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Legality And Regulatory Challenges of Cryptocurrency in India

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Abstract – With the rapid development of technology there has been a nascent growth of cryptocurrencies which has attracted the trade in it multifacetedly involving nations at large. With the use of these currencies in the digitized economy made it popular leading to increase in the demand for these currencies. Due to inapplicability of legal compliance in a specific manner, cryptocurrencies have become a target of security threats. Situations like these have made it necessary to make discussions onto formulating law to regulate these currencies which can help in developing the nations to grow their economy at par with technological advancement and with minimizing the unpredictable security threats.

Index Terms – Blockchains, Cryptocurrency, Regulatory measure, Virtual currency

INTRODUCTION

Money is commonly accepted medium in the exchange and is essential to run the market [1]. With the technological advancement and development in E-commerce there came shift from fiat currency to the other forms of currencies which can be easily tradable through electronical means. The shift to digital dealing has helped in certain aspects like cost reduction, expansion of market and trading activities which has attracted more people. Because of multifaceted advantages that came along with electronic money, exchange through traditional means seemed to have taken back seat in the market [2]. Moreover, the attention for digital money has also increased as it has facilitated the trade much easily even when the parties are not physically present when the agreement is done.

"It is not ironic that Milton Friedman, author of a leading treatise on the interaction of currency, macroeconomics and governmental action prophesized of a time when the internet would help evolve a new currency". Fiat currencies are generally used in trading activities which is centralized as issued and regulated by regulatory body authorized by the central government. Fiat currencies are attached with underlying value of gold. Hence, in the modern time new manner of trading is developed through the currency which works independently without the derivation of its value.

The currency has evolved over the time which can be traced from its history where it was in the form of token money which entailed the value with itself. Then came the idea of creating notional money which does not have value of its own but has derived the value from another place. In opposite to this, credit system was developed where the value was tied indirectly thereby making the person liable when the transaction is done. These systems were developed at a rapid pace which has played vital role towards the effective functioning of digital payment.

Specifically talking about cryptocurrency, which a subdivision of digital currency, is an exchange medium based on cryptography through which new units are created and transactions are made secure transactions. The most glaring feature of cryptocurrency lies in its nature that there is no role of intermediary like banking institution or governmental authority in between when the transaction is transacted. The system itself works altogether which creates new units on prearranged price and thereby released with public. Neither there is any role of government or banking regulator on such currency supply. The system through which cryptocurrencies are made workable at present was introduced by Santoshi Nakamoto in his paper. Although the identity of any such person cannot be traced and it is still not clear whether it is an individual or an entity which has introduced the most popular cryptocurrency, Bitcoin.

The digital world got popularity after the introduction of Bitcoin, which is an experimental currency based on cryptography [3]. It was introduced in 2008 because of layman brothers collapse which has impacted world economy [4]. The incident has impacted in a way that people have lost their faith towards banking institutions and government regulated currencies resulting in the failure of financial institutions and economic structure. The banks and insurance companies were released from its debts after spending millions of dollars. The excessive money supply back in the economy resulted in global recession due to failure of economic productivity. Ultimately, causing debt crisis all over the world [5]. In such situation, the price of gold was also increasing continuously. In such a situation Nakamoto, has for the first time published the paper introducing the working of Bitcoin.

It was mentioned in the paper that while operating the system of lending fiat currency is mismanaged by the banks by keeping no reserves to itself and money is aimlessly given to the people. Cryptocurrency, on the other hand, as remarked in the paper is a "peer to peer" system of electronic payment. It was also mentioned in the paper that under such system holders can send and receive payment directly with no interference of banking institutions. Moreover, there is no role of government and central banks in money regulation since the units are created with no interference of outside parties in it. Nakamoto in his paper remarked, "*everything is based on crypto proof instead of trust"*. Traditionally, the value of currency in the traditional manner is generated through the rules set by the government but this is not the case with cryptocurrency. The virtual currency derives its value in its consistency with demand and supply forces having no interference from external authorities. Therefore, cryptocurrencies are sole dependency of cryptocurrencies are on the people who are willing to trade for it. Hence, it only requires certain programmed algorithms for its regulation while trading and no such regulatory intervention is needed from the authority. Unlike the traditional currencies, cryptocurrency is operated having its virtual form which can be used for online payments as well as payments to be made in the stores. The creation of cryptos with the ever-increasing technology and use digital mode of payment through internet connectivity is unavoidable at present times. Hence, the predictions are made that cryptocurrencies have come up with a potential of becoming international currencies having no bar of territorial interference of any state. After looking onto the growth of cryptocurrencies, many nations have recognized its benefits and incorporated legal norms to regulate virtual currencies. At the same time, there are certain nations who refuse to accept it on legal grounds.

