

Technology & Tax Series

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TECHNOLOGY & TAX SERIES – ISSUE V: CRYPTOCURRENCY BUSINESS MODEL CASE STUDY – FINTECH: PART II

Cryptocurrency first emerged in 2009 when the world's first decentralized currency, Bitcoin, was created by a software developer with the pseudonym Satoshi Nakamoto. Since then, over 5,000 virtual currencies like Litecoin, Ripple, Ethereum and several others have come into existence. Based on application of blockchain technology, it is estimated use of cryptocurrencies could reduce banks' infrastructure costs attributable to cross-border payments, securities trading and regulatory compliance by \$15-20 billion per annum by 2022.¹

While the cryptocurrency space in India has been subject to regulatory resistance, it was at one point estimated that around 5 million traders in India traded in 24 exchanges, with trading volumes in the range of 1,500 Bitcoins a day or around INR 1 billion.² Further, news reports suggest that the trading volume of cryptocurrency in India has increased by 400 percent in the last few months during the nationwide lockdown due to the COVID-19 pandemic.³ The boom in crypto trading can also be attributed to the Supreme Court decision wherein the Supreme Court set aside, on constitutional grounds, a circular issued by the Reserve Bank of India, which had sought to restrict banking facilities from being offered to participants involved in cryptocurrency transactions. The Supreme Court ruling affirmed the virtual currency exchanges' fundamental right to trade and do business, guaranteed under the Constitution of India.

In this context and in continuation of our 'Technology & Tax Series', we are pleased to announce the fifth issue of this series: **'Cryptocurrency Business Model Case Study – Fintech: Part II'**

In this issue, we briefly discuss the India's experience in dealing with virtual currencies. We deep dive into the operational business model and legal structure of cryptocurrency exchanges (based on publicly available information) to determine the potential issues that may arise from a tax perspective. We specifically deal with the operational differences between exchange model and over the counter trading model and discuss how the tax implications may differ under both models, particularly in a cross-border context and also when exchanges are located in India. We also discuss how different tax outcomes arise in absence of any law classifying virtual currencies as goods or commodities or securities or derivatives. We then analyze the impact of income-tax provisions *inter-alia* including provisions related to significant economic presence, attribution rules, transfer pricing, withholding tax obligation under section 194-O, obligation to collect tax at source, equalization levy, and provisions under tax treaties in relation to permanent establishment among other issues. We also delve into the potential implications for each model under the goods and service tax regime. We end the discussion in this case study by highlighting some upcoming issues that may be of relevance in the crypto space since there is not much in terms of guidance from different authorities.

While several countries are exploring to regulate the crypto currency market, recent news report suggest that India plans to introduce a new law banning trade in cryptocurrencies.⁴ With increasing rise in the trading volumes of virtual currencies and the decision of Supreme Court, an overall ban on cryptocurrency may be counter-productive for the Indian economy and may hinder innovation. Given the business uncertainty and regulatory challenges which may arise, we are certain that this report would be of interest to you. Please note that this report is only for private circulation and is available only on a request basis. Please send an email on [digitaltaxseries\(at\)nishithdesai.com](mailto:digitaltaxseries(at)nishithdesai.com) to request for a copy of the case study.

¹ <https://www.finextra.com/finextra-downloads/newsdocs/the%20fintech%20%200%20paper.pdf>

² <https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20MC%20on%20VCs%2028%20Feb%202019.pdf>

³ <https://www.moneycontrol.com/news/business/cryptocurrency/cryptocurrency-trading-in-india-sees-400-jump-during-covid-19-lockdown-5539741.html>

⁴ <https://www.bloombergquint.com/global-economics/india-plans-to-introduce-law-to-ban-trading-in-cryptocurrency>

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