

# Digital Assets Special Tax Law for Cryptocurrency and Non-fungible Tokens

Union Budget 2022-23



## BACKGROUND

India has become one of the largest markets for cryptocurrencies with Indians parking nearly USD 6.6 billion<sup>1</sup> in cryptocurrencies until May this year, compared to USD 923 million until April 2020. India ranks 11 out of 154 nations in terms of cryptocurrency adoption, as per blockchain data firm Chainalysis. While this growth has given Indian cryptocurrency exchanges a reason to celebrate and attract global investors, the regulatory framework has remained unclear and ambiguous.

Reserve Bank of India (RBI), in its Financial Stability Report in the year 2013, warned the public against banking on cryptocurrencies as they posed a challenge to the economy in the form of regulatory, operational, and legal risks. Later, in its circular “**Prohibition on dealing in Virtual Currencies**” dated 6 April 2018<sup>2</sup>, RBI prohibited the entities regulated by it from dealing in/providing any services w.r.t virtual currencies, with a three month ultimatum to those already engaged in such services.

However, on 4 March 2020, the Supreme Court has given its landmark judgment on the said issue, reviving **the market of Cryptocurrencies by holding them valid under the constitution, thereby providing a new lease of life to crypto companies, dealers, and exchanges.**

While the legality of cryptocurrencies is still uncertain, there were also issues on the classification of cryptocurrencies on the tax side and overall tax implications. Accordingly, a separate taxation scheme is proposed in the Finance Bill 2022 for Digital Assets.



1. <https://scroll.in/article/999433/why-indias-cryptocurrency-boom-is-problematic>  
2. RBI/2017-18/154 DBR No.BP.BC.104/08.13.102/2017-18

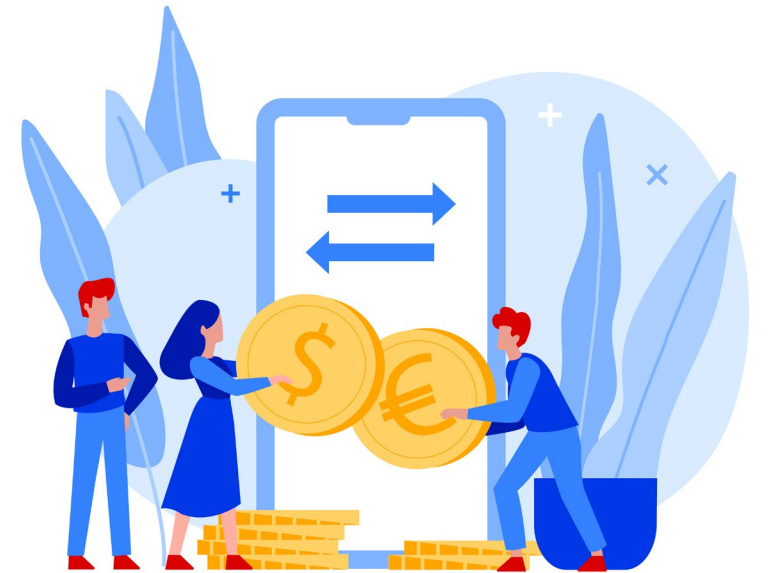
## SCHEME FOR TAXATION OF VIRTUAL DIGITAL ASSETS

### Taxation of virtual digital assets

- Finance Bill 2022 proposes to include Section 115BBH to Income-tax Act, 1961 (Act) to provide for taxation of income from transfer of any virtual digital asset. The applicable tax rate shall be 30% plus the applicable surcharge and cess. There would not be any benefit of income slabs or minimum exemption limit.
- Under Section 2(47A) of the Act, the definition of virtual digital assets has been included. The definition is wide enough to cover cryptocurrencies, Non-fungible Tokens (NFTs), or any other type of digital assets.
- It is also proposed that no deduction for any expenditure (other than the acquisition cost) shall be allowed. Furthermore, no allowance/set-off of any loss on the transfer of digital assets shall be allowed under any provision of the Act to the taxpayer. Such loss shall also not be allowed to be carried forward to subsequent years for set-off.

### Taxation on a gift of virtual digital assets

- It is also proposed to amend deemed gift tax provisions under Section 56(2)(x) of the Act to provide for taxation of the gifting of virtual digital assets in the hands of the recipient. However, gifts from relatives would continue to enjoy the exemption like other gifts/assets.
- Thus, in the case of a gift, the fair market value shall be deemed to be the income of the recipient of these assets. However, how to arrive at the fair market value needs to be examined, and it is better if the government provides some clarity on it.
- Also, there could be double taxation once the receiver receives digital assets as a gift, and when they sell them on the full sales value as for that taxpayer, the cost of acquisition is zero. The government should clarify this aspect also.



## Withholding tax

- It is proposed to include Section 194S to the Act to provide a tax deduction of 1% on payment for the transfer of virtual digital assets to a resident. Where such payment is in kind or exchange of another virtual digital asset or cash is not sufficient to meet the liability of tax deduction, the person before making the payment for such transfer shall ensure that the tax has been paid in respect of such consideration.
- This withholding tax is to be deducted and paid by the person responsible for making payment to the taxpayer who has transferred digital assets.
- It is also proposed that no tax deduction is to be made if:
  - The consideration payable by a specified person does not exceed INR 50,000 during the financial year
  - In any other case, the consideration payable does not exceed INR 10,000 during the financial year.
  - Specified person means:
    - Individuals and HUF having income other than business or professional income-
    - Individuals and HUF having business or professional income where the gross receipts/turnover/ sales do not exceed INR 10 million (in case of a business) and INR 5 million in case of a profession in the immediately preceding year

## Our comments

A specific taxation scheme is certainly a welcome move. It is expected to provide much-required clarity on the taxation of transactions in digital assets and is also likely to widen the tax base. However, it appears that the provisions are adverse compared to other investment class/assets.

One will also have to see how the norms for determining fair market valuation get prescribed considering the peculiar nature of these assets. Also, while the taxation appears to be simple for residents, it would be interesting to understand the tax in the hands of non-residents. Whether such income would deem to accrue or arise in India would be dependent on the situs of the virtual digital asset, and finding the situs would be next to impossible.

With the introduction of withholding tax provisions, it appears that crypto exchanges may have to carry out the compliances.

It would be pertinent to note that the government has a right to tax any income (whether it is legal or illegal). Hence, merely introducing tax provisions for digital assets would not make them legal.

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