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EVOLVING TAXATION OF VIRTUAL DIGITAL ASSETS IN INDIA: INCOME TAX, GST, AND EMERGING CHALLENGES

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ABSTRACT

The extremely high increase in virtual digital assets (Herein after referred as VDAs), cryptocurrency and non-fungible tokens (NFTs), has posed new challenges to taxation systems across the globe. The legislative reaction started with a flat 30-cent tax on the income from transfer of VDAs under section 115BBH of the Income Tax Act², 1961, with a 1 cent Tax Deducted at Source (TDS) on transaction under section 194S of the Act³. This framework that was later reiterated by the Finance Act, 2025, is intended to control an otherwise non-transparent market and also secure revenue collection.

The attitude of India to the taxation of VDA is critically discussed in this paper with references to the three dimensions. The first one is that it will assess how effective the existing framework is in striking a balance between investor confidence and regulating the structure. Second, it examines the uncertainties of the Goods and Services Tax (GST) extension to digital currency transactions because it is the field where the debate on classification is not completely resolved yet. Third, it evaluates the new risks of the new activities like mining, staking, and Initial Coin Offerings (ICOs) and examines ways in which India can be in line with the international best practices. Through both doctrinal and comparative analysis, this research paper identifies the most significant gaps in policies and suggests a balanced approach that would ensure financial interests are achieved without innovation being stifled.

Keywords: Taxation, Virtual digital assets, GST, Initial Coin Offerings, India, digital currency transactions.

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² The Income Tax Act, 1961, §115BBH, Acts of Parliament, 1961(India).

³ The Income Tax Act, 1961, §194S, Acts of Parliament, 1961(India).

INTRODUCTION

Over the past decade, a significant shift has been observed in the global financial landscape with the emergence of blockchain-related technologies. In 2009, a mysterious cryptocurrency developer called Satoshi Nakamoto created Bitcoin, which has since evolved into a huge global industry worth trillions of dollars, including cryptocurrencies, non-fungible tokens, decentralized finance (DiFi), and tokenized assets. Although this would be considered a very careful approach by India, it has emerged as the biggest VDA market in the entire world, and according to estimates, tens of millions of traders in the country invest in the issue of digital currencies.

However, this quick rise has left the regulators with a few challenges. Unlike other kinds of assets, VDA's are not supported by the physical assets or the issuer's state. They are the virtual forms of representation that are encrypted and traded online in markets with no regulations, covering different countries. The oblivion of transactions, high price turns and the threat of speculative bubbles and all of these raise concerns about money laundering, protecting investors and tax evasion. It is no shock that the administration throughout is struggling with a very simple or basic question: how should digital assets be taxed?

The direction the policy of India shows a slow yet conclusive shift of the trend to taxation and not prohibition. First, the Reserve Bank of India (RBI) tried to limit the crypto activity by preventing the service provision by banks to exchanges, which was subsequently declared invalid by the Supreme Court in *Internet and Mobile Association of India v. RBI*⁴(2020). Under the Finance Act, 2022⁵, the government has rejected the possibility of uncertainty in prohibition and created a taxation regime to be provided under the Income Tax Act, 1961. Section 115BBH⁶ taxed income on VDAs at a flat 30 % and Section 194S⁷ taxed deals over specific limits at 1 %. Moreover, VDAs also gained a legal definition in Section 2(47A) of the Act,⁸ which includes cryptocurrencies, NFTs and other notified digital assets.

Although this has improved, there are still big criticisms. This equates to paying taxes at 30 percent reflected as one would pay on any gambling or lottery profits, implying that crypto

⁴ *Internet and Mobile Association of India v. RBI* (2020), MANU/SC/0264/2020.

⁵ The Finance Act, 2022, Acts of Parliament, 2022(India).

⁶ The Income Tax Act, 1961, §115BBH, Acts of Parliament, 1961(India).

⁷ The Income Tax Act, 1961, §194S, Acts of Parliament, 1961(India).

