



Cryptocurrencies: Indian and Global Approaches to Taxation and Regulation

Nagappan Meyyappan ¹

Occasional Paper No. 17

June 11, 2018

All statements and opinions that appear in this paper are to be attributed to the author and not to International Tax Research and Analysis Foundation (ITRAF) or any other institution or individual unless specified.

¹ The author wrote this paper at ITRAF's invitation. He is Leader, Taxation of Digital Economy at Nishith Desai Associates. He has a Masters in Law from Cambridge University, UK.

International Tax Research and Analysis Foundation (ITRAF) is an independent and exclusive forum for tax policy research, analysis and support conducting Research and Analysis on important tax matters including those relevant to India.

The Occasional Paper Series

ITRAF Occasional Papers comprise advanced analysis of a fundamental area of taxation that has been completed by ITRAF researchers after considering and incorporating the comments received on earlier drafts. In a sense, it is produced at a final stage. Occasional Papers are addressed to a wide audience including policy-makers, tax and legal professionals, academicians, the media and the interested general public.

The Working Paper Series

ITRAF Working Papers usually comprise analysis of an emerging or developing area of taxation by ITRAF researchers. Researchers are encouraged to examine areas, which could have an immediate and crucial influence in the prevailing tax environment. Working Papers are published at short notice to stimulate discussion. Generally, modifications and enhancements may continue to be incorporated as comments are received.

The Occasional Paper Series and Working Paper Series are available on the ITRAF website: www.itraf.org. Comments are welcome; please address them to the authors listed below or to feedback@itraf.org mentioning the series number and title of the Occasional Paper or Working Paper on the subject line.

Author: **Nagappan Meyyappan**

Email address: meyyappan.n@nishithdesai.com

Table of Contents

1. Background	4
2. Key Features and Functioning	5
3. Classification of Bitcoins in India.....	7
4. Taxation Regime for Bitcoins in India.....	8
5. Position in Other Countries.....	10
6. Conclusion	13

Cryptocurrencies: Indian and Global Approaches to Taxation and Regulation

1. BACKGROUND:

In this age of rapidly advancing information technology, one of the foremost developments which has taken place is the emergence of virtual currencies. Virtual currencies are currencies in completely electronic form, not having any physical existence, unlike the currencies issued by the central bank. Bitcoins were one of the first decentralized cryptocurrencies which came into existence in 2009. It is based on blockchain technology and was invented by a person who goes by the pseudonym Satoshi Nakamoto. The bitcoin is generated through the functioning of the blockchain system, where the first person/node to verify a block of transactions will be rewarded with the bitcoing. The technology and the features of the cryptocurrency are described below followed by a regulatory and tax analysis. Blockchain technology is basically based on ‘Cryptography’² where distributed ledger technology’ is used for storing data.

Distributed ledger technology refers to the ability of users to record and store data by themselves in a shared database (the ledger) without the requirement of validation of some central authority. In other words, two parties to a particular network can directly undertake a transaction between themselves without any requirement of validation by an intermediary or central authority like banks etc. Once a data is stored through blockchain technology, it becomes immutable and it cannot be tampered with or altered. This is because, unlike a traditional digital network, where with increasing participants, each new user is an additional security risk to that could compromise or hack the network, in the blockchain technology a transaction is recorded only if more than half the registered nodes on the network record the transaction. Therefore, with increasing participants the network becomes counterintuitively more secure. This is the key reason the technology holds great potential for the digital future of the world and could provide the security required for an expansive digital framework in the future. Further, since the blockchain technology negates the role of all the central authorities or intermediaries like banks, land registries etc., the entire system is decentralized and cannot be easily or obviously subjected to any supervision.

The blockchain technology has many applications. It can be used to facilitate banking transactions. Further, it is the technology behind smart contracts.³ In fact, the State Bank of India has launched a blockchain based smart contracts recently.⁴ One of the other prominent use of this transaction is in the Land Registration system.

² Cryptography involves written and generated codes which keeps the information secret. As physical vaults and locks are used in physical world for security purpose, cryptography is used in digital world for the said purpose.

