

“Taxation of Virtual Currency in India”

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INTRODUCTION

The era of information and technology has created ample golden opportunities for the masses in several aspects. One of the fields which has benefited from this advent of technology is the financial and business sector. New financial instruments have bridged the gap between buyers and sellers. Several online users have turned virtual concepts into reality and have created a new business phenomenon. There is rise in new types of trading, transactions and even currencies. The past few years have witnessed the evolution of cryptocurrency. Cryptocurrency can be defined as the medium of exchange used in financial transactions whether they are real or virtual transactions. It does not refer to real world money.¹ Cryptocurrencies represent valuable and intangible objects which can be used electronically or virtually in different applications and networks such as online social networks, online social games, virtual worlds and peer to peer networks.²

Post demonetisation, the popularity of bitcoins increased to a great extent. ‘Bitcoins’ was one of the most searched words by Indians on Google in the year 2017. It is estimated that India accounts for almost 10% of the global virtual currency trade.³ The major reasons behind the growth of cryptocurrencies are decentralisation and absence of intermediaries. The growth of cryptocurrencies in India is still in its nascent stage. There are no clear regulatory mechanisms in place for effective monitoring of cryptocurrencies. However, in 2018, the RBI issued a blanket ban on banks from dealing with cryptocurrencies either directly or indirectly. Critics argue that the ban imposed is short-sighted and must be reconsidered by the RBI. Furthermore, if the government plans on dissuading the masses from using cryptocurrency, then it must introduce taxation as a policy instrument to control consumers. The government, therefore, must take proactive steps in regulating the area of cryptocurrencies to prevent situations of fraud and malpractices. In modern times, cryptocurrency promises to bring about positive changes to e-business and e-payment sectors. The following paper deals with the need to tax virtual currency, the present regulatory framework in India, and judicial interpretation on taxing cryptocurrencies. It also provides for a comparative analysis and enlists certain recommendations in regulating taxation of cryptocurrencies.

¹ A. Greenberg, *Crypto-Currency*, FORBES (Nov. 12, 2020, 11:00 AM), <http://www.forbes.com/forbes/2011/0509/technologypsilocybin-bitcoins-gavin-andresen-crypto-currency.html>.

² Shailak Jani, *The Growth of Cryptocurrency in India: Its Challenges and Potential Impacts on Legislation*, RESEARCHGATE (Nov. 14, 2020, 11:30 AM), <https://www.researchgate.net/publication/324770908>.

³ Nilanjan Chakraborty, *The Bitcoins: A Scam or the Currency of the Future*, INTERNATIONAL JOURNAL OF SCIENCE AND RESEARCH (2018).

PRESENT REGULATORY MECHANISM

The Indian government has been silent on the matter of virtual currency for far too long. There is no law currently that defines or characterizes virtual currencies, crypto assets or crypto currencies in India. The categorization of virtual currencies into goods, services, securities, derivatives or currencies is important as the existing law would apply differently based on their status. VCs like Bitcoin, Ethereum, and Mon-roe are still in the grey area which is evidence of the fact that government bodies, regulators etc have significant reservations with respect to the usage and trade of virtual currencies. However, several committees set up by the government have been studying this new area for the past few years in order to take a well-informed decision in public interest.

There are two bills currently pending in the Indian legislature related to crypto currencies - the Crypto Token and Crypto Asset (Banning, Control and Regulation) Bill, 2018 which led to the Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019.⁴ The Bill provides for a blanket ban on cryptocurrencies and criminalizes activities associated with cryptocurrencies in India. It also provides for the regulation of an official digital currency. In July 2019, an Inter-Ministerial Committee established by the Ministry of Finance released a report⁵ on a proposed regulatory approach towards distributed ledger technology and virtual currencies. The Committee recommended an outright prohibition, along with criminal penalties, on dealing with virtual currencies. It also recommended the promotion of distributed ledger technology without the use of virtual currencies, and the exploration of a sovereign digital currency. The Committee's recommendations are not yet binding and are under consideration of the government.

