UNDERSTANDING CRYPTOCURRENCY & TAXATION FRAMEWORK

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ABSTRACT

The emergence of cryptocurrency has redefined the global financial landscape, introducing both transformative opportunities and complex regulatory challenges. This research paper explores the evolution, technological foundation, and economic implications of cryptocurrencies, with a focus on the Indian legal and taxation frameworks. It offers a comprehensive examination of blockchain technology, the nature and characteristics of key cryptocurrencies, and the legal ambiguity that characterized India's initial approach to digital assets. Special attention is given to the pivotal shift introduced by the Finance Act, 2022, which imposed a 30% tax on crypto gains and a 1% TDS on transactions. The paper further evaluates the regulatory stances of institutions like the RBI, SEBI, and Ministry of Finance, while addressing ongoing challenges related to GST applicability, double taxation, and definitional ambiguities. Through a multidisciplinary lens, this study seeks to clarify the evolving intersection of cryptocurrency and taxation in India and proposes the need for a coherent, innovation-friendly legal framework that balances fiscal accountability with technological progress.

INTRODUCTION

The emergence of cryptocurrency has instigated a transformative alteration within the global financial landscape, presenting both prospects and hurdles for governmental bodies and regulatory authorities. As groundbreaking category of digital financial assets, cryptocurrencies operate independently of traditional centralized banking frameworks and monetary strategies. Their inherently decentralized, borderless, and pseudonymous characteristics have not only redefined financial transactions but also introduced significant challenges related to legal frameworks, regulatory oversight, and tax implications.

Within the Indian context, the cryptocurrency market has experienced remarkable expansion over the past decade, characterized by growing engagement from individual investors, technological pioneers, and financial entities. Nonetheless, Indian legislators and regulatory bodies adopted an initially cautious approach, primarily due to apprehensions surrounding price volatility, investor safeguarding, money laundering, and the absence of inherent asset support. This uncertainty concerning regulatory guidelines persisted until the enactment of the Finance Act, 2022, which established a formal tax structure for Virtual

Digital Assets (VDAs), representing India's inaugural significant legislative measure in the regulation of crypto asset transactions[1].

This chapter serves as a foundational segment for comprehending the development and fundamental construction of cryptocurrency, commencing with an exploration of its definition, historical milestones, and technological underpinnings. It further investigates the role of blockchain technology in supporting cryptocurrency frameworks and fostering trust less, transparent, and immutable financial environments. Additionally, the chapter delineates prominent cryptocurrencies, their diverse applications, and the significance of this technological advancement in relation to taxation policies.

As India endeavours to refine its legal infrastructure to regulate this rapidly evolving domain, a thorough understanding of the origins and characteristics of cryptocurrency is imperative for the formulation of effective tax and compliance strategies. Consequently, this chapter establishes the groundwork for subsequent legal and fiscal analyses by providing an extensive overview of the evolution, features, and increasing significance of cryptocurrency within India's financial and regulatory context.

The Historical Evolution of Cryptocurrency

The idea of digital currency has been present for several decades; however, the effective and decentralized use of cryptocurrency commenced in the early 21st century with the advent of Bitcoin. Prior to this, numerous efforts were undertaken to establish a digital currency, yet none succeeded in achieving widespread acceptance due to various obstacles related to technology, regulation, and scalability.

Initial Trials and Theoretical Underpinnings.

The groundwork for cryptocurrency was established through early innovations in cryptographic and digital payment systems:

David Chaum's DigiCash (1989) represented one of the earliest endeavours to forge a type of electronic money via cryptographic methods. Although it was pioneering, it relied on a centralized model and ultimately fell short commercially due to insufficient uptake[2].

Proposals by **Wei Dai, namely B-Money, and Nick Szabo's Bit Gold**, articulated theoretical frameworks for decentralized digital currency during the 1990s and early 2000s. These concepts prioritized distributed systems and cryptographic security, yet were never fully realized[3].

These early attempts underscored the necessity for a mechanism capable of addressing the "double-spending issue" absent centralized control.

[1] Finance Act, 2022, Government of India. Available at: https://www.indiabudget.gov.in
[2] Chaum, D. (1983). Blind Signatures for Untraceable Payments. Advances in Cryptology
[3] Dai, W. (1998). B-Money Proposal. Available at: http://www.weidai.com/bmoney.txt

The Advent of Bitcoin (2008–2009)

The contemporary phase of cryptocurrency was initiated in 2008 when an individual or group operating under the pseudonym Satoshi Nakamoto released the whitepaper **"Bitcoin: A Peer-to-Peer Electronic Cash System"**[4]. The primary objective of Bitcoin was to create a decentralized currency that enabled users to transfer funds online without intermediaries like banks or governmental institutions.

In January 2009, the Bitcoin network commenced operations with Nakamoto mining the genesis block, signifying the establishment of the first blockchain. The inaugural documented commercial transaction involving Bitcoin transpired in May 2010, when 10,000 BTC were traded for two pizzas, a momentous event now known as Bitcoin Pizza Day.

The Rise of Altcoins and Advancements in Blockchain Technology

Following the success of Bitcoin, a variety of alternative cryptocurrencies, commonly referred to as "altcoins," were introduced to address constraints related to speed, scalability, and programmability:

Litecoin (2011) provided accelerated transaction processing.

Ripple (2012) concentrated on facilitating cross-border financial transactions and enhancing liquidity for banks.

Ethereum (2015) pioneered the integration of smart contracts and decentralized applications (DApps), thereby broadening the applicability of blockchain technology beyond mere digital currency[5].

Such innovations established a foundational framework for Decentralized Finance (DeFi), Non-Fungible Tokens (NFTs), and assorted blockchain-centric applications.

Market Surges and Regulatory Reactions

The bullish market of 2017 witnessed Bitcoin surging to nearly $20,000, while Initial Coin Offerings (ICOs) inundated the market with numerous new tokens, many of which operated without regulatory oversight.

This surge prompted governments globally, including that of India, to explore frameworks for regulation and taxation aimed at safeguarding investors and mitigating potential abuse.

India's Initial Stance and Policy Developments

India's initial perspective was one of scepticism:

In 2018, the Reserve Bank of India (RBI) prohibited financial institutions from engaging with entities associated with virtual currencies[6]

[4] Nakamoto, S. (2008). Bitcoin: A Peer-to-Peer Electronic Cash System.
[5] Buterin, V. (2013). Ethereum White Paper. https://ethereum.org/en/whitepaper/
[6] Reserve Bank of India. (2018). Circular on Prohibition of Dealing in Virtual Currencies, RBI/2017-18/154.

However, in **2020**, India's Supreme Court overturned the RBI's directive, asserting that no legal framework existed to forbid cryptocurrency trading and that the RBI's measures were excessive.

Gradually, with rising adoption, India adopted a more structured regulatory framework:

The Finance Act of 2022 introduced specific provisions for taxation, imposing a flat tax rate of 30% on crypto profits and a 1% TDS on transactions—constituting a significant shift in regulatory policy[7].

Definition and Characteristics of Cryptocurrency

Cryptocurrency is defined as a digital or virtual currency that employs cryptographic techniques to ensure security, rendering it nearly impossible to forge or engage in double-spending. In contrast to fiat currencies that are issued by central authorities, cryptocurrencies function on decentralized networks utilizing blockchain technology. These networks are upheld through distributed ledger systems wherein transactions are validated and documented by numerous nodes (computers) distributed globally.

