

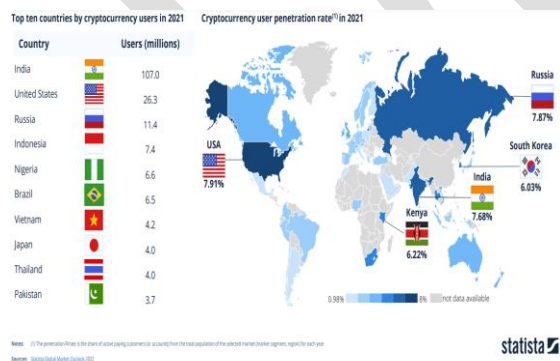
India - Taxation of Virtual Digital Assets*

1. Introduction

Crypto-related transactions and their regulatory and tax implications have become a prominent topic of discussion these days. Irrespective of the advancements that have happened or are happening in the crypto sector, it has often been criticized by people, regulatory authorities etc., for several reasons, some being high volatility, security, privacy concerns.

Several countries worldwide have issued guidelines; some are in the process of issuing guidelines for regulatory and tax aspects. Even in the countries that have issued guidelines, there are many unclear issues, and tax advisors and taxpayers continue to struggle to find answers to these open questions.

In the Indian context, the adoption of cryptocurrency/ Virtual digital assets is increasing across sectors and India had the most cryptocurrency users in 2021.



Source: Statista

In the past, the Reserve Bank of India (RBI) had taken actions to deter financial institutions and users from using VDAs and had issued a Circular to this effect. However, later in the case of Internet and Mobile Association of

India vs RBI (W.P. (C) 528/2018), the supreme court removed the restrictions on dealing in crypto by quashing RBI's circular¹.

The Government of India released guidelines this year in relation to the taxation of Virtual digital assets (VDAs), and new provisions were added to the income tax laws for the taxation of VDAs. The following sections aim at discussing the implications of Indian tax laws on VDA transactions.

2. A walk-through into the relevant provisions in the Indian tax laws

2.1 Direct tax

a. Taxability under Income-tax Act, 1961

Before 1st April 2022

VDA was neither defined in the Income-tax Act, 1961 (ITA) nor the ITA had provisions that dealt with the taxation of VDAs. However, considering the global developments and the quantum of increase in the VDAs, India also brought in new provisions in its taxation laws that deal with the taxation of VDA (covered in the next paragraphs).

This means that taxation of VDAs prior to 1st April 2022 was left on the then-existing provisions of the ITA. Accordingly, the same could be taxable either as business assets or as capital assets depending on the purpose for which VDA was held. Henceforth, the taxability could have been under the provisions of profits & gains from business & profession or capital gains. The losses in such cases from VDA would have been dealt with similar to business losses or capital losses and, in most cases, should have been allowed for carry forward and set-off.²

On and after 1st April 2022

A new taxation mechanism for the taxation of VDA was brought into the taxation regime in Finance Bill 2022 (effective from 1st April 2022).

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¹ W.P. (C) No. 528/2018. Tagged with Rajdeep Singh & Ors. v. Reserve Bank of India, W.P. (C) No. 373/2018.

² Refer to Section 70 to Section 74 of the Income-tax Act, 1961

The definition of VDA provided wide new sub-section³ in the ITA is broad and includes non-fungible tokens, and currency like bitcoins or any other coins which are traded digitally⁴⁵. Further, the Central Government is provided with the power to specify any other digital asset in the definition of VDA by notification in the Official Gazette.

As per the newly inserted section dealing with the taxation of VDA⁶, the taxability triggers on gains or income arising on the transfer of VDAs. It is taxable at a flat rate of 30% plus applicable surcharge rates, as the case may be, and Health and Education cess @4%.

Some other countries that tax it as capital gain have prescribed a range of tax rates vis-à-vis the flat rate of taxation in all situations. For ex.: In Australia, Crypto are subject to capital gains taxes which range from 19 to 45% (based on the applicable personal income tax rate)⁷.

