Explained: New crypto tax rule doesn't differentiate between income slabs, will impact trading volumes

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NEW DELHI: Several income tax proposals, including 30 per cent tax on income from trade in cryptocurrencies will come into effect from today. From April 1, 2022, income from transfer of virtual digital assets or cryptocurrencies is taxable at 30 per cent. Such income will be taxable even if taxpayers' total income is below the threshold limit of Rs 2.50 lakh. Further, unlike in other asset classes like equities, retail investors will not be able to set off losses incurred against crypto coins, claim expenses or acquisition costs, or benefit from a reduced slab for long-term capital gains under the new tax regime.

The proposed 1% TDS on crypto transfers will kick in from July 1, 2022 and talks of imposition of GST on the entire value of crypto transactions are further expected to impact trading volumes.

The crypto tax may convert day traders into long-term investors, while some may abandon the crypto space altogether to invest in traditional assets like equities and debt. Moreover, the new rules will make investors rethink their decision to make India the base for launching crypto platforms and products and there might be a flight of talent to crypto-friendly jurisdictions like Dubai, Malta and Singapore.

Brain drain:

Many Indian entrepreneurs shifted base to crypto-friendly jurisdictions, despite a steeper cost of setting up there due to the prolonged regulatory uncertainty and recent tax blows. While Edul Patel, the founder of Mudrex, set up his company in the US in 2019, Sandeep Nailwal, who co-founded Polygon in 2017, relocated to Dubai in 2020. Crypto exchange Vauld moved to Singapore in 2018 while crypto exchange ZebPay, that was earlier processing majority of cryptocurrency transactions in India at the time, also moved to the country the same year.
“The brain drain is absolutely crazy,” Sandeep Nailwal, whose Polygon operates the biggest so-called Layer 2 protocol for the Ethereum blockchain system, said in an interview with Bloomberg from Dubai. “I want to live in India and promote the Web3 ecosystem,” the 34-year-old said. “But overall, the way the regulatory uncertainty is there and how big Polygon has become it doesn’t make sense for us or for any team to expose their protocols to local risks.”

Siddharth Sogani, founder and CEO of cryptocurrency research company Crebaco, tweeted that India would see the biggest brain drain in the next 8-12 months. “Making #crypto difficult is not going to stop innovation. The smarties will move offshore. And you know what, these smarties will make billion-dollar enterprises in the crypto space,” he said.

Right now, many Indian crypto companies, developers and founders are trying to move to places like Dubai, Edul Patel,founder of Murdrex said in an interview with Bloomberg. One selling point for Dubai is its “sandbox approach,” something India lacks for crypto, he said. Governments often use so-called sandbox setups as a testing ground for promising but unproven financial technologies.

India taxes crypto like gambling win

Earlier this week, BJP member Sushil Kumar Modi said the government should further increase tax on cryptocurrencies from the current rate of 30 per cent,as it is a form of 'gambling'. "Crypto is gambling. It is a form of lottery, a form of horse racing... When you put money in share market you know companies who are behind it but who are behind crypto?," he asked.

But experts feel that the existing 30 per cent is similar to the rates associated with gains from gambling, and will dissuade investors from investing in crypto as opposed to traditional financial instruments.

" The stringent crypto tax regime is expected to cause an adverse effect on daily trading numbers. Such high rate of taxation, as is now being considered to be proposed under GST as well, is similar to regimes associated with gambling, which may discourage investors from investing in crypto," said Rishi Anand, Partner, DSK Legal.

"India has always looked at cryptocurrencies as some of the most volatile and risky investment assets. Far from allowing Indians to use cryptos as fiat currency replacements, they are presently treating them as an asset class and taxing them to high heaven. The stated concern remains investor protection. However, the insistence to tax crypto at the same rate as winnings from gambling especially when there is no clarity on the regulatory stance viz its legality, is bound to hurt," said Anupam Shukla, Partner, Pioneer Legal .

