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TAX REGIME AT THE DAWN OF DIGITAL CURRENCY: A STUDY ON THE REPERCUSSIONS OF "THE UNION BUDGET 2022-23"

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TAX REGIME AT THE DAWN OF DIGITAL CURRENCY: A STUDY ON THE REPERCUSSIONS OF “THE UNION BUDGET 2022-23”

*Tamasi Biswas**

[Abstract: *Digitization and advancement in technology have led the world to think of a new vision. It's a vision where almost every virtue of a Consumer to business (C2B) and business-to-business (B2B) relation is captured within a screen. With the rise of virtual currency in this scene, there have been a lot of debates going around about the legality of the tender. Furthermore, with the latest announcement of attaching the highest tax slab to transactions related to digital currencies, the debate is on fire. It has been just close to a decade since digital currency has stepped into the nation and it has shown a lot of prosperity. In spite of the fact that Digital currency is still in a state of the wide controversy, yet shows a great booming industry in the new age industry. Countries around the world are rapidly evaluating the prospects of taxation, both direct and indirect taxes; for transactions carried out with digital currencies. Different countries are modelling several measures in taxing digital currencies and trying to trace the nature of digital currencies, to consider them within the scope of existing Tax Laws. As Digital Currencies are treated as commodities, any profits or gains on the trading of digital currencies are liable for taxation under IT Act, 1961 for capital gains. However, from a GST perspective, there is uncertainty about the taxation and a lot of clarity is required. Therefore, with many uncertainties at this juncture, this present study focuses on the legal status of digital currency in India, particularly concerning the tax regime. Especially, after the announcement of the Union Budget 2022-23, the status of digital currency is sure to witness wide turmoil throughout the nation. The present study analyses the repercussions of the same on the actors of the virtual market.]*

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I

INTRODUCTION

Cryptocurrency can be seen as a digital (virtual) currency. Virtual currency works on the theory of cryptography which is backed by algorithmic security. Cryptography is a combination of algorithms and codes which is used for the purpose of protecting data privacy. These secure communication techniques are derived from mathematical concepts and a set of rule-based calculations, known as algorithms. These unique algorithms are hard to decipher since the cryptographic key generated by this process can only be operated by a unique digital signature. This ensures the verification process and secures confidential communications. Modern cryptography deals with vitally four-fold objectives of-

- a) securing confidential information;
- b) identity authentication of the sender and the receiver;
- c) non-alteration of the document during the transmission without the permission of the other party;
- d) non-repudiation of the information at a later stage by either party.

A cryptocurrency follows a decentralised network based on Blockchain technology and works on the functioning of a Distributed Ledger. The exchange of cryptocurrency requires only two consented parties without the involvement of any third party, for instance, the regulating agencies or brokers. Thus, Digital currency eliminates third-party risks, and simultaneously, the end user does not have to pay commission, eventually bringing down transaction costs.¹

II

DEBATE ON DIGITAL CURRENCY

Currencies issued by various Federal Governments are fundamentally of two types. Primarily, there is that type of currency which is backed by the reserves of gold equivalently, which is usually referred to as the Gold Standard. The other category is the "Fiat System", wherein the currency system is not backed by any Gold reserves. These Fiat currencies are open to being issued, and the currency value is determined by the demand and supply proportions, as in the case of the US Dollar. However, the Indian currency has been set as per the Gold Standard. With the adoption of digitisation, physical currency is being

¹ Neil Hildreth, *Cryptocurrency Bill 2021: The Road Ahead*, MONDAQ (28 Dec. 2021) available at <https://www.mondaq.com/india/fin-tech/1145012/cryptocurrency-bill-2021-the-road-ahead> (last visited on 12.09.2022).

replaced with digital transactions. As per the latest information available from the National Payments Corporation of India, the number of transactions recorded using the UPI-based payment during Oct 2021 is 4.21 billion, amounting to US 100 billion dollars.

