ISSN 2582-0311 (Print)
ISSN 2582-0303 (Online)

Volume 5
Issue I

August 2023

VIPS STUDENT LAW REVIEW

VIVEKANANDA INSTITUTE OF PROFESSIONAL STUDIES - TECHNICAL CAMPUS

Affiliated to GGSIP University, Delhi
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TABLE OF CONTENTS

S. No. Title of the Paper/ Author **Page No.**

1. Emerging Role of Just Energy Transition vis a vis Sustainable Development Goal 7
Ms. Amita 1

2. Critical Analysis of Social Security Schemes for Women in India
Ms. Richa Srivastava 19

3. Mass Atrocities and Reparation to Rohingyas in Myanmar
Mr. Mostafijur Rahmani 28

4. Constitutional Discourse on Homosexual Rights in Nepal, India and Singapore
Ms. Mansi Singh Tomar & Mr. Kumar Mukul Choudhary 42

5. Open Prisons: Reserialising Prisoner's rights with Freedom
Ms. Ritika Kanwar 54

6. Victim Participation in the Criminal Justice Process: A Therapeutic Approach
Ms. Neha Singh 70

7. Reassessing Section 498A: Exploring Judicial Interpretations and Statistical Data
Mr. Lalit Anjana 90

STUDENTS SECTION

8. Current Regulatory Framework on Cryptos and Crypto Exchanges in India
Mr. Vedant Lathi 109

9. Taxation of Cryptocurrency in India: The Future Finance
Ms. Meher Sachdeva 118

10. Rule of Law Implementation in India: A Critical Review
Ms. Neha Samji 133

11. Beyond Borders- The Use of Comparative Law in Constitutional Interpretation
Mr. Satyam Sah and Ms. Krati Gupta 142

12. Implementation of Section 12(1)(c) of the Right to Education Act: An Overview
Ms. Anushka Singhal and Mr. Ashmit Raj 151

13. Critical Analysis of the Last Seen Theory
Mr. Chaitanya Thakur 167

14. Juvenile Justice Care and Protection Act: Framework on Adoption in India
Ms. Raghvi Kanwal 181

15. Abortion and Natural Law
Ms. Snigdha Rohilla 196

CURRENT REGULATORY FRAMEWORK ON CRYPTOS AND CRYPTO EXCHANGES IN INDIA

Mr. Vedant Lathi*

VIPS Student Law Review
August 2023, Vol. 5, Issue 1, 109-117
ISSN 2582-0311 (Print)
ISSN 2582-0303 (Online)
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https://vslls.vips.edu/vslr/

ABSTRACT

This research paper examines the current regulatory framework for cryptocurrencies and crypto exchanges in India and also traces the evolution of the same. The paper discusses the impact of the Reserve Bank of India's circular prohibiting banks from dealing with cryptocurrency exchanges, the Supreme Court's decision to strike down the circular, and proposed the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021. The paper also examines the regulatory oversight of the Securities and Exchange Board of India and the recommendations of the committee formed by the Ministry of Finance. The paper concludes that the current regulatory framework for cryptocurrencies and crypto exchanges in India is complex and rapidly evolving, with a lack of clear guidelines for the industry. The proposed bill, if passed, would ban private cryptocurrencies, and introduce an official digital currency issued by the RBI. The paper highlights the need for a clear and comprehensive regulatory framework to promote the growth of the cryptocurrency industry in India.

Keywords- *Cryptocurrency, Blockchain, Digital Assets, Virtual Currency, Digital Ledger.*

I. INTRODUCTION

Virtual Currency (**VC**) is a type of currency that is stored on a digital ledger called the blockchain. Transactions involving cryptocurrencies take place privately, which eliminates the need for traditional financial institutions such as banks. However, these decentralized

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characteristics also create challenges for governments to trace any illegal transactions.[1]

Cryptocurrencies are digital representations of value created by means of cryptography and are intended to secure financial transactions or transfer of assets.[2] Currently, India does not have any specific laws to govern the VCs; however, it has modified its Income Tax Act to define the concept of Virtual Digital Assets (**VDA**), which encompasses VCs among other things.

