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**Working Paper**

## Demonetisation: A golden opportunity for widening the taxpayer base

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**Working Paper No. 351**

**Demonetisation – A Golden  
Opportunity for Widening the  
Taxpayer Base**

**Rajiva Ranjan Singh**

**Anandita Bagchi**

**January 2018**



**INDIAN COUNCIL FOR RESEARCH ON INTERNATIONAL ECONOMIC RELATIONS**

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## Abstract

The demonetisation exercise announced by the PM on November 8, 2016, aimed to tackle the problems of black money, fake currency, corruption, and terror funding. With time, more targets were added such as the creation of a cashless economy, curbing real estate prices, and broadening the taxpayer base. Although black money cannot be wiped out in a single stroke the shock effect of demonetisation clearly conveyed the Government's determination to tackle the problem upfront. In the past, too, Governments have provided opportunities to citizens to disclose unaccounted incomes in return for pardons. Indeed, similar efforts to demonetise high value currency, aimed at the black economy were made in 1946 and 1978 but met with little success. The demonetisation of 2016 is expected to yield better results since there is almost 100% banking coverage; the introduction of a taxpayer identification number (PAN) and a citizen identification number (Aadhaar); more digital transactions, extensive computerisation in the banking sector and in government departments, especially the Income Tax department. The latter is equipped with the latest hardware and software and supported by competent officers. The authors acknowledge the stress that this sudden move put on the common man. The RBI's Annual Report 2017, showed that 99 percent of the demonetised currency had found its way back to the banks suggesting first, that most black money in the Indian economy is not held as cash, and secondly, that the Income Tax department now has a large amount of financial database. The authors feel that the Department should use technology to compile 360-degree profiles of all citizens based on: (i) all transactional data received since November 2016, and (ii) the large amount of historical data and third-party information available. Action by the Government/Department should be based on proper data analysis since tax proceedings can be initiated till six years after March 2017. The paper also recommends that the Department act with a focus on the 'customer' and in a non-intrusive and taxpayer-friendly manner.

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**Keywords:** *demonetisation, black economy, digitisation, widening of taxpayer and tax base, corruption, cash in circulation, cash economy, formalisation*

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# **Demonetisation: A Golden Opportunity for Widening the Taxpayer Base**

Rajiva Ranjan Singh, Anandita Bagchi

## **1. Introduction**

On 8<sup>th</sup> November 2016, the Prime Minister (PM) announced late in the evening, on TV and radio that currency notes of two denominations: INR 500 and INR 1,000 (Specified Currency, or Specified Bank Notes, or SBN) would cease to be legal tender from midnight that day. During Diwali festivities only a week earlier, cash transactions had flowed freely, but after the announcement, cash utilisation ground to a temporary halt. In his speech, the PM stated that the government had taken a number of steps to promote inclusive economic growth in all sections of society. Measures such as the Jan Dhan Yojana (for inclusive banking); Jan Suraksha Yojana (insurance for the poor at INR 12 or INR 365 per year); Mudra Yojana (business loans for small enterprises); Stand-up India (for entrepreneurs in the Scheduled Castes and Scheduled Tribes categories, and, women); Ujjwala programme (for cooking gas connections to the poor); e-NAM (the online National Market Place for farmers) were initiated by the incumbent government. However, the continued existence of corruption, incidence of black money, terrorism and fake currency overshadowed these efforts to remove poverty and bring about a sense of parity in the society. Demonetisation was the strong and decisive action against these continuing ills. Citizens were allowed to deposit the demonetised currency notes in their bank accounts up to 30<sup>th</sup> December, 2016<sup>1</sup>, with the facility to withdraw money as per their need. To meet peoples' immediate need for cash, exchange of demonetised currency (up to a limit of INR 4,000) was allowed at banks and post offices upon producing identity documents such as the Aadhar card, PAN card, voter card, ration card, driving licence, or passport. Until the circulation of new currency notes was enough, a withdrawal limit was fixed at INR 10,000 per day, and INR 20,000 per week. While withdrawal of new notes was restricted, demonetised currency (subject to maintenance of proper records of stocks and collections) was allowed at: government hospitals, pharmacies in government hospitals, for purchase of railway, airline and government bus tickets, purchase of petrol, diesel and CNG, at milk booths, consumer cooperative stores authorised by the state or central governments, cremation and burial grounds. As the economy and people grappled with the consequences of this sudden move, a narrative in support of 'Digital India' was built, with the PM repeatedly stressing that there were no restrictions on non-cash payments by cheques, demand drafts, debit/credit cards, electronic fund transfers, etc. Acknowledging the public's suffering, in the short-term, on account of the abruptness of the decision, he requested people to bear with it, explaining that secrecy had been necessary to ensure the success of demonetisation.

Black money in India, as elsewhere in the world, is a hydra-headed monster, with numerous sources, forms and means of hoarding. At any given moment it exists as a stock as well as a flow, and keeps changing form. Black money is essentially money which has been earned

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<sup>1</sup> Subsequently, the government through an Ordinance on 30th December, 2016, allowed non-resident Indians (NRIs) to deposit SBNs up to INR 25,000 by 30th June, 2017.



through legal as well as illegal means, but on which tax has not been paid. Its reach extends to both, the organised sector and the informal sector of the economy, as also to persons in the tax net and out of it. It is therefore scarcely amenable to a single remedy. Nevertheless, the demonetisation of 2016 was a significant attack on black money held in the form of cash within the country. Although it had no direct impact on the black money held by Indians in the form of other physical assets, inside and outside the country, it shocked holders of unaccounted assets, as it conveyed government's determination to tackle the problem upfront.

## 1.1 Objective

The primary targets of demonetisation as announced by the PM were black money, fake currency, corruption and terror-funding.<sup>2</sup> Fake or counterfeit currency was being pumped into India by a neighbouring country to destabilise it (India), promote terrorism, drug and human trafficking and smuggling. As time passed by, the list of justifications for the demonetisation exercise grew and such aims as creation of a cashless economy, curbing real estate prices, and broadening the taxpayer base were added. It is generally understood that black money is generated through corruption and cash transactions. Cash is also extensively used in illegal activities such as drug trafficking, human trafficking and smuggling. These lead to evasion of tax and non-filing of tax returns resulting in low taxpayer base. In the authors' opinion, the real purpose of this exercise was to broaden the very low taxpayer base by digitising the very high proportion of cash transactions in the economy.

One must also bear in mind that '*all black is not cash and all cash is not black*'. Cash is also, widely and legitimately, used in India's large informal sector which contributes over 45% of GDP and 90% of employment. It is used extensively as the medium of transaction in the agricultural sector, outside the ambit of income taxation. It is also a well-documented fact that tax evaders use different devices (shell companies, hawala dealers, for example) to channel black money through the banking system. Even though the authors acknowledge that all cash is not black, cash transactions throw the entire economy wide open to unrecorded transactions, allowing people to avoid the tax net, either as non-filers or under-reporters.

## 2. Opportunities to Come Clean – History of Voluntary Disclosure Schemes in India

Over time, governments have offered reprieves to the public in the matter of tax evasion based on the rationale that people must be given an opportunity to correct their misdeeds and contribute to nation-building. It will be helpful here, to look at some disclosure schemes floated in the past, in chronological order.<sup>3</sup>

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<sup>2</sup> Press Information Bureau (2016), Text of Prime Minister's Address to the Nation; Press Information Bureau, Government of India, Prime Minister's Office, available at <http://pib.nic.in/newsite/PrintRelease.aspx?relid=153404> (accessed on June 30, 2017)

<sup>3</sup> C&AG (2000), Audit Report of Union Government – Direct Taxes – No. 12A of 2000

## **2.1 Voluntary Disclosure Scheme, 1951**

Also known as the 'Tyagi Scheme', it allowed assesseees (taxpayers) to bring forward unaccounted cash before August 31, 1951, after intimating the Income Tax Officer (ITO) and paying tax on it. Citizens were assured that they would be protected from penalties or prosecution. As a result of the scheme, INR 70 crore were disclosed and INR 11 crore collected in taxes, but the move was not considered a success, with citizens unsure about assurances of immunity from penalties and prosecution.

## **2.2 Voluntary Disclosure Scheme, 1965**

The 'Sixty-Forty Scheme', as it was called, allowed citizens to disclose unaccounted incomes by paying tax at the rate of 60 percent and retaining 40 percent, with immunity from penalty and prosecution. Citizens were assured that disclosures would remain confidential and even courts were prohibited from compelling producing these declarations in any proceedings. Tax was permitted to be paid in two instalments. The black money and taxes collected in this scheme were only INR 52.11 crore and INR 29 crore, respectively, as the tax rate of 60 percent was regarded as too high by the tax evaders.

## **2.3 Second Disclosure Scheme, 1965**

The limited revenue resulting from the previous scheme led the Government of the day to announce another, slightly modified scheme, allowing tax evaders to disclose unaccounted income pertaining to any year up to March 31, 1966. This scheme was popular because tax was payable on such disclosed income of various years taken as a single block, at the rates applicable for the year 1965-66, and not a flat rate of 60 percent. The tax could be paid in instalments extending over four years. It succeeded in bringing out black money to the tune of INR 145 crore but the tax collection was very low, INR 20 crore, as most disclosures were made in the names of spouses, children, etc., who were in the lowest slabs. The Wanchoo Committee estimated tax-evaded incomes in 1965 to be around INR 1,000 crore.

## **2.4 Voluntary Disclosure Scheme, 1975**

This scheme was announced in the wake of the Emergency and allowed tax evaders to declare unaccounted income or wealth of any previous year without fear of levy of interest, penalty, or prosecution. Rates at which tax was to be paid were 60 percent (for companies) and 25-60 percent (in case of others for incomes up to INR 25,000, between INR 25,000-INR 50,000, and above INR 50,000). The resultant unaccounted income, unaccounted wealth, and tax collected were INR 738 crore, INR 790 crore, and INR 241 crore, respectively. In 1975, black money was estimated to be 15-18 percent of the GDP: approximately INR 9,958 to INR 11,870 crore.

## **2.5 Amnesty Circulars, 1985**

Undeterred by the failure of successive schemes, the Government came up with another one in 1985, this time by stealth. This was not even called a Disclosure Scheme and was not made with Parliamentary approval either. It came in the form of seven CBDT circulars issued from

June 26, 1985 to February 17, 1986. These allowed tax evaders to disclose their unaccounted incomes and wealth of any year before March 31, 1986 and pay the tax due on it, on the assurance that penal interest would be waived and immunity from penalties would be granted. There was no immunity in respect of excise duty, sales tax, etc. The scheme was extended up to March 31, 1987, and mopped up black money worth about INR 700 crore. Though figures for the period 1985 to 1987, are not available, the black money was estimated, by NIPFP, at 20% of the GDP or INR 1, 00, 000 crore<sup>4</sup>.

## **2.6 Voluntary Disclosure of Income Scheme (VDIS), 1997**

The VDIS-1997 was described as “a golden chance for tax evaders to become honest” and the “last chance to come clean”. The scheme allowed evaders, including non-residents, to disclose unaccounted cash, securities or assets, whether in India or abroad, irrespective of the year, or nature, or source of the funds. The tax rates were 35 percent for companies/firms, and 30 percent for others. The reprieve offered was waiver of interest and penalty and immunity from prosecution under laws of income tax, wealth tax, foreign exchange and companies. It was also stated that the particulars supplied by a declarant were to be kept secret. VDIS attracted 475,477 declarations aggregating to INR 33,697 crore and a tax realisation of INR 9,729 crore. Though the government termed this scheme a great success, in reality the disclosure resulting from it was only 0.79 percent of the GDP. The black money in 1995-96 was estimated at 40% of the GDP or INR 4, 00,000 crore<sup>5</sup>. An audit of the scheme was carried out by the Comptroller and Auditor General of India, and one the main conclusions was that the number of circulars, clarifications, and press briefings that were released inconsistent with the Act, provided dishonest assessee opportunities for widespread misuse.

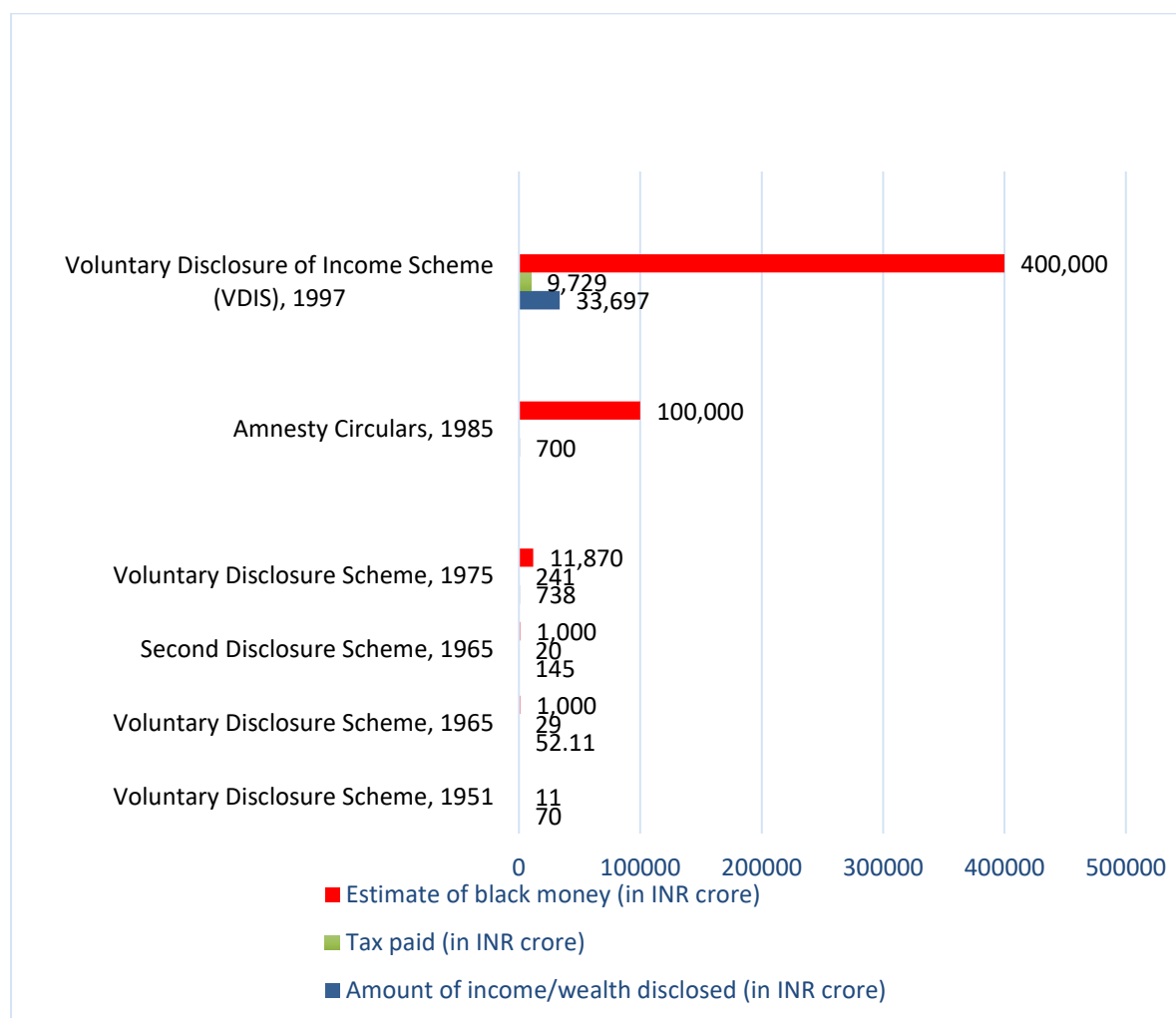
Figure 1 below shows the estimates of black money and the amounts that came forth in each of the above-mentioned amnesty schemes (for details, refer Annexure I)

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<sup>4</sup> Sarkar, S. (2010), The Parallel Economy in India: Causes, Impacts and Government Initiatives, Vol. 11 & 12 No. 1-2 (2010), Economic Journal of Development Issues, Nepal Journal Online, available at <https://www.nepjol.info/index.php/EJDI/article/view/6111> (accessed on June 30, 2017)

<sup>5</sup> Sarkar, S. (2010), The Parallel Economy in India: Causes, Impacts and Government Initiatives, Vol. 11 & 12 No. 1-2 (2010), Economic Journal of Development Issues, Nepal Journal Online, available at <https://www.nepjol.info/index.php/EJDI/article/view/6111> (accessed on June 30, 2017)

**Figure 1: Estimates of Black Money and Amounts Disclosed under Various Disclosure Schemes**



Source: Extracted from Khan (2012) and National Institute of Public Finance and Policy reports

In addition to the schemes listed above, the government opened up many other modes allowing taxpayers to turn their unaccounted money into legitimate wealth: in some cases, this also became available to the government for its own use, as in the case of the Indira Vikas Patra, 1986, and the Kisan Vikas Patra, 1988. Apart from these two, over the years, successive governments have offered an assortment of options such as the National Defence Gold Bonds, National Defence Remittance Scheme, Special Bearer Bonds 1981, National Housing Bank Deposit Scheme 1991, Foreign Exchange Remittance Scheme and India Development Bonds, Gold Bonds Scheme 1993.

### 3. Earlier Efforts at Demonetisation of Currency

Two demonetisation initiatives had been carried out in 1946 and 1978.

### 3.1 Demonetisation of 1946

The rationale for the first of these two, in 1946, was recorded in the History of the Reserve Bank of India<sup>6</sup> (RBI) in the following words: *“Soon after the war, while Governments were giving attention to ways and means of averting the expected slump, thought was also given to check black market operations and tax evasion, which were known to have occurred on a considerable scale. Following the action in several foreign countries, including France, Belgium and the United Kingdom (U.K.), the Government of India decided on demonetisation of high denomination notes in January 1946. It is interesting that as early as April 7, 1945, in an editorial on the tasks before the new Finance Minister, Sir Archibald Rowlands, the Indian Finance Minister referred to the action of the Bank of England in calling in notes of £10 and higher denominations and suggested similar action in India as ‘one more concrete example for the Indian Government to follow in its fight against black market money and tax evasions which have now assumed enormous proportions.’”*

To bring to realisation the first demonetisation that the country witnessed, an Ordinance was promulgated by the Government on January 12, 1946. The Ordinance demonetised currency notes of INR 500, INR 1,000, and INR 10,000 with a directive that they could be exchanged within ten days. The period of exchange was extended a number of times by both, the RBI and the Government. By the end of 1947, out of a total of INR 143.97 crores of high denomination notes, notes of the value of INR 134.9 crores had been exchanged. Thus, notes worth INR 9.07 crores were demonetised, or not exchanged, indicating that the move had not really been a success. The first Indian Governor of the RBI, Sir Chintaman D. Deshmukh is quoted in the RBI’s documents<sup>7</sup> to have summed up the measure saying, *“It was really not a revolutionary measure and even its purpose as a minatory and punitive gesture towards black-marketing was not effectively served. There was no fool-proof administrative method by which a particular note brought by an individual could be proved as the life-savings of the hard-working man who presented it or established as the sordid gains of a black-marketer.”* Another limitation to this measure was that the currency notes exchanged by the princely States, which were not a part of British India, were not questioned. However, eight years on, the year 1954, saw notes of the same denomination INR 1,000, INR 5,000, and INR 10,000, being reintroduced into the system.<sup>8</sup>

### 3.2 Demonetisation of 1978

Following the general elections of 1977, India got its first non-Congress government. The country underwent yet another demonetisation drive under this government whose stated objective was to declare illegitimate black money supposedly held in high denomination currency notes. The government resorted to demonetisation of INR 1,000, INR 5,000, and INR

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<sup>6</sup> RBI History, Volume I (1935-1951), p.706, available at <https://rbidocs.rbi.org.in/rdocs/content/PDFs/89654.pdf> (accessed on June 17, 2017)

<sup>7</sup> RBI History, Volume I (1935-1951), p.709, available at <https://rbidocs.rbi.org.in/rdocs/content/PDFs/89654.pdf> (accessed on June 19, 2017)

<sup>8</sup> Press Trust of India (2016), ‘High-value notes demonetisation: Its 1978 redux!’, The Hindu Business Line, available at <http://www.thehindubusinessline.com/money-and-banking/highvalue-notes-demonetisation-its-1978-redux/article9320703.ece>. (accessed on June 19, 2017)

10,000 notes on January 16, 1978, under the High Denomination Bank Notes (Demonetisation) Ordinance, 1978 (No. 1 of 1978)<sup>9</sup> and people were allowed three days to exchange their notes. During this demonetisation exercise, out of INR 146 crore of the demonetised notes, INR 124.45 crore were exchanged and a sum of INR 21.55 crore, or 14.76% of the demonetised currency notes, were extinguished<sup>10</sup>. Currency notes of INR 500 were reintroduced in 1987, and those of INR 1,000 in 2000<sup>11</sup>. On the impact of this second demonetisation, the then Governor of RBI recalled in his memoir that, “*such an exercise seldom produces striking results*”<sup>12</sup> since people who have black money on a substantial scale rarely keep it in cash. “*The idea that black money or wealth is held in the form of notes tucked away in suitcases or pillow cases is naïve*”. In any case, big players holding large amounts of undisclosed cash can usually find agents to convert the notes through a number of small transactions “*for which explanations cannot be reasonably sought*”. Yet, since the Government was insistent, “*the gesture had to be made, and produced much work and little gain*”.<sup>13</sup>

The demonetisations of both, 1946 and 1978, were followed by enquiries into amounts exchanged or deposited in order to bring black money, if any, to tax. However, details of the results of such enquiries are not readily available for public consumption.

#### 4. Demonetisation of 2016

A total of 9,026.6 crore (90.266 billion) currency notes in volume valued at INR 17, 97, 46,000 crore (INR 17.97 trillion) were in circulation as of 4<sup>th</sup> November 2016 (Annexure II). Of these, currency notes of INR 500 numbering 1,650 crores and valued at INR 8.25 lakh crore (INR 8,250 trillion), and currency notes of INR 1,000 numbering 670 crore valued at INR 6.70 lakh crore were demonetised on November 8, 2016. It has been extensively reported that these Specified Bank Notes (SBN) that were demonetised amounted to INR 15.44 lakh crore or 86.4% of the currency in circulation. As on December 12, 2016, the total specified currency notes deposited with the RBI was INR 12.44 lakh crore. Though the official final figures of SBN exchanged or deposited are not yet available, media reports suggest that the RBI informed the Public Accounts Committee of the Parliament that SBNs valued at INR 15.28 lakh crore had returned to the RBI treasury. Therefore, only currency worth INR 16,000 crore or 1.03% of the demonetised currency was extinguished. Figures 2, 3, and 4 below show pictographically the situation in the three demonetisations of 1946, 1978, and 2016.

