Demonetisation and Emerging Tax Scenario

On 8th November 2016, in a televised speech to the nation, Hon'ble Prime Minister of India made a historic announcement that ₹500 and ₹1000 currency notes would cease to be legal tender with effect from that midnight. With avowed objectives of strengthening the fight against corruption, black money and the activities of terrorists, antisocial and antinational elements using fake currency, an Official announcement of the demonetisation was made by the Department of Economic Affairs of Ministry of Finance. This article proposes to deal with the emerging tax scenario in the wake of this demonetisation, in particular the tax implications of deposit of those illegal tenders (₹500 an ₹1000 notes) in Banks. It is also pertinent to note that in view of the emergence of law keeping in tune with the present times the case law relating to the previous demonetisations have become redundant and may not be of much use. Read on…

1.0 Demonetisation—Shock and Awe

On 8th November 2016, after the historic announcement on demonetisation, ₹500 and ₹1000 currency notes (*specified bank notes* referred as SBN in this article) ceased to be legal tender with effect from the midnight of that day. Demonetsiation aims to strengthen the fight against corruption, black money and the activities of terrorists, antisocial and antinational elements using fake currency. As per Notification No S.O.3707(E) dated 8th November 2016, by the Department of Economic Affairs of Ministry of Finance the reasons for *demonetisation* are:

a) Difficulty in identifying fake currency notes and the use of fake currency notes causing adverse effect to the economy of the country
b) High denomination notes are used for storage of unaccounted wealth as has been evident from the large cash recoveries made by law enforcement agencies and
c) fake currency being used for financing subversive activities such as drug trafficking and terrorism, causing damage to the economy and security of the country.

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The permission to use the SBN (specified bank notes of ₹500 an ₹1000) for specified purposes such as payment of tax, etc., is not capable of being misused as it is for genuine day-to-day expenditure and through government agencies/petrol bunks.

While announcing new series of ₹500 and ₹2,000 notes, the Notification provided the following alternatives with respect to SBN:

a) Permitted usage as legal tender for different purposes specified in the notification such as payment of tax, *etc*. The specified purposes were modified/added/deleted from time to time by subsequent notifications and the last date of such usage was 14th December 2016.
b) *Over the counter* exchange of SBN with Banks, limited to ₹4000 per person per day. This facility was withdrawn with effect from 25th November 2016.
c) Deposit of SBN in the Bank account(s) maintained by any person, without any limit on the quantity or value of SBN to be so credited to the Bank account on or before 30th December 2016. However, where compliance with the extant KYC is not complete in an account, the maximum value of SBN as may be deposited shall be ₹50,000. SBN may also be deposited in the account of a third party other than the tenderer of the SBN provided specific authorisation therefor accorded by the third party is presented to the Bank. (The Deposits can also be made with cooperative Banks and Post offices, all of which for brevity sake are referred to as Bank Deposits in this article.)
d) Any person who is unable to exchange or deposit the specified bank notes in their bank accounts or or before the 30th December, 2016 shall be given an opportunity to do so at specified offices of the Reserve Bank of India or such other facility until a later date as may be specified by the Central government.

1.1 The permission to use the SBN for specified purposes such as payment of tax, *etc*., is not capable of being misused as it is for genuine day-to-day expenditure and through government agencies/petrol bunks. The OTC exchange window was intended for facilitating cash requirements for immediate expenses, and does not leave a trail. However, this route was quickly closed, as the government sensed that it was being misused by a section of people for conversion of unaccounted monies, leaving the deposit with Bank for credit in the account maintained with the Bank as the sole mechanism.

1.2 It is reported that the SBN would be the order of 15.44 lakh crores, constituting 86% of the currency in circulation as on 8th November 2016. One measure of success of the demonetisation is the amount of SBN not deposited into Banks by 30th December 2016 as it can be said to be clearly unaccounted or Black money, the holders of which are unable to come clean as it would have been earned by illegal means. There are varying estimates of such money ranging from 3 to 5 lakh crores that would not be deposited into Banks. Another measure is the Tax and Penalty that is ultimately collected on the SBN which represents money hitherto unaccounted under the emerging tax laws enacted to deal with the post demonetisation scenario.

2.0 Demonetisation—Gathering of Information by Government

2.1 At the outset, it must be noted that the Tax Department, as indeed the other agencies of the Government, has been proactively amending the tax laws and issuing clarifications/press releases required to ensure that the demonetisation scheme wages an effective battle against black money and is not misused for conversion of black money by dubious methods. This article is not intended to discuss the very many schemes and plans aimed at converting, by dubious methods, the unaccounted money into "Deposits with Banks", except perhaps to note that the Government and all its arms are determined and hawk eyed in their fight against black money and those who choose such dubious methods are doing so at their own risk and peril.

