

Technology and Tax Series: Issue 5

Cryptocurrency Business Model Case
Study – Fintech: Part II

October 2020

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1. Introduction

The advent of blockchain technology has paved way for emergence of virtual currencies (“VCs”) around the world. Unlike fiat currency or the currency issued by the central bank of a country, VCs are in electronic form, have no physical existence and are not backed by any assets. Bitcoin, the first cryptocurrency which came into existence in 2009, was intended to be a peer-to-peer electronic cash system that bypassed the need for an intermediary to verify transactions.¹ Since then, cryptocurrencies like Litecoin, Ripple, Ethereum and several others have come into existence. Despite several benefits, the technology remains incompletely understood and different countries have taken a range of approaches in relation to regulating cryptocurrencies, with some countries even banning them.

However, recently, some countries are increasingly attempting to put in place cogent and comprehensive policies for cryptocurrencies. For example, few countries like Singapore, Estonia, Liechtenstein, Dubai, identifying the potential of blockchain technology have introduced frameworks to regulate, promote and monitor cryptocurrency businesses and also provided clarification from tax perspective. While several countries are exploring to regulate the cryptocurrency market, recent news report suggest that India plans to introduce a new law banning trade in cryptocurrencies.²

1. <https://bitcoin.org/bitcoin.pdf>

2. Bloomberg Quint. 2020. India Plans to Introduce Law to Ban Cryptocurrency Trading [online] Available at: <https://www.bloombergquint.com/global-economics/india-plans-to-introduce-law-to-ban-trading-in-cryptocurrency> [Accessed 28 September 2020]

2. Cryptocurrencies: The Indian Experience

- In April 2018, the Reserve Bank of India (“RBI”) issued a circular,³ which prohibited entities regulated by RBI from dealing in VCs⁴ or providing services for facilitating any person or entity in dealing with or settling VCs. This blanket ban on VCs was challenged in Internet and Mobile Association of India vs RBI⁵ (“IAMI case”) and the ban was recently overturned by the Supreme Court (“SC”) on ground of proportionality.⁶
- The SC also analysed how these VCs should be classified to determine whether it fell within the control of RBI. The SC noted that the identity of VCs eludes precision and some call it an exchange of value, some call it a stock and some call it a good / commodity. Specifically, the SC also looked at whether VCs can be categorised as money, goods or commodities. In this regard, the SC analysed how VCs were defined (i) by regulators in different jurisdictions and (ii) by the governments and other statutory authorities of various countries, through statutory instruments and non-statutory directives and (iii) by courts of different jurisdictions. While the SC did not conclude on the categorisation of VCs, the SC held that anything that may pose a threat to or have an impact on the financial system of the country, can be regulated or prohibited by RBI, despite the said activity not forming part of the credit or payment system.
- Pertinent to note that there is no law that expressly classifies VCs as goods or commodities, services, securities, derivatives or currencies. The categorisation of VCs into one or more of these stated classes is important, as the existing law would apply differently based on the categorisation. Most tax issues (as discussed in detail below) in crypto transactions also arise due to lack of characterisation of VCs.
- The SC judgement came as a huge relief to the crypto industry in India and has left the fate of the draft Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 in limbo. Further, given the lack of any regulatory or taxation framework governing the cryptocurrency transactions, uncertainty with respect to crypto business still exists from a practical standpoint. Despite this, media reports suggest that the trading volume of cryptocurrency in India has increased by 400% in the last few months during the nationwide lockdown due to the COVID-19 pandemic.⁷

3. RBI/2017-18/154, DBR.No.BP.BC.104/08.13.102/2017-18

4. The term virtual currencies has not been defined by the RBI or any government authority in India. While regulatory action seems to suggest that the intention was to definitely cover cryptocurrencies, it is not clear whether all other virtual currencies including tokens were intended to be covered. While the SC referred to the definition of VC provided in the RBI in the Financial Stability Report of 2013 and a 2014 Report by the Financial Action Task Force, there was no finding or ruling in this aspect by the SC

5. Writ Petition (Civil) No.528 of 2018

6. Disclosure: Nishith Desai Associates represented the Internet and Mobile Association of India in the case and played a key role in the proceedings

7. MoneyControl. 2020. *Cryptocurrency trading in India sees 400% jump during COVID-19 lockdown* [online] Available at: <https://www.moneycontrol.com/news/business/cryptocurrency/cryptocurrency-trading-in-india-sees-400-jump-during-covid-19-lockdown-5539741.html> [Accessed 23 September 2020]

3. Scope and Limitations of Study⁸

- While the blockchain eco-system allows for different type of digital assets like tokens and other variations of digital assets, in this case study, we have limited our analysis to cryptocurrencies only.⁹
- While we are aware that people are increasingly exploring other arenas like remittance model,¹⁰ crypto conversion service providers,¹¹ such models have still not gained momentum from an Indian perspective. Similarly, ICO or Initial Coin Offerings have not also taken off due to regulatory restrictions under Foreign Exchange regulations and Securities Exchange Board of India regulations. Accordingly, we have not included such models in our analysis below.
- This case study sets out the operational features of such exchange-based cryptocurrency models and looks at common structural issues that may arise in such models from an income-tax, international tax, transfer pricing and Goods Service Tax (“GST”) perspective.

8. Please note that the law relating to crypto-assets in India is far from settled and is in flux even after the SC judgment in IMAI case. Further, no law has been specifically clarified in India with reference to crypto-assets. Our analysis in this paper will therefore be dealing with several grey areas in the law and will contain certain assumptions and qualifications

9. While the examples in the case study may refer to bitcoins, it should apply equally to other cryptocurrencies as well

10. Cryptocurrency remittance services providers link remitters with remitees, while undercutting the pricing model of traditional payment remittance services and taking a fee. Another advantage that crypto remittance services have over traditional payment processing or remittance systems is that the time taken to credit transactions could be significantly lesser depending on the manner in which the service provider operates. Typically, they host a wallet on their website itself

11. Service of converting fiat currencies into crypto or vice-versa for a fee

4. Operational Business Model of Cryptocurrency Players

A brief role of the participants in the cryptocurrency ecosystem has been provided under:

- **Miners:** Miners use computing power to solve cryptographic problems generated by the blockchain software. Upon solving the cryptographic problem i.e. verification of the transaction over the blockchain network, the miner is credited with a cryptocurrency (say bitcoin) by the software. The customer can select the cryptocurrency that they want mined, a pool on which they want, set the price that they are willing to pay for it, and place the order.
- **Cryptocurrency exchange:** Cryptocurrency exchanges act as online platforms that enable the traders and casual customers to buy and sell cryptocurrencies. Typically, these exchanges charge fees for matching the traders and casual customers (“**Marketplace Model**”). Exchanges may also trade cryptocurrencies directly in the over the counter (“**OTC Model**”) model to its consumers.
- **Cryptocurrency wallet service providers:** The cryptocurrency wallet service providers create value by offering i) free cryptocurrency wallets towards cryptocurrency holders, ii) open cryptocurrency application program interface (“**APIs**”) for developers, iii) search engine services to monitor cryptocurrency data. It aims to make customer interaction with cryptocurrency easy and make transactions between individuals seamless.
- **Hash power rental companies:** The hash power rental companies invest money in buying specialized computer equipment that has been designed and manufactured for the purpose of mining bitcoins and then rent the computing power to other miners or third parties in exchange for fees. This can be understood as providing infrastructure as a service.
- **Traders:** Traders are individual or companies that are engaged in the business of buying and selling cryptocurrency with the intention of making a profit.
- **Casual Trader / Individual Customers:** In some of the transactions, particularly with the wallet providers and exchanges, individuals undertake cryptocurrency transactions without the intent to carry on a business. While historically bitcoin mining and trading was more of a hobby, with the current competition on mining, only sophisticated players with access to advanced computing systems participate.

5. Legal Provisions

I. General taxation framework under Income-tax Act, 1961

A. Charging provisions

- Taxation of income in India is governed by the provisions of the Income-tax Act, 1961 (“ITA”) which contains separate rules for the taxation of residents and non-residents. As per Section 4 read with Section 5 of the ITA, residents are taxable on worldwide income, while non-residents are taxable only on India-source income i.e., only and to the extent that such income accrues or arises or is deemed to accrue or arise in India or is received or deemed to be received in India.
- Section 9(1) of the ITA explains the scope of the phrase ‘income deemed to accrue or arise in India’. In this regard, ‘all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India’, shall be deemed to accrue or arise in India. By virtue of section 5(2), as aforesaid, such income of non-resident will be taxable in India.

- Explanation 2A to section 9(1)(i) of the ITA provides that significant economic presence (“SEP”) of a non-resident in India shall constitute business connection in India. Explanation 2A¹² to section 9(1)(i) of the ITA defines SEP to mean:
 - Transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, is taxable in India if the aggregate of payments exceeds thresholds, which are yet to be notified.
 - Any systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, which are yet to be notified, would also make income from such transactions taxable in India.

In case a non-resident has a SEP in India, so much of the income of the non-resident attributable to such SEP will be taxable in India.

- The SEP provisions come into effect from April 1, 2021. While currently the thresholds on number of users or transaction value to trigger SEP as stated above, has not been notified, should such thresholds be satisfied there could SEP after March 31, 2021 resulting in a business connection in India.

12. “Explanation 2A.—For the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute “business connection” in India and “significant economic presence” for this purpose, shall mean—

- (a) Transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or
- (b) Systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not—

- (i) The agreement for such transactions or activities is entered in India; or
- (ii) The non-resident has a residence or place of business in India; or
- (iii) The non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.”

- Explanation 3 to section 9(1)(i) of the ITA provide that in case a non-resident has a business connection in India, so much of the income as is attributable to such business connection is taxable in India.
- The Finance Act, 2020 (“FA, 2020”) expanded the attribution rules by inserting Explanation 3A¹³ to section 9(1)(i) of the ITA (“**Expanded attribution rules**”). Explanation 3A provides that the income attributable to the operations carried out in India shall include income inter-alia from:
 - Advertisement that targets Indian customers or
 - Sale of goods or services using data collected from India.

The Expanded attribution rules apply to all business connection situations.

B. Profit Attribution

- Collection of tax revenue depends on quantum of income attributable to India. India has made reservations against the revised Article 7¹⁴ of the OECD Model Tax Convention and has taken a stand that the process of attribution of profits by using functions performed, assets used and risks assumed (“**FAR**”) analysis, negates role of ‘demand side factors’ in the profitability of an enterprise.

Instead, the Central Board of Direct Taxes (“**CBDT**”) in its report on profit attribution to PE (“**CBDT Report**”) has considered options based on mixed approach which allocates profits between jurisdictions based on both demand and supply factors. Consequently, a ‘fractional apportionment approach’ based on apportionment of profits

13. “Explanation 3A.—For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, as referred to in Explanation 1, shall include income from—

(i) Such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

(ii) Sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

(iii) Sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.”