<sup>9</sup> RBI History, Volume III (1967-1981), p.450, available at <https://www.rbi.org.in/scripts/RHvol-3.aspx> (accessed on June 19, 2017)

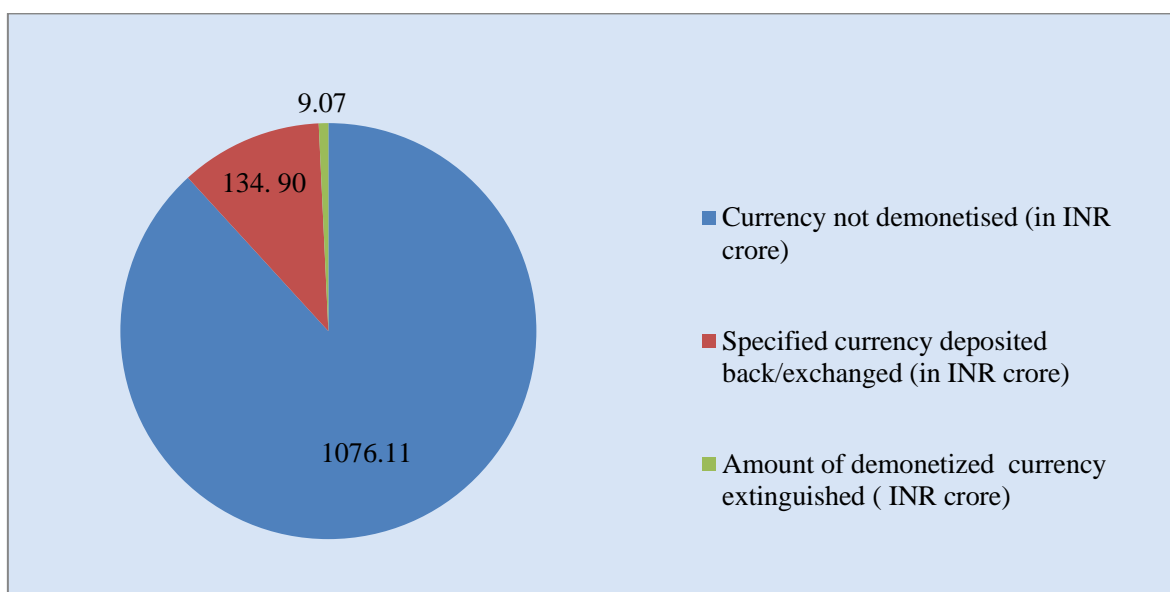
<sup>10</sup> Lekhi, R. (2003), The Economics of Development and Planning, 8<sup>th</sup> Edition, Kalyani Publications, Delhi

<sup>11</sup> Press Trust of India (2016), ‘High-value notes demonetisation: Its 1978 redux!’, The Hindu Business Line, available at <http://www.thehindubusinessline.com/money-and-banking/highvalue-notes-demonetisation-its-1978-redux/article9320703.ece>. (accessed on June 19, 2017)

<sup>12</sup> Patel, I.G. (2002), Glimpses of Indian Economic Policy: An Insider’s View, Oxford University Press, Oxford, United Kingdom, p.159

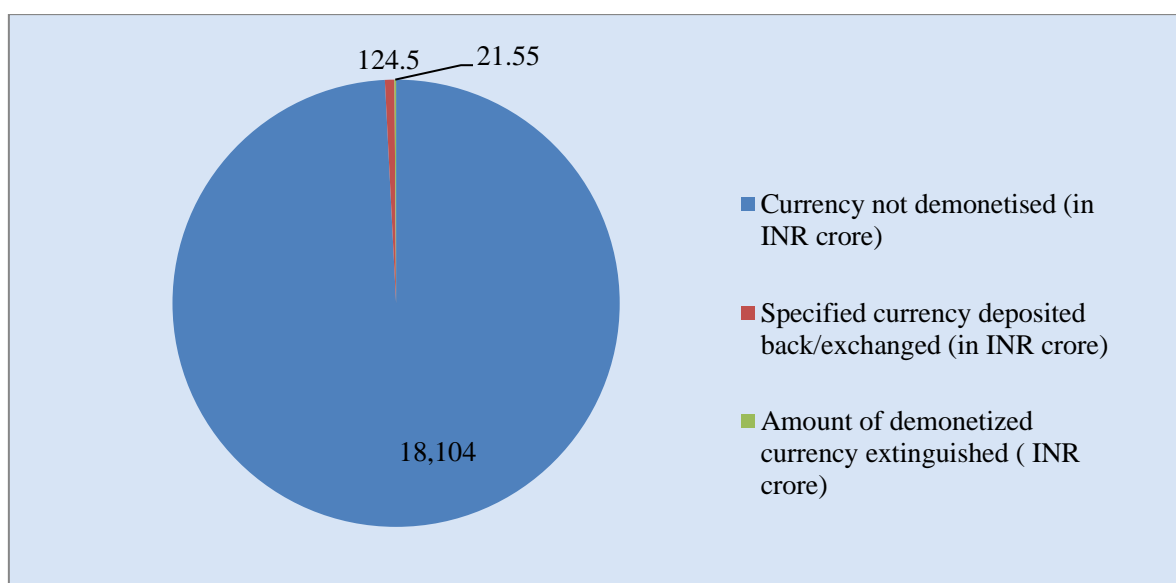
<sup>13</sup> Ghosh, J., Chandrashekhar, C.P., Patnaik, P. (2017), Demonetisation Decoded: A Critique of India’s Currency Experiment, Routledge Focus, United Kingdom

**Figure 2: Demonetisation of 1946 - Total currency incirulation: INR 1,220.08 crores**



Source: Lekhi, R. (2003), *The Economics of Development and Planning*, 8<sup>th</sup> Edition, Kalyani Publications, Delhi; multiple articles<sup>14</sup>

**Figure 3: Demononetisation of 1978 - Total currency of INR 1,825 crore in cirulation**



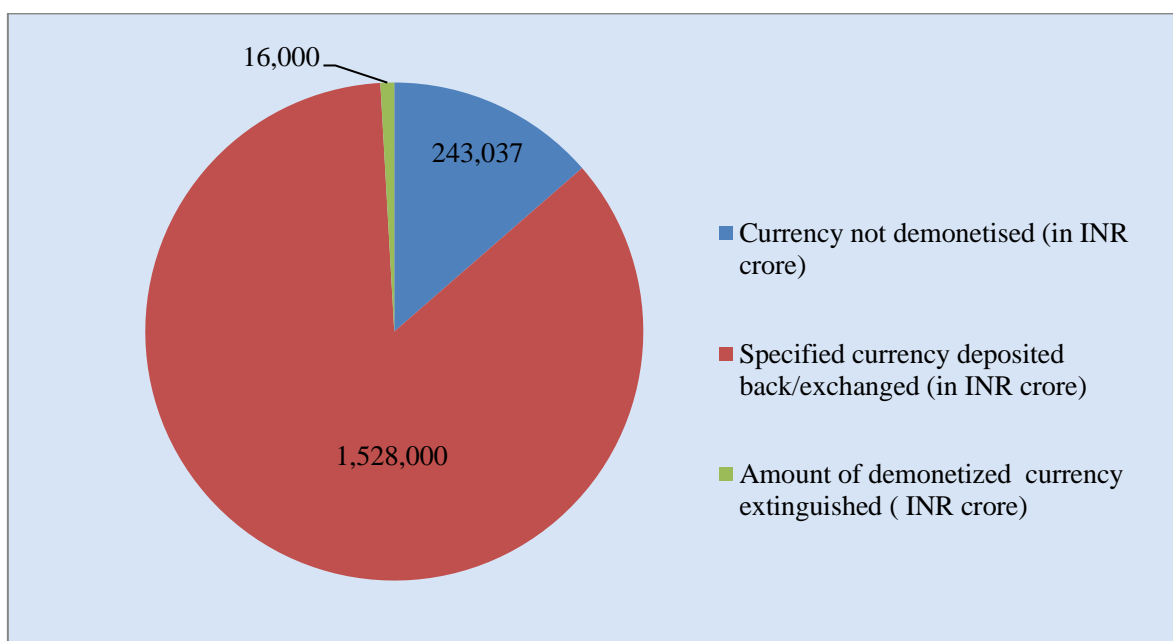
Source: Lekhi, R. (2003), *The Economics of Development and Planning*, 8<sup>th</sup> Edition, Kalyani Publications, Delhi; multiple articles<sup>15</sup>

<sup>14</sup> Choudhury, S. (2016), 'Demonetisation: Newspaper Headlines From 1946 Tell a Story Similar to 2016', News18, available at <http://www.news18.com/news/india/demonetisation-newspaper-headlines-from-1946-tell-a-story-similar-to-2016-1311844.html> (accessed on September 22, 2017)

'Digging through India demonetization history — 12 Jan 1946 (Saturday) and 16 Jan 1978 (Monday)', available at <https://mostlyeconomics.wordpress.com/2016/11/11/digging-through-india-demonetization-history-12-jan-1946-saturday-and-16-jan-1978-monday/#more-19016> (accessed on September 22, 2017)

<sup>15</sup> Choudhury, S. (2016), 'Demonetisation: Newspaper Headlines From 1946 Tell a Story Similar to 2016', News18, available at <http://www.news18.com/news/india/demonetisation-newspaper-headlines-from-1946-tell-a-story-similar-to-2016-1311844.html> (accessed on September 22, 2017)

**Figure 4: Demonetisation of 2016 - Total currency in circulation INR 17.97 lakh crore**



Source: Lekhi, R. (2003), *The Economics of Development and Planning*, 8<sup>th</sup> Edition, Kalyani Publications, Delhi; multiple articles<sup>16</sup>

From the above figures it is clear that in 1946, only 11.8%, and in 1978, only 0.8% of the currency notes were demonetised out of the total currency in circulation at that time; in 2016, 86.4% of the total value of currency notes in circulation was demonetised. This definitely sucked away a major chunk of cash from the economy hurting people whose transactions were mainly in cash.

## 5. The Status Prior to November 8th, 2016

In the introduction to this paper, we highlighted the primary targets of the demonetisation drive of 2016. We now assess the situation in the Indian economy before November 8, 2016:

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<sup>16</sup> 'Digging through India demonetization history — 12 Jan 1946 (Saturday) and 16 Jan 1978 (Monday)', available at <https://mostlyeconomics.wordpress.com/2016/11/11/digging-through-india-demonetization-history-12-jan-1946-saturday-and-16-jan-1978-monday/#more-19016> (accessed on September 22, 2017)

Choudhury, S. (2016), 'Demonetisation: Newspaper Headlines From 1946 Tell a Story Similar to 2016', News18, available at <http://www.news18.com/news/india/demonetisation-newspaper-headlines-from-1946-tell-a-story-similar-to-2016-1311844.html> (accessed on September 22, 2017)

'Digging through India demonetization history — 12 Jan 1946 (Saturday) and 16 Jan 1978 (Monday)', available at <https://mostlyeconomics.wordpress.com/2016/11/11/digging-through-india-demonetization-history-12-jan-1946-saturday-and-16-jan-1978-monday/#more-19016> (accessed on September 22, 2017)



## 5.1 Fake and counterfeit currency

As per the RBI's Annual Report, fake currency notes valued at INR 27 crore were seized primarily by banks during the year 2015-16. These notes are alleged to have been smuggled in by one of India's neighbours and were being used to fund terrorism, drug and human trafficking, smuggling, and agitations and insurgencies in different parts of the country. Though no authentic figures from the government are available, a study is said to have been carried out by security agencies along with the Indian Statistical Institute which pegged the value of counterfeit notes at INR 400 crore.<sup>17</sup> It has also been reported that in contrast to countries such as Britain, Canada, and Mexico, the study found a higher rate of occurrence of Fake Indian Currency Notes (FICN) in India and estimated it to be at 250 pieces per million.<sup>18</sup> The study also estimated that attempts are being made to push about INR 70 crore into the Indian economy every year, of which only one-third is seized.

## 5.2 Black money

Black money is generated by the informal sector, the real estate sector, international transactions, etc. The people involved are either completely outside the tax net (non-filers) or are those who do not declare their total income correctly (under reporters)<sup>19</sup>. One of the most important reasons for a low taxpayer base is the existence of a very large black or unaccounted economy. Figure 5 (refer Annexure III) shows how India's actual GDP is underestimated on account of the shadow economy. Various studies have estimated the size of black economy: in 1975-76 it was estimated to be 15% to 18% of the GDP; 18% to 21% of the GDP in 1980-81; and, 19%-21% of the GDP in 1983-84, according to a study by the NIPFP (White Paper on Black Money, Ministry of Finance). A study by Suraj B Gupta<sup>20</sup> put this figure at 51% in 1987-88, while a study by Arun Kumar (2006) estimated it at 40% in 1995-96<sup>21</sup>. In 2013, a McKinsey & Company report estimated India's shadow economy to be 26 percent of the

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<sup>17</sup> Tripathi, R. (2016), 'Secret study pegs value of fake notes in circulation at Rs 400 crore', The Economic Times, available at [http://economictimes.indiatimes.com/news/defence/secret-study-pegs-value-of-fake-notes-in-circulation-at-rs-400-crore/articleshow/55424455.cms?utm\\_source=contentofinterest&utm\\_medium=text&utm\\_campaign=cppst](http://economictimes.indiatimes.com/news/defence/secret-study-pegs-value-of-fake-notes-in-circulation-at-rs-400-crore/articleshow/55424455.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst). (accessed on July 31, 2017)

<sup>18</sup> Tripathi, R. (2016), 'Secret study pegs value of fake notes in circulation at Rs 400 crore', The Economic Times, available at [http://economictimes.indiatimes.com/news/defence/secret-study-pegs-value-of-fake-notes-in-circulation-at-rs-400-crore/articleshow/55424455.cms?utm\\_source=contentofinterest&utm\\_medium=text&utm\\_campaign=cppst](http://economictimes.indiatimes.com/news/defence/secret-study-pegs-value-of-fake-notes-in-circulation-at-rs-400-crore/articleshow/55424455.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst). (accessed on July 31, 2017)

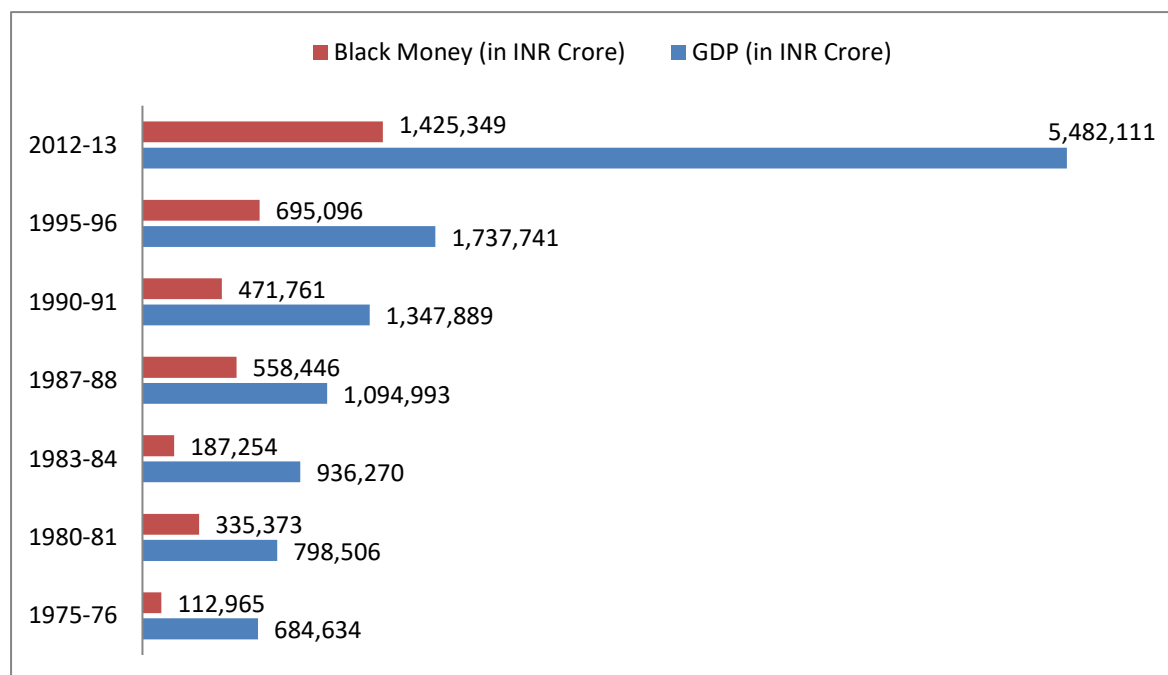
<sup>19</sup> Extracted from Ministry of Finance (2012), White Paper on Black Money, Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, New Delhi, available at [http://www.prsindia.org/uploads/media/White%20Paper%20Black%20Money/WhitePaper\\_BackMoney2012.pdf](http://www.prsindia.org/uploads/media/White%20Paper%20Black%20Money/WhitePaper_BackMoney2012.pdf) (accessed on July 31, 2017); Kumar, A. (2006), Black Economy, Underestimation of Unemployment and Budget 2005-06, Vol. 41, Issue No.30, Economic and Political Weekly, New Delhi, available at <http://www.epw.in/or/journal/2006/30/special-articles/black-economy-underestimation-unemployment-and-budget-2005-06.html> (accessed on June 19, 2017)

<sup>20</sup> Kumar, A. (2016), Estimation of the Size of the Black Economy in India, 1996-2012, Vol.51, Issue No.48, Economic and Political Weekly, New Delhi, available at [http://www.epw.in/journal/2016/48/estimation-size-black-economy-india-1996-2012.html?0=ip\\_login\\_no\\_cache%3Ddeed0701a920ab1009a6d613a13ec4f33](http://www.epw.in/journal/2016/48/estimation-size-black-economy-india-1996-2012.html?0=ip_login_no_cache%3Ddeed0701a920ab1009a6d613a13ec4f33) (accessed on June 20, 2017)

<sup>21</sup> Singh, R.R. and Manchanda, S. (2016), Widening of Taxpayer Base, Singh, R.R. (ed.) (2016), Challenges of Indian Tax Administration, Lexis Nexis, New Delhi

country's GDP<sup>22</sup>. The report further stated that, “a prevalence of cash often allows an 'informal' or 'shadow' economy—one that is not taxed, monitored by government, or included in the GDP—to grow or dominate. International comparisons show a clear correlation between cash usage in the economy and the size of the shadow economy”<sup>23</sup>. In 2016, Arun Kumar<sup>24</sup> estimated the size of the black economy in 2012 to be as high as 62% of the GDP.

**Figure 5: Data on GDP and Black Money**



Source: Extracted from Ministry of Finance (2012), White Paper on Black Money, Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, New Delhi, available at [http://www.prsindia.org/uploads/media/White%20Paper%20Black%20Money/WhitePaper\\_BackMoney2012.pdf](http://www.prsindia.org/uploads/media/White%20Paper%20Black%20Money/WhitePaper_BackMoney2012.pdf) (accessed on July 31, 2017); Planning Commission (2014), Data-book Compiled for Use of Planning Commission, Planning Commission, Government of India, available at [http://planningcommission.nic.in/data/datatable/data\\_2312/comp\\_data2312.pdf](http://planningcommission.nic.in/data/datatable/data_2312/comp_data2312.pdf) (accessed on July 31, 2017); McKinsey and Co. (2016), Forging a Path to Payments Digitisation, McKinsey on Payments (16), available at [https://www.mckinsey.com/~media/mckinsey/dotcom/client\\_service/financial%20services/latest%20thinking/payments/mop16\\_forging\\_a\\_path\\_to\\_payments\\_digitization.ashx](https://www.mckinsey.com/~media/mckinsey/dotcom/client_service/financial%20services/latest%20thinking/payments/mop16_forging_a_path_to_payments_digitization.ashx) (accessed on July 31, 2017)

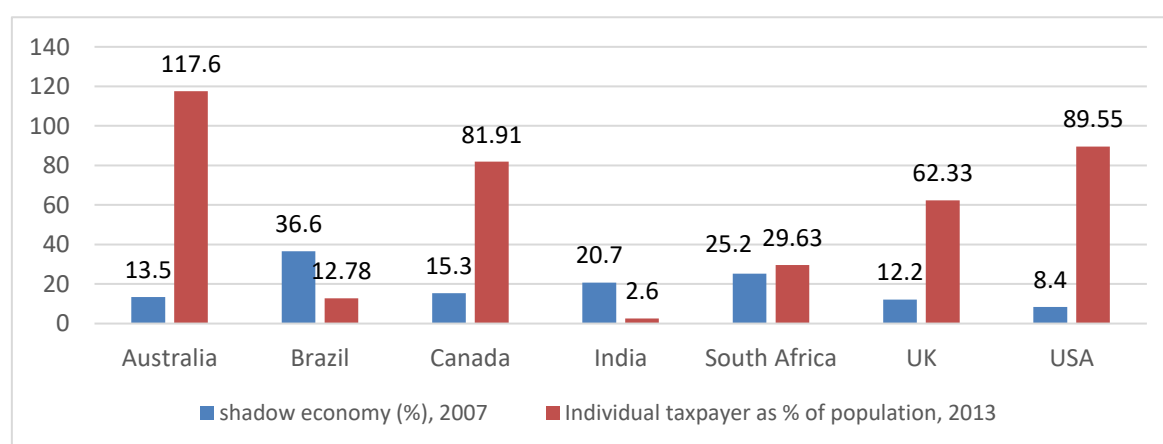
<sup>22</sup> Jain, M. (2016), ‘The Beginning of The End Of The Parallel Economy In India?’, Bloomberg Quint, available at <https://www.bloomberquint.com/business/2016/11/09/the-beginning-of-the-end-of-the-parallel-economy-in-india> (accessed on August 1, 2017)

<sup>23</sup> McKinsey and Co. (2016), Forging a Path to Payments Digitisation, McKinsey on Payments (16), available at [https://www.mckinsey.com/~media/mckinsey/dotcom/client\\_service/financial%20services/latest%20thinking/payments/mop16\\_forging\\_a\\_path\\_to\\_payments\\_digitization.ashx](https://www.mckinsey.com/~media/mckinsey/dotcom/client_service/financial%20services/latest%20thinking/payments/mop16_forging_a_path_to_payments_digitization.ashx) (accessed on July 31, 2017)

<sup>24</sup> Kumar, A. (2016), Estimation of the Size of the Black Economy in India, 1996-2012, Vol.51, Issue No.48, Economic and Political Weekly, New Delhi, available at [http://www.epw.in/journal/2016/48/estimation-size-black-economy-india-1996-2012.html?0=ip\\_login\\_no\\_cache%3Deed0701a920ab1009a6d613a13ec4f33](http://www.epw.in/journal/2016/48/estimation-size-black-economy-india-1996-2012.html?0=ip_login_no_cache%3Deed0701a920ab1009a6d613a13ec4f33) (accessed on June 20, 2017)

Figure 6 shows the correlation between the black economy and percentage of taxpayers in a nation<sup>25</sup>. The figure shows that in countries with a small black economy, the percentage of taxpaying population is higher. We also note that even though Brazil and South Africa are estimated to have larger black economies than India, they have a higher number of taxpayers as a percentage of their respective populations. This inference is without prejudice to the fact that black money holders include persons with taxable incomes and not filing tax returns, as well as those filing tax returns but not declaring their complete income, prevalent in every country around the world.

**Figure 6: Cross-country comparison of shadow economy vis-a-vis the taxpayers**



Source: OECD and World Bank reports; Singh, R.R. and Manchanda, S. (2016), p. 106

### 5.3 Corruption

Corruption is an issue that adversely affects the country's economy, the credibility of its governments at the central, state, and local levels, while also hampering its global standing. The Corruption Perception Index 2016,<sup>26</sup> ranks India 79<sup>th</sup> out of 176 countries, with a score of 40, on a scale of 0 to 100 (0 stands for the most corrupt, and 100, the cleanest economy). Not only has corruption held back the economy from reaching new heights but it has also arrested India's development. Corruption and black money are connected by an umbilical cord as the former is one of the biggest generators of the latter, which is either stored in bank lockers, in the form of gold, or invested in the real estate market or in shell companies or spent on ostentatious purchases. Spreading its tentacles deep, corruption has become rife amongst politicians, bureaucrats, and businesses and has affected the basic fabric of Indian society.

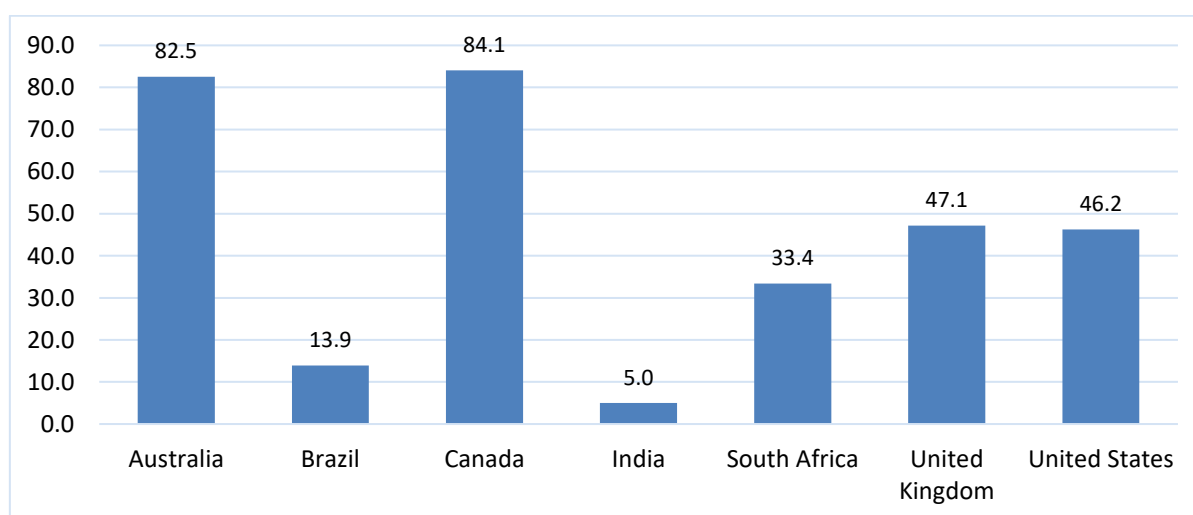
<sup>25</sup> A balanced selection of developed countries which have successful tax administrations such as Australia, Canada, UK, and USA, and emerging economies such as Brazil and South Africa, which are more comparable to India have been selected for this comparison.

<sup>26</sup> Transparency International (2017), Corruption Perceptions Index, 2016, available at [https://www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2016](https://www.transparency.org/news/feature/corruption_perceptions_index_2016) (accessed on July, 31, 2017)

## 5.4 Low Taxpayer Base

In 2015-2016, of the total population of 129 crore, only 5.70 crore were taxpayers<sup>27</sup>. That accounted for a meagre 4.4% of the population. This number included both categories of people, those who have filed their returns of income as well as those in whose case tax has been paid or deducted but no return of income has been filed. In the same year, a paltry 4.3 crore people (or 3.3% of the population) filed income tax returns. During the period 1990-1991 to 2015-2016, the percentage of effective number of taxpayers in the total population of the country grew from 0.85% to 6.6%. Though the growth in number of taxpayers in relation to total population is a positive development, the present number of taxpayers is not satisfactory when compared with other countries around the world. Data from a few successful tax administrations around the world shows that 84.1% of the population of Canada, 46.2% of the population of USA, and 47.1% of UK's population filed tax returns during calendar year 2015. In that year only 3.3% of India's population had filed returns (this figure is based on data available on the website of the Income Tax Department for the financial year 2015-2016; data for the calendar year 2015 is not available on the website), proving that India's position was the worst even amongst the BRICS nations. In South Africa, 33.4% of the population (with hardly 8% of the population comprising affluent whites) and 13.9% of Brazil's population were taxpayers (Figure 7). It is small wonder then that the Finance Minister in his budget speech on March 1, 2017, stated that India is, "a tax non-compliant society and too many people evade taxes". In calendar year 2014, the direct tax to GDP ratio was 5.1 percent in India, compared to 15.5%<sup>28</sup> percent in USA, 26% in UK, 18.2% in Canada, 19.6% in South Africa and 17.9% in Brazil (Figure 8).