30% flat tax doesn't differentiate between income slabs or short-term capital gains from long-term gains

Investors are worried about the tax rate because a flat 30% tax doesn’t differentiate between your income slab either. Usually a person who earns less than Rs 2,50,000 annually does not have to file an income tax return. But now, if the person is earning income from crypto, they will have to pay a 30% tax and file a return, even if the income is as low as Rs 10,000.

" The move will have an impact on the number of people who trade and volume of trade on exchanges. Further, a flat 30% tax that does not differentiate short-term capital gains from long-term gains, with no provision for deducting expenses incurred or offsetting losses is not in tune with the tax framework for other asset classes and is discriminatory. The industry has also not yet received the clarifications it had sought on the implementation of tax proposals, and this ambiguity may result in operational obstacles. It is the need of the hour that the government issue these clarifications before the TDS comes into effect on July 1, 2022, said Ashish Singhal, Co-founder and CEO, CoinSwitch.

Singhal instead recommends that a cohesive tax framework would encourage users to diversify their investments across asset classes. He said Indians have already invested more than $6 billion in cryptos, and prohibitive taxes are likely to unsettle these investors, expose them to possible losses, and possibly drive them out.

Another major fallout could be drastic dip in trading volumes as well as investors moving to decentralised exchanges and international exchanges.

"Trading volumes are expected to dip significantly in the coming days. Many have exited positions and offset losses before the new tax regime came into place. Fresh buying is likely to be for more long term holdings," said Meyyappan Nagappan, leader, Digital Tax, Nishith Desai Associates.

"With increasing regulatory requirements and introduction of tough tax laws on crypto trading, is likely to negatively impact crypto volumes. People will evaluate the impact of these tax laws before trading in crypto and might wait for dust to settle down around crypto tax laws before starting to trade again," said Maneet Pal Singh, Partner, I.P. Pasricha & Co.

Crypto as an asset class has become less attractive

While many small investors have offloaded their portfolios, the big ones are likely to continue trading, while several will hold on to their portfolios until taxes are lowered.

The digital assets space has attracted mostly young and first-time investors, who are now becoming wary of crypto as an asset class. " What is the point of holding on to my investment.. I will hardly be able to make any profits, I would rather go the traditional route of SIPs," said 28-year-old Akash Singhi, who last year invested Rs 30,000 in crypto assets and is now feeling stuck with the investment. Many of India's first-time crypto investors are either in the lowest income tax bracket or do not generate enough income to pay taxes at all.
"Crypto has become less attractive as an asset class and there is a broad consensus that current holders and investors would sell, given the tax regime announced for virtual digital assets. But high-net worth investors who are already in the 30% tax bracket may look at this scenario a little differently especially if they are betting on windfall gains on the back of how large crypto markets recognize and regulate crypto during FY22," explained Harish Prasad, Head of Banking, FIS, a Fortune 500 global company that deals with payment solutions.

Small-time investors will not want to take a risk with cryptos
" Given the high tax rate and no set-off of losses allowed the investors may look at other asset classes which have a more attractive regime. There may be an impact on the volumes overall as many small-time investors may not find it worth to take the

risk given the high tax rate and also withholding tax provisions which would apply from July. Currently, due to tax issues and also because of question mark on legality of the Cryto's many big investors would be on the fence," said Nishit Parikh – Partner, Sudit K Parekh & Co, LLP.

Is it best to sit on the gains then?

An investor's crypto gains will not be taxed till he/she sells the crypto-asset which has appreciated in value, and turns a profit on it.

"Some optimistic investors may choose to sit on their gains and not redeem the same in hopes of change in regulatory winds. The rest are also contemplating solutions like investing in entities abroad who trade in cryptos," said Anupam Shukla, Partner, Pioneer Legal.

Flight of capital out the country

The crypto community believes that if high taxes continue in India, taxmen will have to grapple with high tax evasion.

Crypto investor Suraj Pandey tweeted that he was quitting Indian crypto exchanges. "Sending my money to my friend who lives in Thailand. So, he bought crypto on my behalf in Binance. I can also trade using his Binance account in India."

Nishchal Shetty, the founder of WaxirX, tweeted that the crypto tax would lead to a flight to foreign exchanges, trade without KYC, grey markets, a large pool of tax defaulters, and huge TDS refunds.