THE ECONOMIC TIMES | Markets
English Edition | 07 March, 2022, 09:32 AM IST | E-Paper

Crypto airdrops, swaps a valuation hurdle

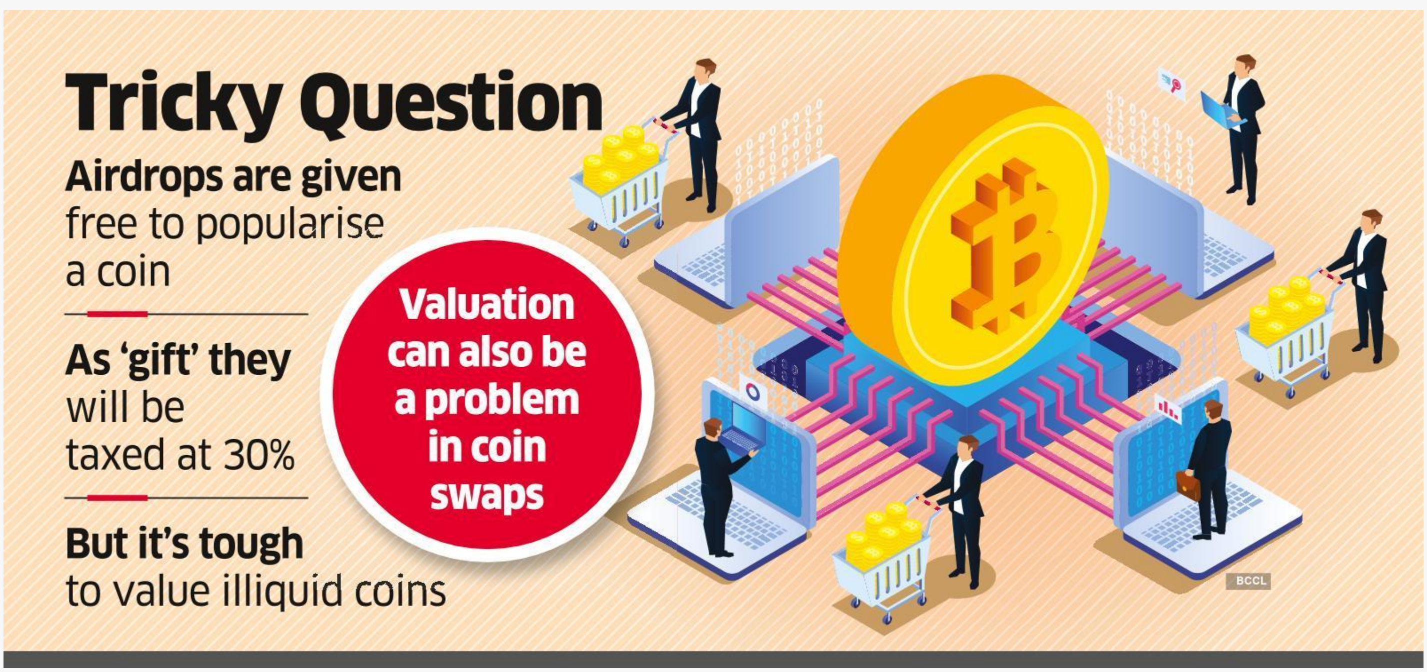
Synopsis
Until now, almost everyone in the crypto universe has been oblivious of the need to value the virtual digital assets as free coins doled out promotional drives by offshore entities landed up in their wallets, or when they traded a slice of their crypto holdings to own a different coin in cashless deals. Not any more.

However, ambiguities around airdrops and valuation, though flagged off by professionals, have received little attention in the post-Budget representations. It could spell trouble later.

Mumbai: Come April, the crypto crowd in India will be caught in a 'valuation' conundrum they receive 'airdropped' coins and swap one crypto for another.

Until now, almost everyone in the crypto universe has been oblivious of the need to value the virtual digital assets as free coins doled out in promotional drives by offshore entities landed up in their wallets, or when they traded a slice of their crypto holdings to own a different coin in cashless deals. Not any more.

Almost every fortnight, developers and blockchain-based projects, from across the world, send out tokens, as part of marketing efforts, to crypto investors who are randomly picked from their public addresses that exist on the blockchain. Now, for local investors to cough up tax on such 'gifts' - which they are required to pay as per the new tax laws proposed in the last Union Budget - they have to first figure out the value of the free, airdropped coins.
But that isn't easy. Airdropped tokens are often new coins for which a market is yet to develop and traded prices (which can be used for valuation) are not readily available. Significantly, investors have no control over airdropped cryp



tocurrencies - they can't say 'no' to these digital gifts or block their wallets from accepting them.

Investors may choose neither to disclose the gifts nor pay tax on them under the impression that tax authorities would not come to know but may run into problems later when they eventually sell the cryptocurrencies to generate cash. Typically, at some point, most traders or investors decide to convert the digital assets into legal tender, and that's when they leave a trail for the taxman to chase.

Valuations can pose a dilemma for others involved in different kinds of transactions. "Investors, exchanges, and others who accept crypto in exchange for services or goods may face difficulties with discharging their tax obligations due to lack of clarity around the valuation of cryptos. Gifts, airdrops of valuable cryptos may also entail tax depending on its value at a given point in time. There could be a lot of litigation around this in the future unless the rules clarify how valuation is to be done," said Meyyappan N, who leads the digital tax practice at the law firm Nishith Desai Associates.

Coin swaps happen between two investors in peer-to-peer transactions, or between a trader and a cryptocurrency exchange.

Such deals generate more questions: Since cryptos comprise both the legs of the transaction, who is the buyer and who is the seller?

Will both have to pay the 1% TDS (tax deducted at source)? (Today, exchanges have to deduct 1% as TDS from the sale proceeds of an investor).

And, given the volatility and price disparities between local and global platforms as well as between two domestic exchanges, how does one value the cryptos?

Since there are no rules, said Meyyappan, "clients are having to take a stance based on information they have and documentation basis which they can convince tax authorities that they have not evaded any tax by taking a favourable valuation".

While there will be a 30% tax on coins received through an airdrop, computing tax on that based on the valuation will be complex, agrees Amit Maheshwari, tax partner at tax consultancy firm AKM Global. "Valuation will depend on whether there are any restrictive covenants and the price at which the coin was being traded when it was received," said Maheshwari.

The Budget has clarified that profits from crypto trades are not capital gains and would be taxed at 30%. Exchanges and industry lobbies are predominantly concerned with the TDS because a rate as high as 1% for every trade, irrespective of whether money is made or lost, can erode the capital of day traders. However, ambiguities around airdrops and valuation, though flagged off by professionals, have received little attention in the post-Budget representations. It could spell trouble later.