Union Budget 2017-18: Outlook

Budget in the Time of Demonetisation

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Demonetisation is a weapon to stop the black money in the country. But cash is only a small portion of black money. Also the economy has been affected by this step. How will the government tackle this situation through the coming Budget?

Budget is an annual financial statement of the Government's expected revenue and proposed spending. It is now a recognized political document. It embodies Government's policies and programmes, both on revenue and expenditure counts. It is an ongoing exercise, annual, and by its very continuity, takes the current scenario, economic social and political, as the base to move on. In a year, preceded by demonetisation of currency, a policy document, the budget, ought to, (for if it does not, demonetisation can die its own death) identify hit and uproot all mechanisms adopted to convert 'black cash' without payment of any taxes. This has happened post demonetisation, on an unimaginably large scale. That is why the talk around of a very high percentage (actual figures not yet available) of entire demonetized currency getting deposited in banks (as if to suggest there never existed a parallel economy). This is despite two opportunities in the near past to declare, pay the tax along with nominal penalty and lead a life free of tension. The audacious attitude, the utter disregard for Law of the Land, odious as it is, needs condemnation and punishment. One such modus operandi is narrated here (there may be more!).

At the ground level, post demonetisation, business community has clandestinely liquidated stocks (available in their books of account), showing fake sales, and deposited corresponding cash (the 'black cash' which was otherwise available with them) in their bank accounts. The cash thus deposited is in the garb of sale proceeds. In reality, the physical stock remains unsold and, as and when actually sold at a future point of time, shall not be accounted in the books of account (it is already shown sold in books of account) and resulting cash shall be pocketed leading to regeneration of black economy. In so adjusting unaccounted cash, accommodation of third party cash has also been done, though from a country perspective it is not material that cash belonged to a third party. Activities where monthly reporting is not required by any law had an open field, back-dating sales, perhaps from the beginning of the financial year.

Post 9th of November, substantial sales in cash were neither feasible nor legally valid, the latter because the old notes (of Rs. 500/- and 1000/-) had ceased to be legal tender, meaning one could not have transacted with that currency and, not feasible because, for once all Indians were alike being devoid of any legal tender worth the name. Government notification is unambiguous and categorical. The demonetized currency could only be deposited by banking channels (exceptional specified uses apart). Logical implication follows that such cash deposited in bank account as sale proceeds were actually "black" cash of the business itself. The situation demands budget to blast this scenario. Be it jewellers or retailers or manufacturers, the sales shown in books of account in illegal tender and deposited in bank account, the budget ought to provide, is deemed income. Section 2(24) of the Income Tax Act, defining income, should declare it to be so. Extremely harsh as it may seem, it really is the answer to the audacity.

There can be arguments of practical application of such a radical legislation. Well, there is a need to suspend scrutiny assessments that the department of income tax religiously undertakes year after year with undeclared ‘macro’ achievements. The total suspension has to be for five years during which the CPC becomes synonymous with the well known department and remains the final assessing authority. The entire work force can then be oriented towards identification of bank deposits (which is now a computerized process and data already flowing in) with assessees and identifying the modus operandi in the books of account. Law shall take care of the rest. Let the menace of black economy be set to rest.

An interesting feature of such an exercise is that it can be undertaken and income assessed at ANY time in future; there is no time limit for making assessment of such an income. Adequate amendments for this to happen are already in place.

The fictitious sales recorded in books of account in the scenario described shall regenerate ‘black cash’ when stocks are actually sold. It shall get stocked in the currency chests (or may be gunny bags) of this rich and affluent class of the country. The need of the hour is to stop this ‘HOARDING’, to set an upper limit to “cash holding”. The explicit philosophy of currency as a legal tender is an assurance by the apex bank backed by collateral securities to facilitate transactions by one and all. A substantial cost is incurred not only in printing but in management and supervision of the system. This cost is borne by each one of us. “Hoarding” of currency therefore not only disrupts the entire system but is an unnecessary physical cost on the country and has the ill-effects of inflation and widening of the disparities. In short, it is anti-national and the budget should hold it to be so. A graduated decline of the upper limit that an individual can hold is the need today. Be it 10 lakhs now and 1 lakh after five years, per individual, or whatever best thought of. The surplus, when identified, should be declared to be a criminal offence with confiscation and punishment in addition to consequences under the Income Tax Act.