14. Under the Article 7 as modified by OECD in 2010, the OECD mandated the Authorized OECD Approach (“AOA”) as the preferred approach for attribution of profits to a PE. The AOA requires attribution of profits to the PE on the basis of FAR analysis per prescribed OECD’s Transfer Pricing guidelines

derived from India has been considered as the best option under the CBDT Report. A three-factor method based on one-third weight each accorded to sales (representing demand), manpower and assets (representing supply) has been proposed.

Importantly, the CBDT Report also dealt with profit attribution in case where business connection is established due to SEP in India. The CBDT Report provides for addition of a fourth factor of apportionment i.e. ‘users’ for businesses in which users contribute significantly to the profits of an enterprise. The degree of apportionment on basis of ‘users’ differs according to ‘user intensity’ in a business. For businesses with low and medium user intensity, users have been assigned a weight of 10% while other three factors have been assigned 30% weight each. For businesses with high user intensity, users have been assigned a weight of 20% while the share of assets and employees is reduced to 25% each and sales have been assigned 30% weight.

C. Royalty and Fees for Technical Services

- Section 9(1)(vi) of the ITA provides that ‘royalty’ earned by a non-resident shall be deemed to be sourced in India (and hence taxable in India) if it is paid by a resident (except if the royalty is payable in respect of any right, property or information used outside India or any services utilised for business purposes outside India or for the purposes of earning any income outside India) or non-residents where the royalty is payable in respect of any right, property or information used in India or any services utilised for business purposes in India or for the purposes of earning any income in India.
- As per Explanation 2 to Section 9(1)(vi) of the ITA, ‘royalty’ is defined as the consideration (including lump sum payment) for, amongst other things, the transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, design, secret formula, process, trademark, copyright, literary, artistic or scientific work. The SC in case of *Tata Consultancy Services*

*v. State of Andhra Pradesh*¹⁵ held that meaning of goods cannot be construed narrowly and it includes intangible and incorporeal property as well. While cryptocurrency can be considered as goods having regard to its utility and capability of being brought or sold, consideration received for transfer of cryptocurrency should not qualify as royalty without there being transfer of a right in copyright at the first place. In that context, it is pertinent to note that cryptocurrencies do not normally involve the transfer of any right in a copyright. Typically, only the right to possess the cryptocurrency and sell it is held by the owner of the cryptocurrency.

- Similarly, section 9(1)(vii) provides that ‘fees for technical services’ (“**FTS**”) earned by a non-resident shall be deemed to be sourced in India if it is paid by a resident (except if the FTS is payable in respect of any right, property or information used outside India or any services utilised for business purposes outside India or for the purposes of earning any income outside India) or non-residents where the FTS is payable in respect of any right, property or information used in India or any services utilised for business purposes in India or for the purposes of earning any income in India.
- Under the ITA, FTS is defined as any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like projects.
- The term ‘technical services’ in the definition of FTS was interpreted by the Supreme Court in *CIT v. Kotak Securities Ltd.*¹⁶ It was held that the term has to be interpreted applying the principle of ‘*noscitur a sociis*’ as per which the meaning of doubtful words may be ascertained by reference to words associated with it. The term ‘technical services’ comes in between the terms ‘managerial and consultancy services’ – both of which require human intervention. Applying the principle of

‘*noscitur a sociis*’ the term ‘technical services’, placed between the terms ‘managerial and consultancy services,’ shall be interpreted to mean services which involve human intervention. Therefore, any service without human intervention should not qualify as FTS under the ITA.

D.Capital gains

- Section 45 of the ITA provides that any profits and gains derived from transfer of a ‘capital asset’¹⁷ during any previous year shall be chargeable to income-tax as ‘capital gains’ in the hands of the transferor and shall be deemed to be the income of the previous year in which the transfer took place.
- The essential condition for applicability of section 45 is that there should be a transfer of ‘capital asset’ as defined under the ITA. The term ‘capital asset’ under the ITA has a wide ambit and includes both tangible as well as intangible material.¹⁸
- Cryptocurrency being intangible in nature may be considered as capital asset provided it does not fall under the exceptions provided under the said section. One of the exceptions which can have wide applicability in the case of cryptocurrency is the exception of stock-in-trade. Stock-in-trade means all assets that are used for the purpose of buying and selling in course of one’s business activities. These are assets that are held by individuals in form of investments for a short period with an intention of deriving sufficient returns.¹⁹ The determination of whether an asset is a capital asset or stock-in-trade depends on the facts and circumstances of the case. There is no straightjacket formula to arrive at a conclusion.²⁰
- If cryptocurrencies are considered as stock-in-trade, they will not be considered as capital assets. Income from the transfer of such assets will be considered

15. 271 ITR 401 (2004)

16. [2016] 383 ITR 1 (SC)

17. Capital asset means property of any kind held by a taxpayer, whether or not connected with his business or profession but does not include i) any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession and ii) personal effects, being, movable property held for personal use by the taxpayer or any member of his family dependent on him, subject to certain exclusions.

18. Haji Abdul Kader Sahib v. CIT, (1961) 42 ITR 296 (Ker.)

19. Fort Properties Pvt. Ltd. v. CIT, (1994) 208 ITR 232 (Bom.)

20. CIT v. Gangadar Bajinath, (1972) 86 ITR 19 (SC)

as business income (not capital gains) and will be taxed accordingly. If a person is involved in trading of bitcoins, then there exists a possibility that transfer of cryptocurrencies held by him may be considered as stock-in-trade. However, if a person holds cryptocurrencies as an investment, then same may be considered as capital asset.

- In case cryptocurrencies are considered as 'capital assets' gains arising from transfer of such assets should be considered capital gains and should be computed as per section 48 of the ITA. According to section 48 of the ITA, capital gain is computed by deducting from the consideration received on account of transfer of capital asset:
 - a. The amount of expenditure incurred wholly and exclusively in connection with such transfer;
 - b. The cost of acquisition ("COA") of the asset and the cost of any improvement thereto
- Section 55 of the ITA deems the COA of certain intangible assets *inter-alia* being goodwill, trademark, right to manufacture, right to carry on business, tenancy rights, stage carriage permits and loom hours to be Nil. Cryptocurrencies may not fall within the scope of the aforementioned intangible assets. Consequently, arguably it may not be possible to ascertain its COA in the event it is obtained through mining as it would be akin to a self-generated intangible asset. In case where cryptocurrency was bought / purchased, then the price at which the cryptocurrency was bought would be its COA under Section 48.
- In light of the above, if the COA of cryptocurrency cannot be calculated as per the law laid down by the Hon'ble SC in the case of *CIT v. B.C. Srinivasa Shetty*,²¹ arguably no capital gains tax may be levied at all in some circumstances.

E. Tax treaty relief²²

- Section 90(2) of the ITA provides that a non-resident in a country with which India has a tax treaty, shall be taxed as per the provisions of the tax treaty or the ITA, whichever is more beneficial.
- In order to obtain treaty relief, the non-resident entity must be a resident liable to tax in its country of residence.
- With the ultimate objective of preventing double taxation by allocating taxing rights between the resident and source countries, tax treaties provide relief in various ways such as a narrower definition of terms such as FTS, royalty, Permanent Establishment ("PE") (which is the tax treaty equivalent of the test of 'business connection) etc., lower rates of withholding in case of dividends, interest, royalty etc.
- Under some of India's tax treaties', for the FTS clause to be triggered, the provision of services must qualify the 'make available' provision, i.e. the services must be provided in such a manner that it enables the service recipient to re-apply the technology provided as part of the service
- The concept of PE is the tax treaty equivalent of the concept of business connection under the ITA. There are several types of PE. Essentially, PE is a fixed place of business through which business is carried out. The components for satisfaction of fixed place PE are as follows: (i) the physical test i.e. the foreign enterprise has at its disposal a physical premise in India, (ii) the temporal test i.e. there is a degree of permanence or the physical presence in India is of an enduring nature and not temporary, (iii) the functionality test i.e. the foreign enterprise

22. The General Anti-Avoidance Rules ("GAAR") provisions introduced under the ITA are effective from April 1, 2017. The GAAR provisions enable Indian tax authorities to declare an arrangement to be an Impermissible Avoidance Arrangement ("IAA") and to determine the tax consequences by disregarding any structure, reallocating or recharacterizing income or even denying tax treaty relief, etc. Therefore, demonstration of adequate commercial substance would be imperative to obtain benefits under tax treaties. Having said this, practically, in case of participants in the cryptocurrency ecosystem, GAAR provisions should not be an issue as choice of jurisdiction for establishing operations is usually dependent on the regulatory environment in relation to cryptocurrency in the country, which is significant commercial non-tax reason especially in this industry.

21. (1985) 5 Taxman 1 (SC)

must conduct its own business through such fixed base or premise.

- In relation to capital gains, tax treaties generally allocate taxing rights to the source state to tax capital gains arising from sale of shares of a company resident in the source state. The residuary provision allocates taxing right to tax any other capital gains in the resident state itself. Cryptocurrencies have not been specifically included under the tax treaties. Accordingly, the resident state should typically have the right to tax capital gains from transfer of cryptocurrency by virtue of the residual provision under the capital gain article. However, the taxability of capital gains may differ in case of non-treaty jurisdictions or where capital gain article provides that both contracting states have the right to tax capital gains.

F. Other provisions

- Issues can also arise with respect to the applicability of the Tax Collection at Source (“TCS”) under Section 206C and applicability of Tax Deduction at Source (“TDS”) under Section 194-O of the ITA. These are two recently introduced sections which impose different deduction obligations in relation to transactions in ‘goods’.
- Section 206C imposes an obligation on a seller to collect tax at source at rate of 0.1% of the sale consideration received on sale of goods in excess of INR 50 lacs as income-tax.²³ Please note that this tax is required to be collected by the seller from the buyer only if the total sales, gross receipts or turnover of the business carried on by the seller is more than INR 10 crores during the financial year immediately preceding the financial year in which the sale of goods is carried out. Further, the TCS is deemed to be payment of tax on behalf of the buyer and the buyer is given the credit of such TCS. In relation to the tax base, currently, it is unclear whether the GST component will be included in the sale consideration for the purpose of TCS.

- Section 194-O provides that where sale of goods of an Indian resident seller is facilitated by an e-commerce operator through its digital or electronic facility or platform, such e-commerce operator shall, at the time of credit of the amount of sale to the account of the seller or at the time of payment, whichever is earlier, deduct income-tax at the rate of 1% of the gross amount of such sales or services or both. Pertinent to note that section 194-O does not differentiate between a resident or a non-resident e-commerce operator. Therefore, basis a strict reading, the withholding obligations under section 194-O may also apply to non-resident e-commerce operator facilitating sale of goods of Indian resident sellers.