³ Smart Contracts are self-executory contracts. They are based on self-executing instructions drafted in computer code.

⁴ SBI to use Blockchain for smart contracts and KYC by next month, The Economic Times (20/11/2017), available

Another important aspect of blockchain technology is the facilitation of bitcoin transactions through bitcoin network. Once a bitcoin transaction takes place, the blockchain technology ensures that the transaction is recorded and stored in an immutable manner.

There have been subsequent currencies that have tried to emulate the bitcoin and may broadly fall within the parlance of virtual currencies but are entirely different. For instance, while cryptocurrencies do not have a counterparty issuer and are a produce of the blockchain technology, some companies have issued tokens which can then be used or redeemed towards certain services or goods. They may be similar to bitcoins in that they are freely tradeable and that a market exists for that virtual currency, However, this distinction plays a crucial role from technology, regulatory and tax perspectives as will be discussed below.

2. KEY FEATURES AND FUNCTIONING:

Every currency is backed by a central authority. For example, in India, the Indian Rupee is backed by the Reserve Bank of India. Whenever a currency is backed by a central authority, there is stability in the value of currency chiefly due to the trust and confidence in the central authority. In case of virtual currencies like Bitcoins, there is no backing of any central authority, making bitcoins highly volatile as their value is increasingly influenced by the market forces of demand and supply. Further, in a bitcoin network, the identity of the bitcoin holder is anonymous to a great extent since only a web wallet address may be available and to that extent there could be difficulties in ascertaining the identity of beneficial owner of bitcoins.

As the total number of bitcoins present in the bitcoin network are only 21 million which are expected to be extinguished by 2041, trading⁵ of bitcoins as opposed to mining⁶ of bitcoins has become popular. Based on the success of bitcoin, other virtual currencies like Ethereum, Litecoin, Ripple have also increased their market share and popularity.

A person can receive Bitcoins either:

- i. Through purchase and sale of bitcoins on bitcoins network;
- ii. Through mining of bitcoins; or
- iii. Through purchase from bitcoins exchange.

a. Functioning of the Bitcoin network:

The participants on a bitcoin network are called ‘nodes’. Every node on a bitcoin network holds its bitcoins in e-wallets. Every e-wallet has two keys: public key and private key.

at <https://economictimes.indiatimes.com/industry/banking/finance/banking/sbi-to-use-blockchain-for-smart-contracts-and-kyc-by-next-month/articleshow/61715860.cms>, (last seen on 07/04/2018).

⁵ Blundell-Wignall, A., *The Bitcoin Question: Currency versus Trust-less Transfer Technology*, OECD Working Papers on Finance, Insurance and Private Pensions, No. 37, OECD Publishing (2014) p. 4: Bitcoins trade on an online market and anyone can buy them at the going exchange rate with the dollar on Bitcoin broker platforms (like Coinbase).

⁶ *Ibid*: Mining is the process of spending computing power to process transactions, secure the network, and keep everyone in the system synchronized together.

While public keys can be made freely available to other participants of bitcoin network as they are like email addresses or bank account numbers, a private key is like a password or signature which is why it is necessary to maintain secrecy of the same. Therefore, if a participant wishes to send some bitcoins, he can ask the other participant to provide his public key. On receipt of the same, he can transfer the bitcoins using that public key.

A private key on the other hand is proof that a particular person is the beneficial owner of a transaction. Only a person who has access to private keys can have access to that particular e-wallet. Therefore, only a person having access to a private key can transfer bitcoins from one participant to another by using the recipient's public key. Thus he transfers from his e-wallet using his private key, by using the recipient's public key. In such a scenario the transaction would take place as follows.

- i. The first step is that a participant intending to transfer bitcoins to another participant will scan the public key of the other participant.
- ii. On scanning of the public key of the other participant to whom the bitcoins are intended to be transferred, the said transaction will be broadcasted to all participants of the network. The transaction will be accompanied by a digital signature generated by the private key of transferor of bitcoins.
- iii. Broadcast of the transaction is followed by the process of authentication by the other participants. The blockchain technology allows all the participants to get access to the records of previous transactions undertaken by the transferor. By using this information the participants verify and authenticate the various aspects of the transactions, for example, checking if there are sufficient bitcoins with the transferor to effect the transfer. Further, they will also verify whether the digital signature generated out of the private key of the transferor belongs to the transferor.
- iv. Once the transaction is authenticated, a separate block is created for the transaction. This block is then pooled together with other blocks⁷.

