
CRYPTOCURRENCIES; UNRAVELING REGULATORY REALITIES

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ABSTRACT

Over the past decade, there has been a notable emergence of virtual digital assets (VDAs) utilizing blockchain and other distributed ledger technologies. The rapid global expansion of these assets underscores the imperative of comprehending the regulatory frameworks that surround them. Cryptocurrencies, poised to revolutionize various sectors including digital payments, investment management, and asset management, are at the forefront of this transformation.

The global cryptocurrency market is projected to reach a total market capitalization of \$467.2 million by 2028. With a growing number of investors worldwide, there is a marked trend towards diversifying portfolios and wealth creation through this asset class.

Currently, India lacks a regulatory framework to protect its cryptocurrency investors. This regulatory gap has prompted a migration of investors from the Indian market to global cryptocurrency markets, resulting in significant losses for the Indian government.

The Reserve Bank of India (RBI) and the Central Government have articulated their stance through various circulars and the Cryptocurrency and Regulation of Official Digital Currency Bill 2021, which aims to ban private cryptocurrencies and introduce a Central Bank Digital Currency (CBDC). Meanwhile, the Securities and Exchange Board of India (SEBI) has expressed interest in exploring cryptocurrency investments.

This study contributes to existing literature in three primary ways: Firstly, by defining virtual digital assets and cryptocurrencies; secondly, by examining the regulatory frameworks established by governmental bodies within respective jurisdictions; and thirdly, by elucidating the evolving global landscape and international recognition of these assets.

The findings of this research underscore the potential of blockchain-based systems while highlighting significant challenges such as volatility,

susceptibility to cyberattacks, and fraudulent activities that necessitate systematic regulation. Recommendations derived from this study are proposed to inform strategies for the oversight of virtual digital assets and cryptocurrencies. Various parameters have been analyzed to draw informed solutions and conclusions regarding these matters.

Keywords: Bitcoin, Cryptocurrency Bill 2021, Central Bank Digital Currencies, Blockchain

I. INTRODUCTION

Virtual assets, commonly referred to as crypto assets, encompass any digital representation of value capable of digital trading, transfer, or use for payment, excluding fiat currencies. The emergence of cryptocurrencies, notably Bitcoin ("BTC"), marked the inception of the world's first decentralized digital currency. The substantial returns facilitated by these novel blockchain-based entities ignited widespread investment enthusiasm, giving rise to numerous crypto exchanges, hedge funds, and tokenization practices.

India has adopted a broad definition of virtual digital assets (VDAs), which includes assets representing value created using encryption or similar methods, encompassing unique digital items such as non-fungible tokens (NFTs). Prominent examples of virtual assets include cryptocurrencies such as Bitcoin, Litecoin, Ethereum, and Dogecoin. Gaming tokens, NFTs, and governance tokens may also fall under the virtual asset category, depending on specific circumstances and contextual usage.

Virtual assets offer significant potential benefits, such as facilitating easier, faster, and cost-effective payments, thereby providing alternative financial avenues for individuals without access to traditional financial services. However, their largely unregulated nature exposes them to risks such as volatility, potential devaluation, susceptibility to cyberattacks, and fraudulent schemes.

Furthermore, the absence of adequate regulatory oversight renders virtual assets vulnerable to exploitation for illicit financial activities by criminals and terrorists. The Financial Action Task Force (FATF) closely monitors developments in the crypto sphere and has established global standards to combat the misuse of virtual assets for money laundering and terrorist financing. While some countries have initiated regulatory frameworks, others have opted to ban virtual assets outright, illustrating the divergent global approach to their regulation.

In India, the Reserve Bank of India (RBI) introduced the e-rupee as a digital currency, but currently, no specific legislation governs VDAs. Previously, the RBI attempted to restrict VDAs within the Indian financial ecosystem, a move later overturned by the Supreme Court as disproportionate, affirming the RBI's authority to regulate virtual currencies while indicating the necessity for comprehensive legislative measures.

The taxation of virtual asset transactions at 30 percent underscores the complexities of the evolving regulatory landscape, compounded by existing legal frameworks ill-equipped to address issues related to virtual currencies, taxation, insolvency, and data protection. The primary challenge in regulating virtual assets lies in defining their legal classification as goods, commodities, currencies, or property, necessitating focused research and policy development to effectively navigate these complexities.

II. DEMYSTIFYING DIGITAL ASSETS AND CRYPTOCURRENCIES

Since the advent of Bitcoin in 2009, the discourse surrounding digital assets and their regulatory frameworks has significantly intensified. Digital assets, often referred to as virtual assets, are tradable through digital mediums and function similarly to legal tender in terms of their utility as a medium of exchange.

These assets leverage Blockchain technology, an advanced, publicly shared database that stores information in blocks linked together through cryptography. The primary function of this technology is to facilitate the tracking and trading of both tangible and intangible assets via the blockchain network, thereby reducing costs and ensuring transactional efficiency.

