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Blockchain and Cryptocurrency in the Indian Paradigm: A Suggestive Model

BLOCKCHAIN AND CRYPTOCURRENCY IN THE INDIAN PARADIGM: A SUGGESTIVE MODEL

by

Anomitra Debnath and Trikansh Kher

Abstract

This paper aims at a multi-pronged analysis of India's present policy regarding block-chain technology and cryptocurrency, and the creation of a sustainable model outlining the structure of a proposed regulatory framework. Herein, India's behaviour and attitude towards the technology is studied in light of official statements, infrastructural development, and legislative action with respect to block-chain, and the present policy is inferred to be observational in nature and may also be referred to as a 'wait-and-watch' policy. This existing policy in India is then thoroughly examined and three loopholes in applicability identified, a comparative policy analysis is attempted in context of G7 and BRICS. In light of such analysis, the need for a distinct regulatory framework for block-chain and virtual currency is stressed and a model for the requisite framework is thus proposed. Under the given model, three aspects are emphasised—the nature of crypto currency based on purpose, taxability of crypto assets, and prevention of crypto crime—and a structure is proposed both within the existing legislation and through amendments to it. Finally, it concludes that India's existing policy is inadequate and flawed on numerous counts. It is recommended that India work on a comprehensive and extensive regulatory framework for block-chain and cryptocurrency and hence, actively strives towards leading the block-chain revolution.

INTRODUCTION

Most of history has been dedicated towards compressing the world into a space as small as possible. From integrated circuits to bionic chips and hand-held computers, it is indisputable that mankind has invested a great deal of time and energy into compressing the universe. It is rather strange then, that the most revolutionary technology since the advent of the Internet is aimed,



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principally, towards preserving anonymity and distance; even though it is equally true that its integration has been largely resisted by most societal institutions, including those in India. Regardless, it is in this paradox that block-chain exists and thrives.

The concept of block-chain was first put forth by a pseudonymous entity, Satoshi Nakamoto, when he (or she) published his (or her) white-paper entitled, 'Bitcoin: A Peer to Peer Electronic Cash System.'¹ The white-paper sought to solve the problem of double-spending in the economy through a purely peer-to-peer transactional currency which would eliminate the need for any intermediary institution, thereby rendering most of our financial institutions redundant. However, this paper proposes the preservation of existing financial structures without losing out on the brilliant transparency solution put forward by Nakamoto, and essentially advocates the creation of a middle ground between the two.

The Indian economy is in a unique position to create such a middle ground. It is imperative for India to utilise this opportunity and set landmarks in crypto currency legislation, infrastructure, and usage. It is in such context that India's existing block-chain and crypto policy is analysed and its features, pros and cons are suitably discussed.

Furthermore, a model regulatory framework is proposed which aims to firmly establish India's position as a rapidly growing yet stable economy.

A pre-requisite to the formation of a sound policy is an understanding of the chronological events preceding its inception. An isolated study of a country's policy, although of utmost importance in comprehending what the existing financial framework has to offer, can serve as a major ground for improvement only when supplemented by a comparative study of other countries' policies. It is only through this process that one can outline a more comprehensive framework for crypto regulations.

UNDERSTANDING INDIA'S BLOCK-CHAIN POLICY

The end of 2018 may have marked the end of a decade since Satoshi Nakamoto's white-paper; however, it may be acknowledged that it is still the foetal stage for a nascent technology. This assumption is further substantiated when we shift our lens towards the Indian scenario in particular. In the absence of a requisite legal framework for block-chain and crypto currency usage, there is a need to meticulously investigate India's stance on the issue, as expressed through the relevant authorities.



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A Brief Timeline

A study of how India has chosen to navigate block-chain technology may be effectively conducted in three stages:

- The Pre-cautionary Stage (2013-2017)
- The Cautionary Stage (2017-2018)
- The Post-Cautionary Stage (2018 onwards)

The Precautionary Stage

The first stage, which spans through years 2013 to 2017, can arguably be said to consist of warnings and words of caution to the general public, informing them that crypto currency and block-chain were endeavours to be undertaken at one's own risk.

The 2013 Reserve Bank of India Press Release

In light of the ever growing curiosity surrounding Nakamoto's innovation, December 2013 marked the first time the Reserve Bank of India (hereinafter 'RBI') took cognizance of crypto currency and the legality of its use; releasing the very first official statement pertaining to the same.

