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Recuperation mechanism of direct taxation to control post covid economic contraction: India's new tax reform with crypto tax

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Abstract

This study explores the impact of the progressive tax structure on income equality, emphasizing the significance of direct taxes in promoting economic and social equality. It also examines the challenges faced by the Indian government in meeting its revenue targets due to the decline in corporation tax and personal income tax revenues. The present study assesses the role of the newly implemented tax by the Indian Finance Ministry on capital gains from the sale or purchase of cryptocurrencies and its impact on economic growth. A qualitative approach has been adopted, utilizing secondary information sources for characterization and analysis. The study relies on Time Series Data from the Income Tax Department for the financial years 2000-01 to 2018-19 and global estimates of total tax revenues published by the International Centre for Tax and Development (ICTD). The findings indicate that the substantial decline in direct tax revenues necessitated a search for alternative sources of income. The separate taxation system for cryptocurrencies has legitimized digital assets and enabled the government to monitor transactions and capital gains. The introduction of the "Digital Rupee" aims to enhance the digital economy through efficient currency management. This research highlights the need for policymakers to develop a well-defined regulatory framework for cryptocurrency taxation. Clear regulations on cryptocurrency taxation and the "Digital Rupee" could help India boost its digital economy while ensuring better monitoring of crypto transactions and revenues.

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Capital gains tax
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1. Introduction

Taxes have a key role to play in making growth sustainable and equitable. Government of any country finance its developmental policies with the help of taxes, grants and debt. In a study Prichard diagrammatically (Figure 1) provides a conceptual classification of revenues other than debt (Prichard, Cobham, & Goodall, 2014).

