Workarounds for ₹ 2000 banknotes

– Tax considerations

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Withdrawal of circulation of ₹ 2000 banknotes

- The ₹ 2000 denomination banknote was introduced in November 2016 with the objective to meet the currency requirement of the economy in an expeditious manner after withdrawal of the legal tender status of all ₹ 500 and ₹ 1000 banknotes in circulation at that time. With fulfilment of that objective and availability of banknotes in other denominations in adequate quantities, printing of ₹ 2000 banknotes was stopped in 2018-19.

- In pursuance of the "Clean Note Policy", the RBI has decided to withdraw the ₹ 2,000 denomination banknotes from circulation. **Here are the key things to know about the withdrawal of the ₹ 2,000 bank notes from circulation:**
  - The ₹ 2000 banknotes continue to be legal tender till 30 September 2023 and the public can continue to use ₹ 2000 notes until 30 September 2023
  - RBI has directed banks to provide deposit and/or exchange facilities for ₹ 2000 notes until 30 September 2023
  - The public can deposit ₹ 2000 banknotes into bank accounts without any restrictions.
  - The public can exchange of ₹ 2000 banknotes up to a limit of ₹ 20,000 at a time. Non-account holders can also avail of the facility for the exchange of ₹ 2000 banknotes from any branch. The exchange facility will begin from 23 May 2023 and will be provided free of cost.

Depositing ₹ 2000 banknotes in Banks or adopting innovative strategies to get away from ₹ 2000 banknotes may invite tax implications and attention of the income-tax authorities

In ensuing slides, we have highlighted key tax considerations on such workaround strategies

Reporting of high value transactions

To keep a watch on high value transactions undertaken by the taxpayers, the concept of Statement of Financial Transaction (SFT) or reportable account was framed under ITA. With the help of the statement, the tax authorities will collect information on certain prescribed high value transactions undertaken by a person during the year.

Following key cash transactions are covered under SFT reporting:

Cash deposits or withdrawals from Current Account	Cash deposits or withdrawals (including through bearer's cheque) aggregating to ₹ 50 lakhs or more in a financial year, from one or more current account of a person shall be subject to SFT reporting by Banks
Cash deposits in Savings Account	Cash deposits aggregating to ₹ 10 lakh or more in a financial year, in the savings account of a person shall be subject to SFT reporting by Banks
Cash payment of credit card bills	Payments of an amount aggregating to ₹ 10 lakh or more in cash in a financial year against bills raised in respect of one or more credit cards shall be subject to SFT reporting by Banks or Credit Card companies
Receipt of cash for sale of good or services	Receipt of cash exceeding ₹ 2 lakhs against sale of goods or services shall be subject to SFT reporting by recipient who is liable for tax audit

TDS on cash withdrawal from Banks

Exchanging of ₹ 2,000 bank notes by cash withdrawal and subsequent cash deposit in Bank

- ❖ There may be situation where a person may not have enough cash balance as per the books of accounts to deposit ₹ 2,000 bank notes in the Bank (i.e. unexplained cash)
- ❖ In such a case, person may tend to withdraw cash from the bank account and subsequently deposit cash (₹ 2,000 bank notes) in the Bank.
- ❖ In case where withdrawal of cash from bank exceeds ₹ 1 crore during the financial year, bank shall deduct TDS @ 2%. If the person has not filed return of income for last 3 years, bank shall levy TCS @ 2% for cash withdrawal in excess of ₹ 20 lakhs and TCS @ 5% for cash withdrawal in excess of ₹ 1 crore.
- ❖ It is pertinent to note that such practice of exchanging ₹ 2,000 bank notes by cash withdrawal and subsequent cash deposit in Bank (even below above TDS limits) may invite detailed scrutiny from tax department.

Penalty on cash transactions

Undertaking transactions exceeding ₹ 2,00,000

- In order to utilize large amounts of cash of ₹ 2000 banknotes, people may resort to spending these banknotes on expensive purchases such as consumer durables, furniture, luxury items, jewellery, travel, or cash spending on marriage functions, etc.
- As per ITA, a person is prohibited to receive an amount of ₹ 2,00,000 or more in any below scenario:
  - Receipt of ₹ 2,00,000 or more in aggregate from a person in a day
  - Receipt of ₹ 2,00,000 or more for a single transaction
  - Receipt of ₹ 2,00,000 or more for transactions relating to one event/ occasion from a person
- If a person receives cash over the above-specified limit of ₹ 2,00,000, he is liable to pay a penalty equal to the amount received in cash
- Accordingly, cash sales of ₹ 2,00,000 or more may invite penal consequences under the ITA

Disallowance of business expenses and depreciation

Incurring business expenditure in cash

- A person may tend to make payments of various day-to-day business expenditures in cash say, purchases, salary payments, lease rents, transport charges, electricity expenses, mobile and internet charges, etc.
- In case where payment of any expenses, in aggregate to a person in a day, is made in cash in excess of ₹ 10,000 (₹ 35,000 in case of freight charges), deduction of such business expenditures shall not be allowed under ITA, subject to certain exceptions.
- Such disallowances are required to be specifically disclosed in income-tax return and tax audit report.
- Salary payments to employees in cash shall not be eligible for additional deduction under section 80JJAA of the ITA.

