



Crypto-Currency: Legality and Enforceability in India

1Komal Chowbey, 2Saket Anand

1Student of BBA LL.B 5th year, 2Student of BBA LL.B 5th Year

1Faculty of Law, Banasthali Vidyapith, Tonk, Rajasthan, India,

2University Institute of Legal Studies, Chandigarh University, Mohali, Punjab, India

Abstract

"Necessity is the mother of invention" and the incredible came with innovation. The need to regulate the thing and test the same on the benchmark of national integration and economic feasibility arose with the emergence of a new innovation. One of the world's biggest incredible innovations has been the birth of Crypto-Currencies. Crypto-Currencies are kind of digital money, that depends on distributed networks plus public ledger to integrate the key concepts of cryptography with the monetary network to build a Virtual Currency that is private, identifiable, reliable and potentially secure. In India Crypto-Currencies perhaps not be much of a peril to fiat Currency, but with regard to the Crypto-Currencies, India cannot be ignored. One of the impediments confronted by the Indian economy is the perceived risk regarding legitimacy of Crypto-Currencies. The paper aims to understand the status of Crypto-Currencies in India and to analyse present Indian laws applicable on Crypto-Currencies.

1. Introduction

On October 31, 2008, a paper entitled *"Bitcoin: A Peer-to-Peer Electronic Cash System"* was presented by Satoshi Nakamoto, a presumed pseudonym¹. The intent was to build a decentralized digital Currency that would execute devoid of a central bank, using cryptography to verify and validate transactions through an open-sourced network. Under this model no intermediaries would be needed, and each transaction would be recorded on a public ledger called a block-chain. Last since 1983, when an American cryptographer David Chaum presented *"e-cash"* anonymous digital cryptographic money, many people had attempted to develop an alternative to paper Currencies that get their value by the Government regulation. But Bitcoin's invention was the first time it had made a real discovery.

¹Satoshi Nakamoto, "Bitcoin: A Peer-to-Peer Electronic Cash System" *Bitcoin* Oct. 31, 2008. <https://bitcoin.org/bitcoin.pdf>. (last visited on June 14, 2020, 12:39 PM)

Since then, several other Crypto-Currencies have arisen, all using block-chain technology to witness the transactions. In June 2019 the Facebook declared that it proposed to launch its open form of Crypto-Currency, “Libra”. In India, several Crypto-Currency exchanges began operating after the launch of Bitcoin. Although they all were functioning in what was really a regulatory space.

2. What are Crypto-Currencies?

Crypto-Currencies are a special form of digital Virtual Currency that can be exchanged as an asset or else used as a Currency via a public ledger online, usually acknowledged as block-chain, that maintains a record of all the Crypto-related transactions that have ever been made and the entire network of the individual node / user or computer keeping a copy of the ledger is shared and agreed upon. Crypto-Currencies’ transactions through block-chain are decentralized and secured by a method of cryptographic encryption. Usually, each newly generated block in the block-chain is verified in a transaction involving Crypto-Currencies and is permitted by each node/user upon being verified, which helps to make it approximately highly impossible to forge entries made in every transaction.

3. Developments of Crypto Currencies

The Crypto Currencies have got tremendous popularity throughout the world to provide expeditious, decentralized and anonymous transactions and have been one of digital currency / assets most widely used, accepted and intriguing. Decentralization would assume there’s no central authority where transaction records are kept and on the contrary, transaction data will be recorded and shared via a distributed ledger technology usually acknowledged as the block chain across multiple distribution networks.

Handling of Crypto Currencies in different jurisdictions

Countries have given virtual currency different legal status worldwide. The New York provides crypto-assets to be used as payment methods subject to the superintendent’s registration and licensing requirements in accordance with federal legislation, and as investment alternatives pursuant to the Securities and Exchange Commission regulation and supervision, that has stated that it recognizes Crypto-Currencies as securities. Further, Commodity Futures Trading Commission has regulated virtual currencies as commodities and will continue to regulate it in the USA.

Conversely, China² forbids all sorts of transaction in such Crypto Currencies. Notably though, China enacted a law on cryptography to address emerging regulatory and legal challenges in the use-cases of commercial cryptography. Broadly, the said legislation requires that all state secrets be secured and transferred utilizing “core and common” encryption, and that organizations operating on cryptography have to set up “management systems” that warranty the safety of that encryption.

