

## Tax updates

### Crypto Taxation – Key highlights

#### Background & Introduction

Crypto currency seems to have created a buzz amongst participants in the crypto ecosystem with user sign ups jumping by 30%-50% on crypto platforms and indulging in trading of crypto on a daily basis. The crypto industry in India was already raging due to the many complexities surrounding the legality, taxability and regulatory issues, when the Finance Minister, Nirmala Sitharaman proposed the much-awaited tax regime for taxation of virtual digital assets (“VDAs”) in India applicable from financial year 2022-23. It is important to bear in mind that merely because taxation regime of VDAs has been formulated, it does not affirm the legality of the crypto currencies. On the regulatory front, the question of nature and classification of VDAs is still in open to interpretation. However, recognition of VDAs in tax laws, does provide some much needed clarity to the sector.

#### What is Virtual Digital Asset?

Proposed new clause states that virtual digital asset(“VDA”) mean:

- a) any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means, providing a digital representation of value exchanged, 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;
- c) any other digital asset, as notified.

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

The definition of Virtual Digital Assets is very broad and might end up covering within its ambit reward points, flexi points, coupons etc which is offered by various companies to its customers / employees apart from crypto currencies.

#### Taxation Highlights

##### Income Tax

##### 1. Flat Rate of 30% u/s 115BBH

- The Budget 2022, proposed a flat rate of 30% tax (excluding surcharge and cess) on income from virtual digital assets irrespective of the period of holding;
- Surcharge on above shall be applicable at rates applicable to the person holding such assets i.e. upto 37% surcharge in the hands of individuals;

##### 2. Cost of Acquisition

- The Budget also provides that taxpayers shall only be allowed the actual cost of acquisition as an allowable deduction and no other deductions shall be permissible;
- Losses arising from the other heads of income cannot be set off against any income earned from the transfer of VDA;

### 3. Set off and carried forward of Losses

- Losses arising from the transfer of crypto assets cannot be set off against any other income and also it cannot be carried forward;
- However, intra-head consolidation of all VDA transactions entered during the year is permissible. For instance, a taxpayer gained Rs. 5 Lakhs on the sale of Cryptocurrency A and posted a loss of Rs. 2 Lakhs on the sale of Cryptocurrency B. The taxpayer can set off the loss and the net gain from the sale of crypto assets (both Cryptocurrency A and B) and Rs. 3 lakh would be subject to tax @30%;

### 4. Withholding Tax provisions

- As per section 194S, any person who pays consideration to a resident for the transfer of a virtual digital asset is required to withhold TDS at the rate of 1% subject to threshold limits;
- Provisions of section 194S shall have overriding effect over withholding provisions under section 194-O i.e. for ecommerce operator;

### 5. Gift of Virtual Digital Asset

- The definition of "property" under section 56 to include Virtual Digital Assets, effective from April 1, 2022. As a result, the gift of a Virtual Digital Asset shall also be taxable in the hands of the person who has received it where the same has been transferred for less than fair market consideration.

## Open issues

Even though this is a good beginning for the Indian crypto eco-system, certain aspects require clarification from the long-term stability perspective. Some of them are listed herein below:

1. The use of words 'information', 'code', 'number' makes the definition of VDA all encompassing. Further, the presence of 'or otherwise' in the phrase "*generated through cryptographic means or otherwise*", may be interpreted to mean that any information or code which is generated through non-cryptographic means could also be covered under definition of VDA. Therefore, questions regarding scope of VDA remain and absence of clarity may lead to confusion and litigation in future.
2. Prior to proposed tax regime for cryptos, it was possible to categorise income earned from cryptos and VDA as **business income** and claim expenses or in case of an investor claim **long term capital gain** rate of 20% based on the facts of the case. Accordingly, this may result into tedious litigations as regards the nature and head of income for assessment years prior to AY 22-23.
3. As regards the cost of acquisition, a question arises as to if, **direct expenses** such as brokerage charges, exchange fees, and various directly incidental expenses paid through the exchange transactions would be included in the cost of acquisition and hence allowable as a deduction.
4. The liability to withhold tax is of the person making the payment for transfer of VDAs. However, in case of transaction routed through exchanges, it's not apparent who's responsible for deducting TDS on exchange transactions as the buyer and seller can't be identified.
  - The Central Board of Direct Taxes issued guidelines vide Circular 13 of 2022 dated 22<sup>nd</sup> June, 2022 to remove difficulties in the implementation of section 194S of the Act. The above guidelines clarify that in most cases where transactions are undertaken through an exchange, the liability of withholding tax is of the exchange and not of the purchaser of VDA.