According to the Oxford Dictionary of Finance and Banking, cryptocurrency is characterized as "a digital currency in which transactions are verified and records maintained by a decentralized system using cryptography, rather than by a centralized authority"[8]. The Reserve Bank of India (RBI), in its 2018 circular, described cryptocurrencies as "digital tokens not backed by any government and without any intrinsic value"[9].

Core Characteristics:

- **Decentralization:**

Cryptocurrencies lack control from a central authority, such as a central bank. They depend on decentralized ledger technologies, notably blockchain, wherein oversight is dispersed among a network of participants.

- **Cryptographic Security:**

The integrity and security of transactions and the generation of new coins are ensured through cryptographic algorithms, which promote security and transparency.

- **Immutability:**

Once recorded on the blockchain, transactions cannot be modified or deleted. This immutable nature fosters trust in the system.

- **Limited Supply:**

A majority of cryptocurrencies possess a capped or restricted supply. For instance, Bitcoin is limited to 21 million coins. This characteristic mirrors the scarcity typically associated with precious metals.

[7] Government of India. (2022). Finance Act, 2022. https://www.indiabudget.gov.in/
[8] Oxford Dictionary of Finance and Banking (2023 Edition).
[9] Reserve Bank of India. (2018). Prohibition on dealing in Virtual Currencies, RBI Circular RBI/2017-18/154.

- **Pseudonymity:**

Transaction processes in cryptocurrencies do not necessitate the revelation of personal identities. Users interact through wallet addresses instead of identifiable names, which raises privacy issues and presents regulatory challenges.

- **Global and Borderless:**

Cryptocurrencies facilitate cross-border transactions without the need for conventional financial intermediaries, thus presenting an appealing option for remittances and international payments.

- **Programmability and Smart Contracts:**

Platforms such as Ethereum have pioneered the concept of programmable currency through smart contracts—self-executing agreements written into the blockchain—allowing for automation in financial transactions.

These defining characteristics set cryptocurrencies apart from traditional financial instruments and form the foundation for their disruptive capabilities as well as regulatory challenges. The growing adoption of cryptocurrencies across both financial and non-financial domains has led various governments, including that of India, to formulate appropriate tax regulations, compliance strategies, and legal classifications.

Role of Blockchain Technology

In the contemporary digital landscape, blockchain technology has emerged as a transformative innovation that serves as the underlying architecture for a vast majority of cryptocurrencies. Often regarded as the linchpin of the cryptocurrency ecosystem, blockchain was originally conceived as a decentralized ledger to facilitate transactions for Bitcoin, the first and most prominent cryptocurrency. However, over time, it has undergone significant evolution, transcending its initial purpose to find relevance in a multitude of industries. A comprehensive understanding of blockchain technology is imperative for grasping the operational mechanics of cryptocurrencies and for recognizing the distinctive regulatory challenges they pose to authorities, particularly in the realms of governance and tax compliance.

Definition and Concept of Blockchain Technology

At its core, blockchain can be elucidated as a decentralized and immutable ledger that chronologically records digital transactions. These transactions are encapsulated within blocks, which are then distributed across a peer-to-peer (P2P) network. Each block encompasses critical components: a list of transactions, a timestamp, a cryptographic hash of the preceding block, and a nonce, which is particularly utilized in proof-of-work mechanisms to validate new blocks within the chain. This structural design is pivotal as it guarantees that every block is intrinsically connected to its predecessor. Consequently, any attempt to tamper with a block necessitates alterations to all subsequent blocks within the entire network, a process that is

computationally prohibitive. This inherent quality of blockchain serves to ensure the integrity, transparency, and robust security of the data it encompasses[10].

Applications of Blockchain Beyond Cryptocurrency.

While blockchain technology was initially conceived to support the Bitcoin network, its utility has been recognized across diverse sectors, including but not limited to the following:

- **Banking and Finance:** Blockchain facilitates faster settlements of transactions, optimizes cross-border payments, and supports the tokenization of various assets, thereby enhancing liquidity and accessibility.
- **Supply Chain Management:** The implementation of blockchain in supply chain logistics has yielded significant improvements in transparency and traceability of goods, leading to more efficient management practices and reduction in fraud.
- **Healthcare:** In the medical field, blockchain can securely store and manage patient medical records, ensuring data integrity while allowing authorized personnel to access relevant information seamlessly and securely
- **Voting Systems:** The deployment of blockchain for electoral processes provides tamper-proof records that enhance the integrity of democratic elections, thereby increasing public confidence in electoral outcomes.
- **Real Estate and Land Records:** By utilizing blockchain for property title management, stakeholders can ensure the immutability of land records, thus simplifying property transactions and reducing the potential for disputes.

Implications for Regulation and Taxation

The adoption of blockchain technology within the cryptocurrency domain presents both promising opportunities and formidable regulatory challenges.

- **Auditability:** The transparency of blockchain could potentially streamline tax audits and enhance compliance if regulatory frameworks were to integrate effectively with this technology.
- **Anonymity:** Despite the public nature of the blockchain ledger, user identities remain obscured behind wallet addresses, which poses significant challenges for tax enforcement and Anti-Money Laundering (AML) compliance efforts.
- **Cross-Border Transactions:** The capability for transactions to circumvent traditional banking channels results in complex jurisdictional ambiguities that complicate taxation efforts across different territories.

[10] Narayanan, A., Bonneau, J., Felten, E., Miller, A., & Goldfeder, S. (2016). Bitcoin and Cryptocurrency Technologies. Princeton University Press

In light of these complexities, it is imperative for governments, such as that of India, to harness the myriad benefits presented by blockchain technology while simultaneously formulating strategies to mitigate associated risks related to privacy concerns, fraud, and tax evasion.

Key Cryptocurrencies and Their Use Cases

The global cryptocurrency ecosystem is a complex and rapidly evolving landscape that comprises thousands of distinct digital currencies. Each of these cryptocurrencies is developed with specific functionalities, purposes, and technological foundations to meet diverse user needs. While Bitcoin is undoubtedly the most recognized and widely adopted cryptocurrency, several other notable digital assets have emerged to address various limitations of Bitcoin, introduce innovative functionalities, or serve distinct sectors of the burgeoning digital economy. This section seeks to delineate some of the most pivotal cryptocurrencies and elucidates their unique use cases within the dynamic framework of the blockchain ecosystem.

- **Bitcoin (BTC): The Digital Gold**

Since its inception in 2009, Bitcoin has established itself as the first successful execution of a decentralized digital currency. It is often regarded as a "store of value," drawing parallels with traditional gold due to its capped supply of 21 million coins[11], which creates scarcity and contributes to its value proposition. The primary utility of Bitcoin lies in its utility as:

A Store of Value: Many investors perceive Bitcoin as a hedge against inflation and economic instability, likening it to digital gold for its potential to preserve wealth over time.

A Peer-to-Peer Transaction Medium: Bitcoin facilitates direct transactions between users without the need for intermediaries such as banks or payment processors, thereby reducing transaction costs and enhancing speed and security.

Bitcoin's main use cases encompass long-term investment strategies (often referred to in the crypto community as "HODLing"), international remittances, and, increasingly, the direct purchase of goods and services across various merchants and platforms.

