CMA Bhogavalli Mallikarjunna Gupta
CFO, GST & Management Consultant

TAXATION IMPLICATION CRYPTO CURRENCIES IN INDIA: SOME THOUGHTS

Trade and Commerce play a vital role in the progress of any country's economy. Trade started about 1,50,000 years ago, and in the initial days of trade, goods and services were exchanged. Over a period, bater has been replaced with physical currency. The currency issued by various Federal Governments is of two types, Gold Standard. The currency which is backed by the quantity of gold equivalently is known as Gold Standard. The other category is Fiat System. In this, the currency system is not backed by any Gold reserves. They are open to be issued, and the demand and supply determine the currency's value. US dollars is the classic example for the Fiat system-based currency, and Indian Rupee is the example for the Gold Standard.

With the adoption of digitization, physical currency is being replaced with digital transactions. As per the latest information available with the National Payments Corporation of India, the number of transactions recorded using the UPI-based payment during Oct 2021 is 4.21 billion, amounting to US 100 billion dollars. Cryptocurrencies are the new buzzword in the market.

Cryptocurrency

The word "cryptocurrency" is derived from the encryption techniques which are used to secure the network. Cryptocurrency is a digital currency used over the internet to purchase goods or services or traded for profit. Cryptocurrencies are created using a technology called the blockchain. Blockchain is a decentralized technology spread across many computers that manage and records transactions.

Cryptocurrencies are fiat currency, and any Federal Government in the world do not regulate them. Though the cryptocurrencies are claimed to be safe, there were instances where millions of cryptocurrencies were stolen and used by anti-national forces. Some experts claim that Cryptocurrencies are the future of finance as the transfer of funds between two parties is instantaneous. There is no involvement of third parties like banks or financial institutions. The transfer happens with minimal charges compared to the traditional banking channels. The transfer happens through a combination of public and private keys.

In the cryptocurrencies world, they are termed public keys as they are public-facing, i.e., the address to which the cryptocurrencies are received. They are tagged with a public address like a country, city, street name, and house number. The public keys are based on a complex mathematical algorithm. Private Keys are like the password for the wallets, and the fund transfer happens on a combination of the public and private keys.

The cryptocurrencies started in 2009 with the introduction of **bitcoin.** The value of cryptocurrencies fluctuates on day to day basis. As per CoinMarketCap.com there are about 13K+ cryptocurrencies that are traded in the market. List of the top 10 cryptocurrencies with the highest market capitalization as per CoinMarketCap.com as of 8th Nov 2021.

Sr. No	Cryptocurrency	Market Capitalization
1	Bitcoin	$1.2 trillion
2	Ethereum	$557.2 billion
3	Binance Coin	$107.7 billion
4	Solana	$73.6 billion
5	Tether	$72.6 billion
6	Cardano	$67.4 billion
7	XRP	$58.5 billion
8	Polkadot	$52.1 billion
9	Dogecoin	$36.5 billion
10	USD Coin	$34.3 billion

Legal Status

Though cryptocurrencies are used very widely in many countries, it is yet to be declared or notified as legal tender. As of the date on El Salvador is the only country that has declared cryptocurrencies as legal tender. Now in El Salvador, the citizens can buy any goods or services using bitcoins or pay taxes. It also offers citizenship if anyone purchases three bitcoins.

In India, investors trading in bitcoins is very high though it is not legal tender. The recent Honorable Supreme Court Judgement has set aside the RBI Circular issued in April 2018 while delivering the verdict in the case of Internet and Mobile Association of India Vs. RBI. The honorable Supreme Court has stated that the circular issued by RBI instructing banks to make sure customers dealing in cryptocurrencies should not be allowed access to banking services is not legal in the absence of any legislative ban on the buying or selling of cryptocurrencies, the RBI cannot impose disproportionate restrictions on trading in these currencies. The court felt such restrictions would interfere with the fundamental right of citizens to carry out any trade that is deemed legitimate under the law.

