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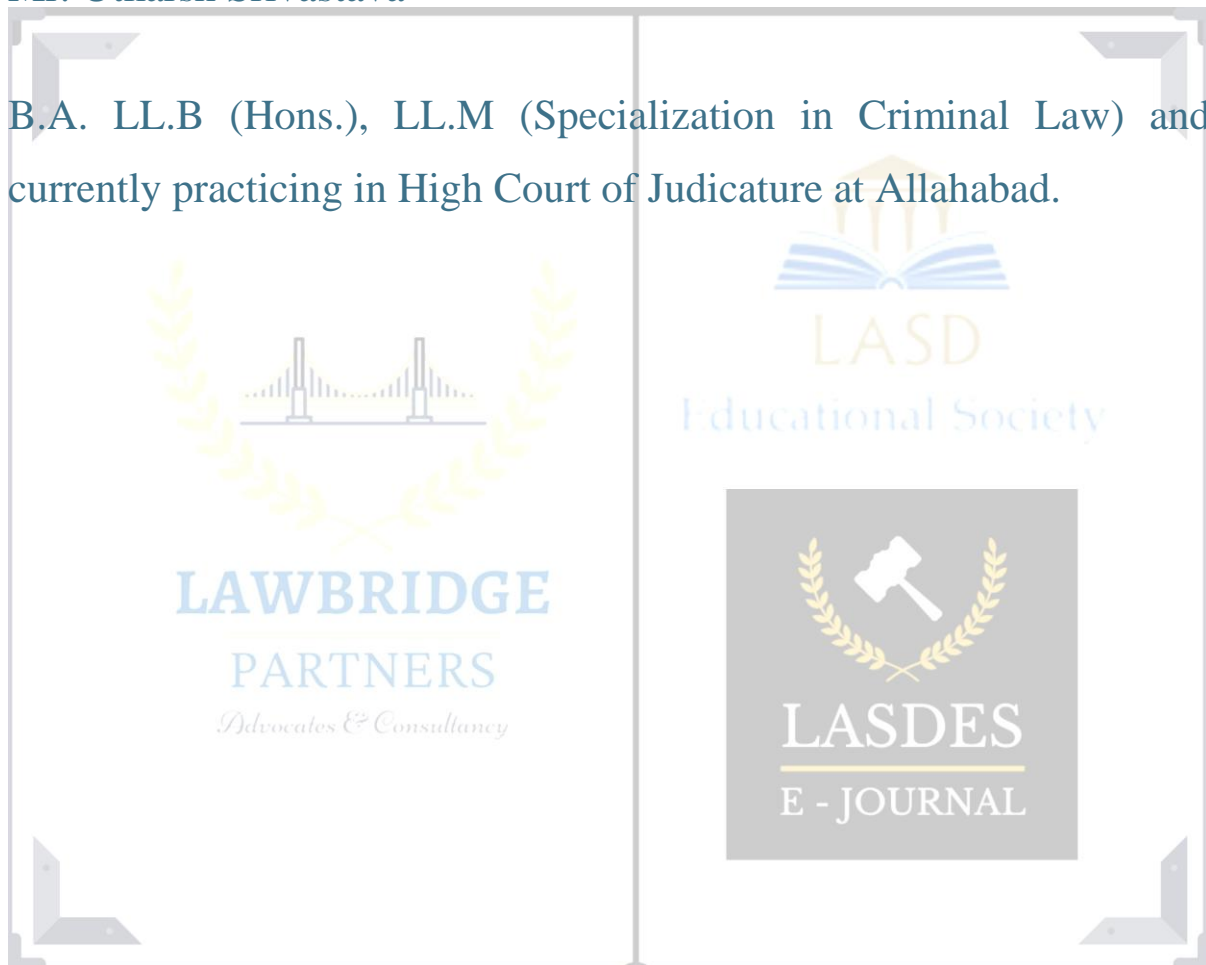
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**The Anomalous Taxonomy: A Statutory &
Constitutional Analysis of Virtual Digital Asset
Taxation under Income Tax Act, 1961 –
SHASHANK KUMAR & SHRUTI LAL**

