TDS on Virtual Digital Assets

A REPORT ON THE EFFECTS OF THE 1% TDS ON TAX REVENUE AND USER TRENDS

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BY: CENTRE FOR TAX LAWS (SUPPORTED BY TAXMANN), NALSAR

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About Centre for Tax Laws (Supported by Taxmann), NALSAR

NALSAR University of Law is one of the premier Law Universities of the country and since its inception, the University has been home to vital conversations on law and justice. NALSAR has pioneered legal research and has been at the forefront of introducing innovations in legal education throughout India. NALSAR has been consistently ranked as a top-tier Law University of India. It has been graded as Category-I University by the UGC as per the UGC Categorization of Universities (only) for Grant of Graded Autonomy Regulations, 2018. NALSAR has been accredited by NAAC with A++ grade scoring 3.52 CGPA out of 4.00. In furtherance of its research objectives and goals of nurturing and advancing inter-disciplinary and intra-disciplinary study of law, the University has established Centre for Tax Laws (supported by Taxmann). CTL engages with critical thinking on questions of tax justice and deepening the discourse on normative, legal, policy and regulatory aspects of taxation. CTL is committed to building a non-hierarchical, collaborative, decentralized network of academia, researchers, professionals, students, industry, and government. And thereby, broaden and deepen collaborative best practices and research in the area of tax laws and provide policy support to government, regulators, and corporation.

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Disclaimer

Please note that this Report is intended to provide insights into the impact on the tax revenue and user trends due to the imposition of 1% TDS on transfer of VDAs. The scope of this Report does not and is not intended to cover other aspects of VDA taxation or regulation, including any interlinkages. The authors reserve the right to cover items not addressed in the Report or clarify any aspect of the Report in subsequent publications. Nothing in this Report should be seen as the authors endorsing any tax proposal that is seeking tax sops or incentives for VDAs. The Report also limits the critical analysis of the 1%TDS only to the stated objective of it being introduced as a transaction tracking tool and it is not part of this study to critically examine of comment upon whether such rationale for TDS introduction is justified. This Report is premised on the assumption that such rational is sufficient and then proceeds to set out based on data how the stated objective is not being met. This Report should also not be understood as an endorsement of the 1%TDS or the rationale behind its introduction. Further, since the Report is only limited to the analysis of the 1%TDS and its impact on tax revenues and user trends, the recommendations are also be understood in the context of the limited scope of this Report. The authors reserve the right to amend the recommendations pursuant to any future or proposed regulatory or tax changes that may arise.

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Executive Summary

This Report examines the impact on the user trends and tax revenues of the exchequer due to the imposition of 1% withholding tax/tax deduction at source (**TDS**) applicable on transfer or trade of virtual digital assets (**VDAs**) by Indian users. The Report considers data from top 6 Indian VDA Exchanges (**Indian Exchanges**) on trading volume, active user count, TDS deposits, and gross income, and finds that: (a) the TDS policy has contributed to significant losses in trade volume on Indian exchanges and a corresponding exodus to offshore VDA Exchanges (**Offshore Exchanges**) and unregulated markets; (b) the exchequer may have potentially lost ~INR 2,489 crores in tax revenue between February 2022 and January 2024 from VDA trades undertaken on the top 6 Indian Exchanges due to introduction of the 1% TDS[1]; (c) in case the current TDS policy continues, the Indian exchequer may potentially lose out on tax revenues of around INR 5,894 crores from the top 6 Indian Exchanges in the next 3 years; and (d) the tax revenue can more than double in the current FY where TDS is reduced from 1% to 0.01% rate.[2]

The primary reason for loss in exchequer can be attributed to the decline in transaction volume on Indian Exchanges. For instance, the total volume of VDAs traded on Indian Exchanges fell by around ~97% within two years of the announcement of the 1% TDS and the harsh tax regime for taxation of income from VDAs. Likewise, the number of active users on the Indian Exchanges fell by ~81% during the same period. Of the total decline of ~97%, with a global downward price action of ~45% during this period, ~52% of the decline in volume of VDAs traded on Indian Exchanges appears to be attributed to the VDA tax policy, particularly the introduction of the 1% TDS.

The Report also notes that post introduction of TDS, there has been a significant uptick of Indian users on the Offshore Exchanges. Thus, the new tax regime has led to a mass migration of Indian users from Indian Exchanges to Offshore Exchanges and unregulated markets. Hence, apart from causing significant loss to the exchequer, the 1% TDS may have not met the very objective behind its introduction, i.e., tracking of VDA transactions undertaken by Indian users.

This Report also notes that the TDS on the transaction volume of VDAs is contrary to the well-established tax policy principles. Further, the approach towards taxation of income from VDAs akin to gambling / sin activity as opposed to being taxed as property / commodity and 1% TDS has caused a ripple effect on the economy with many businesses and a skilled talent pool moving outside India to pursue opportunities in the VDA economy, depriving the nation of the

[1] Please refer our findings in Table 3.
[2] Please refer our findings in Figure 8.

positive externalities of the VDA economy. Hence, the 1% TDS is a significant hurdle in the development of emerging technologies in India.

In light of the overwhelming unfavourable impact of the 1% TDS, particularly the non-fulfilment of its intended objective of tracking VDA transactions, the Report suggests some alternatives towards meeting the intended objective, without collateral harm to stakeholders in the VDA ecosystem. Particularly, the TDS on a 'per transaction' basis may be replaced with a transaction reporting requirement which is already partly fulfilled by other regulators such as the Financial Intelligence Unit. This may also be supplemented by other reporting requirements such as return filings without the imposition of TDS. In case a roll back of TDS entirely is not feasible, at least the transactions carried out on the regulated VDA exchanges which are complying with transaction reporting requirements should be exempted from the levy of TDS. Further, in any case, the objective of transaction tracking could be met by the imposition of a lower TDS rate. It has been estimated that a 1% TDS levy could potentially block up to ~90 to 99% of a user's capital within a quarter, whereas a 0.01% TDS levy should only block ~2.5 to 5% of a user's capital.[3] Notwithstanding the argument on the necessity of TDS as a tracking tool (which objective may be met through statutory reporting requirements), reducing the TDS rate to 0.01% would ensure the monitoring of VDA transactions, without unduly impacting to stakeholders in the VDA ecosystem.

[3] Please refer our findings in Figure 7.

A. Introduction

1. India introduced a 1% TDS on transfers of VDAs with effect from July 1, 2022.[4] India also introduced a 30% tax on income from VDA transfers with effect from April 1, 2022.[5] This Report discusses the correlation between TDS and the VDA activity in India and attempts to estimate the impact of the TDS policy on the tax revenue of the Indian exchequer. Based on various quantitative and qualitative attributes, this Report discusses the effectiveness of the policy in attaining its desired objectives, and alternative policy recommendations.

2. Before the introduction of these tax changes, the tax regime in India did not contain explicit provisions for the classification and taxability of income from VDA transfers, which was potentially classified either as business income, other income, or capital gains.[6] Further, in the absence of an explicit withholding tax provision, withholding tax implications in respect of VDA transfers varied depending on factors such as the residential status of the recipient and the nature of income arising from the transfer.[7]

3. The key features of the current Indian VDA tax regime include:

    a. A wide definition of 'VDAs' with limited exclusions;[8]

    b. A 30% tax on income from VDA transfers without any allowance, or deduction in respect of any expenditure incurred for the sale other than cost of acquisition (**30% VDA tax**);[9]

    c. No set-off of losses incurred on transfer of other VDAs allowed against any income of the taxpayer and such losses are not allowed to be carried forward.

    d. A 1% withholding tax on VDA transfers with low threshold requirements (for instance, in case of individuals not engaged in any business or profession, the 1% withholding tax need not be deducted if the aggregate annual consideration does not exceed INR 10,000);[10] and

[4] Income Tax Act, 1961, section 194S.
[5] Income Tax Act, 1961, section 115BBH.
[6] Income Tax Act, 1961, sections 4, 14, 28 and 45.
[7] Income Tax Act, 1961, sections 194Q, 194O, 195 and 206(1H).
[8] Income Tax Act, 1961, section 2(47A); Notification No. 74/2022 dated 30 June 2022.
[9] Income Tax Act, 1961, section 115BBH.
[10] Income Tax Act, 1961, section 194S.

e. Gift tax implications in respect of VDA transfers without or for inadequate consideration, which are taxable in the hands of the recipient at applicable slab rates as 'income from other sources,' provided that the value of the benefit exceeds INR 50,000.[11]

4. As illustrated in Figure 1 below, India's flat tax of 30% on all VDA transactions irrespective of the income threshold of the taxpayer is one of the highest across comparative economies. Further, the tax impact is particularly harsh considering that India does not allow set-off and carry forward of losses, which is uniquely discriminatory, even when compared to other industry sectors in India.

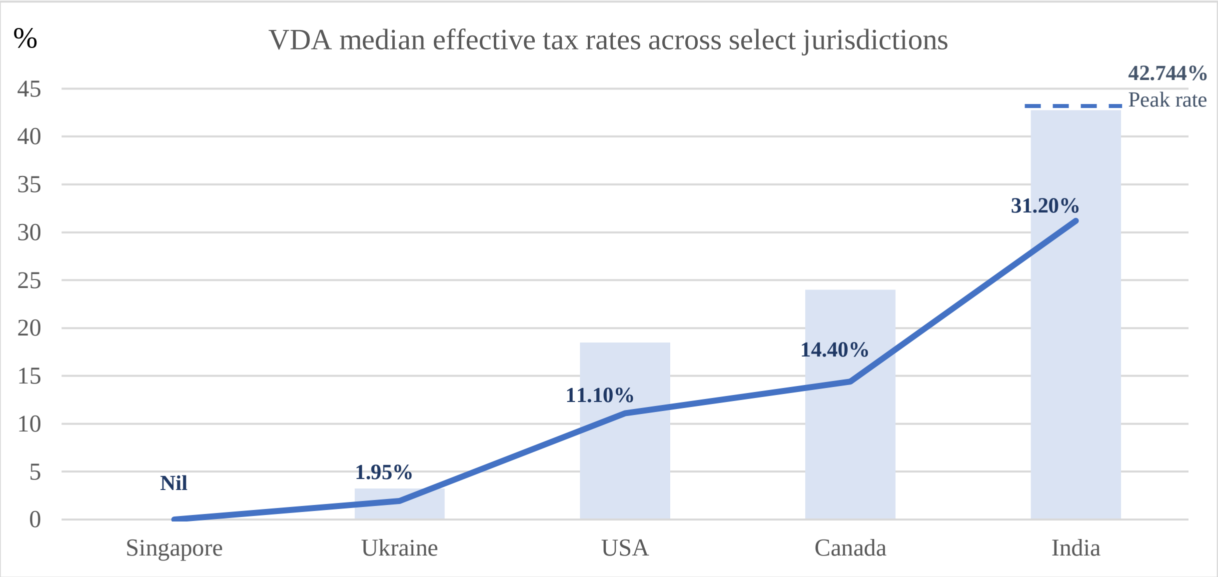

Figure 1: VDA Median Effective Tax Rate across Select Jurisdictions

[11] Income Tax Act, 1961, section 56(2)(x).

