
COVER STORY

CRYPTOCURRENCY

INDIA'S CRYPTOMAZE

CENTRE, RBI AND THE
JUDICIARY BLOW HOT
AND COLD ON LEGALITY
OF CRYPTO-CURRENCIES,
LEAVING INVESTORS
AND 340 TRADING
PLATFORMS IN A FIX

BY AVNEET KAUR

ILLUSTRATION BY RAJ VERMA

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340

NUMBER OF
CRYPTO START-
UPS IN INDIA

\$400-500

million
DAILY CRYPTO TRADING
VOLUME IN INDIA

₹25.47

lakh
PRICE OF 1 BITCOIN
AS ON JUNE 21, 2021

Om

May 22, 2010, Laszlo Hanyecz, a Florida-based programmer, made the world's first commercial transaction using bitcoins. He bought two pizzas for 10,000 bitcoins. At today's prices, that's \$357 million, making it the world's most expensive food order ever. A month ago, when bitcoin was at its peak, the two pizzas would have been valued at \$600 million. Cryptocurrency enthusiasts celebrate May 22 as the Bitcoin Pizza Day.

Despite their enormous appeal and growing demand, cryptocurrencies such as bitcoin are fighting for legitimacy globally. But nations detest them. Government of India is, in fact, looking at criminalising possession, mining, trading, transfer and issue of crypto assets. Even though this threatens the Digital India initiative by hurting the development of blockchain – a database that stores data in blocks and could potentially help governments and companies in seamless record-keeping and reducing frauds.

\$1.33 trillion **Market cap of global crypto industry as on June 21, 2021**

Source: CoinMarketCap

TO BE OR NOT TO BE



NIRMALA SITHARAMAN,
Finance Minister



**SUPREME
COURT**

March 2021
A lot of negotiations and discussions are happening around cryptocurrency with RBI. We want to make sure there is a window available for all kinds of experiments which will have to take place in the crypto world

Feb 2021
A high-level committee formed to study issues related to virtual currencies (VCs) has recommended that all private cryptocurrencies, except those issued by the state, should be prohibited.

Feb 2021
Central bank has reservations about cryptocurrencies and is working on its own digital currency



SHAKTIKANTA DAS,
RBI Governor

March 2020
When the consistent stand of RBI is that they have not banned VCs and when the Government is unable to take a call despite several committees coming up with several proposals, including two draft bills, both of which advocated exactly opposite positions, it is not possible for us to hold that the impugned measure is proportionate

PHOTOGRAPH BY BANDEEP SINGH

Over the past eight years, the central government, the Reserve Bank of India (RBI) and the judiciary have been blowing hot and cold over cryptocurrencies, without providing a clear answer whether they are legal or not. This has kept those who have invested ₹15,000 crore in 340 crypto trading platforms on tenterhooks. Nearly \$400-500 million (₹2,920-3,650 crore) worth of daily trading is at stake as industry awaits in stony silence.

What are Cryptocurrencies?

Cryptocurrencies are digital assets on peer-to-peer net-

works. They run on blockchain. This makes it impossible to change, hack or cheat the system as transaction ledgers are distributed across peer networks. New transactions are added to every participant's ledger. The digital ledger publicly validates all transactions.

These digital coins can be used as currency, asset, securities or utilities. As currency, they can be used for buying various goods and services. Bitcoin, for instance, is being accepted for various goods and services. As an asset or a security, it is like shares. The security tokens derive value from an external asset that can be traded. These tokens

represent rights over property, company shares, revenue streams or underlying assets. In some countries, there are tokens where anytime a company makes, say, \$100 in profit, and there are 100 token holders, each person automatically receives one unit in value. “It’s like programming dividend distribution into blockchain,” says Jaideep Reddy, Technology Lawyer, Nishith Desai and Associates. Utility tokens are user tokens or app coins which provide discounts or additional benefits, just like an Amazon coupon. The Ether token represents right of access to the Ethereum network. A crypto asset can fall into more than one category. Ether can be used both as a payment and utility token.