Though the restriction has been lifted based on the judgment of the Honorable Supreme Court in the trading of cryptocurrencies, the Reserve Bank of India has asked banks to continue other due diligence procedures on cryptocurrency traders under rules linked to anti-money laundering and prevention of terrorism.

The basis on the recommendations of the RBI, in India, during the last 6 months, about 2 lacs accounts have been blocked by the top three cryptocurrency exchanges - WazirX, CoinSwitch Kuber and CoinDCX, citing malicious activities. It also means that there is still an active mechanism by the cryptocurrency exchanges with respect to KYC and monitoring the transactions from whom the users have received and the usage of the funds.

Taxation of Cryptocurrencies

Cryptocurrencies are about a decade old, and they are still in the evolving stage. As of date, only one country has made it a legal tender. Other countries are still evaluating the treatment of taxation (direct and indirect taxes) for transactions carried out with cryptocurrencies. Different countries have adopted different measures in taxing cryptocurrencies.

United States of America

The US Treasury has been issuing guidelines on cryptocurrencies since 2013, and they have not classified/ declared them as currency. Cryptocurrencies have been declared as Money Services businesses. It has been declared as property for taxation purposes.

Profit from cryptocurrencies trading is considered for capital gains. The tax has to be paid based on the holding period, either as short-term capital gains or long-term capital gains.

Canada

Cryptocurrencies are used in Canada to buy goods and services online or offline stores as long as they accept them. However, the Government has not declared it as legal tender. The exchanges dealing with cryptocurrencies are required to registered as Money Services Business and register with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)

Canadian Revenue Agency considers Bitcoins as a commodity, which means that transactions carried out in cryptocurrencies will be a barter transaction. Once the transaction is classified as a barter transaction, the buyer paying in bitcoins has to issue a tax invoice, and Canadian VAT is applicable.

Russia

In Russia, cryptocurrencies are treated as digital assets like property, and they cannot make payments in cryptocurrencies. It means cryptocurrencies can be traded, and on trading, profits are taxable. Investors in cryptocurrencies have to disclose their holding in their returns income tax returns or pay a penalty of 10%. Reporting of holdings in cryptocurrencies is mandatory from April 2022.

United Kingdom

The United Kingdom has classified cryptocurrencies as property in 2020. The cryptocurrency exchanges have to be registered with Financial Conduct Authority. Individuals residing in the UK and holding cryptocurrencies will be taxed on profits made on the purchase and sale of cryptocurrencies as capital gains. The regular exemption on the capital gains up to £12,300 is available, which means that if the profit is less than £12,300*, it is exempted and above that is taxable.* It is not considered as a legal tender to date.

Australia

According to the Australian Tax Office, cryptocurrencies are viewed as digital assets. On cryptocurrency transactions, both income tax and capital gains taxes are applicable. In case if the business receives payments in cryptocurrency, it has to be recorded in the books with the amount received in cryptocurrency and in Australian currency.

Switzerland

In Switzerland, taxation is different for different cantons, and this can lead to some confusion. In Zurich, cryptocurrencies are treated as digital payment units and are considered virtual currencies. It means that it can be used for regular payments or as investments. Virtual currencies are subject to wealth tax.

In Bern, for individuals, cryptocurrencies are treated as private assets and are subject to wealth tax and are classified as "miscellaneous assets." It means capital gains are also applicable

India

In India, cryptocurrencies are not considered legal tender. They are considered commodities as they are tradable in the exchanges. As they are treated as commodities, any profits or gains on the trading of cryptocurrencies are liable for taxation under Income Tax Act 1961 for capital gains.

From a GST perspective, there is uncertainty on the taxation and a lot of clarity is required. The main challenge is cryptocurrencies are not considered as legal tender by the Government. Suppose cyrpocurriences have to be considered legal tender. Section 22 and Section 26 of the Reserve Bank India Act 1934 have to be amended accordingly. Section 22 of the RBI Act 1934, only the Reserve Bank of India can issue Bank Notes. As per Section 26 of the RBI Act, only notes issued by RBI will be considered as legal tender. Suppose cryptocurrencies have to be declared as legal tender. In that case, the relevant provisions of the RBI Act have to be amended in the first place.