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ABSTRACT

Digitalization is the beginning as well as the symbolization of the current era, where everything, right from the education system to the system of governance, right from the currency to assets, is metamorphosed itself primarily on digital platforms. While talking about digitalization, the concept of Virtual Digital Assets like crypto currency, Non – fungible Tokens, which is nothing but a digital representation of an item that has value in a specific environment, comes into the picture. The Ministry of Finance announced The Union Budget 2022, which introduced taxation and tracking provisions for tracking Virtual Digital Assets. Along with the taxation framework of Virtual Digital Assets, certain Amendments in the Income Tax Act are introduced. This paper is quite focused on analysing the amendments that include the taxation scheme of Virtual Digital Assets. The scope of this paper is to briefly describe the concept of Virtual Digital Assets, along with their evolution and transition. Not to forget, this paper quite extensively analyses the impact of the 2022 Union Budget on the status of Digital assets in the Indian investment market. Further, the paper concludes with

certain suggestive remarks that might better off the whole concept of Virtual Digital Asset in India.

Keyword: Virtual Digital Asset, Taxation, Crypto-currency, Non-fungible Tokens, investment, Union Budget.



INTRODUCTION

In the year 2009, one pseudonym developer by the name 'Satoshi Nakamoto' left his mark in the glorified history of digital assets by inventing the very first decentralized crypto currency termed as 'Bitcoin.' Ever since then, crypto currencies have fascinated technologists and investors around the world demography. Interestingly, over the period of time, India has turned out to be one of the prominent centers of Virtual Digital Asset investments, as per the report facilitated by 'NASSCOM' an NGO in association with 'WazirX,' a crypto currency exchange platform, it has been seen that there has been a tremendous advancement in the field of 'Crypto-Tech' in India. It has been anticipated that in the coming ten years, India will invest around 241 million dollars in Virtual Digital Assets.¹

Since then, India has seen huge investments in the field of Virtual Assets. In fact, till January 2022, there were eight thousand plus Crypto currencies in the market, some of the popular ones being Bitcoin Cash, Litecoin, Ripple (XRP). However, it is very interesting to note that there is a lack of legal framework with regard to legislation that bans, regulates,

¹ Shah. K., A new era in taxes has kicked in with taxation of virtual digital assets. But, what next?, EY (22 Apr., 2022) available on- https://www.ey.com/en_in/tax/why-taxation-of-virtual-digital-assets-still-needs-clarity.

or governs the Indian Virtual digital arrangements. Keeping in view the risks associated with this type of investment, it was speculated that the Indian government might ban or regulate the exchange of Crypto currencies. However, on the contrary, the Union Budget has initiated a huge step with regard to taxing the exchange of not only Crypto currencies but also all types of Virtual Digital Assets, including NFT but not limited to that. This step, in itself, implicitly shows that the government is expecting the concept of Virtual Digital Assets, rather than banning it, is in favor of regulating it. There has been a number of legal provisions introduced in Income Tax that tends to govern the investment in Virtual Digital Assets (VDA) from the assessment year 2023-24. Thus, it can be stated that any investment in VDA on or after 1st April 2022 was proposed to be taxable under the new law.

The rapid global proliferation of decentralized financial instruments and Virtual Digital Assets including crypto currencies and Non-Fungible Tokens presented significant challenges to established tax jurisdictions worldwide, creating a regulatory and fiscal vacuum in India. Prior to 2022, the tax treatment of income derived from VDA transactions was characterized by deep ambiguity, compelling taxpayers to

report gains inconsistently, typically under either the head of Capital Gains, Profits and Gains of Business or Profession (PGBP), or Income from Other Sources. This regulatory uncertainty led to significant potential for tax avoidance and complicated enforcement efforts for the tax authorities.