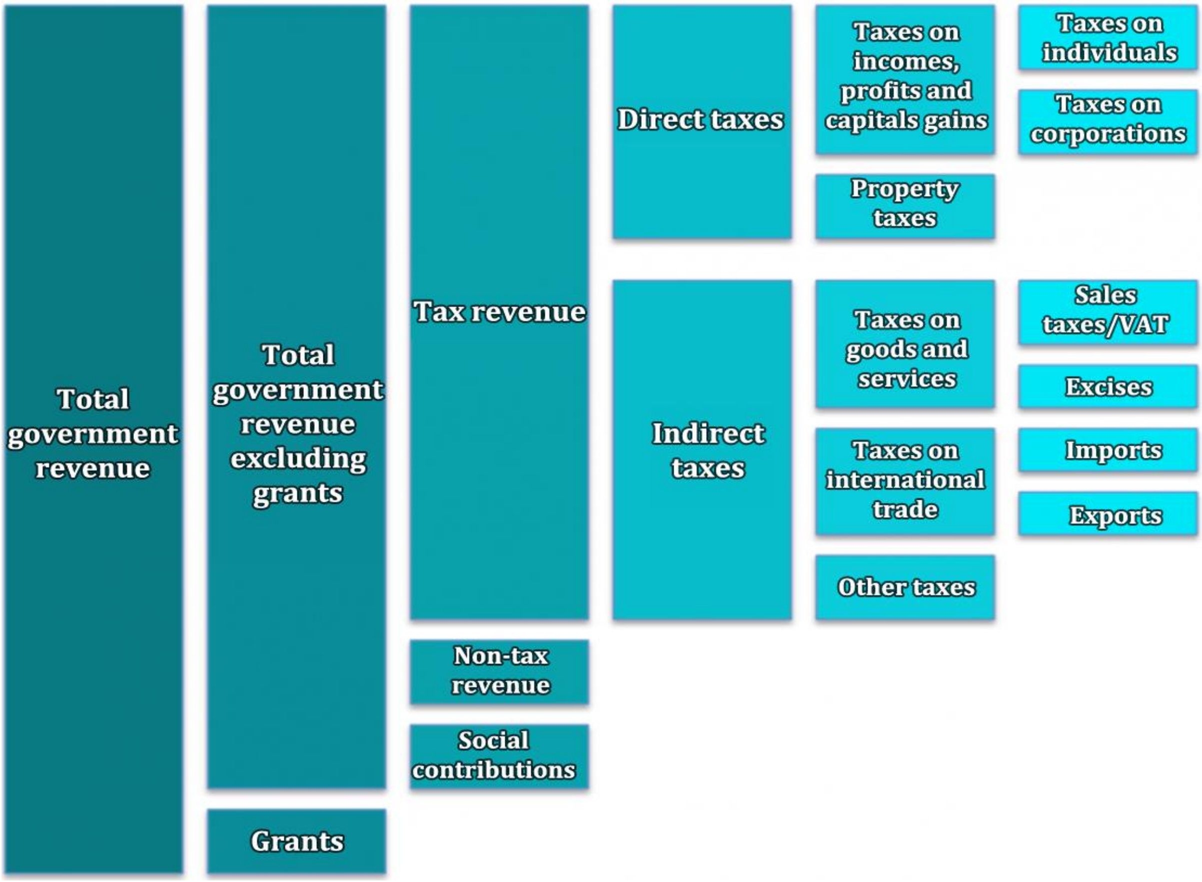

Figure 1. Classification of government revenue.

Source: Prichard et al. (2014).

International Centre for Tax and Development (ICTD) estimates of total tax revenues worldwide are expressed as a percentage of GDP (Ortiz-Ospina & Roser, 2016).

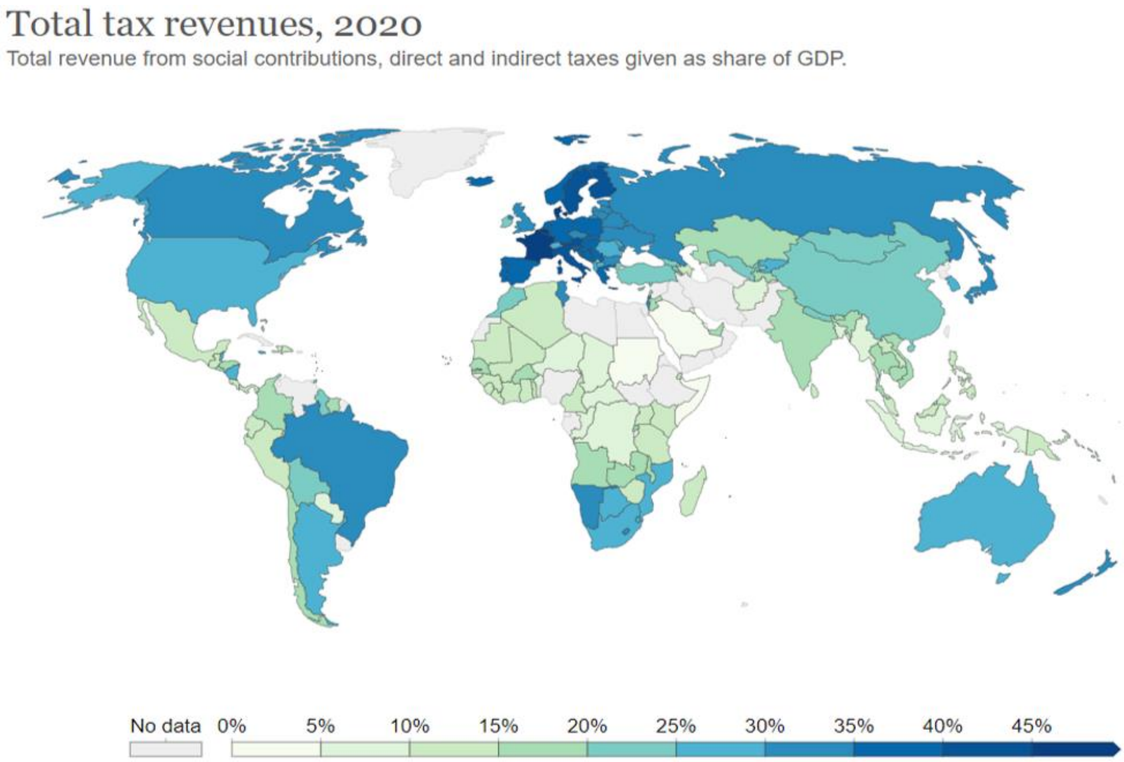

Figure 2. Countries total tax revenues, 2020.

Source: ICTD/UNU-WIDER government revenue dataset, August 2021 (Home - ICTD: Research on Tax and Development, 2022).

From Figure 2 the most recent data, we can see that at one end of the spectrum, we have countries like Cuba, France, Denmark, Norway, and Sweden, where the total tax revenue is higher than 30%. Alternatively, we have countries like Libya and Saudi Arabia, where taxes make up less than 2% of national income. According to the report, most high-income countries have not experienced a significant change in tax revenues in the last decade; but in developing countries, trends and patterns are less clear. Particularly among countries with higher incomes, tax revenues have consistently increased.