⁸ The Income Tax Act, 1961, §2, cl.47A, Acts of Parliament, 1961(India).

gains are being considered as speculative instead of a legitimate investment income. Set-off of losses, whether among various VDA or between other head of income, is not permitted thus deterring active participation of the market. There is also an increase in compliance burdens, and exchanges and individuals have multifaceted obligations under Section 194S. Additionally, there are also doubts regarding indirect taxation, whether cryptocurrency swaps ought to be levied with GST, and whether in this case they should be subject to goods, services, or sui generis taxation of digital assets.

India has a framework that looks extremely strict in the global area. Some jurisdictions, including the United States, treat cryptocurrencies as property, which is subject to capital gains tax, and Singapore does not. The European Union is on the path to harmonized regulation with the framework Markets in Crypto Assets (MiCA). The flat-rate regime in India, although it allocated fiscal revenue, may lead to innovation going from the country.

The paper will be a critical analysis of the Indian taxation regime on VDAs guided by three questions. The former discusses how the existing framework, especially the flat 30% tax system plus the 1% tax system on transaction side, will solve the specificities of cryptocurrency transactions. The second explores how difficult the implementation of GST to crypto is, which is a field where the issues of classification cannot be snowballed. The third looks at the way India should control and tax new ventures such as mining and ICOs between innovation and fiscal prudence.

The research seeks to add to the current discussion on how to formulate an effective, fair, and at the same time, innovative taxation regime by putting the tax regime of India in the context of domestic and global policy-making.

ANALYTICAL SECTION CHAPTER-1

EFFECTIVENESS OF THE CURRENT TAX FRAMEWORK ON VDAS IN INDIA

1.1 The Legislative Provisions: Section 115BBH and Section 194S

Taxation of virtual digital assets in India is focused on two main statutory provisions introduced by the Finance Act, 2022.

- **Section 115BBH of the Income Tax Act⁹, 1961:** This section levies a flat thirty

⁹ The Income Tax Act, 1961, §115BBH, Acts of Parliament, 1961(India).

percent tax on income by any transfer of a VDA. This section outrightly rejects any deductions of expenditures except for the acquisition cost and prohibits the set-off or losses from carry forward.

In practical words, it can be said that this proviso creates a “ring-fenced” regime where the profits from VDA are taxed in isolation from all other kinds of income.

- **Section 194S¹⁰** - this provision of the income tax Act requires a mandate of one percent TDS (tax deducted at source) on payment of consideration for the transfer of VDAs when it exceeds the value of rupees ten thousand in a fiscal year (₹50,000 in the case of specified individuals or HUF). This ensures transaction-phase monitoring and reporting.

The objectives of the government’s concerning these provisions are:

- (a) Acquire revenue from a booming but opaque sector and
- (b) Institute a compliance mechanism for transactions that are else anonymous.

1.2 Rationale for the tax imposed under these provisions:

The thirty per cent rate for tax under Section 115BBH of the Act shows the historical conduct rendered to winnings from game shows, lotteries and races such as horse racing. The underlying message is that the profits from VDAs are seen as risky and could also cause instability.

From the point of revenue, this approach can be seen as attractive as it prevents the tax base from being eroded by too many deductions or unused losses being carried forward, while making sure there’s a constant flow of money from an unpredictable industry. The approach of the government shows that they are cautious as they only allow VDA as an option for investment but not as a regular part of the financial structure.

Nevertheless, this is too punitive. Unlike lotteries, VDAs are not just a game of chance since they are rather investment tools that have true application in the real world. Considering them as gambling tools can damage the investor's trust and make people less likely to hold this kind of investment, ultimately. In addition, the restriction on loss set-off leads to the situation where the gains are taxed, but the losses are counted at zero, contrary to the concern of the horizontal equity of taxation.

¹⁰ The Income Tax Act, 1961, §194S, Acts of Parliament, 1961(India).