The Department of Revenue has been actively involved in the working papers being developed by the Financial Action Task Force on issues pertaining to virtual currency, proliferation financing etc. which will act as guidance for the member countries.⁶ The Department of Science and Technology, Ministry of Commerce and Industry, Ministry of Law and Justice, Ministry of Human Resources Development, and the Department of Information Technology gathered at Blockchain Summit India to discuss various crypto-related topics including regulation and how to speed up crypto regulation.⁷ India's Union Home Minister Rajnath Singh inaugurated a national cyber forensic lab and the Delhi

⁴ DEPARTMENT OF ECONOMIC AFFAIRS – MINISTRY OF FINANCE, GOVERNMENT OF INDIA, <https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf> (last visited Nov. 12, 2020).

⁵ PRESS INFORMATION BUREAU, <https://pib.gov.in/PressReleasePage.aspx?PRID=1579759> (last visited Nov. 12, 2020).

⁶ Kevin Helms, *Indian Government Progressing on Crypto Regulation Amid Ban Rumor*, BITCOIN (Apr. 26, 2019), https://news.bitcoin.com/india-progressing-crypto-regulation/?preview_id=310460.

⁷ Kevin Helms, *11 Crypto Initiatives Indian Government Has Taken*, BITCOIN (May 1, 2019), <https://news.bitcoin.com/cryptocurrency-initiatives-indian-government/>.

Police's cybercrime unit called Cypad⁸ to help detect fraud online, including those involving cryptocurrency.

A guidebook titled "Introduction to Crypto-currencies and Forensic Examination of Bitcoin,"⁹ has been created by India's Central Board of Direct Taxes. The nation's income tax department has been training its officials since 2017 to investigate cryptocurrency investment. The Serious Fraud Investigations Office, the investigative arm of the Ministry of Corporate Affairs, was instructed to gather data regarding the use of bitcoins by corporate entities.¹⁰

Earlier, the RBI and the Ministry of Finance had issued warning statements about the risks associated with virtual currencies, including money laundering, consumer protection, market integrity, cybersecurity and volatility. The indirect tax department had launched an investigation into Bitcoin exchanges operating in India to ascertain the GST rate that can be levied on them. The sales tax department and VAT authorities too had launched an investigation on the taxability of Bitcoins few years back. Earlier this year, the Income Tax Department sent detailed notices to cryptocurrency investors asking for details on their investment in Bitcoin or other cryptocurrencies.

Recently, cryptocurrency exchanges have written to the RBI seeking clarity as to whether they are being categorized as commodity, currency, goods or a service as this is set to impact the way they get taxed under Goods and Services Tax framework.¹¹ In response to an RTI filed by Naimish Sanghvi of CoinCrunch which sought to ask whether the regulator was working on a policy to deal with crypto currencies, the IEPFA confirmed that the inter-departmental committee discussed that Cryptocurrencies has features of Ponzi Scheme and so must be banned.¹²

CASE ANALYSIS

The case of **Internet & Mobile Association of India v. Reserve Bank of India**¹³ assumes great significance as it is the first case adjudicated by the Supreme Court in the matter of validity of virtual currency in India. It is therefore pertinent to analyze this case from a judicial lens to understand the regulatory framework of virtual currencies.

⁸ THE HINDU, <https://www.thehindu.com/news/cities/Delhi/rajnath-inaugurates-cybercrime-detection-centre-in-capital/article26307171.ece> (last visited Nov. 13, 2020).

⁹ Vireshwar Tomar, *India's Income Tax Department Is Secretly Training Its Officials to Investigate Cryptocurrencies*, COINTELEGRAPH (Dec. 18, 2019), <https://cointelegraph.com/news/indias-income-tax-department-is-secretly-training-its-officials-to-investigate-cryptocurrencies>.

¹⁰ ECONOMIC TIMES, <http://economictimes.indiatimes.com/news/economy/policy/government-steps-up-vigil-on-bitcointransactions/articleshow/58911702.cms> (last visited Nov. 13, 2020).

¹¹ ECONOMIC TIMES, <https://economictimes.indiatimes.com/industry/banking/finance/banking/cryptocurrency-exchanges-approach-rbi-seeking-clarity-on-status-taxability/articleshow/75523505.cms?from=mdr> (last visited Nov. 13, 2020).

¹² COIN CRUNCH INDIA, <https://coincrunch.in/2019/06/18/government-body-confirms-unanimous-decision-to-ban-cryptocurrencies-in-india/> (last visited Nov. 13, 2020).

