



## Demonetization : Reasons & Excuses

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### Abstract

*The first and foremost justification of demonetization of Rs 500/- and Rs. 1000/- was that it would reduce the huge pile-up of black money into a pulp of waste paper. It had also cited counterfeit currency menace as an equally important urgency. Tagged with it was also the reasons of terrorist funding with counterfeit currency to unleash mayhem in India. At last came the cashless economy argument, check Maoists hit no stone pelting in J & K, Municipalities making record recoveries of house tax. Similarly, many businessmen recovering past dues and getting advances for new orders. Prop art prices claimed to come down by 25%, democracy deepened. All caste/creeds standing in same queue.*

*Surprisingly, however, some very respected experts have virtually negative impact of the move by pushing argument that do not be befitted their intellectual acumen and integrity.*

*A very eminent administrator like former Chief Election Commission S.Y. Qureshi has also ventured to say that demonetization will be to good effect if it is going to take us forward on the path of long-cherished electoral reforms, Chiefly finding of political parties and elections.*

### Introduction

Historically, previous Indian Governments had demonetized bank notes. In January 1946, bank notes of Rs. 1000 and Rs. 10000/- were withdrawn and new notes of Rs. 1000/-, 5000/-, and 10,000/- were introduced in 1954. The Janata Party coalition government had again demonetized bank notes of Rs. 1000/-, 5000/- and 10000/- on 16<sup>th</sup> January 1978 as a means of curbing counterfeit money and black money. In 2012, The Central Board of Direct Taxes had recommended against demonetization saying in a report that demonetization may not be a solution for tackling black money or economy which is largely held in the form of 'benami' properties, bullion and jewellery. According to data from Income tax probes black money holders keep only 6% or less of their ill gotten wealth as cash hence targeting this cash may not be a successful strategy.

On 28<sup>th</sup> October 2016 the total bank notes in circulation in India was Rs. 17.77 Trillion. In terms of value the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued of Rs. 16.42 Trillion of which nearly 86% were RS. 500 and Rs. 1000 bank notes.

The Government of India devised an Income Declaration Scheme (IDS) which opened on 1<sup>st</sup> June and ended on 30<sup>th</sup> September 2016. Under the scheme the black money holders could come clean by declaring the assets paying the tax and penalty of 45% thereafter.

The Government of India vide their notification no. 2652 dated November 8, 2016 has decided to discontinue the legal tender character of high denomination bank notes of Rs. 500 and Rs. 1000/-. In other words such notes will not be a legal tender from midnight of November 8, 2016. This decision is being made to curb financing of terrorism through the proceeds of fake Indian currency Notes and for eliminating Black Money.

Demonetization does not mean that the currency notes available with the people are worthless. They still have equivalent worth as it had before The only thing which has happened that it has lost its tender for transactions in that market. The transaction through net banking, RTGS, NEFT and mobile wallets etc., are still unaffected.

### Recent steps by Government

In last two years, the government has taken a number of steps to curb the menace of



black money in the economy including setting up of a Special Investigation Team (SIT) enacting a law regarding undisclosed foreign income and assets, amending the double taxation avoidance agreement between India and Mauritius and India & Cyprus, reaching an understanding with Switzerland for getting information on Bank A/cs held by Indians with HSBC encouraging the use of non cash and digital payments, amending the 'Benami' Transaction Act and implementing the income declaration scheme 2016.

Among the key reasons that triggered the move was the moderate response to Income Declaration Scheme (IDS), which charged a onetime effective tax rate of 45% on undisclosed income or property giving a chance to domestic tax payers to declare undisclosed income or assets by September 30<sup>th</sup> 2016. The scheme offered immunity from prosecution under the Income Tax Act, Wealth Tax Act and 'Benami' Transactions (Prohibition) Act.

According to estimates the Government collected 65250 Crore resulting in Tax Revenue of Rs. 30000 Crore about 0.2% of GDP. The Government has also tried to deal the currency problem where 250 out of every 1 million notes are found fake, according to the data submitted by the Union Home Ministry to Parliament on May 3<sup>rd</sup> 2016.