- **Ethereum (ETH): The Smart Contract Pioneer**

Launched in 2015 by visionary developer Vitalik Buterin, Ethereum has emerged as a pioneering decentralized platform that enables the development of smart contracts and decentralized applications (DApps). Its notable features include:

Programmable Agreements: Smart contracts on the Ethereum blockchain allow for the automation of various agreements and transactions without the need for intermediaries, thus enhancing efficiency and reducing counterparty risk.

[11] Nakamoto, S. (2008). Bitcoin: A Peer-to-Peer Electronic Cash System.

Catalyst for Decentralized Finance (DeFi): Ethereum serves as the backbone for the rapidly expanding DeFi sector, which aims to recreate traditional financial services—such as lending, borrowing, and trading—on a decentralized architecture.

Hosting Non-Fungible Tokens (NFTs): Ethereum supports the creation and trading of NFTs, blockchain-based digital assets that have revolutionized the art and gaming industries by providing a unique proof of ownership and authenticity.

Due to its extensive versatility, Ethereum is often referred to as the "world computer," indicating its broad applicability across various use cases.

- **Ripple (XRP): Cross-Border Payments**

Ripple, founded with the objective of enabling instantaneous cross-border payments between financial institutions, operates on a fundamentally different model compared to Bitcoin and Ethereum. Key characteristics of Ripple include:

Centralized Validator Structure: Unlike Bitcoin's decentralized validation process, Ripple employs a more centralized approach to validator nodes, which facilitates faster transaction processing.

Strategic Partnerships: Ripple has formed partnerships with numerous banks and remittance services to establish real-time gross settlement systems (RTGS)[12], enhancing liquidity and transaction speed across borders.

Ripple's primary use case revolves around bridging the divide between traditional financial systems and the cryptocurrency realm, exemplified by its capacity to provide liquidity in cross-border transactions.

- **Tether (USDT) and USD Coin (USDC): Stablecoins**

Stablecoins represent a category within the cryptocurrency market designed to maintain price stability by pegging their value to fiat currencies, such as the United States dollar (USD). These assets are crucial for investors and traders navigating the volatile cryptocurrency market. The roles of stablecoins include:

Stable Value Storage: By pegging their value to fiat currencies, these digital assets provide a reliable means of storing value in an otherwise highly volatile environment.

Facilitation of Trading Pairs: Stablecoins serve as prominent trading pairs on various cryptocurrency exchanges, enabling traders to execute trades with reduced risk of price fluctuations.

Cross-Border Transactions and Remittances: Stablecoins are utilized for quick and cost-effective cross-border payments, offering an alternative to traditional remittance services.

Tether (USDT) and USD Coin (USDC) are two of the leading stablecoins by market capitalization, demonstrating significant adoption and utility in various digital asset markets.

[12] Ripple Labs. (2023). How Ripple Works. https://ripple.com/

- **Solana (SOL), Cardano (ADA), and Polkadot (DOT): Ethereum Alternatives**

In the ongoing race to overcome the limitations of Ethereum, several alternative platforms, referred to colloquially as "Ethereum killers," have emerged. These include Solana, Cardano, and Polkadot, which offer distinct advantages such as:

Enhanced Transaction Speed: These platforms provide faster transaction processing capabilities compared to Ethereum, enabling seamless user experiences.

Lower Transaction Fees: A more cost-effective transaction model makes these platforms attractive to users who may be deterred by Ethereum's high gas fees.

Energy-Efficient Consensus Mechanisms: Many of these cryptocurrencies employ energy-efficient consensus protocols, such as Proof-of-Stake, to enhance sustainability while maintaining high levels of throughput.

The applications of these platforms encompass a range of functionalities including smart contracts, DeFi operations, and token creation, positioning them as viable challengers to Ethereum's market dominance.

- **Dogecoin and Shiba Inu: Meme and Community-Driven Coins**

Initially created as a light-hearted joke cryptocurrency, Dogecoin (DOGE) has witnessed an incredible surge in popularity, fueled by internet culture and endorsements from high-profile public figures. Similarly, Shiba Inu (SHIB) capitalized on the meme-based appeal, attracting a passionate community of supporters. While their intrinsic utility remains limited, these cryptocurrencies serve specific roles, such as:

Facilitating Tipping and Donations: Users often employ these coins for tipping content creators and supporting charitable causes within their respective communities[13].

Demonstrating Social Sentiment: The rise of Dogecoin and Shiba Inu illustrates the social and speculative dynamics inherent in cryptocurrency markets, where community engagement plays a pivotal role in driving value.

These coins exemplify the interplay between community engagement, market dynamics, and speculative investment in the broader cryptocurrency landscape.

Use Case Summary Table

Cryptocurrency	**Primary use case**	**Unique feature**
Bitcoin (BTC)	Store of value, payment	Fixed supply decentralization
Ethereum (ETH)	Smart contracts Dapps, Defi	Programmability

[13] MarketWatch. (2022). Rise of Meme Coins: Dogecoin and Shiba Inu.

Ripple (XRP)	Cross border payments	Fast settlement, bank partnerships
Tether (USDT), (USDC)	Stable transaction trading	Pegged to flat
Solana, Cardano	Defi, scalability	Fast energy efficient
Dogecoin, Shiba Inu	Speculation, community	Meme based adaption

Legal status of cryptocurrency in India

The legal environment surrounding cryptocurrency in India has been characterized by a degree of uncertainty, accompanied by a cautious approach to policymaking and a notable hesitation in regulatory enforcement. As technological innovations have rapidly advanced and investor enthusiasm for digital currencies has surged to unprecedented levels, the Indian government, alongside various regulatory authorities, has found itself facing significant challenges. These challenges are primarily associated with the complexities inherent in a decentralized and financial system, which inherently contrasts with traditional financial frameworks that prioritize regulation and oversight.

In this context, the present chapter aims to delineate the evolution of India's legal position regarding cryptocurrency. It offers a comprehensive examination of pivotal regulatory actions taken by governmental bodies, judicial interventions that have shaped the discourse, and a close analysis of the current stance adopted by key institutions involved in financial regulation, such as the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and the Ministry of Finance. Through a methodical exploration of these developments, this chapter seeks to provide a nuanced understanding of how legal interpretations and regulatory policies in India have transformed over time in response to the dynamic landscape of cryptocurrency investment and usage.

In doing so, the chapter will illustrate how multiple factors—including technological innovation, market dynamics, and the evolving expectations of the public—have influenced the trajectory of cryptocurrency regulation in India. Furthermore, this examination will highlight the interplay between the need for regulatory clarity and the imperative of fostering an environment conducive to innovation and economic growth. By presenting a detailed analysis of the interactions between these various elements, this chapter will contribute to a deeper understanding of the challenges and opportunities that lie ahead for cryptocurrency regulation in India, offering insights that could inform future policy decisions. Ultimately, the significant ambiguity that currently pervades the legal framework surrounding cryptocurrencies in India necessitates a robust discourse on the implications for both investors and regulators in this rapidly evolving financial landscape.