The press release addressed the creation, trading, and usage of virtual currencies (Bitcoin, Ethereum, etc.) and categorically declared that the aforementioned activities were neither regulated nor authorised by any central bank or regulatory body within India.² The same notice informed users, holders, and traders of the multifarious potential risks involved in such activities. Primarily, five risks were identified:

- Permanent loss of virtual currency due to hacking, loss of password, compromise of credentials, malware attack and more, owing to a lack of regulation.
- No established framework for recourse to customer problems and disputes due to the lack of a central authorised agency.
- Loss of value of virtual currency because such value is based purely on speculation.
- Virtual currency trading on platforms within hazy legal jurisdiction.



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- Usage of virtual currency for illicit and illegal activities in contravention of established laws.

India's First Bitcoin Raid

A few days after the issuance of RBI's first official statement, a bitcoin raid was conducted in Ahmedabad at two locations. Acting on a tip-off, 15 Enforcement Directorate (hereinafter 'ED') officials raided the offices of [buysellbitco.in](#) and [rbitco.in](#) which had been trading in bitcoins for the previous three months.³

ED officials claimed that the company was based on a fake address and chose to thoroughly investigate the use of virtual currency traded on the platform, thus fully demonstrating the central bank's intent to crack down on such unrecognised virtual currencies.

RBI Press Release (2017)

In wake of the launch of bitcoin exchanges such as [BTCX India](#)⁴, as well as funding received by bitcoin start-ups such as [Unocoin](#)⁵, the RBI reiterated its concerns expressed in its 2013 circular. The same concerns were relayed to the public by two press releases dated February 01, 2017⁶ and December 05, 2017⁷ respectively. It was further clarified that no platform trading in crypto currency had received authorisation from the central bank.

Hence, the RBI, during this period chose to adopt and moreover advised the public to adopt, a strictly adverse attitude to the Bitcoin wave, treating the technological development as exclusively undesirable at the given point in time.



The Cautionary Stage

In the period preceding 2018, the RBI took a completely intolerant attitude towards all aspects of block-chain and crypto currency. However, 2018 saw a more refined attitude towards the technology from RBI:

The Union Budget Presentation

On February 01, 2018, Finance Minister Arun Jaitley specifically addressed crypto currency in the annual budget presentation, declaring that crypto currency was not recognised as legal tender, and that the Government would actively take steps to eliminate its use in illicit activities. In the same breath, he clarified that the use of block-chain independent of crypto currency would be explored to best suit the interests of a digital economy.⁸

RBI Notification

Following the budget speech, RBI further clarified the official stance by issuing a circular in April 2018 prohibited RBI-regulated bodies from dealing in crypto currency or supporting such transactions with a three-month period to wrap up existing obligations.⁹ This was followed by a backlash among crypto-stakeholders, with many of them moving the Court, claiming that the notification violated their right to trade.¹⁰ The matter is still pending before the Supreme Court.

The RBI Right to Information petition

Further fuel was added to the fire when a Right to Information petition (hereinafter 'RTI') filed by Varun Sethi, 'a block-chain lawyer,' revealed that the RBI had not set up any committee, nor had it conducted proper research before issuing the April notification.¹¹ The RTI further illustrated the unwillingness of RBI to answer or clarify any policy measure that it was not legally required to.



Embracing Block chain

Even in the face of rising hostility against crypto-currency, the Government made it clear that it did not extend the same stance towards block-chain technology; by announcing myriad schemes, setting up the first block-chain district in India and more.¹²

As a consequence, 2018 saw a more refined policy wherein block-chain was embraced as opposed to crypto currency, which was actively shunned. However, this stage was hardly one of clarity as there remained fear, uncertainty, and doubt regarding the future of crypto-regulations, especially considering RBI's stone-faced silence and inadequate replies. Such confusion has been furthered by the matter pending in the Supreme Court, giving rise to a situation in the country where crypto currency is not laid down as being either illegal or legal.