The final step of pooling blocks is rather complicated and requires a nuanced understanding of the technicalities involved. Since the blockchain technology is based on computer codes, one cannot simply validate and add a block to the blockchain. The blockchain requires it to be decrypted for addition of a new block, which involves solving a complex mathematical puzzle. Only when that puzzle is solved will the blockchain be decrypted and a block will be added to the blockchain. Solving these complex puzzles requires equipment with high computational power.

b. Mining of bitcoins:

⁷ Kibum Kim, *Does Technology Against Corruption Always Lead to Benefit? The potential Risks and Challenges of the Blockchain Technology*, 2017 OECD Global Anti-corruption & Integrity Forum, available at <https://www.oecd.org/cleangovbiz/Integrity-Forum-2017-Kim-Kang-blockchain-technology.pdf> (last seen on 24/05/2018): A block is a current part of the chain which records the history of the most recent transaction on a 'nonce' and once completed it goes into the blockchain as a permanent database. Whenever a block is completed, a new block is generated and then linked as a chain in a chronological order with every block containing a part of the previous block, which is known as a 'hash'.

The job of solving complex mathematical problems to validate the transaction is undertaken by miners and the activity undertaken of solving complex mathematical problem is called ‘mining’. If a miner is successful in solving the complex mathematical problem first and validating the transactions, only then will that miner be rewarded with bitcoins. Therefore, mining used to be the primary method of acquiring bitcoins.

c. Purchase from bitcoin exchanges:

Bitcoin exchanges allow trading of bitcoins for fiat currency and also act as an intermediary between people who hold bitcoins and people who wish to purchase bitcoins. In India, there are various bitcoin exchanges like Unocoin, Zebpay, and Coinsecure. However, with the recent RBI ban on banks facilitating such transactions, the operation of the exchanges that enable legitimate trading in virtual currencies has come into question.

3. CLASSIFICATION OF BITCOINS IN INDIA

As ‘*Currency*’:

Under the Foreign Exchange Management Act, 1999, currency includes “all currency notes, postal notes, postal orders, money orders, cheques, drafts, travelers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank of India” (“Currency”).⁸ This means a particular tender will be considered as falling in the definition of Currency in India, only if the same has been notified by the Reserve Bank of India (“RBI”). Till date, bitcoins have not been notified as Currency by the RBI. In fact, the RBI has constantly considered bitcoins as a threat and has cautioned the consumers from risks associated with it.⁹ Recently, the RBI has banned all institutions which fall under its regulatory framework from rendering services for any activity of virtual currencies.¹⁰

As ‘*Goods*’

The definition of goods under Sales of Goods Act, 1930 is “every kind of movable property other than actionable claims and money, and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale” (“Goods”).¹¹ Therefore, Goods include every kind of moveable property which is agreed to be sold under a contract of sale. A contract of sale is nothing but purchase of goods by the buyer from the seller for a price,¹² i.e.

⁸ Section 2(h), Foreign Exchange Management Act, 1999.

⁹ *RBI Cautions users of Virtual Currency against Risks*, RBI Press Release No. 2013-2014/1261 (24/12/2013), available at http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=30247; RBI Press Release No. 2016-2017/2054 (01/02/2017), available at https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=39435; RBI Press Release No. 2017-2018/1530 (05/12/2017), available at https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=42462, (last seen on 09/04/2018).

¹⁰ *Prohibition on dealing with Virtual Currencies*, RBI Notification no.: RBI/2017-18/154 (06/04/2018), available at <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11243&Mode=0>, (last seen on 09/04/2018).

¹¹ Section 2(7), Sale of Goods Act, 1930.

¹² *Id.*, Section 4.

monetary consideration.¹³ Thus, every kind of moveable property which is sold for a monetary consideration will be considered as Goods.

