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TAXATION FRAMEWORK FOR CRYPTOCURRENCY TRANSACTIONS

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ABSTRACT

The swift expansion of cryptocurrency has presented new obstacles for tax systems globally, which are frequently ill-equipped to address the intricacies of digital assets. This paper examines the various approaches taken by countries regarding the taxation of cryptocurrency transactions, encompassing topics such as mining, trading, and the regulations governing these digital currencies. The introduction outlines the fundamentals of cryptocurrency, its functionality, and the challenges tax authorities encounter when determining how to impose taxes on these digital assets. Additionally, it considers how the borderless aspect of cryptocurrencies complicates efforts for nations to enforce their tax regulations, particularly given the absence of clear guidelines in numerous jurisdictions. The second segment of the paper investigates how various nations are managing the taxation of cryptocurrencies. It underscores the differing classifications of cryptocurrencies (such as being categorized as property or currency) and the resulting tax regulations that stem from these classifications. The third section analyzes the tax consequences of activities like mining, staking, and trading, addressing income tax, capital gains tax, and transaction taxes for individuals and businesses alike. The paper further examines the existing laws and regulations regarding cryptocurrency taxation, emphasizing how governments are attempting to revise their regulations to keep pace with digital assets. It also addresses the challenge of tax evasion, particularly given that cryptocurrency transactions can be hard to track and often remain anonymous. Finally, the paper offers ideas for the future, suggesting ways to improve international cooperation, create clearer rules, and find better ways to ensure tax compliance. The goal is to contribute to the ongoing discussion on how to effectively tax cryptocurrencies in an ever-changing digital world.

Keywords: Cryptocurrency, transactions, tax evasion.

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INTRODUCTION

The rules for taxing cryptocurrency transactions have changed a lot in recent years as governments try to manage the fast-growing digital asset market. Cryptocurrencies, along with other digital assets like NFTs (Non-Fungible Tokens), are now subject to specific tax laws in many countries. These rules aim to ensure people pay taxes properly, make transactions more transparent, and generate government revenue while addressing the unique challenges of these decentralized and secure digital currencies.

For example:

- In India, profits from trading or selling cryptocurrencies are taxed at a flat 30% rate, regardless of how long you held the asset or your income level. Additionally, a 1% Tax Deducted at Source (TDS) applies to transactions over certain limits to track activity.
- In the U.S., cryptocurrencies are treated as property. Taxes are applied when you sell, exchange, or use crypto and make a profit. Short-term gains are taxed like regular income, while long-term gains have lower rates.

These frameworks vary by country but generally focus on taxing profits from crypto activities like trading, mining, or receiving crypto as payment. However, they also bring challenges like compliance burdens and restrictions on offsetting losses. Governments continue to refine these rules to balance regulation with innovation in the digital economy.

Key Elements of Cryptocurrency Taxation Frameworks-

1. Flat Tax Rates:

- Profits from cryptocurrency transactions in India are taxed at a flat 30% rate.
- This applies regardless of income level or whether the income is from investments or business activities.
- The rate is higher compared to traditional assets like stocks.

2. Tax Deducted at Source (TDS):

- A 1% TDS is applied to crypto transactions exceeding ₹50,000 annually for certain individuals and ₹10,000 for others.
- This helps track transactions but adds compliance challenges.

3. Loss Offset Restrictions:

- Losses from cryptocurrency transactions cannot be set off against other gains or carried forward to future years.

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4. Mandatory Reporting:

- Starting from fiscal year 2025-26, all crypto transactions must be reported in a dedicated section of Income Tax Returns (ITR).

5. Classification as Capital Gains:

- In some countries, profits from selling cryptocurrencies are treated as capital gains, similar to stocks or property.

GLOBAL TAXATION APPROACHES FOR CRYPTOCURRENCY TRANSACTIONS

1. **Capital Gains Tax vs. Income Tax:**

   Most countries treat cryptocurrencies as property or digital assets. Capital Gains Tax applies when cryptocurrencies are sold, traded, or spent (e.g., in the U.S., Canada, Australia, and UK). Income Tax applies to earnings from mining, staking, or receiving crypto as payment, often at higher rates than capital gains.

2. **High-Tax Countries:**

   Japan: Taxes crypto gains at progressive rates of 15%-55%, among the highest globally.

   Denmark: Crypto profits are taxed at 37%-52%, depending on income levels.

   Germany: Short-term gains are taxed up to 45%, but long-term holdings (over one year) are tax-free.