2. Literature Review

There is a great deal of literature on capital gains tax theory, but there is little information on how governments have resolved this dilemma. It explains how various countries tax capital gains and the benefits and pitfalls of these approaches. It was written by a team of distinguished international experts (Michael, 2017).

Jagbir Singh Kadyan, Dr Renu Sobti, Leena Jenefa and M Abu Naser reviewed analytically the Direct Taxation in India under three major research questions to understand the quantum of direct tax collection, the relationship between direct tax collection with the total tax revenue collection and the cost of direct tax collection in India (Kadyan, Sobti, Jenefa, & Naser, 2021).

In a panel of 51 countries spanning the period 1992 to 2016, Taufik Abd Hakim investigated the effects of direct and indirect taxes on economic growth and total taxes. Indirect taxes seem to have a positive but insignificant impact on the dependent variable, whereas direct taxes are significant and negatively correlated with the economy. This study also found that direct taxes contributed significantly and positively to the total tax revenue, compared to indirect taxes. Ultimately, direct taxes such as those on income, profits, and capital gains have been found to be harmful to economic growth, yet more effective in collecting taxes in a country. (Abd Hakim, 2020).

Many developed countries no longer tax capital gains made by non-residents; they cannot be deemed experts on capital gains taxation. The challenge is to establish a culture of compliance and enforce the tax in developed countries. However, it is worthwhile to point out that the conventional assumption that non-resident capital gains are not taxed does not encourage compliance. More importantly, the topic of international tax over the past few decades has been dominated by the question of whether non-residents should be taxed on capital gains rather than how they are to be taxed. Although, arguably, the legitimacy of such a tax should depend at least as much on how capital gains are taxed as on whether a tax is imposed (Cui, 2015).

3. Objective of the Study

We aim to review the literature and available information related to the topic in this article. Our objectives include:

1. Understanding the contribution that direct taxes make to the Indian tax system.
2. Understanding the contribution that various components of direct taxes make to direct tax revenue.
3. An assessment of the need for Crypto Tax as a revenue recovery measure for direct taxes.
4. Highlight the key benefits of cryptocurrency taxation and traders' opinions on 1% TDS on cryptocurrency trades.

4. Methodology

Present study is done in order to assess the role of the newly implemented tax by the Indian Finance ministry on capital gains from the sale or purchase of Cryptocurrencies and to analyze results on respective economic growth. To obtain a reasonable result, qualitative method has been adopted. Secondary information sources have been used for characterization and reasoning. Time Series Data of Income Tax Department for the financial Year 2000-01 to 2018-19 and worldwide estimates of total tax revenues, published by International Centre for Tax and Development (ICTD) have been used for most of the analysis.

5. Discussion

5.1. Taxation in India

India's economy is growing rapidly - it is now the sixth largest in the world. The process of funding the financial needs of a country the size of India is extremely complex. Across the globe, taxation has been the primary source of revenue for governments since ancient times, and India is no different. Figure 3 Governments have developed a tax system that uses both progressive and proportional taxation, based on income and other factors. 44.37% of the total government receipts were derived from net tax revenues in 2021-22.

