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Taxation of Virtual Digital Assets

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Draft for discussion purposes only

Business Models

- Exchanges
  - Indian (Coindcx) / Global (Binance)
  - Centralized / Decentralized (Uniswap)
- Brokers / Aggregators (place user orders to other exchanges)
- Employee Incentive (receiving salary in VDAs)
- Minting of tokens
- Wallet / custody services
- Crypto funds and investment professionals
- Remittance / Fintech (cross border payments in stablecoins)
- NFT marketplace
- Real world asset tokenization (IFSCA paper)
- Gaming – player cards as NFTs
- DeFi
- Others (e.g., social media, music, content creation)

Regulatory Regime

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October 2008
A paper titled "Bitcoin: A Peer to Peer Electronic Cash System" in was published by a pseudonymous developer by the name of Satoshi Nakamoto. On January 3, 2009, first bitcoin was mined.

December 2013
The RBI issued a circular warning users of the potential risks (security, no central agency, security, no inherent value, legal status and usage in illicit activities) pertaining to the use of virtual currencies (**VC**)

Feb 2017
The RBI clarified that it has not given any approval to any entity to operate schemes or deal with any VC. Further, it cautioned that any user, holder, investor, trader, etc. dealing with VCs will be doing so at their own risk.

December 2017
In the wake of significant spurt in the valuation of many VCs and rapid growth in Initial Coin Offerings (ICOs), RBI reiterated the concerns conveyed in the earlier press releases.

April 2018
RBI imposed a ban on entities regulated by it to not deal with VCs or provide services for facilitating any person or entity in dealing with or settling VCs.

July 2019
An Inter-Ministerial Committee established by the MoF released a report on a proposed regulatory approach towards distributed ledger technology and VCs. The Committee recommended an outright prohibition, along with criminal penalties, on dealing with VCs.

March 2020
The SCI set aside, on constitutional grounds, April 2018 circular issued by the RBI. This affirmed virtual currency exchanges' fundamental right to trade and do business, guaranteed under the Constitution of India.

April 2022
A new income tax regime was introduced for virtual digital assets (VDAs) which included definition of VDAs, Taxation of income from the transfer of VDAs, Gift tax on VDAs, and withholding obligation on transfer of VDAs.

March 2023
The Ministry of Finance extended the applicability of certain compliance obligations under the PMLA Act to various service providers in the virtual digital asset ecosystem.

February 2025: A recent statement by the Secretary, Department of Economic Affairs suggests that India is reviewing its stance on the crypto-assets due to the shifting attitudes towards VDAs in other jurisdictions. A discussion paper capturing India's regulatory approach is expected to be released shortly in this regard.

Regulatory: PMLA Applicability

MINISTRY OF FINANCE

(Department of Revenue)

NOTIFICATION

New Delhi, the 7th March, 2023

S.O. 1072(E).—In exercise of the powers conferred by sub-clause (vi) of clause (sa) of sub-section (1) of section 2 of the Prevention of Money-laundering Act, 2002 (15 of 2003) (hereinafter referred to the as the Act), the Central Government hereby notifies that the following activities when carried out for or on behalf of another natural or legal person in the course of business as an activity for the purposes of said sub sub-clause, namely:-

(i) exchange between virtual digital assets and fiat currencies;

(ii) exchange between one or more forms of virtual digital assets;

(iii) transfer of virtual digital assets;

(iv) safekeeping or administration of virtual digital assets or instruments enabling control over virtual digital assets; and

(v) participation in and provision of financial services related to an issuer's offer and sale of a virtual digital asset.

Explanation:- For the purposes of this notification "virtual digital asset" shall have the same meaning assigned to it in clause (47A) of section 2 of the Income-tax Act, 1961 (43 of 1961).

Definition of VDAs

The Finance Act, 2022 has defined VDA under section 2(47A) of the ITA.