What Government Wants

The uncertainty around cryptocurrencies in India is a result of conflicting statements by government and RBI. In February 2021, RBI Governor Shaktikanta Das said the central bank has reservations about cryptocurrencies and is working on its own digital currency. Around the same time, Finance Minister Nirmala Sitharaman said in the Rajya Sabha that a high-level committee formed to study

issues related to virtual currencies (VCs) has recommended that all private cryptocurrencies, except those issued by the state, be prohibited. Next month, she said, “A lot of negotiations and discussions are happening around cryptocurrency with RBI, which will take a call on what kind of unofficial cryptocurrency will have to be planned and how it is to be regulated. We want to make sure there is a window available for all kinds of experiments which will have to take place in the crypto world.”

Meanwhile, the government is tightening the regulatory noose on crypto traders and platforms. A notification by the Ministry of Corporate Affairs earlier this year makes it mandatory for companies to disclose details of cryptocurrency trading and investments during the financial year. The government wants to gather data on companies’ exposure to cryptocurrencies. Experts fear this could be the start of investigations around institutions which buy and sell digital currencies. “This investigation might be used to take penal action in future,” says Uday Ved, head of tax at KNAV, a global accounting firm.

In June 2021, the Enforcement Directorate (ED)

Bitcoin: The Trailblazer



- **Oct 2008:** Satoshi Nakamoto releases white paper 'Bitcoin: A Peer-to-Peer Electronic Cash System'
- **Dec 2010:** Nakamoto leaves Bitcoin community; 1 bitcoin at \$0.06
- **Jun 2011:** Bitcoin at \$32, gains traction on Dark Web
- **2012:** Cryptocurrency makes subtle India entry
- **Jun 2013:** RBI releases first Financial Stability Report, defines virtual currencies as type of 'unregulated digital money'
- **Dec 2013:** India's first cryptocurrency exchange Unocoin launched; Bangalore hosts India's first global Bitcoin conference

\$605 billion

Market cap of Bitcoin, the largest cryptocurrency, as on June 21, 2021

charged WazirX, India's largest cryptocurrency exchange, with money laundering and fund diversion. Its notice alleged violation of FEMA Rules, 1999, for transactions involving cryptocurrencies worth ₹2,790.74 crore. According to the ED, WazirX users received cryptocurrency worth ₹880 crore via its pool account from Binance, the world's largest cryptocurrency exchange, and transferred out cryptocurrency worth ₹1,400 crore to Binance accounts. The ED is also probing some Chinese nationals who allegedly laundered ₹57 crore by converting the money into digital currency Tether and sending it to Binance accounts. Officials say none of these transactions are available on blockchain for audit or investigation. "It was found that WazirX clients could transfer 'valuable' cryptocurrencies to any person irrespective of location and nationality without proper documentation, making it safe for those indulg-

ing in money laundering or other illegitimate activities," says an ED official.

Rajesh Narain Gupta, Managing Partner, SNG & Partners, a full-service law firm, says WazirX may face rough weather in India. "Indian regulators need to adopt a firm stand on cryptocurrency as fate of investors and platform-offering services hangs in balance," he says. "The government has been aware of cryptocurrencies since 2013. Since nothing significant could be done in the past seven-eight years, no harsh steps should be taken suddenly when so much is at stake. There is a need to take a logical, informed and global view," says Gupta.

Blowing Hot and Cold

In 2013, RBI, for the first time, released a Financial Stabil-

Nov 2016: Demonetisation fuels investment in cryptocurrencies

Dec 2017: Bitcoin crosses \$20,000

Feb 2018: Government of India announces Bitcoin will not be legal tender

Apr 2018: RBI issues circular prohibiting dealing in virtual currencies

Feb 2019: Finance ministry committee recommends banning cryptocurrencies, suggests creation of digital Rupee. Recommends fine of up to ₹25 crore, or imprisonment of 1-10 years, or both.

