

INTO THE CRYPTOVERSE: BUILDING A REGULATORY REGIME

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***A**bstract—Sovereignty is the supreme authority of a State within its territory. This control is exercised in several avenues, a major one being the State creating its currency and authorising its flow internally and internationally. A State's sovereignty also relies largely on how its currency is valued against another State's currency in terms of Foreign Exchange. The hierarchy of internal control of money-flow stems from the Central Bank instituted by the State. India's central monetary authority is the Reserve Bank of India (hereinafter "RBI") which controls the rupee-flow in all forms across all systems. This is achieved through a central ledger the RBI maintains that tracks the rupee-flow and places control of the rupee in the hands of the Union Government as well as aids in taxation purposes. Blockchain technology is a subset of technological evolution that creates a digital ecosystem where the service provider can choose between a centralised system or a decentralised system of authority. In a decentralised setup, the individuals can hold autonomous authority, holding control of their transactions, communications, storage of information etc. Access to this information becomes privileged, thus allowing exclusive and exhaustive ownership control. Blockchain technology is used in several sectors, but the idea and the feature to transact information in a decentralized setup paved the way for the creation of virtual currency and the exchange surrounding it. Bitcoin was the first decentralized cryptocurrency founded in 2009 by Satoshi Nakamoto. Today, there are about 6500 active cryptocurrencies in the world.*

The paper will analyse virtual monetary systems, the underlying blockchain technology and the position of India as a

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regulatory principle. The researchers will strive to answer why India has the urgent requirement to legitimise cryptocurrency transactions and harness maximum benefit from the unassailable current the blockchain technology has generated, in light of the introduction of the Central Bank Digital Currency, in the Finance Bill of 2022.

Keywords: Cryptocurrency, Central Bank Digital Currency, Virtual Currency, State-Regulation, Blockchain Technology.

INTRODUCTION

The idea of cryptocurrency desensitises the sovereign control of States over their official currencies. As the validation of the virtual currency is not authorised by the States, cryptocurrency enables a parallel economy to emerge and gains value against these official currencies. This emergence of a parallel economy has complicated the situation for governments. Several schemes linked to official currencies like taxation, foreign exchange etc., are affected by the virtual currency as they disregard any principles of international law and bi/multilateral agreements. Further, cryptocurrency dilutes the nature of official currency being a territorial instrument. The States theoretically cannot assume control over cryptocurrency transactions occurring in their territories, in their movement, and determination of their values.²⁵⁷ The value of cryptocurrency is determined by the concept of free-market capitalism, where governmental intervention is minimal to none.

Cryptocurrencies transcend national/international sovereignty principles and central banks and pose an unprecedented threat to States, which otherwise assume sole administrative control at all levels. As cryptocurrencies are universal, they cannot assume any jurisdiction.²⁵⁸ The overarching negative effects on several States' fiscal systems and their obligations to international law have created an exigency for States to counteract against the virtual economy.²⁵⁹ The States by virtue of their varied public policy mechanisms, do not share the same view necessarily to curtail the flow of cryptocurrency transactions altogether, domestically

²⁵⁷ William Magnuson, *Blockchain Democracy: Technology, Law and the Rule of the Crowd* (CUP 2020) 14.

²⁵⁸ Paul Vigna and Michael J Casey, *The Age of Cryptocurrency: How Bitcoin and Digital Money are Challenging The Global Economic Order* (St Martin's Press 2015).

²⁵⁹ *ibid* 23.

or internationally.²⁶⁰ Few states have legitimised private virtual cryptocurrencies, while some others are in the process of maximising their benefit arising out of these transactions. States' response towards cryptocurrency is situation-oriented and based on their socio-legal-economic and political circumstances.²⁶¹

India has always strong-armed its regulatory exercise against the very idea of cryptocurrency.²⁶² Renowned for being aggressive in safeguarding its sovereignty, India's despise of cryptocurrency is evident in the government's agenda to place itself on a higher pedestal by countering an unstoppable technology.²⁶³ However, blockchain technology pierces any regulatory mechanisms due to its decentralised nature and usage of the internet. Theoretically, no government can extend its legal long-arm provisions to completely curtail the implementation of the blockchain effect due to their limitations.²⁶⁴

The RBI has strictly resisted and discouraged cryptocurrency transactions. In 2018, the RBI, through a circular²⁶⁵, expressly banned the banking and non-banking sectors from dealing and facilitating cryptocurrency transactions for its users. This circular was quashed by the Supreme Court of India in the case of *Internet and Mobile Assn of India v Union of India*²⁶⁶ (hereinafter "IAMAI case") in March 2020. The court based its decision on the principles of the doctrine of proportionality and under the ambit of one's fundamental right to carry out business and profession under Article 19(1)(g)²⁶⁷ of the Indian Constitution. Despite the Supreme Court's ruling, certain banks like HDFC and State Bank of India unofficially advised their customers against dealing in cryptocurrency and threatened with suspension of accounts through SMS in May 2021.²⁶⁸

²⁶⁰ Joseph Raz, 'Why the State?' (2003) King's College London Dickson Poon School of Law Legal Studies Research Paper 38/2014 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2339522> accessed 1 May 2022.

²⁶¹ *ibid.*

²⁶² Jonathan M Warren, 'A Too Convenient Transaction: Bitcoin and its Further Regulation' (2020) 8 (1) *Journal of Law & Cyber Warfare* 5 <www.jstor.org/stable/26915562> accessed 1 February 2022.

²⁶³ Jaideep Reddy, 'The Case for Regulating Crypto Assets' (2019) 15 (2) *IJLT* <www.ijlt.in/journal/the-case-for-regulating-crypto-assets> accessed 1 February 2022.

²⁶⁴ *ibid.*

²⁶⁵ Reserve Bank of India, 'Prohibition on Dealing in Virtual Currencies (VCs)' (6 April 2018) <www.rbi.org.in/commonman/English/Scripts/Notification.aspx?Id=2632> accessed 1 February 2022.

²⁶⁶ *Internet & Mobile Assn of India v RBI* 2020 SCC OnLine SC 275 (*IAMAI*).

²⁶⁷ The Constitution of India 1950, art 19(1)(g).