3. **Crypto Tax-Free Havens:**

   Countries like El Salvador, Switzerland, United Arab Emirates, and Hong Kong do not tax crypto gains for private investors. These nations aim to attract crypto businesses and investors with lenient policies.

4. **Unique Regional Policies:**

   United States: Short-term capital gains are taxed at regular income rates (10%-37%), while long-term gains have lower rates (15%-20%). Losses can offset gains or reduce taxable income by up to $3,000 annually.

   Australia: Offers a 50% discount on long-term capital gains but taxes short-term gains at rates up to 45%.

   Canada: Only 50% of capital gains are taxable; losses can offset gains or be carried forward.

   European Approaches:

   France: Individual traders pay a flat 30% tax; professional traders face higher rates of

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up to 45%.

Italy: A flat 26% tax applies to crypto gains above €2,000; losses can be carried forward for five years.

Spain: Taxes crypto gains up to 47%; wealth tax may apply based on asset value.

5. **Developing Frameworks:**

   India: Introduced a flat 30% tax on crypto profits and a 1% TDS on transactions above certain limits. Losses cannot offset other income or be carried forward.

   The European Union is working on regulations requiring exchanges to share user data with tax authorities for better enforcement.

6. **Challenges in Compliance:**

   Global compliance is low; only about 0.53% of crypto investors pay taxes on their transactions. Some countries, like Finland, have higher compliance rates (4.09%), while others, like the Philippines, remain extremely low (0.03%).

TAX IMPLICATIONS OF CRYPTOCURRENCY MINIING, STAKING AND TRADING

Cryptocurrency activities such as mining, staking and trading are subject to taxation in most jurisdictions. These activities are taxed differently depending on their nature, how the income is earned, and the applicable tax laws in a specific country. Below is an elaboration of tax implications for each activity.

1. **Cryptocurrency Mining**
   - **Tax as Income**

     Cryptocurrency earned through mining is typically treated as taxable income at the time it is received. The fair market value of the mined cryptocurrency (in local currency) on the date of receipt is used to calculate the taxable amount.

     For instance:

     In the United States, mining rewards are considered ordinary income and must be reported on Form 1040 Schedule C if it is a business or Schedule 1 if it is a hobby. Self-employed miners must also pay self-employment taxes (Social Security and Medicare).

     In India, mining income is taxed under "Income from Other Sources" if done as a hobby or under "Business Income" if conducted professionally. Business

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miners can deduct expenses like electricity and hardware costs, but hobby miners cannot claim such deductions.

- **Capital Gains Tax**

  When mined cryptocurrency is later sold, traded, or spent, it triggers CGT. The capital gain or loss is calculated as the difference between the selling price and the fair market value of the cryptocurrency at the time it was mined.

- **Deduction for expensess**

  Professional miners in many countries can deduct costs like electricity, hardware, maintenance, and internet from their taxable income. However, hobby miners are often not allowed to claim such deductions.

2. **Cryptocurrency Staking**

Staking involves locking up cryptocurrencies in a blockchain network to support its operations and earn prices. Taxation of staking prices depends on when they're entered and how they're used.

- **Tax as Income**

  Staking Prices are generally treated as taxable income at the time they're entered. The fair request value of the staking prices (in original currency) on the date of damage determines the taxable quantum.

- **Capital Gains Tax:**

  If staked cryptocurrency or staking rewards are later sold or traded, CGT applies. The capital gain or loss is calculated based on the difference between the selling price and the fair market value at the time the staking rewards were received.

- **Ongoing Debates:**

  Some jurisdictions are debating whether staking rewards should be taxed only when sold (realized) rather than when received (unrealized). For example, in the U.S., there have been legal challenges arguing that staking rewards should not be taxed until they are sold.

3. **Cryptocurrency Trading**

Trading cryptocurrencies involves buying, selling, or exchanging digital assets for profit. The tax implications depend on whether trading is considered an investment activity or a business activity.

- **Capital Earnings duty (CGT)**

  Gains from trading cryptocurrencies are generally subject to CGT. The duty

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rate depends on how long the cryptocurrency was held before being vended

Short- Term Earnings

Cryptocurrencies held for lower than one time before trade are tested at regular income duty rates in utmost countries. In the United States, short- term earnings are tested at ordinary income rates (10- 37). In India, all crypto trading gains are tested at a flat rate of 30, anyhow of holding period.

Long- Term Earnings

Cryptocurrencies held for further than one time may qualify for lower duty rates in some countries. In the U.S., long- term earnings are tested at reduced rates (0, 15, or 20 depending on income position). In Germany, long- term effects (over one time) are fully duty-free for private investors.

