

Virtual Digital Assets under Direct Taxation

Until recently, when referring to an asset, we focused primarily on fixed assets, current assets and investments. With technological advancement, a new category of assets known as digital assets has emerged. These assets, which have the ability to generate revenue, are referred to as Digital Virtual Assets. They can be stored in digital format, are uniquely identifiable and can hold value, such as documents, audio files, videos, logos, spreadsheets, slide presentations, websites, cryptocurrencies, tokens, NFTs, stablecoins, central bank digital currencies and digital bonds. Like fixed and current assets, they also have the potential to yield economic benefits.



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INTRODUCTION

The term 'Asset' is a resource having economic value and the same may be owned by an individual, entity, or country. Assets are classified based on (i) convertibility, (ii) physical existence, and (iii) usage. These are discussed as under:

- (i) **Convertibility:** Based on easy convertibility into cash, assets are classified into fixed or current assets. Fixed assets or non-current assets cannot be readily converted into cash or cash equivalents. Assets are also termed as long-term assets i.e. land, building, machinery, patent, trade mark. On the other hand, Current Assets are easily converted into cash and cash equivalent. Current Assets are also termed liquid assets. i.e. cash, cash equivalent, short-term deposits, inventory, and office supplies.
- (ii) **Physical Existence:** Classifying assets, based on physical existence, divide assets into tangible and intangible. Tangible assets are those having physical existence i.e. land, building, machinery, cash, inventory, equipments, office supplies. Intangible assets do not have physical existence i.e. goodwill, patents, brands, copyright, trademarks, licenses, and permits.
- (iii) **Usage:** Based on usage in business, assets are classified into operating and non-operating. Operating assets are required in the daily operation of business. Usage of assets generate revenue i.e. cash, inventory, account receivables, building, patents, and copyright. Non-operating assets are not required for daily business operations, but they generate revenue i.e. short-term investment marketable securities, vacant land, and interest income from a fixed deposit.

EMERGENCE OF DIGITAL ASSETS WITH THE APPLICATION OF TECHNOLOGY

Until recently, by an asset, we meant fixed assets, current assets, and investments. With the advancement of technology, a class of assets have emerged under the term, digital assets. Such assets, capable of generating revenue, came to be termed as Digital Virtual Assets. The assets can be stored digitally and are uniquely identifiable and can realize value i.e. documents, audios, videos, logos, spread sheets, slide presentations, websites, cryptocurrencies, tokens, NFT, stable coins, central bank digital currencies, digital bonds and like fixed and current assets possess the potential to produce economic benefits. A 'digital asset' should:

- (i) be a digital file owned by an individual or company,
- (ii) be of value (economic benefit) to the individual or company, and
- (iii) be searchable, discoverable, and available for use.

The definition of a digital asset is subject to change with technology. As digital file formats are being invented, they are being added to the list.

DIGITAL ASSETS DISTINGUISHED FROM OTHER FILES

Digital asset is represented in digital form having intrinsic or acquired value. Virtual Digital Assets (VDA) are subsets of all digital assets transacted on a blockchain, such as non-fungible tokens (NFTs), cryptocurrencies and other virtual assets. Ordinarily it means cryptocurrencies, decentralised finance and non-fungible tokens (NFTs). The list is symbolic and is not exhaustive. Cryptocurrencies gained momentum world-wide, and India was no exception. The Central Government cleared grounds for taxation of VDAs. The Union Budget for 2022-23 presented on 1st February 2022 included provision for taxation of VDAs. It included cryptocurrencies and non-fungible tokens ('NFTs'). The definition of Virtual Digital Assets was inserted vide Clause (47A) in Section 2 of the Income Tax Act, 1961 ('the Act'). As per the Act, features of VDA include:

- (a) Information code, number or token generated through cryptographic means. Cryptography is the study of secure communication techniques that allow only sender and intended recipient of a message to view its contents;
- (b) a non-fungible token or any other token of similar nature, by whatever name called, NFT is said to mean such digital asset as the Central Government may by notification in the Official Gazette specify. Notification No. 75/2022 dated 30/6/2022 specifies a token that is a VDA as a non-fungible token within the meaning of Section 2(47A) of the Act but excludes non-fungible token whose transfer results in transfer of ownership of such underlying tangible asset that is legally enforceable; and
- (c) any other digital asset as the Central Government may by notification in the Official Gazette specify.