5. In an instance where employers pay salary in the forms of tokens to their employees, an ambiguity arises on TDS compliances to be undertaken under section **192 vis-à-vis 194S**.
6. Similar to point 5 above, where consideration for services availed are discharged by means of VDAs, an ambiguity arises on TDS compliances to be undertaken under section **194J / 194C or 194S**. Further, the computation mechanism as provided under the tax regime shall fail in such cases as value of sales consideration cannot be computed.
7. Another intriguing aspect is that the new provision states that taxpayers must withhold 1% tax on transfer of virtual digital currency, even if the same is entirely on barter, or partly in cash and partly on barter basis. When the cash component is insufficient to cover the 1% TDS, the person in charge of paying must ensure before releasing final consideration that the requisite tax has been paid. Alternatively, the purchaser must ensure that the recipient, i.e. the seller, has paid the tax. It is unclear how this will be accomplished, whether taxpayers will be required to rely on the CA certificate, the advance tax challan, or some other method. Clarity is required in this regard in order to avoid future contractual and legal litigation.

## GST

The matter of taxability of cryptocurrencies under The Goods and Services Act is yet to be addressed by the government at length.

### Can Cryptocurrencies be classified as “money” or “securities” under GST laws?

On perusal of its features i.e., store of value, unit of account etc., it seems to be money. However, as per the provisions of CGST Act, 2017 “money” means legal tender or foreign currency recognized by RBI and hence, it will not be regarded as money, as the same does not fulfil such conditions.

The CGST Act, 2017 defines securities as having the same meaning as assigned to it under The Securities Contracts (Regulation) Act, 1956. On perusal of that definition too, cryptocurrencies are concluded to be fallen outside the meaning of “securities”.

Accordingly, transactions of transfer of VDAs might fall within the ambit of GST.

### Whether VDAs is a good or service?

On analysis of the definition of “goods” as specified in CGST Act, 2017, we can observe that it cannot be classified as “goods” as the same is neither a movable property nor an actionable claim. Further, “services” as defined in GST states that “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; Explanation—For the removal of doubts, it is hereby clarified that the expression “services” includes facilitating or arranging transactions in securities. The definition of services clearly states that whatever that is not good is a service, so it seems really appropriate to classify cryptocurrencies as “services”.

As seen from the above analysis, there is no clarity on classification of cryptocurrencies under GST regulations. The government may consider such transactions of VDA as supply of service and may tax it accordingly. However, as of now no legal clarification is present in this respect. One can only think of possible implications under GST regulations on transactions of VDA.

## Conclusion

Despite the above ambiguities, the introduction of a tax regime for virtual digital assets is a step in the right direction and iterations are expected considering the fact that it's a newly evolving technology and not yet regulated. Introduction of tax regime alone shall not be construed as the government's intention to legalise the cryptocurrency. Though the latest indications as such are that the government would permit holding of crypto currencies as assets but not as a legal tender, we have to wait and watch for the proposed regulation to be tabled in the parliament.

Indian government is beginning to recognize crypto as an emerging asset class, and thereby introduction of Crypto tax was a milestone in Indian income tax laws. Furthermore, as tax bracket of 30% for VDAs are similar to regular taxes on short-term securities holdings and income from speculation business, the new regime shall have a negligible impact on trifling crypto investors.

Next issue on the block would be to untangle the GST levy on the crypto transactions. Several state tax officers are definitely working on this thread to identify the areas for which taxation needs to be clarified.

We hope that further clarifications from government on the taxation aspects including income tax and GST are on the way vide Budget 2023 which would add stability to the overall taxation of crypto in India.

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