

GST ON CRYPTO CURRENCIES- AN OVERVIEW

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Abstract

Introduction of TDS of 1% on consideration paid for purchase of Virtual Digital Assets gives information to the respective authority about a person dealing or holding such assets. Due to this, many people are calling this budget Crypto Budget which gives birth to the Crypto tax. Crypto income was already taxed before Finance Bill, 2022 but there was no clarity on how it should be taxed neither to investor nor to authority. This Crypto Budget provides clarity on taxation of Virtual Digital Assets.

Keywords: GST, Virtual Digital Assets and Crypto currencies.

Introduction

In this era where we see the boom of crypto currency, we thought it pertinent to go into its roots to identify its taxability both under Income Tax Act and the Goods and Service Tax Act. Under this article, we are trying to determine the basic features of crypto currency and its taxability under the goods and services tax act.

In the recent budget tabled before the parliament, taxability is provided under the Income Tax Act. Still, the government has not addressed the issue of taxability under the GST Act.

The crypto world has gone so vast, starting from Funigble tokens, private crypto currency, and NFT. Further, there are exchanges, brokers, bots and metaverse under the virtual world. There are multi-dimensions to this topic. However, the same cannot be summarized in one article itself. Hence, in this article, we are covering only the basics of cryptocurrency and its taxability under the Goods and Services Tax Act.

Objectives of the Study

- To understand the concept of Crypto Currency
- To analyze and contrast existing models and proposed national and international laws on cryptocurrency regulation and governance.
- To study the implications of GST on Crypto Currency

Literature Review

Hileman, Garrick & Rauchs, Michel. (2017)

In their Global Cryptocurrency Benchmarking Study focused on alternative payment systems and digital assets. It examined the burgeoning global cryptocurrency industry and its key constituents, which include exchanges, wallets, payments and mining. The research team collected data from cryptocurrency companies and organisations across 38 countries and five world regions from September 2016 to January 2017. The findings of the study are both striking and thought-provoking. First, the user adoption of various cryptocurrencies has really taken off, with billions in market cap and millions of wallets estimated to have been active in 2016. Second, the cryptocurrency industry is both globalised and localised, with borderless exchange operations, as well as geographically clustered mining activities. Third, the industry is becoming more fluid, as the lines between exchanges and wallets are increasingly blurred and a multitude of cryptocurrencies, not just bitcoin, are now supported by a growing ecosystem, fulfilling an array of functions. Fourth, issues of security and regulatory compliance are likely to remain prevalent for years to come.

Dourado, Eli & Brito, Jerry. (2014)

In their article „Cryptocurrency“ discusses about problems that have plagued digital cash in the past and the technical advance that makes cryptocurrency possible. It discusses about problem of double payment and Byzantine Generals Problem. The study concludes that Cryptocurrency is an impressive technical achievement, but it remains a monetary experiment. Even if cryptocurrencies survive, they may not fully displace fiat currencies.

Yli-Huumo J, Ko D, Choi S, Park S, Smolander K (2016)

In their study where is Current Research on Blockchain Technology? Systematic Review analyses challenges and future directions regarding Blockchain technology from the technical perspective. The results show that focus in over 80% of the papers is on Bitcoin system and less than 20% deals with other Blockchain applications including e.g. smart contracts and licensing. The majority of research is focusing on revealing and improving limitations of Blockchain from privacy and security perspectives, but many of the proposed solutions lack concrete evaluation on their effectiveness. Many other Blockchain scalability related challenges including throughput and latency have been left unstudied.

Chan, Stephen; Chu, Jeffrey, Nadarajah, Saralees and Osterrieder, Joerg (2017)

In their study A Statistical Analysis of Cryptocurrencies‘ analysed statistical properties of the largest cryptocurrencies (determined by market capitalization), of which Bitcoin is the most prominent example. The study characterizes exchange rates of cryptocurrency versus the U.S. Dollar by fitting parametric distributions to them. It is shown that returns are clearly non-normal; however, no single distribution fits well jointly to all the cryptocurrencies analysed. We find that for the most popular currencies, such as Bitcoin and Litecoin, the generalized hyperbolic distribution gives the best fit, while for the smaller cryptocurrencies the normal inverse Gaussian distribution, generalized t distribution, and Laplace distribution give good fits. The results are important for investment and risk management purposes.