Sl. No	Jurisdictions	Classification for tax purposes	Tax rate/ range		TDS Applicability	Set-off/ carry forward of losses
			Long-term gains/ income	Short-term gains/ income		
1.	India	Capital gains/ business income/ other sources but taxed as akin to gambling[12]	31.20%[13] ***With surcharges, this may go up to ~42.744%***		✓	✗
2.	USA	Property	0-20%	10-37%	✗	✓
3.	UK	Virtual asset	0-20% on capital gains above the tax-free allowance; 0-45% income tax		✗	✓
4.	Canada	Commodity	15-33% based on classification as income or capital gains		✗	✓
5.	Netherlands	Asset	For corporate entities, income from VDAs is taxed as per Dutch corporate tax at the rate of 19% or 25.8%. Individuals may be subject to the Dutch wealth tax basis a deemed fictional return of 6.17% on the value of the VDAs at the rate of 34%.[14]		✗	✓
6.	Ukraine	-	5% with plans to increase to 18%; Individuals are subject to an additional military tax at the rate of 1.5%.[15]		✗	✓
7.	Philippines	Corporate income/ Personal Income	0-35% income tax for individuals 20-25% corporate income tax.[16]		✗	✓
8.	Singapore	-	No tax unless engaged in trading		✗	-

Table 1: VDA Tax Regimes across Select Jurisdictions[17]

[12] Please note that while income from VDAs can be characterised as capital gains as well i.e., VDAs are treated as capital assets (includes property of any kind), however, the tax treatment for income from VDAs is quite different from tax on other capital assets. The tax treatment for income from VDAs is harsher than even income from speculative business, gambling income as discussed in supra note 20 and Section 25 of the Report.

[13] Effective tax rates range between 34.94 - 42.744% inclusive of 30% tax under section 115BBH, 4% cess and highest applicable surcharge i.e., 37% surcharge for individuals (not having income under section 115AD and not having income chargeable under section 115BAC) and 12% for domestic companies (not having income chargeable under section 115BAA or section 115BAB of the Income Tax Act, 1961).

[14] PwC Annual Global Crypto Tax Report 2024, can be accessed here.

[15] Jana Trouch, Ukraine to Introduce Taxation of Crypto Asset Transactions, IBFD, November 2023; Dr. Vikash Gautam. *Virtual Digital Asset Tax Architecture in India: A Critical Examination.* Special Issue No.208, January 2023, Esya Centre; IFC Review, EU TAX: Ukraine to Charge 18% Tax on Crypto Profits Starting in 2024, June 2023.

[16] PwC Annual Global Crypto Tax Report 2024, can be accessed here; Carina C Laforteza, Joanna Marie O Joson, Joanna Marie O Joson, Corporate Tax 2024: Philippines, Chambers and Partners, can be accessed here.

[17] Dr. Vikash Gautam, *Virtual Digital Asset Tax Architecture in India: A Critical Examination.* Special Issue No.208, January 2023, Esya Centre, for details for jurisdictions other than India.

5. As illustrated in Table 1, India's VDA taxation regime is one of the most stringent and harshest tax regimes in the world:

   a. India's 1% TDS on the entire transaction value is an outlier in the entire world. Most countries with significant VDA exposure (and the inherent accompanying risks) do not impose such withholding tax. Countries like Thailand that impose withholding tax, do so only on the income element and not on the transaction volume.[18]

   b. Most jurisdictions have a progressive rate structure as opposed to a flat rate structure (unlike India). Further, while the ceiling tax rate in certain jurisdictions (for instance, the US and Canada) exceeds India's flat 30% rate, such a ceiling rate is expected to impact a smaller portion of high-income traders.[19]

   c. India is one of the few countries that do not allow for set-off and carry forward of losses from VDA transactions (others include Brazil and Japan).[20]

   d. Most jurisdictions treat VDAs as property / commodity[21] and tax income from VDAs accordingly. On the contrary, India's tax policy of a flat 30% tax on income from VDAs without set off and carry forward of losses is different from taxation of securities or capital assets in general and is even more stringent than taxation of speculative income.[22]

[18] Dr. Vikash Gautam, *Virtual Digital Asset Tax Architecture in India: A Critical Examination.* Special Issue No.208, January 2023, Esya Centre, for details for jurisdictions other than India.

[19] World Inequality Database, discussed in Vikash Gautam, *Virtual Digital Asset Tax Architecture in India: A Critical Examination.* Special Issue No.208, January 2023, Esya Centre.

[20] Dr. Vikash Gautam, *Virtual Digital Asset Tax Architecture in India: A Critical Examination.* Special Issue No.208, January 2023, Esya Centre.

[21] The Supreme Court of India in *Internet and Mobile Association of India v. Reserve Bank of India* (2020) 10 SCC 274 (**IAMAI Case**) has also referred to possible characterisation virtual currencies as 'intangible property'. Further, while examining the nature of virtual currencies / cryptocurrencies, the court referenced the decision of the Singapore International Commercial Court in *B2C2 Ltd. v. Quoine Pte Ltd* (2020) SGCA (I) 02 (**B2C2 Case**), which held, "*cryptocurrencies… do have the fundamental characteristic of intangible property as being an identifiable thing of value*" and "*cryptocurrencies may be treated as property that may be held on trust"*. Such a classification would be consistent with the emerging practice of recognising VDAs as 'property' across common law countries in various judicial precedents such as *AA v. Persons Unknown,* [2019] EWHC 3556 (Comm); *David Ian Ruscoe v. Cryptopia Limited,* [2020] NZHC 728; B2C2 Ltd v. *Quoine Pte Ltd,* [2019] SGHC (I) 03; *Gatecoin Limited v. Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32)*, [2023] HKCFI 914; *Bdi Capital, LLC v. Bulbul Invs. LLC,* 446 F. Supp. 3d 1127 (N.D. Ga. 2020).

[22] Under section 73 of the ITA, losses from a speculative business are allowed to be set off against income from another speculative business. Further, such losses can also be carried forwarded to up to 4 years. However, similar set off and carry forward provisions are specifically excluded when computing income from transfer of VDAs.

Rationale for the 1% TDS

6. The 1% TDS was introduced along with the 30% VDA tax to track VDA transactions as well as to discourage users from speculative trading[23]:

    a. The Hon'ble Finance Minister in her budget speech delivered on 1 February 2022 specifically stated that the 1% TDS is introduced to "capture VDA transaction details".[24]

    b. The Hon'ble Finance Minister during a debate in the Parliament on the Finance Bill 2022 reiterated that the 1% TDS is not an additional tax but is introduced with the objective of tracking VDA transactions.[25]

7. From the statistics (outlined in the ensuing sections of this Report), the introduction of TDS of 1% on VDAs does not appear to have succeeded in fulfilling its intended purpose of tracking VDA transactions. On the other hand, it has negatively impacted the Indian VDA users and customers, causing a mass migration of trading activity from Indian platforms in favour of foreign platforms and other informal channels. Consequently, it has also inadvertently affected the potential revenue collections of the exchequer.

    a. Despite the harshest tax regime, India continues to be one of the leading markets globally for VDAs.[26] As mentioned above, the 1% TDS only resulted in shifting of trade volumes and users from the Indian Exchanges to Offshore Exchanges and unregulated peer to peer markets, weakening the government's oversight on such transactions.[27]

    b. With this shift in volumes to foreign and other similar platforms, the 1% TDS has been able to track only a small percentage of VDA transactions undertaken by Indian users. It has been estimated that less than 7% of the total VDA transactions (including transactions on Indian Exchanges and transactions by Indian users on the Offshore Exchanges) have been subject to the 1% TDS.[28]

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[23] Dilip Chenoy, India's crypto taxation framework: How does it fare globally? Economic Times, October 2023, can be accessed here, Himanshi Lohchab, Indian crypto investors take illegal routes to avoid tax burden, Economic Times, May 2024, can be accessed here

[24] Budget 2022 – 2023, ccc.

[25] Nirmala Sitharaman, Minister of Finance, can be accessed at: Minister Nirmala Sitharaman's Reply | The Finance Bill, 2022 (youtube.com)

[26] Market studies have shown that even after the imposition of the 1% TDS, India is one of the leading markets for VDAs. In particular, India is estimated to be the second largest VDA market in terms of transaction volume, behind only USA. Further, the adoption of VDAs in India is not confined to the rich and wealthy, it has been reported that India leads the world in terms of grassroots adoption of VDA. (Please refer to "The 2023 Geography of Cryptocurrency Report by Chainalysis", October 2023 at page 56)

[27] ESYA Centre, Impact Assessment of Tax Deducted at Source on the Indian Virtual Digital Asset Market, November 2023.

[28] Ibid.

c. Consequently, while VDAs continue to find favour with India's young and tech savvy population and India's dominance as one of the leading VDA markets in the world, the tax collections from VDAs have been extremely underwhelming.[29]

8. In light of the failure of the 1% TDS in its primary purposes of i) tracking of VDA transactions; ii) discouraging trading; iii) the consequent negative impact on tax collections for the government; and iv) the impact on Indian Exchanges and the Indian VDA industry, this Report explores alternatives that may be considered by the government to set right these negative externalities, track VDA transactions, encourage domestic tax compliance, and generate tax revenue from this sector.

[29] Please refer to section 19 of the Report.

B. Quantitative Arguments

Significant Decline in Trade Volume and Users on Indian Exchanges

9. There has been a drastic fall of around ~97% in the total volume of VDAs traded on Indian Exchanges in just a couple of years since the announcement of the 1% TDS (refer Figure 2 for movements in trade volume of top 6 Indian Exchanges from February 2021 to January 2024).