- **Loss Offsets**

  Certain countries permit traders to use losses from cryptocurrency trading to offset capital gains from other sources or to be postponed for use in future tax years.

  For instance:

  In Canada, only 50% of capital gains are subject to taxation; losses can be used to counterbalance gains or carried over. In India, losses incurred from crypto trading cannot be used to offset income from other sources or deferred to future years.

- **Frequent Trading as Business Income**

  If a person engages in cryptocurrency trading frequently or on a professional basis, in some nations this activity might be recognized as a business rather than merely an investment. In these situations, profits could be taxed at higher business rates instead of capital gains tax (CGT). Additionally, traders operating as a business may qualify to deduct expenses tied to their trading operations.

REGULATORY AND LEGAL FRAME WORKS FOR CRYPTOCURRENCY TAXATION

Cryptocurrency taxation frameworks are developing worldwide as governments aim to regulate this growing digital asset class, ensure tax compliance, and promote transparency. In India, cryptocurrencies are classified as Virtual Digital Assets (VDAs) and taxed at a fixed rate on profits, regardless of the investor's income level. Additionally, a 1% Tax Deducted at Source

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(TDS) applies to transactions exceeding specific thresholds to track activity. Investors and exchanges are required to report all crypto transactions in their income tax returns under a dedicated section, ensuring greater accountability. Authorities have also introduced strict measures to identify unreported crypto holdings, treating them as undisclosed income and imposing penalties. However, challenges persist in India's framework, including the inability to offset crypto losses against other income or carry them forward, which increases the tax burden on investors.

Globally, countries adopt varied approaches to cryptocurrency taxation. Some nations, like Germany, encourage long-term investment by exempting crypto holdings from taxation if held for more than one year. Others, like the United States, treat cryptocurrencies as property, taxing short-term gains at regular income tax rates and long-term gains at reduced rates. Meanwhile, tax-free havens such as El Salvador, Switzerland, and the UAE impose no taxes on crypto gains to attract investors and businesses. High-tax jurisdictions like Japan and Denmark impose progressive rates based on income levels.

To address cross-border challenges in cryptocurrency regulation, international organizations are working toward global standardization. The OECD's Crypto-Asset Reporting Framework (CARF) and the European Union's DAC8 require cryptocurrency exchanges to report user transaction data to tax authorities. These efforts aim to improve transparency and prevent tax evasion across borders.

Despite these advancements, regulating cryptocurrencies remains complex due to issues like unclear rules for taxing mining and staking rewards and low compliance rates among investors. Governments face the challenge of balancing strict enforcement with fostering innovation in the crypto space. As regulations continue to evolve, it is crucial for investors and businesses to stay informed about their obligations to ensure compliance and avoid penalties.

TAX EVASION RISKS AND COMPLIANCE MECHANISMS IN CRYPTOCURRENCY TRANSACTIONS

Tax evasion in cryptocurrency transactions is a growing concern for governments due to the decentralized and pseudonymous nature of blockchain technology, which makes it challenging to track and monitor taxable activities. Many individuals falsely assume that cryptocurrency

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transactions are completely anonymous and therefore fail to report gains from trading, mining, staking, or other crypto-related activities. Common methods of tax evasion include using offshore exchanges that do not comply with local tax laws, privacy-focused cryptocurrencies (like Monero or Zcash) that obscure transaction details, and mixers or tumblers that make it harder to trace the origin of funds. Additionally, some users deliberately underreport or omit crypto earnings entirely from their tax filings, exploiting gaps in regulatory frameworks.

To address these risks, governments and international organizations have implemented various compliance mechanisms. Many countries now require cryptocurrency exchanges to adhere to strict Know Your Customer (KYC) and Anti-Money Laundering (AML) regulations, ensuring that user identities are tied to transactions. Exchanges are also mandated to report user activity to tax authorities—for example, the U.S. requires exchanges to issue Form 1099-DA for crypto transactions starting in 2025. Similarly, India has introduced a 1% Tax Deducted at Source (TDS) on crypto transactions above certain thresholds to improve traceability.

On a global scale, initiatives like the OECD's Crypto-Asset Reporting Framework (CARF) and the European Union's DAC8 aim to standardize cross-border reporting by requiring exchanges and wallet providers to share user data with tax authorities. These frameworks are designed to close loopholes that allow users to shift assets across borders undetected.

