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Crypto Tax: The Conundrum continues!

Crypto-currencies and blockchain technology has been in the limelight in recent years. While some advanced economies have not banned crypto-currencies, India found itself in a limbo, unsure if it wants to regulate it, legitimize or ban it altogether. In this respect, the Finance Bill 2022 introduced in the *Lok Sabha* ("**Bill**") shed some light on the tax position to be adopted by New Delhi.

Proposals under the Bill

The Bill seeks to bring within Indian tax net ambit a wide range of assets, being termed 'virtual digital assets' ("**VDA**") with effect from April 1, 2022. While the term 'crypto-currencies' is not specifically mentioned, the scope of VDA is broad to include crypto-currencies and non-fungible tokens. The Bill defines VDA as any information or code or number or token- (excluding Indian currency or foreign currency) generated through cryptographic means or otherwise 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. Additionally, the Central Government has ben vested with the power to notify any other digital asset as VDA by notification in the Official Gazette.

Some of the key proposals on the crypto tax being:

1. 30% tax on the income from transfer of any VDA;
2. No deduction or expenditure available other than amount paid to acquire such VDA while determining taxable income;
3. No set-off of losses from VDA available against any income of the taxpayer;
4. No carry forward of losses in relation to the VDA to subsequent financial years;
5. 1% tax deduction at source applicable on any payment to a resident for transfer of VDA.

This suggests that income only arises upon transfer of VDA and not while acquiring or holding it.

Regulatory approach

The government's stand with regard to this provision is that acknowledging that the income is taxable does not mean that they have legalized Crypto. The Finance Minister has gone on record to say that we refer to it merely as 'crypto' and NOT 'Crypto currency'. Thus, they seem to have acknowledged the existence and dealings in Crypto. They have also indicated that whether to ban or permit dealings in Crypto is the job of the central bank of the country, the Reserve Bank of India ("**RBI**") and that the RBI will come out with a holistic regime for regulation of the VDA and its trading. The fact that New Delhi has not banned trading in crypto-currencies through the Finance Bill resulted in euphoria for the Crypto-currency traders and a significant in rise opening of new accounts with Indian crypto exchanges is witnessed[1]. The stance of the RBI has been a slow yet cautious approach. Due to the inherent nature of the crypto-currencies being based on acceptance by private parties, the RBI finds itself unconvinced with the idea of regulating and legitimizing VDAs. In a recent keynote address by the RBI Deputy Governor on 14th February, 2022, it was deliberated that crypto-currencies/VDA pose a threat to financial sovereignty and make it susceptible to strategic manipulation by private corporates resulting in these currencies or governments controlling them, and are likely to wreck the currency system, the monetary authority, the banking system, and the Government's ability to control the economy.[2] Owing to the above reasons, the Ld. Governor concluded that perhaps banning the crypto-currencies is most advisable option available to India. Having said this, it is important to note that this is not the last we have heard on this issue and the RBI will need to come out with much more reasoned approach.

Taxability and Way forward

The proposals made by the Bill does provide clarity on the taxability of the VDAs, and the stance of the Indian Government, that if an investor/taxpayer is making gains out of the VDAs, the tax would need to be paid, however there is no respite for the losses arising (if any). Essentially, this income is treated like winning from lotteries or gaming. Moreover, the proposal to introduce 1% tax deduction at source on the person making the payment to a resident is onerous and it will require any non-resident to comply with the provision, in case of purchase of VDA from an Indian resident. It is interesting to note that the obligation to deduct tax has been fastened on the person making the payment, even in cases where the transfer of the VDA is taking place in kind or partly in cash and in kind, and if the cash component is not enough to discharge the liability to deduct tax, the taxpayer making the payment would need to bear the tax, from his own pocket.

One may wonder, if the high tax rate of 30% would result in taxpayers exploring to undertake transaction between two principals without involving the exchanges. It seems that this may not be useful since the proposed provisions in their current form do not seem to distinguish between a transfer of crypto-currencies on and off the crypto-exchanges. Coupled with the fact that the monies would be routed through banking channels, the parties would run the risk of being chased by the taxmen for tax along with interest and penalty.

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[1] https://economictimes.indiatimes.com/markets/cryptocurrency/crypto-tax-in-india-spurs-bonanza-for-digital-coin-bourses/articleshow/89643361.cms

[2] Crypto-currencies – An assessment, Keynote address delivered by Shri T Rabi Sankar, Deputy Governor, Reserve Bank of India - February 14th, 2022 - at the Indian Banks Association 17th Annual Banking Technology Conference and Awards, available at https://www.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1196

The crypto tax proposals offer smidgen of conclusive stance on legitimizing or regulating the crypto-currencies, as tax has little to do with legality of the transaction or the income itself. Having said this, an ostrich policy of taxing the gains without regulating the crypto-currencies may not help in the longer run, which makes a compelling case for formulation of a holistic policy, not only from a tax perspective but also from a regulatory perspective. Such policy and consequent regulations could go a long way in addressing concerns regarding the threat to the financial sovereignty posed by crypto-currencies, and the possible misuse of the crypto-currencies in money laundering etc.