**Law relating to legal tender and**

**Demonetization**

1. **INTRODUCTION:**

The Prime Minister exploded the bomb on 8th November and the demonetisation of the currency notes of Rs 500 and Rs 1000. is one of the boldest economic decisions ever taken after independence. The PM announced this decision in his broadcast to the nation through television at 8PM. The Ministry of Finance (Department of Economic Affairs) issued a notification No S.O 3407 (E) dated 8.11.2016 in exercise of the powers conferred on it u/s 26(2) of the Reserve Bank of India (RBI) Act 1934 whereby it was declared that specified bank notes (Rs 500 and Rs 1000 and referred hereinafter as

“old notes”) shall cease to be a legal tender. It was also provided that the said old notes can be exchanged till 30.12.2016 with any Issue office of the RBI or any branch of public sector banks, private Cooperative Banks and State Cooperative Banks. Certain specified outlets (for e.g.medical shops, petrol pumps etc) were also allowed to accept the said notes till such time as may be notified.

Naturally those who possess black money or laundered money have panicked. The innocent common man who has nothing to do with black money suffered a lot due to scarcity of currency notes and the limits placed on cash drawls from banks and ATM’s. Practically there is no precedence of this type of a situation in this country. The previous two demonetisations of 1946 and 1978 did not seriously affect the common man. The purpose of this article is to discuss about the law in this regard and also legal or other issues arising out of the demonetisation.

1. **THE LEGAL PROVISION:**

The legal provisions relating to demonetisation can be found in section 26 of the ReserveBank of India Act 1934 and is reproduced below for ease of reference.

“26. Legal tender character of notes.

1. Subject to the provisions of subsection (2), every bank note shall be legal tender at any place in [India] in payment or on account for the amount expressed therein, and shall be guaranteed by the 5[Central Government].

(2) On recommendation of the Central Board the 6[Central Government] may, by

notification in the Gazette of India, declare that, with effect from such date as may be specified in the notification, any series of bank notes of any denomination shall cease to be legal tender [save at such office or agency of the Bank and to such extent as may be specified in the notification].”

1. **WHAT IS LEGAL TENDER**

Legal tender is a medium of payment recognized by a legal system to be valid for meeting a financial obligation. Paper currency and coins are common forms of legal tender in many countries. Legal tender is variously defined in different jurisdictions. Formally, it is anything which when offered in payment extinguishes the debt. The law does not relieve the debt obligation until payment is tendered. Coins and Bank notes are usually defined as legal tender. Some jurisdictions may forbid or restrict payment made other than by legal tender.

For example, such a law might outlaw the use of foreign coins and bank notes or require a license to perform financial transactions in a foreign currency. (Source: Wikipedia)Therefore author is of the view that strictly speaking cheques, drafts or pay orders are not legal tender.

1. **ANALYSIS OF LEGAL TENDER:**

The expression “legal tender: is not defined in any enactment. Therefore we have to look elsewhere for ascertaining the meaning of the said expression.

On a close analysis of what constitutes “legal tender” it emerges clearly that a payment in legal tender would be recognised by law of this country as a valid discharge of the underlying obligation that resulted in the payment. As per section 26(1) it shall be recognised by law as legal tender on payment or on account. It may be noted that when payment is made by a party in legal tender the payee can accept the same and would validly discharge the payer from his obligation. But that will not lead to the necessary conclusion that the payee can accept only a legal tender in the form of currency or its equivalents. The author is of the view that a payee can accept anything which is valuable for him like goods, shares or even old currency which is stripped off its character as a legal

tender. As already noticed , cheques, drafts etc though not legal tender still all of us accept them as lawful payments and treat the payer as discharged from his obligations.

Therefore, generally speaking, the payee is given the full freedom so as to decide the mode or method of payment that he would accept. It may be noted that normally the payer is under an obligation to accept the legal tender or currency notes/coins up to the prescribed limit (See The Coinage Act 2011). In short, payer pays and payee accepts the local currency, unless the parties agree otherwise. So long as the payee assigns value to whatever paid by the payer either in the form of legal tender or old demonetised notes it constitutes valid discharge of the obligation of the payer.

1. **IS IT A PROMISSORY NOTE?**

What is the status of the old notes and whether the old notes continue to have any value is the question to be considered. The author is of the opinion that consequent to the demonetisation those old notes have become mere promissory notes within the meaning of Section 4 of the Negotiable Instruments Act 1881 (NI Act) and carry value since the same value can be obtained by any person from banks and other agencies till 30.12.2016 and from RBI afterwards.

**Let us see Sec4 of the NI Act which is reproduced below.**

“A promissory note (PN) is an instrument in writing (note being a banknote

or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instruments.”

