

THE TAXATION OF CRYPTOASSETS IN INDIA: A REVIEW OF EVOLVING TAX POLICY AND LAW

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ABSTRACT

The evolution of cryptoassets has been an exasperating experience for tax administrations the world over and it is no different in India. Over the years, the Indian authorities have struggled to frame regulations delineating the acceptability and contours of cryptoasset transactions and the issue has been compounded by judicial involvement. Nonetheless, the Indian tax administration has shed its inertia in order to introduce a specific and high tax incidence regime for cryptoassets, which treats these assets as distinct from capital assets. The value-added tax (VAT) rules, however, are a work in progress. The purpose of this paper is to trace the evolution of the taxation of, and regulatory framework for, cryptoassets in India, which continue to be intricately intertwined. The methodology employed in this paper is deliberately less analytical and more informative so as to inform the readers about contemporary developments, thereby highlighting the challenges faced by developing nations when framing tax policy and law for cryptoassets. The paper finds that the existing regulations are a work in progress, with larger concerns, such as money laundering and tax evasion, overwhelmingly dictating the evolution and enforcement of tax laws for cryptoassets. These findings have serious implications for the crypto ecosystem, because the initial reaction of the crypto market participants to these high tax incidence and strenuous withholding tax requirements reveals a clear inverse correlation between the tough tax and regulatory regime and crypto transactions.

Keywords: Virtual Digital Assets, Cryptoassets, Taxation, India.

INTRODUCTION

Like the evolving contours and technological applications of crypto², the policy and regulatory response of the Government of India (GOI) to tax and/or regulate these assets is a work in progress. Although there have been multifarious developments in the past few years, the GOI's final policy stance is yet to crystallise. Nonetheless Indian policy's tryst with crypto presents enough fodder for a researcher to chew on to help them to understand the competing priorities and intertwined variables affecting the regulation and taxation of crypto, especially in a developing country.

This essay is an attempt to detail the priorities and policy considerations that Indian policymakers have engaged themselves in, together with the resultant regulations. This reveals the innate challenges associated with framing an appropriate response to an evolving technology. The scope of this essay is limited to the dissection of the tax policy and law in India relating to crypto technology and its products. Nonetheless, in as much as certain non-tax regulatory and policy variables are intertwined, a reference to these variables has been appropriately factored in. The underlying intent is to detail the holistic span of constituents that have caught the attention of the policy-framers for the reader. These constituents, who span beyond tax, are in any case relevant, as they form both the context and the bedrock of the process employed to calibrate the tax system's response to the evolving contours of crypto.

Regulatory Scepticism and Judicial Rebalance: India's First Tryst with

Crypto

Cryptocurrency-related developments were taken cognisance of by the financial market regulator, i.e. the Reserve Bank of India (RBI), for the first time in 2013 (RBI, 2013). The RBI cautioned market players against using, holding, or trading cryptocurrencies (RBI, 2013). Perturbed by the growth in transactions, in 2018, the RBI outrightly and equivocally sought to ban cryptocurrencies. Exercising its wide powers, it issued statutory and binding instructions directing banking institutions, inter alia, not to deal in virtual currencies (VCs) “or provide services for facilitating any person or entity in dealing with or settling VCs” (RBI, 2018a).³ These instructions were preceded by a policy statement which justified the measures as being introduced in a step towards “ring-fencing regulated entities from virtual currencies”. This response from the RBI was, inter alia, driven by “concerns of consumer protection, market integrity and money laundering” (RBI, 2018b, p. 5), and reflected the views expressed by the GOI’s finance minister, tax board, securities market regulator, and other officials in their earlier deliberations.

Feeling aggrieved by the loss of opportunities in view of these restrictions, the prescriptive policy stance was challenged by crypto players before the Supreme Court of India (SCI). The challenge was made on rather technical grounds, whereby it was highlighted that cryptoassets were not legal tender but were instead akin to ordinarily traded goods and, hence, it was beyond the regulatory prowess of the RBI to prohibit them, given its limited mandate to regulate the financial and credit market. The SCI accepted this challenge and quashed the RBI’s circular in a detailed judgment (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275). The key findings of the SCI are detailed below.