These provisions could have different implications for crypto-exchanges, both in India and abroad, where domestic sellers are involved, depending on the whether a Marketplace Model or an OTC Model or back to back buy and re-sell model is being followed by the crypto-exchange. All of this may be applicable only if cryptocurrencies are considered ‘goods’. Interestingly, the SC in the IMAI case recently observed that cryptocurrencies demonstrated some of the characteristics of money but did not conclude finally regarding the same. The implication is that if cryptocurrency is categorised as money, it is automatically excluded from the definition of ‘goods’ under the GST and Sale of Goods Act, 1930 (“SOGA”) definitions. Further, courts have held that the meaning of the word ‘goods’ includes shares,²⁴ electricity,²⁵ licenses and scrips,²⁶ canned software incorporated in a media,²⁷ but would not include debentures and other debt instruments.²⁸ Certain observations in the *Tata Consultancy Service Ltd. v. State of Andhra Pradesh* case demonstrate

23. Section 206C(1H) of the ITA; the provision comes into effect from October 1, 2020

24. *Vadilal Sarabhai v. Manekji Pestonji Bharucha*, (1923) 25 BomLR 414, decided in the context Indian Contract Act, 1872, before the Sale of Goods Act, 1930 was introduced

25. *Karnataka Power Transmission Corporation v. Ashok Iron Works Pvt. Ltd.*, (2009) 3 SCC 240, decided in the context of Consumer Protection Act, 1986

26. *Vikas Sales Corporation v. Commissioner of Commercial Taxes*, (1996) 4 SCC 433

27. *Tata Consultancy Service Ltd. v. State of Andhra Pradesh*, (2004) 137 STC 620 (SC)

28. *R D Goyal v. Reliance Industries Ltd.*, (2003) 1 SCC 81, decided in the context of Monopolies and Restrictive Trade Practices Act, 1969

that intangible moveable property can also be goods irrespective of the medium. Therefore, the classification of cryptocurrencies can have a wide impact on various tax related requirements and outflows.

In this context, the CBDT has recently released a clarificatory circular²⁹ stating the provisions of section 206C and 194-O shall not be applicable in relation to *inter-alia* i) transactions in securities or commodities which are traded through recognized stock exchanges located in International Financial Service Centre, ii) transactions in electricity and renewable energy certificates traded through registered power exchanges. The CBDT has also clarified that a payment gateway will not be required to deduct tax under section 194-O on a transaction, if tax has been deducted by the main e-commerce operator under section 194-O on the same transaction. However, none of these directly impact cryptocurrency operations and the ambiguity in classification of cryptocurrencies remains.

II. Developments in relation to tax treaties

- As a result of Action Plan 15³⁰ of the Base Erosion and Profit Shifting project, the Multilateral Instrument (“MLI”) was brought into force on July 1, 2018 and it entered into force for India on October 1, 2019.³¹ The MLI modifies the application of various bilateral tax treaties concluded to eliminate international cross border tax avoidance. It also implements agreed minimum standards to counter tax treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. The MLI is intended to modify tax treaties that each country notifies as a Covered Tax Agreement (“CTA”).

29. CBDT Circular No. 17/2020, F.No.370133/22/2020-TPL dated 29 September, 2020

30. OECD (2015), Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 -2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264241688-en>

31. India signed the MLI on June 7, 2017 and deposited its instrument of ratification on June 25, 2019. See OECD (2020), Signatories and Parties to the Multilateral Convention to Implement Tax Treaty related Measures to Prevent Base Erosion and Profit Shifting, available at <https://www.oecd.org/tax/treaties/beps-ml-signatories-and-parties.pdf>

- Article 7 of the MLI *inter-alia* recommends inclusion of the principal purpose test (“PPT”) in tax treaties as a minimum standard. The PPT rule applies by default where both parties to a CTA do not choose to apply the limitation of benefit (“LoB”) rule (detailed or simplified). Since few states have chosen the LoB rule, it is anticipated that the PPT will be incorporated in more than 1100 tax treaties.³² The PPT essentially states that if it can be reasonably concluded that obtaining benefits under tax treaties was one of the principal purposes of any arrangement or transaction, benefits under the tax treaty would be denied unless it is established that granting of such benefits is in accordance with the object and purpose of the provisions of such tax treaty. Accordingly, going forward, demonstration of commercial rationale and substance will play an integral role in obtaining benefits under tax treaties.

III. International developments

In January 2020, the OECD released a statement (“OECD Statement”) outlining the architecture of the Unified Approach under Pillar One and welcoming the progress made on Pillar Two.³³ The OECD Statement endorses the Unified approach encompassing three types of taxable profits that may be allocated to a market jurisdiction i.e. Amount A, Amount B and Amount C. The OECD Statement provides that the Unified Approach is designed to adapt taxing rights by taking into account new businesses models and thereby expand the taxing rights of market jurisdictions (which, for some business models, is the jurisdiction where the user is located).

Please note that there are reports that a draft Blueprint of Pillar One and Pillar Two (“Blueprints”), though

32. Vikram Chand (2018), The Principal Purpose Test in the Multilateral Convention: An in-depth Analysis, Intertax Volume 46 Issue I, Kluwer Law International BV.

33. OECD (2020), Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy – January 2020, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, available at www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf

not publicly released, have been leaked inadvertently.³⁴ The official Blueprints on Pillar One and Pillar Two are scheduled to be released at the Inclusive Framework on BEPS meeting of October 8–9 and then at the G20 Finance Ministers meeting the following week. The Blueprints are expected to provide further guidance on open issues identified in the OECD Statement. Please note that we have not analysed the impact of the Blueprints in this paper. However, we observe that the approach is quite detailed and complicated in the draft Blueprints. Our prima-facie comments in this regard are at the end of this paper.

A. New taxing right – Amount A:

- **Determination of residual profit:** The primary response of the OECD Statement to tax challenges of the digitalisation of the economy is a new taxing right called ‘Amount A’ by which a country will be able to tax profit earned by a multinational without regard to whether the multinational has a physical presence in the country. Under Amount A, a share of the deemed residual profit will be allocated based on a formulaic approach to market jurisdictions using the new nexus standard that is not dependent on physical presence. The OECD Statement provides that the calculation of Amount A will be based on a measure of profit derived from the consolidated group financial accounts and suggests ‘profit before tax’ as the preferred profit measure to compute Amount A.

Currently, the OECD Statement provides for a turnover threshold, in-scope revenue thresholds, business line profitability and de minimis test on aggregate residual profits. The appropriate amount / percentages of these thresholds are yet to be provided by OECD.

- **In scope businesses:** The OECD Statement provides two categories of businesses that will fall within the scope of Amount A namely:

- i. *Automated Digital services (“ADS”)*– These services will cover businesses that generate revenue from the provision of ADS that are provided on a standardised basis to a large population of customers or users across multiple jurisdictions and includes online gaming. However, digital services which involve human intervention, like live video streaming games, may or may not be covered under this definition;
- ii. *Consumer facing business (“CFB”)*– This would cover businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, i.e. individuals that are purchasing items for personal use and not for commercial or professional purposes.

- **Establishing nexus with market jurisdiction:** The OECD Statement provides for a new nexus rule based on ‘significant and sustained’ engagement with market jurisdictions for in-scope businesses. The new nexus rule will be contained in a standalone rule to limit any unintended spill-over effects on other existing tax or non-tax rules. For ADS, the revenue threshold will be the only relevant test required to create nexus. For other in-scope activities, sustained interaction with market or physical presence or other additional factors are also necessary for creation of nexus.

- **Elimination of double taxation:** The OECD Statement recognises that it will be essential to have appropriate mechanisms to eliminate double taxation as Amount A is an overlay to the existing method of allocation of profits on basis of arms-length principle. In this regard, the OECD Statement states that mechanisms to eliminate double taxation in relevant tax treaties like Article 9(2) may not be useful given that Amount A is not premised on identifiable transactions between group entities. Further, in case where jurisdictions want to eliminate double taxation by way of providing credits, it will be necessary to determine which jurisdiction will have an obligation to eliminate tax and whether there can be any adjustments made to Amount A to avoid situations of double taxation.

34. International Tax Review. 2020. This week in tax: Pillar one and pillar two documents are leaked [online] Available at: <https://www.internationaltaxreview.com/article/b1n79rkv8p8oq6/this-week-in-tax-pillar-one-and-pillar-two-documents-are-leaked> [Accessed 23 September 2020]

■ **Interactions and potential of double counting:**

The OECD Statement states that there should be no significant interaction between Amount A and Amount B. In relation to interaction between Amount A and Amount C, the OECD Statement provides that there may be a case where both Amount A and Amount C are allocated to market jurisdiction like India as MNE group has a taxable presence in such jurisdiction. There exists a risk of double taxation due to double counting of profits in Amount A and Amount C. While the OECD Statement currently does not provide any mechanism to resolve double taxations in such cases, it may be useful for MNEs to re-visit their structures and agreements to obtain more clarity with respect to arms-length principle and distribution of profits within separate entities.

B.Fixed remuneration based on arms' length price - Amount B

- Amount B is a fixed remuneration based on the arms' length price ("ALP") for defined baseline distribution and marketing functions that take place between related parties in the market jurisdiction. Amount B does not create a new taxing right.
- Amount B aims to simplify administration in transfer pricing ("TP") rules for tax administrations, lower compliance costs for taxpayers and enhance certainty about pricing of transactions.
- The OECD Statement acknowledges that the design of Amount B will need to ensure the baseline distribution and marketing activities are only remunerated in Amount B and not (again) in Amount C.
- While the OECD Statement does not provide a clear definition of baseline distribution and marketing activities, the OECD Statement provides that definition of baseline distribution activities will include distribution arrangements with routine levels of functionality, no ownership of intangibles and no or limited risks

- Further, as per the OECD Statement it is expected that treaty changes will not be required to implement the Amount B regime. Allocation of taxable profits to market jurisdictions under Amount B is based on the existing profit allocation rules (including reliance on physical presence).

C.Allocation of additional profit - Amount C

- The return under Amount C covers any additional profit where in-country functions exceed the baseline activity compensated under Amount B. A further aspect of Amount C is the emphasis it gives to the need for improved dispute resolution processes. Amount C does not create a new taxing right.
- Allocation of taxable profits to market jurisdictions under Amount C is based on the existing profit allocation rules (including reliance on physical presence).

IV. Equalisation levy framework under Finance Act, 2016

- Equalisation levy ("EL") was introduced in India with effect from June 1, 2016 under Chapter VIII of the Finance Act, 2016 ("FA, 2016"), as a separate, self-contained code, not forming part of the ITA. The EL as introduced by the FA, 2016 ("2016 EL") was levied at rate of 6% on the amount of gross consideration received by non-residents for online advertisement and related services provided to i) a person resident in India and carrying on business or profession; or ii) an NR having a PE in India.³⁵ Income arising from provision of online advertisement services which is subject to 2016 EL is exempt from income-tax under the ITA.³⁶
- The Finance Act, 2020 ("FA, 2020") expanded the scope of EL to apply EL at rate of 2 percent ("2020 EL") on the amount of consideration received

35. Section 165(1) of FA, 2016

36. Section 10(50) of ITA

or receivable by ‘e-commerce operators’ from ‘e-commerce supply or services’ made or provided or facilitated by it to:

- i. Person resident in India; or
- ii. A non-resident under specified circumstances; or
- iii. A person who buys such goods or services or both using an internet protocol (“IP”) address located in India.³⁷

‘Specified circumstances’³⁸ in case of a non-resident have been defined as:

- a. Sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement through IP address located in India; and
- b. Sale of data, collected from a person who is resident in India or uses IP address located in India.

