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Taxability of Cryptocurrency in India

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ABSTRACT

This paper aims at a multi-pronged analysis of India's present policy regarding block-chain technology and cryptocurrency, and the creation of a sustainable model outlining the structure of a proposed regulatory framework. Herein, India's behaviour and attitude towards technology are studied in light of official statements, infrastructural development, and legislative action with respect to blockchain, and the present policy is inferred to be observational in nature and may also be referred to as a 'wait-and-watch' policy. The present paper focuses on the taxability of crypto-assets in India. The nature of cryptocurrency for regulatory purposes in the suggested framework is proposed to be two-fold. This would depend on the purpose for which virtual currency is utilised, either by consumers, trading platforms, exchanges, etc., that is, on time-based usage.

Keywords: *virtual currency, trading, taxation, bitcoin, cryptocurrency*

I. INTRODUCTION

A type of unregulated digital currency is a virtual currency. A central bank does not issue or control it. Bitcoin, Litecoin, and XRP are examples of virtual currencies. Digital currencies are digital currencies that are stored in and transacted through specific software, applications, and networks. Private issuers typically issue virtual currencies, which are used within specific virtual communities. The security of the software and networks that support virtual currencies is a major concern. The categories for the classification of virtual currency thus identified are:

1. ***Capital Assets***

Capital assets are defined under Section 2(14)(a) of the Income Tax Act 1961 (hereinafter 'ITA, 1961') as, *"property of any kind held by an assessee, whether or not connected with his business or profession"*.

Virtual Currency is hence proposed to be treated *as 'property held by an assessee'* thus making crypto holdings taxable as capital assets under the ITA, 1961. It is submitted that virtual currencies ought to be considered a 'digital asset' for non-trading purposes. Under the suggested framework, this would include crypto holdings for investment purposes.

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2. ***Business Income***

Business Income is defined under Section 28 of Income Tax Act, 1961. It includes profits and gains accrued by the assessee arising from the practice of a business or profession. With respect to cryptocurrency, this would include within its ambit, income derived from mining and trading of virtual currencies (this would require mining to be treated as an entrepreneurial activity that takes up resources).

Hence, it is proposed that virtual currencies should be considered as 'business income' as far as their acquisition through mining is concerned, or in case of income earned by individuals/groups engaged in trading digital assets.

3. ***Taxation Framework***

One of the key components of any policy regarding value-based assets must necessarily include a taxation framework for the same. This paper proposes that taxes imposed on any economic activity involving crypto-currency may be taxed under the same heads of either capital assets or business income, depending on its usage. The differentiation in tax rates applicable and the categories under which such assets would be taxed depends on two factors-the time period for which crypto assets are held and their specific use. This proposition seeks to utilise existing taxation norms under the ITA, 1961 that deal with taxes applicable on capital assets and business income and is discussed further below.

4. ***Short Term Capital Assets***

Short-term capital assets are defined under Section 2(42A) of the ITA, 1961 as, *"a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer"*

The insertion of a sub-clause is proposed wherein crypto assets are to be considered short-term capital assets if they are held for a minimum time period of six months, but not exceeding twenty-four months immediately preceding the date of its transfer.

The profits from the sale of short-term capital assets would be taxed as short-term capital gains defined under Section 2(42B) of the ITA, 1961.

5. ***Long Term Capital Assets***

Long-term capital assets are defined under Section 2(29A) of the ITA, 1961 as "a capital asset which is not a short-term capital asset".

Under the proposed sub-clause, it would imply any and all crypto-related capital assets that are held for a time period exceeding twenty-four months immediately preceding the date of its transfer.

The profits from the sale of long-term capital assets would be taxed as long-term capital gains as defined under Section 2(29B) of the ITA, 1961.

6. ***Taxation of Business Income***

As per Section 28 of ITA, 1961, business income is chargeable to income tax. Cryptocurrency, when traded or mined by registered individuals or agencies is proposed to be included within the definition of profits or income arising from business/entrepreneurial activity and is, hence, liable to be taxed under the head 'profits and gains of business or profession'.

