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TAX FLASH NEWS

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CBDT releases guidelines to remove difficulties for deduction of tax at source on transfer of virtual digital asset

The Finance Act, 2022 had introduced the requirement of tax deduction at source on the amount of consideration for transfer of Virtual Digital Asset (VDA). In this regard, section 194S was introduced in the Income-tax Act, 1961 (the Act), requiring tax withholding at the rate of 1 per cent on consideration paid for transfer of VDA, with effect from 1 July 2022**.**

Section 194S also provided that the Central Board of Direct Taxes (CBDT) may issue guidelines for removal of difficulties, with the approval of the Central Government. These guidelines are required to be laid before each House of Parliament and shall be binding on the income-tax authorities and the person responsible for paying the consideration for transfer of VDA.

In line with the above provision, the CBDT has issued guidelines[1] in a question-and-answer format[2]. The guidelines are summarised as follows:

Question	Answer
Question 1: Who is required to deduct tax when the transfer of VDA is taking place on or through an Exchange[3] and the payment is made by the purchaser to the Exchange (directly or through broker[4]) and from the Exchange it goes to seller directly or through the broker?	If the transaction is taking place on or through an Exchange there is a possibility of tax deduction requirement under section 194S at multiple stages. Hence, following clarifications are issued: • **In a case where the transfer of VDA takes place on or through an Exchange and the VDA being transferred is owned by a person other than the Exchange:** In this case buyer would be crediting or making payment to the Exchange (directly or through a broker). The Exchange then would be required to credit or make payment to the owner of VDA, either directly or through a broker. Since there are multiple players, to remove difficulty it is clarified that: ➢ Tax may be deducted under section 194S only by the Exchange which is crediting or making payment to the seller (owner of the VDA). In a case where broker owns the VDA, it is the broker who is the seller. Hence, the amount of consideration being credited or paid to the broker by the Exchange is also subject to tax deduction under section 194S. ➢ In a case where the credit/payment between Exchange and the seller is through a broker (and the broker is not seller), the responsibility to deduct tax under section 194S shall be on both the Exchange and the

[1] CBDT Circular No. 13 of 2022, dated 22 June 2022
[2] These guidelines will apply only in cases where transfer of VDA is taking place on or through an Exchange. In other cases (like peer to peer and others) provisions of Section 194S shall apply and so far as these guidelines are concerned, clarifications provided only in Question 6 shall apply.
[3] The term "Exchange" means any person that operates an application or platform for transferring of VDAs, which matches buy and sell trades and executes the same on its application or platform.
[4] The term "Broker" means any person that operates an application or platform for transferring of VDAs and holds brokerage account/accounts with an Exchange for execution of such trades.

	broker. However, if there is a written agreement between the Exchange and the broker that the broker shall be deducting tax on such credit/payment, then broker alone may deduct the tax under section 194S. The Exchange would be required to furnish a quarterly statement (in Form no 26QF) for all such transactions of the quarter on or before the due date prescribed in the Income-tax Rules, 1962 (the Rules). • **In a case where the transfer of VDA takes place on or through an Exchange and the VDA being transferred is owned by such Exchange:** ➢ In this case there are no multiple players. The buyer is required to deduct tax under section 194S. However, there may be a practical issue as the buyer may not know whether the VDA is owned by the Exchange or not. Hence, there may be genuine doubt in the mind of the buyer with regard to its responsibility to deduct tax under section 194S of the Act. This difficulty would also be there if the buyer is buying VDA from an Exchange through a broker. ➢ To remove this difficulty, it is clarified that while the primary responsibility to deduct tax under section 194S, in this case, remains with the buyer or his broker, as an alternative, the Exchange may enter into a written agreement with the buyer or his broker that in regard to all such transactions, 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) for all such transactions of the quarter on or before the due date prescribed in the Rules. 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 section 201 for these transactions.
Question 2: Question No. 1 was with respect to transactions where the consideration for transfer of VDA is not in kind. How will this operate in a situation where it is in kind or in exchange of another VDA?	According to proviso to section 194S(1), there could be situations where the consideration is in kind or in exchange of another VDA or partly in kind and cash is not sufficient to meet the TDS liability. In these situations, the person responsible for paying such consideration is required to ensure that tax required to be deducted has been paid in respect of such consideration, before releasing the consideration. In the above situation, the buyer will release the consideration in kind after seller provides proof of payment of such tax (e.g., challan details, etc.)[5]. This would then be required to be reported in TDS statement along with challan number. This year Form No. 26Q has included provisions for reporting such transactions. For specified persons, Form No. 26QE has been introduced. However, if the transaction is through an Exchange, there is practical issue in implementing this provision. In order to address this practical issue and to remove difficulty, it is clarified that in such a situation, as an alternative, tax may be deducted by the Exchange. Such an alternative mechanism can be exercised by the Exchange based on written contractual agreement with the buyers/sellers. If such an alternative mechanism is exercised, • The Exchange would be required to deduct tax for both legs of the transactions and pay to the Government. Reporting of the same is to be made in the Form 26Q. • The buyer and seller would not be independently required to follow the procedure prescribed in proviso to section 194S(1).

[5] In a situation where VDA 'A' is being exchanged with another VDA 'B', both the persons are buyer as well as seller. One is buyer for 'A' and seller for 'B' and another is buyer for 'B' and seller for 'A'. Thus, both need to pay tax with respect to transfer of VDA and show the evidence to other so that VDAs can then be exchanged.