Mar 2020: SC strikes down RBI's crypto ban, terming circular unconstitutional

Apr 2020: Cryptocurrencies trading volume up 700-800%

Jan 2021: Bitcoin touches \$30,000 and then \$40,000 in a week

Jan 2021: Government plans 'The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021' to create sovereign digital currency; ban private cryptocurrencies

Feb 2021: Bitcoin breaches \$50,000; RBI's Shaktikanta Das says central bank working on digital currency; FM Nirmala Sitharaman states panel recommended prohibiting all private cryptocurrencies, except state-issued virtual currencies

Mar 2021: Bitcoin breaches \$60,000; FM softens stance on crypto,

says not all windows to be shut; Schedule III of Companies Act amended to make it mandatory for companies to disclose crypto trading and investments during the fiscal year

Apr 2021: Bitcoin peaks at \$64,000; Many banks blacklist crypto merchants and block crypto transactions in customers' accounts; MoS for Finance and Corporate Affairs, Anurag Thakur, assures protection of investors' interests; expresses concern over volatile prices

May 2021: Bitcoin plunges 50% to near \$30,000 on Elon Musk's tweet suspending vehicle purchase using Bitcoin and Chinese government issuing warning to financial institutions not to conduct virtual currency-related business

ity Report in which it defined VCs as “unregulated digital money, issued and controlled by developers and used and accepted by members of a specific virtual community.” Later that year, it cautioned users, holders and traders of VCs about financial, legal and security risks. It said RBI was examining the legality of such currencies. The 2017 report of an Inter-Disciplinary Committee advised against dealing in VCs. It recommended legislative changes that would make “possession, trading and use of cryptocurrencies illegal and punishable”. In 2018, RBI prohibited use of the banking system for cryptocurrency-related payments. This was set aside by the Supreme Court in 2020.

After this, people rushed to invest in bitcoin and other cryptocurrencies. Crypto exchanges in India have seen a multifold growth in volumes in last one year. WazirX saw a 700-800 per cent rise in volumes. Meanwhile, the price of Bitcoin surged 790 per cent from \$6,500 in March 2020. It delivered over 300 per cent returns in FY20 and over 800 per cent in FY21, the highest across asset classes. Investor interest means India now has around 340 start-ups in the crypto space. A lot is at stake.



PHOTOGRAPH BY SUBIR HALDER



CRYPTOCURRENCIES BASICALLY HAVE NO VALUE AND THEY DON'T PRODUCE ANYTHING. IN TERMS OF VALUE: ZERO. I DON'T HAVE ANY CRYPTOCURRENCY AND I NEVER WILL

Warren Buffett, CEO and Chairman, Berkshire Hathaway

High Stake-Game

Around one crore investors in India are believed to be holding ₹10,000-15,000 crore worth of cryptocurrencies. That's a lot of money for an outright ban. “The draft that said possessing, holding, transferring cryptocurrencies would be punished by imprisonment or fine would bring lakhs of people under lens and force them to liquidate their assets,” says Jaideep Reddy.

Experts say even if the government provides investors a 90-day window to get rid of their holdings, who will they sell to? “It will be difficult for small investors as they won't be able to liquidate,” says Harish B.V., Co-founder & COO, Unocoin, a platform for trading cryptocurrencies.

Does this mean those who own cryptocurrencies will be stuck with their holdings? Experts don't believe the government will wipe out such huge investments belonging to millions of people. Reddy says a ban may remove the legitimate ecosystem and preserve the grey market.