The Post-Cautionary Stage

The end of this period of confusion seems to be not too far, even as Indian markets await a report from the Garg Committee which is likely to come by the end of 2019. Moreover, the rise of peer-to-peer transactions to bypass RBI sanctions has prompted increased attention with the RBI stating that it has its eyes on such activities.¹³

Expectations are rife within the crypto ecosystem. The introduction of concepts such as stable coins¹⁴ could possibly address the primary concern of volatility in value which is currently determined by users' confidence in the virtual currency. Stable coins are tethered to stable collateral and therefore, are not subject to erratic fluctuations as other cryptocurrencies presently are. Regardless, even if such regulations are announced by early 2019, they are unlikely to be crypto-friendly. This much may be safely ascertained from India's stone-faced aversion to virtual currency. Indeed, positive developments, if any, are likely to lean towards India's new favourite buzzword-block-chain.



HOW LEGALLY SOUND IS INDIA'S POLICY?

The notification released by the RBI in April, 2018 raised a number of questions pertinent to the legal aspect of cryptocurrency in India. These primarily concern the grounds on which such regulation was decided upon, the power exercised by the central bank to do so, and the possible loopholes present in what can decidedly be said to be an inadequate and incomplete measure in light of the information revealed thereafter.

In pursuance of the aforementioned issues, an RTI was filed¹⁵ and subsequently elicited a response from the RBI. The key points have been discussed hereafter.

What was the Basis for Issuance of the Notification?

To operate under the assumption that the first regulation regarding a matter of paramount importance would have been issued after conducting proper research would be natural. However, the RTI revealed that no committee was set up and no independent research was conducted. The RBI denied having consulted with any other such central banks. However, on the question of whether an expert's opinion was sought, RBI only forwarded an inconclusive reply.

On the basis of the available information, it is probable that such a decision was arbitrary. Moreover, this seems to be a temporary speed-breaker to buy time and

supplement the 'wait-and-watch' policy that India has adopted. Such a conclusion is concerning, to say the very least.

Nevertheless, it may also be safely assumed that the suppression of cryptocurrency is in furtherance of India's intent to prevent the usage of such virtual currencies for illicit activities (money laundering, terrorism funding, etc.) under pseudonym afforded by such a peer-to-peer transaction system.

Is the Issuance of Such Notification within the Purview of RBI's Powers?

In reply to the RTI filed, the provisions under which the RBI had exercised its powers to bring forth such regulation have been clarified. These are:

- Section 35A read with Section 36(1)(a) of the Banking Regulation Act 1949.¹⁶



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- Section 35A read with Section 36(1)(a) and Section 56 of the Banking Regulation Act 1949.¹⁷
- Sections 45JA and 45L of the Reserve Bank of India Act 1934.¹⁸
- Section 10(2) read with Section 18 of the Payment and Settlement Systems Act 2007.¹⁹

What are the Loopholes that Exist, if any, in such Notification?

Although at first glance, the RBI notification may seem simple, uniform and exhaustive with respect to prohibiting its own agencies from dealing in virtual currency, this is not exactly the case in fact. There exist a number of loopholes that prevent the uniform application of such rules amongst other things.

Applicability in Sikkim

Under Article 371F of the Constitution of India,²⁰ the state of Sikkim enjoys special status and autonomy in a number of matters. This includes the functioning of the State Bank of Sikkim, constituted under the State Bank of Sikkim Proclamation, 1968.²¹ The State Bank of Sikkim is not licensed under Section 22(1) of the Banking Regulation Act, 1949 by the RBI and the Banking Regulation Act of 1949 is not yet applicable to the State Bank of Sikkim.

Would this imply that crypto exchanges and firms can legally operate in Sikkim? If the State Bank of Sikkim chooses to allow cryptocurrency trading, RBI regulations would not be applicable to it and hence, such action would be totally legal. However, this does not imply the creation of a completely unregulated market. Anyone wishing to operate in this arena will be required to have a bank account with the State Bank of Sikkim; this in itself requires a vagary of documents including a proof of local residence. Regardless, the RBI notification remains successfully circumvented. This fact has also been admitted by RBI in its reply to the RTI wherein it stated that no specific information exists regarding the State Bank of Sikkim as the same is not governed by the RBI. Needless to say, this effectively defeats the purpose of plugging virtual currency from circulation in Indian markets.



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Peer-to-Peer Decentralised Exchanges

Peer to Peer (hereinafter 'P2P') exchanges are yet another method of exploiting deficiencies in crypto regulation. These exchanges work as escrow accounts that hold

virtual currency for the respective parties before their transaction reaches fruition.²² This is meant to prevent either party from reneging on fulfilling their half of the transaction. Although these exchanges are on the RBI radar, they are still within the existing legislation.