¹³ *Internet & Mobile Association of India v. Reserve Bank of India*, 2020 SCC Online SC 275.

Facts: The Reserve Bank of India while exercising its powers under the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934 and the Payment and Settlement Systems Act, 2007 issued a circular dated April 6, 2018¹⁴ directing the entities regulated by it not to deal in VCs or provide services for facilitating any person in dealing with or settling VCs. It restricted the use of regulated banking and payment channels for the sale and purchase of virtual currencies. This RBI Circular was challenged before the Supreme Court of India by the Internet and Mobile Association of India and the shareholders/ promoters of VC exchanges. The petition was permitted on the ground of proportionality.

Issues: Whether RBI has the power to prohibit the activity of trading in virtual currencies? If yes, whether this power was exercised properly as per law? Whether such a prohibition violated the petitioner's fundamental right to trade in VCs?

Contentions:

- Petitioners contended that VC's are not legal tender but tradable commodities/digital goods not falling within the regulatory framework of RBI and the circular was a violation of the fundamental right to trade exercised by the petitioner under Article 19 of the Constitution.
- Respondents contended that RBI had the power to regulate VCs and the circular was issued to deal with concerns relating to anonymity of the transactions and the protection of investors when dealing in cryptocurrencies due to an increase in the number of scams in the country.

Judgment:

- 1) The SC analyzed the RBIA, BRA and PSSA to hold that they cumulatively recognize and confer wide powers on the RBI to operate the currency and credit system of the country to its advantage, to take over the management of the currency from central government, to regulate the financial system of the country to its advantage, and to regulate and supervise the payment systems. It also examined the definition of "currency" in Foreign Exchange Management Act, 1999 and held that VCs can be included within the ambit of this definition if the RBI notifies it under the category of 'other similar instruments'.
- 2) The SC analyzed the status of VCs as per different governments and money market regulators of the world and understood that most of them do not recognize VCs as legal tender but they do believe that it is capable of performing the functions of real currency. The courts of different countries have identified VCs to belong to different categories ranging from property to commodity to non-traditional currency payment instrument to money to funds depending upon the text of the statute involved in the case and context. It therefore rejected the argument that VCs can't be regarded as money but are goods/ commodities.
- 3) The SC decided that RBI has the power to prohibit and/ or regulate the activity of trading VCs. to address all the issues that are perceived as potential risks to the monetary,

¹⁴ RESERVE BANK OF INDIA, <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11243&Mode=0> (last visited Nov. 14, 2020).

currency, payment, credit and financial systems of the country including VCs. It held that the RBI Circular does not impose a prohibition on the use of or the trading of VCs but merely directs banking companies not to provide banking services to those engaged in the trading or facilitating the trading of VCs.

- 4) The SC also rejected the contention that the impugned RBI Circular is vitiated by non-application of mind, malice in law and colorable exercise of power by RBI. RBI had exercised its power after a thorough understanding of the implications of VCs on the economic climate of India, in good faith to achieve its objectives and to prevent the general public from accepting VCs as legal tender backed by a central authority. Therefore, the threshold of satisfaction has been met under the RBI Act 1934.
- 5) It was contended that the right to access the banking system is integral to the right to carry on any trade or business, guaranteed by Article 19(1)(g) of the Constitution and therefore the denial of such access to the petitioners by the RBI Circular is not a reasonable restriction and is extremely disproportionate. The Court relied on the case of *Md. Yasin v. Town Area Committee*¹⁵, which makes it amply clear that the right under Article 19(1)(g) would be affected “in effect and in substance” when there is a complete stoppage of a particular business activity, owing to a certain measure that was undertaken. In addition to this, the Court examined the four tests laid down in the case of *Modern Dental College and Research Centre v. State of Madhya Pradesh*¹⁶. The SC held that the measure taken by RBI should pass the test of proportionality and it must be checked if there were less intrusive measures available and whether RBI considered these alternatives. It referred to the Report of the European Union Parliament titled ‘Cryptocurrencies and Blockchain’, 2018¹⁷ which was of the opinion that cryptocurrencies must be regulated and not banned as imposing a ban would be an extreme measure and the same objectives can be achieved through other regulatory measures. It was concluded that alternative measures were not considered by RBI which resulted in the complete shutdown of VC exchanges although there was no adverse impact on the activities of the banking companies. Therefore, the Circular was held unreasonable and disproportionate.