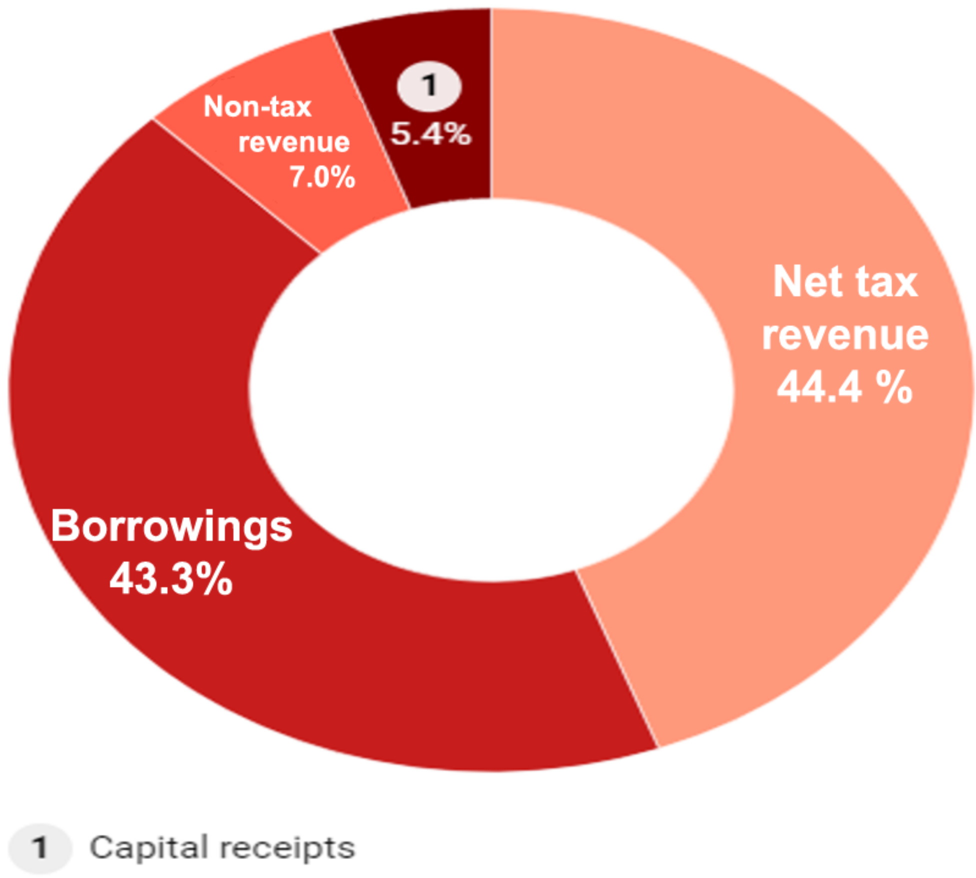

Figure 3. Union budget 2021-22: Receipts.

Source: PRS legislative research.

5.2. Contribution of Direct Taxes to Total Tax Revenue

Individuals who can afford direct taxes are considered to be more equitable than those who cannot afford them. Additionally, the proportions of direct and indirect taxes show how the government manages its finances. Table 1 and Figure 4 Direct taxes account for a higher share of total taxes collected in most developed countries than indirect taxes. In India Net Direct Tax collections for the Fiscal Year 2021-22 are at Rs. 13,63,038 crore showing a growth of over 48.4% (Press Release, 2022).

Table 1. Contribution of direct taxes to total tax revenue.

Financial year	Direct taxes (Rs. crore)	Direct tax as % of total taxes	Direct tax GDP ratio
2000-01	68,305	36.31%	3.25%
2001-02	69,198	37.10%	3.03%
2002-03	83,088	38.52%	3.38%
2003-04	1,05,088	41.42%	3.81%
2004-05	1,32,771	43.72%	4.1%
2005-06	1,65,216	45.32%	4.47%
2006-07	2,30,181	48.80%	5.36%
2007-08	3,14,330	52.97%	6.3%
2008-09	3,33,818	55.34%	5.93%
2009-10	3,78,063	60.78%	5.85%
2010-11	4,45,995	56.48%	5.81%
2011-12	4,93,987	55.82%	5.48%
2012-13	5,58,989	54.17%	5.53%
2013-14	6,38,596	56.32%	5.62%
2014-15	6,95,792	56.16%	5.55%
2015-16	7,41,945	51.03%	5.47%
2016-17	8,49,713	49.65%	5.53%
2017-18	10,02,037	52.24%	5.86%
2018-19	11,37,685	54.78%	5.98%

Source: Income tax department time series data financial year 2000-01 to 2018-19 (Direct Taxes Data, 2023).

