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.

1. INTRODUCTION

Like the evolving contours and technological applications of crypto[2], 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 crystalise. 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.

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[2] Throughout this essay—for ease of reference, consistency, and holistic coverage—the expression "crypto" is employed to refer to the amalgam of various technological innovations and financial products that are modeled on blockchain technology. Specific references are made where regulations refer to a specific blockchain technology product, such as cryptocurrencies or non-fungible tokens, etc.

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, which 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.

2. 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".[4] This response from the RBI was, inter alia, driven by "concerns of consumer protection, market integrity and money laundering" (RBI, 2018b, p. 5),[5] and reflected the views expressed by the GOI's finance minister, tax board, securities market regulator, and other officials in their earlier deliberations.[6]

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

[3] The RBI (2018a) also clarified that 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 transfer/receipt of money in accounts relating to purchase/sale of VC".

[4] The following reasons were assigned as the rationale for the instructions:

> Technological innovations, including those underlying virtual currencies, have the potential to improve the efficiency and inclusiveness of the financial system. However, Virtual Currencies (VCs), also variously referred to as crypto currencies and crypto assets, raise concerns of consumer protection, market integrity and money laundering, among others.
>
> Reserve Bank has repeatedly cautioned users, holders and traders of virtual currencies, including Bitcoins, regarding various risks associated in dealing with such virtual currencies. In view of the associated risks, it has been decided that, with immediate effect, entities regulated by RBI shall not deal with or provide services to any individual or business entities dealing with or settling VCs. Regulated entities which already provide such services shall exit the relationship within a specified time. (RBI, 2018b, p. 5)

[5] Each of these variables has been regularly cited by the RBI as a larger policy objective with a view to insulating the market and investors.

[6] It is not out of place to point out that the GOI even mulled over multiple draft legislations, purportedly seeking to ban cryptocurrencies.

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).[7] 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).[8]
- 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

[7] https://main.sci.gov.in/supremecourt/2018/19230/19230_2018_4_1501_21151_Judgement_04-Mar-2020.pdf

[8] The SCI, inter alia, supplemented this rationale to observe that "if a Central authority like RBI, on a conspectus of various factors perceive the trend as the growth of a parallel economy and severs the umbilical cord that virtual currency has with fiat currency, the same cannot be very lightly nullified as offending" the fundamental rights of the citizens (*Internet and Mobile Association of India v. Reserve Bank of India* [2020] SCC Online SC 275, section 6.156, p. 152).

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.[10]

3. 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) cryptoassets[11] (which exclude "Indian currency or foreign currency")[12] (b) non-fungible tokens (NFTS)[13], 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

[9] "There has been a massive increase in retail investors in India after the SCI ruled against the Reserve Bank of India ban of 2018, which prohibited all banks from allowing customers to trade in crypto transactions" (Sharma, 2022).

[10] "Around 15 million Indians are believed to have made investments in private cryptocurrency holdings. Cryptocurrency investments in the nation increased from $923 million in April 2020 to almost $6.6 billion by May 2021, a growth of about 400% in only one year" ("India among the global leaders for crypto adoption", 2021).

[11] Defined as "any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically" (ITA, Section 2[47a]).

[12] In the scheme of VDAs, these expressions have been linked to the foreign exchange controls of India. According to one author, this linkage creates a complex issue because

> [c]ountries such as El Salvador and recently, (with effect from April 27, 2022) Central African Republic have adopted Bitcoin as legal tender. Would that mean that Bitcoin is a foreign currency and therefore, transactions in Bitcoin would not have to be tested against the VDA taxation regime? (Jhunjhunwala, 2022, p. 111)

[13] In the scheme of VDAs, the GOI is required to specify the NFTs subject to tax in notifications (ITA, Section 2[47A], Explanation [a]). To this end, the GOI has specified all NFTs other than those "whose transfer results in transfer of ownership of underlying tangible asset and the transfer of ownership of such underlying tangible asset is legally enforceable" (Central Board of Taxes, Department of Revenue, Ministry of Finance, 2022a).

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]).[14]

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.[15] 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[16] 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 acquisition[19] 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.[20]

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

[14] Exercising this power, the GOI has excluded the following from the scope of VDAs: (i) gift cards/vouchers, (ii) loyalty/reward points, and (iii) subscriptions to websites/platforms/applications (Central Board of Taxes, Department of Revenue, Ministry of Finance, 2022b).

[15] However, official digital currency is excluded from the scope of VDAs (ITA, Section 2[47A].

[16] Chapter XII of the ITA is replete with such special provisions for the "determination of tax in certain special cases". To illustrate, Section 115BBF ("Tax on income from patent") and Section 115BBG ("Tax on income from transfer of carbon credits") precede Section 115BBH, which taxes cryptoassets.

[17] Section 115BBH(3) of the ITA, read with Section 2(47) of the ITA, which covers sales, exchanges, relinquishments, compulsory lawful acquisitions, etc.