A 'Calibrated' approach

Going by the finance minister's recent remarks, the government does not seem to be going for a blanket ban. In March, she said the central government will give people adequate leeway to experiment with bitcoins, blockchain and cryptocurrencies. Saying that fintech is an area where India has an advantage, she spoke in favour of blockchain and noted that India cannot be left behind in technology. “Many fintech companies have made much progress. We have received several presentations. Much work at the state level is happening. We want to take it up in a big way in the Gandhinagar Gift City,” she said.

These statements suggest the proposed Bill will put a legal stamp on buying, selling and trading of cryptocurrencies. “This is conjecture at this point, and it remains to be seen what path Parliament decides to adopt,” says Gupta.

RBI is also working on its own digital currency – Cen-

Companies Adding Bitcoin to Balance sheets



TESLA: In February 2021, Tesla disclosed it had bought \$1.5 billion worth of Bitcoins (10% of the cash reserves). CEO **Elon Musk** also said they would start accepting bitcoin as payment on a limited basis (this was stopped in May)



Square: The financial payments company, run by Twitter founder **Jack Dorsey**, bought a combined \$50 million worth of Bitcoins in the fourth quarter of 2020 and added an additional \$170 million of Bitcoin to its balance sheet in February 2021



MicroStrategy: The Virginia-based software company holds roughly \$4.5 billion worth of Bitcoins from an initial purchase price of \$2.1 billion. CEO **Michael Saylor** remains bullish on Bitcoin with MicroStrategy making an additional \$10 million investment in March 2021

tral Bank-backed Digital Currency. It would be different from cryptocurrencies, said RBI's Das. "We don't want to be left behind in the technological revolution. The benefits of blockchain need to be capitalised. We've certain concerns regarding cryptocurrencies," he added.

In May 2021, the National Payments Corporation of India rejected a proposal for a ban on cryptocurrency transactions. It asked banks to decide whether to allow transactions involving digital currencies based on their own risk assessment. Some bankers had asked the agency to block crypto transactions on its network. At present, most banks do not offer UPI services to crypto investors.

The Missing Details

Not many know the contents of the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021, as officials have not consulted industry players yet. "No one knows what's in the Bill except the finance ministry. However, the government may form a panel to study and regulate crypto. It believes recommendations made by the Garg Committee in 2019 might be outdated. There is need for a fresh look instead of an outright ban," says Nischal Shetty, Founder and CEO, WazirX. The committee, headed by the then finance secretary, S.C. Garg, had recommended penalties of up to ₹25 crore (\$3.63 million) and jail term of up to 10 years for anyone who mines, generates, holds, sells, transfers or issues cryptocurrency.

Why Governments Dislike Crypto?

The primary worry for governments is the decentralised design of cryptocurrencies. They

\$225 billion

Market cap of Ethereum, the second largest cryptocurrency, as on June 21, 2021

What India Can Gain From Cryptocurrencies



Digital transformation and innovation in BFSI sector

Make all financial transactions safe

Create immutable record of past ownership and transactions (this will help in things such as land registry management)

Instant and cheaper cross-border payments

Better medical record maintenance and elimination of fake drugs

More efficient supply chain management

What It loses If It Goes For a Ban

Miss the global technological advancement

Blockchain development will come to a standstill

Loss of foreign investment , jobs

Loss of wealth for small investors



are not backed by any sovereign. According to a Citi Research report, this puts them at the opposite end of the spectrum from central banks, which use monetary power to frame policy and control currency circulation. This allows governments to stimulate investment/spending, generate jobs and prevent inflation and recessions.

Minister of State For Finance Anurag Thakur has in the past raised concerns over price volatility in cryptocurrencies saying these coins often move 10 times in weeks. "That doesn't happen in fiat currencies," he said. This means common people cannot use it to pay for goods and services.