Digital assets are categorized into various types within the regulatory sphere to aid legislation in formulating appropriate laws and regulations. These categories include Cryptocurrencies, Central Bank Digital Currencies (CBDCs), Virtual Currencies, and Non-Fungible Tokens (NFTs).

1. Cryptocurrencies:

Cryptocurrencies, also known as crypto, represent a digital or virtual form of currency that operates independently of centralized issuing agencies or regulatory oversight. Utilizing decentralized systems, cryptocurrencies record transactions and issue new units through

blockchain technology, thereby bypassing traditional banking authentication processes. This unregulated framework facilitates global digital payments among individuals.

Transactions are logged in a public blockchain ledger and stored in digital wallets. The creation of cryptocurrencies, exemplified by Bitcoin, involves mining processes where computational power is used to solve complex equations, resulting in the generation of coins. Alternatively, cryptocurrencies can be acquired through brokers in intangible form, granting owners cryptographic keys for peer-to-peer transfers without intermediary involvement.

Bitcoin emerged in 2009 and gained global transactional capability in 2010 amid the backdrop of the 2008 global recession. Initially introduced via bitcoin.org by an anonymous entity purportedly under the pseudonym Satoshi Nakamoto, Bitcoin's foundational research paper "*Bitcoin: A Peer-to-Peer Electronic Cash System*"¹ outlined its operational principles. Since then, global crypto transactions and incidents, including scams, have underscored its evolving landscape, with over 18,000 cryptocurrencies documented worldwide as of March 2022.

Beyond Bitcoin, notable cryptocurrencies include Bitcoin Cash, Ether, Stablecoins like Tether, Solana, and Cardano, each contributing distinct functionalities and market presence to the digital currency ecosystem.

2. Central Bank Digital Currencies (CBDCs - E Rupee):

The Reserve Bank of India introduced its digital currency, E Rupee, in 2022. This digital token functions as legal tender within India and operates under the regulatory oversight of the RBI. Modeled after cryptocurrencies, the E Rupee distinguishes itself by centralizing transaction authentication under the auspices of the Central Bank of India, thereby bolstering public trust compared to decentralized alternatives.²

The E Rupee complements traditional forms of currency such as banknotes and coins, with each unit equivalent in value to one Indian Rupee. To facilitate usage, the RBI has launched the e-Rupee app, providing a secure digital wallet for storing and managing the currency.

¹ BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM, <https://bitcoin.org/bitcoin.pdf> (last visited July 9, 2024)

² https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54773

Transactions using the Central Bank Digital Currency (CBDC) incur sales tax, contrasting with cryptocurrencies which are subject to capital gains tax.

Transactions with E Rupee are streamlined, utilizing phone numbers or QR codes for seamless exchanges. Importantly, E Rupee maintains stability comparable to the Indian Rupee, ensuring confidence in its value over time.

3. Non-Fungible Tokens (NFTs):

In 2022, Non-Fungible Tokens (NFTs) emerged as a prominent phenomenon, capturing widespread attention as individuals engaged in the purchase and sale of digital artworks and content. NFTs, analogous to cryptocurrencies in concept, leverage blockchain technology to tokenize pieces of art, digital content, or videos for online transactions. Each NFT is uniquely identified through blockchain encryption, featuring distinct metadata and the ability to be exchanged for currency, cryptocurrencies, or other NFTs.³

III. GOVERNMENTAL FRAMEWORK ON VDAs & CRYPTOCURRENCY: UNREGULATED OR A PRUDENT STEP?

Taking into account the fragile status of digital assets jurisprudence in India, this unprecedented circumstance would raise multiple legal issues for consideration. India lacks a sophisticated and nuanced framework concerning the regulation or prohibition of virtual assets. The regulations in this sector being in their nascent stages, with no law in place, dedicated to regulation of crypto assets and other virtual digital assets, there are certain other measures taken by the government for the administration of the same.

In 2022, the **Income Tax Act, 1961** introduced the definition of these assets. Under it, virtual assets are:

1. Information, code, number of tokens providing a digital representation of value, that can be exchanged with or without consideration, and can be transferred, stored, and traded electronically. Such assets do not, however, include Indian or foreign currency.

³ Robyn Conti, What Is An NFT? Non-Fungible Tokens Explained, Forbes Advisor, (July 8. 2024, 8:16 pm), <https://www.forbes.com/advisor/investing/cryptocurrency/nft-non-fungible-token/>

2. Non-fungible tokens, or tokens akin to NFTs.
3. Other digital assets, as notified by the Central Government.

For the new tax regime, the Central Board of Direct Taxes (CBDT) released instructions concerning the definition of a virtual digital asset and for income arising from virtual digital assets introduced by the Finance Act, 2022. The CBDT issued two notifications to define virtual digital assets under **Section 2(47A)** of the Act—one excluding certain assets from the definition, and a second defining NFT in order to facilitate the said provision. For instance, it shall not cover any subscriptions to OTT Platforms, e-commerce platforms or mobile applications.⁴

On June 22, 2022, the RBI annual report perpetuated its stance that cryptocurrencies are a ‘clear danger’ and that such currencies derive value based on make-believe, however, it passed a circular bearing no. **F. No. 370142/29/2022-TPL**, which introduced **Section 194S** in the **Income Tax Act, 1961** which mandates that a person who is responsible for paying any resident consideration for the transfer of virtual digital assets, at the time of credit of such consideration to the account of the resident or at the time of payment, deduct an amount equal to 1% of such consideration as income tax. However, the tax is not deductible in the following cases:⁵

- (i) If the consideration is payable by a specified person and the value or aggregate value of such consideration does not exceed INR 50,000 during the financial year; or
- (ii) If the consideration is payable by any person other than a specified person and the value or aggregate value of such consideration does not exceed INR 10,000/- during the financial year.