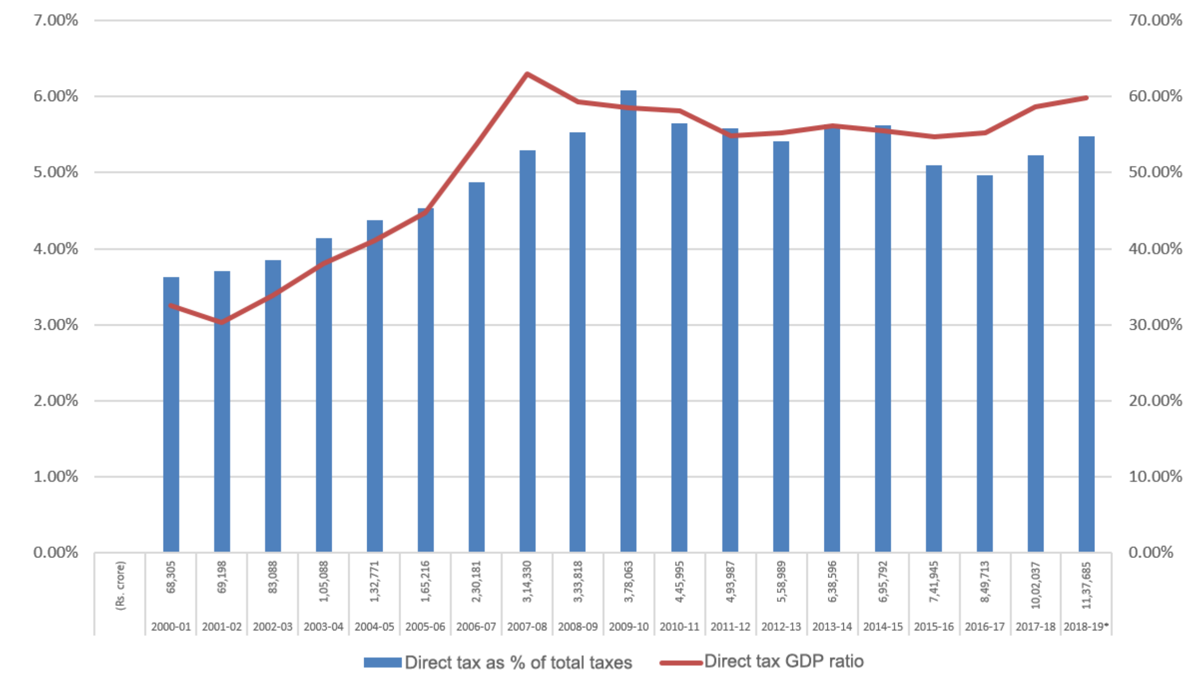

Figure 4. Contribution of direct taxes to total tax revenue.

Source: Income tax department time series data financial year 2000-01 to 2018-19 (Direct Taxes Data, 2023).

The importance of direct taxes is that they are paid directly to the government and make up a significant portion of India's tax generated revenue.

5.3. Advantages of Direct Taxes

Since the Indian Government has introduced well-balanced tax slabs based on an individual's income and age, direct taxes maintain economic and social equilibrium. Those who are able to pay higher taxes are taxed more by the government. Those taxes go towards helping the poor and the underprivileged in India. Direct taxes also increase when the number of taxpayers increases. For this reason, direct taxes are considered very Figure 5 productive. In the form of fiscal policy, tax increases by the government reduce the demand for goods and services, which leads to a reduction in inflation. Tax revenues from direct taxes create certainty for taxpayers and the government. Both the taxpayer and the government know how much must be paid and collected.

Figure 5. Classification of the direct tax revenue of central government.

5.4. Components of Direct Taxes

Table 2 and Figure 6 Out of the various components of direct tax, corporate tax is the one that covers biggest percentage of revenue collection followed by income tax as the second biggest component. Capital gains tax and few other components are the source of a smaller proportion of direct tax revenue (Anuj, 2016).

Table 2. Contribution of various components of direct taxes to total direct tax revenue.

Financial year	Corporate tax (In crores)	Income tax (In crores)	Other direct tax (In crores)	Total direct tax (In crores)
2009-2010	244725	132833	505	378063
2010-2011	298688	146258	1049	445995
2011-2012	322816	170181	990	493987
2012-2013	356326	201840	823	558989
2013-2014	394678	242888	1030	638596
2014-2015	428925	265772	1095	695792
2015-2016	454419	286801	1075	742295

Source: Income tax department, government of India (Home—Central Board of Direct Taxes, 2022).