However, this brings with it its own set of problems with numerous users complaining of having been scammed by seemingly trustworthy crypto exchanges and are then left without any legal recourse. It seems plausible that the RBI would take the stand of having warned the public and hence, having fulfilled its obligation. However, such measures are half-baked and inadequate on part of the chief financial regulator of the country. Thus, the need for a prompt and clear legislation on virtual currency and block-chain is felt again.

Point-of-Sale Application

In spite of banks being prohibited from dealing in virtual currency, there has been no abrupt stoppage in transactions involving such currency with numerous companies utilising Point of Sale (hereinafter 'POS') application of block-chain instead. Herein, a company (say, A) does not offer crypto transaction options (say bitcoin) on its online or any other digital platform. However, A may accept payments in bitcoin at its physical locations. The bitcoin is thereafter converted to fiat currency before being deposited with a bank. Again, this effectively circumvents RBI's rules.²³

Nonetheless, it is worth noting that the legality of this particular usage is mostly hazy and although it has not yet been taken cognizance of by authorities, this may not be the case in the near future. As such, it is advisable for the public at large to exercise its options cautiously and in awareness of the turbulent winds prevailing in crypto markets today.

INTERNATIONAL POLICIES: AN ANALYSIS

The end of 2018 marked one of the most significant decades in technology with the advent of renewed interest in block-chain and cryptocurrency. These



developments have only served to reaffirm what Moore's law²⁴ had already illustrated approximately half a century ago; technology grows exponentially. One would hope that a society could keep up with such evolution, predominantly with respect to its key regulatory structure i.e. the legal framework. Regrettably, this has not always been the case and the same remains true for crypto regulation.

Cryptocurrency, being a relatively recent development, hasn't seen perfect or even passable legislation on an international level to govern its usage. Nevertheless, numerous countries are currently engaged in building policies on an individual level. It is the international scenario in crypto regulation that a developing country like India may utilise to form more comprehensive and fool-proof legislations before it is too late. Hence, a comparative study of the legislation and policies abroad would serve as a precursor to forming a model to regulate cryptocurrency in a complex economy like India.

Group of Seven (G7)

The Group of Seven (hereinafter 'G7') is an informal bloc consisting of Canada, France, Germany, Italy, Japan, the United Kingdom (hereinafter 'UK'), and the United States (hereinafter 'US'). These countries, with the seven largest advanced economies in the world,²⁵ represent 58% of the global net wealth.²⁶ These countries are widely regarded as economic frontrunners and it is not implausible to expect that the bloc can very well implement an effective global policy on block-chain if it so wishes. As such, the G7 represents where India would like to see itself and picking their minds would enable India to incorporate such policy aspects as would be suitable to its economy-both domestic and global.



Country	Nature of Crypto-assets	Regulatory Framework	Regulatory Body	Taxation Framework	Features adaptable in India
Canada	Not legal tender; treated as a commodity; treated as a money-service business for anti-money laundering purposes.	Subject to the Income Tax Act and Proceeds of Crime (Money Laundering) and Terrorist Financing Act.	Canadian Revenue Agency;	Tax laws are applicable to all cryptocurrency transactions.	Inclusion of virtual currencies in the purview of Anti-Money Laundering Laws.
Japan	Income from crypto-related economic activity is categorized as miscellaneous income.	Payment Services Act; Registration with local Finance Bureau required; Firms dealing in crypto are subject to auditing and inspection; Act on Prevention of Transfer of Criminal Proceeds is meant to regulate suspicious activity.	Financial Services Agency; National Tax Agency	Profit earned from the sale of cryptocurrency is taxed as miscellaneous income and not as capital gains, and is taxed under the Income Tax Act.	Registration of all crypto trading platforms; provisions for auditing and inspection of all such platforms.
France	Undefined	Unregulated	None	Profits from the sale of virtual currency are taxable; the value of crypto assets is taken into account in the calculation of wealth tax.	-
Germany	Financial Instruments	Licensing required; cryptocurrency used for payment is	German Federal Financial Supervisory Authority	Exchange of virtual currency for fiat currency and vice-versa	Compulsory licensing.