This decision has ensured that VC exchanges can rely on the banking system and therefore investors can freely engage in VC trading through these exchanges. It has suggested the creation of a regulation that can monitor and control cryptocurrencies, without bringing about a blanket ban, which ought to be considered by the government in light of the pending bill. A balance is essential to ensure that India benefits from exploring opportunities that cryptocurrencies offer.

¹⁵ *Mohammad Yasin v. Town Area Committee*, AIR 1952 SC 115.

¹⁶ *Modern Dental College and Research Centre v. State of Madhya Pradesh*, (2016) 7 SCC 353.

¹⁷ EUROPEAN PARLIAMENT - REPORT OF THE EUROPEAN UNION PARLIAMENT, [https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU\(2020\)648779_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU(2020)648779_EN.pdf) (last visited Nov. 15, 2020).

CHALLENGES IN CATEGORIZATION OF VIRTUAL CURRENCY

Virtual currency is an emerging non-physical financial medium that can substitute real currency in several monetary transactions, investments and other purposes. Virtual currencies have come under the scanner of tax authorities primarily due to the high prices at which they are traded in India and around the world. In order for regulators and tax authorities to come out with clear position on the issue of taxation of virtual currency, the conflict and ambiguity regarding whether bitcoins is a currency or good/service must be understood. When income is taxed, the virtual currency must represent income or asset value, and when expenditure is taxed, it must be cost of acquiring bitcoin, central sales tax, value added tax, service tax, etc.

BITCOINS AS CURRENCY – ‘Currency’ has been defined under Section 2 of FEMA¹⁸ to include, ‘all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank’. This definition therefore does not explicitly cover Bitcoins which are not issued under the Coinage Act or RBI Act. In order to include it within the ambit of ‘such other similar instruments’, it must be specifically notified by the RBI. Therefore, under the provisions of existing law, Bitcoin cannot be treated as currency and so are not liable to tax. The position in United States is quite clear where the U.S courts¹⁹ asserted that Bitcoins can be classified as money due to their ability to be easily purchased in exchange for legal tender.

BITCOIN AS GOODS – Since Bitcoins are an intangible asset, it can be brought within the ambit of “goods” which are defined as “every kind of movable property other than actionable claims and money; and includes stock and shares” under the Sale of Goods Act. In *Tata Consultancy Services v. State of Andhra Pradesh*²⁰, the Supreme Court stated that, “computer software is intellectual property, whether it is conveyed in diskettes, floppy, magnetic tapes or CD ROMs, whether canned (Shrink-wrapped) or uncanned (customized), whether it comes as part of computer or independently, whether it is branded or unbranded, tangible or intangible; is a commodity capable of being transmitted, transferred, delivered, stored, processed, etc. and therefore as a ‘good’ liable to sale tax.” Similarly, Bitcoin being of an incorporeal nature may be considered as “goods”.

TAXABILITY UNDER INCOME TAX ACT, 1961 - Taxation of income in India is governed by the provisions of the Income Tax Act. Income from virtual currency may be treated as:

- ‘Income from Capital Gains’²¹ - Sec 2(14) of the ITA²² defines capital asset as “property of any kind held by the assessee whether or not connected with his business or profession” Hence, any gain arising from the transfer of bitcoins must be considered

¹⁸ Foreign Exchange Management Act, 1999, § 2, No. 42, Acts of Parliament, 1999 (India).

¹⁹ *United States v. Faiella*, 39 F. Supp. 3d 544, 545, (S.D.N.Y., 2014).

²⁰ *Tata Consultancy Services v. State of Andhra Pradesh*, AIR 2005 SC 371.

²¹ Income Tax Act, 1961, §45(1), No. 43, Acts of Parliament, 1961 (India).