Fiat currencies, as is in their usage now, were developed to replace the barter system. Fiat currencies are issued under the seal of the Central Government. It represents a promissory note which is backed by government sanction bearing a contractual promise to pay the amount as consideration owed and promised to the bearer. Contrary to Fiat currency, virtual currencies are fundamentally a collection of binary data encrypted to secure transaction records. A virtual currency, unlike fiat currency, is not backed by any single authority regulating its issuance; instead, they are distributed over a vast network of computers and exists with technical support. A Virtual currency consists of a limit up to which it can be available as a resource. Every ASCII computer file specifies the quantity of a coin, as for instance, there are only 21 million Bitcoins released. The principle of demand and supply applies to this kind of currency. As the demand for virtual currencies increases, so does its value.²

Considering the inspiring growth in the demand for Virtual currencies, the question arises as to why there is a lack of governmental consideration relating to the legal viability and recognition of virtual currencies.

The prime reason is the lack of privacy which in turn proved to be a serious threat to national security. Virtual currencies are based on blockchain technology, which is highly secure. Such a wallet is linked to a private key rather than an individual person. Consequently, it becomes challenging to trace the origin of a transaction. Because virtual currencies use pseudonyms to carry out transactions, it has the potential to be used for illegal activities. Another concern is that virtual currencies are not backed by any sanction and, therefore can lose their values if the promoter of the virtual currencies stops the trading activity.³ The latest example is Squid Game Crypto Scam⁴, where it is estimated that the promoters scammed an estimated \$ 3.38 million by drawing in buyers and thereafter stop trading, leaving the buyers with tokens which have no financial value.

III

THE JOURNEY OF DIGITAL CURRENCY IN INDIA FROM A

² *Ibid.*

³ *Ibid.*

⁴ *Squid Game crypto token collapses in apparent scam*, BBC (2 Nov. 2021) available at- <https://www.bbc.com/news/business-59129466> (last visited on 19 September 2022).

LEGAL PERSPECTIVE

The year 2013 may be traced to the initiation of the digital currency trend in India. In the midst of ambiguities and confusion, digital currencies developed in India during this reign around 2013 - 2017. In the very initial phase, RBI warned consumers, holders, trading persons/agencies etc. about the risks attached to the launch of digital currencies. The Financial Regulating Authority stated that the nation is still observing the crypto currency-related developments very closely, including Bitcoins and other cryptocurrencies, such as Altcoins. Although the circular almost went unnoticed by the financial institutions and consumers, Digital currencies flourished in Indian Market as well.

In the midst of this, in June 2013, the Financial Action Task Force (hereinafter referred to as "FATF") an inter-governmental organisation founded in 1989 on the initiative of G-7 to develop policies to combat money laundering, came up with what came to be known as "New Payment Products and Services Guidance" (hereinafter referred to as 'NPPS Guidance, 2013').⁵ It was actually Guidance for a Risk-Based Approach to Pre-paid cards, Mobile Payments and Internet-based Payment Services. NPPS Guidance did not define the expressions 'digital currency', 'virtual currency', or 'electronic money', nor did it focus on virtual currencies, as distinct from internet-based payment systems that facilitate transactions denominated in real money, such as Paypal, Alipay, Google Checkout etc. Therefore, a short-term typologies project was initiated by FATF to promote a fuller understanding of the parties involved in convertible virtual currency systems and to develop a risk matrix.⁶

In June 2015, FATF came up with a "Guidance for a Risk-Based Approach to Virtual Currencies", which suggested certain recommendations in countries to identify, assess and understand risks and to take action aimed at mitigating such risks. *National authorities to undertake a coordinated risk assessment of virtual currencies products and services that:*

- 1) *enables all relevant authorities to understand how specific virtual currency products and services function and impact regulatory jurisdictions for Anti Money Laundering (AML) and Combating the Financing of Terrorism (CFT) treatment purposes;*
- 2) *promote similar AML/CFT treatment for similar products and services having same risk profiles.*

Where countries are prohibiting virtual currency products and services, they should take into account, among other things, the impact a prohibition would have on local

⁵ *Internet Mobile Association of India v. RBI*, 2020 SCC OnLine SC 275.

