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## Avinash Kumar



*Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.*

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# **REGULATORY FRAMEWORK AND TAXATION OF CRYPTOCURRENCY GAINS AND LOSSES IN INDIA: ANALYSING CURRENT LAWS AND FUTURE IMPLICATION**

AUTHORED BY - AISWARYA LAKSHMI JS

## **ABSTRACT**

Cryptocurrencies have emerged as a transformational force in the global financial landscape, introducing fresh methods for digital transactions, investment, and innovation. In India, the rise of cryptocurrencies has elicited conflicting reactions, with policymakers grappling with the consequences for economic stability, consumer protection, and taxation. The sheer nature of cryptocurrencies, particularly their decentralization, anonymity, and volatile market dynamics, presents substantial problems to existing regulatory and taxation frameworks. This paper examines the regulatory and taxes landscape affecting cryptocurrency gains and losses in India. It critically examines current legislation, such as the provisions of the Income Tax Act of 1961 and the Goods and Services Tax regime, in light of recent legislative developments such as the tax on virtual digital assets included in the Union Budget 2022. The report identifies loopholes and uncertainties in the current system, particularly regarding the classification of cryptocurrencies as assets, currencies, or commodities and the resulting tax implications. Furthermore, the study looks at worldwide best practices to propose alternative options for India to build a strong regulatory and taxing environment that balances innovation and compliance. In this way, the research will address crucial concerns such as tax evasion, valuation complexity, and cross-border transactions, providing actionable insights into how cryptocurrency legislation might be aligned with India's economic and legal frameworks. The current study's findings underline the importance of taking a comprehensive and flexible approach to regulating and taxing cryptocurrencies in India. This includes working cooperatively with regulatory organizations, improving legislation clarity, and utilizing technology to comply more efficiently. The study concluded with recommendations for a future-ready framework that will enable the growth of the cryptocurrency ecosystem while also protecting the interests of stakeholders and the broader economy.

**KEYWORDS:** Cryptocurrency Regulation, Taxation of Virtual Assets, India Cryptocurrency Laws, Virtual Digital Assets (VDA) Taxation, Cross-Border Transactions

## INTRODUCTION

The entire financial world has changed in the light of introducing the cryptos as decentralized and digital equivalents of the traditional fiat. Bitcoin, Ethereum, or other cryptos are fundamentally based on blockchain technology allowing people for doing secure peer-to-peer transaction devoid of intermediaries such as banks or financial organizations<sup>1</sup>. This revolutionary breakthrough attracted much interest among investors, entrepreneurs, and governments around the world, especially in India. However, legislative regimes with regard to crypto currencies like taxation differed significantly from each other across nations. In India, because of increasing usage of bitcoin and other crypto currencies, a legal landscape and tax treatment of crypto currency gains or losses have been examined in public debate and policy response is under development.

Currently, India lacks a robust legislative framework governing cryptocurrencies. The lack of defined rules has created confusion and doubt about the legal status and tax implications of cryptocurrencies. Cryptocurrencies are not formally prohibited in India, but the country's central bank, the RBI, has issued many circulars restricting banks' provision of services to cryptocurrency-based enterprises, posing practical challenges for persons and entities working in cryptocurrencies. Despite the vagueness of the legislation, authorities have made steps to limit various parts of bitcoin transactions, with a primary focus on anti-money laundering (AML) and know your customer (KYC) compliance. The Prevention of Money Laundering Act of 2002 (PMLA) has been used to regulate cryptocurrency exchanges and transactions, requiring them to keep track of transactions and report anything suspect<sup>2</sup>.

The taxation of cryptocurrency profits and losses in India is highly influenced by various aspects, including the form of the transaction, the duration of holding, and the taxpayer's status. There is some disagreement and difficulty in establishing specific regulation that relates directly with cryptocurrency. While the Income Tax Act of 1961 is one of the key statutes that establishes the basis for Indian income taxes, the taxability of cryptocurrency transactions in

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<sup>1</sup> Magnuson, W., 2018. Financial regulation in the Bitcoin era. *Stan. JL Bus. & Fin.*, 23, p.159.