1.3 Effectiveness of the current tax framework on VDAs in India

The initiation of Section 194S has fetched a one per cent TDS on all transfers of VDAs. In trades concerning exchanges, the transaction is generally on the side of the exchange, but in OTC trades, the buyer has to pay tax. Under the instance of replacing VDAs with each other, both parties may be liable, except that the exchange is through a contractual arrangement. Though the provision was meant to be a tracking tool, in reality, it causes a lot of compliance burdens.

For active traders, repeated deductions lower liquidity. A trader who rotates ₹1,00,000 across ten trades in a day ends up losing 10% of their capital to TDS, even if their overall profits are small. This problem gets worse when payments are made in kind: exchanges have to sell part of the crypto each day to convert it into fiat currency for TDS, which adds extra costs and makes operations more complicated.

The effect was instant on the domestic VDA market of India. The reports in 2022 show the decline in trading volumes on crypto exchanges in India like WazirX and CoinDCX after the enforcement of Section 194S on July 1, 2022. These have experienced volume declines of over 70% after this implementation, leading to a wide market volume decrease.¹¹ Global economic slowdowns have also been responsible, but the situation in India including a flat tax of 30 per cent under Section 115BBH, and an inflexible 1 per cent TDS figure has been identified as a key cause of flights out of the country. Many investors shifted their money to other foreign platforms where tax regulations are not as strictly applied, which contradicts the attempts by the government to make the system more transparent and move more operations into the formal domain.

From the view of the regulatory perspective, the statutory framework has had diverse consequences. On one side, the law gives legal status to VDAs via Section 2(47A), makes it strong and clear on how they are taxed, helps generate more revenue, and progresses how transactions are pursued. On the other side, strict rules like high tax rates, not permitting loss adjustments and taking taxes through TDS discourage people from joining the regulated system. This creates a problem; while the law brings in money quickly, it may damage the local

¹¹ Wazirx: Wazirx says crypto trading volumes fell 76% from Jan to Nov The Economic Times, <https://economictimes.indiatimes.com/tech/technology/wazirx-says-crypto-trading-volumes-fell-76-from-jan-to-nov/articleshow/96342670.cms?from=mdr>.

industry over time.

The comparative look points to the divergence of India:

- Crypto is taxed in the US as a capital gains type of property, and the allowance on loss set-off¹².
- The United Kingdom has capital gains tax, which is exempted on small investors.¹³ Singapore has no exemption on long term holdings but taxes on business activity.
- There is no capital gains tax in Singapore, benefitting VDAs' investors to enjoy. Keeping cryptocurrency as an investment and not trading it often or participating in structured trading activities, the profits are usually not taxed. Holding it for a long time or buying and selling it occasionally for personal reasons also does not result in tax liability.¹⁴
- The European Union is pursuing the goal of homogenous regulation through MiCA (“The Markets in Crypto-Assets Regulation”) and focuses on its regulation but not on punitive taxes¹⁵.

It is on this background that the Indian direction appears to be in a quite distinct treatment of VDAs, similar to taxation on gambling winnings, as the same and does not allow for simple tax reliefs that would otherwise be available to other forms of assets.

Certain areas might require additional consideration to be made so as to be clear and allow easier compliance. These are the possibility of converting losses across VDAs to offset each other, the rate of 1% TDS might be redefined and adjusted in value so that the monitoring of thousands of transactions and the liquidity can be equalized, and how to differentiate between long-term investment and short-term trading. Further clarification to certain tasks could also be helpful to airdrops, staking, and mining, the taxation of which has not been covered in all aspects.

¹² Crypto taxes USA: September 2025 guide | Koinly, <https://koinly.io/guides/crypto-taxes/> (last visited Sep 15, 2025)

¹³ Capital gains tax in the United Kingdom Wikipedia, https://en.wikipedia.org/wiki/Capital_gains_tax_in_the_United_Kingdom#:~:text=capital%20gains%20made,-,Exemptions%20and%20allowances,holdings%20in%20ISAs%20or%20gilts. (last visited Sep 15, 2025)

¹⁴ Crypto tax in Singapore (2025 guide): What every investor and trader needs to know Gemini, <https://www.gemini.com/cryptopedia/crypto-tax-singapore> (last visited Sep 15, 2025)

¹⁵ Markets in crypto-assets Wikipedia, https://en.wikipedia.org/wiki/Markets_in_Crypto-Assets (last visited Sep 15, 2025)

Overall, the taxation framework, which is established based on the provisions of Sections 115BBH and 194S, is a giant step towards the legalisation of VDAs in the tax system of India. It offers insights on the way such transactions would be taxed and offers methods of tracking them. At the same time, certain issues of implementation and scope are probably in need of a revision to facilitate efficient revenue collection as well as to facilitate compliance.

