
THE 2 C's: CRYPTO AND CONUNDRUM

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ABSTRACT

Humans have always sought to explore unexplored areas in order to succeed in the race of competition and persistent innovation. These innovations add up to our lives and make them simpler, one such mindboggling innovation is Cryptocurrencies which exists on digital platform and are a form of virtual currency which is decentralised and protected by cryptographic encryption techniques. These are considered “digital gold” due to their skyrocketing demand irrespective of the fact that they were not given fiat status by the apex bank of any country. Nonetheless, the same notion does not hold good today as many nations have started adopting crypto as a part of their payments system. Also, worth to note is the fact that El Salvador legalised crypto recently owing to its lucrative returns.

It is usually said that every coin has a flip side and hence even crypto, apart from being a lucrative income and investment poses certain legal challenges to common Populus as well as the nation as a whole. Be that as it may, the author will initially explain the functioning of the cryptos and the plausible rationales driving its high demand, enthusiasm, and craze. Thereafter, the author will try to bring out the major legal problems which may conceive once a country adopts crypto as its fiat. The author also will attempt to compare the legal framework which is put in place by modern democracies to regulate cryptos. The author will also attempt to analyse

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the plausible rationale behind scepticism in the acceptance of cryptocurrencies. Later the author will bring out the legal blockades in the acceptance and approbation of cryptocurrencies as legal tender. Finally, the author will conclude by suggesting plausible solutions in the acceptance of cryptos.

Introduction

Today the digital world has transcended far beyond geopolitical boundaries. The latest report by National Family and Health Survey-5 (NFHS-5) highlights that India has 350 million internet users.³ The report also highlights the fact that this base is expected to continuously grow.⁴ Therefore, with a fast-changing world and quest for innovation, the world has made a fair number of things easy and simpler for people. This is a result of innovative minds which work behind the screens that one is able to access thousands of information online from ordering groceries to getting an appointment everything is available at the convenience of a user with a touch of a button. The partial success can be attributed to the policies of the government such as “Start-Up India”, and “Skill India” which are initiatives of the Indian Government for ensuring the entrepreneurial development of an individual. One such innovation is Cryptocurrency or virtual currency⁵ which exists in virtual space, i.e., it exists over the internet, such currencies do not have a shape of their own and cannot be touched or felt but these can be seen as well as utilised. These have taken over the financial systems of every country by storm. According to Global Financial Stability Report published in the year 2021, the popularity of VCs is continuously growing. Today, the market value of crypto has surpassed 2.5 trillion dollars.⁶ Earlier, the transactions used to take place using barter system but with progress in civilisation the position changed and the gold became the currency which had legal tender, then came the currency notes which are considered as a *fiat money* as they are issued by the country’s central bank, RBI in India, and are not inherently valuable. With the advent of digital age many digital players, including private institutions, undertake digital transactions by providing a platform for transfer of money, and the money today can be seamlessly transferred through online means such as UPI, Digital Wallet, and Net Banking. However, at times the banks make their share of cut by levying certain charges on transaction

³ https://main.mohfw.gov.in/sites/default/files/NFHS-5_Phase-II_0.pdf

⁴ KANTAR, 22nd ICUBE 2019 report on digital adoption and usage trends in India. https://imrbint.com/images/common/ICUBE_2019_Highlights.pdf

⁵ Hereinafter also referred to as “VC”.

⁶ <https://www.imf.org/en/Publications/GFSR/Issues/2021/10/12/global-financial-stability-report-october-2021>

value. Now, this leads us to a question what if these charges get eliminated and there is no need of paying charges to their bank whenever the amount is transacted within or outside the borders?

This innovative step was thought of in the year 2009 by an organisation, Satoshi Nakamoto, who invented Bitcoin, a virtual currency, which was free from the clutches of centralised control or interference of the government. This currency was open for utilisation in every nook and corner of the world.⁷ Information stored on VCs are usually distributed across computers across the globe. This information generally gives a description of transactions of a similar kind which are recorded in computer systems across the globe by making use of Distributed Ledger Technology (DLT). DLT consists of chain of digital signatures, i.e., in the form of a hash code. Since the information is stored in multitude of computers it becomes practically impossible to hack them. Also, a user may verify legitimacy of a VC by looking at its history. Further, they may also be transferred to another person upon request. Thus, the VCs are stored over a network which ensures due safety and anonymity of every transaction. The structure of the network also requires that the transaction must be disclosed in order to aid its identification, but the identities of parties are kept confidential.

Risks associated with VCs

Popularity among thieves and fraudsters.

As VCs cannot be traced, they are more popular amongst thieves and fraudsters who run Ponzi schemes, these are used as a ransom. Secondly, even though the VCs are stored over a system which is well immune from all types of cyber attacks and the risk of their being counterfeited is very low, the digital wallets of the users are not immune from such risk.

