



TAXES ON VIRTUAL DIGITAL ASSETS: THE LEGAL IMPLICATIONS

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The **Union Budget, 2022** introduced taxation on **Virtual Digital Assets (VDA)**, commonly referred to as cryptocurrencies. Tax will be levied on transfer of VDA at a flat **tax of 30%** (besides cess and applicable surcharge). More importantly, income from VDA will be computed without deduction for any expenses and any setting-off of losses (if any). Further, as expected, the requirement for withholding taxes on VDA transactions has also been introduced with effect from **1 July 2022**. The transferee is required to withhold taxes at the rate of **1% on transfer of VDA** to a resident taxpayer.

The **Red Lab** team decided to do this Report on a subject that is somewhat off-beat for us, but of major interest to a lot of our audience.

Under the new tax rules, **social media influencers** will also be

required to pay a **10% tax** deducted at source (TDS) on freebies and perks worth above **₹20,000**, received from businesses for sales promotion, effective July 1. This could include free air tickets, mobile phones, hotel stays, luxury products, and other free gifts or services, as per Section 194R, a recent addition to the **Income-tax Act**. However, they will be exempted from the tax if they return the product to the respective brands.

Nano influencers with followers between 100 to 10,000, may feel that this will affect their brand collabs as they will not be able to afford the products and barter deals will no longer be as viable. This may be true. But the tax itself indicates that the government sees 'value' in content creation and the profession has come of age!

VIRTUAL DIGITAL ASSETS AND THE FINANCE ACT, 2022



The **Virtual Digital Assets (VDAs)** economy has been growing and surging both in India and across the globe.

The definition of VDAs under **the Income-Tax Act, 1961**, was introduced by the **Finance Act, 2022**, so as to provide an expansive understanding of such transactions using any information or code or number or token, generated through cryptographic means or otherwise, and having any specified representation, consideration, or value as has been detailed in the definition and may at any stage be notified by the **Central government** in the **Official Gazette**.

The VDAs are taxed at **1% TDS** on transaction, **30%** on income generated from transfer, and against gifts of VDAs.





A LEGAL OVERVIEW



Taxes on **Virtual Digital Assets (VDAs)** are applicable as per definition of VDAs under **Section 2, Clause (47A) of the Income-Tax Act, 1961**. TDS as per **Section 194S** is “to provide for deduction of tax by any person who is responsible for paying consideration to a resident person in respect of the transfer of VDAs.” The primary liability for the deduction on transactions remains with the buyer, even involving those with an Exchange or broker in said manner.



Firstly, when there are multiple players in an Exchange, the corresponding compliance burden of multiple stages will be discharged by said parties.

Secondly, as per powers conferred under **Section 194S sub-clause (6)**, the **CBDT** has issued guidelines to remove difficulties arising from the TDS deducted by clarifying different situations involving individuals, Exchange or a broker; in cash or in kind; application of **Section 194S** to exchange of one VDA to another, in cash or in kind.

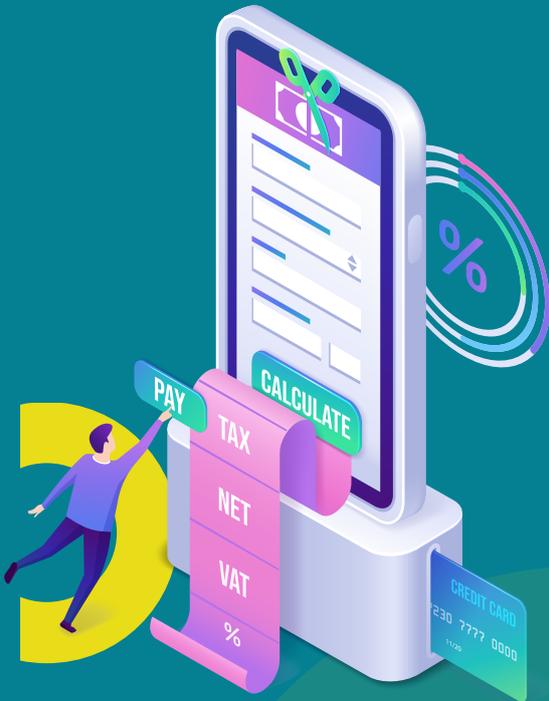




TAX

Section 115BBH(1) stipulates taxation of income from transfer of VDAs at **30% (+SC +HEC i.e. surcharge and education cess)**. The application of **Section 115BBH(1)** for assessment year **2023-24** implies that:

- ◆ Expenditure on transfer of VDAs is not deductible from full consideration of any sum of VDA as per Act.
- ◆ Business loss or carry forward of business loss, for deduction against capital gains must not be adjusted against income arising from VDAs.
- ◆ Prior to application of tax vide **Section 115BBH(1) @30% (+SC +HEC)**, the income under the head 'capital gains' cannot be adjusted in light of losses incurred from transfer of VDA, and nor is it possible to carry forward such loss.



