Promoting Cashless Transactions through a Rebate on Income Tax

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Abstract

While the economy stands to gain significantly by making transactions cashless, the current set of policies and charging mechanisms are not aligned to encourage the citizen to adopt cashless modes of payment. Merchants do not encourage such transactions, due to potential tax implications as also due to the nominal charges payable to banks towards maintaining payment infrastructure. With banks bearing the cost of free cash withdrawal under RBI guidelines, there is every incentive to deal only in cash and little incentive for consumers to go electronic. In effect, the current combination of policies promotes cash transactions, which has massive implications for the economy, beyond the mere cost of cash withdrawal. This paper suggests that a small income tax rebate be granted to taxpayers making more than a certain percentage of their payments using cashless channels. The paper attempts to quantify some obvious benefits that would offset the loss to Government revenue due to the suggested tax rebate mechanism. This policy initiative would motivate taxpayers to switch to a cashless mode of spending, which would have positive impact on Government revenues, financial inclusion and banking sector efficiencies, besides promoting transparency and reducing unaccounted transactions.

A. Promotion of Cashless Transactions – Critical Necessity and an Opportunity

Policy-making in India has by and large supported the spread of electronic transactions in the economy. RBI's vision, evident in continuous reform measures over the last year, has clearly taken the direction of facilitating digital payments. Following are some advantages of cashless transactions and the critical necessity for encouraging such transactions in the emerging Indian context:

1. Benefits of going cashless:

(i) Cashless transactions promote transparency in the economy. All cashless transactions, whether electronic or through cheque payments, leave a clear audit trail.

(ii) Cashless transactions reduce avenues of tax evasion.

2. **Cash dispensation costs and sub-optimal usage of cards:**

    (i) Cash withdrawal at ATMs cost the banks around INR **17** per transaction[1]. Currently banks are bearing the cost. SBI allows **5** free transactions at its own ATMs and **3** additional transactions (5 additional transactions in non-metros) in respect of third-party ATMs.

    (ii) Only **50**% of debit cards issued are used at ATMs and **14**% are used at POS. Inefficient cash withdrawal through bank branches continues, with **80**% of cash withdrawals in branches being less than INR **25,000** in value. Only **1**% of active SB customers in public sector banks and **10**% in private sector banks use mobile banking[2]. Clearly, there is an opportunity for ushering in efficiencies through greater adoption of available technology solutions.

    (iii) From 2007 and 2012, the number of financial cards in circulation more than doubled, from about **150** million to over **400** million[3]. In the same period, the total value of ATM transactions increased more than five times, from approximately **3** trillion to **18** trillion rupees[3]. Nonetheless, concurrent growth in the value of card payment transactions has remained largely stagnant.

3. **No incentive for consumers to go cashless:**

    (i) Most banks have established robust e-payment platforms, covering online, card and mobile interfaces. Efficient working models are available for merchants to hook up with these e-payment platforms, enabling them to offer both card-based as well as mobile payment options to consumers. However, merchants do not encourage such transactions, due to potential tax implications as also due to the nominal charges payable to banks towards maintaining the payment infrastructure. Consequently, customers are encouraged to pay in cash. With banks bearing the cost of free cash withdrawal under RBI guidelines, there is clearly no incentive for the consumers to go electronic and every incentive to deal only in cash.

    (ii) In effect, the current combination of policies is somewhat self-defeating and promotes cash transactions, which has massive implications for the economy, beyond the mere cost of cash withdrawal. International studies indicate that the burden of cash usage on national economies is substantial, representing as much as **1.5**% of GDP[4]. According to RBI

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[1] The Art of Living for ATMs in India - Ashish Das, Department of Mathematics, IIT Bombay; September 2014

[2] Productivity in Indian Banking: 2014 - Saurabh Tripathi, Bharat Poddar, and Yashraj Erande, The Boston Consulting Group, FICCI, and Indian Banks' Association; September 2014

[3] The Cost of Cash in India – The Fletcher School, TUFTS University; 2014
http://fletcher.tufts.edu/CostofCash/~/media/Fletcher/Microsites/Cost%20of%20Cash/COC-India-lowres.pdf

[4] Measuring progress towards a cashless society - Hugh Thomas, MasterCard; 2013

data, cash accounted for **90%** of all monetary transactions in India which is well above most developed economy figures. Also, the value of banknotes and coins in circulation as a percentage of GDP is much higher when compared to other emerging markets[5].