Can cryptocurrencies can be classified as security? If yes, we need to review the definition of security as defined in Section 2(h) of the Securities Contracts (Regulations) Act 1956. It defines securities as

Securities include

(i) *shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company 14[or a pooled investment vehicle or other body corporate];*

ia) derivative;

ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

id)) units or any other such instrument issued to the investors under any mutual fund scheme;

securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938 (4 of 1938);

ida) units or any other instrument issued by any pooled investment vehicle;]

ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;

(ii) *Government securities;*

Iia) such other instruments as may be declared22 by the Central Government to be securities; and

(iii) *rights or interest in securities;*

As cryptocurrencies cannot be classified as securities, it is paving the way for wider interpretation. There are various schools of taught processes on the taxation of cryptocurrencies, which gives an interpretation that it has to be classified as goods or services. The provisions of Section 7 of the CGST Act 2017 defined supply and included barter also.

For the purposes of this Act, the expression "supply" includes—

(a) all forms of supply of goods or services or both such as sale, transfer, ***barter****, exchange, licence, rental, lease or disposal made or agreed to be made for* ***a consideration*** *by a person in the course or furtherance of business;*

(b) import of services for a consideration whether or not in the course or furtherance of business 1[and];

(c) the activities specified in Schedule I, made or agreed to be made without a consideration;

Consideration – Section 2(31)

"consideration" in relation to the supply of goods or services or both includes—

(a) any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;

(b) the monetary value of any act or forbearance, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government:

Money Section 2(75)

"money" means the Indian legal tender or any foreign currency, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller cheque, money order, postal or electronic remittance or any other instrument recognised by the Reserve Bank of India when used as a consideration to settle an obligation or exchange with Indian legal tender of another denomination but shall not include any currency that is held for its numismatic value;

Cryptocurrency cannot be considered as money basis on the above provisions in GST Act 2017.

Suppose cryptocurrencies are paid for the purchase of goods or services or both. In that case, the same transaction is to be considered Barter as per the above provisions. The buyer will be giving cryptocurrencies in place of legal tender in the form of cryptocurrencies. They are not legal tender in India at this point.

Example

A purchase a villa in the construction stage worth 5 crores in Hyderabad from builder B and pays B in cryptocurrency, i.e., pays Coinhaze coins (cryptocurrency) brought from Exchange E. The villa is transferred in A's name, and an occupancy certificate is received subsequently. B Pays 140 coins of conihaze as consideration.

Why it is a supply under GST?

I. There is a transaction of between A & B, B is giving Villa

II. There is the consideration paid by A to B

A is supposed to pay in rupees, but he is paying in Coinhaze coins, which means there is an exchange of villa for Coinhaze coins, and this purely falls under the category of "barter."

Cambridge dictionary defines barter as *"to exchange goods for other things rather than for money:"*

Merriam Webster defined barter as *"to trade by exchanging one commodity for another **:** to trade goods or services in exchange for other goods or services"*

From the above definitions, it is clear that the transaction between A & B is barter. It falls under the definition of supply as per the provisions of GST.

When the transaction is defined as barter, there will be a requirement to issue two tax invoices for a barter transaction. One tax invoice will be issued by the B for the sale of the villa. Another tax invoice has to be issued by A for Coinhaze coins, as it is not considered legal tender.

From the above, it is very clear that if cryptocurrency is used to purchase goods or services, it must be treated as supply, and GST is applicable. The next question arises: Is it to be treated as a supply of goods or services? As it is taxable under GST, the transaction has to be classified as either goods or services.

Definition of goods as per the provisions of Section 12(52) of the CGST Act 2017

"goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;

The definition of goods in GST is borrowed from the definition of goods given in the Sale of Goods Act 1930.

Services are defined in Section 2(102) of the CGST Act 2017

"services" means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;

The above two definitions clearly indicate that cryptocurrencies have to be classified as services. Cryptocurrency is intangible and cannot be seen physically or felt, or touched.