For instance, if a user stores bitcoin on his/her desktop and fail to take adequate measures to protect it with anti-virus or backup measures then the fraudster may enter his system and may even take away his VC and transfer them to a server which is under their management and control. Instances of such events are well documented in the past when in 2011, security experts came across a malicious software which could, once installed, was capable enough to steal all Bitcoin from the victims' desktop and transferred them to a server which was under the thieves' control.⁸ Further, even the wallets are prone to attack. One such instance was where a service

⁷ See Satoshi Nakamoto, Bitcoin: A Peer-to-Peer Electronic Cash System, BITCOIN.

<http://www.bitcoin.org/bitcoin.pdf>

⁸ Orin S. Kerr. A Theory of Law, 16 GREEN BAG 2D 111 (2012).

provider was robbed of more than 12,000 dollars of funds belonging to users when the hacker was maliciously able to gain control of accounts of the company.

Recently scammers are also able to deceive individuals into handing over their VCs sans payment, as opposed to forcefully obtaining the funds from an unwitting user by hacking or another technique. Programs that identify themselves as investment funds are very new to the VCs scene and have started to proliferate all over the system. Many of these funds make monthly return promises that are more than 12%. Not surprisingly, the methods by which these monies are intended to produce such outstanding results are kept a secret.

Value not constant

Presently, frequent changes in exchange rate are the biggest threat to people whose wealth is partially held in VCs. It was only in 2011 that the value of bitcoin soared around \$32 and since then the value had been consistently increasing. Today, as of 5 June 2022, a bitcoin can be exchanged at \$21,000.

There are numerous factors which play an active role in the precariousness of Bitcoin, however, the most noteworthy is the lack of trust in the acceptance of VC by the customers, the hesitation in acceptance by merchants, and the dependence on speculation. Users do not prefer to jeopardize having their wealth in a currency that they are unable to sell or a wealth which possesses no scope for profit in the forthcoming future. However, the growth of VCs can be rationally supposed as a result of the Internet and computerized business expansion and the ingenuity of these currencies to achieve rapid, more anonymously, and nominal transaction costs than conventional substitutes. Trust will likely increase as the chain grows extensive and less buoyant, but the legal ambiguities inundating virtual currencies in general, also hamper confidence.

Scepticism in acceptance

Since the currency do not have any legal backing and is not endorsed by the government. Due to its non-acceptance, the investors are generally hesitant in investing their hard-earned money, as once they loose the money there is none to provide them with recompense. In the annual report of RBI in the year 2017-18, the RBI clarified that due to its non-coverage by any financial institution. Further, RBI clarified, that the transactions are usually peer-to-peer based

and there exists no operational control from the central bank of any country thereby making the currencies fit for scammers, terror organisations, and money launderers.⁹

However, a certain section of society is also of the optimistic view that the currency has the vast potential and it is controlled by an opaque government who can inflate the currency as per their whims and fancies, such government, they clarify, exists only in a virtual space.¹⁰ Furthermore, past records point out that a currency may not be wrecked purely because it is neither endorsed by a state, nor exchangeable for a product.

Status of VCs in India

The status of VCs in India can be broadly categorised into two heads:

Position prior to 2021

It was only in 2013 that the RBI, through its orders explicitly imposed a direct ban on the sale and purchase of VCs and warned individuals against the use of VCs.¹¹ The order provided that the use of VCs in any form is not authorised by the RBI or monetary authority. Later, in February 1, 2017, owing to the reports from certain sections regarding the acceptance of VCs by some banks. The central bank issued another advisory cautioning the users wherein it cautioned users that they are deliberately exposing themselves to financial, operational, legal, customer protection and security-related risks.¹² In 2019, an inter-ministerial committee was set up to dwell into the question of acceptance and non-acceptance of VCs. The committee decided to put a complete ban on VCs.¹³ In its report, the committee cited following reasons for doing so:

1. The value of digital currency is a digital representation of value and can serve as a store value, but it does not have status of a legal tender.
2. To raise money through this medium, the companies usually resort to Initial Coin Offerings but whether the company has a tangible product or not cannot be verified.

⁹<https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSRJUNE2022F758BFB27A9145A385FE9AC8D204AC82.PDF>

¹⁰ Nikolei M. Kaplanov, Comment, Nerdy Money: Bitcoin, the Private Digital Currency, and the Case Against Its Regulation 5 (Temple Univ. Legal Studies Research Paper, 2012), available at <http://ssrn.com/abstract=2115203>

¹¹ https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=30247

¹² https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=39435

¹³ Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019.