4. **Jan Dhan program – Emerging scenario:**

   (i) If the **15.86** crore newly opened bank accounts under the Pradhan Mantri Jan Dhan Yojana[6] become active as envisaged, the total number of ATM withdrawals is likely to go up significantly. This would have consequent cost for banks with public sector banks bearing the brunt of it. Most withdrawal transactions from the newly opened bank accounts would be of small value, making such transactions all the more unsustainable. Also, charging for these small-value withdrawals beyond the free limit, would hit the small account holder hard and be hugely unpopular. Hence, there is need for providing more avenues to small account holders for cashless transactions.

   (ii) Around **58%** of the newly opened Jan Dhan accounts have zero balance. Even if cash is deposited through government programs, it is likely to be withdrawn immediately, unless sustainable options for digital payments are made available to small account holders. Traditionally, accounts opened for inclusion have been designed more as a conduit of cash disbursal, not for facilitating payments by the account holders.

B. Suggested Policy Intervention – A Small Tax Incentive

There is a clear room for granting a small incentive to taxpayers as an income tax rebate that could change consumer behaviour and incentivise them to opt for cashless transactions. As a suggestion, **Government could consider granting 5% income tax rebate for all taxpayers making more than 85% of their payments in the cashless mode (*percentages could vary*).** The required percentage of cashless transactions for rebate eligibility could be even higher for very high income groups. This percentage can be quite easily determined from banking systems. A routine bank statement / certificate stating percentage of cash debits separately would suffice to claim the rebate. This would also not burden taxpayers, as they do furnish personal banking information showing interest income accrued and tax

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[5] Payment System Vision Document (Vision 2012-15) - Reserve Bank of India

[6] http://www.pmjdy.gov.in/Images/snapshot.png; Accessed on 10th June 2015 (status as of 27th May 2015)

payable / deducted. So administering such incentive should involve no extra load, either on the banks or on the taxpayer.

The suggested policy initiative could suck cash out of the economy, promote transparency, and boost Government revenues. It would have a number of positive consequences, which would include:

1. **Expansion of cashless payment options and volumes:**
   (i) Push consumers towards merchants who support cashless transactions. This would expand the number of retail outlets / merchants providing electronic payment options. This could also open up the potential of mobile-to-mobile transfers at POS's, driving down costs of cashless transactions.
   (ii) Boost volume of cashless transactions at outlets equipped with the facility making operations at such outlets more viable for the bank / merchant.
2. **Impact on Government revenues:**
   (i) Increase Government revenues, at the Central and State levels, by bringing a far greater number of transactions within the tax net. VAT revenues would increase, with consequent positive impact on direct tax revenues, given increased transparency in operations, and reduction in unaccounted transactions.
   (ii) Work hand in hand with electronic invoicing and thus set the stage for enabling smooth introduction of GST.
3. **Financial inclusion:**
   (i) Provide a trigger to expand outlets where the vast number of new account holders under the Jan Dhan scheme can make cashless debit transactions. These new account holders would no longer need to withdraw all their cash, thus making these small value accounts more viable for the banks.
   (ii) Use of electronic payments would allow the newly banked to start building a transaction history, which will enable them to obtain other credit-related financial services. Thus, while small account holders may not be taxpayers themselves, they would stand to benefit significantly from an increase in number of outlets accepting cashless payments.
4. **Banking sector efficiency:**
   (i) Save thousands of crore of money for banks, which is currently being spent by them to subsidize inefficient / non-transparent cash transactions.

(ii) Studies indicate that by digitizing processes end to end, engaging customers on digital channels for transactions and sales, and collectively working towards eradicating cash, banks can achieve up to **30%** jump in sales productivity, reduce administrative staff by about **10-15%** and improve back office staff productivity by **20%**[7].

5. **Improve business efficiency and enhance India's global competitiveness**.

C. Indicative Estimates

Based on data and research available in the public domain, indicative estimates have been worked out (see Annexure). A conservative estimation of Payback has been made just along two dimensions – savings in terms of **25%** reduced ATM transaction costs and a **0.5%** increase in sales tax revenues, more to show the essential workability of the proposition. The analysis also brings out why the payback and actual benefits could be much higher. The required investments in devices and tools to support cashless transactions would be driven by a combination of consumer demand, savings, transaction efficiencies, newer technologies and sustainable business models.