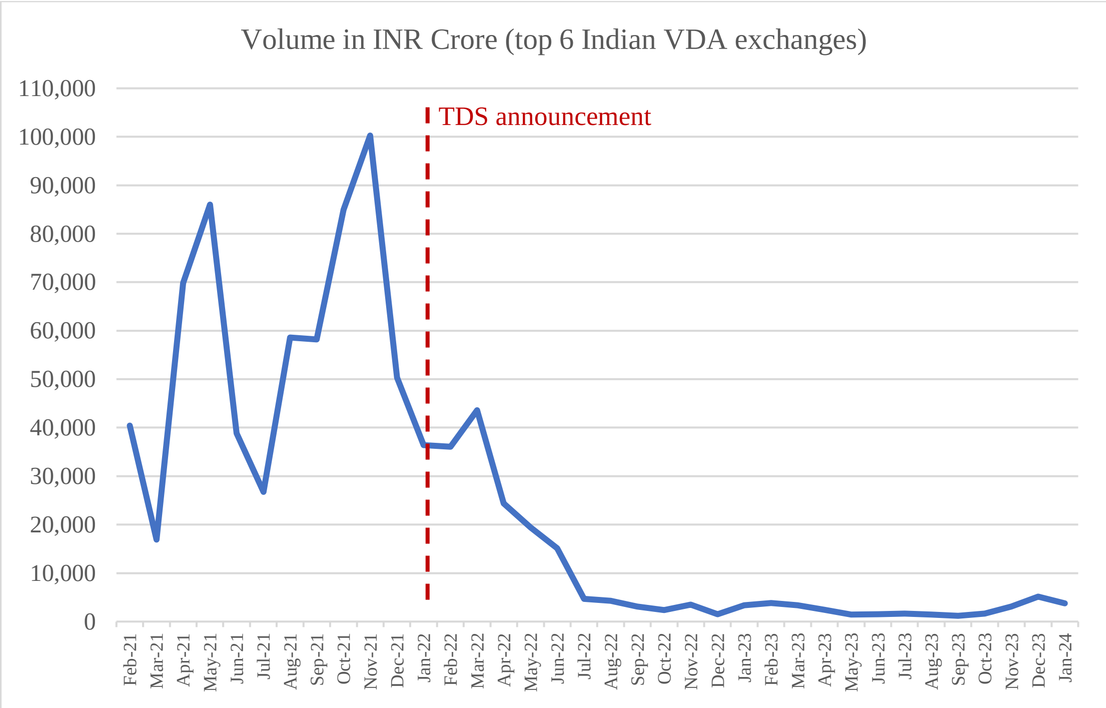


Figure 2. Trade Volume of Top 6 Indian Exchanges[30]

The maximum fall in volume is observed in cases of high value trades (of above INR 1 crore, which fell by ~98%), whereas trades with values in the range of INR 100-10,000 fell by ~81%.[31]

10. Similarly, the number of active users[32] on Indian Exchanges fell by ~81% in the second year since the implementation of the 1% TDS (~1.02 crore users in the year in which TDS was announced to ~19.55 lakh users in the year ending January 2024) (refer Figure 3). It is important to note that large volume traders (who made at least one trade of INR 1 crore in a given year) declined by 96% at the same time.

[30] Source: Data shared by top 6 Indian exchanges
[31] Source: Data shared by top 6 Indian exchanges
[32] An active user has been considered as a registered user in any of these 6 VDA exchanges who has made at least one trade in a year (February - January).

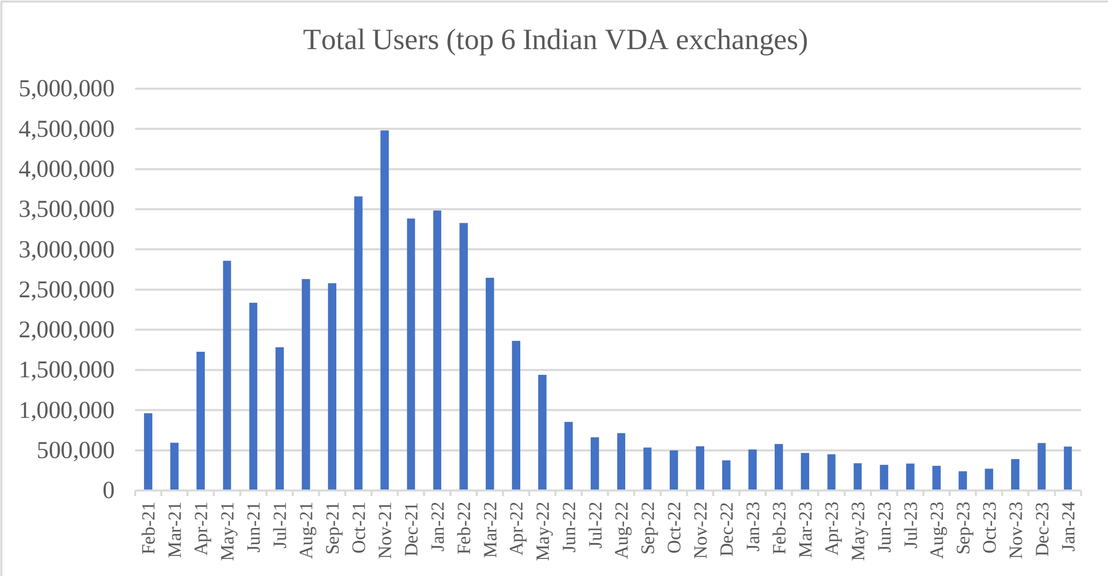


Figure 3. Number of Active Users on Top 6 Indian Exchanges

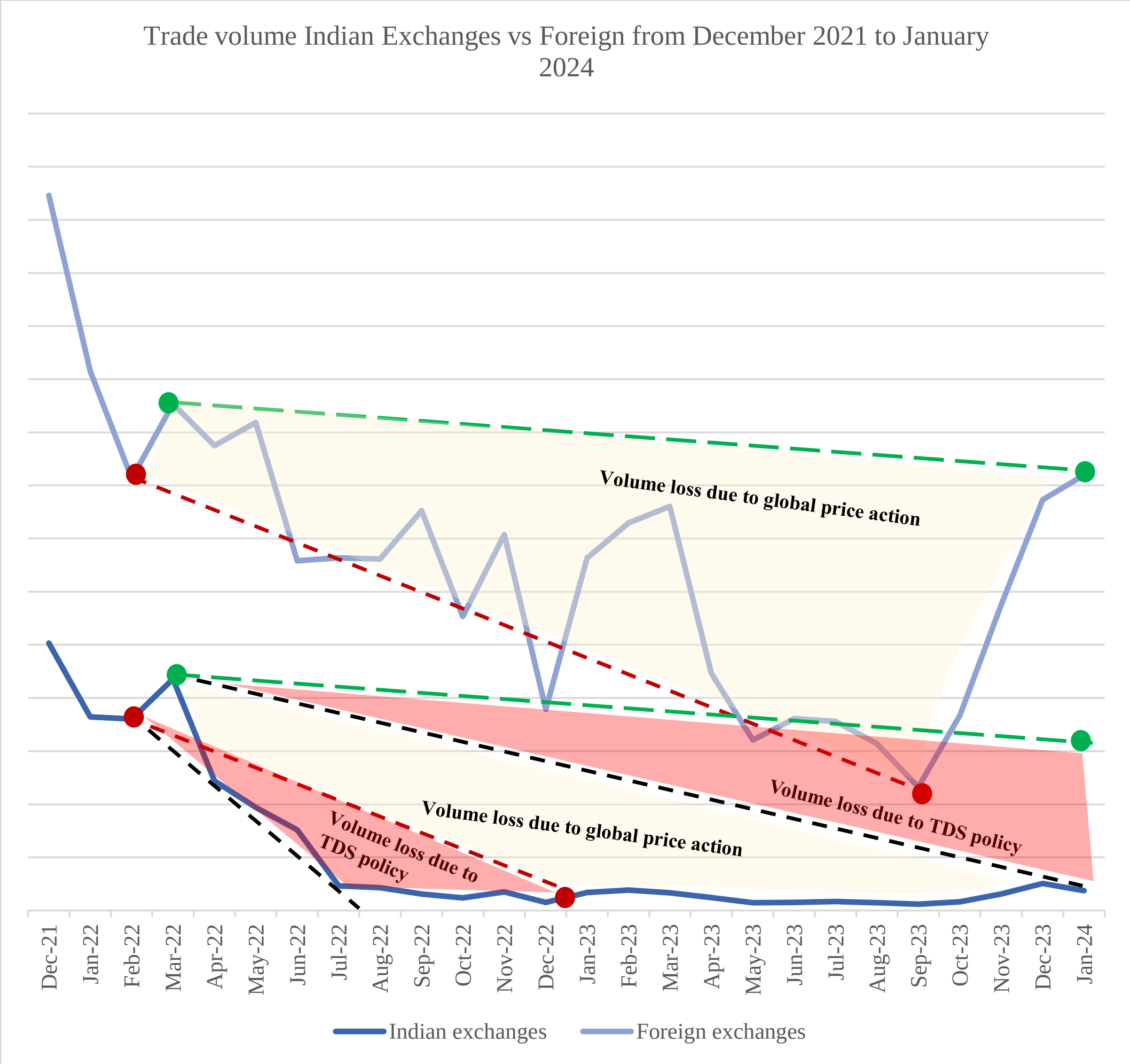
Exodus of Indian users to Offshore Exchanges and Unregulated Markets

11. While the decline in trade volumes and active users on the Indian Exchanges might be attributed to the bearish market cycle for the VDAs globally[33], it must be noted that such price action did not lead to a proportionate drop in global trading volumes on the Offshore Exchanges (please refer to Figure 4). A similar study carried out on data set between April 2022 to July 2023 also shows decline of 97% of trade volume on the Indian Exchanges, whereas fall of merely 45% of global trade volume on Offshore Exchanges.[34] Assuming parity of price sensitivity between users on Indian and Offshore Exchanges, out of the total decline of ~97%, only around ~45% decline may be attributed to price trends and market factors. The differential of ~52% clearly seems to be attributed to the tax policy, which has inadvertently had the impact of distorting the market.[35]

[33] The price of the leading VDA, Bitcoin went from a low of USD 3780 in March 2020 to high of USD 64985 in April 2021. Further, it again went to low of USD 28,800 in June 2021 before touching another high of USD 69,000 in November 2021. This price action was prior to introduction of TDS (February 2022) which would have attracted majority of users. From November 2021 to December 2022, the price was in a continuous downtrend which may have discouraged users to trade VDA. However, after the low of USD 16,250 in December 2022 the price has been in uptrend till January 2024 (touching high of USD 48,900), but the user trend has not been in uptick on the Indian exchanges. Data Source: Coingecko [Bitcoin Price: BTC Live Price Chart, Market Cap & News Today | CoinGecko]

[34] Dr. Vikash Gautam, Impact Assessment of Tax Deducted at Source on the Indian Virtual Digital Asset Market. Special Issue No. 210, November 2023, Esya Centre at page 6.

[35] Please refer attributes of sound tax policy in Paragraph 21 below.



Notes:
Indian Exchange figures are in INR Crores; Offshore Exchange figures are in USD billions

Upper trend as per global price action
Lower trend as per global price action
Actual upper and lower trends of Indian Exchanges for corresponding period

Figure 4. Trade Volume Indian Exchanges vs Offshore Exchanges[36]

12. Further, it has also been reported that India ranked number 1 in terms of overall crypto adoption in 2023.[37] Specifically, in respect of P2P exchange trade volume, India's ranking boosted from 82nd in 2022 to 5th in 2023, whereas volume on Indian Exchanges and price of VDAs have declined significantly during this period. Hence, it is clear that levy of TDS merely shifted the volume of VDA transactions

[36] Source: Indian Exchanges volume - Data shared by top 6 Indian Exchanges; Offshore Exchange volume: Cryptocurrency Monthly Exchange Volume of Binance, Coinbase, Upbit, Huobi, OKX and Bithumb as reported on the Block here.
[37] Chainalysis, The 2021 Geography of Cryptocurrency Report, October 2021; Chainalysis, The 2022 Geography of Cryptocurrency Report; and Chainalysis, The 2023 Geography of Cryptocurrency Report, October 2023.

to Offshore Exchanges and unregulated P2P markets instead of reducing the volume of such transactions undertaken by Indian users.