²⁶⁸ 'Cryptocurrency: HDFC, SBI, Other Banks Warn Users of Account Suspension if Trading Continues' (*Money Control*, 31 May 2021) <www.moneycontrol.com/news/business/cryptocurrency/cryptocurrency-hdfc-sbi-other-banks-warn-users-of-account-suspension-if-trading-continues-6962931.html> accessed 29 January 2022.

Albeit unofficial, these actions might still reflect the vision of the larger RBI that principally discourages cryptocurrency transactions. The COVID-19 lockdown scenario encouraged several people to deal in cryptocurrency trading as its value ascended, generating profits.²⁶⁹ After the lockdown, the situation of cryptocurrency trading had normalised among the public as several Indian start-ups indulged in the cryptocurrency exchange business. They mobilised virtual currency through cryptocurrency trading to anyone with a smartphone, internet, and a little money to invest.²⁷⁰ The series of investments in these private cryptocurrency exchanges has also sharply increased. Several multinational companies and hedge fund operators are beginning to trust the virtual currency model and investing millions of dollars.²⁷¹ The current COVID circumstances have presented a different reality from what the Indian government has always represented. Regulating the virtual economy and digital trading ecosystem offers a plausible situation by regulating the cryptocurrency exchanges that are the registered companies in India. The government is presently considering introducing a new Bill titled ‘Cryptocurrency and Regulation of Official Digital Currency Bill, 2021’²⁷² (hereinafter “the Bill”), an updated draft from its 2019 predecessor. The Bill intends to ban private cryptocurrencies in India with certain exceptions to promote the underlying technology and trading of cryptocurrency. It also aims to provide a framework for creating an official digital currency which appears likely to be issued by the RBI. This Bill has hinted that the Indian government may have plans to introduce itself as a virtual currency issuer in the sector currently populated by private entities.

The Parliament is finally about to circulate the Bill in the Winter Session of 2021.²⁷³ The Bill is both most anticipated for the arrival of a

²⁶⁹ ‘Cryptocurrency has Risen Despite the Pandemic & is Expected to Continue’ *The Economic Times* (20 May 2021) <<https://economictimes.indiatimes.com/markets/cryptocurrency/cryptocurrency-has-risen-despite-the-pandemic-is-expected-to-continue/articleshow/82800680.cms?from=mdr>> accessed 1 February 2022.

²⁷⁰ Deepsekhar Choudhury and Namit Gupta, ‘Indian Crypto and Blockchain Startups are Reimagining How the Web Works’ *Business Standard* (2 November 2021) <www.business-standard.com/article/technology/indian-crypto-and-blockchain-startups-are-reimagining-how-the-web-works-121110201679_1.html> accessed 1 February 2022.

²⁷¹ Claire Groden, Edoardo Saravalle and Julia Solomon-Strauss, ‘Uncharted Waters: A Primer on Virtual Currency Regulation Around the World’ (*Centre for a New American Security*, 2 October 2018) <<https://www.cnas.org/publications/reports/uncharted-waters>> accessed 1 February 2022.

²⁷² ‘Cryptocurrency and Regulation of Official Digital Currency Bill 2021’ (*SCCOnline Blog*, 18 August 2021) <www.sconline.com/blog/post/tag/cryptocurrency-and-regulation-of-official-digital-currency-bill-2021/> accessed 1 February 2022.

²⁷³ ‘Centre Likely to Move Modified Cryptocurrency Bill at Start of Parliament’s Winter Session’ (*Money Control*, 8 November 2021) <www.moneycontrol.com/news/business/>

new virtual coin or minting of the existing rupee but in a cryptocurrency format. Either way, the regulation in toto might be new and abstract for a growing market like India where the market sensibilities may not be high as compared to other countries. This paper will analyse how far India has prepared itself to regulate and convene on the cryptocurrency flow.

BLOCKCHAIN: THE FOUNDATIONAL TECHNOLOGY

Despite the advent of several virtual payment methods and the significantly reduced hassles of cash payments, several companies still do not have faith in a virtual currency. Some companies like Tesla have repeatedly announced that they would be dealing in cryptocurrencies to sell their products. Although many organisations do not have immediate intentions to transact on cryptocurrency for their businesses, the underlying blockchain technology on which cryptocurrency is built has prompted considerable interest because of its wide variety of potential applications.²⁷⁴

With blockchains, several types of transactions can be engaged, including products, information, etc., in a more secure and reliable manner while also maintaining the integrity of trust. It is imperative to understand how blockchain technology has expedited the technology revolution and how cryptocurrency has the potential to revolutionise payment methods and systems.

Blockchain technology and its usage across the world is at a steady growth. A blockchain is a conglomeration of several sequences of records called blocks. The blocks are interlinked in a systemic pattern that ensures both privacy to these records and to the entire process that follows the principles of cryptography.²⁷⁵

Larger blocks take longer to produce (or have a greater latency on the server). Hence, the size of each block in a blockchain is fixed in several applications, such as banking transactions. Blocks could be any size but the larger the block, the slower the process of creating new blocks is. Regardless of what data is stored on a blockchain, the most notable feature is that the blockchain continues to work effectively.

[cryptocurrency/centre-likely-to-move-modified-cryptocurrency-bill-at-start-of-parliaments-winter-session-7691841.html](#)> accessed 1 February 2022.

²⁷⁴ Magnuson (n 257) 65.

²⁷⁵ *ibid* 44.

The term 'blockchain' is most often connected with cryptocurrency because of the way it records financial transactions among digital wallets.²⁷⁶ Apart from cryptocurrency's association, blockchain is well known for its usage in the enforcement of smart contracts in digital verification, recording various phases of a supply-chain, DRM Records, healthcare industry, transaction of critical information, etc. The mechanism of blockchain technology is universal, and there is no specific custom method of making it function as per varying regulatory conditions in different countries. Blockchain offers a long-term, consistent, secure, unremitting, and tamper-proof record that is almost impossible to alter. It addresses two major issues and may be used in a variety of contexts: how to keep data safe while distributing them and how to prevent double payments (that would emanate from other difficulties outside the domain of cash payment like IPR, etc.). It is also of use in recording risk management procedures because of the blockchain's variety of applications and handling of information.²⁷⁷

It takes a few blocks to build a blockchain since every single block references its predecessor. The cryptographic hash of the parent block is included in each subsequent block utilising cryptographic criteria outlined in the blockchain protocols to assure the security of this link. These operations are one-time functioning algorithms that convert any volume of data into the hash, but though, the hash is easy to derive however, it is inconceivable to recover the original block. Any minor differences made to the original block will consequently affect a series of unpredictable changes in the resulting hash, making it impossible to verify the integrity of the data.

