

# Cryptocurrency: Legal and Regulatory Challenges in India

Dr. Navya Gupta, Assistant Professor, Lloyd Law College, Knowledge Park, Greater Noida

Dr. Anil Kumar, Assistant Professor, Lloyd Law College, Knowledge Park, Greater Noida

**Abstract:** Global discussions have been triggered by the rise in popularity of cryptocurrencies, with India serving as a prime illustration of the regulatory unpredictability. There is an increasing need for clear restrictions as interest and related hazards rise. India's unclear regulations make its position on cryptocurrency more interesting. India is in a murky position when compared to nations that have either outright outlawed cryptocurrency or completely accepted it with well-defined laws. The fact that cryptocurrencies are neither outright prohibited nor completely legalized reflects a "wait-and-watch" perspective that results in frequent changes to regulation and ongoing discussions. The present paper discusses the legal issues, regulations and the challenges like security and unclear rules, etc. related to cryptocurrency.

The increasing number of cryptocurrency users worldwide makes it evident that physical marketplaces are being replaced by online ones in the financial industry. Technological advancement has given birth to Cryptocurrency. The word "Virtual currency" can be used in broader sense and cryptocurrency as a little part of it. As defined by Reserve Bank of India Virtual currency operates as a decentralized form of digital money, typically developed and overseen by its creators, and adopted by participants within designated virtual communities. This type of currency operates outside traditional regulatory frameworks, providing users with a unique and often community-driven financial system. On the same grounds, Cryptocurrency is a form of digital currency, leverages cryptography to ensure robust security, significantly mitigating the risks of double spending or counterfeiting. This advanced cryptographic framework renders such fraudulent activities exceedingly difficult, if not virtually impossible, to execute within the cryptocurrency ecosystem. According to Merriam Webster Dictionary "cryptocurrency is a sort of virtual money that only exists digitally, has no physical form, and is not subject to government control or centralized regulatory agencies". Similarly, Cambridge dictionary defines cryptocurrency as created by decentralized public networks in contrast to centralized authorities unlike fiat currencies that are issued by governments. These currencies make use of cryptographic methods to enable safe network payments and transactions. The world of virtual currencies today includes more than 1,500 distinct varieties, all of which are unique in their own right and possess distinctive attributes. The way in which different currencies are categorised depends on the unique characteristics and features that each possesses. Some of the major and most frequently used cryptocurrencies are "Bitcoin, Ethereum, Binance coin, Polka dot, Internet computer, Zepay, CoinDCX, Bitcoin cash", etc...

**Keywords:** Cryptocurrency, India, Legal Challenges, Regulatory Framework, Digital Currency, Blockchain, Financial Compliance, Monetary Policy, Anti-Money Laundering, Investor Protection

## I. INTRODUCTION

### How Cryptocurrencies are operated?

Bitcoin is a type of virtual currency in which the value of each unit is verified using cryptographic techniques. Virtual currency transactions usually require consent from both the seller and the buyer.<sup>1</sup> As opposed to commodity-backed currencies or non-legal tender cryptocurrencies, fiat currencies are those that are legally recognized by a government

<sup>1</sup>Velde, F. (2013). Bitcoin: A primer. Chicago Fed Letter, (Dec).



but do not have backing from physical assets such as precious metals. As a result, when a cryptocurrency achieves fiat status<sup>2</sup>, its transactions are governed by conventional laws pertaining to money transfers. Cryptocurrency, which is frequently represented by Bitcoin, functions via a peer-to-peer network that is a decentralized virtual framework in which ownership is anonymous. This network records transactions using a massive database called the “blockchain”. Cryptographic keys are used by participants in transactions as distinct credentials that function as signatures and are verified by the network. As a result, every transaction modifies and replicates the sender and recipient information in the blockchain ledger. The blockchain’s integrity is maintained by miners, who validate transactions in a decentralized fashion. Some economists have referred to Bitcoin as a “fiduciary currency” because it has no intrinsic value and only has value based on transactions against fiat currencies backed by governments or acceptance by different organizations online.