The **Information Technology Act, 2000** does not provide a concrete definition of digital assets. Nevertheless, it governs a number of electronic record-related private law issues. It specifies how the records are to be properly credited to their creators. Moreover, it establishes the legal fiction via which these records may be sent or received between the addressees' and originators' places of business. Furthermore, it specifies the authentication paradigm for these

⁴ The Income Tax Act, 1961, § 2(47A), No. 4, Acts of Parliament, 1961, (India)

⁵ The Income Tax Act, 1961, § 194 S, No. 4, Acts of Parliament, 1961, (India)

kinds of records. Consequently, the plethora of aspects relating to the digital asset exchange in India are likely to be regulated under the IT Act.

In addition to that, under **Section 70B (6)** of the Information Technology Act, 2000,⁶ the Indian Computer Emergency Response Team ("CERT-In"), which is housed within the Ministry of Electronics and Information Technology ("MeitY"), released directions on April 28, 2022, regarding information security practices, procedures, prevention, response, and reporting of cyber incidents for Safe & Trusted Internet. These directions aimed to safeguard and reinforce cybersecurity in India. They mandate that all cybersecurity events be reported to CERT-In by service providers, intermediaries, data centers, business entities, and government organizations.

Given that all "attacks or malicious/ suspicious activities affecting systems/servers/networks/software/applications related to" are covered by the Directions, the blockchain, VDA, and Web3 industries are immediately impacted. Moreover, all virtual asset service providers, virtual asset exchange providers and custodian wallet providers are required to mandatorily maintain all information obtained as part of Know-Your-Customer ("KYC") procedures and records of financial transactions for a period of five years.

The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 ("2021 Bill") aims to create an empowering framework for the official digital currency to be issued by the RBI, and to restrict all private cryptocurrencies available in India. The legislation has to evaluate and assess the risks and benefits as well as the evolution of common taxonomy by all international stakeholders for the regulation of cryptocurrencies and the proposed 2021 Bill is off the table till a global compact can be firmed up on the regulation of cryptocurrencies.

The Ministry of Finance (the "MoF"), through a Notification dated March 7, 2023, has stipulated that the following activities, when conducted for or on behalf of another natural or legal person in the course of business, shall be categorized as a "designated business or profession":

(i) Exchange between virtual digital assets ("VDAs") (as defined under **Section 2(47A) of the**

⁶ The Information Technology Act 2000, § 70 B (6), No. 21, Acts of Parliament, 2000, (India)

Income-tax Act, 1961⁷) and fiat currencies;

(ii) Exchange between one or more forms of VDAs;

(iii) Transfer of VDAs;

(iv) Safekeeping or administration of VDAs or instruments enabling control over VDAs; and

(v) Participation in and provision of financial services related to an issuer's offer and sale of a VDA.

Consequently, all persons engaged in the aforementioned activities are now considered "reporting entities" under the Prevention of Money Laundering Act, 2022 ("PMLA").

The **Union Budget 2023** stands silent concerning the issues pertaining to digital assets or the cryptocurrency in particular. However, as per Union Budget 2022, there was an introduction of crypto taxation for the first time by including private cryptocurrencies under the ambit of virtual digital assets (VDAs). Under the recently formulated **Section 115BBH** of the **Income Tax Act, 1961**⁸ the following recommendations were made:

1. A 30% tax (plus applicable surcharge and 4% cess) to be levied on profits made from crypto trading from April 1, 2022, onwards
2. Losses made on any particular cryptocurrencies cannot be offset against profits made on other cryptocurrencies
3. 1% TDS (Tax Deductible at Source under section 194S of the Income Tax Act) to be levied on crypto transactions above INR 10K with effect from July 1, 2022.

Subsequent to the new crypto tax regime announcement, the cumulative trade volume of around 90 percent plummeted from domestic Centralized VDA exchanges to foreign ones during February-October, 2022. It resulted in more than 17 Lakh users switching to foreign exchanges to evade taxes. As a consequence, following the levy, Indian exchanges lost up to

⁷ *Supra note at 4*

⁸ The Income Tax Act, 1961, § 115BBH, No. 4, Acts of Parliament, 1961, (India)

81 percent of their trading volumes in three-and-a-half months between July 1 and October 15, 2022.