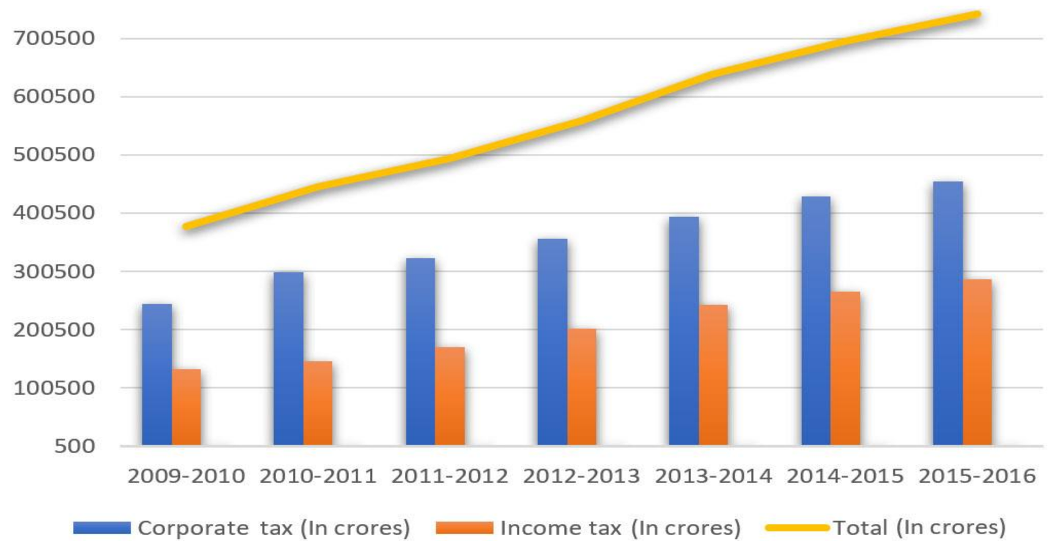

Figure 6. Contribution of various components of direct taxes to total direct tax revenue.

Source: Income tax department, government of India (Home—Central Board of Direct Taxes, 2022).

It is evident from the past data that other direct tax components, such as capital gains tax, securities transaction tax, perquisite tax do a very small contribution in total amount of direct tax collection. In the Budget for 2018-19, the government had introduced a tax for long term capital gains exceeding Rs 1 lakh at the rate of 10 per cent. The then Finance Minister Arun Jaitley had said in his Budget speech in 2018 that the revenues in subsequent years would be more (Aanchal Magazine, 2022).

5.5. Impact of Covid-19 on Income, Consumption, Poverty and Unemployment in India

On 25 March 2020, the Indian government announced a comprehensive nationwide lockdown. The vast majority of public offices, commercial and private establishments, and industrial units were closed during this phase. Flights, trains, and roadways were all suspended - including international and domestic flights. Schools and hospitals were closed. The lockdown lasted until 3 May 2020.

Between April and May 2020, India's first national lockdown resulted in a 40% drop in individual income. Three months of income was lost by households in the bottom decile (Robert, Tarun, & Sonalika, 2021).

CMIE's Consumer Pyramid Household Survey (CPHS) is the largest private survey conducted in India. It shows that India's per capita consumption expenditure dropped more than GDP during a period of reduced social distancing, but did not return to pre-lockdown levels. After the first lockdown, consumption spending per capita continued to be more than 20% lower. In January 2020, the CPHS reported a 9.3% increase in rural poverty and an 11.7% increase in urban poverty from December 2019 to January 2020. Data from CPHS earlier months shows rural poverty increasing by 14.2 percentage points while urban poverty increased by 18.1 percentage points. Covid-19, however, is likely to cause an even greater increase in poverty than the CPHS data suggest. Young people, who are over-represented in informal work due to the pandemic, have suffered severe economic hardship. With young people making up a large percentage of India's workforce, the pandemic puts them at an increased risk of long-term unemployment.

5.6. Tax and Fiscal Policies after the COVID-19 Crisis

The COVID-19 pandemic has had a huge impact on the health of both people and economies, with developing countries, like India, hit the hardest due to limited fiscal space and heavy debt burdens. It needs to raise more tax revenues to finance the sustainable development goals (SDGs). Improving tax policy so that it is aligned to SDG financing strategies to ensure vital public goods, such as skills development and education, health and infrastructure are properly funded and so that social protection is available to all citizens.

5.7. Crypto Tax

Nirmala Sitharaman presented a positive vision for Budget 2022, with the introduction and announcement of a new tax on capital gains from the sale or purchase of Cryptocurrencies. Several Internal Revenue Service (IRS) notices from 2014 assert that cryptocurrencies, including non-fungible tokens (NFTs), are classified as "property." This means they are subject to the same capital gains tax as stocks or "real" property.