2(47A) states :-

(a) any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically;
(b) a non-fungible token or any other token of similar nature, by whatever name called;
(c) any other digital asset, as the Central Government may, by notification in the Official Gazette specify:
Provided that the Central Government may, by notification in the Official Gazette, exclude any digital asset from the definition of virtual digital asset subject to such conditions as may be specified therein.
"(d) any crypto-asset being a digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions, whether or not such asset is included in sub-clause (a) or sub-clause (b) or sub-clause (c)." (*Proposed to be inserted with effect from 1 April 2026*)

Explanation: For the purposes of this clause,-
(a) "non-fungible token" means such digital asset as the Central Government may, by notification in the Official Gazette, specify;
(b) the expressions "currency", "foreign currency" and "Indian currency" shall have the same meanings as respectively assigned to them in clauses (h), (m) and (q) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999).

Definition of VDAs: Dissection

Necessary Criteria	Additional Criteria	Exclusions
▪ any information or code or number or token, ▪ generated through cryptographic means or otherwise, ▪ can be transferred, stored or traded electronically;	• providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or • functions as a store of value or a unit of account (including its use in any financial transaction or investment, but not limited to investment scheme);	Indian currency or foreign currency as defined under Foreign Exchange Management Act, 1999 is excluded from the ambit of VDA meaning that anything that is Indian currency or foreign currency is automatically not a VDA. Further, Central Government has power to notify in the Official Gazette to exclude any digital asset from the definition of virtual digital asset subject to such conditions as may be specified therein.

(a) NFT: The definition of VDA also specifically includes a non-fungible token ("NFT") or any other token of similar nature, by whatever name called;
(b) any other digital asset, as the Central Government may, by notification in the Official Gazette specify; and
(c) Crypto assets **being a (i) digital representation of value; (ii) relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions**

Definition of VDAs: Key Considerations

- **Expansive scope**:
    - 'information', 'code', 'number' makes the definition of VDA all encompassing
    - generated through cryptographic means **or otherwise**
    - Coverage of other assets - credit card / debit card reward points, airline miles, digital vouchers, in-game currencies, dematerialised securities etc.
    - Crypto Futures – ticking bomb?

- **Inherent value**
    - '..promise or representation of having inherent value…'
    - Inherent value not necessary at time of issuance – reference to offer documents

- **Non-exclusion of securities** – already defined and taxable for the purpose of ITA. Further, the definition of 'securities', under the Securities Contracts (Regulation) Act, 1956 (**SCRA**), includes traditional financial instruments such as stocks, bonds, and 'commodity derivatives', but does not include VDAs or VDA derivatives. That said, the definition of 'securities' is an inclusive list, leaving room for interpretive and legislative expansion in the future.

- **One size fit definition -** The current VDA definition is overly broad and fails to capture the varied use cases—such as utility, payment, security, or asset-backed tokens—resulting in a one-size-fits-all tax treatment. The inclusive language (e.g., "any information or code or number or token") risks enveloping non-crypto assets like digital vouchers, airline points, and game currencies, thus creating regulatory uncertainty beyond the intended scope. Additionally, the rapid evolution of VDAs, coupled with their diverse models, design, and underlying blockchain technologies, further complicates their classification and alignment with international standards.

Definition of VDAs: Exclusions

Notification no. 74 of 2022

- Gift cards or vouchers, being a record that may be used to obtain goods or services or a discount on goods or services
- Mileage points, reward points, loyalty cards, being a record (i) given without direct monetary consideration under an award, reward, benefit, loyalty, incentive, rebate or promotional programme (ii) that may be used or redeemed **only** to obtain goods or services or a discount on goods or services
- Subscriptions to websites or platforms or applications.

Notification no. 75 of 2022

- Transfer of NFTs – two transfers? Eg. NFT representing an immovable property.
- An NFT whose transfer results in transfer of ownership of underlying tangible asset and the transfer of ownership of such **underlying tangible asset** is legally enforceable is excluded from the scope of NFT.

