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Decoding the Crypto Conundrum: Navigating the Legal Landscape of Taxing Cryptocurrency in India

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ABSTRACT

Cryptocurrency trading gained prominence in India during the COVID lockdown, with current transactions now reaching an impressive $250 billion, second only to the USA. Nevertheless, the government has yet to establish a comprehensive mechanism for taxing and maintaining regulatory oversight over cryptocurrency. Initially, the central government was enthusiastic about prohibiting cryptocurrency in 2021, going so far as to draft a bill for that purpose. However, the central government swiftly recognized the inadequacy of this idea. This realization, combined with the Supreme Court's annulment of the RBI circular banning cryptocurrency in March 2020, brought an end to the initiative. Moreover, on March 7, 2023, the Central government instituted a flat tax of 30% on cryptocurrency through the introduction of Section 115 BBH in the Income Tax Act, 1963. This action indirectly—though not officially—acknowledged cryptocurrency transactions in India. Consequently, the Income Tax Authority is now legally empowered to levy taxes on cryptocurrency. Nonetheless, the RBI governor, as of January 2023, emphatically asserted the imperative of banning cryptocurrency due to its perceived threat to the financial stability of the country. The government's exclusive focus on levying taxes on cryptocurrency, without considering the potential for individuals to incur losses and still be obligated to pay taxes, alongside restrictions on the carry forward of losses, has resulted in more complications than it ostensibly aims to resolve. The absence of clarification regarding whether cryptocurrency is classified as a security, income, asset, legal tender, etc., has led to a lack of SEBI oversight. Consequently, conflicting ideas and approaches on cryptocurrency persist among the government, RBI, SEBI, and IT department. Therefore, there arises a necessity to draw insights from countries where cryptocurrency transactions are widespread, comprehend their regulatory and tax frameworks, and formulate a bespoke approach for India to regulate and tax cryptocurrency.

***Keywords**: Cryptocurrency, block chain technology, heads of income, taxation, ambiguity.*

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I. INTRODUCTION

The advent of Bitcoin, a novel form of currency widely known as a cryptocurrency, has captured the attention of the global community. Diverging significantly from conventional fiat currency, this digital asset has experienced a remarkable surge in value, acceptance, and utilization over the course of this decade[2]. Although the intricacies pertaining to the underlying blockchain technology and cryptographic processes involved in Bitcoin mining shall not be expounded upon extensively, this discourse shall hone in on the specific issue of taxation, with a particular focus on the Indian tax landscape. Cryptocurrencies, unlike their fiat counterparts, possess distinctive characteristics. Namely, they operate devoid of any form of governmental backing, qualifying as a nonpareil platform susceptible to fraudulent activities and tax evasion, despite the advantages stemming from the absence of an intermediary[3] authority. Consequently, the quandary faced by the government revolves around the conundrum of effectively levying taxes on these intangible virtual currencies.

The present research shall refrain from delving into the tax treatment of cryptocurrency derivatives or exploring other forms of distinct crypto-tokens or securities. Rather, its scope is limited to Bitcoin-style cryptocurrencies, which inherently function as transferable assets possessing inherent value. Presently, the taxation of cryptocurrencies in India lacks a comprehensive legislative framework. The primary objective of this study is to examine the existing position of cryptocurrency taxation within the ambit of the Income Tax Act of 1961[4], complemented by pertinent judicial pronouncements. Furthermore, it aims to investigate taxation methods adopted by various international jurisdictions and propose recommendations to incorporate relevant principles, in anticipation of an eventual shift towards a global cryptocurrency regime.

The Reserve Bank of India (RBI) has refrained from explicitly categorizing cryptocurrencies as illegal or conferring upon them the status of legal tender[5]. Within the comprehensive framework of the Foreign Exchange Management Act (FEMA), wherein the expression "currency" is inclusively defined, cryptocurrencies have not been expressly designated as

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[2] "Cryptocurrency trading, user signups spike in India on stable Bitcoin (6 October 2022) https://www.livemint.com/market/cryptocurrency/cryptocurrency-trading-user-signups-spike-in-india-on-stable-bitcoin-11665078872661.html." Accessed 10 September 2023.

[3] Harwick, Cameron, 'Cryptocurrency and the Problem of Intermediation' (2016) 20(4) The Independent Review 569–88 http://www.jstor.org/stable/44000162 Accessed 10 September 2023.

[4] The Income Tax Act 1961 (India)

[5] Bharadwaj, N., 'RBI Gov Calls for an Outright Ban on Cryptocurrency as Union Budget 2023 Approaches' (India Today, 16 January 2023) https://www.indiatoday.in/cryptocurrency/story/rbi-gov-calls-for-an-outright-ban-on-cryptocurrency-as-union-budget-2023-approaches-2322146-2023-01-16 accessed 10 September 2023.

falling within this purview[6], nor have they been officially endorsed as a recognized form of legal tender by the RBI[7]. Conversely, the Securities and Exchange Board of India (SEBI) has not accorded them the classification of tradable instruments, given their issuance by a non-human entity referred to as a "Server" rather than a discernible individual[8].