Another big worry for governments is terror financing. In 2016, an online jihadi unit launched social media campaigns to raise funds through bitcoins, says a paper by Abhinav Pandya, Founder & CEO, Usanas Foundation, and a geopolitical analyst. "Earlier, in June 2015, a Virginia teen was posting instructions on Twitter on how to donate to IS using bitcoins. In June 2017, the *Wall Street Journal* reported that a Syria-based Indonesian militant was using PayPal and bitcoins to fund the IS. On November 6, 2017, Dawaal Haqq, the Islamic news agency, sought donations on Facebook through bitcoins. In December, a few more

pro-IS websites were soliciting funds through bitcoin donations." Pandya says while cryptocurrency has the potential to revolutionise the global financial transaction system, it has characteristics that make it attractive to cyber criminals, money launderers, drug smugglers and terrorists.

However, according to 'An Analysis of Bitcoin's Use in Illicit Finance' by Michael Morell, former CIA Director, the share of illicit activity in total cryptocurrency activity from 2017 to 2020 was less than 1 per cent. "For Bitcoin specifically, blockchain analytics firm CipherTrace estimates that illicit activity makes up less than 0.5 per cent of total transaction volume."

The former CIA terrorism expert believes hype is much greater than the reality and that cryptocurrency is not yet an important platform for terrorist organisations. Anyways, is it not the role of officials to make policies that help an innovation's benefits to flourish and protect users from the downside?

The Solution

India's 340 cryptocurrency start-ups want regulation in-

stead of a ban. Industry experts are seeking a dialogue with the government. They say the government needs to know the practical aspects of this technology. “Right now, the Bill comes from theoretical knowledge, not practical knowledge which the industry has. We are the ones getting our hands dirty and building it. We need both practical and theoretical expertise,” says Nilesh Shetty of WazirX.

According to Sharan Nair, Chief Business Officer at CoinSwitch Kuber, 99 per cent use cases in India involve

trading cryptocurrencies as an asset. “Our appeal to the government has been, do not use the word ‘currency’, but treat it as a commodity, like gold,” says Nair. No one is making payments in cryptocurrency here, he adds.

Industry association IndiaTech.org has given a five-point framework on how the government can regulate cryptocurrencies while encouraging innovation. It has suggested treating cryptocurrencies as an asset, not a currency. “Crypto must be understood to refer to digital assets



WE SHOULD THINK OF CRYPTO AS AN ASSET CLASS. CRYPTO AS A TRANSACTION MEDIUM WILL NOT WORK AS FAST AS UPI. HOWEVER, CRYPTO HAS ENORMOUS CAPITAL

Nandan Nilekani, Co-founder and Chairman, Infosys



PHOTOGRAPH BY NILOTPAL BARUAH

and not a replacement of fiat currency,” says its white paper. Second, as there is no clarity on taxation, IndiaTech’s paper suggests that digital assets should be treated as other investments and subject to capital gains taxes under the Income Tax Act. It recommends self-regulation and common KYC for easy traceability of transactions.

