

Legality of Cryptocurrency in India

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Abstract:

Recently, the crypto trade has taken the world by storm but at the same time with many questioning its legal sanctity. The sudden rise in popularity of this blockchain driven currency and the short term high returns has made it tempting for many to invest in it. But, is that all, these high returns and its decentralised framework come with a lot of risks which has made many countries critical about whether or not to give it a legal status. India, being one of them, has not accepted it as a legal tender. The recent Union Budget has issued some tax provisions in the context of crypto-trade which has sparked the debate about its legal status in India. The purpose of this paper is to analyse the legality of cryptocurrency in India. The analysis is supplemented by some recent news articles, information on the government website and tax provisions in Budget 2022. The paper, in detail, discusses the variation in legality of crypto in India, from when it started to take a peak to till now.

Keywords: Cryptocurrency, Crypto-trade, Legality of Crypto in India, crypto in India, Budget 2022

Introduction:

Recently, crypto trade has taken the world by storm but at the same time with many questioning its legal sanctity. So, what exactly is cryptocurrency- it is a digital asset which works under a decentralised framework and is governed by blockchain technology.

Critical and Concerning:

1. *Decentralised Framework-* The decentralised framework is suggested to develop and diversify user liberty but at what cost due to lack of regulation and absence of a solution provider regulating the transactions the crypto trade is prone to more frauds. Bitcoin Savings & Trust (BS&T) was initially a ponzi scheme (where money generated for early investors is just taken from later investors), but grew into one of the most infamous fraud cases involving a fake Initial Coin Offering (ICO). Secondly the proposed trustee's environment is a utopian concept i.e it is too good to be true.

2. *Blockchain Technology*- This technology is said to increase the efficiency of the transactions but at the same time this is a new concept which has far way to go in order to fulfil its potential. Secondly, people and governments and people are unfamiliar with this technology which makes them hesitant to accept and invest in a framework that is governed by blockchains.
3. *Volatile*- Cryptocurrencies are known for short term returns which tempts investors and crypto enthusiasts to invest in it but is that all? These high returns come with a lot of risks, one of them being the extreme fluctuations in its value. Due to its volatility many sovereign countries are dubious about the idea to accept and introduce it in the commercial markets.

Global Situation:

The currency is highly volatile in nature and the absence of a regulating body has made the sector prone to frauds, which has made many sovereign governments sceptical about it. Many of them have imposed a permanent and absolute ban on them and some have imposed an implicit ban. According to the Library of Congress in 2021, *‘an "absolute ban" on trading or using cryptocurrencies applies in eight countries: Algeria, Bolivia, Egypt, Iraq, Morocco, Nepal, Pakistan, and the United Arab Emirates. An ‘implicit ban¹’ applies in another 15 countries, which include Bahrain, Bangladesh, China, Colombia, the Dominican Republic, Indonesia, Iran, Kuwait, Lesotho, Lithuania, Macau, Oman, Qatar, Saudi Arabia and Taiwan.* So, we can infer that all the governments globally are resistant in adopting cryptocurrency as a legal tender but,

- Why is it so?
- What are their concerns?

Following we will try to answer these questions:

Why is it so?

1. **Digital Currency:** Cryptocurrency is a form of digital currency in which cryptographic techniques are used to control the creation of currency units and to validate the transfer of

¹ Implicit ban :Implicit bans refer to those which prohibit banks or other financial institutions from dealing in [cryptocurrencies](#) or offering services to people or businesses that involve crypto. They also refer to placing bans on cryptocurrency exchanges from operating in the jurisdiction.

funds. It is not issued by any central authority that would theoretically render it immune to government interference or manipulation.

2. **Decentralised Control:** Decentralised cryptocurrency exchange, on the other hand, is like a centralised one, except it does not have a third party on which you can rely. They are completely decentralised platforms that support peer-to-peer (P2P) trading using assets, proxy tokens and an escrow system, instead of IOU-based systems that use centralised exchanges, unlike the IOU-based system a centralised crypto exchange uses.
3. **Novelty of technology:** The technology in question is new which is why it has many loopholes which can be exploited by criminals and cyber attackers/hackers. Significant technological advancements will have a positive impact. This includes structural advancements including the Bitcoin Lightning Network and new common blockchain technologies like Ethereum but it will take time and a lot of research to develop the desired result.
4. **Volatility and Speculation:** There are also lots of new cryptocurrencies popping up all the time looking to compete and take some market share from the established ones which makes the market volatile. This volatile nature of cryptocurrency attracts swing traders to make big money by guessing the swings. Hence, crypto-buyers constantly indulge in gambling and speculating the price of cryptocurrencies. These speculative bets add to the already choppy market's uncertainty.

What are some of their major concerns?

1. **Tax evasion:** Cryptocurrency enables the citizens of a country to undermine government authority by circumventing capital controls imposed by it. Governments often institute capital controls to prevent outflows of a currency because exports could debase its value. For some, this is another form of control exerted by governments on economic and fiscal policy. In such instances, the stateless nature of bitcoin comes in handy to circumvent capital controls and exporting wealth.
2. **Money Laundering:** The ability to bypass existing financial infrastructure for a country is a blessing in disguise for criminals because it enables them to camouflage their involvement in such activities. Crypto network is pseudonymous, meaning users are

identified only by their addresses on the network. Which may result in an increase in money laundering cases or similar crimes.