Considering the wide ambit of the definition of goods under the Sale of Goods Act, 1930, there exists a possibility of characterizing bitcoins as Goods provided the same is sold for a monetary consideration. However, if bitcoins are used as a medium of exchange to purchase other items, then it may not be characterized as Goods as no monetary consideration will be involved in the said transaction. In such situations, it would amount to barter or in other words a mutual exchange of goods.

4. TAXATION REGIME FOR BITCOINS IN INDIA

Direct Tax Implications

Under Section 45 of the Income Tax Act, 1961 (the “Act”), any profits or gains arising out of transfer of capital asset is chargeable to capital gains tax. The essential condition for applicability of Section 45 is that there should be a transfer of ‘capital asset’, which is defined under sub-section 14 of Section 2 of the Act. Capital asset under the Act has a wide ambit and includes both tangible as well as intangible material.¹⁴ Bitcoin being intangible in nature may be considered as capital asset provided it does not fall under the exceptions provided under the said section.

One of the exceptions which can have wide applicability in the case of bitcoins is the exception of stock-in-trade. Stock-in-trade means all assets that are used for the purpose of buying and selling in course of one’s business activities. These are assets that are held by individuals in form of investments for a short period with an intention of deriving sufficient returns.¹⁵ The determination of whether an asset is a capital asset or stock-in-trade depends on the facts and circumstances of the case. There is no straightjacket formula to arrive at a conclusion.¹⁶

If bitcoins is considered as stock-in-trade, it will not be considered as a capital asset. This means income generating from the transfer of the same will not be considered as capital gains, as it will be considered as business income and will be taxed accordingly. If a person is involved in trading of bitcoins, then there exists a possibility that transfer of bitcoins held by him may be considered as stock-in-trade. However, if a person holds bitcoins as an investment, then same may be considered as capital asset.

Taxability of bitcoins as capital asset

If bitcoins fall under the ambit of capital assets, then any gains generating from the transfer of the same will be subject to capital gains tax’ under Section 45 of the Act. However, before taxation of gains it is necessary to ascertain the quantum of capital gains on which

¹³ *Id.*, Section 2(10).

¹⁴ *Haji Abdul Kader Sahib v. CIT*, (1961) 42 ITR 296 (Ker.).

¹⁵ *Fort Properties Pvt. Ltd. v. CIT*, (1994) 208 ITR 232 (Bom.).

¹⁶ *CIT v. Gangadar Bajinath*, (1972) 86 ITR 19 (SC).

tax should be charged. Under Section 48 of the Act, capital gains is the total amount left after deducting cost of acquisition, cost of improvement and any expenses incurred in relation to transfer from the total value of consideration.

Therefore, in computation of capital gains on transfer of bitcoins as well, all the aforesaid expenses should be deducted from the total value of consideration. Only the amount which is left after deducting the said expenses from total value of consideration should be subject to tax. Thus, in order to determine the quantum of capital gains, it is necessary to first determine the quantum of the aforesaid expenses.

The quantum of cost of acquisition has been prescribed under Section 55 of the Act. Under the said section, cost of acquisition in case of intangible capital asset is restricted to goodwill, trademark, right to manufacture, right to carry on business, tenancy rights, stage carriage permits and loom hours. Bitcoins may not fall within the scope of the aforementioned intangible assets. Consequently, arguably it may not be possible to ascertain its cost of acquisition in the event it is obtained through mining. In case it was bought, then the price at which the bitcoin was bought would be cost of acquisition.

In light of the above, if the cost of acquisition of bitcoins cannot be calculated as per the law laid down by the Hon'ble Supreme Court in the case of *CIT v. B.C. Srinivasa Shetty*¹⁷, arguably no capital gains tax may be levied at all in some circumstances.

Indirect Tax Implications:

If bitcoins are considered as goods, transfer of the same may have Goods and Service Tax ("GST") implications. Under the GST regime, GST is levied on supply of goods. Supply includes sale as well as barter.¹⁸ For that reason, GST may be levied in both scenarios (i) where Bitcoins are sold for cash, and (ii) where bitcoins are given as a consideration for other goods and services, such that the value on which the tax may be levied will be the open market value of the goods or services for which bitcoins is given as consideration.¹⁹ However, such sale should be in furtherance of business, or else it will not be treated as a taxable supply under Sec. 7 of the Central Goods and Service Tax ("CGST") Act. Further, in the case of a barter, it could be considered as dual supplies that occur simultaneously and therefore the overall GST impact could be significant.

