ANALYSIS OF CRYPTOCURRENCY AND THE NEED FOR ITS REGULATION IN INDIA

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ABSTRACT

A "virtual currency" is a sort of digital money that frequently stays uncontrolled. Virtual currencies are seen as including "cryptocurrencies" like Bitcoin and Ethereum. A cryptocurrency manages and controls the generation of new currency units and uses encryption technology to keep transactions safe. Such cryptocurrencies exist and are traded on specialized, public blockchain networks. Cryptocurrencies are not recognized as legal money in many places since any nation or government does not back them. Any associated bodies do not issue a cryptocurrency, and assets like bullion do not back it. As opposed to traditional forms of money, cryptocurrencies are traded frequently globally due to their potential for significant returns, which can create wealth for traders. This calls for a comprehensive approach to cryptocurrency regulation. The exchange of cryptocurrencies operates on the basic economic premise of supply and demand. The structure of Bitcoin has presented difficulties for many regulators, as most have struggled to discover ways to manage it. As a result, some nations banned or made it illegal, while others maintained their observance, and others devised methods to tax and control its activities. The current study examines the development of cryptocurrencies, the legal problems surrounding them and their trade, and the situations that call for strict control.

Keywords: Virtual Currency, Bitcoin, Supply and Demand, Bullion, Transactions

INTRODUCTION

We live in an age driven by Information and Technology. The sectors of industries that gain the most from these types of technologies contribute to the betterment of the country's economy. These industries are mainly the financial and business sector. As technology has developed over time, it has given rise to various new transaction options arising as remarkable financial forms. Cryptocurrency is one of those forms developed over time and now has become an established currency used as legal tender in many countries. Not only as a Legal tender but also as a trading tool, Cryptocurrencies are valuable and immaterial items that may be utilized electronically or digitally in various applications and networks, including peer-to-peer networks, virtual worlds, online social networks, and online social games. The Concept of Bitcoin and Blockchain was first coined in a paper released by an anonymous named Satoshi Nakamoto titled Bitcoin: A Peer-to-Peer Electronic Cash System. In this paper, the authors introduced the concept of Blockchain, which is the central technology behind the operation of every cryptocurrency in the market, primarily used in Bitcoin. Blockchain functions as something like a global ledger or spreadsheet. It operates on computers given by volunteers worldwide and lacks a central database. Because a blockchain exists on the network rather than within a single organization, anybody may examine it at any moment. A blockchain employs public and private keys to preserve virtual security and is encrypted. Using a blockchain, one may securely transfer money to another person without going through a bank or financial institution. The main advancement of blockchain technology is its capability to enable participant-to-participant asset transfers over the Internet without using a centralized third party. A decade ago, cryptocurrencies were on the periphery of financial market activity. Today, they are an asset class worth more than $1 trillion, traded on exchanges, and held by millions worldwide. Around $1.5 trillion is the entire market value of all cryptocurrencies, with Bitcoin now accounting for more than half of that amount. Owning crypto assets has become a peculiar craze. People are taking unprecedented risks to obtain rewards only available through questionable Ponzi schemes and not through popular asset classes that can be traded on global markets.

In virtual money or cryptocurrency, mining validates the transaction. One or more computers may work together to participate in this validation procedure. An intricate mathematical method is used in the validation process, and it gets more complicated as additional members

join the network and validation process. The transaction fee is the incentive for participating in this mining operation. In a different instance, the participant in this mining process releases a new coin in exchange for a reward. The paper also examines current cryptocurrency platforms and systems to identify concerns, difficulties, problems, and challenges. It examines the relationship between fundamental laws and the usage of CC to highlight the significant effects of the cryptocurrency idea on several elements of the natural world, including genuine monetary systems, commercial industries, rates of breaching the law, and criminal payment methods. The results highlight the significance of restricting cryptocurrency use for all parties involved and impacted by cryptocurrency platforms. Governments, operators, and users are those parties. The findings also warn legislators and virtual currency providers to issue and enact stringent laws, regulations, and policies to regulate virtual currency systems.