Year	Overall Global Crypto Adoption Index Ranking	P2P Exchange Trade Volume Ranking
2021	2	72
2022	4	82
2023	1	5

Table 2. Crypto Adoption and P2P Exchange Trade Volume Rankings of India[38]

13. A recent study[39] of Indian users on the Indian Exchanges vis-à-vis the Offshore exchanges taking into account factors such as platform usage and activities, reach and growth metrics, and trade statistics, since introduction of the TDS (July 2022) to May 2023 implies a significant uptick of Indian users on the Offshore Exchanges, as outlined in the figure below.

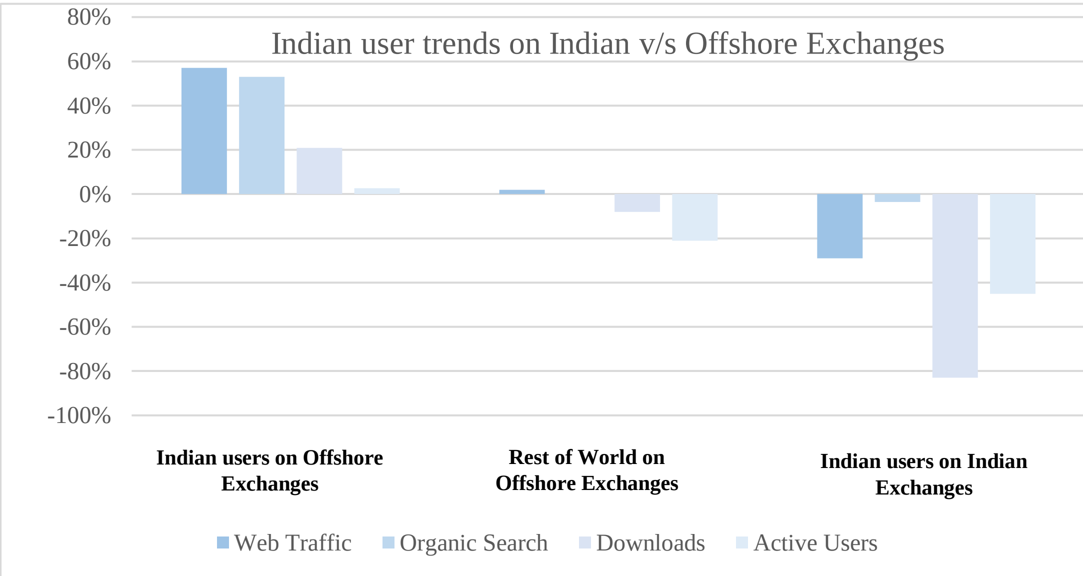


Figure 5. Indian User Trends on Indian Exchanges v/s Offshore Exchanges

[38] Ibid

[39] Dr. Vikash Gautam, Impact Assessment of Tax Deducted at Source on the Indian Virtual Digital Asset Market. Special Issue No. 210, November 2023, Esya Centre at page 9)

14. The impact of the tax policy has significantly impaired the markets, with no signs of reversal, should these policies not be revisited. As one can observe from recent statistics (May 2023 – April 2024) Indian users continue to spend approximately 70% of the time on the Offshore Exchanges as compared to on the Indian Exchanges.[40]

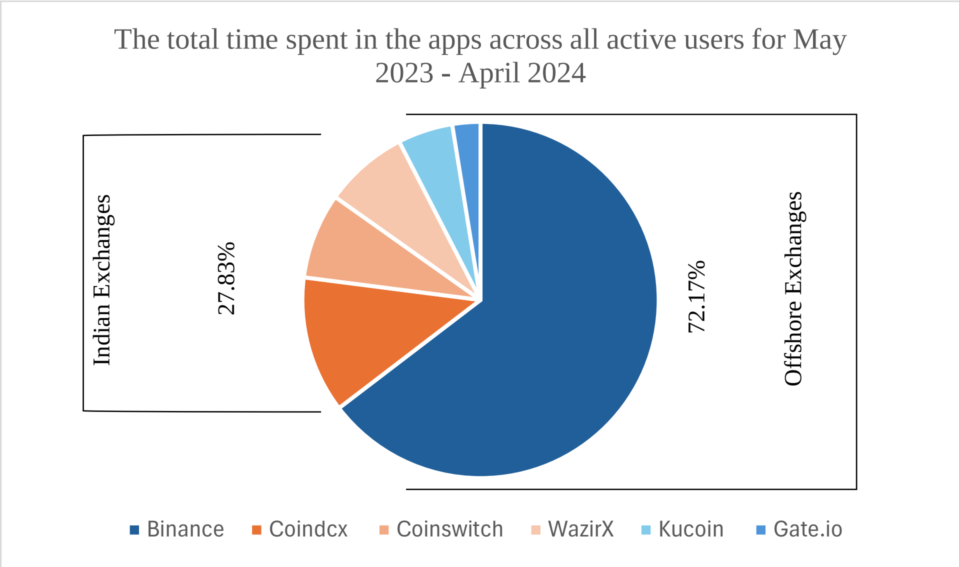


Figure 6. Total Time Spent by Active Indian Users

15. Further, a study has estimated that between July 2022 to October 2022 around USD 9.67 billion of volume was traded by Indian users on the Offshore Exchanges.[41] It is pertinent to note that none of the major Offshore Exchanges were in compliance with TDS requirements at that time.[42]

16. Taking into account the above metrics, it can be concluded that the introduction of the new tax regime has led to a mass migration of Indian users from Indian Exchanges to Offshore Exchanges. This has thwarted the very intent behind the introduction of TDS, which is to track and monitor VDA transactions.

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[40] Data Source: Data.ai 2024 time spent by Indian users on following VDA Exchange apps (IOS and Android): Binance, Coindcx, Coinswitch, WazirX, KuCoin and Gate.io.
[41] Dr. Vikash Gautam. Virtual Digital Asset Tax Architecture in India: A Critical Examination. Special Issue No. 208, January 2023, Esya Centre at pg 20.
[42] KuCoin is one of the first Offshore Exchange which has implemented the 1% TDS from April 2024. Between July 2022 to April 2024, no other major Offshore Exchange had implemented 1% TDS. [KuCoin Completes Registration with India's FIU, Will Deduct 1 Percent TDS on Transactions | Technology News (gadgets360.com)]

Impact of TDS on the User Capital

17. It is essential to understand that TDS on VDAs is a transaction level tax. Although the rate of 1% may at the outset seem nominal as compared to rates prescribed for other TDS provisions under the ITA, one must take into account the recurring effect of such levy on the user's capital. A 1% TDS on the entire transaction volume can have a compounding effect with every increase in the frequency of trades. Based on a quantitative study of 1% TDS on the user's capital (refer **Annexure 1**), it is apparent that ~39.50% of a user's capital could be blocked upon the execution of 100 trades (irrespective of whether such trades lead to profits or losses). This percentage increases to ~91.89% and ~99.34% respectively in case a user executes 500 or 1,000 trades in a particular financial year. In other words, a trader performing mere ~4-5 trades a day may wipe out most of their capital towards meeting TDS obligations within the matter of just a quarter, which is refundable only after the end of the financial year.

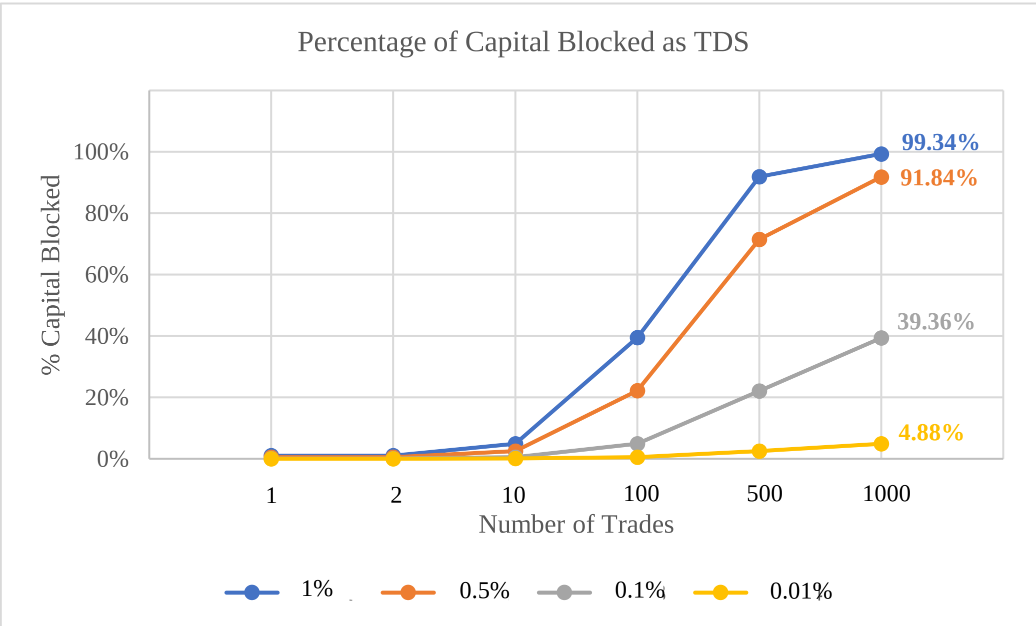

Figure 7. User Capital Blocked at Various Number of Trades at Different TDS Rates

18. However, in case the TDS rate is reduced to 0.01%, the amount of user capital blocked towards TDS significantly reduces to ~0.50%, ~2.47% and ~4.88% on execution of 100, 500, and 1,000 trades, respectively. It is pertinent to note that a lower TDS rate of 0.01% will also help the government to meet their objective of transaction tracking, and at the same time it will not distort the user activity as such. Furthermore, to the extent limited user capital is blocked as TDS on account reduction of TDS rate, users will be able to execute more trades which should potentially result into more profits and consequently higher tax revenue for the government.

