# The Accounting Times


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## Demonetisation and its Effects

On November 8th India's prime minister, Narendra Modi, announced a course of action just as radical as that described above, if the converse of it. He declared that all 500- and 1,000-rupee notes—making up 86% of the cash in circulation in India—could no longer be used in shops. More financially mature economies than India would struggle to cope with such a scheme, but this one floundered at once. Though Indians have until the end of the year to swap their defunct bills, the roll-out of new ones has been bungled. A broad cash crunch and broken supply chains threaten a sharp economic slowdown—albeit one that will abate, at least in part, as the cash squeeze is alleviated. India's "demonetisation" is a cautionary tale of the reckless misuse of one of the most potent of policy tools: control over an economy's money.

Unlike most currency reforms, designed to boost confidence in the currency, Mr Modi's motivation is different. The primary aim of demonetisation is reasonable enough: the government hopes to improve the functioning of the economy and boost its tax take by cracking down on the shadow economy. The vast majority of transactions in India take place in cash; many escape book-keepers' notice. Economists reckon that India's black economy accounts for at least 20% of GDP. Such off-the-books activity shields fortunes from taxation and allows corruption to flourish. Past efforts to attract black money into the light—using tax amnesties, for example—have had little effect

The government claimed that the demonetisation was an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism, as well as a crack down on black money in the country.The move was described as an effort to reduce corruption, the use of drugs, and smuggling However, in the days following the demonetisation, banks and ATMs across the country faced severe cash shortages The cash shortages had detrimental effects on a number of small businesses, agriculture, and transportation, while people seeking to exchange their notes had lengthy waits, and several deaths were linked to the rush to exchange cash.Also, following Modi's announcement, the BSE SENSEX and NIFTY 50 stock indices crashed for the next two days.

The demonetisation received support from several bankers as well as from some international commentators, although it was criticised by members of the opposition parties, which led to debates in both houses of parliament and triggered organised protests against the current government in front of the parliament and elsewhere across India.[13][14]

***The demonetization is going to have aheavy adverse impact on the following sectors:***

**Black money hoarders -** A recent study had pegged India's black market economy at over Rs 30 lakh crore or about 20 percent of total GDP. This is even bigger than the GDP of countries like Thailand and Argentina. The black money holders are now left with just two options – deposit the money in banks, declaring it to be their income or burn all of it. In first case, the question arises that how did they earn that income? Their files would be subjected to scrutiny and a minimum tax of 60 percent (30 percent general tax rate with 100 percent penalty) would be payable on the declared amount if it is found to be undisclosed previous income. Even if they show this as income in the normal course of business, they will have to pay taxes on it as per current rate.

**Fake note circuits -** Militants operating against India use fake notes of Rs 500 and Rs 1000 (total worth about $7.50 at current exchange rates, source : Media Report). But have you ever thought about how these militants and terrorists get their money? Enemies from across the border run their operations using fake currency notes. Hence, the withdrawal of these currency notes is equivalent to carrying out a surgical strike on these people.

**Illegal election fundings -** We all know how much black money is used by political parties. It will be a very tough task to use trucks of money at least for the upcoming five state elections.

**Rural economy** - A very strong criticism of the scheme that came across is the possible draconian impact it can have on the rural economy. India reportedly has somewhere around 10 lakh bank branches all over India. However, there are 6.8 lakh villages alone and most of these villages are without a bank. Rural economy mostly thrives on currency transactions. Most of the population does not even have the slightest idea of banking. This is likely to come across as a huge shocker for such sections. Jan Dhan scheme, UPI/digital payment stack, and payment banks are still in the nascent stage. It will be a long time before rural India moves to completely cashless transactions. In the short term, people in rural India who have a significant amount of Rs 500 and Rs 1000 notes, but no official form of identification, will have a tough time in exchanging their notes.

**Agriculture -** Transactions in the Indian agriculture sector are heavily dependent on cash and is hugely affected by the demonetisation of ▪ 500 and ▪ 1000 banknotes. Many farmers have insufficient cash to purchase seeds, fertilizers and pesticides needed for the plantation of rabi crops usually sown around mid-November.

**The unorganized sector** - The poor do not have black money. They work hard to earn two squares of meal and do not have sufficient savings so as to deposit in any bank. They are the people who are most affected by this sudden decision. How do you expect people running grocery shops, chai-wallas, and maids to leave their businesses and stand in a queue to deposit these notes in the bank?

**Transportation -** Major highway toll junctions on the Gujarat and Delhi-Mumbai highways also saw long queues as toll plaza operators refused the old banknotes. Nitin Gadkari, the Minister of Transport, subsequently announced a suspension of toll collections on all national highways across India until midnight of 11 November, later extended until 14 November and again until midnight of 18 November, and yet again till 2 December.

