Source : www.livemint.com Date : 2021-06-22

INCOME EARNED VIA CRYPTOCURRENCY MUST BE DISCLOSED

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

Income from cryptocurrency sale can be taxed as capital gains income or as profits

Cryptocurrencies have been in the spotlight in the recent past owing to factors such as the dramatic rise and fall of prices, views of certain high-net-worth individuals and actions taken by various governments. Lured by the prospect of high returns, several Indians have invested in cryptocurrencies such as bitcoin, ethereum and dogecoin. Such investors must be careful while preparing their tax return. They must make appropriate disclosure of the income earned from the sale of cryptocurrencies. Let’s look at some nuances of taxation of income earned from transacting in cryptocurrencies.

Neither the Income Tax Act, 1961, nor the Central Board of Direct Taxes stipulates any specific tax treatment for income earned from investments in cryptocurrencies. Under the Act, income earned from the sale of cryptocurrency can be taxed either as income from capital gains, or as profits/gains from business or profession. The classification of income and its computation mechanism are determined by whether an individual holds cryptocurrency as an investment or stock-in-trade.

Capital gains: Cryptocurrency in its generic meaning gives the holder exclusive rights to access/spend and may likely be qualified as a financial asset, as the Indian regulatory framework does not consider them legal tender. The Act defines capital asset broadly to include any kind of asset, interest or rights in a property, unless specifically excluded. Cryptocurrency is not specifically excluded from the definition of capital asset.

The difference between sale consideration, cost of acquisition and expenses incurred on transfer of cryptocurrencies is considered as capital gains. The cost of acquisition is the cost of purchase of such cryptocurrency plus the broker’s commission or wire transfer fee . Since cryptocurrencies are held in an electronic wallet, in case of purchase of cryptocurrency at various points of time and cost, it becomes fungible, which leads to issues with identifying which tranche of purchase is being sold and the cost of acquisition. In such a case, the taxpayer must adopt a first-in-first-out method to determine the cost of acquisition.

The capital gains are further classified into short-term or long-term gain depending on the period for which such an asset is held. Gains earned on cryptocurrency held for less than three years from the date of acquisition are considered short-term gains and taxed as per applicable slab rates (top tax rate 42.74%), while those held for more than three years are considered as long-term. The gains are subject to a beneficial tax regime (top tax rate 28.49%). The taxpayer is also eligible for indexation benefit on the cost of acquisition. In case one cryptocurrency is bartered with another, each swap shall be considered a transaction and be subject to capital gains tax. The taxpayer shall be required to report and pay taxes on each such disposal. Considering the recent fall in cryptocurrency prices, some investors would also have incurred capital loss while selling cryptocurrency. These losses can be set-off against gains from sale of other assets, subject to existing rules.

Income from business or profession: Taxpayers who speculate on short-term price movements, or who hold the cryptocurrency as stock-in-trade may be considered as traders.

Whether a person qualifies as trader or investor depends on aspects including frequency in buying and selling, period of holding, and intent of investment. Where a taxpayer qualifies as a trader, any income earned from sale of cryptocurrency shall be taxed as income from business or profession. Taxpayers should also evaluate whether the income shall be considered as speculative income or not. Whether the income is considered speculative or not will depend on whether the cryptocurrency is considered a commodity and is periodically or ultimately settled otherwise than by way of actual delivery or transfer of such commodity.

Return disclosures: Taxpayers whose income exceeds 50 lakh in a year are required to report their assets and liabilities in Schedule for Assets and Liabilities along with cost of acquisition. Since cryptocurrencies are also regarded as assets, taxpayers shall include cryptocurrencies in the said Schedule.

Additionally, taxpayers who qualify as resident and ordinary residents are required to disclose overseas income and assets in the tax return. Considering the tax and penal consequences under the Act and the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, it may be prudent for taxpayers to disclose the cryptocurrency holdings in the foreign asset or income schedule.

Amarpal Chadha is tax partner and India mobility leader, EY.

Aditya Modani, director - people advisory services, EY India, has contributed to this column.

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