Tax Revenue Lost on Account of TDS

19. As outlined above, there was a significant decrease in trade volumes from February 2022 onwards when the TDS (and taxation) was just announced. The table outlined below highlights the potential losses in tax revenue for the exchequer from the top 6 Indian Exchanges on account of distortion of market owing to changes in tax policy:

Particulars	Reference	Amounts (in INR Crores)
Base Year trade volume (Feb 21-Jan 22)[43]		10,695,410.36
Trade volume lost for Year 1 (Feb 22 to Jan 23)[44]	(A)	843,538.45
Trade volume lost for Year 2 (Feb 23 to Jan 24)[45]	(B)	187,931.48
Cumulative loss in trade volume[46]	**(C) = (A) + (B)**	**1,031,469.93**
Percentage of trade volume lost from Base Year	(D)	-97%
Global price action related fluctuation[47]	(E)	-45%
Tax policy related fluctuation	**(F) = (D) – (B)**	-52%
Loss in trade volume due to tax policy	**(G) = (C) / (F)**	531,831.05
Net income on above at average rate of 1.50%[48]	(H)	7,977.47
Opportunity cost / loss in tax revenue potential at median rate (excluding surcharge)	**(H) * 31.20%**	**2,488.97**

Table 3. Estimated Loss in Tax Revenue Potential for Period between February 2022 to March 2024 from Trades on Top 6 Indian Exchanges

Projection of Potential Tax Revenue Losses on Account of TDS

20. Where the current TDS regime continues, on conservative estimates of realisable gains, the Indian exchequer may potentially lose out on tax revenue collections of over an estimated INR 4,700 crores from the top 6 Indian Exchanges in the next 3 years. This denotes under-tapping of VDA tax revenue potential by ~87%. Outlined below are projected Indian exchequer revenue estimates from VDA tax from the top 6 Indian Exchanges for a period of 3 years[49]:

[43] Total volume traded on top 6 Indian Exchanges between February 2021 to January 2022 (**Base Year**) i.e., the year before which TDS was announced.
[44] Difference in total volume traded on top 6 Indian Exchanges between Base Year and February 2022 to January 2023 (**Year 1**).
[45] Difference in total volume traded on top 6 Indian Exchanges between Year 1 and February 2023 to January 2024 (**Year 2**).
[46] Based on data of top 6 Indian exchanges
[47] Please refer section 11 of the Report regarding fall in trade volume on Offshore Exchanges.
[48] Based on data of top 6 Indian exchanges
[49] Base data of trade volume, user growth rate, and gross income percentage is based on details shared by top 6 Indian VDA exchanges. Growth rate attributed to price action is based on average projected CAGR of top select VDAs. Growth rate attributed to variance in TDS factors percentage multiple based on Pearson's correlation coefficient computed based on the trade volume and TDS data of top 6 exchanges for February 2021 to January 2024 (refer **Annexure II**). Adjustment for preferential / behavioural factors is based on market assumptions. Tax is computed at median rates excluding surcharges.

A. TDS continues at 1%

Particulars	Feb 24 – Jan 25	Feb 25 – Jan 26	Feb 26 – Jan 27
Past year trade volume	37,669.58	47,840.36	60,852.94
Growth rate attributed to increase in active users	2.00%	2.20%	2.42%
Growth rate attributed to price action[50]	25.00%	25.00%	25.00%
Growth rate attributed to variance in TDS (adjusted for preferential / behavioural factors)	0.00%	0.00%	0.00%
Net growth rate	**27.00%**	**27.20%**	**27.42%**
Net trade volume for year	**47,840.36**	**60,852.94**	**77,538.82**
Net income %	1.50%	1.50%	1.50%
Net income (INR crore)	717.61	912.79	1,163.08
Exchequer revenue at 31.20% (INR crore)	**223.89**	**284.79**	**362.88**

B. TDS is reduced to 0.50%

Particulars	Feb 24 – Jan 25	Feb 25 – Jan 26	Feb 26 – Jan 27
Past year trade volume	37,669.58	57,107.08	87,328.15
Growth rate attributed to increase in active users	13.20%	14.52%	15.97%
Growth rate attributed to price action	25.00%	25.00%	25.00%
Growth rate attributed to variance in TDS (adjusted for preferential / behavioural factors)	13.40%	13.40%	13.40%
Net growth rate	**51.60%**	**52.92%**	**54.37%**
Net trade volume for year	**57,107.08**	**87,328.15**	**134,810.20**
Gross income %	1.70%	1.70%	1.70%
Gross income (INR crore)	970.82	1,484.58	2,291.77
Exchequer revenue at 31.20% (INR crore)	**302.90**	**463.19**	**715.03**

C. TDS is reduced to 0.10%

Particulars	Feb 24 – Jan 25	Feb 25 – Jan 26	Feb 26 – Jan 27
Past year trade volume	37,669.58	74,141.26	148,567.23
Growth rate attributed to increase in active users	35.64%	39.20%	43.12%
Growth rate attributed to price action	25.00%	25.00%	25.00%
Growth rate attributed to variance in TDS (adjusted for preferential / behavioural factors)	36.18%	36.18%	36.18%
Net growth rate	**96.82%**	**100.38%**	**104.30%**
Net trade volume for year	**74,141.26**	**148,567.23**	**303,529.38**
Gross income %	1.80%	1.80%	1.80%
Gross income (INR crore)	1,334.54	2,674.21	5,463.53
Exchequer revenue at 31.20% (INR crore)	**416.38**	**834.35**	**1704.62**

[50] We have assumed CAGR of the VDAs to increase by 25%.

D. TDS is reduced to 0.01%

Particulars	Feb 24 – Jan 25	Feb 25 – Jan 26	Feb 26 – Jan 27
Past year trade volume	37,669.58	81,806.64	196,367.03
Growth rate attributed to increase in active users	45.74%	68.61%	102.91%
Growth rate attributed to price action	25.00%	25.00%	25.00%
Growth rate attributed to variance in TDS (adjusted for preferential / behavioural factors)	46.43%	46.43%	46.43%
Net growth rate	**117.17%**	**140.04%**	**174.34%**
Net trade volume for year	**81,806.64**	**196,367.03**	**538,716.26**
Gross income %	2.00%	2.00%	2.00%
Gross income (INR crore)	1,636.13	3,927.34	10,774.33
Exchequer revenue at 31.20% (INR crore)	**510.47**	**1225.33**	**3361.59**

E. TDS is reduced to 0%

Particulars	Feb 24 – Jan 25	Feb 25 – Jan 26	Feb 26 - Jan 27
Past year trade volume	37,669.58	92,177.46	252,934.94
Growth rate attributed to increase in active users	59.40%	89.10%	106.92%
Growth rate attributed to price action	25.00%	25.00%	25.00%
Growth rate attributed to variance in TDS (adjusted for preferential / behavioural factors)	60.30%	60.30%	60.30%
Net growth rate	**144.70%**	**174.40%**	**192.22%**
Net trade volume for year	**92,177.46**	**252,934.94**	**739,126.47**
Gross income %	2.00%	2.00%	2.00%
Gross income (INR crore)	1,843.55	5,058.70	14,782.53
Exchequer revenue at 31.20% (INR crore)	**575.19**	**1578.31**	**4612.15**

Table 4. Projected Tax Revenue at Various TDS Rates

21. Illustrated below is a comparative depiction of the estimated Indian exchequer revenue from VDA tax for a 3-year period at various rates of TDS:

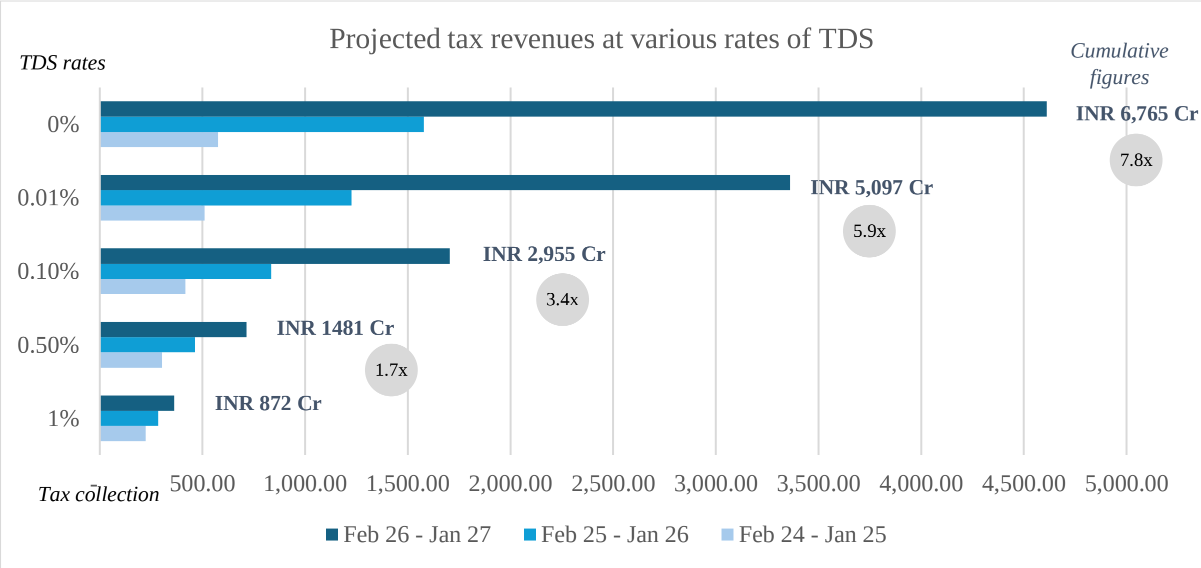

Figure 8. Projected Tax Revenues at various TDS Rates

22. The quantitative analysis above is also corroborated by a case study of Indonesia, whereby excessive taxes resulted in significant decline in the trading volume of VDAs, and in turn in lower tax revenue collections. Indonesia's tax collections fell by whopping 62% after the implementation of a 0.1% income tax and 0.11 value added tax on every VDA transaction.[51] It has been reported that Indonesia is considering revising the tax framework to make it less burdensome for the taxpayers.[52]

[51] Indonesia's Crypto Tax Revenue Falls 63% in 2023 Despite Bitcoin's Surge (coindesk.com).
[52] Indonesia mulls tax adjustment for crypto transactions | INSIDER - Indonesia Business Post.

C. Qualitative Arguments

23. The analysis above demonstrates that the imposition of the 1% TDS and the onerous tax regime has (i) resulted in shift of the transaction volume from Indian Exchanges, to either Offshore Exchanges or peer to peer unregulated markets; (ii) negatively impacted the capital of users who continued to operate on VDA exchanges complying with the TDS, putting them at a significant disadvantage; and (iii) most importantly resulted in a decline in the tax revenue collected by the government. Thus, effectively, the 1% TDS has crippled the VDA industry in India (and with it hampered the larger digital industry), adversely affected the Indian traders, and has had a negative impact on the government treasury.

24. The 1% TDS continues to negatively impact VDA traders, exchanges, and the government, and has caused ripple effects across the Indian economy:

VDA tax regime does not conform with well-established tax policy principles

25. Well-established attributes of a good tax policy include economic efficiency, fairness, simplicity, and ease of administration.[53]

a. ***TDS on VDA transfers is not economically efficient***:[54]

The 1% TDS on VDA transfers is not economically efficient considering that:

i. Distortions arise from the inconsistency in the withholding tax treatment of transfers of VDAs as compared to transfers of other asset categories such as commodity, property, and securities. For instance, transfers of unlisted securities by residents are subject to withholding tax at a lower 0.1% rate where certain threshold requirements are met.[55] Further, on-market sales of securities through recognised stock

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[53] Sir James Mirrlees, Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James Poterba, *Tax by Design: The Mirrlees Review* (Oxford University Press 2011) 21-45; Michael Devereux, Auerbach, Keen, Oosterhuis, Schön and John Vella, *Taxing Profit in a Global Economy* (Oxford University Press 2021) 33-55.