### **Is Cryptocurrency Legalized in India?**

Addressing inquiries about the legality of cryptocurrencies in India requires a thorough explanation. Currently, cryptocurrencies are not deemed illegal, yet the lack of comprehensive regulation leaves considerable ambiguity. The absence of robust regulatory frameworks underscores the need for further development in this area. These new financial services and products come with a lot of issues when it comes to protecting customers, maintaining monetary and financial stability, and balancing the advantages and disadvantages of incorporating these innovations into the current payment system. Legislators and regulators alike must give this considerable thought. The problems with this financial technology that have been brought to light, especially in the context of India, include several important areas:

- *Performance and Scalability*: Meeting the demands of quicker transaction processing and effectively managing an increasing number of transactions.
- *Proficiency and Knowledge*: Raising experts’ and the public’s knowledge and awareness of blockchain technology in order to promote its broader adoption and application.
- *Security and Safety*: Ensuring strong security protocols to safeguard confidential information and addressing privacy issues in blockchain apps and transactions.
- *Standardization and Interoperability*: Creating shared guidelines and conventions to facilitate easy communication and exchange between various blockchain networks and platforms.
- *Legal and Regulatory Issues*: Handling the intricate legal and regulatory environment to guarantee adherence and make it easier to incorporate blockchain technology into current frameworks.

The entire potential of blockchain technology can be achieved by resolving these issues, which will promote innovation and have a good effect on many Indian industries.

### **Evolution of Cryptocurrency in India**

The years 2013 to 2017 witnessed the rise in popularity and appearance of cryptocurrencies in India, which is considered to be the start of the trend. Between 2013 and 2017, the Reserve Bank of India (RBI) and the Ministry of Finance issued several advisories highlighting potential risks linked with cryptocurrencies, including financial instability, customer protection concerns, and security vulnerabilities.<sup>3</sup> Subsequently, in 2018, the RBI issued a circular prohibiting entities under its regulation from participating in cryptocurrency transactions or providing support for such activities.<sup>4</sup> The circular mandated regulated entities to cease any existing services related to cryptocurrencies within a three-month timeframe.

<sup>2</sup> New York State Administrative Procedure Act (SAPA) 2015. 23 NYCRR Part 200 Virtual currencies.

<sup>3</sup> RBI cautions users of Virtual Currencies against Risks’, RBI, December 24, 2013; ‘RBI cautions regarding risk of virtual currencies including Bitcoins’, RBI, December 5, 2017; ‘Government cautions people against risks in investing in virtual currencies’, Press Information Bureau, Ministry of Finance, December 29, 2017

<sup>4</sup> RBI Circular on Prohibition on dealing in virtual currencies (VCs) dated 06.04.2018, RBI/2017-18/154 DBR.No.BP.BC.104 /08.13.102/2017-18