Under the extant statutory framework governing the exercise of regulatory powers, the RBI is empowered to regulate any currency or instrument that affects financial markets in India. In view of the technological possibilities offered by cryptocurrencies and their contemporary usage, the SCI rejected the contention that they “are just goods/commodities and can never be regarded as real money” (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275, section 6.86, p. 107).

Hence, cryptocurrencies are not beyond the regulatory purview of the financial market regulator (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275, section 6.87, p. 108). Accordingly, the RBI’s instructions about cryptocurrencies are not ultra vires its powers (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275, section 6.88, p. 109).

The SCI further concluded that the apprehensions of RBI with regard to the possibility of cryptocurrencies affecting the functioning of the financial markets were not completely out of place and, hence, the exercise of regulatory power was beyond cavil.

Nonetheless, the SCI disapproved the outright ban on market players accessing formal banking channels in order to trade cryptocurrencies. According to the SCI, the complete preclusion of banking platforms for cryptocurrencies violated the constitutional protection to right to carry out business as it failed the “test of proportionality” (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275, section 6.156, p. 152). Taking cues from the developments in other jurisdictions, the SCI highlighted the failure of the RBI to consider alternatives to an outright exclusion. It took note of the prevailing thought

within the RBI itself that “a ban might be an extreme tool and that the same objectives can be achieved through regulatory measures” (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275, section 6.167, p. 173), which the SCI juxtaposed alongside the fact that “[t]ill date, RBI has not come out with a stand that any of the entities regulatory by it ... has suffered any loss” (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275, section 6.172, p. 176). On this standalone ground of violation of the proportionality principle, therefore, the SCI quashed the RBI’s instructions and permitted unrestricted access to banking facilities for trade in cryptocurrencies.

Even though the operative part of the SCI’s decision was limited in scope and merely called upon the RBI to have a rethink, it was perceived by the market players as a judicial vindication and legitimisation in India of crypto products in general and cryptocurrencies in particular.⁹ The RBI’s abstinence from taking remedial action after the SCI’s decision added further credence to such market sentiments, resulting in the existence of more than 100 million crypto owners in India, the highest number in any country in the world (Livemint, 2021). This has been witnessed in form of increased citizenry participation in trade in Bitcoins and other digital currencies, the mushrooming of crypto exchanges, mass public advertisements, and the search for greater public participation.

The Direct Tax Landscape Background

Regulations in the Indian direct tax laws relating to any class of cryptoassets have not been in place for long. On 1 February 2022, as part of the annual budget, the first specific tax policy proposals for the taxation of cryptoassets were unveiled by the GOI. These proposals were accepted by the Indian Parliament, which enacted the Finance Act, 2022 to amend the Indian Income Tax Act, 1961 (ITA), inter alia, to tax certain aspects of cryptoassets from 1 April 2022 onwards. This section explains the salient features of the new direct tax law governing cryptoassets in India.

Scope

In order to comprehensively address the taxability of cryptoassets, a new definition has been inserted into Section 2(47A) of the ITA. It refers to “virtual digital assets” (VDAs), a term which has three limbs: (a) cryptoassets¹¹ (which exclude “Indian currency or foreign currency”) (b) non-fungible tokens (NFTS), and (c) “any other digital asset” which may be included in the scope of VDAs by the GOI through an official notification (ITA, Section 2[47A]). Thus, the definition appears to be forward-looking, which permits the GOI to address technological advancements without asking Parliament to amend the law each time in order to expand its scope. However, to avoid any unintended externalities, Parliament has empowered the GOI to “exclude any digital asset from the definition of virtual digital asset subject to such conditions as may be specified therein” (ITA, Section 2[47A]).

Thus, under the incumbent regulations, Parliament has conferred wide discretion upon the GOI to define the scope of cryptoassets’ taxability by giving it the flexibility to expand or prune the list of taxable cryptoassets. This legal position appears to be a logical response by which to address the ever-changing dynamics and overwhelming technological variables that shape the contours of cryptoassets.