<sup>2</sup> Principal, D.B., 2024. BLOCK CHAIN AND CRYPTOCURRENCY LAWS AND REGULATIONS 2024—AN ANALYSIS. *International Journal of Information Technology (IJIT)*, 5(1).

India is still being debated<sup>3</sup>.

In 2018, the Indian government formed an interdisciplinary group to study cryptocurrency regulations and give policy suggestions<sup>4</sup>. While the committee has advocated tough laws to combat the criminal activities related with cryptocurrencies, such as outlawing their use, no actual legislative or regulatory actions have been adopted to date.

This paper focuses on the existing legislation and taxation of cryptocurrencies, including gains and losses. There will be a review of current legislation, court precedents, and administrative guidelines, as well as potential future consequences for investors, traders, and other players in the greater cryptocurrency ecosystem. Based on its complete overview and critical analysis, this study will elucidate the problems, opportunities, and uncertainties surrounding the aforementioned issue under Indian jurisdiction.

## WHAT IS CRYPTOCURRENCY?

The digital payment system known as bitcoin does not rely on banks to validate transactions. Peer-to-peer technology allows anyone, anywhere, to give and receive money. In contrast to physical money, which is transported and exchanged in the real world, cryptocurrency payments are made up entirely of digital entries to an online database tracking individual transactions<sup>5</sup>. A public ledger records all bitcoin transactions that take place when money is moved. Crypto wallets are used for storing cryptocurrency.

Its name comes from the fact that it uses encryption to verify transactions. This means that storing and sending bitcoin data between wallets and public ledgers requires coding. Bitcoin was the first cryptocurrency, launched in 2009, and remains the most well-known name in this category<sup>6</sup>. People desire to speculate with cryptocurrencies in order to profit, which accounts for a big portion of their appeal. Prices can increase due to speculators' influence.

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<sup>3</sup> Jain, Tarun. "The Taxation of Cryptoassets in India: A Review of Evolving Tax Policy and Law." *Available at SSRN* (2024).

<sup>4</sup> Singh, A.K. and Singh, K.V., 2018. Cryptocurrency in India-its effect and future on economy with special reference to bitcoin. *International Journal of Research in Economics and Social Sciences (IJRESS)*, 8(3), pp.115-126.

<sup>5</sup> Camenisch, J., Maurer, U. and Stadler, M., 1997. Digital payment systems with passive anonymity-revoking trustees. *Journal of Computer Security*, 5(1), pp.69-89.

<sup>6</sup> Panda, S.K., Sathya, A.R. and Das, S., 2023. Bitcoin: Beginning of the cryptocurrency era. In *Recent Advances in Blockchain Technology: Real-World Applications* (pp. 25-58). Cham: Springer International Publishing.

**Key Features:**

1. **Digital or Virtual:** Because cryptocurrencies exist only in the virtual domain, they do not have tangible manifestations such as coins or notes. Transactions are entirely virtual, usually carried out via online media or with the help of a bitcoin wallet.
2. **Decentralized:** Cryptocurrencies operate on decentralized networks, which implies that no central authority, such as a government or financial institution, controls them. Instead, transactions are confirmed and recorded on a distributed network of computers known as nodes using a consensus process, such as PoW or PoS.