Thus the above definition of PN shall not apply to a currency note and specifically

excludes from the definition. Now the demonetised notes are no longer a currency and hence fall under the definition of PN u/s 4 of the NI Act. It may be noted that the old notes contain an unconditional undertaking signed by the governor of RBI to pay the sum to any bearer further guaranteed by the central government. Therefore a clear duty is imposed on the central government to pay equivalent value on surrender of old notes.

The legal validity of the condition that the notes must be surrendered for encashment before 30.12.2016 is also not free from doubt. It is because a promissory note must be unconditional. Therefore according to the author the old currency notes continue to be a PN within the meaning of NI Act 1881 and therefore actionable.

1. **OLD NOTES STILL CARRY VALUE:**

Therefore, based on the status of old notes till 30.12.2016 DISCUSSED ABOVE the author is of the view that a payee can continue to accept old demonetised notes of Rs 500 or Rs 1000 since those notes can be accepted as valid consideration. There is no prohibition or lawful direction not to pay or accept old notes. One more aspect to be taken notice is that the old notes still continue to be convertible into money since any person who is validly in possession of the old notes can get them converted into legal tender from banks or can tender it for payment to specified transactions. There are no rules forbidding the payments in old notes. Therefore it is not correct to say that the old notes do not carry

any value.

1. **WHEN THE NOTIFICATION IS EFFECTIVE?**

It is settled law that a notification becomes effective when it is published in the gazette and is made available to the public for sale. If that be so whether the notification dated 8.11.2016 is effective from the midnight of 8th November 2016 is open to challenge. In a recent decision of the Hon Supreme court in UOI v Param Industries Ltd and others (2015) 59 taxmann.com 208(SC) / (2015) 312 ELT 192( S.C) it was again reiterated that a notification becomes effective only when it is made available for sale to the public and not when it was printed and kept for delivery in the press.

1. **ACCOUNTING ISSUES:**

There can be certain accounting issues that may arise when a person receives old notes and the same are accounted as money received. The immediate problem is whether the so called old notes can be regarded as money as we understand it. Since it is not a legal tender can it be described as Rupees or money? According to the author it can be accounted as money on the ground that it is a “money equivalent” because of its potential convertibility into money by depositing the same with bank. Anyway we account cheques or drafts or pay orders as money equivalents in the accounts and hence the author fails to

see any reason why same treatment should be given to old notes. An issue related to VAT is whether the consideration can be regarded as “price” since as per section 2(10) of the Sale of goods Act 1930 it means “money consideration”. Therefore if one makes a sale and receives old notes, whether VAT is payable on the same is a debatable issue. But courts have taken the view that money equivalents can also be regarded as “consideration” and this legal position may also be taken note of.

1. **TAXATION ISSUES:**

The author is of the view that so long as the receipt of old notes are genuine and properly recorded in the accounts with supporting evidences the normal tax provisions alone shall apply. The author is not expressing opinion regarding money represented by proceeds of crime etc covered under the Prevention of money laundering Act, 2002. So long as the income represented by old notes is disclosed and tax paid thereon there cannot be any application of penalty u/s 270A of the Income Tax Act

**10.** **IS IT AN OFFENCE TO RECEIVE OLD NOTES?**

The author is of the view that a person who receives the old notes is not violating any law for the time being in force. As already stated so long as the receipt of old notes is represented by lawful consideration there is no violation of any law. The RBI Act 1934 did not contain any provision relating to penalty in relation to legal tender. It may be noted that what is not expressly or impliedly prohibited is permitted and hence in the absence of any such prohibition in either accepting or paying old notes there appears to be no violation of any law. The views of the readers are solicited in this regard.

**11. RESTRICTION ON WITHDRAWAL OF CASH:**

The RBI has instructed the banks to place restrictions on withdrawal of cash from SB account and Current accounts. The legal validity of such is also open to doubt. The author is of the view that as between the bank and the customer there exist the relationship of debtor and creditor. The bank is contractually bound to honour the cheques issued for drawl of cash. Putting restrictions other than those agreed upon with the customers at the time of opening of the account cannot be relied upon by the bank except the well known grounds like frustration of contracts or supervening impossibility etc.

**12. CONCLUSION:**

In view of the above discussions the author is of the view that there is no bar in paying or accepting old notes by any person so long as it is in connection with genuine transactions. The law did not put any embargo on the freedom of the parties to settle their respective obligations. The old notes still carry value as those notes are still in circulation and the government is bound by the promise made by it. The well settled legal doctrines of promissory estoppels or legitimate expectation etc can be invoked in case the government seeks to go back on its promise. Since there is no precedent in this area of law we have to deal with the matter based on our own understanding and interpretation of law and

connected matters.

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