[54] It is well-established that a good tax system should minimise negative effects of taxes on economic activity. While all taxes impose an inevitable burden on economic agents equivalent to the tax collected (i.e., the 'income effect'), in assessing economic inefficiencies arising from the 1% withholding tax on VDA transfers, it is relevant to consider any excess burden (i.e., the 'deadweight cost') arising from behavioural distortions. Such distortions generally arise from inconsistencies in the tax treatment of similar asset categories or financial products (notably, the distinction in the tax treatment of different forms of financing i.e., debt and equity). Further, where the tax is not appropriately calibrated, it distorts the market by either being too high or too low relative to the asset in question, thereby acting as a barrier in many cases for the conduct of normal economic activity.

[55] Income Tax Act, 1961, section 194Q.

exchanges are not subject to such withholding tax and are subject to a much lower rate of securities transaction tax (i.e., 0.001% to 0.2%).[56]

ii. As noted in Table 1, VDAs have been characterised and taxed as property, virtual asset or commodity, in most other jurisdiction rather than having a separate tax regime which is more stringent than even taxation of income from speculative business and gambling activities.[57] Hence, the taxation of income from VDA should at bare minimum be equivalent to taxation of income from transfer of property / commodity or at most be taxed as income from speculative business.

iii. Indian Exchanges are competitively disadvantaged as compared to their offshore counterparts on account of the 1% withholding tax on VDA transfers, as discussed above.

b. ***VDA tax regime is not fair or progressive***:[58]

Several features of the Indian VDA tax regime entail regressive effects and horizontal equity issues, including:

i. The flat 30% tax rate is applicable to all VDA transfers irrespective of the income threshold of the taxpayers. Hence, while taxpayers with higher income threshold[59] are anyways taxed at 30% tax rate, however, taxpayer below the 30% slab rates are also taxed at 30% on income from VDA transfers. The impact is further augmented due to non-availability of any allowance, set off of loss, or deduction in respect of any expenditure incurred for the sale other than cost of acquisition;[60] and

ii. The distinction in the tax treatment of investors in VDAs as compared to investors in other asset categories. For instance, on-market sales of securities through recognised stock exchanges are subject to a much lower rate of securities transaction tax (i.e., 0.001% to 0.2%). While both the 1% withholding tax on VDA transfers as well as the securities

[56] CBDT circular no. 13/2021, dated June 30, 2021.
[57] *Supra* note 20.
[58] In assessing the fairness of tax policy, it is relevant to consider fairness both in terms of economic activity (i.e., a *neutral* tax policy should tax *similar* activities in a *similar* manner) as well as progressivity and 'horizontal equity' (i.e., a good tax policy should tax *similar* people in a *similar* manner).
[59] Income above INR 10,00,000 is taxed at 30% (exclusive of cess and surcharge) for resident individuals (INR 15,00,000 in case of new regime).
[60] Income Tax Act, 1961, section 115BBH.

transaction tax are transaction level taxes imposed on trades carried out through exchanges, their rates significantly vary.

c. ***VDA tax regime entails high compliance costs for taxpayers***:[61]

The Indian VDA tax regime entails excessive compliance costs for taxpayers particularly since the 1% withholding tax rate on the entire transaction value is excessive, including when compared to global standards.

VDA transactions are akin to investing rather than gambling

26. India continues to be one of leading markets for VDAs, including at the grassroot level.[62] While the Indian VDA tax regime is based on an archaic understanding of VDAs, by taxing income from VDA transfers akin to winnings from gambling or lottery winnings[63], estimates from a study by Brigham Young University's Marriott School of Business suggest that household spending from VDA gains is more similar to the patterns observable from traditional equity investments rather than from lottery or gambling winnings.[64] Hence, income from VDAs should not be taxed as a sin activity rather it should be taxed as investment income.

Impact on GDP and secondary revenues

27. The 1% TDS is a significant roadblock to the growth of the VDA industry in India, and consequently in the development of emerging technologies such as Web 3.0.[65] The government of India is keen to enhance the growth of the digital economy in India, including emerging technologies such as Web 3.0.[66] Facilitation of development of VDAs and Web 3.0 in India would help realise government's goals and would help enhance India's GDP significantly:

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[61] It is a well-established principle of good tax policy that compliance costs for taxpayers and administrative costs for tax authorities should not be excessive relative to the revenue raised from the tax.

[62] Market studies have shown that even after the imposition of the 1% TDS, India is one of the leading markets for VDAs. In particular, India is estimated to be the second largest VDA market in terms of transaction volume, behind only USA. Further, the adoption of VDAs in India is not confined to the rich and wealthy, it has been reported that India leads the world in terms of grassroots adoption of VDA. Please refer to "The 2023 Geography of Cryptocurrency Report by Chainalysis", October 2023.

[63] It can be argued one step further that VDA transactions are taxed worse than gambling, given that even income from winnings from gambling is taxed on a net basis after taking into account any offset of losses and provision for carry forward of losses are also available.

[64] Lamborghini Bros No More: Crypto Is Creating a New Wealth Effect, *Bloomberg* (May 2024).

[65] US-India Strategic Partnership Forum and Crosstower, India's $1 Trillion Digital Asset Opportunity, December 2021.

[66] The Minister of State for Electronics and Information Technology (**IT Minister**), had stated in June 2023 that India's target is that technology and digital economy should amount to 20% of the total GDP by 2025 – 2026, please refer here and here. Further, The IT Minister in a reply to a question raised in the Rajya Sabha that the Ministry of Electronics and Information Technology (MEITY) stated that the government recognises the importance of emerging technologies such as Web 3.0 and it runs numerous programs for the promotion startups engaged in development of these technologies, please refer to the IT Ministers answer to the unstarred question no. 1014 in the 259th session of the Rajya Sabha.

a. The Minister of State for Electronics and Information Technology (IT Minister) stated that VDAs and blockchain are the building blocks of Web 3.0.[67] Thus, at the level of the government, there is an acceptance of the importance of blockchain and VDAs as the fuel required for development of emerging technologies such as Web 3.0 and in turn the further development of India's GDP.

b. Considering the acceptance even at the level of the government that VDAs are essential for the development of emerging technologies including Web 3.0, there is an urgent need to revisit the 1% TDS to facilitate the growth of these emerging technologies in India.

c. As per a report published by US-India Strategic Partnership Forum (USISPF) and Crosstower in December 2021 (before the introduction of the stringent 30% tax and the 1% TDS), embracing and fostering VDAs could contribute an additional USD 1.1 trillion to India's GDP by 2032.[68] The report estimated that the bulk of this additional GDP growth would be achieved from ancillary VDAs related businesses.

d. Thus, a relaxation from the 1% TDS has the potential to significantly facilitate and promote the development of futuristic technologies such as blockchain and Web 3.0. Moreover, with the growth these technologies, India's digital economy can truly grow and contribute significantly to India's GDP in line with the goals of the Indian government.

Consumer Protection Concerns

28. Due to migration of users to Offshore Exchanges and unregulated markets, there are certain consumer protection concerns as well:

a. Trading with regulated exchanges may provide Indian users with more security and protection, as compared to unregulated and Offshore Exchanges. Accordingly, the shift in transaction volume from the Indian Exchanges to the Offshore Exchanges or peer to peer unregulated markets resulting from the imposition of the 1% withholding tax on VDA transfers is likely to entail

[67] Answer by the Minister of State for Electronics and Information Technology to the unstarred question no. 1014 raised in the 259th session of the Rajya Sabha.
[68] US-India Strategic Partnership Forum and Crosstower, India's $1 Trillion Digital Asset Opportunity, December 2021.

increased consumer protection issues for investors owing to the lack of oversight by tax and regulatory authorities.

b. Further, according to a report by an Indian cyber security company in 2022, Indian investors have reportedly lost around INR 1,000 crores through fake VDA exchanges that have spread through social media portals.[69]

Brain Drain and Impact on Employment

29. The continued regulatory uncertainty in India has often resulted in Indian VDA businesses moving out of India.[70] With the imposition of the 1% TDS and the migration of Indian users to Offshore Exchanges, this process has only been exacerbated:

a. A number of VDA exchanges have moved outside India or stopped operations in India because of the harsh tax regime and the regulatory uncertainty.[71]

b. Leading VDA professionals and entrepreneurs have also moved outside India.[72]

Administrative Inconvenience and Interest Expenditure for the Revenue on Account of Refunds

30. Given the significantly high TDS rate, it is possible that the amount of TDS collected (which can go up to 99% of the user's capital)[73] is more than the ultimate tax liability of the user at the end of the year (30% of the gross income). TDS is a tax collection provision and is not the ultimate tax liability of the taxpayer. In case the TDS amount deposited is higher that the ultimate tax liability, the taxpayer is eligible for a refund of the difference. Further, the taxpayer is also eligible for simple interest of 0.5% per month from the tax department.

[69] Indian investors likely lost Rs 1,000 Cr to fake crypto exchanges, *The Economic Times* (June 2022).
[70] CNBC, Quit India movement in crypto may accelerate; Singapore, Dubai, US lap up Indian talent, March 2022.
[71] Sunianaa Chadha, Explained: Crypto exchanges may move base overseas but you will still have to pay tax on your cryptocurrency, February 2022; CNBC, Quit India movement in crypto may accelerate; Singapore, Dubai, US lap up Indian talent, March 2022; Shashank Bhardwaj, OKX crypto exchange shuts down operations in India, Forbes, March 2022.
[72] Pranav Mukul, Clampdown, unclear policy prompt crypto exchange founders to leave India, Indian Express, June 2022; Sanghamitra Kar, The new brain drain: Indian Web3 startups flock to Dubai amid regulatory uncertainty, stiff taxes, Moneycontrol, April 2022; Economic Times, The talent exodus: Are blockchain entrepreneurs moving to Dubai, other crypto-friendly nations?, August 2022.
[73] Refer to Paragraph 14-15 of the Report.

31. It is pertinent to note that in certain market situations, there are hardly any profitable traders.[74] Assuming a trader who has capital of INR 2 crore makes 20 circular trades with entire capital, and does not have any profitable trade, then while there is a TDS liability of INR 20 lakhs (INR 2 crore * 1% * 10) there is no ultimate tax liability as such for the trader. Assuming the refund of TDS amount is credited after 6 months, the government would be liable to pay INR 60,000 (INR 20 lakhs * 0.5% * 6 months) out of pocket.

32. In this regard, it may be worth noting that as per a study performed by the SEBI, it is estimated that 9 out of every 10 traders, i.e., ~90% of the traders in the equity futures and options segment incur losses[75]. Drawing a comparison based on similar trading patterns, one may assume that a similar number of traders on Indian VDA Exchanges may be loss-making. In a scenario that ~50% of such traders are completely loss-making, and the other ~50% of such traders are partially loss-making (for instance, have made profits on ~50% of their overall trades), it may be estimated that around ~68%[76] of the TDS collected may be attributable to loss-making trades, which are to be refunded to the users. Indicatively, in such a scenario, ~72% of the total TDS collected (which includes interest on such TDS) may be required to be refunded by the tax department.

