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CBDT PROVIDES MUCH AWAITED GUIDELINES IN RELATION TO TDS ON PAYMENTS FOR VIRTUAL DIGITAL ASSETS

The Finance Act, 2022 (FA 2022) amended the Income-tax Act, 1961 (IT Act) by introducing a new taxation regime in relation to Virtual Digital Assets (VDAs) wherein: (i) a 30% tax has been levied on income from transfer of VDAs in the hands of the transferor; (ii) receipt of VDAs for nil or inadequate consideration has been made taxable in the hands of the recipient; and (iii) an obligation has been imposed (under Section 194S of the IT Act) on the persons responsible for paying any consideration to 'Indian residents' for transfer of VDAs to deduct tax at source (TDS) at 1% (with effect from 1 July 2022). Our *Ergo* on budget 2022 proposals can be accessed here.

With respect to implementation of 1% TDS obligation in relation to VDA transactions undertaken on Exchanges, there were certain practical concerns and difficulties as in such transactions, details such as identity / PAN of the seller are generally not known to the buyer. Further, in case of barter of one VDA for another VDA, there were also some doubts regarding the manner of computation of TDS.

Now, the Central Board of Direct Taxes (CBDT), the apex body for direct tax administration in India, has issued guidelines vide Circular No. 13 of 2022 dated 22 June 2022 (CBDT Guidelines) to clarify certain aspects in relation to this TDS obligation. Key aspects of the same are summarized below:

Sr No.	Particulars	CBDT Guidelines and Khaitan Comments
1.	In case transfer of VDA takes place on or through an Exchange[1] and payment is made by the purchaser to the Exchange (directly or through broker) and then from the Exchange it goes to seller directly or through the broker, the issue which arises is who is required to deduct tax in relation to such transfer since there is a possibility of TDS being applicable at multiple stages on the same transfer	The CBDT has clarified as follows: (a) <u>Where transferred VDA is not owned by the Exchange:</u> Tax may be deducted under Section 194S by the Exchange only, at the time of credit / payment to the seller i.e. owner of VDA. It has been further clarified that where such credit/payment between Exchange and the seller is through a broker, both the Exchange and the broker are required to deduct tax under Section 194S of the IT Act unless there is a written agreement between the Exchange and the broker that the broker shall be deducting tax on such credit/payment. The Exchange would be required to furnish a quarterly statement in Form no 26QF within the prescribed timeline.

[1] Any person that operates an application or platform for transfer of VDAs, which matches buy and sell trades and executes the same on its application or platform.

		(b) <u>Where transferred VDA is owned by the Exchange:</u> The buyer or his broker is required to deduct tax. The CBDT has provided that, alternatively, the Exchange may enter into a written agreement with the buyer or his broker that the Exchange would be paying the tax on or before the due date for that quarter. The Exchange would be required to furnish a quarterly statement in Form No. 26QF within the prescribed timeline. The Exchange would also be required to furnish its income tax return and all these transactions must be included in such return. If these conditions are complied with, the buyer or his broker would not be held as 'assessee in default' under the IT Act. **Comment:** These clarifications were much awaited and are likely to resolve the practical difficulty in determining which stakeholder is required to comply with the 1% TDS obligation on VDA transfers undertaken on the Exchanges. The requirement for a written agreement and reporting obligation by the Exchange are noteworthy to avoid any adverse consequences for the stakeholders.
2.	Applicability of 1% TDS obligation where consideration is in kind or in barter for another VDA or partly in kind and partly in cash	The CBDT has clarified that if such transaction is not undertaken on an Exchange, the buyer (in a barter, both the parties would be buyers) is required to ensure that TDS has been paid in respect of such transaction before release of consideration. Further, where such transaction is through an Exchange, the Exchange is permitted to deduct tax from administrative convenience standpoint, subject to written contractual agreement with the buyers/sellers and certain other compliances. A detailed procedural mechanism has also been provided in the CBDT Guidelines to compute the quantum of TDS amount in case of barter of one VDA for another VDA. **Comment:** Implementation of this 1% TDS obligation for transfer of VDAs for non-monetary consideration / barter for another VDA was difficult. The aforesaid clarification by CBDT is expected to ease the difficulty to some extent for the stakeholders. Having said that, the requirement of written contractual agreement and practical feasibility of the detailed procedural mechanism laid out for computing this TDS amount are noteworthy and needs to be evaluated in greater detail.
3.	Interplay of Section 194Q (TDS on transfer of 'goods') with Section 194S	The CBDT has clarified that without evaluating whether VDA qualifies as 'goods' or not,in case tax is deducted on transfer of VDAs under Section 194S of the IT Act, no tax is required to be deducted again under Section 194Q of the IT Act. **Comment:** The issue of whether VDA qualifies as 'goods' or not has been a subject matter of divergent interpretations. While the clarification that once a transaction is subject to TDS under Section 194S, it will not trigger TDS again under Section 194Q brings some clarity on the taxability of VDAs, some clarity on the characterization aspect of VDAs (i.e. whether it falls within the ambit of goods or not) would have been even better. Further, clarity on interplay of this 1% TDS obligation with other TDS provisions should also be provided.

4.	Obligation to deduct tax where payment gateways are involved i.e. the obligation is on the buyer or the payment gateway	In cases where the payment is made through payment gateways, it has been clarified that the payment gateway shall not be required to deduct tax under Section 194S, if tax has been deducted by the person required to make such deduction (buyer). Further, it has been mentioned that to facilitate proper implementation, the digital platform (payment gateway) may take an undertaking from the buyer regarding deduction of tax. **Comment:** This provides much needed clarity to avoid the issue relating to double deduction of tax on the same transaction. The aspect of obtaining an undertaking is noteworthy for the payment gateway.

COMMENTS

Considering that 1% TDS obligation under Section 194S of the IT Act will apply from 1 July 2022, these clarifications are timely and much needed for the stakeholders involved in VDA transactions.

While these clarifications are welcome, one expects that clarity is also accorded on certain other aspects such as valuation of VDAs in an Exchange transaction, characterization of reward points / loyalty points. Additionally, only notified non-fungible token (NFT) is included in the definition of VDA – however, no NFT has been notified so far by the Government and thus, a notification for the same is also expected. Clarifications on these aspects is certainly the need of the hour considering the sheer growth of crypto transactions in India.

From the perspective of Exchanges, the aspects of written contractual agreement, written undertaking, etc. should be evaluated in detail.

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