Additionally, other anomalies exist under the GST regime. Under the Integrated Goods and Service Tax ("IGST") Act, the point of taxation or the point at which IGST²⁰ is levied is at the point that the goods are imported into the country. In case of bitcoins, being a digital good, unless it is stored in a wallet that is in a physical medium such as a pen drive or a hard drive, it is unlikely to actually cross the customs border of India, in which case even if it is technically taxable the IGST would practically not be levied due to the failure of the

¹⁷ (1985) 5 Taxman 1 (SC).

¹⁸ Section 7, Central Goods and Services Act, 2017.

¹⁹ Rule 27, Central Goods and Services Rules, 2017.

²⁰ Section 5(1), The Integrated Goods and Services Act, 2017: integrated goods and services tax is a tax levied on all inter-State supplies of goods or services or both, except on the supply of alcoholic liquor for human consumption.

taxation mechanism. Further, for a transaction to be subject to either IGST or CGST²¹ it is required to determine whether it is an intra state or an interstate supply. The two reference points are the location of the supplier of goods and the location of supply. The location of supply for some cases is where the good is actually located. Unfortunately, due to the nature of cryptocurrencies, it is effectively a locationless good unless some reference can be made to a tangible medium it is stored in. Further, to make matters worse, while there is a definition in relation to the location of supplier of services in the CGST, there is no provision in relation to the location of a supplier goods. Arguably, no GST should be levied on any supply of good as it should be impossible, short of creating our own legal fiction, to determine whether IGST or CSGT applies!

Since the RBI notification barring lenders from dealing in virtual currencies, a recent news report²² has disclosed that a proposal for levying 18% GST on cryptocurrency trading is presently being considered by the Central Board of Indirect Taxes and Customs. Cryptocurrency may be classified as an intangible good, comparable to software to bring it under the purview of GST.²³

According to the proposal, purchase or sale of cryptocurrencies would be considered supply of goods and those facilitating transactions like mining of cryptocurrencies, its supply, transfer, storage and accounting would be treated as supply of services. Tax on mining would be collected from the miner on transaction fees or reward and if the value of reward exceeds INR 20 lakh, the individual miners have to register under GST. The valuation of cryptocurrency may be determined on the basis of transaction value in rupees or equivalent of a freely convertible foreign currency.

To determine the place of supply, if buyers and sellers are in India, the buyer's location shall be the place of supply, as is the case with supply of software. In case of transfer or sale, the location of registered person shall be place of supply. However, if the sale is to a non-registered person, the location of the supplier shall be regarded as the place of supply. For transactions beyond the territory of India, IGST shall be applicable and their nature would be import or export of goods, such as cross-border supplies.

5. POSITION IN OTHER COUNTRIES:

As a currency:

The status of bitcoins as a currency differs in various jurisdictions. China, United States, France, Denmark, Canada, Croatia, Poland, Singapore, Spain are the jurisdictions where

²¹ The implications for SGST will be similar to IGST or CGST, which is why SGST has not been discussed separately.

²² Nikunj Ohri, Indian Enforcement Agencies Seek Trading Ban On Virtual Currencies, Bloomberg Quint, April 20, 2018, available at <https://www.bloombergquint.com/bitcoin/2018/04/20/indian-enforcement-agencies-seek-trading-ban-on-virtual-currencies#gs.BvgD3Hw> (last updated April 21, 2018).