However, it is worth noting that despite these circumstances, several entities readily accept cryptocurrencies such as Bitcoin as a medium of payment[9], thereby implicitly recognizing their validity as a form of currency. In the absence of a comprehensive regulatory framework governing these matters, trading and transactions involving cryptocurrencies persist in an unregulated manner, giving rise to a multitude of accountability concerns that necessitate specific attention, particularly in relation to taxation.

The introductory segment of the paper shall explicate the fundamental principles of cryptocurrency, encompassing a historical exposition and an elucidation of the underlying rationale that necessitated its inception. Subsequently, attention shall be directed towards a comprehensive examination of the present status quo pertaining to cryptocurrency within the Indian legal system. Subsequent sections will be dedicated to an in-depth analysis of the diverse cryptocurrency regulatory regimes followed across various international jurisdictions. Lastly, the paper will conclude with the integration of informed recommendations and valuable insights, tailored specifically to address the unique challenges and opportunities presented within the Indian context.

II. Cryptocurrency

Cryptocurrency has evolved as an innovative form of "soft-money," steadily gaining prominence as a transactional mechanism on a global scale since its inception in 2009[10]. Operating as a web-based platform, it facilitates the exchange of financial transactions through cryptographic functions, leveraging the transformative potential of blockchain technology to

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[6] Ghosh S, 'Traders in Dilemma over Disclosing Cryptocurrency as Foreign Asset' (The Economic Times, 26 July 2023) https://economictimes.indiatimes.com/tech/technology/traders-in-dilemma-over-disclosing-cryptocurrency-as-foreign-asset/articleshow/102115549.cms accessed 12 September 2023.

[7] Bharadwaj, N., supra note 4.

[8] Srinivasan S, 'Explained: What Are SEBI's Concerns around Crypto Assets?' (The Hindu, 13 June 2022) https://www.thehindu.com/business/Economy/explained-what-are-sebis-concerns-around-crypto-assets/article65517621.ece#:~:text=According%20to%20media%20reports%2C%20SEBI,used%20under%20the%20SEBI%20Act. accessed 12 September 2023.

[9] Kulkarni S, 'These Indian Companies Accept Bitcoin Payments in India' (GoodReturns, 15 November 2021) https://www.goodreturns.in/personal-finance/investment/these-indian-companies-accept-bitcoin-payments-in-india-1230180.html accessed 13 September 2023.

[10] Ashmore D and Powell F, 'Bitcoin Price History 2009 to 2022' (Forbes, 14 June 2023) https://www.forbes.com/advisor/in/investing/cryptocurrency/bitcoin-price-history-chart/ accessed 14 September 2023.

achieve decentralization. To embark upon a comprehensive exploration of this subject matter, it is imperative to establish a clear understanding of its precise definition. Cryptocurrency encompasses digital or virtual currencies that rely on cryptographic techniques for robust security measures[11]. The salient feature inherent in cryptocurrency systems, characterized by their independence from central authority control, owing to the decentralized nature of blockchain technology, thereby rendering them impervious to conventional forms of government oversight[12] and intervention.

1. Evolution of Currency

Currency has held a significant role in human society and the progression of civilization since time immemorial. In the early stages, mankind relied upon the barter system as a means of trade, although its practice posed considerable challenges. The absence of simultaneous mutual needs, the lack of a standardized unit of value for commodities, and the limitations on mobility hindered the efficacy of this form of exchange[13]. Unlike the convenience offered by modern-day currency or mobile e-wallets, the barter system fell short in terms of ease and portability. Consequently, an awareness emerged among individuals that the barter system was not sufficiently efficient, leading to the introduction of official currencies. In Europe, the minting of coins as official currency commenced as early as 110 BC, and subsequent progress saw the advent of gold-plated florins from 1600 to 1900[14], signifying a notable advancement in the evolution of currency systems.

The evolution continued with the introduction of paper currency, which has since emerged as the preeminent and universally relied-upon medium of wealth exchange. The governments backed the fiat money printed by them with a particular quantity of gold or linked their currency a country that did so. The USA which had a huge gold reserve after world war naturally emerged as a popular choice. However, the gold standard has its own set of problems as gold was a rare and limited metal of value while the economy was growing at record pace. Finally,

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[11] Scarfone K, 'Blockchain Security: Everything You Should Know for Safe Use' (TechTarget, 20 June 2023) https://www.techtarget.com/searchsecurity/feature/Blockchain-security-Everything-you-should-know-for-safe-use accessed 14 September 2023.

[12] Bag S, 'The G20 and India's Role in Cryptocurrency Regulation' (ORF, 5 January 2023) https://www.orfonline.org/expert-speak/the-g20-and-indias-role-in-cryptocurrency-regulation/ accessed 15 September 2023.

[13] Nitisha, 'Barter System and Its Drawbacks' (Economics Discussion, 11 August 2015) https://www.economicsdiscussion.net/money/barter-system-and-its-drawbacks/4056 accessed 15 September 2023.

[14] Sussman N and Eichengreen B, 'The International Monetary System in the (Very) Long Run1' (IMF eLibrary, 1 March 2000) https://www.elibrary.imf.org/configurable/content/journals$002f001$002f2000$002f043$002farticle-A001-en.xml?t%3Aac=journals%24002f001%24002f2000%24002f043%24002farticle-A001-en.xml accessed 16 September 2023.

in 1971 the USA under President Nixon abolished the gold standard thereby bringing an end to the system of allowing direct convertabilty of the dollar to gold[15].