Additionally, the **Union Budget 2022**, highlights that the gift of a digital asset is also proposed to be taxed at the hand of the recipient and any loss from the transfer of the digital asset cannot be set off against any other income. While the suggested amendments do not provide any credibility or legitimacy to cryptocurrency, it is likely to unfold stringent regulation of cryptocurrency in India.

Although the **Union budget 2022** and its amendments promised a path toward cryptocurrency legalization and regulation in India without outright prohibiting any activity pertaining to cryptocurrencies, direct or indirect, the Ministry of Finance's and the RBI's intentions appear unclear in light of the lack of concrete actions taken in this regard.

IV. ROLE OF THE RESERVE BANK OF INDIA AND SEBI

The Reserve Bank of India (RBI) has adopted a stringent stance on the use of cryptocurrencies within the country. While their concerns regarding financial stability and consumer protection are valid, the rapid implementation of these bans was met with significant opposition. Consequently, several affected parties sought judicial intervention, bringing the matter before the Hon'ble Supreme Court of India in 2020.

In 2018, the Reserve Bank of India (RBI) issued a press release (2013-2014/1261)⁹ to caution traders, holders, and users of virtual currencies about the various legal, operational, and financial risks associated with cryptocurrencies. Although the RBI did not call for an outright ban, it emphasized that the agency was actively researching the multifaceted issues posed by cryptocurrencies. Furthermore, the RBI indicated that it was examining global crypto regulations to integrate relevant aspects with India's Foreign Exchange and Payment Systems laws and regulations.

In this specific circular, the Reserve Bank of India (RBI) expressed concerns regarding digital wallets, highlighting their susceptibility to hacks, security breaches, and malware attacks. The RBI noted that the loss of an e-wallet would result in the loss of any cryptocurrency stored

⁹ <https://www.rbi.org.in/commonman/English/Scripts/PressReleases.aspx?Id=2522>

within it. Additionally, they pointed out the absence of customer support mechanisms to address potential issues, underscoring the risks associated with the use of digital wallets.

Regarding legal disputes, the Reserve Bank of India (RBI) cautioned that issues could arise pertaining to jurisdictional ambiguities or the absence of clear legal frameworks. Emphasizing their stringent stance, the RBI highlighted the potential for cryptocurrencies, such as Bitcoin, to be utilized in funding illicit and illegal activities.

In 2018, amidst the chaos of demonetization in India, one overlooked aspect was the significant boost to the crypto market as a direct result. Subsequently, the Reserve Bank of India (RBI) intensified its regulatory efforts by issuing press circular DBR, BP.BC.104/08.13/02/2017-18 on April 6, 2018¹⁰. This directive restricted banks and non-banking financial companies (NBFCs) from dealing with cryptocurrencies and mandated the discontinuation of such services if they were already being provided.

The circular prompted considerable upheaval, leading to petitions filed in the Supreme Court of India challenging the move, and sparked public backlash that culminated in the launch of the #IndiawantsCrypto campaign, advocating for positive regulation of cryptocurrencies in the country.

The Securities and Exchange Board of India (SEBI) has adopted a distinct perspective on the highly debated issue of virtual digital assets (VDAs). SEBI proposed a multi-regulatory approach to oversee the regulation of VDAs in India. However, the Reserve Bank of India (RBI) opposed this proposal, citing concerns over tax evasion, which they argued could ultimately threaten fiscal stability in the country. In response, legislators drafted the Crypto Bill 2021, which remains pending and has not yet been passed into law.

V. NAVIGATING THE CRYPTOCURRENCY LANDSCAPE: KEY LEGAL PRECEDENTS AND PUBLIC INTEREST LITIGATIONS ACROSS JURISDICTIONS

Challenging the Reserve Bank of India's (RBI) ban on cryptocurrencies, the respondents petitioned the Supreme Court of India, contesting the validity of the circular. The Supreme

¹⁰ <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI15465B741A10B0E45E896C62A9C83AB938F.PDF>

Court's judgment effectively stayed the ban on cryptocurrencies, thereby placing the issue in a legal gray area and deferring the responsibility of comprehensive regulation to the legislature.

On March 4, 2020, a three-judge bench of the Supreme Court of India, comprising Justices Rohinton Fali Nariman, Aniruddha Bose, and V. Ramasubramanian, in the case of *Internet and Mobile Association of India v. Reserve Bank of India*,¹¹ ruled against the Reserve Bank of India's (RBI) circular that prohibited the trading and handling of cryptocurrency in India.

The Internet and Mobile Association of India, along with several other stakeholders, challenged the RBI's circular dated April 6, 2018, in the Supreme Court of India. The circular, which was set to take effect in July 2018, prohibited banks and non-banking financial companies (NBFCs) from dealing in or providing services to individuals or entities involved in cryptocurrency transactions, such as those involving Bitcoin.

The primary issues before the court were threefold:

1. Whether the RBI has the authority to regulate matters pertaining to virtual currencies (VCs).
2. Whether VCs amounted to money.
3. Whether the circular issued by the RBI was within its legal purview.