Overview of Regulatory Stance Prior to 2022

Prior to 2022, India's regulatory framework concerning cryptocurrency was primarily marked by a posture of caution and uncertainty, accompanied by a notable absence of legislative clarity. The status of

cryptocurrencies was neither overtly prohibited nor formally legalized, resulting in a regulatory vacuum that left investors, exchanges, and regulatory bodies in a state of confusion. Although the government and its financial regulatory authorities issued numerous advisories and policy recommendations, they refrained from the implementation of binding legal measures.

Initial Caution from the RBI and Other Authorities.

The Reserve Bank of India (RBI) was the first regulatory entity to publicly recognize the emergence of cryptocurrencies. In December 2013, the RBI released a press statement alerting the public to the risks associated with virtual currencies, including Bitcoin. Concerns highlighted included issues of security, price volatility, insufficient consumer protection, and the potential for misuse in illicit activities such as money laundering and financing terrorism[14].

Similar warnings were reiterated in February 2017 and again in December 2017. These communications emphasized that, while cryptocurrencies were not illegal outright, participants in the market were operating at their own peril[15].

Establishment of the Inter-Ministerial Committee (IMC)

In 2017, the Ministry of Finance established an Inter-Ministerial Committee (IMC) led by Subhash Garg to investigate the legal and technological dimensions of cryptocurrencies and propose a regulatory framework. The IMC submitted its report in February 2019, which became pivotal in shaping the policy discourse surrounding digital assets in India[16].

The IMC advocated for a total prohibition of private cryptocurrencies and put forth the draft "Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019." The report pointed out that cryptocurrencies possess no intrinsic value, present considerable risks to financial stability, and could be exploited for unlawful purposes. Concurrently, the committee suggested that India should consider the introduction of a state-backed digital currency, specifically a central bank digital currency (CBDC), under the auspices of the RBI[17].

Lack of Formal Legislation

Despite the IMC's robust recommendations, the draft legislation was never presented to Parliament, resulting in no statutory prohibition being enforced. This created a state of regulatory uncertainty wherein cryptocurrency trading was not explicitly illegal but was actively discouraged by financial regulators.

[14] Reserve Bank of India. (2013). RBI Cautions Users of Virtual Currencies. Press Release
[15] Reserve Bank of India. (2017). Press Releases on Virtual Currencies.
[16] Ministry of Finance. (2019). Report of the Committee to Propose Specific Actions on Cryptocurrency.
[17] Ibid

During this period:

- Cryptocurrency exchanges were allowed to operate without licenses or formal oversight.
- There were no established tax or accounting regulations pertaining to virtual digital assets.
- Financial institutions and banks exhibited reluctance in servicing cryptocurrency-related enterprises, often acting on informal advice rather than formal legal guidelines.

This absence of regulatory clarity impeded the institutional development of the cryptocurrency sector in India and imposed substantial operational challenges for both businesses and investors alike.

RBI's Approach to cryptocurrencies and the banking ban.

The Reserve Bank of India (RBI), serving as the nation's central banking authority, has historically adopted a prudent and frequently antagonistic approach towards cryptocurrencies. As the principal regulator of monetary stability and financial institutions in India, the RBI has consistently raised early alarms regarding the speculative and unregulated characteristics associated with crypto assets.

Initial Alerts and Regulatory Issues

In December 2013, the RBI issued its first formal advisory against cryptocurrencies, warning the public about various risks related to financial, operational, legal, and consumer protection aspects. The announcement highlighted specific dangers tied to price volatility, malware risks, the potential loss of private keys, and the absence of established mechanisms for dispute resolution in cryptocurrency transactions[18].

Throughout the years, the RBI reaffirmed its stance by releasing further advisories—most notably in February and December 2017—clarifying that it had neither authorized nor licensed any entities to engage with virtual currencies. The central bank emphasized that cryptocurrencies posed significant risks to consumer protection, market integrity, and financial stability[19].

RBI's Circular of April 6, 2018

On April 6, 2018, the RBI took decisive action by issuing a circular titled "Prohibition on Dealing in Virtual Currencies". This circular mandated that all institutions regulated by the RBI—including banks, payment service providers, and non-banking financial companies (NBFCs)—refrain from offering services to individuals or businesses involved in the trading or settlement of virtual currencies[20].

[18] Reserve Bank of India. (2013). RBI cautions users of Virtual Currencies.
[19] Reserve Bank of India. (2017). Press Releases on Virtual Currencies.
[20] Reserve Bank of India. (2018). Circular: Prohibition on dealing in Virtual Currencies, RBI/2017-18/154.

Consequently, this move:

- Severed the connections between cryptocurrency exchanges and the formal financial system.
- Compelled crypto businesses to halt operations or relocate offshore.
- Rendered fiat-to-crypto transactions nearly untenable within regulated frameworks.

The RBI rationalized this prohibition by citing several systemic concerns, including:

- The potential utilization of virtual currencies for money laundering and financing of terrorism.
- Risks to consumer protection stemming from the speculative and volatile nature of crypto assets.
- Threats to the integrity of the payment system, accompanied by challenges in maintaining regulatory oversight.

However, it is notable that the RBI did not perform a comprehensive empirical analysis of the actual harms caused by cryptocurrencies in India prior to issuing this directive.

Implications for the Industry

The implementation of the ban produced immediate and widespread repercussions:

- Prominent Indian cryptocurrency exchanges such as Zebpay and Koinex suspended fiat deposits and withdrawals.
- Startups and investors encountered operational and legal ambiguity.
- Indian users increasingly sought out foreign platforms or engaged in peer-to-peer (P2P) transactions, thereby shifting activity beyond formal regulatory oversight.

Despite the disruptive effects of the ban, many exchanges adapted by pivoting to crypto-to-crypto trading models or relocating to jurisdictions more favourable to cryptocurrency, such as Singapore and Dubai.

Criticism and Legal Contestation

The 2018 circular faced significant criticism for its perceived arbitrariness, lack of stakeholder engagement, and for penalizing an industry lacking legislative backing. In reaction to this, the Internet and Mobile Association of India (IAMAI), along with various crypto exchanges, filed a petition before the Supreme Court, leading to the landmark 2020 ruling that invalidated the RBI circular[21].

Supreme Court Ruling in Internet and Mobile Association of India v. Reserve Bank of India (2020)

The case of Internet and Mobile Association of India v. Reserve Bank of India (2020) represents a significant juncture in the development of cryptocurrency regulation within India, marking the first notable judicial examination of the Reserve Bank of India's (RBI) jurisdiction over virtual currencies. This ruling provided

[21] Internet and Mobile Association of India v. Reserve Bank of India, Writ Petition (Civil) No. 528 of 2018, Supreme Court of India.

essential clarity to a regulatory landscape previously characterized by administrative directives and vague policy guidelines.

Background of the Case

In light of the RBI's directive issued on April 6, 2018, which prohibited banking institutions and other regulated entities from servicing businesses engaged with virtual currencies, the Internet and Mobile Association of India (IAMAI) along with various cryptocurrency exchanges initiated a writ petition under Article 32 of the Constitution of India before the Supreme Court.

The petitioners contested the circular on several grounds:

- The RBI lacked the legislative authority to impose a comprehensive ban on businesses associated with cryptocurrencies.
- The directive infringed upon the fundamental right to engage in trade and professional activities as stipulated in Article 19(1)(g) of the Constitution.
- The RBI failed to supply empirical evidence demonstrating that cryptocurrencies had negatively impacted India's financial system[22].