In simple words, if an unauthorised person attempts to enter a blockchain and changes the hash value of one block, the block whose value was changed will not match its hash value with the parent block and thus, will break the chain of communication (blockchain). As a result, the transaction in progress will terminate. This can be used as a theft-free measure which further strengthens the blockchain technology to be virtually impenetrable.²⁷⁸

For this reason, whenever a new block is added to a blockchain, the preceding blocks are effectively 'frozen' and cannot be changed without causing the chain to break. Thus, a blockchain is a distributed ledger

²⁷⁶ Don Tapscott and Alex Tapscott, *Blockchain Revolution: How the Technology Behind Bitcoin and other Cryptocurrencies is Changing the World* (Portfolio Publishing House 2018) 21.

²⁷⁷ *ibid.*

²⁷⁸ Warren (n 262).

available to all parties, including the public, in which several parties may collaborate to keep records of transactions.

However, the person who transacted using blockchain technology can remain anonymous. The very transaction will remain accessible to the public due to the transparent nature of the digital ledger technology, whose whole point is to be accessible to anybody requesting access to such information. In this manner, transparency in the process can be upheld while keeping the identity of the transactor anonymous. This right balance of blockchain technology offered a breakthrough for the cryptocurrency to be a reliable source transparent in its functions. It guaranteed the privacy of the transacting individuals, which the wire or bank transfer never offered. It was because these agencies maintained a central ledger, so there was always an oversight mechanism or regulation or authority that had the power to pierce the iron curtain of a transaction and identify the transacting party.

THE CRYPTOCURRENCY CONUNDRUM: A CURRENCY OR COMMODITY

Since Bitcoin was the first form of cryptocurrency, the terms bitcoins and cryptocurrency have become synonymous, despite the existence of several valuable cryptocurrencies in the crypto trading pool. There was a discourse among the crypto traders and the public that emerged when the crypto trading practices gained popularity: whether to categorise cryptocurrency as a commodity or a currency. This confusion arose because cryptocurrency was viewed with dual purposes. First, as an alternative to money, as how it was initially advertised by the founder of Bitcoin. Second, as people realised the dynamic nature of its value corresponding to every event in the real world, the traders considered cryptocurrency as an asset and thus, started buying and saving them like gold-biscuit trading.²⁷⁹

The intention of saving the coins was to sell when the value was high. This created another market with a reason to engage in cryptocurrency trading. The people hoarding bitcoins like a commodity also posed another challenge. The money flow was incomplete, and a shortage of bitcoins threatened inflation in their values, collapsing the demand-supply curve. This situation occurred because bitcoins were created in limited numbers to have their value determined by the demand-supply curve.

²⁷⁹ Akanksha Singh and Sharan Chawla, 'Cryptocurrency Regulation: Legal Issues and Challenges' (2019) 7(2) IJRRSS <<https://ijrrsonline.in/AbstractView.aspx?PID=2019-7-2-13>> accessed 1 May 2022.

The discourse meant that cryptocurrency suffered an identity crisis. There are several ways in which currency may be used as a commodity, such as trading it for other currencies and assets. Despite this, its major function is to allow communication between and among people. The cost of a shoe may be determined by comparing it to other unique products, such as maize, books, and more. Unlike a single currency, commerce from investments to the purchase of food, which has a positive effect on economic growth, is slowing down for the cryptocurrency which is matter of serious concern. Moreover, other currencies have an exchange value that is different from their use. Even if gold's utility value may be low, it serves as an excellent currency because of its high exchange rate. The value of a currency must remain somewhat stable. It becomes less effective at pricing exchanges when it swings too much. Currency may fluctuate, but it can't be so volatile that sellers and buyers are afraid to establish prices for products and services that are denominated in that currency. In the past, currencies have plummeted in value, resulting in political and economic instability. Rarely do they skyrocket in value at once. Modern currencies, which are not underpinned by a set quantity of gold, may or may not be valuable stores of wealth. As a result, currencies are supported by their ability to access and acquire goods and services in any country that issues them.

Since its inception, Bitcoin has not operated in the manner of a currency. The rapid rise in its value has sparked a great deal of concern. Healthy currencies don't raise questions for their users. Values may fluctuate, although not to the extent that every transaction becomes a risk.²⁸⁰ In this manner, Bitcoin has behaved like a commodity. There are times when commodity prices rise dramatically, but this is not the norm and commodities are not utilised as currency in most cases. Commodities are things that can be used and now after determining that bitcoin is a commodity, the next hypothesis to be tested is: what kind of commodity is it?

Market predictions, based on the usage value of an item, influence their exchange values.²⁸¹ The price of a Bitcoin is solely based on what people estimate it to be worth in the future. The value of the dollar is expressed in terms of other currencies and goods. Only in relation to the dollar can the worth of a Bitcoin be determined. What is important to

²⁸⁰ Nathan Reiff, 'Why is Bitcoin Volatile?' (*Investopedia*, 4 January 2022) <www.investopedia.com/articles/investing/052014/why-bitcoins-value-so-volatile.asp> accessed 1 February 2022.