²² Income Tax Act, 1961, §2(14), No. 43, Acts of Parliament, 1961 (India).

as capital gains, if they are held for the purpose of investment. Depending on the period of holding, it may be long term capital gains (more than 36 months) or short-term capital gains. The major issue that arises in treating bitcoins as capital assets is in the determination of the ‘cost of acquisition’ at the time of mining. Since bitcoin is a ‘self-generated asset’ generated by the system as a reward for verifying the transactions, the cost of acquisition is technically unascertainable as the only input the miner employs is the computer capacity under the system. The Supreme Court²³ has held that where the COA is ‘indeterminable’, no capital gains would be chargeable on such costs. Under such a circumstance, there may be a possibility that the gain from sale of such bitcoins is exempt from tax.

- ‘Profits and Gains from Business and Profession’²⁴ - When such cryptocurrencies are held in the furtherance of business activity, it is treated as profits from a business. Any continuous activity in the nature of trade in cryptocurrencies or mining of bitcoins can be included within the ambit of Sec 28 of the ITA. Therefore, ITA needs to be interpreted keeping in mind the facts and circumstances of each transaction, since individuals and corporates may deal with virtual currencies in a variety of contexts as capital assets or in the course of business.

TAXABILITY UNDER GOODS & SERVICES TAX ACT, 2017 – Taxability of goods and services are governed by Central Goods and Services Tax Act, 2017, the Integrated Goods and Services Tax Act, 2017 and the respective State Goods and Services Tax Acts. The Tariff Schedule for Goods currently contains no specific category for virtual currencies, but does contain a residuary category of goods. As there are a multitude of virtual currencies and each transaction varies in nature, determinations of GST must be made on a case-by-case basis.²⁵ GST is also payable with respect to services provided in connection with the sale and purchase of virtual currencies. Any transaction in which cryptocurrencies are exchanged for money and a separate commission is charged as consideration, GST will have to be paid on the value of cryptocurrencies (supply of goods) as well as on the commission charged (supply of services). In case of exchange of cryptocurrencies for goods and services, GST would be chargeable on the transaction value. The mining activity of bitcoins is done in furtherance of business and so can be considered as a ‘service’ under the Act, since it is a supply of computing power (service), by the bitcoin miner (service provider) to the users of bitcoin system (service recipient) in exchange for bitcoins. There is a possibility that certain transactions are taxable twice - on supply and on consideration unnecessarily leading to higher tax. Major issues could arise regarding valuation of bitcoins for the purpose of GST or double taxation where consumers might be taxed while purchasing virtual currencies, and again on their use in exchange for other goods and services. Another major challenge in this model is with respect to international transactions. Since cryptocurrencies are volatile in

²³ Commissioner of Income-tax v. B.C. Srinivasa Shetty, (1981) 2 SCC 460.

²⁴ Income Tax Act, 1961, §28, No. 43, Acts of Parliament, 1961 (India).

²⁵ Michael S Sackheim & Nathan A Howell, *VC Regulations*, 2 VIRTUAL CURRENCY REGULATION REVIEW (2019).

nature, a purchaser may choose to make payment when the value is lower which leads to lower collection of taxes.

REGULATION OF CRYPTOCURRENCY AROUND THE WORLD

Many countries have regulated the field of cryptocurrencies; however, some countries have imposed a strict ban on the use of cryptocurrencies. Let's take a closer look at how various jurisdictions deal with cryptocurrencies: -

United States of America – Cryptocurrencies are regulated by both federal and state regulators in the US. As per the ruling of a US federal court, virtual currencies are commodities under the US Commodity Exchange Act of 1936 and may act as the underlying asset in future contracts.²⁶ In the case of Securities and Exchange Commission v. Trendon Shavers²⁷, the US Supreme Court held that bitcoins do qualify as money subject to the acceptance of the other party. Further, it can also be exchanged for other well-established currencies. The Internal Revenue System of US treats virtual currencies as property for federal income tax purposes.²⁸ The value of the virtual currency is determined at the market value on the date of such receipt.