		treated just like any other means of payment.		is taxable under other services but are exempted from VAT; Use of virtual currency as a means of payment is not taxable.
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Country	Nature of Cryptoassets	Regulatory Framework	Regulatory Body	Taxation Framework	Features adaptable in India
Italy	Undefined	Unregulated	None	European Court of Justice (ECJ) decision in <i>Skatterverket v. David Hedqvist</i> wherein cryptocurrency is not taxable under VAT; Profits on sale of cryptocurrencies are taxable as capital gains;	Taxability of profits from the sale of crypto assets as capital gains.
UK	"Unique Identity" of cryptocurrency is acknowledged.	Unregulated	None	Taxability is dependent upon the context of usage; VAT is chargeable only on goods exchanged for virtual currency;	Usage-based categorization of cryptocurrency.
US	Legality depends on state. Definition of bitcoin and cryptocurrencies vary between sectors.	Fin CEN Regulations 2014/2015; Uniform Regulation of Virtual-Currency Business Act (URVCBA) 2017; Bank	IRS for taxation purpose only.	Taxed as property as per IRS regulation 2014	Robust taxation legislation.

		Secrecy Act (BSA)1970 (Fin CEN clarification)		
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(Table illustrating a Comparative Study of Block-Chain Policy in G7 Countries; Data derived from secondary sources)



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BRICS

BRICS is the acronym coined for an association of five major emerging national economies: Brazil, Russia, India, China and South Africa. BRICS members are known for their significant influence on regional affairs and all are members of G20. An analysis of policies adopted by these top-most developing and emerging economies (of which India is a part) would be of even greater value as it would help us in understanding developing countries like ours-growing at a phenomenal rate but yet to achieve the economic prowess of the G7 countries. The problems unique to economies of this status in particular, pose certain unique problems in tackling the dual requisites of faster growth accompanied by economic stability. Though the G7 countries show us a utopia, albeit imperfect, of what India could be, the BRICS brotherhood clarifies the stark reality of developing economies. The formation of a quintessential policy would thus be virtually irrelevant without proper insight into the policies of these countries.



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Country	Nature of Cryptoassets	Regulatory Framework	Regulatory Body	Taxation Framework	Features adaptable in India
Brazil	Not recognized as legal tender and subject to risks;	No specified regulation.	No specified regulatory body;	Crypto transactions are taxable; tax regulations are still in the drafting process;	-
Russia	Digital assets under the draft bill;	The draft bill proposes KYC norms for ICOs; trading will only be allowed through authorized exchanges; cryptocurrency will likely not	Ministry of Finance; Central Bank;	Crypto income is taxable subject to certain exemptions; tax regulations are still in the drafting process;	Classification of virtual currency as digital assets;

		be considered a legitimate means of payment.			
India	Undefined; Not legal tender; Not illegal;	As of April 2018, all financial institutions regulated by the RBI have been disallowed from dealing with crypto or firms that do so.	Unclear; The Reserve Bank of India has issued all existing rules.	Undefined; Income from crypto-assets is definitely taxable, the provisions under which taxes are to be paid remain unclear;	-
China	Special virtual asset not equivalent to currency	Crypto related activities are banned;	Institute of Digital Money within the People's Bank of China.	Not applicable as crypto activities are banned.	-
South Africa	Not legal tender; Considered part of gross income for taxation purposes.	No specified regulation. A position paper released by the South African Reserve Bank (SARB)	Unclear; Possibly the South African Reserve Bank (SARB).	Taxable as part of income, payable to the South African Revenue Services (SARS)	Proper research conducted by Central Bank.



(Table illustrating a comparative study of block-chain policy in G7 countries; data derived from secondary sources.)

FRAMEWORK FOR CRYPTO REGULATIONS IN INDIA: A MODEL

In the current context wherein there exists no clearly defined legislative or regulatory framework for cryptocurrency in India, and in light of the draft policy that is to be discussed in the Lok Sabha in January, 2019, a policy is suggested that seeks to eliminate the confusion prevailing within the area under discussion, and clearly outline what is proposed to be an efficient approach towards handling block-chain and virtual currency.

Block-Chain: With or Without Cryptocurrency?