Taxation of Income from Transfer of VDAs

Tax Rate	• Special tax rate of 30% (exclusive of surcharge and cess) applicable
Computation	• Income to be computed without taking effect of: • Any deduction in respect of any expenditure (other than cost of acquisition) incurred for such transfer; or • Any allowance or set off of any loss.
Inter-head set off	• Loss from transfer of VDAs shall not be permitted to be set off against income computed under any other head under the ITA. The loss shall not be allowed to be carried forward to succeeding assessment years as well.
Characterisation	• Characterisation should largely not matter as no deductions or set off or carry forward of losses are permitted under section 115BBH. However, for non-residents who wish to claim treaty relief, characterisation may still be relevant. • ITR forms provide that income from transfer of VDAs can either be business income / capital gains. Hence, puts an end to characterisation issues under the ITA. • Moreover, the Jodhpur ITAT bench in *Raunaq Prakash Jain* ruled that with the Finance Act, 2022 formally recognizing virtual digital assets as assets, any ambiguity in interpretation is resolved in favour of the taxpayer. The ITAT also ruled that the crypto-currencies were held over 36 months making the gains taxable as long-term capital gains while allowing exemptions under section 54F.

Schedule VDA

ITR-6 , Income-tax Rules, 1962

37 of 62 180%

Schedule VDA	**Income from transfer of Virtual Digital Assets (Note: Details of every transaction are to be filled, wherein every 'transfer' is a transaction)**					
Sl. No.	Date of Acquisition	Date of Transfer	Head under which income to be taxed (Business/Capital Gain)	Cost of Acquisition (In case of gift; a. Enter the amount on which tax is paid u/s 56(2)(x) if any b. In any other case cost to previous owner)	Consideration Received	Income from transfer of Virtual Digital Assets (enter nil in case of loss) (Col. 6 – Col. 5)
(Col. 1)	(Col. 2)	(Col. 3)	(Col. 4)	(Col. 5)	(Col. 6)	(Col. 7)
Add Rows						
A.	Total (Sum of all Positive Incomes of Business Income in Col. 7)					**(Item No. 3f of Schedule BP)**
B.	Total (Sum of all Positive Incomes of Capital Gain in Col. 7)					**(Item No. C2 of Schedule CG)**

Key Issues:

- Levy of tax on transaction basis? Intent of the provisions.
- If two transfers in same VDA take place on the same date, can they both be clubbed and reported in Schedule VDA?
- When a VDA market sale order is placed and is executed in 'n' different blocks, should each block be individually reported?
- Can inter-VDA trades be clubbed? Difference from shares. Loss set off can happen in such situation
- Conundrum on date of transfer being prior to date of acquisition – short sellers.