Further, the term ‘e-commerce operators’ has been defined to mean an NR who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both.³⁹ The term ‘e-commerce supply or services’ is defined to mean i) online sale of goods owned by the e-commerce operator; ii) online provision of services provided by the e-commerce operator; iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator; or iv) any combination of the above.⁴⁰

- While the Expanded EL has been applicable from April 1, 2020; a corresponding exemption from income tax has been provided in the ITA for income arising from any e-commerce supply or services made or provided or facilitated on or after April 1, 2021.⁴¹
- 2020 EL will not be applicable where i) the e-commerce operator has a PE in India and e-commerce supply or services is effectively

connected with such PE; or ii) 2016 EL is leviable on such transaction or iii) where sales / turnover / gross receipts of the e-commerce operator from e-commerce supply or services is less than INR 2 crores (~USD 263,000) in the previous year.

- Given that 2020 EL applies on e-commerce operators who owns, operates or manages a digital or electronic facility or platform for online sale of goods, applicability of EL *inter-alia* depends on qualification as an ‘e-commerce operator’ and on whether cryptocurrency qualifies as ‘goods’ or not.
- The provisions of 2020 EL have been drafted very loosely and do not define or explain the meaning of several words used in the statute. For example, the provisions do not define terms like ‘goods’, ‘platform’, ‘online sale’ etc. While the provisions of EL provide that the words and expressions used but not defined Chapter VIII of FA, 2016, can derive its meaning from the ITA or Income-tax Rules, 1962 (“ITR”), interestingly, these words are not defined under the ITA or ITR as well. This creates interpretational issues such that the provisions may be interpreted in broad manner covering transactions / situations which were not intended to be covered at the first place.
- It is a basic canon of interpretation that each statute defines the expressions used in it and that definition should not be used for interpreting any other statute unless in any other cognate statute there is no definition, and the extrapolation would be justified.⁴² The SOGA defines the term goods to *inter-alia* mean every kind of movable property other than actionable claims and money. There is plethora of judicial guidance under SOGA in relation to the meaning of ‘goods’, which is similar to how the term was defined under Sales tax laws as well. At the same time, ‘goods’ defined under the current GST laws include actionable claims. Therefore, it will have to be determined whether one can apply the definition of ‘goods’ under SOGA or the GST laws in the context of EL. There may not be a straight forward answer and one may have to look in the

37. Section 165A(1) of FA, 2016

38. Section 165A(3) of FA, 2016

39. Section 164(ca) of FA, 2016

40. Section 164(cb) of FA, 2016

41. Section 10(50) of ITA

42. All Kerala Chartered Accountants' Association v. Union of India, [2002] 176 CTR 268 (Kerala)

object and purpose of SOGA / GST to conclude on its applicability in context of EL.

- Further, it may be permissible to refer to the dictionary to find out the meaning of a word as it is understood in the common parlance. However, where the dictionary gives divergent or more than one meaning of a word, the word has to be construed in the context of the provisions of the act and regard must also be had to the legislative history of the provisions of the act and the scheme of the act.⁴³ For example, the dictionary meaning provides several meanings of the word 'platform' in ordinary parlance. However, the word 'platform' in the context of e-commerce transactions seems to be a technical word and therefore, ascertaining its meaning in the correct sense will be extremely important.
- In order to qualify as an e-commerce operator, it will also be important to ascertain the meaning of the terms 'operate' or 'manage'. In this regard, according to dictionaries the term 'operate' means, 'to perform a function: exert power or influence', 'bring about, effect' (Merriam-Webster) or to 'control the functioning of (a machine, process, or system)' (Oxford). The Authority for Advance Rulings while discussing a similar definition of 'e-commerce operator' under section 2(45) of the Central Goods and Services Tax Act, 2017 ("CGST Act"), has generally found entities to be 'operating' an e-commerce website where they are the providers of the e-commerce platform and control its functioning.⁴⁴ Further, the term 'manage' in the context of business activity has been discussed in various income-tax cases, which have laid down principles as to what constitutes a managerial activity. It has been stated to mean functions which are predominantly managerial and includes the exercise of control in an indirect (where the entity is acting under the instructions of a controlling entity) or direct manner.

43. Commissioner of Income-tax v. Venkateswara Hatcheries (P.) Ltd., Civil Appeal No. 5066 OF 1996

44. In Re: Sadashiv Anajee Shete, (2019) 71 GST 619 (AAR). However, please note that the meaning of the word 'operate' was not discussed in detail

V. GST Framework

- GST, effective in India since July 1, 2017, has comprehensively replaced the erstwhile indirect tax regime. India has a dual GST system with both the Central Government and the State Governments (and Union Territories) levying separate but concurrent taxes on supply of goods and services. The legislative framework of GST primarily comprises the CGST Act and the Integrated GST Act, 2017 ("IGST Act") enacted by the Parliament and State GST Acts ("SGST Acts") enacted by legislature of each state.⁴⁵
- For every intra-state supply, CGST under the CGST Act and SGST under the relevant SGST Act are concurrently levied by the Central and State Governments respectively. For every inter-state supply, IGST is levied by the Central Government under the IGST Act. The rate of CGST / SGST / IGST is determined as the per the rates schedules for goods and services notified under the respective Acts.

A. Whether Cryptocurrencies are goods or services

- Section 2(52) of the CGST Act defines 'goods' as every kind of movable property other than money and securities, but includes, *inter-alia*, actionable claims. Further, Section 2(102) of the CGST Act defines services to mean "*anything other than goods, money and securities but includes activities relating to money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged*".
- The SC in the case of *Tata Consultancy Services v. State of Andhra Pradesh*,⁴⁶ was faced with the question of whether sale of a packaged software was subject to sales tax under the Andhra Pradesh General Sales Tax Act, 1957 ("AP Act"). The SC held that the term 'goods' for the purpose of levying sales tax, cannot be narrowly construed

45. The Parliament has also enacted the Union Territory GST Act, 2017 providing for taxing powers of each Union Territory in India

46. 271 ITR 401 (2004)

to only include tangible property. The property would be regarded as “goods” provided it has the attributes thereof having regard to (a) its utility; (b) it being capable of being bought and sold; and (c) it being capable of being transmitted, transferred, delivered, stored and possessed.

- Since cryptocurrency is not yet recognized as legal tender or currency in India, it is not clearly excluded from the ambit of definition of goods and it is required to examine whether cryptocurrencies qualify as ‘goods’ or services for the purpose of GST.
- A cryptocurrency is similar to an intangible good unlike intellectual property rights, such as software that is not embedded into a physical format like a disc and is also an intangible movable property capable of abstraction, consumption and use. It can also be transmitted, transferred and delivered, and can be possessed and stored in wallets hosted on physical servers. Therefore, a cryptocurrency may meet the test of ‘goods’ as laid down by the SC and may accordingly qualify as ‘goods’ under the CGST Act. Given that cryptocurrencies may be construed as ‘goods’, they should not be construed as ‘services’ as defined under GST.

B. Possible implications under GST law

- Under the GST regime, GST is levied on supply of goods which includes sale as well as barter in furtherance of business.⁴⁷ If bitcoins are considered as goods, transfer of the same may have GST implications. Accordingly, GST may be levied in both scenarios (i) where cryptocurrency is sold for cash, and (ii) where cryptocurrency is given as a consideration for other goods and services, such that the value on which the tax may be levied will be the open market value of the goods or services for which cryptocurrency is given as consideration.⁴⁸
- In case of cross-border supply of goods, the IGST Act provides that the point of taxation is the point at which the goods are imported into the country.⁴⁹

In case of cryptocurrencies, being a digital good, unless it is stored in a wallet that is in a physical medium such as a pen drive or a hard drive, it is unlikely to actually cross the customs border of India, in which case even if it is technically taxable IGST would practically not be levied due to the failure of the taxation mechanism.

- Another important consideration for a transaction to be subject to IGST or CGST is determination of whether it is an intra-state or an interstate supply. The two reference points are the location of the supplier of goods and the location of supply. The location of supply for some cases is where the good is actually located. The nature of cryptocurrencies is such that it is effectively a location less good unless some reference can be made to a tangible medium it is stored in. Further, while there is a definition in relation to the location of supplier of services in the CGST Act, there is no provision in relation to the location of a supplier goods. Arguably, no GST should be levied on any supply of good as it should be impossible, short of creating our own legal fiction, to determine whether IGST or CSGT applies.
- Further, section 52 of the CGST Act imposes an obligation to collect tax at source on every electronic commerce operator at a rate not exceeding 1% of the net value of taxable supplies made through it by other suppliers where the consideration with respect to such supplies is to be collected by the operator. Further, net value of taxable supplies has been defined to mean the aggregate value of taxable supplies of goods, made during any month by all registered persons through the operator as reduced by the aggregate value of taxable supplies returned to the suppliers during the said month. Taxable supplies under section 7 of the CGST Act are typically supplies made in course of furtherance of business. Therefore, in case supply of cryptocurrency is considered taxable, cryptocurrency exchanges may be under the obligation to collect tax at source from the supplies made through it.