In response to this emerging challenge, the Finance Act, 2022, introduced a specialized and highly stringent tax framework for VDAs, primarily codified in Section 115 BBH, effective from April 1, 2022, and complemented by the withholding provision in Section 194S, effective July 1, 2022. The primary objective of this legislative intervention was two-fold: first, to establish definitive statutory certainty regarding the taxation of VDAs; and second, to bring previously untaxed or "black money" income streams into the formal economic system by establishing a rigorous tracking mechanism.

This specialized tax structure, however, is exceptional within the architecture of the Income Tax Act (ITA), 1961, due to its restrictive nature. The imposition of a flat, high tax rate, combined with severe restrictions on deductibility and loss management, positions the VDA regime as an aggressive measure primarily focused on revenue maximalist and strict

compliance enforcement. The stringent and revenue-maximized structure of Section 115 BBH demonstrates that the legislature's intent was not simply to integrate VDA income into existing tax principles but also to employ the tax mechanism as a *de facto* non-monetary regulatory hurdle aimed at tracking and potentially curbing the volume of VDA transactions in India.²

The Subject Matter: Section 2(47A) and the Scope of "Virtual Digital Asset":

The taxation mechanism introduced by the Finance Act, 2022, is founded upon the newly inserted definition of "Virtual Digital Asset" (VDA) in Section 2(47A) of the ITA, 1961. This definition is purposefully expansive to capture the widest possible range of digital instruments. A VDA is broadly defined to include "any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise," which provides a digital representation of value exchanged with or without consideration, or functions as a store of value or a unit

² Dua S., Tax on crypto, virtual assets decoded, THE ECONOMIC TIMES (24 Jun., 2022), available on-<https://m.economictimes.com/wealth/tax/tax-on-crypto-virtual-assetsdecoded/what-does-the-law-on-tds-on-vda-crypto-say/slideshow/92429435.cms>.

of account, and can be transferred, stored, or traded electronically. The definition specifically encompasses cryptocurrencies, Non-Fungible Tokens (NFTs), and any other token of a similar nature, thereby creating a comprehensive umbrella for the digital asset ecosystem. Recognizing the overly broad nature of the statutory language, the Central Government subsequently issued Notification No. 74/2022, utilizing its power to exclude certain digital assets from the VDA definition. Exclusions include gift cards or vouchers, mileage points, reward points, and loyalty cards used for obtaining goods, services, or discounts.³ These administrative clarifications indicate a regulatory recognition that the statutory definition, absent refinement, would have captured conventional digital entitlements, necessitating a targeted exemption.

The Operation of Section 115 BBH:

Section 115 BBH constitutes the primary charging provision for VDA income. The section begins with a powerful non-obstante clause: "Notwithstanding anything contained in any other provision of this Act".⁴

³ Ministry of Finance, Department of Revenue, Notification No. 74/2022

⁴ See, Section 115 BBH, Income Tax Act, 1961

This framing is critical, as it mandates that where an assessee's total income includes any income from the transfer of any VDA, that income must be computed and taxed solely under the conditions specified in this section, effectively overriding the general charging provisions and the traditional classification of income under the five statutory heads (Salary, House Property, PGBP, Capital Gains, and Other Sources).

The tax imposition under Section 115 BBH is exceptionally punitive, prescribing a flat tax rate of thirty per cent (30%), augmented by the applicable surcharge and cess, on the income derived from the transfer of VDAs. This rate is applied uniformly, irrespective of the assessee's taxable income slab or whether the gains would typically qualify as beneficial Long-Term Capital Gains (LTCG). The structure of Section 115BBH, being an isolated charging section utilizing a non-obstante clause, suggests a legislative intent to categorize this income independently. This income stream is operationalized for taxation purposes as a separate, sixth stream of income, designed to be taxed similarly to speculative winnings or unexplained income taxed under

Section 115BBE, rather than as conventional capital investment gains or business profits.⁵

This inherent structural contradiction – applying a stringent, speculative tax regime to assets that may be held as genuine long-term investments—forms a core foundation for the critique regarding fiscal equity.