As business operations expanded from local to regional and ultimately to the international level, the demand for expeditious, user-friendly, and cost-effective wealth transfer methods escalated. This demand, in turn, fostered the advent of credit cards, cryptocurrencies, and digital wallets, representing innovative solutions designed to address the evolving dynamics of wealth management and transactional efficiency. However, amidst the aforementioned advanced forms of money transfer, cryptocurrency possesses a distinctive edge by virtue of its minimal interference from centralized regulatory authorities, reduced susceptibility to technical glitches, absence of a central point of failure, and enhanced protection against hacking and identity theft that often plague traditional banking systems[16].

These advantages strongly indicate that the future lies in the realm of cryptocurrency. Operating as a digital or virtual currency, it functions as a medium of exchange akin to fiat currency, albeit without a tangible form[17]. By employing cryptography, a unique method of encryption, it effectively prevents illicit activities such as hacking, thereby ensuring a secure and trustworthy environment.

The term "Cryptocurrency" derives its name from the element of "Crypto," which directly references to a methodological approach employed to safeguard communication and monetary transfers through the use of encryption and decryption techniques. Typically, the implementation of cryptography entails the utilization of a computational algorithm (blockchain technology) that serves as the central processing unit responsible for facilitating cryptocurrency transactions. As an illustration, the well-known cryptocurrency, Bitcoin, utilizes a distinctive hashing algorithm known as SHA256, which serves as the public key shared amongst users[18]. Additionally, a private algorithm acts as the master key for these transactions, representing the user's confidential digital signature.

2. Benefits of Cryptocurrency

Cryptocurrency effectively addresses the challenges inherent in the contemporary banking

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[15] U.S. Department of State (Nixon and the End of the Bretton Woods System, 1971–1973) https://history.state.gov/milestones/1969-1976/nixon-shock accessed 15 September 2023.

[16] Weichbroth P, Wereszko K, Anacka H and Kowal J, 'Security of Cryptocurrencies: A View on the State-of-the-Art Research and Current Developments' (2023 23(6) Sensors 3155) https://doi.org/10.3390/s23063155. PMID: 36991866; PMCID: PMC10051655.

[17] 'ibid'

[18] Ahmed DrM, 'BLOCKCHAIN TECHNOLOGY CRYPTOGRAPHIC SECURITY, HASHING AND DIGITAL SIGNATURE' (Digital India) https://egovstandards.gov.in/sites/default/files/2023-05/Blockchain%20Cryptographic%20Security%2C%20Hashing%20and%20Digital%20Signature.pdf.

system, offering individuals a range of valuable advantages. By functioning in a decentralized manner, it liberates money transfers from over regulation and mitigates the risks associated with a centralized point of failure[19]. The addition of new units is subject to stringent compliance with predetermined conditions, thereby ensuring a controlled and regulated system. Notably, the authenticity of fund transfers can be easily ascertained within the cryptocurrency framework, as transactions occur through an immutable block system that safeguards against unauthorized modifications[20].

In the context of bitcoins, for instance, the generation of new Bitcoins relies on miners successfully appending blocks to the blockchain, constituting the exclusive mechanism for their production. Furthermore, unlike conventional transactions involving banks and e-wallets that incur taxes and service fees, cryptocurrency transfers impose a very minimal additional costs[21]. This streamlined approach has substantially expedited and simplified international money transfers, thereby contributing to overall economic growth and the advancement of a nation's gross domestic product[22] (GDP).

3. How does Cryptocurrency work?

The initiation of a cryptocurrency transfer necessitates the satisfaction of certain fundamental prerequisites. Foremost, it requires the involvement of two parties equipped with compatible forms of cryptocurrency, such as bitcoins. Furthermore, the party intending to effect the transfer must possess the requisite transaction details pertaining to the recipient. Upon embarking on the transfer process, the initiating party generates a confirmation notification, which serves as tangible evidence of their expressed intent to transfer a specified amount[23]. Successful completion of the transaction hinges upon the mutual agreement and consent of both parties involved, validating their willingness to engage in the transfer process.

The subsequent phase entails the meticulous validation of the user's identity and a comprehensive assessment of whether the transferring party possesses the requisite balance to facilitate the intended transaction. Upon satisfying all the aforementioned prerequisites, the

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[19] Summers MrBJ, '7 Payment System Risk and Risk Management' (IMF eLibrary) https://www.elibrary.imf.org/display/book/9781557753861/ch07.xml accessed 17 September 2023.
[20] 'ibid'.
[21] Bylund A, 'How much are cryptocurrency transaction fees?' https://www.fool.com/investing/stock-market/market-sectors/financials/cryptocurrency-stocks/transaction-fees/ accessed 17 September 2023.
[22] Sahu B, Divakar H, 'Cryptocurrency and Its Impact on Indian Economy' (Journal of Global Economics, 28 March 2023) https://www.hilarispublisher.com/open-access/cryptocurrency-and-its-impact-on-indian-economy-98448.html accessed 17 September 2023.
[23] 'How Bitcoin Transactions Work: Learn All about BTC: Get Started with Bitcoin.Com' (Bitcoin.com) https://www.bitcoin.com/get-started/how-bitcoin-transactions-work/ accessed 17 September 2023.

