

Income arising from crypto sales prior to April 1, 2022 to be taxed as capital gains and not as income from other sources

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Background

An individual salaried taxpayer (the “**Individual**”) purchased bitcoins during the financial year 2015-16 and sold them in the financial year 2020-21. In the tax return, the Individual claimed that the bitcoins sold qualified as a capital asset under Section 2(14) of the IT Act; and, therefore, gains arising from the sale of bitcoins must be regarded as long-term capital gains as the Individual had held the bitcoins for more than thirty-six (36) months. Additionally, the Individual claimed long-term capital gains tax exemption under Section 54F of the IT Act as the capital gains were used to purchase a residential property. The Indian tax authorities rejected the Individual’s claim and held that bitcoins did not qualify as a capital asset under Section 2(14) of the IT Act and, therefore, the gains must be taxed as income from other sources. This also led to rejection of the Individual’s claim for tax exemption under Section 54F of the IT Act.

The Individual lost his appeal before the Commissioner of Income-tax (Appeals) and, subsequently, preferred an appeal before the Income Tax Appellate Tribunal, Jodhpur (the “**Jodhpur Tribunal**”).

Legal position

Under the provisions of the Income-tax Act, 1961 (the “**IT Act**”) in the case of individual taxpayers, “long-term capital gains” on sale of property (which is a capital asset) that has been acquired before July 23, 2024 and held for more than thirty-six (36) months is taxed at the rate of 20% (excluding surcharge and cess) whereas any “income from other sources” is taxed at the rate of 30% (excluding surcharge and cess). A tax exemption is available to an individual taxpayer if the long-term capital gains is utilized to purchase a residential property. Moreover, in computing the long-term capital gains tax, the IT Act also allows indexation benefits to determine the cost of acquisition of the property. Such beneficial tax provisions are not available to an individual taxpayer if tax has to be calculated on “income from other sources.” Thus, the characterization of income is crucial in determining the final tax liability.

The Jodhpur Tribunal’s ruling

The Jodhpur Tribunal noted that the term “capital asset” as defined under Section 2(14) of the IT Act means “property of any kind held by an assessee, whether or not connected with his business or profession.” The Jodhpur Tribunal delved into Explanation 1 to Section 2(14) of the IT Act, which clarifies that the term “property” includes and shall be deemed to have always included any right in or in relation to an Indian company, including the right of management or control or any other right whatsoever. Moreover, the Jodhpur Tribunal highlighted that the term “transfer” under Section 2(47) of the IT Act in relation to a capital

asset includes the sale, exchange, relinquishment or extinguishment of any right therein. On this basis, the Jodhpur Tribunal concluded that the Indian tax authorities were not correct in asserting that one should actually own something as property for it to qualify as a capital asset. Even if a person has a right or claim in a property, it should be considered a capital asset under Section 2(14) of the IT Act.

The Jodhpur Tribunal further noted that Section 2(47A) of the IT Act pertaining to “Virtual Digital Assets” (“VDA”) (which include underlying assets such as bitcoins) was only inserted in 2022. Although from 2022 onwards, VDAs were taxed at a higher rate, they, nevertheless, continued to retain the character of capital assets by default and were to be considered as “property of any kind.” Moreover, as the relevant amendment to the IT Act on the taxation of VDAs was prospective in nature, the lower rate of tax on capital gains would apply to the Individual’s sale of bitcoins prior to 2022.

The Jodhpur Tribunal also discussed the point on dual interpretation of a statutory provision, i.e., whether bitcoin was a capital asset or not. Relying on the Supreme Court’s decisions in the *Vegetable Products* and the *Safari Retreats* tax cases, the Jodhpur Tribunal concluded that when two (2) views or interpretations are possible, the view that is more favourable to the taxpayer must be considered.

Based on all the foregoing, the Jodhpur Tribunal held that all rights are property, and therefore, the right of the taxpayer in the bitcoin is a capital asset (albeit a virtual one), which results in capital gains and is not chargeable under the head income from other sources.

Our comments

This is one of the first rulings in India where a tax tribunal has held that bitcoin or cryptocurrency, being a virtual asset, is a capital asset, because of which gains on the sale thereof are to be classified as capital gains and not as income from other sources. This decision negates the position taken by the Indian tax authorities that when you buy a bitcoin you own nothing, except your right to sell your share therein to another willing buyer. The Jodhpur Tribunal has clarified that the amendments pertaining to the taxability of VDAs introduced by the Finance Act, 2022, are prospective in nature and cannot be made applicable to prior years. Please refer to our previous update [here](#) on Indian tax implications in cryptocurrency transactions post April 1, 2022.

More likely than not the Indian tax authorities will appeal the Jodhpur Tribunal’s decision to the Rajasthan High Court; however, considering the well-drafted and reasoned thirty-one (31)-page order passed by the Jodhpur Tribunal, it remains to be seen what the outcome will be.

As we see it, the cryptocurrency industry in India is still in a nascent stage with skewed knowledge available regarding its working, which complicates its classification and, therefore, its categorization under India’s taxation system. The tax rate of 30% (irrespective of the income bracket of the taxpayer), non-availability of any deductions (other than the

cost of acquisition), non-availability of set-off of losses, and the requirement to withhold tax, all seem to be aimed to discourage investments in VDAs.