Budget’s ‘crypto signal’ awaits reforms

(Mains GS :2 & 3 : Government policies and interventions for development in various sectors and issues arising out of their design and implementation & Science and Technology- developments and their applications and effects in everyday life.)

Context:

In the Union Budget 2022-23, Finance Minister Nirmala announced a 30% flat tax rate levied on any gains made from the transfer of virtual assets including cryptocurrencies and Non-Fungible Tokens (NFTs).

Towards policy shift:

- Cryptocurrency (crypto) consists of a digital denomination designed to work as a medium of exchange through a distributed computer network (a blockchain) that is not reliant on any central authority such as a government or a bank for its upholding and maintenance.
- Announcement of a tax rate on cryptocurrency amounts to effectively being a de facto affirmation of the role that cryptocurrency and related technologies could play in India’s financial-cum-economic system.
- Foreseeable are changes that would, down the road, legitimise and formally legalise the activities of crypto start-ups and enable them to access the necessary support system which might not have been available previously.

Open up more doors:

- It is high time that crypto made a splash in the country, but this splash must, as with all innovation, be carefully managed to prevent rushed creative destruction and systemic liabilities.
- While critics are observing that the 30% flat tax rate is a harsh rate, this is a premium and price well-worth paying in exchange for what is effectively a ruling-out of prospects for a total ban on crypto by the central government.
- Additionally, while the high tax rate would inevitably hamper the willingness of investors to convert cryptocurrencies into the national fiat, this may, in turn, open up more doors for technologically savvy and innovation-minded investors.

Involve DeFi (Decentralised Finance):

- The extremely high tax rate and the fact that the losses cannot be offset would invariably propel investors to turn to alternative means of storing and undertaking transactions in cryptocurrencies.
- Such transformations would involve DeFi (Decentralised Finance) activities such as staking, lending, and providing liquidity, among others.
- DeFi (or "decentralized finance") is an umbrella term for financial services on public blockchains and with DeFi, one can do most of the things that banks support but it is faster and does not require paperwork or a third party.
- As with crypto generally, DeFi is global, peer-to-peer (meaning directly between two people, and not routed through a centralised system), pseudonymous, and open to all.
- further, the adoption of crypto currencies and virtual assets would enable quicker and cheaper transactions compared to banks and new forms of wealth creation without centralised intermediaries.

Access the ecosystem:

- The community of small and medium-sized enterprises (SMEs) and lower-end high net-worth individuals is going to find it most difficult to access the ecosystem given the substantial barriers posed by the tax rates.
- Unless radical reforms are undertaken to liberalise the system it is unlikely that small and medium-sized enterprises (SMEs) and lower-end high net-worth individuals will reap the gains from the system.
- Additionally, when it comes to India's crypto policy at large, there is a fundamental lack of clarity in aspects other than taxation.

Defeats the fundamental purpose:

- In the Budget presented for 2022-23, the Finance Minister had also announced the introduction of India's Central Bank Digital Currency (CBDC) to give a 'big boost' to the digital economy.

- The consolation offered by the Government in the form of the Reserve Bank of India's CBDC, or Central Bank Digital Currency, will definitely help in pushing for the adoption of digital currencies, but, equally, defeats the fundamental purpose of cryptocurrency, which is decentralisation.
- As a flourishing and dynamic democracy, India deserves an empowered and mobilised middle class of consumers, investors, and crypto-minded citizens who can imbue their civic engagement and economic activities with cryptocurrency in contributing toward a brighter and better political future for all in India.

Needs systemic reforms:

- Since cryptocurrencies are unlike any other asset class, stored and traded virtually, there are varied challenges which need to be addressed in order to streamline the process of taxing crypto transactions.
- The solution rests with systemic and real reforms which would be to reduce tax rates in the future, though this must be weighed against considerations concerning government revenue and the need to curb speculative bubbles surfacing in relation to the currency.
- Cryptocurrency could pose medium- to longer-term threats and the solution here lies not with taxing crypto altogether, but in introducing more rigorous regulations where appropriate without which crypto has the potential to become a source of illegitimate political funding or black money.

Conclusion:

Systemic reforms are by no means easy, but they are critical as an amplifier of the successes and as an accelerator of India's advancement in the sphere of cryptofinance and blockchain social policymaking.