[18] To be increased by applicable surcharge and cess, which would depend on which tax slab the income of the taxpayer concerned falls under.

[19] There is no guidance in law as to what constitutes the "cost of acquisition" of a VDA. Although Section 55 of the ITA contains a definition of the term, this is for the limited purpose of assessing capital gains and has not been specifically extended to include VDAs. This is potentially litigative. See generally, the GOI's Response in Parliament to Lok Sabha Unstarred Question No. 2800 (CoinSwitch, 2023) which, inter alia, states that "infrastructure costs incurred in mining of VDA (e.g. crypto assets) will not be treated as cost of acquisition as the same will be in the nature of capital expenditure which is not allowable as deduction as per the provisions of" the ITA (p. 49).

[20] This implies that "any loss from transfer of a VDA is a sunk cost and the seller is liable to pay tax on every profit made on transfer of a VDA" (Jhunjhunwala, 2022, p. 113).

- 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 obligations[23] 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])[24] has been expanded to include gifts of VDAs.[25] 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.

[21] In their 2022-2023 budget speech, the GOI's Finance Minister specifically stated that "the magnitude and frequency of these transactions have made it imperative to provide for a specific tax regime" (GOI, 2022a, paragraph 131, p. 23).
[22] For illustration, see IRS (2014), which treats virtual currency as property for federal tax purposes. See also Sharma (2022) for a summary of tax regulations in select jurisdictions.
[23] See, generally, Central Board of Taxes (TPL Division), Department of Revenue, Ministry of Finance, GOI (2022a; 2022b).
[24] It is noteworthy that a transfer with inadequate consideration is considered a gift for the purposes of this provision.
[25] ITA, Explanation to Section 56(2)(x).

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.[26]

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[27] 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

[26] It is argued that by extending the withholding obligation to such transactions, the withholding obligation may trigger "both, the buyer and seller, being mutually liable to pay consideration in exchange for transfer of a VDA" (Jhunjhunwala, 2022, p. 113).

[27] For illustration, a High Court is seized of the issue of whether withholding tax obligations under other provisions of the ITA are applicable to crypto exchanges in the wake of the tax department's actions against them on the alleged grounds that such transactions facilitate e-commerce activity. See Moneylife Digital Team (2022).

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.

4. 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).[33] Gogoi notes that this is despite a lack of clarity, particularly in relation

[28] A similar situation has arisen since 2016 with the introduction of the equalisation levy (and its expansion in 2020) in India on digital services provided by non-resident service providers to Indian residents.

[29] While the issue of the characterisation of income from the transfer of cryptoassets as "other income" may be debatable, such characterisation appears to be the most likely conclusion for income earned by way of a gift of cryptoassets.

[30] For illustration, see Article 23(3) of IRS (1999) and Article 23(3) of HM Revenue and Customs (2022).

[31] For illustration, see Ministry of Finance, GOI, Income Tax Department (1999).

[32] In the 2022-2023 budget speech (GOI, 2022a), the Minister of Finance stated that:

> Accordingly, for the taxation of virtual digital assets, I propose to provide that any income from 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. Further, loss from transfer of virtual digital asset cannot be set off against any other income.
> - Further, in order to capture the transaction details, I also propose to provide for TDS on payment made in relation to transfer of virtual digital asset at the rate of 1 per cent of such consideration above a monetary threshold.
> - Gift of virtual digital asset is also proposed to be taxed in the hands of the recipient. (paragraph 131, pp. 23–24)

[33] Ritesh Pandey (Lok Sabha Secretariat, 2022) noted that "[i]n a single stroke, the Government has managed to hamper India's crypto currency future" as these tax changes "will greatly hamper India's Web 3.0 space" (p. 927). He stated that Web 3.0 is not just about "crypto currencies where there are movies, music, gaming, ticketing, and commerce" and that "[i]t intends to revolutionize the world with smart contracts and the metaverse" (Lok Sabha Secretariat, 2022, p. 926).

to cryptocurrencies, as the nuances of their regulatory treatment are yet to be spelt out by the GOI (Lok Sabha Secretariat, 2022).[34]

- 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:[36]

- In Lok Sabha on 25 March 2022, Nirmala 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).

[34] The lack of clarity and absence of an official government vision for cryptocurrencies was also emphasised by others. For illustration, see Supriya Sadanand Sule's speech in Lok Sabha on 25 March 2022 (Lok Sabha Secretariat, 2022), in which she observes, inter alia, that "[t]he Government has to have a vision on crypto" and that it must "[h]ave some strategy and come clear" about its approach (p. 864).

[35] See also Pinaki Misra's speech in Lok Sabha on 25 March 2022 (Lok Sabha Secretariat, 2022), in which he observes, inter alia, that "[t]he Government has gone on to a 30 per cent slab on the basis that it [crypto] must be at a higher slab than equity gains, because it is some kind of a sin" and with this "notion of a sin activity has not sent the right message" (p. 889–890).