47. Section 7 of the CGST Act

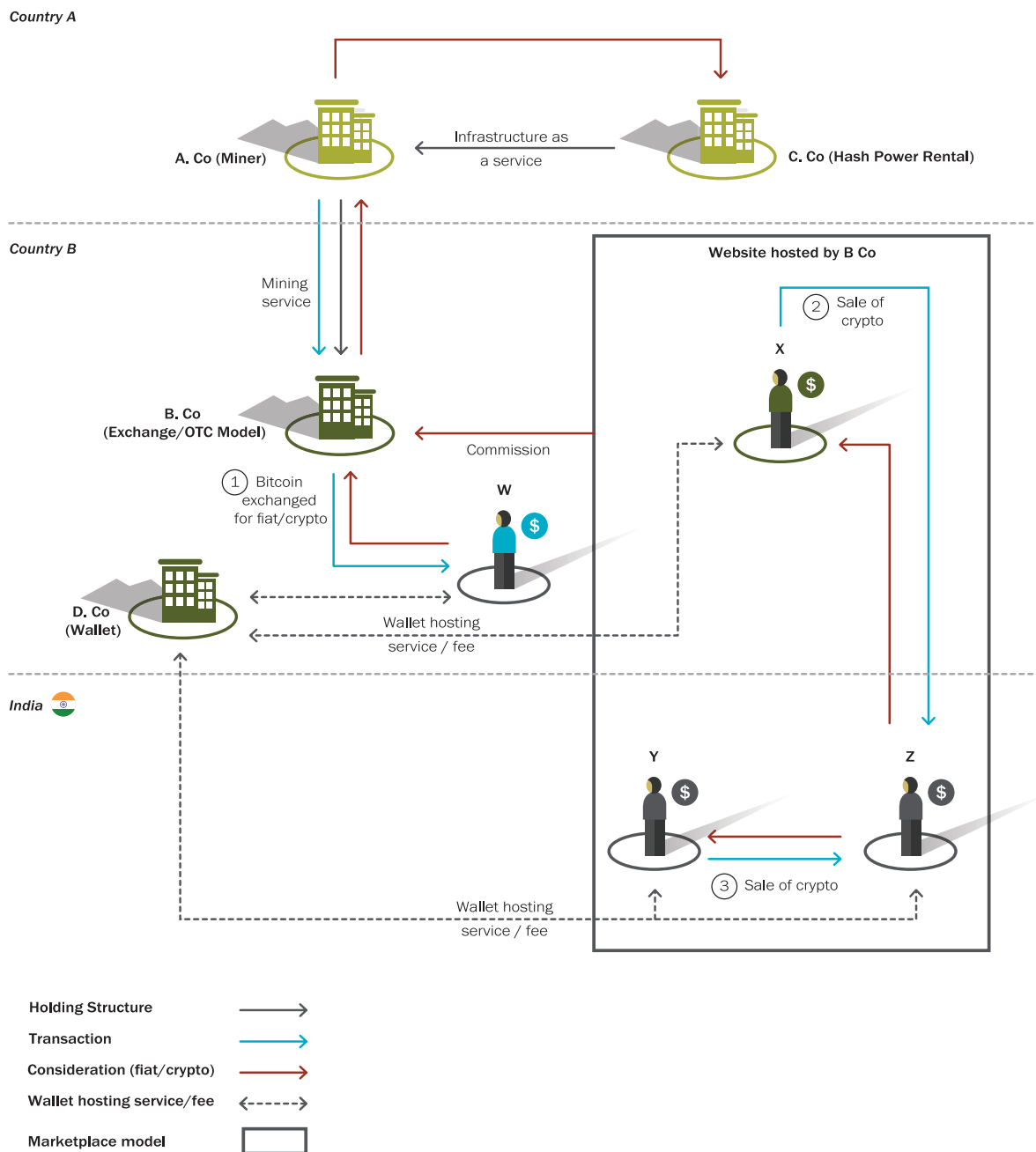
48. Rule 27, Central Goods and Services Rules, 2017

49. Section 5(1), the IGST, 2017: IGST is a tax levied on all inter-State

supplies of goods or services or both, except on the supply of alcoholic liquor for human consumption

6. Legal Structure of Players in Cryptocurrency Ecosystem

Please note that we have incorporated several structural relationships in this case study to reflect several market realities noticed in cryptocurrency ecosystem. While there may be several other permutations in the relationships, we have analysed the intra-firm structure and relationship between participants in the cryptocurrency ecosystem as stated in the structure below:



- A Co is a company incorporated in Country A who is engaged in mining cryptocurrency (say bitcoin) and provides mining services to other third parties. A Co also has a subsidiary in Country B i.e. B Co. A Co is providing mining service to B Co in return of a service fee from B Co.
- For the purpose of this case study, we have analysed the exchange model in relation to B Co. The exchange model includes both Marketplace Model and OTC Model (both cryptocurrency-cryptocurrency and fiat-cryptocurrency transactions are allowed on the platform).
- C Co is a hash power rental company and has the computing power required for mining cryptocurrencies. C Co has collaborated with A Co, wherein C Co is providing hash power infrastructure as a service to A Co. A Co mines cryptocurrency by using the computing power provided by C Co.
- D Co is a company incorporated in Country B and is a cryptocurrency wallet service provider. D Co provides wallet services to individuals / traders entering into buy / sell transactions in cryptocurrency on the exchange platform provided by B Co in return for a fee.
- Mr. W, an individual resident outside India, is a trader who trades in bitcoins and enters into an OTC transaction with B Co to i) buy bitcoins in exchange of fiat currency; and ii) sell bitcoins in exchange of another cryptocurrency.
- Mr. X, an individual resident outside India, is a trader who trades in bitcoins and enters into a transaction on the website of B Co (i.e. Marketplace Model) to sell bitcoin to an identified buyer. B Co matches Mr. X with a buyer Mr. Z, an individual resident in India in return of a commission.
- Mr. Y an individual resident in India enters into a transaction on the website of B Co (i.e. Marketplace Model) to sell bitcoin to an identified buyer. B Co matches Mr. Y with a buyer Mr. Z, an individual resident in India in return of a commission.
- Mr. W, Mr. X, Mr. Y & Mr. Z are all storing their cryptocurrency in the wallet hosted by D Co.

7. Analysis

Please note that in the table below, we have analysed the tax issues transaction by transaction from the perspective of each entity or person. In the first column, we have analysed the tax implications of each entity / person as set out in the model above. *In order to provide a more comprehensive view, we then analyse the tax implications under different scenarios by assuming the location of the same entity / person flipped to either offshore or onshore as the case may be.*⁵⁰

S No	Transaction	Tax Implications		
1.A Co - Miner				
Transaction description		Implications under the Model	Scenario 1	Scenario 2
(a)	<p>A Co providing mining service to B Co for service fee.</p> <p>A Co receives service fee (fiat) from B Co at the end of the service transaction. B receives crypto after it is mined.</p> <p>A Co is the 100% shareholder of B Co.</p>	<ul style="list-style-type: none">Not within the ambit of Indian law as both A Co and B Co are outside India.	<p>Assumption: A Co is assumed to be in India.⁵¹ B Co is outside India.⁵²</p> <p>Implications under ITA:</p> <ul style="list-style-type: none">Service fee received by A Co will be taxable in India under head profits and gains from business and profession (“PGBP”) at applicable corporate tax rate.⁵³ If service fees are paid in crypto, income-tax implications would be the same, except, valuation issues could arise on valuing the service fees. Further, given that income-tax would have to be paid in fiat it will be important to be cognizant of cash flow issues.	<p>Assumption: A Co is outside India. B Co is assumed to be in India.⁵⁴</p> <p>Implications under ITA:</p> <ul style="list-style-type: none">At the outset, A Co, being a non-resident is liable to be governed by the provisions of the ITA or relevant tax treaty, whichever is more beneficial.⁵⁵Possibility of constitution of SEP of A Co to be analysed – depends on transaction value, the thresholds of which are yet to be notified. In case SEP is constituted in India, so much of the income attributable to the SEP will be taxable in India.

50. Please note that all rates of tax mentioned in this paper are exclusive of applicable surcharge and cess, unless mentioned otherwise.

51. Please note in case A Co is an LLP, the implications discussed herein may differ, for example, tax rate of LLP is 30% (plus applicable surcharge and cess).

52. Please note that foreign exchange regulations in India do not permit investment by an Indian Party engaged in financial services sector in an entity outside India engaged in financial services sector under the automatic route Whether business of B Co would qualify as financial services or not would depend on classification and regulation in the resident country

53. Income to be taxable at 30% where total turnover / gross receipt in FY 2017-18 is more than INR 400 crores, otherwise income taxable at rate of 25%. Further, option available to taxpayer to opt for concessional regime provided under section 115BAA of the ITA wherein corporate income-tax is levied at rate of 22%, subject to fulfillment of conditions provided under section 115BAA

54. 100% foreign direct investment in other financial services sector is permitted without government approval except where the financial services activity is not regulated by any financial sector regulator (RBI). It can be argued that since the IAMA case lays down that the RBI has jurisdiction over the virtual currency space, there is no doubt regarding the regulatory oversight and, hence, FDI is permitted without government approval

55. Section 90(2) of the ITA

S No	Transaction	Tax Implications		
1.A Co - Miner				
Transaction description	Implications under the Model	Scenario 1	Scenario 2	
		<ul style="list-style-type: none">Question may arise as to whether tax is required to be deducted at source under section 194J at 10% on the gross service fees. Section 194J applies to payments made to residents in the nature of professional or technical services. Mining service provided by A Co should not be considered technical or professional services as there is no human involvement in provision of such service and the service is not related to any management or consultancy service. Further, there are arguments to also state that section 194J does not apply to non-resident payers such as B Co in this case.Further, tax authorities may also argue that the service fee qualifies as royalty. However, it may be possible to contest such claim and argue that the service fee does not qualify as royalty since there is no transfer or licence of a copyright in this case and there is no copyright in the cryptocurrency at the first place.Transaction between A Co and B Co to comply with transfer pricing (“TP”) provisions. Service fee to be determined on basis of arms-length price (“ALP”). <p>Pillar I Implications:</p> <ul style="list-style-type: none">While the OECD Statement currently does not provide a definition of baseline activities, arms-length pricing for service fee between A Co and B Co should constitute Amount B under Pillar I calculations.	<ul style="list-style-type: none">Practically, there might be enhanced risk for companies situated in non-treaty jurisdictions like Cayman Islands, British Virgin Islands, etc. once the SEP thresholds are notified as these companies would not have shelter of PE under the tax treaties.Tax authorities may also allege that the service fee received by A Co qualifies as royalty / FTS. However, as mentioned under Scenario 1, there are arguments to defend such contentions.In case service fee earned by A Co qualifies as royalty / FTS, service fee should be taxable at 10% of the gross royalty amount.⁵⁶ B Co should be required to withhold tax under section 195 on payment of service fee to A Co.⁵⁷Transaction between A Co and B Co should comply with TP provisions. Service fee should be determined on basis of ALP. <p>Tax treaty implications (would not apply in case A Co is situated in a non-treaty jurisdiction):</p>	

56. Section 115A(2) of the ITA

57. Alternatively, A may consider undertaking a one-time assignment of technology / IT rights to B

S No	Transaction	Tax Implications	
1.A Co - Miner			
Transaction description	Implications under the Model	Scenario 1	Scenario 2
		<ul style="list-style-type: none">Further, allocation of Amount A would depend on whether activities of A Co fall under the ambit of ADS or CFB. While the OECD Statement do not provide definition for ADS / CFB, <i>prima-facie</i>, it appears that A Co should not be considered as ADS / CFB.⁵⁸ <p>GST Implications:</p> <ul style="list-style-type: none">No GST applicable on service fee received by A Co, subject to fulfilment of conditions for export of service like payment to be received in convertible foreign exchange etc.	<ul style="list-style-type: none">A Co should not be liable to be taxed in India as service fee should not qualify as royalty / FTS under the relevant tax treaty.In such a case, A Co should be liable to tax in India, only if it has a PE⁵⁹ in India. A Co not likely to have a fixed place PE,⁶⁰ agency PE⁶¹ or service PE.⁶² <p>Pillar I Implications:</p> <ul style="list-style-type: none">Same as Scenario 1. <p>GST Implications:</p> <ul style="list-style-type: none">Mining service provided by A Co to B Co should be considered as import of service by B Co.⁶³ B Co, as a recipient of service should be liable to pay GST at rate of 18% on reverse charge basis.⁶⁴