	When the Exchange opts for deduction of tax under section 194S on such transactions, there is also a possibility that the tax amount deducted is also in kind and needs to be converted into cash before it can be deposited with the Government. In this regard, the following mechanism shall be adopted by the Exchange: • At the time of transaction, the Exchange will deduct TDS in the pair being traded. For example, in case of trade for A to B, 1 per cent of A and 1 per cent B will be deducted as tax under section 194S by the Exchange and balance shall be transferred to the customer. • The trail of transactions evidencing deduction of 1 per cent of consideration for every VDA-to-VDA trade shall be maintained by the Exchange. • The Exchanges shall immediately execute a market order for converting this tax deducted in kind (1 per cent A/ 1 per cent B in the above example) to one of the primary VDAs (BT, ETH, USDT, USDC) which can be easily converted into INR. • This step will ensure that the tax deducted under section 194S in the form of non-primary VDAs like A/B is converted to an equivalent of primary VDAs which have a ready INR market. • Time stamps of timing of orders to be maintained to ensure such conversion of VDAs withheld to be done on immediate basis by the Exchange. If the taxes are withheld in primary VDAs, this step would be ignored. • All the tax deducted under section 194S in the form of primary VDAs (or converted into primary VDA) will be accumulated for the day[6]. The accumulated balance of primary VDAs at 00.00 hours will be converted into INR based on the market rate existing at that time[7]. • Customer will be issued a contract note over email which will include the amount of tax withheld in kind under section 194S and the amount of INR realised from such tax withheld. • The tax withheld in kind under section 194S and converted into INR by following the above procedure shall be deposited in the Government Account as per the timeline and process given in the Rules. • It is clarified that there would not be any further TDS for converting the tax withheld in kind in the form of VDA into INR or from one VDA to another VDA and then into INR.
Question 3: Whether the provision of section 194Q is also applicable on transfer of VDA?	Without going into the merit whether VDA is goods or not, once tax is deducted under section 194S, tax would not be required to be deducted under section 194Q of the Act.
Question 4: Whether the consideration for transfer of VDA shall be on Gross basis after including GST/commission or it shall be	The tax required to be withheld under section 194S shall be on the 'net' consideration after excluding GST/charges levied by the deductor for rendering service.

[6] Time limit will be from 00:00 hours to 23:59 hours. VDA accumulation by the Exchange shall be verifiable from the trail of orders for VDA-to-VDA trades executed during the day.

[7] In order to bring in consistency and to avoid discretion, the Exchanges are required to place market order at 00:00 hours for the tax withheld (or converted) in form of primary VDAs for conversion into INR. These sell market orders shall be executed based on the open buy orders in the market. Price and quantity data for every matched trade shall be maintained by the Exchange and shall be available for verification. It shall be verifiable from the system coding that the conversion into INR happened at the first available buy order based on the prevailing buy order book of the respective Exchange at the time of conversion. As a practice, the respective Exchange liquidating the VDA shall be prohibited to be a buyer for these VDAs.

on ‘net basis’ after exclusion of these items.	
Question 5: In transactions where payment is being carried out through payment gateways, there may be tax deduction twice. To illustrate, a person ‘XYZ’ is required to make payment to the seller for transfer of VDA. He makes payment of INR 1,00,000/- through digital platform of ‘ABC’. On these facts, liability to deduct tax under section 194S may fall on both, ‘XYZ’ and ‘ABC’. Is tax required to be deducted by both?	• The payment gateway will not be required to deduct tax under section 194S on a transaction, if the tax has been deducted by the person (XYZ) required to make deduction under section 194S. • Hence, in the above example, if ‘XYZ’ has deducted tax under section 194S of the Act on INR 1,00,000/-, ‘ABC’ will not be required to deduct tax under section 194S on the same transaction. To facilitate proper implementation, ‘ABC’ may take an undertaking from ‘XYZ’ regarding deduction of tax.
Question 6: Section 194S provides threshold of INR 50,000/INR 10,000 during the financial year. It is not clear how this threshold is to be computed when section 194S would come into effect from 1 July 2022?	• Since the threshold is with respect to the financial year, calculation of consideration for transfer of VDA triggering deduction under section 194S shall be computed from 1 April 2022. • Hence, if the value or aggregate value of the consideration for transfer of VDA payable by a person exceeds the threshold during the financial year 2022-23 (including the period up to 30 June 2022), the provision of section 194S shall apply on any sum, representing consideration for transfer of VDA, credited or paid on or after 1 July 2022. • Since the provision of section 194S applies at the time of credit or payment (whichever is earlier) of any sum, representing consideration for transfer of VDA, such sum which has been credited or paid before 1 July 2022 would not be subjected to tax deduction under section 194S.

Our comments

The issuance of guidelines before the effective date of the provisions will help businesses better prepare for the implementation of this provision. However, requirements with respect to maintaining documents between the transacting parties, for example agreement, challans, undertakings etc. may result into higher compliance burden. Further, the Central Government has been given powers to exclude any digital asset from the definition of VDA. Considering the wide ambit of the definition of VDA, representations have been made before the CBDT seeking such exclusions for various assets. It is imperative that the government comes out with the notification before the tax deduction requirement on transfer of VDA comes into effect from 1 July 2022.

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