



“The Taxation Mess of Crypto currency Regulation in India.”

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ABSTRACT: In the Indian context, a market far from ripe for crypto currencies is just as unpredictable as its legal framework is. The same uncertainty carries forward to the tax statutes that are supposed to govern crypto currency. Nobody can discriminatively say if the lack of legal analysis in India on a spontaneously growing market of crypto currencies is due to the banks being insecure of a decentralised system or the sheer complexities of incorporating them in the law. This paper analyses the current position of statutes, especially concerning taxation over crypto currency. It then attempts to analyse how crypto should be segregated so as to tax it in accordance with the appropriate slab, additionally what is the position of law on the taxability of profits made from selling crypto. Further, it goes over regulatory obstructions and attempts to present proposals and suggestions to overcome the same.

KEYWORDS: Crypto currency, Crypto mining, Bitcoin, Taxation, Regulation

Introduction

In its policy to tax profits on crypto by classifying them as capital gains, it would seem that India has adopted an approach similar to that of the UK,¹ however, in its potential policy of banning pre-existing crypto currencies to introduce a state backed digital currency for it to be ultimately regulated by the RBI is similar to that of China. It would be noteworthy that regulations in the domain of crypto currency exchanges have progressively become controlling to the extent of The Reserve Bank of India banning financial institutions from indulging in transactions with crypto currency; with much needed judicial intervention, the said ban was lifted by the Apex Court in *Crypto currency v. RBI*,² providing a necessary relief.



Current Legal Scenario

It was held that the RBI has failed to depict any damage to banks or similarly regulated entities, caused by trading of crypto currency and that in the latter's functioning, the 'banking system was the lifeline' for trading. Post judgement, there have been demands from the industry leaders of crypto currency, for it to be included in the RBI's regulatory sandbox.³ The lack of regulation has subjected the world of crypto currency to transform into means of money laundering. However, the Central Economic Intelligence Bureau has suggested the bitcoin would be classified as an 'intangible asset' and GST would be levied on it accordingly. CEIB has proposed to levy 18% GST on transactions, which could amount to roughly 40,000 crores of revenue annually.⁴

In India, there is no definition of currency or virtual currency per se; neither can the latter be read into the definition of foreign currency.⁵ The Apex court has affirmed the view that crypto currency cannot fall under the ambit of this act in *TCS v. State of AP* ⁶ and *Shankara Rao Badam & Ors. v. State of Mysore & Anr*, 2002 178 ELT 22 S.C. Therefore, as of now, Bitcoin operates as an asset in India, i.e., a store of value which when sold, incurs capital gains that can be taxed. However, Bitcoin, being a crypto currency can be used as a medium of exchange as well, thereby bearing the charge of indirect goods tax as well, consequently creating the double taxation problem.⁷

Classification Problem

The views of the Chairman of the Central Board of Direct Taxation are in consonance with multiple officials from the income tax department when they say that for individuals to be liable to pay taxes on crypto currency, it should be treated as a part of capital gains.⁸ In common parlance around income tax, the tax structure enforced on crypto currency ideally depends on the nature of its investment, i.e., whether the same is in the form of an asset or currency. However, the distinction lies wherein if crypto currencies are traded frequently as a business income, then the profit gained on the same can be taxed according to the respective slab rate but if it is held for investment purposes then the tax rate can be applied on profit in the form of capital gains.



Further, if an individual uses their investment within a span of 3 years, then the relevant tax slab would be applied on the profit in accordance of it being a short-term capital gain but if the taxpayer redeems their investment after a span of 3 years, then the profit can be regarded as a long-term capital gain and therefore will be taxed at 20% with indexation.⁹

Crypto Mining:

Ideally the process of mining crypto currency is considered as a taxable event, and the same generated by the process of mining can be considered as a self-generated capital asset. However, this asset cannot be taxed as capital gain because in India Section 55 of the IT Act¹⁰ does not recognise it as such. Specifically for mining if the taxpayer runs in mining business, then they can avail business deduction on their tax bill in lieu of the resources utilised in the process of mining, and such relaxations cannot be availed if mining crypto currency has been done in furtherance of personal gain.¹¹

Particularly Bitcoin, being a self-generating asset like other crypto currencies, cannot be evaluated for a definite cost of acquisition hence the mechanism of computing capital gains on the same fails as supported by the decision of the Supreme Court in the case of BC Srinivasa Setty.¹² Since as of now the Indian tax laws are completely silent on the taxability of bitcoins it would be safe to assume that the income tax authorities would opt for taxing the value of crypto currency generated via mining under the head of 'income from other sources'.¹³