Chiu, Jonathan, Koepl, Thorsten. (2017)

In their study The Economics of Cryptocurrencies- Bitcoin and Beyond. Analyses how well can a cryptocurrency serve as a means of payment? The study examines optimal design of cryptocurrencies and assesses quantitatively how well such currencies can support bilateral trade. The challenge for cryptocurrencies is to overcome double-spending by relying on competition to update the blockchain (costly mining) and by delaying settlement. The study estimates that the current Bitcoin scheme generates a large welfare loss of 1.4% of consumption. This welfare loss can be lowered substantially to 0.08% by adopting an optimal design that reduces mining and relies exclusively on money growth rather than transaction fees to finance mining rewards. The study also point out that cryptocurrencies can potentially challenge retail payment systems provided scaling limitations can be addressed.

Foley, Sean and Karlsen, Jonathan R. and Putniņš Talis J (2018)

In their paper ‘Sex, Drugs, and Bitcoin: How Much Illegal Activity Is Financed Through Cryptocurrencies?’ reports that approximately one-quarter of bitcoin users and one-half of bitcoin transactions are associated with illegal activity. Around \$72 billion of illegal activity per year involves bitcoin, which is close to the scale of the US and European markets for illegal drugs. The illegal share of bitcoin activity declines with mainstream interest in bitcoin and with the emergence of more opaque cryptocurrencies. The techniques developed in this paper have applications in cryptocurrency surveillance. Our findings suggest that cryptocurrencies are transforming the way black markets operate by enabling black e-commerce.

Research Methodology

Bearing the nature of the problem in mind, research was conducted to derive the appropriate critical findings and conclusions. The present research focuses on the content analysis of legislation and judicial decisions. It utilises the descriptive technique in conjunction with critical analysis and assessment of court judgments and legislation. During the course of the study, primary sources such

as decisions of the Apex Court of India and abroad, as well as reports of different high-power bodies, are reviewed.

The concept of Crypto Currency

To understand cryptocurrency in simple terms, you can say that it is digital/virtual asset acting like a currency. To make it clearer, let us say Physical Currency, the Indian Rupee is being issued by Central Agency named Reserve Bank of India; you would find that every note contains a unique Serial Number. The same is being certified by the Governor of RBI. An essential feature of any currency is that it cannot be double used. For example, a rupee two thousand note bearing serial number “15462” cannot be used twice, and RBI Confirms the authenticity of the same whether the note is original or counterfeit.

Cryptocurrency has a slightly different version; unlike physical form, it has a digital form. But as we have a central agency such as RBI to regulate the physical INR, this digital currency is managed over decentralized networks based on block chain technology. Records of ownership and transfers are being stored over various digital blocks called distributed ledgers on decentralized servers which are connected to each other like a chain. Hence, there is no possibility of the double use of any currency as all of them are being backed by Distributed ledgers provided by a network of different computers. As the transaction is encrypted and have hash codes, if any manipulation is done with this ledgers, the blocks would not tally with each other; as a result, the whole block would fall out from the chain. Transfers made of these cryptocurrencies are being confirmed by the miners who have the records, i.e. the address from crypto currency originated.