[36] See also Sitharaman's speech in Rajya Sabha on 29 March 2022 (Rayja Sabha Secretariat, 2022).

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.

5. 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 repository[37] 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.[38]

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 cryptoassets[40] 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,

[37] In addition, customs duties are imposed on the import or export of goods from the territory of India.

[38] It is noteworthy that, in an amendment to the Central Goods and Services Tax Act, 2017, to provide clarity to taxation of online gaming (The Central Goods and Services Tax [Amendment] Act, 2023), it has been provided in Section 2(80B) and Section 2(105) that payment in form of VDAs shall be considered as "consideration" for online gaming activity (p. 2).

[39] See, generally, Bhattacharjee et al. (2022).

[40] Unlike the ITA, GST law does not include a comprehensive definition that covers all cryptoassets, so classification issues are likely to arise distinctively for each class of cryptoassets. See also Gupta et al. (2022, pp. 13–16).

[41] Under the GST law, "services" is defined very widely to cover "anything other than goods, money and securities" (The Central Goods and Services Tax Act, 2017, Section 2 [102]). It therefore appears unlikely that cryptoassets would be outside of the scope of the GST law in India.

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).

6. 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.[44]

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.[46, 47] 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

[42] The GOI has been invested in evolving a policy framework to regulate cryptoassets for a few years now. See, generally, Ministry of Finance, GOI (2021d). See also Ministry of Finance, GOI (2021c).
[43] The GOI has acknowledged that "a Bill on the Cryptocurrency and Regulation of Official Digital Currency is under finalisation for consideration of the Cabinet" (Ministry of Finance, GOI, 2021e, p. 1). See also Ministry of Finance, GOI (2021a). However, the GOI has clarified that, as a policy stance, it "has no plans for boosting the cryptocurrency sector in India" (Ministry of Finance, GOI, 2021b).
[44] It is interesting that, in a related technology context (data privacy), the GOI has withdrawn draft legislation from the Parliament, preferring to work on establishing a "comprehensive legal framework" in the wake of extensive stakeholder input (Barik, 2022).
[45] See Response in Parliament to Lok Sabha Unstarred Question No. 2864 (CoinSwitch, 2023, pp. 50–51).
[46] The GOI is on record that it "does not consider crypto-currencies legal tender or coin and will take all measures to eliminate use of these crypto-assets in financing illegitimate activities or as part of the payment system" (GOI, 2018, paragraph 112, p. 20).
[47] These aspects are in addition to investor protection concerns qua trade in cryptocurrencies. See, generally, Dash (2022).
[48] For illustration, see paragraph 58 of G20 (2023, p. 23).

discourage cryptocurrencies[49] 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.[50] These are persons who, either for themselves or others, undertake:

> (i) exchange between virtual digital assets and fiat currencies;
> (ii) exchange between one or more forms of virtual digital assets;
> (iii) transfer of virtual digital assets;
> (iv) safekeeping or administration of virtual digital assets or instruments enabling control over virtual digital assets; and
> (v) 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)[51]

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.

7. 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

[49] For illustration, see Anand and Bhat (2022) and Business Today Desk (2022a). See also Ministry of Finance, GOI, Press Information Bureau (2023).
[50] See Department of Revenue, Ministry of Finance, GOI (2023), issued under Section 2(1)(sa)(vi) of the Prevention of Money-Laundering Act, 2002 (PMLA).
[51] For this purpose, "virtual digital asset" has been assigned the same expansive meaning as applicable under the ITA.
[52] Chapter 1, Section 2(wa) of the PMLA, read with the Prevention of Money Laundering (Maintenance of Records) Rules, 2005.
[53] The powers of the ED have recently received extensive judicial elocution by the SCI in its decision in *Vijay Madanlal Choudhary v. Union of India* (2022: INSC: 756).

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).[54] 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.[55]

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 transactions[59] 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

[54] See also Business Today Desk (2022b).
[55] It appears that the usage of crypto for money laundering is not limited to India. See, generally, Sigalos (2022). See also United Nations Conference on Trade and Development (2022b).
[56] In the context of cryptoassets and money laundering, see, generally, Grijseels and Spreutels (2001); Gruber (2013); Kemsley et al. (2022).
[57] See, generally, Business Today Desk (2022c); CNBCTV18.com (2022); Special Correspondent (2022).
[58] See section 3, "The Direct Tax Landscape", above.
[59] See section 3, "The Direct Tax Landscape", above.

have introduced some tranquillity into the wild, unregulated world of cryptoassets, even if that is with a high tax incidence regime for them.

8. 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.[60] 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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[60] Compare with Parsons (2022), who "highlights the harms Congress and Treasury are risking by not taking action on cryptocurrency taxation" and argues that "uncertainty and lack of guidance on the appropriate taxation of cryptocurrency is opening the door for a critical juncture in tax law to be decided via strategic litigation" (p. 1).

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