VDA Taxation: Comparative Analysis

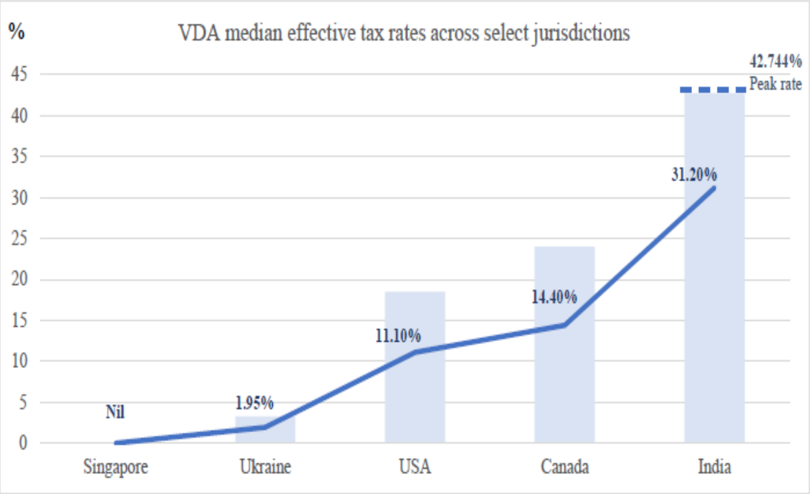

Figure 1: VDA Median Effective Tax Rate across Select Jurisdictions

Sl. No	Jurisdictions	Classification for tax purposes	Tax rate/ range		TDS Applicability	Set-off/ carry forward of losses
			Long-term gains/ income	Short-term gains/ income		
1.	India	Capital gains/ business income/ other sources but taxed as akin to gambling[12]	31.20%[13] *With surcharges, this may go up to ~42.744%*		✓	✗
2.	USA	Property	0-20%	10-37%	✗	✓
3.	UK	Virtual asset	0-20% on capital gains above the tax-free allowance; 0-45% income tax		✗	✓
4.	Canada	Commodity	15-33% based on classification as income or capital gains		✗	✓
5.	Netherlands	Asset	For corporate entities, income from VDAs is taxed as per Dutch corporate tax at the rate of 19% or 25.8%. Individuals may be subject to the Dutch wealth tax basis a deemed fictional return of 6.17% on the value of the VDAs at the rate of 34%.[14]		✗	✓
6.	Ukraine	-	5% with plans to increase to 18%; Individuals are subject to an additional military tax at the rate of 1.5%.[15]		✗	✓
7.	Philippines	Corporate income/ Personal Income	0-35% income tax for individuals 20-25% corporate income tax.[16]		✗	✓
8.	Singapore	-	No tax unless engaged in trading		✗	-

Withholding Obligation

- Section 194S of the ITA obligates "any person responsible for paying to a **resident** any sum by way of consideration for transfer of a VDA to withhold tax at rate of 1% at the time of payment or credit, whichever is earlier.
  - High rate of tax? Comparison with STT, other transaction based levies
  - Capital stuck for users on rotation – issue for high frequency traders, liquidity providers

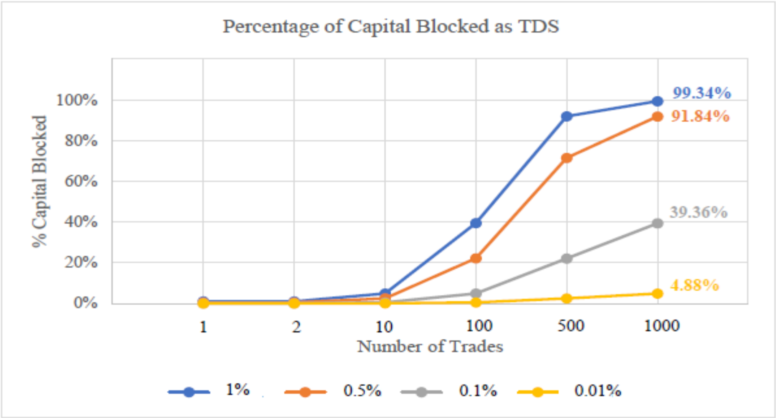

Figure 7. User Capital Blocked at Various Number of Trades at Different TDS Rates

- The Direct tax collected by way of tax deducted at source under section 194S of the Income-tax Act, 1961, on payments made upon transfer of VDA aggregates to **Rs. 157.9 crore upto 20-3-2023** (from July 1, 2022) for FY 2022-23.

- Withholding liability under Section 194S is applicable when the payment for the transfer of VDA exceeds
  - INR 50,000 during the financial year in the case of a specified person; and
  - INR 10,000 in other cases.

Withholding Obligation

- In case consideration is payable in kind on transfer of VDA, the person responsible for paying should, before release of the consideration, ensure that tax required to be deducted has been paid in respect of such consideration for the transfer of VDA.
  - VDA to VDA trades quite common
  - In case VDA accepted as consideration for performance of service?
  - Buyer may release the consideration in kind after seller provides proof of payment of such tax (e.g. challan details etc.) or Buyer may deposit such tax on behalf of seller.
- Crypto sale on exchange – who is person responsible for paying?
  - Issue with buyer not able to identify the counter party
  - Circular 13 of 2022 – "*To remove this difficulty, it is clarified that while the primary responsibility to deduct tax under section 194S of the Act, in this case, remains with the buyer or his broker, as an alternative the Exchange may enter into a written agreement with the buyer or his broker that in regard to all such transactions the Exchange would be paying the tax on or before the due date for that quarter.*"
  - Definition of exchange: "*The term "Exchange" means any person that operates an application or platform for transferring of VDAs, which matches buy and sell trades and executes the same on its application or platform.*" – Peer to peer marketplace?
- Interplay with other withholding tax provisions under the ITA
  - 194Q – Circular 14 of 2022 - "*Without going into the merit whether VDA is goods or not, it is clarified that once tax is deducted under section 194S of the Act, tax would not be required to be deducted under section 194Q of the Act.*"

