On crypto assets and regulation

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(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:

> The announcement of a 30 percent tax on income from cryptos and other virtual assets is welcomed by the experts but also raises a number of concerns on its impact on the industry.

Discourage investors:

- Many argue that after years of speculation and discussions of a ban on cryptocurrencies, a clear tax regime is a step towards a more structured recognition for cryptos by the government.
- But, a 30 percent tax rate could discourage investors, especially new ones from dabbling in an asset class that is still struggling for wider acceptance among governments globally.
- Moreover, cryptos are now taxed on par with gains from speculative activities such as gambling, and lotteries, etc., putting the digital assets in the highest tax band.

Nature of cryptocurrencies:

- Crypto-assets or cryptocurrencies are being embraced by many but they are under fire mostly by the officialdom in many parts of the world.

- It is primarily because the transaction process using cryptocurrencies is so secure that only a money transfer can be seen and nothing can be known about the sender and the recipient.
- These decentralised assets, with no central bank controlling them, may therefore be used for 'hawala', which is a trust-based system of transferring money quickly in a parallel arrangement avoiding the traditional banking system and escaping the due tax.
- Anonymity and privacy are the underlying characteristics as well as the potential danger of cryptocurrencies.
- The risks investors and consumers face in dealing with these so-called currencies, given that they are neither 'a store of value nor are they a medium of exchange', and the ostensible threat they pose to financial stability, are also key factors.

Varied challenges:

- An estimate suggests that as many as 10 crore Indians may already have investments exceeding a total of $10 million in them which not only creates an avenue for generation of tax revenue for the nation but also puts forth a Herculean challenge for the tax authorities who have to track and tax transactions involving cryptocurrencies.
- 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 absence of explicit tax provisions has led to uncertainty and varied interpretations being adopted in relation to mode of computation, applicable tax head and tax rates, loss and carry forward, etc.

Hard to regulate:

- Besides the 30 percent tax, the budget also said that a 1 percent tax deduction at source (TDS) will be applicable when trades and transfers are executed.
- Experts see the minimal TDS as a reason to ensure that all transactions can be tracked which further signals the need for increased compliance and a requirement of KYC for all investors.
- Even if the crypto-market intermediaries are regulated and follow Know Your Customer (KYC) norms, there remains a scenario, where physical cash or other goods/services may change hands in return for cryptocurrencies.

Steps forward:

- The income-tax laws pertaining to the crypto transactions need to be made clear by incorporating detailed statutory provisions which could include provision of a definition for crypto assets for tax purposes and guidelines addressing the major taxable events and income forms associated with virtual currencies.
- The practice of having separate mandatory disclosure requirements in tax returns (as is the case in the United States) should be placed on the taxpayers as well as all the intermediaries involved, so that crypto transactions do not go unreported.
- The existing international legal framework for exchange of information should be strengthened to enable collecting and sharing of information on crypto-transactions.
- Tax authorities should also equip themselves with the latest forensic software which can analyse a high volume of crypto transactions at a time and raise red flags in cases of suspicious transactions.

Conclusion:

- Delay in arriving at a forward-looking approach to crypto market oversight pre-empts Indian start-ups and innovators from developing products and ideas that can be scaled up globally given the nature of these assets.
- Thus a streamlined tax regime will be essential in the formulation of a clear, constructive and adaptive regulatory environment for cryptocurrencies.

This provides some relief for the growing flock of crypto investors. The Government may still not consider them fully legit, yet the tax regime indicates the hard option of an outright ban that was signalled in the nomenclature of a proposed crypto law last year is off the table. Listed first for Parliament's monsoon session, then again in the winter, that legislation is also now off the agenda. All this time, India's youth, who the Prime Minister worried were being lured by crypto players' misleading ads, continue to be swayed, with no norms brought in place to rein in such ballyhoo, and no regulatory watch. Whether this case is different from collective investment and plantation schemes that were belatedly regulated is ponderable. The delay in arriving at a decision also pre-empts Indian start-ups and innovators from developing products and ideas that can be scaled up globally given the nature of these assets.

In November, the Government had indicated a forward-looking approach to crypto market oversight. It is time those words are matched with a clear regulatory framework soon instead of ambiguous waffling and dithering.