⁶ *Ibid.*

and global level of money laundering/terrorism financing risks, including whether prohibition would drive such payment activities underground, where they will operate without AML/CFT controls.

In accordance with the international directions, the Indian infrastructure, in August 2017, the Securities and Exchange Board of India (SEBI) established a 10-member advisory panel to examine global fintech developments and report on opportunities for the Indian securities market. The goal of the new Committee on Financial and Regulatory Technologies was to help prepare India to adopt fintech solutions and foster innovations within the country.⁷ Later, on 02-11-2017, the Government of India constituted a committee chaired by the Secretary (Department of Economic Affairs) and comprising of the Secretary, Ministry of Electronic and Information Technology, Chairman, SEBI and Deputy Governor, RBI (Inter-Ministerial Committee) to propose specific actions to be taken in relation to virtual currencies.⁸

After repeated warnings about the risks of digital currencies in scams and financial tourism went unnoticed, in the last quarter of 2017, RBI ultimately issued a crystal warning on “**Prohibition on dealing in Virtual Currencies**”. Circular ‘RBI/2017-18/154’⁹ dated April 6, 2018, declared:

- 1. Reserve Bank has repeatedly through its public notices on December 24, 2013, February 01, 2017 and December 05, 2017, cautioned users, holders and traders of virtual currencies, including Bitcoins, regarding various risks associated in dealing with such virtual currencies.*
- 2. In view of the associated risks, it has been decided that, with immediate effect, entities regulated by the Reserve Bank shall not deal in VCs or provide services for facilitating any person or entity in dealing with or settling VCs. Such services include maintaining accounts, registering, trading, settling, clearing, giving loans against virtual tokens, accepting them as collateral, opening accounts of exchanges dealing with them and transferring / receipt money in accounts relating to purchase/ sale of VCs.*
- 3. Regulated entities which already provide such services shall exit the relationship within three months from the date of this circular.*
- 4. These instructions are issued in exercise of powers conferred by section 35A read with section 36(1)(a) of Banking Regulation Act, 1949, section 35A read with section 36(1)(a) and section 56 of the Banking Regulation Act, 1949, section 45JA and 45L*

⁷ Internet and Mobile Association of India v. Reserve Bank of India, 2020 SCC OnLine SC 275.

⁸ *Ibid*, at 7.

⁹ RBI/2017-18/154, DBR.No.BP.BC.104 /08.13.102/2017-18 (April 6, 2018) available at <https://www.rbi.org>.

of the Reserve Bank of India Act, 1934 and Section 10(2) read with Section 18 of Payment and Settlement Systems Act, 2007.

On 02-04-2018, RBI sent an e-mail to the Government, enclosing a note on regulating crypto assets. It was with reference to the record of discussions of the last meeting of the Inter-Ministerial Committee on virtual currency.¹⁰ This note examined the pros and cons of banning and regulating digital currencies and suggested that it had to be done, backed by suitable legal provisions. The Central Board of Direct Taxes (CBDT), by an Office Memorandum dated 05-03-2018, submitted to the Department of Economic Affairs, a draft scheme proposing a ban on digital currencies. But the draft scheme advocated a step-by-step approach, as many persons had already invested in digital currencies. The scheme also contained advice to carry out legislative amendments before banning them.¹¹ Immediately thereafter, the Statement dated 05-04-2018 and the Circular dated 06-04-2018, impugned in these writ petitions, came to be issued by RBI. It appears that at around the same time (April 2018), the Inter-Ministerial Committee submitted its initial report (or a precursor to the report) along with a draft bill known as Crypto Token and Crypto Asset (Banning, Control and Regulation) Bill, 2018. Some major points of aforementioned Act are stated below:

- Trading, mining, holding or transferring/use of cryptocurrencies is subject to prosecution in India with a fine or/and imprisonment which may extend up to 10 years.
- Any holder/user/person must declare/dispose of all cryptocurrencies in his/her possession within a time span of 90 days with effect from the publish date of the Act.
- The technology of cryptocurrencies can be utilized for research and academic purposes.
- RBI may launch the digital rupee as a legal tender in India in future, which will thereon be considered as a currency backed by legal sanction.
- The government of India may give relaxation in certain trading activities in digital currency as it may deem fit for the public interest.