² Jon Fingas, “China passes law regulating data encryption”, *Engadget*, Oct. 27, 2019, <https://www.engadget.com/2019/10/27/china-cryptography-law/>. (last visited on June 14, 2020, 02:19 PM)

According to the International Monetary Fund, the definition of money is (i) a medium of exchange and/or (ii) a unit of account and/or (iii) a store of value. It is to be noted that as of a date no country across the world treats Virtual Currencies as “*legal tender*” but there is a harmony of opinion amid all the regulators and the governments of different Countries that although Virtual Currencies haven’t obtained the status of a legal tender, they however constitute digital representations of value and that they are competent of carrying out as (i) a medium of exchange and/or (ii) a unit of account and/or (iii) a store of value.

4. Overview of International scenario

How Crypto-Currency is disruptive to global economy

Fewer barricades to entry

There are hardly any impediments to Crypto-Currency investment or trading. As more and more individuals get engaged in the crypto-world, more tools and software are available to lend a helping hand. One of the several tools, for example, is the Bitcoin Code System, a Crypto-Currency trading system which can deliver a remarkable return on the investment. It can help you get started from 0 with its help option and give you information and tips where required, with its assistance option.

No middleman

The best aspects of using Crypto-Currency as a comparison to the traditional banking system, when you transfer your Crypto-Currency coins, authorization or authentication are no longer required. And the transfer fees are subsequently marginal. This is where banks fall short and have a trouble competing.

Replacing cash

One of Crypto-Currency’s by-products is completely substituting cash. As a consequence, we are inching closer to an absolutely cashless society. People are moving from cash to debit cards to Crypto-Currency towards a more efficient payment method.

A new age of Crowd funding

The crowd funding process has been cut down with the Crypto-Currencies and block-chain technologies. As of 2017, ICOs have been the leading crowd funding tools. ICO represents Initial Coin Offering. Nowadays, entrepreneurs don't need business saints to finance their projects or venture capitalists.

Challenging the USD

The global economy depends on the USD. It's a reserve Currency of the world economy. The USD is up to a big challenge with Bitcoin on the road. With most of the transactions, Crypto-Currencies keep the high ground and the US dollar is losing in this battle. Crypto-Currencies seem to deal with the de-dollarization process, shifting the global economy.

Crypto-Currency and international trade law

Crypto-Currencies have both positive and negative impacts on the international trade.

The positive impact Virtual Currencies on international trade are following-

- As Crypto-Currencies & block-chain don't need any an actual brick-and-mortar structure to operate, there was a very significant cost of international transactions prior to implementing Crypto-Currency, but today because this Currency is available to the global economy in a Virtual mode; the transaction fee persists very marginal. Additional, it's a peer-to-peer transaction and thus no taxes subsist.
- Secure Payment- There is a regulated payment platform which regulates all outs as well as in-payment. Parties conducting the money transfer via Crypto-Currencies are mandated to have cash available in advance to avoid the possibility of transaction bouncing concerns.
- Amplified Transparency of Transactions-As all transactions in block-chain technologies are encrypted and digitized, they all are recorded in a distributed ledger. The best thing about distributed ledger is that neither individuals nor corporations can exploit it. That indicates underdeveloped Countries are also more likely to enter the financial game.
- Great Opportunities for Poorly Banked Countries-More than a quarter of the world's population has no access to adequate banking facilities that can bail them out in the event of personal financial crisis-loans, etc. Such individuals who are already financially vulnerable in most situations usually have access to risky and harmful lending activities. The interest rate of all these activities is anything but equal, which contributes to greater uncertainty among the people who asked for the loan. That's where Crypto-Currencies and its high volatility and ease of use come in.
- A Beneficial Rise in Economic Activities-There's already a whole industry construct around Crypto-Currencies also it is held by institutes enthusiastic to manage all the Virtual Coin exchanges taking place all through the globe. The speed with which the Crypto-Currency is rising is earth shattering, and early adopters who became wealthy rapidly and found opportunities to grow financially will confirm this. Bitcoin, the most prominent of such Crypto-Currencies, has already allowed for the growth and flourishing of many people and businesses, although many depend also on trading as their income source. The economy is gradually evolving to accommodate those needs, and Crypto-Currencies have great potential to meet them.
- During an international trade transaction, an individual has had to deal with suppliers and buyers from various Countries, which is why the exchange rate is problematic. The Currency of each nation has different values and different exchange rates compared to the Currency of another nation. In such a controversial circumstance, Crypto-Currency provides a basic rate that is recognised by

approximately all the trader in international transfers. Individuals use same Currency so there is no question of the exchange rate.

- It takes barely 10 minutes to verify payment in the block-chain, and therefore money moves quite speedily from suppliers to customers.
- As explained above, all transactions made by using Virtual Currency as a payment method are kept in the record. These records may be inspected and rechecked by parties at whatever time.