NEED FOR REGULATION

In many of these nations, the legal position of Bitcoin and other associated crypto-related instruments is currently unclear or in flux. Most countries do not forbid the use of Bitcoin per se, but different regulatory ramifications depend on whether it is viewed as money or a commodity. Its use and commerce are expressly permitted in certain states but are prohibited or subject to restrictions in others. Likewise, numerous government departments, organizations, and courts have assigned Bitcoins various classifications. Unregistered with regulatory bodies, digital assets like cryptocurrencies offer significant profits. However, neither the company nor the regulatory authorities have accepted these assets for registration. As a result, the asset being sold to the public lacks credibility due to the lack of a registered prospectus confirming the security, information about the management, or financial statements. Regulators are naturally racing to protect the interests of investors with a significant effort toward regulation and regularisation due to the enormous growth in the issuance of crypto-securities and the lack of explicit common knowledge of the business or the difficulties. Blockchain technology and privacy have been the subject of heated controversy. According to many experts and academic observers, blockchain technology is incompatible with privacy regulations like the EU General Data Protection Regulation, or GDPR. Privacy issues and data theft in the bitcoin industry are closely intertwined. Because of their apparent anonymity, cryptocurrencies are preferred by many users. However, several analytical firms have shown

that this anonymity is, at the very least, frequently grossly exaggerated. For instance, Chainalysis, a blockchain analytics company, said it could track most Zcash and Dash transactions, calling privacy coins' bluff.

CRYPTOCURRENCY AS SECURITIES

Black's Law Dictionary[i] defines the term "security" to encompass an instrument that proves a holder's ownership rights in a company or a holder's creditor connection with a company, even when the term is used in its usual sense (or government). Additionally, it says that security denotes an interest based on an investment in a single business. There are no such ownership rights, credit ties, or investments in a joint company for virtual currencies like Bitcoin and Ether. As a result, it is doubtful that these virtual currencies would qualify as securities. Virtual currencies like Bitcoin and Ether are unlikely to be subject to securities rules under the existing legal framework. There is presently no regulatory advice about the applicability of the Securities Contracts (Regulation) Act of 1956 (SCRA), which offers a non-exhaustive definition of securities in the context of virtual currencies. Virtual currencies do not fit under the definition's list of things.

Additionally, the definition-covered objects get their worth from an underlying asset. The fundamental assets of virtual currencies like Bitcoin and Ether are absent. Instead, just supply and demand are used to establish the value. Furthermore, unlike the things listed in the Indian legal definition of security, virtual currencies like Bitcoin sometimes lack an identified issuer. The Companies Act's rules, known as the Companies (Acceptance of Deposits) Rules 2014 (Deposits Rules), outline when a corporation might receive money in the form of a deposit, a loan, or any other type of payment, as well as several exceptions to its applicability. For instance, if an advance is used to pay for the provision of goods or services within 365 days, it is not considered a deposit or money received in business conduct. Several compliance procedures mandated by the Companies Act and its rules and RBI regulations would be triggered if a firm was regarded to be receiving deposits. The Securities and Exchange Board of India Act of 1992 regulates collective investment plans, which include some token issuances of virtual currencies.

TAX REGULATIONS FOR CRYPTOCURRENCY

National and international tax authorities have faced enormous hurdles in adapting the current tax regimes to a digitalized economy. Governments have, on occasion, advocated applying broad-based "virtual" profit allocation criteria rather than the notions of permanent establishment. India now applies an "equalization levy" on certain non-resident online service providers' payments. The European Union has contemplated similar actions. A "virtual permanent settlement" idea is envisioned in the long run. A 30% tax on revenue from the transfer of virtual digital assets has been imposed under the ITA, and it will take effect in April 2022. No losses, including those incurred by trading virtual digital assets, may be offset in any way. When paying sellers who are Indian residents, exchanges and purchasers must subtract 1% as tax deducted at source (TDS). Despite the vague language, non-fungible tokens (NFTs) backed by tangible assets, loyalty or reward points, and other digital assets are not subject to the 30% tax and 1% TDS. Whether a virtual currency qualifies as "goods" determines whether GST applies to that currency. No legislation defines *virtual currencies* as goods, as stated in Section I. Although the Supreme Court addressed whether virtual currencies should be classified as money or products (or commodities) in the IAMAI case[ii] and stated that virtual currencies contain characteristics of both of these categories, it did not make any firm categorization, leaving the subject open. If virtual currencies are regarded as money, then GST should not be charged as money is not covered. However, the Supreme Court noted that virtual currencies might also be considered intangible commodities and property. Therefore, how virtual money is classified for GST purposes may ultimately rely on the circumstances of the transaction. The possibility of customers being liable to GST when acquiring virtual currency and again when using them to exchange other products and services also subject to GST raises the possibility of double taxation. The GST system has not yet considered these problems. It should be emphasized that there is no explicit government guidance on applying GST to virtual currencies. The conclusion above is based on our examination of GST laws as they apply generally.

