA.
- 4) Initiatives with OECD and G20¹¹ countries for information exchange.
- 5) Income disclosure scheme¹² (IDS) – This scheme was launched as a part of 2016 Union budget to unearth black money and bring it back into the system. Lasting from 1st June to 30th September, the scheme provided an opportunity to income tax and wealth tax defaulters to avoid litigation and become compliant by declaring their assets, paying the tax on them and a penalty of 45% thereafter.

- 6) The Benami Transactions (Prohibition) Amendment Act, 2016, came into effect from 1st November, 2016¹³. The amended law empowers the specified authorities to provisionally attach benami properties, which can eventually be confiscated. Besides, if a person is found guilty of offence of benami transaction by the competent court, he shall be punishable with rigorous imprisonment for a term not less than one year but which may extend to 7 years and shall also be liable to a fine, which may extend to 25% of the fair market value of the property.
- 7) 'Amendment to the Prevention of Corruption Act' and passing of the 'Whistle Blower Protection Act'.
- 8) Pradhan Mantri Garib Kalyan Yojna¹⁴- This scheme was launched in December 2016 on the lines of the Income declaration scheme, 2016 (IDS) that provides an opportunity to declare unaccounted wealth and black money in a confidential manner and avoid prosecution after paying a fine of 50% on the undisclosed income. An additional 25% of the undisclosed income is invested in the scheme, which can be refunded after four years, without any interest.
- 9) In last two and a half years about a total of 25 Group A officers, including one IAS and two IPS, and 99 Group B officers were prematurely retired and 199 Group A officers, including eight from the IAS¹⁵, were penalized on remuneration for corruption which is much more than such actions in the past.

Strategy to curb black money and corruption has three aspects

- Confiscate the money generated through corrupt and illegal

activity.

- Collect due tax and penalties on undisclosed incomes.
- Launch prosecution.

And the process is

- Identification and verification of business transactions.
- Filling the gaps in law enforcement and enacting new laws.

Across globe there is a clear link between cash and nefarious activities, higher the cash greater is the corruption. If we see the Soil Rate¹⁶ i.e. rate at which currency notes comes to the RBI to get changed after being damaged, we see that for low denomination notes it was 33%, for Rs.500 notes it was 22% and for Rs.1000 notes it was 11%. That means higher denomination notes are used for storage, estimated about 89% of high denomination money was not used for transactions. That comes to, as high as Rs.7.5 lakh crores. No doubt the rough estimate of black money in cash currency was about Rs.3 lakh crores.

Demonetisation was brought in with four objectives. These were basically to curb corruption, confiscate counterfeit currency, check terrorist and Maoist activities and eliminate wealth accumulated in the form of black money.

Demonetisation is a tax administration measure. As per the latest RBI report (2016-17) about 99% of currency in circulation has returned in the banking channels. Once the money has been deposited in the bank account, it has now identified owner. Complete audit trail for transactions can now be established. These deposits are now being analyzed and matched with the declared source of income of the assessee. Any black money deposited through layering and benami transaction will be

caught. About 18 lakhs¹⁷ notices have been sent to those account holders, where unusual activities were found post demonetisation.

The Special Investigation Team (SIT)¹⁸ was set up by the government to suggest modifications in cash transactions and other measures to curb corruption. Based on their recommendations certain measures were taken by the government.

Relevant portions of SIT the report¹⁹ on cash holding

Chapter 1: Cash Holdings

Clause 3. Provisions on cash transactions in other countries:

For the aforesaid purpose, it would be appropriate to refer to the provisions incorporated in some countries restricting cash holding or cash transactions:

(i) France : France's success in moving away from cash comes in part from its high level of banked population (97%) and also from a long-standing government focus on the efficiency and financial inclusion aspects of payments. France has been actively focused on payments innovation, bringing to market new solutions such as mobile payments, contactless cards, and m-POS to meet the diverse payment needs of French consumers.

(iii) Portugal : Cash payments of goods and services between consumers and traders are limited by the law. It requires that the payment of invoices or similar documents on the amount of more than Euro 1,000 should be made to trader's bank account by a means that allows the identification of the receiver (bank transfer, bank debit or by a nominative check).