#### Recommendations for Demonetization

There had been various recommendation for banning notes of higher denominations in the recent past. Following are elaborated below:

#### Cash Transactions

The special investigation team (SIT) has felt that large amount of uncounted wealth is stored and used in form of cash. Having considered the provisions which exist in this regard in various countries and also having considered various reports and observations of court regarding cash transactions the SIT felt that there is a need to put an upper limit to cash transactions. Thus SIT has recommended that there should be a total ban on cash transactions above Rs 3,00,000

and an act be frame to declare such transactions as illegal and punishable under law.

#### Cash Holding

The SIT has further felt that given the fact of unaccounted wealth being held in cash which are further confirmed by huge cash recoveries in numerous enforcement actions by law enforcements agencies from time to time the above limit of cash transactions can only succeed if there is a limitation on cash holding as suggested in its previous reports. SIT has suggested an upper limit of 15 lakhs on cash holding. Further, stating that in case any person or industry requires holding more cash, it may obtain necessary permission from the commissioner of Income tax of the area.

#### Demonetization Reasons

The availability of high denomination bank notes (Say Rs. 500 and Rs. 1000 notes) will facilitate the illicit transfer of money for financing transactions which are :

- (a) Harmful to the national economy or
- (b) Used for illegal activities.

Therefore it is necessary in the public interest to demonetize the high denomination bank notes. Few reasons behind such demonetization are :

1 Black Money &Corruption : The impact of black money usage will be temporary as those would eventually move to the new rupees 2,000 notes in time. Also a lot of the black money lies in real estate, gold & other physical things. Still even a temporary small impact on this factor is better than nothing. The mere fear of Government taking out your black money is good enough. That the Government could so secretly do this will increase the fear.

2 The financial Tax force : A globally body that looks at the criminal use of the international financial system, notes that high value bills are used in money laundering schemes, racketeering and drug and people trafficking.

3 Arms Smuggling, espionage and terrorist related activities will be chocked due to lack of finding.



4 A centre for media studies report showed that nearly Rs. 30000 Crores was spent during the 2014 general election, while official spending only accounted for Rs. 7000 Crores.

5 This is only scratches the surface major industries such as real estate have historically been conduits of black money.

6 Bringing out illicit money sloshed in the parallel economy.

7 Cashless Society incentivizing India to cashless economy. The banks would not hand you stack of the new cash but will just credit the money to your bank a/c in place of our old currency. The pain of transferring cash could incentivize many to think about going bits and plastic. Today could be a day to introspect for the legal users of the currency. That could have a more significant impact on counterfeiting and unaccounted money.

8 Counterfeiting – moving the notes to a more secure standard with better protection against counterfeiting. Many dealers with the existing counterfeit notes would be stuck as they would have to take the notes to the bank and have better chances of getting their racket exposed. Thus they are more likely to destroy their notes and incur losses. It would be quite hard to counterfeit the new currency and until they develop the technology for that, there will be an impact on counterfeit notes and terrorism that is funded through that.

9 Curbing inflation in real estate and reducing gold imports

10 Banking to all : The Govt's key objective is to bring banking to all and this will help that. If you have more than Rs 4000, the bank will not give you new notes but will just ask you to open an account and credit the amount in respective account.

However, there is no good estimate of India's Black money other than currency/physical notes such as gold, jewellery land or any other form of wealth. Therefore banning Rs. 500 and Rs. 1000 notes will have little effect on black money started away in foreign tax havens.

## Conclusion

In order to control the rising incidence of black money, fake notes, & terrorist funding the scheme to withdraw currency notes of Rs. 500 and Rs. 1000 has been introduced. This will bring the black money into the mainstream and by the injection of which the Indian Economy will get a boost and it may work against inflation as well. For fake currency this will act as a complete whitewash, as the government has discontinued the legal tender of Rs. 500 and Rs. 1000 notes. Terrorist funding will also be curbed by this decision as most of the funds of the terrorist organization are routed through cash.

## References

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