Other Key Income Tax Considerations

Situs of VDAs to tax non-residents

- To determine the taxability of income from the transfer of VDAs by a non-resident in India, the situs (location) of the VDA is a key factor. If the VDA is considered situated in India, the income from its transfer will be taxable in India, subject to relevant DTAA provisions.
- The determination of the situs of VDAs is unclear and difficult due to its borderless and disintermediated architecture, especially when a non-resident transacts with an Indian resident.
- Under domestic law, the characterisation of income from VDAs as business income, capital gains or otherwise is largely irrelevant, as a flat tax rate of 30% applies. However, for non-residents, clarity is required on characterisation to assess applicability of tax treaty benefits.

Rollback of Equalisation Levy and Interplay with SEP

- The 2% Equalisation Levy on non-resident e-commerce operators has been rolled back with effect from 1 August 2024 and has potential implications for offshore VDA exchanges.
- The levy was likely to be applicable upon offshore VDA exchanges, and if discharged, their income would have been subsequently exempt from any income tax in India.
- With the roll-back, non-resident VDA operators offering services to Indian users will need to assess their income tax exposure in India, especially those operating from non-treaty jurisdictions.
- Particularly, exposure under Significant Economic Presence (SEP) provisions should be evaluated, which has the following applicability thresholds at a broad level: (a) INR 20 million in revenue from Indian users, or (b) interaction with 300,000 or more users in Indian.

Gift Tax

- Section 56(2)(x) is an anti-abuse provisions which deems income in the hands of the recipient, if any (i) sum of money, (ii) immovable property, or (iii) any property (other than an immovable property) is received by such recipient (i) without consideration and the fair market value ("FMV") of the property exceeds INR 50,000 or (ii) for a consideration which is less than aggregate FMV of the property by an amount exceeding INR 50,000.
- 'Property' has been defined under explanation to section 56(2)(x) of the ITA read with sub-clause (d) to the explanation to section 56(2)(vii) as ""property" means the following capital asset of the taxpayer, namely:- (i) immovable property being land or building or both; (ii) shares and securities; (iii) jewellery….". VDAs also included in definition of 'property'.
- Certain exemptions: receipt of property
  i. from a relative,
  ii. under will or inheritance,
  iii. from any trust or charitable institution registered under ITA, etc.
- Airdrops: Can a view be taken airdropped tokens have been received because use of a particular VDA's ecosystem, for which the taxpayer may have incurred certain transaction cost as well, and hence the VDA has not been received without consideration.

Changes Proposed in Finance Bill 2025

Reporting Framework under ITA

- A new reporting framework is proposed to be implemented by the **Finance Bill, 2025** for prescribed virtual asset service providers to provide certain information on 'crypto-asset' transactions and their users (including undertaking some due diligence measures), for the purpose of implementing the OECD Crypto Asset Reporting Framework (**CARF**) (pursuant to the G20 Leader's New Delhi Declaration September 2023).
- The CARF provides for the automatic exchange of tax-relevant information on crypto-assets between different reporting jurisdictions. To achieve uniformity in implementation it is likely that such rules will be broadly based on the rules and guidance provided in the CARF.
- Several key details remain to be defined, such as who will be the reporting entities (including whether non-resident entities would be covered), nature of information, manner in which such information would be maintained, date of the reporting obligation and other ancillary details will be prescribed in separate rules to be outlined by the government.
- It has also been proposed to expand the VDA definition to include 'crypto-assets' to align with CARF framework (*as discussed in slide 5*). This may impact tax aspects such as on income from transfer of 'crypto-assets' being subject to flat 30% tax and 1% withholding tax liability (including for crypto derivatives).