²⁸¹ Craig Wright, 'Negotiable Instruments' (*Medium*, 2 July 2018) <https://medium.com/@craig_10243/negotiable-instruments-ad059d60f0e4> accessed 1 February 2022.

remember is that Bitcoin just has an economic advantage. It does not represent anything useful under the surface.²⁸²

Bitcoin futures are currently being traded on commodity exchanges.²⁸³ Any wager on anything is allowed since brokers are bookmakers and earn a percentage of every transaction, no matter how high or low it goes. Virtual code is a commodity that can only persist in digital form, and brokers are developing marketplaces for it.²⁸⁴ As with the dollar its worth is derived from the fact that it may be used as currency to buy goods and services. It all hinges on the desire of proprietors to accept Bitcoins in the United States (hereinafter “US”). That, in turn, is dependent on the stability of Bitcoin. Understanding the nature of a cryptocurrency is imperative as the Indian government has been revealing signs through its bureaucratic dissention towards cryptocurrency trading and private cryptocurrency exchanges for a long time. The Bill’s short title revealed India’s position on banning cryptocurrency. This also leaves a significant question behind: if India is aware that the virtual currency market has caught the attention of the Indian users, promoting such trade unless it is illegal should be the government’s duty.

If the government shows keenness in banning cryptocurrency, it would also pave the way for the possibility of the government introducing itself as a virtual currency trader. Only this time, the trader and the issuer of the virtual currency shall be the Indian government. The practice of crypto trading might appear to be new, but if cryptocurrency is perceived as a commodity, then India has long been involved in the trading of several assets and promoting mutual funds in this sector. Cryptocurrency would just be another fruit in the basket it would aspire to sell. Keeping the market flow under its control is what appears to be in the government’s best interests at the moment. This would necessitate a look into the countries that have legalised cryptocurrency trading or have welcomed the trade by legitimising virtual currency.²⁸⁵

²⁸² Warren (n 262).

²⁸³ Magnuson (n 257) 41.

²⁸⁴ Deepsekhar (n 270).

²⁸⁵ Jaideep Rao and Prashanth Jyoti, ‘A Study of Cryptocurrency in India: Boon or Bane’ (2019) 6(2) *International Journal of Emerging Technologies and Innovative Research* 412-17 <www.jetir.org/papers/JETIRZ006066.pdf> accessed 1 February 2022.

CRYPTOCURRENCY — POSITION IN FOREIGN JURISDICTIONS

United Kingdom²⁸⁶

Currently, there is no overarching legislation on cryptocurrency regulation in the United Kingdom (hereinafter “UK”). The Financial Conduct Authority (hereinafter “FCA”) awards licenses to regulated cryptocurrency-related enterprises, including crypto-exchanges, within the existing system. To get a license from the Financial Conduct Authority, these firms must follow a strict set of regulations. Those firms involved in trading cryptocurrency derivatives face the most stringent regulations. Cryptocurrency trades are taxed the same as any other currency trades in the United Kingdom. Cryptocurrency trading enterprises and cryptocurrency exchanges are taxed according to corporate tax laws. Nonetheless, the FCA is aware of the hazards associated with cryptocurrencies. Traders and venture capitalists in the UK have received similar cautionary messages from the Bank of England and RBI on a regular basis.

United States of America²⁸⁷

The US is akin to India in its dual legislative system in which the federal and state governments both have legislative authority. The US has a huge spectrum of regulations related to cryptocurrencies; however, the government has supported the idea of permitting all crypto trading and investment activities. New York, especially, is a prime example of a legislative atmosphere conducive to business. BitLicense is a licensing framework for regulating Bitcoin firms and exchanges. It was introduced in New York City in 2016. There is a licensing requirement for organisations that want to transfer or keep, purchase, or sell bitcoins under the new system. Except for the Wyoming Province, which excluded cryptocurrency inventors and dealers in 2018, all other states in the United States have favourable regulatory environments for the use of digital currency.

²⁸⁶ Ryan Browne, ‘Most Young Crypto Traders Don’t Realize it’s Not Regulated, UK Markets Watchdog Says’ (*CNBC*, 20 October 2021) <www.cnbc.com/2021/10/19/young-traders-treat-crypto-investing-like-a-competition-fca-says.html> accessed 1 February 2022.

²⁸⁷ Tanvi Ratna and others, ‘Blockchain Regulation in the United States: Evaluating the Overall Approach to Virtual Asset Regulation’ (*New America*, 2019) <<https://www.newamerica.org/fellows/reports/anthology-working-papers-new-americas-us-india-fellows/blockchain-regulation-in-the-united-states-evaluating-the-overall-approach-to-virtual-asset-regulation-tanvi-ratna/>> accessed 1 February 2022.

EUROPEAN UNION²⁸⁸

Some issues are handled by individual European Union (hereinafter “EU”) members, while others are handled at a pan-EU level, making its legislation a complex issue. So far, each EU state has regulated and governed cryptocurrencies in its own way, with the majority opting for a light-touch approach. Although the EU has recently been considering a unified framework for cryptocurrencies, this has not yet been implemented. It is expected that in 2022, the European Commission will issue a draught law titled ‘Markets in Crypto Assets Regulation’. As per the proposal, Bitcoin and other virtual currencies will be classified as financial instruments. Like other types of financial instruments, cryptocurrencies will require special clearance from the authorities before any company may hold or trade, provide brokerage services, or provide investment advice on cryptocurrencies. Coins of various forms, including crypto-assets, utility tokens, asset tokens, and e-money tokens, are considered in the draught law, which recommends distinct laws for each form of these tokens. China²⁸⁹

It’s been tumultuous for China in its relationship with cryptocurrencies. Since its inception, it was one of the most restrictive cryptocurrency trading places globally, specifically in regard to mining. About 75% of the global mining of cryptocurrency took place in China. A prohibition on cryptocurrency mining was imposed in September 2021 to reduce worldwide mining activities. It was already ordered that cryptocurrency exchanges be closed when China prohibited Initial Coin Offerings (hereinafter “ICOs”) in 2017. Legislators, on the other hand, have not forbidden or trading in cryptocurrencies, despite their major complaint being with ICOs. The Chinese government has shown a great deal of interest in blockchain technology and fostered the creation of blockchain start-up businesses. Chinese officials are already working on an official fiat cryptocurrency, the digital Yuan, expected to be released soon. Real-world testing of the cryptocurrency that would be controlled by the government has already begun.

The introduction of a virtual Yuan by China might also serve as an inspiration for India to introduce its own virtual cryptocurrency. This would also ensure the taxation and the ledgers would be under the control

²⁸⁸ ‘Cryptocurrency Regulations in the EU’ (*Comply Advantage*, 2020) <<https://comply-advantage.com/knowledgebase/crypto-regulations/cryptocurrency-regulations-eu-european-union/>> accessed 1 February 2022.