Selling a cryptocurrency for more than its purchase price is a capital gain. The gain you make if you buy one bitcoin for $20,000 and sell it for $50,000 is $30,000 taxable income. To put it another way, when you make money from the sale of a crypto or non-fungible token (NFT), the IRS views it as a taxable event. (Stephan, 2022).

5.8. Crypto Users in India

Table 3 and Figure 7 With 10.07 crore crypto owners, India has the most cryptocurrency owners in the world despite the legal ambiguity surrounding cryptocurrency investment in India and the high volatility in crypto prices. The US ranked second in terms of crypto owners behind Russia (1.74 crore) and Nigeria (1.30 crore). According to the number of crypto owners as a percentage of the population, India ranked fifth at 7.30%. The number of Ukrainians who own crypto was 12.73%, followed by Russians (11.91%), Kenyans (8.52%), and Americans (8.31%) (Global Cryptocurrency Ownership Data, 2021).

Table 3. Top ten countries of the world that have highest number of crypto-owners.

Rank	Country	Number of crypto owners	Percentage of the population
1	India	100,740,320	7.30%
2	USA	27,491,810	8.31%
3	Russia	17,379,175	11.91%
4	Nigeria	13,016,341	6.31%
5	Brazil	10,373,187	4.88%
6	Pakistan	9,051,827	4.10%
7	Indonesia	7,285,707	2.66%
8	Vietnam	5,961,684	6.12%
9	Ukraine	5,565,881	12.73%
10	Kenya	4,580,760	8.52%

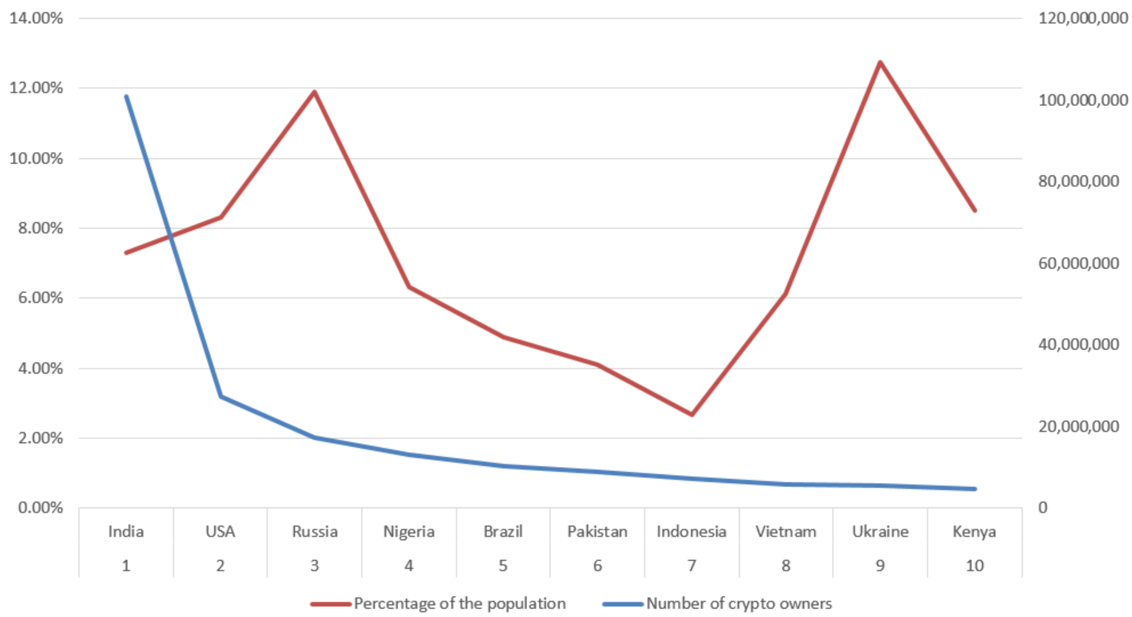

Figure 7. Top ten countries as crypto owners.

There is no legal tender status for cryptocurrencies in India. RBI restricted crypto exchanges' access to banking facilities in 2018 in an attempt to impose a ban. Despite constitutional grounds and virtual exchanges' fundamental rights, the Supreme Court struck down the ban. Tax implications for gains earned from crypto transactions have not yet been clarified by the income tax department (Khan & Hakami, 2021).