CHAPTER-2

GST AMBIGUITIES IN VDA TRANSACTIONS IN INDIA

2.1 Classification and Applicability of GST

The definition for virtual digital assets has not yet been provided under the goods and service tax (hereafter referred to as GST) framework. These have normally been treated as goods for the purpose of GST since these assets does not come within the meaning of money or securities provided under the statute. Under the HSN code 960899(other miscellaneous articles) tentatively¹⁶, VDA transactions are currently taxed at 18%, based on the interpretation given above. The same rate has been applied concerning fees charged by the exchanges for services like withdrawals and trading.

The importance of the classification is clear when talking about how GST is applied and levied. If VDAs are treated as goods, the GST will apply to their supply. However, if they are considered as services, the framework around where the supply happens and the way of determination of value could change a lot. Because of the fact that VDAs are a different entity of operation, the fact that they are not subject to any particular legal grouping has brought about ambiguity. An elaborate categorization would help in improving conflicting behaviour and having a stable manner of treatment across platforms and tax authorities.

2.2 Compliance Obligations and Market Practices

The way the cryptocurrency services are to be dealt with under GST has been both structure-giving and challenge giving into the system. On the favorable scale, online transactions alongside service companies, regardless of the foundation in India or other countries are generally regarded as Online Information and Database Access or Retrieval (OIDAR) services. This implies that they must subscribe to GST and abide by the provisions. That assists the VDA platforms in the importation of the analogous regulatory framework as those of

¹⁶ GST on supply of crypto or Digital assets cleartax, <https://cleartax.in/s/gst-on-supply-of-crypto-digital-assets> .

other digital ventures, which increase transparency and accountability. GST levied or charged on the well- defined services such as withdrawal fees, trading fees and conversion commission ensures that tax is charged or levied on the same as opposed to a frequently changing value of the underlying asset. This aids in the keeping in line with GST.

Another benefit is the ability to claim ITC (Input Tax Credit) for businesses. ITC may be availed to crypto companies on the cost of consultancy, exchange software or mining inputs provided these are applied to business purposes. This reduces their tax liabilities and they end up doing what the other industries are doing. Compliance with such rules as issuing of full invoices, regular filing of GST returns and maintaining detailed documentation of each and every transaction also leaves a clear structured trail. This is useful to the tax authorities and in an audit.

2.3 Unresolved issues and the need for clarity:

Regardless of the progress in the application of GST to the virtual digital assets, a few important areas remain unsettled. The significant example of this is the “crypto-to-crypto swaps”: these depict barter transactions, but the framework concerning GST does not yet propose valuation methods for exchanges such. Uncertainty is also seen with respect to airdrops and staking rewards, since they can be regarded as gratuitous transfers or as service consideration. With no clear statutory requirements, taxpayers and authorities have a risk of variable approaches.

The significance to address these issues is seen in the trends of implementation. Central GST formations registered tax evasion amounting to 81.54 crores by 11 cryptocurrency exchanges with penalties also amounting to nearly 95.86 crores being recovered. The deals covered a number of the top Indian exchanges like CoinDCX, CoinSwitch Kuber, and WazirX.¹⁷ This shows that compliance issues are not phantom but are already in reality being effected.