## A TIMELINE OF INDIA'S CRYPTO LAWS

The Reserve Bank of India and the government have historically been apprehensive about crypto transactions, with warnings and bans to the stringent new tax bill. Here's a quick timeline of how crypto has fared over the years in India:

- 2013: The RBI issues a circular that warns investors about speculative investments such as cryptocurrencies.
- 2013-2017: Coupled with the movement toward digital payments in India, the crypto industry establishes its roots. Indian exchanges such as Zebbay and Unocoin start to gain traction.
- 2017: Two writ petitions are filed – one to ban cryptocurrencies and one to regulate cryptocurrencies. The government forms a regulatory body to investigate cryptocurrencies further.
- 2018: Despite multiple warnings by the RBI, Indian crypto markets add a record number of users. To counter that trend, the RBI issues a circular in April restricting banks and lenders from any association with crypto exchanges, effectively strangling the blossoming industry.
- 2019-2020: Indian exchanges and blockchain advocates go to court, filing multiple petitions in a bid to overturn the ban on cryptocurrency.
- 2020: After a drawn-out case, the Indian Supreme Court finally strikes down the RBI order, declaring it unconstitutional to prohibit trading without any regulations. That coincides with the crypto boom of 2020 and serves as the break the Indian crypto market desperately needs.
- 2021: The government continues its efforts to curtail the crypto industry by proposing a blanket ban on private currencies and introducing a private central bank digital currency instead.

- 2022: While crypto laws are still under discussion, the budget bill specifying crypto tax regulations is passed in March.<sup>7</sup>

Prior to the budget bill of 2022, Indian government officials didn't have an official stance on the taxation of cryptocurrencies, but that doesn't mean the tokens weren't taxed.

## CURRENT LEGAL STATUS OF CRYPTOCURRENCIES IN INDIA

The term cryptocurrency has not been clearly defined under the income tax act, 1961 as a legal tender or currency. The Union Budget rules of 2022 have been one of India's first laws to recognize crypto assets, hence putting down taxation on crypto in India. However, following that, crypto assets have been categorized as "virtual digital assets" and not "currencies" backed by the central bank.

*According to the 115BBH section of the Finance Bill, a taxable event is defined as:*

1. Conversion of any digital assets to INR or any other fiat currency.
2. Conversion of one virtual digital asset type to another may include crypto-to-crypto trading or trading in stablecoins.
3. Paying for goods and services using a virtual digital asset.

As per the announcements on the taxation on crypto in India, the profits that will or have been incurred from the above transactions are subjected to a 30% tax, which is equivalent to India's highest income tax bracket. Furthermore, if the transaction exceeds INR 10,000, the crypto tax will then have an additional 1% tax levied on them.

### What are Virtual Digital Assets?

Virtual Digital Assets refer to any digital assets that are not physical or tangible. In layman's terms, it basically means cryptos, DeFi (decentralized finance), and non-fungible tokens (NFTs). Prima facie excludes digital gold, central bank digital currency (CBDC), or any other traditional digital assets and is specifically aimed at taxing cryptos.

### Crypto Taxation in India Explained

Though there are still many discussions that the Indian Government is yet to have with the Indian masses regarding the regulations on Crypto Taxation in India in India, or for the 'Virtual Digital Assets'; according to the Budget 2022 session, these are the pointers any crypto investor should keep in mind:

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<sup>7</sup> The State of Crypto Taxation in India: Past, Present and Future, available at: <https://www.coindesk.com/layer2/2022/11/14/india-cryptocurrency-tax-laws/> (Visited on 17 December 2023)

1. Income from the transfer of virtual digital assets such as crypto and NFTs will be taxed at 30% at the end of each financial year.
2. No deduction, except the acquisition cost, will be allowed while reporting income from the transfer of digital assets.
3. Loss from digital assets cannot be set off against any other income.
4. The gifting of digital assets will attract tax in the hands of the receiver. Losses incurred from one virtual digital currency cannot be set off against income from another digital currency. 1% TDS point should also be mentioned in this list of pointers as it was announced in Budget 2022.

*As per Section 206AB of the Income-Tax Act, 1961:*

1. If any user has not filed their Income Tax Return in the last two years and the amount of TDS is INR 50,000 or more in each of these two previous years, then the tax (TDS) to be deducted for Crypto-related transactions will be at 5%.
2. TDS provisions will apply if an order is placed before July 1, 2022, but the trade is executed on or after July 1, 2022.