Russia – The Russian government permits the use of virtual currencies for trading goods and services. It has recognised virtual currency as a valid mode of payment. The same was projected in the amendment of the Russian Civil Code wherein the concepts of “digital money” and “digital rights” were inserted to protect the rights of owners of cryptocurrencies.²⁹ The Russian Finance Ministry came with a Draft Law in 2018 to deal with digital financial assets. These assets were defined as property in electronic form. The rationale behind the enactment of such a law was to tax the enterprises at the time of creation of cryptocurrency. However, the Russian Central Bank has opposed this law and has sought a complete ban on the issuance and circulation of cryptocurrencies.³⁰

Japan – It has one of the biggest crypto asset markets in the world. Japan has even approved transactions through its exchanges in cryptocurrencies. All the matters relating to cryptocurrency including taxation are governed by the Payment Services Act, 2009 and the Financial Instruments and Exchange Act.

The following countries have imposed a ban on the issuance and circulation of cryptocurrency:

²⁶ CFTC v. My Big Coin Pay, No. 18-CV-10077 (D. Mass., Sept. 26, 2018).

²⁷ Securities and Exchange Commission v. Trendon Shavers, Case No. 4: 13-Cv-416 (August 6, 2013).

²⁸ US INTERNAL REVENUE SYSTEM, https://www.irs.gov/pub/irs-drop/n-14-21.pdf#_blank (last visited Nov. 15, 2020).

²⁹ Vasilisa Strizh, Dmitry Dmitriev and Anastasia Kiseleva, *Blockchain and Cryptocurrency Regulation 2020/ Russia*, GLOBAL LEGAL INSIGHTS (Nov. 15, 2020, 12:00 PM), <https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/russia>.

³⁰ Helen Partz, *Russia Postpones Its Crypto Law Again, Now Blaming Coronavirus*, Coin Telegraph (Nov. 15, 2020, 12:30 PM), <https://cointelegraph.com/news/russia-postpones-its-crypto-law-again-now-blaming-coronavirus>.

China – The concerned authorities and the government have prohibited financial institutions from providing services to virtual currency platforms. In 2017, the People’s Bank of China along with the Central Internet Information Office, the Ministry of Industry and Information Technology, the Industrial and Commercial Administration, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission released a joint statement to prevent the issuance of virtual currency and to spread awareness regarding the risks associated with virtual currency.³¹ The salient provisions of the statement are as follows: -

- Virtual currencies shall not be circulated in the market as currency;
- Any token issuance or related financial activity must be immediately liquidated;
- Prohibition on exchange platforms dealing with cryptocurrencies;
- Prohibition on financial institutions and non-banking institutions from providing virtual currency services.

The major reason behind such a ban is that China is planning to come up with its own cryptocurrency which will be equal to a Chinese Yuan.

Indonesia – Bank Indonesia (central bank) issued a statement against the buying, selling and trading in virtual currencies in the year 2018.³² The statement read that virtual currencies are not legitimate instruments of payment. This blanket ban is mainly due to the risky nature of virtual currencies which are “vulnerable to bubble risks,” and “susceptible to be used for money laundering and terrorism financing.” Bank Indonesia and Finance Ministry have stated that virtual currencies can disrupt financial stability and cause financial harm to the society.

Middle East – Countries such as Alegria, Bahrain, Egypt, Iran, Iraq etc. prohibit the issuance and circulation of cryptocurrencies and have asserted that any trade involving virtual currency is illegal. They maintain that virtual currencies damage national security, disturb financial systems and could also be used as a tool to fund terrorism and terrorist activities.³³ Many countries have also put in place penal provisions in cases of deviation from the law.

Comparative Summary: -

It is clearly evident that cryptocurrency is a fast-growing market sector across the globe. On the other hand, it can be noticed that governments and banks take an active role in issuing notices and educating citizens about the pitfalls of cryptocurrencies. These institutions make it clear that citizens who opt to invest in cryptocurrency must do so at his/her own risk by forfeiting the option of a legal recourse. Middle-eastern countries along with China, Pakistan, Nepal, Vietnam, Bolivia, etc. have imposed a complete ban on activities involving cryptocurrencies. Some countries such as Bahrain and Qatar prohibit citizens to deal with

³¹ PEOPLE’S BANK OF CHINA, <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3374222/index.html> (last visited Nov. 15, 2020).

³² BANK INDONESIA, http://www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_200418.aspx (last visited Nov. 15, 2020).