(iv) Slovakia : Cash payments have been regulated in Slovakia by the Act No.394/2012 dated 01st January. The Act has set

restrictions for the cash payments:

(a) B2B, C2B and B2C payments up to 5,000 Euro; and
(b) Natural person who is acting for purposes which are outside his or her trade, business up to 15,000 Euro by payments higher than afore-mentioned limits can be processed only by cashless transactions.

(v) Czech Republic : The limit for cash payments is 3,50,000 CZK (about Euro 14,000) in one day. As for the coins, the limit is 50 pieces.

(vi) Spain : Since 19th November, 2012, the limit is Euro 2,500 (for Spain residents) and Euro 15,000 (for non-residents). If the amount is higher than these (in each case), the payment should be done by bank transfer. The fine for failing to carry out this precept could be about 25% of the total transferred amount.

(vii) Bulgaria : Limit is up to 10,000 leva (approximately Euro 5,112). If the transaction is over that limit, then the consumer should pay through a bank.

(viii) Belgium : Belgian Government has imposed a limit on cash payments limiting it to 3,000 Euro.

(ix) Greece : Cash payments (including VAT) for the purchase of products and services are permissible up to 1,500 Euro. Beyond that limit, payments should be done via bank accounts, cheque or credit/debit cards.

Clause 4. Press release on “ECB ends production and issuance of Euro 500 banknote”:

In the press release dated 4th May, 2016:

“Today, the Governing Council of the European Central Bank (ECB) concluded a review of the denominational structure of the Europa series. It has decided to permanently stop

producing the Euro 500 banknote and to exclude it from the Europa series, taking into account concerns that this banknote could facilitate illicit activities.”

Clause 5. Limit for cash holding:

(i) For successful implementation of restricting accounted/unaccounted cash transaction, it is absolutely necessary to have reasonable restriction in holding cash and to fix the limit of cash holdings. It is known fact that a number of persons are holding cash of lacs of rupees and such holding is undoubtedly unaccounted.

Benefits of Demonetisation

- Due to huge currency in circulation, economy had inflationary pressure and value of housing etc. was getting out of common man's hands. Demonetisation reduced prices in real estate. According to RBI, CPI on housing²⁰ has reduced from 5.2 in January, 2016 to 5 in November-December 2016. Prices in the secondary market have fallen²¹ by 4% at an aggregate level.
- Brought resources to the Government for social benefit schemes for the poor and low-income groups and infrastructure development in particular in the rural sector. According to CBDT, post demonetisation – the growth in returns filed by individuals²² is 25.3% with 2,79,39,083 returns having been received up to August 5, 2017 as against 2,22,92,864 returns in the corresponding period of 2016-2017.
- Post-demonetisation, 23.3 million new accounts were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY)²³, bulk of which (80 per cent) were with public

sector banks. Deposits under PMJDY accounts increased significantly post demonetisation to Rs.746 billion as on December 7, 2016 from Rs.456 billion as on November 9, 2016 – an increase of 63.6%, stated RBI's report on demonetisation.

Helping us to move towards a low interest rate economy, with loans for housing sector, poor and rural sector of society at lower rates. According to RBI²⁴, the weighted average lending rate (WALR) of banks in respect of fresh rupee loans declined by 56 bps during November 2016 - January 2017, reducing the overall cost of borrowing.

- Created ecosystem for smooth implement of GST. Success of GST depends on business transactions moving through banking channels and there is complete audit trail, so that transactions can be matched by GST network across nation for smooth input tax credit. This will ensure tax compliance and check evasion. As GST is revenue neutral it will help reducing indirect taxes.
- Curbing terrorist activities and other criminal activities like Maoist insurgency and extortions in North Eastern area etc. As per the reports of Ministry of Home Affairs demonetisation led to instant extinguishment of Pakistan-printed high quality fake Indian currency notes and also adversely affected the hawala operators.
- As per the data provided by NCRB²⁵ there has been a Removal of Fake currency in circulation.
- Lower cost of transaction (cost of online payments and mobile banking are much cheaper) according to a report physical transaction costs Rs.80 per transaction to the bank

and the transaction done online costs Rs.1 only and through mobile the cost comes to less than a rupee i.e. 60 paisa only.

- Resulted in higher tax collection. Third quarter tax collection report shows;
- 22% increase in indirect tax collection²⁶
- 14.8% increase in direct tax collection as compared to last year.²⁷
- It has helped informal economy to move to a formal segment.