II. INDIA'S STANCE ON CRYPTOCURRENCY

The Indian governments' stance on Cryptocurrencies remains ambivalent. Now there's a threat of a replacement jurisprudence that might end many crypto exchanges. There is now a threat of a replacement jurisprudence, which could put an end to many crypto exchanges. According to media reports, the Indian government is considering a bill that would levy an 18% tax on Bitcoin transactions. The Indian tax authorities would wash a meg U dollar into their coffers with a transaction volume of 5.5 billion US dollars per year. The proposal was submitted to the Central Board of Indirect Taxes and Customs by the CEIB (Central Economic Intelligence Bureau), a branch of the Ministry of Finance (CBIC). The CBIC in India serves as a think tank for the Ministry of Finance. It has already been applied in a study on the parties of product and service tax (GST) on cryptocurrency[2].

CEIB has requested that the Indian government recognise Bitcoin as an asset. This effectively grants permission to levy a GST tax on all Bitcoin transactions within the country. The progress is not surprising. Authorities have been concerned about the lack of cryptocurrency regulations for quite some time. The use of Bitcoin in illegal activities such as concealment and betting has come to light.

III. FORMATION & PURCHASING OF BITCOINS

Mining is an action where a person known as a miner utilizes his computing ability to break computationally troublesome riddles and codes. The way toward breaking such riddles which are essential to blockchain innovation, help in looking after them. For this help they get incentives in the form of bitcoins, the miner gets new bitcoins which only lead to the formation

[2] Pradeep Thakur, *Govt weighs imposing 18% GST on bitcoin trade*, THE TIMES OF INDIA (DEC 29, 2020 06:51AM) https://timesofindia.indiatimes.com/business/india-business/govt-weighs-imposing-18-gst-on-bitcoin-trade/articleshow/80001885.cms

of Bitcoins. Everybody can't be a cryptocurrency miner. Subsequently, you can consider purchasing bitcoins from crypto trades and store them in an online wallet in the digital form of Mining is an action in which a miner uses his computing ability to solve computationally difficult riddles and codes. The path toward solving such riddles, which are essential to blockchain innovation, aids in their care. For their assistance, they are rewarded with bitcoins, and the miner receives new bitcoins, resulting in the formation of Bitcoins. Nobody can become a cryptocurrency miner. As a result, you can consider purchasing bitcoins from cryptocurrency exchanges and storing them in a digital wallet. Unicorn, Bitxoxo, Zebpay, Coinbase, and others are examples of online crypto wallets in India. These cryptocurrencies would be purchased in exchange for real money.[3]

Even though this isn't a frequent occurrence in India right now, there aren't many prudent money managers who accept bitcoins (rather than genuine cash) in the trading of goods and services. Tesla, a car manufacturer, recently announced plans to accept bitcoins in car-purchasing transactions. This resulted in a massive increase in bitcoin prices around the world. Because bitcoins are limited, if many people start holding them, the prices rise; if more people start selling them, the prices fall[4].

IV. INCOME FROM BITCOINS

Bitcoins generated through mining are a self-produced capital resource. The resulting offer of such bitcoin would, of course, offer an ascent to capital increase. However, one should keep in mind that the cost of obtaining a bitcoin cannot be predicted because it is a self-produced asset[5].

If bitcoins, which are capital assets, have been held speculation and are moved in exchange for genuine money, the appreciation in worth would offer ascent to a long-haul capital increment or a brief capital addition, depending on the time of holding of the bitcoin. The income derived from bitcoin exchanging action would provide an ascent to pay from bitcoin, and similarly, the benefit derived from such bitcoin would be liable to pay taxes according to the individual tax slab.