FUNCTIONING OF CRYPTOCURRENCIES

"*Bitcoin is a cryptocurrency, a form of payment that uses cryptography to control its creation and management, rather than relying on central authorities*". Bitcoin was introduced in 2009 which works as an open-source software to facilitate payments through online mode. Bitcoins got its recognition as decentralized currency throughout the world [6]. Bitcoins are also formed as peer-to-peer system of digital payments. There are several difficulties which are always stressed upon while creating channel for cryptocurrencies. While criticizing the working of cryptocurrencies, the question of "double spending" is stressed upon where the currency unit is not associated in tangible form which can be spent more than single time immeasurably. Additionally, no algorithms suggest any mechanism to control such problem. Answerably, the system of "block chains" are relied upon to combat the problem of double spending where blocks are shared with public, and every block records the transactions made in cryptocurrencies. Thus, combatting with the problem of non-availability of regulator for checking upon the transactions and eliminates the problem of double spending. Through cryptography process authenticity is managed whereby the data is secured with encrypted tool referred as cipher text which convert the information in format unreadable in nature causing no misuse of information by any person except an authorized user. Unique keys are used for keeping the data secure and encrypted. Only the authorized access of unique key can decipher the message. The classification of cryptography is done in following manner:

- System of asymmetric encryption where single key is used which are with sender and recipient, and
- System of public key where two keys are used, public key is available with everyone and private key is unique and restricted to be kept with the recipient only.

Major benefits

Cost effective: In comparison to traditional banking setup, transactions which are operated through online digital means involves less cost. No such infrastructural facility is required is digital banking apart from internet connectivity and technologically smart instruments to operate it. Moreover, the fees charged in lieu of services provided by the banking institute can be saved while transacting through online mode.

➢ No restrictions are imposed upon cross boundary transactions: no requirements are needed to handle paper notes and coins. This is in turn helps to make transactions are across the nations and can be proved as cost effective since dealings through internet transaction are one and same whether made within nation or outside the country.

➢ Helps in enhancement of safety and security: in involves lesser risk of theft when money is kept in electronic form. Thus, creating the system with utmost safety while dealing in block chain.

LEGAL ANALYSIS OF CRYPTOCURRENCIES IN INDIA

Indian Constitution authorizes the central government to look upon the matters which comes within its legislative competence under Article 246. Schedule VII of Indian Constitution empowers central government to legislate in the matters pertaining to currency, money as legal tender, negotiable instruments, and other instruments [7].

The pragmatic solution can be made if it is reasonably proved that cryptocurrencies can be interpreted in the manner that it can be a subject matter of central government's legislative competence. The constitution of India is regarded as grund norm of the nation which provides with the powers and defines the scope to exercise those powers. Resultantly, if any such power is exercised outside its scope is regarded to be struck down by judicial process. The legal analysis of cryptocurrencies can be made by giving reference to certain laws as mentioned below:

RBI regulates the currency and foreign exchange in India. all these enactments deal with currency issuance and its utilization [8]. In the absence of clear definition of currency under RBI Act, the reference can be made from FEMA which defines currency, which includes, "*all currency notes, postal notes, postal orders, money orders, cheques, drafts, travelers' cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank."* Furthermore, the notes which are issued by RBI are regarded as legal tender. Subsequently, as per the Coinage Act, inclusion of legal tender includes only the coins which are authorized to be issued with the authority of section 6 of the said Act. Therefore, cryptocurrency do not fall under the category of legal tender or currency. Thus, if the statue expressly mention instrument within its ambit would mean that it is impliedly excluding other instruments to fall within its ambit. Therefore, conclusion can be drawn that virtual currencies do not fall within these definitions and thus should be excluded to be considered as currency