The Government was well aware of the liquidity crunch, but this was sorted out. The Government is asking people to move towards less cash economy through online payments and mobile banking but it will do this through creating awareness and not compulsion.

The government is well aware that, there is a chance that this squeeze in liquidity can affect the economic activities in the country.

The government has a roadmap to revitalize the growth of GDP

- A) The current account and savings accounts deposits (CASA) of banks have increased. This has reduced their cost of funds and will also result in increased availability of funds. Government is pushing for credit at lower rate of interest.
- B) Special focus on credit through startup, standup, MUDRA loans to medium and small sector and rural sectors of economy at reduced rate of interest.
- C) Real estate price to fall further and with fall in rate of EMI will help in affordable housing, bringing it within the reach of the common man. It will also boost construction industry.

- D) Government will move towards lower rates of direct and indirect taxation, and will create premium on honesty.
- E) To curb black money establishing identity and ownership is very important. With 99 % of money in circulation coming to the banking channels, its ownership and identity is established. Now the government is investigating it with the known source of income of the account holders to find out any mismatch. With the Benami Properties Act in place authorities can confiscate black money and impose penalties on defaulters.
- F) Increased tax collections have started enhancing government resources, government will go for huge capital investments and social sector spending to improve quality of life of the common men and catalyze growth.
- G) With supply of black money under check, government has started much needed electoral reforms like reducing the limit of cash donations to political parties and the scheme for political donations through bearer bonds, which can be purchased through bank payments only.

Government has also acted on the SIT report²⁸ on shell companies

SIT on Black Money submitted its third report in May 2015 wherein a recommendation with regards to “Shell Companies and Beneficial Ownership” was made alongwith other recommendations. On the basis of the aforesaid recommendation, investigation was carried out and money laundering of unaccounted cash was found.

“During the follow up investigation done by SFIO, a clear case of money laundering has been established. In its report, it

has been recommended that money laundering, being an organized crime, requires coordinated investigation by many agencies including Enforcement Directorate, Income Tax department, Reserve Bank of India, SEBI and ICAI. The report has identified 559 beneficiaries during the Financial Year 2009-10 and the total quantum has been estimated at a minimum of Rs.11,970 crores.” If there is a limit on cash holding and direction is issued to the banks to report suspicious transactions, then such fraud and money laundering could be easily controlled.

Based on this report government has initiated strong action on shell companies. Identifying about 300,000 companies, which have not complied with registrar of companies (ROC) requirements. Out of these about 200,000 companies have been de-registered. Government has also identified 37,000 shell companies and strong penal action taken on them.

Shell companies, as the name itself suggests, are companies only in their outward appearance and do not carry any real business in its name. They are not illegal under Indian laws but are generally used for dubious purposes like tax evasion and hiding of individuals behind the corporate veil. Sometimes the arrangements are such that the ultimate beneficiaries of a corporate entity are neither the persons who are operating and managing the company nor its owner(s) but they all are a proxy for someone who exercises the ultimate control over the corporate entity through them. Shell companies take this anonymity a step further because they don't need to have a running business. A maze of shell companies can be created with minimal capital to achieve this purpose.

Government vide its circular released on 5th September stated the following steps to be taken by the banks in relation to shell companies and their directors :

Government has stepped up decisive action against companies falling within the ambit of Section 248 of the Companies Act. The names of 2,09,032 companies have been struck off from the Register of Companies under Section 248 (5) of the Act. The existing Directors and Authorized Signatories of such struck off companies will now become ex Directors or ex Authorized Signatories. These individuals will therefore not be able to operate bank accounts of such companies till such companies are legally restored under Section 252 of the Companies Act by an order of the National Company Law Tribunal. The restoration, as and when it happens shall be reflected by change in the status of the company from 'Struck off' to 'Active'.

Government is showing strong resolve to eliminate black money and curb corruption. Demonetisation is part of the larger plan of Prime Minister Shri. Narendra Modi government to eliminate black money and curb corruption. It is the part of the process to create an ecosystem of equal and transparent opportunities for economic growth, for the common men in all segments of the society across all geographical areas. This has created a disruption in the economy, which was very much needed. Corruption and black money had become part of the normal and successive government in the past did not have the will power to control it. The system had created a stake in this black economy, which could have been broken by only one and only one. The man of the hour is our Prime Minister Shri. Narendra Modi and he has done it.