Media Coverage and Interference: Since, cryptocurrency is a niche industry with a lot of hype, the media has a big influence over where the prices fluctuate. Speculators and analysts are constantly observing the press for the latest major story that will either launch or crash the economy. When something does emerge, everybody understands that it's a sprint to buy or sell. In this race the quickest will earn maximum profit whereas the slowest will lose the most. The media's coverage of the cryptocurrency industry has a major effect on its prices. Most of the time it does not help in the cryptocurrency business as people are getting their information from dubious sources and social networking. This adds to existing uncertainty of the sector and is not reliable which justifies why governments are not ready to commercially accept it.

India's standpoint:

The crypto sector is currently one of the fastest-growing investment markets in the world and India is not far behind. In recent years, as real interest rates have gone down, traditional, and even first-time investors have been looking for investment options with short-term high returns and cryptocurrencies have been an attractive alternative. But before we go into further details and assess India's standpoint it is important to have clarity regarding some points.

What is a currency according to the Indian Legal Framework?

THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999 states "Currency" includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank. From here we can infer that according to *THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999* cryptocurrency can't be considered as a currency rather currently it is only a digital asset.

Crypto timeline in India

- Introduction and Initial Phase-: 2008 - 2016: During this decade many events took place from proposing a basic outline about the concept and how the framework will work in 2008 to the first commercial transaction of Bitcoin in 2010. From there onwards with the launch of Unocoin in 2013, that facilitated Bitcoin transactions in India, there was no turning back with valuation of Bitcoin increasing 10 times from \$100 to \$1000. In 2016 due to demonetisation there was a spike in the number of crypto-users. But during this time RBI issued an advisory against crypto currencies, warning the public against use of virtual currencies, adding that their prices were a “matter of speculation” in the absence of backing by an asset or reserves.
- Breakthrough but critically acclaimed: In 2017 Bitcoin price had gone up sharply from a low of \$2,500 to a high of nearly \$20,000. Search interest in bitcoin went up by 20x, according to data from Google Trends. But at same time the financial regulatory bodies of India were by and large critical, with the RBI and Finance Ministry again and again cautioning the public against the crypto currency. The Finance Ministry comparing crypto currencies with ponzi schemes. A committee comprising the Finance Minister, RBI and SEBI members was formed to look after the regulations over the asset. Two PILs are filed against the use of crypto currencies in the Supreme Court.
- Wazirx and Ban: In 2018 Wazirx starts operations and the subsequently RBI issues a notice imposing an effective ban by prohibiting banking support for the purchase and sale of cryptocurrencies, which was overturned by the Supreme Court in 2020 due to the lack of legislative force.
- Present: The latest amendment to Schedule III of the Companies Act, 2013 issued on March 24th 2021 states that from the new financial year, all companies will be required to disclose their investments in crypto currencies and also state any profit or loss involved in the transaction. The holder of any virtual currencies will also have to declare the number of holdings, details of deposit and advances from any person for the purpose of trading or investing in cryptocurrency. In 2021 Prices nearly doubled again, with Bitcoin topping out at nearly \$64,000, before halving in price. Banks issue advisory cautioning clients against cryptocurrency citing RBI’s 2018 circular. The central bank says its circular is no longer valid in light of the Supreme Court’s ruling. Currently, more than 10

crore Indians, including senior citizens, are said to have invested in crypto currencies, making the total investments in cryptocurrencies to more than 10 billion USD in 2021 from a little under USD 1 billion in 2020. Earlier in 2019 and in February 2021, the government had tried to bring legislation to regulate crypto but those efforts had to be abandoned. But, now, amidst the uncertainty and tremendous price swings in the crypto market, the central government has introduced some tax provisions in the Union Budget 2022.

Provisions in the Union Budget of 2022:

What are the Provisions?

The Indian finance minister in the Union Budget 2022 announced that "any income from transfer of any virtual digital asset shall be taxed at the rate of 30 per cent." Further, tax deduction at source at the rate of 1% has been proposed for transactions involving cryptocurrency. The minister also stated that taxation of a virtual digital asset does not imply the legal recognition of crypto currencies.

What do these provisions signify about the legality of crypto currency in India?

The Income Tax Act does not differentiate between income earned legally or illegally. Hence, the Income Tax department can collect tax on all incomes. However, when the government is aware that income has been generated through illegal sources, it is under a statutory obligation to punish the perpetrators under various punitive laws, including the Indian Penal Code, Benami Transactions Act, etc. Since the government has not yet started criminal investigations against any investor, trader or service provider of crypto currency, it can be safely assumed that the government is tacitly agreeing that income earned from crypto currencies is legal income from a legal source. If the government were to decide otherwise and prosecute citizens dealing in cryptocurrencies, it certainly would be a topic of debate.

Conclusion:

Currently the Government of India has kept a neutral stand on whether or not to accept the crypto currencies a legal tender. Recently a sudden rise in its popularity has made the centre wary of it hence it has introduced these tax provisions. India’s concerns are in line with global concerns even though after introducing the tax provisions India is vague about the legality and is tactfully handling the situation. But it is more likely that the Indian government has permitted de facto approval of cryptocurrencies and the dealing/trading of them.

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