The Supreme Court's Analysis*

On March 4, 2020, a bench comprising Justices Rohinton Nariman, Aniruddha Bose, and V. Ramasubramanian issued the judgment.

The Court's reasoning encompassed several key aspects:

- **Right to Trade and Occupation:** The Court asserted that access to banking facilities is a crucial element for conducting business. By restricting such access to cryptocurrency exchanges, the RBI effectively hindered the operational viability of an entire sector, constituting an infringement on the right to pursue any occupation[23].
- **Doctrine of Proportionality:** The judgment emphasized the doctrine of proportionality, which obliges the state to ensure that any limitations imposed on fundamental rights are justified and substantiated by adequate evidence. The Court concluded that the RBI had not provided proof of any adverse effects of cryptocurrencies on regulated financial entities, thereby failing the proportionality assessment[24].
- **Lack of Legislation**: The Court recognized that while the RBI possesses the authority to oversee the financial system, it lacked a statutory framework from Parliament that explicitly prohibits cryptocurrencies. In the absence of a defined legislative basis, the extensive prohibition imposed by the RBI was considered excessive[25].

[22] Supreme Court of India. Internet and Mobile Association of India v. Reserve Bank of India, (2020) 10 SCC 274.
[23] Ibid., para 163–165.
[24] Ibid., para 166–170
[25] 10 SCC 274

Outcome and Impact

The Supreme Court nullified the RBI's circular, thereby reinstating banking services to cryptocurrency exchanges and other enterprises engaged in virtual currency transactions. This decision was warmly received by industry stakeholders, viewing it as an affirmation of their business practices and a prompt for a more measured regulatory approach.

Following the judgment, numerous cryptocurrency exchanges resumed their fiat-to-crypto services, leading to increased investor engagement. Nonetheless, the ruling also placed responsibility on legislators and financial authorities to develop a comprehensive and enforceable legal framework for virtual digital assets.

The evolving stance of Indian regulatory bodies (RBI, SEBI, Ministry of Finance

Following the Supreme Court's 2020 ruling that revoked the Reserve Bank of India's (RBI) restrictions on cryptocurrency trading, regulatory authorities in India have begun to adopt a more cautious and progressively adaptive approach towards digital assets. Although a comprehensive legal framework for cryptocurrency regulation in India is yet to materialize, principal regulatory entities such as the RBI, the Securities and Exchange Board of India (SEBI), and the Ministry of Finance have embarked on initiatives to establish a regulatory framework through indirect mechanisms, including taxation, compliance advisories, and public policy discussions.

RBI's Stance Post-Judgment

In the aftermath of the Supreme Court's ruling in IAMAI v. RBI (2020), the RBI affirmed via a circular dated May 31, 2021, that its 2018 directive which barred banks from engaging with cryptocurrency entities was no longer enforceable and should not be utilized as a rationale for service denial[26]. Nevertheless, the RBI has sustained a cautious perspective, continuously emphasizing the systemic risks that cryptocurrencies pose to monetary policy, capital controls, and consumer protection.

In public declarations during 2021 and 2022, RBI Governor Shakti Kanta Das cautioned that private cryptocurrencies might instigate the "dollarization" of the Indian economy and jeopardize financial sovereignty[27]. The RBI has persistently advocated for a prohibition on cryptocurrencies and concurrently promoted the inception of a Central Bank Digital Currency (CBDC)—the digital rupee—which was officially launched in a pilot phase at the end of 2022[28].

SEBI's Engagement and Jurisdictional Considerations

The Securities and Exchange Board of India (SEBI) has adopted a relatively restrained stance regarding cryptocurrencies. Although SEBI has not officially categorized cryptocurrencies as securities, it has articulated concerns regarding crypto-related investment vehicles, such as Initial Coin Offerings (ICOs) and exchange-traded products (ETPs).

[26] Reserve Bank of India. (2021). Clarification on Prohibition Circular of April 2018.
[27] Business Standard. (2022). Crypto Can Lead to Dollarisation: RBI Governor Shakti Kanta Das.
[28] Reserve Bank of India. (2022). Concept Note on Central Bank Digital Currency.

In 2022, SEBI conveyed a confidential note to a parliamentary committee indicating that the regulation of cryptocurrencies might not fall within its current jurisdiction, particularly because cryptocurrencies do not signify ownership of any tangible asset or corporate entity. SEBI indicated that the establishment of a new regulatory authority might be necessary, or significant amendments to existing legislation, including the SEBI Act of 1992 and the Securities Contracts (Regulation) Act of 1956, would be required to encompass virtual digital assets within their scope.

Ministry of Finance: Transitioning from Uncertainty to Taxation

The Ministry of Finance has undertaken the most definitive actions regarding the formulation of India's cryptocurrency policy. Despite reiterating that cryptocurrencies are not recognized as legal tender, the Ministry proceeded to implement a taxation framework in the Budget of 2022. The Finance Act, 2022, introduced critical provisions under the Income Tax Act of 1961:

Section 115BBH: Instituted a flat tax rate of 30% on income derived from the transfer of Virtual Digital Assets (VDAs), without permitting any deductions for expenses aside from the acquisition cost, nor allowing set-off of losses[29].

Section 194S: Enforced a 1% Tax Deducted at Source (TDS) on payments concerning the transfer of VDAs, effective from July 1, 2022[30].

The Ministry clarified that the taxation of VDAs does not equate to legalization but is intended to facilitate financial reporting and monitoring of crypto-related income.

Moreover, India's presidency of the G20 in 2023 afforded the Ministry of Finance a platform to advocate for international collaboration on cryptocurrency regulation. The government accentuated the necessity for global consensus to achieve effective cross-border regulation, tax treatment, and compliance with anti-money laundering protocols[31].

2.3 Overview of Taxation in India Before the Crypto Tax Regime

Prior to the enactment of the Finance Act, 2022, which specifically established a taxation framework for virtual digital assets (VDAs), the consistent treatment of cryptocurrencies within the Indian taxation system was characterized by ambiguity, inconsistency, and a notable absence of comprehensive regulatory guidelines. The surge in cryptocurrency adoption—fueled by both domestic and global trends outpaced the existing regulatory frameworks, thereby exposing significant gaps in the legislative environment that governs the taxation of such assets. This chapter provides a critical analysis of the status of cryptocurrency

[29] Finance Act, 2022. Government of India. Section 115BBH, Income Tax Act, 1961.
[30] Finance Act, 2022. Government of India. Section 194S, Income Tax Act, 1961.
[31] Ministry of Finance. (2023). Press Statement on Global Cooperation for Virtual Asset Regulation during India's G20 Presidency.

taxation within the purview of pre-2022 income tax and indirect tax laws in India, while also highlighting the myriads of challenges that arose due to the legislative uncertainties surrounding virtual currencies.

2.3.i. Taxation Under the Existing Income Tax Framework

Up until 2022, the Income Tax Act of 1961 did not provide explicit provisions dedicated to the taxation of cryptocurrencies or VDAs. Nonetheless, income generated from transactions involving virtual currencies was subject to general principles applicable under income tax law. The Income Tax Department adopted a somewhat piecemeal approach, relying predominantly on existing provisions within the Act, which included:

Section 28: Income categorized under "Profits and gains from business or profession" applied in cases where crypto trading practices were frequent or systematic. This included cases where individuals engaged in trading behaved similarly to stockbrokers or commercial entities.