Special Charging Provision

The specific definition addressing the scope of cryptoassets within the ITA

has been complemented by a special charging provision which exclusively addresses the tax consequences arising from the transfer of VDAs (ITA, Section 115BBH). The provision is agnostic to the tax residence of the transferor and thus applies to income earned by both residents and non-residents.

All forms of transfer are taxed under this provision, which, given the width of the statutory provision, include transactions involving the barter or exchange of VDAs.¹⁷ Income from such transfers is taxable at a fixed rate of 30%.¹⁸ Only the cost of acquisition¹⁹ is allowed as a deduction when determining the income earned from the transfer. The provision specifically precludes the deduction of any other expenditure or set-off of any loss from other income in order to determine the income (ITA, Section 115BBH [2][a]). In fact, each VDA is considered to be distinct for tax purposes because a loss on a sale of VDAs is not permitted to be set off to determine the income from the transfer of another VDA or to be set off against any other income.

The salient features and consequences of the aforesaid scheme are as follows:

The introduction of a new scheme appears to be guided by the legislative intent to postulate cryptoassets as a distinct area of taxation.²¹ This scheme also insulates cryptoassets from the application of the general provisions of the ITA.

Due to a special provision, the ITA has obviated the issues relating to the characterisation of income from cryptoassets (such as business income versus capital gains etc.) and, thus, distanced itself from the debates about tax treatment in other countries.²²

The current scope of the tax law under the ITA is limited to the transfer of cryptoassets. Hence, the incumbent tax law is conspicuously silent on the tax consequences that arise from the origin/evolution/creation of cryptoassets. For illustration, certain activities qua VDAs, such as the mining of or the mere acquisition of crypto coins (without a subsequent transfer), appear to be outside of the scope of the ITA.

Under the incumbent provisions, income from transfer of VDAs is taxed at the highest rate under the ITA. The GOI is on record acknowledging that the high tax incidence is intentional in order to discourage the trading of cryptoassets.

Digital currency that constitutes legal tender is excluded from the scope of VDAs. Thus, while cryptocurrency is covered within the scope of tax as VDAs, the transfer of official digital currency is a carve-out and not taxed.

There is no distinction in law between cryptoasset transactions that take place on centralised exchanges and those that take place on decentralised exchanges. Thus, there is parity in the tax law. However, the tax incidence and withholding obligations²³ may differ owing to differential factual transaction settings and the roles played by the participants.

Gifts of Cryptoassets are also Taxable

Like income from transfers, gifts of cryptoassets are taxable under the ITA. The provision governing the taxation of gifts (ITA, Section 56[2][x]) has been expanded to include gifts of VDAs. However, in view of the general scheme governing the taxation of gifts, the generic exceptions (such as *de minimis* exemptions, gifts amongst relatives, gifts to charitable institutions, etc.) would also apply to gifts of VDAs.

The tax liability is different when gifts of cryptoassets are made than when cryptoassets are transferred. When cryptoassets are transferred, the tax incidence arises in the hands of the transferor, while when they are gifted; it arises in the hands of the transferee i.e., the recipient of the gift.

Tax Withholding Obligation

“In order to widen the tax base from the transactions so carried out in relation to” VDAs (GOI, 2022b, p. 55), a special tax withholding provision has also been introduced in the ITA (ITA, Section 194S). The provision obliges both resident and non-resident buyers of VDAs to observe the withholding tax. However, the withholding is limited to transactions where the transferor is an Indian tax resident.

The withholding obligation applies irrespective of whether or not the transfer is against monetary consideration and obliges the buyer to ensure that appropriate tax on VDAs has been paid where the VDA is transferred on account of consideration in kind or in exchange for another VDA.

The withholding is 1% of the consideration for the transfer of a VDA. However, certain *de minimis* exemptions have been stipulated which relieve the transferee from the need to observe the withholding obligation in certain situations.

By way of certain administrative clarifications, the GOI has issued guidelines to remove hardships in certain situations, especially in context of scenarios where there are multiple tax withholdings (Central Board of Taxes [TPL Division], Department of Revenue, Ministry of Finance, GOI, 2022a, 2022b).