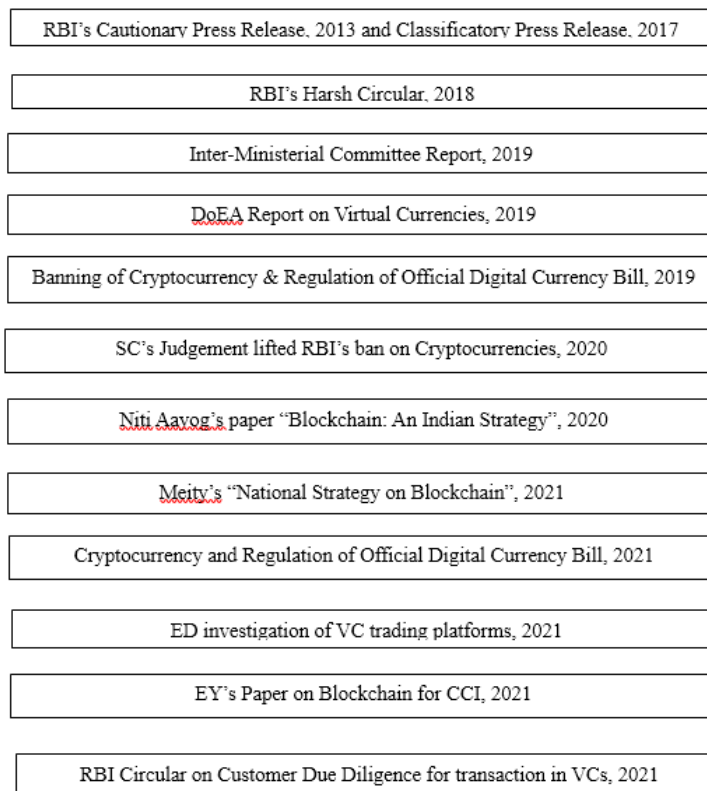


In the IMMAI Case<sup>5</sup>, the Supreme Court of India deliberated on the challenge to the RBI Circular. At the heart of this case was the pivotal question of whether virtual currencies should be classified as commodities outside the purview of RBI regulation or as financial instruments within the realm of RBI's oversight. The Supreme Court stressed that any intangible property that may be used as money could be subject to RBI regulation, even if it decided to invalidate the Circular based on proportionality.<sup>6</sup> The RBI's right to step in and issue orders in these situations was upheld by the Court.

### **Legal Regulatory framework of Cryptocurrencies in India**

India has adopted a complete strategy to manage blockchain and cryptographic money innovation. This technique includes different government bodies, controllers, and divisions giving public statements, fliers, bills, and reports to address the advancing scene of computerized resources.

Nevertheless, India's way to deal with these advances has displayed some uncertainty and unusualness, with shifts in feeling over the long haul. A synopsis of key improvements has been given sequentially in the infographic underneath:



<sup>5</sup>Internet and Mobile Association of India v Reserve Bank of India, 2020 SCC Online SC 275

<sup>6</sup>The Supreme Court had proceeded with the quashing of the impugned RBI Circular holding that it did not meet the test of proportionality. It was pointed out by the Court that even though the RBI Circular was not prohibiting or banning virtual currencies directly, the ultimate effect of the Circular was restriction of carrying out the Virtual Currency exchanges and the trading of Virtual currencies, which has not been yet prohibited by the Legislature. On this count the Court held that the RBI Circular is violative of the fundamental right to carry on occupation, trade or business under Article 19(1)(g) of the Constitution.



Several following bills have been drafted with the aim of either regulating or prohibiting cryptocurrency within various jurisdictions.

a) “*Crypto Token and Crypto Asset (Banning, Control and Regulation) Bill, 2018*”<sup>7</sup>: In 2018, the Inter-Ministerial Committee on Virtual Currencies formulated and submitted the 2018 Bill. This proposed legislation aimed to address two main aspects: firstly, preventing individuals engaged in cryptocurrency token activities from misrepresenting these assets as securities or investment schemes, and secondly, regulating venture capital exchanges and brokers facilitating the trading of cryptocurrency tokens. However, despite its submission, the bill did not progress to parliamentary discussion.

b) “*Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019*”<sup>8</sup>: proposes a comprehensive ban on all aspects related to cryptocurrencies within India. It prohibits activities such as mining, creation, holding, selling, trading, issuing, transferring, disposing, or usage of cryptocurrencies. The bill explicitly prohibits the use of cryptocurrency as legal tender or money anywhere in the country. Additionally, it restricts cryptocurrency from being used as a store of value, unit of account, or medium of exchange. The bill suggests that any involvement in violating these regulations could lead to criminal charges, punishable by up to ten years in prison along with fines. Individuals engaging with cryptocurrencies, whether as users, holders, investors, or traders, were assumed to accept the associated risks at their own discretion. All individuals who hold or use cryptocurrencies are required to declare and dispose of their holdings within 90 days from the publication date of this act. Procedures and technologies related to cryptocurrencies can be utilized for academic research, development, and educational purposes, facilitating learning and innovation in the field. To safeguard the public interest, the Indian government reserves the right to temporarily waive specific trading regulations if deemed necessary. Although the Bill was supposed to be introduced in the Lok Sabha during the 2021 budget session<sup>9</sup>, it was eventually not discussed during that session.