The negative impact Virtual Currencies on international trade are following-

- Some Crypto-Currencies are not valid as well as legitimate in certain Countries. This causes a problem while dealing with any person in those Countries. If a person accepts these Currencies, he or she will be responsible for illegal trade transactions.
- Crypto-Currency isn't a physical object, and the value of the same thing remained unclear. However, such Currencies may be even more beneficial than a gold coin, as well as situations may be just unfavourable and therefore suggest that there is ambiguity about the value of same. People aren't fully aware of the notion of crypto Currency.

Impact of crypto Currency on international Trade law

Many of the Countries are involved in an international transaction. The main concern relating to Crypto-Currency in international transfers is taxation. Every nation has different tax codes, and it is common to verify whether a transaction is eligible for tax. Through use of Crypto-Currency is challenging these international laws. Security legislation is another area of concern.

5. Indian scenario

The Crypto Currencies are controversial and speculative and have been recognised with a subatomic eye by government bodies of different jurisdictions. India was no exception to this steer, in November 2017, the Inter-Ministerial Committee was established under the chairmanship of Shubash Chandra Garg (Secretary, Department of Economic Affairs) to study Virtual Currency issues and propose specifications. The Inter-Ministerial Committee report analysed the impact of Crypto-assets / Currencies on multiple variables such as regulation, legal tender or mode of payment, as an exchange token, enforceability and investment preferences in different jurisdictions. It recommends every Private Crypto-Currency, except any Crypto-Currency approved by the state government, shall be prohibited in India because of its high volatility and also as there is no fundamental intrinsic value thereof³.

³Department of Economic Affairs, "Report of the Committee to propose specific actions to be taken in relation to Virtual Currencies", (Ministry of Finance 2019), <https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf> (last visited on June 15, 2020, 01:35 PM)

Perhaps there was an obvious inconsistency in the government directives. The Inter-Ministerial Committee, primarily recommended a specific framework namely, “*Crypto-token Regulation Bill 2018*” moreover was of the view that a forbid may be an intense tool also that the same purposes may be accomplished by regulatory measures, on the contrary in July 2019, the Inter-Ministerial Committee released its report and proposed a “*Banning of Crypto-Currency and Regulation of Official Digital Currency Bill, 2019*” and criminalized carrying out any activity associated with Crypto Currencies in India, including mining, buying, selling or storing Crypto Currencies, and their use as a means of raising funds or for investments.

Digital Currency for India

The notion of Central Bank Digital Currency (CBDC) was proposed in the third chapter of the report of Inter-Ministerial Committee which states that the “*Digital Rupee*” is India's only Crypto-Currency with the following main attributes⁴-

- a) The Central Bank issues it.
- b) Besides cash and reserve money it is a third variant and
- c) It might represent as a competitor to cash and bank account money.

CBDC allows transferring to different categorizations including such peer-to-peer transmission, account-based and value-based.

Subsequently, in April 2018, the RBI, introduce a Notification⁵, directed all RBI regulated entities not to cope with or even provide “*services*”⁶ in Crypto-Currencies to facilitate any person or organization in dealing with or else settling Crypto-Currencies. Previous to the notification the banks in India offered current account amenities as well as investors transferred the money to exchange platforms as well as received money from them via the bank services.

Grounds for the ban of Crypto-Currencies

RBI's key reason is to defend its investors, as Crypto-Currency lacks any built-in value moreover provides confidentiality to its holder. According to news reports, the RBI is determined to “*ring-fence gullible investors and lenders from scams, several of which have happened internationally*”. Considering the nature of Crypto-Currency, an obligation of “*know-your-customer*” regulations by itself doesn't help to reduce the potential risk of fraudulent transactions, as it's difficult to determine the actual Crypto-Currency holder.

In fact, an unverified holder has other problems, like insufficient remedy available in the event of illegal activity, because the accused has to be an “*identifiable party*” for the Courts to call for such illegal activity as well as hold it responsible. Whilst any Currency, including fiat Currency, could therefore facilitate illegal

⁴*Ibid.*

⁵“Prohibition on dealing in Virtual Currencies”, *Reserve Bank of India*, No. DBR. No. BP. BC. 104 /08. 13.102/2017-18, April 06, 2018, <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11243>. (last visited on June 16, 2020, 11:30 AM)

⁶*Ibid.*“The said “services” include maintaining accounts, registering, trading, settling, clearing, giving loans against Virtual tokens, accepting them as collateral, opening accounts of exchanges, dealing with them and transfer or receipt of money in accounts relating to purchase or sale of Crypto Currencies”.

transactions and tax evasion, Crypto-Currency might go yet another step further and safeguard a party involved in such activities, making common owners susceptible.