Tax authorities are also leveraging advanced blockchain analytics tools to trace transactions on public blockchains. These tools can identify patterns of tax evasion and link wallet addresses to individuals or entities. Governments are increasingly collaborating with private firms specializing in blockchain forensics, such as Chainalysis or Elliptic, to enhance their enforcement capabilities.

The penalties for noncompliance can be severe. Taxpayers who fail to report crypto income or gains may face fines, interest on unpaid taxes, audits, or even criminal prosecution for intentional evasion. For example, in the U.S., the Internal Revenue Service (IRS) has issued warnings and conducted audits targeting crypto users who fail to disclose their holdings. In India, unreported cryptocurrency holdings are treated as undisclosed income and taxed at higher rates with additional penalties.

As regulations tighten and enforcement improves, it is becoming increasingly difficult for

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taxpayers to evade taxes on cryptocurrency transactions. Governments are sending a clear message that crypto is no longer a "gray area" for taxation. To avoid penalties and legal consequences, individuals and businesses involved in crypto must ensure accurate reporting of all taxable events and maintain proper records of their transactions.

FUTURE DIRECTIONS AND POLICY RECOMMENDATIONS FOR CRYPTOCURRENCY TAXATION

The future of cryptocurrency taxation should focus on creating clear, fair, and globally consistent rules while supporting innovation in the rapidly growing digital economy. As cryptocurrencies become more main stream, governments must address uncertainties around how to tax activities such as mining, staking, and trading. Clear guidelines are needed to ensure taxpayers understand their obligations. For instance, offering lower tax rates for long-term holdings, similar to traditional investments like stocks, could encourage investors to hold onto their cryptocurrencies rather than engaging in speculative trading. This approach would not only promote stability in the market but also align crypto taxation with existing financial systems.

Improved reporting systems are essential for ensuring transparency and compliance. Governments should require cryptocurrency exchanges and wallet providers to report user transactions directly to tax authorities. Countries like India have already introduced stricter reporting requirements through dedicated sections in income tax returns (e.g., Schedule VDA) and mandatory Tax Deducted at Source (TDS) on transactions. Expanding such measures globally can help authorities track crypto activity more effectively while reducing the burden on individual taxpayers by automating reporting processes.

International collaboration is crucial for addressing cross-border challenges in cryptocurrency taxation. Frameworks like the OECD’s Crypto-Asset Reporting Framework (CARF) and the European Union’s DAC aim to standardize reporting requirements across countries, making it harder for individuals to evade taxes by transferring assets between jurisdictions. These initiatives encourage cooperation between governments and create a unified approach to regulating the global crypto market.

Governments should also consider making cryptocurrency taxation more equitable by allowing

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taxpayers to offset losses from crypto trading against other income or carry them forward to future years. Additionally, permitting deductions for transaction-related costs, such as exchange fees or gas fees, would align crypto taxation with how traditional investments are taxed. This would make the system fairer and reduce the financial burden on investors.

While blockchain analytics tools can help authorities trace transactions and identify noncompliance, privacy concerns must also be addressed. Overly intrusive measures could erode trust in the system and discourage participation in the crypto market. Striking a balance between enforcement and protecting user privacy is essential for maintaining public confidence.

Policymakers should actively engage with industry stakeholders, including cryptocurrency exchanges, blockchain developers, and financial experts, to ensure that regulations are practical and do not stifle innovation. Overregulation could drive crypto businesses and investors to more lenient jurisdictions, harming economic growth. By adopting a balanced approach that promotes fairness, compliance, and innovation, governments can create a robust framework that supports the growth of the cryptocurrency ecosystem while ensuring it contributes fairly to public revenue systems.

CONCLUSION

The taxation framework for cryptocurrency transactions reflects governments' efforts to regulate this rapidly evolving asset class while ensuring transparency and revenue generation. India's model, with a 30% tax on profits from Virtual Digital Assets (VDAs) and a 1% TDS on transactions, exemplifies a stringent approach aimed at curbing speculative activities and enhancing compliance. However, limitations such as the inability to offset losses or claim deductions beyond acquisition costs have raised concerns about fairness and the potential to stifle innovation. Globally, there is a growing call for balanced tax policies that distinguish between cryptocurrencies' use as investments and as transactional tools. Allowing loss offsets, reducing TDS rates, and aligning crypto taxation with other asset classes could foster a more inclusive and innovation-friendly environment. In conclusion, a well-designed taxation framework should balance regulatory oversight with growth, ensuring compliance while supporting the sustainable development of the cryptocurrency ecosystem.