Extrapolating from the foregone analysis of Indian policy, it is unequivocal that India is not opposed to the extensive usage of block-chain in the economy, and rightly so. The sheer number of applications of block-chain, even excluding financial ones, is indicative of the massive potential of the technology. However, India's aversion and apprehension regarding virtual currency also arise from the very same analysis. Herein, it is put forth that

despite India's unwillingness to actively adopt virtual currency into mainstream economy, leaving the sector unregulated with only a temporary blanket ban (which in itself is flawed), is neither beneficial nor advisable. In fact, the need for prompt action and formulation of a legislative framework is felt, owing to the status enjoyed by cryptocurrency in the country at present; making it neither legal nor illegal. The lacuna thus formed continues to widen with the delay in the creation of unambiguous regulations.

Moreover, the fact that crypto-related activities continue to flourish despite the notification issued needs to be taken into cognizance. It is postulated that trying to eliminate or plug virtual currency from the economy is both futile and counter-productive; it is a herculean task to try and stop an impending technological tsunami. Building a dam and subsequently trying to channel the flow instead is, naturally, far more efficient.

Hence, this paper advocates the creation of effective crypto-regulations that may enable the phased integration of block-chain and virtual currency in a controlled manner, without overwhelming India's existing infrastructure and yet affect optimal utilisation of the same. The skeletal structure of such a regulatory framework is suggested hereinafter.

Nature of Virtual Currency

The nature of cryptocurrency for regulatory purposes in the suggested framework is proposed to be two-fold. This would depend on the purpose



for which virtual currency is utilised, either by consumers, trading platforms, exchanges etc., that is, on time-based usage.

The two categories for the classification of virtual currency thus identified are:

Capital Assets

Capital assets are defined under Section 2(14)(a) of the Income Tax Act 1961²⁷ (hereinafter 'ITA, 1961') as, "*property of any kind held by an assessee, whether or not connected with his business or profession*"

Virtual Currency is hence proposed to be treated as 'property held by an assessee' thus making crypto holdings taxable as capital assets under the ITA, 1961.

It is submitted that virtual currencies ought to be considered a 'digital asset' for non-trading purposes. Under the suggested framework, this would include crypto holdings for investment purposes.

Business Income

Business Income is defined under Section 28 of ITA, 1961. It includes profits and gains accrued by the assessee arising from the practice of a business or profession. With respect to cryptocurrency, this would include within its ambit, income derived from mining and trading of virtual currencies (this would require mining to be treated as an entrepreneurial activity that takes up resources).

Hence, it is proposed that virtual currencies should be considered as 'business income' as far as their acquisition through mining is concerned, or in case of income earned by individuals/groups engaged in trading digital assets.

Taxation Framework

One of the key components of any policy regarding value-based assets must necessarily include a taxation framework for the same. This paper proposes that taxes imposed on any economic activity involving crypto-currency may be taxed under the same heads of either capital assets or business income, depending on its usage. The differentiation in tax rates applicable and the categories under which such assets would be taxed depends on two factors-the



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time period for which crypto assets are held and their specific use. This proposition seeks to utilise existing taxation norms under the ITA, 1961 that deal with taxes applicable on capital assets and business income and is discussed further below.

Taxation of Capital Assets

Capital assets are taxed under two heads based on the time period for which they are held before sale.

Short Term Capital Assets

Short-term capital assets are defined under Section 2(42A) of the ITA, 1961 as, "*a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer*".

The insertion of a sub-clause is proposed wherein crypto assets are to be considered short-term capital assets if they are held for a minimum time period of six months, but not exceeding twenty-four months immediately preceding the date of its transfer.

The profits from the sale of short-term capital assets would be taxed as short-term capital gains defined under Section 2(42B) of the ITA, 1961.

Long Term Capital Assets

Long-term capital assets are defined under Section 2(29A) of the ITA, 1961 as "*a capital asset which is not a short-term capital asset*".

Under the proposed sub-clause, it would imply any and all crypto-related capital assets that are held for a time period exceeding twenty-four months immediately preceding the date of its transfer.

The profits from the sale of long-term capital assets would be taxed as long-term capital gains as defined under Section 2(29B) of the ITA, 1961.

Taxation of Business Income

As per Section 28 of ITA, 1961, business income is chargeable to income tax. Cryptocurrency, when traded or mined by registered individuals or agencies (as discussed later) is proposed to be included within the definition of profits or income arising from business/entrepreneurial activity and is, hence, liable to be taxed under the head 'profits and gains of business or profession'.