²⁸⁹ Alice Ekman, ‘China’s Blockchain and Cryptocurrency Ambitions: The First-Mover Advantage’ (*EUISS*, 2021) <<https://www.iss.europa.eu/content/chinas-blockchain-and-cryptocurrency-ambitions>> accessed 1 February 2022.

of the Indian government. Thus, the element of trust that fiat money commands over cryptocurrency will also prevail in that case.

Taxation will be the next concern, and India might want to look confident while looking ahead to other jurisdictions in managing cryptocurrencies under states' tax policies.

- a. Australia²⁹⁰ classified the cryptocurrency as intangible assets and had further amended its GST laws so that all crypto transactions can be covered under the GST premises.
- b. Brazil also suffers from a lack of regulation in this avenue, but the largest bank has taken its first step towards entertaining crypto transactions. Denmark discredited the status of currency for cryptocurrency and announced it would regulate the market. It imposed a taxing structure for every trade and income through cryptocurrency. However, crypto mining has been exempted from taxation policies to invite more miners and transform Denmark into a crypto haven.
- c. Thailand has totally abhorred cryptocurrencies, and any form of dealing in the currency is violation of the laws.
- d. The US has intentionally left the taxation part from regulating cryptocurrency transactions. This is to foster more business and encourage crypto flow as both money and commodity inside the US.

India does not recognise cryptocurrency as a legitimate instrument. This gives leeway to various law enforcement agencies and State departments, like the Enforcement Directorate (hereinafter "ED"), income tax authorities, and the RBI, to take appropriate action per their respective law for dealing with cryptocurrency as commodities/services of like nature. Likewise, the courts and police authorities deal with the subject under the India Penal Code, 1860. Given the myriad risks attached to cryptocurrency, the Government of India (hereinafter "GOI") and RBI continue to issue advisories, circulars and press releases for the benefit and risk assessment of the Indian investors.

With the growing trajectory of investment in cryptocurrencies within the territory of India, the GOI tried to tackle the subject with an ardently strict policy attitude. Although this means that cryptocurrencies cannot be considered legal in India, the country still allows multiple start-up

²⁹⁰ 'Cryptocurrency Regulation Around the World & How India Compares' *LiveMint* (8 November 2021) <www.livemint.com/brand-stories/cryptocurrency-regulation-around-the-world-how-india-compares-11636355438835.html> accessed 1 February 2022.

cryptoexchanges to function. Estimates show that India has over 200 blockchain start-ups²⁹¹ and over 15 million investors who hold around USD 1.3 billion in value of virtual currencies.²⁹² While the need for a robust regulatory framework is recognised, the licensing process stands protected, making it cumbersome to use some cryptocurrencies and related technologies.

In light of the precarious nature of the subject, the RBI, vide its circular dated 6 April 2018, banned institutional entities from engaging and providing their services to cryptobusinesses. The situation was remedied in the IMAI case²⁹³ by the Supreme Court of India vide its judgment dated 4 March 2020, allowing such businesses to operate within the nation. This following section shall attempt to study the regulatory position of India as it has evolved in the past few years and the battle of GOI to overcome the challenges it poses.

REGULATORY POSITION IN INDIA

Indian law first recognized cryptocurrencies vide circulars in the nature of warnings issued by the RBI from 2013²⁹⁴ through 2017²⁹⁵, cautioning the investors/potential investors of the varied risks they could be exposed to in dealing with cryptocurrency. Vide circular dated 5 April 2018²⁹⁶, the RBI expressed the need to study the desirability of introducing a Central Bank Digital Currency (hereinafter “CBDC”). Counterintuitively, the same circular also restricted banking and non-banking financial institutions and payment system service providers, i.e., all entities regulated by RBI from dealing in or settling or providing

²⁹¹ Apoorva Komarraju, ‘The Latest Update about Cryptocurrency Regulations in India’ (*Analytics Insight*, 31 May 2021) <www.analyticsinsight.net/the-latest-update-about-cryptocurrency-regulations-in-india/> accessed 1 February 2022.

²⁹² V Parikh and Jaideep Reddy, ‘The Virtual Currency Regulation Review: India’ (*The Law Reviews*, 2 September 2021) <<https://thelawreviews.co.uk/title/the-virtual-currency-regulation-review/india>> accessed 1 February 2022.

²⁹³ *IMAI* (n 266).

²⁹⁴ Reserve Bank of India, ‘RBI Cautions Users of Virtual Currencies against Risks’ (24 December 2013) <https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=30247> accessed 1 February 2022.

²⁹⁵ Reserve Bank of India, ‘RBI Cautions Users of Virtual Currencies’ (1 February 2017) <<https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR205413F23C955D8C45C4A1F56349D1B8C457.PDF>> ; Reserve Bank of India, ‘Reserve Bank Cautions Regarding Risk of Virtual Currencies Including Bitcoins’ (5 December 2017) <<https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR15304814BE14A3414FD490B47B0B1BF79DDC.PDF>> accessed 1 February 2022.

²⁹⁶ Reserve Bank of India, ‘Statement on Developmental and Regulatory Policies’ (5 April 2018) <www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=43574> accessed 1 February 2022.

any services to any person or entity in relation to transactions facilitating any usage of virtual currencies. The aforementioned regulated entities were mandated to exit their relations with any such customers within three months of the circular dated 6 April 2018.²⁹⁷ This circular was challenged before the Supreme Court of India in the IMAI case.²⁹⁸ As the investor attraction towards cryptocurrency grew, the GOI, in November 2017, constituted a high-level Inter-Ministerial Committee (hereinafter “IMC”), under the chairmanship of Mr. Subhash Garg, to assess and evaluate the issues of dealing in virtual currencies and the way forward. The key recommendations of the IMC report submitted on 28 February 2019 included.²⁹⁹

- i. Virtual currencies could hold a ‘form of value’ but did not have the ‘status of legal tender’;
- ii. There is need for a committee to study and cultivate an apt ‘model of digital currency’ for India. Such a committee should have representatives of RBI, Ministry of Electronics and Information Technology, and Ministry of Finance;
- iii. Except the ones issued by the State, a blanket ban on all private cryptocurrencies in India. Any activity connected thereto shall stand criminalized under law;
- iv. The requirement for substantial infrastructural investments to cater to logistical and technological needs such as high electricity consumption and internet connectivity issues;
- v. The high utility of Distributed Ledger Technologies for fraud detection, know-your-customer (hereinafter “KYC”) processing, insurance claim management, etc. Measures should be taken to facilitate usage of the same;

IMC also proposed a draft bill, ‘Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019.’ The bill attempted to define the term ‘cryptocurrency.’³⁰⁰ It also sought the ban and criminalization of all acts pertaining to them. These included being used as

²⁹⁷ Reserve Bank of India (n 265).