**No big impact on foreign accounts** - The big fish will be left out whose black money is in the form of foreign currency, gold, and stashed away in Swiss/Panama Banks, offshore accounts, gold, and property, etc. How the government plans to nab these offenders is yet to be seen

**- Mr. Ranjeet Rao**

## In run-up to GST, budget to see cleanup of imports sops

The upcoming budget is likely to see a massive cleanup of exemptions available for imports as a precursor to the roll out of goods and services tax.

The finance ministry has begun discussions with other ministries and departments to move some essential direct exemptions to subsidy-based ones.

"The import regime also has to be in line with the goods and services tax regime," said a government official.

Changes to the import duty framework will be in focus in the budget, the official added. There are two components of import duty: basic customs duty and countervailing duty (levied in lieu of excise duty). But the system is laden with exemptions for both. A number of incentives are provided by different ministries through their schemes, including tax concessions and exemption from basic customs duty in some cases and countervailing duty in other. North Block now wants these schemes rejigged in view of the GST regime, which will work on the principle of minimal exemptions.

The government is proposing to roll out GST from next financial year. Blanket CVD exemptions cannot be allowed under the proposed GST regime as states would not agree to it. Moreover, the GST framework is proposed to function on the principle of upfront payment of duty, which can be refunded later to incentivize a sector. A number of sectors enjoy exemptions from import duties: BCD in some cases and CVD in the other.

- **Mrs. Shahana Shaikh**

## Equity MFs see $2.8 bn inflows in October-November as markets slump

With the markets on a slippery ground, investors are ramping up their purchases in equity mutual funds (MFs). Equity MFs (including equity-linked savings schemes or ELSS) have seen net inflows (higher purchases in equity schemes than sales) of about $2.8 billion (Rs 18,473 crore) in October and November, the best showing over a two-month timeframe in 15 months.

Strong inflows into equity schemes allowed fund houses to deploy more money in stock markets. Equity MFs made net investments of nearly $3.3 billion (around Rs 21,950 crore) in October-November, data with markets regulator SEBI showed.

The benchmark Sensex and broader Nifty lost 4.8% and 5.1% respectively during October-November on the back of sharp selling by foreign institutional investors (FIIs). FIIs sold shares to the tune of $3.4 billion during these twomonths.

"Investors have used the drop in the markets to put more money," says Chandresh Nigam, managing director and CEO, Axis MF. "Gross inflows have risen by 15%-20%. Redemptions (investor exits) have also fallen resulting in a huge increase in net inflows," he says.

- **Mrs. Shahana Shaikh**

## India steps up efforts to trace Indians' Swiss account details

Stepping up its efforts to trace black money parked abroad, India has shot off at least 20 'administrative assistance' requests to Switzerland in recent months seeking details of Indians suspected to have misused Swiss banks' famed high-secrecy walls to evade taxes.

The individuals and companies about whom India has requested for information include at least three listed companies, former CEO of a real estate major, wife of a Delhi- based former bureaucrat, a Dubai-based Indian origin investment banker, a high-profile fugitive along with his wife and an UAE-based holding company, as also some Gujarati businessmen settled abroad and presumably in trading business.

Many of these are suspected to have maintained accounts in Swiss banks through offshore entities, including in Panama and British Virgin Islands.

These requests for 'administrative assistance', which typically involves exchange of information on submission of proof by the requesting country about the account holder's wrongdoing, have been documented by Swiss authorities in their Federal Gazette as per local laws to give the concerned person or entity a last chance to appeal against sharing of data.

While India and Switzerland last week signed a new pact for automatic exchange of information about account details September 2018 onwards, the pending requests have been made under their existing bilateral tax treaty.

In the past also, names of some Indian nationals figured in Switzerland's Federal Gazette notifications after the Swiss authorities were approached by India for information about those people with regard to the pending tax-related probes against them.

After following the due process prescribed under Swiss law, the information has been shared by Switzerland with India in some cases, pursuant to which the Indian authorities -- including the tax department and Enforcement Directorate -- have proceeded with their prosecution and other actions.

However, the pace of seeking such details seems to have quickened in the recent months, going by the sudden spurt in the number of Indian names figuring in such notifications.

So far in November alone, five Indian names have been disclosed, while a similar number of 'administrative assistance' requests were notified in October as well. Since June this year, at least 20 such requests have been disclosed by the Swiss authorities.

Typically, these notifications include name, nationality and date of birth of the concerned individual, while in case of companies, their names and the country of registration are mentioned.

For long, Switzerland has been known for strict secrecy clauses about details of foreigners having accounts in Swiss banks. However, under growing global pressure, Switzerland has begun sharing information in cases where other countries have been able to present some evidence of suspected illegalities.

Under Swiss law, a prescribed procedure is followed for any administration assistance or information exchange by the FTA (Federal Tax Administration of Switzerland) with India or any other country with which the Alpine nation has tax treaties about their respective nationals.

Among other provisions, this procedure also seeks to safeguard "the right to be heard" of the person about whom information is sought by a foreign country.