Analysis of Section 194S (TDS)-Mandatory Source Deduction:

To ensure effective tracking and compliance, the Finance Act, 2022, simultaneously introduced Section 194S, mandating Tax Deducted at Source (TDS) on VDA transfers. Section 194S places an obligation on the person responsible for paying any sum to a resident as consideration for the transfer of a VDA to deduct tax at the rate of **one per cent (1%)** of the transaction value.

The application of TDS is contingent upon specific transaction thresholds:

1. **General Threshold:** INR 10,000 in a financial year for persons other than specified persons.

⁵ Triveni Enterprises Ltd. V. CIT, 2023 SCC Online Del 8343 Decided on 18-12-2023.

2. **Specified Persons Threshold:** INR 50,000 in a financial year for specified persons (individuals or Hindu Undivided Families not subject to tax audit requirements).⁶

A significant administrative challenge arises when the consideration for the VDA transfer is paid wholly or partly in kind specifically, in VDA-to-VDA swaps. CBDT guidelines clarified this complex scenario. When one VDA is exchanged for another, both transacting parties technically act as both buyer and seller. The CBDT addressed this by specifying that the person responsible for paying the consideration (often the crypto exchange facilitating the transaction) must ensure that the requisite 1% tax is paid *prior to* releasing the VDA consideration to the seller. This mechanism, requiring tax payment before the asset transfer is fully complete, imposes substantial practical and liquidity burdens on exchanges and users, as it necessitates liquidating a portion of the VDA or introducing fiat currency

⁶ See, Section 194S, Income Tax Act, 1961

specifically to meet the TDS obligation for otherwise non-cash transactions.⁷

The Evolution of Characterization: Pre-2022 Judicial Landscape

The Ambiguity before Codification:

In the period preceding the Finance Act, 2022, the tax treatment of crypto currency transactions in India was entirely dependent on the taxpayer's classification of the digital assets. Taxpayers generally enjoyed the flexibility to classify their holdings based on their intention. If the VDA was held for sustained growth as a passive investment, it was treated as a Capital Asset; if it was bought and sold frequently with the intent of profit-making in the course of regular business, it was treated as Stock-in-Trade, resulting in PGBP income. This approach led to significant inconsistencies in reporting and disputes between taxpayers and tax authorities, particularly concerning the applicability of beneficial tax provisions.

⁷ Magazine and Mukul P., TDS on transfer of virtual digital assets, applicable from July 1 — what the guidelines say, THE INDIAN EXPRESS (20 Jun., 2022) Available on <https://www.google.com/amp/s/indianexpress.com/article/explained/tds-on-transferof-virtual-digital-assets-applicable-from-july-1-guidelines-7986718/lite/>

Landmark ITAT Rulings and the Recognition of VDA as a 'Capital Asset':

A pivotal development in the pre-codification era was the ruling by the Income Tax Appellate Tribunal (ITAT), Jodhpur, which addressed the fundamental nature of crypto currencies under the ITA, 1961. The case involved a taxpayer who purchased Bitcoin in the financial year 2015-16 and sold it in 2020-21, declaring the gains as long-term capital gains (LTCG). Tax authorities initially rejected this classification, arguing that Bitcoin did not qualify as a capital asset under Section 2(14) of the ITA, 1961, and thus sought to tax the income as "Income from Other Sources," thereby rejecting the taxpayer's claim for exemption under Section 54F.

The Jodhpur Tribunal delivered a landmark judgment in 2024, ruling decisively in favour of the taxpayer. The Tribunal held that crypto currencies, including Bitcoin, fall squarely within the definition of a 'Capital Asset' under Section 2(14)⁸. The ruling provided crucial clarity:

1. **Capital Asset Recognition:** The tribunal explicitly rejected the tax officer's argument that Bitcoin's intangible nature precluded its status as a capital asset,

⁸ Raunaq Prakash Jain v ITO, [2024] 169 ITAT 298

confirming its recognition as a form of property held for investment.