²⁹⁸ *IMAI* (n 266).

²⁹⁹ ‘Draft Banning of Cryptocurrency & Regulation of Official Digital Currency Bill 2019’ (*PRS India*) <<https://prsindia.org/billtrack/draft-banning-of-cryptocurrency-regulation-of-official-digital-currency-bill-2019>> accessed 1 February 2022.

³⁰⁰ Banning of Cryptocurrency and Regulation of Official Digital Currency Bill 2019, s2(1)(a).

a payment system, medium of exchange; or providing services such as selling, trading, registering it to individuals or with other currencies; or using it as an investment, credit, or financial product; or as a means of raising or acquiring funds, etc. The draft bill provided the penalty for its violation in the nature of fines and/or imprisonment extending upto 10 years. The bill faced a lot of industry resentment and opposition including from National Association of Software and Services Companies (hereinafter “NASSCOM”). The critique from NASSCOM was on the point of not offering any particular solutions to deal with the bill’s cons, nor allowing for any constructive measures to protect the investors instead of placing an umbrella ban.

In January 2020, NITI Aayog published its draft strategy paper ‘Blockchain: The India Strategy, towards Enabling Ease of Business, Ease of Living, and Ease of Governance.’³⁰¹ A blueprint for blockchain technology’s adoption was proposed to iron out the hiccups and inefficiencies that crop up in the business and governance processes in dealing with such technological advances. Not only have cryptocurrencies been recognized as tokens which are a key component of majority public blockchains, they have also been classified as an ‘unique asset class’ that shape up as basic units of value exchange, and direct towards ownership of the network as is the case of shares in a company. Providing much-awaited respite to the investors and cryptocurrency enthusiasts, earlier in March 2020, the apex court in the IAMA case³⁰² recognized cryptocurrency as a form of intangible property. The court enunciated that an umbrella ban on cryptocurrency would be tantamount to unreasonable and disproportionate restriction on the fundamental right guaranteed under Article 19(1)(g)³⁰³ of the Constitution of India. This was in alignment with the Court’s positions in *Rustom Cavasjee Cooper v Union of India*³⁰⁴ where it was held that commercial activities like mining crypto-assets, buying and selling crypto-assets, or bartering crypto-assets by individuals is an exercise of their fundamental right under Article 19(1)(g) and constitutional right under Article 301. Similarly, the verdict abided by the rationale given in *K.S. Puttaswamy v Union of India*³⁰⁵ upholding the right to make decisions autonomously, and *Indian Hotel and Restaurant Assn. v State of Maharashtra*³⁰⁶ sustaining the right to be free from State’s arbitrary and discriminatory actions, etc. The RBI, at the crest of January

³⁰¹ NITI Aayog, ‘Blockchain: The India Strategy’ (January 2020) <www.niti.gov.in/sites/default/files/2020-01/Blockchain_The_India_Strategy_Part_1.pdf> accessed 1 February 2022.

³⁰² *IAMA* (n 266).

³⁰³ The Constitution of India 1950 (n 267).

³⁰⁴ *Rustom Cavasjee Cooper v Union of India* (1970) 1 SCC 248.

³⁰⁵ *KSPuttaswamy v Union of India* (2017) 10 SCC 1.

³⁰⁶ *Indian Hotel and Restaurant Assn v State of Maharashtra*(2019) 3 SCC 429.

2021, released ‘Payments and Settlement Systems in India, Journey in the Second Decade of the Millennium 2010-2020’³⁰⁷ wherein it recognized CBDCs as electronic currencies which are “*a legal tender and a central bank liability in digital form denominated in a sovereign currency and appearing on the central bank’s balance sheet.*”³⁰⁸ The said booklet spoke of the likelihood of the central bank rolling out its own digital currency. Following this, the Ministry of Corporate Affairs vide its notification dated 24 March 2021, rolled out an amendment in Schedule III of the Companies Act, 2013. The said amendment requires in clear terms for companies to declare the following information with effect from 1 April 2021:

- i. All transactions of profit and loss pertaining to cryptocurrencies;
- ii. As on the date of reporting, the total value of cryptocurrency held by the companies;
- iii. All advances and/or deposits made by any individual for investment or trade in cryptocurrency.

Settling the dust over the legality and ban on transactional and allied activities pertaining to cryptocurrency, vide circular dated 31 May 2021,³⁰⁹ the RBI issued clarification for banks and other regulated entities to not act under its previously restrictive circulars of 6 April 2018 given the stance of Supreme Court in the IMAI case. The said circular also emphasized the need to carry on ‘customer due diligence processes’ by banks and other regulated entities in coalition to their obligations under the Prevention of Money Laundering Act, 2002 (hereinafter “PMLA”). These processes should be in alignment to the regulations governing standards for Anti-Money Laundering (hereinafter “AML”), KYC, Combating of Financing of Terrorism (hereinafter “CFT”), along with satisfying compliance with appropriate provisions regarding overseas remittances under Foreign Exchange Management Act, 1999 (hereinafter “FEMA”).

³⁰⁷ Reserve Bank of India, ‘Payment Systems in India: Journey in the Second Decade of the Millennium’ (25 January 2021) <<https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/PSSBOOKLET93D3AEFDEAF14044BC1BB36662C41A8C.PDF>> accessed 1 February 2022.

³⁰⁸ *ibid* 111.