processing or transfer of the cryptocurrency ensues[24]. Notably, this entails subjecting the transaction to a rigorous hashing algorithm, with Bitcoin's implementation utilizing the esteemed SHA256 hashing algorithm[25]. The resulting output, derived from the application of the signature algorithm utilizing the user's private key, assumes a distinctive role in uniquely identifying the user. This output is subsequently distributed across the network, thereby facilitating the involvement of miners, whose responsibility lies in diligently verifying the transaction's authenticity using the sender's public key[26]. Once the transaction successfully satisfies all the aforementioned conditions, it finds its rightful place within the blockchain, where any further modifications are rendered impossible[27].

Hence, the aforementioned processes exhibit remarkable efficiency by concluding within mere minutes, surpassing the comparatively sluggish pace of traditional money transfer methods. However, it is important to acknowledge a significant constraint in the domain of bitcoins, specifically the predetermined limit of 21 million units beyond which no additional bitcoins can be mined[28]. Notably, the minimal level of governmental oversight exerted over these operations, coupled with their internet-based nature, presents considerable hurdles in terms of regulatory control, particularly in preventing the illicit exploitation of bitcoins by money launderers and terrorist organizations[29].

Moreover, the utilization of a block system in cryptocurrency transactions introduces an irreversible nature, rendering any errors or erroneous transfers unrectifiable unless the reciever voluntarily sends it back. Nonetheless, certain economists persistently contend that, with the implementation of comprehensive regulatory measures, cryptocurrencies possess unparalleled potential as a superlative medium for financial transfers[30]. The presence of a block system within the transfer process greatly assists governing bodies in identifying the origins of such

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[24] 'ibid'

[25] Zubair M, 'How Is SHA-256 Used in Blockchain, and Why?' (*Educative*) <https://www.educative.io/answers/how-is-sha-256-used-in-blockchain-and-why> accessed 19 November 2023.

[26] Shin H, '*The Future Monetary System'*, (21 June 2022) <https://www.bis.org/publ/arpdf/ar2022e3.htm> accessed 18 September 2023.

[27] '*Can my transaction be canceled or reversed?' (blockchain support center*) <https://support.blockchain.com/hc/en-us/articles/211162263-Can-my-transaction-be-canceled-or-reversed-> accessed 19 September 2023.

[28] Publisher, 'What Happens When All 21 Million Bitcoin Are Mined?' (*Nasdaq*) <https://www.nasdaq.com/articles/what-happens-when-all-21-million-bitcoin-are-mined> accessed 19 September 2023.

[29] Howcroft E and Wilson T, 'Crypto's Role in Terrorist Financing' (*Reuters*, 23 October 2023) <https://www.reuters.com/technology/cryptos-role-terrorist-financing-2023-10-23/#:~:text=The%20Financial%20Action%20Task%20Force,transactions%20of%20criminals%20and%20terrorists%22.> accessed 19 September 2023.

[30] Adrian T and others, 'Crypto Needs Comprehensive Policies to Protect Economies and Investors' (*IMF*, 18 July 2023) <https://www.imf.org/en/Blogs/Articles/2023/07/18/crypto-needs-comprehensive-policies-to-protect-economies-and-investors> accessed 19 September 2023.

transactions. It is important to recognize that even conventional fiat currencies, currently in circulation, do not fully evade analogous concerns, including the circulation of counterfeit currencies, hawala transactions and the clandestine concealment of income from governmental authorities.

Subsequent to this, the cryptocurrency is subjected to the operations of a hashing algorithm. In the case of Bitcoin, the esteemed SHA256 algorithm is employed, yielding an outcome that then traverses a signature algorithm utilizing the user's private key. This resultant output assumes the role of a unique identifier for the user and is subsequently disseminated across the network via the sender's public key, thereby enabling verification by a cohort commonly referred to as miners[31]. These diligent verifiers assume the critical responsibility of determining the authenticity and validity of the transaction. Following the successful completion of this meticulous process, the transaction finds its permanent abode within the blockchain, establishing an immutable record that precludes any subsequent modifications. This robust mechanism serves as an impregnable safeguard against fraudulent endeavours aimed at distorting data concerning an individual's income and overall net worth.

III. Legal position of cryptocurrency in India

The status of Cryptocurrency in India is currently shrouded in ambiguity and uncertainty, with no clear guidance from the Income Tax Department regarding its treatment or taxation. From a legal standpoint, if cryptocurrency is considered as 'currency' according to the definition stipulated in the Foreign Exchange Management Act, it may be exempt from taxation. Moreover, the Income Tax Act of 1961 does not explicitly define cryptocurrency[32] within its definition of "income" as stated in Section 2(24)[33]. Any potential tax liability would likely be limited to the monetary value associated with cryptocurrency transactions. If Cryptocurrency is deemed to be a good or property, the appropriate charging section would depend on whether it is utilized in commercial transactions or generates income from capital gains. The absence of definitive regulations leaves room for interpretation and further examination of the tax implications surrounding cryptocurrencies in India.