ROLE OF RBI AND JUDICIARY TOWARDS CRYPTOCURRENCY

There have been relentless efforts made by the central government to put a categorical ban on trading of cryptocurrencies [9]. Due to lack of governance from banking regulator various concerns have been raised towards cryptocurrency which can be used as conduit for black money or its funding for terrorism. Despite all odds, virtual currency has over the time has become popular globally and gathered its momentum in India as well. To stop the trading, RBI has always prohibited users not to operate in virtual currencies. Through various press releases it has warned the risk to the financial setup of India because of use of cryptocurrencies. Through its circular prohibition was imposed upon buying, trading and exchange of cryptocurrencies. Resultantly various enterprises had gone bankrupt and many of them have shifted their base to other countries [10]. Additionally, "Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019" was proposed in the parliament through inter- ministerial committee on 28th February,2019 suggesting complete ban on private cryptocurrencies [11]. Although, the Bill did not get approved in the Parliament. The said circular of banning cryptocurrencies has put entire cryptocurrency trading in India in turmoil. Consequently, different trading entities through writ petition has challenged the validity of circular [12]. Analysing the role of RBI as central bank, the apex court has accepted the role of RBI to regulate virtual currency business in India. Yet, the circular was struck down by the Supreme Court as RBI has failed to prove the 'proportional damage' caused by cryptocurrency trading in India.

Interestingly, in the judgment of March 2020 given by the Hon'ble Supreme Court of India in *Internet and Mobile Association of India and Others v. Reserve Bank of India,* held that Central Bank of the country could not demonstrate the requisite evidence to validate the harm caused by cryptocurrency in the present trading setup in India. The decision of Supreme Court has somewhere proved validity of cryptocurrency [13]. Though the Apex Court has suggested for regulation of cryptocurrencies in India, which was a provision relief to all the users, there felt an urgent need for a definitive regulation for virtual trading. Most recently, the parliament has not yet introduced any legal framework to regulate digital assets, but Finance minister has clarified that such assets would be taxed with a uniform rate of 30 % [14]. This step of government to regulate digital currency has given some hope to the cryptocurrency market in India but at the same time it is aiming towards ban of private cryptocurrencies which is leading towards uncertain future of digital currencies like Bitcoin. Crypto market in India at one end, has witnessed satisfactory growth during COVID 19 pandemic, but the recent approach of Indian government has threatened the future of crypto industry once again.

The Payments Act empowers RBI to keep a check on to the system of payment in India. cryptocurrency transaction is based upon peer-to-peer system which can be said that not settlement of payment is made between payer and payee, thus, cannot be brought under the purview of this Act. As per the directions given by RBI payments through any prepaid instrument is paid by keeping the equivalent value of it. It is functioned by keeping the value stored in the equivalent manner as the value paid by holder. Cryptocurrencies on the other hand, derive its value from the speculations made in the market rather than following the principle of equivalence which in turn creates a lot of fluctuations in its value. Moreover, cryptocurrencies neither can be treated as securities as per Securities Contract (Regulation) Act, 1956 because no such asset is underlined while dealing in cryptocurrencies. Also, cryptos are not issued by the company rather they are created through mining process.

Additionally, to make observations regarding the violation of public policy while dealing in cryptocurrencies, a reference can be made to Indian Contract Act, which provides that certain contracts may be declared as unlawful if it is against the public policy. The Supreme Court while dealing with the same questions has viewed that, "*A contract relating to Bitcoin, prima facie, is not such that its enforceability would defeat the provisions of law or is otherwise fraudulent. Therefore, a contract respecting Bitcoin, whether it is in relation to mining of Bitcoin, transfer of Bitcoin or transfer of Bitcoin for consideration, is not per se illegal.*" Thus, there is nothing in the law which suggests that cryptocurrency is going against the public policy and hence, the contract made while dealing in the cryptocurrency cannot be declared as unlawful [15].