Pertinent point to note while computing these gains:

- No deduction is allowed for any expenditure other than the cost of acquisition. Also, the cost of acquisition would not include infrastructure cost. In

many countries, though infrastructure cost of electricity/ equipment's is allowed as a deduction⁸.

- Set off of losses arising on the sale of VDAs is not permissible against any other income, and there is no carry forward of these losses. Also, losses from any other sources cannot be set off against the income from the transfer of VDAs. The practice on this varies across countries. For ex. - In Sweden, losses are deductible up to 70%⁹.
- There should be no tax liability on receiving the reward from mining/ staking. Tax liability arises only on the transfer of earnings/ rewards. Practise varies amongst countries on this. For ex. The United Kingdom treats mining as a taxable event¹⁰.
- Separately, it is specified that where VDA is given as a gift, it will be taxable as income from Other Sources¹¹ in the hands of the recipient as per the existing provisions. There is a dichotomy on how the fair value of consideration would be determined

³ Section 2(47A) of the ITA defines Virtual Digital Assets as under:

'virtual digital asset' means—

- (a) any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically;
- (b) a non-fungible token or any other token of similar nature, by whatever name called;
- (c) any other digital asset, as the Central Government may, by notification in the Official Gazette specify:

Provided that the Central Government may, by notification in the Official Gazette, exclude any digital asset from the definition of the virtual digital asset subject to such conditions as may be specified therein.

⁴ Pertinent to mention that the Central Bank Digital Currencies will not be covered in the definition of VDA as specific exclusion has been provided for Central bank issued currency even where they could satisfy the definition of VDAs.

⁵ Wide Notification No. 74/2022 (SO 2958(E)) dated 30th June 2022, the government has clarified that gift cards or vouchers, mileage or reward points are given without direct monetary consideration, subscriptions to websites/applications etc. are not included in the scope of VDA.

⁶ Section 115BBH in Finance Bill 2022, the relevant section concerning the taxability of VDA, is quoted as under: (1) Where the total income of an assessee includes any income from the transfer of any virtual digital asset, notwithstanding anything contained in any other provision of this Act, the income-tax payable shall be the aggregate of—

- (a) the amount of income-tax calculated on the income from transfer of such virtual digital asset at the rate of thirty per cent; and
- (b) the amount of income-tax with which the assessee would have been chargeable, had the total income of the assessee been reduced by the income referred to in clause (a).

⁷ Crypto Tax Australia : Here's How Much You'll Pay in 2022, Koinly (2022); available at <https://koinly.io/guides/crypto-tax-australia/>

⁸ Ex.: Finland

⁹ Guide to declaring crypto taxes in Sweden (2022); available at <https://divly.com/en/guides/sweden>.

¹⁰ Daniel Howitt, What taxes do cryptocurrency miners pay in the UK? recap; available at <https://help.recap.io/en/articles/3315712-what-taxes-do-cryptocurrency-miners-pay-in-the-uk>

¹¹ Refer to Section 56(2)(x) of the Income Tax Act, 1961. Per this section, gifts from specified relatives are exempt from taxation, while gifts exceeding INR 50,000 from non-relatives are taxable.

under the current rule¹² (Rule 11UA) which lays down guidelines for determining the property's fair market value for Section 56(2)(x).

b. Tax deduction at source

Further, a new section in relation to tax deduction at source (TDS) was introduced for payments made for VDA's¹³ transactions. From 1st July 2022 onwards, any person who is responsible for paying any consideration to an Indian resident for transfer of a VDA is required to deduct TDS at the rate 1% if the payment exceeds the threshold limit (refer table below)

Liability for deduction	Threshold
All individuals and HUF (less than Rs. 1 Crore annual turnover in business or less than Rs. 50 lacs in case of professionals)	Rs.50,000
Other Individuals, HUF, Companies, LLPs, Firms	Rs.10,000

The CBDT also later released Circular¹⁴ to provide guidance on several open points in relation to the applicability of the provisions dealing with TDS in the case of VDA, the most prominent one being the clarification on the responsibility of TDS deduction when the purchase and sale of VDA happen through an exchange platform.