V. CRYTOCURRIENCIES TRADING IN INIDA

The challenges posed by unregulated cryptocurrency exchanges and their trading are magnified

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[3] Tushar Deep Singh, *Finding India's next crypto unicorn,* THE ECONOMIC TIMES (OCT 8, 2021 06:46 PM) https://economictimes.indiatimes.com/tech/startups/indias-top-5-cryptocurrency-platforms-and-what-they-offer/articleshow/86812478.cms?from=mdr

[4] Steve Kovach, *Tesla buys $1.5 billion in bitcoin, plans to accept it as payment,* CNBC (FEB 8, 2021 01:43 PM) https://www.cnbc.com/2021/02/08/tesla-buys-1point5-billion-in-bitcoin.html

[5] Euny Hong, *How does Bitcoin mining work,* INVESTOPEDIA (SEPT 21, 2021) https://www.investopedia.com/tech/how-does-bitcoin-mining-work/

in the current scenario. The Indian Supreme Court lifted a two-year ban on the Indian financial organisation RBI. Since March 2020, cryptocurrency trading has been permitted in India. Since then, banks and financial institutions have been able to trade digital currencies again. As soon as the ban was lifted, the number of transactions skyrocketed. The Indian government previously drew attention with a harsh stance against cryptocurrency. According to a BTC-ECHO report from August of this year, the government was considering completely prohibiting trading in Bitcoin and other cryptocurrencies. It is unclear how feasible this approach will ultimately be. After all, India is the world's third-largest economy, with one of the highest growth rates among the world's largest economies. However, it should be noted that there is a desire for action in terms of regulation.[6]

Taxing trading as GST would imply a tip for several crypto exchanges in India, including a Bitcoin exchange. Expert Praveen Kumar explained in a letter to the RBI that as long as the RBI does not create clear rules, crypto exchanges will be unable to obtain financial services from their lenders. It should be obvious that the announced 18% taxation does not provide the clarity that crypto exchanges require[7].

According to the Income Tax Act, an individual with a yearly pay of more than Rs 2.5 lakh or who has received any instalment on which duty was deducted at source (TD) is required to file an Income Tax Return (ITR), disclosing all profits. Regardless, there is confusion among many as to how income from internet in digital form of money should be disclosed in the ITR, and there is no guidance on this. Because of the disarray, the concept of income from investment in digital currencies has yet to be defined. There is no clearance on tax collection from such profit in this manner.

Tax consequences for any benefit or gain derived from holding Cryptocurrency will be determined by whether it is money or property. For the most part, cryptographic forms of money are used for the exchange of goods or administration. Currently, in India, digital forms of money are not regarded as cash by the RBI, and consequently, annual expense law does not classify it as money. Thu, neither Indian money nor unfamiliar cash can be viewed as a cryptographic form of money. As a result, for the purposes of personal assessment, it will be considered a property, and expense suggestion will be comparable if one possesses some other property. As

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[6] *China bans financial, payment institutions from cryptocurrency business,* REUTERS (MAY 18, 2021 05:57 PM) https://www.reuters.com/technology/chinese-financial-payment-bodies-barred-cryptocurrency-business-2021-05-18/

[7] George Mathew, *Cryptocurrency bank plans India operations, takes cooperative route to get around RBI rules,* INDIAN EXPRESS (JULY 19, 2021 07:16 AM) https://indianexpress.com/article/business/banking-and-finance/cryptocurrency-bank-plans-india-operations-takes-cooperative-route-to-get-around-rbi-rules-7411089/

such, the benefit of gain arising from digital form of money can be taxed as a business benefit if the equivalent was obtained to make profit by exchanging/mining or capital increased if the equivalent was obtained to make income.

VI. Taxation in India & cryptocurrency

Any exchange, including cryptocurrency, can be classified into two parts: payment and consumption. The nature of the exchange and the parties to the exchange would determine whether it was permissible under the Income Tax Act of 1961, the Goods and Services Tax Act of 2017, and other applicable laws.

Taxes are divided into two categories Direct and Indirect taxes. We can differentiate them based on how they are implemented. Direct taxes are paid by an individual or entity while Indirect taxes are levied on goods and services.

In the direct tax regime, the treatment of digital forms of money (i.e., Cryptocurrency) under the direct tax system is essentially administered by the Income Tax Act, 1961 in India. In the current legal scenario, there is no conviction regarding the tax ailment from digital money, nor is there a divulgence requirement for the pay procured by the Income Tax Department.

