

Demonetisation of High Value Currency Notes—Short Term Pain but Long Term Gain for Economy



In a welcome move, Prime Minister Shri Narendra Modi has rightly decided for ₹500 and ₹1000 currency notes of the Mahatma Gandhi Series issued by the Reserve Bank of India to cease to be legal tender from November 9, 2016. Indian accountancy profession supports this decision for it will go a long way in rooting out and nullifying black money hoarded in cash, corruption, terror financing and fake currency. Despite some temporary hiccups in the very short term, the move will provide a big boost to national economy and discourage parallel economy. Our Prime Minister said this was being done to tackle the menace of black money in the country, which has sapped the economy. The Indian Accountancy profession agrees with the Prime Minister when he said in his address to the nation that “We are among the fastest-growing economies, but we also rank high in global corruption rankings... Black money and corruption has taken roots in the country, these are the biggest obstacles in eradicating poverty. India’s common citizens live their lives honestly. But black money, corruption make the nation hollow from inside.” Read on to know more...

“With a view to curbing financing of terrorism through the proceeds of Fake Indian Currency Notes and use of such funds for subversive activities such as espionage, smuggling of arms, drugs and other contrabands into India, and for eliminating

(Contributed by Editorial Board Secretariat of the ICAI. Comments can be sent to eboard@icai.in.)

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Black Money which casts a long shadow of parallel economy on our real economy, it has been decided to cancel the legal tender character of the High Denomination bank notes of ₹500 and ₹1000 denominations issued by RBI. This will take effect from the expiry of the 8th November, 2016,” said a press release of Department of Economic Affairs after Prime Minister’s historic address to the nation on November 8, 2016.

It was good to know from Prime Minister Shri Narendra Modi during his address to the nation on 8th November 2016 that in the last two-and-half years, at least ₹1.25 lakh crore of black money has been recovered. The Indian accountancy profession stands committed to government’s fight against black money. As many would be aware, the ICAI and its members played a crucial role in making the recent Income Declaration Scheme 2016 a grand success, which was acknowledged by our Finance Minister Shri Arun Jaitley too.

The combined worth of ₹500 and ₹1000 currency notes in the system was ₹16 lakh crore. As such, the transition period following the demonetisation of these currency notes is not going to be easy. Prime Minister Shri Modi said that *“there may be temporary hardships to be faced by honest citizens. Experience tells us that the ordinary citizens are always ready to make sacrifices and face difficulties for the benefit of the nation. So, in this fight against corruption, black money, fake notes and terrorism, in this movement of purifying our country, will our people not put up with difficulties for some days? I have full confidence that every citizen will stand up and participate in this mahayagna. My dear countrymen, after the festivity of diwali, now join the nation and extend your hand in this imandari ka utsav (celebration of honesty), this pramanikta ka parv, this celebration of integrity, this festival of credibility.”*

Short Term Pain, Long Term Gain for Economy

It is a fact that large-scale cash-based economy runs parallel to formal economy in India. According to Department of Economic Affairs press release, *“the World Bank in July, 2010 estimated the size of the shadow economy for India at 20.7% of the GDP in 1999 and rising to 23.2% in 2007. There are similar estimates made by other Indian and international agencies. A parallel shadow economy corrodes and eats into the vitals of the country’s economy. It*

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generates inflation which adversely affects the poor and the middle classes more than others. It deprives Government of its legitimate revenues which could have been otherwise used for welfare and development activities.”

If a significant part of economic activity lies beyond government’s gaze, an unfair burden is imposed on honest tax payers. Therefore, the demonetisation can catalyse long term reform and gains of a well-executed exercise can be significant. The demonetisation will affect about 86% of total currency in circulation, amounting to ₹14.6 trillion. According to a World Bank estimate, the parallel economy makes up about one-fourth of the total economy.

Despite some initial short term hiccups, disruptions in the system and related pains, Indian national economy is set to reap to long-term gains in view of the demonetisation of high value currency. Assuming that a significant amount of black money held as cash will come into the banking system to be replaced, government has an opportunity to utilise the resultant trail to boost its tax collections in the longer-run. The impact of the move could lead to lower interest rates. As per one reliable estimate, this could see disclosure of 1-2% of GDP. Once the size of the parallel economy shrinks, the tax base will automatically widen. This will allow government to reduce rates and boost consumption.

According to economists the move is expected to have several spin-offs for Asia’s third largest economy, including lowering inflations, improving tax to GDP ratio, raising public investments and could lead to healthy public finances. The sectors with large exposure to cash like real estate, transport and food could witness downward price pressures. In the long term, however, the demonetisation could change the face of Indian economy, improve the government’s fiscal position and tax compliance. The size of the cash economy will shrink, as will black money generation avenues, because of better cash flow trails, ratings agency Crisil said.

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Temporary Downside: Some economists, however, pointed to some short-term risks. If money supply declines temporarily because of the demonetisation, then assuming no immediate change in velocity of circulation, we would either see some deflationary tendencies or lowering of real demand (economic activity). The demonetisation could rewrite some macro parameters. The December quarter GDP growth and corporate performance could sag. However, the impact on the economy will depend upon two factors, one how much time the currency replenishment would take, and two the amount of replenishment of new notes in proportion to the existing notes in circulation. If progress on any of the front is slow, it will decelerate the velocity of money—the rate at which money is exchanged from one transaction to another—the impact on the economy will be protracted.

The combined worth of ₹500 and ₹1000 in the system was ₹16 lakh crore. If even about 20% of these high value notes are not replenished it could result in wealth erosion of ₹3 lakh crore. Demand destruction could happen from monetary tightening.