¹² Clause (b) of the Explanation to Section 56(2)(vii) empowers CBDT to notify rules for the determination of fair market value for Section 56(2)(x).

¹³ Refer to Section 194S Payment on transfer of virtual digital asset' of the Income-tax Act, 1961
'194S(1) Any person responsible for paying to any resident any sum by way of consideration for transfer of a virtual digital asset shall, at the time of credit of such sum to the account of the resident or at the time of payment of such sum by any mode, whichever is earlier, deduct an amount equal to one per cent of such sum as income-tax thereon:

Provided that in a case where the consideration for transfer of virtual digital asset is—

- (a) wholly in kind or in exchange of another virtual digital asset, where there is no part in cash; or
- (b) partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of such transfer,

2.2. Indirect tax

Currently, no separate set of rules is prescribed concerning the taxation of VDA in the Indian Goods and Services Tax Act (GST). For determining whether GST can be leviable on VDA, it needs to be first determined whether transactions in VDA's can be covered in the definition of Supply per the GST law. (refer to analysis in the following paragraphs.

The GST laws¹⁵ defines Supply in an inclusive manner. Supply includes *sale, transfer, exchange, barter, license, rental, lease and disposal of Goods or Services or both, in the course or furtherance of business for a consideration*¹⁶.

Whether cryptocurrency can be regarded as goods/ services under GST laws? (Refer table in the next page)

Whether it can be treated as Goods ¹⁷ ?
Goods means any kind of movable property , including actionable claims , but does not include money and Securities .
Analysis of whether cryptocurrency can be regarded as goods:
- Whether cryptocurrency can be regarded as movable property? For the definition of movable property, reference is to be placed on the General clauses act, 1897 ¹⁸ , as the GST law does not define it. Per the General clauses act, the movable property would mean <i>property of every</i>

the person responsible for paying such consideration shall, before releasing the consideration, ensure that tax required to be deducted has been paid in respect of such consideration for the transfer of virtual digital asset.....'

¹⁴ Circular No. 13 of 2022 (22nd June 2022)

¹⁵ The Central Goods and Services Tax Act, 2017

¹⁶ Subject to Schedule-I Supplies, which can be done without a consideration.

¹⁷ Section 2(52) of the Central Goods and Services Tax Act, 2017, "goods" means every kind of movable property other than money and securities but includes actionable claims, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before Supply or under a contract of Supply.

¹⁸ Section 2(36) of the General Clauses Act

description, except immovable property.

Immovable property is defined in the General clauses act, 1897¹⁹ to include land, benefits arising out of land, and things attached to the earth, or permanently fastened to anything attached to earth.

The cryptocurrency would not satisfy the definition of immovable property mentioned above, hence it may be regarded as movable property.

- **Whether cryptocurrency can be regarded as money/ securities?** Money means Indian legal tender/ foreign currency, any instrument recognized by RBI.
- Further, cryptocurrency doesn't fall in the specified list of securities.²⁰ Hence, cryptocurrency cannot be regarded as money/ securities.
- **Whether cryptocurrency can be regarded as Actionable claim?** For the definition of Actionable claim, reference is to be placed Transfer of Property Act 1882. The definition mainly intends to cover claims in the nature of debt other than secured debt or claim to any beneficial interest in movable property not in possession of the claimant²¹. The cryptocurrency would not satisfy the definition of an actionable claim mentioned above, hence it may be regarded as an actionable claim.

Whether it can be treated as Services²²?

Services means anything other than goods, money and securities. Since cryptocurrency may be regarded as movable property; hence it may fall in the definition of goods and may be out of the definition of services.

¹⁹ Section 2(26) of the General Clauses Act

²⁰ Refer to section 2(h) of the Securities Contracts Act, 1956

²¹ Refer to Section 3 of the Transfer of Property Act, 1882, actionable claim means a claim to any debt, other than a debt secured by mortgage of immoveable property or by hypothecation or pledge of moveable property, or to any beneficial interest in moveable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent

The taxable event for the purpose of levy GST on transactions in cryptocurrency would be at the time of Supply took place. The supplier, i.e., Seller of the cryptocurrency, will charge GST @18% on such Supply and collect it from the recipient, i.e., buyer of the cryptocurrency. However, it is to be noted that there are some threshold limits given under the GST Act for applicability of GST. Thus, taxability here will be subject to the threshold specified in the GST Act.