Moving on, if digital money is classified as 'cash,' it is exempt from taxation under the Income Tax Act. The main reason for this is that, under this enactment, the definition of "income" is broad, including the term "natural," which refers to the thing mentioned in Section 2(24) of the Income Tax Act. However, neither the regular importance nor Section 2(24) of the IT Act include 'cash' or 'money' as income, despite including 'financial instalment'.

Furthermore, as a way of thinking, the expense frequency would be on the exchange rather than the currency. However, if digital currency were considered a merchandise/property, it would unmistakably be covered in the charging arrangement of 'Profit and Gain from Business and Profession'.

As a result, any cryptocurrency transaction can be analyzed from two perspectives: income and expenditure. The nature of the transaction and the parties to the transaction would determine whether it was taxable under the Income Tax Act of 1961, the Central Goods and Services Tax Act of 2017, and other laws.

Direct Tax Regime:

In India, the Income Tax Act governs the treatment of cryptocurrency under the direct tax regime. There is no certainty regarding the taxation of cryptocurrency in the current legal landscape, nor is there any disclosure requirement regarding the income earned issued by the

Income Tax Department.

Moving on, if cryptocurrency were considered a 'currency,' it would be exempt from taxation under the IT Act. The first reason is that, under the Act, the definition of "income" is inclusive, including not only the "natural" meaning but also the item mentioned in Section 2(24) of the IT Act.[8] However, neither the natural meaning nor Section 2(24) of the IT Act include 'money' or 'currency' as a form of income, though it does include 'monetary payment.' Secondly, because this is a mode of consideration, the tax incidence would be on the transaction rather than the currency. On the other hand, if cryptocurrency were considered a good/property, it would clearly be covered within the charging provision of 'Profit and Gains from Business and Profession'[9] or 'Income from Capital Gains'[10], depending upon its use for business/profession or not. It would not be out of place to state that the ambit of the word 'income' is not restricted to the words 'profits' and 'gains' and anything which can appropriately be designated as 'income' is liable to be taxed under the IT Act, unless expressly exempted.[11]

- **Treatment under the head 'Capital Gains':**

Section 2(14) of the IT Act defines a capital asset as ***"property of any kind held by the assessee whether or not connected with his business or profession".***[12] This definition of 'capital asset' provided is widest in itself and covers all kinds of property except those expressly excluded under the Act.[13] Therefore, any gains arising out of the transfer of cryptocurrency must be considered as capital gains, if they are held for investment.

- **Taxability under 'Profit and Gains from Business and Profession':**

The tax treatment of cryptocurrencies when held as **'stock in trade'** is not the one which faces major difficulties as the issues arising while treating it as capital gains do not arise when such cryptocurrencies are held in furtherance of business activity. Under Section 2(13) of the IT Act, the definition of 'business' is inclusive, and comprises of ***"trade, commerce or manufacture or any adventure or concern of such nature".*** Moreover, any continuous activity like trade in cryptocurrencies is included within this definition, and profits realized are taxable thereunder, chargeable under **Section 28** of the IT Act.[14]

The profits may not necessarily be in the form of money, they are taxable even if they are 'in-

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[8] CIT/CWT v. P.R.S. Oberoi, (1990) 183 ITR 103 (Cal.).
[9] Section 28, Income Tax Act, 1961.
[10] Section 45(1), *Id.*
[11] Maharajkumar Gopal Saran Narain Singh v. CIT, (1935) 3 ITR 237 (Bom.).
[12] Section 2(14), Income Tax Act
[13] CIT v. B.C. Srinivasa Shetty, (1981) 2 SCC 460.
[14] Section 28, Income Tax Act

kind'. Any expenditure incurred for this purpose, such as the purchase of computing power as a capital asset, should be allowable as a deduction per the provisions specified in Section 30 to Section 43D of the IT Act.

Indirect Tax Regime

The classification of cryptocurrency as a good/property implies that the supply of bitcoin is a 'taxable supply' and thus subject to GST. Technically, the supply of cryptocurrency as a good or property in exchange for other virtual/real goods would be considered a 'barter transaction,' because bartering implies the exchange of one good for another.