ASSETS NOT INCLUDED UNDER VDA

- (i) Indian Currency
- (ii) Foreign Currency
- (iii) Central Government may by notification in the Official Gazette exclude any digital asset from the definition of VDA subject to such conditions as may be stated.
- (iv) Pursuant to Notification No. 75/2022 dated 30/6/2022 it does not include an NFT the transfer of which results in the transfer of ownership of underlying tangible asset, legally enforceable.
- (v) Pursuant to Notification No.74/2022 dated 30/6/2022 the Central Government notified that the following VDAs will not be included in the definition of VDA:
 - (a) gift card or vouchers, being a record that may be used to obtain goods or services or a discount on goods or services, and
 - (b) mileage points, reward points, or loyalty card, being a record given without direct monetary consideration under an award, reward, benefit, loyalty, incentive rebate, or promotional program that may be used or redeemed only to obtain goods or services or a discount on goods or services,
 - (c) subscription to websites or platforms or applications.

Digital Asset is represented in a digital form having intrinsic or acquired value. Virtual Digital Assets (VDAs) are subsets of all digital assets transacted on a Blockchain, such as Non-Fungible Tokens (NFTs), Cryptocurrencies and other virtual assets.

outside the ambit of currency. VDAs include NFTs being cryptographic assets on a blockchain with unique identification codes and metadata that distinguished from others. NFTs represent property rights and other rights of individuals.

CRYPTOCURRENCY

Cryptocurrencies exist digitally and they have no regulating authority. A decentralized system is used to record transactions to manage new units which depends on cryptography to prevent counterfeiting and fraudulent transactions. Cryptocurrencies are not controlled by the Government or any authority. Cryptocurrency is not a part of the banking system with different brands or types and prominent among them is Bitcoin.

TAXATION OF VDAs TILL 31ST MARCH 2022

Till 31st March 2022, VDAs held, traded, and exchanged were taxed as income defined in Section 2 (24) of the Act which includes all sorts of income. The Act taxes all incomes including illegal income. Income from VDA attracted benefits under Sections 54 and 54EC.

TAXABILITY OF VDAs FROM 1ST APRIL 2022

The Finance Act, 2022 effective 1/4/2023 (Financial Year 2022 to 2023) came to deal with VDAs and its taxation. Section 2(47A) was inserted in the Act to define VDA. Further, the inserted new Section 115BBH provides for taxation on income for transfer of VDAs at a flat rate of 30 percent. Section 2(47A) of the Act defines VDAs to mean 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.

VDA has been inserted in the definition of 'property' for taxation of deemed income under Section 56(2)(x) which provides for taxation of Gift of VDA in the hands of the recipient. Under Section 194S, TDS is deductible on transfer of VDA at the rate of 1 percent above a monetary threshold.

METHOD OF COMPUTATION AND TAX APPLICABLE ON VDA

Section 115BBH provides for computation of tax on VDA at the flat rate of 30 percent. No other provision of the Act is made applicable while determining 30 percent on the value of transfer. Taxation will be applicable on the fulfillment of the following conditions:

VDAs AND DIGITAL CURRENCY

Currency is issued only by the Central Bank of countries i.e. inter *alia* includes Rupee, Dollar, Pound and Yen. VDAs are not issued by the Central Bank of countries

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- i) There shall be a transfer of a VDA held as capital asset or not.
- ii) Cost of acquisition will be allowed as deduction. None other deduction to be allowed towards expenditure or allowance.
- iii) No set-off of any loss under any provision of the Act will be allowed in computation of such income.
- iv) Tax on income from transfer of such VDA shall be calculated at the rate of 30 percent.
- v) Any loss on transfer of VDA shall not be allowed to be set-off against income computed under any provision of the Act and such loss shall not be allowed to be carried forward to succeeding assessment years.

TRANSFER OF VDA: APPLICATION OF SECTION 2 (47) OF THE ACT

Section 115BBH(3) of the Act states that 'transfer' of VDA attracts Section 2 (47) of the Act whether it is a capital asset or not. The term defines transfer from one person to another. The following transactions fall within the ambit of transfer:

- (a) Sale, (b) Exchange, (c) Relinquishment, (d) Extinguishment of any right therein, (e) Compulsory acquisition, and (f) Conversion of investment/capital asset into stock-in-trade.

Transactions not falling within Section 47 of the Act will not be taxed under Section 115BBH of the Act:

- (a) Distribution on the total or partial partition of a HUF.
- (b) Transfer under a gift or will or any irrevocable trust.
- (c) Transfer by a company to its subsidiary company or vice versa (subject to conditions).
- (d) Transfers under restructuring schemes (subject to conditions),
- (e) Transfers on conversion of firm/sole proprietor to a company or company to a LLP (subject to conditions).

Further, Section 46 of the Act provides that distribution of assets of companies in liquidation to its shareholders, does not fall under transfer, by a company.

Section 47 (iii) of the Act provides that gift of any capital asset is not regarded as transfer. Therefore, gift of VDA is not considered a transfer and would be exempt from tax in the hands of the donor.

