



Himachal Pradesh National Law University, Shimla (India)

JOURNAL OF TAX LAW (JTL)

JOURNAL ARTICLES

ISSN: 2584-0428

JOURNAL OF TAX LAW

Volume I (2022)

TAXATION OF VIRTUAL DIGITAL ASSETS IN INDIA: A CRITICAL ANALYSIS

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Recommended Citation:

Vatsa Akanksha, *Taxation of Virtual Digital Assets in India: A Critical Analysis*, I HPNLU JTL 130 (2022).

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TAXATION OF VIRTUAL DIGITAL ASSETS IN INDIA: A CRITICAL ANALYSIS

*Vatsa Akanksha**

[Abstract: Digitalization marks the beginning as well as a symbolisation of the current era, wherein from the education system to governance and currency to assets, everything seems to be metamorphosed itself primarily on digital platforms. Speaking of which brings in the idea of Virtual Digital Assets (VDS) like cryptocurrency, Non-fungible Tokens (NFT), etcetera, which is nothing but a digital representation of an item that has value in a specific environment. The Ministry of Finance announced The Union Budget 2022, that proposed taxation and tracking provisions for tracking VDS. Alongside the taxation framework on VDA by introducing certain Amendments in the Income Tax Act. On that note, this Article is fairly dedicated to analysing those amendments that encompass the taxation scheme on VDA. The scope of this article is to briefly illustrate the meaning of virtual Digital assets and discuss their evolutionary transitory. Not to mention, this paper substantially analyses the impact of 2022 Union Budget on the position of the Digital assets in the Indian investment market. More so, the paper ends with conclusive and suggestive remarks that might better off the whole Virtual Digital Asset in India.

Keyword: *Virtual Digital Asset, Taxation, Crypto-currency, Non-fungible Tokens, investment, Union Budget]*

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I

INTRODUCTION

In the year 2009 one pseudonymous developer named Satoshi Nakamoto marked his name in the glorified history of digital assets with the development of the first ever decentralised cryptocurrency called 'Bitcoin'. Thenceforth, cryptocurrencies allured technologists and investors across the world demography. Interestingly over the period, India became a hub for virtual Digital Asset investment, as per the report facilitated by 'NASSCOM' an NGO in collaboration with WazirX,' a cryptocurrency exchange platform, there appears to be a remarkable advancement in the Crypto-Tech industry in India. It has been anticipated that in the coming ten years, India may invest around 241 million dollars in Virtual Digital Assets.¹

Since then, India has seen enormous investment in the field of Virtual assets. In fact, till January 2022, there were eight thousand plus Cryptocurrencies in the market. some of the popular among them are Bitcoin Cash, Litecoin, Ripple (XRP), etcetera. However, interestingly there is a lack of legal framework when it comes to legislation that prohibits, regulates, or governs Indian Virtual digital arrangements. Given the risks correlated with this investment, it was speculated that the Indian government might ban or regulate the exchange of Cryptocurrencies. However, on the contrary, the Union Budget initiated a wide step to tax the exchange of not only Cryptocurrencies but all forms of Virtual Digital Assets, including NFT but not limited to that. This step implicitly exhibits that the government is excepting the idea of virtual Digital assets, and instead of banning it altogether, it stands in favour of regularisation. Several legal provision has been introduced in the Income Tax that tends to govern investment in Virtua Digital Assets (VDS) from the assessment year 2023-24. Hence, any investment in VDS on or after 1st April 2022 was proposed to be taxable under the new law.²

II

WHAT ARE VIRTUAL DIGITAL ASSETS?

¹ Shah. K., *A new era in taxes has kicked in with taxation of virtual digital assets. But, what next?*, EY (22 Apr., 2022) available on- https://www.ey.com/en_in/tax/why-taxation-of-virtual-digital-assets-still-needs-clarity (last visited September 25, 2022).

² Dua S., *Tax on crypto, virtual assets decoded*, THE ECONOMIC TIMES (24 Jun., 2022), available on- <https://m.economictimes.com/wealth/tax/tax-on-crypto-virtual-assets-decoded/what-does-the-law-on-tds-on-vda-crypto-say/slideshow/92429435.cms> (last visited Sep 25, 2022).

In general terms, a virtual digital asset is a digital holding encrypted on blockchain technology that allows an individual to verify the authenticity and ownership. As these assets are non-fungible, it is believed to be unique and hence can be sold, bought, or transferred to anyone for that matter.³ However, for the first time, the central government tried to define these assets, and accordingly, the Union Budget 2022-23 proposed an amendment to the Income Tax Act, 1961, and one of those amendments is the introduction of Section 2 clause (47A) that defines VDS. This section exclusively defines VDS to include NFTs, Cryptocurrencies or any other VDS as the government of India may notify from time to time. However, this Section excluded subscriptions to mobile applications, e-commerce, OTT platform, digital currency, and Central Bank Digital Currency (CBDC). etc.⁴ More so, the power has been reserved for the central government to exclude any digital asset from the purview of VDS after fulfilling certain prerequisites.