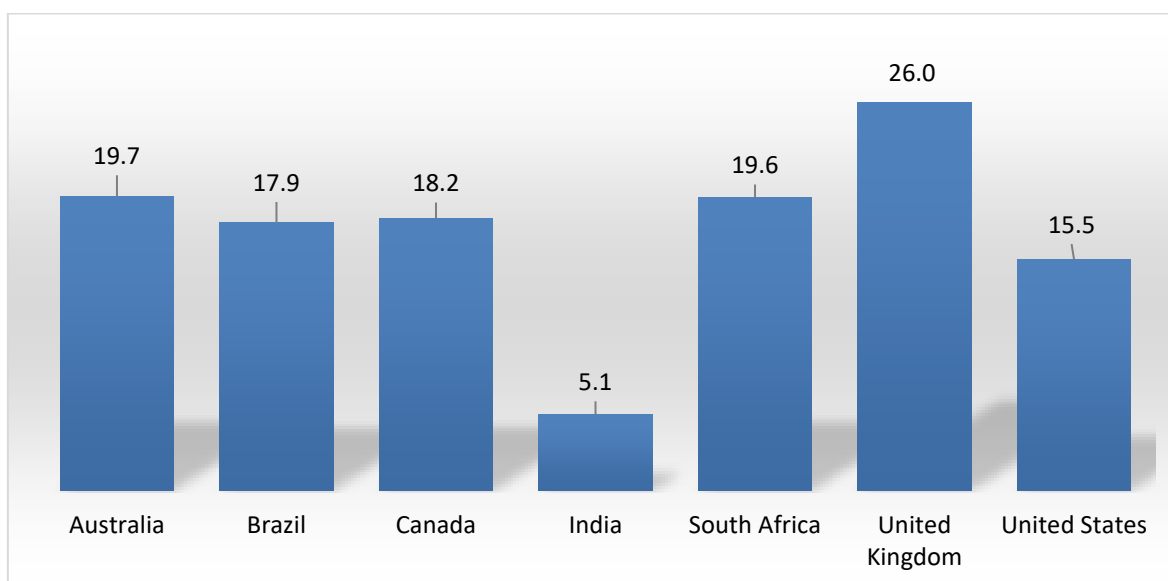
**Figure 7: Active Individual Taxpayers as a percentage of citizen population, 2015**



Source: OECD (2017), *Tax Administration*, available at <http://dx.doi.org/10.1787/888933546184> (accessed on September 30, 2017)

<sup>27</sup> Number of Taxpayers during 2016-17 was 6,26,91,961 out of which 5,28,68,037# had filed their tax returns  
<sup>28</sup> OECD (2016), *Revenue Statistics 2016*, OECD Publishing, Paris; OECD Data, Tax on personal income (indicator), available at <https://data.oecd.org/tax/tax-on-personal-income.htm> (accessed on April 10, 2017); Figure for 2015

**Figure 8: Tax / GDP Ratio 2014**



Source: OECD (2017), *Tax Administration*, available at <http://dx.doi.org/10.1787/888933546184> (accessed on September 30, 2017)

A low taxpayer base has often been explained by the fact that agricultural income is not taxable. However, it must be noted that the share of agriculture in total GDP came down from 24.9% in 1990-91, to 11.8% in 2012-13 while the share of industry and services in the GDP grew from 27.6% and 42.5%, respectively, in 1991-92, to 27.2% and 58.7%, respectively, in 2012-13.<sup>29</sup> Hence it is evident that agriculture, which contributes 1/10<sup>th</sup> of the GDP cannot be responsible for income taxpayer base being consistently low.

A glance at different categories of people, who are identifiable and on government records suggests that even they do not all file returns or pay taxes.

#### **5.4.1 Salaried Taxpayers**

As against an estimated 4.2 crore people employed in the organised sector, the number of individuals filing returns for salary incomes is only 1.74 crore<sup>30</sup>.

#### **5.4.2 MSMEs and Professionals**

The number of MSMEs in 2015-2016 was estimated to be 51.3 million<sup>31</sup>. In the category of professionals, the total number of doctors registered with the Medical Council of India as on

<sup>29</sup> Singh, R.R. and Manchanda, S. (2016), *Widening of Taxpayer Base*, Singh, R.R. (ed.) (2016), *Challenges of Indian Tax Administration*, Lexis Nexis, New Delhi

<sup>30</sup> Ministry of Finance (2017), Speech of Arun Jaitley, Minister of Finance, Union Budget 2017-2018, Ministry of Finance, Government of India, available at <http://www.indiabudget.gov.in/ub2017-18/bs/bs.pdf> (accessed on July 31, 2017)

<sup>31</sup> Ministry of MSME (2017), Annual Report 2016-2017, Ministry of Micro, Small, and Medium Enterprises, Government of India, available at <http://msme.gov.in/relatedlinks/annual-report-ministry-micro-small-and-medium-enterprises> (accessed on September 21, 2017)

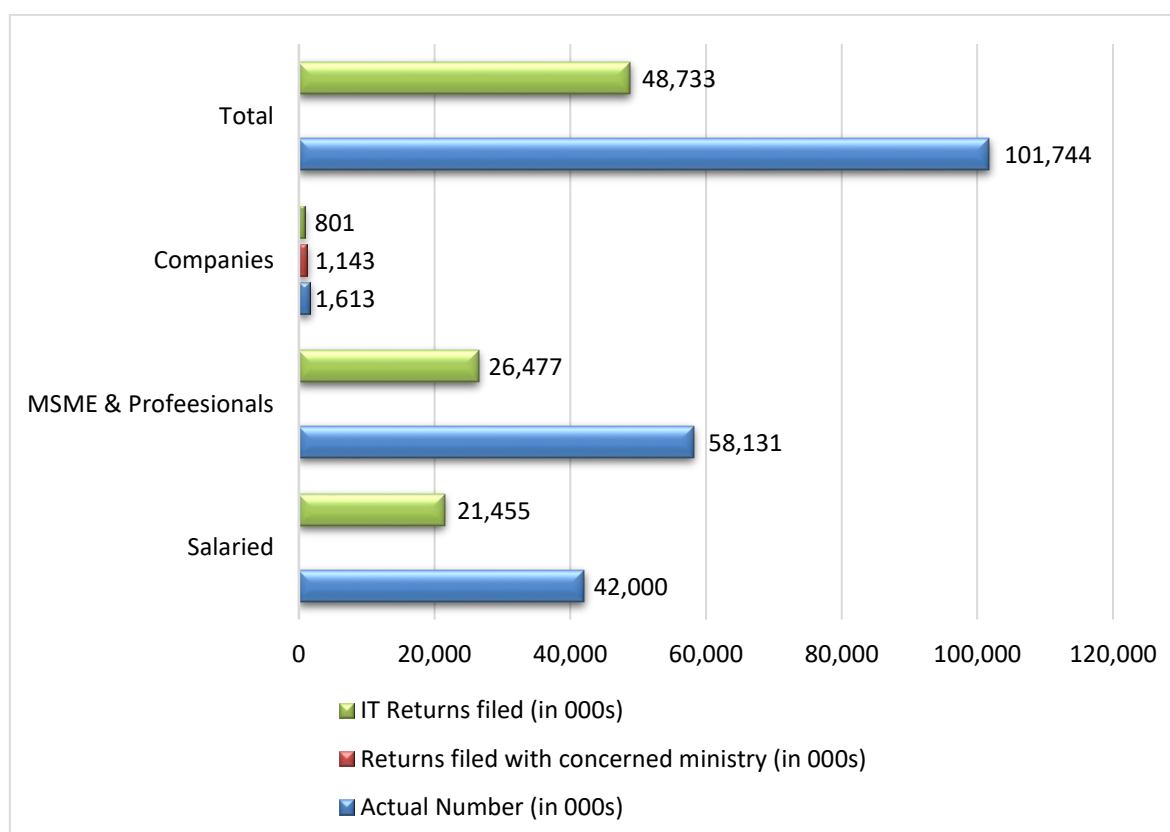
March 31, 2016, was 978,735, <sup>32</sup>, registered dental surgeons, 1,97,734, registered AYUSH doctors, 7,71,468, registered nurses, 27,78,248, registered pharmacists, 7,41,548, registered advocates, 13,00,000, registered architects 63,791. Thus, there is a total of 5,81,31,524 MSMEs and professionals, but the number persons who filed returns with Income Tax Department during 2016-17 was just 2,64,77,325 or 45.5% of the total.

### 5.4.3 Companies

Out of 16, 13,000 companies registered, only 11,43,000 have filed statutory returns with the Ministry of Corporate Affairs but only 8, 01,115 filed income tax returns during 2016-17.

Figure 9 below shows the number of potential taxpayers within these categories (details in Annexure IV).

**Figure 9: Chart Potential Taxpayers among Salaried, MSMEs, Professionals, and Companies**



Source: Extracted from multiple reports and websites<sup>33</sup>

<sup>32</sup> Medical Council of India (2016), Annual Report 2015-2016, Medical Council of India, Government of India, available at <https://www.mciindia.org/documents/annualReports/AnnualReport.pdf> (accessed on September 21, 2017)

<sup>33</sup> Ministry of Finance (2017), Speech of Arun Jaitley, Minister of Finance, Union Budget 2017-2018, Ministry of Finance, Government of India, available at <http://www.indiabudget.gov.in/ub2017-18/bs/bs.pdf> (accessed on July 31, 2017)

Income Tax Department (2017), ITR Wise receipt of e-Return, Income Tax Department, Government of India, available at <https://incometaxindiaefiling.gov.in/moreStatistics> (accessed on September 21, 2017)

In general, growth of direct tax collections has always been higher than growth in the number of taxpayers. This clearly brings out the fact that the burden of paying taxes falls on a limited number of taxpayers. One sign of an inequitable distribution of tax burden is that from 2001-02 to 2016-17, tax collections grew by 91.9% whereas the number of taxpayers grew only by 58.2%. This will be evident from Figure 10 below (with details of data in Annexure V) showing that a small part of the population bears the weight of the entire tax revenue collected<sup>34</sup>. This has necessitated the need for widening the taxpayer base by bringing potential taxpayers into the tax net.

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Ministry of MSME (2017), Annual Report 2016-2017, Ministry of Micro, Small, and Medium Enterprises, Government of India, available at <http://msme.gov.in/relatedlinks/annual-report-ministry-micro-small-and-medium-enterprises> (accessed on September 21, 2017)

Medical Council of India (2016), Annual Report 2015-2016, Medical Council of India, Government of India, available at <https://www.mciindia.org/documents/annualReports/AnnualReport.pdf> (accessed on September 21, 2017)

Ministry of Health and Family Welfare (2017), National Health Profile 2017, Central Bureau of Health Intelligence, Ministry of Health and Family Welfare, Government of India, available at <http://cbhidghs.nic.in/> (accessed on September 22, 2017)

IMT News Desk (2017), 'Over 7.7 lakh registered 'AYUSH Doctors' practising in India', India Medical Times, available at <http://www.indiamedicaltimes.com/2017/04/07/over-7-7-lakh-registered-ayush-doctors-practising-in-india/> (accessed on September 21, 2017)

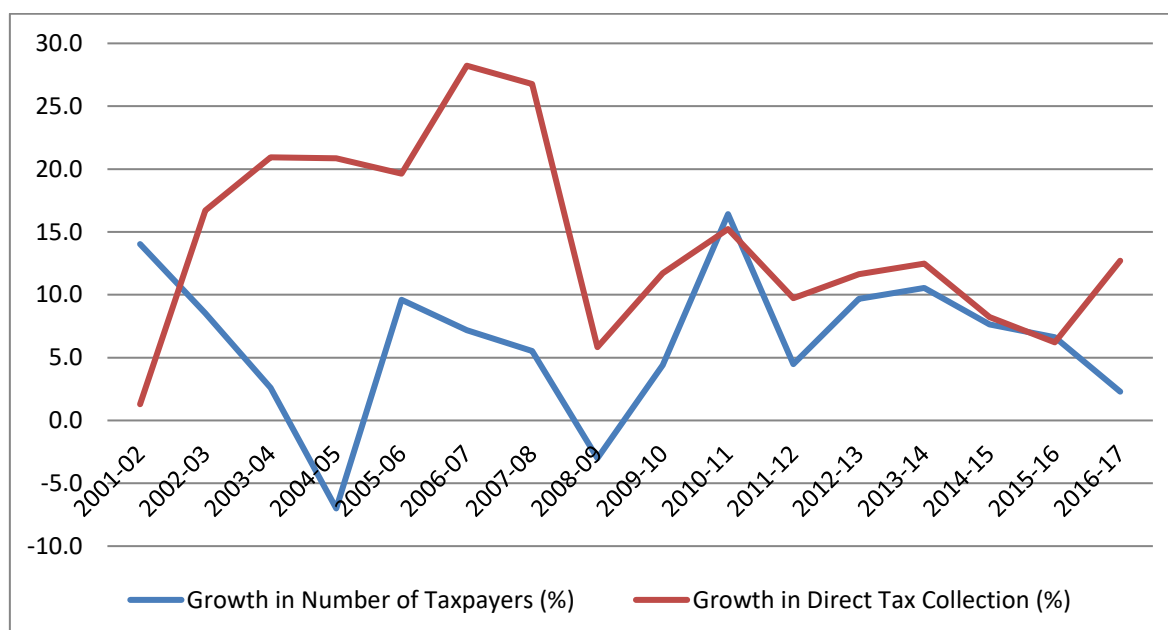
Council of Architecture (2017), State-wise architects (as on September 22, 2017), Council of Architecture, Government of India, available at <https://www.coa.gov.in/index1.php?lang=1&level=1&sublinkid=376&lid=330> (accessed on September 22, 2017)

MCA (2017), Annual Report 2015-2016, Ministry of Corporate Affairs, Government of India, published on January 3, 2017, available at [http://reports.mca.gov.in/Reports/2nd%20Annual%20Report\\_Companies%20Act%20\(03.01.17\).pdf](http://reports.mca.gov.in/Reports/2nd%20Annual%20Report_Companies%20Act%20(03.01.17).pdf) (accessed on September 22, 2017)

<sup>34</sup> Certain studies have documented that since the liberalisation of the Indian economy in the early 1990s, the wealth of the richest Indians has grown disproportionately. An Oxfam study released ahead of the annual World Economic Forum meeting in 2017 showed that just 57 billionaires in India owned the same amount of wealth (\$216 billion) as the bottom 70% of the population. Noted economists, Thomas Piketty and Lucas Chancel, reported in 2017, that during the period 1980-2014 the average real annual income per adult in India for the top 10% income group rose to 4.96% as compared to 1.2% during 1950-1980. It was also stated that within the top 10% income group, the growth in income of the top 1% was 6.7% during 1980-2014 as compared to 0.2% during 1950-1980. In the absence of income survey data over long periods in the country, the conclusions of the study adopted income figures reported in the tax returns for the richest 5% and adjusted NSSO consumption data for others also assuming that the rich were under-reporting their consumption. Swami Anklesaria Aiyar has rebutted the above claims and conclusions on the grounds that it is not only the rich who don't disclose their actual consumptions during NSSO surveys, but also the non-rich, who lie for fear of losing benefits.



**Figure 10: Comparison of Growth: Taxpayers and Direct Tax Collections from 2001-02 to 2016-17**



*Source: Calculated by authors using data extracted from Annual Reports, Ministry of Finance, Government of India and Website of the Income Tax Department, Government of India*

Note: From Financial Year 2010-11, in addition to the number of returns filed, the number of non-zero TDS cases where no ITR is entered in the System has also been included in the total number of assesses.

### 5.5 Persons holding Permanent Account Numbers (PAN)

During the current year (2017-18)<sup>35</sup>, there are 32.42 crore<sup>36</sup> PAN card holders but only 3.2 crore<sup>37</sup> citizens have filed income tax returns. During 2016-2017, from among 26.8 crore PAN card holders, only 5.3 crores filed returns (refer Annexure VI). This gap has persisted for a long time; PAN cards have, over time been obtained by those wanting to enter into financial or other kinds of transactions where quoting the PAN has been made mandatory by the Government. It can be easily inferred that those with PAN cards are potential taxpayers. It has also been stated later in this Working Paper that not all transactions where PAN is required to be quoted, are reported to the Income Tax Department. This is also one of the reasons for the huge gap, shown in Figure 11, and it needs to be studied and analysed. There is also a need to analyse income and transactions based on third-party information in respect of all PAN holders and others in the Department's possession and to continue monitoring them.

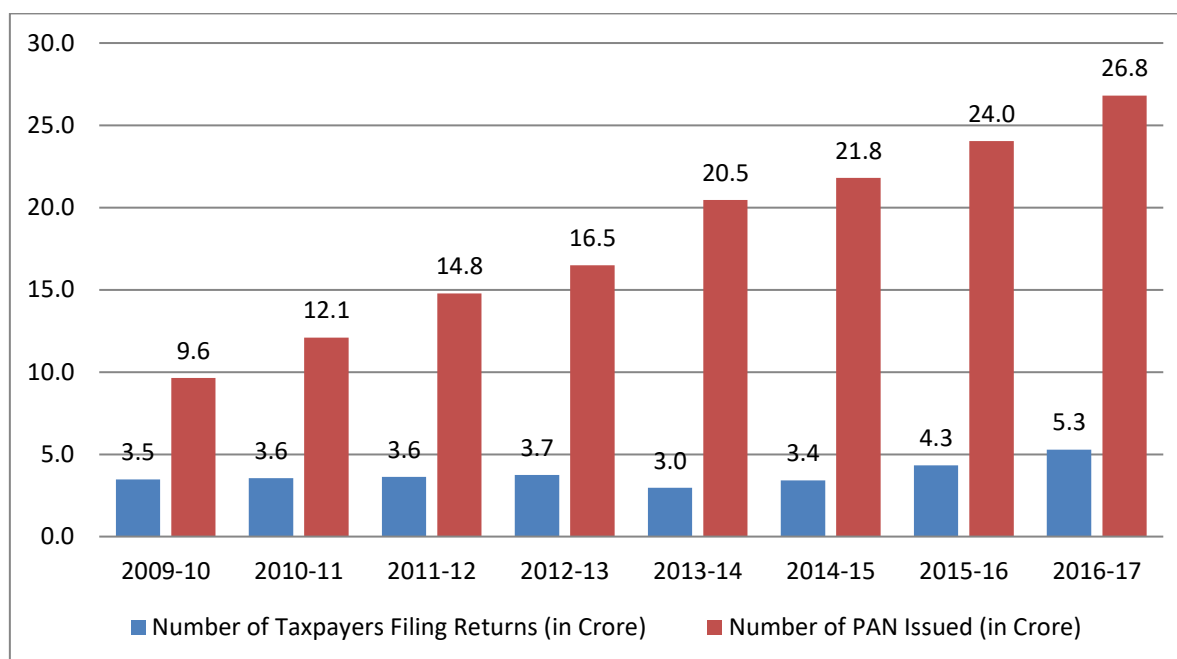
<sup>35</sup> Data retrieved on September 27, 2017

<sup>36</sup> As on July 17, 2017

<sup>37</sup> As on August 31, 2017. The deadline for filing returns is March 31, 2018.



**Figure 11: Number of Taxpayers Filing Returns vs. Total Number of PAN Issued**



*Source: Extracted from Annual Reports, Ministry of Finance, Government of India and E-filing website of the Income Tax Department, Ministry of Finance, Government of India*

## 5.6 Cash in Circulation

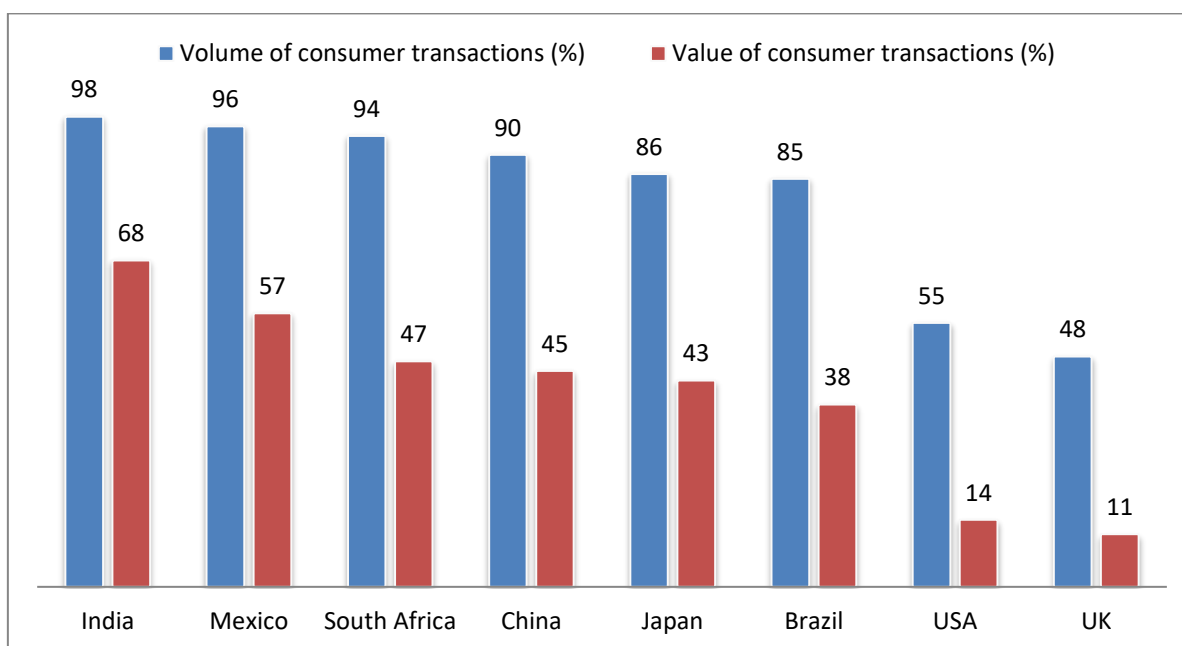
India mainly runs on cash. The cash economy brings with it a set of problems, the most prominent of which is the generation of black money, which fuels the nation's shadow economy and is used to evade taxes and scrutiny.<sup>38</sup> This negatively affects the taxpayer base. The Prime Minister, in his speech on the night of November 8, 2016, stated that, "The magnitude of cash in circulation is directly linked to the level of corruption. Inflation becomes worse through the deployment of cash earned in corrupt ways. The poor have to bear the brunt of this. It has a direct effect on the purchasing power of the poor and the middle class...High circulation of cash also strengthens the hawala trade which is directly connected to black money and illegal trade in weapons..."

Cash payment transactions (excluding commercial) in India have increased over the years<sup>39</sup>. It was reported by PwC in 2015 that India has one of the highest usages of cash around the world: 98% of the volume of consumer transactions is by cash, and 68% of the total value of consumer transactions are conducted in cash (Figure 12).

<sup>38</sup> Jain, M. (2016), 'The Beginning of The End Of The Parallel Economy In India?', Bloomberg Quint, available at <https://www.bloombergquint.com/business/2016/11/09/the-beginning-of-the-end-of-the-parallel-economy-in-india> (accessed on August 1, 2017)

<sup>39</sup> Mazzotta, B.D. et. al. (2014), The Cost of Cash in India, The Institute for Business in the Global Context The Fletcher School, Tufts University, available at <http://fletcher.tufts.edu/~media/Fletcher/Microsites/Cost%20of%20Cash/COC-India-lowres.pdf> (accessed on September 22, 2017)

**Figure 12: Consumer Transactions Carried Out in Cash**



Source: Extracted from PricewaterhouseCoopers (2015), available at <https://www.pwc.in/assets/pdfs/publications/2015/disrupting-cash-accelerating-electronic-payments-in-india.pdf> (accessed on October 1, 2017)

## 5.7 Credit/Debit Cards

Use of credit and debit cards has been very low because of the low penetration of POS at merchant establishments, reluctance to use cards on account of service charges ranging from 1.4% to 3.6%<sup>40</sup>, levy of service tax on service charges, reluctance of businesses to engage in recorded transactions, sub-optimal telecom and internet infrastructure, absence of innovative cashless payment options, lack of thrust on part of the government to encourage cashless transactions, inadequate financial inclusion, and a cultural disinclination towards a cashless economy. Payments using debit or credit cards help track transactions. Annexures VII and VIII show how India has progressed in terms of digital transactions.

## 6. Sectors Running Largely on Cash Economy

In India, apart from extensive generation and use of cash by the informal sector, black money has been used for money laundering, drug and human trafficking as well as for funding unrest across the country, and terrorist activities, for a long time. The Financial Action Task Force (FATF), an international body of 37 countries which tracks criminal use of the international financial system has stated that high denomination currency notes are used in money laundering, drug and human trafficking.<sup>41</sup> In fact, it is understood that stone pelting in Kashmir lessened in the aftermath of demonetisation since INR 500 notes were not available to be given

<sup>40</sup> Just before demonetisation.