TAXATION ON VDA ACQUIRED AS CAPITAL ASSET AND CONVERTED AS STOCK IN TRADE

VDA acquired as investment/capital assets and subsequently, converted into stock in trade shall be



deemed that the VDA is transferred during the previous year when the conversion took place. Further, the fair market value (FMV) of the VDA, on the date of conversion or treatment is deemed to be the receipt of the full value or accrual as a result of transfer of the VDA. However, the liability to pay tax arises in the previous year in which such stock-in-trade is sold or otherwise transferred [Section 45(2)].

Similarly, VDAs held as inventory and converted into capital assets, the FMV, as on the date of conversion shall be taxable as business income under Section 28 (iva) of the Act. The FMV of the inventory converted shall be the price, it would ordinarily fetch, on sale in the open market, on the date of conversion.

TAXABILITY OF VDAs TRANSFERRED NOT AT ITS FMV

Section 115BBH does not provide the method of computation of FMV. CBDT is also not empowered to state the method of such conversion. Under Section 50C of the Act, the special provision for full value of consideration in certain cases can be applied. Section 50CA especially provides for full value of consideration for transfer of shares other than quoted shares.

TRANSFER OF VDA BY WAY OF EXCHANGE WITH ANOTHER CAPITAL ASSET OR IN KIND

Section 50D provides that FMV is deemed to be the full value of consideration received or accrued on the transfer of a capital asset by an assessee where the consideration cannot be determined. For the purpose of computing income chargeable to tax as capital gains, the FMV of the said asset on the date of transfer shall be deemed to be the full value of the consideration received or accruing on such transfer. Accordingly, transfer of VDA by way of exchange with capital asset, the FMV of the asset shall be deemed to be the full value of consideration. There may be practical difficulties in determining the FMV of VDA's due to high fluctuation

in its value and moreover, exchange platforms may have different prices for the same virtual currency, at a point of time.

COST OF ACQUISITION OF VDA

For the computation of capital gains or business income from transfer of VDA no expenses is deducted to determine cost of acquisition. The following shall be ignored for computing income for transfer of VDA:

- (a) Expenditure incurred in connection with the transfer of VDA.
- (b) Cost of improvement relating to VDA.
- (c) Exemption under Section 54F of the Act.
- (d) Depreciation.
- (e) Other expenses.

COST OF ACQUISITION OF MULTIPLE BUY AND SALE TRANSACTIONS

Section 115BBH does not lay down guidance on how buy and sale transactions shall be correlated in case a person regularly buys and sells VDAs. There are two possible views:

- (i) **Follow FIFO Method:** As per Circular No. 768 dated June 24, 1998 issued by CBDT, FIFO method should be used to determine the period of holding of securities held in demat form (akin to the digital form VDAs are held).
- (ii) **Fellow Weighted Average Method:** In the absence of specific provisions, in Section 115BBH or clarification from CBDTs for VDAs.

Apparently, the net income or loss from transfer of VDAs will be the same in either case, while the selection of the method makes a difference as losses from transfer of one VDA cannot be set-off against income from transfer of another VDA.

NO INDEXATION BENEFITS IRRESPECTIVE OF HOLDING PERIOD

Indexation of cost of acquisition of VDA shall not be allowed, irrespective of the holding period.

CLASSIFICATION OF INCOME FROM TRANSFER OF VDA: HEAD OF INCOME

Generally, income of traders of cryptocurrencies would be taxable under the head Profit and Gains of Business or Profession. The income of investors would be taxable under the head Capital Gains.

Rate of tax on VDA under either head of income is the same. Classification is essential for computation of interest under Section 234C of the Act. If there is shortfall

in payment of advance tax on understating or failure to estimate the accrual of capital gains, such shortfall, is ignored in computing interest under Section 234C of the Act.

REBATE UNDER SECTION 87A OF THE ACT

Rebate under Section 87A of the Act is allowed to any resident individual unless prohibited. Section 115BBH does not prohibit such rebate. It is neither a deduction nor allowance, accordingly, will be allowed to a resident individual.

INCOME OF A NON-RESIDENT FROM TRANSFER OF VDAs TO A RESIDENT IN INDIA

As per Section 5(2), a non-resident is chargeable to tax in India, in respect of income as follows:

- (a) Received or deemed to be received in India; and Income which accrues or arises or is deemed to accrue or arise in India.

Section 9 (1) (1) of the Act provides that any income inter-alia arising due to transfer of capital asset in India shall be deemed to accrue or arise in India and hence taxable. To determine whether the income has arisen to a non-resident on transfer of VDA, the Act does not provide any guidance. Capital assets fall in the category of intangible assets, therefore, reference is to be made to judicial precedents.

CONCLUSION

In the Income Tax Bill, 2025, it is observed that there is no change in the definition of VDAs. The definition given in the Finance Bill, 2025, remains the same. The Finance Bill, 2025 has expanded the definition of VDAs to include any code, number, or token generated cryptographically and provide a digital representation of value exchanged. VDAs are expected to make further inroads into the Indian economy.

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