The lack of control exercised by central authorities over Crypto-Currency is a quoted reason for resentment by governments / regulators linked with investor protection. While making the banking system superfluous may not seem problematic immediately, regulatory authorities concern that if a payment is hacked or there is a failure to deposit money due to a technical failure, an investor would have no recourse.

An analysis of the proposed Bill “*Banning of Crypto-Currency and Regulation of Official Digital Currency Bill, 2019*” (hereinafter referred to as “*Bill*”)

The Bill is alienated into two main parts, First “*Prohibits of Crypto-Currency*” and Second, “*Regulates Official Digital Currency*”

- Prohibition of Crypto-Currency-

Section 2(1) (a) of the Bill defines Crypto-Currency⁷. This definition comprise all the well-known Crypto-Currencies i.e. - Bitcoin, Etrereum, Zcash, Moneo, and other 2119 private Crypto-Currencies. It restricts anyone who directly or else indirectly mines, produces, retains, sells, trades, transfers or disposes of or issues Crypto-Currency shall be punished by imprisonment not less than one year but up to 10 years or fine or both⁸. On the other hand, the bill permits the use of technology or processes underlying any Crypto-Currency for experimental or research purposes, such as providing instructions to students as long as no Crypto-Currency is used to make or receive payment in such activity⁹.

- Regulation of Digital Currency

This portion not just regulates the legal tender for Indian Digital Currency, but moreover identifies as well as regulates the official Foreign Digital Currency as a Foreign Currency in accordance with the regulation approved by RBI in compliance with the provisions of the Foreign Exchange Management Act, 1999¹⁰.

This Bill is contrary to the spirit of the current meeting of G20 Finance Ministers, in which India showed harmony at the meeting with rest of the nations to legalize crypto-assets and apply the recently modified Financial Action Task Force Standards on Virtual Currencies as well as associated anti-money laundering providers and counter-terrorism financing.

⁷Banning of CryptoCurrency and Regulation of Official Digital Currency Bill, 2019, Section 2(1)(a), 2019. “As by whatever name called, means any information or code or number or token not being part of any Official Digital Currency, generated through cryptographic means or otherwise, providing a digital representation of value which is exchanged with or without consideration, with the promise or representation of having inherent value in any business activity which may involve risk of loss or an expectation of profits or income, or functions as a store of value or a unit of account and includes its use in any financial transaction or investment, but not limited to, investment schemes”.

⁸ Banning of CryptoCurrency and Regulation of Official Digital Currency Bill, 2019, Section 8 of the Bill (2019), https://www.prsindia.org/sites/default/files/bill_files/Draft%20Banning%20of%20Cryptocurrency%20%26%20Regulation%20of%20Official%20Digital%20Currency%20Bill%2C%202019.pdf (last visited on June 17, 2020, 11:45 AM)

⁹Ibid, s.3(2),2019.

¹⁰Ibid, ss. 4, 5, 2019.

Indian Laws that are applicable to Crypto-Currency

Payment and Settlement Systems Act, 2007

As most Virtual Currencies are a way of exchanging money, raising questions over whether the Payment and Settlement Systems Act, 2007 (PSS Act) requires any authorisation or enforcement. Section 2(1) (i) of the PSS Act defines a payment system as *“a system that enables payment to be effected between a payer and a beneficiary”*. If Virtual Currency-based system forms a payment system, any individual commencing otherwise operating it, must take the approval of the RBI as per section 4(1) of the PSS Act. Nothing exempts Virtual Currency under the PSS Act, because only the word payment, as opposed to cash, legal tender, or money, is used. Whether a specific Crypto-Currency based system allows payment to be made between a payer and a beneficiary, or a person to start or operate such a system, needs to be judged.

It is debatable that several Virtual Currencies are not part of a network that allows transfers to be made between a payer and a beneficiary. For instance, a consumer can purchase Virtual Currency for investment using fiat Currency, also never want to make any payment with it, and instead dispose of it for fiat Currency in return. In this relation, there would be no payment, payer or beneficiary and it would reflect selling and buying an asset like gold. Additionally, the presumption that the value accompanying the Virtual Currency isn't guaranteed nor supported by the issuing body or any other reflects the notion that a Virtual Currency isn't likely to be perceived a payments system. In this opinion, Virtual Currencies can be defined as commodities or digital items that people trade like any other digital products such as music files, e-books, etc. In addition, due to the decentralized nature of several Virtual Currencies, like Bitcoin, it is difficult to identify issuers who commence systems. That would indicate that if decentralized Virtual Currencies contribute to payment systems, because they are anonymous, regulators might not pursue issuers.