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Legal Framework

With the advent of any technology, there arises the parallel possibility of its misuse, as is the case with block-chain and virtual currency. In fact, one of the principal barriers to the mainstream adoption of cryptocurrency, as identified by the RBI, is the possibility of crypto crimes which are numerous in quantity and varied in nature. Owing to the relatively underdeveloped status of cryptocurrency at present, the technology to effectively combat such crypto-crimes is also not fully developed. Hence, it would be remiss to not propose a legal framework in order to minimise these criminal activities.

The issue of money laundering forms the base for further crimes such as terror funding and funding related to illegal activities. Through extensive analysis, it has been understood that the Prevention of Money Laundering Act, 2002 stands insufficient to deal with the crime of money laundering through cryptocurrency. The need for a Know Your Customer (hereinafter 'KYC') system for all bank transactions relevant to crypto is, therefore,

necessary. This would help in dealing with problem of anonymous insertion of 'dirty' money into the banking system. The establishment of a repository of information pertaining to the individuals and institutions dealing in cryptocurrency would help in weeding out individuals or institutions using the blanket of pseudonym afforded to block-chain to engage in illicit and illegal activities. Hence, a regulatory body which would handle surveillance, implement registration of individuals/firms dealing in cryptocurrency and carry out research and development in the field is needed. This proposal takes cognizance of the deficiencies in Anti-money laundering laws when it comes to tackling crypto crimes. Therefore, the need for the establishment of an autonomous body for regulation of cryptocurrency in India is acutely felt.

The established body would concern itself with the following:

Registration and Licensing

The mainstream adoption of cryptocurrency by implementing registration and licensing in countries like Japan has been observed to be beneficial. The registration would be a necessary step for every individual seeking entry into the industry. This would involve a registration process from which a repository of data of cryptocurrency users can be maintained. The process of licensing would also be made mandatory for everyone. The licensing process would classify the registered on the basis of their investment and size into large Scale stakeholders, small scale stakeholders and micro level traders/investors. This would also ease the process of taxation as each would be taxed on the basis of scale (depending on the existing tax slabs). This would establish a centralised



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data repository which can be used to track transactions in the cryptocurrency ecosystem and hence prevent tax evasion and money laundering.

Know Your Customer

A KYC procedure would be made mandatory for all consumers holding accounts at their respective banks for the specific purpose of cryptocurrency transactions. All entities, individuals or firms, would be required to open separate bank accounts for the purpose for crypto-related transactions which would be linked to the specific digital wallet for the purposes of prevention of laundering and income tax evasion. The regulatory body would oversee the process of the KYC. This would include establishing standard procedure for collection and transmission of the collected information to the regulatory authority. The method of KYC for separate accounts seems to be the most efficient way to keep the unaccounted value flow from crypto sources in check. This streamlined process has been effectively implemented in Japan, and India should model its policy on a similar process so as to acquire perfect knowledge about the climate in its crypto ecosystem.

Issuing Rules, Directives, and Guidelines

At present, virtual currencies are in a state of constant evolution. Therefore, meticulous and exhaustive study, technical prowess, programming skills, and economic knowledge is required to fully understand the technology in order to regulate it. Thus, the proposed regulatory body would require personnel well versed in these aspects, as well as analysts who understand how to read the crypto skies.

The composition of any regulatory body has to be such as may propose and implement water-tight guidelines and rules and drafting a set of rules for entities to follow in the trading and mining of cryptocurrencies would be one of its primary tasks. The body would issue regular and prompt notifications in case of any discrepancies. Furthermore, initiatives aiming to educate citizens regarding block-chain technology and virtual currency must also be undertaken by such a body.

It is worth noting that any such body must seek to constantly keep itself aware of any

technological developments. Thus, a relatively flexible structure is suggested. Revision and adaptation of rules to any such changes must also be swiftly implemented in order to create a robust and pervasive framework that will help build lasting confidence within crypto markets in India.



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Initial Coin Offerings and P2P Exchanges

In the suggested framework, unregulated peer-to-peer transactions would not be considered legal. Such transactions, if any, would be conducted through registered exchanges which would be required to maintain digitised records, and be subject to inspection and auditing by the aforementioned regulatory body. Moreover, these records would be tamper-proof owing to the consensus model followed by block-chain technology.

Thus, the setting up of a transparent payment, exchange and crowdfunding system is advocated with respect to virtual currency. This may, in future, also act as a catalyst in ushering India in a cashless economy.