The main point of deliberation centered on the third issue, examining the extent of the RBI's regulatory power in this context.

The petitioners, which included various cryptocurrency exchanges such as Koinex, CoinDCX, Throughbit, and CoinDelta, contended that the RBI had exceeded its authority in issuing the circular under the Banking Regulation Act, 1948, and the Payment and Settlement Systems Act, 2007. They argued that virtual currencies (VCs) were beyond the scope of these acts and that the RBI was only empowered to issue circulars related to fiat currency, thus VCs did not fall under its jurisdiction.

Their argument was based on the doctrine of colorable legislation, which asserts that what is prohibited directly cannot be achieved indirectly, and the legislature cannot act beyond its

¹¹ *Internet And Mobile Association of India v. Reserve Bank of India*, 2020 SCC Online SC 275.

power of interpretation. The RBI had previously admitted that VCs were beyond its regulatory scope and, by prohibiting banks and NBFCs from dealing with cryptocurrencies, indirectly attempted to impose a ban on them, thereby violating this doctrine.

Furthermore, the petitioners argued that the RBI acted beyond its powers in issuing the circular, as concerns of money laundering fall under the purview of the Department of Economic Affairs, and tax evasion falls under the jurisdiction of the Central Board of Direct Taxes.

The petitioners also contended that no department in the country had imposed an outright ban on VCs; rather, they regulated their use in the larger interest of the public. Therefore, they argued that their right to carry on any occupation, business, or trade under Article 19(1)(g) of the Constitution of India was violated.

In response, the RBI adopted a firm stance, arguing that virtual currencies (VCs) were being used similarly to legal tender and posed significant risks related to money laundering and illegal activities. The RBI asserted that it derived its authority under the Banking Regulation Act, 1948, the Payment and Settlement Systems Act, 2007, and the Reserve Bank of India Act, 1934, to issue the circular as part of its duty to protect the country's payment system. To support their position, the RBI submitted extensive literature on the perils of VCs.

In its judgment, the Supreme Court of India discussed various legal concepts. First, they held that the RBI derived power under Section 3(1) of the RBI Act, 1934¹². While VCs were not within the scope of legal currency, they were being emulated and used as actual currency, thereby obligating the RBI to regulate them.

When deciding on the issue of the violation of Article 19(1)(g), the Supreme Court employed the test of reasonableness. They quashed the circular on the grounds that it did not pass this test. The test of reasonableness is a well-established principle in Indian constitutional jurisprudence, supported by several landmark judgments.

The Supreme Court relied on the precedent set in *State of Maharashtra v. Indian Hotel and Restaurants Association*¹³ wherein the court emphasized the need for reliable empirical data to substantiate any claimed harm. In this case, the RBI failed to provide such data, leading the

¹² The Reserve Bank of India Act, 1934, § 3(1), No. 2, Acts of Parliament, 1934, (India)

¹³ *State of Maharashtra v. Indian Hotel and Restaurants Association*, Civil Appeal No. 2705 of 2006

court to conclude that a total ban on cryptocurrencies was disproportionate and excessive. Consequently, the court quashed the RBI circular, ruling that it violated the doctrine of proportionality and infringed upon Article 19(1)(g) of the Constitution of India

The Supreme Court has made its stance on the topic very clear in *Arnav Gulati v. SBI & Ors*¹⁴. The Delhi High Court heard a petition challenging the State Bank of India's (SBI) action that forbade the UPI platform from dealing with and settling funds on the WazirX cryptocurrency exchange.

The petition argued that this action violated the fundamental rights to equality under Article 14 and to trade under Article 19(1)(g) of the Constitution¹⁵. The petitioner claimed that the bank was forcing its clients to use alternative payment methods, which are more time-consuming and may incur additional fees such as convenience fees, GST, or service charges, thus making it more difficult for users and retail investors to receive their funds on time.

Considering all factors, it is clear that since India does not have specific cryptocurrency laws, transactions involving virtual currencies are in a gray area. This view is further supported by the Revenue Secretary's remarks at the post-budget press conference, stating that taxing virtual digital assets does not equate to legalizing cryptocurrency transactions. Considering tax implications, the Supreme Court held that business income arising from unlawful activities is subject to tax and allowed the deduction of expenses from such income.

Similarly, in *CIT v. S. C. Kothari*¹⁶, The Supreme Court held that a loss incurred in carrying on an illegal business must be deducted before computing the true figure of taxable profits under Section 10(1) of the Indian I.T. Act, 1922.

Similarly, while deciding on the issue of income from unlawful activities, the Supreme court explained that income from unlawful activities is taxable, and expenses related to such income are also deductible. Thus, in the context of unregulated income and its taxation status, it can be concluded that there is no bar to taxing such income.

¹⁴ *Arnav Gulati v. SBI & Ors.*, Second Appeal No. CIC/SBIND/A/2019/111324

¹⁵ INDIA CONST. art. 19(1)(g)

¹⁶ *Commissioner of Income-Tax v. S.C. Kothari*, [1968] 69 ITR 1 (GUJ)

Various High Courts across the country have also entertained Public Interest Litigations (PILs) which brought relief to litigants while also filling gaps in the regulatory sphere.

