
CRYPTO TAXATION IN INDIA: OVERREGULATION OR GROWTH?

Sneha Gupta, Manav Rachna University

ABSTRACT

India's evolving approach to taxing cryptocurrencies is examined in this article, as well as whether the current framework is barrier to innovation or an opportunity for economic growth. The article starts off by introducing cryptocurrency as a decentralized digital asset driven by blockchain technology, and emphasizing how Indian investors are becoming more and more interested in it. The article then examines the legal acceptance of cryptocurrencies as "Virtual Digital Assets" or VDAs under the Income Tax Act, 1961 through the Finance Act, 2022, and considers key provisions including the statutory rate of 30% on earnings under section 115BBH and the statutory tax reduction of 1%. Despite enhancing legal clarity, these initiatives highlight key difficulties such as high taxation, liquidity limits owing to TDS, lack of loss adjustment, and the absence of a uniform supervisor, each of these discourage participants and drive their activity to unregulated platforms. A dedicated authority, rationalized taxation, and loss set-off are among the reforms suggested in the article. According to these findings, cryptocurrencies' full potential in India's digital economy requires a more balanced, investor-friendly framework.

Keywords: Cryptocurrency, Virtual Digital Assets (VDAs), Crypto Taxation, India, Blockchain Regulation.

Introduction

In India, cryptocurrencies have emerged as a popular investment choice for private citizens. However, their path in India has been anything but stable. From being completely banned to now coming under strict regulatory scrutiny, these virtual assets have faced a series of challenges and uncertainties. Nevertheless, the promise of high returns continues to captivate investors, especially millennials. With over 100 million cryptocurrency investors reside in India now, surpassing the entire number of stock market participants. The following article will explain cryptocurrency, its tax and legal framework in India, tax law loopholes, the effects of these problems, and how to close these gaps within the current legislation to support the future expansion of our economy as a whole.

Understanding Cryptocurrency: Definition

A cryptocurrency is a kind of digital or virtual currency that depends on the technology known as blockchain for security and transparency and was created to be used as payment for goods and services made online. In contrast to other payment systems (like conventional notes, bank accounts, etc.) which are regulated by governments and financial institutions, cryptocurrency has no central authority and is unaffected by third parties, meaning that it is not issued or managed by either of these entities.

Cryptocurrency is revolutionizing finance and banking around the world, it has influenced and impacted an enormous number of people worldwide.

A few well-known cryptocurrencies include Dogecoin (DOGE), Bitcoin (BTC), Binance Coin (BNB), Tether (USDT), Ether (ETH), Litecoin (LTC), and several others are among the most recognized cryptocurrencies.

Cryptocurrency Taxation in India

The Indian government addressed the absence of formal legal status for cryptocurrency by defining "Virtual Digital Asset" (VDA) within the Income Tax Act, 1961 through the Finance Bill, 2022. The Finance Ministry clarified the taxation framework for VDAs, classifying them as digitally represented values created via cryptographic methods, applicable to investments and financial transactions. This includes non-fungible tokens. According to provisions in Section 194(S), by March 20, 2023, Rs 157.9 crore was collected in direct taxes via tax

deduction at source for the fiscal year 2022-2023, marking a step toward legitimizing cryptocurrencies in India.

Navigating Crypto Taxation in India's Regulatory Framework

Let's examine the intricacies of India's cryptocurrency tax laws and how you can maximize your investments while being compliant with the law.

1. Tax Rate on VDAs [Section 115 (BBH)]

This section mandates a 30% tax on income from selling or transferring VDAs, applied uniformly regardless of income amount. Taxpayers can only deduct the buying cost, with no allowances for other expenses or loss adjustments. This provision aims to tax VDA income separately, discouraging speculative trading and ensuring tax compliance clarity.

2. Tax Deduction at Source (TDS) on transfer of VDAs [Section 194S]

This section enforces a 1% tax deduction on payments for transferring Virtual Digital Assets (VDAs). Tax is withheld upon fund crediting or payment execution. Payers must ensure tax payment prior to VDA transfer, regardless of payment method. No TDS is required for transactions of ₹50,000 or less paid by individuals or ₹10,000 or less by non-specified persons. Payments to suspense accounts incur TDS, supporting small traders while encouraging compliance.