Crypto-Currency distinctive from prepaid instruments (PPIs)

The distinguishing factors of Crypto-Currency from prepaid instruments are the anonymous nature and absence of inherent value of Crypto-Currency, the latter being lawful and regulated. PPIs and payment systems are regulated by the Payments and Settlement Act, 2007 (PSSA) and RBI Master Directions on Issuance and Operation of PPIs dated October 11, 2017.

The intention of the PSSA is to control PPIs, i.e., payment systems that affect electronic transfers. The Master Directions describe PPIs as *“payment instruments that facilitate purchase of goods and services, including financial services, remittance facilities, etc., against the value stored on such instruments”*.

The regulations also specify that all these instruments can be converted/ reconverted in cash, by debiting to a bank account, by card transactions and other PPIs. PPIs shall be converted/ reconverted electronically through PPIs issued only by regulated entities in India and must also be in INR only. The instrument based on the above, acts merely as a method for the transfer of regulated Currency, akin to a bank transfer. Thus, unlike Crypto-Currency, the value of which (if any) may depend on its demand / supply, PPIs have an intrinsic value related with them, including an identifiable holder thereof.

Applicability of Coinage Act, 2011

In India Coins are regulated through the Coinage Act, 2011. Section 2(a) defines Coins which means

: any coin which is made of any metal or any other material stamped by the Government or any other authority empowered by the Government in this behalf and which is a legal tender including commemorative coin and the Government of India one rupee note.

From the aforesaid definition, it's indeed obvious that since Crypto-Currency is a Virtual Currency that lacks the authorization of the relevant authority in India, it is not governed by the Coinage Act.

Foreign Exchange Management Act, 1999(FEMA)

As regards Crypto-Currency, one has to look at FEMA's rules to see whether Bitcoin can be deemed a Currency. For this, take a glance at section 2 (m) which states about foreign Currency, section 2(q), which states about Indian Currency also section 2 (h) which states about Currency.

Glance of all these Sections would highlight that Crypto-Currency is nowhere blanketed in the definitions. Therefore, FEMA isn't applicable to the regulation of Crypto-Currency in India, which additional means that the RBI at this stage is incapable to control Crypto-Currency and its operations.

Regulation for Miners

Mining can be regarded as an activity of developing software that generates value in terms of a newly generated Virtual Currency and is also acknowledged as the block reward. There is no Indian legislation directly governing the Virtual Currency mining operation. While there's no legal precedent in this matter, FEMA as well as its regulations may be appropriate where block reward is sent to a virtual wallet location in India and then transferred to a foreign wallet.

Even then, an arrangement wherein the physical mining platform is provided by an Indian entity but the newly generated Virtual Currency is used directly via a wallet address held by a foreign entity overseas shall not attract FEMA's legal export and import obligations. In these cases, the Virtual Currency was never kept in India and hence there's no transfer via India to a foreign nation of a Virtual Currency.

Nature of Virtual Currencies mining operation under FEMA

FEMA does not give a clear definition of goods. Although, as per the Foreign Exchange Management (Export of Goods & Services) Regulations, 2015, goods as well as software¹¹ are dealt analogously. As Virtual Currency is information, it seems it come under the software definition.

Furthermore, on the issue that whether certain software would fall under the scope of goods within state sales tax legislation the Apex Court¹² held that the expression "goods" as explained in the Indian

¹¹, Foreign Exchange Management (Export of Goods & Services) Regulations, 2015, Regulation 2 (viii), (2015). "Software means any computer program, database, drawing, design, audio/video signals, any information by whatever name called in or on any medium other than in or on any physical medium".

Constitution and under the applicable Act is “very wide and includes all types of movable properties, whether those properties be tangible or intangible”¹³. Also the Court had laid down test for when software would turn out to be goods¹⁴. Although the decision wasn’t in the specific context of a Virtual Currency or perhaps the FEMA definition of goods, it presents valuable guidance on interpretation, as the word goods was not specified under FEMA. It may be argued whether Virtual Currencies possess utility or not.

As Virtual Currency is intangible, also is stored, made as well as marketed on physical servers. It is competent of being purchased and sold, and stored, transmitted, delivered, transferred and possessed. Though, a Virtual Currency like Bitcoin is used for a variety of purposes. The demand for these Virtual Currencies thus reflects their efficacy. Therefore, a Virtual Currency such as Bitcoin may be equivalent to goods within FEMA.