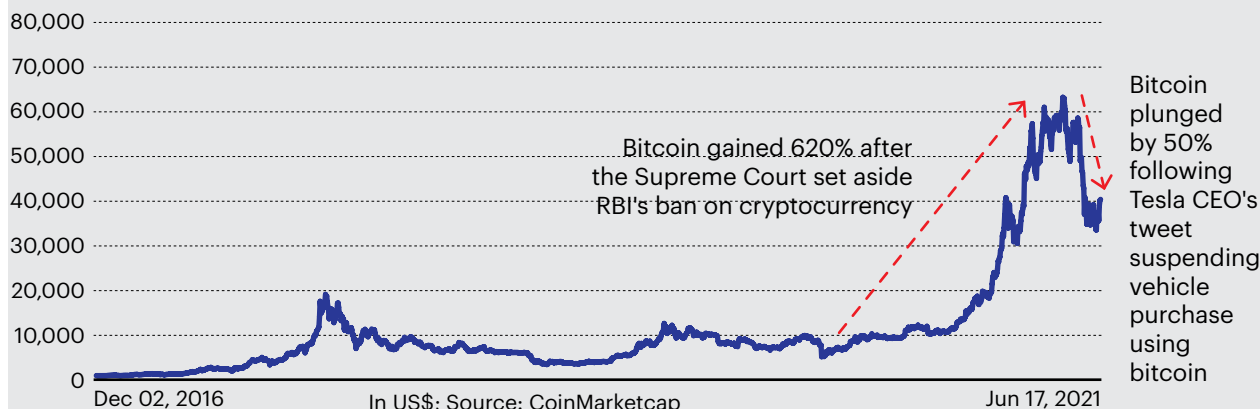
Regulation in Other Countries

In economic impact terms, the World Economic Forum (WEF) anticipates that 10 per cent of global GDP will be supported by blockchain by 2025. China is turning legal tender into computer code, though it banned cryptocurrencies in 2017 after which most of its exchanges shifted to Japan, which treats profits from cryptocurrencies as miscellaneous income. Japan, one of the early adopters and the biggest markets for bitcoin, has legalised cryptocurrencies as property. The US, the second-largest adopter of bitcoin, does not accept it as legal tender but treats it as a capital asset. It, though, allows purchase of goods and services through cryptocurrencies and taxes profits as capital gains.

Switzerland allows its citizens to purchase bitcoins at hundreds of automated teller machines and ticket vending machines. South Korea and Germany do not recognise cryptocurrencies as legal tender but allow citizens to trade and invest in bitcoin.

Singapore taxes cryptocurrencies based on their uses. Profits earned by businesses that use cryptocurrencies in the ordinary course of their business are taxed. Profits of businesses which mine and trade digital tokens in exchange for money are also taxed. Businesses that buy digital tokens

An Unstoppable Rally & A Great Fall



as a long-term investment enjoy tax-free capital gains.

Most countries have not clearly determined the legality of cryptocurrencies, preferring to adopt a wait-and-watch approach. "Some have indirectly assented to legal use of cryptocurrencies by regulatory oversight. However, cryptocurrencies will never be legally acceptable as a substitute for a country's legal tender, unless they are backed by the government," says Rajesh Narain Gupta SNG & Partners.

Can Cryptocurrency be Banned?

The use of digital money as a currency cannot be banned unless it is used to perform an unlawful act. A cryptocurrency may be defined as an asset, commodity, currency or security. But fundamentally, it does have value and liquidity. "There are millions of people around the world willing to hold cryptocurrencies. I can send you some bitcoin, you can send it back. You can call it currency or not, definitions do not matter. If there is an agreement, it acts as a medium of exchange," says Changpeng Zhao, CEO of Binance. Zhao explains if you agree to be paid in bitcoins for a good or a service, it is a currency, though you may call it by any name.

"The only way to ban cryptocurrencies is to stop the internet," says Nischal Shetty. The only operational challenge is to classify whether something is being used as a currency or not. For example, one can buy or sell gold, but if one exchanges gold for a car, does that mean payment for the car or sale of gold? "How can we decide when something is a currency, as barter is not prohibited in India? We have systems like loyalty points, exchange offers. You can

even swap cars," says Jaideep Reddy of Nishith Desai and Associates.

Inseparables: Blockchain & Crypto

The government says it is in favour of blockchain but not private cryptocurrencies. Technically, these two cannot be separated. "A blockchain without cryptocurrency will end up like any random database that you build within a computer. That is not real innovation," says Vijay Ayyar, Head of Asia Pacific & Global Expansion at Luno, a cryptocurrency wallet and exchange. There is no technical way to run public blockchain network systems without cryptocurrency. Reddy explains with an example. If someone wants to build a software application on Ethereum, he has to use Ethereum's native currency Ether to pay for buying services within Ethereum. Thus, if you want to use blockchain, use of cryptocurrency is unavoidable.