³³ LIBRARY OF CONGRESS, https://www.loc.gov/law/help/cryptocurrency/world-survey.php#_ftnref665 (last visited Nov. 15, 2020).

cryptocurrency within the national jurisdiction, but allows them to do so outside their national borders. It is opined by these nation States that cryptocurrencies are opposed to public policy, provide loopholes for money laundering, facilitate terrorism and organized crimes. Taking note of such possible outcomes, countries such as Australia, Canada have enacted laws to bring cryptocurrency under the ambit of money laundering and counter-terrorist financing laws. Many countries such as the United States, United Kingdom, Australia, Spain, Belarus etc. recognise cryptocurrency as an evolving field with a strong potential to compete with real currency in the near future.³⁴ These countries have resorted to developing cryptocurrency-friendly legislations to attract investments. Some countries such as China, Venezuela etc. are planning to come up with their own virtual currencies.³⁵

Several countries have brought cryptocurrency under the ambit of taxation by categorizing them under income or capital gains.³⁶ Argentina, Denmark and Spain tax virtual currency in line with income tax. Cryptocurrencies are taxed as assets and financial assets in Israel and Bulgaria respectively. Switzerland taxes virtual currency as foreign currency. In South Africa, normal principles of taxation are applicable on cryptocurrencies equating them with intangible assets. In United Kingdom, any sale pertaining to cryptocurrency is subject to capital gains tax. France presents an interesting picture – the French Government taxes cryptocurrency only when it is converted to ‘traditional money’ while crypto-crypto transactions are not taxed. Therefore, various jurisdictions have regulated the field of cryptocurrencies while some are yet to validate virtual currencies.³⁷

RECOMMENDATIONS

The tax authorities must keep pace with the evolving sector of information technology and must address the challenges posed by new business models and new technologies. Although cryptocurrency is new, it amounts to significant numbers in the market. It is observed that trading cryptocurrency increases the economic strength of a taxpayer, but the important question which arises is with regard to the method of taxation. The following recommendations provide for effective regulation of cryptocurrencies and facilitate its uses and applications: -

- Tax legislations must provide for clear and unambiguous definitions of cryptocurrencies and ways of taxation. There is an urgent need for a uniform approach which must be simple, clear, applicable and effective in such a manner that it does not create an excessive burden on the administration as well as the taxpayer. A uniform approach would lead to better compliance and would help in meeting the specifics of legal tax requirements.

³⁴ MARIO COSTANZ, CRYPTO TAXES MADE HAPPY (Happy Tax Publishing 2018).

³⁵ Nishchal Joshipura & Meyyappan Nagappan, *Crypto-currencies - Regulatory and Tax Issues*, 4 CTCITJ 86, 86-90 (2018).

³⁶ OECD, <https://www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.pdf> (last visited Nov. 16, 2020).

³⁷ CIAT, https://www.ciat.org/cryptocurrency-taxation-how-to-take-a-step-forward/?lang=en#_ftnref16 (last visited Nov. 16, 2020).

- Tax authorities must provide guidance with respect to the comprehensive structure of cryptocurrency and address the major taxable events. Clarity regarding creation of virtual currencies and related expenses, exchange with other virtual currencies, disposal, inheritance, loss, theft, and emerging developments must be taken into consideration by policymakers. Further, the policymakers must incorporate various other forms of crypto-assets and other related securities within the ambit of taxation.
- Tax authorities and appropriate administrative bodies must regularly review the policies and mechanism in place to keep pace with the fast-changing nature of virtual currency. Regular reviews would ensure transparency in the process. Reviewing the policies regularly would also provide with a chance to incorporate different approaches adopted by other countries and any emerging international trends.
- A central regulatory board or a quasi-judicial body dedicated to dealing with issues arising from cryptocurrency transactions, or a licensing authority to prescribe preconditions for exchanges to obtain a trading license must be set up.
- Compliance methods must be improved. The fast-moving values of virtual currency, different exchange rates for the same virtual currency, and complex records create hurdles in the process of complying with tax rules. Reducing the need for valuation, bringing pooling rules, mitigating exchanges, simplifying certain rules, balancing tax planning risks, etc. could facilitate the process of compliance. Effective compliance leads to better regulation leaving behind no loopholes.
- The framework for taxing virtual currencies must be in tune with the broader regulatory framework. It must be coherent on policy aspects including tax transparency and legal, financial and consumer protection requirements.
- It must be noted that virtual currencies are mostly used by individuals for personal purposes and not in a business capacity. The tax authorities must consider practical settings for this group of individuals to encourage compliance. Difference between small trades and big trades must be coherently enunciated so as to avoid capital gains tax consequences each time a transaction is completed. Thus, policymakers must come up with a simplified tax regime to cover all sorts of groups.
- Time and again, the Central Government has pushed for a Digital India and has promoted cashless transactions. The outbreak of COVID-19 has acted as a major boost towards cashless transactions involving virtual currency. The tax treatment of virtual currencies, therefore, must be aligned with other such policy objectives.
- Several threats lurk around the concept of cryptocurrencies. Although cryptocurrencies are becoming common and growing tremendously in India, the uncertainty surrounding it must not be ignored. There are many risks associated with cryptocurrencies – high risk in investment, intangible and unsecured form of nature of cryptocurrencies, manipulation by extortion, and cyber risks such as dark web,