A distinct reporting requirement—Form No. 26QF—has also been notified by the GOI to effectuate the withholding compliance (Central Board of Taxes, Department of Revenue, Ministry of Finance, 2022c).

Effective Dates

The provisions governing taxability on the transfer of VDAs came into force from 1 April 2022. The withholding obligation, however, was deferred and came into force from 1 July 2022.

Doubts continue to linger about the manner of taxability of cryptoasset transactions that had taken place before the provisions applied (31 March 2022), as there is no clarity either in the law or by way of an official statement from the GOI. In such cases, it is possible that, depending upon their specific nature, different tax considerations may apply (cryptoassets may be taxed under business income provisions, investors may be taxed on capital gains, etc.).

Tax Treaty Relief

Owing to the peculiar status of income earned from cryptoassets, there are doubts about the availability of tax treaties for non-residents subjected to such tax in India. A view exists that cryptoassets are not treated as capital assets and their transfer does not result in business income in view of the scheme for the taxation of VDAs.²⁸ Thus, in view of the domestic law characterisation in India, income from cryptoassets may be considered under the “other income” provisions of the tax treaties.²⁹ Such characterisation of income from cryptoassets can result in differential treatment for non-residents, as most Indian tax treaties permit India, as the source country, to tax such income that arises in India.³⁰ In such cases, at least double taxation relief can be claimed in the resident states, provided such states agree that the crypto tax in India is in accordance with the provisions of the respective tax treaties. However, there are some Indian tax treaties that do not have an “other income” provision altogether.³¹ In such cases, the income may be subject to double taxation.

The Evolution of Direct Tax Policy: A Recap

The aforesaid legal position on direct taxes came into force when the parliament approved the GOI's proposals. This process involved extensive parliamentary scrutiny and debates that provide illuminating insights into the rationale for the tax law as it stands.

According to the GOI (2022a), the two brief yet interlinked reasons that prompted it to change the status quo were (a) that there had been “a phenomenal increase in transactions” and (b) this meant that the “magnitude and frequency of these transactions have made it imperative to provide for a specific tax regime” (paragraph 131, p. 23).³² Each of these received mixed responses from the members of Parliament, with some questioning the move while others supported the proposed changes. Some of the main observations are detailed below:

According to Gaurav Gogoi (Lok Sabha Secretariat, 2022), the 30% tax rate “is intended to disincentive and discourage people from trading, occupying or holding” VDAs (p. 824). Gogoi notes that this is despite a lack of clarity, particularly in relation to cryptocurrencies, as the nuances of their regulatory treatment are yet to be spelt out by the GOI (Lok Sabha Secretariat, 2022).

The application of a high tax rate to VDAs indicates that the GOI wants to, as Gogoi (Lok Sabha Secretariat, 2022), describes it, “treat crypto as a sin” (p. 825),³⁵ an approach which is incongruent with the permitted trade in cryptoassets. Furthermore, banning versus regulating crypto transactions is a delicate balancing job, given that a ban may, as Gogoi (Lok Sabha Secretariat, 2022) notes, result in crypto becoming the “route for money laundering, illicit activities, drugs, or crime”, whereas the international experience has revealed that its regulation is equally challenging (p. 825).

Notwithstanding the tax policy outlined by the GOI, the status and asset class of crypto continue to be unclear. In any case, tax policy cannot precede a dispassionate determination of the crypto industry's employment generation capacity—its ability to, as Priyanka Chaturvedi puts it, “create an enabling eco-system” (Rajya Sabha Secretariat, 2022, p. 107)—and linkages with effects on Web 3.0 etc., which can only be addressed by way of a calibrated regulatory regime.

Sunita Duggal notes that the imposition of a tax deduction obligation is appreciable as it would permit the tracking of crypto transactions, which would reveal the participants in this industry and demystify the source for its wide-spread growth (Lok Sabha Secretariat, 2022). However, when viewed from another perspective, the deduction of tax would take the sheen away from this attractive asset class, which is popular with the youth (see Pandey's speech in Lok Sabha Secretariat [2022]).