The term 'virtual digital asset' is defined under Section 2(47A) of the Income Tax Act, 1961 to include the following:

> *(a) "Any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically;*
>
> *(b) Non-fungible token (NFT) or any other token of similar nature, by whatever name called;*
>
> *(c) Any other digital asset, as the government may specify by notification."*

A cryptocurrency exchange is a digital marketplace where people can buy, sell, and trade cryptocurrencies. The exchange typically acts as an intermediary, matching buyers and sellers and charging a fee for each transaction. As per a recent circular[3] issued by the Central Board of Direct Taxes (**CBDT**) the term 'exchange' is now defined as any person that operates an application or platform for transferring of VDAs, which matches buy and sell trades and executes the same on its application or platform.

1 Vikram Jeet Singh and Kalindhi Bhatia, "*Cryptocurrency In India: State Of Play*", *available at* https://www.mondaq.com/india/fin-tech/1196300/cryptocurrency-in-india-state-of-play_

2 AZB & Partners, "*Regulation of Cryptocurrencies in India*", *available at* https://www.azbpartners.com/bank/regulation-of-cryptocurrencies-in-india/

3 Circular F. No. 370142/29/2022-TPL dated 22 June 2022 by Ministry of Finance Department of Revenue Central Board of Direct Taxes, Government of India.

The Government's position on VDAs will be clearer once the Proposed Bill titled 'The Cryptocurrency and Regulation of Official Digital Currency Bill 2021' is released to the general public.

During a G20 seminar[4], India called for a collaborative global endeavor to tackle the challenges presented by cryptocurrencies like Bitcoin and to establish a unified framework, demonstrating India's dedication and proactive stance towards addressing this issue.

II. A BRIEF TIMELINE OF THE EVOLUTION OF CRYPTO REGULATIONS IN INDIA

When	Event
24 December 2013	The Reserve Bank of India (**RBI**) issued a press release cautioning users of cryptocurrencies of the potential risk associated with the same.
2017	RBI again cautioned users of cryptocurrencies and explicitly stated that no licenses had been granted to operators trading in cryptocurrencies in India.
6 April 2018	RBI, through a notification, prohibited all entities regulated by the RBI from dealing in virtual currencies or providing services to facilitate any transaction involving virtual currencies.
July 2019	Indian exchanges and blockchain advocates filed multiple petitions and went to court in a bid to overturn the ban on crypto. Government of India (**GoI**) released a draft bill 'The Banning of Cryptocurrency and Regulation of Official Digital Currency Bill 2019' which sought to ban any person from 'mining, generating, holding, selling, dealing in, issuing, transferring, disposing of or using cryptocurrency in the territory of India'.
4 March 2020	The Supreme Court of India struck down RBI's order in the case of *Internet and Mobile Association of India v. Reserve Bank of India*, where the Supreme Court declared the RBI circular unconstitutional.
25 May 2020	RBI clarified that presently there is no prohibition applicable to banks to provide bank accounts to crypto exchanges or crypto traders.

4 Reuters, "India's push to regulate crypto gains IMF, U.S. support at G20", *available at* https://www.reuters.com/business/finance/indias-push-regulate-crypto-gains-imf-us-support-g20-2023-02-25/

2021	On 24 March 2021, the Ministry of Corporate Affairs (**MCA**) issued a notification to make it mandatory for companies to disclose any dealings in cryptocurrency or virtual currency in their balance sheets. In January 2021, the government introduced the Cryptocurrency and Regulation of Official Digital Currency Bill 2021 (**the Bill**).
2022	With Crypto laws still under discussion, the budget bill that was passed in the Union Budget 2022 specified crypto tax regulations.
7 March 2023	The Finance Ministry announced that all VDAs will fall under the scope of the Prevention of Money Laundering Act 2002 (**PMLA**).

III. CURRENT REGULATORY FRAMEWORK IN INDIA

The Bill

According to the Lok Sabha bulletin dated November 23, 2021, the Bill seeks '*to create a facilitative framework for the creation of the official digital currency to be issued by the Reserve Bank of India. The Bill also seeks to prohibit all private cryptocurrencies in India; however, it allows for certain exceptions to promote the underlying technology of cryptocurrency and its uses*.[5]

Publicly available information also indicates that in May 2021, the government was looking to set up a new panel to decide the fate of cryptocurrency regulation in India. However, details of whether this panel has been set up or any developments in cryptocurrency regulations continue to be unavailable. The government of India was scheduled to introduce new cryptocurrency regulations during the Winter Session of Parliament. This was the second time that the Cryptocurrency bill was listed but got delayed. The first time it happened was during the Budget Session of Parliament in 2021.

