TAXATION ON VIRTUAL DIGITAL ASSET

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Background:

Virtual Digital Assets ("VDA") refer to any digital representation of value that can be digitally traded, transferred or used for payment. They have many potential benefits and dangers. They have gained tremendous popularity in recent times and the volumes of trading in such digital assets has increased substantially. They have the scope to make payments easier, faster and cheaper, and provide alternative methods for those without access to regular financial products.

The magnitude and frequency of these transactions have made it imperative to provide for a specific tax regime. There were no provisions and regulations governing the taxability of VDAs earlier. With this background a new taxation framework for VDAs was introduced and a new Section 115BBH was inserted in Income Tax Act 1961("the Act") for taxation of VDAs. The provisions relating to VDAs have come into force from April 1, 2022 except provisions for tax withholding which came into force from July 1, 2022.

What does Virtual Digital Asset Means?

Before going into taxation of VDAs let us first understand what does VDA mean or what is included in VDA. As per Section 2(47) of the Act, Virtual Digital Asset means -

1. *Any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically;*

2. *Non-fungible Token (NFT) or any other token of similar nature, by whatever name called;*

3. *Any other digital asset, as the Central Government may, by notification in the Official Gazette specify.*

The government has so far not issued any detailed clarifications or classification regarding what would form part of VDAs. VDAs include crypto currency, NFTs or another virtual digital asset as notified by the Central Govt. It will not cover subscription to any OTT platforms, mobile applications, e-commerce platforms etc. Virtual means "not real" i.e. an asset which cannot be touched or felt and digital means any information or code or number or token generated electronically. VDA refer to any digital representation of value that can be digitally traded, transferred or used for payment.

Central Boar of Direct Taxes (CBDT) has issued two notifications for providing further clarity on VDAs. CBDT vide Notification 74 of 2022 provided exclusions from the definition of VDA:

Gift card or vouchers that may be used to obtain goods or services or a discount on goods or services

Mileage Points, Reward Points or loyalty card that may be used or redeemed only to obtain goods or services or a discount on goods or services.

Subscription to websites or platforms or application

CBDT Notification No. 75 of 2022 provides for exclusion of NFTs from definition of VDA. As per the said notification, *a non-fungible token whose transfer results in the transfer of ownership of the underlying tangible asset, and the transfer of ownership of such underlying asset is legally enforceable*, is carved out from definition of VDA.

Taxability of VDAs prior to 31.03.2022:

Different approaches were adopted by taxpayers for taxation of VDAs depending on character in respective hands of assessee. Income was considered taxable under the head "Income from business and profession" where VDA was held as business commodity or under head "Capital Gains" if held as a capital asset or investment. In case of stray transactions in VDA, the same was taxable as residuary income under the head "Income from other sources".

Taxability of VDAs from 01.04.2022:

Section 115BBH has been inserted with effect from 01.04.2023 i.e. financial year beginning 01.04.2022. As per this section income from transfer of VDAs will be taxed at 30% flat rate.

No deduction of any expenditure (other than cost of acquisition) or allowance or set off of any loss shall be allowed in computing the income under this section. No loss shall be allowed to be set off from transfer of VDAs neither such loss will be eligible for carried forward to succeeding assessment years.

The section has laid down separate system for taxation whereby income from transfer of VDAs shall be taxable at 30%. The tax shall be charged irrespective of fact that income of assessee is below threshold limit or assessee has sustained loss. Further loss from transfer of VDAs is not eligible for set off against any income including income from transfer of VDAs.

Head of Income:

Even though income from taxation of VDAs is governed by Section 115BBH of the Act, government has not clarified regarding the head of income under which income from transfer of VDA will be taxable. Let's understand how the income will be taxable in different heads of income.

Income from Business or Profession

- If the transaction in VDAs are frequent and voluminous and where VDAs are held as stock in trade, it may be held that assessee is engaged in is trading of such assets and income from sale of VDAs will be considered as business income.
- The net income will be taxable @ 30% plus surcharge plus cess.
- Under business head surcharge can be levied up to 37%.

Capital Gains

- VDAs may be classified as income under the head capital gains if purchased by assessee for investment purpose. Once income is classified under capital gains then further classification relating to long term and short term would depend on period of holding.
- If held more than 36 months it will be treated as long term gains and if less than 36 months it will be short term gains.
- The tax will be leavied @ 30% plus surcharge plus cess.
- If it is long term surcharge will be restricted to 15% in case of short term it will be 37%.

IFOS

- In case of stray transaction in VDA, income would be reported under income from other source.
- If a person receives a VDA without consideration (gift) or for inadequate consideration and the value of such benefit exceeds Rs. 50,000, it shall be taxable in the hands of the recipient under Section 56(2)(x) as income from other sources.

Sec 194S: Payment on transfer of VDA (Applicable from 01/07/2022)

Nature of Payment	Payer	Payee	Limit	Rate
Consideration for Transfer of VDA	Any Person	Resident Person	Consideration> Rs 10,000	1% of Consideration
Consideration for Transfer of VDA	Specified Person*	Resident Person	Consideration > Rs 50,000	1% of Consideration

* *Specified Person* means a person being an individual or a HUF, not having any income under Head "Profits & Gains from Business & Profession or having any income under Head "Profits & Gains from Business & Profession" whose previous year Turnover or Gross Receipts does not exceed Rs 1 crore in case of Business and Rs 50 lakhs in case of Profession.

The tax shall be deducted at time of payment by any mode or at the time of credit of such sum to the account of the resident, whichever is earlier. In case of specified persons obtaining of TAN is not mandatory. For other persons, TAN is mandatory.

Below examples will clarify TDS provisions:

Date of Sale or Exchange	Nature of transaction	Consideration	PAN of payee available	Payer is a specified person	TDS	Remarks
01-03-2022	Cash	15,00,000	Yes	No	–	Not applicable on transaction done before 01-04-2022
01-04-2022	Cash	9,000	Yes	–	–	Consideration is less than Rs. 10,000 in a financial year
01-04-2022	Cash	45,000	Yes	Yes	–	Consideration is less than Rs. 50,000 in a financial year
01-04-2022	Cash	10,00,000	Yes	No	10,000	TDS at the rate of 1% of consideration
01-04-2022	Cash	10,00,000	No	No	2,00,000	TDS at the rate of 20% of consideration under Section 206AA
02-04-2022	Car	10,00,000	Yes	Yes	10,000	Before releasing the consideration, the deductor shall ensure that tax has been deducted and paid in respect of such consideration.