In July 2019, a committee comprising senior officials from various ministries recommended

[31] Natarajan H, '*Distributed Ledger Technology (DLT) and Blockchain - World Bank*' <https://documents1.worldbank.org/curated/en/177911513714062215/pdf/122140-WP-PUBLIC-Distributed-Ledger-Technology-and-Blockchain-Fintech-Notes.pdf> accessed 21 September 2023.
[32] Hussain H, '*Reinventing regulation: The curious case of taxation of Cryptocurrencies in India'*, (22 March 2018) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3143091> accessed 21 September 2023.
[33] Income Tax Act 1961, s 2.

the prohibition of all virtual cryptocurrencies[34]. This high-level inter-ministerial committee also submitted a draft bill known as the Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019, which aims to invalidate the possession and transfer of cryptocurrencies[35]. However, it is important to note that these recommendations hold no legal significance unless they are incorporated into law. Although the Indian Judiciary has recently nodded to the use of Cryptocurrency in the case of Internet and Mobile Association of India v. Reserve Bank of India[36] by striking down the RBI circular passed on April 2018 banning Cryptocurrency as unconstitutional[37]; there are more impediments in making Cryptocurrency legitimate in India. The verdict of the Supreme Court on April 7, 2020 has only dealt with the constitutional validity of the circular passed by the RBI, as there is no such law in India banning Cryptocurrency yet[38]. The question of legitimacy of Cryptocurrency in India is still left unattended.

As this paper focuses on the examination of direct taxation as a means to tax cryptocurrencies, the question arises regarding the feasibility of taxing cryptocurrencies under the existing direct tax regime. The initial concern revolves around the classification of cryptocurrencies within the tax framework, specifically within the domain of direct taxation.

Before delving into the intricacies, it is imperative to grasp the underlying concept of cryptocurrency mining. Referred to as crypto-mining, this process entails the validation and incorporation of transactions pertaining to various forms of cryptocurrency into the blockchain digital ledger[39].

In simpler terms, mining involves the creation and verification of cryptographic codes that facilitate these transactions. The cryptocurrency generated through mining can be deemed as a self-generated capital asset. Consequently, any subsequent sale of such cryptocurrency would ordinarily give rise to capital gains. However, it is noteworthy that determining the acquisition cost of a cryptocurrency is unfeasible as it qualifies as a self-generated property.

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[34] Shrivastava R, ‘Govt Committee recommends ban on cryptocurrency in India’ (24 July 2019) <https://www.indiatoday.in/technology/news/story/govt-committee-recommends-ban-on-cryptocurrency-in-india-1572446-2019-07-23> accessed 21 September 2023.

[35] 'ibid'

[36] Internet and Mobile Association of India v Reserve Bank of India [2020] SCC Online SC 275 (India).

[37] Mohanty S and Anand N, ‘India’s Top Court Strikes down RBI Banking Ban on Cryptocurrency’ (*Reuters*, 4 March 2020) <https://www.reuters.com/article/us-india-cryptocurrency-idUSKBN20R0KV/> accessed 22 September 2023.

[38] Suhrith Parthasarathy, 'Decoding The Supreme Court’s Cryptocurrency Judgment' (BloombergQuint, Mar. 11, 2020), https://www.bloombergquint.com/opinion/decoding-the-supreme-courts-cryptocurrency-judgment.

[39] Forrest Stroud, 'Cryptocurrency Mining', (Webopedia) https://www.webopedia.com/TERM/C/cryptocurrency-mining.html.

Therefore, it does not fall within the scope of Section 55[40] of the Income-tax Act, 1961, which definitively elucidates the determination of the cost of acquisition for certain assets generated by oneself. As cryptocurrency qualifies as a 'self-generated asset' engendered by the system as a recompense for verifying transactions, the cost of acquisition ('COA') becomes technically unascertainable since the sole input employed by the miner pertains to the computational capacity within the system[41]. It is essential to underscore that the scope of the term 'income' extends beyond mere 'profits' and 'gains', and any element appropriately characterized as 'income' is subject to taxation under the ITA unless explicitly exempted[42].

The Supreme Court had also made an observation regarding this in the recent case of *CIT v. B.C. Srinivasa Shetty*[43], where the court opined that currently the tax laws in India are silent on taxing cryptocurrency and there is a possibilty that the government will not consider bitcoin as a capital asset and hence provisions related to capital gains cannot be applied. However, the income tax department can consider taxing it under the provisions related to "Income from other sources[44]".

Therefore, it can be posited that the taxation of cryptocurrency should not be based on capital gains, but rather it should fall under the purview of "Income from other sources." In such a scenario, the taxpayer would be liable to pay taxes according to the applicable tax slab corresponding to their income level[45]. In the case of cryptocurrency taxed under this classification, only investments would be taken into consideration for taxation, in compliance with Section 56 of the IT Act.