Even in its most novel form, any barter transaction has two essential components:

1) Direct exchange of one good or service for another good or service and
2) No use of money.

Prior to GST, the incidence of tax arose when there was a sale of goods in exchange for cash, deferred payment, or any other valuable consideration under the various state VAT laws. 15 The expression 'any other valuable consideration' excludes a wide range of ambiguity, because the term would typically derive reference, *ejudem generi*, from its preceding term (i.e. cash and deferred payment)[15], and thus cannot include an exchange of good for other good. The Supreme Court reiterated this view in the case of ale Tax Commissioner v. Ram Kumar Agarwal[16], where a transaction of gold bullion in exchange for ornament was excluded from the definition of ale under Section 2(h) of the Sale of Goods Act, 1930. However, similar to when a transaction used a device to conceal monetary consideration, the court may unravel the device to include it within the scope of sale.

An approach in which cryptocurrencies are considered a good means that some transactions would be taxed twice - once on supply (otherwise exempt for a transaction in money) and once on consideration, resulting in an unnecessarily higher tax. The higher incidence of taxation places businesses operating in cryptocurrencies at a significant disadvantage, reducing their purchasing power. When it comes to international transactions, the situation becomes even more complicated.

VII. CONCLUSION & RECOMMENDATIONS

As an investment, cryptocurrency is rapidly growing in India. Although the Reserve Bank of India (RBI) has not granted bitcoin and other cryptocurrencies legal tender status, there is no

[15] Devi Dass Gopal Krishnan v. State of Punjab, (1967) 20 STC 430.
[16] Sales Tax Commissioner v. Ram Kumar Agarwal, (1967)

tax evasion for cryptocurrency investment benefits. According to the Economic Times, the Indian government intends to separate tangible funds and their tax management based on their operating conditions- payments, investments, or assistance[17].

"Cryptocurrency profits can happen in many ways such as mining, farming, farming, or general buying and selling", said Edul Patel, founder and CEO of San Francisco's cryptocurrency trading platform Mudrex.[18] The benefits of trading in digital assets can be categorized under **'business revenue'**, while other activities may fall below **'revenue from other sources'.** Bringing additional rules or amendments will put unnecessary burdens on the taxpayer, Patel said[19].

Computers can 'mine' bitcoin by solving complex metaphors that result in bitcoin rewards. Similarly, cryptocurrency staking pays a token to determine whether a transaction meets certain protocol requirements. Crop farming, which is typically done using the Ethereum ecosystem, entails borrowing crypto assets in exchange for payment. While it is unclear whether the Indian government will establish a regulatory framework for tangible assets, certain transparency provisions have been included. The Indian government made it mandatory for financial transactions to disclose profits or losses from cryptocurrency trading as well as the amount of cryptocurrency held on their balance sheets in March. Amendments to the Companies Act took effect on April 1 of this year. The then Finance Minister, Anurag Singh Thakur, clarified that *"the profits resulting from the transfer of crypto / assets are less taxable under the head of revenue, depending on the type of similar holding."*[20]

It is critical to evaluate the nature of these investments. Cryptocurrency can be classified as an investment asset or a source of revenue for a business. When a digital token is purchased for investment, it is considered a capital asset, which means it is taxed at a higher rate. Depending on the holding period, these investments are divided into significant long-term or short-term gains. Profits earned after holding the cryptocurrency for 36 months or more are taxed as long-term monetary benefits, whereas short-term accumulated profits are taxed as short-term capital gains. According to Harsh Bhuta, a partner in the Bhuta Shah & Co. book company, these profits are taxable at the taxpayer's applicable slab rates, whereas long-term capital profits are taxed at

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[17] *Definition of 'Property Tax'*, THE ECONOMIC TIMES (OCT 29, 2021 01:26PM) https://economictimes.indiatimes.com/definition/property-tax

[18] Hiral Thanawala, *Investing in cryptocurrencies made easier: Mudrex offers Coin baskets*, MONEYCONTROL (OCT 26, 2021 09:26AM) https://www.moneycontrol.com/news/business/personal-finance/mudrex-offers-coin-sets-do-they-make-investing-in-cryptocurrencies-simpler-7634221.html