hackers, viruses, etc. Policymakers must therefore come up with an inclusive framework which leaves behind no aspect of virtual currency or cryptocurrency.³⁸

- Lastly, policymakers must also strive to provide a solution to other new token types and emerging characteristics.

The advent of virtual currency has created a dynamic market and although the blockchain technology is still a new concept, there is tremendous competition in the market of cryptocurrency.³⁹ Banks opine that virtual currencies are here to stay for a long period of time and will give a tough competition to the centralised bodies of government. However, the legality of bitcoins is a debatable issue, but trends prove that world has accepted virtual currencies and the days are not far away when there will be one world and one currency.⁴⁰

CONCLUSION

With the advent of technology over the years, several opportunities have knocked mankind's doors. One such facet of development is cryptocurrency. It offers a new, effective and attractive model of payment. Although cryptocurrency platforms open new portals for financial transactions, the same are not regulated adequately. Approximately one-fifth of the Indian population remains unbanked. Many individuals do not have access to basic banking facilities. Virtual currencies provide a solution to such problems by ensuring universal access, low transaction costs, and secured infrastructure.

Income earned by trading cryptocurrency is treated as a capital gain and not normal income. It must be borne in mind that capital gains tax rates are subject to the holding period of the asset, i.e., a person will be charged for the crypto earnings held by him. Thus, capital gains tax is applied on crypto related income earned by an Indian citizen. Mining of cryptocurrency might not be treated as capital asset. Sale of such cryptocurrency maybe taxed under the head of 'income from other sources.'

India is yet to bring about a legislation governing the aspects of cryptocurrencies including taxation matters. The current mechanisms of KYC Norms, anti-money laundering standards, General Anti Avoidance Rules must be extended to virtual currency exchanges. RBI may set up a specialised body to monitor the benefits and risks associated with virtual currencies. The best approach is to regulate the field rather than imposing stringent bans. The future belongs to cryptocurrency and blockchain technology and therefore, now is the right time to establish clear rules and regulations pertaining to regulatory as well as taxation aspects to ensure stability and security. India can learn a great deal from the foreign models and establish a strong cryptocurrency regime.

³⁸ Michael S Sackheim & Nathan A Howell, *The Virtual Currency Regulation - India*, 2 Virtual Currency Regulation Review (2018).

³⁹ Krishna Kumar Thakur & Dr. G.G. Banik, *Cryptocurrency: Its Risks and Gains and The Way Ahead*, 9 IOSRJE 42, (2018).

⁴⁰ Ashish Mohod, Anmol Mannarwar & Kaustubh Badukale, *What is the future of Cryptocurrency in India?*, 4 IJRSE, (2018).

Cryptocurrency has become very popular in the last few years. It is becoming an important and integral part of transactions and has won the faith of general public in terms of privacy and security. If regulated properly, it can act as a strong asset for the Indian market and economy. Strict rules and regulations, smooth compliance mechanisms, absence of loopholes, penal provisions in cases of deviation, reasonable taxation rates can help create a strong legislation to regulate the wide arena of cryptocurrency in India. Looking at various other jurisdictions, especially Australia and Japan could provide a lot of positive insight for regulating virtual currencies. India must keep pace with the changing aspects of international trends in order to attract investments and help in the growth of economy.