Cash is only one small component of black-money that has been driving our economy. Gold jewellery and under-valued properties are the other major components. With sentiments attached to ornaments and jewellery, it is hard to visualize extreme steps. On the property (immovable) front, a new scenario has emerged in the recent years, that of official rates for documentation being substantially high, sometimes even higher than the prevailing market price. But that has not restrained transactions taking place much below the official rates even at the cost of paying higher documentation charges. That official rate, by whatever name called, evaluated for payment of documentation charges, needs to be declared the minimum permissible transaction rate. For then, those who absolve their undisclosed black cash in such property transactions shall be deprived of this channel. Simultaneously, there is a recognized need to do away with capital gain tax benefits, be it the shares sold through stock exchange or sale of immovable properties. Yes, there can be counter arguments of slackening of investments. Well, if that be the concern, restrict these benefits to affordable housing alone. Why all immovable properties and why share market. Who is benefiting! More than 90% of population cannot even afford a so called affordable house and more so, may not have a De-mat Account. Budget needs to address these issues.

There have been talks of doing away with so many exemptions and deductions. To some extent it is expected and required. But not at the cost of provisions for promoting geographical spread of trade and industry. There is a meagre number of tax payers in India. They are the identified class above the rest and should not be afforded the luxury of deductions and exemptions. Such provisions need total withdrawal. Yet one would expect the tax rates to go down.

The demonetization already has adversely affected economic performance of the country. It ought to. How long this will continue can only be a blind guess better not taken recourse to. The world has never experienced this kind of shock. The few historical instances were minuscule. At the macro level, neutralization is definitely required. This calls for an innovative mechanism to boost private investment in addition to government spending in selected sectors. This is likely to be supplemented with 'Direct Transfers' to the needy to boost demand and consequent positive impacts at the macro level. At least one expects that to happen. These efforts will be critically contingent upon reduction in liability of the apex bank, the Reserve Bank of India, consequent upon demonetization (to the extent of demonetized currency not getting deposited back in the banking channels and augmented by reduction in the quantum of currency now issued in comparison to earlier currency amounts in circulation). One has to wait and see the treatment that RBI adopts in its accounts and its effect upon income by way of higher dividends/reduction in collateral securities of government with RBI and resulting liquidity to which the government becomes eligible.

On the international taxation front, the revision of crucial treaties with Mauritius, Cyprus and Singapore having concluded with resounding expectations and with revised POEM guidelines already announced, the indirect transfer taxation issues of small investors will require address and clarity. The reporting structure of international transactions requires a fresh look to give more leverage of information to the tax administrator and at the same time to be in line with CBC reporting. The lead taken in taxing online advertisement payments under the separate code Equalization Levy requires strengthening to encompass a larger basket and a relook at the 6% rate.

Some statistical facts for common knowledge

As on March 31st 2016

- Currency with Public = Rs. 15,97,250 crores
    - This includes currency of all denominations including coins. Currency in denominations of Rs. 1000/- and Rs. 500/- which were demonetised were approximately 85% in value terms which comes to Rs.13, 57,662.5 crores.
- Money Supply (M3) = Rs. 1,16,17,620 crores
    - Money supply can be measured in a variety of ways, M3 being the most recognized measure adopted by Reserve Bank of India and includes, in addition to currency, demand deposits and time deposits with banks as also some deposits with Reserve Bank of India itself. Money supply is a multiple of currency held by public and the above figures suggest a multiple of 7.27

which is technically called the ‘multiplier’. The multiplier for unaccounted money is far higher than multiplier for accounted money.

- The corresponding figures as on 23rd December 2016 post demonetization was Currency with public at Rs. 7, 82,910 crores and money supply at 1,20,44,950 crores.
- Post demonetization Between November 10, 2016 and December 19, 2016 (for which data is available in public domain) currency with 5, 92,613 crores has been issued to public. The break up in terms of number of notes is very interesting. A total of 2260 crores number of currency notes were issued which included currency notes numbering 2040 crores in small denominations of hundred rupees and lower and only 220 crores in higher denomination of 2000/- and 500/-. This is contrary to general perception.

This article is dedicated to the philosophy of rational use of technology for generating reliable and far sighted solutions to social and economic problems.