In November 2021, a Public Interest Litigation (PIL) was filed in the *Bombay High Court*, requesting the Union of India to formulate a comprehensive mechanism, including appropriate legislation and guidelines, to mitigate the risks associated with the largely unregulated cryptocurrency market in India.¹⁷

The petitioner asked the High Court to order the respondent state to create laws and regulations governing the use of cryptocurrencies within India, oversee the registration of cryptocurrency exchange platforms, establish a robust mechanism for monitoring international cryptocurrency transactions, create a grievance redressal system for trading platforms, and develop a foolproof taxation scheme for such transactions.

The PIL highlighted that unlike traditional currencies, cryptocurrencies lack a central authority to manage or control their value. It also pointed out that the absence of regulations and regulatory agencies in cryptocurrency trading could lead to a scam similar to the NSEL Case of 2013. The petitioner submitted an analytical report on cryptocurrencies along with the petition.

A month later, a PIL was filed in the Madras High Court where litigants requested that the government prohibit marketing and promoting cryptocurrency trading on all media platforms until appropriate laws and regulations are established.¹⁸

The Ministry of Information & Broadcasting, the Finance Secretary, and the Cabinet Secretary were named as respondents and were ordered to cease promoting cryptocurrency trading within the time frame given by the High Court. The submitted PIL argued that illicit cryptocurrency trading has facilitated money laundering, financing of terrorism, and extortion.

While cryptocurrencies still remain a gray area within the Indian landscape, several jurisdictions across the world have legislated and permitted use of cryptocurrencies. Given the

¹⁷ Neha Joshi, Lawyer moves Bombay High Court seeking regulation of cryptocurrency market, BAR AND BENCH, (July, 9, 2024 3:06 PM) <https://www.barandbench.com/news/litigation/lawyer-moves-bombay-high-court-seeking-regulation-of-cryptocurrency-market>

¹⁸ Sebin James, Plea Before Madras High Court Seeks Ban on Cryptocurrency Trade Advertisements, LIVE LAW, (July, 9, 2024 3:06 PM), <https://www.livelaw.in/news-updates/madras-high-court-pil-to-ban-cryptocurrency-advertisements-in-media-platforms-until-crypto-regulations-made-187070>

absence of definitive rulings regarding the legality of virtual currencies in India, examining global legal precedents is instructive.

In the *Ainsworth Case*, The House of Lords established the property litmus test. The ruling stated that an interest or right must meet certain criteria to be classified as property: it must be definable, identifiable by third parties, capable of being assumed by third parties, and have some degree of permanency. These characteristics of "property" emphasize that distinctiveness and actual existence are essential.¹⁹ While deciding on the issue of "*concept of ownership of property*," The Income Tax Appellate Tribunal cited *Ainsworth* in *Shakti Insulated Wires Ltd. v. Joint Commissioner of Income Tax*.²⁰

Further in *IMAI vs. RBI*, The Supreme Court recognized *Ainsworth* as the authoritative standard on the "*attributes of property*." The Court observed that, while the four-pronged test was not explicitly applied, its widespread acceptance has solidified its prominence in property law.

Applying the *Ainsworth* criteria, courts in various jurisdictions have concluded that virtual currencies (VCs) qualify as a form of property.

VI. UNDERSTANDING THE INTERNATIONAL LEGAL STATUS OF CRYPTOCURRENCIES AND ASSETS

In the current global landscape, the treatment of cryptocurrency assets varies significantly across different countries. The primary factor distinguishing these nations is their stance on cryptocurrency transactions, which can be categorized into four distinct positions:

A) Legal Tenders, Properties or Currencies

In countries such as Australia, Japan²¹, El Salvador²², and Switzerland²³, both crypto assets and

¹⁹ LawTeacher. November 2013. *National Provincial Bank v Ainsworth*. [online]. Available from: <https://www.lawteacher.net/cases/national-provincial-v-ainsworth.php?vref=1> [Accessed 9 July 2024].

²⁰ *Shakti Insulated Wires Ltd. v. Joint Commissioner of Income Tax*, [2003]87ITD56(MUM)

²¹ Tokentax. (n.d.). *Crypto Taxes in Japan*. Retrieved July 9, 2024, from <https://tokentax.co/blog/crypto-taxes-in-japan>

²² Yale Insights. (n.d.). *El Salvador adopted Bitcoin as an official currency; Salvadorans mostly shrugged*. Retrieved July 9, 2024, from <https://insights.som.yale.edu/insights/el-salvador-adopted-bitcoin-as-an-official-currency-salvadorans-mostly-shrugged>

²³ RSM Switzerland. (n.d.). *Cryptocurrency tax treatment in Switzerland*. Retrieved July 9, 2024, from <https://www.rsm.global/switzerland/en/news/cryptocurrency-tax-treatment-switzerland>

their exchanges are recognized as legal, and these nations have adopted cryptocurrencies as legal tender. This demonstrates the feasibility of government acceptance and has fostered an environment conducive to their growth. In these countries, cryptocurrency holdings are treated as legal property and are subject to wealth taxes, capital gains taxes, and other levies that must be reported on annual tax returns. Therefore, individuals are required to maintain detailed records of all Bitcoin transactions for taxation purposes.