²³ <https://www.bloombergquint.com/gst/2018/05/23/india-mulls-gst-on-trading-of-virtual-currencies#gs.qzLNNAE>

the status of bitcoin as a currency has been explicitly rejected.²⁴ On the other hand, Japan is the first country to recognize bitcoin and other virtual currencies as currency.²⁵

Taxation:

a. United States of America

Bitcoins transactions have been subject to tax liability in the U.S. The same has been clarified by the Internal Revenue Service through its Notice 2014-21.²⁶ For tax purposes, bitcoins have been considered as property, which means the characterization of income generated out of sale of bitcoins and its taxability will depend on whether bitcoins have been held as capital asset. Further, mining of bitcoins also has been subject to tax. The fair market value of bitcoins on the date of receipt of bitcoins out of mining is included in gross income and for tax purposes.

b. United Kingdom

The tax regulatory authority of the UK has clarified its stance on taxation of bitcoins through a policy paper dated March 3, 2014.²⁷ The profits and losses arising out of transactions involving bitcoins undertaken by companies will be subject to general corporation tax. Further, it is also required that such transactions are disclosed in the books of accounts as per the Corporation Tax Rules. In case of individuals, any income generating from bitcoin transactions will be subject to normal income tax, unless the receipts are not in the nature of trading profits, hence making them subject to capital gains tax. Additionally, the mining services provided by the miners are not subject to value added tax.

c. Australia

In Australia, bitcoins have been treated as ‘property’. Therefore, any gains arising from the sale of bitcoins which is not in ordinary course of business is subject to capital gains tax.²⁸ To the contrary, in ordinary course of business bitcoins will be treated as trading stock and will be taxable accordingly.²⁹ Moreover, when an employee has a valid salary sacrifice

²⁴ Regulation of Bitcoins in selected jurisdictions, The Law Library of Congress, available at <https://www.loc.gov/law/help/bitcoin-survey/regulation-of-bitcoin.pdf>, (last seen on 07/04/2017).

²⁵ TERAZONO, Emiko, *Bitcoin gets official blessing in Japan*, Financial Times, October 17, 2017, available at: <https://www.ft.com/content/b8360e86-aceb-11e7-aab9-abaa44b1e130>.

²⁶ Notice 2014-21, available at <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>, (last seen on 09/04/2018).

²⁷ Revenue and Customs Brief 9 (2014): *Bitcoins and other Cryptocurrencies*, available at <https://www.gov.uk/government/publications/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies>, last seen on 09/04/2018

²⁸ Taxation Determination 2014/26, available at, <https://www.ato.gov.au/law/view/document?src=hs&pit=99991231235958&arc=false&start=1&pageSize=10&total=7&num=2&docid=TXD%2FTD201426%2FNAT%2FATO%2F00001&dc=false&tm=phrase-basic-TD%202014%2F26>, (last seen 09/04/2018)

²⁹ Taxation Determination 2014/27, available at

agreement³⁰ for receiving wages in cryptocurrency, the said wages will be subject to fringe benefits tax.³¹ With respect to GST, the bitcoin transactions have been exempted from the same.³²

d. Japan

In Japan, the bitcoins transactions are subject to capital gains tax. The tax rate for the such transactions is very high ranging from 15% to 55%.³³ However, the said transactions are exempt from consumption tax.³⁴

Measures undertaken to prevent money laundering and illicit activities

One of the unique features about bitcoins is the anonymity of a bitcoin holder. The identity of a bitcoin holder is kept completely secret so there is no mechanism to ascertain the beneficial owner of bitcoins. This may give rise to an apprehension of wide range of illegal activities and in fact the said apprehension has come true in past. No concrete measures have been taken by India till date except the measure of banning banks from providing services for facilitation of cryptocurrency transactions as stated above. However, purchase of bitcoins using cash in the past, prior its price going up significantly, could potentially be seen as being funded through black money unless the purchasers are able to show the source of funds clearly and continues to be a huge risk even for genuine purchasers. In many cases, the exchanges through which they bought such coins do not exist anymore. Additionally, it may be a challenge to prove the date of acquisition as well in such cases since even though the blockchain may record the fact that a particular web wallet address was credited with bitcoins on a certain date, the possession of the hard wallet containing such bitcoins could be transferred for cash to another party potentially.