58. We understand that under the draft Blueprint ADS has been defined by way of a general definition along with a positive and negative list of services. Mining services provided by A Co are not included in the positive or negative list. Accordingly, whether A Co would come under the ambit of ADS or not will have to be determined basis the general definition provided under draft Blueprint. ADS businesses refer to businesses which generate revenue from the provision of ADS that are provided on a standardised basis to a large population of customers or users across multiple jurisdictions, typically using little or no local infrastructure. The nexus and revenue sourcing rules would depend on the characterisation of A Co as ADS or CFB. Given that the business of A Co, being a miner of cryptocurrency cannot be easily scaled by without significant additional cost on computing equipment for increasing mining operations, it seems that it should not come under the ambit of ADS despite being primarily an online or digital service.
59. Article 7 of tax treaties allocates taxing rights on business profits of an enterprise to the source country in case such enterprise carries on its business in that country through a PE situated therein. The concept of PE is largely conceived as a fixed place of business through which business of an enterprise is carried on, thereby, establishing taxable nexus based on physical presence. Article 7 envisages several forms of PE being inter-alia i) Fixed Place PE, ii) Service PE, iii) Dependent agent PE etc.
60. Fixed place PE is the fixed place of business through which business of an enterprise, wholly or partly is carried out
61. A person is considered as a dependent agent if he is acting on behalf of an enterprise and, in doing so, he habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts
62. Constitution of service PE is connected with the provisioning of services by an enterprise in a jurisdiction through its employees for more than a specified period in a year
63. Mining service should not qualify as OIDAR service as B Co is a registered person and is receiving the services for the purpose of its business
64. Under the IGST Act, any service supplied by any person who is located in a non-taxable territory to any person other than non-taxable online recipient is taxable on reverse charge basis

S No	Transaction	Tax Implications		
1.A Co - Miner				
Transaction description		Implications under the Model	Scenario 1	Scenario 2
				<p>If service fees are paid in crypto, GST implications would be the same, except, valuation issues could arise on valuing the service fees. Further, given that GST would have to be paid in fiat it will be important to be cognizant of cash flow issues.</p> <ul style="list-style-type: none">■ B Co has to comply with mandatory GST registration with tax authorities if its turnover is more than INR 20 Lakh.■ B Co should be able to avail of GST credit against its outward supplies.
2.B Co – Exchange Model ⁶⁵				
Transaction description		Implications under the Model	Scenario 1	
(a)	<p>Commission received by B Co for facilitating transaction between Mr. X (non-resident seller) and Mr. Z (resident buyer).</p> <p>B Co charges commission from the seller.</p> <p>Commission payment received by B Co is in fiat.</p>	<p>Implications under ITA:</p> <ul style="list-style-type: none">■ At the outset, B Co, being a non-resident is liable to be governed by the provisions of the ITA or relevant tax treaty, whichever is more beneficial.■ B Co likely to constitute a ‘business connection’ in India through the SEP test. Pertinent to note that while Mr. Z (resident) is not paying B Co, the language of the SEP provisions may be construed to be wide enough to cover such transactions also as B Co could qualify as having a transaction with Mr. Z in respect of any good or property (cryptocurrency) even though its income is derived from payments made by X who is a non-resident. It is questionable whether the provision could be read so widely to cover situations where the payments are not being made by Mr. Z (resident). However, considering the subsequent limb of the provision where reference is made to the presence of users in India, such a reading cannot be ruled out.	<p><i>Assumptions: B Co is assumed to be in India and is paid in INR.</i>⁶⁶</p> <p>Implications under ITA:</p> <ul style="list-style-type: none">■ Commission will be taxable under head PGBP at rate of 30% / 25%.■ Section of the 194-O should not apply as the seller is a non-resident.	

65. Provisions of section 206C in relation to TCS should not be applicable to B Co as it is not the seller; B Co is providing a platform for the buyers and sellers to interact. While applicability of section 206C depends on whether crypto currency qualifies as ‘goods’, however, in case applicable, the seller may be required to comply with the TCS obligation provided the gross turnover / receipt exceeds INR 10 crores. This may not be practically possible except in case of crypto traders

66. Relevant regulations under Foreign Exchange Management Act, 1999 will have to be examined to determine whether foreign investment in B Co is allowed or not. FDI implications may differ in case B Co is established as LLP

2.B Co – Exchange Model

Transaction description	Implications under the Model	Scenario 1
	<ul style="list-style-type: none"> Further, SEP may be constituted on a separate ground that B is engaged in systematic and continuous soliciting business activities through users in India. The threshold of number of users yet to be notified. In case SEP is constituted in India, so much of the income attributable to the SEP will be taxable in India. Even in this case, it is unclear whether the provisions intend non-paying users to be covered within its ambit, however such an interpretation may be possible. Practically, there might be enhanced risk for companies situated in non-treaty jurisdictions like Cayman Islands, British Virgin Islands, etc. once the SEP thresholds are notified as these companies would not have shelter of PE under the tax treaties. The CBDT Report in relation to profit attribution deals with profit attribution in case where business connection is established due to SEP in India. While the CBDT Report has recommended allocation on basis of three factors in non-SEP cases, the CBDT Report recommends for addition of a fourth factor of apportionment – ‘users’ for SEP cases. Accordingly, depending on the user intensity by the traders an additional 10%-20% attribution of profits may happen in the future. Commission received by B Co should not qualify as royalty as it is not related to transfer of any licence or copyright. Further, it should not qualify as FTS as it is not in relation to provision of managerial, technical or consultancy services. Section 194-O of the ITA should not be applicable B Co is facilitating sale by a non-resident seller. <p>Tax treaty Implications (would not apply in case B Co is situated in a non-treaty jurisdiction):</p> <ul style="list-style-type: none"> In the absence of any amendment in the tax treaties in relation to SEP, B Co may continue to be governed by the provisions of the tax treaty being more beneficial. Otherwise, commission income would be subject to tax in India only if B Co has a PE in India. B Co is unlikely to have a PE in India. 	<p>GST Implications:</p> <ul style="list-style-type: none"> B Co to be liable for GST as intermediary, which will be charged along with commission at 18% on service fees. The tax base for levy of GST would be the commission earned by B Co and not the crypto transaction value. The obligation to collect tax at source should not apply as supply of cryptocurrency from Mr. X to Mr. Z is not a taxable supply in furtherance of business. However, the obligation to collect tax at source may apply in case Mr. X is in the business of trading in cryptocurrency.

2.B Co – Exchange Model

Transaction description	Implications under the Model	Scenario 1
	<p>Pillar I implications</p> <ul style="list-style-type: none"> ■ Prima-facie, business activities of B Co should fall under ADS as ADS covers businesses that generate revenue from the provision of ADS that are provided on a standardised basis to a large population of customers or users across multiple jurisdictions and includes online intermediation platforms. In case business of B Co qualifies as ADS, allocation to be directly in proportion to number of users in India. ■ However, there have also been discussions around financial transactions not being covered by Pillar I. Therefore, the classification of crypto transactions as a transaction in goods or money may also have an impact on the future applicability of Pillar I. ■ The OECD Statement provides for a new taxing right called ‘Amount A’ by which a country will be able to tax profit earned by a multinational without regard to whether the multinational has a physical presence in the country. Under Amount A, a share of the deemed residual profit will be allocated based on a formulaic approach to market jurisdictions using the new nexus standard that is not dependent on physical presence. In case international consensus is reached and in the absence of B Co’s PE in India, it may be possible to allocate Amount A in India. <p>Equalization Levy Implications:</p> <ul style="list-style-type: none"> ■ 2020 EL may apply at rate of 2% in case B Co qualifies as an e-commerce operator. It will be essential to establish that B Co owns / manages / operates a ‘platform’ for online sale of goods. The provisions of 2020 EL do not define the terms ‘platform’, ‘operate’ or ‘manage’ or ‘goods’. ■ Typically, e-commerce operator should be akin to provider of goods or services over a marketplace. Given that cryptocurrency may be classified as goods, 2020 EL may apply as B Co may be considered to facilitate sale of goods to a person resident in India. However, 2020 EL may not apply in case cryptocurrency transactions are considered akin to financial transactions i.e. transaction in money / currency. ■ Further, please note that 2020 EL should not apply to a one-off transaction and will be applicable only when the gross receipt / turnover of the e-commerce operator is more than INR 2 crores. 	

2.B Co – Exchange Model

Transaction description	Implications under the Model	Scenario 1
	<p>GST implications:</p> <ul style="list-style-type: none"> ■ GST should not be applicable on commission received by B Co from Mr. X (non-resident seller) as the place of supply of intermediary service is deemed to be outside India.⁶⁷ ■ Even if B Co is not considered as intermediary, no GST should apply as service recipient i.e. Mr. X is outside India. ■ A question can arise whether B Co is under an obligation to collect tax at source as per section 52 of the CGST Act. The obligation to collect tax at source should not apply as supply of cryptocurrency from Mr. X to Mr. Z is not a taxable supply in furtherance of business. However, the obligation to collect tax at source may apply in case Mr. X is in the business of trading in cryptocurrency. 	
<p>(b) Commission received by B Co from facilitating transaction between Mr. X (non-resident buyer) and Mr. Z (resident seller)</p> <p>B Co charges commission from the seller.</p> <p>Commission payment received by B Co is in INR.</p>	<p>Implications:</p> <p>All implications in relation to B Co same as (a) above, other relevant points mentioned below:</p> <ul style="list-style-type: none"> ■ B Co likely to constitute a ‘business connection’ in India through the SEP test by virtue of being engaged in systematic and continuous soliciting business activities through paying users / sellers in India. ■ Additionally, B Co may also constitute SEP as it has a transaction in respect of a good or property with a person / seller in India. However, whether the provision can be read so widely is questionable since B Co is only facilitating the sale of crypto by the Indian seller. ■ Profit attribution to B Co may be more than model above due to more value derived from Indian operations (by virtue of the seller being in India). 	<p><i>Assumption: B Co is assumed to be in India and is paid in INR</i></p> <p>Implications:</p> <p>All implications in relation to B Co same as row 2(a) above (Scenario 1), except:</p> <ul style="list-style-type: none"> ■ In case B Co qualifies as an e-commerce operator, B Co may be liable to withhold tax at rate of 1% under section 194-O of ITA on payment to Mr. Z if cryptocurrencies are considered as goods.