IV

A SETBACK TO RBI'S INITIATIVE

Circular No. RBI/2017-18/154, *Prohibition on dealing in Virtual Currencies (VCs)* (RBI, 6 Apr. 2018) *available at* https://www.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=11243 (last visited on 15 September 2022).

¹¹ See generally, *supra* Note 7.

In March 2020, the apex court of India gave a major setback to RBI by removing the ban on cryptocurrencies imposed by RBI. A bench consisting of three judges, Rohinton Nariman J., Aniruddha Bose J. and V. Ramasubramanian J. have passed a verdict claiming that:

RBI has not mentioned any point regarding regulations of virtual currencies to date by nationalised banks/commercial banks/other financial institutions etc and also, RBI did not yet mention any adverse effect directly or indirectly, completely/partially due to the exchange of virtual currencies. J. Ramasubramanian, the Chief Justice for this Judgment, opined that the RBI stand was very disproportionate. The Supreme Court has also indicated the failure of the government of India that even after several bills and committees, the government is failed to introduce any legal digital Indian rupee.¹² This gave birth to the Crypto Currency and Regulation of Official Digital Currency Bill, of 2021. The Act seeks to prohibit all private cryptocurrencies in India while allowing for certain exceptions that promote the technology of cryptocurrency. Also, creates a framework for a digital currency that will be issued by the Reserve Bank of India.

V

TAXABLE EVENTS OF DIGITAL CURRENCIES

Digital currency is still in a state of legal controversy. Till the time it is considered as a legal tender, it is quite impossible to determine the taxation aspects of the same. No legal or regulatory mechanism yet clarifies whether a virtual digital asset of an assessee will be considered as currency, commodity or security.

Section 2(14) of the Income-tax Act, 1961 (hereinafter referred to as the IT Act, 1961) defines a capital asset including property of any kind held by a person, whether or not connected with his business or profession. The term 'property' signifies a bundle of rights and vested interests that a juristic person can acquire, hold, or enjoy. Hereby, digital currencies ought to be deemed capital assets. In case such currencies are purchased for investments by an assessee, the profit arising on the transfer of such assets shall be taxable under the head capital gains under Section 115BBH of the IT Act, 1961. The aforementioned section lays down that:

¹² M. Qureshi, *From ban to regulation, Cryptocurrency's journey so far in India*, THE INDIAN EXPRESS (30 Nov., 2021) available at- <https://indianexpress.com/article/technology/crypto/cryptocurrency-in-india-a-look-at-the-regulatory-journey-of-cryptocurrencies-7648767> (last visited on 15 September, 2022).

*If gains arising from the transfer of virtual digital assets are treated as capital gains, their further classification into short-term or long-term gains would depend upon the period of holding of such assets. If a virtual asset is held for more than 36 months from the date of purchase, it will be considered a long-term capital asset; otherwise a short-term capital asset. The income arising from the transfer of virtual digital assets shall be taxed at the rate of 30%. Thus, short-term and long-term capital gains both shall be taxed at a flat rate of 30%. Further, no deduction under Chapter VI-A or an exemption under Section 54F shall be allowed from such capital gains. However, relief under Section 87A can be claimed.*¹³

However, if the transactions in such assets are substantial and frequent, it should be held that the taxpayer is trading in such assets. In this case, income from the sale of such assets should be taxable as business income.