Section 45: Taxation came into play under "Capital gains" when cryptocurrencies were retained as capital assets, necessitating a distinction between short-term and long-term capital gains, dependent on the holding period of these digital assets.

Section 56(2)(x): Any income arising from the gifting of cryptocurrencies was to be taxed under "Income from other sources," making it imperative for recipients of such gifts to report them accurately in their tax filings[32].

Despite these provisions, the lack of a uniform classification system for cryptocurrencies led to considerable disputes regarding their nature—specifically, whether they were to be viewed as commodities, securities, currencies, or distinct digital assets. A notable gap in the regulatory framework was the absence of any formal directives or circulars issued by the Central Board of Direct Taxes (CBDT) aimed at clarifying these classifications. This left individual taxpayers in a precarious position, compelled to determine their own tax treatment, which inevitably contributed to a landscape of uncertainty and inconsistency in both reporting and assessment.

In a notable response to a Right to Information (RTI) application submitted in 2020, the Income Tax Department conceded that there existed no specific guidelines pertaining to the taxation of cryptocurrency gains[33]. This discretionary framework effectively allowed tax officials broad latitude to interpret the source, nature, and rate of taxation applicable to virtual currency transactions, leading to varied interpretations and enforcement practices across different jurisdictions.

Applicability of GST and Indirect Taxes on Crypto Transactions.

In conjunction with the income tax framework, the Goods and Services Tax (GST) regime, which was established in 2017, similarly suffered from a lack of definitive guidance on the applicability of GST to

[32] Income Tax Act, 1961. See Sections 28, 45, 56.
[33] Hindustan Times. (2020). No clear taxation rules for cryptocurrency income in India, RTI reveals.

transactions involving cryptocurrencies. The classification of virtual currencies elicited diverse and often conflicting interpretations, which further complicated compliance for taxpayers and businesses alike:

- Some stakeholders contended that cryptocurrencies should be classified as "goods," thereby rendering transactions subject to GST upon sale or exchange.
- Meanwhile, others proposed that cryptocurrencies ought to be classified as "securities," which were explicitly exempt from GST according to Schedule III of the Central Goods and Services Tax (CGST) Act, 2017.

In 2019, the Directorate General of Goods and Services Tax Intelligence (DGGI) took a proactive approach by issuing tax notices to several cryptocurrency exchanges. These inquiries were primarily aimed at ascertaining whether trading fees associated with crypto assets and activities related to crypto mining constituted taxable services[34].

Key issues that emerged within this context included:

- The question of whether transactions involving the exchange of one cryptocurrency for another should be recognized as a taxable supply under GST principles.
- The challenge of assigning value to crypto transactions that were denominated in digital tokens rather than fiat currency, which complicated the assessment for taxation purposes.
- The potential liabilities of exchanges, particularly regarding their status as intermediaries, which could result in the imposition of an 18% GST on their operations.

The lack of clear and consistent classification led to a fragmented approach to compliance among businesses engaged in cryptocurrency transactions. For instance, while some exchanges took the initiative to apply GST on trading fees, others interpreted crypto transfers as non-taxable or categorically exempt activities. This inconsistency in industry practices heightened the risk of retrospective audits and the imposition of penalties by tax authorities.

In light of numerous appeals for guidance, it is worth noting that the GST Council did not reach a consensus or finalize a comprehensive framework for taxing cryptocurrencies until after 2022, thereby leaving stakeholders in a state of uncertainty for an extended period.

By delving into the historical context and legal precedents governing cryptocurrency taxation in India, we gain a clearer understanding of the challenges and complexities that precipitated the need for a specialized taxation regime, ultimately culminating in the legislative developments of 2022.

Lack of Explicit Tax Provisions Prior to the Finance Act, 2022

Before the implementation of the Finance Act, 2022, the legal framework governing the taxation of cryptocurrencies and other digital assets in India was glaringly inadequate. The absence of explicit and

[34] The Economic Times. (2019). Crypto exchanges under DGGI lens for possible GST evasion.

dedicated legal provisions raised significant concerns among policymakers, tax authorities, and stakeholders regarding various issues, including tax evasion, base erosion, and the underreporting of income derived from cryptocurrency transactions. This regulatory gap not only undermined the integrity of the tax system but also allowed foreign exchanges and peer-to-peer (P2P) trading platforms to operate with relative impunity, free from effective oversight and regulatory scrutiny.

One particularly troubling aspect of this regulatory void was the lack of an obligation for taxpayers to report cryptocurrency assets on their annual tax returns. This omission created a substantial risk of underreporting, as individuals and entities engaged in cryptocurrency transactions could choose not to disclose their holdings or profits, thereby evading taxation altogether. Additionally, there were no withholding tax obligations in place that would facilitate the real-time tracking of gains obtained from the trading of cryptocurrencies. Consequently, the effective monitoring and taxation of these digital assets proved exceedingly challenging for tax authorities.

Moreover, the regulatory ambiguity extended to the treatment of losses incurred from cryptocurrency trading. Investors often exploited this ambiguity by offsetting these losses against other sources of income, further exacerbating the potential for tax revenue loss. Such practices not only distorted the equity of the tax system but also contributed to significant discrepancies in reported income and actual earnings from these rapidly evolving markets.

In a notable parliamentary response in 2021, the Ministry of Finance acknowledged the challenges posed by these inadequacies. The Ministry clarified that while profits generated from cryptocurrency transactions were indeed subject to taxation, the absence of a formal definition of cryptocurrency and related digital assets within Indian law severely hindered enforcement efforts[35]. Agencies responsible for maintaining financial integrity, such as the Enforcement Directorate (ED) and the Financial Intelligence Unit (FIU), found themselves hampered in their ability to track and investigate illicit activities associated with cryptocurrencies. The lack of a clear legal framework created a permissive environment for illicit financial behaviours, including money laundering and other forms of financial crime.

This policy vacuum persisted for an extended period until the enactment of the Finance Act, 2022. This landmark legislation marked a pivotal moment in the regulation of digital assets in India by introducing well-defined parameters for their taxation. For the first time, a statutory definition of Virtual Digital Assets was incorporated under Section 2(47A) of the Act, providing clarity to both taxpayers and regulatory authorities. Furthermore, the Act established a special flat tax rate of 30% applicable to profits earned from these digital assets under Section 115BBH, thereby creating a distinct tax regime for their treatment.

Additionally, a mandatory 1% Tax Deducted at Source (TDS) on crypto transfers was introduced under Section 194S, obligating parties involved in such transactions to contribute to tax revenue at the point of transaction. These advancements represent significant strides toward establishing a more robust and

[35] Ministry of Finance, Government of India. (2021). Unstarred Question No. 1156, Rajya Sabha

transparent regulatory environment for cryptocurrency, with the potential to mitigate risks associated with tax evasion and enhance compliance among taxpayers engaging in digital asset transactions.

Introduction of Cryptocurrency Taxation in India (Finance Act, 2022.