However, it is crucial to note that if cryptocurrencies are held as stock-in-trade for the purpose of exchange with real currency or received as consideration for the sale of goods and services, they would be subject to taxation under the category of "profits or gains from business or profession." Under this classification, the taxation of cryptocurrency would adhere to the provisions outlined in Section 28, necessitating the fulfilment of all five conditions. Failure to meet these conditions would result in the classification of cryptocurrency under income from other sources. The five conditions are as follows[46]:

1. A business or profession must exist.

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[40] Income Tax Act 1961, s 55.
[41] Kevin Werbach, 'Trust, but Verify: Why the Blockchain Needs the Law' (2018) 33 Berkeley Technology Law Journal 487) https://www.jstor.org/stable/26533144 Accessed 23 September 2023.
[42] Gopal Saran Narain Singh v. CIT [1935] SCC OnLine PC 24, (1935) 3 ITR 237.
[43] *CIT v. B.C. Srinivasa Shetty [(1981) 128 ITR 294; (1981) 2 SCC 46 (India)].*
[44] 'ibid'.
[45] Income Tax Act 1961, s 56.
[46] Income Tax Act 1961, s 28.

2. The assesses should have conducted the business or profession.
3. The business or profession should have been operational for some duration in the previous year.
4. The charge pertains to the profits and gains of the business or profession in the previous year.
5. The charge encompasses any business or profession in operation.
6. Under Section 2(13) of the ITA[47], the definition of 'business' is inclusive, and comprises of "trade, commerce or manufacture or any adventure or concern of such nature.

In March 2023, the Central Government implemented a uniform tax rate of 30%, accompanied by an additional 4% cess on cryptocurrency[48] through the introduction of Section 115BBH[49]. Despite the positive aspect of governmental intervention, this measure lacks a thorough and encompassing legislative framework. The provision falls short in addressing the earlier discourse within this paper regarding the classification of cryptocurrency. Instead, it resorts to the use of a notwithstanding clause to circumvent the complexities arising from other provisions of the Income Tax Act. The government's primary focus appears to be on levying taxes without delving into the broader intricacies associated with cryptocurrency.

The utilization of the term "any virtual asset" within the Act, coupled with the absence of a definitive classification of categories under the Income Tax Act (ITA), gives rise to multiple interpretations and potential conflicts. Furthermore, there exists ambiguity regarding the supervisory jurisdiction over cryptocurrency, with uncertainty prevailing as to whether SEBI holds supervisory authority or if it is restricted solely to the purview of the RBI. To mitigate these uncertainties and establish regulatory clarity, it becomes imperative to categorize cryptocurrency under a specific heading. Consequently, the government should carefully deliberate upon the various pertinent factors elucidated in this paper before hastily imposing a uniform tax on cryptocurrency.

IV. CRYPTOCURRENCY TAXATION IN OTHER COUNTRIES

(i) Taxation of Cryptocurrency in the USA.

The United States stands as the host to the largest community of cryptocurrency owners and

[47] Income Tax Act 1961, s 2.
[48] Maiti M, 'How Are Cryptocurrencies Taxed? How to Report Crypto Income in ITR?' (Outlook Business, 18 October 2023) https://business.outlookindia.com/personal-finance/tax/how-are-cryptocurrencies-taxed-how-to-report-crypto-income-in-itr. accessed 25 September 2023.
[49] Income Tax Act 1961, s 115.

Bitcoin users, accompanied by considerable trading volumes of Bitcoin[50]. As cryptocurrency represents a digital form of currency, the U.S. Securities and Exchange Commission (SEC) has expressly designated it as a form of security[51]. The SEC possesses substantial authority to oversee security regulations, extending its purview to encompass cryptocurrency exchanges and digital asset storage companies, among other entities[52].

Regarding the taxation of cryptocurrencies, the Internal Revenue Service (IRS) of the United States has issued specific notices to delineate the various taxation categories applicable to these digital assets. Despite bitcoin's function as a medium of exchange, it does not possess the same legal status as traditional tender. However, unlike India there is a well established regulatory oversight exercised by the SEC.

In the context of tax regulations in the United States, cryptocurrency is classified as a property rather than a currency for federal tax purposes. This categorization places it in the same class as other capital assets like stocks and bonds, emphasizing its status as a form of tangible asset rather than a traditional medium of exchange. Consequently, the established principles and guidelines governing property transactions are deemed applicable to transactions involving cryptocurrencies.

The Internal Revenue Service (IRS) has issued a notice (2014-21)[53] providing explicit guidance on the treatment of virtual currencies. According to this notice, virtual currencies are considered as if they were exchanged for goods or services, thereby impacting the computation of gross income in accordance with the prevailing federal tax laws. To assess the gain or loss arising from the value of the received cryptocurrency, it is necessary to determine its fair market value. Only upon a subsequent sale or exchange event can the resulting outcome be classified as a capital gain or loss.

However, recommendations have been presented to the Congress, emphasizing the need for the Internal Revenue Service (IRS) to devise a more intricate tax guidance framework[54]. The objective is to prevent users and businesses from facing unwarranted penalties while striving

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[50] 'Fact Sheet: Climate and Energy Implications of Crypto-Assets in the United States' (*The White House*, 8 September 2022) <https://www.whitehouse.gov/ostp/news-updates/2022/09/08/fact-sheet-climate-and-energy-implications-of-crypto-assets-in-the-united-states/> accessed 27 September 2023.