67. B Co should be considered as an intermediary; section 2(13) of the IGST Act defines intermediary to inter-alia mean any person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but does not include a person who supplies such goods or services or both or securities on his own account

2.B Co – Exchange Model

Transaction description	Implications under the Model	Scenario 1
	<ul style="list-style-type: none"> In case B Co qualifies as an e-commerce operator, B Co may be liable to withhold tax at rate of 1% under section 194-O of ITA on payment to Mr. Z. Applicability of withholding tax obligation under section 194-O would also depend on whether cryptocurrency qualifies as 'goods' or not. Please note that currently, section 194-O does not make a distinction between a resident and a non-resident e-commerce operator. Therefore, basis a strict reading, the withholding obligations under section 194-O may also apply to a non-resident e-commerce operator i.e. B Co facilitating sale of goods of an e-commerce participant (Mr. Z). Further, the tax base for withholding would depend on the model adopted by B Co – generally, tax should be deducted on cryptocurrency transaction value and not on the commission charged by B Co. 	<ul style="list-style-type: none"> The tax base for withholding would depend on the model adopted by B Co – generally, tax should be deducted on cryptocurrency transaction value and not on the commission charged by B Co.⁶⁸

3.B Co – OTC Model

Transaction description	Implications under the Model	Scenario 1
(a) Consideration received by B Co for selling cryptocurrency to a Mr. W (non-resident buyer)	Not within the ambit of Indian law as both B Co and Mr. W i.e. the buyer are outside India. Further, given that the nature of cryptocurrencies is such that it is effectively a location less good unless some reference can be made to a tangible medium it is stored in, it may not be considered to be located in India as Mr. W stores the cryptocurrency in the wallet provided by D Co in Country B.	<p><i>Assumption: B Co is in India and sells cryptocurrency for fiat consideration.</i></p> <p><i>Implications under ITA:</i></p> <ul style="list-style-type: none"> Income from sale of cryptocurrency by B Co would be taxable in India under head PGBP at rate of 30% / 25% as B Co holds cryptocurrency as stock-in-trade. However, in case it is held that the cryptocurrency held by B Co is capital asset, income from sale of cryptocurrency will be taxable as capital gain. Rate of tax on capital gain is dependent on the nature of capital gains i.e. whether it is long-term capital gain or short-term capital gain.⁶⁹ Capital gains to be determined by reducing COA from sales consideration.

68. In some cases exchanges charge a separate service fee and in some cases exchanges deduct the service fee from the value of the crypto being transferred. Therefore, the gross value of supply may change depending on the model.

69. In case cryptocurrency is held for a period of more than 36 months prior to transfer, it should be considered as long-term capital asset, otherwise it would be short-term capital asset

3.B Co – OTC Model

Transaction description	Implications under the Model	Scenario 1
	<ul style="list-style-type: none"> In case B Co qualifies as an e-commerce operator, B Co may be liable to withhold tax at rate of 1% under section 194-O of ITA on payment to Mr. Z. Applicability of withholding tax obligation under section 194-O would also depend on whether cryptocurrency qualifies as 'goods' or not. Please note that currently, section 194-O does not make a distinction between a resident and a non-resident e-commerce operator. Therefore, basis a strict reading, the withholding obligations under section 194-O may also apply to a non-resident e-commerce operator i.e. B Co facilitating sale of goods of an e-commerce participant (Mr. Z). Further, the tax base for withholding would depend on the model adopted by B Co – generally, tax should be deducted on cryptocurrency transaction value and not on the commission charged by B Co. 	<p>Scenario 1</p> <ul style="list-style-type: none"> In case B Co sells cryptocurrency in exchange of cryptocurrency (instead of fiat consideration), there may be valuation issues under ITA. <p>GST Implications:</p> <ul style="list-style-type: none"> B Co should be liable to GST at rate of 18% on total value of cryptocurrency as it a supply in furtherance of business. It may be possible to contend that the supply qualifies as zero-rated supply being export of goods. However, given that the nature of cryptocurrencies is such that it is effectively a location less good, tax authorities may challenge such argument. Taxpayer would have to prove that the sale of the crypto to a non-resident resulted in the export of a goods from within India to a place outside of India to argue that it is a zero-rated supply. In case B Co sells cryptocurrency in exchange of cryptocurrency (instead of fiat consideration), it may be possible to be considered as a barter transaction and GST may be applicable on both transactions.

3.B Co – OTC Model

Transaction description	Implications under the Model	Scenario 1
(b) Consideration received by B Co for selling cryptocurrency to a resident buyer	<p>Implications under ITA:</p> <ul style="list-style-type: none"> At the outset, B Co, being a non-resident is liable to be governed by the provisions of the ITA or relevant tax treaty, whichever is more beneficial. In case B Co holds cryptocurrency as stock-in-trade, business income from its transfer should be liable to tax in India, only if B Co has a business connection in India. B Co is likely to constitute a 'business connection' in India through the SEP test, as it is engaged in systematic and continuous soliciting business activities through users in India. The threshold of number of users yet to be notified. In case SEP is constituted in India, so much of the income attributable to the SEP will be taxable in India. In case B Co holds cryptocurrency as capital asset, income from its transfer should be considered as capital gains. In such a situation, it should not fall within the ambit of business income. Capital gains from sale of cryptocurrency by B Co may not be taxable in India due to lack of nexus as location of cryptocurrency is not ascertainable. Moreover, B Co and the buyer store their money in the wallet provided by D Co which is also located in Country B. As discussed above, the SC in IAMA case noted that cryptocurrency has no location. In our view, location of the owner is closest approximation of the location of cryptocurrency, therefore in this case it should be treated to be outside of India at the time of sale. Section 194-O should not apply as B Co is not facilitating sale of goods but is transacting on its own behalf. Applicability of tax collection obligation dependent on whether cryptocurrency qualifies as 'goods' or not. In case cryptocurrency is considered as goods, B Co to collect tax at source under section 206C of the ITA at rate of 0.1% of the sale consideration received on sale of goods in excess of INR 50 lacs as income-tax. Obligation to collect tax at source to arise provided that gross turnover / receipts of B Co exceed INR 10 crores during the financial year immediately preceding the financial year in which the sale of goods is carried out. <p>Tax treaty Implications (would not apply in case B Co is situated in a non-treaty jurisdiction):</p>	<p>Assumption: B Co is in India and sells cryptocurrency for fiat consideration</p> <p>Implications:</p> <p>All implications in relation to B Co same as row 3(a) above (Scenario 1), other relevant points mentioned below:</p> <ul style="list-style-type: none"> The amount paid by resident buyer as consideration to B Co will be considered to be its COA. In case B Co sells cryptocurrency in exchange of cryptocurrency (instead of fiat consideration), there may be valuation problems in determining the COA in hands of the resident buyer. Since the buyer is in India, there is no question of the transaction qualifying as zero-rated supply and therefore GST should be applicable at 18% on the total value of the cryptocurrency.

3.B Co – OTC Model

Transaction description	Implications under the Model	Scenario 1
	<ul style="list-style-type: none"> ■ In the absence of any amendment in the tax treaties in relation to SEP, B Co may continue to be governed by the provisions of the tax treaty being more beneficial. Further, in case B Co holds cryptocurrency as stock-in-trade, business income from its transfer should be liable to tax in India, only if it has a PE in India. B Co unlikely to have a fixed place PE, agency PE or service PE. ■ In case B Co holds cryptocurrency as capital asset, income from its transfer should be considered as capital gains. Taxability of capital gains to be dependent on the language of the relevant tax treaty. Typically, the source state has the right to tax capital gains arising from sale of shares of a company resident in the source state. The resident state should have the right to tax capital gains from transfer of cryptocurrency by virtue of the residual provision under the capital gain article. However, where treaties have language that allows for both countries to tax capital gains such as the India-UK DTAA or where B is located in Cayman or a non-treaty country, the above protections may not be available. <p>Equalization Levy implications</p> <ul style="list-style-type: none"> ■ 2020 EL may apply at rate of 2% as B Co may be considered to sell goods owned by it to person resident in India. However, as discussed above, the applicability of 2020 EL may depend on whether cryptocurrency qualifies as a 'good' or not. <p>GST Implications:</p> <ul style="list-style-type: none"> ■ The transaction should not be considered as supply of service as there is no separate consideration charged by B Co for any services. Therefore, the question of applicability of provisions related to OIDAR service does not arise. ■ In case cryptocurrency is considered as currency, the transaction should be considered as a transaction in money and no GST should be chargeable. ■ In case cryptocurrency is considered as goods, the transaction should be considered as import of goods (provided we approximate the location of goods to be the location of buyer after the sale). Further, given the nature of cryptocurrency and in the absence of determination of point at which the goods are imported in India, GST should not be applicable due to failure of taxation mechanism. This is because, GST is applicable on import of goods only at the point in time where customs duties are payable. Since currently no customs duty is applicable on import of intangible goods, no GST should also be consequently applicable. 	

4.C Co - Hash Rental Company

Transaction description	Implications under the Model	Scenario 1
<p>(a) Provision of infrastructure as a service to A Co for mining in return of service fee</p>	<p>Not within the ambit of Indian law as both C Co and A Co are outside India.</p>	<p><i>Assumption: C Co is assumed to be in India. A Co is outside India.</i></p> <p>Implications under ITA:</p> <ul style="list-style-type: none"> Corporate tax implications in relation to C Co to be similar in case where A Co is in India (scenario 1) as stated in row 1(a). The right to use the computing infrastructure may constitute equipment royalty as the control of the servers are exclusively given to the A Co. A Co may have to withhold tax at 10% on payment of service fee to C Co under Section 194J as it may amount to royalty; C Co to obtain credit of tax withheld by A Co. No TP implications. <p>GST Implications:</p> <ul style="list-style-type: none"> GST will be similar in case where A Co is in India (scenario 1) as stated in row 1(a).