2.1 Amendment of Income-tax Rules: As an immediate measure to keep track of the SBN deposits the Government has swiftly amended the Rule no. 114B of the Income-tax Rules, 1962 ("Rules") regarding quoting of PAN number and Rule no. 114E of the Rules regarding of furnishing of financial information. The information regarding SBN deposits would be readily available to the Tax Department in view of the notification no. 104/16

dated 15th November 2016 whereby a new Sl. No. 12 is inserted in the Table in Rule 114E requiring Banks and Post offices to report cash deposits during the period 9th November 2016 to 30th December 2016 aggregating to ₹12,50,000 or more in one or more current account of a Person or ₹2,50,000 or more in one more accounts (other than a current account) of a Person. The above AIR statement is to be furnished on or before 31st January 2017, though the time limit prescribed in respect of the other transactions under Rule 114E is 30th May 2017, showing the intention of the Tax Department to utilise the information regarding cash deposits as immediately as possible. Further in view of the substitution of Sl. No. 10 in the Table in Rule 114B, quoting of PAN would be mandatory in respect of cash deposits in excess of ₹50,000 on any one day and more than ₹2,50,000 in aggregate during the period 9th November 2016 to 30th December 2016, leaving enough trail for the Tax Department.

2.2 No Immunity for Any Deposit: It is important to note that the limits for quoting PAN and limits of filing AIR with Tax Department in respect of cash deposits are only to regulate the flow of information and do not in any way give immunity from scrutiny or levy of tax, etc., in respect of any deposit of any SBN, whether within the limits or above the limits specified in Rule 114B and/or Rule 114E. **Tax consequences of any deposit of SBN, irrespective of the quantum, is to be determined on the basis of the applicable law, in particular, the amendments which are on the anvil**.

3.0 Demonetisation and Amendments to Income-tax Act, 1961

3.1 There were suggestions that the unaccounted SBN can be declared as income of the financial year 16-17 for the tax purposes and tax paid @30% under Section 115BBE. It was also suggested that in such cases, no penalty can be levied under the existing tax laws. The Government noted the concerns that the some of the provisions of the Income-tax Act, 1961 could be used for conversion of black money. The Government therefore quickly proposed necessary amendments to the Income-tax Act, 1961 through the Taxation Laws (Second Amendment) Bill, 2016. ("Bill"), so as to ensure that the defaulting assesses are subjected to tax at a higher rate and stringent penalty provision. The severity of the proposed amendments, as discussed hereinafter, shows the seriousness and determination of the government to fight out black money and this change in the scenario needs to be noted. It also needs to be said that the proposed amendments not only eliminate the possible loopholes in the law but also effectively neutralises any scheme or plans to convert black money.

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3.2: Enhanced Tax and Penalty on Unexplained Income/ Investments/Expenditure Referred to in Sections 68 TO 69 D

3.2.1 The incomes of the nature as above are at present charged to tax at a flat rate of 30% as per Section 115 BBE, without allowing any deductions, expenditure or set off of loss against such Incomes.

3.2.2 The Bill proposes to insert a new sub-section (1) containing two clauses in Section 115BBE effective from the Assessment Year 2017-18 that is

a) Where the total income of the includes any income referred to in Section 68 to 69D and reflected in the return of income furnished under Section 139;
b) Where the total income of an assessee determined by the Assessing Officer includes any income referred to in Section 68 to 69D, if such income is not covered under clause (a).

It is proposed that in both the above cases the rate of tax will be 60%. Further the rate of tax will be subject to surcharge of 25% of the tax making the total tax and surcharge at 75%. The total tax liabilty including education cess will be 77.25%.

3.2.3 Further a penalty @ 10% on the tax payable is leviable under the proposed Section 271 AAC, aggregating to tax, surcharge, cess and penalty of 83.25%. The penalty under Section 271AAC as above is not leviable to the extent such income has been included by the assesse in the return of income filed under Section 139 and the tax under Section 115BBE (1)(i) has been paid on or before the end of the relevant previous year. Thus, a penalty can be

avoided if the tax is paid voluntarily that too before end of the previous year.

3.2.4 *The intention of the new clause (a) of Section 115BBE (1) is to secure that even if the income under Section 68 to 69D is offered by the assesse in the return of income, the rate of tax will be 60% plus surcharge. This effectively negates the suggestions in some quarters that the unexplained income represented by SBN can be offered as income from other sources for the Assessment Year 2017-18 and tax @ 30% paid under Section 115BBE as it exists now.*

3.3 Enhancement Tax and Penalty in Search Cases

3.3.1 The tax and penalty payable in search cases is also proposed to be made stringent. In respect of any Search initiated after the Taxation Laws (Second Amendment) Bill, 2016 receives the assent of the President of India, the penalty under the new sub-section 271AAB(1A)(a) will be 30% of the undisclosed income, if all the following four conditions are satisfied:

i) The assessee in course of the search, in a statement under Section 132(4) admits the undisclosed income and specifies the manner in which such income has been derived;
ii) The assessee substantiates the manner in which the undisclosed income was derived;
iii) The assessee pays the tax, together with interest, if any, in respect of the undisclosed income; and
iv) The assessee furnishes the return of income for the specified previous year declaring such undisclosed income therein.