2. **LTCG Benefits:** Since the taxpayer had held the assets for more than three years, the gains were classified as LTCG. This classification provided access to lower tax rates generally applicable to long-term gains.

3. **Indexation and Exemptions:** Crucially, this classification entitled the taxpayer to indexation benefits (adjusting the cost of acquisition for inflation) and eligibility for statutory exemptions like Section 54F (allowing LTCG to be reinvested in residential property).

The judicial interpretation before 2022 demonstrated a willingness to integrate virtual assets into the existing, nuanced framework of the ITA, 1961, based on the principle of taxpayer intent and economic reality.

How Section 115BBH Subverts Prior Judicial Precedent:

The introduction of Section 115BBH by the Finance Act, 2022, constitutes a significant legislative correction of this judicial trend favouring VDA investors. For all transactions

occurring on or after April 1, 2022, the statutory provisions of 115BBH override the beneficial treatments established by the ITAT rulings. By employing the non-obstante clause and mandating a flat 30% tax, Section 115BBH eliminates the distinction between short-term and long-term holdings, thereby terminating the applicability of lower LTCG rates and indexation benefits. Furthermore, the section explicitly disallows any exemptions available under other parts of the Act, including those under Section 54F.

The legislative response demonstrates the Parliament's explicit intent to treat VDA income uniquely—not as traditional capital gains or PGBP, despite the assets themselves being treated as capital assets by judicial bodies. This strategy of isolating VDA income and subjecting it to a stringent tax regime ensures maximum revenue collection and minimizes the potential for tax structuring or avoidance schemes previously leveraged under the traditional heads of income.

The Fundamental Principle Challenge: Erosion of the Net Income Concept:

The most profound statutory critique of Section 115BBH centres on its radical departure from the globally recognized principle of net income taxation. This principle dictates that tax should be levied only on the profit (receipts minus necessary costs incurred to generate that receipt) and not on gross receipts. Section 115BBH severely undermines this principle through its restrictive provisions concerning allowable deductions.⁹

Detailed Examination of Section 115 BBH (2) (a): Restriction on Deductions:

Section 115 BBH (2) (a) explicitly states that in computing the income from the transfer of a VDA, "no deduction in respect of any expenditure (other than cost of acquisition, if any) or allowance or set off of any loss shall be allowed to the assessee under any provision of this Act".

The statute restricts the allowable deduction exclusively to the 'cost of acquisition'. This means that the taxable income is calculated simply as the sale price minus the purchase price (cost of acquisition).

⁹ Raote and Nagarsenkar M., Tax withholding on virtual digital assets, LIVEMINT (4 Jul., 2022) Available on <https://www.google.com/amp/s/www.livemint.com/news/india/tax-withholding-onvirtual-digital-assets/amp-11656933779442.html>

The strict statutory limitation to the cost of acquisition results in the explicit disallowance of all necessary operational and transaction-related expenses incurred by traders and investors. These disallowed costs include, but are not limited to:

1. **Transfer Expenses:** Brokerage fees, commission charges paid to exchanges, and network transaction fees, commonly known as “gas fees,” are explicitly excluded from deduction.
2. **Cost of Improvement:** Any expenditure incurred to enhance the value or utility of the VDA (e.g., development costs associated with an NFT) is not permitted as a deduction.
3. **Interest Costs:** Any interest paid on funds borrowed specifically for the acquisition of the VDA is also excluded from being claimed as an allowance or expenditure.

This gross-revenue-based approach effectively inflates the taxable base, particularly for high-frequency traders who incur significant cumulative operational expenses, thereby increasing their effective tax rate relative to their actual economic profit.