CRYPTOCURRENCY AS COMMODITIES

The Supreme Court raised some concerns in the IAMAI case on whether a virtual currency might also be categorized as an item or commodity. Ultimately, it was decided that a virtual currency is an intangible asset that functions as money under particular conditions. A commodities spot exchange, which deals with immediate delivery, and a commodities derivative exchange, which deals with derivative contracts, are both essential ideas in the commodity arena. Without government clearance, the NDI Rules limit foreign involvement in commodities spot markets to up to 49% of the share capital. Any exchange that facilitates commodities derivatives must be a recognized stock exchange, according to the SCRA.

Cryptocurrencies are listed and traded on stock exchanges across several nations. BTC in China, Bit Box in the United States, Mt. Gox in Japan, Bitcurex in Poland, and Bitsamp in Slovenia are a few examples. There are more than 100 cryptocurrencies on the market, with Bitcoin leading the pack. There is no official cryptocurrency exchange in India. However, you may purchase and trade cryptocurrencies through various websites in India. India accounts for one out of every ten bitcoin purchases and sales. The Supreme Court recognized computer software as a "good" subject to sale tax in the case of Tata Consultancy Services v. State of Andhra Pradesh[iii]. The ability to be transferred, delivered, saved, processed, etc., makes computer software conveyed on diskettes, CD ROMs, floppy discs, magnetic tapes, etc., a component of a computer or separate commodities.

The central government may, however, classify virtual currencies (generally speaking, or any group of them) as commodities under the announcement above. Derivative contracts in virtual currency would thus be within the SCRA's purview (and so fall under SEBI's authority). FDI would then be limited to 49% of the capital for spot trading. Currently, there is no distinct licensing system for commodities spot exchanges.

OTHER REGULATORY ASPECTS

Virtual currency exchanges and trading platforms are not explicitly controlled; their operations are constrained by applicable corporate, criminal, labor, municipal, and tax laws. Despite the Supreme Court's decision to invalidate the VC Circular, exchanges are encountering obstacles when trying to use the services of licensed financial institutions. The RBI issued a circular to

its regulated businesses on May 31, 2021, providing clarification. Due to the pseudonymous nature of virtual currency transactions, it is sometimes challenging for authorities to follow them. Although wallet IDs may be recorded on the blockchain, connecting these wallet identities to specific individuals is difficult. Because authorities cannot follow the flow of money that may be used for money laundering, they are alarmed by the possibility of transmitting something of value via the internet while evading the traditional financial surveillance system. Blockchain technology is frequently described as "tamper-proof." Every previous block is tied to every new digital "block" containing a record of transactions. A dishonest player would need to alter all blocks behind it in the chain to alter any records stored within without being noticed. There is no single point of failure that dishonest players may override since blockchain is a decentralized ledger. Instead, they would need much power to overrule and change every node concurrently. Public blockchains, where there may be any number of nodes present anywhere in the globe, are particularly notable for this. Because critical servers may be targeted and changed covertly in centralized systems, blockchain poses a lesser risk of assault. The safety of wallets, double-spending, increasing susceptibility to planned assaults on Bitcoin exchanges, and worries about rogue miners engaged in selfish mining are just a few of the severe security issues and concerns associated with virtual currencies. These worries might be harmful to Bitcoin or any other cryptocurrency, but perhaps not in the same way.

OTHER COUNTRIES PERSPECTIVES ON CRYPTOCURRENCY

United States of America

The US Securities and Exchange Commission (SEC) views cryptocurrencies as securities and thus broadly applies securities regulations to digital wallets, impacting both exchanges and investors. On the other hand, the Commodities Futures Trading Commission (CFTC) has taken a more accommodative stance, recognizing Bitcoin and Ethereum as "commodities" and permitting other virtual and cryptocurrency futures to trade openly on exchanges that it oversees. The Justice Department, the SEC, CFTC, and other agencies are still working together.[iv] Authorities discuss potential cryptocurrency rules to guarantee efficient consumer protection and improved regulatory control. The government strategy is still sluggish, though,

due to the Covid-19 situation, which is impeding (while increasing the urgency of) efforts to progress cryptocurrency legislation. Despite difficulties, US politicians are eager to regulate cryptocurrencies in light of the possible disruptive effects that private and centrally banked currencies may have on the US dollar, which now holds the majority of the world's reserves. Despite not considering cryptocurrencies legal cash, the Internal Revenue Service describes them as "a digital representation of value that operates as a medium of exchange, a unit of account, and a store of value" and has published tax guidelines in that regard.