Indirect tax and uncertainty of compliance also emerges as market behaviour emphasizes. Trading volumes on domestic exchanges dropped dramatically after the introduction of the 2022 VDA tax regime in India, which accumulated both direct and indirect tax requirements. One analysis itself estimated that 32000 crore in the volume of trade was transferred offshore during the period between February and October 2022 and 17 lakh users also transferred to

¹⁷ 11 crypto exchanges probed for tax evasion: Minister The Hindu, <https://www.thehindu.com/business/11-crypto-exchanges-probed-for-tax-evasion-minister/article65268039.ece>.

foreign exchanges. At the same time, the transactions within the country turned by as much as 81% in domestic exchange volumes¹⁸. The trade within the nation recorded a drop of up to 81% in the exchange volumes of the same period. Though these trends were also determined by the market conditions, they demonstrate how investor and platform decisions can be affected by taxation and compliance regulations.

In order to establish predictability, the following policies can be considered by policymakers: the introduction of standard HSN code, specific valuation principles of transactions with the elements of barter, and comprehensive instructions on mining, staking, and airdrops. These would not only lower the risk of litigation but also enhance confidence on the way India treats VDAs indirect-tax wise.

CHAPTER-3

TAXATION OF EMERGING VDA ACTIVITIES IN INDIA

3.1 Mining and Staking

The Indian tax law does not have clear provisions on mining or staking. Generally, any form of income is subject to tax as prescribed by Income-tax Act, 1961 and when the token has been mined or staked is sold, the tax is payable under section 115BBH of the Income Tax Act¹⁹, 1961 in 30%. The question that still lingers is whether acts of generation of tokens is a taxable supply in GST as mining does not have a direct counter party. In the world, there are various strategies. The United States taxation authority (Internal Revenue Service) considers mining rewards their income at the time when received and the capital gain when tokens were sold. In Australia tax treatment is dependent on scale, business level mining is taxed like income but the mining as a hobby might not be.

An objective finding here is that it may aid in India by making the rules more transparent, as this would decrease uncertainty in compliance. The businesses would also be eligible to apply input tax credit (ITC) to the cost of electricity, hardware, or software as a taxable supply and reduce operation costs. Nonetheless, in the case of small-scale miners or individuals, the implication of detailed reporting may be very challenging.

¹⁸ Crypto: Domestic crypto trade volume worth 32,000 crore shifted to foreign bourses The Economic Times, <https://economictimes.indiatimes.com/tech/technology/domestic-crypto-trade-volume-worth-32000-crore-shifted-to-foreign-bourses/articleshow/96718950.cms?from=mdr>

¹⁹ The Income Tax Act, 1961, §115BBH, Acts of Parliament, 1961(India).

3.2 Initial Coin Offerings (ICOs) and Token Sales:

ICOs enable organizations to raise funds through issuing new tokens which can be in the form of utility, ownership or investment rights. India lacks any particular legal framework of ICOs. According to the existing legislation, the proceeds of ICO might be regarded as the business income, and the following transfer of tokens might be considered in accordance with Section 115BBH. There is no certainty with regards to the classification of GST, because the tokens would be classified as either goods or services depending on how they would be used.

Singapore does not exempt the issuers of ICOs by requiring them to register to pay GST at the international level provided the token is representing a service but free of those which are regarded as capital raising²⁰. Switzerland has different tax implications on different types of payment, utility and asset tokens.²¹

To India, the categorical distinction may lessen the use of offshore jurisdiction to launch tokens. Following the introduction of VDA tax regime in India, approximately 32,000 crore of trading volume was diverted offshore and approximately 17 lakh of users transferred to foreign exchanges²². Though this data is related to secondary trading, but not to ICO, it implies that as the lack of transparency in tax policies, it might also affect the location where projects and investors will be. Simultaneously, it has been observed throughout the world that there is a risk of fraudulent ICOs, making regulatory protection significant.

3.3 Decentralized Financial Transactions

Intermediary-free, smart contract-based platforms allow users to lend money, borrow money, trade and earn interest by way of DeFi. In India the DeFi income which might consist of lending interest or yield farming rewards could be treated as VDA income and be taxed at 30. This is a practical problem of enforcement: transactions are made pseudonymous, and the smart contracts lack identifiable service providers when it comes to GST or TDS obligations.