As per the definition of goods given in the Constitution of India, then it will be considered as goods. But going through some of the previous case laws gives an idea that it can also be classified as good as in the case of "***electricity***" based on the jurisprudence provided in the case of Associated Power Company vs. R.T Roy by the honorable High Court of Kolkata.

Goods have been defined in Article 366(12) as

"*goods includes all materials, commodities, and articles.*"

In the case of Associated Power Co. v. R.T. Roy, the Calcutta High Court held that electricity comes under the ambit of 'goods' under Article 366 (12) of the Constitution. It can be argued that since electrical energy can be brought and sold, it will come under the ambit of a 'commodity or an 'article').

Taking a cue from the above judgment, we can also consider cryptocurrencies as goods as cryptocurrencies are traded as commodities in the exchanges. To classify it as goods or services as we have seen in other countries, there should be a clarification from the Government through legislation.

After classifying it as goods or services, the next question is the HSN code for cryptocurrencies is? It can be determined only as and when we have clarity on the classification and with necessary amendments for classification have been made. The basis on the classification, then only the tax rate can be determined.

If a tax invoice is required to be issued by A, the next question which comes into mind is on what value tax invoice has to be issued? It has to be valued as per provisions of Section 15 of CGST Act 2017; the transaction value paid in rupee terms for acquiring the villa can be taken, and, on that value, GST is to be computed.

Valuation – Section 15 of CGST Act 2017

(1) The value of a supply of goods or services or both shall be the transaction value, which is the price actually paid or payable for the said supply of goods or services or both where the supplier and the recipient of the supply are not related and the price is the sole consideration for the supply.

(2) The value of supply shall include–––

(a) any taxes, duties, cesses, fees and charges levied under any law for the time being in force **other than** *this Act, the State Goods and Services Tax Act, the Union Territory Goods and Services Tax Act and the Goods and Services Tax(Compensation to States) Act, if charged separately by the supplier;*

In the previous example, we have seen that A pays B 140 coins, which is also being paid on GST. Ideally, it is not required to be paid based on GST provisions for Valuation as it has explicitly excluded the CGST, SGS, IGST and Compensation Cess taxes.

Going by our initial example, A has to issue a tax invoice for ₹ 5 crores as he is paying consideration in other than money. Now the question is GST applicable additionally on ₹ 5 crores or not? If yes, who will pay the tax amount? This also needs to be notified by the department to keep away the ambiguity. Ideally, A has to pay a value of ₹ 5 crores and on that GST at the applicable rate as this is purely an independent transaction.

Particulars	Amounts
Value of each coin = A	5,000
Currency Exchange Rate (USD to INR) = B	75
Value in INR = C (A X B)	3,75,000
Cost of Villa = D	5,00,00,000
GST @5% = E	25,00,000
Total value = F (D X E)	5,25,00,000
No of coins to be issued if Tax is to be included = G (F/C)	140
No of coins to be issued if Tax is to be excluded = H (D/C)	133

The input tax credit can be claimed if the buyer buys cryptocurrencies and uses them for business purposes. The exchanges charge some amount of fee for the transaction, and on the GST is applicable. The other question that arises is that as cryptocurrencies are to be treated as commodities, then is GST applicable to the value of cryptocurrencies purchased? Yes, it is applicable, and as of the date, it is not being charged by many of the exchanges.

The buyers have to obtain registration under GST if their threshold has crossed ₹ 40 lacs and pay GST on the transactions where they use cryptocurrencies to purchase goods or services or both. After obtaining GST registration, the buyer has to file GST Returns periodically and discharge GST with the input tax credit or cash for the invoices the buyer of cryptocurrencies.

Income Tax Implications

Now let's review the impact from the Income-tax point. On the sale of cryptocurrencies, Income tax is applicable. It will be taxed as it is not explicitly exempted in the Income Tax Act 1961. If the cryptocurrencies are treated as commodities, they are taxed on the profit as business income. The applicable tax rate is the individual taxpayer's bracket. There is also another school of taught which advocates cryptocurrencies as investments. If they are treated as investments, then it is applicable to be treated under capital gains based on the holding. The second school of taught may not hold good as the profit earned on the sale of cryptocurrencies is not a speculative income as per Income Tax Act Provisions as the delivery of cryptocurrencies has taken place.