³⁰⁹ Reserve Bank of India, ‘Customer Due Diligence for Transactions in Virtual Currencies (VC)’ (31 May 2021) <<https://rbidocs.rbi.org.in/rdocs/notification/PDFs/45VIRTUALCURRENCIES37FE644EF97F4A36AAB951C73A411E96.PDF>> accessed 1 February 2022.

A bird's eye view would suggest India's softening stance towards cryptocurrencies. This can also be evidenced by GOI's listing of a proposed Bill on the Lok Sabha Bulletin dated 29 January 2021 under the title 'Cryptocurrency and Regulation of Official Digital Currency Bill, 2021'.³¹⁰ Though the Bill was not available in the public domain, the Finance Minister presented the Finance Bill, 2022³¹¹ before the Parliament, indicating the treatment of cryptocurrencies under the umbrella of 'virtual digital asset' by way of inserting new clause 47A of Section 2 of the Income Tax Act, 1961.³¹² The new development confirms that India is about to step up its ambitions of enabling the decentralised finance ecosystem, with RBI introducing its 'official digital currency' by 2023. Speculation on the ban on the use of private cryptocurrencies still remains in sight. However, it is predicted that a cushion will be provided to investors who may be given anywhere between 3 to 6 months to withdraw their investments therein.

THE GROUND REALITY OF DEALING IN CRYPTOCURRENCY IN INDIA

While the regulatory tide seems to be turning in favor of crypto investors and enthusiasts, there remains a vast web of legal lacunae that needs to be addressed. This chapter deals with broad regulations that incorporate within their scope regulation of cryptocurrencies.

Challenges under securities and investment laws

We can venture into the question if virtual currencies should be treated as securities under the Securities Contracts (Regulation) Act, 1956 (hereinafter "SCRA"), which gives out a non-exhaustive definition of securities.³¹³ Virtual currencies do not hold any underlying assets. Instead, its value is determined by demand and supply in the market. Also, contrary to the Indian law's circumference on the definition of securities, they do not even have an identifiable issuer, ownership rights, credit relationships or investment in a common enterprise. The lack of these components makes it difficult for virtual currency to be covered within the definition of securities.

³¹⁰ 'Lok Sabha Bulletin Part-II' (29 January 2021) <<http://loksabhadocs.nic.in/bull2mk/2021/29012021.pdf>> accessed 1 February 2022.

³¹¹ The Finance Bill 2022, Lok Sabha, Bill No 18 (2022) <www.indiabudget.gov.in/doc/Finance_Bill.pdf> accessed 1 February 2022.

³¹² Income Tax-Act 1961, s2 (47)(A).

³¹³ Securities Contracts (Regulation) Act 1956, s 2(h).

Further, a study of the scope of deposit under the Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014 determines that receipt of virtual currency does not trigger these regulations. In fact, the Banning of Unregulated Deposit Schemes Act, 2019, remands the virtual currency token issuers to remain outside the scope of this Act³¹⁴ and ensure that no money received there under is liable to be returned under unregulated deposit schemes.³¹⁵ Another question that arises is if virtual currencies can be regulated as a good or commodity under FEMA. This was also tackled by the apex court in the IAMAI case,³¹⁶ which answered that virtual currency is an intangible property that may be treated as money under specific circumstances. It can be suggestively argued that in case we treat virtual currencies as commodities under FEMA, then carrying on operations as exchanges for the purpose of trading virtual currencies may well fall within the regulatory bounds of a ‘commodity exchange’. This would, in turn, invoke provisions of inward foreign direct investment (hereinafter “FDI”) under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (hereinafter “the NDI Rules”).

However, the NDI Rules make it abundantly clear that virtual currencies do not stand within the meaning of commodities under them, ergo, cannot be regulated via this route. Furthermore, the GOI notification dated 26 September 2016³¹⁷ read with the SEBI circular dated 28 September 2016³¹⁸ does not include virtual currencies in the list of goods to be linked to commodity derivatives under SCRA. Thus, there seems to be an invisible intra-legislations catch game to determine where virtual currencies will fall for regulation and control.

We also find a gap in determining the application of FDI Rules on the virtual currency-based businesses based out of India. The IAMAI case³¹⁹ did sponsor jurisdiction to RBI over matters pertaining to virtual currencies, given its recognition of virtual currencies as money under specific circumstances. It remains ambiguous whether virtual currency businesses would stand restricted in their operations since they would fall under the cadre of ‘other financial services’ within the NDI Rules. However, given the clarity on RBI having regulatory oversight, the IAMAI case sufficiently answers that FDI shall be permitted without the government approval route.

³¹⁴ Banning of Unregulated Deposit Schemes Act 2019, s 2(4).

³¹⁵ *ibid.*

³¹⁶ *IAMAI* (n 266).

³¹⁷ Ministry of Finance, Department of Economic Affairs Notification (27 September 2019) <<https://egazette.nic.in/WriteReadData/2016/171934.pdf>> accessed 1 February 2022.

³¹⁸ SEBI, ‘List of Commodities Notified under SCRA’ (28 September 2016) <https://www.sebi.gov.in/sebi_data/attachdocs/1475059402243.pdf> accessed 1 February 2022.

³¹⁹ *IAMAI* (n 266).

Challenges under banking and money transmission

This paper has indulged in the regulatory disarray on the prohibition of transacting in/with virtual currencies, as discussed in the previous section detailing the RBI notifications and IAMA I judgment. We proceed to stir the regulatory gaps of the Payment and Settlement Systems Act, 2007 (hereinafter “PSSA”) or if virtual currencies fall under the mandate of any compliance under the PSSA. If operations in virtual currency fall within Section 2(1)(i)³²⁰ of the PSSA, any individual operating the same shall need the authorization of RBI under Section 4(1)³²¹ of the PSSA. The PSSA refers to the term payment instead of using currency or legal tender, which by implication, does not exclude virtual currencies.

However, there exist multiple virtual currencies that do not form part of a system. Instead, the transaction would resemble the sale and purchase of an asset. Another issue that crops up is the value basal of virtual currencies. They are not backed by the issuing entity or any other party, which signifies their inability to be treated as a payment system under the PSSA. Further still, the decentralised character of virtual currencies makes it practically impossible to trace the issuers of the virtual currencies responsible for commencing the systems.