Back in 2021, Minister of State for Finance, Mr. Anurag Singh Thakur had said in response to a question in the Rajya Sabha that “the gains resulting from the transfer of digital currencies are subject to tax under the head of income, depending upon the nature of holding of the same”.¹⁴ However, within a span of a year since this aforementioned statement, the Ministry of Finance took a completely different and classification-agnostic approach to taxing digital currencies. The budget tabled reforms in the Customs Administration of Special Economic Zones will be undertaken, and it shall henceforth be fully IT driven and function on the Customs National Portal with a focus on higher facilitation and with only risk-based checks. This reform shall be implemented by 30th September 2022.¹⁵ In the Budget for the Financial Year 2022-23, the Finance Minister made the following key changes:

- Section 2(47A) defines “virtual digital assets”. It includes:
 - “Cryptocurrency” is derived from encryption techniques which are used to secure network. It is a digital currency used over the internet to purchase goods or services or traded for profit. It is created using a technology called Blockchain. Blockchain is a decentralised technology spread across many computers that manage and record transactions. It started in 2009 with the introduction of Bitcoin;
 - NFT is a digital certificate representing the ownership or rights with respect to an indivisible asset (either in the physical or intangible form). NFTs can act as a digital twin to a physical asset. The digital offering of the products with limited editions drives

¹³ The Income Tax Act 1961, S. 115BBH.

¹⁴ *Ibid.*

¹⁵ ICSI, *Emerging Financial Transformation & Today's Professionals*, E-JOURNAL FOR EXECUTIVE & PROFESSIONAL STUDENTS 20-29 (Feb. 2022).

demand due to scarcity. NFT works on the blockchain as it gives users complete ownership of a digital asset. For instance, if you're a sketch artist, and if you convert your digital asset to an NFT, what you get is proof of ownership powered by Blockchain technology;

- The gains on virtual digital assets are proposed to be taxed @ 30%;
- No deduction and no set-off will be allowed other than the cost of acquisition in computing gain on virtual digital assets. No set off of loss from the transfer of the virtual digital asset shall be allowed against income computed under any other provision of this Act to the assessee and such loss shall not be allowed to be carried forward to succeeding assessment years. Any loss arising from the transfer of VDA would be a dead loss. It will not be allowed to be adjusted against income arising from the transfer of another VDA (whether of the same category or not);
- TDS under section 194S @ 1% on transfer of virtual digital assets is levied;
- Further, in order to provide for taxing the gifting of virtual digital assets, it is also proposed to amend section 56 of the Act to, provide that the expression "property" shall include virtual digital assets. If a gift received from a non-relative of VDA more than 50,000 shall be taxable under Income from Other Sources. An explanation under clause (x) of section 56(2) to the effect that property would include 'virtual digital asset';
- Section 194S provided for tax deduction at source on payment towards consideration for transfer of virtual digital assets.

The above provisions are announced with effect from 1st April 2022. However, income tax was payable on transactions in digital currency prior to 1st April 2022 as well. The amount of tax payable was determined on the basis of the classification of digital currencies: either as a capital asset or as stock in trade.

A separate framework for taxing digital currencies in the indirect taxation space is still under consideration. At present, the services provided via crypto exchanges are taxable at 18%. Factors relating to valuation, place of supply, etc. for the purposes of levy of a goods and services tax are still unanswered.

As of date, the equalisation levy does not apply to the digital currencies purchased by Indian citizens from exchanges located outside India. As these exchanges are not paying any taxes, the Government may notify them down the line for the applicability of the equalization levy.¹⁶

¹⁶ CMA Bhogavalli Mallikarjunna Gupta, *Taxation Implication Crypto Currencies In India: Some Thoughts*, TAX BULLETIN VOLUME 18-27 (2021).