Tax and Regulatory Difficulties

Till now, the RBI has not declared bitcoins or other crypto currencies as a formally approved currency, and this seems to be a remote possibility. Fiat currencies are often backed by governmental bodies or central banks and are secured by assets like gold that are held by the issuing institution. Bitcoin generated by the block chain technology doesn't really satisfy those requirements. If bitcoin had been categorised as currency, it would have been instantly exempted from GST because the term "goods" does not cover currency. Property of any type which is movable in nature qualifies as a good under the Sale of Goods Act of 1930 if it is sold in



exchange of monetary consideration. Hence, bitcoins are goods as per this statute only in transactions of fiat to crypto or crypto to fiat. Barter exchanges are not authorised which will in theory cover all transactions of crypto to crypto. Using the same reasoning, a person purchasing other products using crypto would not be included as per the Sale of Goods Act, 1930.

Since the scope of "goods" is broad enough to include intangible property such as crypto currencies, GST must also apply to crypto currency trades. If bitcoin is sold for fiat money in such a case, there is a single supply which should be subjected to GST. When bitcoin is exchanged for another product, it should be regarded as barter or, more accurately, two supplies happening simultaneously, leading to two GST payments causing a severe GST effect. The Income Tax Act, 1961 defines capital assets as any property of any sort, which is likely to include bitcoins. The issue then becomes whether bitcoins may be classified as a stock-in-trade or capital asset. Judging by past explanations by the Central Board of Direct Taxes about the categorisation of shares as stock-in-trade or capital assets, it might be plausible to consider a bitcoin sold by a normal customer to be a capital asset, while a crypto trader may classify it as stock in trade. When it is classified as stock-in-trade, taxes on the amount received will be due under the heading of business income. If bitcoin is supplied by a customer but not during the course of business operations, such as to purchase coffee, it should not be considered a taxable supply as per GST.

Individuals, particularly those who purchased bitcoins with cash in the early days of bitcoin or NRIs, are at greater risk of being examined. There is no need for an NRI who holds bitcoins outside of India to declare their ownership in India. If an NRI receives money from the sale of crypto in India, then only he or she is required to report it and pay taxes. Nevertheless, if an NRI sells bitcoins outside of India and then tries to send the money back to India, it would be carefully examined since they would have mostly earned significant profits. Income tax authorities might issue notices, inquiring about the source of income or wealth and demanding evidence that it is not hidden or black money.



This may be a major issue since proving how bitcoins were obtained in the early years of the ecosystem can be challenging at times. It's also difficult to prove that the bitcoin was purchased outside of India since it's a location-less asset, with the closest estimate to a location being the wallet in which it was kept at the time of purchase. However, it's likely that customers are unaware of the location of the server where the wallet is stored, which may result in litigation. Likewise, resident Indians who've already purchased bitcoins outside of India are required to report foreign assets and funds in foreign banks. Even for legitimate users, the concerns identified with regard to source of money and asset location may continue to be complex challenges. In the event that they make a mistake, the consequences could be severe.

Since utility tokens indicate a claim for movable goods or services, they may not be taxed under GST, which excludes actionable claims under GST except for gambling, betting, and lottery. When such tokens do not constitute an actionable claim, then perhaps the point of taxing is moved to the time when the token is actually swapped for services or commodities. If the RBI imposes a ban, it will be impossible to implement in reality since the consumers will lose value, exchanges will lose business, government will lose revenue, and transactions would most likely shift overseas or underground. All parties are losing in this scenario, and now the only way ahead is to acknowledge the problems in the present approach and take appropriate measures to govern crypto currencies in India.

Conclusion

The Government of India has stated several times that crypto currency-related earnings will be taxed based on the method of the crypto currency being held. On crucial issues like what will be the initial tax event and the valuation process, as well as who must be responsible for reporting crypto currency trades, a precise road map and formal instructions are eagerly expected. The Income tax authorities have delivered letters to crypto currency investors and exchanges in past years, requesting information about their bitcoin operations. As a result, it would be interesting to observe how the Indian government implements crypto legislation. If



properly regulated, this asset class might provide significant tax income for the government, which could be utilised to support the country's development goals.

End-Notes:

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