<sup>41</sup> (2016), 'Pieces of Paper: Demonetisation of Rs 500 and Rs 1000 Notes Explained', The Wire, available at <https://thewire.in/78694/paper-money-ban-rs-500-rs-1000-notes-explained/> (accessed on June 30, 2017)

to stone-throwers on a daily basis<sup>42</sup>, though this statement by the Defence Minister was contradicted by the Jammu and Kashmir Chief Minister<sup>43</sup>. The real estate sector is another area where the use of black money is rampant; it has historically been a conduit for black money<sup>44</sup> with 40% to 60% of all transactions in real estate carried out in cash. In land deals, part of the consideration is also paid in cash on account of higher circle rates for registration of properties, amongst other reasons. It has been stated in the media that 40% to 45% of India's economy is informal<sup>45</sup>, which means the transactions are in cash and are therefore not recorded and not declared. Businesses outside the formal system have a serious adverse effect on the tax base. Anecdotal evidence also indicates that businesses, restaurants, medical professionals and private hospitals are known to deal in cash extensively. Only a few years ago, RBI data showed that cash still accounted for 90% of all monetary transactions in India<sup>46</sup> (Annexure IX). As recently as December 2016, a Government report<sup>47</sup> stated that, overall, about 78% of all consumer spending in India by cash. Most wholesale and agricultural transactions are conducted using cash. It is a well-known fact that an extensive amount of gold and gold jewellery is purchased in cash on account of reluctance on the customers' part to pay VAT, apart from wanting to avoid creating a record of spending ill-gotten money. Black money is used for hoarding gold as well as for ostentatious expenditure. As per an RBI report, 80% of all gold jewellery is bought in cash.<sup>48</sup>

Professional institutions, too, have had a long-standing reputation of taking capitation fees/donations in cash for the admission of students. In June 2016, Income Tax Officials recovered INR 80 crore in cash from certain medical, engineering and nursing colleges in Puducherry and Chennai.<sup>49</sup> An Income Tax raid in August 2016, in Mumbai, led to the seizure of more than INR 30 crore in unaccounted cash and bullion and gold jewellery, amounting to at least 40 kg, from a group which runs educational institutes and were allegedly taking

<sup>42</sup> TNN and Agencies (2016), 'No stone pelting on forces in Kashmir after demonetisation move, says Manohar Parrikar', India Times, available at <http://timesofindia.indiatimes.com/india/Demonetisation-has-led-to-decline-in-separatist-instigated-violence-in-the-Valley-MHA-sources/articleshow/55419257.cms>, (accessed on June 30, 2017)

<sup>43</sup> Wani, F. (2017), 'No impact of demonetisation on Kashmir unrest: JK Govt', The New Indian Express, available at <http://www.newindianexpress.com/nation/2017/jan/16/no-impact-of-demonetisation-on-kashmir-unrest-jk-govt-1560184.html>, (accessed on June 30, 2017)

<sup>44</sup> (2016), 'Pieces of Paper: Demonetisation of Rs 500 and Rs 1000 Notes Explained', The Wire, available at <https://thewire.in/78694/paper-money-ban-rs-500-rs-1000-notes-explained/> (accessed on June 30, 2017)

<sup>45</sup> Krishnan, A. (2017), 'Cracking the GDP mystery', The Hindu, available at <http://www.thehindu.com/todays-paper/tp-opinion/cracking-the-gdp-mystery/article17420118.ece> (accessed on June 30, 2017)

<sup>46</sup> Jayaram, A. (2014), 'For aam India, cash is still king', The Hindu Business Line, available at <http://www.thehindubusinessline.com/money-and-banking/for-aam-india-cash-is-still-king/article5538950.ece> (accessed on June 30, 2017)

<sup>47</sup> Ministry of Finance (2016), Medium Term Recommendation to Strengthen Payment Ecosystem: Report of the Committee on Digital Payments, Ministry of Finance, Government of India, available at [http://www.finmin.nic.in/reports/watal\\_report271216.pdf](http://www.finmin.nic.in/reports/watal_report271216.pdf) (accessed on June 30, 2017)

<sup>48</sup> RBI (2017), Macroeconomic Impact of Demonetisation – A preliminary assessment, Reserve Bank of India, Government of India, p.36, available at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/MID10031760E85BDAFEFD497193995BB1B6DBE602.PDF> (accessed on September 22, 2017)

<sup>49</sup> (2016), 'Income Tax raid at medical and allied colleges reveals Rs 80 crores cash', Medical Dialogues, available at <http://medicaldialogues.in/it-raid-at-medical-and-allied-colleges-reveals-rs-80-crores/> (accessed on June 30, 2017)

capitation fee or donations for admission to its various courses. In the highest-ever spot seizure of cash and jewellery that the department had as yet made, documents pertaining to multiple investments in fixed deposits and real estate by the group were also uncovered and taken into custody.<sup>50</sup> In another incident, the Investigation Directorate of the Income Tax Department, Bengaluru, seized unaccounted cash worth INR 43 crore from the premises of a medical college in south-east Bengaluru.<sup>51</sup> Two more sectors in which massive movements of cash take place are politics, which is overrun by corrupt politicians, and the bureaucracy, in which government officers and employees accept bribes in cash. In January 2017, the Income Tax Department detected undisclosed assets worth well above INR 162 crore and seized INR 41 lakh in cash, apart from over a dozen kilograms in gold and jewellery during search conducted on the premises of a politician in Karnataka.<sup>52</sup> According to a report by the Centre for Media Studies, high denomination notes are spent by government, political parties, and candidates during general elections. During the 2014 general election, nearly INR 30,000 crore was spent by candidates and parties on election campaigning while the officially reported figures accounted for only INR 7,000 to INR 8,000 crore.<sup>53</sup> Foreign exchange dealers and hawala traders also form an integral part of the cash economy. They accept or pay money in cash in Indian currency and give or receive cash abroad in foreign currency. Lastly, the practice of over-invoicing imports and under-invoicing exports leads to money deposited in secret bank accounts in tax havens where the account holders' identity is protected by the banking laws in that country.

## 7. Steps Taken by the Government before Demonetisation

Though the incumbent government's move to outlaw high denomination notes seemed like a very sudden move, it is part of an observable pattern to tackle black money over the past three years, from giving the opportunity to voluntarily declare unaccounted money, to efforts made in the direction that a majority of Indians should have bank accounts which would aid cashless transactions, to the final move scrapping INR 500 and INR 1,000 notes. The sequence of events since 2014, is presented in the following paragraphs.

### 7.1 Special Investigative Team

A Special Investigative Team headed by a retired Supreme Court judge was set up in May 2014 to unearth black money.

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<sup>50</sup> Narayan, K. (2016), 'Rs 30 crore, 40 kg bullion seized from D Y Patil Group by Income Tax', The Indian Express, available at <http://indianexpress.com/article/india/india-news-india/d-y-patil-group-income-tax-raid-cash-unaccounted-jewellery-seized-2950621/> (accessed on June 30, 2017)

<sup>51</sup> (2016), 'Rs 43 crore cash seized in I-T raid at medical college in South-East Bengaluru', The Indian Express, available at <http://indianexpress.com/article/india/india-news-india/south-east-bengaluru-medical-college-income-tax-raid-3055260/> (accessed on June 30, 2017)

<sup>52</sup> Press Trust of India (2017), 'I-T finds Rs 162 cr, 12 kg gold after raids on Karnataka minister, Cong leader', The Hindustan Times, available at <http://www.hindustantimes.com/india-news/rs-162-cr-undisclosed-income-by-karnataka-minister-congress-member/story-jpigjsvyPVbasQBaeLGquO.html> (accessed on June 30, 2017)

<sup>53</sup> Singh, R. (2014), 'Black Money and Elections: Who Will Bell the Cat?', The Hindu Centre for Politics And Public Policy, available at <http://www.thehinducentre.com/verdict/commentary/article5959650.ece> (accessed on June 30, 2017)

## **7.2 Renegotiation of Double Taxation Avoidance Agreements (DTAA)**

Renegotiations with a number of countries were started to prevent tax evasions. Revised DTAA's have since been signed with Mauritius, Cyprus, Singapore, and South Korea.

Though it was never specifically stated as the objective, the Government did provide ample opportunity to declare their black money stashed away in India or abroad, and come clean by paying the requisite tax and penalty.

## **7.3 Black Money Act, 2015**

The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, provides for the separate taxation of any undisclosed income in relation to foreign income and assets at the rate of 30%, with an added penalty of 30%. This scheme was functional for the period July 1, 2015, to December 31, 2015. Though 644 declarations of undisclosed foreign income and assets amounting to INR 4,164 crore were received in response to this legislation, only INR 2,428 crore was collected in taxes. 90% of the collection came from 5% of the declarations. This scheme did not prove to be as successful as was expected probably because no discount was given on the original tax rates or the rates at which such high incomes are normally taxed. In fact, the cumulative rate of taxation was higher at 60% (30% in taxes and 30% penalty) instead of the normal tax rate of 30%. Another reason for fewer declarations could be that the scheme was not available for illegal money parked abroad. It is quite possible that celebrities and persons of repute in society stayed away from making use of the opportunity for fear of their public image being tarnished, should their names emerge through a Public Interest Litigation (PIL) in a court of law.

## **7.4 Income Declaration Scheme (IDS)**

The Income Declaration Scheme came into effect from June 1, 2016. It gave people the opportunity to come forth with details of undisclosed income and pay tax at the rate of 30%, along with a surcharge of 25% and a penalty of 25%, the latter two calculated on the amount of tax. This added up to an effective rate of 45% of the undisclosed income. According to the scheme, the declarations were to be filed up to September 30, 2016 and taxes, surcharge, and penalties were to be paid up by November 30, 2016. 71,726 declarations were made of income amounting to INR 67,382 crore<sup>54</sup> and approximately INR 12,700 crore came into the government coffers as the first two installments of tax and penalties in 2016-2017.<sup>55</sup> The remaining 50% of the tax and penalties under the IDS was to be paid by September 30, 2017.<sup>56</sup>

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<sup>54</sup> Ministry of Finance (2017), Annual Report 2016-2017, Budget Division, Department of Economic Affairs, Ministry of Finance, Government of India, p.184, available at <http://dea.gov.in/sites/default/files/Annual%20Report-2016-17-E.pdf> (accessed on June 30, 2017)

<sup>55</sup> Magazine, A. (2017), '1.37 crore who don't file returns are now on Income Tax radar', The Indian Express, available at <http://indianexpress.com/article/india/1-37-crore-who-dont-file-returns-are-now-on-income-tax-radar-4602911/> (accessed on June 30, 2017)

<sup>56</sup> (2016), 'Income Declaration Scheme extended to September 2017', The Hindu, available at <http://www.thehindu.com/business/Economy/Income-Declaration-Scheme-extended-to-September-2017/article14488683.ece> (accessed on June 30, 2017)

## 7.5 Pradhan Mantri Garib Kalyan Yojana (PMGKY)

The PMGKY was an amnesty scheme announced in November 2016 for the period running up to March 31, 2017. This scheme was for people who had not taken advantage of the previously concluded IDS and who continued to hold unaccounted-for money or had deposited it in their bank accounts after demonetisation. Under this scheme, one was allowed to disclose unaccounted cash and deposits, and avoid punishment by paying 50% of the disclosed amount as tax, and depositing 25% in an interest-free scheme of PMGKY for four years. Along with the announcement of the PMGKY, the government introduced amendments to the Income Tax Act in order to enable levy of a higher penalty and tax rate on assessee's unexplained deposits<sup>57</sup>. These high rates of tax can loosely be divided into four categories<sup>58</sup>:

- (i) Tax, surcharge, and cess totalling 77.25% of the income: in case undisclosed cash or deposits were not declared under the PMGKY scheme but are disclosed in the income tax returns.
- (ii) Additional penalty of 10%: if disclosure has neither been made in income tax returns nor under the PMGKY scheme.
- (iii) Tax and penalty totalling 107.25%: in case of undisclosed income not being declared and the holder being raided, if the holder surrenders such income during search.
- (iv) Tax and penalty totalling 137.25%: in case of those who do not surrender such hidden income even during searches.

The PMGKY scheme, which ended on March 31, 2017, saw income amounting to INR 4,900 crore being declared by 21,000 people with tax and penalty collections totalling INR 2,451 crore<sup>59</sup>. This was much lower than the earlier four-month long tax compliance window of the IDS.

## 7.6 Jan Dhan Accounts

Though banks accounts were being opened for inclusive growth since nationalisation of banks in 1969, the move never achieved its objective. A fresh impetus to cover every household without a bank account was given with the launch of the Jan Dhan Account scheme. As a result,

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<sup>57</sup> Magazine, A. (2017), '1.37 crore who don't file returns are now on Income Tax radar', The Indian Express, available at <http://indianexpress.com/article/india/1-37-crore-who-dont-file-returns-are-now-on-income-tax-radar-4602911/> (accessed on June 30, 2017)

<sup>58</sup> Magazine, A. (2017), '1.37 crore who don't file returns are now on Income Tax radar', The Indian Express, available at <http://indianexpress.com/article/india/1-37-crore-who-dont-file-returns-are-now-on-income-tax-radar-4602911/> (accessed on June 30, 2017)

<sup>59</sup> Press Trust of India (2017), '21,000 people disclosed Rs 4,900 crore black money under government scheme: Official', The Times of India, available at <http://timesofindia.indiatimes.com/business/india-business/21000-people-disclose-rs-4900-crore-black-money-under-government-scheme-official/articleshow/60410568.cms> (accessed on September 10, 2017)



30.09 crore accounts had been opened till August 30, 2017 with a balance of INR 65, 799 crore and the number of RuPay cards issued till then was 22.75 crore<sup>60</sup>.

## 7.7 Aadhaar

The allotment of Aadhaar numbers has been going on since 2010. The total number of Aadhaar cards allotted till May 2014 was only 63.22 crore.<sup>61</sup> Concerted efforts by the new government to allot Aadhaar cards to all eligible people resulted in the number of enrolments rising to 107 crore in October 2016. By August 2017, the number of Aadhaar cards allotted was 117.6 crore<sup>62</sup> or 95.1% of the entire population of the country. Aadhaar will ultimately facilitate Direct Bank Transfers (DBT) of benefits to real beneficiaries and thus eliminate leakages. The DBT in turn, will eliminate both, cash and black money. There are 316 benefit schemes under 51 ministries of the Government of India under which a total of INR 2, 16,040.16 crore has been paid.<sup>63</sup> As of June 2017, 92 centrally-sponsored schemes from 19 Ministries were implemented through DBT.<sup>64</sup> The total recorded savings to the Government of India in 2014-2015 and 2015-2016 were to the tune of INR 49,560 crore. In 2016-2017, INR 57,029 crore was saved under DBT, which, if disbursed, would have been black money. The number of beneficiaries also rose from 10.71 crore in 2013-2014 to 35.62 crore, in 2017-2018<sup>65</sup>. It has also been reported that State Governments have been requested to bring about 3,000 schemes within the ambit of DBT. With this inclusion, an estimated INR 6 lakh crore of Government benefits will be paid through DBT<sup>66</sup>.

## 8. Discouraging Cash Transactions and Widening of Taxpayer Base – Lacunae in the Current System

The Income Tax Department instituted a number of steps to discourage cash transactions, encourage recorded transactions, and report transactions which could have helped widen the

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<sup>60</sup> Ministry of Finance, Pradhan Mantri Jan Dhan Yojana (PMJDY), Department of Financial Services, Ministry of Finance, Government of India, available at <https://www.pmjdy.gov.in/account> (accessed on September 7, 2017)

<sup>61</sup> Press Information Bureau (2017), UIDAI Achieves 111 Crore Mark on Aadhaar Generation Unique Identity Covers to Over 99 Percent Adult Residents of India, Press Information Bureau, Ministry of Electronics and IT, Government of India, available at <http://pib.nic.in/newsite/PrintRelease.aspx?relid=157709> (accessed on June 30, 2017)

<sup>62</sup> For details, see [https://uidai.gov.in/search.html?searchword=ssup&searchphrase=all&option=com\\_search](https://uidai.gov.in/search.html?searchword=ssup&searchphrase=all&option=com_search) (accessed on September 7, 2017)

Rajagopal, K. (2017), 'Centre's Aadhaar affidavit in Supreme Court: 'Welfare of masses trumps privacy of elite'', The Hindu, available at <http://www.thehindu.com/news/national/centres-aadhaar-affidavit-in-supreme-court-welfare-of-masses-trumps-privacy-of-elite/article18951798.ece> (accessed on June 30, 2017)

<sup>63</sup> As on August 11, 2017. For details, see <https://dbt.bharat.gov.in/> (accessed on June 30, 2017)

<sup>64</sup> Deepalakshmi, K. (2017), 'The long list of Aadhaar-linked schemes', The Hindu, available at <http://www.thehindu.com/news/national/the-long-list-of-aadhaar-linked-schemes/article17641068.ece> (accessed on June 30, 2017)

<sup>65</sup> Press Trust of India (2017), 'Over Rs 57,000 crore savings through DBT: Government', The Economic Times, available at <http://economictimes.indiatimes.com/news/economy/finance/over-rs-57000-crore-savings-through-dbt-government/articleshow/59531183.cms> (accessed on July 31, 2017)

<sup>66</sup> Surabhi (2017), '3,000 State schemes to be brought under DBT ambit', The Hindu Business Line, available <http://www.thehindubusinessline.com/economy/3000-state-schemes-to-be-brought-under-dbt-ambit/article9872739.ece> (accessed on October 1, 2017)

taxpayer base. However, the following limitations have prevented desired results from being achieved.

- (i) Expenses in excess of INR 20,000 incurred by businesses were not allowed to be paid by means other than account payee cheques or bank drafts. Acceptance of payments or repayments of loan(s), deposits or specified sums of an aggregate amount of INR 20,000 or more is also not allowed other than by account payee cheques, bank drafts or through the Electronic Clearance System (ECS) and is liable to a penalty equal to the amount involved. While both these measures are to discourage the use of cash/black money, encourage the use of recorded transactions and can be expected to deter backdated transactions, people have still found a way to circumvent the provisions. For instance, in the first case, amounts of INR 20,000 are broken up into smaller sums to evade the provision.
- (ii) The Income Tax Department has powers under Section 133B to survey premises where any business or profession is carried out in order to ascertain whether the people running the business or carrying on the profession are taxpayers or not and to seek information in the prescribed form. In addition to the powers prescribed in this provision, street-wise and building-wise directories of businesses and professionals were also prepared to ensure comprehensive coverage of potential taxpayers. This was done to confirm that every eligible person was paying taxes and filing returns. However, due to opposition from businesses, this provision has hardly been used since the late 1990s, even though application software to create a computerised database has been developed by the department. The absence of such a directory leaves a glaring gap through which large numbers of people escaped the tax net.
- (iii) The tax deducted at source (TDS) mandated to be deducted on payment of interest on fixed deposits, loans, etc., used to be at the rate of 10%. This did not prove to be a sufficient deterrent to those who did not comply as they might be taxable at a higher rate, 20% or 30%, along with their other income or even on their cumulative interest income itself from different sources and parties. Therefore, the rate at which TDS would be deducted if the PAN was not provided was raised to 20% as against the normal rate of 10% in cases where the PAN was provided. This, too, may not be very helpful in compelling taxpayers in the 30% tax bracket to divulge their PAN when interest income is paid to them, because by paying TDS at the rate of 20% they will still be able to save taxes to a certain extent.
- (iv) The Income Tax Department has failed to educate taxpayers regarding the concept of 'income'. It is noticed that a large number of potential taxpayers do not pay tax and nor do they file tax returns because they labour under the impression that household expenses, medical expenses, rent for residential house, etc., do not form part of their 'income' earned. They lack the understanding that these expenses are an application of their taxable income and hence no deduction, except as written in the law, is to be claimed or allowed.



- (v) There are many categories of legal persons statutorily required to file their returns every year. However, reports<sup>67</sup> show that such categories (such as, all political parties, NGOs, educational institutions, trusts, etc.) do not file returns.
- (vi) Of 32.42 crore PAN holders<sup>68</sup>, barely 20% file income tax returns. Such people obtain PAN cards because it is a requirement in some transactions: they are also potential taxpayers. As stated earlier in the paper, there is a need for continued analysis of income and transactions based on third party information in respect of PAN holders and others in the Department's possession.
- (vii) It is common knowledge that the Income Tax Department has not been issuing notices to such non-filers asking them to file their returns mostly because it is perceived as increasing the work burden. Moreover, the Department has also not been levying the statutory penalty of INR 5,000 or initiating prosecution proceedings leading to imprisonment under the Income Tax Act, 1961<sup>69</sup>, for non-filing of returns.
- (viii) A number of information fields relating to citizenship of the applicant, members of an HUF, AOP, BOI, etc., partners in firms, holding positions of directorship in companies, nature of business, date of commencement of business, and a few more fields were dropped from the PAN application form in 2003. There is a very high chance that this may hinder proper analysis of third party information data during data mining, matching, and analysis by the Income Tax Department.
- (ix) There is lack of uniformity in obtaining and quoting of PAN, and reporting it to the department. If a person does not have PAN or is not obliged to obtain PAN, how could he be expected to quote the PAN in financial transactions where quoting the PAN is mandatory? In such cases, both parties to the transaction willingly fill up Forms 60 and 61<sup>70</sup>. These forms were unstructured and hand-filled and were to be digitised, but this process did not take place. All information in Forms 60 and 61 was, therefore, wasted. If all transactions, where PAN is required to be quoted, are not reported to the tax department, then the entire exercise is futile.

## 9. Pains of Demonetisation

Demonetisation had a significant adverse impact on the working class, small businesses and rural businesses, as most dealt in cash on a daily basis. Drivers, maids, cooks, electricians, plumbers, those employed in MSMEs, and those who were paid on a monthly or bi-monthly basis were also affected. The move also impinged upon daily wage workers in the informal sector. The rural areas lacked the basic infrastructure needed to handle demonetisation. Cooperative banks, local area banks (LABs), primary agricultural cooperative credit societies,

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<sup>67</sup> For details, see [http://adrindia.org/sites/default/files/Income%20of%20Political%20Parties\\_v4.pdf](http://adrindia.org/sites/default/files/Income%20of%20Political%20Parties_v4.pdf) (accessed on July 31, 2017)

<sup>68</sup> Reply to Lok Sabha Question on 21 July, 2017

<sup>69</sup> As amended from time to time

<sup>70</sup> Form 61 was to be filled up by persons having agriculture income and Form 60 by persons not having PAN

regional rural banks (RRBs), and even thinly-staffed (sometimes with just two persons) commercial banks did not have the capacity to handle the cash exchange in their areas of operation<sup>71</sup>. The early phase of demonetisation saw a slow-down in the business of e-commerce companies especially in cases where cash-on-delivery payments were to be made. Altogether, these factors affected the GDP growth rate: the figure was 7.1% during 2016-17 (against an estimated 7.2%), with an actual growth rate of 6.1% in the last quarter of 2016-2017<sup>72</sup>. Manufacturing also slowed down, and employment was affected. Business sentiment, as reflected by the PMI was also affected.

Absence of banking services in all parts of the country, poor internet penetration and a habit of dealing in cash were factors that caused the general public much suffering during the demonetisation process. It is generally felt that insufficient planning on the part of the Government and the RBI led to chaos. Adding to the public's confusion was the intermittent issuing of circulars by the RBI; bank staff, meanwhile, were unable to keep up with the flurry of instructions from the Reserve Bank. It must be kept in mind though, that corrective measures had to be taken to prevent mischief by unscrupulous elements and also to facilitate cash availability to the common man. Details of these measures are listed in Annexure X. It is relevant to note that the discussion on demonetisation between the government and the RBI started in January-February, 2016, and an RBI panel firmed up the decision in May 2016<sup>73</sup>. While it is true that more detailed plans could have been drawn up, it is equally important to note that any large-scale involvement of officers and staff at the planning stage would have taken away the element of surprise upon which the entire exercise depended and would have defeated its purpose. The common man did not object to the move so much as he/she did to the way it was executed, for the most part; a fairly large number of people have taken to digital transactions since then (Annexures VII and VIII).

## **10. Attempts to Defeat the Purpose of Demonetisation by Various Sections of the Society**

In the days following demonetisation, newspapers were replete with reports of how people with unaccounted money were trying to convert it into legitimate money. The Income Tax Department, Enforcement Directorate, Central Bureau of Investigation (CBI), Financial Intelligence Unit, Serious Fraud Investigation Office (SFIO) and the police uncovered wrongful actions by a variety of people some examples of which are mentioned in this section.

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<sup>71</sup> Raju, Dr. B.Y. (2016), 'How Demonetisation has Affected Rural Areas', Money Life, available at <http://www.moneylife.in/article/how-demonetisation-has-affected-rural-areas/48809.html> (accessed on June 30, 2017)

<sup>72</sup> Mishra, A.R. (2017), 'Demonetisation pulls down India GDP growth rate to 6.1% in Q4 2016-17', Live Mint, available at <http://www.livemint.com/Politics/Ig7hWnKkVbhVGXxovJOYGO/GDP-grows-at-61-in-fourth-quarter-below-estimate-of-71.html> (accessed on June 30, 2017)

<sup>73</sup> Manoj, C.L. (2017), 'Raghuram Rajan was on board on demonetisation, Economic Affairs Secretary tells Parliament panel', Economic Times, available at <http://economictimes.indiatimes.com/news/politics-and-nation/raghuram-rajan-was-on-board-on-demonetisation-economic-affairs-secretary-tells-parliament-panel/articleshow/58847012.cms> (accessed on June 30, 2017)

## 10.1 Bank employees

Many bank employees assisted in opening fake bank accounts using incomplete or fake identity and proof-of-address documents, accepting deposits in these accounts and later transferring them by internet banking to the real beneficiary, either directly, or through a chain of transactions. In Bengaluru and Delhi, bank staff and a bank manager were caught exchanging new INR 2,000 currency notes amounting to several crores, thereby helping black money holders.<sup>74</sup> In March 2017, it was reported that banks had accepted high-value deposits totalling INR 1.13 lakh crore without PAN details, mandatory for deposits over INR 50,000<sup>75</sup>. As on February 2017<sup>76</sup>, as many as 156 senior officials of state-owned banks were suspended and 41 transferred after they were found involved in irregularities related to demonetisation. Banks are reported to have filed 26 cases with the police and the Central Bureau of Investigation (CBI), wherever criminal cases were involved.

## 10.2 Cooperative banks

Cooperative banks, with a weak KYC procedure, accepted back-dated deposits of huge amounts and also issued cheques for loans against such money to the beneficiaries. These banks deposited, or tried to deposit, this money in scheduled banks. The irregularities were detected, and the RBI banned all District Cooperative Banks from accepting or exchanging demonetised currency with effect from November 15, 2016. A multi-state cooperative urban credit society in Mumbai was also investigated by the Income Tax Department and Enforcement Directorate for transferring more than INR 2,000 crore after accepting tranches of INR 9 lakh several times a day from its members who did not appear to be very moneyed<sup>77</sup>.

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<sup>74</sup> Anand, K. (2016), 'Over 200 Crore In New Notes Found In Raids On Banks Across India That Are Helping Launder Black Money', India Times, available at <http://www.indiatimes.com/news/india/over-200-crore-in-new-notes-found-in-raids-on-banks-across-india-that-are-helping-launder-black-money-267497.html> (accessed on July 5, 2017)

<sup>75</sup> Suresh, A.E. (2017), 'Demonetisation violation? Banks accepted over Rs 1 lakh crore without PAN details', Hindustan Times, available at <http://www.hindustantimes.com/business-news/demonetisation-in-possible-violation-banks-accepted-over-1-crore-lakh-deposits-without-pan/story-bQbHbFtBgggK7fFh5j0jqI.html> (accessed on July 5, 2017)

<sup>76</sup> Times News Network (2017), '156 public sector bank officials suspended for note ban irregularities', The Economic Times, available at <http://economictimes.indiatimes.com/industry/banking/finance/156-public-sector-bank-officials-suspended-for-note-ban-irregularities/articleshow/56967520.cms> (accessed on July 5, 2017)

<sup>77</sup> Ghosh, S. (2017), 'This is how black money holders are using a unique laundry to turn tainted money into white', The Economic Times, available at <https://economictimes.indiatimes.com/news/politics-and-nation/this-is-how-black-money-holders-use-this-unique-laundry-to-turn-tainted-money-into-white/articleshow/58797016.cms> (accessed on July 5, 2017)

### 10.3 Chartered accountants and advocates

These two groups of professionals have helped a large number of people launder their black money through accounts of shell companies which had no employees or transactions, and then transfer the amounts to the real beneficiaries through internet banking either directly or through a chain of transactions. The CBDT had sent<sup>78</sup> names of 12 CAs indulging in tax evasion to the Institute of Chartered Accountants of India (ICAI). The Government is also reported to be mulling over stricter penalties: under the Income Tax Act, Section 278, any CA found indulging in tax evasion or helping others evade tax can be prosecuted and can be punished with imprisonment ranging from six months to seven years. The government has shared<sup>79</sup> the names of 34 chartered accountants (CAs) with the ICAI for investigation after the professionals were allegedly found to be involved in money laundering through shell companies during the demonetisation period.