[51] 'Cryptocurrency/ICOs' (*U.S. Securities and Exchange Commission*, 10 January 2018) <https://www.sec.gov/securities-topics/ICO> accessed 10 November 2023.

[52] Sigalos M and Levy A, 'SEC's Gensler Says "the Law Is Clear" for Crypto Exchanges and That They Must Comply with Regulators' (*CNBC*, 27 April 2023) <https://www.cnbc.com/2023/04/27/sec-chairman-gary-gensler-says-the-law-is-clear-for-crypto-exchanges.html> accessed 11 November 2023.

[53] 'Digital Assets' (*Internal Revenue Service*) <https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets> accessed 12 November 2023.

[54] (*Electronic Tax Administration Advisory Committee annual report to congress*) <https://www.irs.gov/pub/irs-pdf/p3415.pdf> accessed 14 November 2023.

to comply with their tax liabilities. Consequently, it becomes apparent that the existing model of taxing cryptocurrency in the United States is not exempt from shortcomings and is still undergoing refinement. In contrast to India's approach of outright flat taxation without any classification or further clarity, the US has opted for a clear taxation regime that accommodates cryptocurrency transactions.

(ii) Taxation of Cryptocurrency in the UK.

The United Kingdom's tax collection authority, HMRC, has provided explicit directives in 2014 regarding the taxation of Bitcoin and other cryptocurrencies[55]. These guidelines establish the applicability of Corporation tax, Income tax, and capital gains tax to cryptocurrencies. Furthermore, the tax treatment, including the Value Added Tax (VAT) treatment, implemented by the UK aligns with the prevailing tax laws within the European Union[56].

The mining of Bitcoins or any other cryptocurrency is deemed a non-economic activity due to the lack of sufficient connection between the services rendered and the corresponding considerations received. Consequently, Value-added Tax (VAT) does not generally apply to income generated from Bitcoin mining as it falls outside the scope of VAT. The cashless nature of these transactions further reinforces this distinction. Notably, under the EU VAT Directive[57], the income earned by miners, which pertains to services associated with transaction verification and entails specific charges, is exempted from VAT. Moreover, when engaging in exchanges involving traditional currencies such as the dollar or sterling with Bitcoins, such transactions are not subject to VAT[58].

At present, in the United Kingdom, there exists no prescribed taxation for the issuance or transfer of cryptocurrencies. However, income arising from charges associated with Bitcoin transactions is subject to the purview of Corporation tax, while Income tax and Capital Gains Tax also hold relevance. The determination of taxable provisions for profit or gain falls within a realm that remains open and necessitates a case-by-case analysis to establish the appropriate tax treatment. In this regard, the consideration of pertinent legislation and subsequent case laws

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55 'HMRC Approach to the Taxation of Cryptoassets' (*Deloitte Briefing document*, 7 August 2023) <https://taxscape.deloitte.com/article/hmrc-approach-to-taxation-of-cryptoassets.aspx#:~:text=HMRC%20state%20that%20cryptocurrencies%20may,long%E2%80%91term%20asset%20on%20a>.

56 'Revenue and Customs Brief 9 (2014): Bitcoin and other cryptocurrencies', GOV.UK (2014), https://www.gov.uk/government/publications/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies accessed 15 November 2023.

57 Article 135(1)(d) of the EU VAT Directive.

58 Williams D, 'Value-Added Tax' (*IMF eLibrary*) <https://www.elibrary.imf.org/display/book/9781557755872/ch06.xml> accessed 16 November 2023.

becomes imperative for arriving at accurate conclusions.

The taxation of profits generated from mining Bitcoins is contingent upon the specific details of each case, and such profits may be subject to capital, income, or no tax at all[59]. In the United Kingdom, if individuals hold cryptocurrencies as investments, these holdings are classified as assets and fall under the purview of capital gains taxation. Conversely, companies that fall within the scope of corporation tax will have their profits or losses resulting from currency exchanges, including cryptocurrencies, subject to income tax[60]. Individuals involved in cryptocurrency trading will be obligated to pay income tax on their profits. Furthermore, these tax regulations extend to non-residents engaged in trading activities within the UK through a permanent establishment.

(iii) Taxation of Cryptocurrency in Switzerland

Cryptocurrencies and exchanges are deemed legal in Switzerland, where they have been designated as assets by the Tax administration. This classification subjects them to Swiss wealth tax[61], necessitating their declaration in annual tax returns. Residents of Switzerland are obligated to fulfill their tax obligations, including Income Tax, Profit Tax, and wealth tax, in relation to their cryptocurrency holdings. It is important to note that VAT exemptions extend to cryptocurrency sales in all EU countries, and Switzerland is no exception to this rule[62].

Cryptocurrencies falling under the purview of wealth tax in Switzerland are expressly detailed in the Schedule of Securities and Assets in the Swiss Tax return[63]. Individuals holding these cryptocurrencies are obligated to pay taxes at a predetermined rate established by the competent authority on the final day of the fiscal year, specifically December 31. The applicable rates are determined based on the average value observed across various trading platforms. It is noteworthy that Switzerland refrains from imposing capital gains tax on cryptocurrencies, as movable assets, including cryptocurrencies, enjoy an exemption from such taxation.