Prior to the year 2022, the taxation framework governing cryptocurrency in India was characterized by a significant level of regulatory ambiguity. While the existing provisions of the Income Tax Act technically imposed taxes on profits derived from cryptocurrency transactions, the absence of definitive legal guidance resulted in varied practices and considerable tax evasion. Acknowledging the increasing acceptance of cryptocurrencies alongside the necessity for a coherent tax framework, the Government of India implemented specific regulations pertaining to virtual digital assets (VDAs) through the Finance Act of 2022. This chapter examines the statutory regulations delineated in Section 115BBH and Section 194S, and analyzes their impact on investors and the wider cryptocurrency ecosystem.

2.4.i. Section 115BBH: Imposition of a 30% Tax on Cryptocurrency Gains

The Finance Act of 2022 introduced Section 115BBH into the Income Tax Act of 1961, establishing a definitive and standardized taxation approach concerning income derived from the transfer of virtual digital assets (VDAs).

Under Section 115BBH (1)[36]:

"When the total income of an assessee contains any income resulting from the transfer of a virtual digital asset, any contrary provisions of this Act notwithstanding, the income tax owed shall be the sum of— (a) the income tax calculated on the income from the transfer of such asset at a rate of thirty percent; and (b) the income tax that the assessee would have owed had the total income been reduced by the amount specified in clause (a)."[37]

Key Features:

- A uniform tax rate of 30% applies to any income generated from the transfer of a VDA.
- No basic exemption threshold exists, meaning this rate is applicable regardless of overall income levels.
- This tax rate does not include any surcharges or cesses, which could elevate the effective tax rate above 31.2% for individuals in higher tax brackets.
- This substantial tax rate categorizes earnings from cryptocurrencies similarly to speculative income such as lottery winnings and betting on horse races (as per Section 115BB), reflecting the government's intent to classify such income as high-risk.

[36] Income Tax Act, 1961. Section 115BBH. Inserted by Finance Act, 2022.
[37] Income Tax Act, 1961. Section 115BBH. Inserted by Finance Act, 2022.

Section 194S: Implementation of 1% TDS on Cryptocurrency Transactions.

To facilitate the traceability of cryptocurrency transactions and curb under-reporting, the Finance Act also brought forth Section 194S, which became effective on July 1, 2022. This statute mandates the deduction of tax at source (TDS) at a rate of 1% on payments made for the transfer of a VDA.

According to this section:

"Any individual liable for compensating any resident for the transfer of a virtual digital asset must, at the point of crediting the payment to the resident's account or at the time of making the payment, whichever occurs first, deduct an amount equal to one percent of that payment as income tax."[38]

Key Features:

- The responsibility of deducting TDS lies with the buyer (payer).
- This requirement only takes effect if the transaction exceeds ₹10,000 within a financial year (₹50,000 for certain specified individuals).
- It is applicable to both crypto-to-crypto and crypto-to-fiat transactions.
- TDS must be deducted even in scenarios where the transaction incurs a loss.
- The provision is designed to establish a transaction trail and to support real-time tax compliance.

Restrictions on Loss Offsetting and Deductions.

Section 115BBH (2) enforces stringent restrictions on the offsetting of cryptocurrency losses:

"No deductions with regards to any expenditures (except for the cost of acquisition), allowances, or loss set-offs shall be permitted to the assessee under any section of this Act while calculating the income cited in clause (a) of sub-section (1)."[39]

Implications:

- Losses arising from the sale of one cryptocurrency cannot be offset against gains from another.
- Losses incurred in the cryptocurrency market cannot be rolled over to subsequent years.
- Deductions for expenses such as transaction fees, electricity costs related to mining, or exchange fees are explicitly prohibited.
- This policy diverges from the treatment of capital assets under Sections 70 and 71 of the Income Tax Act, signalling a strategic aim to deter speculative practices within the cryptocurrency domain.

[38] Income Tax Act, 1961. Section 115BBH. Inserted by Finance Act, 2022.
[39] Income tax act, 1961. Section 11BBH (2)

Impact of the New Tax Regime on Crypto Investors and Traders.

The implementation of the new tax regime in 2022 has profoundly influenced the landscape of India's cryptocurrency markets, engendering both immediate and far-reaching repercussions for investors and traders alike. This regulatory shift has provoked a paradigm change in market activity, compelling stakeholders to reassess their strategies in light of the evolving fiscal landscape.

According to comprehensive analyses conducted by CREBACO Global, trading volumes on major Indian cryptocurrency exchanges experienced a dramatic decline of over 60% to 70% within a mere span of two months following the introduction of the new tax provisions. This stark decrease in trading activity can be attributed largely to the introduction of a 1% Tax Deducted at Source (TDS) on cryptocurrency transactions. This regulatory measure has particularly dissuaded high-frequency traders and individuals engaged in arbitrage, as the associated tax implications have rendered such strategies less viable. The resultant contraction in trading activity has further diminished market liquidity, creating an environment that may deter new entrants and engender uncertainty among existing participants[40].

Moreover, several prominent Indian cryptocurrency exchanges have reported a notable trend of user migration towards foreign platforms that remain unencumbered by Indian tax obligations. This shift not only underscores the challenges faced by domestic exchanges in retaining their user base but also raises significant concerns regarding the future competitiveness of the Indian crypto market on a global scale. The phenomenon of capital flight to foreign jurisdictions highlights the critical need for a regulatory framework that fosters an equitable environment for domestic operators.

The impact of the new tax regime has been particularly pronounced among retail investors, notably those within the middle-income demographic. Many such investors have found themselves compelled to exit the cryptocurrency market, largely due to the inability to offset incurred losses against gains in a taxable environment. This inability to mitigate losses undermines investor confidence and exacerbates the volatility that characterizes the cryptocurrency space, leading to a more cautious approach among potential and current participants.

Furthermore, the taxation regime has significantly increased the complexity of compliance for both investors and trading platforms. The heightened administrative burden associated with adhering to the new tax regulations has prompted calls for more accessible regulatory guidelines, as well as enhanced measures to safeguard investor interests. Although the tax provisions offer a degree of clarity in terms of fiscal obligations, they have simultaneously faced criticism for being excessively punitive and for their failure to constitute a cohesive legal framework that adequately addresses broader facets of cryptocurrency regulation. Stakeholders argue that a more balanced and comprehensive approach to regulation would not only enhance compliance but also foster a more robust and sustainable cryptocurrency ecosystem in India.

[40] CREBACO Global. (2022). Impact Report: Taxation of VDAs in India Post Finance Act 2022

In conclusion, the 2022 tax regime's implications for crypto investors and traders in India are profound and multifaceted. Addressing the challenges posed by this new regulatory framework is essential to safeguard the interests of stakeholders and ensure the long-term viability of the cryptocurrency market in the country. As the regulatory environment continues to evolve, it will be crucial for policymakers to consider the unique characteristics of the cryptocurrency market in order to devise strategies that promote growth while ensuring investor protection.

Taxation of Cryptoassets: Income Tax & GST Perspectives.

The classification and taxation of crypto assets within both direct and indirect tax frameworks have presented considerable obstacles for tax authorities globally. In India, these complexities are exacerbated by the lack of a clear regulatory framework for virtual digital assets (VDAs). The Finance Act of 2022 introduced fundamental direct tax provisions aimed at mitigating some of these challenges, yet uncertainties persist, particularly concerning the Goods and Services Tax (GST). This chapter provides a comprehensive analysis of the treatment of crypto assets under the Income Tax Act of 1961, as well as under GST legislation, while also examining the issues of double taxation and inconsistent asset classification.