The restrictive deduction regime creates a crisis of fiscal rationality when applied to income generated through cryptocurrency mining. Income from mining is generated not through purchase but through the complex computational process that validates network transactions and creates new VDA tokens (rewards). For VDAs acquired through such non-purchase methods, including mining rewards or airdrops, the monetary cost of acquisition of the VDA token itself is typically considered "zero". However, mining operations are inherently resource-intensive, requiring substantial operational costs. These business expenses include significant outlays for specialized computer hardware and infrastructure (capital expenditure, typically eligible for depreciation allowance) and enormous electricity/utility charges.¹⁰ The government has confirmed that, under Section 115BBH, these operational expenses (electricity, hardware costs) are "not allowed as deduction". This application of the law leads to a situation where the gross revenue generated by the miner

¹⁰ Ranga, S and Ali. F, Virtual Digital Assets in India: A Sneak Peek into India's Regulatory Framework, MONDAQ (22 Feb., 2022) Available on <https://www.mondaq.com/india/fin-tech/1164634/virtual-digital-assets-in-india-asneak-peek-into-india39s-regulatory-framework>

is taxed at 30%, without any regard for the cost of earning that income.¹¹

The disallowance of high operational costs for miners results in taxation that can be potentially confiscatory and irrational. Consider a scenario where a miner generates Rs. 100 in VDA revenue, but incurs Rs. 95 in electricity and hardware maintenance necessary to generate that revenue, yielding a net economic profit of Rs. 5. Under Section 115BBH, since only the zero cost of acquisition is allowed, the taxable income remains Rs. 100, resulting in a tax liability of Rs. 30 (30% of Rs. 100). In this instance, the tax liability (Rs. 30) far exceeds the actual net profit (Rs. 5), translating into an effective tax rate of 600% of the true income. This outcome represents a direct violation of the net income principle and raises significant concerns regarding the constitutional validity of the provision, as the measure imposes an unreasonable and arbitrary burden that threatens economic viability.¹²

¹¹ Chaudhary, Pankaj (Minister of State for Finance), *Written Reply to Lok Sabha/Rajya Sabha Question* (Statements on Mining Costs and VDA Taxation), The Deccan Herald/ET (Mar. 2022).

¹² Dutta S., *Income tax on virtual digital assets Under Section 115BBH*, CA CLUB INDIA (5 May, 2022) available on <https://www.google.com/amp/s/www.caclubindia.com/amp/articles/income-tax-onvirtual-digital-assets-under-section-115bbh-47118.asp>

Denial of Indexation Benefits:

A further departure from rational capital taxation principles is the denial of indexation benefits. Indexation is a mechanism allowed under traditional capital gains provisions to adjust the cost of acquisition for inflation, thus ensuring that tax is paid only on the *real* appreciation of an asset. As the 30% tax rate under 115BBH is applied to the gross gain irrespective of the holding period, indexation is inherently disallowed. This severely penalizes long-term VDA investors, subjecting them to a higher real tax burden compared to holders of other long-term capital assets like shares, mutual funds, or real estate.

The Discriminatory Treatment of VDA Losses:

Analysis of Section 115BBH(2)(b): Prohibition of Set-off and Carry-forward

The severity of the VDA taxation regime is compounded by the restrictive treatment of losses under Section 115 BBH (2) (b). This sub-section imposes a categorical prohibition against adjusting losses arising from the transfer of VDAs. Specifically, the provision dictates two absolute limitations:

- 1. No Inter-head/Inter-source Set-off:** Loss from the transfer of a VDA is not allowed to be set off against

income computed under any other provision of the ITA, 1961. This means VDA losses cannot reduce income from salary, house property, business profits, or traditional capital gains.

2. No Carry-forward: Furthermore, such loss "shall not be allowed to be carried forward to succeeding assessment years". The loss is permanently absorbed in the year it occurs.

The implications of this clause are even more granular, as internal discussions on the provision clarify that a loss realized on the transfer of one VDA (e.g., Bitcoin) cannot be set off even against a profit realized on the transfer of another VDA (e.g., Ethereum) within the same financial year (an inter-source restriction within the VDA category itself). This restriction mandates that tax is paid on every profitable trade, regardless of corresponding or offsetting losses incurred in other VDA transactions during the same period.