Furthermore, in the case of Initial Coin Offerings (hereinafter 'ICOs'), they must be subject to rigorous registration and approval procedures before they are granted permission to operate. This would reduce the possibility of scams. It is hoped that by implementing strict procedures in this respect, a safe space for handling a relatively less known and volatile entity may be created whilst preserving the benefits of the same.

The Regulatory Body

The regulatory body is the key to the above proposed legislative reform. The body would principally be a non-statutory body established by a government order. The body would deal with norms regarding registration, licensing, KYC, data repository management, and research and development in issues relating to cryptocurrency. The proposed body would be only in its nascent stage and thus, it would be established as a non-statutory body by a government order. The establishment of the aforementioned body in non-statutory form would be on a pilot basis.

It will be important to see if the body could efficiently perform its intended role and affect intended regulations and exercise a degree of control in the crypto economy. The nature of cryptocurrency is relatively unstable at present and its future is uncertain. It functions purely on the principle of 'trust' and if the same is suddenly lost in the system, then the crypto economy would collapse. Considering the resources and transformative change invested, the loss to the economy would be profound; making it a gamble not worth taking. Any future action is proposed to be purely observatory and analytical. If cryptocurrencies prove to be the revolutionary technology they are touted to be, then this resolution pushes for the establishment of this body as an autonomous statutory body therefore granting it a more permanent place in the Indian politico-economic structure.



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Conclusion

"Block-chain technology could change our world more than people imagine. Bitcoin, however, could be a bubble." —Jack Ma

A blessing in disguise or a Trojan horse— cryptocurrency may as well adapt to either of

these roles for an economy like ours. The existence of a unique mixed economy model brings an unexplored paradigm to the cryptocurrency debate. The technology has led many to invest in it-some being tech enthusiasts who are genuinely interested, while most look at cryptocurrencies as the goose that lays golden eggs. The abnormal speculative activity in crypto markets in absence of proper knowledge regarding the same has led to government intervention in order to protect the economy from instability brought about by volatile assets. This too has been criticised, and the ban from trade in cryptocurrency is resented by those who hold it to be in violation of their fundamental right to practice any trade they like.

The pivotal question which thus arose was this-is the Indian Government babying its citizens, or is India just not ready?

The answer to this can only be understood in reference to what other countries have chosen to do. The majority of the G7 countries, despite being leading economies, were observed to exercise the same cautious approach that India has chosen to do, albeit with a heavier hand. Even so, India's approach is neither adequate nor appropriate. This is better understood in light of the proactive policies that emerging economies like South Africa and Venezuela have adopted with an aim to earn a place in the crypto economy.

Which way does India choose to go then?

A thorough analysis of the existing legal framework in India compared to that of other major economies effectively answers the question and illustrates that cryptocurrency is a gamble, but for India, it is a gamble worth taking. At the same time, the sheer instability of virtual currencies is not to be taken lightly. It is undeniable that the system provides for anonymity that is conducive to of illegal funding of illicit activities, money laundering and black-market operations. However, it is worth noting that the resolution of these issues is not impossible.

Missing out on the Dotcom revolution has set India back several years; and yet most Indians are provided with employment in the Information and Technology Sector. With the contemporary issue of cryptocurrency pending in the upcoming Lok Sabha discussion, the question of whether we should gamble on this technology and if there exists a way to do so with a safety net



duly arose. This paper has proposed a solution in the form of a model draft resolution. The reforms, in the form of amendments in taxation policy, are of utmost urgency not only in financial terms but also in terms of effective control on unaccounted financial assets. The setting up of a regulatory body under the order of the Government is a tried-and-tested solution for tackling crypto crime and this paper advocates the same. The regulatory body is of paramount importance, being the principal institution in dealing with a wide range of tasks from licensing and registration to formulating rules and regulations for cryptocurrency users in the country. The model is proposed as a panacea for the ills brought forth by virtual currencies. However, the structure proposed is basic in nature and its success depends solely on how it is fleshed out by the Government, and its reception in the crypto community in the future.

One question still remains-where does block-chain and crypto go from here? The paper demands a shift in perspective and proposes that a different question be asked, Where can India take block-chain? It is only by contemplating this question that India can carve out its place in what will go down as one of the greatest technology revolutions in history and what Bill Gates refers to as the "*Tour De Force of this century*".

Perhaps, it is time.

* Students, BA LLB (Hons), Hidayatullah National Law University.

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