VI

TAXATION ASPECT OF DIGITAL CURRENCY

Thereafter, a high-level Inter-Ministerial Committee (IMC) was formed (having the secretary of economic affairs as chairman of the committee), which was assigned with the task of studying various issues of cryptocurrencies and suggestions for future actions. Honourable Finance Minister Nirmala Sitharaman, on February 2021 in Rajya Sabha, indicated that the government wants to reconsider research and innovation in crypto-related areas with an open mindset. In November 2021, the standing committee on finance, headed by Jayant Sinha, holds a meeting with various representatives of crypto exchanges in India and concluded that it would be unfair to ban digital currencies in India rather, it needs to be regulated. This verdict follows with, RBI governor 'Shaktikanta Das' who mentioned that digital currencies could be a threat to the financial system because they are unregulated and discussed the keen intention of RBI to launch its own digital currency which will act as a legal tender within the nation. The finance minister Nirmala Sitharaman stated in Rajya Sabha that the government has not taken any step towards banning of digital currency advertisements in India, but government will spread awareness on the usage of digital currencies through RBI and SEBI.¹⁷

Tax on virtual digital assets: Income from the transfer of cryptocurrencies and non-fungible tokens will be taxed at the rate of 30%. Any loss incurred from such transfers cannot be set off against any other income or carried forward to subsequent years.¹⁸

The Government proposed to introduce Digital Rupee, using blockchain and other technologies, to be issued by the Reserve Bank of India starting 2022-23. This will lead to a more efficient and cheaper currency management system, encouraging a boost to the digital economy. For the taxation of virtual digital assets, the budget provides that any income from the transfer of any virtual digital asset shall be taxed at the rate of 30 per cent. No deduction in respect of any expenditure or allowance shall be allowed while computing such income except cost of acquisition.¹⁹ Further, loss from the transfer of virtual digital

¹⁷ K. Rajagopal, *Supreme Court sets aside RBI ban on cryptocurrency transactions*, The HINDU (4 Mar., 2020) available at <https://www.thehindu.com/news/national/supreme-court-sets-aside-rbi-ban-on-cryptocurrency-transactions/article30979301.ece> (last visited at 19 September, 2022).

¹⁸ *Union Budget 2022-23 Analysis*, PRS LEGISLATIVE RESEARCH (1 Feb., 2022).

¹⁹ Lalatendu Mishra, *Budget 2022: Virtual Digital Assets To Attract 30% Tax*, THE HINDU (1 Feb., 2022) available at <https://www.thehindu.com/business/budget/union-budget-2022-virtual-digital-assets-to-attract-30-tax/article38357950.ece> (last visited on 20

asset cannot be set off against any other income. In order to capture the transaction details, a provision has been made for TDS on payment made in relation to the transfer of virtual digital assets at the rate of 1 per cent of such consideration above a monetary threshold.²⁰ The gift of a virtual digital asset is also proposed to be taxed in the hands of the recipient.²¹

VII

CONCLUSION

From origin to evolution, which comes down to the recent tax draft norms of digital currency, it can be inferred that digital currency is no more tending to be banned and rather would be legally secured and sanctioned. The trip of digital currency is not too long in India but has seen many highs and lows in an unbelievably short span of time. Virtual currencies have already flourished a lot, and the recent debate attached to it after the release of the union budget of 2022-23 made the space of digital currency consistent in the Indian Economy. A lot of up and down is still waiting up ahead, especially after the sudden announcement of 30% tax impositions on virtual digital assets. It will be interesting to note the status of digital currency in India. Moreover, the launch of RBI-sanctioned digital currency will be another hectic step.

September 2022).

²⁰ *Budget 2022: Income from Transfer of Virtual Asset to be Taxed at 30%*, BUSINESS TODAY (1 Feb. 2022) available at- <https://www.businesstoday.in/union-budget-2022/decoding-the-budget/story/budget-2022-income-from-transfer-of-virtual-digital-assets-to-be-taxed-at-30-says-sitharaman-321065-2022-02-01> (last visited on 22 September 2022).

²¹ *UNION BUDGET 2022-23*, PRESS INFORMATION BUREAU (1 Feb., 2022).