EXPANDING VDAs



The ideas of utilizing technologies and interactivity are diverse, to say the least. The impact on fundamental businesses can be considered modest, where the use of financial services can be regulated such as in the interpretation of VDAs under **Section 2 (47A) of the I-T Act**.

The bouquet of VDAs as already defined under the I-T Act are vastly connected to concerns of major businesses using blockchains, managing the risk arising to users, issues of liquidity and networks. The government, at the time of introduction of said changes in the **Financial Act, 2022**, envisioned regulating VDAs in line with other speculative transactions which can include requirements to govern blockchains or bring forward a global perspective for financial inclusion.



REGULATIONS AND FUNDAMENTAL RIGHTS IN VIRTUAL CURRENCY BUSINESSES



BACKGROUND

The Para 13 of Reserve Bank of India (RBI) **Statement on Developmental and Regulatory Policies of 2018** which specifies a complete ban on virtual currencies including cryptocurrencies despite the potential of virtual currency technological innovations, raises concerns of consumer protection, market integrity and money laundering, among others.



The same and corresponding circulars as per the powers of the RBI, were challenged before the **Honorable Supreme Court** vide writ petitions decided upon in the present judgment. The framework adopted by the RBI with regard to virtual currencies post-2018 presents several measures including circulars and citing a range of concerns such as jurisdiction, terror-funding, activities of existing stakeholders etc. On the other hand, the virtual currency ecosystem presents a jigsaw of opinions and possibilities, on grounds that are ethical and progressive.

THE SUPREME COURT JUDGMENT IN INTERNET AND MOBILE ASSOCIATION IN INDIA VS RESERVE BANK OF INDIA, 4 MARCH 2020

The judgment talks at length about the history, intent, establishment, powers and functions of the RBI. This is not just in the interest of determining the rationale adopted by the RBI but so as to clearly define the ambit of present writ applications.

The identity of **virtual currencies (VCs)** has been detailed by enlisting definitions under a variety of jurisdictions, remarks and regulations of several financial institutions in different jurisdictions, and miscellaneous.

The **Supreme Court** has considered a gamut of precedents and issues involving the identity of VCs; the legality of policies and arguments forwarded by the RBI; precedents to established



and unidentified aspects of markets, values, commodities etc. Before looking at the final reasoning taken by the Supreme Court, it is pertinent to mention that not many of the linkages to the RBI policy forwarded in the writ applications have been confirmed/ merited.



The Supreme Court did not find any proportionality in the freezing of the accounts in question, and was unable to sustain the pre-emptive policy taken by the RBI without proving damages accruing to regulated entities, keeping in mind the statutory powers of the RBI as well a national economic mandate.

THE OUTCOME

The financial systems are responding to the changes as can be seen through these measures, as there has already been a significant shift from the **Reserve Bank of India (RBI)** policies restricting VDAs, in light of the Supreme Court decision in **Internet and Mobile Association in India vs Reserve Bank of India**, 4 March 2020.



INFLUENCER ECONOMY WHOSE PARAMETERS, WHAT AUDIENCE?



A cursory glance at customer-base or brand-loyalty in the present understanding of influencer economy creates both a potential for tapping into new choices as well as plugging any lacuna in the laws applicable upon influencers.

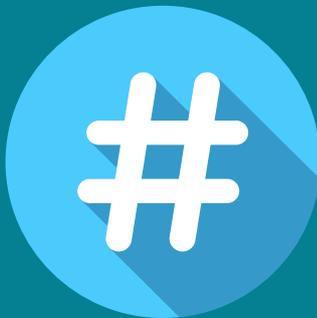
Just as it is advisable to identify influencers based on the number of followers and activities/endorsements, it is incumbent on the government introducing the **10% TDS** to consider a wide ambit of activities for the purpose of assessment. This would broadly cover activities that harness the potential of influencers by using **free products, paid promotions, sponsored travel, vouchers and gift cards, samples etc.**





MATERIAL CONNECTION

How can influencers respond to changes in the social media environment wherein **ASCI** guidelines for hashtags create a predecessor to the **10% TDS** on freebies?



◆ Disclosure Labels

Guidelines are transparent in the sense that influencers must not misappropriate disclosure labels, in contravention of the guidelines.

◆ Declaration

The idea of declaration applies also to the brand posting on or at **social media**, and is very much like an uncertainty about how the hashtags are being used, not just by influencers.



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