The Minister of State Finance, Shri Pankaj Chaudhary, on behalf of the Ministry of Finance answered the questions by saying, 'Crypto assets are by definition borderless and require international collaboration to prevent regulatory arbitrage. Therefore, any legislation on the subject can be effective only with significant international collaboration on evaluation of the risks and benefits and evolution of common taxonomy and standards.'

5 Neil Hildreth, "*Cryptocurrency Bill 2021: The Road Ahead*", *available at* https://www.mondaq.com/india/fin-tech/1145012/cryptocurrency-bill-2021-the-road-ahead

Prevention of Money Laundering Act

The notification published in the gazette[6] by the Ministry has expanded the scope of the Prevention of Money Laundering Act, 2002 to include cryptocurrency transactions.

As a result, Indian cryptocurrency exchanges will be required to notify the Financial Intelligence Unit - India (**FIU-IND**) of any suspicious buying or selling activities related to cryptocurrency. The FIU-IND is a central agency responsible for receiving, processing, analyzing, and distributing information regarding suspicious financial transactions to both law enforcement agencies and foreign FIUs. If the FIU-IND detects any misconduct during its investigation, it will inform the Enforcement Directorate (ED).

Taxation

In the 2022 Budget, Finance Minister Mrs. Nirmala Sitharaman made revolutionary changes to the virtual asset class by the introduction of a wide definition of VDAs and thereby including cryptocurrencies and non-fungible tokens (NFTs) within its ambit. It was for the first time, the government officially classified digital assets, including crypto assets, as "Virtual Digital Assets." This category encompasses all cryptocurrencies such as Bitcoin and Ethereum, as well as other digital assets.

The Finance Act of 2022 has introduced a regime for the taxation of VDAs by amending the Income Tax Act, of 1961. The 2022 Budget Session laid down the following rules:

a) Income from the transfer of virtual digital assets such as crypto and NFTs will be taxed at 30% at the end of each financial year.

b) No deduction, except the cost of acquisition, will be allowed while reporting income from the transfer of digital assets.

c) Loss from digital assets cannot be set off against any other income.

d) The gifting of digital assets will attract tax in the hands of the receiver. Losses incurred from one virtual digital currency cannot be set off against income from another digital currency.

Ministry of Corporate Affairs

The latest amendment to Schedule III of the Companies Act, 2013 issued on 24 March 2021 states that from the new financial year, all companies will be required to disclose their

6 Notification S.O. 1072(E). dated 7th March, 2023 by Ministry of Finance, Government of India, *available at* https://egazette.nic.in/WriteReadData/2023/244184.pdf

investments in cryptocurrencies and also state any profit or loss involved in the transaction. The holder of any virtual currencies will also have to declare the number of holdings, details of deposits and advances from any person for trading or investing in cryptocurrency.

CERT-In Directions to Crypto Exchanges

The Indian Computer Emergency Response Team (the CERT-In), set up under the Information Technology Act, 2000 (IT Act), had, on 28 April 2022, issued directions under the IT Act with respect to information security practices, procedures, prevention, response, and the reporting of cyber incidents for a safe and trusted internet.

These directions require, *inter alia,* the 'virtual asset service providers,' 'virtual asset exchange providers' and 'custodian wallet providers' to mandatorily maintain:

a) information obtained as part of KYC; and

b) records of financial transactions, for five years.

The directions also prescribe a list of 'officially valid documents' for the customer identification procedure in line with the RBI Directions 2016/ SEBI circular dated 24 April 2020/Department of Telecom notice 21 September 2021 for the purpose of KYC. It may also be noted that the terms 'virtual asset service provider,' 'virtual asset exchange provider' and 'custodian wallet provider' are presently not defined under these directions; however, the frequently asked questions issued in relation to these directions indicate that such providers may include crypto asset businesses as well.[7]

ASCI Guidelines

On 23 February 2022, the Advertising Standards Council of India (ASCI) framed guidelines for the advertising and promotion of VDAs. The salient features of these guidelines are as follows:

a) Advertisements pertaining to VDAs must carry the prescribed disclaimer.

b) Words like "currency," "securities," "custodian" and "depositories" must not be used.

c) Depiction of minors is prohibited.

d) Risks should not be downplayed. VDAs should not be compared to any other regulated assets.

7 AZB & Partners, Cryptoassets & Blockchain 2023, *available at* https://www.azbpartners.com/bank/cryptoassets-blockchain-2023/

e) Celebrities and influencers are required to carry out proper due diligence before taking part in such promotions.

