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Article on
VIRTUAL DIGITAL ASSETS: THE INDIAN TAX FRAMEWORK

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The Finance Act, 2022 marked a defining moment in India's approach to digital asset taxation - formally recognizing Virtual Digital Assets as a distinct asset class for the first time and introducing a dedicated tax regime under what was then Section 115BBH of the Income Tax Act, 1961. Prior to that, no statutory framework existed. Income from cryptocurrency transactions was reported inconsistently across heads, with practitioners relying on analogical reasoning in the absence of direct legislative guidance.

The Income Tax Act, 2025, which received Presidential assent on 21 August 2025 and comes into force from 1 April 2026, replaces the Income Tax Act, 1961 in its entirety. The VDA tax regime is carried forward without substantive change. The 30% flat rate, the prohibition on deductions beyond cost of acquisition, the loss set-off restrictions, and the TDS framework — all are preserved under the new Act, now governed by the corresponding provisions of the Income Tax Act, 2025.

1.1 STATUTORY DEFINITION

Section 2(111) of the Income Tax Act, 2025 defines a Virtual Digital Asset as any information, code, number, or token - not being Indian currency or foreign currency - generated through cryptographic means or otherwise, providing a digital representation of value, which can be transferred, stored, or traded electronically. The definition further includes non-fungible tokens and any other digital asset notified by the Central Government.

The Finance Act, 2025 has expanded this definition with effect from 1 April 2026 by inserting a new sub-clause, which explicitly includes:

"any crypto-asset being a digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions, whether or not such asset is included in the preceding sub-clauses."

This insertion solidifies the inclusion of a wide range of crypto-assets within the statutory definition, irrespective of their prior classification. The definition is technology-neutral and expansive. The phrase "by whatever name called" forecloses any argument that a particular instrument escapes coverage on account of nomenclature alone.

1.2 EXCLUSIONS

The Central Government, vide Notifications No. 74 and 75 of 2022 — carried forward under the new Act — excluded gift cards, vouchers, mileage and loyalty points, platform subscriptions, and NFTs representing ownership of underlying tangible assets. Central Bank Digital Currency is excluded by the definition itself.

1.3 TAXABLE EVENTS

Transfer of a VDA — whether held as a capital asset or otherwise — is the triggering event under the charging provision. Transfer includes sale, exchange of one VDA for another, and gifting. Airdrops and staking rewards, not arising from a transfer, are taxable separately as income from other sources under the corresponding provision of the Income Tax Act, 2025.

1.4 SIGNIFICANCE

Correct classification under Section 2(111) is the threshold inquiry for every VDA transaction. Assets falling within the definition are governed exclusively by the VDA charging provision. Assets outside it is taxed under the general provisions of the Act.

SECTION 2: TAXATION OF VDA INCOME - SECTION 194(1) (SL. NO. 4) OF THE INCOME TAX ACT, 2025

Section 194(1) (Sl. No. 4) of the Income Tax Act, 2025 is the primary charging provision governing income arising from the transfer of a Virtual Digital Asset. The provision opens with a non-obstante clause, expressly overriding any other provision of the Act wherever conflict arises. Income from the transfer of a VDA is chargeable to tax at a flat rate of 30%, exclusive of surcharge and health and education cess at 4%. The flat rate applies irrespective of:

· The head of income under which the VDA income falls.
· The period of holding of the asset.
· The residential status or category of the assesse.

No deduction in respect of any expenditure or allowance is permitted in computing VDA income, other than the cost of acquisition. Under the VDA taxation provision, the only permitted deduction is the cost of acquisition; hence computation is restricted to determining such cost. The basic exemption limit available to individuals and Hindu Undivided Families is not available against VDA income. VDA income is chargeable at 30% in full, irrespective of whether the assesse’s total income falls below the basic exemption threshold.

SECTION 3: THE NO-DEDUCTION REGIME

3.1 STATUTORY POSITION

Section 194 (Sl. No. 4) of the Income Tax Act, 2025 expressly provides that no deduction in respect of any expenditure, allowance, or set-off shall be permitted in computing income from the transfer of a VDA, other than the cost of acquisition. The general provisions of the Act permitting deductions — whether under the head of capital gains, profits and gains of business or profession, or income from other sources — are displaced by the non-obstante clause to the extent of any conflict.