INDIAN HISTORY OF CRYPTO CURRENCY

2013	<ul style="list-style-type: none"> • Bitcoin Begins to trade on multiple exchanges. RBI cautioned citizens on bitcoins
2014-15	<ul style="list-style-type: none"> • Cryptoexchanges formed in India; awareness increased
2017	<ul style="list-style-type: none"> • No regulations in India; • RBI stated that virtual currency is driven by speculation;
2018	<ul style="list-style-type: none"> • Circular issued by RBI to banks to stop providing any services to any Individual or business dealing with or settling digital currency • Crypto token and crypto asset (Banning, control and regulation) Bill, 2018 Tabled for discussion • Petition filed by Internet and Mobile Association of India before SC • In his 2018 Budget speech the FM mentioned that “the Govt. does not consider cryptocurrencies as legal tender or coin and will take all measures to eliminate use of these crypto assets in financing illegitimate activities or as part of payment systems”.
2019	<ul style="list-style-type: none"> • Banning of Cryptocurrency and regulation of Official Digital Currency Bill, 2019 bill tabled
2020	<ul style="list-style-type: none"> • SC set aside RBI circular and held the same as “manifestly arbitrary, based on non-reasonable classification and it imposes disproportionate restrictions” • Allows cryptocurrency trade to be supported by the financial system. • SC stated that Crypto currency are unregulated but not illegal
2021	<ul style="list-style-type: none"> • The Cryptocurrency Regulation of Official Digital Currency Bill, 2021 tabled for discussion
2022	<p>Announcements in Budget 2022 (approved in Lok Sabha):</p> <ul style="list-style-type: none"> • Income tax on transfer of Virtual Digital Asset (VDA) @ 30% • Set-off of losses (same source/other source) –Not allowed • 1% TDS on all crypto transactions • Only cost of acquisition will be allowed as deduction; Expenditure on mining infrastructure not to be treated as cost

GLOBAL TAXATION OF CRYPTO CURRENCY

- OECD has recently issued Crypto-Asset Reporting Framework (CARF) and Amendments to the Common Reporting Standards.
- The OECD is now seeking public comments on the proposals by April 29, 2022.
- This framework shall be of use when tax authorities exchange data with respect to crypto transactions. Thus, the same shall increase global tax transparency in the domain.

EL SALVADOR	El Salvador became first country to accept Bitcoin as Legal Tender in June 2021
CUBA	Resolution to recognize and regulated Cryptocurrencies such as Bitcoin in August 2021
CHINA	The government of China, the single largest market for cryptocurrency, declared all cryptocurrency transactions illegal in September 2021
USA	Cryptocurrency is a capital asset □taxable between 0% to 37%
UK	All cryptocurrency firms, that have direct / indirect services within the UK market must register with the Financial Conduct authority.
SA	Many scams related to cryptocurrency have taken place Putting a regulatory timeline in place, that will produce a regulatory framework
CANADA	Cryptocurrency treated as commodity; Income tax or capital gains tax applicable
AUSTRALIA	Cryptocurrency is treated as an asset and attracts capital gains tax/ income tax
NETHERLANDS	Wealth tax levied
GERMANY	Treats cryptocurrency as private asset. Tax is only levied if it is sold within the same year as it was bought
SWITZERLAND	Crypto currency is treated as an asset.
OTHERS	Complete Ban –Nepal, Pakistan, Egypt etc. Implicit Ban –China, Bahrain, KSA, Qatar etc.

Is it legal to use cryptocurrency? Is crypto a viable alternative to fiat money?

People have a lot of questions about whether cryptocurrency is legal in India. Now the answer to this question is, as of now, cryptocurrency is not illegal in India. But we also need to acknowledge that there is no legislation over it yet as of the date. We can expect that some or the other legislation will come down soon. The second part of the question is whether crypto currency is a substitute for physical currency, i.e. whether it is a legal tender as of the date. The answer is **no** cryptocurrency is not a legal tender to accept payments. Currency notes have a fundamental element of a promissory note, which is missing in the case of cryptocurrency as they are not promissory notes. Further, the basis of printing currency notes is based on something such as the nation’s wealth, which is not the case in the case of cryptocurrency. That means you cannot go and buy a refrigerator and tell him to accept payments in the form of bitcoins. Yes, it is also true in India that Cryptocurrency is not a legal tender for making payments, and this is true for almost all the countries in the world.