III

TRANSITORY OF VIRTUAL DIGITAL ASSETS IN INDIA

Since the cryptographic development and launch of Bitcoin in 2009, Indian investors have never looked back, and they constitute top investors in virtual digital assets across the world. In fact, cryptocurrencies have more worth than the total of biggest Indian stocks combined. In spite of that, the legal position of cryptocurrencies, or VDA for that matter, has always been very sceptical and sketchy. The conflicts amongst economies and central banks about the stand of cryptocurrencies are something worth examining in India.

For instance, The Reserve Bank of India (RBI), in 2013, notified the public of the potential financial, legal, operational, security-related, and customer risks associated with the transactions made through these assets. In fact, a notice was also served to everyone who indulged in the transaction, including holders, traders, and users of these virtual currencies.⁵

Further, in 2017 PILs by Siddharth Dalmia and Vijay Pal Dalmia were filed before the Apex Court seeking a ban on the selling and buying of these

³ Pachal D., *Explained: What are virtual digital assets and how are they different from digital currency?*, THE INDIAN EXPRESS, (2 Feb., 2022) available on-
<https://www.google.com/amp/s/indianexpress.com/article/explained/virtual-digital-assets-vs-digital-currency-explained-7752936/lite/> (Last visited Sep 25, 2022).

⁴ *Id.*

⁵ Ranga, S and Ali. F, *Virtual Digital Assets in India: A Sneak Peek into India's Regulatory Framework*, MONDAQ (22 Feb., 2022) Available on-
<https://www.mondaq.com/india/fin-tech/1164634/virtual-digital-assets-in-india-a-sneak-peek-into-india39s-regulatory-framework> (Last visited Sep 26, 2022).

cryptocurrencies in India. Not to mention notification from time to time has been issued by the finance ministry warning against cryptocurrencies. That same year another petition seeking cryptocurrencies to be regulated was preferred before the Apex Court by one Dwaipayan Bhowmick. Consequently, the government 2017 formed a committee to analyse problems associated with virtual currencies and come up with certain desired actions.⁶

In 2019, the Centre introduced 'The Banning of Cryptocurrency and Regulation of Official Digital Currency Bill 2019', a bill which intends to ban crypto-tech activities like buying, selling, mining, holding, and dealing. However, by the end of 2020, the Apex Court lifted the ban imposed on crypto-related activities and hence financial institutions were allowed to facilitate banking services to those involved in crypto assets transactions.⁷

From the aforementioned discussion, it is evident that since forever, the future of VDS in India has been dicey, and therefore, investment and transition in any of these virtual assets are not excluded from the risk. However, the 2022 Finance Bill turned the table by proposing a taxation scheme for Virtual Digital Assets. Now the implicitly clear picture has been painted for the good of the virtual assets' owner and business⁸.

IV

TAXATION IMPOSED ON VIRTUAL DIGITAL ASSETS IN INDIA

Section 115BBH of the Income Tax Act, 1961

Since the onset of the 2022 Finance Bill, taxation of "VDA" has been the talk of the town. The centre has imposed taxes on the transition of all kinds of Virtual Digital Assets in India. A new Provision, 'Section 115BBH', was included under the Income Tax Act, 1961.

As per this section, a straight jacket tax of 30% will be charged on the gain arising out of the transaction of the Virtual Digital assets besides cess and applicable surcharge. They will be taxed under the head of Capital Gains under Section 45 of the Income Tax Act, 1961. More so, only the cost of acquisition is allowed to be deducted and not any other expenses. Not to mention, this Section also prohibits the set-off and carry forward of losses when

⁶ Murali. A, *Two young Indians turn to Supreme Court to make laws around Bitcoin, cryptocurrencies less turbid*, FACTOR DAILY (14 Nov., 2017) Available on-<https://archive.factordaily.com/bitcoin-regulation-pil-supreme-court/> (last visited Sep 26, 2022).

⁷ *Supra* Note 6.

⁸ *Supra* Note 4.

occurred via the transaction in VDS. Exemption under Section 45F of the Income Tax Act, 1961 is not applicable to Virtual Digital Assets.⁹

Section 56(2)(x) of the Income Tax Act, 1961

As already mentioned, the Finance Act 2022 included VDSs under the category of movable assets and the Act and the tax on the VDS have primarily been included under income from other sources. For the same purpose, VDS has been inserted under Section 56(2)(x) of the Income Tax Act 1961, which basically talks about the taxation of gifts.

In the present case, It can be extracted that VDS will be considered a gift when an Individual/HUF receives it without any consideration, and its value is more than Rs. 50,000. All those incomes in the form of VDS will be taxed as a gift.¹⁰ However, it has also been considered under the new finance Act that when the transactions related to VDS are frequent, then it will be considered as Business and the tax levied will be under the head of business income. Therefore, the profit arising out of such business transactions of VDS shall be calculated without any deduction at the flat rate of 30%.

Section 194S of the Income Tax Act, 1961

As per the announcement made by Finance Minister Nirmala Sitharaman, a TDS of 1% will be charged on the buying of VDS. While buying any form of VDS, the buyer needs to deduct 1% tax before paying the amount to the seller. Nonetheless, TDS will only be deducted when the transaction amount exceeds a specified threshold limit. However, that threshold limit can be eliminated through single or multiple transactions.¹¹

For instance, TDS is applicable only in the case when the amount paid by the specific person is more than INR 50,000 during a financial year or INR 10,000 if the transaction is made by any person other than a specified person.