VARIOUS CHALLENGES WHILE REGULATING CRYPTOCURRENCIES

Such uncertain circumstances call for a legitimate policy to regulate cryptocurrency in India. RBI has always opposed trading in cryptocurrencies and through various notifications taken steps to put a ban on cryptocurrencies in India. RBI has time and again cautioned all the traders not to trade in cryptocurrencies through its press release. RBI has analyzed the risk involved in cryptocurrency trading, for which it discourages cryptocurrency [16].

The nature of cryptocurrencies is digitalized which can pose online security threats. It gets more serious when there are no regulatory measures which are defined to protect rights against such threats. Such situations can lead to the permanent loss of digital money with no application of measures of legal recourse that can be applied. Moreover, the transaction is done online which again fails to provide mechanism for resolving disputes of consumer protection. Another reason can be the volatile nature of cryptocurrency where the price of cryptos is solely dependent upon the speculations based on demand and supply with no backing of any underlying assets which again can cause uncertainties [17]. Not all the jurisdictions have recognized the legality of cryptocurrency. Thus, it can cause financial risk to the investors and dealers trading in cryptocurrencies since their right are not protected under the legislation of countries which has not accepted or partially accepted the legality of cryptocurrencies [18]. No KYC norms can be applied onto cryptocurrency since it is not available in physical form. Hence, it can attract transactions of money laundering since the transactions cannot be traced or monitored. It is reported that after the inception of cryptocurrencies, the digital money is used as an instrument of appropriation of money illegally by opting through various techniques of money laundering which has been the major concern of most nations.

FINDING OF THE STUDY

In an era of nascent technologically guided business worldwide, it is essential for country like India, which is developing at a very fast pace to formulate regulatory measures to deal in cryptocurrencies. The absence of regulation makes it dubious for banks and financial institutions to have inclination towards making an investment in virtual currencies. Systematic regulatory measures for cryptocurrency trading are quintessential for avoidance diversion of capital and investments through cryptocurrency to other nations having liberal rules. Author has also noticed that there exist various private digital currencies which can be a challenge to regulate through proper mechanism. Hence, there is requirement of systematic approach through which definition of cryptocurrency can be clarified which in turn can help the nation to develop a unified policy to regulate cryptocurrency. A comparative analysis of legality of cryptocurrency at global level has resultantly drawn an outcome of significant variation in their approach from country to country. Several countries have recognised legal status of cryptocurrencies while others have refused to accept it as legalised platform to have trade in. USA being one of the countries which has not given cryptocurrency the status of fiat money but has recognised it legally. Perhaps, the regulatory compliance has been stringently applied to check upon diversion of cryptocurrency for unlawful activities such as money laundering, funding for terrorist activities and other illicit activities such as narcotics, frauds etc. The upward rise of trading in digital currencies during COVID-19 should be considered as greatest milestone to have a positive perspective towards crypto trading in India. Also, using the comparative legal methods for the development of regulatory framework on cryptocurrency in India is the need of an hour rather than following sledgehammer approach of totally banning crypto currency trading. Thus, regulatory framework should be made in such a way which punishes the wrongdoers rather than banning the technology.

CONCLUSION

Soon, it is predicted that virtual currencies do have potential to replace the traditional form of currency. Thus, the government can either rejects the legality of cryptocurrency and can invalidate it or it can decide to regulate the transactions dealing with cryptocurrency by forming the regulation in this respect. It is suggested that looking onto the development of online transactions, the reluctant approach of rejecting the new developments in the technology by declaring cryptocurrency as illegal transaction would not solve the purpose. Thus, regulating it would be a better step for India rather than opposing the working of cryptocurrency because any such stringent approach towards virtual currency may show that government lack in accepting the new challenges that are brought forward in its way of legislative competence. Moreover, as suggested in supreme court ruling where no evidence could be proved by RBI and government that cryptocurrencies are creating security threats in Indian markets, the government cannot oppose cryptocurrencies based on assumption which in turn will also violate the fundamental rights of the individual to carry the trade freely. It is also observed that many countries have decided to regulate cryptocurrency looking onto the potential of it becoming an internationally recognized currency.

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