These observations notwithstanding, the GOI's original policy outline and the legislative proposals to tax VDAs were approved by the parliament with minor changes. These approvals were obtained after the GOI presented, inter alia, the following rejoinder to defend the tax policy on VDAs.

In Lok Sabha on 25 March 2022, Nirjala Sitharaman noted that while clarity is awaited on the formulation of the regulatory provisions, tax policy and law cannot stand still until such time because “there is a lot of reported activity happening: a lot of transactions are happening” and “people of putting money, people are taking money, people are creating assets, and assets are being sold and bought” (Lok Sabha Secretariat, 2022, p. 934).

Sitharaman also stated that the tax deduction obligation “is more for tracking; it is not an additional tax, it is not a new tax, it is a tax which is going to help people to track it” and one “can always reconcile it with the total tax” by way of adjustment (Lok Sabha Secretariat, 2022, p. 934). She added that the tax deduction mechanism “is

always a legitimate way through which we are tracking the transactions and, therefore, it is helpful to widen the tax base” (Lok Sabha Secretariat, 2022, pp. 934–935).

The aforesaid discussion clearly reveals the emphasis upon two key aspects i.e., (a) the intrinsic link between regulatory and tax policy vis-à-vis crypto, and (b) the perceived death knell for trade in crypto with high tax incidence on its transactions. These concerns continue to linger despite the approval and enforcement of a new direct tax landscape for crypto in India.

The Indirect Tax Landscape

While there is clarity under the direct tax framework, albeit from a particular date, there is no such clarity under the indirect tax framework. The Goods and Services Tax (GST) law is the principal repository³⁷ for Indian indirect tax laws from 1 July 2017 and covers both domestic and cross-border transactions of all goods and services. The GST law is conspicuously silent on the treatment of cryptoassets.

In the absence of formal clarity on the GST provisions, various disputes have arisen about the indirect tax consequences of cryptoassets. Based on commentaries,³⁹ the following issues can be culled out as requiring advertence:

The classification of cryptoassets⁴⁰ as “goods”, “services”, or neither under the GST law,⁴¹ and the concomitant consequences.

The identification of “consideration”, valuation issues, and the applicable rate of tax on crypto transactions (i.e., 18% standard rate versus 28% rate on sin activities).

Issues relating to the taxability of crypto transactions qua rules contingent upon the location of the transacting parties and the transacting medium i.e., issues involving import, export, place of supply, special rules for e-commerce transactions, withholding tax obligations, extra-territoriality etc.

As under the ITA, the application of GST laws is doubtful on situations other than the transfer of cryptoassets. Hence, in both the direct and indirect tax frameworks, the incumbent tax law is conspicuously silent about the tax consequences arising from the origin/evolution/creation of cryptoassets.

Additional issues that arise in relation to the tax treatment of crypto exchanges and other intermediaries, given the lack of special rules for them such as are provided under the GST law in respect of e-commerce intermediaries.

It is understood that the formulation of the GST policy for crypto transactions continues to be a work in progress (Kannan, 2022). There are conflicting media reports about whether the GST Council, which is the highest policy recommendation body in respect of the GST, is considering a proposal where all activities and services related to cryptoassets may be subjected to 28% GST, i.e., the highest tax slab in the GST (Asoodani & Chaturvedi, 2022; FE Online, 2022). Meanwhile, however, the GOI continues to apply the generic GST rules and this has resulted in substantive recoveries being made from multiple crypto exchanges (Department of Economic Affairs, Ministry of Finance, GOI, 2022) and individuals (Ohri, 2022).

Once Bitten, Twice Shy: Exploring the Possible Rationale for a Go-Slow on Implementing a Definite Regulatory Framework

No standard approach to designing a crypto policy framework appears to emanate from a review of cross-jurisdictional practices. Hence, the GOI’s delay in finalising its policy stance is unsurprising.⁴² In fact, the delay is quite understandable because the regulatory policy must not impinge upon the citizens’ constitutional rights, as emphasised by the SCI (*Internet and Mobile Association of India v. Reserve Bank of India* [2020 SCC Online SC 275]). Another reason for the delay is

the change in stance of the GOI, which is seeking to abandon its earlier approach of establishing an administrative framework via which to regulate cryptoassets, preferring to find a legislative solution instead (Ministry of Finance, Government of India, 2021e).⁴³ One would hope that the law, once enacted, would holistically address the rights and liabilities of crypto transaction participants as well as delineating the empowerment and duties of the designated crypto regulator.