Applicability of KYC

KYC means “*Know Your Customer*”¹⁵. It’s a mechanism from which banks collect information about their customers’ identities and address. The KYC procedure is intended for the banks to follow before opening accounts of their customers. Within India, RBI sets KYC norms as banks are expected to track the activities of their customers on an ongoing basis, maintain an up-to-date record of their identities and take reasonable measures if any of a customer's activities depart from their normal activity pattern.

One of India’s most popular Bitcoin wallet / app, Zebpay, adheres to a self-regulation¹⁶ system while adopting the KYC and Anti-Money Laundering norms. This provides for the necessity to draw the applicability of the Prevention of Money Laundering Act, 2002 provisions to guarantee as well as secure that persons or organisations don’t use these channels for illegal purposes.

Applicability of the Sale of Goods Act, 1930

There is a likelihood that Crypto-Currency may be deemed as “*goods*” according to section 2 (7) of the Sale of Goods Act, 1930. Nevertheless, in cases where Crypto-Currency is used as a consideration, this Act does not apply, because consideration can only be in the form of price as provided for in section 2(10) of the Sale of Goods Act, which is governed by an established law and not otherwise, i.e., consideration can’t be in kind under the Sale of Goods Act.

Taxability of Crypto-Currency in India

¹² Tata Consultancy Services v. State of Andhra Pradesh, 271 ITR 401 (SC)(2004).

¹³*Ibid*, “The Court held that the moment copies are made and marketed, it becomes goods, and a transaction sale of computer software is clearly a sale of ‘goods’ within the meaning of the [relevant Sales Tax Act]”, and “the term all materials, articles and commodities includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, transferred, delivered, stored, possessed etc.”.

¹⁴*Ibid*, “Goods may be tangible property or intangible property. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of transmitted, transferred, delivered, stored and possessed. If a software whether customized or non-customized satisfies these attributes, the same would be goods”.

¹⁵“Master Direction - Know Your Customer (KYC) Direction, 2016”, Reserve Bank of India, Master Direction DBR.AML.BC.No.81/14.01.001/2015-16, April 20,2020

<https://www.rbi.org.in/CommonPerson/english/scripts/notification.aspx?id=2607>.(last visited on June 20, 2020, 03:33 PM)

¹⁶“KYC and on Boarding, Term of Use, Legal and Privacy”, Zebpay, <https://www.zebpay.com/legal>.(last visited on June 20, 2020, 03:59 PM)

As becoming popular on the Indian market, Crypto-Currency has raised concerns about its taxability according to Indian taxation law. Taking that into consideration, taxes are levied by the central and state governments. If tax is on income, Crypto-Currency may represent such income, or Crypto-Currency may represent asset value.

Crypto-Currency can be classified as capital assets according to section 2(14)¹⁷ of the Income Tax Act, 1961, which addresses investments and shares owned by an assessor. However, any benefit or gain resulting from the transfer and selling of an asset, i.e., Crypto-Currency can be revenue or capital gain under the Income Taxation Act, rendering it taxable accordingly.

Crypto-Currency- deposit or security

Provided that Crypto-Currency is sometimes correlated with speculation, one could discover whether accepting specific Crypto-Currencies like tokens could be a deposit or perhaps a security. The SEBI, unlike the RBI, persists to remain quiet on the matter, probably as

SEBI regulations shall be applicable to Initial Coin Offerings (ICOs) if it satisfy the explanation of “*securities*” under section 2(h) of Securities Contract (Regulation) Act, 1956 (SCRA). The SCRA states a comprehensive definition of “*security*”¹⁸.

As per the definition of security the instrument has an underlying capital asset. Even though all coin offerings aren't accompanied via an underlying asset, some “*asset coins*” offer debt or equity claims against the issuing firm. Those asset coins are equivalent to the above instruments. However, if the tokens or coins don't come under the term “*shares*” or “*debentures*”, they can come under the expression “*other marketable securities of a like nature in or of any incorporated company or other body corporate*”¹⁹.

The Hon'ble Apex Court has held that “*marketable securities of a like nature*” implies that the securities shall be freely transferable²⁰. In the case of Sahara India Real Estate Corporation Limited v. Securities and Exchange Board of India the same was upheld by Court, the Court held that a “*marketable securities*” will fall within the framework of section 2(h) of SCRA also that marketable means “*capable of being sold*”. There should therefore be no constraint on transferring these asset coins offered by the ICOs for SEBI to have regulatory authority over the same.

¹⁷ Income-tax Act, 1961, s. 2(14), as amended by Finance Act, 2020 (2020), <https://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx> (last visited on June 20, 2020, 01:09 PM)

¹⁸ Securities Contract (Regulation) Act, 1956, Section 2(h).

