

CRYPTO TAXATION IN INDIA: LOOPHOLES, ENFORCEMENT CHALLENGES, AND THE ROAD AHEAD

Abstract

The taxation of cryptocurrencies and other Virtual Digital Assets (VDAs) has emerged as a significant policy challenge for tax administrators across the world. In India, the Finance Act, 2022 introduced a dedicated tax framework for VDAs by imposing a flat tax rate on gains and introducing a Tax Deducted at Source (TDS) mechanism on transfers. While these measures brought much-needed legal certainty, they also exposed several practical challenges relating to compliance, reporting, valuation, and enforcement.

The rapid growth of decentralised financial systems, offshore exchanges, private wallets, and crypto-to-crypto transactions has created circumstances in which taxable events often occur beyond the visibility of traditional tax administration mechanisms. As a result, a gap continues to exist between the legislative intent of the law and its practical implementation.

This paper examines the existing taxation framework governing VDAs in India, identifies structural loopholes and enforcement constraints, and analyses international approaches adopted by major jurisdictions. Drawing upon regulatory developments, professional observations, and comparative practices, the paper proposes policy measures aimed at improving transparency, strengthening compliance, and encouraging responsible participation in the digital asset ecosystem. It also highlights the emerging role of Cost and Management Accountants in assisting taxpayers with transaction reconciliation, compliance reviews, tax reporting, and risk assessment in the evolving crypto economy.



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Introduction

The rapid growth of cryptocurrencies and other Virtual Digital Assets (VDAs) has transformed the global financial landscape

and created new challenges for tax administrations worldwide. In India, increasing participation in digital asset markets prompted the Government to introduce a dedicated taxation framework through the Finance Act, 2022, which has been carried forward under the Income Tax Act, 2025. The framework provides for taxation of gains arising from VDA transfers and introduces reporting mechanisms aimed at improving compliance.

Despite the establishment of a statutory framework, several practical challenges continue to persist. Transactions through offshore exchanges, wallet-to-wallet transfers, decentralised finance (DeFi) platforms, and crypto-to-crypto exchanges often create difficulties in monitoring and enforcement. In addition, many taxpayers remain unaware of the tax implications of certain digital asset transactions,

resulting in unintended non-compliance.

Against this backdrop, this paper examines the existing VDA taxation regime under the Income Tax Act, 2025, identifies key loopholes and enforcement challenges, and analyses international practices in crypto taxation. It further explores the role of Cost and Management Accountants (CMAs) in promoting compliance and proposes policy measures for strengthening India's digital asset taxation framework.

The Legal Framework for Crypto Taxation in India

1. Definition and Scope of Virtual Digital Assets

The Income Tax Act, 2025 has retained and expanded the taxation framework applicable to Virtual Digital Assets (VDAs). Under Section 2(111)(d), a VDA broadly includes any digitally generated token, code, number, or cryptographically secured asset capable of representing value or ownership in a digital environment.

One notable development under the 2025 framework is the express inclusion of the term "crypto-asset" within the statutory definition. This clarification assumes significance because the digital asset ecosystem has evolved considerably beyond traditional cryptocurrencies such as Bitcoin and Ether. Stablecoins, governance tokens, meme coins, exchange tokens, tokenised assets, and similar blockchain-based instruments now form a substantial part of market activity.

2. Key Taxation Provisions

The taxation regime governing VDAs under the Income Tax Act, 2025 continues to follow a separate and relatively stringent structure when compared with the taxation of conventional capital assets.

The principal features of the framework are as follows:

- ⊙ Income arising from the transfer of a Virtual Digital Asset is taxable at a flat rate of 30 percent, together with applicable surcharge and health and education cess.
- ⊙ No deduction is allowable while computing such income except the cost of acquisition of the asset transferred.
- ⊙ Loss arising from the transfer of a VDA cannot be set off against income under any

other head.

- ⊙ Such losses are also not permitted to be carried forward to subsequent assessment years.
- ⊙ Tax is required to be deducted at source under Section 393 on consideration paid for the transfer of a VDA, subject to the prescribed threshold limits.

The legislative design clearly indicates a policy objective of discouraging speculative trading while ensuring tax visibility through the TDS mechanism. However, the practical impact of these provisions has generated considerable debate among taxpayers, professionals, and industry participants.

Structural Loopholes in the Current Regime

The introduction of a dedicated taxation framework for Virtual Digital Assets (VDAs) under the Income Tax Act, 2025 represents a significant step towards regulatory certainty. However, taxation is ultimately effective only when taxable transactions can be identified, measured, and reported with reasonable accuracy. The unique characteristics of blockchain based assets continue to create gaps between the legal framework and practical enforcement.