There are various types of cryptocurrencies in the market. It is estimated that more than 2000 types of cypto currencies are trading in the market. Few of the currencies values are being linked to a particular kind of asset. For example, the value of the USD Tether (Poplularly known as USDT) is linked to the value of USD. There are few other tokens whose value is linked with the GOLD prices. Hence, these kinds of currencies are called fiat currencies.

Are there any underlying assets in cryptocurrency?

You would see currently that numerous technological projects are going on in the market, and many start-ups have used this route to raise funds under the name of crowd funding. The question would remain in the mind that when you acquire this crypocurrency do you acquire any rights over the asset

of the project or something. Sadly the answer is negative. You do not hold any rights over the company or project when you buy this kind of token in the primary or secondary markets.

GST on Cryptocurrencies

Why can't cryptocurrencies be classified as securities and so exempt from GST?

Let us examine how securities are being defined in the act. As per section 2(101) of the Central goods and services tax act, 2017, securities are "securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956). It is a well-known fact that cryptocurrencies are not covered under any act, so the question of getting covered under the securities contracts (Regulation) Act, 1956 is out of context. Hence, cryptocurrency cannot be classified as securities.

What position does it take on GST, whether it pertains to goods or services?

As per section 2(52) of the Central Goods and Service Tax Act, Goods are being defined as follows:- "goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;

If we carefully go through the definition of goods, we can find out that cryptocurrency is not a movable property; it is not even an actionable claim. Hence, we cannot classify the same as goods.

Section 2(102) of the Central Goods and Service Tax Act defines service as follows:- "services" means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.

Explanation: For the removal of doubts, it is hereby clarified that the expression "services" includes facilitating or arranging transactions in securities; The services' definition explicitly states that whatever is not goods is a service, so cryptocurrencies should be classified as services.

Another viewpoint is that cryptocurrencies should be viewed as goods, similar to off-the-shelf software. Is that possible?

In the FAQ published for IT/ITES it was mentioned that "if a pre-developed or pre-designed software is supplied in any medium/storage (commonly bought off-the-shelf) or made available through the use of encryption keys, the same is treated as a supply of goods classifiable under heading 8523"

As per the Section 65 (53a) of the erstwhile Finance Act, Information Technology Software is being defined as follows:-

"Information technology software" means any representation of instruction, data, sound or image, including source code and object code, recorded in a machine-readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment"

If we refer to the cryptocurrency, both are not given to us if we buy the token source code and object code. Further, cryptocurrencies cannot be manipulated or provide interactivity to a user, and they are merely capable of exchanging or transferring from one virtual address to another virtual address.

Cryptocurrency also cannot be compared to off the shelf software because of the fundamental reason that the off-the-shelf software is a complete product. On the other hand, you would find that the cryptocurrencies are being mined. You cannot say that software is being mined. Any cryptocurrency is a kind of digital asset which cannot amount to software.

Hence, cryptocurrencies are incomparable to software.

What's the big deal about whether it's a service or a product?

Yes, there is a lot of discussion about whether cryptocurrency is a service or a good because under GST points of taxation are different for services and goods. There is also a different basic exemption limit being assigned both to the goods and services. Further taxation under the reverse charge mechanism is different under goods and services, and hence, this would make a lot of difference.

Conclusion

Introduction of a scheme of taxation of virtual digital assets is a welcome move for the crypto world. A crypto taxation framework will bring clarity and boost investments in cryptocurrency. We need to understand that this income is considered as speculative income by the Government. Hence, they are taxing it in a manner similar to lottery income i.e., at the 31.2% rate. Still, certain developments needed to remove ambiguity for banks so that they can provide financial services to the crypto industry. The government is likely to introduce legislation on cryptocurrencies which provides the required framework on regulating cryptocurrencies and its usages. The Finance Bill, 2022 states that if any difficulties arise in the practical adaptability of Section 194S, the Central Board of Direct Taxes (CBDT) will issue guidelines/clarifications to ameliorate the situation. Along with this, the government also needs to clarify the treatment of crypto and its income from the GST perspective.

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