Block Assessments

The scope of 'undisclosed income' for the purposes of 'block assessment' has been proposed to be expanded by the Finance Bill, 2025, to include VDAs. Within such a framework, in a case involving search / seizure, the tax officer can make a tax assessment at 60% plus surcharge and cess for a block of <6 financial years on unreported VDA holdings.

GST Characterisation

- Currently there is no guidance on the manner in which GST provisions are applicable to transactions involving in VDAs.
- GST is a levy on supply of goods or services
- Definition of goods under GST – Section 2(52) of CGST Act:
  - *"**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"*
- Meaning of property - *Therefore, the word **'property' connotes** everything which is **subject of ownership, corporeal or incorporeal, tangible or intangible, visible or invisible, real or personal**; everything that **has an exchangeable value**, or which goes to make up wealth or estate or status*.
- Foreign case laws –
  - UK - Robertson v Persons Unknown (unreported, CL-2019-000444) – fraud protection
  - UK - AA v Persons Unknown [2019] EWHC 3556 (Comm) – interim proprietary injunction
  - New Zealand – Cryptopia – VDAs are property which are capable of being held in trust
  - Singapore - ByBit Fintech Ltd v Ho Kai Xin and others [2023] SGHC 199 – USDT is a property
- VDAs have been considered 'property' for the purpose of gift tax. Further, income from transfer of VDA can also be characterised as capital gains.
  - Definition of capital assets – "*"capital asset" means—*

  *(a) **property of any kind** held by an assessee, whether or not connected with his business or profession;*",

GST: Key Considerations

- In June 2022, during the 47th GST Council Meeting, it was noted that the Fitment Committee felt that there is a need to "identify all relevant supplies associated with crypto-ecosystem which are under the ambit of GST; their nature whether those activities are goods or services; their applicable rate based on appropriate classification". The issue was further deferred in the 48th GST Council Meeting held in December 2022.

Lack of Guidance on Valuation

- There are no prescribed valuation rules for VDAs which causes tax ascertaining issues, especially where consideration is payable in the form of VDAs. Further, the location of supply is also an integral factor to determine the 'place of supply' for GST purposes. In transactions involving VDAs, especially VDA-VDA transactions, block rewards, mining and decentralised protocols, the GST department should clarify the place of supply.

Enforcement Trends

- As per a news report from August 2024, a show-cause notice was issued to a prominent offshore VDA exchange, demanding unpaid GST dues of INR 722 crore (approximately USD 86 million) presumably upon the service fees collected from the Indian users. This reportedly marks one of the first enforcement cases by the tax department against an offshore exchange. Further, with the recently increasing trend of offshore exchanges registering with the FIU-IND, the communication channels between regulators and these platforms are likely to open and the enforcement requests from the tax department is also expected to increase, adding pressure on other offshore VDA platforms to adhere to Indian tax laws by adjusting their business models to ensure compliance or reconsider their commercial operations in India. For Indian users, this could result in disruptions in services or increased costs of services.

Key Commercial Applications and Implications

- **FEMA applicability**

- **AML Compliances**

- **Offshore Structures** for Minting, Global Platforms – POEM?
  - INR 50 crore threshold

- **Gaming integration**
  - Minting usually outside India – how to determine cost of acquisition?
  - Ring fencing for Indian users

- **Employee incentive**
  - Receiving VDAs from the offshore company – cross border barter – will attract FEMA
  - Receiving VDAs directly from the protocol as first owners – no movement in / outside India, 56(2)(x), cost of acquisition?
  - Phantom options – bonus income – no VDA element

- **Real world tokenization**
  - Transfer of token results in transfer of underlying property?
  - NFT exemption applicable in case of tangible property only

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- TDS on Virtual Digital Assets: A Report On The Effects Of The 1% TDS On Tax Revenue And User Trends – June 2024

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