3.3.2 In those cases where all the above conditions are not fulfilled, the penalty under the new sub-section 271 AAB(1A)(b) will be 60% of the undisclosed income. *It is also important to note that this Penalty is mandatory and not discretionary and hence the Assessing Officer will have no choice of not levying the penalty. This would mean that the total tax and penalty liability in those cases will be 95.54%. In those cases where the search assessment results in an addition under Sections 68 to 69A attracting the provisions of Section 115BBE the tax rate will be 77.25% and after adding the penalty under Section 271AAC as above the final liability could be 107.25% or 133.25%, making tax evasion literally prohibitive.*

4.0 Tax Implications of Demonetisation

4.1 From a tax point of view, the SBN that would be deposited into Banks can classified into the following three broad categories:

i) *Accounted Money*: Accounted money held in cash for various legitimate requirements, the source of which can be clearly explained with reference to contemporaneous Books of Accounts maintained and disclosed in the tax returns filed.
ii) *Explainable Money*: Money held in cash for various legitimate requirements, the source of which can be reasonably explained with reference to incomes/assets/transactions disclosed in the Tax returns filed for the earlier years though Books of accounts are not maintained/are not required to be maintained by law.
iii) *Unaccounted Money*: Unaccounted money or Black money representing income earned or moneys received through transactions such loans, gifts, etc., which are not disclosed in Tax returns, and held in cash without depositing in Bank to avoid/evade tax.

It is possible that a Person may possess SBN representing combination of any one or more of the categories (i) to (iii) above.

4.2 *It may not be surprising that the Black Money as in category (iii) above could be held by different sections of the Society and not confined to business entities. Examples would include undisclosed rental incomes, undisclosed Fixed deposits and interest incomes, cash allowances received by employees, cash incomes of professionals, undisclosed capital gains in real estate transactions/sale of ancestral properties etc. When all of this SBN gets deposited into Banks before 30th December, the inevitable churn or cleaning up process, would take place, however painful that process may be to the holders of Black Money.*

4.2.1 Out of the three categories identified above, those falling in the category of *Accounted Money*, who have maintained contemporaneous Books of Accounts and other records such as Invoices, Excise Records, VAT records, or other verifiable records and have deposited the SBN held as per the Books of Accounts will obviously have no tax liability on such deposits and the proposed Section 115BBE will have no application. There is no limit on the value of such deposits as the

sources in such cases are verifiable from the Books of Accounts. The above proposition, of course, cannot hold good in such cases where the Books of Account have been found to be manipulated. Such cases of manipulation will not only attract the tax and penalty of 83.25 % under Section 115BBE but would also invite Prosecution proceedings.

4.2.2 In respect of category of *Explainable Money*, the quantum of SBN deposit that can be accepted as explainable will be subject to common sense test that is with reference to the incomes disclosed in the return of income, withdrawals from the disclosed Bank Accounts, past cash expenditure pattern and the facts and circumstances of each case. The onus is on the SBN depositor to prove the availability of the quantum of SBN. If the explanation of the SBN depositor is not satisfactory the Tax Department may invoke the provisions of Section 115BBE.

4.2.3 The SBN to the extent it is not accounted for or is not explainable will attract the provisions of Section 69A and will be deemed to be the income of the financial year in which the assesse is found to be owner of such money which in this case would be the financial year 2016-17. This would trigger the enhanced tax and penalty under the proposed Section 115BBE. It is also to be noted that such SBN cannot be offered as " Income from other sources" since any income referred to Section 68 to 69D is an income by deeming fiction and cannot be taken as income under specific head of income. In this regard reference may be made to the decision of the Chennai Bench of the ITAT in the case of *ARK Poly Industries Ltd (ITA No 1042/ Mds/2012).*

4.2.4 The SBN deposits representing *Unaccounted or Unexplainable Moneys* will not only result in tax being levied under Section 115BBE but would also lead to tax on Escaped Income of earlier years also being brought to tax and the consequent interest, penalty and prosecution as the case may be. It would also to lead inevitable consequences under other laws such as Excise Duty, Customs Duty, Service Tax, VAT *etc.* The tax department has made it clear that in appropriate cases, such as cases of deposit of SBN in the accounts of third parties, misuse of Jandhan accounts of others the provisions of Prevention of Money Laundering Act, 2002 and The Prohibition of Benami Property Transactions Act,1988 as amended in 2016 would be invoked resulting in confiscation of the Deposits and criminal prosecution. This is the avowed objective of the demonetisation and those who have violated the Laws of the Land, have no option but to pay the heavy price.