The restrictions under 115BBH contrast sharply with the established principles governing losses under traditional heads of income in the ITA, 1961:

- **Traditional Capital Gains:** Losses are generally permitted to be set off against other capital gains (long-term losses against long-term gains, and short-term losses against both), and if unabsorbed, they can be carried forward for up to eight subsequent assessment years.

- **PGBP Income:** Business losses can typically be set off against income under any head (except salary) in the same year and can be carried forward for eight years, subject to specific conditions. The permanent absorption of VDA losses under 115 BBH (2) (b) constitutes a significant departure from these rational norms of tax law. The structure effectively penalizes active market participants, whose profitability is inherently dependent on managing volatility and offsetting losses against gains.

Constitutional Review: Section 115BBH, Proportionality, and Article 14

The Doctrine of Reasonable Classification in Tax Law:

Any challenge to the constitutional validity of a taxation statute in India must navigate the constraints imposed by

Article 14 of the Constitution, which guarantees equality before the law.¹³

The Constitution of India This doctrine permits legislative classification only if two conditions are met: (1) the classification must be founded on an intelligible differentia that distinguishes persons or things grouped together from others left out of the group; and (2) that differentia must have a rational nexus to the object sought to be achieved by the legislation.

Indian courts traditionally grant significant latitude to the legislature in matters of fiscal policy, often relying on the principle that "There is no equity in tax" and being reluctant to interfere merely on grounds of perceived hardship. However, this deference is not absolute and does not extend to classifications that are manifestly arbitrary or operate in a confiscatory manner.

Argument for Arbitrariness: Equating VDA Trading with Purely Speculative Income

¹³ See, Article 14

The core constitutional challenge against Section 115BBH focuses on the lack of an intelligible differentia and the resultant manifest arbitrariness, particularly in three areas:

1. Arbitrary Classification (Intelligible Differentia)

The legislation mandates uniform taxation for all VDA income, regardless of the nature of the activity (passive investment, active trading business, or industrial mining). This classification treats legitimate capital investment (holding VDA for years) identically to highly suspicious or purely chance income (like lottery winnings taxed under 115BBE). Critics argue that this classification fails the rational nexus test. While the object of the law may be to ensure regulatory certainty and capture revenue, achieving this object by grouping established, transparent market activities with inherently speculative ones is arbitrary. The differential tax treatment of VDA assets compared to other major capital assets (which receive indexation, exemptions, and loss set-offs) suggests that the legislative differentiation imposed by 115BBH is punitive rather than fiscal.

2. Erosion of Net Income (Manifest Arbitrariness)

The second and more potent constitutional argument stems from the **complete denial of necessary business expenses,**

particularly for VDA mining operations. As demonstrated, Section 115 BBH (2) (a) compels the taxation of gross revenue, even when the required operational costs (electricity, hardware depreciation) exceed the net profit, resulting in a potentially confiscatory tax liability.

While the judiciary typically avoids striking down tax laws based on economic hardship, a taxing statute that taxes a non-existent or negative economic profit moves beyond mere "hardship" and enters the realm of manifest arbitrariness. In instances where legitimate, documented business activity (such as organized VDA mining) is subjected to a tax regime that results in an effective tax rate exceeding 100% of the true income, the legislation may be challenged on the grounds that it is destructive of the economic activity itself and disproportionate to the stated object of taxing income.

3. Precedential Context: Distinction from Section 115BBE

Constitutional scrutiny often involves comparing the provision under challenge to existing legislation. Section 115BBE, which taxes unexplained cash credits and other suspicious assets, is the closest analogy to 115BBH due to its flat 30% rate and restricted deductions. The Delhi High Court

has previously upheld the constitutional validity of Section 115BBE, confirming that it cannot be held unconstitutional based merely on apprehension of misuse.