United Kingdom

Cryptoassets are defined as "a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology (DLT) and can be transferred, stored, or traded electronically" in the Money Laundering, Terrorist Financing, and Transfer of Funds (Information on the Payer) Regulations of 2017[v] (MLRs). When we refer to virtual currencies in this chapter, it should be taken to include all forms of crypto assets as existing UK regulatory legislation and advice typically refers to them as such (rather than virtual currencies). In response to the regulatory ambiguity surrounding cryptocurrencies, the UK government established a task group in 2018. The task force established a necessity for extra AML/CFT and taxes considerations before defining three categories of cryptocurrencies and three methods for employing crypto assets. The tax authority of the United Kingdom, Her Majesty's Revenue and Customs (HMRC) has released a brief on the taxation of cryptocurrencies, claiming that due to their "unique identity," they cannot be compared to traditional investments or payments and that their "taxability" is dependent on the actions and parties involved. Cryptocurrency profits and losses are subject to capital gains tax. However, it is anticipated that the UK's crypto regulatory environment will eventually differ somewhat from the EU's. HM Treasury guidance, released through the UK Crypto Asset Task Force in January 2021, emphasized the UK's intention to consult on bringing specific cryptocurrencies under the purview of "financial promotions regulation" and to continue considering a "broader regulatory approach" to crypto assets. However, at this time, no specific UK crypto legislation is on the horizon.

Canada

The regulatory challenges confronting bitcoin consumers and companies are caused by the fact that cryptocurrencies are treated as commodities and are subject to the PCA. Given that both provincial and federal legislation impact how cryptocurrencies are handled in Canada, it is important to consider Canada's financial regulatory framework and practices while analyzing the legal implications and concerns of the PCA. Canada does not have a federal securities regulator, unlike the Securities and Exchange Commission of the United States. Instead, each province is given the power to oversee the regulation of securities, real estate, and other rights. Although not considered legal cash in Canada, cryptocurrencies can be used to pay for products and services online or at merchants that accept them. It was the first nation to approve AML-related regulation of cryptocurrency service providers, primarily regulating them under provincial securities laws as money service businesses (MSBs) to protect the public. Canada has been relatively proactive in treating digital, virtual, and cryptocurrencies. Exchanges in Canada are subject to the same regulations as money services businesses (MSBs) dealing with fiat currencies, including the same duties for due diligence, record keeping, verification, and reporting. Following the PCMLTFA's[vi] revisions, adopted in July 2019, all cryptocurrency exchanges will need to register with FinTRAC and, if necessary, adhere to margin and market value rules starting in June 2020. Although Canada's cryptocurrency rules work to centralize the underlying decentralized technology and may deter potential users, Canadians should be optimistic about the future of cryptocurrencies in their nation. The Canadian government has realized the potential advantages and has taken decisive action to adopt the technology. The government may need some time to find a good balance between instilling fear and promoting innovation. To safeguard themselves and their companies until the government's concerns subside, bitcoin users should become well-versed in the tax laws and regulations.

Australia

The MoneySmart website[vii] of the Australian Securities and Investments Commission (ASIC) outlines hazards related to purchasing, trading, or investing in virtual currencies. These include the lack of safety because exchange platforms are typically unregulated, significant value volatility, potential hacker theft, and the prevalence of virtual currencies among criminals. Information regarding initial coin offerings, which ASIC describes as a "high-risk speculative investment," is available on a separate website. The lawmaker clarified that Bitcoin (and

cryptocurrencies with similar properties) should be regarded as property and taxed on capital gains (CGT). Under Australia's goods and services tax (GST), cryptocurrencies were previously subject to contentious double taxation; the change in tax classification reflects the Australian government's progressive stance on the cryptocurrency problem.