Nonetheless, it is clear that the thrust of the GOI's actions lies in its increasingly closer scrutiny of crypto transactions. It has been well documented that the GOI's evolving policy stance appears to be heavily influenced by, in addition to concerns about tax evasion, the larger apprehensions about cryptocurrencies being used for nefarious designs, such as money laundering ("Biggest risk of cryptocurrency", 2022), the financing of terrorism,⁴⁵ drug trafficking and other illegitimate activities. In fact, the GOI is also pitching for regulation to be introduced at a global level to prevent the abuse of cryptocurrencies for illicit purposes (Shukla, 2022). Considerable effort has been made by the GOI to pioneer a multilateral solution under the aegis of the G20.⁴⁸ Thus, the GOI can be expected to ask the parliament for a law replete with granular detail about crypto technology and transactions, and call for an excessively empowered regulator.

While legislation on the subject is awaited, extensive regulatory action, which particularly targets cryptocurrencies, has been taken. The RBI has given repeated warnings seeking to discourage cryptocurrencies and these appear to be taking their toll on cryptocurrency transactions (Rai, 2022). Effective from 7 March 2023, the GOI has designated certain persons as reporting entities within the scope of India's anti-money laundering (AML) legislation. These are persons who, either for themselves or others undertakes;

Exchange between virtual digital assets and fiat currencies.

Exchange between one or more forms of virtual digital assets.

Transfer of virtual digital assets.

Safekeeping or administration of virtual digital assets or instruments enabling control over virtual digital assets; and

Participation in and provision of financial services related to an issuer's offer and sale of a virtual digital asset. (Department of Revenue, Ministry of Finance, GOI, 2023).

In view of the applicable law,⁵² these persons are obliged to record all transactions exceeding INR 1 million (Rule 3 of the Prevention of Money Laundering [Maintenance of Records] Rules, 2005). Additionally, they are required to undertake client due diligence, which requires them to collate details of their clients, including beneficial owners (Rule 3 of the Prevention of Money Laundering [Maintenance of Records] Rules, 2005). There are both civil and criminal penalties for failing to comply with the obligations. Crypto platforms and financial intermediaries facilitating crypto transactions would fall within the wide scope of India's AML legislation. Thus, pending crypto-specific regulatory legislation, crypto transactions have been made subject to AML regulations.

The Tax Avoidance/Tax Evasion Perspective

The concerns set out in the earlier sections are not just theoretical, but are pragmatically alive for both the crypto-participants and the Indian tax administration. In fact, the prevailing scenario speaks volumes about the reasons for the GOI's scepticism and, in hindsight, perhaps also justifies the tax measures that have recently been introduced. However, to appreciate this aspect, which is closely linked

to the tax avoidance/tax evasion perspective, one must necessarily traverse the regulatory landscape.

Given its wide mandate to pursue white-collar offences, the Indian AML regulator (i.e. the Directorate of Enforcement, or Enforcement Directorate [ED])⁵³ has been in overdrive trying to unearth the rotten apples in the crypto trading arena (“ED now raids CoinSwitch Kuber”, 2022). The rationale, as explained in an official press release by the ED, is the ease with which crypto participants can launder ill-gotten wealth and benefit from the anonymity offered by crypto exchanges. According to the ED, investigations have revealed, inter alia, that a “large amount of funds were diverted by the fintech companies to purchase Crypto assets and then launder them abroad” (ED, Department of Revenue, Ministry of Finance, Government of India, 2022). They add that these assets are still untraceable (ED, Department of Revenue, Ministry of Finance, GOI, 2022). These investigations have resulted in the seizure of sizable assets from those crypto exchanges that have been unable to provide details, most of which are very basic and expected to be readily available, such as lists of relevant crypto transactions, details of wallets and wallet holders, and blockchain ledger records, etc., to the ED (ED, Department of Revenue, Ministry of Finance, GOI, 2022). More critical, it is abysmal to note, is the admissions by crypto exchanges regarding their non-maintenance of records relating to the bank accounts used for cryptoasset transactions and lack of verification of crypto participants etc., which, according to the ED, amounts to “encouraging obscurity and having lax AML norms” (ED, Department of Revenue, Ministry of Finance, GOI, 2022) and thus explains the expansion in the scope of AML regulations to include crypto transactions.