### **How Much Tax Will You Pay on Crypto in India?**

In short, two types of crypto taxes are now set to be levied on crypto assets. There is a 30% tax on the annual profits from crypto trades and a 1% TDS on every crypto transaction. The TDS cut is eligible to be filed for returns during the ITR filings.

### **What is 1% TDS on crypto?**

According to the revised Income Tax Regulations for Crypto Taxation in India, the 1% TDS applies to all crypto asset sell transactions. This will be effective on July 1, 2022. However, please note that the TDS will be deducted from the final sale amount, not just the profits. For TDS, it doesn't matter if you earn a profit or book a loss on your trade. It will be deducted, no matter what.

### **How is the 30% Crypto Taxation in India Calculated?**

The flat income tax rate is applicable to retail investors, traders, or anyone transferring crypto assets in a given financial year with no distinctions between short-term and long-term gains. The 30% tax rate is levied on any profits made from the transfer of virtual assets.

This 30% crypto tax rate under the current crypto taxation in India will remain the same

irrespective of the nature of income i.e., it does not matter if it is an investment income or business income and is irrespective of the holding period.

### **Restrictions on Loss Set-Off for VDA Transactions under the Income Tax Act**

Additionally, The Income Tax Act explicitly prohibits offsetting losses incurred from the transfers of Virtual Digital Assets (VDAs) against income or gains derived from other VDAs. For example, if an individual sells one crypto asset incurring a loss, this loss cannot be offset against a gain made from transferring another VDA.

## **DIRECT TAX REGIME**

The treatment of cryptocurrencies under the direct tax regime is mainly governed by the Income Tax Act in India. In the current legal landscape, there is no certainty regarding the taxation of cryptocurrency nor any disclosure requirement about the income earned issued by the Income Tax Department.

Moving on, if cryptocurrency is considered as 'currency', it would not be susceptible to tax under the IT Act. The first reason being, under the Act, the definition of 'income' is an inclusive one, which comprises not only the 'natural' meaning but also the items mentioned under Sec 2(24) of the IT Act.<sup>8</sup> But neither the natural meaning nor Sec 2(24) of the IT Act includes 'money' or 'currency' as income, although it includes 'monetary payment'. Secondly, being a mode of consideration, the tax incidence would be on the transaction and not on the currency. On the other hand, if cryptocurrency is considered as goods/property, then clearly it would be either covered within the charging provision of 'Profit and Gains from Business and Profession'<sup>9</sup> or 'Income from Capital Gains'<sup>10</sup>, depending upon its use for business/profession or not. It would not be out of place to state that the ambit of the word 'income' is not restricted to the words 'profits' and 'gains' and anything which can appropriately be designated as 'income' is liable to be taxed under the IT Act, unless expressly exempted.<sup>11</sup>

### **1. Treatment under the head 'Capital Gains'**

Sec 2(14) of the IT Act defines a capital asset as "property of any kind held by the assessee whether or not connected with his business or profession".<sup>12</sup> This definition of

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<sup>8</sup> CIT/CWT v. P.R.S. Oberoi, (1990) 183 ITR 103 (Cal.).

<sup>9</sup> Sec 28 the Income Tax Act, 1961

<sup>10</sup> Sec 45(1) the Income Tax Act, 1961

<sup>11</sup> Maharajkumar Gopal Saran Narain Singh v. CIT, (1935) 3 ITR 237 (Bom.).

<sup>12</sup> Sec 2(14) the Income Tax Act, 1961.

‘capital asset’ provided is widest in itself and covers all kinds of property except those expressly excluded under the Act.<sup>13</sup> Therefore, any gains arising out of the transfer of cryptocurrency must be considered as capital gains, if they are held for investment.