Loopholes in India's Digital Asset Taxation and its Impact

Even though levying taxes on cryptocurrencies in India is a step in the right direction, the legislation still has plenty of errors and discrepancies which restrict its efficacy and the emergence of the cryptocurrency ecosystem. Correcting these obstacles can promote development and economic growth in addition to increasing compliance. A breakdown of the issues and its impact on the digital world is provided below:

1. Elevated Tax Rates (30% on Earnings)

Issue: Traders and regular investors are deterred by the standard 30% tax rate on all virtual gains, irrespective of the earnings bracket generated, and the ban on deductions for any expenses.

Impact: Buyers are forced onto uncontrolled platforms or foreign exchanges in an effort to evade paying excessive taxes, which reduces transparency and tax revenue.

2. 1% TDS on Every Transaction

Issue: Imposing 1% TDS for every cryptocurrency transaction lead to delay in liquidity.

Impact: It deters involvement in the bitcoin business and limits expansion by increasing compliance burdens. Because the TDS reduces their earnings and restricts their growth, amateur traders and investors who work on tight margins are disproportionately impacted.

3. No Offset of Losses

Issue: In contrast to traditional investments like stocks, cryptocurrencies losses cannot be offset from other sources of income.

Impact: Since investors suffer the entire expense related to losses with no tax relief, this restricts risk-taking abilities which ultimately hinders the growth of our Economy. This restricts involvement in digital currency market and discourages taking risks.

4. Restriction on carry forward of Losses

Issue: Unlike losses from conventional assets like equities, losses from cryptocurrencies cannot be carry forwarded to future years in order to compensate for his losses for future gains.

Impact: As a result, investors are less able to recoup from losses and are discouraged from taking risks.

5. Lack of a Dedicated Regulatory Authority

Issue: While there isn't a single, concentrated regulatory body in India that addresses cryptocurrencies exclusively; RBI, SEBI and Ministry of Finance currently serve as the primary authorities in charge of crypto taxes and compliances.

Impact: Companies and investors face inconsistent orders from the RBI, SEBI and

Ministry of Finance without an integrated regulatory authority. This delays the rise of cryptocurrency economy in India by making both foreign and regional investors hesitant.

Outlook for India's Cryptocurrency Policy

- 1. Clear Regulatory Framework:** An act was suggested in 2021 through Cryptocurrency and Regulation of Official Digital Currency Bill is yet to be passed. But in my opinion, this bill deserves to be passed since it achieves a balance between economic growth and regulation.
- 2. Rationalized Tax Structure:** Trading volumes on Indian exchanges have been restricted by high tax rates on cryptocurrency income (30%) and transactions (1% TDS). Amendments in such rates could promote domestic investment and minimize capital flight.
- 3. Balanced Risk Management:** RBI and SEBI are promoting a structured regulatory framework for cryptocurrencies in India, aiming to protect investors and ensure economic stability, while balancing innovation and risk; overly strict regulations could hinder creativity and the nation's global stance.
- 4. Anti-Money Laundering Compliance:** The Ministry of Finance released a notice on March 7, 2023, bringing all transactions through VDAs—including cryptocurrency transactions—within the purview of the Prevention of Money Laundering Act. This program seeks to lessen the risks associated with terrorist financing and money laundering while also strengthening oversight of cryptocurrency-related activities.
- 5. Global Collaboration:** India is aggressively collaborating with international groups like the G20 and the Financial Action Task Force, or FATF, to establish a unified set of rules and regulations for cryptocurrency worldwide. This strategy emphasizes the understanding that digital assets are essentially limitless and that successful regulation requires international cooperation.

Conclusion

In conclusion, India's cryptocurrency taxation policy marks a significant step in defining the

crypto industry but also exemplifies overregulation. The establishment of a tax framework via the Income Tax Act, 1961 and the classification of virtual assets provide crucial clarity. However, the system remains overly rigid and investor-unfriendly, featuring a fixed 30% tax rate, a 1% TDS on all transactions, and restrictions on offsetting losses. This discourages participation, particularly from individual investors and startups, pushing them toward unregulated channels. Nevertheless, India's proactive stance in global regulatory discussions and the inclusion of digital currency under the PMLA highlight an awareness of digital assets' importance. A more balanced strategy, including lower tax rates, risk allowances, and a dedicated regulatory body, could facilitate a thriving cryptocurrency market. Successful implementation of these measures could transition cryptocurrencies from a regulatory issue to a contributor to India's GDP growth. The government prioritizes international collaboration to ensure the legitimization and security of digital assets while combating illegal activities.