We do, however, come across a counter argument to the legion of loops stated above. Considering that the technology at play, in giving effect to a virtual currency transaction, ultimately facilitates the transfer of value from person to person, it may well form a payment system. This system, in turn, leans on the operating or commencing entity to procure authorisation under the PSSA and thereby be subject to regulation thereunder.

It is significant to mention here that in the IAMA I case, the RBI vide its submissions before the Supreme Court, has declared that virtual currencies operations and transactions do not tantamount to being a payment system under the PSSA.

Challenges under anti-money laundering laws

It is a well-documented threat that the anonymous nature of virtual currencies makes them formidable to be tracked by regulators across the globe. This regime of untraceability has alarmed the State authorities,

³²⁰ The Payment and Settlement Systems Act 2007, s (1)(i).

³²¹ The Payment and Settlement Systems Act 2007, s (4)(i).

who have been cautioned to navigate the flow of funds possibly being used for money laundering and other criminal purposes.

At present, we can find a range of RBI directions and a spectrum of broadly applicable legislation that set out the requirements for maintaining the standards of KYC and AML norms for all entities falling under their purview. These norms apply to all such entities and businesses regulated by RBI, SEBI, and such other regulators.

However, we have yet to come across an overt application of any of such norms on virtual currency-based businesses aside from those entities which are otherwise regulated as financial institutions. It would still seem advisable for virtual currency-related businesses to fall in line with customer due diligence processes, KYC, and AML norms mirroring the best practices followed by regulated entities and businesses. Such compliance would prove to be a determinant factor in growing regulatory framework by voluntarily assisting in investigations and partaking in the onus of direct liability.

While there is no specific law pointing to such a mandate, the ED has rained down on businesses and entities who have tried to flout provisions of PMLA, 2002 using the cryptocurrency route, including the infamous cases of Raj Kundra,³²² Amit Bhardwaj,³²³ Naiser Kothari,³²⁴ etc.

CONCLUSION

As India's 2022 Budget announced that the government's own cryptocurrency, the 'Central Bank Digital Currency' will be regarded as banknotes,³²⁵ it presented a case of the government's willingness to consider CBDC as a currency. While referring to its inserted inclusion of a definition of virtual digital asset, insub-clause 47A under Section 2 of the Income Tax Act, 1961,³²⁶ a subsequent observation of how the government considers cryptocurrency at all, in its dual purpose, is revealed. The government has not only joined the 'crypto-verse' race before several developed nations at the regulatory level, but has also conveyed its intention to

³²² 'ED Grills Raj Kundra in Bitcoin PMLA Case' *The Statesman* (14 November 2021) <www.thestatesman.com/business/ed-grills-raj-kundra-bitcoin-pmla-case-shilpa-shetty-1502644694.html> accessed 1 February 2022.

³²³ *ibid.*

³²⁴ 'ED Arrests a Crypto-Currency Trader Under PMLA' (*United News India*, 11 December 2019) <www.uniindia.com/ed-arrests-a-crypto-currency-trader-under-pmla/india/news/2260925.html> accessed 1 February 2022.

³²⁵ Finance Bill (n 311) 270.

³²⁶ *ibid.*

exhaustively cover all segments of a crypto-asset. It further aims to give itself the power to include/exclude subsequent technologies built on the blockchain technology. As the present narrative is guided by the government officiating its plans to regulate digital payments in a bid for cheaper currency management,³²⁷ the next two months will divulge how the government is willing to take the approach forward. The finance minister communicated the idea to commence the issuance of digital currency from the Financial Year 2022-23. How the government will co-manage separate ledgers under the same regulatory head (RBI), only due course of time will reveal.

While the Supreme Court, in IMAI case³²⁸ accorded relief to the crypto-asset activities against the RBI circular on 'virtual currencies', it is apparent that cryptocurrency is undergoing a tumultuous regulatory embargo in India. Considering the increasing traffic of cryptocurrency being transacted by the Indian citizenry and to cater to this perplexing situation, the government has introduced CBDC and has revealed its plans to regulate the space, including other crypto-assets like the new and sensational Non-Fungible Tokens. The introduction of Section 2(47A) is critical to further the Indian government's agenda to proceed as a machinery before private players command the market. With the situation being novel, it is incumbent to study the gaps within the existing setup and its certificatory proposal and analyse plausible outcomes.³²⁹

The Finance Bill carries provisions to tax the income generated through cryptocurrency trading. There are several open-ended questions on what private cryptocurrencies would be banned and retained, which taxation head will the income come under, will there be different heads used for incomes generated through cryptocurrency as asset and as currency, the challenges to identify individuals since the blockchain technology pseudonymizes the transactor's identity, etc. As the finance minister has explained that the government will lead and facilitate the CBDC transactions,³³⁰ it will be interesting to witness the proactive engagement by the RBI to involve a decentralized ledger technology into its centralized structure of ledger system. Although India urgently requires laws

³²⁷ Sneha Kulkarni, 'Digital Rupee to be Introduced by the RBI: Budget 2022' *The Economic Times* (1 February 2022) <<https://economictimes.indiatimes.com/wealth/personal-finance-news/digital-rupee-to-be-introduced-by-the-rbi-budget-2022/article-show/89267150.cms>> accessed 1 February 2022.

³²⁸ *IMAI* (n 266).

³²⁹ Manish Kumar, 'New Law Set to Transform Cryptoverse and How' *The Economic Times* (4 September 2021) <<https://economictimes.indiatimes.com/markets/cryptocurrency/new-law-set-to-transform-cryptoverse-how/articleshow/85924303.cms>> accessed 1 February 2022.

³³⁰ Sneha (n 327).

to accept and legitimise cryptocurrencies, the introduction of Section 2(47A) could hinder its development or result in a regulation made in haste. Blockchain technology carries the potential to revolutionise both the finance and technology sectors. As the world expects India to become the next industrial giant, it could open new horizons for the nation on both financial and technological fronts. Being a huge IT colossus, India cannot avoid being involved in the emerging field of cryptocurrency and blockchain technology. The Finance Bill 2022 reveals the elusive plan to embrace a cashless or cash deficit economy in a short period of time using cryptocurrencies.