Pertinent to mention that the practice on the applicability of indirect taxes on cryptocurrency transactions varies across countries. For ex. - The European Court of Justice (ECJ) in the case of Hedqvist²³ held that virtual currencies can be compared with fiat currencies in that *their sole purpose was to provide a means of exchange* and ruled that transactions including the exchange of fiat currency for virtual currencies and vice versa, performed for consideration, are transactions exempt from VAT within the meaning of Article 135(1)(e) of the EU VAT Directive.

However, the characterization of non-fungible tokens may not be the same as that of cryptocurrency. Many countries are facing the issue of characterization in relation to NFTs, like whether they can be classified as goods or services. For ex., NFTs are not covered in the definition of 'cryptocurrency' in the GST Act in New Zealand, thus NFTs sales follow the standard framework for supplies of electronically supplied services (ESS)/remote services. Spain also confirmed NFTs are subject to ESS rules in March 2022²⁴. It is yet to be seen how NFTs are classified for the Indian GST purposes, where GST are applicable on them – Can those be covered in still in the ambit of goods or would those be regarded as

²² Section 2(102) of the CGST Act defines services as 'services means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.'

²³ Skatteverket vs David Hedqvist Case C-264/14

²⁴ Non Fungible Tokens : Significant and Emerging VAT Issues, PWC; available at <https://www.pwc.co.uk/services/tax/indirect-taxes/non-fungible-tokens-significant-and-emerging-vat-issues.html>

services or, more specifically, OIDAR services²⁵?

c. Certain open issues

There are still various open issues or policy questions, some of which are mentioned below:

- **Valuation issues:** What should the cost basis for Crypto assets – whether the FIFO method should be followed to determine the cost of acquisition? The practice for determination of cost basis varies amongst countries. For ex. - specific identification of units (e.g., U.S.), deemed chronological order (such as first-in, first-out, or FIFO) (e.g., Finland), or basis pooling (e.g., U.K.)²⁶.
- **Indexation benefit:** How indexation would work for the determination of Cost of acquisition where the gains are long-term gains. With no clarity on this front - it seems that indexation benefits will not be provided in determining the cost of acquisition in case of long-term capital gains.
- **Determination of cost of acquisition in case of gifts:** Where someone receives VDA as a gift, what cost of acquisition should be considered in case of future sales. Should the prevailing rates of the VDA at one of the exchanges when the gift was received be

taken as cost of acquisition for determining Fair Market Value under Rule 11UA?

- **TDS on Payments to non-residents:** The TDS deduction for VDAs is prescribed in Section 194S, while TDS deductions for non-residents are covered in Section 195. It needs to be clarified whether there is a liability of TDS deduction in cases where VDAs are sold to Non-residents. Also, considering the broad scope of the equalization levy, it needs to be clarified that the equalization levy shall not be applicable in the case of VDAs.
- **Foreign currency recognized as legal tender in other countries:** Foreign currency is not included in the scope of the VDA definition. In certain countries, cryptocurrencies are treated as legal tender El Salvador, Central African Republic & Panama. Thus, crypto recognized as legal tender in other countries should be excluded from the definition of VDA.

3. Ending remarks

The practice of cryptocurrency taxation varies across countries. The framework regarding regulatory and tax aspects for the crypto sector is still evolving. It is yet to be seen how tax law evolves in coming years on this front to take into account the myriad variants of used cases/ transactions that is evolving in this space.

²⁵ Online Information Data Base Access and Retrieval services; for details refer <https://www.cbic.gov.in/resources//htdocs-cbec/gst/OIDAR.pdf>;jsessionid=86CDA18286679B3FF066E331F3FE23E4

²⁶ OECD (2020), Taxing Virtual Currencies: An Overview Of Tax Treatments And Emerging Tax Policy Issues, OECD, Paris. www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.htm