D. Conclusion – Promoting Cashless Transactions would be a Win-Win for All

Prime Minister Shri Narendra Modi stated on Jan 3, 2015, "*Of many solutions to tame black money, cashless transaction is one of the very important solutions. This is a very big opportunity and we should promote this. People should inculcate the habit of cashless transaction*."

Economic theory tells us that humans change behaviour in response to incentives. A small income tax rebate at the end of a year for a certain percentage of cashless payments, will motivate consumers to change their habitual mode of spending, and drive more business towards transparency and tax compliance. With the suggested policy initiative, a vast majority of honest taxpayers will strive to maximize their cashless transactions, with consequent benefits to individuals, organizations, the Government, and the economy as a whole.

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[7] Productivity in Indian Banking: 2014 - Saurabh Tripathi, Bharat Poddar, and Yashraj Erande, The Boston Consulting Group, FICCI, and Indian Banks' Association; September 2014

E. Annexure – Impact of Incentivizing Cashless Transactions

#	Parameters	2011-12	2012-13	2013-14	2014-15	2015-16	Notes
1	No. of debit card transactions at ATMs (in crore)[1]	541	578	671	780	907	For estimating 2015-16 data, the average growth rate for 2013-14 and 2014-15 has been used i.e. 16.25%
	Annual growth		*6.8%*	*16.1%*	*16.4%*		
2	Cost of an ATM Transaction[2]	NA	NA	17	18	19	ATM transaction cost for 2014-15 and 2015-16 has been estimated by applying 7% inflation rate only
3	ATM Operations Cost (in INR crore)	NA	NA	11,402	14,197	17,659	
4	Estimated Personal Income Tax Collection (in INR crore)[3]	1,70,788	1,96,079	2,25,115	2,58,451	2,96,723	Personal income tax collection data is available till 2011-12. Estimations for subsequent years have been done using CAGR of personal income tax collection for the period of 2007-2012 i.e. 14.81%
5	5% Rebate on Personal Income Tax for Eligible Taxpayers (in INR crore)	NA	NA	NA	NA	3,709	Assumption: 25% taxpayers make payments for 85% or more of their expenses in cashless mode
6	Estimated Savings in Annual ATM Transactions Cost (in INR crore)	NA	NA	NA	NA	4,414.64	Assumption: Suggested incentive will cause 25% reduction in annual ATM transactions
7	Estimated State Sales Tax/VAT Collection Excluding Petroleum Products (in INR crore)[4]		2,90,771	3,46,702	3,86,485	4,45,578	Sales tax data for 2015-16 has been estimated by using CAGR of sales tax collection between 2012-13 and 2014-15
8	Estimated Increase in Sales Tax Collection (in INR crore)					2,228	Assumption: Additional 0.5% of VAT/state sales tax gets collected due to incentivizing cashless payments
	Overall Economic Benefit (in INR crore)					**2,933**	Overall Economic Benefit = Savings in ATM operations cost + Increase in sales tax - Rebate on income tax

🟩 Actual Data
🟨 Estimated Data

1 http://dbie.rbi.org.in/DBIE/dbie.rbi?site=home
2 The Art of Living for ATMs in India (Technical Report 2014), Ashish Das, IIT Bombay; September 2014
3 Department of Revenue, GOI website - http://dor.gov.in/revenue_previous_ctc
4 State Finances: A Study of Budgets of 2014-15 - http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/00SFLF53D1E4239044DCA9F79D47327947CFC.PDF

The payback could be much higher due to following reasons:

1. The above impact projection does not include savings relating to reduced withdrawal from bank branches; these transactions are even more inefficient than ATM transactions and cost the banks more.

2. It does not quantify the socio-economic benefits accruing from improved sustainability of recent financial inclusion initiatives.
3. PMJDY alone has added **15.86** crore accounts as on 27th May 2015. However, most of the PMJDY bank account holders would not be utilizing the ATMs for cash withdrawal (due to unavailability of ATMs in remote areas), but would withdraw money through other channels such as business correspondents and bank branches, which also have accompanying costs. Withdrawal from bank branches, in addition to creating burden on branches, has socio-economic cost for the citizens (such as travel cost, opportunity cost etc.). The costs related to cash withdrawal from the number of operational accounts opened under PMJDY scheme have not been considered.
4. It does not include increased inflows from other forms of Government taxes, both direct and indirect, due to improved transparency and compliance environment. Notably, it does not quantify the positive impact on reducing black money.
5. It does not quantify benefits accruing to individuals and organizations due to improved efficiencies which will positively impact economy as a whole and enhance India's competitiveness at a global level.

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