### 10.4 Jan Dhan accounts

Employers, businessmen, and others deposited money into the Jan Dhan accounts of their staff/employees or other people known to them. Deposits in the Jan Dhan accounts went up from INR 45,640 crore in November 2016, to INR 74,600 crore by the end of December 2016. However, this went down to INR 63,885 crore by March 8, 2017, as restrictions on withdrawals were lifted. The Government warned people against letting their Jan Dhan accounts be misused and also restricted deposits of more than INR 50,000 in these accounts with effect from November 15, 2016.<sup>80</sup>

### 10.5 Bullion traders and gold jewellers

These two categories of businessmen are known for dealing in cash, with 80% of gold/gold jewellery/gems being sold in cash transactions.<sup>81</sup> On the night demonetisation was announced, a large amount of gold and gold jewellery<sup>82</sup> was sold within a span of four hours by back-dating transactions, splitting transactions into bills of amounts lower than INR 2 lakh to bypass the requirement of obtaining and quoting PANs, providing entries through bogus sales, recording of multiple transactions to hide the identity of the real beneficiary, accepting advances in cash

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<sup>78</sup> (2017), 'CBDT sends names of 12 CAs indulging in tax evasion to ICAI; govt mulling stricter penalties', Money Control, available at <http://www.moneycontrol.com/news/business/markets-business/cbd-t-sends-names-of-12-cas-indulging-in-tax-evasion-to-icai-govt-mulling-stricter-penalties-2317481.html> (accessed on July 31, 2017)

<sup>79</sup> FE Bureau (2017), 'Demonetisation: Narendra Modi govt hands 34 chartered accountants' names to ICAI for money laundering investigation', Financial Express, <http://www.financialexpress.com/economy/demonetisation-narendra-modi-govt-hands-34-chartered-accountants-names-to-icai-for-money-laundering-investigation/551650/> (accessed on July 31, 2017)

<sup>80</sup> IANS (2017), 'Cash deposit limit in Jan Dhan accounts set at Rs 50,000: Finance ministry', Hindustan Times, available at <http://www.hindustantimes.com/india-news/cash-deposit-limit-in-jan-dhan-accounts-set-at-rs-50-000-finance-ministry/story-t0HTUtFq3fDm2WE4ZHUrgP.html> (accessed on July 31, 2017)

<sup>81</sup> Dubey, J. (2016), 'Modi's demonetisation to hit real estate, jewellery sectors hardest', Hindustan Times, available at <http://www.hindustantimes.com/business-news/modi-s-demonetisation-to-hit-real-estate-jewellery-sectors-hardest/story-vgWsgUI7YETUzbkWGlyGIN.html> (accessed on July 31, 2017)

<sup>82</sup> Ministry of Finance (2017), Operation Clean Money – Status Report May 2017, Income Tax Department, Ministry of Finance, Government of India, New Delhi, available at [https://www.cleanmoney.gov.in/pdf/OCM\\_Status\\_Report-16\\_May\\_2017.pdf](https://www.cleanmoney.gov.in/pdf/OCM_Status_Report-16_May_2017.pdf) (accessed on July 31, 2017)

against future sales, etc. Certain jewellers in Delhi reportedly sold unaccounted-for gold stating that it was part of stocks bought from parties in other cities. These parties were, in fact, non-existent; in any case it would have been impossible to have brought the gold to Delhi from the cities indicated by the dealers in even 6 to 8 hours.

## **10.6 Businessmen, industrialists, and contractors**

These categories of the public paid salaries and wages for a month or more in advance, in demonetised currency, to their employees/workers. Real estate developers and property dealers inflated expenses and accepted advances, in violation of rules, and also deposited money in several accounts in the names of family members. Businessmen also sent the same employee/s to different banks and their branches with different identity documents to exchange unaccounted-for money, which prompted the RBI to bring in ‘inking of fingers’ as a measure preventing multiple exchanges of currency by the same person under different identities.

## **11. Real Issues Plaguing the System**

Indians have been used to dealing in cash for a very long time and avoid using cheques, bank drafts, debit/credit cards, mobile wallets, net banking, etc., because of an unwillingness to pay taxes. The tendency to evade taxes prevails among, both, traders and purchasers alike<sup>83</sup> and is a phenomenon occurring all over the world where both, the retailer and the customer, readily agree to share the amount of tax (VAT/GST) evaded.<sup>84</sup> The examples below show how people find ways to avoid dealing in recorded transactions to avoid paying taxes.

### **11.1 Roadside vegetable vendor<sup>85</sup>**

Immediately after demonetisation (November 15, 2016, to be precise), roadside vegetable vendors began accepting payments through the mobile wallet, Paytm. The very next day, a vendor in question said that her Paytm limit of INR 20,000 had been exceeded and that she could not accept further payments via Paytm till she got her Aadhaar number linked to her Paytm account. The day after that the vendor not only got her mobile number linked to her Aadhaar number, but had also obtained another new mobile linked with Aadhaar in her own name. Her monthly limit now went up to INR 2 lakh, but from January, 2017, she stopped accepting Paytm payments. While it may not be easy to estimate her monthly or annual turnover, it can certainly be inferred that her daily turnover was a modest INR 10,000. Multiplied by even 320 days in the year, the turnover would be INR 32 lakh. This vendor sells vegetables at double the rate in the local vegetable market, and so, if her margin is 50%, she

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<sup>83</sup> Bhakta, P. and Mehta, S. (2016), ‘Demonetisation: Modi govt is betting its future on digital India. Will it bear good results?’, The Economic Times, available at <http://economictimes.indiatimes.com/industry/banking/finance/banking/demonetisation-modi-govt-is-betting-its-future-on-digital-india-will-it-bear-good-results/articleshow/55969340.cms> (accessed on July 31, 2017)

<sup>84</sup> Immorino, G. and Russo, F. F., (2014), Taxing Cash to Fight Collaborative Tax Evasion, Working Paper No. 351, Centre for Studies in Economics and Finance, Capri, Italy, available at <http://www.csef.it/WP/wp351.pdf> (accessed on July 31, 2017)

<sup>85</sup> Author’s personal experience

would have an annual income of INR 16 lakh. Even at a 10% margin, her income would be INR 3.2 lakh, which is above the income tax exemption limit of INR 2.5 lakh.

## **11.2 Local taxi drivers<sup>86</sup>**

A few months ago, a taxi driver in Bengaluru on being asked his annual income, stated that he had five taxis of which he drove one himself with the remaining four rented out to other drivers. A rough calculation suggests annual savings (after all expenses on hire-purchase payments, insurance, taxes, permits, petrol/gas, etc.) were between INR 5 lakh to INR 6 lakh.

## **11.3 Construction, electrical, and plumbing shops<sup>87</sup>**

On numerous occasions, the author/s encountered owners of shops selling construction, electrical, and plumbing material reluctant to accept electronic payments. On one occasion, a shop owner in NCR refused to sell 12 inverter batteries against a payment made by cheque or card, insisting on cash. On another occasion, before demonetisation, an electrical repair shop in Khan Market (Delhi) charged INR 25 extra for accepting card payments saying he had to pay a service charge to the Point of Sale (POS) machine provider/bank. Even as recently as September, 2017, some professionals and shops charge INR 50 extra for payments by debit or credit card citing the burden of service charges and GST. Yet another electrical repair shop owner in Khan Market was hesitant to accept a card payment as he would have had to pay service tax, an inconvenience. In another incident, before demonetisation, a photocopier and laminating shop in Delhi did not welcome card payments because of service tax (which was ultimately borne by the customer), service charge, and service tax on service charge. Construction, electrical, and plumbing material suppliers/sellers invariably sell goods in exchange for cash and issue 'katchha' receipts. Purchasers are usually happy to avoid VAT or service tax this way, little realising that the supplier/seller also made a tidy margin ranging from 10% to 40% in their dealings with the Original Equipment Manufacturer (OEMs) and distributor, depending on the item and market situation. In another instance of tax evasion suppliers/sellers issue bulk receipts for tax paid on total sales without actually selling anything to real estate companies, builders, construction companies, to help them inflate their purchases or costs of construction. Such deals are arranged through 'agents' at a certain cost, with benefits to both parties. Thus, both the supplier/seller and the purchaser have always colluded in evading VAT, and ultimately income tax.

## **11.4 Uber/Ola drivers**

A newspaper report claimed that on an average, Uber taxi drivers earn INR 80,000 per month with earnings varying between INR 75,000 and INR 1 lakh per month.<sup>88</sup> When the incentive structure of cab companies such as Uber/Ola changed, drivers registered with them protested

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<sup>86</sup> Author's personal experience

<sup>87</sup> Author's personal experience

<sup>88</sup> Thimmaya, P.P. and Hector, D.J. (2015), 'Uber and Ola drivers earn up to Rs 1 lakh per month', Financial Express, available at <http://www.financialexpress.com/industry/appy-drivers-earn-up-to-rs-1-lakh-per-month/80533/> (accessed on July 31, 2017)



that their income had fallen by 2/3rds. In one media report during that period, one Ola driver was quoted to have said, “I used to earn anything between INR 90,000 to INR 1 lakh every month....that is down to INR 35,000 now.”<sup>89</sup> Using both monthly figures, the driver’s annual income would be approximately INR 10.8 lakh or INR 4.2 lakh, but there is no evidence that they are taxpayers.

### **11.5 Sellers of old books in Daryaganj**

Daryaganj’s book sellers saw their business dip by almost 90 percent after the scrapping of SBN because the market thrives on cash transactions. A seller in the market has been reported to have stated that he usually made INR 8,000 to INR 10,000 every Sunday, but in the month of December, 2016 he had managed only INR 1,500<sup>90</sup>. Though it is true that the immediate unavailability of cash affected businesses in general, calculation of this particular seller’s yearly income before demonetisation, suggests an amount anywhere between INR 3, 84,000 and INR 4, 80,000, well above the exemption limit for taxation. This calculation is done taking four Sundays a month, twelve months a year, into account. There are several book sellers in this market and one can only imagine the business generated here every Sunday, most of it falling within the ambit of the cash economy. A few sellers in the market do accept payments via e-wallets, but not all of them are aware of these facilities, and there is an immediate need to educate people about cashless modes of payment available to the common man.

### **11.6 Incorrect declaration of income**

The author has personally known of a large number of businessmen and professionals who declare their income as slightly higher than the exemption limit. This limit used to be INR 3, 000 before 1970 and INR 8,000 around 1985<sup>91</sup>, and taking advantage of the small income or summary assessment schemes, such people ended up paying income tax between INR 10 (in 1970s) and INR 100 (in 1980s). They were not always people of modest means and their returned income would go up in tandem with the exemption limit so that they always remained taxpayers but never paid more than a meagre amount.

While the above examples do show that certain sections of the society tend to evade taxes, there is another angle to this issue. Most businesses have to pay bribes in cash to people such as corrupt government officials, local politicians and police officers, to start and run their

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<sup>89</sup> Goswami, Shweta (2017), ‘Autos may join Ola, Uber strike – Changing perks, low income scare drivers’, Hindustan Times, available at <https://www.pressreader.com/india/hindustan-times-delhi/20170211/281535110737563> (accessed on July 31, 2017)

<sup>90</sup> Bhaumik, S. (2016), ‘Note ban scripts trouble for Sunday book market’, The Times of India, available at <http://timesofindia.indiatimes.com/city/delhi/Note-ban-scripts-trouble-for-Sunday-book-market/articleshow/55931933.cms> (accessed on July 31, 2017)

<sup>91</sup> Ministry of Finance (2004), Report of the Task Force for Review of the General Financial Rules, 1963, Ministry of Finance, Government of India, Department of Expenditure, Ministry of Finance, Government of India, New Delhi, available at <http://doe.gov.in/sites/default/files/ReportTFofGFR.pdf> (accessed on July 31, 2017)

businesses<sup>92</sup>. This compels them to deal in cash rather than in recorded transactions. Eliminating the scourge of bribes and facilitation payments will encourage people to be tax-compliant. While it is true that every businessman of the above categories may not have taxable income, given the prevailing culture of non-compliance, it is essential to encourage tax-compliance by analysing and monitoring information about income and other transactions collected through third parties.

## 12. Impact of Demonetisation

Within the first three weeks of demonetisation, a sum of INR 8.11 trillion was deposited with various banks and INR 33.9 billion was exchanged, bringing the total amount to INR 8.44 trillion.<sup>93</sup> The cash withdrawn from banks and ATMs added up to INR 2.16 trillion<sup>94</sup>. As per information available on December 12, 2016, the total SBN deposited with the RBI treasury was INR 12.44 lakh crore. According to some press reports<sup>95</sup>, SBNs valued at INR 15.28 lakh crore had been returned to the RBI treasury by June 30, 2017 (the figure is subject to future corrections based on verification process by the RBI. Therefore, only INR 16,000 crores or 1.03% worth of currency was extinguished.

The data<sup>96</sup> on bank deposits revealed that amounts ranging from INR 2 to 80 lakh were deposited in 1.09 crore bank accounts from October 8, 2016, to December 30, 2016, with the average per account standing at INR 5.03 lakh. Amounts exceeding INR 80 lakh were deposited in 1.48 lakh accounts with an average of INR 3.31 crore.

In the wake of demonetisation, the use of electronic transactions, net banking, plastic money, other digital media such as mobile applications, went up, with the government, too, increasingly using the digital mode for transactions. Digital transactions by the Central and State governments have risen steadily from 357.70 crore in 2014, 1,089.8 crore in 2016 to 737.35 crore as of June 25, 2017<sup>97</sup> (refer Annexure XI). Investments in mutual funds had risen to INR 20 trillion by the end of July 2017. Insurance premium collections witnessed double digit growth in May-June 2017. More than 1 crore workers were added to the Employee

<sup>92</sup> Shashikant, U. (2017), 'For those who pay no taxes, cash is king', The Times of India, available at <http://timesofindia.indiatimes.com/business/india-business/for-those-who-pay-no-taxes-cash-is-king/articleshow/60251446.cms> (accessed on October 1, 2017)

<sup>93</sup> Nair, M. And Nair, V. (2016), 'Rs 8.44 trillion deposited in banks as demonetisation reaches halfway mark', Live Mint, available at <http://www.livemint.com/Industry/9ZNJ0leyHQL85GtTHfpzKI/Modis-black-money-drive-in-blues-as-only-half-of-old-curren.html> (accessed on July 31, 2017). The figures are as of November 27, 2016

<sup>94</sup> Nair, M. And Nair, V. (2016), 'Rs 8.44 trillion deposited in banks as demonetisation reaches halfway mark', Live Mint, available at <http://www.livemint.com/Industry/9ZNJ0leyHQL85GtTHfpzKI/Modis-black-money-drive-in-blues-as-only-half-of-old-curren.html> (accessed on July 31, 2017). The figures are as of November 27, 2016

<sup>95</sup> Press Trust of India (2017), 'No information on how much black money removed by note ban, says RBI', The Times of India, available at <http://timesofindia.indiatimes.com/business/india-business/no-information-on-how-much-black-money-removed-by-note-ban-says-rbi/articleshow/60365571.cms> (accessed on

<sup>96</sup> Ministry of Finance (2017), Speech of Arun Jaitley, Minister of Finance, Union Budget 2017-2018, Ministry of Finance, Government of India, available at <http://www.indiabudget.gov.in/ub2017-18/bs/bs.pdf> (accessed on July 31, 2017)

<sup>97</sup> Ministry of Electronics and Information Technology, Electronic Transaction Aggregation & Analysis Layer (etaal), Government of India available at <http://etaal.gov.in> (accessed on July 31, 2017)



Provident Fund (EPF) scheme and Employee State Insurance Corporation (ESIC) scheme, an increase of 30% over the existing number of beneficiaries. Bank accounts for 50 lakh wage earners were also opened<sup>98</sup>. It was reported that there was a visible reduction in corruption, at least during the months of November 2016 and December, 2016, due to non-availability of cash.

However, GDP growth during 2016-2017 came down to 6.1% in the last quarter, compared to an estimated growth of 7.9% during 2015-2016 due to several factors, including industrial slowdown. The USD-to-INR exchange rate strengthened from INR 67.7 in January 2016 to INR 64.61 in June 2017. Bond yield came down to 6.53% (the lowest since 2009) resulting in lower borrowing cost for companies, leading to higher investments and higher profitability. Banks were flush with excess cash, and interest rates on home loans as well as on deposits were reduced. Collection of property tax and utility charges increased manifold with demonetised currency being allowed for these payments. Ninety-one lakh<sup>99</sup> new taxpayers were added during 2016-2017, in the aftermath of demonetisation, taking the total number of taxpayers to 6.5 crore<sup>100</sup>. The number of returns filed has increased to 5.28 crore in 2016-2017 compared to 4.33 crore filed during 2015-2016, excluding paper returns filed. For Assessment Year 2017-2018, 3.17 crore returns had already been filed as of August 31, 2017, which is 60% of the total returns filed in 2016-2017. Taxpayers still have time up to 31<sup>st</sup> March, 2018, to file their tax returns for the financial year 2016-17. It would appear that the number of taxpayers has risen because of a change in the definition of ‘taxpayer’, the case of non-filers (whose taxes have been deducted at source but no returns have been filed) requires following-up because of the large possibility that they are avoiding the disclosure and payment of taxes (likely at a higher rate).

### **13. Reasons Why the Demonetisation of 2016 is Likely to Succeed**

Compared to earlier demonetisations, the present scheme is likely to be more successful in reducing black money, encouraging digital transactions, increasing recorded transactions and widening the taxpayer base, owing to a number of factors, listed below in this section.

#### **13.1 Coverage of Banking Services**

Compared to 1946 and even 1978, the coverage of banking services has risen (Figure 13 below and Annexure XII).

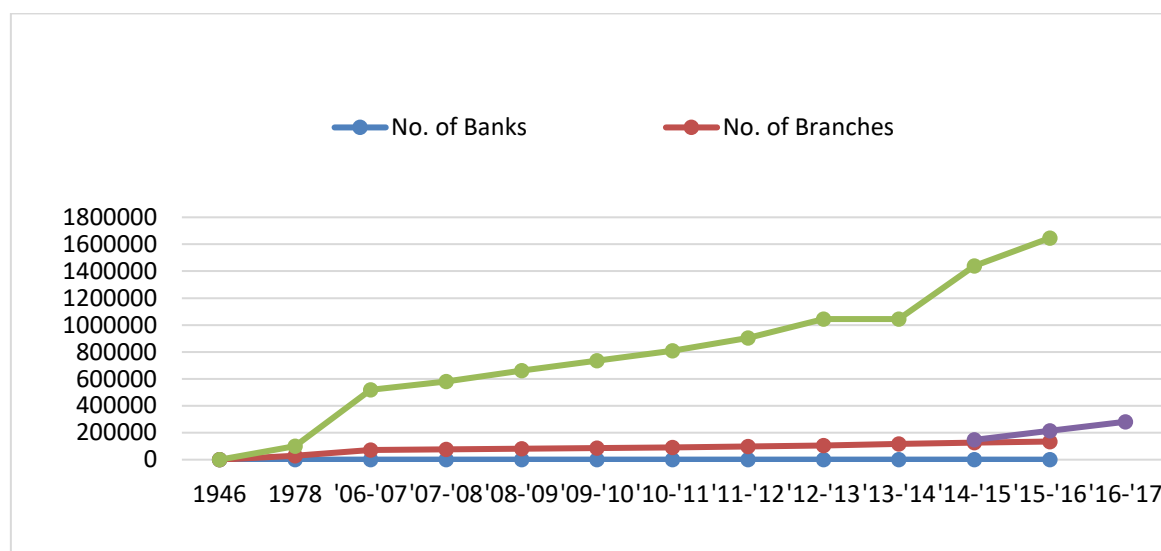
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<sup>98</sup> Times News Network (2017), ‘In black money fight, I-T lens on 14,000 property dealings’, The Times of India, available at <http://timesofindia.indiatimes.com/business/india-business/in-black-money-fight-i-t-lens-on-14000-property-dealings/articleshow/60316430.cms> (accessed on October 1, 2017)

<sup>99</sup> Mishra, A.R. (2017), ‘Demonetisation effect: 9.1 million new taxpayers’, Live Mint, available at <http://www.livemint.com/Politics/WRTgYztM2cSiT0deLmMWjN/Demonetisation-effect-91-million-new-taxpayers.html> (accessed on July 31, 2017)

<sup>100</sup> Mishra, A.R. (2017), ‘Demonetisation effect: 9.1 million new taxpayers’, Live Mint, available at <http://www.livemint.com/Politics/WRTgYztM2cSiT0deLmMWjN/Demonetisation-effect-91-million-new-taxpayers.html> (accessed on July 31, 2017)

**Figure 13: Spread of Banking in the Country**



Source: Extracted from RBI (1978), *Banking Statistics*, Vol. 8. (June 1978 – December 1978), available at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/54899.pdf> (accessed on September 22, 2017) and Database on Indian Economy, RBI's Data Warehouse, Government of India, available at <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#19> (accessed on September 22, 2017)

In 1946, there were nearly 1000 very small banks, of which 22 became members of the Indian Banks Association (IBA) which was set up that very year. By 1978, the number of banks had grown to 128 with 28,016 branches which increased to 221 banks and 1, 34,858 branches in 2016. Though the figure for 'total number of bank accounts' is not available for the year 1946 this number was 10 crore in 1978 and 104 crore in 2014, increasing to 164.61 crore by March 2016. The number of Jan Dhan accounts has also swelled significantly, from 5.37 crore at the end of September 2014, to 30.09 crore accounts till August 30, 2017<sup>101</sup>. The Annual Report<sup>102</sup> (2016 – 2017) of the Ministry of Finance stated that almost 99.99% of the 21.22 crore households, surveyed during the preparation of the report, had been covered by the PMJDY as compared to a far lower figure of 58.7% in 2011.

As per the December 2016 ICE 360° survey<sup>103 104</sup>, 99% of households in both rural and urban India have at least one member with a bank account. Ninety-one percent of households in urban India have their Aadhaar cards linked to their bank accounts. The corresponding figure is lower

<sup>101</sup> Ministry of Finance, Pradhan Mantri Jan Dhan Yojana (PMJDY), Department of Financial Services, Ministry of Finance, Government of India, available at <https://www.pmjdy.gov.in/account> (accessed on September 7, 2017)

<sup>102</sup> Ministry of Finance (2017), Annual Report 2016 – 2017, Budget Division, Ministry of Finance, Government of India, available at <http://dea.gov.in/sites/default/files/Annual%20Report-2016-17-E.pdf> (accessed on July 31, 2017)

<sup>103</sup> PRICE (2016), Insight from ICE360° Survey, 2016 – 99% Indian households are covered by a bank account, available at <http://www.ice360.in/en/projects/homepagesurvey/99-indian-households-are-covered-by-a-bank-account> (accessed on July 31, 2017)

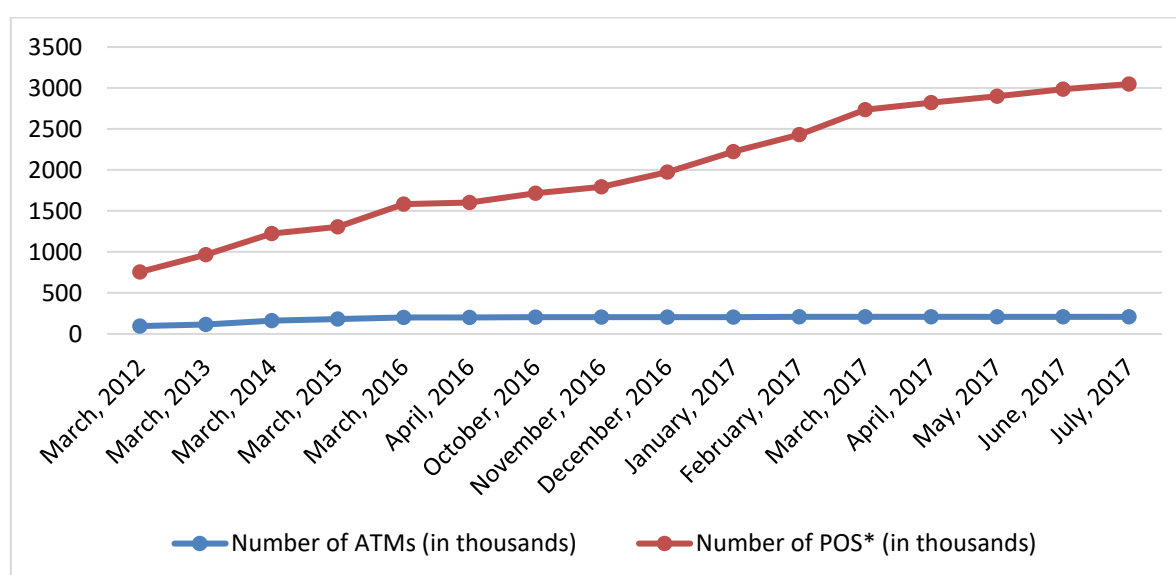
<sup>104</sup> Bhattacharya, P. (2016), '99% Indian households are covered by a bank account', Live Mint, available at <http://www.livemint.com/Specials/vKbQ0cMmiNbdwOlfd0Z4N/99-Indian-households-are-covered-by-a-bank-account.html> (accessed on July 31, 2017)

for rural India, at 78%. The survey, covering 61,000 households, was amongst the largest consumer economy surveys in the country and it captured data till July 2016. It depicts a big jump in banking access as compared to 2011, when the last census was conducted. The census showed that only 58.7% households had access to banking. However, one must bear in mind that while the 2011 figure is based on a complete census, the 2016 figure is an estimate made on the basis of a survey and hence needs to be interpreted with greater caution.