The utilization of bitcoins for payment transactions through the blockchain method gives rise to income from movable property. Thus, it becomes necessary for individuals who receive

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[59] Wimmer F, 'UK Crypto Mining Taxes: Complete HMRC Guide [2023]' (*Blockpit*, 12 September 2023) <https://blockpit.io/en/blog/uk-mining-ax/#:~:text=Mining%20rewards%20are%20tax%2Dfree,depending%20on%20the%20income%20range.> accessed 16 November 2023.

[60] 'ibid'.

[61] Stephan E, 'Crypto Tax Switzerland: The Complete 2023 Guide - Accointing' (*Accointing*, 29 May 2023) <https://www.accointing.com/en-CH/blog/crypto-taxes-switzerland> accessed 16 November 2023.

[62] Dewhurst D, 'Switzerland to Exempt Bitcoin from VAT' (*Tax Foundation*, 24 July 2023) <https://taxfoundation.org/blog/switzerland-exempt-bitcoin-vat/> accessed 20 November 2023.

[63] Legge M, 'Crypto Tax Switzerland: 2023 Guide' (*Koinly*, 14 June 2023) <https://koinly.io/guides/switzerland-crypto-tax-guide/> accessed 18 November 2023.

cryptocurrencies as salary or benefits to include them in their salary statement as taxable income. Additionally, the profits generated from mining activities are regarded as income and are subjected to corresponding taxation[64]. In Switzerland, the possession of cryptocurrencies and the realization of capital gains from them must be disclosed in the tax return, accompanied by precise information concerning their value and source[65].

V. Conclusion

The problem at hand is that the Indian Government is unable to develop a proper regime of taxation that suitably addresses cryptocurrency transactions. The statutory provisions are not a bar for tax compliance because, under one head or the other, a windfall is liable to be taxed. However, the problem is not of lack of provisions, but the absence of a proper regulatory mechanism to address this new event in commercial transactions. The government's initiative to impose a uniform tax on cryptocurrency, devoid of a well-defined classification, is poised to create more issues than resolutions.

The absence of a precise classification for cryptocurrency, whether as digital currency, property, security, or income, contributes to a significant level of confusion regarding the regulatory authority, raising questions about whether SEBI is empowered to regulate it or if oversight remains within the purview of the RBI. Additionally, the lack of clarity surrounding the taxation of cryptocurrency acquired as a long-term investment security further compounds the regulatory ambiguity.

The taxation dynamics for cryptocurrency if treated as a stock will be different as taxation typically occurs upon sale rather than purchase. The inherent volatility of the cryptocurrency market introduces an additional layer of complexity, as individuals may sell the cryptocurrency they bought at a loss. According to fundamental principles of taxation, levying taxes on losses contradicts standard practice. The situation is exacerbated by Section 115 BBH of the Income Tax Act (ITA), which not only fails to permit the set-off of any losses but also exacerbates the taxation burden on individuals in the cryptocurrency realm.

It is argued that Bitcoin and its likes are the flag-bearers of a new no-state-interference economic regime or revolutionary laissez-faire policy. India, in contradiction to the laissez-faire economic model, has a policy of stiff bureaucratic control on taxation. The power of the new regime is still unknown and to certain countries, too insignificant to warrant statutory

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[64] Wimmer, supra note 58.

[65] OECD (2020), Taxing Virtual Currencies: An Overview Of Tax Treatments And Emerging Tax Policy Issues, OECD, Paris. www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emergingtax-policy issues.htm.

recognition; it is believed by a few that the cryptocurrency is just one of those economic bubbles that will eventually burst into oblivion. Such an argument falls flat as it is quite evident that modern-day transactions have been made in this sphere and the windfall is not minuscule enough to be ignored.

Further, a threat to global peace is a very imminent threat especially when terrorism and other global ills are reportedly enjoying the absence of regulation to their benefit. Recently in the conflict between Israel and Hamas that shook the middle east various reports points out that the terror group sourced its funding through the cryptocurrency market. The Indian government has been calling on the global countries for a long time to make an effective regulation to deal with the cryptocurrency market and has warned of potential misuse by terrorist organizations and other socio economic offenders. In the G-20 event hosted by India the government of India addressed the need for a global consenus to make laws to regulate cryptocurrency.

The cryptocurrency market cannot be regulated effectively by the action of a single government without a global consenus. The measures to be made can begin through soft laws. International consensus can establish institutions to handle the problem of taxability taking fully into account the economic realities of cryptocurrency transactions; discussions on double-taxation, double-spending, tax avoidance can be settled if there is an internationally accepted regime.

A suggestion to this effect would be to regulate the conversion of fiat currency to cryptocurrency, to license businesses and entities authorized to deal with crypto-currency. To quote the possibility of crypto-crime as a bar to such exercise is weak as fiat currency too has its share of criminal offenders. Further, it is recommended that India undertake the categorization of cryptocurrency within a distinct head of taxation, providing explicit clarity on the respective supervisory and regulatory jurisdictions of both the RBI and SEBI.

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