3.2 DEDUCTIONS SPECIFICALLY DISALLOWED

The Act explicitly states that no deduction in respect of any expenditure, allowance, or set off of any loss shall be allowed under any provision — only the cost of acquisition is permitted. In practice, this disallows brokerage fees, loan interest, advisory costs, and indexation benefit, among others. Losses cannot be set off against other VDA gains, other income, or carried forward. A 1% TDS applies on qualifying transactions exceeding statutory thresholds.

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3.3 PROVISIONS DISPLACED

The charging provision for VDA income operates as a self-contained code by virtue of its non-obstante clause. The following general provisions of the Income Tax Act, 2025 are displaced to the extent of conflict:

· Mode of computation of capital gains — indexation and cost inflation adjustment are not available

· Tax on long-term capital gains — the beneficial rates applicable to long-term capital assets do not apply to VDAs.

· General deduction for business expenditure — no expenditure incurred in the course of trading in VDAs is deductible.

· Presumptive taxation of business income — the presumptive scheme is not available where income is governed by the VDA charging provision

3.4 COST OF ACQUISITION

Cost of acquisition is the only deduction expressly preserved. Where a VDA is acquired by purchase, the actual purchase price constitutes the cost of acquisition. Where it is acquired otherwise — by gift, inheritance, or airdrop previously taxed under the income from other sources provision — the fair market value on the date of acquisition, or the value on which tax has been paid, as the case may be, shall constitute the cost.

SECTION 4: LOSS SET-OFF AND CARRY FORWARD

4.1 STATUTORY POSITION

Section 194 of the Income Tax Act, 2025 expressly provides that no loss arising from the transfer of a VDA shall be set off against income computed under any other provision of the Act, nor shall any such loss be carried forward to any subsequent tax year. The prohibition against cross-provision set-off and carry-forward is absolute.

4.2 PERMISSIBILITY OF INTRA AND INTER SET-OFF

While a literal reading of Section 194 suggests a rigid transaction-by-transaction lockout of losses, a significant divergence exists in practice. The Central Board of Direct Taxes (CBDT) has operationalized a broader aggregation approach within the electronic filing infrastructure. Schedule VDA of the official ITR utility automatically aggregates multi-token transaction lines, allowing intra-year losses from one asset to offset intra-year gains from another before computing the final taxable total. If the aggregate annual portfolio yields a net positive income, it attracts the flat 30% tax; if it results in a net loss, the utility schema floors the output to zero. A loss from the transfer of a VDA cannot be set off against income under any other head — salary, house property, business income, capital gains, or income from other sources

4.3 NO CARRY FORWARD

Section 194(2)(b) further dictates that any net loss arising from VDA transactions completely lapses at the close of the financial year in which it is sustained. It cannot be carried forward to any subsequent tax year. This marks a stringent departure from the general provisions of the Act, which routinely allow capital or business losses to be carried forward for eight succeeding assessment years.

4.4 PRACTICAL CONSEQUENCE

The loss lockout has the most severe impact on active traders holding diversified VDA portfolios. Unlike equity investors — who may set off short-term capital losses against both short-term and long-term capital gains — VDA losses are entirely stranded in the year of arising.

SECTION 5: TAX DEDUCTION AT SOURCE ON TRANSFER OF VDA

5.1 CHARGING PROVISION

Under the Section 393(1) (Sl. No. 8(vi)) of the Income-tax Act, 2025, an obligation to deduct tax at source is cast upon any person responsible for paying consideration for the transfer of a Virtual Digital Asset (VDA). This provision mirrors the erstwhile Section 194S of the Income-tax Act, 1961, and has been carried forward without any substantive modification.

5.2 RATE AND THRESHOLD

Tax is deductible at source at the rate of 1% of the consideration paid on transfer of a VDA. The obligation to deduct arises where:

· The aggregate value of consideration paid or payable to a resident during the tax year exceeds ₹50,000 — in the case of a "specified person", being an individual or Hindu Undivided Family (HUF) whose turnover or gross receipts do not exceed ₹1 crore in business or ₹50 lakhs in profession in the preceding tax year, or who has no income under the head "Profits and Gains of Business or Profession"

· The aggregate value of consideration exceeds ₹10,000 — in all other cases.

5.3 WHO IS RESPONSIBLE FOR DEDUCTION

· Where the transfer is made through a recognised exchange, the exchange is responsible for deduction.

· Where the transfer is a peer-to-peer transaction, the buyer is responsible for deduction.