Particulars (In INR Cr)	Feb 24 - Jan 25	Feb 25 - Jan 26	Feb 26 - Jan 27
Total trading volume	47,840	60,853	77,539
Sell volume (indicatively at ~50%)	23,920	30,426	38,769
TDS at 1% on sell volume	**239**	**304**	**388**
% of TDS attributable to loss-makers	68%	68%	68%
Net TDS refund and interest[77]	**171.15**	**217.70**	**277.40**

Table 5. Indicative TDS refund and interest attributable to loss-making traders

33. As per a sample study involving 10 random traders on VDA exchanges with high quantum of tax refunds, we note the following statistics:

[74] More than 90% traders on the Indian Exchanges made net losses between April 2022 to December 2023. Refer Dr. Vikash Gautam and Tamanna Sharma. Taxes And Takedowns: An Assessment of India's Key Policy Tools for Virtual Digital Asset Markets. Issue No. 042, May 2024, Esya Centre at page

[75] Analysis of Profit and Loss of Individual Traders dealing in Equity F&O Segment, SEBI, 25 January 2023

[76] Trades in which users suffered loss undertaken by users who are completely loss making [50% of 90% (45%)] + Trades in which users suffered loss undertaken by users who are loss making during a given financial year, but have made profits in certain trades [50% of 50% of 90% (22.5%)] = Overall percentage of loss making trades where TDS was to be refunded [67.5%]

[77] 68% of TDS at 1% on trade volume + 6% interest per annum on such TDS liability

Sl.	Traded Volume	TDS Deducted	Income	Income Tax (30%)	Diff of TDS and Income tax	Interest on excess TDS (6%)	Total Refund Amount by Govt.	Total refund as a % of TDS
	(A)	(B)	(C)	(D) = 0.03 * (C)	(E) = (B) - (D)	(F) = 0.06 * (E/2)	(G) = (E) + (F)	(H) = (G) / (B)
1	4,797,204	43,595	6,353	1,906	41,689	1,251	42,940	98.50%
2	2,154,300	21,500	4,300	1,290	20,210	606	20,816	96.82%
3	2,750,130	27,446	6,860	2,058	25,388	762	26,150	95.28%
4	2,835,379	26,947	10,483	3,145	23,802	714	24,516	90.98%
5	1,993,841	19,742	9,370	2,811	16,931	508	17,439	88.33%
6	1,008,263	9,075	5,257	1,577	7,498	225	7,723	85.10%
7	1,041,447	11,123	6,810	2,043	9,080	272	9,352	84.08%
8	262,874,010	2,446,842	3,985,683	1,195,705	1,251,137	37,534	1,288,671	52.67%
9	53,203,910	527,254	640,010	192,003	335,251	10,058	345,309	65.49%
10	9,308,730	92,925	81,080	24,324	68,601	2,058	70,659	76.04%
Total	**341,967,214**	**3,226,449**	**4,756,207**	**1,426,862**	**1,799,587**	**53,988**	**1,853,575**	**57.45%**

34. As may be noted from the above, while the high rate of TDS impacts the user's capital significantly, it may also causes an administrative inconvenience to the tax authorities in terms of the volume and number of TDS refund cases, along with the costs of such administration and interest on refunds, which may otherwise be avoidable.

Relooking the Approach of Transaction Tracking

35. In light of the 1% TDS falling short in achieving its stated objectives, and the extreme negative impacts it had caused, the government may consider obtaining data from other regulators and introducing a specific tax reporting requirement for the purpose of tracking VDA transactions.

i. Under the Prevention of Money Laundering Act 2002 (**PMLA**), persons engaged in certain designated activities are classified as reporting entities and are required to *inter alia* <u>verify the identity of their clients, maintain records of specified transaction, and submit the specified information to the Financial Intelligence Unit (**FIU**)</u>.

ii. It is pertinent to note that while the TDS was introduced in July 2022 for the purpose of transaction reporting, the Government of India through a notification dated 7 March 2023 (PMLA Notification)[78] extended the application of PMLA reporting provisions to VDA exchanges.[79]

iii. The PMLA laws inter alia require VDA service providers (**VDA SPs**) to register with the Financial Intelligence Unit (FIU) and perform the following activities:

- Incorporate client due diligence measures (CDD) to verify the identity of the clients and the beneficial owner of such clients, including permanent account number (PAN) verification of the Clients;

- Maintain records of all transactions inter alia including the copy of the data obtained by the VDA service providers to verify the identity of its clients and the beneficial owners;

- Retain all identification documents (of both the customers and beneficial owners of such customers) and transaction records (in a manner to enable the VDA service providers to reconstruct individual transaction) for five years after the business relationship has ended or the account has been closed, whichever is later;

iv. Further, all the VDA SPs are required to *inter alia* furnish information regarding (i) cash transactions exceeding INR 10 lakh and (ii) cross border wire transfers exceeding INR 5 lakh where the destination or origin of funds is India, to the FIU on a periodic basis.

v. Thus, currently, all VDA exchanges (Indian and Offshore) registered with the FIU are required to collect significant information about all VDA transactions and submit information about cross-border transactions and high value cash transactions to the FIU. Thus, evidently, the government has already started receiving information about transactions that are most prone

[78] Notification no. S.O. 1072(E), Department of Revenue, Ministry of Finance, Government of India's notification dated 7 March 2023.

[79] The Notification has specified the following activities as designated activities for the purposes of registration and reporting with FIU:

(i) exchange between virtual digital assets and fiat currencies;
(ii) exchange between one or more forms of virtual digital assets;
(iii) transfer of virtual digital assets;
(iv) safekeeping or administration of virtual digital assets or instruments enabling control over virtual digital assets; and
(v) participation in and provision of financial services related to an issuer's offer and sale of a virtual digital asset.

to tax avoidance (high value transactions and offshore transactions) through FIU, and effectively the transaction monitoring objective of TDS can be achieved through data collected by the FIU.

vi. The government can supplement the data already received through the FIU with a specific tax reporting measure. The government may consider enhancing the scope of existing reporting requirements such as the statement of financial transactions or introduce a new reporting requirement without the imposition of a TDS (including retaining the Form 26QE and Form 26QF without the 1%TDS).[80]

vii. Such a measure without imposing a TDS will incentivize the VDA exchanges to comply with the reporting requirements while staying in India.[81] VDA exchanges in the past have cooperated with Indian regulatory and tax authorities.[82]

Considering that most of the transaction data would already be collected under the PMLA laws, exchanges should be able comply with such reporting requirements effectively. Thus, in all likelihood the government should be able to track significantly higher number of VDA transactions than the current TDS regime.

36. Further, the government may also explore the possibility of exempting regulated entities from the levy of TDS. As stated previously, the aim to introduce 1% TDS was to merely track VDA transactions.[83] Hence, to the extent, transactions with respect to VDAs are being properly reported to the tax department or other regulators such as FIU, levy of TDS to that extent could be reconsidered.

For instance, as discussed above, the information collected by the FIU from the VDA SPs may be shared with the tax department. Further, the current withholding reporting requirement (Form 26QE) by the exchanges which is

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[80] Tax reporting measures are prevalent even in the current scheme of the ITA. Section 285BA of the ITA read with Rules 114E of the Income Tax Rules 1962 requires specified persons to furnish a statement of financial transaction containing information regarding certain transactions. By way of an illustration trustees of a mutual fund are required to furnish information about receipt of an amount aggregating to ten lakh rupees or more in a financial year for acquiring units of one or more schemes of the mutual fund.

[81] Considering that the VDA exchanges are already required to collect significant information about their clients and the beneficial owner of the clients including the PAN details of the clients, compliance with the reporting requirements would be simpler for the VDA exchanges.

Similar reporting measures are also in the process of being implemented in the United State of America (USA) without an imposition of a TDS. In August 2023, the USA's Internal Revenue Service (IRS) published a new proposed regulation outlining reporting requirements for VDA brokers. Recently, the IRS released a draft of the form which requires VDA brokers to report proceeds VDA digital asset dispositions to users. For further information please refer here, and here.

[82] As many as 28 exchanges and VDA service providers have already registered with the FIU as per an answer given by the Minister of State for Finance, can be accessed here.

[83] Please refer section 6 of the Report.

required to be filed on a monthly basis and contains the relevant data points for reporting such as PAN, name, communication details, address of the deductee and the deductor, date of transfer of VDA, total value of consideration, whether consideration for transfer is received in cash or in kind, is a sufficient tool for reporting of the transaction even without levy of TDS. Further, there have been recent reports that even the Securities Exchange Board of India (**SEBI**) is willing to oversee trading of VDAs, which may create enhanced regulatory environment, increased transparency, monitoring and tracking of VDA transactions.

It is pertinent to note that around half of the total value of VDAs received during July 2021 to June 2023 was on the centralised exchanges in the Central and Southern Asia and Oceania (where India is the largest market).[84] Even in terms of share of web traffic by platform type share of centralised exchanges exceeds 60% when compared with other VDA gaming and gambling platform, DEX, NFT Protocols and P2P exchanges.[85]

Hence, a major section of the VDA transactions being undertaken on the centralised exchanges, and such exchanges being subject to reporting requirement, the objective of transaction tracking can be achieved without levy of TDS, which has caused significant impact on all the stakeholders involved in the industry. Tax authorities of other jurisdictions such as Canada, the United States and the UK have tied up with centralised exchanges for information sharing and transaction tracking purpose without involvement of any withholding tax requirements.[86]

Further, in case transaction carried out on regulated VDA exchanges are exempted from TDS, it will incentivize users to trade on regulated exchanges, and will ultimately lead to enhanced tax compliance.

37. In any case, the government should consider reducing the applicable TDS rate as the primary aim of the TDS to track VDA transactions can be achieved through a significantly lower TDS rate. In fact, a lower TDS rate should not cause the negative externalities that the current 1% TDS has caused, allowing better tracking of VDA transactions.

[84] Chainalysis, The 2022 Geography of Cryptocurrency Report; and Chainalysis, The 2023 Geography of Cryptocurrency Report, October 2023.

[85] The 2023 Geography of Cryptocurrency Report, October 2023 at page 54.

[86] Canada intends to implement the international Crypto-Asset Reporting Framework (CARF) for taxation by 2026 imposing reporting requirements on VDA service providers, can be accessed here; The USA has released proposed regulations and a draft form for reporting of VDA transactions by the brokers, can be accessed here and here; The UK has released a consultation for the implementation of the CARF in the UK, can be accessed here

The tax department in past has considered the genuine hardship faced by the taxpayers on account of withholding taxes leading to blockage of users capital and provided exemption from levy of withholding taxes. For instance, a multi-level TDS was applicable on software sales, where TDS was levied at every level of software distribution (master distributor, sub-distributor, retailer and end user). Such levy of TDS was causing significant cash flow issues for the software distributors who were operating on thin margins and making their business model unsustainable.[87] The tax department provided an exemption from withholding on multiple level, subject to tax being paid at one level of the distribution chain.[88]

Similarly, the government should consider reducing the TDS rate on VDA transactions to a rate similar to the rate of securities transaction tax (applicable at a rate of 0.001% to 0.2%) or the TDS under Section 194Q (applicable at a rate of 0.1%). As highlighted above, the reduction in rate of TDS from 1% to 0.01% can help in the achieving the objective of transaction reporting and at the same time reduce the negative externalities caused by the 1% TDS (including a potential exchequer loss of around INR 4700 crores in the next 3 years).[89]

[87] Govt to remove multi-level TDS on software from July (deccanherald.com)
[88] Notification 21 of 2021 dated June 13, 2021.
[89] Section 20 of the Report.