Under the Income Tax provisions, what should be the treatment if the cryptocurrencies are purchased at a lower price and transferred to another person in exchange of goods or services? In such cases, is there any impact of Income Tax? The answer is yes, and it is to be taxed on the difference between the transfer price in Indian Rupees and the purchase price in Indian Rupees.

Normally wallets transfer coins to the holders as part of marketing and promotion to the existing holders, and it is termed as airdrops. The question is income tax applicability on the coins received as air drops when the recipient sells them or uses them to purchase goods or services? The answer is yes for the applicability of Income Tax. At the time of receipt of airdrops from the wallet owner, there is no GST as it is a gift in the recipient's hands. Still, GST will be applicable if the coins received as gift are used to acquire goods or services or both.

Equalization Levy

As of date, the equalization levy does not apply to the cryptocurrencies purchased by the Indian citizens from the exchanges located outside India. As these exchanges are not paying any taxes, the Government may notify them down the line for the applicability of the equalization levy.

OIDAR

To provide a level playing field for the domestic players, digital services provided by foreign companies to recipients in India are taxed as part of OIDAR services. The foreign entity must take registration under GST in India and pay GST on the services provided by them to Indian clients.

As of date, many of the cryptocurrency exchanges based out of India are not paying GST under OIDAR Services. This could be a bone of contention, and the department may go behind them to recover duties. This is a low-hanging sword, and they have to cough up 18% as and when they are issued notices by the officials.

As of date, there is an ambiguity on the taxation of cryptocurrencies in India as there is no specific legislation for the same. The interpretation or analysis is purely the author's views based on his experience and interpretation of the provisions. To clear this ambiguity, the Government should expedite the process of introducing the proposed Cryptocurrency Bill 2021, and it should clear the following grey areas

a) Treatment of mining of cryptocurrencies

b) Classification of Cryptocurrencies as goods or services

c) Taxability of cryptocurrencies as taxable or exempted

d) Applicable tax rates if they are treated as taxable goods or services

e) Equalization levy applicability on purchase of cryptocurrencies by Indian from foreign companies

f) The implication of trading of cryptocurrencies as per Income Tax, GST and other applicable laws

g) How to determine the exchange value for converting into INR for compliance purposes

h) Treatment of airdrops issued by the wallets to holders from time to time

i) Treatment under Income Tax as asset or security for taxation purpose

Though cryptocurrency is not a legal tender in India, many people have started investing in cryptocurrencies. These are used to purchase goods or services or for trading to make money or as an investment. It is also learned that many NRIs are remitting to their family members in cryptocurrencies to save the financial charges levied by the financial intermediaries. Few companies in India are accepting cryptocurrencies for the goods or services supplied by them.

The Government and the Reserve Bank of India are also contemplating a lot on the legislation for cryptocurrencies. As of date, it has not been made as a legal tender as India; we follow the Gold Standard for the issue of currency notes. Still, in cryptocurrency, they are not backed by any sovereign guarantee as they are privately held. The value of cryptocurrencies is highly volatile. In multiple instances across the globe, it has been observed that cryptocurrencies are miss used by anti-national forces. The legislation should be brought on cryptocurrencies at the earliest to avoid litigation. It will clarify the future course of action for the investors and address the above challenges being discussed. If possible, the Government should introduce The Cryptocurrency and Regulation of Official Digital Currency Bill 2021in the upcoming winter session and take inputs from all the stakeholders similar to GST for effective implementation of the same and avoid disputes between the tax authorities with the trade & industry and investors.

Till it is made as legal tender, in any country it opens a can of worms for the law enforcing agencies on the taxation of the cryptocurrencies under the direct and indirect tax legislations in their countries.

Disclaimer:

Any views or opinions represented above are personal and belong solely to the author and do not represent those of people, institutions, or organizations that the author may or may not be associated with in a professional or personal capacity unless explicitly stated. Any views or opinions are not intended to malign any religion, ethnic group, club, organization, company, or individual.