· When swapping one VDA for another, tax must be deducted on both sides of the transaction. Each party must ensure the 1% tax is paid—either from a cash component or via direct payment—before completing the transfer.

5.4 CONSEQUENCES OF NON-DEDUCTION

Failure to deduct tax attracts a penalty equal to the tax amount. Additionally, deducting tax but failing to deposit it with the government exposes the responsible person to prosecution and fines. Once successfully deposited, the TDS serves as a tax credit for the transferor and reflects in their Annual Information Statement (AIS).

SECTION 6: COMPLIANCE AND REPORTING

6.1 RETURN OF INCOME

VDA income is required to be reported in Schedule VDA within the prescribed return of income. Each transaction — acquisition date, transfer date, cost of acquisition, and sale consideration — must be disclosed separately. Individuals report VDA income in ITR-2 (capital gains) or ITR-3 (business income).

6.2 RETURN FILING UTILITY LIMITATIONS

The e-filing portal's validation logic does not permit taxpayers to offset VDA income with exemptions under Section 86 or general deductions under Chapter VIII. Any taxpayer attempting to claim these benefits against VDA gains outside the standard utility parameters must accept an elevated risk of automated processing adjustments, scrutiny, and reassessment.

6.3 UNDISCLOSED VDA HOLDINGS

The formal recognition of Virtual Digital Assets under Section 2(111) of the Income-tax Act, 2025 does not alter the established distinction between standard charging provisions and search-and-seizure machinery. While disclosed VDA gains are governed by the special VDA tax regime, unrecorded VDA holdings unearthed during a search are treated strictly as undisclosed income.

In such scenarios, the block assessment framework applies. The Assessing Officer remains confined to computing the total undisclosed income of the block period based strictly on seized material, maintaining the classic jurisprudential emphasis on evidentiary nexus and the restricted scope of search-based assessments.

6.4 BITCOIN ETFS

Units of Bitcoin ETFs may not constitute VDAs under Section 2(111), as investors hold fund units rather than cryptocurrency directly. Unless the Central Board of Direct Taxes notifies Bitcoin ETF units as VDAs, gains are likely taxable under general capital gains provisions.

6.5 GST ON EXCHANGE SERVICES

Brokerage, trading margins, and service fees charged by cryptocurrency exchanges attract GST at a flat rate of 18%. From a direct tax standpoint, this transactional cost cannot be claimed as an expense or an addition to the cost of acquisition when computing taxable VDA income.

6.6 INTERNATIONAL REPORTING

India has committed to adopting the OECD Crypto-Asset Reporting Framework from 2027. Cryptocurrency exchanges will report transaction-level data to tax authorities for automatic international exchange. This will significantly enhance detection of unreported VDA income.

6.7 CONSEQUENCES OF NON-COMPLIANCE

The tax department's ability to track VDA transactions has grown significantly. Exchange KYC data flows into the Annual Information Statement automatically, TDS trails are linked to PAN, and FIU-IND registered exchanges report transaction data to authorities. Non-disclosure is no longer a low-risk oversight — it is a detectable one.

Under-reporting or misreporting VDA income attracts a penalty ranging from 50% to 200% of the tax evaded. Wilful evasion can invite prosecution. Where VDA holdings are held offshore and not disclosed under Schedule FA, the Black Money Act, 2015 applies — carrying a flat 30% tax on undisclosed amounts plus a 90% penalty, effectively a 120% consequence on the asset value. Under Section 195 of the Income Tax Act, 2025, unreported domestic crypto holdings detected by authorities are explicitly classified as undisclosed income, making them subject to a flat 30% tax rate upon detection.

Statutory Safe Harbor: To protect minor or inadvertent omissions, the prosecution and penalty provisions under Sections 49 and 50 of the Black Money Act will not be triggered if the aggregate value of the undisclosed foreign financial assets (other than immovable property) does not exceed ₹20 lakhs.

SECTION 7: CONCLUSION

The VDA tax regime under the Income Tax Act, 2025 is unambiguous in its design - a flat rate of 30%, no deductions beyond cost of acquisition, no set-off, no carry forward. It is among the strictest treatments accorded to any asset class under the Act.

The contested positions - the exemption corresponding to Section 86, Chapter VIII deductions, and the rebate under Section 156 — are each textually arguable but disputable in practice. The ITR utility does not permit them, the department's stance is adverse, and litigation is the only available avenue. Whether to assert these claims is ultimately a question of risk appetite.