B) Treatment as Assets

While they do not recognize cryptocurrency as legal tender, several economies—including those of the US, Canada, Singapore, South Korea, Indonesia, Brazil, the UK, Malta, Estonia, Gibraltar, Luxembourg, Germany, Thailand, and others—have embraced it by classifying it as an asset. The associated exchanges are recognized, and trading in digital assets is permitted and considered lawful. Consequently, transactions in these countries are governed by specific laws and regulations.²⁴

Cryptocurrency exchange service providers and wallets in these jurisdictions are required to register with the appropriate regulatory bodies, implement Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) programs, maintain necessary records, and submit timely reports to the authorities. Securities laws in these countries fully apply to digital wallets and exchanges, necessitating that all financial institutions and money service businesses track electronic cash transfers and cross-border cryptocurrency transactions.

C) Declared Illegal

While many developed and developing countries are considering regulating cryptocurrencies rather than outright banning them, several nations have already implemented a complete ban on crypto assets. Cryptocurrencies are not recognized as lawful in countries such as China, Algeria, Bolivia, Egypt, Indonesia, Russia, Turkey, Bangladesh, Ecuador, Macedonia, Saudi Arabia, Morocco, Qatar, Vietnam, and others known for their strict regulatory environments.

²⁴ Perkins Coie LLP. (2023). *Digital currencies: International actions and regulations 2023*. Retrieved July 9, 2024, from <https://www.perkinscoie.com/en/news-insights/digital-currencies-international-actions-and-regulations-2023.html>

The primary reasons for these bans are the volatile nature of cryptocurrencies and their association with illicit activities and money laundering.

D) Undecided Stance

Many regions, such as India and the European Union, maintain an ambiguous stance on cryptocurrencies, with regulations and official positions remaining uncertain. In India, while the legal status of cryptocurrencies is not clearly defined, the Reserve Bank of India (RBI) has launched a pilot program for a Central Bank Digital Currency (CBDC) based on blockchain technology, recognizing the foundational role of blockchain in the cryptocurrency landscape.

In the European Union, the use of Bitcoin is legal, and specific services and assets are regulated under the Markets in Crypto Assets (MiCA) Regulation. MiCA's Title III and Title IV came into effect on June 30, 2024, with Titles I, II, V, VI, and VII becoming effective by December 2024. However, securities tokens and non-fungible tokens (NFTs) are exempt from this regulation. MiCA aims to harmonize financial standards across the EU, prevent the fragmentation of financial regulatory frameworks, and ensure accessibility and safety for the general public in utilizing Bitcoin and other cryptocurrencies.²⁵

VII. RECOMMENDATIONS

The Cryptocurrency Bill 2021, introduced for discussion in the winter session of Parliament, is yet to become law. This bill aims to ban all private cryptocurrencies in India and establish a Central Bank Digital Currency (CBDC) known as the e-Rupee.

Several prominent centralized cryptocurrency agencies, which have experienced significant growth recently, have expressed concerns that an outright ban on cryptocurrencies could negatively impact the national economy.

Industry stakeholders advocate for cryptocurrencies to be recognized not as a parallel or substitute currency to the Indian Rupee, but rather as an investment, asset, or security for wealth creation. They collectively hope for favorable cryptocurrency regulations and a reduction in taxation on gains from cryptocurrencies.

²⁵ Eucrium. (n.d.). *New rules for crypto assets in the EU*. Retrieved July 9, 2024, from <https://eucrium.eu/news/new-rules-for-crypto-assets-in-the-eu/>

The global cryptocurrency market has surpassed a capitalization of \$2.5 billion as of 2024 and is forecasted to reach \$343.5 million within the same year, with an estimated annual growth rate of 7.99%. This growth trajectory projects a total market capitalization of \$467.2 million by 2028.²⁶

Due to regulatory frameworks, or the lack thereof, approximately 5 million cryptocurrency users have migrated their transactions offshore²⁷. This migration has resulted in a potential loss of \$420 million in taxation revenue for the Government of India.

1. Establishment of Statutory Virtual Asset Regulatory Authority

One of the primary concerns faced by Indian investors is the absence of regulations safeguarding their cryptocurrency investments. To address this issue, the Indian legislature should consider establishing a dedicated cryptocurrency regulatory authority under a statute rather than imposing a ban on private cryptocurrencies. This agency would help alleviate concerns regarding the decentralized nature of cryptocurrencies by providing a structured and secure regulatory framework.