Despite the RBI's March 2020 ban on cryptocurrencies, interest has skyrocketed ever since, with Indian exchanges recording impressive user additions and a continuous surge in daily volume trading. Finance minister Nirmala Sitharaman said the government would bring clarity on cryptocurrency formalization soon after the recent rise in usage of cryptocurrencies (ClearTax, 2024).

It cannot avoid taxation despite not yet being legalized by the Reserve Bank of India (RBI). A cryptocurrency investor should pay income tax on profits from the sale of cryptocurrencies. Except for income explicitly exempted by the Income Tax Act, all income is subject to tax. The gains from crypto-transactions would be subject to income tax under the standard income tax rules as;

(i) Business income- Gains from cryptocurrency transactions are taxed as business income if they are frequent and high-volume transactions.
(ii) Capital gains- If you own them primarily so that they appreciate in value over time with less trades, the gains will be taxable as 'capital gains'.

This classification will depend on the investors' intention and nature of these transactions.

Impact of heavy taxation on crypto investors in India:

The Indian crypto community was impatiently waiting for clarity on how the taxation of crypto assets would work. Investors would be discouraged by high taxes. The regulatory framework needs to be simplified. Particularly when it comes to TDS. 1% of all crypto-related transactions involves TDS (tax-deductible at source). This poses a problem to analysts. Tax should now be deducted from the recipient's return in the amount of 30%, regardless of his or her income level. Even though cryptocurrency is referred to as an asset in the budget, it is treated differently than other assets. It is possible that cryptocurrencies' bias in the recent budget will have serious implications for the industry. Moreover, people are concerned that higher taxes will force the industry to move. There have been some concerns that high taxes may drive the industry underground and cause upcoming innovations to be moved offshore (Ojha, 2022).

5.9. Benefits of Crypto Tax

- As a result of the crypto taxes, taxpayers are able to determine what tax liability they will be subject to in the event they sell their crypto holdings.
- It became certain that Crypto in India is not banned. Taxation aspect offered a legitimacy to the whole concept of cryptocurrency network.
- As a result of taxation, the government gets an excellent source of income.
- Cryptocurrency being a risky asset will discourage investors from speculating. Investors may focus on long-term investments instead.

Opinion on 1% TDS on Cryptocurrency Trading:

WazirX's founder, Nischal Shetty, stated that 1 percent TDS on crypto trading will result in a huge loss of tax revenue for the government.

- 1% TDS on cryptocurrency trades shows the following:
- There will be a decrease in trading volume.
- There will also be a decrease in profits from trading.
- Additionally, TDS refunds must be processed in large numbers.
- The government will have to endure massive income tax losses.

According to Vikram Subburaj, Co-Founder and CEO of Giottus Cryptocurrency Exchange, a 1 percent TDS could deprive frequent traders of the capital to make every trade. It is important to clarify how much capital can be locked into a PAN card in a year for short-term traders.

Nangia Andersen LLP Partner Sandeep Jhunjhjnwala said that the TDS on crypto trading could lead to cash flow problems for the buyer, since he would have to arrange funds to deposit taxes with the government.

In addition, Zerodha CEO and co-founder Nithin Kamath said Crypto volumes in India will begin to drop significantly soon after the law comes into effect on July 1st 2022 (Singh, 2022).

6. Conclusion

It gave cryptocurrencies an air of legitimacy when a separate taxation system was introduced. Digital assets might generate taxes according to Finance Minister Sitharaman. Crypto is something that many Indians see as a future prospect, making it a source of revenue for the government. Crypto tax is something that will keep things in check, and allow the government to know the volume of transactions and the amount of capital gains coming from crypto.

In a recent announcement, the finance minister announced the introduction of the "Digital Rupee", a digital currency based on blockchain technology. The digital economy will be boosted with the introduction of Central Bank Digital Currency (CBDC). In addition to being more efficient and cheaper, the digital currency will lead to a more effective currency management system. Therefore, Digital Rupee will be introduced by the

Reserve Bank of India, using blockchain and other technologies and will begin to circulate in 2022-23," Sitharaman stated.

However, the downside is that investors won't be able to wipe out any losses. In the case of foreign exchanges and crypto-to-crypto trades, where there is no clear indication of who will be designated as the buyer, experts have pointed out the impracticality of enforcing the TDS provision. Exchanges will lose volumes due to heavy taxation.

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