### 13.2 Bank computerisation, ATM, POS, etc.

All the 135,263<sup>105</sup> bank branches (leaving aside District Cooperative Banks in rural areas) are now not only computerised but also use networked integrated banking software or core banking software, such as Finacle, BaNCS, Flexcube, etc. Installation of POS machines in particular, for cashless transactions, increased in the period immediately following demonetisation; 177,020 machines were added between November 2016 and December 2016; 248,120 machines between December 2016 and January 2017; 209,130 machines between January 2017 and February 2017; and 304,160 machines between February 2017 and March 2017 (Figure 14 and Annexure VIII).

**Figure 14: Trends in Number of ATMs and POS in the Country**



Source: Extracted from RBI (2017), *Data on Bankwise ATM/POS/Card Statistics*, available at <https://rbi.org.in/scripts/atmview.aspx> (accessed on September 14, 2017)

<sup>105</sup> Ministry of Finance (2017), *Economic Survey 2016-2017*, Vol. 2, A69, Economic Division, Department of Economic Affairs, Ministry of Finance, Government of India, New Delhi, available at [http://www.indiabudget.gov.in/e\\_survey2.asp](http://www.indiabudget.gov.in/e_survey2.asp) (accessed on July 31, 2017)

### 13.3 Mobile applications

In addition to internet banking facilities, there are a number of mobile and computer based non-cash payment options such as Unified Payment Interface (UPI), Unstructured Supplementary Service Data (USSD) and mobile wallets which is encouraging use of digital transactions.

The picture below shows a small road side tea vendor near a construction site announcing that he accepts payments by the mobile wallet, Paytm. The signboard announces in Hindi:

“Credit sale is closed PAYTM 9457286074”

“PAYTM karo 9457286074”



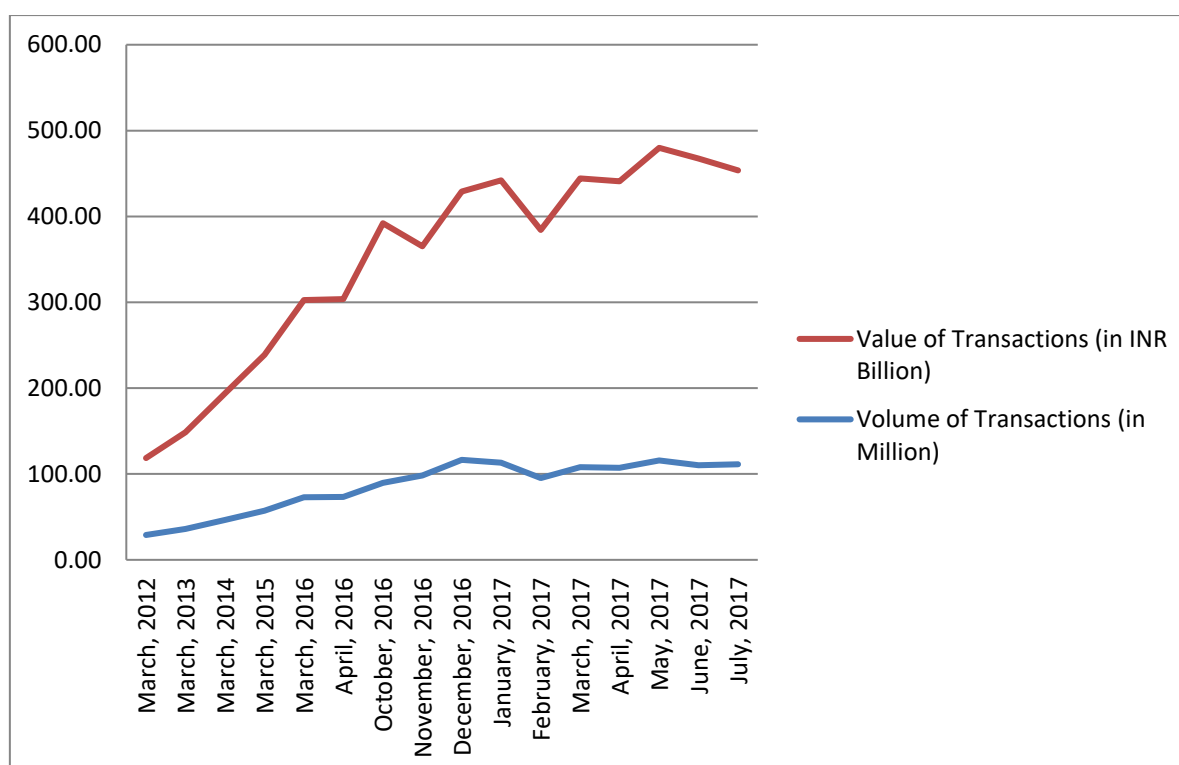
### 13.4 Mobile and broadband services

Mobile and broadband services have spread with a total of 117 crore mobile phones across the country; 2.5 lakh *gram panchayats* are also being linked on broadband.

### 13.5 Digital Transactions

Today there are a large number of choices for carrying out digital transactions or recorded transactions and these are being increasingly used. Internet penetration<sup>106</sup> in India, which stood at 35.41 crore in 2015 (27% of the population) increased to 46.21 crore in 2016 (34.8% of the population). The government also took a number of steps to encourage digital transactions such as: a) waiving service charges in certain cases on the use of ATM/ Debit/ Credit cards RuPay cards, linked to a large number of banks have been issued and are being encouraged; b) instituting awards for digital transactions by users and dealers (detailed list of the measures taken by the Government to promote digital transactions in Annexure XIII). Trends in digital transactions (credit and debit cards) are shown in Figures 15 and 16 (detailed table in Annexure VIII).

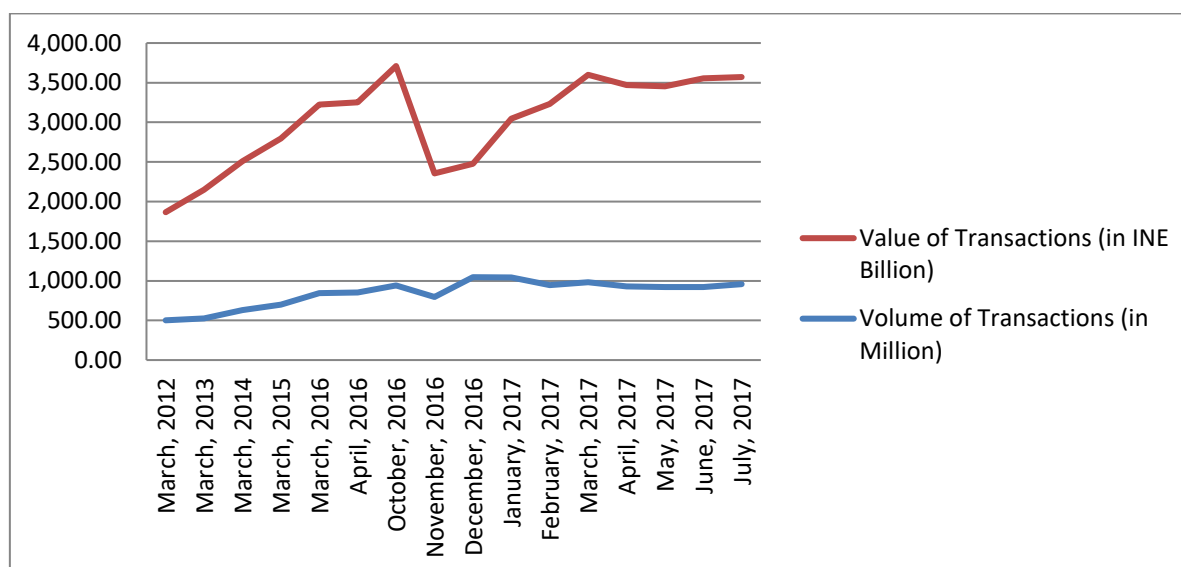
**Figure 15: Trends in Volume and Value of Transactions - Credit Cards**



Source: Extracted from RBI (2017), *Data on Bankwise ATM/POS/Card Statistics*, available at <https://rbi.org.in/scripts/atmview.aspx> (accessed on September 14, 2017)

<sup>106</sup> Internet Live Statistics, Internet Users by Country (2015), available at <http://www.internetlivestats.com/internet-users-by-country/2015/> and Internet Users by Country (2016), available at <http://www.internetlivestats.com/internet-users-by-country/> (accessed on July 31, 2017)

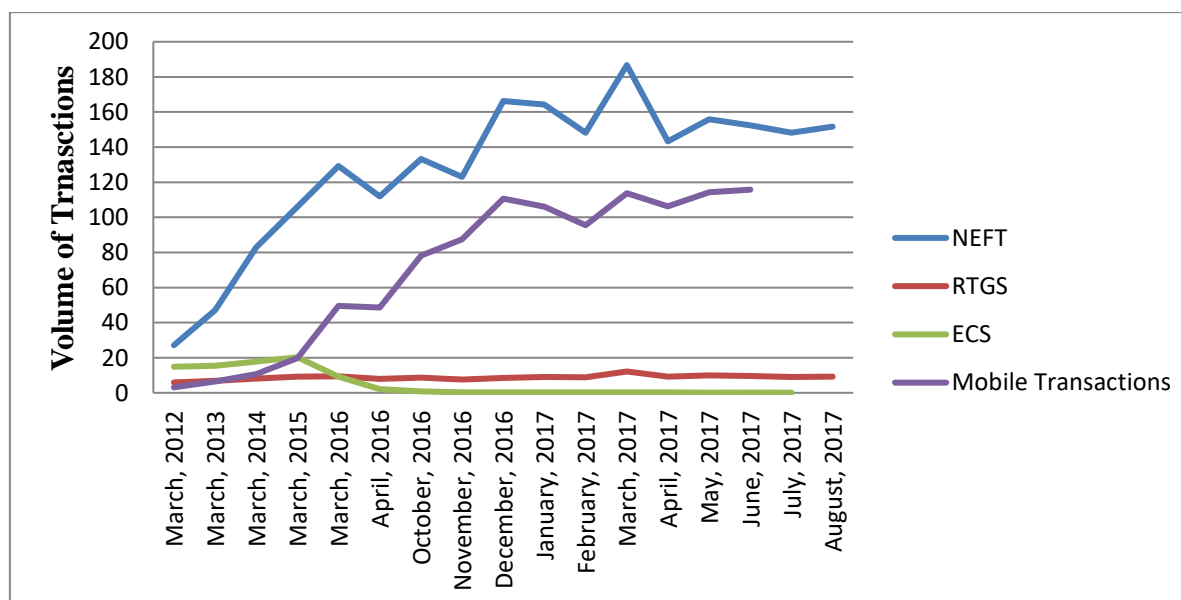
**Figure 16: Trends in Volume and Value of Transactions - Debit Cards**



Source: Extracted from RBI (2017), Data on Bankwise ATM/POS/Card Statistics, available at <https://rbi.org.in/scripts/atmview.aspx> (accessed on September 14, 2017)

The use of other cashless modes of transaction such as NEFT, RTGS, ECS and mobile banking has also risen (Figure 17 below and Annexure VII).

**Figure 17: Trends in Volume of Transactions for NEFT/RTGS/ECS/Mobile Banking**



Source: RBI Data on Bank-wise Volumes in ECS/NEFT/RTGS/Mobile Transactions, available at <https://m.rbi.org.in/scripts/NEFTView.aspx> (accessed on September 14, 2017)



### 13.6 Extensive availability of ID and use

In 1946 or even in 1978, a unique taxpayer identification number or citizen identification number did not exist but today there is a practically universal coverage with a single centralised database, apparent from the numbers of PAN cards and Aadhar cards issued.

- (i) Taxpayer Identification Number (PAN): 32.4 crore
- (ii) Citizen Identification Number (Aadhaar):<sup>107</sup> 117.6 crore<sup>108</sup>

Other identity documents were allowed to be used to deposit money in banks during the demonetisation period and are backed by computerised databases. These include the Election Commission Photo Identity Card or EPIC (district/state wise), Driving Licence (national register), Passport (national). The magnitude of coverage by these is evident from the following data:

- (i) Passports: 6.9 crore
- (ii) EPIC: 60 crore (approx.)
- (iii) Ration Card: 15.17 crore (approx.)
- (iv) Driving Licence: 17.37 crore

These computerised databases will help the Income Tax Department link and collate potential taxpayers' data and transactions.

### 13.7 Various steps taken by the government

Presented below are a number of steps that the government has taken over the years to reduce the generation of black money and encourage recorded transactions:

- (i) Benami Act, 1998

This Act, which provides for seven years of imprisonment and a fine for holding property in a fake name or other persons' name, after comprehensive amendments was notified in

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<sup>107</sup> Rajagopal, K. (2017), 'Centre's Aadhaar affidavit in Supreme Court: 'Welfare of masses trumps privacy of elite'', The Hindu, available at <http://www.thehindu.com/news/national/centres-aadhaar-affidavit-in-supreme-court-welfare-of-masses-trumps-privacy-of-elite/article18951798.ece> (accessed on June 30, 2017)

<sup>108</sup> For details, see [https://uidai.gov.in/search.html?searchword=ssup&searchphrase=all&option=com\\_search](https://uidai.gov.in/search.html?searchword=ssup&searchphrase=all&option=com_search), (accessed on September 7, 2017)  
Rajagopal, K. (2017), 'Centre's Aadhaar affidavit in Supreme Court: 'Welfare of masses trumps privacy of elite'', The Hindu, available at <http://www.thehindu.com/news/national/centres-aadhaar-affidavit-in-supreme-court-welfare-of-masses-trumps-privacy-of-elite/article18951798.ece> (accessed on June 30, 2017)

November, 2016. A good number of cases (245 benami transactions) are under scrutiny and some 124 properties worth INR 55 crores have already been attached<sup>109</sup>.

(ii) Income Tax Act, 1961

The following legislative changes have been made in to the Act to encourage digital or recorded transactions and to also make compulsory reporting of certain transactions to help widen the taxpayer base:

- a. Accepting payments or repayments of loan(s), deposits, or specified sums of an aggregate amount of INR 20,000 or more was not allowed otherwise than by account payee cheque, bank draft, or through ECS (electronic clearing system). A transgression of this provision was made liable for a penalty equal to the amount involved. The provision has the potential to discourage the use of black money and can certainly be expected to deter back-dated transactions. This has now been extended to cover payments for transfer of immovable property with effect from April 1, 2015.
- b. Tax Collection at Source at the rate of 1% has been prescribed on all purchases made in cash exceeding INR 2 lakh and on the purchase of cars valued at INR 10 lakh or higher. The concept of connected or related transaction has also been brought in.
- c. Earlier, the classes ‘Individuals’ and ‘Hindu Undivided Family (HUF)’ were not required to deduct tax at source from the rent that was paid by them. Consequently, such rent when received by the owners of the rented properties, would almost never be declared in their income tax returns. With effect from June 1, 2017, ‘Individuals’ and ‘HUF’ have been mandated to deduct tax at source at the rate of 5%, from a rent of INR 50,000 or more paid by them.
- d. Deduction of any amount of donations exceeding INR 2,000 under Section 80G of the Income Tax Act will not be allowed if it is paid in cash.
- e. Previously, in order to encourage digital or recorded transactions through cheques, bank draft, net banking; cash payments, any business or professional expenditure other than capital expenditure exceeding INR 20,000 (barring specified cases) was not allowed. However, from the current year (2016-17) onwards, this limit of INR 20,000 has been reduced to INR 10,000 in each case, with the objective of curtailing cash payments. Additionally, the purchase of any capital asset in cash exceeding INR 20,000 will not be eligible for depreciation.
- f. So far small businesses were being allowed to pay tax on deemed income at the rate of 8% of the turnover without maintenance of any accounts if their turnover did not exceed INR

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<sup>109</sup> ANI (2017), ‘CBDT signifies achievements towards eliminating domestic black money’, Financial Express, available at [www.financialexpress.com/economy/cbd-t-signifies-achievements-towards-eliminating-domestic-black-money/619001](http://www.financialexpress.com/economy/cbd-t-signifies-achievements-towards-eliminating-domestic-black-money/619001) (accessed on July 31, 2017)



2 crore. In order to encourage digital transactions, the deemed income will be taken at the rate of 6% of the turnover if the payments are received via non-cash modes<sup>110</sup>.

- g. To target curbing of black money in the economy, receipts in cash amounting to INR 2 lakh or more in aggregate, from a person in one day, or with respect to a single transaction, or with respect to transactions relating to one event or occasion from a person, without using any non-cash mode, is not permitted. People receiving such payments will be liable to a penalty equivalent to the amount involved.
- h. Income of political parties will not be exempt if they receive donations of amount exceeding INR 2,000 or more in cash and fail to file their income tax returns within the due date. However, they are still permitted to receive donations in the form of electoral bonds without disclosing the names of donors.
- i. Revised requirements for quoting of PAN in specified transactions were notified in January 2016.
- j. The previously prescribed Form 60 in respect of persons with agricultural income, and Form 61 for persons to whom PAN had not been allotted, have now been merged into one Form 60, which has been expanded and restructured with effect from January 2017 to ensure that meaningful data for collation, matching and mining in respect of transactions of potential taxpayers, is captured. All details of the concerned person and transactions recorded in Form 60 are to be reported to the Income Tax department in digital form.
- k. The earlier Annual Information Return in respect of seven specified transactions has been replaced by the Statement of Financial Transactions, under Rule 114E of the Income Tax Rules, and it now covers 13 specified transactions<sup>111</sup> (Annexure IV). However, the very purpose of quoting of PAN with certain lower monetary threshold loses its efficacy as the threshold for reporting of transactions under Rule 114E is pegged at a higher amount. For instance, quoting of PAN is essential for cash deposits of INR 50,000 and above but reporting by banks under Rule 114E is confined to deposits of INR 10 lakh or more in a year. Similarly, while purchase or sale of immovable property of INR 10 lakh or more requires quoting of PAN, the reporting under Rule 114E is confined to immovable property of value exceeding INR 30 lakh. This allows potential taxpayers to split the transaction so that the sale/purchase amount does not cross the reporting threshold amount under Rule 114E. Since the majority of data is digitised it would not cost the concerned agencies to report all transactions with a lower threshold as well. This will also help Income Tax department build a better and more comprehensive profile of potential taxpayers.
- l. The CBDT/RBI has mandated PAN or Form 60 for all savings accounts in banks and post offices (except Basic Bank Deposit Accounts) and customers were asked to update or link their PAN by February 28, 2017. This date was later extended to June 30, 2017. With effect

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<sup>110</sup> Such as account payee cheques, account payee bank draft, or ECS through a bank.

<sup>111</sup> For details, see <http://incometaxindia.gov.in/Rules/Income-Tax%20Rules/10312000000007545.htm> (accessed on July 31, 2017)

from December 15, 2016, the RBI had barred any withdrawals from or transfers to accounts which did not comply with KYC norms<sup>112</sup>.

- m. In another move, with effect from July 1, 2017, linking of Aadhaar with PAN and furnishing of Aadhaar details in PAN applications has been made compulsory by CBDT in pursuance of the Supreme Court's ruling<sup>113</sup>. The Income Tax department had earlier stated that tax returns filed without linking the two would not be processed unless the linking was done by August 31, 2017. In a relief to the taxpayers, the deadline was extended to December 31, 2017.<sup>114</sup>

### (iii) Robust Information Technology Infrastructure

The Income Tax department now has a rigorous information technology set-up in terms of hardware, software, and personnel. In contrast to the situation about two decades ago, all operations are now fully computerised with a very strong third-party reporting system. Matching and analysis of data using sophisticated software will help link transactions. Some initiatives of the department are described below:

#### a. Non-Filers Management System (NMS)

The Income Tax department has been working on the NMS for the last three years and has identified non-filers with potential tax liabilities. The numbers of persons identified were 12.19 lakh in NMS Cycle 1 (2013), 22.09 lakh in Cycle 2 (2014), 44.07 lakh in Cycle 3, and 58.95 lakh in NMS Cycle 4 (2015)<sup>115</sup>. The 5<sup>th</sup> NMS Cycle for 2015-2016 identified 67.54 lakh potential non-filers<sup>116</sup>. Thus, so far 2.04 crore potential non-filers have been detected.

#### b. Project Insight and Operation Clean Money

The department has started these two projects and has also hired three firms, two for data analytics and mining, and the third for managing processes connected with handling of data. It is learnt that in addition to these, the Income Tax department has acquired some of the best data and business analytics, and data management software which has features of Master Data Management. The department is also building a very comprehensive database for 360-degree

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<sup>112</sup> Sharma, A.K. (2017), 'PAN is now mandatory for all savings accounts', Live Mint, available at <http://www.livemint.com/Money/k6EuXeFXgRUhuM0oNhQmjL/PAN-is-now-mandatory-for-all-savings-accounts.html> (accessed on July 31, 2017)

<sup>113</sup> Ananthakrishnan, G. (2017), 'Supreme Court upholds linking Aadhaar with PAN, but exempts those without it for now', The Indian Express, available at <http://indianexpress.com/article/india/sc-upholds-linking-aadhaar-with-pan-but-exempts-those-without-it-for-now-4696631/> (accessed on July 31, 2017)

<sup>114</sup> ET Online (2017), 'Deadline for linking Aadhaar and PAN extended to December 31', The Economic Times, available at <http://economictimes.indiatimes.com/wealth/personal-finance-news/deadline-for-linking-aadhaar-pan-by-itr-filers-extended-to-december-31/articleshow/60309075.cms> (accessed on October 1, 2017)

<sup>115</sup> Magazine, A. (2017), '1.37 crore who don't file returns are now on Income Tax radar', The Indian Express, available at <http://indianexpress.com/article/india/1-37-crore-who-dont-file-returns-are-now-on-income-tax-radar-4602911/> (accessed on June 30, 2017)

<sup>116</sup> Press Trust of India (2016), 'Nearly 70 Lakh Income Tax Non-Filers For 2015-16 Identified By Authorities', NDTV, available at <http://www.ndtv.com/india-news/authorities-identify-68-lakh-income-tax-non-filers-for-2014-15-1640835> (accessed on July 31, 2017)

profiling of taxpayers. The first phase of Operation Clean Money ran from February 2017 to April 2017, focussing on three areas: preliminary assessment, e-verification process, and targeted enforcement actions. The preliminary assessment resulted in identification of about 17.92 lakh people, whose taxpaying profile did not match their cash transactions, had been identified for the process of e-verification. The main sources of cash deposits that emerged during the e-verification process were: cash sales (57.5%), cash out of earlier income or savings (20.0%), other cash receipts (9.6%), cash out of receipts exempt from tax (4.2%), cash withdrawn out of bank accounts (4.1%), loan repayments in cash (2.9%), others (1.7%). The second phase of Operation Clean Money, which started in May 2017, includes the following activities: comprehensive risk assessment, differentiated, targeted treatment, enabling citizen engagement, identification of new cases for online verification, identification of high-risk cases using advanced analytical techniques, ensuring complete and accurate reporting of information.

(iv) Close coordination and collaboration

Unlike in the past, the current situation saw enforcement agencies such as the Income Tax department, the Enforcement Directorate (ED), the Central Bureau of Investigation (CBI), Directorate of Revenue Intelligence (DRI), Financial Intelligence Unit (FIU), Serious Fraud Investigation Office (SFIO), Economic Offences Wing (EOW) of the State Police, coordinating and collaborating closely in their operations. While the Income Tax department has the power to seize cash and valuables, it does not have powers to arrest: those lie with the ED, CBI, and the police. This has resulted in effective enforcement.

The value of suspicious transactions detected during 2016-2017 range between INR 1.6 to 1.7 lakh crore. The number of such transactions reported by banks increased to 3.61 lakh, from 0.61 lakh in the previous year, by financial institutions, to 0.95 lakh from 0.40 lakh, and by entities registered with the Securities and Exchange Board of India (SEBI), to 0.17 lakh from 0.05 lakh<sup>117</sup>.

Three lakh shell companies were detected, out of which 2.1 lakh have been de-registered. It has been reported that more than 1,150 shell companies were being used as conduits by 22,000 beneficiaries to launder over INR 13,300 crore<sup>118</sup>. SEBI has also delisted 450 suspicious companies and frozen the demat accounts of their promoters. 1.06 lakh directors of shell companies have been disqualified by the Ministry of Corporate Affairs, not only from their own boards but also from the boards of other companies, for a period of five years<sup>119</sup>. Investigations by the SFIOP have helped identify 54 professionals who allegedly assisted 559

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<sup>117</sup> Times News Network (2017), 'In black money fight, I-T lens on 14,000 property dealings', The Times of India, available at <http://timesofindia.indiatimes.com/business/india-business/in-black-money-fight-i-t-lens-on-14000-property-dealings/articleshow/60316430.cms> (October 1, 2017)

<sup>118</sup> <sup>118</sup> Times News Network (2017), 'In black money fight, I-T lens on 14,000 property dealings', The Times of India, available at <http://timesofindia.indiatimes.com/business/india-business/in-black-money-fight-i-t-lens-on-14000-property-dealings/articleshow/60316430.cms> (October 1, 2017)

<sup>119</sup> Mani, V. (2017), 'Over 100,000 shell firm directors disqualified for five years', Business Standard, available at [http://www.business-standard.com/article/companies/shell-cos-crackdown-over-100-000-directors-to-be-disqualified-for-5-yrs-117091201423\\_1.html](http://www.business-standard.com/article/companies/shell-cos-crackdown-over-100-000-directors-to-be-disqualified-for-5-yrs-117091201423_1.html) (accessed on October 1, 2017)

beneficiaries in laundering illicit cash<sup>120</sup>. In fact, the CBDT has sent the names of 12 Chartered Accountants (CAs) indulging in tax evasion to the Institute of Chartered Accountants of India (ICAI). Under Section 278 of the Income Tax Act, any CA found indulging in tax evasion or helping others evade tax can be prosecuted and can be punished with an imprisonment ranging from six months to seven years<sup>121</sup>.

#### **14. Way Forward and Recommendations**

As has been mentioned earlier in this report, the government has from time to time, provided opportunities to all citizens to come clean, file their returns/declarations or offer their untaxed incomes and legitimise it by paying taxes and penalties, perhaps at a higher rate. However, most people did not take advantage of these schemes probably because they felt they would not be caught.