3. There is no uniform treatment accorded to VCs around the globe. Where on one hand some countries accept money through VCs, on the other hand, some countries have gone to the extent of imposing a complete ban on these currencies.
4. The mining of VCs require enormous capital investment and infrastructure.

As the digital transactions sidestep a reliable institute i.e., RBI and permit individuals to transact solely based on their digital identities, the RBI through a circular in 2018 passed an order wherein it explicitly prevented banks and payment system providers from adopting VCs and providing facilities to bodies trading with them. This circular was challenged before the Apex Court in *Internet & Mobile association of India v. Reserve Bank of India & Ors*¹⁴. The Court struck down the circular deciding the writ petition on 20th March 2020, on the ground that the VCs are unregulated but not illegal in India. The reasoning that stimulated the Court to reach this verdict was the coherent attitude of RBI that they have not verboten VCs.

Therefore, it can be inferred that prior to 2022 the VCs were not accepted in India as a medium of exchange.

Position post 2021

It was only after the meeting chaired by the government that the stakeholders of the VCs met and came to a conclusion that VCs should not be banned, instead they should be regulated. In the meantime, the RBI continued to hold its ground and opposed the inclusion of VCs in India. It suggested that legalising the use of VCs would jeopardise internal security and would also undermine the financial stability of India as these are not regulated by any central bank.

Things were made crystal clear in the Union Budget 2022 wherein the Finance Minister, Mrs Nirmala Sitharaman, announced that the profit or income gained by way of selling of a VC shall be liable to be taxed at 30 percent under Schedule III of the Income Tax Act, 2013. Also, an additional TDS (Tax Deductible at Source) at the rate of 1 percent will be levied on cryptocurrency. Further, in cases involving the transfer of VC by way of the gift will also be taxed. An interesting point to be noted here is the act, *Cryptocurrency and Regulation of Official Digital Currency Bill, 2021*, which seeks to regulate the VCs is not yet tabled by the government.

¹⁴ 2020 SCC Online SC 275.

So far as legal regime is concerned, the *Indian Computer Emergency Response Team* (CERT-In) issued directions under section 70B(6) of the Information Technology Act, 2000

Status of VCs in modern democracies’ – min 4 pages (uk, us, France, Germany)

Status of VCs in Britain

Owing to the rising demand of VCs, UK government, in 2021, decided to come up with their own digital currency by the name “Bitcoin”. The currency intends to provide the facility to businesses and consumers with an option of holding the same in their respective bank accounts. The currency is regulated by the central bank of England popularly called as “Bank of England”. The principal intent behind the introduction of this currency was to reduce the dependency of people on unregulated and unchecked VCs, to give boost to domestic payment systems, and to minimise financial stability risks. Nonetheless, the introduction of local currency is yet to be deliberated upon with stakeholders and beneficiaries on the potential risks and practices.¹⁵

There are various regulations in place which allow the British residents to trade in VCs. But, the sale of profits derived from VCs to retail customers is prohibited by FCA (Financial Conduct Authority). The British government has also banned sale, marketing, and distribution of contracts for differences (CFDs) if they are unregulated. Interestingly, the ban does not stretch to professional traders or institutional firms. The reasons cited by the FCA were:

- i. Non-reliability for valuation.
- ii. Susceptible to market abuse.
- iii. High volatility.
- iv. Lack of legitimate requirement of investment.

In order to regulate the VC market, “Cryptoassets Taskforce” was established in 2018 which was tasked to examine, regulate and identify eight “actors” in the market”

- i. Developers and issuers of VC;
- ii. Investors;
- iii. Financial intermediaries;
- iv. Miners;
- v. Platforms facilitating exchanges and trading;

¹⁵ <https://www.reuters.com/business/finance/uk-launches-taskforce-potential-bank-england-digital-currency-sunak-2021-04-19/>.

- vi. Liquidity providers;
- vii. Payment and Merchant service providers; and
- viii. Wallet service providers.

In UK, the government has also made it obligatory for organisations to follow KYC norms so as to ensure due-diligence and to keep a check on VC business. Likewise, the providers dealing in virtual assets have been asked to keep exhaustive archives containing the details of every beneficiary. It is also mandatory for VAP's "Virtual Asset Providers" to appoint persons who shall oversee and facilitate the compliances. Also, in order to sell or distribute a VC, the provider shall mandatorily apply for e-money license.

Further, so far as taxability is of the VC, in UK, is concerned, they are taxable under the capital gains and other activities.