Demonetisation to Change the Way People Spend: FM

Finance Minister Shri Arun Jaitley has said the demonetisation of high value currency notes will change social culture—in how people keep and spend



The old currency notes of ₹500 and ₹1000 denominations can be deposited in one's bank or post office accounts up to December 30, 2016. However, the Government is going to be hawk-eyed on the high volume deposits. Huge unexplained cash deposits may lead them to treat it as undisclosed income and tax, interest and penalty up to 200% may be levied.

money and boost the economy, although it may cause some inconvenience in the immediate term. Interacting with the media a day after the decision, Jaitley said *"This is a big reform as it expands the GDP and makes it cleaner. It pushes revenues, pushes economy, pushes money into banking systems... the parallel economy had been running and impacting the economy. Tax non-compliance was a key impact....This is an effective way to make this country cashless. It does not nudge the economy but pushes the economy in that direction... Tax collections would increase, deposits will increase in banks and their capacity to support the economy will increase,"* he added.

A Big Blow to Counterfeit Currency

As per a study done by the Indian Statistical Institute, Kolkata, in 2015, the only concrete work done on the subject, at any given point of time ₹400 crore worth fake notes were in circulation in the economy. In the study done on behalf of the National Investigation Agency (NIA), it said that ₹70 crore fake notes were pumped into the economy every year. The demonetisation of high value currency will be a big blow to this fake currency racket, which was largely used to fund terror and related activities in India.

Government Keeping an Eye

The old currency notes of ₹500 and ₹1000 denominations can be deposited in one's bank or post office accounts up to December 30, 2016. However, the Government is going to be hawk-eyed on the high volume deposits. Huge unexplained cash deposits may lead them to treat it as undisclosed income and tax, interest and penalty up to 200% may be levied.

The Finance Minister Shri Jaitley recently said that *"the honest person has the satisfaction to be honest and the not so honest should worry,"* adding the government was monitoring transactions to ensure there is no laundering of demonetised notes. *"The Government is keeping an eye on conversions. The revenue department is also keeping a watch. Those who indulge in this trade run a high risk,"* he warned adding that *"It should be clear that this is no immunity scheme. This does not provide any relief from taxation. The law of the land will apply (on source of funds)... If the money is legitimate which had been previously withdrawn from banks or earned legally and saved and had been disclosed, there is nothing to worry about,"* he said.

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According to reports, the government would monitor all cash deposits of over ₹2.5 lakh made and impose a penalty of up to 200% in case the funds did not tally with an individual's tax returns.

More Measures to Curb Black Money Likely

It seems that Government has concrete action plan to bring in control the parallel economy. The step to demonetise may as well be one among many steps to be introduced by the Government. Revenue Secretary Shri Hashmukh Adhia, while talking to the media recently said, more measures to tackle the menace of black money, including restriction on the use of cash for high value transactions, may be taken in coming days. *"There will be many more follow-up steps. Of course, it is a continuous drive and we have been taking different measures at different times,"* he said. It is worth noting here that the SC-appointed Special Investigation Team had recently recommended that curbs be imposed on cash deposits of over ₹3 lakh. The limit is aimed to ensure that transactions are made using credit or debit cards, cheques or drafts which can be tracked.

In the past too, the Government has taken several measures as part of its drive against black money. The measures include setting up a Special Investigation Team (SIT) and accepting some of its recommendations, Black Money (Undisclosed Foreign Income And Assets) And Imposition of Tax Act, 2015, Income Declaration Scheme 2016, Benami Transactions (Prohibition) Act 1988 and proposal of its amendment vide Benami Transactions (Prohibition) Amendment Bill, 2015, imposition of excise duty on gold, amending the Double Taxation Avoidance Agreement between India and Mauritius and India and Cyprus; reaching an understanding with Switzerland for getting information on Bank accounts held by Indians with HSBC; the Money Laundering Act, Real Estate (Regulation and Development) Act, 2016, etc. The upcoming GST regime is also set to become a major hindrance to generation of black money in view of better transaction trails offered by it.

ICAI's Support to anti-Black Money Drive

The Institute of Chartered Accountants of India (ICAI) and Indian Accountancy Profession has been extending its all-out support to the Government's anti-black money drive and related measures. In recognition to crucial role of the ICAI and its

ICAI and its members played a proactive role in making this Scheme a great success. A huge sum of ₹65,250 crore in black money had been disclosed through 64,275 declarations, as reported on 1st October 2016, marking it the biggest-ever disclosure of hidden wealth that raked in ₹29,362 crore in taxes to the exchequer.



members in this regard, the ICAI had recently been chosen as preferred institution to partner with the Government to create awareness about the Income Declaration Scheme 2016. ICAI and its members played a proactive role in making this Scheme a great success. A huge sum of ₹65,250 crore in black money had been disclosed through 64,275 declarations, as reported on 1st October 2016, marking it the biggest-ever disclosure of hidden wealth that raked in ₹29,362 crore in taxes to the exchequer.

By teaming up with the Ministry of Finance, the ICAI left no stone unturned for the success of the programme. As a result, the Hon'ble Finance Minister Shri Arun Jaitley tweeted recently to acknowledge and appreciate the endeavours of ICAI and its members in making this scheme a great success: *"My gratitude to the ICAI for the role that the Institute and their Members played in the success of IDS 2016"*. Hon'ble Prime Minister Shri Narendra Modi had also tweeted to compliment the Finance Minister and his Team for the "hard work" resulting in the successful outcome of IDS, 2016. The Indian accountancy profession stays committed to support all similar initiatives and programmes of the Government in future too. ■