## 2. Taxability under 'Profit and Gains from Business and Profession'

The tax treatment of cryptocurrencies when held as ‘stock in trade’ is not the one which faces major difficulties as the issues arising while treating it as capital gains do not arise when such cryptocurrencies are held in furtherance of business activity. Under Sec 2(13) of the IT Act, the definition of 'business' is inclusive, and comprises of "trade, commerce or manufacture or any adventure or concern of such nature."<sup>14</sup> Moreover, any continuous activity like trade in cryptocurrencies is included within this definition, and profits realized are taxable thereunder, chargeable under Sec 28 of the IT Act.

The profits may not necessarily be in the form of money, they are taxable even if they are 'in-kind'. Any expenditure incurred for this purpose, such as the purchase of computing power as a capital asset, should be allowable as a deduction per the provisions specified in Sec 30 to Sec 43D of the IT Act.<sup>15</sup>

## INDIRECT TAX REGIME

The treatment of cryptocurrency as goods/property implies that the supply of bitcoins is a 'taxable supply' and hence subject to GST. Technically, a supply of cryptocurrency as goods or property in exchange for other virtual/real goods should fall within the ambit of 'barter transaction' since bartering is simply an exchange of one good for another.

Even in its most innovative form, any barter transaction has two essentials –

- i. direct exchange of goods or services for other goods/services and
- ii. no use of money.<sup>16</sup>

Before GST, under the various state VAT laws, the incidence of tax arose when there was a sale of goods in exchange for cash, deferred payment, or any other valuable consideration.<sup>17</sup> The expression ‘any other valuable consideration’ leaves out a wide scope of ambiguity, since the term should typically derive reference, ejusdem generis, from its preceding

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<sup>13</sup> Commissioner of Income Tax v. B.C. Srinivasa Shetty, (1981) 2 SCC 460.

<sup>14</sup> Sec 2(13) the Income Tax Act, 1961.

<sup>15</sup> Sec 30 and Sec 43D the Income Tax Act, 1961.

<sup>16</sup> George Dalton, Barter, JOURNAL OF ECONOMIC ISSUES (2016) (discussing the essentials and intricacies of barter transactions).

<sup>17</sup> Pawan K. Aggarwal, Incidence of Major Indirect Taxes in India, 14–16, 1995, available at [http://www.nipfp.org.in/media/medialibrary/2014/10/INCIDENCE\\_OF\\_MAJOR\\_INDIRECT\\_TAXES\\_IN\\_IN\\_DIA.Pdf](http://www.nipfp.org.in/media/medialibrary/2014/10/INCIDENCE_OF_MAJOR_INDIRECT_TAXES_IN_IN_DIA.Pdf) (Visited on 19 December 2023).

terms (i.e. cash and deferred payment),<sup>18</sup> and therefore, must not include an exchange of goods for other goods. This view was reiterated by the Supreme Court in the case of Sales Tax Commissioner v. Ram Kumar Agarwal,<sup>19</sup> where a transaction of gold bullions in exchange for ornaments was excluded from the definition of sale under Sec 2(h) of the Sale of Goods Act, 1930. However, the position is similar to when a transaction is used as a device to conceal monetary consideration, courts may unravel the device to include it within the ambit of sale.<sup>20</sup>

An approach where cryptocurrencies are considered as goods means that some transactions would be taxed twice – at first on supply (otherwise exempted for a transaction in money) and secondly on consideration, unnecessarily leading to higher tax. This higher incidence of taxation puts the businesses operating in cryptocurrencies at a huge disadvantage which also diminishes their purchasing capacity. The issue gets further complicated in cases of international transactions.

## **FUTURE OUTLOOK AND RECOMMENDATIONS**

### **1. Clarity and Specificity in Tax Regulations**

The Indian government should work towards providing clear and specific tax regulations for cryptocurrencies. This includes defining cryptocurrencies for tax purposes, explaining their categorization, and providing clear guidelines for calculating taxable events like capital gains. Clarity will help taxpayers understand their obligations and ensure compliance.

### **2. Addressing Technological Challenges**

The government should invest in building expertise in blockchain technology and cryptocurrency analytics. This will aid in effective tracking and monitoring of cryptocurrency transactions for taxation purposes, while also staying ahead of potential tax evasion and money laundering risks.