Status of VCs in Russia

The Digital Financial Asset (DFA) allows people to transact using VCs, at the same time, it restricts their usage as payments for goods and services. It is only the Russian Banks which are listed with central bank of Russia popularly known as "Bank of Russia" who has the authority to supervise DFAs. In 2021 a notification was issued which mandates the VC owners to declare their transactions to Russian tax authorities in cases where the amount of transactions exceed six lakh rubles. It is also compulsory for Russian government employee to declare VCs with them, if any. Also, the miners are required to disclose their transactions to Federal Financial Monitoring Service (FFMS). Also, the term VC has been clearly defined under the Russian Virtual Currency Laws as "an aggregate of electronic data capable of being accepted as the payment means, not being the monetary unit of the Russian Federation or a foreign state, and as investments". The also further states that "digital currency cannot be used at the same time to pay for any goods and services". Further, the DFA's are defined as "digital rights comprising money claims, ability to exercise rights under negotiable securities, reasons to participate in equity of a non-public stock company and right to claim transfer of negotiable securities set in a resolution on the DFA issue".

However, recently on 16th July, the Russian President banned the use of VCs. Accordingly, cryptocurrencies and NFTs (Non Fungible Tokens) are not accepted in the country, nonetheless, they are still possible to buy, sell, pledge, and exchange these assets.¹⁶

Status of VC in Australia

The constitutional position of VCs in Australia means that they are subject to the **Anti-Money Laundering and Counter-Terrorism Financing Act 2006**¹⁷ (AML/CTF 2006), section 5 and related regulations. Correspondingly, VCs that share its components, are considered as property. Even the conversion of VC to fiat currency is considered as a capital gain and therefore is subjected to Capital Gains Tax (CGT). The gains from sale or gift of VCs are considered as profits VCs have hitherto been subject to contentious dual tax collection under Australia's goods and services tax (GST): the transformation in their tariff strategy is suggestive of the Australian government's progressive attitude to the cryptocurrency principle. The law also requires the VC exchanges to be linked to ATO (Australian Tax Office).

Suggestions and Conclusion

Firstly, since the individual who is undertaking the transaction is incommunicado there emerges a need to set up benchmarks which expedite the recognition of the consumer for example – extending the applicability of KYC (Know Your Customer) norms to VCs.

Secondly, in most countries, VCs are yet not proscribed again, there are some countries like El Salvador which has legalised VCs thus even if VC gets outlawed in one country the individual who makes use of VC is free to operate from any other country which does not have a regulatory framework to govern VCs. Therefore, the only solution is to come up with a pan-world regulation to either regulate the VC or ban it altogether.

Thirdly, there is a need to define stakeholders as these are the people who are not known. Stakeholders may be broadly classified into the following:

- a. The one who takes service, i.e., consumers as the major amount of transaction is merely based on speculative business as there is no certainty attached to VCs, their prices are often driven by market forces of demand and supply, making it a most vulnerable currency and a currency which is not easy to determine.

¹⁶ <https://www.cnbc.com/2022/07/16/cryptocurrency/cryptocurrency-putin-bans-digital-payments-a-quick-recap-of-russia-love-hate-relationship-with-it-14170302.htm>.

¹⁷ <https://www.legislation.gov.au/Details/C2021C00243>.

- b. The one who provides service or those who hold the VC.
- c. The one who earns a commission.
- d. The national community. Stringent laws are required to be legislated so as to ensure strict compliance of persons dealing in VCs.
- e. The international community at large as the boundaries of VC are pervasive.

Fourthly, there is a need to clearly define broaden the definition of currency under section 2(h) the Foreign Exchange Management Act, 1999 (FEMA)¹⁸. The act defines currency as “*currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank*”. Therefore, there is no mention of digital currency or virtual currency, the contention was also raised in *Internet & Mobile Association of India v. Reserve Bank of India*¹⁹.

VCS are not a correct fit under the definition provided by Section 2(h) of the Act as a definition of bitcoin has to include terms like physical, fungible, and moveable within the ambit of its definition. Also, it is a well-established principle of jurisprudence that taxing statutes have to be construed strictly, therefore, it is not open for the court to add own interpretation to the words and rectify the error thereby implying that the words mentioned under Section 2(h) of the Act are correct and unambiguous.

The possible solution however is to include the definition of VCs under section 2(26) of the Benami Transactions Act which explicitly states that property means any kind of property, moveable or immovable, tangible or intangible, and would also include any right of interest in such property. VCs can be fitted within the purview of the aforementioned definition, however, the only problem that arises is VCs are moveable property as they can be transferred from one holder to another.

Categorically, it can be said that VCs, to some extent, are driving market forces, therefore, it is high time for the government to undertake pilot projects and roll out its own VCs which shall be under the control and supervision of the RBI. Also, the legislature shall, rather than trying to add more provisions to the already existing paradoxical and irksome laws, try to promulgate new laws.

¹⁸ Hereinafter also referred to as “Act”.

¹⁹ Ibid at p.5



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