"If the person concerned has not designated a person authorised to receive the notifications, the FTA shall inform this person about the pending administrative assistance procedure through the requesting authority.

"Simultaneously, the FTA shall set a period of time for the person concerned to designate a person authorised to receive notifications. The FTA may inform the concerned person directly provided that the requesting authority expressly consents to this procedure in that case," the rules say.

If the person concerned is found to be entitled to appeal, he or she may participate in the procedure and inspect the files. The information can be shared with the foreign authorities after the appeal is rejected.

As per the latest data by Swiss National Bank, money held by Indians in Swiss banks fell to to a record low of 1.2 billion franc (about Rs 8,392 crore) at the end of 2015.

The funds held by Indians with Swiss banks stood at a record high of CHF 6.5 billion (Rs 23,000 crore) at 2006-end.

However, the quantum of these funds has been falling since then, except for in 2011 and in 2013 when Indians' money had risen by over 12 per cent and 42 per cent, respectively.

The funds, described by SNB as 'liabilities' of Swiss banks or 'amounts due to' their clients, are the official figures disclosed by the Swiss authorities and do not indicate the quantum of the much-debated alleged black money held by Indians in the safe havens of Switzerland.

SNB's official figures also do not include the money that Indians or others might have in Swiss banks in the names of entities from different countries.

There are more than 250 banks in Switzerland and they together have an estimated 1.24 lakh full-time employees.

Last week, Switzerland agreed to automatic sharing of information with India on Swiss bank accounts of Indians.

The 'Joint Declaration' in this regard provides that both countries will start collecting data in accordance with the global standards in 2018 and exchange it from 2019 onwards.

While Switzerland has conformed to the global standards on automatic exchange of information with the signing of the declaration, India, on its part, has promised to safeguard the confidentiality of the data.

- **Mrs. Liily Chwda**

## Gold import to determine size of India's current account deficit : Icra

With India's gold import bill in October - November 2016 is estimated to be equivalent to that in the previous six months, the country's current account deficit (CAD) for October '16 - March '17 is estimated to be significantly higher than that in the first half of the current financial year, rating agency Icra forecast in its latest study.

Moreover, the demand for gold in the remainder of this year would influence the size of the deficit in the second half of FY2017, it added. Icra expects India's current account deficit to be curtailed under $20 billion in FY2017, lower than the around $22 billion in FY2016.

"If the recent amendments to the Income Tax Act dispel demand for the holding of gold as well as jewellery, the gold import volumes may decline significantly in the coming months. Assuming that the volume of gold imports during December2016 — March 2017 reverts to the average of around 45 tonnes per month seen in April —November 2016, India's current account deficit would be curtailed at around $15 billion in FY2017," said Aditi Nayar, Principal Economist, Icra.

She added, "However, if the volume of gold imports in the last four months of FY2017 is elevated at an average of 70 tonnes per month, driven by continued wedding demand, India's current account deficit could be as high as nearly $20 billion in FY2017."

The combined imports of gold, silver and precious and semi-precious stones declined to $26.4 billion in April-October 2016 from $33.2 billion in April-October 2015. By contrast, exports of gems and jewellery rose to $26.4 billion in April-October 2016 (in line with the imports in that period) from $23.1 billion in April-October 2015.

This suggests that either domestic stocks were drawn down extensively, or some imports were procured through unofficial channels. Anecdotal evidence suggests a sharp rise in gold imports in November 2016, on the back of inventory replenishment, festive season and wedding demand as well as some impact of demonetisation. The extent of demand for gold through official channels in the coming months would crucially affect the size of the current account deficit in H2 FY2017. The agency expects gold prices to fluctuate in the range of $ 1,150 - 1,250/ounce, driven by global trends.

Growth in the volume of crude oil imports would be muted in Q3 FY2017, following a temporary lull in trade-related activity post-demonetisation, as well as a step-down in irrigation-related demand for diesel given healthy reservoir levels.

However, following the agreement of the Organization of the Petroleum Exporting Countries (Opec), on November 30, 2016, to cut total crude oil production of its member countries by 1.2 million barrels per day from January 2017, crude oil prices are likely to be significantly higher at $55/barrel in December2016-March 2017, relative to $45/barrel in the first eight months of this fiscal. This uptick in crude oil prices is likely to inflate India's net crude oil import bill by a modest $4 billion in the remainder of FY2017, which Icra has built into its baseline projections.

India's current account deficit shrank to a marginal $0.3 billion in Q1 FY2017 from $6.1 billion in Q1 FY2016. With the narrowing of the merchandise trade deficit in Q2 FY2017 substantially larger than the fall in the services surplus, Icra expects the current account deficit for the just-concluded quarter to print at $2.5-3.5 billion, less than half of the $8.5 billion recorded in Q2 FY2016. As a result, the current account deficit in H1 FY2017 was likely subdued at under $4 billion.

- **Mrs. Liily Chwda**