⁹ Dutta S., *Income tax on virtual digital assets Under Section 115BBH*, CA CLUB INDIA (5 May, 2022) available on-
<https://www.google.com/amp/s/www.caclubindia.com/amp/articles/income-tax-on-virtual-digital-assets-under-section-115bbh-47118.asp> (last visited Sep 26, 2022).

¹⁰ Raote and Nagarsenkar M., *Tax withholding on virtual digital assets*, LIVEMINT (4 Jul., 2022) Available on-
<https://www.google.com/amp/s/www.livemint.com/news/india/tax-withholding-on-virtual-digital-assets/amp-11656933779442.html> (Last visited Sep 27th 2022).

¹¹ Magazine and Mukul P., *TDS on transfer of virtual digital assets, applicable from July 1 – what the guidelines say*, THE INDIAN EXPRESS (20 Jun., 2022) Available on-
<https://www.google.com/amp/s/indianexpress.com/article/explained/tds-on-transfer-of-virtual-digital-assets-applicable-from-july-1-guidelines-7986718/lite/> (last visited September 26, 2022).

V

ANALYSIS

The legal position of VDS in India has been a Roller coaster, right? Even though steps have been taken by the judiciary wherein the Apex Court has lifted the prolonged restrictions imposed on the transactions of VDS. Still, this community has been lobbying and waiting for any form of concrete guidelines as there lacked proper regulating guidelines. The court only invalidated the previous circular pursuant to the fundamental right violation of those engaged in these activities without substantiating it with appropriate reasoning.

Not to mention the presence of this ambiguity, in one way or another, hampered the potential growth in this area as numerous sincere investors refrained from applying their faith in this field.

However, post the Finance Act of 2022, the hope of the crypto community has reached its zenith. The move initiated by the Finance Ministry has been interpreted as a governmental acceptance towards the VDA business.

More so, this calculated move of the government has been anticipated as an attempt to bring in legislative reform in this arena and gain some revenue from the enormous transactions that had been prevalent in this space.

However, there are certain Grey areas that need to be reconsidered for a better VDS atmosphere in the nation. On one hand, the government came out with a prudent way to enforce a tax on one of the most budding spaces but on the other hand, there are still no legislative guidelines or regulations that will govern and provide clarity to this area.

Even though the definition prescribed under Section 2 clause (47A) of the Income Tax Act 1961, is quite fascinating and open-ended, giving enormous power to the central government for amending, editing and omitting the whole definition still what all would be covered within the ambit of this definition is not quite clear and need to be seen in due course. For instance, the definition of NFT has not been exclusively included and can only be understood in layman terms. Also, the clarity as to whether credit card points, which are nothing but numbers and represents value, can be covered under the ambit of 'VDA' or not. Further, if any redemption can therefore be covered within the mischief of this section is open for debate.¹²

Moving ahead, considering the objective of the authorities is to tax profits arising out of VDAs but the fact that the definition allocated to this is wide and open-ended may lead to significant challenges when it comes to enforcing

¹² *Supra* Note 3.

these provisions.

Moreover, the fact that a tax of 30% is levied on income arising out of certain wagering contracts like lotteries and betting. Putting gains from VDS under the 30% taxation bracket some whither indicates that the government is considering the gains from VDA on the same footing as that of a wagering contract.¹³

The Act not to mention has also imposed 1% TDS on payment on transfer of any VDA, which clearly implies that in case a VDA has been transferred on any crypto-exchange platform, the liability to withhold will fall on the crypto-exchange as it is not possible for the buyers to know the seller. Therefore, swap transactions may lead to enormous issues.

Further, the tax imposed on these assets is not subjected to any deduction or set off, which might upset certain categories of investors. Intact exemption under Section 445F of the income tax act 1961, s not applicable to Virtual Digital Assets. Nonetheless, relief under Section 87A may be entertained by the investors.

However, on the brighter side, the 2022 budget has given a ray of hope to millions of investors and a source of revenue for the government. In addition to that, the introduction of TDS is yet another milestone that assist the government in tracking the flow of money by providing vital information about the extent as well as the nature of transaction happening in the industry. This might prove itself to be the dynamic provision that not only ensures fair collection of the tax to the government but also furnishes relevant data transactions among resident Indians.

VI

CONCLUSION

Considering the substantial number of stakeholders in this space, the taxation regime on cryptocurrencies is the most awaited and desired move. However, there is an urgent need to formulate a regulatory framework with proper discussion and debate not only among the legislators but from multi-stakeholder consultation with necessary stakeholders including crypto exchanges, consumer organisations and allied organisations.

Apart from that since some of these VDA platforms render services to the investors and users, the government should impose GST charges on all those platforms, which will eventually add to revenue. Last but not least, the definition of certain terms like NFT needs to be revised and reintroduced in the

¹³ *Supra* Note 3.

Act for better clarity.