Acquiring any business asset in cash

- A person may resort to purchasing any business assets in cash, such as purchase of machines, computers, mobile phones, furniture, office equipments and electricals, etc.
- In such a case, where payment for purchase of any business asset, in aggregate to a person in a day, is made in cash in excess of ₹ 10,000, depreciation on such business assets shall not be allowed under ITA.

Quoting of PAN

Cash deposits in a year

Cash deposits in one or more bank account of a person of an amount aggregating to ₹ 20 lakhs or more in a financial year

Cash deposits in a day

Cash deposits in bank of an amount exceeding ₹ 50,000 during any one day

Hotel and restaurant bills

Cash payment to a hotel or restaurant of an amount exceeding ₹ 50,000 at a time

Foreign travel or forex purchase

Cash payment for foreign travel or purchase of foreign currency of an amount exceeding ₹ 50,000 at a time

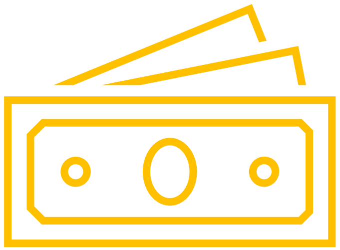
Cash withdrawals in a year

Cash withdrawals from one or more bank account of a person of an amount aggregating to ₹ 20 lakhs or more in a financial year

Higher cash deposits, greater chances of tax scrutiny

Increase in cash sales and cash deposits may invite tax scrutiny

- As it happened in the past, consequent to demonetization in November 2016 post withdrawal of ₹ 2,000 banknotes from circulation, person with increased cash sales and cash deposits, may again face income-tax notices or searches without any of their fault, as they may receive more payments in cash in the coming months.
- As per ITA, any amount credited in the books of the person without proper explanations about the nature and source, may be taxable as income of the person at the tax rate of 60% along with penal consequences.
- Accordingly, businesses with increased cash sales in coming months should maintain adequate documentation in the form of invoices, vouchers, cash book and day-to-day stock register having complete quantitative details of cash sale transactions to justify the case during scrutiny assessments.



Acceptance or repayment of loans or deposits in cash

Acceptance or repayment of loans or deposits in cash

- In order to deposit unexplained cash (₹ 2,000 bank notes) in the Bank, which is not reflected in the books of accounts, a person may tend to inflate the cash balances by introducing fictitious entries of receipt of loan or deposits in cash from multiple persons.
- Acceptance of loan or deposits from other person (including relatives) of amount ₹ 20,000 or more in cash is prohibited and liable for penalty equal to the amount of loan or deposit so received in cash.
- Similarly, repayment of loan or deposit (including interest) of amount ₹ 20,000 or more in cash is prohibited and liable for penalty equal to the amount of loan or deposit so repaid in cash.
- It is pertinent to note that acceptance or repayment of loans or deposits in cash even below the above-specified limit of ₹ 20,000 from multiple persons may lead to higher chances of detailed tax scrutiny for unexplained credits.

Higher cash income, higher tax and compliances (1/2)

Option of availing presumptive taxation in case of cash sales

- Section 44AD and Section 44ADA of the ITA was introduced to provide relief to small businesses and professionals from maintenance of books of accounts and tax audit report, subject to payment of taxes on presumptive basis (i.e., business income is computed based on % of turnover or gross receipts).
- In order to avail the benefit of presumptive taxation, turnover or gross receipts in a financial year shall not exceed ₹ 2 crores (in case of business) or ₹ 50 lakhs (in case of profession).
- If the receipts in cash does not exceed 5% of turnover or gross receipt, the above eligibility limit shall increase to ₹ 3 crores (in case of business) or ₹ 75 lakhs (in case of profession). Therefore, the businesses having higher cash sales may have lower chances to opt for presumptive taxation and thereby lead to increased tax compliances and reporting.
- Under presumptive taxation, business income is presumed minimum at 6% of sales (in case of non-cash sales) and 8% of sales (in case of cash sales). Therefore, the businesses having higher cash sales could be liable to higher income presumption rate and thereby pay higher taxes

Continued…

Higher cash income, higher tax and compliances (2/2)

Getting the books of account tax audited

- Person having sales turnover less than ₹ 1 crore are not required to get their accounts audited.
- However, if cash receipts and cash expenses pertaining to business does not exceed 5% of receipt and payments respectively, the above exemption limit is increased to ₹ 10 crores.
- Therefore, the business with higher cash sales and cash payments may unlikely be eligible for increased exemption limit of ₹ 10 crores and thereby required to get their accounts audited.

Donations in cash

Donation to charitable institution, scientific research and political parties

- Any donation in cash exceeding ₹ 2000 to certain relief funds and charitable institutions shall not be allowed as a deduction under the ITA.
- Any donation in cash exceeding ₹ 2000 made towards scientific research or rural development shall not be allowed as a deduction under the ITA.
- Any contributions or donations to political parties or electoral trusts in cash shall not be allowed as a deduction under the ITA.
- Any contributions or donations received by political parties in cash exceeding ₹ 2000 shall not be eligible for income-tax exemption.

Glossary

FY	Financial Year
ITA	Income-tax Act, 1961 and related Rules framed thereunder
PAN	Permanent Account Number
RBI	Reserve Bank of India
SFT	Statement of Financial Transaction
TCS	Tax Collected at Source
TDS	Tax Deducted at Source

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