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UPDATES

Budget 2022: New Scheme for the Taxation of Virtual Digital Assets

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The Budget 2022 marks an important milestone for the blockchain ecosystem in India with the Finance Minister announcing the launch of India's official digital currency (digital rupee) which will be issued by the Reserve Bank of India starting 2022-23. Considering the phenomenal increase in the volume of the transactions in the virtual digital assets (**VDAs**) space, the Finance Bill, 2022 (**Bill**) proposes a new and separate scheme for taxation of VDAs (although the legality of the same is still unclear). The key highlights of this development are discussed below.

Government proposes to tax virtual digital assets such as cryptocurrencies and non-fungible tokens in India as it gears up for the introduction of an official digital currency.

1 Definition of '*virtual digital asset*'

The Bill proposes to define VDAs to mean, (i) any information, code, number, or token (not being an Indian or a foreign currency) which is generated through cryptographic means or otherwise and which can be transferred, stored, or traded electronically, (ii) non-fungible tokens; or (iii) other to be notified digital assets. The definition seems to have been kept broad to cover new assets emerging in this space and is proposed to come into effect from 1 April 2022.

2 Computation of income arising from the transfer of VDAs and tax rate

The Bill proposes to tax the income arising to any taxpayer from the transfer of any virtual digital asset at a flat rate of 30% (plus applicable surcharge and health and education cess). While computing the income arising from such transfer, no deduction for any expenditure or loss will be allowed to the taxpayer except the cost incurred in acquiring the VDAs. Further, the taxpayer will not be entitled to set-off or carry forward any loss arising on transfer of VDAs.

The amendment, proposed to be effective from 1 April 2022, is likely to bring much needed clarity regarding the taxability of VDAs going forward. However, since the provisions are proposed to be applicable prospectively, several questions may remain unanswered regarding the tax positions adopted by the taxpayers in the preceding years.

3 Gift of VDAs made taxable in the hands of recipient

The Bill proposes to make the receipt of VDAs as a gift (i.e. for nil or inadequate consideration) taxable in the hands of the recipient taxpayer as income from other sources, with effect from 1 April 2022. However, the Bill does not provide any guidance on the valuation norms for computing such income in the hands of recipient.

4 TDS obligations

With an intention to track transactions in VDAs, the Bill proposes to introduce, with effect from 1 July 2022, deduction of tax at source (**TDS**) on the transfer of VDAs at the rate of 1% by <u>any person</u> who is responsible for paying any consideration for the transfer of a VDA to **any resident**. Compliance with the TDS provisions needs to be ensured even in a scenario where the transfer is wholly or partly in kind or in exchange for another VDA.

Further, the Bill proposes to exempt a payer who is a '*specified person*' and the value, or the aggregate value of the consideration payable is less than INR 50,000 during the relevant financial year. In any other case, the said limit is proposed to be INR 10,000 during the relevant FY.

The term *specified person* is defined to mean (i) an individual or Hindu undivided family (**HUF**) whose total sales, gross receipts, or turnover does not exceed INR 10 million if income is characterised as business income, or INR 5 million in a case where income is characterised as professional income; and (ii) an individual or HUF not having any income under the head profits and gains of business or profession.

In its current form, the tax proposals appear onerous, and could discourage trading and ownership in VDAs, especially among small retail investors. Even though a separate chapter on the taxability of VDAs has been proposed, the question of the legality of cryptocurrencies in India remains unresolved.

At this stage, several questions remain unanswered such as (i) whether VDAs are financial assets, (ii) how will the cost of acquisition be determined, (iii) how would income from transfer of VDAs be characterised (as capital gains or business income or other income) i.e. provide for a charging section for VDAs, (iv) what will be the tax implications in the hands of crypto-miners, (v) can the sale of VDAs attract GST, and (iv) would there be GST on crypto exchanges?

Further, while it is clear that VDAs are proposed to be taxed prospectively, it would be apt to clarify whether VDAs transferred before 1 April 2022 would be exempt.