In August 2017, the government proposed a bill in Parliament to implement the Senate committee's recommendation to include digital currency exchange providers under the AML/CTF regulatory framework. This is in the domain of anti-money laundering and terrorist funding (AML/CTF). The essential parts of the law went into effect on April 3, 2018, after the bill was passed in December 2017.[viii]

Australia has a history of aggressive cryptocurrency regulation, and these most recent rules show the nation's ongoing commitment to offering a crystal-clear operating environment for bitcoin enterprises moving forward. However, the way AUSTRAC conducts future compliance enforcement will undoubtedly change in light of recent discoveries that have highlighted severe faults in Australia's financial sector. This will probably result in enhanced scrutiny and tighter regulatory restrictions.

RECENT DEVELOPMENTS

Due to its imprecise character and the underlying effects connected with it, the term "private cryptocurrency" used in the Lok Sabha Bulletin has sparked controversy and criticism. It is argued that the Government's definition of "private" might indicate that any digital money that is not sovereign could be viewed as a private currency as the text of the Bill is not currently available in the public domain. Additionally, this interpretation of "private" would forbid the two most widely used cryptocurrencies. While the Government has been considering the future of cryptocurrencies for many years and has released several advisories through the RBI warning investors against the risks of crypto/virtual currencies, this decision to outlaw "private cryptocurrencies" is being seen by some experts as being rushed/hasty without consulting the stakeholders and setting India back by a decade. The Bulletin further noted that although the measure is against private cryptocurrencies, it would provide specified exclusions to advance the cryptocurrency's core technology and applications, increasing Bill's ambiguity. A high-level Inter-Ministerial Committee (IMC) has been established, and its role is to research

different cryptocurrency-related issues and provide recommendations for future measures. Nirmala Sitharaman, the finance minister, made all of this official in the Rajya Sabha on February 20, 2021. The Government is adamant about introducing a bill on cryptocurrencies, according to Anurag Thakur, minister of state for finance, who announced in the legislature. Nirmala Sitharaman, the minister of finance, has also stated that the Government wants to foster innovation and research in fields connected to cryptocurrencies with a flexible outlook. The Blockchain and Crypto Assets Council (BACC) and various representatives of Indian cryptocurrency exchanges met with the standing committee on finance in November 2021. They concluded that it would be unfair to ban cryptocurrencies outright in India but that they should be regulated instead.

CONCLUSION

India's cryptocurrency market will remain uncontrolled until a framework for regulation is implemented. Although the Supreme Court's decision has given the cryptocurrency market momentum and cryptocurrency start-ups are growing and introducing new products in India, there are some worries as well due to reports that the finance ministry has floated a government bill for inter-ministerial consultations that could outlaw cryptocurrencies. Cryptocurrency has the potential to improve the e-Business and e-payment sectors even more. However, there is not currently much confidence in cryptocurrencies. Numerous bitcoin systems are plagued by various worries, difficulties, and problems. Users of cryptocurrencies should exercise additional caution while utilizing them until it is properly regulated and managed. When creating new rules and regulations regulating cryptocurrencies and VC exchanges, the government must consult and include all significant players. For India to accept cryptocurrencies, there is much support from all sectors of the business and IT community. In a Financial Times interview, Nandan Nilekani, co-founder, and chairman of Infosys, voiced enthusiasm and support for cryptocurrencies in India and urged Indians to accept digital money as an asset class. After considering the opinions and suggestions of stakeholders and market players, a risk-based framework must be created. Such a system may be created in stages for practical reasons. If this materializes, cryptocurrencies will have a promising future in India and develop further over the coming several years.

Even if the government could have some qualms about cryptocurrencies, it should move quickly with developing its own digital money.

The Indian government should not fall behind in the new-age technological transformation and should work to profit from what blockchain technology has to offer.

ENDNOTES

[i] Black's Law Dictionary (Eleventh Edition), 2019

[ii] Internet and Mobile Association of India v. Reserve Bank of India, 2019 SCC OnLine SC 1800

[iii] Tata Consultancy Services v. State of Andhra Pradesh (2005) 1 SCC 308, 2004 SCC OnLine SC 1419

[iv] David Lucking, Vinod Aravind: Cryptocurrency as a Commodity: The CFTC's Regulatory Framework, (2019) https://www.allenovery.com/global//media/allenovery/2_documents/ news_ and_insights/publications/2019/8/cryptocurrency_as_a_commodity_the_cftcs_regulator_framework.pdf

[v] The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.

[vi] Govt. of Cananda, Proceeds of Crime (Money Laundering) and Terrorist Financing Act, https:// www. fintrac-canafe.gc.ca/act-loi/1-eng

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