“i. shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

a. derivative;

b. units or any other instrument issued by any collective investment scheme to the investors in such schemes;

c. security receipt as defined in clause (zg) of section 2 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

d. units or any other such instrument issued to the investors under any mutual fund scheme;

ii. Government securities;

iii. such other instruments as may be declared by the Central Government to be securities;

iv. rights or interest in securities”.

¹⁹ *Ibid.*

²⁰ Bhagwati Developers Pvt. Ltd. v. Peerless General Finance, 9 SCC 584, (2013).

Additional, such coins must be issued through an “*incorporated company or a corporate body*” to come within the scope of the “*securities*” under section 2(h) of SCRA. A corporate body has been described comprehensively under section 2(11) of the Companies Act, 2013 also includes companies incorporated outside India. Even then, sometimes coins are issued by unincorporated entities. Coins issued by unincorporated entities may fall beyond the scope of the securities as defined under SCRA. The interpretation of securities in India is quite constrictive. As a consequence, several ICOs will be beyond the scope of the SEBI Regulations.

The Companies (Acceptance of Deposits) Rules, 2014 (Deposits Rules) specify “*when the receipt of money, by way of deposit or loan or in any other form, by a company would be termed a deposit, and also provides certain exemptions from its applicability*”. Likewise, debt / deposit in India are linked to repaying money. It is debatable that Crypto-Currency issuance may generate a debt on part of the issuer to the extent that the issue consideration is viewed as a debt till the Crypto-Currency is transferred to the buyer.

Criminal and Civil Fraud

There is presently no legislation specifically targeted at fraud in the Virtual Currency market. While in India it may be a general misconception that Virtual Currency businesses in a fully unregulated environment, it's not the case. The Consumer Protection Act, 1986, The Indian Penal Code, 1860 also The Prize Chits and Money Circulation Schemes (Banning) Act, 1978, take action against fraudulent business activity. The Consumer Protection Act provides a civil remedy whereas the other two are criminal laws.

Cheating is criminalised under IPC (section 415 to 420). Cheating is defined under section 415²¹ the definition states whoever, by deceiving any person therefore includes a Virtual Currency business. Person doing such act may be punished under sections 417 and 420. Furthermore, the Prize Chits Act penalizes programs for making money rapidly or easily (money circulation schemes) and different forms of reward distribution schemes (prize chits). The Consumer Protection Act provides protection from unfair trade practices, service deficiencies and product defects. Unfair marketing practices include advertising, which is false or misleading. Consequently, customers would have protection under the CPA if any Virtual Currency company makes misrepresentations to customers or offers deficient services.

Constitutionality of Crypto-Currencies

There is fundamental right of Right to Equality²², Right to carry out “*Trade or Business*”²³ and Right to Life and Personal Liberty²⁴ as stated under the Indian Constitution. Banning Crypto Currencies must be based on the principle of “*intelligible differentia*” they can't be differentiated, devoid of any reasonable basis, from

²¹Indian Penal Code, 1860, Act no. 45 of 1860, s. 415, (2020). “Whoever, by deceiving any person, fraudulently or dishonestly induces the person so deceived to deliver any property to any person, or to consent that any person shall retain any property, or intentionally induces the person so deceived to do or omit to do anything which he would not do or omit if he were not so deceived, and which act or omission causes or is likely to cause damage or harm to that person in body, mind, reputation or property, is said to ‘cheat’.”

²² Constitution of India, 1950, art. 14 (2020).

²³ *Ibid*, art. 19(1)(g) (2020).

²⁴ *Ibid*, art. 21 (2020).

other individuals engaged in the business, including that of pre-paid wallets and other electronic/digital dealing in money, purely because they are engaged in the use, trade or dealing of Crypto Currencies and prohibition shall not infringe the right to carry out trade and business also it should not prejudice the right to life and liberty.

6. Judicial interpretation of Crypto-Currency

Joggled by the Notification of RBI, the crypto community and individuals holding Crypto-Currencies have filed writ petitions before the Supreme Court and various High Courts, challenging the constitutional validity of the Notification.

Internet and Mobile Association of India and others vs Reserve Bank of India²⁵

Grounds of challenge

The grounds for the petition

- (i) The RBI has no authority to bar the activities of trading in Virtual Currencies because inter alia
 - a. Virtual Currencies aren't "*legal tenders*" and therefore not regulated through the RBI
 - b. Service provided by Virtual Currencies exchanges don't meet the requirements of "*payment system*", so aren't entities that are regulated through the RBI under "*Payment Settlement and System Act, 2007*".
- (ii) The mode in which the RBI implemented its authority with regard to the ban didn't persuade the accepted parameters.
 - a. There was no application of mind by the RBI while passing the RBI notification.
 - b. The RBI notification was stained to be Malice-in-law because it was issued with mala fide intention lacking the objective of defending the regulated entities or else the public.
 - c. The notification infringes the Right to carry out "*Trade or Business*"²⁶ because it doesn't pass the test of reasonable basis/ "*ground of proportionality*".