However, a fundamental distinction exists. Section 115BBE targets unexplained income – income the taxpayer cannot account for—justifying the punitive nature of the tax.

Conversely, Section 115BBH applies to explained, legitimate income generated through transparent, verifiable market transfers (often tracked via the Section 194S TDS mechanism). Applying a tax regime intended for income derived from suspicious sources to a legitimate business activities, while denying the corresponding cost of income generation, strengthens the argument that the classification is arbitrary and lacks a rational nexus to the objective of fair income taxation.

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Conclusion and Recommendations for Legislative Reform:

The Indian taxation framework for Virtual Digital Assets, implemented through Section 115BBH and Section 194S of the Income Tax Act, 1961, represents a decisive governmental step towards establishing clear regulatory certainty and enhancing revenue tracking in a previously ambiguous domain. The non-obstante clause of 115BBH, coupled with the mandatory 1% TDS provision, successfully creates an enforced and highly visible compliance pathway. However, this legislative achievement is realized through fiscally punitive measures that fundamentally violate established taxation principles. The flat 30% tax rate, the denial of necessary operational expenditures (leading to gross income taxation, particularly for miners), and the permanent absorption of realized losses, create a tax regime that is disproportionately harsh and discriminatory when compared both internally (to traditional capital assets and business income) and externally (to major global jurisdictions). The current model risks stifling domestic VDA market participation, incentivizing capital flight, and undermining the

potential for India to be a leader in the underlying digital asset technology sector.¹⁴

To rectify the fiscal anomalies and potential constitutional infirmities inherent in Section 115BBH while maintaining the government's objectives of revenue security and compliance tracking, the following legislative and policy reforms are recommended:

Recommendation 1: Introduce Differentiated Tax Treatment Based on Intent

The current uniform application of the 30% rate must be replaced by a differentiated structure that recognizes the taxpayer's intent and activity, aligning with global best practices:

- 1. Investment Activity:** VDAs held for passive investment should be taxed under the head of Capital Gains. This would re-establish the benefits available prior to 2022, including indexation (for long-term holdings) and eligibility for capital gains exemptions (like Section

¹⁴ Murali. A, Two young Indians turn to Supreme Court to make laws around Bitcoin, cryptocurrencies less turbid, FACTOR DAILY (14 Nov., 2017) Available on <https://archive.factordaily.com/bitcoin-regulation-pil-supreme-court/>

54F), provided the mandatory holding period criteria are met.

2. Trading or Business Activity: VDA income derived from active trading or industrial operations (such as mining) must be classified under the head of Profits and Gains of Business or Profession (PGBP).

Section 115 BBH should, consequently, be reformed to apply only to genuinely speculative VDA income (analogous to the income targeted by 115BBE) or to VDA gains where the acquisition source or transfer details are opaque, thus preserving the stringent tax rate for revenue protection without punishing legitimate economic activity.

Recommendation 2: Explicitly Allow Operational Expense Deduction for Income Generation

For VDA-related business activities (including mining) that cannot be immediately integrated into PGBP rules, the definition of ‘cost of acquisition’ in Section 115BBH(2)(a) must be broadened. If the legislature insists on retaining VDA income under a special category like 115BBH, the statute must be amended to explicitly permit the deduction of all

costs necessarily incurred for the generation or acquisition of the VDA, including, but not limited to, essential operational and infrastructure expenses such as electricity charges, hardware depreciation, and network fees. This reform is essential to eliminate the risk of confiscatory taxation based on gross revenue.

Recommendation 3: Rationalize Loss Treatment

The current absolute denial of loss set-off and carry-forward is the most economically damaging aspect of the statute. Section 115BBH(2)(b) should be reformed to, at a minimum, permit losses from the transfer of VDAs to be set off against VDA income earned in subsequent years (a limited carry-forward). This measure would partially align India's regime with basic principles of capital risk management, mitigating the extreme hardship imposed on market participants and creating a more rational investment climate.