5.D Co – Wallet service providers

Transaction description	Implications under the Model	Scenario 1
<p>(a) Provision of wallet hosting service to Mr. W, Mr. X, Mr. Y & Mr. Z in return of service fee</p>	<p>Implications under ITA:</p> <ul style="list-style-type: none"> At the outset, D Co, being a non-resident is liable to be governed by the provisions of the ITA or relevant tax treaty, whichever is more beneficial. D Co is likely to constitute a ‘business connection’ in India through the SEP test as D Co is engaged in systematic and continuous soliciting business activities through users i.e. Mr. Y and Mr. Z in India. The threshold of number of users yet to be notified. In case SEP is constituted in India, so much of the income attributable to the SEP will be taxable in India. Practically, there might be enhanced risk for companies situated in non-treaty jurisdictions like Cayman Islands, British Virgin Islands, etc. once the SEP thresholds are notified as these companies would not have shelter of PE under the tax treaties. The CBDT Report in relation to profit attribution deals with profit attribution in case where business connection is established due to SEP in India. While the CBDT Report has recommended allocation on basis of three factors in non-SEP cases, the CBDT Report recommends for addition of a fourth factor of apportionment – ‘users’ for SEP cases. Accordingly, depending on the user intensity by the traders an additional 10%-20% attribution of profits may happen in the future. Service fee received by D Co should not qualify as royalty as it is not related to transfer of any licence or copyright. Further, it should not qualify as FTS as it is not in relation to provision of managerial, technical or consultancy services. Section 194-O of the ITA should not be applicable as D Co is not facilitating any sale of goods or provision of service for an Indian resident. <p>Tax treaty Implications (would not apply in case D Co is situated in a non-treaty jurisdiction):</p> <p><i>Withholding tax obligation of D Co would be determined basis provisions of the applicable tax treaty (if any). In case D Co is from a non-treaty jurisdiction, withholding obligations under the ITA would apply.</i></p> <ul style="list-style-type: none"> Royalty / FTS: The service fee should not qualify as royalty / FTS under tax treaty as well as it only a digital service. Further, in order to trigger FTS provisions under certain tax treaties the provision of services must qualify the ‘make available’ provision. Service fee paid for wallet hosting service provided by D Co should not fulfil the make available test. 	<p>Scenario 1</p> <p><i>Assumption: D Co is assumed to be in India.</i></p> <p>Implications under ITA:</p> <ul style="list-style-type: none"> Service fee received by D Co will be taxable in India under head PGBP at applicable corporate tax rate. If service fees are paid in crypto, income-tax implications would be the same, except, valuation issues could arise on valuing the service fees. Further, given that income-tax would have to be paid in fiat it will be important to be cognizant of cash flow issues. Section 194J of the ITA not applicable on individual payers. <p>GST Implications:</p> <ul style="list-style-type: none"> D Co should be subject to GST at rate of 18% for supply of service in furtherance of business.

5.D Co – Wallet service providers

Transaction description	Implications under the Model	Scenario 1
	<ul style="list-style-type: none"> ■ D Co should be able to obtain credit of tax withheld by B Co. ■ In the absence of any amendment in the tax treaties in relation to SEP, D Co may continue to be governed by the provisions of the tax treaty being more beneficial. ■ Otherwise, service fee would be subject to tax in India only if D Co has a PE in India. D Co unlikely to have a PE in India. <p>Pillar I implications</p> <ul style="list-style-type: none"> ■ Prima-facie, business activities of D Co should fall under ADS as ADS covers businesses that generate revenue from the provision of ADS that are provided on a standardised basis to a large population of customers or users across multiple jurisdictions and includes online intermediation platforms. In case business of D Co qualifies as ADS, allocation to be directly in proportion to number of users in India. ■ The OECD Statement provides for a new taxing right called 'Amount A' by which a country will be able to tax profit earned by a multinational without regard to whether the multinational has a physical presence in the country. Under Amount A, a share of the deemed residual profit will be allocated based on a formulaic approach to market jurisdictions using the new nexus standard that is not dependent on physical presence. In case international consensus is reached and in the absence of D Co's PE in India, it may be possible to allocate Amount A in India. <p>GST implications:</p> <ul style="list-style-type: none"> ■ GST should not be applicable on service fee received by D Co from Mr. W and Mr. X, being non-residents. ■ Business to consumer import of service is exempt from GST, unless the service is OIDAR. ■ Given that D Co would provide wallet hosting services over internet without any human intervention, it should qualify as OIDAR service. D Co should be under the obligation to register in India and pay GST at rate of 18% on the amount of service fee. 	

8. Upcoming Issues to Watch Out For!

- Emergence of stablecoins: While popular cryptocurrencies face criticism due to price volatility, stablecoins promise price stability. For example, Terra, the stablecoin initiated by one of South Korea's e-commerce giants employs a protocol programmed to ensure price-stability through an algorithm that expands and contracts overall money supply.⁷⁰ While the pandemic has caused huge losses in traditional financial markets and crypto markets, stablecoins have seen a net inflow of \$2 billion representing the largest surge in demand, in line with dollar's demand surge in traditional financial markets.⁷¹ In light of the SC's ruling in IMAI case and given the potential of stablecoins to offer price stability, it will be interesting to see if the Indian exchange control laws would allow for cross border settlements using stablecoins in the future.
- Recent clarifications by RBI: Recently, RBI in response to an application under the Right to Information Act, 2005⁷² clarified that there is no restriction or prohibition under law on banks providing accounts to VC / cryptocurrency exchanges and traders and RBI has not issued any legally binding directions to banks and other regulated entities regarding cryptocurrency exchanges / traders. RBI also clarified that there is no restriction or prohibition under the Foreign Exchange Management Act, 1999 on banks facilitating purchase and sale of cryptocurrency.
- Payments through cryptocurrency in online gaming: Many online gaming platforms allow for payments through cryptocurrency. Given that gambling is prohibited in India and using cryptocurrency to make payments for such activities may also not be allowed the regulatory and tax risks prior legal advice should be sought before making such payments.
- Potential issues pursuant to the Pillar One Blueprint: As mentioned above, the draft Pillar One Blueprint has been inadvertently leaked in the public domain. While the draft Pillar One Blueprint addresses multiple issues in the proposed Pillar One architecture, it is extremely complex and digital businesses will have to apply the tests provided in the Blueprint to assess its applicability and impact. For example, the draft Pillar One Blueprint provides that in-scope activities for allocation of Amount A would include ADS and CFB. ADS has been defined by way of a general definition along with a positive and negative list of services. Services in relation to VCs models are not included in the positive or negative list. Accordingly, businesses in relation to VCs will have to determine whether they qualify as ADS basis the general definition provided or they qualify as CFBs. Determination of nexus and revenue sourcing rules are different for ADS and CFBs. Another relevant consideration for VCs businesses is that the draft Blueprint explicitly excludes financial transactions from Amount A. Therefore, it will also be important to determine whether VCs businesses would fall within the category of financial transactions or not. Lastly, the actual impact of the Pillar One proposals on VC businesses would depend on the thresholds agreed for application of Pillar One. While there are several players operating in the VC segment, no single player dominates the market to have a substantial top line figures.
- Qualification as an e-commerce operator under Consumer Protection (E-commerce) Rules, 2020: The tests for managing, operating or owning in relation to a platform are assuming more significance not only because of income-tax or GST provisions (TCS under section 52 of CGST Act or TCS under 206C of the ITA or TDS under 194-O of the ITA), all of which use the same language. It is becoming crucial even in the context of the recently passed Consumer Protection (E-commerce) Rules, 2020 under the Consumer Protection Act, 2019 which arguably mandates a

70. <https://terra.money/>

71. <https://www.coindesk.com/usd-stablecoins-are-surging-but-zero-interest-rates-complicate-business-model>

72. Disclosure: Nishith Desai Associates played a key role obtaining the clarifications from RBI

foreign e-commerce operator, who owns, operates or manages a platform for the online sale of ‘goods’ to have a local presence in India. Therefore, the entity or party who has to comply with this localisation requirement would have to satisfy the test of owning, operating or managing a platform. Further, compliance with any such localisation requirements can enhance tax issues such as creation of a PE in India or TP issues.





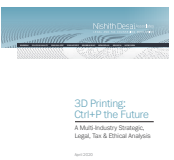


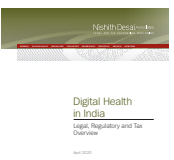
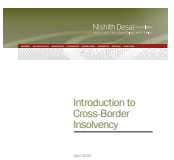
- Disclosure under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015: The Indian government enacted the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (“**Black Money Act**”) to tax undisclosed foreign income and assets⁷³ of assessee (includes both tax residents and persons who no longer are tax residents of India) with effect from April 1, 2016. Non-disclosure of foreign income and assets is

subject to 30% tax with a penalty of three times the tax due and rigorous enforced imprisonment of between 3-10 years. There could be a potential issue under the Black Money Act in relation to persons or companies who have stored money in crypto wallets outside India.

- Issues under the foreign exchange regulations: The Foreign Exchange Management Act, 1999 governs the inflow and outflow of foreign exchange in India. Given that the nature of VCs is unknown, it is unclear whether the activity of operating an exchange for trading VCs may be regulated as a commodities exchange or securities exchange, which can further have implications under India’s regulation on inward foreign direct investment. Further, given that the classification of cryptocurrency as well as its location is not clear, it is unclear whether FEMA regulations in relation to import or export of goods would apply or not.

73. Section 2(12) of the Black Money Act defines ‘undisclosed foreign income and asset’ as the total amount of undisclosed income of an assessee from a source located outside India and the value of an undisclosed asset located outside India referred to under the Act

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NDA Insights

TITLE	TYPE	DATE
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Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Our dedication to research has been instrumental in creating thought leadership in various areas of law and public policy. Through research, we develop intellectual capital and leverage it actively for both our clients and the development of our associates. We use research to discover new thinking, approaches, skills and reflections on jurisprudence, and ultimately deliver superior value to our clients. Over time, we have embedded a culture and built processes of learning through research that give us a robust edge in providing best quality advices and services to our clients, to our fraternity and to the community at large.

Every member of the firm is required to participate in research activities. The seeds of research are typically sown in hour-long continuing education sessions conducted every day as the first thing in the morning. Free interactions in these sessions help associates identify new legal, regulatory, technological and business trends that require intellectual investigation from the legal and tax perspectives. Then, one or few associates take up an emerging trend or issue under the guidance of seniors and put it through our “Anticipate-Prepare-Deliver” research model.

As the first step, they would conduct a capsule research, which involves a quick analysis of readily available secondary data. Often such basic research provides valuable insights and creates broader understanding of the issue for the involved associates, who in turn would disseminate it to other associates through tacit and explicit knowledge exchange processes. For us, knowledge sharing is as important an attribute as knowledge acquisition.

When the issue requires further investigation, we develop an extensive research paper. Often we collect our own primary data when we feel the issue demands going deep to the root or when we find gaps in secondary data. In some cases, we have even taken up multi-year research projects to investigate every aspect of the topic and build unparalleled mastery. Our TMT practice, IP practice, Pharma & Healthcare/Med-Tech and Medical Device, practice and energy sector practice have emerged from such projects. Research in essence graduates to Knowledge, and finally to *Intellectual Property*.

Over the years, we have produced some outstanding research papers, articles, webinars and talks. Almost on daily basis, we analyze and offer our perspective on latest legal developments through our regular “Hotlines”, which go out to our clients and fraternity. These Hotlines provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our Lab Reports dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research articles and disseminate them through our website. Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with much needed comparative research for rule making. Our discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged. Although we invest heavily in terms of time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

As we continue to grow through our research-based approach, we now have established an exclusive four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. **Imaginarium AliGunjan** is a platform for creative thinking; an apolitical eco-system that connects multi-disciplinary threads of ideas, innovation and imagination. Designed to inspire ‘blue sky’ thinking, research, exploration and synthesis, reflections and communication, it aims to bring in wholeness – that leads to answers to the biggest challenges of our time and beyond. It seeks to be a bridge that connects the futuristic advancements of diverse disciplines. It offers a space, both virtually and literally, for integration and synthesis of knowhow and innovation from various streams and serves as a dais to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear your suggestions on our research reports. Please feel free to contact us at research@nishithdesai.com

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