D. Conclusion and Recommendations

The imposition of TDS has fallen short in achieving the twin objective of (a) tracking the transactions, and (b) widening of tax base. In contrast it has led to more volume of trading going in unregulated territory (P2P, offshore exchanges or in cash), and consequently leading to loss in tax revenue. Ideally, levy of TDS should be reconsidered as the policy objective of capturing transaction details and consequently expanding the tax base can be ensured through adequate reporting requirements.

Particularly, where the transactions are carried on regulated centralised exchanges which are under monitor from the regulators such as FIU and the tax department, such transactions can be tracked and monitored by the tax department through the filings required to be made by the exchanges. In this context, government may consider alignment with global standards such as the Crypto-Asset Reporting Framework (CARF) developed by the Organization for Economic Cooperation and Development (OECD). The framework provides for countries to seamlessly exchange tax information and transactions in VDAs in a standardized manner.

In any case, assuming that the objective of transaction reporting can only be fulfilled by levy of TDS, the TDS rate may be reduced to 0.01% (which may reduce capital blockage from ~99% to ~5%), or in any case to 0.1%, which should reduce the significant negative impact caused by the 1% TDS.

Research Methodology

For the analysis under the Section C of the Paper (Quantitative Arguments) we have relied on the data of top 6 Indian Exchanges provided to us by Bharat Web3 Association (**BWA**), including:

- Monthly number of active users between February 2021 to January 2024 of the top 6 Indian Exchanges

- Yearly number of active users between February 2021 to January 2022, February 2022 to January 2023 and February 2023 to January 2024 for 3 Indian Exchanges across various ranges of trade volume

- Monthly trade volume in INR between February 2021 to January 2024 of the top 6 Indian Exchanges

- Yearly trade volume in INR between February 2021 to January 2022, February 2022 to January 2023 and February 2023 to January 2024 for 3 Indian Exchanges as per the following range – (a) up to INR 100, (b) INR 100 to INR 10,000, (c) INR 10,000 to INR 1,00,000, (d) INR 1,00,000 to INR 1,00,00,000 and (e) above INR 1,00,00,000

- Monthly TDS deposited by the top 6 Indian Exchanges from July 2022 to January 2024

- Gross income (in INR) earned by the users on 3 Indian Exchanges on a yearly basis between February 2021 to January 2022, February 2022 to January 2023 and February 2023 to January 2024 for 3 Indian Exchanges across various ranges of trade volume.

- Details of sample population of traders on VDA exchanges with high quantum of tax refunds.

Further, we have carried out the analysis on impact of TDS on user capital as per the assumptions and methodology mentioned in **Annexure 1**.

The correlation between TDS and trade volumes on Indian Exchanges is determined based on statistical tools and assumptions outlined in **Annexure 2**.

The potential loss in tax revenue from top 6 Indian Exchanges on account of the TDS policy for the periods February 2022 to January 2024 is computed based on trading volume information provided by BWA, estimates of global price action related fluctuation as per secondary sources, and an average gross income margin of 1.50% (based on average gross income details of top 6 Indian Exchanges).

The projected tax revenues of the exchequer for the periods February 2024 to January 2027 is computed based on user trade volumes of top 6 Indian Exchanges, estimated growth rates considering global price action, correlation of user activity with TDS, estimated preferential and behavioural factors to user and trade volume growth rates, and varied estimates of gross income ratios at varied rates of TDS. It is presumed that in favourable market conditions, a higher concentration of active / profitable traders on Indian Exchanges would contribute to higher gross margin ratios. Further, it is also presumed that in case TDS is removed and the industry is regulated, such as by efforts of FIU and potentially by SEBI, apart from the retail participation even institutional capital may be attracted which can leads to significant growth in user participation.[90]

Further, we have relied on certain third-party sources for data pertaining to Offshore Exchanges, tax regime in different jurisdiction, time spent by Indian users on different exchanges, Indian user trends on Indian vs Offshore Exchanges. We have provided the specific source in the footnotes mentioned in the relevant area. We have also relied on certain calculations and statistical tools for Figure 7 (User Capital Blocked at Various Number of Trades at Different TDS Rates), Table 3 (Estimated Loss in Tax Revenue Potential for Period between February 2022 to March 2024) and Table 4 (Projected Tax Revenue at Various TDS Rates) which we have explained in relevant footnotes and Annexure 1 and 2.

[90] For instance, with the launch of spot BTC and ETH ETFs in the US, it has been reported that institutional capital has been attracted. Please refer - Bitcoin ETFs: The gateway to mainstream crypto adoption - The Economic Times (indiatimes.com)

Annexure I: Study on impact of TDS at various rates on user capital

Test: To evaluate the capital balance available with a user pursuant to various milestones of trading at different rates of TDS.

Assumptions:

- An Indian user undertakes trades on a VDA exchange which deducts tax under section 194S;
- The user starts with an initial capital of INR 1,00,000 and trades only in INR / A-Coin pair, where price of 1 A-Coin is pegged to INR 100;
- The user undertakes each trade with the entire capital (i.e., when A-Coin is bought, entire INR balance is used to purchase A-Coin and when A-Coin is sold, the entire balance of A-Coin is sold for INR);
- After each buy trade, the user consequently does a sell transaction;
- The net result of the trading is a no profit / no loss situation i.e., once a buy / sell transaction is completed, the user has not gained any profits, nor incurred any loss; and
- TDS is imposed on each A-Coin sell transaction i.e., the buyer remits net 99% of the cash consideration and TDS is deposited with the government.

The above model is run on 2, 10, 100, 500 and 1,000 trades to show the compounding impact of TDS on the user capital, i.e., upon completion of such number of trades, the amount of capital left and the portion of capital which is blocked on account of TDS. Further, the model has also been run assuming the TDS rate to be 0.5%, 0.1% and 0.01%.

Result: Based on the above facts, please refer the percentage of user capital blocked as TDS upon completion of 2, 10, 100, 500 and 1000 trades in each case where TDS rate is 1%, 0.5%, 0.10% and 0.01%.

Number of trades	Percentage of User Capital Blocked as TDS at various rates			
	1%	**0.50%**	**0.10%**	**0.01%**
2	1.00%	0.50%	0.10%	0.01%
10	4.90%	2.48%	0.50%	0.05%
100	39.50%	22.17%	4.88%	0.50%
500	91.89%	71.44%	22.13%	2.47%

1000	99.34%	91.84%	39.36%	4.88%

Limitations: Study is based on the assumptions outlined above; change in assumptions and trade patterns, including unusual events may render a different numerical analysis.

Annexure II: Study on correlation between 3-year user volume and TDS data (based on data of top 6 Indian VDA exchanges)

Test: To evaluate the correlation between two sets of variables, viz., user volumes and TDS deposited by top 6 Indian VDA exchanges across a period of 36 months as per the Pearson's Correlation Co-efficient which indicates linear correlation between two sets of data. A correlation of 0 indicates no correlation; a correlation of (+1) indicates positive correlation; and a correlation of (-1) indicates negative / inverse correlation.

Pearson's correlation coefficient (***r / ρ***), when applied to a sample population, is computed as per the following formulae:

$$r = \frac{n(\sum xy) - (\sum x)(\sum y)}{\sqrt{[n\sum x^2 - (\sum x)^2][n\sum y^2 - (\sum y)^2]}}$$

Were,

n = Period
x = Data set 1 (Trade volume)
y = Data set 2 (TDS)

Data:

Numbers in Crores

***n* (period)**	**x *(Trade volume)***	**y *(TDS)***	**xy**	**x^2**	**y^2**
Feb-21	57,403.06	-	-	3,295,110,808	-
Mar-21	52,502.67	-	-	2,756,530,052	-
Apr-21	115,770.70	-	-	13,402,854,984	-
May-21	140,078.24	-	-	19,621,912,569	-
Jun-21	58,464.11	-	-	3,418,052,138	-
Jul-21	40,279.57	-	-	1,622,443,878	-
Aug-21	91,946.16	-	-	8,454,096,390	-
Sep-21	89,324.42	-	-	7,978,851,749	-
Oct-21	134,508.45	-	-	18,092,522,268	-
Nov-21	155,025.53	-	-	24,032,916,502	-
Dec-21	77,286.18	-	-	5,973,153,797	-
Jan-22	56,550.43	-	-	3,197,950,971	-
Feb-22	52,551.90	-	-	2,761,702,168	-
Mar-22	64,538.52	-	-	4,165,220,439	-
Apr-22	35,191.17	-	-	1,238,418,181	-
May-22	26,346.59	-	-	694,142,801	-
Jun-22	18,880.66	-	-	356,479,490	-
Jul-22	6,080.05	31	190,853	36,967,007	985

Aug-22	5,328.67	27	146,373	28,394,725	755
Sep-22	3,612.53	19	69,437	13,050,365	369
Oct-22	2,917.05	15	44,442	8,509,192	232
Nov-22	4,144.62	21	85,814	17,177,843	429
Dec-22	1,887.56	10	18,373	3,562,885	95
Jan-23	4,121.74	21	86,201	16,988,755	437
Feb-23	4,829.25	25	121,463	23,321,692	633
Mar-23	3,993.84	18	72,109	15,950,749	326
Apr-23	3,075.21	17	52,100	9,456,918	287
May-23	1,885.29	11	20,185	3,554,335	115
Jun-23	1,934.49	11	21,762	3,742,262	127
Jul-23	2,095.69	13	27,027	4,391,931	166
Aug-23	1,786.62	11	19,037	3,192,022	114
Sep-23	1,434.62	8	12,157	2,058,146	72
Oct-23	2,050.36	12	24,469	4,203,996	142
Nov-23	3,752.70	23	84,992	14,082,794	513
Dec-23	6,279.43	36	223,179	39,431,223	1,263
Jan-24	4,552.05	27	121,765	20,721,143	716
Total	**1,332,410**	**356**	**1,441,738**	**121,331,117,167**	**7,775**

Result:

n	36.00
n(Σxy)	51,902,574.28
(Σx) (Σy)	473,899,669.33
n(Σx^2)	4,367,920,218,022.23
n(Σy^2)	279,893.00
Σx^2	1,775,316,801,631.95
Σy^2	126,501.87
r / ρ	**-0.67**

A result of (-0.67) indicates a strong and inverse correlation between the user volumes and TDS during the period from February 2021 to January 2024.

Limitations:

- The Pearson's correlation coefficient cannot determine nonlinear relationships between variables and does not take into account external factors or hidden influences such as user behaviour or preferences.
- The correlation is sensitive to outliers in the data points. Inclusion or exclusion of outliers may lead to changes in the computation.
- Correlation may not always indicate causation and a high correlation may sometimes be purely coincidental.

- The test above is based on a sample population of top 6 Indian exchanges and date between February 2021 to January 2024; a change in the sample or the timeline may lead to varied results.