

TAXATION OF INCOMES FROM VIRTUAL DIGITAL ASSETS

Slightly Off from A Point of Absolute Uncertainty

Recently there were certain media reports on the Government's scrutiny of virtual digital assets, questioning its very existence from a regulatory perspective.

Virtual assets like crypto tokens, being a new age digital asset, require better understanding of the technology involved and associated complexities. To this end, the Government has been attempting to introduce the Crypto Bill and enactment of laws around the same. However, the tabling of Bill in the Parliament was deferred indefinitely with bureaucrats citing sensitivity & intricacies involved, which is delaying the finalization.

At this juncture, the buzz word was taxation of income from these digital assets – whether capital gain tax should apply/are they in the same nature of speculative business income, etc. However, the popularity of virtual currencies (one form of a digital asset) and sudden rise in retail investments in these currencies has resulted in large volumes & value of transactions. The traction has also caught the government's attention, which found it worthy enough to announce a separate scheme of taxation in the Union Budget 2022.

While this promises to bring clarity on the taxation aspects, though untested at this juncture, the same in no manner is indicative of what the government wishes to do on the regulatory front for such assets or any class or category thereof. Cryptocurrencies more commonly known as crypto tokens (one form of the virtual digital asset) have, however, gained impetus with these taxation announcements, coupled with the government's plan to introduce a Digital Rupee using blockchain and other technologies, i.e. the same degree employed by the crypto tokens too.

Taxation of Virtual Digital Asset

- IDENTIFICATION:** The Virtual Digital Asset (VDA) has been defined under Section 2(47A) of the IT Act to cover exclusively cover following assets-
 - One qualifying following cumulative conditions:
 - Being any information or code or token generated through cryptographic means/ other means;
 - Not being an Indian currency or any other foreign currency;
 - Providing 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.
 - B. A non-fungible token or (NFT) any other token by whatever name called
 - C. Any other digital asset as may be notified

- Further the power to exclude any qualifying asset from the definition of VDA shall also vest with the Central government.
 - AD-HOC RATE OF TAX:** The Finance Bill, 2022 introduces section 115BBH under the IT Act to bring implicate an ad-hoc 30% tax on the incomes arising from transfer of any VDA, whether in cash or kind. Cess and Surcharges, if any applicable, shall be over and above.
 - GROSS INCOME TAXATION:** The proposal clearly enunciates that neither any deduction shall be allowed from the income so earned - except & other than the cost of acquisition thereof. Nor would the losses, if any, be allowed for set off of any losses or other income(s), in any manner.
 - APPLICABILITY:** These provisions to tax income from VDA transfers shall be applicable for transactions undertaken on or after April 1, 2022.
 - WITHHOLDING REQUIREMENTS:** A proposal for deducting 1% of the payment amount at source and directly depositing with the government has also been incorporated. Exception for small transactions have also been proposed from TDS requirements.

ELP's Insights

The scheme while aiming at certainty of VDA taxation, leaves several parts unaddressed. This includes differentiation between a resident and non-resident taxpayer, taxation of such income for periods prior to introduction of this scheme, challenges in case of VDAs listed on exchanges or platforms based outside India, etc.

The core condition of an asset having an inherent value appears difficult to be met given the nature of blockchain technology. This may lead to dispute on an asset-by-asset basis.

Further, while it appears that losses from transfer of VDA may not be allowed for set off or adjustment against any other income, whether multiple transactions of the same assessment year which would be yielding both losses and gain would be eligible for set off inter-se is doubtful.

Interestingly, since crypto tokens and probably other VDAs operate globally, it will be interesting to understand whether the cost of acquiring multiple VDAs can be considered as a single block of assets or whether the cost of acquisition will have to be determined at a level or asset, asset class or category, etc.

For TDS compliances, identification of counterparty is a challenge and hence, the tax deducted at source could become a permanent cost of the transaction.

With acceptance of VDAs as a class of asset for income tax purposes, the debate for its indirect taxation shall also catch up given that there is no specific exemption being given to same.

Finally, once extant regulatory provisions for VDA are enacted, the recognition of asset may also warrant reconsideration.

Also access ELP podcast unfolding of blockchain technology and derivation of crypto currencies [here](#).