²⁰ E-tax guide on Digital Payment Tokens, https://www.iras.gov.sg/media/docs/default-source/e-tax/e-tax-guide_gst_digital-payment-tokens.pdf.

²¹ Swiss taxation of cryptocurrencies – how are investors taxed? Deloitte, <https://www.deloitte.com/ch/en/services/tax/blogs/swiss-taxation-of-cryptocurrencies--how-are-investors-taxed.html>.

²² Crypto: Domestic crypto trade volume worth 32,000 crore shifted to foreign bourses The Economic Times, <https://economictimes.indiatimes.com/tech/technology/domestic-crypto-trade-volume-worth-32000-crore-shifted-to-foreign-bourses/articleshow/96718950.cms?from=mdr>.

The data collected worldwide reveals the importance of this industry. The total world DeFi transactions amounted to more than 600 billion in 2022, which is an increased proportion of the crypto activity. India is one of the most active users of DeFi service²³. The introduction of DeFi to a tax system might thus increase this transparency and revenue.

Simultaneously, enforcement is still a complicated issue. Determining which events can be taxed in automated protocols and avoid imposing non-compliance is not an easy task. Excessive regulation would drive Indian users to offshore DeFi platforms, which replicated the single change trading volumes after the tax changes in 2022.

3.4 Policy Perspectives:

In comparison to other countries, the United States charges mining rewards on a case-by-case basis, classify some ICOs under the securities law, and consider DeFi income subject to tax. The European Union is shifting towards an integrated system with the framework of Markets in Crypto Assets (MiCA) which contains disclosure of issuing tokens. Singapore and Switzerland place much emphasis on categorization and fit tax laws to the type of token.

In the case of India, the benefit and challenge neutrality is in the acceptance of both benefits and challenges:

Benefits of clearer rules

- Growing tax base and revenue collection.
- Allows businesses to have some assurance, which spurs domestic fundraising.
- Allows ITC mining and staking expenses in business.
- Enhances India as a leading player in the digital economy.

Challenges of regulation

- Small-scale participants may find compliance difficult.
- Barter-like or automated transactions still have not been settled through valuation practices.
- The decentralised environments are complicated to enforce.
- The presence of highly inflexible regulations can provide an incentive to

²³ Journals National Law School of India University, <https://www.nls.ac.in/research/journals/>.

offshore activity, in the case of trading volumes.

Mining, ICOs, and DeFi are emerging operations that are not a part of the existing VDA tax system in India. The international experience indicates that such categorisation and clear guidelines can help decrease uncertainty and contribute to revenue and innovation. In the case of India, the most logical step would be to generate the definitions, valuation regulation, and the mechanism of compliance that is specific to these activities. This would assist in striking the right balance between revenue collection on the one hand and the investor and business confidence, on the other and it would also be in line with the international practice.

CONCLUSION

The introduction of tax on Virtual Digital Assets (VDAs) in India is a big step towards addressing the lack of clarity in a more formal system of laws. Both the collection of revenue and traceability of the transactions are guaranteed after the government introduced Section 115BBH and Section 194S. This has given badly-needed transparency to investors and platforms and put VDAs in line with accepted tax practices and made them part of the formal economy. On the same note, the introduction of Goods and Services Tax (GST) to the services of VDA has also introduced a framework of compliance, although still creating some gaps about which questions are open to classification and value.

Meanwhile, new areas like mining, staking and Initial Coin Offerings (ICOs) have new opportunities and challenges. The stage that India has taken is so far very practical; however, with the changing global practices, it might be best that clearer rules in the given spheres are meant to empower adherence and foster innovation.

Generally, the current model has helped offer a sense of certainty, assure revenue, and as an indicator that India is interested in regulating this industry. As the next step, adjustments, including TDS rates standardisation, more transparent GST classification, and custom-made regulations of the new activities, may strike a balance between revenue goals and investor trust and market maturity. In this way, the current policy of VDAs in India may be regarded as a progressive document and a consistent shift towards a better-balanced approach to the issue.