²⁵ Writ Petition (Civil) No. 528 of 2018, March 04, 2020.

²⁶ Constitution of India, 1950, art. 19(1)(g), (2020).

RBI's response

RBI submitted that

- (i) The RBI notification is within the ample power granted to RBI.
- (ii) There was application of mind in passing RBI notification which is evident from the reports of the committees to which RBI was party also admonitory advisories purportedly issued by RBI over past 5 years.
- (iii) There can't be an unencumbered fundamental right to carry out "*Trade or Business*" on the network of entities governed by RBI
- (iv) The RBI is authorized and duty bound to take preventative measures for the interest public and also have power to regulate which include power to prohibit. Therefore, the RBI notification was necessary for public interest and for the protection interest of regulated entities from high volatility of Virtual Currencies.

Judgment

The bench of Hon'ble Apex Court while quashing the RBI's notification held that:

- The RBI's notification, which banned regulated entities from providing banking services to those involved in the trading otherwise facilitating the trading in Virtual Currencies, was apt to be set aside on the "*ground of proportionality*" since the impugned notification has almost wiped the Virtual Currency exchanges out of the industrial map of the country thereby infringing article 19(1) (g) .
- RBI has not so far found, in the past 5 years or more, the activities of Virtual Currency exchanges to have actually impacted adversely, the way the entities regulated by RBI function. The consistent stand taken by RBI up to and including in their reply dated 04-09-2019 is that RBI has not prohibited Virtual Currencies in the country.
- Even the Inter-Ministerial Committee constituted on 02-11-2017, which initially recommended a specific legal framework including the introduction of a new law namely, Crypto-token Regulation Bill 2018, was of the opinion that a ban might be an extreme tool and that the same objectives can be achieved through regulatory measures.

:The position as on date is that Virtual Currencies, are not banned, but the trading in Virtual Currencies, and the functioning of Virtual Currencies, exchanges are sent to comatose by the impugned Circular by disconnecting their lifeline namely, the interface with the regular banking sector. What is worse is that this has been done (i) despite RBI not finding anything wrong about the way in which these exchanges function and (ii) despite the fact that Virtual Currencies are not banned.

- The Court further held that

“It is as much true that Virtual Currency are not recognized as legal tender, as it is true that they are capable of performing some or most of the functions of real Currency”.

- The Court also stated that

: Promissory notes, cheques, bills of exchange etc. are also not exactly Currencies but operate as valid discharge of a debt only between 2 persons or peer-to-peer. Therefore, it is not possible to accept the contention that Virtual Currencies are just and can never be regarded as real money.

7. Conclusion

From the discussion, it is evident that policymakers and money market authorities across the world have come to cope with the fact that Virtual Currency can also be used as real money; however they have all been rejected by arguing that Virtual Currency should not have the value of a legal tender, since they're not sponsored by a central authority. In the present global situation, Crypto-Currency can be viewed as a virtual commodity with a given value that can be exchanged or transferred online, that can also be used for payment and investment purposes. The definition of Crypto-Currency has been through a wave of transition, with various states, authorities and regulatory bodies relying on their different status.

In India, the pronouncement in the Internet and Mobile Association of India and others vs. Reserve Bank of India²⁷ case comes as a positive step into a progressive digital economy. The Indian industry groups already have explored the use, trading and selling of Crypto-Currencies and set up extremely productive companies in the form of crypto exchanges and block chain-driven start-ups, and thus one can't completely sign off Crypto-Currencies.

There is necessitate to control of numerous ills associated to trading with Crypto-Currencies, including trade confidentiality and volatility and Crypto-Currencies value fluctuation. Because the participants ' identities is not disclosed in the transaction, it can lead to cyber-crimes, money laundering, illegal activities, misled consumer investments and market frauds with no trace of offenders. Crypto-Currencies trading may be regulated by the lawmakers or the RBI, either by drafting specific regulation or by RBI controlling and promoting Crypto-Currencies trading. A few safeguards that should be implemented include compulsory disclosure to RBI of the selling, transfer and usage of Crypto-Currencies to verify the identification of the parties and the sums transacted and quarterly reports by Crypto-Currencies exchange with RBI implying the requisite document of all transactions of Crypto-Currencies.

²⁷ Writ Petition (Civil) No. 528 of 2018, March 04, 2020.