Direct Tax Consequences under the Income Tax Act of 1961.

The taxation of income arising from crypto asset transactions is governed by Section 115BBH of the Income Tax Act of 1961, which was enacted through the Finance Act of 2022. As elaborated in Chapter 2.4, this provision imposes a uniform tax rate of 30% on profits derived from the transfer of VDAs, allowing no deductions for expenses (other than the acquisition cost) and disallowing the offset of losses.

Furthermore:

The imposition of tax on gifts of cryptoassets is stipulated under Section 56(2)(x); specifically, if the fair market value of the VDA received exceeds ₹50,000 and is received without consideration or for inadequate consideration[41].

A Tax Deduction at Source (TDS) of 1% under Section 194S is applied to transactions involving the transfer of cryptoassets that exceed certain specified limits, thereby ensuring a transaction trail and facilitating revenue collection.

These provisions reflect a rather conservative stance, oriented more towards deterrence than facilitation, creating a tax classification that parallels that of lottery and gambling income, indicative of governmental skepticism regarding cryptoassets as a legitimate asset category.

It is noteworthy that the Central Board of Direct Taxes (CBDT) has yet to provide comprehensive guidelines (through circulars or FAQs) on scenarios such as staking, airdrops, mining rewards, or yields from decentralized finance (DeFi), thereby leaving numerous categories of income derived from cryptoassets nebulous and subject to varied interpretations.

[41] Income Tax Act, 1961, Section 56(2)(x).

GST Relevance in Crypto Trading and Mining.

The applicability of GST to activities associated with cryptocurrencies remains ambiguous and largely unregulated, even in light of newly established direct tax measures. The Central Goods and Services Tax (CGST) Act of 2017 does not explicitly define or reference virtual digital assets. Nonetheless, tax authorities and legal analysts have engaged in two primary interpretive frameworks:

- **Cryptocurrency as Goods:**

According to Section 2(52) of the CGST Act, 'goods' encompasses all forms of movable property.

Certain tax officials consider crypto tokens as intangible goods, suggesting that transactions involving cryptocurrencies qualify for GST under the category of goods supply.

Under this interpretation, sales of cryptocurrencies by exchanges may incur an 18% GST, with mining operations potentially regarded as a taxable supply[42].

- **Cryptocurrency as Services or Securities:**

Should VDAs be classified as securities, they would be governed by Schedule III of the CGST Act, which specifically excludes securities from GST applicability.

However, it is essential to note that cryptocurrencies have yet to be officially recognized as securities by the Securities and Exchange Board of India (SEBI), resulting in further ambiguity.

Services rendered by exchanges, such as trading facilitation, wallet storage, and brokerage services, are frequently subject to GST at a rate of 18%, notwithstanding the potential exemption of the cryptocurrencies themselves[43].

In 2022, the law committee of the GST Council is reported to have reviewed proposals to categorize cryptocurrencies either as goods or services, with suggested GST rates ranging from 18% to 28%. However, as of now, no definitive conclusion has been publicly announced.

Issues of double taxation and classification challenges.

The taxation of cryptocurrencies in India presents a series of complex issues that require careful consideration, particularly concerning the implications of double taxation and the challenges associated with the classification of various cryptocurrency-related activities. This framework not only raises significant legal and practical concerns but also complicates tax compliance for traders and investors alike.

One of the most pressing issues within this landscape is the potential for double taxation, which occurs when a single transaction is subject to taxation under both direct and indirect tax laws. For instance, consider a scenario in which a trader engages in the sale of cryptocurrency. Under the current Indian taxation regime, the gains accrued from such a transaction may be subject to a flat income tax rate of 30 percent.

[42] CGST Act, 2017, Section 2(52).
[43] PwC India. (2022). Understanding the Taxation of Cryptoassets in India.

Simultaneously, the trader may also incur an additional liability in the form of an 18 percent Goods and Services Tax (GST) applicable to the fees charged by the trading platform utilized for the transaction. This dual tax burden can significantly diminish the net returns of investors and may deter participation in the cryptocurrency market, as individuals grapple with the financial and administrative complexities of navigating such a convoluted tax landscape[44].

Furthermore, the challenges of taxation are compounded in peer-to-peer (P2P) or barter-type transactions, where traditional fiat currency does not serve as a medium of exchange. In these instances, the determination of GST liability and the proper valuation of the crypto-assets involved become contentious issues. The absence of clear regulatory guidance on the treatment of these transactions leaves room for ambiguity, which can lead to inconsistent tax assessments and undermine taxpayer confidence in the fairness of the taxation system.

Mining activities present an additional layer of classification challenges that further complicate the regulatory environment. The question of whether mining should be classified as a supply of goods—specifically, the provision of computing power or the generation of crypto-assets—or treated as the creation of self-generated assets lacks clarity within the existing legal framework. This uncertainty surrounding classification not only complicates compliance for stakeholders engaged in mining operations but also exacerbates the risk of disputes and litigation arising from differing interpretations by tax authorities.

Moreover, the lack of formal definitions for critical terms such as "mining," "staking," "tokenization," and "airdrops" within the tax code creates an environment of inconsistency in the treatment of various cryptocurrency-related activities. Such definitional ambiguities hinder the ability of taxpayers to adequately understand their obligations and rights, leading to further compliance issues and increased propensity for disputes with tax authorities[45].

In addition, the presence of differing definitions across various legislative instruments, including the Income Tax Act, the Central Goods and Services Tax (CGST) Act, the Foreign Exchange Management Act (FEMA), and the Prevention of Money Laundering Act (PMLA), generates overlapping jurisdictions. This overlap fosters a climate of legal confusion, making it increasingly difficult for taxpayers to navigate the regulatory landscape. As a result, the inconsistency in classification and the complexities of double taxation pose substantial obstacles to the development of a comprehensive and coherent regulatory framework for cryptocurrencies in India. Addressing these issues is essential for promoting effective compliance and fostering an environment conducive to innovation in the burgeoning field of digital assets.

CONCLUSION

Cryptocurrencies, once considered a fringe technological experiment, have now become an integral aspect of the global financial ecosystem. India's journey with digital assets has transitioned from outright skepticism and regulatory uncertainty to a nascent framework for taxation and compliance. The Finance

[44] PwC India. (2022). Understanding the Taxation of Cryptoassets in India.
[45] The Hindu Business Line. (2022). GST Council considers 28% GST on cryptocurrency.

Act, 2022, marked a watershed moment by formally introducing specific tax provisions applicable to virtual digital assets, thereby acknowledging their growing economic relevance. However, while the imposition of a 30% tax on gains and a 1% TDS provides clarity in terms of fiscal obligations, the broader regulatory environment remains fragmented.

This research underscores the necessity of an inclusive and harmonized regulatory framework that addresses classification inconsistencies, GST ambiguity, and issues of double taxation. It is essential that future policies not only safeguard against misuse and financial risk but also encourage innovation and growth in the digital asset sector. As India continues to participate in global dialogues on cryptocurrency governance, the development of clear, technology-neutral, and investor-friendly laws will be vital to ensuring both regulatory efficacy and the sustainable integration of digital assets into the mainstream economy.

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