1. Offshore Exchange Transactions

One of the most significant challenges facing Indian tax authorities is the migration of trading activity to offshore cryptocurrency exchanges. Following the introduction of the 30 % tax on gains and the TDS provisions applicable to VDA transfers, a noticeable portion of Indian trading volume shifted towards foreign platforms. Many of these exchanges operate outside the direct jurisdictional reach of Indian tax authorities and therefore do not automatically implement domestic withholding requirements.

2. Wallet to Wallet Transfers and Pseudonymity

Traditional financial systems rely heavily on regulated intermediaries such as banks, brokers, and payment processors. Cryptocurrencies operate differently. A taxpayer can transfer substantial value directly from one private wallet to another without involving any regulated financial institution. Although blockchain networks publicly record such transactions, wallet addresses generally do

not reveal the identity of the individuals controlling them.

3. Crypto to Crypto Exchanges

A recurring misconception among retail investors is that taxation arises only when cryptocurrency is converted into fiat currency. Under the Income Tax Act, 2025, this assumption is incorrect. The exchange of one Virtual Digital Asset for another generally constitutes a taxable transfer. Nevertheless, practical experience suggests that many taxpayers continue to view such transactions as mere portfolio reallocations rather than disposal events.

4. Decentralised Finance (DeFi) : A Regulatory Grey Zone

Decentralised Finance, commonly known as DeFi, presents perhaps the most challenging area of VDA taxation. Unlike conventional financial arrangements, DeFi protocols operate through self-executing smart contracts without traditional intermediaries. Activities such as staking, liquidity provision, lending, borrowing, and yield farming can generate economic benefits without involving a clearly identifiable payer.

Enforcement Challenges

Despite the introduction of a dedicated taxation framework for Virtual Digital Assets (VDAs) under the Income Tax Act, 2025, effective enforcement remains a significant challenge. The decentralised and borderless nature of cryptocurrencies often limits the ability of tax authorities to track transactions and verify compliance.

1. Cross Border Transactions

Many Indian investors trade through foreign cryptocurrency exchanges that may not be subject to Indian reporting requirements. This creates information gaps and makes it difficult for tax authorities to identify offshore holdings and transactions.

2. Valuation Volatility

Crypto assets are highly volatile, and prices may vary across exchanges. Determining fair market value at the time of a taxable event can therefore be complex, leading to inconsistent reporting and potential disputes.

3. Technological Challenges

Although blockchain transactions are publicly recorded, identifying the individuals behind wallet addresses requires specialised blockchain analytics tools and technical expertise. The absence of robust monitoring infrastructure can limit effective enforcement.

4. Compliance Awareness Deficit

Many retail investors remain unaware that activities such as crypto-to-crypto swaps, staking rewards, DeFi income, and certain gifting transactions may attract tax liability. This lack of awareness contributes to inadvertent non-compliance

A Comparative Global Perspective

The following table contextualises India’s crypto tax framework against those of other major jurisdictions, drawing on OECD (2022) and national revenue authority publications:

Country	Tax Rate	Loss Set-Off	TDS / Withholding
India	Flat 30% + surcharge & cess	Not permitted; no carry-forward	1% TDS (Sec. 393)
USA	Short-term: up to 37%; Long-term: 0–20%	Permitted; \$3,000/year against ordinary income	Broker reporting mandated from 2025
UK	18–24% (Capital Gains Tax)	Permitted against other capital gains	No withholding; self-assessment
Germany	0% if held >1 year; else marginal rate	Permitted within same asset class	No withholding; self-assessment
Singapore	No CGT; income tax if trading income	Permitted against business income	No withholding on capital gains

Source: OECD (2022)

India's regime stands out as among the most restrictive globally in its denial of loss set-off provisions. Economic research on crypto market behaviour suggests that punitive withholding regimes, particularly when combined with loss disallowance, tend to accelerate capital migration to offshore platforms precisely the outcome the 1% TDS was designed to counteract (Nishith Desai Associates, 2022).

Case Illustration: The Hidden Tax in a Crypto Swap

Consider an investor let us call him Sachin who purchases Bitcoin for ₹5 lakh in April 2025. By August 2025, the value of his Bitcoin has risen to ₹8 lakh. Sachin decides not to sell but to exchange his Bitcoin for Ether, believing this to be a portfolio rebalancing exercise with no immediate tax consequence.

Under the Income Tax Act, 2025, this exchange constitutes a 'transfer' of a VDA. The gain of ₹3 lakh (₹8 lakh ₹5 lakh cost of acquisition) is taxable at a flat 30%, resulting in a tax liability of ₹90,000 despite the fact that Sachin has received no rupees whatsoever. He must now either liquidate a portion of his Ether to pay the tax or fund the liability from other savings.