What Investors Want

"I want a favourable decision from the government. Before a blanket ban or taking a harsh view, it should think about those who have invested," says Siddhesh Jamsandekar, 34, who works in a Mumbai-based private organisation. Jamsandekar bought two bitcoins in 2014 at \$500 a piece. He wants his money to be safe and legal.

"All boardrooms are discussing crypto. Corporates are super interested," says the founder of a crypto exchange. "Some big companies, including an OTT platform, have approached us to understand the legal standing of cryptocurrencies," says a legal expert at a reputed law firm.

Most Popular Cryptocurrencies in India

	Coin	Pair	Price (in US\$)	Price in INR	Volume %
1	Bitcoin	BTC/INR	35,805.60	25,47,465	15.08
2	Tether	USDT/INR	1.04	77.31	13.75
3	Polygon	MATIC/INR	1.40	101.51	10.29
4	Shiba Inu	SHIB/INR	0.00000790	0.000578	8.56
5	Dogecoin	DOGE/INR	0.277289	20.15	5.20
6	Ethereum	ETH/INR	2,215.62	1,58,500	4.13
7	WINkLink	WIN/INR	0.00045588	0.0331	2.73
8	Dock	DOCK/INR	0.101048	7.206	1.66
9	Ripple	XRP/INR	0.762018	54.2288	1.48
10	TRON	TRX/INR	0.068651	4.9259	1.20

Top cryptocurrencies on the basis of volume on India's largest crypto exchange, WazirX; Price as on June 21, 2021; Source: CoinGecko

While institutional investors in the US are increasingly buying cryptocurrencies, including bitcoin, Indian companies are shying away from discussing their exposure openly due to lack of legal clarity. "Most corporates are in the exploratory stage. Corporate movement will happen once regulations come in. At an informal level, companies are super interested in cryptocurrencies," says Sharan Nair of CoinSwitch Kuber.

Taxation As a Foreign Asset

Uday Ved of KNAV says just like foreign bank accounts or foreign mutual funds or stocks, cryptocurrencies are foreign assets and need to be disclosed while filing income tax returns. "I don't think there is any crypto listed in India," says Ved. He says there is a ₹10 lakh penalty in case of non-disclosure by an individual. There is no clear rule on taxation but industry is open to any classification as long as there is no double taxation.

Ritesh Kumar S., Executive Director, IndusLaw, says the treatment could depend upon the interval at which income accrues. "The popular approach is to tax as capital gains. This is premised on the assumption that these are capital assets and not traded frequently. However, if the transaction is being carried out as usual business, the income could be taxed as 'profit & gains from business'," he says.

Could there be a sin tax of 28 per cent? "It is difficult to say, but 28 per cent tax on value will distort the market. Indians may not be able to participate at fair prices," says Jaideep Reddy. "The most conservative view is that cryptos are like residuary goods. In that case, there should be 18 per

cent GST," he adds.

Beyond Currency or Asset

In February, 2021, State Bank of India became the first Indian bank to tie up with JP Morgan to use its blockchain technology 'Liink' to speed up overseas transactions. This will reduce the time taken to resolve issues related to cross-border payments from a few days to a few hours. Despite the wide uses of cryptocurrencies and blockchain, there is little discussion beyond price and financial speculation.

"While cryptocurrencies are recognised as new monetary systems and financial networks, public blockchain networks they secure can be used to power diverse use cases and create new applications across industries," notes a WEF booklet. It highlights a non-exhaustive list of companies, protocols and projects that represent the diversity of use cases that cryptocurrencies and networks they power can enable. "It is not just a speculative vehicle. That's a misconception. Actual implementations are occurring globally," says Reddy. Banks have thousands of people enabling and approving transactions. Blockchain, says Sumit Gupta, Co-founder, CEO, CoinDCX, allows all this without involvement of people.

While the debate over cryptocurrencies continues, the fact is that India needs blockchain. Adopting cryptocurrencies with adequate checks and balances can ensure it is in sync with the world. That's a decision that the government needs to take quickly. **BT**

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