The proposed regulatory authority could oversee various facets of the cryptocurrency market, including advisory services, brokerage, dealing, and lending of cryptocurrencies. Additionally, to protect investors' interests, the authority could regulate payments, remittances, custody, and virtual asset management. This framework would be akin to the Virtual Asset Regulatory Authority (VARA) established in Dubai.²⁸

This approach would address the Reserve Bank of India's concerns regarding the decentralization of the cryptocurrency market and offer a measure of security for investors. By implementing such a regulatory framework, the Indian government can ensure a more stable

²⁶ **Fortune Business Insights**, *Cryptocurrency Market Size, Share, and Trends Analysis Report, By Offering (Hardware, Software), By Process (Mining, Transaction), By Type (Bitcoin, Ethereum, Ripple, Litecoin, Others), and Segment Forecasts, 2023 - 2030*, Fortune Business Insights (2024), <https://www.fortunebusinessinsights.com/industry-reports/cryptocurrency-market-100149>.

²⁷ **India's Crackdown on Offshore Crypto Exchanges: Regulatory Moves and Global Impact**, *The Currency Analytics* (July 3, 2024), <https://thecurrencyanalytics.com/press-releases/indias-crackdown-on-offshore-crypto-exchanges-regulatory-moves-and-global-impact-88892>.

²⁸ **Dubai's VARA Issues Regulations for Dubai Virtual Asset Regime**, *Clyde & Co.* (Feb. 21, 2023), <https://www.clydeco.com/en/insights/2023/02/dubai-vara-issues-regulations-virtual-asset-regime->.

and transparent cryptocurrency ecosystem, thereby fostering investor confidence and market integrity.

2. Anti-Money Laundering Standards

One of the primary concerns of the Reserve Bank of India (RBI) is the high level of anonymity that cryptocurrencies offer. This anonymity makes cryptocurrencies an attractive medium for terrorists and other malicious actors to conduct illegal and illicit activities.

To combat this issue, the proposed Virtual Asset Regulatory Authority could enforce strict Know Your Customer (KYC) norms for consumers and centralized cryptocurrency agencies across the country. For reporting entities, the Prevention of Money Laundering Act (PMLA) 2002 already includes various provisions relating to KYC norms. These provisions encompass verification of identity, maintenance of records, furnishing information, and the imposition of penalties.

The Crypto Bill could be aligned with the PMLA to create a more comprehensive regulatory framework, thereby instilling public confidence by ensuring that reporting intermediaries:

1. Demonstrate adequate financial resources for operations.
2. Implement robust customer due diligence procedures.
3. Establish effective policies and procedures to manage risks associated with virtual currencies
4. Establish effective governance controls.

3. Amendment of The Securities Contract Regulation Act, 1956 (SCRA)

At present, Section 2(h) of the relevant legislation defines “securities” to include marketable securities in an incorporated company, government securities, and any such instrument notified by the Central Government as securities.²⁹ This definition is broad and could be interpreted to encompass cryptocurrencies if the Central Government decides to classify them as such.

²⁹ The Securities Contract Regulation Act, 1956, § 2(h), No.42, Acts of Parliament, 1956 (India)

In *Bhagwati Developers Private Limited v. Peerless General Finance & Investment Company Limited*,³⁰ The court emphasized the term "Marketability" when discussing securities. Marketability refers to the ability of a commodity to be sold or marketed. This characteristic is also possessed by Virtual Digital Assets (VDAs) as they can be freely bought and sold through established cryptocurrency platforms. The Securities Appellate Tribunal also discussed that securities should be capable of being bought and sold in the market, irrespective of the market size, and that it has high liquidity and ease of transferability.

Transferability is a fundamental characteristic of virtual digital assets (VDAs). A typical VDA transaction, facilitated by centralized agencies, typically completes within approximately 10 minutes. Cryptocurrency liquidity refers to the speed with which traders can convert digital assets into fiat currency. Regarding liquidity, cryptocurrencies behave similarly to other securities, although the level of liquidity varies among different cryptocurrencies.

A notable challenge for cryptocurrencies is their lack of issuance by a formal incorporated entity currently. Policymakers could explore various considerations, including granting cryptocurrency agencies the status of incorporated entities. This regulatory adjustment would subject cryptocurrencies to the Securities Contracts Regulation Act (SCRA), potentially facilitating VDA trading through public exchanges.

CONCLUSION

As blockchain technology continues to evolve, the global cryptocurrency market has seen substantial investment, prompting countries worldwide to establish robust regulations and laws. These measures aim to protect investors' interests while simultaneously attracting further investment. In India, the regulatory landscape for cryptocurrencies has encountered significant challenges, with the definition and classification of virtual currencies still pending.

However, the cryptocurrency market is poised for continued expansion, emerging as a significant medium for wealth and asset creation. Therefore, it is imperative for the government to implement positive regulations that safeguard investor security and enhance governmental

³⁰ *Bhagwati Developers Private Limited v. Peerless General Finance & Investment Company Limited*, Civil Appeal No. 7445 of 2004

revenue. Such regulatory frameworks would serve the best interests of both investors and the government, fostering a more secure and prosperous economic environment.