But in March 2020, the Supreme Court of India overturned the Reserve Bank of India’s prohibition on cryptocurrency, marking a significant development in the regulatory landscape surrounding digital currencies. In a 180-page ruling, a bench comprising justices Rohinton Nariman, Aniruddha Bose, and V. Ramasubramanian<sup>10</sup> highlighted that the Reserve Bank of India (RBI) had not established regulations regarding virtual currency exchanges conducted by commercial banks, nationalized banks, or other financial institutions. Moreover, the court noted the absence of any explicit mention by the RBI regarding the potential adverse impacts of virtual currency exchanges, either in part or in whole. Chief Justice Ramasubramanian described the RBI’s approach as highly “disproportionate”. This ruling by the Supreme Court underscored the challenges faced by the Indian government in developing a formal digital Indian rupee, despite various legislative efforts and committees’ endeavors to achieve this goal. In 2020, Niti Aayog released “Blockchain: The India Strategy,”<sup>11</sup> a thought-provoking document recognizing blockchain’s potential to revolutionize interactions among corporations, citizens, and governments. The document highlighted how blockchain could enhance operational efficiency, streamline business processes, improve governance, and enhance everyday life experiences.

In the aftermath of the ruling, the RBI issued instructions to banks, advising them not to caution their clients against engaging with cryptocurrencies, as its previous circulars on the matter had been invalidated. However, the RBI emphasized the importance for banks to uphold their due diligence obligations under the Combating of Financing of

<sup>7</sup> <https://law.asia/cryptocurrency-regulation-india/>

<sup>8</sup> <https://www.medianama.com/wp-content/uploads/2021/02/Draft-Banning-of-Cryptocurrency-Regulation-of-Official-Digital-Currency-Bill-2019.pdf>

<sup>9</sup> Lok Sabha Bulletin Part – II, No.1989-2025] (Friday, January 29, 2021/Magha 09, 1942 (Saka)

<sup>10</sup> Internet And Mobile Association of India vs Reserve Bank Of India (Writ Petition (Civil) No. 528 of 2018)

<sup>11</sup> [https://niti.gov.in/sites/default/files/2020-01/Blockchain\\_The\\_India\\_Strategy\\_Part\\_I.pdf](https://niti.gov.in/sites/default/files/2020-01/Blockchain_The_India_Strategy_Part_I.pdf)



Terrorism (CFT) Act, as well as their responsibilities outlined in the Foreign Exchange Management Act of 1999 (FEMA) and the Prevention of Money Laundering Act of 2002 (PMLA).<sup>12</sup>

c) *"The Cryptocurrency and Regulation of Official Digital currency Bill, 2021"*<sup>13</sup>: The Blockchain and Crypto Assets Council (BACC), along with representatives from Indian cryptocurrency exchanges, advocated for the importance of establishing regulations for the crypto industry. They emphasized that while regulations are necessary, an outright ban on cryptocurrencies would be unjust and counterproductive. In this Bill, one proposed approach involves advocating for the prohibition of all forms of cryptocurrencies in India, while simultaneously advocating for the establishment of a supportive framework for the creation of an official digital currency to be issued by the Reserve Bank of India (RBI). After a landmark week featuring the inaugural parliamentary panel discussion on cryptocurrency finance, the 2021 Bill made its appearance on the agenda. Following a consensus reached during the panel discussions favoring regulation over outright prohibition, the term "banning" was omitted from the title of the bill. Subsequent engagements with stakeholders and deliberations on digital currency regulation culminated in the formulation of the 2021 Bill. Despite being scheduled for discussion during the Parliament's winter session, talks were postponed, and the bill was not addressed during the session.

### **Union Budget 2022-23 on Cryptocurrencies in India**

The key features of this Budget were:

- In the Union Financial plan for 2022-23, the Government of India determined that exchanges of virtual cash or digital currency resources will be dependent upon a 30% duty derivation.<sup>14</sup>
- Losses from virtual exchanges can't be put forward.
- Gifts of virtual resources or digital forms of money will be burdened to the beneficiary.
- The RBI intends to give a National Bank Computerized Cash (CBDC) utilizing blockchain innovation by 2023.
- A 1% expense will be deducted at source on installments made for the exchange of computerized resources.

