Bitcoin Bubble Bursts

How to deal with losses from Cryptocurrencies in Income-tax?

Had there been a practice of naming a "Financial Year", then Financial Year 2017-18 would have been christened as year of "Crypto Currencies". The Virtual Currencies had raised from status of charcoal to diamonds and back to black dust in just a couple of months. All the windfall gains earned by investors from Cryptocurrencies in 2nd and 3rd Quarter of F.Y. 2017-18 have been eroded in the 4th quarter. The most popular Cryptocurrency is "Bitcoin" which grew more than 1,000 times in 2017 itself. However, it started singing in sad notes in year 2018. Currently, it is being traded below $8,000 per Bitcoin.

Cryptocurrencies are not regulated by any statutory body, hence, their prices are highly volatile. The sudden decline in the price of Cryptocurrencies could be attributed to many reasons, inter-alia, de-recognition of various exchanges, Banning Ads by Facebook, Google and Twitter, etc. The Finance Minister, Mr. Arun Jaitley, in his Budget, 2018 speech said that "The Government does not consider cryptocurrencies as a legal tender or coin and will take all measures to eliminate the use of these crypto assets in financing illegitimate activities or as part of the payment system." RBI also repeatedly expressed concerns on Bitcoins and cautioning people against its use.

Despite several admonishments by the Govt., Bitcoins remained as one of the most popular speculative investments in India. With the fond hope of another bounce back in the price of Bitcoins, many investors are still holding them dearly while many have already booked the losses.

Capital Asset or Business Asset?

There is no specific provision in the Income-tax Act about the taxability of Cryptocurrencies. However, keeping in view the general provisions of the Income-tax Act, 1961, Cryptocurrencies could be deemed as capital assets if they are held as an investment by the taxpayer. Therefore, any gain arising therefrom should be taxable as capital gains. If a Cryptocurrency is held for more than 36 months from the date of purchase, it will be considered as long-term capital asset, otherwise short-term.

On the contrary, if transactions in Bitcoins are substantial and frequent, it could be held that the taxpayer is trading in Cryptocurrencies and the resultant profits would be taxable as business income.

With same analogy, losses arising from transfer of Cryptocurrencies shall be deemed as capital losses or business losses. The IT Act, 1961 allows adjustment of losses incurred by a taxpayer against other tax income subject to some restrictions.

Speculative or Non-Speculative Business?

Income-tax Act categorizes a business into 'speculative' or 'non-speculative'. Business losses can be set-off against any other income of the taxpayer, while as speculative business loss can be set-off only against other speculative business income. In other words, if trading in Cryptocurrencies is treated as speculative transaction then losses in one Cryptocurrency (say, Bitcoin) can be set-off only against other speculative income or gains from other Cryptocurrencies (say, Ripple or Ethereum).

Section 43(5) of IT Act provides that a transaction shall be deemed as 'speculative' if it is not followed by an actual delivery. In Cryptocurrency trading, the buyers actually get the delivery of underlying Cryptocurrency into their wallets. Therefore, these transactions should not be deemed as 'speculative'.

Set-off and Carry forward?

Income-tax Act allows 'set-off' of losses against profit. Losses are first set-off against income under the same head (intra-head adjustment) and if any loss remains after such set-off, it will be set-off against income from other head (inter-head adjustment). In other words, before making inter-head adjustment, the taxpayer has to first make intra-head adjustment.

If a person is unable to set-off its losses in the current year due to inadequacy of profit, he can carry forward the losses to subsequent year for set-off against future income. All losses can be carried forward for 8 years from the year in which such losses arise. However, losses from speculative business can be carried forward only for 4 years. Further, it is mandatory to file return of income within due date to carry forward the losses to subsequent years.

The rule of adjustment of losses against profits has followings exceptions in respect of capital gains and business profits:

A. Long-term capital losses can be adjusted only against long-term capital gains. However, short-term capital losses can be adjusted against both short-term capital gains and long-term capital gains.

B. Losses from speculative business can be set-off only against speculative income.

C. Business losses can be adjusted against any head of income except salary income.

D. Capital losses can be adjusted only against Capital gains. However, losses under any other head can be set-off against capital gains.

E. Short-term capital losses from equities (held for less than 12 months) can be adjusted only against short-term gains from stocks.

If Cryptocurrencies are treated as business assets, losses incurred therefrom can be adjusted against any other income including capital gains (both, short-term and long-term) except salary. In contrast, if they are treated as capital assets, the resultant long-term capital loss can be adjusted against other long-term capital gains only. If the resultant