A summary of a few laws around the world in this regard is provided below.

a. United States of America

The U.S. has brought amendments in the Bank Secrecy Act. The amendment was brought to the definition of ‘money service businesses’ (“MSA”). Under the said amendment, any

<https://www.ato.gov.au/law/view/document?src=mm&pit=99991231235958&arc=false&start=1&pageSize=10&total=7&num=1&docid=TXD%2FTD201428%2FNAT%2FATO%2F00001&dc=true&tm=and-basic-TD%202014%2F25>, (last visited on 09/04/2018).

³⁰ A salary sacrifice agreement is an agreement where the employee requests the employer to pay the wages in cryptocurrency instead of Australian Dollars.

³¹ Taxation Determination 2014/28, available at <https://www.ato.gov.au/law/view/document?src=mm&pit=99991231235958&arc=false&start=1&pageSize=10&total=7&num=0&docid=TXD%2FTD201428%2FNAT%2FATO%2F00001&dc=true&tm=and-basic-TD%202014%2F25>, (last seen on 09/04/2018).

³² *GST and Digital Currency*, available at <https://www.ato.gov.au/business/gst/in-detail/your-industry/financial-services-and-insurance/gst-and-digital-currency/>, (last seen on 09/04/2018).

³³ *CryptoInvestors face tax of upto 55% in Japan*, BloombergTechnology, Feb. 9, 2018, available at <https://www.bloomberg.com/news/articles/2018-02-08/crypto-investors-in-japan-face-tax-of-up-to-55-on-their-takings>, (last seen on 09/04/2018)

³⁴ *Japan ends 8% Consumption Tax on Bitcoin today*, CNN, July 1, 2017, available at <https://www.ccn.com/japan-ends-8-consumption-tax-on-bitcoin-today/>, (last seen on 09/04/2018).

person who is involved in exchange or administration of bitcoins will fall within the ambit of MSA.³⁵ By virtue of this amendment, all the persons who are involved in exchange or administration of bitcoins are required to register with the Federal Government. Further, they are also required to register all cash transactions and suspicious activities.³⁶

b. Australia

In Australia, the Anti-Money Laundering and Counter-Terrorism Financing (Amendment) Act, 2017 has been introduced to regulate digital currency on December 13, 2017.³⁷ It requires registration of all bitcoin exchanges with the Australian Transaction Reports and Analysis Centre (“AUSTRAC”). All exchanges are also required to undertake customer due diligence and report suspicious activities to AUSTRAC.

c. Japan

In Japan, Payment Services Act, 2009 has been amended to bring bitcoins within the purview of anti-money laundering laws.³⁸ The amendment has been brought in the wake of shut down of Mt. Gox bitcoin exchange. By virtue of this amendment, registration of exchanges has been made compulsory and various disclosure requirements have been imposed on persons involved in transaction of bitcoins.

6. CONCLUSION

Many jurisdictions have undertaken measures in order to provide clarity in relation to tax implications of bitcoin transactions in a domestic economy. In order to curb the repercussions arising out of the anonymity feature of bitcoin network various reporting and registration obligations have also been imposed. However, India, like China, has chosen to effectively ban cryptocurrencies. Further, apart from express measures, indirectly as well there is pressure on this industry for instance practically the Registrar of Companies has stopped accepting applications that have anything in relation to cryptocurrencies or bitcoins.

Considering the pseudo-anonymous nature of bitcoins, it may become difficult to track people dealing with bitcoins in jurisdictions which have no regulations. Moreover, even if the bitcoin holder is present in a jurisdiction which regulates bitcoins, it may not be possible for other jurisdictions to trace the said transactions. For example there are high chances of shifting of Indian bitcoin exchanges operations abroad due to the ban on banks by RBI to facilitate cryptocurrency transactions. Further, even if the Indian exchanges function in a

³⁵ *Guidance on Application of FinCEN's Regulations to Persons Administering, Exchanging or Using Virtual Currencies*, available at <https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering>, (last seen on 09/04/2018)

³⁶ *Money Service Business Centre*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/money-services-business-msb-information-center>, (last seen on 09/04/2018)

³⁷ *Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2017*, available at http://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r5952_asp/aspassed/toc_pdf/17177b01.pdf.fileType=application%2Fpdf, (last seen on 09/04/2018)