### **3. Balanced Tax Rates and Holding Periods**

The tax rates for cryptocurrency transactions should be reasonable and aligned with traditional investment instruments. Additionally, introducing differential tax rates based on the holding period can incentivize long-term investment in cryptocurrencies,

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<sup>18</sup> *Devi Dass Gopal Krishnan v. State of Punjab*, (1967) 20 STC 430.

<sup>19</sup> *Sales Tax Commissioner v. Ram Kumar Agarwal*, (1967) 19 STC 400 All; See also *M Jaihind v. State of Kerala*, (1998) 111 STC 374; *CTO v. Kansari Udyog Sahakari Samiti*, (1979) 43 STC 176.

<sup>20</sup> *C Mohammed Ali v. State of Kerala*, (2010) 31 VST 427; *Dhampur Sugar Mills v. CTO*, (2006) 147 STC 57; *State of Tamil Nadu v. TMT Drill (P.) Ltd.*, (1991) 82 STC 59.

promoting stability in the market.

#### **4. Establishing a Crypto Tax Advisory Body**

The government can consider setting up a dedicated advisory body comprising tax experts, technologists, and representatives from the cryptocurrency industry. This body can provide ongoing recommendations on taxation matters, ensuring that tax policies keep pace with the rapidly evolving cryptocurrency landscape.

#### **5. Promoting Domestic Cryptocurrency Exchanges**

To encourage domestic cryptocurrency exchanges, the government can consider offering incentives or reduced taxation on income generated by these exchanges. This will not only bolster the Indian cryptocurrency ecosystem but also create more tax revenue domestically.

#### **6. Rationalizing Tax on Cryptocurrency Transactions**

India could explore the possibility of rationalizing the tax structure on cryptocurrency transactions by incorporating a simple and uniform tax mechanism. This will make compliance easier for taxpayers and facilitate easier auditing for the tax authorities.

#### **7. International Cooperation and Data Sharing**

Given the cross-border nature of cryptocurrencies, India should collaborate with other countries to share data and tackle global tax evasion and money laundering concerns. International cooperation will lead to a more effective and holistic approach to regulating cryptocurrencies.

#### **8. Public Awareness and Education**

The government should launch awareness campaigns to educate the public about their tax obligations related to cryptocurrencies. Increased knowledge and understanding will lead to higher compliance and reduce the chances of unintentional tax violations.

#### **9. Policy Flexibility**

The government should maintain a degree of policy flexibility to adapt to the fast-paced changes in the cryptocurrency landscape. This means regularly reviewing and updating tax policies as needed to ensure they remain relevant and effective.

#### **10. Encouraging Blockchain and Crypto Innovation**

While addressing tax concerns, the government should also create a conducive environment for blockchain and cryptocurrency innovation. Encouraging innovation will attract more startups and businesses to the sector, potentially leading to economic growth and job creation.

The taxation of cryptocurrencies in India is a complex and evolving area that requires

careful consideration. Striking a balance between taxation, innovation, and investor protection is crucial. By providing clarity in regulations, leveraging technology to address challenges, and fostering cooperation between stakeholders, India can position itself favorably in the global cryptocurrency market while ensuring compliance and transparency in the tax landscape. Continuous assessment and adaptation of policies will be essential to effectively harness the potential of cryptocurrencies while mitigating associated risks.

## CONCLUSION

The crypto in today's scenario has the potential to boost the backbone of India's digital infrastructure and also securing all the transactions made on the digital network. In this situation levying taxes on the transactions involving cryptocurrency should be considered a welcoming move and should not be seen as a restriction. It is a two way street for the crypto transactions to be traced and used legally as well as generating income for the government to be used efficiently. It is also vehemently asserted that employing tax on crypto as a policy matter can help to provide an ideal atmosphere to assure the traders that their money is safe and the risks involved in trading are also mitigated.

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