From a compliance perspective, cases like Sachin's are far from unusual. Professional experience suggests that many retail investors in this position are unaware of the liability until they receive a notice or file their return with professional assistance. The compliance failure here is not wilful evasion it is a structural awareness gap compounded by the absence of any intermediary-triggered TDS at the point of the swap.

This single scenario encapsulates two of the framework's most pressing problems: the non-obvious taxability of crypto-to-crypto transactions, and the absence of any automatic withholding mechanism to catch liabilities that taxpayers don't know they have.

The Role of Cost and Management Accountants (CMAs)

The increasing adoption of Virtual Digital Assets (VDAs) has introduced new challenges relating

to tax compliance, record-keeping, valuation, and reporting. Given the complexity of digital asset transactions and the evolving regulatory framework, taxpayers often require professional assistance to ensure accurate compliance with applicable tax laws. In this context, Cost and Management Accountants (CMAs) are well positioned to support individuals, businesses, and institutional investors through their expertise in taxation, financial reporting, risk management, and regulatory compliance. Their role is likely to become increasingly important as the digital asset ecosystem continues to expand.

1. Transaction Reconciliation and Blockchain Audit

Crypto investors often transact across multiple exchanges and wallets, making it difficult to maintain complete records. CMAs can assist in reconciling transaction histories, determining the cost of acquisition, computing taxable gains, and preparing accurate tax working papers in accordance with the Income Tax Act, 2025.

2. Structuring and Tax Planning

Within the constraints of the current regime, CMAs can identify legitimate tax efficiency opportunities such as timing of disposals to align with lower-income years, optimisation of the Rs. 50,000 gift threshold, and evaluation of the tax treatment of staking income as business income versus other sources where applicable.

3. Risk Assessment and Due Diligence

Businesses, family offices, and institutional investors holding digital assets may require periodic reviews of their compliance position. CMAs can conduct due diligence exercises, assess reporting gaps, and identify potential exposure to penalties arising from inaccurate reporting or non-compliance.

Policy Recommendations

To improve the effectiveness of the VDA taxation framework under the Income Tax Act, 2025, the following measures may be considered:

- ⦿ Review the TDS provisions under Section 393 to balance compliance objectives with market efficiency.

- ⊙ Permit the set-off of VDA losses against VDA gains within the same financial year while continuing to prohibit adjustment against other income.
- ⊙ Strengthen reporting requirements for exchanges and other Virtual Asset Service Providers (VASPs) to improve transaction transparency.
- ⊙ Issue detailed guidance on the taxation of emerging transactions such as staking rewards, airdrops, hard forks, NFT royalties, and DeFi income.
- ⊙ Enhance international cooperation and adopt global crypto-asset reporting standards to improve visibility of offshore holdings and transactions.
- ⊙ Develop specialised blockchain analytics capabilities and dedicated enforcement units within the tax administration.
- ⊙ Increase taxpayer awareness through guidance notes, educational programmes, and professional outreach initiatives.

A balanced approach combining effective reporting, technological capability, taxpayer education, and regulatory clarity will help strengthen compliance while supporting innovation in the digital asset ecosystem.

Conclusion

The introduction of a dedicated taxation framework for Virtual Digital Assets under the Finance Act, 2022 and its continuation under the Income Tax Act, 2025 has provided much-needed certainty regarding the tax treatment of cryptocurrencies and related digital assets in India. The framework establishes clear rules for taxation and reporting, thereby reducing the ambiguity that previously surrounded crypto transactions.

However, several practical challenges continue to affect its effectiveness. Offshore exchanges, decentralised finance platforms, wallet-to-wallet transfers, valuation complexities, and limited taxpayer awareness create significant compliance and enforcement concerns. The restriction on loss set-off and operational challenges associated with TDS compliance have also generated debate among taxpayers and industry participants.

The study indicates that effective taxation of digital assets requires more than statutory provisions. Regulatory clarity, technological capability, international cooperation, and taxpayer education are equally important for achieving the objectives of transparency and voluntary compliance.

Cost and Management Accountants can contribute meaningfully to this process through transaction reconciliation, compliance reviews, tax reporting, and advisory services. Their involvement can help bridge the gap between legislative requirements and practical implementation.

As digital assets continue to evolve, India's taxation framework must remain adaptable to emerging technologies and business models. A balanced approach that promotes compliance, transparency, and innovation will be essential for ensuring the long-term effectiveness of the VDA taxation regime. **MA**

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