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Gains from transfer of cryptocurrency

pre-2022 amendment, taxed as 'capital gains'

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Introduction

The Hon'ble Income-tax Appellate Tribunal (Jodhpur bench) (ITAT), in the case of *Raunaq Prakash Jain v ITO*, [2024] 169 taxmann.com 298 (Jodhpur-Trib) [28.11.2024] ruled that gains arising from transfer of cryptocurrency are taxable as '*capital gains*' (Ruling). Notably, this ruling pertains to FY 2020-21, ie prior to the amendments made to Income-tax Act, 1961 (IT Act) in 2022 when specific provisions for taxation of '*virtual digital assets*' (VDA) – which includes cryptocurrencies – were incorporated in the IT Act.

Background

Finance Act, 2022 (FA 2022) amended the IT Act by introducing a new taxation regime in relation to VDAs when: (i) a 30% tax was levied on income from transfer of VDAs in the hands of the transferor (VDA Gains); (ii) receipt of VDAs for nil or inadequate consideration was made taxable in the hands of the recipient; and (iii) an obligation was imposed (under Section 194S of the IT Act) on the persons responsible for paying any consideration to 'Indian residents' for transfer of VDAs to deduct tax at source (TDS) at 1%. Notably, prior to this amendment, IT Act did not contain any separate regime for taxation of VDA Gains, and hence, there were doubts as to whether the same would be taxed under the head '*Income from Capital Gains*' (CG) or '*Income from Other Sources*' (IFOS).

Ruling

In this case, the taxpayer, a salaried individual, had purchased a VDA in FY 2015-16 for INR 5.05 lakhs and sold the same in FY 2020-21 for INR 6.69 crores. Accordingly, it offered the resultant gains (after applying indexation) as long-term capital gains (LTCG)[1] and also claimed (i) set-off of losses from transfer of shares, (ii) rollover benefit in terms of section 54F of the IT Act (ie capital gains exemption on investment of sale proceeds into a house property). The Assessing Officer (AO) recharacterized the gains as IFOS, denying LTCG treatment (and consequently, the section 54F exemption), by alleging that a crypto-asset has no independent value or inherent utility (and hence, not a 'capital asset'). The same was upheld by the first appellate authority [CIT(Appeals)] and hence, the taxpayer filed a second appeal with the ITAT.

The taxpayer contended that cryptocurrency should be regarded as a '*capital asset*' (as the same would qualify as '*property*' – an essential ingredient for the definition of '*capital asset*' in terms of section 2(14) of IT Act[2]). It further emphasized that the specific incorporation of cryptocurrency as an asset (VDA, as per FA 2022 amendment) meant that even before 01 April 2022, cryptocurrency was an asset and that therefore, gains arising from its transfer should be taxed as CG, and not as IFOS.

On the other hand, the tax department argued that: (i) cryptocurrency lacked the inherent value or utility required to qualify as '*property*' under section 2(14), (ii) the definition of 'capital asset' as provided under

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[1] *Taxable at 20% (plus applicable surcharge, cess), as compared to IFOS which is taxable as per the applicable slab rate (ie not at the concessional tax rate as applicable to long-term capital gains)*
[2] *In terms of section 2(14) of IT Act, 'capital asset' means inter alia, property of any kind held by a taxpayer, whether or not connected with his business or profession.*

section 2(14) does not explicitly or implicitly describe cryptocurrency as 'capital asset'; and that hence, gains arising from its transfer should be taxed as IFOS (ie at the applicable slab rate, and not at the concessional tax rate available for LTCG).

The ITAT ruled in favour of the taxpayer, holding that cryptocurrency qualified as '*property*' in terms of section 2(14) in its broad legal sense and thus constituted a '*capital asset*'. In reaching this conclusion, the ITAT also relied on well-established principles that tax provisions should be construed in favour of a taxpayer in case of ambiguity. Further, the ITAT also took note of assessment orders passed in two cases where the respective AOs had accepted the treatment of cryptocurrency as 'capital asset' and accordingly allowed CG classification.

While doing so, the ITAT dismissed the tax department's argument that cryptocurrency lacked inherent value or utility, stating that such characteristics are not prerequisites for classification as a capital asset. It also referred to the FA 2022, which introduced specific provisions for VDA taxation but did not retrospectively exclude their treatment as capital assets in prior periods. The ITAT emphasized that the legislative acknowledgment of cryptocurrencies as assets through the FA 2022 reinforced their classification as '*property*' even before statutory recognition. Accordingly, section 54F rollover benefit was also upheld for the taxpayer.

Comments

This Ruling is a welcome decision by the Hon'ble ITAT as it gives clarity regarding the taxation of gains arising from transfer of crypto assets, prior to FA 2022 amendment. It also underscores a taxpayer-friendly interpretation of '*property*' which is relevant for the definition of '*capital asset*'. A taxpayer who earned such gains in FY 2021-22 or prior FYs should assess this Ruling to consider its impact on the facts of its case.

- *Raghav Kumar Bajaj (Counsel) and Vishal Samnani (Senior Associate)*

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