³⁸ *Japan: Bitcoin to be regulated*, The Law Library Congress, available at <http://www.loc.gov/law/foreign-news/article/japan-bitcoin-to-be-regulated/>, (last seen on 09/04/2018).

jurisdiction which regulates bitcoin transactions, the Indian government does not have any means to trace the same.³⁹ This would mean that the legitimate participants in this ecosystem will either deal with this outside India while the rest of the trades move underground. With any new technology the risk of abuse is always existent, however, keeping in mind the tremendous potential that the blockchain technology has to offer in the long term that can form the backbone of a secure digital infrastructure and the fact that the bitcoin is an inseparable by-product of this system, it is worth endeavoring to find the appropriate means to regulate this activity instead of banning it outright.

While this article covers the taxation of cryptocurrencies, it is also important to note what it does not cover the tax and regulatory aspects of:

- a. Cryptocurrency mining activities
- b. Trading of cryptocurrencies from the perspective of the exchanges
- c. Renting of hash⁴⁰ power by entities
- d. Cross border aspects in relation to the above
- e. The difference between cryptocurrencies and utility tokens⁴¹
- f. Whether utility tokens are actionable claims or vouchers and how their taxation is different from that of cryptocurrencies.
- g. Initial coin offerings

The attempt by the Government to provide clarity on this complex issue is a step in a right direction and would greatly assure businesses, traders and customers that they are indeed discharging their GST obligations in accordance with law. Similar clarity in relation to utility tokens, their possible classifications, rate and point of taxation would also provide much needed clarity. In that regard, in most cases a utility token is akin to a redeemable voucher and should be taxable as such. Therefore the point of taxation should be at the time such token is redeemed in exchange for services or goods and not at the time of issuance of such voucher/token.

Further, it is essential to also deal with the taxation of a token when it qualifies as an actionable claim. An actionable claim is defined as “*a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of moveable property, or to any beneficial interest in moveable property not in possession either actual or constructive, of the claimant, which the civil courts recognize as affording grounds of*

³⁹ Vaibhav Parikh and Arvind Ravindranath, *Fear of Virtual Currencies*, Business Standard, April 10, 2018, available at http://www.business-standard.com/article/opinion/fear-of-virtual-currencies-118040901185_1.html (last seen on 10/04/2018).

⁴⁰ Blundell-Wignall, A., *The Bitcoin Question: Currency versus Trust-less Transfer Technology*, OECD Working Papers on Finance, Insurance and Private Pensions, No. 37, OECD Publishing, 2014, available at <https://www.oecd.org/daf/fin/financial-markets/The-Bitcoin-Question-2014.pdf> (last seen at 24/05/2018).

⁴¹ Utility token provides future access to a product or service. The State of Wyoming has passed a law defining utility token and has recognized it as a new set of class separate from both security token and commodity. The law excludes “developers or sellers” of tokens from securities laws under the caveat that they meet certain conditions. In order to meet these requirements, the token must not be offered as an investment and must be a vehicle for exchange as a utility token. Open Blockchain Tokens-Exemptions Act of 2018, H.B. 0070, 64th Session, § 1 (2018).

*relief whether such debt or beneficial interest be existent, accruing or conditional or contingent.*⁴² For instance, lotteries are actionable claims and to the extent that a token provides a right to exchange it for a good, it is arguably an actionable claim in which case it is exempt from GST altogether (since only actionable claims that fall within betting, gambling or lottery would be subject to GST). While there are certain judicial decisions that have stated that a claim with respect to an outstanding service could also be actionable claims, it is not a position that appears to be widely adopted currently and hence clarity on the above aspects would be welcome.

Clearly, this area is currently at a nascent stage and the number of issues in relation to the same increase on a daily basis. This, clubbed with the unfavourable regulatory regime and uncertain tax treatment is not good for securing digital India's future in the long term. Moves that hurt genuine customers and incentivize shifting business outside India would also affect the Government as it would be a huge revenue loss to the tax department if the trades simply move abroad. The sooner the Government accepts that banning will not work in the long run and comes up with measures to regulate the same, the better it will be for the customers, businesses and the Government.

⁴² Section 2(1) of the CGST Act, 2017 read with Section 3 of Transfer of Property Act, 1882