To extrapolate the aforesaid developments in the tax law framework (which, as is well acknowledged, is not wholly insulated from money-laundering),⁵⁶ it is obvious that there is considerable tax leakage given such a state of affairs in the crypto world. In the absence of AML coverage, the lack of knowledge regarding the whereabouts of transacting parties, the non-recording of transactions, and the inability to link bank accounts with crypto participants etc., at the end of the crypto exchanges (which are the source of information for the tax administration) are significant roadblocks in the latter’s quest towards enforcing the provisions of the fiscal laws. Thus, the unravelling of the crypto trade in India does not just reveal scope for tax avoidance opportunities. Instead, the tax administration does not appear to be totally off the mark in describing crypto as a hotbed of rampant tax evasion.⁵⁷ It is, therefore, unsurprising that the GOI has received legislative sanction to enforce a withholding tax which extends to almost all crypto transactions and is clearly intended as a step towards tracking the activities of crypto participants.⁵⁸ In addition, the GOI is also contemplating assigning mandatory tax identities to crypto participants (Choudhary, 2022).

The issues relating to cryptoasset transactions is particularly acute for India given that more than 7% of India’s population owns digital currency, with the nation ranking seventh in the list of top 20 global economies for digital currency ownership as a share of population (United Nations Conference on Trade and Development, 2022a). Thus, there appears to be some merit in the GOI’s approach of deploying a high tax incidence strategy as a deterrent in relation to crypto transactions⁵⁹ in the absence of a regulatory framework. While it is true that the immediate plunge in crypto transactions has been attributed to the new tax rules (Banerjee, 2022: Kumar,

2022: Mittal, 2022b; A. Sarkar, 2022; G. Sarkar, 2022), it is very likely that the totality of evidence would nonetheless be evaluated in due course to assess the appropriateness of the new distinct tax law framework for cryptoassets, given that the evidence on the ground has revealed that a significant number of crypto transactions take place under the cover of anonymity. For the time being, the working theory of the GOI appears to be that, at the very least until a specific regulatory regime for cryptoassets kicks in, the tax law measures taken have introduced some tranquillity into the wild, unregulated world of cryptoassets, even if that is with a high tax incidence regime for them.

CONCLUSION

The introduction of definitive rules to tax income arising from crypto transactions has received a mixed reaction. Notwithstanding the delayed introduction of these rules in 2022, the industry has welcomed the introduction of a formal tax regime, as this provides clarity about the applicable rules, thus introduces certainty into industry dealings. At the same time, the high tax incidence and unavailability of loss set-off is being argued as killing the buzz and throttling this emerging industry (Banerjee, 2022; Mittal, 2022a). Nonetheless, propelled by the unveiling of the formal framework for direct taxation, the industry is imploring the GOI to expedite the finalisation of the GST rules and the regulatory framework to comprehensively address the crypto industry in order to obviate the intense tax investigations and permit the calibration of tax costs amongst the participants. Such qualms—ironical as they may be and tax lawyers may disagree—illustrate that ambiguity in tax rules is not always to the benefit of the citizens.

In any case, the tax policy relating to cryptoassets in India is a work in progress, with the incumbent tax policy of the GOI appearing to be overwhelmingly driven by regulatory concerns, inter alia, in relation to money-laundering, and directed towards the evolution of an effective framework with which to regulate the crypto players. At any rate, the developments in India support the hypotheses that cryptoassets and associated transactions (a) do not immediately fit into the existing tax law regulations and (b) have created formidable challenges for tax administrations, inter alia, in terms of bringing them within the ambit of tax regulations and monitoring tax compliance in relation to them.

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