4.3 Revised Return will Attract Scrutiny: The steep tax liability and stringent penalties as proposed by the amendments discussed above has resulted in an ironic situation of the unaccounted money holders seeking to revise the tax returns of earlier years enhancing the income offered therein to cover the unaccounted income held in the form of SBN, since the tax and interest would be less than the enhanced tax liabilities and penalties would be discretionary as against mandatory penalties from the Assessment Year 2017-18. The CBDT *vide* Press note dated 14th December, 2016 has clarified that the Revised return can be filed only to revise any omission or wrong statement in the original return and not for resorting to make changes in the income initially declared so as to drastically alter the form, substance and quantum of the earlier disclosed income. The CBDT has also warned that any such instance of manipulation in the amount of income, cash-in-hand, profits, *etc.*, and fudging of accounts may necessitate scrutiny of such cases to ascertain correct income of the year and may also attract penalty/prosecution in appropriate cases as per provisions of law.

4.4 *The Government is thus clear in its resolve thwart any attempt to misuse the law by wrongly declaring the income either in the current year or earlier to avoid/evade tax. It needs to be noted that the Department is fully equipped with the necessary data of various transactions as well as the authority of law to carry out stringent action.*

4.5 In this emerging scenario, the only saving grace for those holding unaccounted moneys would be to

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avail the PMGKJ scheme, discussed in detail below, to the extent they are eligible under the scheme.

5.0 Pradhan Mantri Garib Kalyan Yojana 2016 ("PMGKY")–One Time Final Amnesty

5.1.1 The Statement of Objects and Reasons of the Taxation Laws (Second Amendment) Bill, 2016 notes that in the wake of declaring specified bank notes as not legal tender, there have been representations and suggestions from experts that instead of allowing people to find illegal ways of converting their black money into black again, the Government should give them an opportunity to pay taxes with heavy penalty and allow them to come clean so that not only the Government gets additional revenue for undertaking activities for the welfare of the poor but also the remaining part of the declared income legitimately comes into the formal economy. Thus, money coming from additional revenue as a result of the decision to ban ₹1,000 and ₹500 notes can be utilised for welfare schemes for the poor.

5.1.2 The Bill therefore proposes to introduce from a date and period to be announced an alternative scheme namely the Taxation and Investment Regime for Pradhan Mantri Garib Kalyan Yojana 2016 ("PMGKY").

5.2.1 Any income consisting of cash or deposit in any specified entity (that is Reserve Bank of India, Banks, Post offices or any other notified by the Central Government) relating to any year up to the Assessment year 2017-18 can be declared under the Scheme. No deduction in respect of any expenditure or allowance or set off of loss will be allowed against such income.

5.2.2 The declarant under the scheme has to pay tax @ 30% plus penalty @ 10% on the undisclosed income. A surcharge of 33% on the tax, that is 10% (rounded off) is also payable, aggregating to 50% of the undisclosed income. The surcharge called "Pradhan Mantri Garib Kalyan Cess" would be used for achievement of the objectives of helping the poor.

5.2.3 Further, the declarant should also deposit 25% of the undisclosed income in PMGK Deposit Scheme, 2016 (to be notified). The deposit will bear no interest and shall be locked in for four years from the date of deposit. This amount is proposed to be utilised for the programmes of irrigation, housing, toilets, infrastructure, primary education, primary health, livelihood *etc.* so that there is justice and equality.

Further, the declarant should also deposit 25% of the undisclosed income in PMGK Deposit Scheme, 2016 (to be notified). The deposit will bear no interest and shall be locked in for four years from the date of deposit.

5.2.4 The scheme is not available to any Person covered by specified economic/criminal offences and income chargeable to tax under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

5.3 *It is to be noted that the scheme is restricted only to Cash or Deposits and not for other unaccounted incomes/assets as was available under the Income Disclosure scheme, 2016. The only alternative available to holders of such unaccounted incomes/ assets is to convert them into cash and deposit them with the specified entities before 31st March, 2016. The intention of the Government perhaps is to channelise the unaccounted wealth into the scheme in liquid form so as to help the achievement of the objectives.*

6.0 Conclusion

While the Government's resolve to fight black money is loud and clear, it is equipped with adequate authority to deal stringently with the black money holders. The Government agencies are fully involved in implementation of the law and achieving the objectives of the Government. All the escape routes for the tax evaders have been closed. There seems to be a new dawn. ■