This conclusive declaration from the Indian government could lay out digital currencies as real resources and approve their exchanging as a lawful action. The lucidity gave on charge guidelines helps settle vulnerabilities and may possibly grow the business. The powerlessness to convey forward misfortunes could be a critical disadvantage for financial backers, given the high instability of digital currencies. This worry might prevent financial backers, especially retail ones, from taking part in digital money exchanging. Furthermore, the high assessment rate will decrease net benefits, and beginning of April 1, 2023, the arrangements under area 115BBH, connected with pay from virtual monetary forms, will produce results. Burdening digital currencies doesn't completely and expressly sanction them, as personal duty guidelines in India center around the actual resources as opposed to the techniques or method for getting those resources. In light of previous encounters and late expense statements, it appears to be exceptionally far-fetched that the Government of India will acquaint another bill with announce digital currencies unlawful.

### **Challenges of Cryptocurrency Adoption in India**

Cryptocurrency represents a digital frontier in finance, offering great potential, yet it faces significant obstacles. In navigating the journey from regulation to broad acceptance within the Indian market, numerous challenges arise that require our careful consideration and vigilance.

<sup>12</sup> RBI Circular 2021-22/45 <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12103&Mode=0>

<sup>13</sup> <https://www.financialexpress.com/money/cryptocurrency-bill-2021-live-updates-crypto-bitcoin-ban-regulation-official-digital-currency-parliament-highlights-key-points-2374661/>

<sup>14</sup> <https://www.cnbtv18.com/cryptocurrency/india-has-raked-in-rs-1579-crore-in-tax-from-virtual-digital-asset-transactions-says-finance-minister-16281911.htm>





As India navigates the realm of cryptocurrency adoption, understanding and mitigating these risks is essential. Moving through the digital landscape requires informed decisions and a vigilant approach to safeguarding your financial interests.

#### 1: Security Threats

In the realm of cryptocurrency, security is paramount. Hackers lurk, ready to plunder your valuable virtual coins or fabricate fake ones, leaving you with nothing but regret. Caution is advised; steer clear of unreliable websites that could jeopardize your digital wealth.

#### 2: Crash Risk

The unlimited printing of virtual currency may sound enticing, but it carries risks akin to those of real-world economies. Unchecked issuance can trigger inflation and even lead to a collapse. Before investing in lesser-known coins, it's wise to weigh the potential pitfalls against the allure of quick gains.

#### 3: Real Money Impact

The rise of cryptocurrency usage for everyday transactions raises a delicate question: how does it impact traditional monetary systems? Striking a balance between the virtual and real economies becomes imperative to ensure the stability of both financial realms.

#### 4: Gold Farming

Beware of the allure of gold farming, a practice where players amass virtual currency in games and sell it for real money. This unregulated process introduces fraud risks, urging caution when considering the purchase of virtual items with your hard-earned cash.

#### 5: Unstable Value

In the volatile world of virtual communities, the value of their currencies mirrors their popularity. A loss in user interest translates to devaluation. Diversification becomes a prudent strategy; avoid putting all your financial hopes in one fading virtual basket.

#### 5: Money Laundering

Cryptocurrency, with its pseudo-anonymous nature, can be a playground for criminals. Platforms facilitating virtual-to-real money exchanges heighten the risk of money laundering. Opting for reputable platforms is key to safeguarding your digital assets.

#### 6: Unknown Identities

Fake accounts add a layer of complexity to cryptocurrency transactions. The lack of authentication makes tracking illegal activities challenging. Exercise caution and conduct due diligence when engaging in online trades.

#### 7: Black Market

The maturation of gaming platforms has given rise to black markets for virtual currency trading. Stick to secure and legal platforms to avoid the risks associated with shady transactions in these shadowy corners.

## II. CONCLUSION

The country has experienced a wave of fluctuating policies regarding cryptocurrency regulations. Cryptocurrencies are neither fully legal nor completely prohibited, resulting in uncertainty while the government develops new digital currency legislation. Implementing appropriate regulations for Bitcoin in India could position the country favorably in the international market by fostering the development of digital assets while ensuring the stability of its financial sector. Cryptocurrency is gaining popularity in India, but several challenges remain, such as unclear regulations and security concerns. Although there are opportunities for financial inclusion and simplified investments, India must establish clear guidelines, educate the public, and enhance technological infrastructure. The government is also exploring Web3 and blockchain technology for potential innovations. Striking a balance between fostering new ideas and implementing proper regulations is essential for the safe and successful adoption of cryptocurrency in India.