With this context in mind, it must be acknowledged that demonetisation was a bold and well-intentioned move. The entire amount of INR 15.28 lakh crore deposited in various banks between November 9, 2016 and December 30, 2016, including the money deposited by NRIs upto June 30, 2017, is now in the banking channel and there is a recorded trail of the money with an identifiable ID. Almost all transactions, except deposits made between November 9, 2016 and November 15, 2016, in the District Cooperative Banks (with very poor controls on the KYC norms) and some Jan Dhan accounts, are KYC compliant, which means these transactions can at least be linked to the respective names, if not PANs in all cases. Transactions of people, who do not have PANs but had deposited or exchanged money in the days following demonetisation, were based on some form of identification, such as, Aadhaar, Driving License, Election Commission Identity Card, Passport, etc., all of which have computerised databases. All banks, cooperative banks, and post offices have also been asked by the government to link all accounts with their respective PANs, where available, or provide Form 60 by February 2017, in cases where the account holders did not have PANs. The deadline was later extended to June 30, 2017. In accordance with the order of the Supreme Court, all existing PANs and all new applications must have Aadhaar details with effect from July 1, 2017. The linking is a requirement even for filing income tax returns. All withdrawals from banks during the period November 10, 2016 to December 30, 2016, were allowed only from KYC-compliant accounts for the purpose of business and marriage expenses. Not only were the banks asked to report all deposits exceeding INR 2 lakh between November 10, 2016 and December 30, 2016, by January 31, 2017, but they were also asked to report all such transactions from April 1, 2016 to November 8, 2016. While filing the income tax return for the financial year 2016-2017, taxpayers have been directed to disclose details of money amounting to INR 2 lakh or more that they may have deposited in their bank accounts.

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<sup>120</sup> Sasi, A. (2017), 'Actionable inputs firmed up on over 1,155 shell firms, entities', The Indian Express, available at <http://indianexpress.com/article/business/economy/actionable-inputs-firmed-up-on-over-1155-shell-firms-entities-4734146/> (accessed on July 31, 2017)

<sup>121</sup> (2017), 'CBDT sends names of 12 CAs indulging in tax evasion to ICAI; govt mulling stricter penalties', Money Control, available at <http://www.moneycontrol.com/news/business/markets-business/cbd-t-sends-names-of-12-cas-indulging-in-tax-evasion-to-icai-govt-mulling-stricter-penalties-2317481.html> (accessed on July 31, 2017)

Money, especially if it is ill-gotten, never remains idle. Though some part of illegal cash does find itself locked away in bank lockers or hidden under mattresses at home, the majority is invested in property, jewellery, high-value purchases, personal foreign travel or that of relatives, investment in unaccounted stocks by benami businesses, and other investments. However, one thing is certain: for every transaction or investment there has to be some link with the real or beneficial owner so that the beneficial owner can retain control and retrieve their investment or property when required. Therefore, such transactions will, in all probability, be linked by some means such as a name, address, telephone number, mobile number, email ID, (which could be more than one in each case) allowing tracking with the assistance of modern software and technology, such as Master Data Management software.

The Income Tax department has data in digital form from the following sources: (a) AIR: seven sources, since 2005 and the 'Statement of Financial Transactions' with information on 13 types of transactions since April 1, 2016, (b) crores of pieces of CIB information (40 sources) for many years, (c) all TDS and TCS returns from 2003, apart from data from tax returns and tax payments. It is understood that data from the Financial Intelligence Unit (FIU) of the Ministry of Finance and enforcement units of the CBEC and Enforcement Directorate are also available. There is an MOU between the Income Tax department and Ministry of Corporate Affairs and they are in close coordination with SEBI. There is even more data available now, data with respect to INR 15.28 lakh crore as a result of demonetisation, suspicious or specified financial transaction reports from the FIU of the Ministry of Finance, Government of India, financial transaction information received from the USA under the Foreign Account Tax Compliance Act, data under Automatic Exchange of Information expected in the near future from a large number of countries.

It is essential that all transactional data from every available source for all years including of earlier years, pertaining to each person must be collected and analysed to create proper taxpayer profiles and history (both behaviour as well as financial) using Master Data Management. Individual or entity-based relationships must also be built using the latest data analytics and mining software available. It has been acknowledged by the Finance Minister in his budget speech that a culture of non-compliance prevails in the country, which must change. Data analytics and mining software must be used to identify every person having an income that is taxable. It is not necessary to only target high-value and high-risk citizens but everyone who crosses the threshold of the exemption limit should be brought under the tax scanner so that the culture of non-compliance can change.

The implementation of GST is being done with one national database under the GST Network (GSTN) as against data distributed at 29 states/Union Territories and nationally with CBEC, under the previous indirect tax regime. This will result in all transactions being recorded at once place with provision for matching all sales and purchase transactions and taxes paid at each stage and also widen the indirect taxpayer base and increase indirect tax collection over VAT, excise, etc. The GST tax base is also bound to go up substantially due to benefits of input credit of taxes and the burden of reverse charge on purchases from unregistered suppliers of good and services. It is reported that as many as 1.6 lakh businesses which were earlier not

registered under VAT, service tax or excise duty, have now registered under GST<sup>122</sup> and thus it can be seen that the widening of taxpayer base has already begun. Analysis of data from the implementation of the unified tax will also help widen the direct taxpayer base and income tax collections.

Further action is still required to make demonetisation a success and to ensure digitisation of all financial transactions and widening of taxpayer base. Some points for action are:

#### **14.1 Electronic Cash Register (ECR)**

Though excellent steps have been taken to encourage digital transactions, there is a need to make the ECR compulsory for all businesses and professions, as has been done in East European and Central Asian countries, Turkey, Brazil, Bangladesh: in fact, more than 40 countries<sup>123</sup>, with connectivity to computers in the tax department. During 2016 and 2017, countries, such as, Austria, Belgium, Colombia, Mexico, Moldova, Romania, Turkey, Russia, Slovenia, Czech Republic, Norway, Hungary statutorily introduced fiscal cash registers with provision for automatic transfer of transaction data to the computers of the tax department. Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, Guatemala, Italy, the People's Republic of China, Peru, Rwanda and Uruguay have introduced electronic invoicing. Germany, France are also going to statutorily introduce fiscal cash registers connected to the tax departments. The success of this single measure is apparent from the experiences of Slovenia and Mexico: In Slovenia<sup>124</sup>, for example, the total turnover of taxpayers using cash registers in the period February-April 2016, was EUR 5.4 billion, which, compared to the same period of the previous year had increased by EUR 293.3 million (5.7%). Mandatory electronic invoicing in Mexico brought 4.2 million micro-businesses into the formal economy<sup>125</sup>. In fact, in Brazil, invoices/receipts issued by sellers carry a QR Code, which on being scanned with their smart mobile phone or tab enables the purchaser to see the transaction recorded in the database of the tax department. These technological innovations with statutory backing must be introduced to bring in transparency and accountability in reporting and is something that can be explored within the Indian system. However, before the introduction of ECR the Government may involve all stakeholders including the State Governments to properly plan the practical and technological aspects and educate businesses on its usage.

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<sup>122</sup> Press Trust of India (2017), '1.6 lakh new businesses register on GSTN in 4 days', The Hindu Business Line, available at <http://www.thehindubusinessline.com/economy/16-lakh-new-businesses-register-on-gstn-in-4-days/article9741431.ece> (accessed on July 31, 2017)

<sup>123</sup> Singh, R.R. and Manchanda, S. (2016), Widening of Taxpayer Base, Singh, R.R. (ed.) (2016), Challenges of Indian Tax Administration, Lexis Nexis, New Delhi

<sup>124</sup> Sales Data Controller (2016), Slovenia: Half year since certified cash registers rollout, available at <http://www.salesdatacontroller.com/slovenia-half-year-since-certified-cash-registers-rollout/> (accessed on October 1, 2017)

<sup>125</sup> OECD (2017), Technology Tools to Tackle Tax Evasion and Tax Fraud, OECD Publishing, Paris, available at <http://www.oecd.org/tax/crime/technology-tools-to-tackle-tax-evasion-and-tax-fraud.pdf> (accessed on October 1, 2017)

## **14.2 Use of Geographic Information Systems (GIS)**

GIS is extensively used for mapping properties with details of owners, occupants, nature of use, business or profession carried out from the premises, etc., in many cities, either by municipal bodies or by private parties. It has resulted in widening the municipal taxpayer base as well as a manifold increase in municipal tax collections in Bengaluru. It is advisable that the Income Tax department obtains GIS map and data from various sources and integrates that with the 360-degree profiling being done for every person to identify all businesses and professions being run in every city, especially in residential areas, and bring them to tax. It is well known that all rental incomes are not disclosed: rented commercial and residential properties can be identified and rental income brought to tax. Electronic streetwise, building-wise registers and maps should be prepared with business and individual taxpayer data included.

The photograph of the building below in a middle-income level commercial area shows a number of sign boards with names of businesses and their mobile numbers and a known address. One can say, fairly certainly, that neither the Income Tax Department nor the Commercial Taxes Department of the Delhi Government will be in a position to say how many business enterprises operate in this building, how many are already taxpayers, how many have taxable incomes and how many do not have taxable incomes. A passive survey noting names, mobile numbers and addresses of such properties is carried out and integrated with GIS data the Department could develop a complete streetwise and building-wise listing of all the businesses.



This data can be analysed together with other demonetisation data and third party information, linking transactions and PANs.



### 14.3 Maintenance of land/property details

Land and immovable properties in benami names have been a major curse and conduit for black money. It is suggested that land and property details be electronically maintained in Torrens system or Cadastre system. If implemented in India, this will not only help in creating a correct digital record of all immovable properties but also help in identifying the real owners of these properties and bringing them within the tax net also reining in harassment of genuine owners. These properties must be linked to the PAN and Aadhar numbers of the real owners as well.

### 14.4 Reducing service charge on card transactions

One must acknowledge that now business outlets and professionals in all metros and Tier 2 cities can be paid using have a number of digital payment options: indeed, even petty, road-side petty vendors accept payments through mobile wallets. The RBI's Annual Report<sup>126</sup> has shown that while the use of cheques has declined, digital transactions have been on the rise

<sup>126</sup> Reserve Bank of India (2017), Annual Report 2016-2017, Reserve Bank of India, Government of India, available at [https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/RBIAR201617\\_FE1DA2F97D61249B1B21C4EA66250841F.PDF](https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/RBIAR201617_FE1DA2F97D61249B1B21C4EA66250841F.PDF) (accessed on October 1, 2017)



since June, 2017 after a slight dip in the month of April, 2017. However, one of the reasons discouraging merchants and service providers from receiving card payments is the bank service charge, ranging from 1.4 percent to 3.6 percent. As a result of demonetisation, there has been a 21 percent reduction in currency circulation<sup>127</sup> and in order to encourage card transactions, bank service charges should ideally be waived completely. Immediately after demonetisation, the government had waived service charges on card transactions, but this cannot be expected to continue indefinitely. It is also true that banks also cannot be expected to provide services completely free of charge since they have to bear the cost of infrastructure and service. There is an opportunity, though for the government to reduce bank service charges owing to a reduction of 21% in circulation of paper money in the economy, and consequent savings on the printing cost of currency notes (INR 2.87 and INR 3.77 per note, for INR 500 notes and INR 1,000 notes is respectively<sup>128</sup>).

#### **14.5 Quoting of price inclusive of GST to be made mandatory**

The fact that collusive evasion of tax is a common phenomenon in society has been referred to earlier in this report. Shopkeepers or service providers tend to quote prices without including GST, but mention it when the customer offers to pay by card, and not cash. The purchaser is tempted deal in cash to avoid paying the GST amount. If it is made mandatory for all sellers and service providers to quote prices inclusive of GST, such a situation can be avoided and digital transactions encouraged. A moderate GST rate would also discourage collusive evasion.

#### **14.6 Reduction in GST rates to encourage digital transactions**

Along the lines of the incentive granted under the Income Tax Act for encouraging digital transactions, the purchasers of goods and services may be allowed an incentive of reduction of 2% in payment GST, if the payments are made in digital form. This would be a big incentive and encourage digital payments.

#### **14.7 Enabling broadband infrastructure**

Under the Bharat Net project, the government is proposing to provide broadband services to 1 lakh gram panchayats by December 2017<sup>129</sup>, which will be increased to 2.5 lakh gram

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<sup>127</sup> Times News Network (2017), 'In black money fight, I-T lens on 14,000 property dealings', The Times of India, available at <http://timesofindia.indiatimes.com/business/india-business/in-black-money-fight-i-t-lens-on-14000-property-dealings/articleshow/60316430.cms> (accessed on October 1, 2017)

<sup>128</sup> Press Trust of India (2017), 'Cost of printing Rs 500, Rs 1000 notes Rs 2.87, Rs 3.77 each says govt; total cost not revealed', First Post, available at <http://www.firstpost.com/business/cost-of-printing-rs-500-rs-1000-notes-rs-2-87-rs-3-77-each-says-govt-total-cost-not-revealed-3337058.html> (accessed on October 1, 2017)

<sup>129</sup> IANS (2017), 'Broadband connectivity in 1 lakh gram panchayats by year end: Union Minister', Business Standard, available at [http://www.business-standard.com/article/news-ians/broadband-connectivity-in-1-lakh-gram-panchayats-by-year-end-union-minister-117090801438\\_1.html](http://www.business-standard.com/article/news-ians/broadband-connectivity-in-1-lakh-gram-panchayats-by-year-end-union-minister-117090801438_1.html) (accessed on October 1, 2017)

panchayats by December 2018<sup>130</sup>. This needs to be expedited and implemented in a time-bound manner.

#### **14.8 Security of personal and transactional information:**

Since trillions of transactions relating to billions of people will be on record in government and private systems, there is an immediate need for a futuristic data protection law and increased awareness and adoption of a data security culture.

#### **14.9 Filing of returns to be made mandatory**

Filing of returns by all eligible people must be made mandatory as non-filing or exemptions granted from filing of returns under the Income Tax Act creates gaps in the database, which not only hinders the widening of taxpayer base but also hinders proper data analysis. In fact, every PAN holder must be asked to file a return, whether they have taxable income or not. This will ultimately also help in cleaning up the Below Poverty Line database and prepare the groundwork for introducing the 'Universal Basic Income Scheme'<sup>131</sup> aimed at reducing poverty. In USA and Canada, even students receiving scholarship are required to file income tax returns. The Canadian Revenue Agency uses tax returns to determine need of persons requiring benefits to be provided by the Government and also disburses these benefits to recipients.

#### **14.10 Bolster information technology capabilities**

Each business and profession that operates in the black money domain or informal economy has its own *modus operandi* and processes. Even money which has been deposited with or exchanged from the banks by various sections of citizens needs different treatment. In-depth knowledge about these is essential for the data analytics team of the Income Tax department. For this, it would be desirable to create a very robust and large information technology team in the Directorate of Income Tax (Systems) headed by one Additional Director General of Income Tax (DGIT(S)), with a number of sub-teams headed by Additional Directors of Income Tax for each business, profession, or vertical operating in the black money domain or informal economy.

#### **14.11 Tracking of transactions with different IDs**

Names and transactions with different IDs and addresses can be linked by the DGIT(S) team using MDM, SAS and other analytical software. The following points are recommended:

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<sup>130</sup> Kala, R.R. (2017), 'Bharat Net, intended to connect 2.5 lakh gram panchayat with high speed Internet, set to be delayed; PMO cracks whip against DoT', Financial Express, available at <http://www.financialexpress.com/economy/bharat-net-intended-to-connect-2-5-lakh-gram-panchayat-with-high-speed-internet-set-to-be-delayed-pmo-cracks-whip-against-dot/767535/> (accessed on October 1, 2017)

<sup>131</sup> Ministry of Finance (2017), Economic Survey 2016-2017, Vol. 2, A69, Economic Division, Department of Economic Affairs, Ministry of Finance, Government of India, New Delhi, available at [http://www.indiabudget.gov.in/e\\_survey2.asp](http://www.indiabudget.gov.in/e_survey2.asp) (accessed on July 31, 2017)

- (i) All demonetisation data, including all historical data, available with the Department, to be analysed by data analytics software.
- (ii) Based on all the annual data, including data from returns of taxes deducted at source (TDS) and Taxes collected at source (TCS), taxes paid, information obtained and received from all third party sources in its possession must be collated and analysed. Once it is established that the income of the person has crossed the tax exemption limit and has taxable income, the Department should send **“Pre-Filled”** returns to each and every person irrespective of the category that the individual falls in (high-risk or high-value) This will be a non-intrusive, tax friendly action and will warn wrongdoers about their liability and make them comply. It will also go a long way in changing the culture of non-compliance.
- (iii) All returns must be filed and processed at the Central Processing Centre and only a limited number of cases with maximum revenue potential should be picked up for scrutiny through Computer Aided Scrutiny Selection (CASS).
- (iv) No notices to be issued, nor enquiry to be made nor any immediate scrutiny to be carried out. Only letters/emails, with complete details of transactions, to be sent to the concerned people; asking them to either explain their transactions or to file their returns and pay tax. This is, in fact, already being done.
- (v) There must be mixed examples of large, medium, and small income cases to send out a clear message that no one will be allowed to get away.

#### **14.12 360-degree profiling**

It is essential that all transactional data from every available source for all years pertaining to each person, including demonetised money deposited or exchange with the banks, must be collected, collated and analysed to create proper taxpayer profiles as well as histories using Master Data Management. Individual or entity-based relationships must also be built using latest data analytics and mining software tools available with the Income Tax department. It is essential not to restrict action in cases belonging to persons with only high-value and high-risk transactions, but every single person crossing the exemption limit, should be asked to file a return or, preferably, be sent a pre-filled return asking them to file their return so that the culture of non-compliance can change. There is a need to add up all the transactions, investments, expenditure, and income along with the deposits made in the banks pursuant to demonetisation, for each taxpayer in a meaningful and logical manner, in order to have foolproof evidence against defaulters. The Government/Department must not be in a hurry to begin action without proper marshalling and analysing data and facts as the Income Tax Department has six years time from the end of March 2017 to initiate tax proceedings.

#### **14.13 Facilitating ease of doing business**

As pointed out at the end of para 10 earlier, the major reason that a large number of businesses do not follow formal and legal channels, is that the money they have to spend on bribe etc., in

obtaining business premises, starting the business and expanding it. Much has been done by the government to improve the ease of doing business: the Department of Industrial Policy & Promotion has issued extensive directives and questionnaires to ensure end-to-end digital/online transactions right from obtaining registrations/permits or licences, to obtaining allotments of land, etc., to various compliances. In reality, a lot is not happening on the ground and a physical interface/contact persists. If human interaction is eliminated by clear entitlements, end-to-end online processes for all activities including inspections and scrutiny, etc., only then payments of rents (bribe) in cash will be eliminated and businesses encouraged to formalise.

## **15. Conclusion**

Dealings in cash, black money, and corruption have been rampant throughout the country for a long time. These have also prompted a culture of non-compliance with respect to taxes leading to a narrow taxpayer base. A very small percentage of honest and compliant taxpayers have increasingly been bearing the burden of running the development and welfare schemes of the government. There is a glaring disparity in income across society and the wealth of people with unaccounted for incomes, but the government and the common man appear to be helpless. Ostentatious expenditures incurred by such non-compliant citizens is not fair to honest taxpayers.

Since 1946, successive governments have carried out demonetisation exercises to weed out black money from the economy and have introduced disclosure/amnesty schemes on the premise that citizens with unaccounted for money and wealth need to be given an opportunity to come clean.<sup>132</sup> It is well known that steps to curb black/unaccounted-for money will increase recorded transactions resulting in widening the taxpayer base and increased tax collections.

All disclosure schemes introduced from 1951 to 1997 were opportunities that were provided to holders of unaccounted/black money to declare their undisclosed income and wealth at rates of tax and penalty lower than those prevailing, but these disclosure/amnesty schemes were unethical and an insult to honest taxpayers.

The current government provided three schemes: The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015; Income Declaration Scheme, 2016; and Pradhan Mantri Garib Kalyan Yojana (PMGKY), for declaring unaccounted income and wealth, albeit at tax and penalty rates slightly higher than existing rates.

The demonetisations of 1946 and 1978 failed on account of sparse banking coverage in the country, negligible use of recorded transactions and complete reliance on manual working in the banks as well as in the Income Tax department. The demonetisation of 2016 has the benefit of almost 100% banking coverage, the presence of the taxpayer identification number (PAN) and the citizen identification number (Aadhaar), comparatively high use of digital transactions, extensive computerisation in the banking sector and in various government departments,

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<sup>132</sup> Khan, S.S. (2012), Tax Amnesties in India, Tax India International, available at <https://taxindiainternational.com/columnDesc.php?qwer43fcxzt=NzU=> (accessed on July 31, 2017)

especially the Income Tax department, which has state-of-the-art hardware, software, data and data analytics software supported by an excellent team of officers.

This demonetisation is a golden opportunity to widen the taxpayer base. This is also a big opportunity for the government to convert all financial and commercial transactions from manual to digital eventually eliminating corruption and black money. It will also make it easier to engage in business and allow the economy to grow.

It is well-known that recipients of black money invest or convert it into other assets which may or may not be in their own name or could be in benami names. While estimates of the quantum of black money have been made, there is no estimate of how much is held in other forms such as gold, jewellery, or land. Demonetisation might help eliminate black money in the form of currency notes but cannot tackle black money converted into other forms. Greater use of technology by the Income Tax department will be very useful in this endeavour.

While acknowledging that demonetisation and the introduction of GST slowed down the economy to a certain degree, it is felt that these two measures and the processes under GST and actions taken by the Income Tax Department, will definitely lead to considerable formalisation of the economy. This is a massive economic culture change; short-term pain and an economic slowdown should not deter the government and the nation from going forward. Formalisation will improve the environment for business, widen the tax base and considerably increase tax collections. Patience and perseverance are necessary for a few years.

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## Annexures

### Annexure 1: Estimates of Black Money and Amounts Disclosed under Various Disclosure Schemes

	Scheme	Amount of income / wealth disclosed (in INR crore)	Tax paid (in INR crore)	Estimate of black money (in INR crore)	Estimated percentage of black money Declared
1.	<b>Voluntary Disclosure Scheme, 1951</b>	70	11	N.A.	N.A.
2.	<b>Voluntary Disclosure Scheme, 1965</b>	52.11	29	1,000	5.21
3.	<b>Second Disclosure Scheme, 1965</b>	145	20	1,000	14.5
4.	<b>Voluntary Disclosure Scheme, 1975</b>	Income - 738 Wealth - 790	241	9,958 to 11,870	6.76*
5.	<b>Amnesty Circulars, 1985</b>	700	N.A.	100,000 or 20% of GDP in 1983-84	0.7
6.	<b>Voluntary Disclosure of Income Scheme (VDIS), 1997</b>	33,697	9,729	4,00,000 or 40% of GDP in 1995-96	8.42

\*Calculated using the figure for 'Income' and the average of the range of 'Estimate of Black Money'  
Source: Extracted from Khan (2012) and National Institute of Public Finance and Policy reports

### Annexure 2: Currency Notes in Circulation as of November 2016 and Demonetised w.e.f. November 8/9, 2016

Denomination of Currency Notes	Date	Volume of Notes (in billions)	Value of Notes (in trillions)
Total paper money in circulation	November 2016	90.266	17.974
INR 500 in circulation	March 2016	15.7	7.850
	November 2016	16.5	8.580
INR 1,000 in circulation	March 2016	6.33	6.330
	November 2016	6.7	6.860
INR 1,000 and INR 500	November 2016	23.2	15.440

Source: Extracted from RBI (2016), *Weekly Statistical Supplement*, available at <https://www.rbi.org.in/Scripts/WSSView.aspx?Id=20999> (accessed on September 25, 2017), Reply to Rajya Sabha Question on November 29, 2016 in Pawariya, A. (2016), 'How much of the 'demonetised' currency is actually coming back?', *Swarajyamag*, available at <https://swarajyamag.com/economy/how-much-of-the-demonetised-currency-is-actually-coming-back> (accessed on September 25, 2017)

### Annexure 3: Data on GDP and Black Money

Financial Year	Gross Domestic Product (GDP) (in INR Crore)	Black money (in INR Crore)
1975-76	684,634	112,965
1980-81	798,506	335,373
1983-84	936,270	187,254
1987-88	1,094,993	558,446
1990-91	1,347,889	471,761
1995-96	1,737,741	695,096
2012-13	5,482,111	1,425,349

Source: Extracted from Ministry of Finance (2012), *White Paper on Black Money*, Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, New Delhi, available at [http://www.prsindia.org/uploads/media/White%20Paper%20Black%20Money/WhitePaper\\_BackMoney2012.pdf](http://www.prsindia.org/uploads/media/White%20Paper%20Black%20Money/WhitePaper_BackMoney2012.pdf) (accessed on July 31, 2017); Planning Commission (2014), *Data-book Compiled for Use of Planning Commission*, Planning Commission, Government of India, available at [http://planningcommission.nic.in/data/datatable/data\\_2312/comp\\_data2312.pdf](http://planningcommission.nic.in/data/datatable/data_2312/comp_data2312.pdf) (accessed on July 31, 2017); McKinsey and Co. (2016), *Forging a Path to Payments Digitisation*, McKinsey on Payments (16), available at [https://www.mckinsey.com/~media/mckinsey/dotcom/client\\_service/financial%20services/latest%20thinking/payments/mop16\\_forging\\_a\\_path\\_to\\_payments\\_digitization.ashx](https://www.mckinsey.com/~media/mckinsey/dotcom/client_service/financial%20services/latest%20thinking/payments/mop16_forging_a_path_to_payments_digitization.ashx) (accessed on July 31, 2017)

#### Annexure 4: Potential Taxpayers among Salaried, MSMEs, Professionals, and Companies

	Category	Sub Category	Actual Number	As on Date/Year	Returns filed with concerned ministry	ITR No.	IT Returns filed
1	Salaried		4.2 crore (42,000,000)	February 1, 2017	N.A.	ITR-1	21,455,515
	Total number of MSME and Professionals	Registered MSMEs	51,300,000	2015-2016	N.A.	ITR-3, ITR-4, ITR-4S, ITR-5	26,477,325
		Registered Doctors	978,735	March 31, 2016	N.A.		
		Registered Dental Surgeons	197,734	December 31, 2016	N.A.		
2		Registered AYUSH Doctors	771,468	January 1, 2016	N.A.		
		Registered Nurses	2,778,248	December 31, 2015	N.A.		
		Registered Pharmacists	741,548	November 15, 2016	N.A.		
		Number of Registered Advocates	1,300,000	2011	N.A.		
		Registered Architects	63,791	September 22, 2017	N.A.		
		Total	58,131,524				
3	Companies		1,613,000		1,143,000	ITR-6	801,115
4	Grand Total		10,17,44,000				4,87,33,955

Source: Extracted from multiple reports and websites<sup>133</sup>

<sup>133</sup> Ministry of Finance (2017), Speech of Arun Jaitley, Minister of Finance, Union Budget 2017-2018, Ministry of Finance, Government of India, available at <http://www.indiabudget.gov.in/ub2017-18/bs/bs.pdf> (accessed on July 31, 2017)  
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**Annexure 5: Comparison of Growth: Taxpayers and Direct Tax Collections**

Financial Year	Number of Taxpayers Filing Returns (in Crore)	Number of PAN Issued (in Crore)
2001-02	14.0	1.3
2002-03	8.5	16.7
2003-04	2.6	20.9
2004-05	-7.0	20.9
2005-06	9.6	19.6
2006-07	7.2	28.2
2007-08	5.5	26.8
2008-09	-3.0	5.8
2009-10	4.4	11.7
2010-11	16.4	15.2
2011-12	4.5	9.7
2012-13	9.7	11.6
2013-14	10.5	12.5
2014-15	7.6	8.2
2015-16	6.6	6.2
2016-17	2.3	12.7

*Source: Calculated by authors using data extracted from Annual Reports, Ministry of Finance, Government of India and Website of the Income Tax Department, Government of India*

Note: From Financial Year 2010-11, in addition to the number of returns filed, the number of non-zero TDS cases where no ITR is entered in the System has also been included in the total number of assesses.