[19] Ibid

[20] Harsh Bhuta, *Hold crypto assets? Here's how you are going to pay income-tax on it*, THE ECONOMIC TIMES (JUNE 6, 2021 11:00AM) https://economictimes.indiatimes.com/markets/cryptocurrency/hold-crypto-assets-heres-how-you-are-going-to-pay-income-tax-on-it/articleshow/83277122.cms?from=mdr

a lower rate of 20% on the index income. According to Bhuta, "more clarity" is still required in the process of managing various types of profits and income.

Once the profit margin is applied, the tax rate below the long-term level can be reduced, allowing the investor to adjust for inflation while the investment is held. The Central Tax Board reports the inflation rate in which these assessments are conducted every year. However, if the trader regularly conducts cryptocurrency operations, any profits made will be taxed as business revenue.

India's cryptocurrency bill may require further disclosure. Many countries already have a cryptocurrency profit tax system in place, but India's cold response to a tangible monetary system makes it difficult for investors to file their tax returns. Indians had deposited about $ 6.6 billion (Rs49,189 crore) in cryptocurrencies since May this year, compared to about $ 923 million until April 2020, according to blockchain data company Chainalysis[21].

As cryptocurrency regulations in India remain ambiguous, an increasing number of Indians are gaining access to digital tokens by buying and selling on foreign platforms that may offer better features and customer service. However, if Indian authorities warm up to the crypto token market, one of those companies may decide to enter the domestic crypto trade.

According to July reports, the Indian government may levy an 18% Property and Services (GST) levy on foreign cryptocurrency trading to balance the domain with domestic. India is also said to be considering a 2% tax on foreign exchange trading. The Indian cryptocurrency exchange charges 18% GST as a trading fee for customers, similar to how stock brokerages are set up. Market participants are now clenching their teeth in anticipation of the Indian parliament's winter session, where the country's first cryptocurrency law may be introduced.

In today's scenario, crypto has the potential to strengthen the backbone of India's digital infrastructure while also securing all transactions made on the digital network. In this situation, levying taxes on cryptocurrency transactions should be regarded as a positive step rather than a constraint. It is a two-way tree that allows crypto transactions to be traced and used legally while also generating revenue for the government to be used efficiently. It is also strongly advocated that imposing a tax on cryptocurrency as a policy matter can help to create an ideal environment in which traders can be assured that their money is safe and the risks associated with trading are reduced.

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[21] Sunainaa Chadha, *Over 10 crore Indians own cryptocurrency***,** THE TIMES OF INDIA (OCT 12, 2021 02:07PM) https://timesofindia.indiatimes.com/business/cryptocurrency/bitcoin/over-10-crore-indians-own-cryptocurrency-highest-in-the-world-report/articleshow/86962167.cms

A high volatility trend in cryptocurrencies especially Bitcoins in recent times have made it a preferable option for investors to earn a fortune on their investment. The value multiplication of bitcoins attracted investors resulting in demand hike which further led to increase in Bitcoin value. While all this may look attractive, one needs to be careful while investing in them. In the last couple of years, there have been multiple incidences of fake cryptocurrencies.

It is advisable not to expose too much to cryptocurrencies unless a person knows in and out about them. In order to create a balance between risk/reward and investment, one can invest a portion for long term in such digital currencies and trade with the remaining portion taking out 10-40% profit on investment.

Despite the challenges, some people's faith in Bitcoin or any decentralized currency is likely to grow over time. Decentralization can be a first step toward transferring power from large institutions to everyone else. Also, keep in mind that the government's current aversion to regulating cryptocurrency is likely to change very soon, and the digital currency sector will be heavily regulated. Tax departments are also likely to enact provisions to tax bitcoin trading gains. Some experts compare Bitcoins or digital currency in general to a bubble that can burst at any time, leaving investors with nothing, while others believe that this is the future of currency and trade and will revolutionize the way we deal with money.

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