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Analysing developments impacting business

UPDATE: RECENT DEVELOPMENTS REGARDING TAXATION OF CRYPTO-ASSETS IN INDIA

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With the increasing adoption of crypto-assets in India and the rapid developments in the crypto space, the government introduced a separate regime for levy of income tax on virtual digital assets (VDAs) in the 2022 Budget proposals (Budget VDA Proposals).

The Budget VDA Proposals : (i) provide a 30% tax on income arising from transfer of VDAs; (ii) provide recipient level tax in case of gift of VDAs for nil or inadequate consideration and (iii) also introduce a new tax deduction at source (TDS) obligation (with effect from 1 July 2022) on persons responsible for paying any consideration to residents for transfer of VDAs. Our *Ergo* on the 2022 Budget, covering the Budget VDA Proposals can be accessed [here](#).

Post the announcement of the Budget VDA Proposals, some interpretational issues had cropped up, and lately certain other developments have also arisen regarding taxation of VDAs.

Set out below is a summary of such developments that have taken place in the income tax space:

- *Inter se set-off of loss not allowed:* Upon introduction of the Budget VDA Proposals, there remained an ambiguity as to whether the loss arising from transfer of one VDA (say Bitcoin) can be set-off against the income arising from transfer of another VDA (say Ethereum). In this regard, amendments have been made to the Budget VDA Proposals to make it clear that such inter se set-off of loss will not be permissible.
- *Costs for mining of crypto-assets may not be treated as 'cost of acquisition':* The Ministry of Finance, in response to a question posed to it during the Lok Sabha session on 21 March 2022, has stated that 'infrastructure costs' incurred in mining of crypto-assets will not be treated as 'cost of acquisition' as these costs will be in the nature of capital expenditure, and hence will not be allowed as a deduction.
- *Writ petition challenging TDS proceedings initiated against a crypto-platform:* *Reportedly*, the Karnataka High Court has admitted a writ petition, wherein the petitioner, a crypto-platform, has challenged the TDS proceedings initiated

against it by the income-tax department. It has been reported that the income-tax department has taken a view that:

- The petitioner executes sale or purchase orders for cryptocurrencies on another third-party platform for its customers and hence the petitioner is a facilitator i.e., an e-commerce operator, for the purposes Section 194-O (i.e., 1% TDS on e-commerce platforms) of the Income-tax Act, 1961 (IT Act).
- Cryptocurrencies are 'goods' and provisions of Section 194Q (i.e., 0.1% TDS on purchase of goods) and Section 206C(1H) (i.e., 0.1% TCS on sale of goods) of the IT Act are applicable.

Now with the enactment of Finance Act 2022, the new regime for taxation of VDA has become applicable. Our *Ergo* covering the changes made to the Finance Bill 2022 during its passage in the Parliament can be accessed [here](#).

Developments in the GST space

GST investigations were undertaken against various crypto-exchanges in India in late 2021-early 2022 and as per news reports, past taxes equivalent to around \$12 million USD were recovered from them, predominantly vis a vis portions of commission income earned by them.

Given such spotlight on crypto-assets so close to the 2022 Budget, there was a lot of expectation about clarifications emerging *vis a vis* GST implications on various transactions involving crypto-assets, more so, given the Budget VDA proposals under Income Tax laws. However, such clarity under GST still eludes us, even though, reportedly, the Central Board of Indirect Taxes and Customs (CBIC) has been in the process of finalising its recommendations in this context for the consideration of the GST Council (GST Council is the Constitutional body responsible for all policy decisions under GST). If news reports are to be believed, the delay in this regard is possibly because there are many different schools of thought *vis a vis* GST and crypto-assets within the CBIC.

Nonetheless, it is pertinent to note that the following points are under active consideration of the CBIC *vis a vis* GST and crypto-assets, as per news reports:

- Whether to tax crypto-assets as 'goods' or 'services' - There is a prominent school of thought which seeks to levy GST on the entire value of a crypto-asset, when it is transferred. What is being evaluated is the best way to achieve this end - whether to classify transfer/sale of crypto-assets as 'sale/supply of goods' (albeit intangible goods) or 'supply of services'. Globally, both precedents exist.
- What should be the applicable GST rate *vis a vis* crypto-assets - While the 'goods or services' conundrum is not resolved yet, the transaction value in rupees or the equivalent denomination in a foreign currency, may be used to determine the taxable base for levy of GST on a transaction involving crypto-assets.

However, when it comes to the applicable rate of GST, reportedly, the following options are under consideration:

- Applying the standard GST rate of 18% under the residuary category;

- There is a school of thought which believes that transactions in crypto-assets ought to be treated at par with things like lottery, casinos, betting, gambling and horse racing and thus ought to be liable to GST at 28%; and
 - Another school of thought recognizes the potential adverse effect of high rates of taxation on the crypto ecosystem and proposes a highly concessional GST rate in the range of 0.1% to 1 % (for context, such concessional rates are currently available for categories like: (i) export supplies in certain scenarios; and (ii) under-construction affordable housing).
- Taxing services associated with crypto-assets including services by exchanges – Various services such as mining and related services such as wallet, facilitating sale and purchase, transfer, etc. are also being considered to be taxed at the GST rate of 18%.

Specifically, exchanges facilitating transactions in crypto-assets are under particular scrutiny. In this context, the GST authorities have reportedly noted the following in order to arrive at a conclusion:

- Only a few exchanges in India actually have crypto-assets on their financials, available for purchase/sale by traders/investors. In most cases, exchanges/holding companies outside India hold the crypto-assets which are made available to the Indian exchanges in various ways.
- While the exchange may be located in India, the buyer or seller may often be based outside India.

In this context, specific amendments are reportedly being evaluated in the 'place of supply' related provisions under GST laws to clearly provide for levy of GST on some of the cross-border transactions

- Can crypto-assets, at least some of them, qualify as "actionable claim" – Transactions in 'actionable claims' (with a few exceptions) are excluded from levy of GST. GST laws borrow the definition of 'actionable claims' from Transfer of Property Act, 1882 and the same comprises of claims to any unsecured debt or any beneficial interests in moveable property which is not in possession.

The government is reportedly evaluating the possibility of at least some of the crypto-assets/transactions qualifying as actionable claim in which case they will be out of the GST net and consequently, GST will only be levied on the service components and not on the entire value of the crypto-assets.

COMMENTS

On the income-tax front, while not allowing set-off of inter se VDA losses seems to discourage people from trading in VDAs, it is helpful that the government has provided such clarification beforehand itself and has put to rest any doubts in this regard.

Given the sheer volume of transactions in crypto-assets in India, it is hoped that a rational tax regime under GST is introduced soon, covering the entire spectrum of transactions in crypto-assets – this will help investors/traders achieve complete clarity *vis a vis* implications under both direct and indirect taxes.

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