**Annexure 6: Number of Taxpayers Filing Returns vs. Total Number of PANs Issued**

Financial Year	Number of Taxpayers Filing Returns (in Crore)	Number of PANs Issued (in Crore)
2009-10	3.5	9.6
2010-11	3.6	12.1
2011-12	3.6	14.8
2012-13	3.7	16.5
2013-14	3.0	20.5
2014-15	3.4	21.8
2015-16	4.3	24.0
2016-17	5.3	26.8*
2017-18	3.2***	32.42**

\* As on December 30, 2016 \*\* As on July 17, 2017 \*\*\* As on August 31, 2017

*Source: Extracted from Annual Reports, Ministry of Finance, Government of India and E-filing website of the Income Tax Department, Ministry of Finance, Government of India*

<https://www.coa.gov.in/index1.php?lang=1&level=1&sublinkid=376&lid=330> (accessed on September 22, 2017)

MCA (2017), Annual Report 2015-2016, Ministry of Corporate Affairs, Government of India, published on January 3, 2017, available at [http://reports.mca.gov.in/Reports/2nd%20Annual%20Report%20Companies%20Act%20\(03.01.17\).pdf](http://reports.mca.gov.in/Reports/2nd%20Annual%20Report%20Companies%20Act%20(03.01.17).pdf) (accessed on September 22, 2017)

## Annexure 7: Digital Financial Transactions: Trends in NEFT, RTGS, ECS and Mobile Banking

Month, Year	NEFT*		RTGS#	
	Volume of Transactions (in Millions)	Value of Transactions (in INR Billion)	Volume of Transactions (in Millions)	Value of Transactions (in INR Billion)
March, 2012	27.11	2,403.89	5.91	49,670
March, 2013	47.09	3,602.48	6.8	60,038
March, 2014	82.83	5,312.25	8.2	65,212.63
March, 2015	106.00	7,173.09	9.26	79,645.95
March, 2016	129.24	10,226.36	9.48	84,661.99
April, 2016	111.84	8,324.52	7.97	55,515.68
October, 2016	133.21	9,504.50	8.67	65,533.86
November, 2016	123.05	8,807.88	7.56	66,880.17
December, 2016	166.31	11,537.63	8.47	72,702.57
January, 2017	164.19	11,355.08	8.98	68,863.65
February, 2017	148.21	10,877.91	8.79	66,382.31
March, 2017	186.70	16,294.50	12.14	111,825.01
April, 2017	143.17	12,156.17	9.23	73,603.70
May, 2017	155.82	12,410.81	10.01	80,716.62
June, 2017	152.34	12,694.20	9.51	83,330.95
July, 2017	148.14	12,011.60	9.07	77,675.80
August, 2017	151.61	12,500.38	9.16	79,157.81

\*Total Outward Debits Volume and Value, #Inward Customer Volume and Value

Month, Year	ECS\$		Mobile Banking	
	Volume of Transactions (in Millions)	Value of Transactions (in INR Billion)	Volume of Transactions (in Millions)	Value of Transactions (in INR Billion)
March, 2012	14.79	77.47	3.12	2.32
March, 2013	15.39	95.22	6.4	9.91
March, 2014	17.74	126.34	10.73	34.07
March, 2015	20.27	155.17	19.76	169.14
March, 2016	9.17	68.31	49.48	572.8
April, 2016	2.03	14.38	48.67	524.83
October, 2016	0.82	2.04	78.12	1,139.41
November, 2016	0.28	1.38	87.47	1,365.70
December, 2016	0.25	1.55	110.64	1,498.18
January, 2017	0.20	1.43	106.13	1,383.05
February, 2017	0.19	1.31	95.41	1,279.93
March, 2017	0.23	1.55	113.65	1,730.88
April, 2017	0.19	1.21	106.27	1,612.65
May, 2017	0.17	1.06	114.26	2,134.20
June, 2017	0.13	0.89	115.73	1,807.65
July, 2017	0.14	0.93	N.A.	N.A.
August, 2017	N.A.	N.A.	N.A.	N.A.

\$ECS (Debit) Volume and Value

Source: Extracted from RBI (2017), Data on Bankwise Volumes in ECS/NEFT/RTGS/Mobile Transactions, available at <https://m.rbi.org.in/scripts/NEFTView.aspx> (accessed on September 14, 2017)

## Annexure 8: ATM/POS/Debit and Credit Card Statistics

Month, Year	Number of ATMs (in Thousands)	Number of POS* (in Thousands)	Increase in Number of POS (in Thousands)
March, 2012	95.69	660.92	N.A.
March, 2013	114.01	854.29	193.37
March, 2014	160.06	1,065.98	211.69
March, 2015	181.40	1,126.74	60.76
March, 2016	199.10	1,385.67	258.93
April, 2016	199.95	1,403.44	17.77
October, 2016	205.15	1,512.07	108.63
November, 2016	205.41	1,590.71	78.64
December, 2016	205.86	1,767.73	177.02
January, 2017	206.61	2,015.85	248.12
February, 2017	207.40	2,224.98	209.13
March, 2017	208.35	2,529.14	304.16
April, 2017	207.81	2,614.58	85.44
May, 2017	208.48	2,692.99	78.41
June, 2017	208.48	2,776.95	83.96
July, 2017	208.21	2,840.11	63.16

\*Point of Sale

Month, Year	Credit Card		
	Number of Outstanding Cards as at Month end (in Millions)	Volume of Transactions (in Millions)	Value of Transactions (in INR Billion)
March, 2012	17.65	28.95	89.58
March, 2013	19.54	35.84	112.71
March, 2014	19.18	46.40	147.15
March, 2015	21.11	57.34	181.33
March, 2016	24.51	72.83	229.75
April, 2016	24.86	73.42	230.11
October, 2016	27.34	89.49	302.42
November, 2016	27.78	98.31	266.99
December, 2016	28.32	116.46	312.37
January, 2017	28.85	113.24	328.62
February, 2017	29.08	95.35	288.95
March, 2017	29.84	108.10	336.20
April, 2017	30.37	107.06	333.76
May, 2017	30.86	115.88	364.02
June, 2017	31.48	110.03	357.50
July, 2017	32.06	111.38	342.15

Month, Year	Debit Cards		
	Number of Outstanding Cards as at Month end (in Millions)	Volume of Transactions (in Millions)	Value of Transactions (in INR Billion)
March, 2012	278.28	501.70	1,363.70
March, 2013	331.20	527.38	1,623.28
March, 2014	394.42	628.48	1,881.87
March, 2015	553.45	700.31	2,095.76
March, 2016	661.82	844.59	2,380.45
April, 2016	671.19	851.68	2,400.13
October, 2016	739.28	942.65	2,767.23
November, 2016	744.58	797.82	1,556.26
December, 2016	761.12	1,045.93	1,429.65
January, 2017	817.98	1,040.97	2,006.48
February, 2017	839.98	944.32	2,286.81
March, 2017	854.87	981.28	2,616.45
April, 2017	867.00	928.32	2,543.41
May, 2017	880.03	920.20	2,535.54
June, 2017	793.83	922.47	2,632.17
July, 2017	804.05	957.69	2,614.11

Source: Extracted from RBI (2017), Data on Bankwise ATM/POS/Card Statistics, available at <https://rbi.org.in/scripts/atmview.aspx> (accessed on September 14, 2017)

#### Annexure 9: Cash Money in Circulation

2007	2008	2009	2010	2011	2012
90.6%	90%	89.7%	89.5%	87.9%	86.6%

Source: Extracted from Mazzotta, B.D. et. al. (2014), The Cost of Cash in India, The Institute for Business in the Global Context The Fletcher School, Tufts University, available at <http://fletcher.tufts.edu/~media/Fletcher/Microsites/Cost%20of%20Cash/COC-India-lowres.pdf> (accessed on September 22, 2017)

## **Annexure 10: Demonetisation – Measures to mitigate hardships**

### **Calibrated Adjustment of Limits for Exchange of Specified Bank Notes (SBNs)**

- The exchange facility of specified bank notes (SBNs) at banks, which was initially allowed up to INR 4,000, was increased to INR 4,500. It was reduced to INR 2,000 (effective November 17, 2016). This facility was subsequently discontinued effective November 25, 2016 at banks, but was available at RBI counters up to December 30, 2016.

### **Withdrawal Limit from Automated Teller Machines (ATMs)**

- The limit for cash withdrawal from ATMs, which was initially set at INR 2000 per day, was enhanced to INR 2500 per day and further to INR 4500 and INR 10,000 and was withdrawn from February 1, 2017.

### **Gradual Relaxation of Limits on Withdrawal from Bank Accounts**

- The limit of withdrawal from saving account, which was initially stipulated at INR 20,000 per week, was revised to INR 24,000 and further to INR 50,000 per week (effective February 20, 2017). Effective March 13, 2017, there will be no limit on cash withdrawals from savings accounts.
- Current account withdrawal of INR 50,000 per week was enhanced to INR 1, 00,000 per week effective January 16, 2017. Limit on cash withdrawals from current accounts was removed effective January 30, 2017.
- Cash withdrawals from the bank deposit accounts up to INR 2,50,000 were allowed from November 21, 2016 to meet wedding-related expenses.

### **Deposit of SBNs**

- Deposits of SBNs in bank accounts were permitted up to December 30, 2016.
- The facility for exchange of SBNs for the residents, who could not avail the facility from November 9 to December 30, 2016 on account of their absence from India during the aforementioned period, was made available at the RBI up to March 31, 2017 and for non-resident Indian citizens up to June 30, 2017.

### **Other measures**

- Banks were advised to waive ATM charges on withdrawals between November 10 and December 30, 2016.
- The limit for cash withdrawal at POS (for debit cards and open system prepaid cards issued by banks in India) was made uniform at INR 2000/- per day across all centres for all merchant establishments enabled for this facility and customer charges were not to be levied on such transactions from November 18, 2016 to December 30, 2016.

*Source: Extracted from RBI (2017), Macroeconomic Impact of Demonetisation – A preliminary assessment, Reserve Bank of India, Government of India, available at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/MID10031760E85BDAFEFD497193995BB1B6D BE602.PDF> (accessed on September 22, 2017)*



**Annexure 11: Increase in digital transactions by the Central and State Governments**

Year	Volume of Digital Transactions (in crore)
2013	241.76
2014	357.70
2015	760.75
2016	1089.80
2017 (up to June 25, 2017)	737.35

Source: Extracted from Ministry of Electronics and Information Technology, Electronic Transaction Aggregation & Analysis Layer (etaal), Government of India available at <http://etaal.gov.in> (accessed on September 22, 2017)

**Annexure 12: Spread of banking in the country**

Year	No. of Banks	No. of Branches	No. of Accounts	Jan Dhan Accounts (in crore)
1946	22*	NA	NA	
1978	128	28,016	10,00,14,000	
2006 – 2007	183	71,839	51,91,99,207	
2007 – 2008	175	76,050	58,16,58,012	
2008 – 2009	170	80,547	66,23,02,403	
2009 – 2010	169	85,393	73,48,69,141	
2010 – 2011	169	90,263	81,0,129,353	
2011 – 2012	173	98,330	90,3200257	
2012 – 2013	155	1,05,437	104,51,04,595	
2013 – 2014	151	1,17,280	104,5104595	
2014 – 2015	152	1,25,672	143,98,92,283	14.72
2015 – 2016	221	1,34,858	164,6116,065 <sup>#</sup>	21.42
2016 – 2017	N.A.	N.A.	N.A.	28.17**

Source: Extracted from RBI (1978), Banking Statistics, Vol. 8. (June 1978 – December 1978), available at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/54899.pdf> (accessed on September 22, 2017) and Database on Indian Economy, RBI's Data Warehouse, Government of India, available at <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!9> (accessed on September 22, 2017)

\* In the year 1946, there were nearly 1,000 very small banks of which 22 became members of Indian Banks Association (IBA) which was established in the same year.

<sup>#</sup>51.44 crore savings accounts were seeded with Aadhar as on January 25, 2017

\*\*As on March 29, 2017, 21.99 crore RuPay cards were issued and 18.34 crore were linked to Aadhaar

## Annexure 13: Recent Policy Measures for Promoting Digital Payments

### I. Government of India

In the aftermath of the cancellation of the legal tender character of old ₹ 500 and ₹ 1,000 notes, there has been a surge in digital transactions through use of credit/debit cards and mobile phone applications/e-wallets, etc. To further accelerate this process, the Central Government announced on December 8, 2016, the package of incentives and measures for promotion of digital and cashless economy in the country as reproduced below: (<http://pib.nic.in/newsite/PrintRelease.aspx?relid=155137>)

- a. *The Central Government Petroleum PSUs shall give incentive by offering a discount at the rate of 0.75% of the sale price to consumers on purchase of petrol/diesel if payment is made through digital means.*
- b. *To expand digital payment infrastructure in rural areas, the Central Government through NABARD will extend financial support to eligible banks for deployment of 2 POS devices each in 1 lakh villages with population of less than 10,000. These POS machines are intended to be deployed at primary cooperative societies/milk societies/agricultural input dealers to facilitate agri-related transactions through digital means.*
- c. *The Central Government through NABARD will also support Rural Regional Banks and Cooperative Banks to issue “Rupay Kisan Cards” to 4.32 crore Kisan Credit Card holders to enable them to make digital transactions at POS machines/Micro ATMs/ATMs.*
- d. *Railways through its sub-urban railway network shall provide incentive by way of discount upto 0.5% to customers for monthly or seasonal tickets from January 1, 2017, if payment is made through digital means.*
- e. *All railway passengers buying online ticket shall be given free accident insurance cover of upto ₹ 10 lakh.*
- f. *For paid services e.g. catering, accommodation, retiring rooms etc. being offered by railways through its affiliated entities/corporations to the passengers, it will provide a discount of 5% for payment of these services through digital means.*
- g. *Public sector insurance companies will provide incentive, by way of discount or credit, upto 10% of the premium in general insurance policies and 8% in new life policies of Life Insurance Corporation sold through the customer portals, in case payment is made through digital means.*
- h. *The Central Government Departments and Central Public Sector Undertakings will ensure that transactions fee/MDR charges associated with payment through digital means shall not be passed on to the consumers and all such expenses shall be borne by them. State Governments are being advised that the State Governments and its organizations should also consider to absorb the transaction fee/MDR charges related to digital payment to them and consumer should not be asked to bear it.*
- i. *Public sector banks are advised that merchant should not be required to pay more than ₹ 100 per month as monthly rental for PoS terminals/Micro ATMs/mobile POS from the merchants to bring small merchant on board the digital payment eco system.*
- j. *No service tax will be charged on digital transaction charges/MDR for transactions upto ₹ 2000 per transaction.*
- k. *For the payment of toll at Toll Plazas on National Highways using radio-frequency identification technology (RFID) card/Fast Tags, a discount of 10% will be available to users in the year 2016-17.*

NITI Aayog announced the schemes Lucky Grahak Yojana and the Digi-*₹* Vyapar Yojana to give cash awards to consumers and merchants who utilise digital payment instruments for personal consumption expenditures on December 15, 2017. The scheme became operational with the first draw on 25th December, 2016 and will end with a Mega Draw on 14th April 2017. The scheme is focused on small transactions (entered into by common people) within the range of ₹ 50 and ₹ 3000. (<http://pib.nic.in/newsite/PrintRelease.aspx?relid=155418>)

- a. *Lucky Grahak Yojana [Consumers]: (i) Daily reward of ₹ 1000 to be given to 15,000 lucky Consumers for a period of 100 days; (ii) Weekly prizes worth ₹ 1 lakh, ₹ 10,000 and ₹ 5000 for Consumers who use the alternate modes of digital Payments such as UPI, USSD, Aadhar Enabled Payment System (AEPS) and RuPay Cards.*
- b. *Digi-*₹* Vyapar Yojana [Merchants]: (i) Prizes for Merchants for all digital transactions conducted at Merchant establishments; (ii) Weekly prizes worth ₹ 50,000, ₹ 5,000 and ₹ 2,500.*
- c. *Mega Draw on 14th of April: (i) 3 Mega Prizes for consumers worth ₹ 1 crore, 50 lakh, 25 lakh for digital transactions between 8th November, 2016 to 13th April; (ii) 3 Mega Prizes for merchants worth ₹ 50 lakhs, 25 lakh, 12 lakh for digital transactions between 8th November, 2016 to 13th April, 2017 to be announced on 14th.*

## II. Government of India: Budget 2017-18 Proposals

Main proposals made in the Union Budget, 2017-18 are reproduced below. <http://indiabudget.nic.in/ub2017-18/bs/bs.docx>

- (i) *At present, 8% of their turnover is counted as presumptive income for small and medium tax payers whose turnover is up to ₹ 2 crore. There is a proposal to make this 6% in respect of turnover which is received by non-cash means. This benefit will be applicable for transactions undertaken in the current year also.*
- (ii) *There is a proposal to limit the cash expenditure allowable as deduction, both for revenue as well as capital expenditure, to ₹ 10,000. Similarly, the limit of cash donation which can be received by a charitable trust is being reduced from ₹ 10,000/- to ₹ 2000/-.*
- (iii) *The Special Investigation Team (SIT) set up by the Government for black money has suggested that no transaction above ₹ 3 lakh should be permitted in cash. The Government has decided to accept this proposal. Suitable amendment to the Income-tax Act has been proposed in the Finance Bill for enforcing this decision.*
- (iv) *To promote cashless transactions, there is a proposal to exempt BCD, Excise/CV duty and SAD on miniaturised POS card reader for m-POS, micro ATM standards version 1.5.1, Finger Print Readers/Scanners and Iris Scanners. Simultaneously, I also propose to exempt parts and components for manufacture of such devices, so as to encourage domestic manufacturing of these devices.*

## III. Reserve Bank of India

The measures undertaken by the Reserve Bank are also detailed below.

- a) *Enhancement in the limit of semi-closed Prepaid Payment Instrument (PPI) with minimum details from ₹ 10,000/- to ₹ 20,000.*
- b) *Introduction of a new category of PPI for small merchants on a self-declaration basis with maximum value of ₹ 20,000/- at any point of time.*

- c) Extending the permission given to banks to issue prepaid instruments to a larger set of entities/employers such as unlisted corporates/partnership firms/sole proprietorship/public organizations such as municipal corporations, urban local bodies (employers) for onward issuance to their staff/employees/contract workers. Earlier this was permitted only for corporates listed on stock exchanges.
- d) Rationalisation of merchant discount rate (MDR) for transactions up to ₹ 2000/- (special measure) from January 1, 2017 to March 31, 2017.
- e) Customer charges waived on Immediate Payment Service (IMPS), Unified Payment Interface (UPI) and USSD-based \*99# platform transactions up to ₹ 1000/- from January 1, 2017 to March 31, 2017.
- f) In-principle approval given to National Payments Corporation of India (NPCI) for launching the Common App for UPI (BHIM App), design changes in USSD \*99# and Common App for enabling Aadhaar-based merchant payments (Aadhaar Pay).
- g) In-principle approval given to NPCI for launching the Pilot of National Electronic Toll Collection (NETC) system for facilitating electrification of toll payments.
- h) Rationalisation of Merchant Discount Rate (MDR) – draft circular issued for public comments on February 16, 2017.
- i) Supportive measures:
  - (i) All authorised card networks have been advised to standardise the quick response (QR) code so that inter-operability of transactions using this mechanism is possible. This inter-operable QR code (Bharat QR) was launched on February 20, 2017.
  - (ii) All authorised entities/banks issuing PPIs in the country have been advised to carry out a special audit by the empanelled auditors of CERT-IN on a priority basis and take immediate steps thereafter to comply with the findings of the audit report.

*Source: Extracted from RBI (2017), Macroeconomic Impact of Demonetisation – A preliminary assessment, Reserve Bank of India, Government of India, available at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/MID10031760E85BDAFEFD497193995BB1B6DBE602.PDF> (accessed on September 22, 2017)*

**Annexure 14: List of specified transactions for furnishing the ‘Statement of Specified Transactions’ under Section 114E of the Income Tax Rules**

	<b>Nature and Value of Transaction</b>	<b>Class of Person (Reporting Person)</b>
1	<p>a) Payment made in cash for purchase of bank drafts or pay orders or banker's cheque of an amount aggregating to ten lakh rupees or more in a financial year.</p> <p>b) Payments made in cash aggregating to ten lakh rupees or more during the financial year for purchase of pre-paid instruments issued by Reserve Bank of India under section 18 of the Payment and Settlement Systems Act, 2007 (51 of 2007).</p> <p>c) Cash deposits or cash withdrawals (including through bearer's cheque) aggregating to fifty lakh rupees or more in a financial year, in or from one or more current account of a person.</p>	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act).
2	Cash deposits aggregating to ten lakh rupees or more in a financial year, in one or more accounts (other than a current account and time deposit) of a person.	<p>(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act);</p> <p>(ii) Post Master General<sup>10</sup> as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898 (6 of 1898).</p>
3	One or more time deposits (other than a time deposit made through renewal of another time deposit) of a person aggregating to ten lakh rupees or more in a financial year of a person.	<p>(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act);</p> <p>(ii) Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898 (6 of 1898);</p> <p>(iii) Nidhi referred to in section 406 of the Companies Act, 2013 (18 of 2013);</p> <p>(iv) Non-banking financial company which holds a certificate of registration under section 45-IA of the Reserve Bank of India Act, 1934 (6 of 1934), to hold or accept deposit from public.</p>
4	<p>Payments made by any person of an amount aggregating to—</p> <p>(i) one lakh rupees or more in cash; or</p> <p>(ii) ten lakh rupees or more by any other mode, against bills raised in respect of one or more credit cards issued to that person, in a financial year.</p>	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act) or any other company or institution issuing credit card.
5	Receipt from any person of an amount aggregating to ten lakh rupees or more in a financial year for acquiring bonds or debentures issued by the company or institution (other than the amount received on account of renewal of the bond or debenture issued by that company).	A company or institution issuing bonds or debentures.

6	Receipt from any person of an amount aggregating to ten lakh rupees or more in a financial year for acquiring shares (including share application money) issued by the company.	A company issuing shares.
7	Buy back of shares from any person (other than the shares bought in the open market) for an amount or value aggregating to ten lakh rupees or more in a financial year.	A company listed on a recognised stock exchange purchasing its own securities under section 68 of the Companies Act, 2013 (18 of 2013).
8	Receipt from any person of an amount aggregating to ten lakh rupees or more in a financial year for acquiring units of one or more schemes of a Mutual Fund (other than the amount received on account of transfer from one scheme to another scheme of that Mutual Fund).	A trustee of a Mutual Fund or such other person managing the affairs of the Mutual Fund as may be duly authorised by the trustee in this behalf.
9	Receipt from any person for sale of foreign currency including any credit of such currency to foreign exchange card or expense in such currency through a debit or credit card or through issue of travellers cheque or draft or any other instrument of an amount aggregating to ten lakh rupees or more during a financial year.	Authorised person as referred to in clause (c) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999).
10	Purchase or sale by any person of immovable property for an amount of thirty lakh rupees or more or valued by the stamp valuation authority referred to in section 50C of the Act at thirty lakh rupees or more.	Inspector-General appointed under section 3 of the Registration Act, 1908 or Registrar or Sub-Registrar appointed under section 6 of that Act.
11	Receipt of cash payment exceeding two lakh rupees for sale, by any person, of goods or services of any nature (other than those specified at Sl. Nos. 1 to 10 of this rule, if any.)	Any person who is liable for audit under section 44AB of the Act.
12	Cash deposits during the period 09th November, 2016 to 30th December, 2016 aggregating to— (i) twelve lakh fifty thousand rupees or more, in one or more current account of a person; or (ii) two lakh fifty thousand rupees or more, in one or more accounts (other than a current account) of a person.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898 (6 of 1898).
13	Cash deposits during the period 1st of April, 2016 to 9th November, 2016 in respect of accounts that are reportable under Sl.No.12.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898 (6 of 1898).

Source: Website of the Income Tax Department, Ministry of Finance, Government of India available at <http://incometaxindia.gov.in/Rules/Income-Tax%20Rules/103120000000007545.htm> (accessed on September 22, 2017)

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