IV. COMPARISON WITH OTHER JURISDICTIONS

According to PwC's Global Crypto Regulations Report 2023[8], a large proportion of countries are at various stages of drafting regulations around crypto. Most countries have already brought digital assets under anti-money laundering laws. Singapore, Japan, Switzerland, and Malaysia have legislations on regulatory framework. The U.S., U.K., Australia, and Canada have initiated plans on regulating. So far, China, Qatar, and Saudi Arabia have issued a blanket ban on cryptocurrency. The EU is also preparing a cross-jurisdictional regulatory and supervisory framework for crypto-assets. The framework seeks to provide legal clarity, consumer and investor protection, and market integrity while promoting innovation in digital assets.

USA

The United States operates under a dual governance system, which means that there can be different laws and regulations for cryptocurrencies in different states. For instance, New York has been a proponent of cryptocurrencies since 2016 when it introduced a licensing framework for crypto and business exchanges known as "BitLicense." However, there are many states in the US that have yet to take a definitive stance on cryptocurrencies. While different states have varying regulations for cryptocurrencies, the overall approach in the US towards the trading community is positive, and cryptocurrency is legal in the country.

The Financial Crimes Enforcement Network (FinCEN) does not consider cryptocurrencies to be legal tender but considers cryptocurrency exchanges to be money transmitters on the basis that cryptocurrency tokens are "other value that substitutes for currency." The Internal Revenue Service (IRS) does not consider cryptocurrency to be legal tender but defines it as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value" and has issued tax guidance accordingly.

Cryptocurrency exchanges are legal in the United States and fall under the regulatory scope of the Bank Secrecy Act (BSA). In practice, this means that cryptocurrency exchange service providers must register with FinCEN, implement an AML/CFT program, maintain appropriate records, and submit reports to the authorities. Meanwhile, the US Securities

8 PwC Global Crypto Regulation Report 2023, *available at* https://www.pwc.com/gx/en/new-ventures/cryptocurrency-assets/pwc-global-crypto-regulation-report-2023.pdf

and Exchange Commission (SEC) has indicated that it considers cryptocurrencies to be securities, and applies securities laws comprehensively to digital wallets and exchanges. By contrast, The Commodities Futures Trading Commission (CFTC) has adopted a friendlier, "do no harm" approach, describing Bitcoin as a commodity and allowing cryptocurrency derivatives to trade publicly.

In response to guidelines published by FATF in June 2019, FINCEN made clear that it expects crypto exchanges to comply with the "Travel Rule" and gather and share information about the originators and beneficiaries of cryptocurrency transactions. It places virtual currency exchanges in the same regulatory category as traditional money transmitters and applies all the same regulations, including those set out in the Bank Secrecy Act – which has established its own version of the Travel Rule. In October 2020, FINCEN released a Notice of Proposed Rulemaking (NPRM) on adjustments to the Travel Rule, signaling the introduction of new compliance responsibilities for cryptocurrency exchanges.

The Justice Department continues to coordinate with the SEC and CFTC over future cryptocurrency regulations to ensure effective consumer protection and more streamlined regulatory oversight.

Singapore

Singapore has taken a friendlier position towards cryptocurrency exchanges and trading than many of its neighboring countries. While cryptocurrencies are not considered legal tender, they are treated as goods and subjected to the Goods and Services Tax. The Monetary Authority of Singapore (MAS) has generally been accommodating towards crypto regulation, and in 2020 and 2022, issued warnings to the public on the risks of investing in cryptocurrency products. The Payment Services Act 2019 brought exchanges and other crypto businesses under MAS regulatory authority and imposed a requirement for them to obtain a MAS operating license.

Since then, MAS has issued licenses to a number of high-profile crypto service providers. MAS is likely to follow up with additional regulations to further align its position. Singapore's recent regulatory efforts have attracted international interest in its crypto industry, especially after China's crackdown on cryptocurrencies prompted many high-profile Chinese service providers to migrate to Singapore.

V. CONCLUSION AND RECOMMENDATIONS

India does not currently have a comprehensive regulatory framework specifically designed for virtual currencies. Cryptocurrencies cannot be used as legal tender or a medium of exchange in the country, they are not regulated by any central authority. There are no rules and regulations or any guidelines laid down for settling disputes while dealing with cryptocurrency. So, trading in cryptocurrency is done at investors' risk.

Additionally, there is no specific framework for registering or licensing cryptocurrency platforms. Presently, crypto asset businesses primarily operate under self-regulatory codes, which include complying with KYC, Anti-Money Laundering (AML), and Countering the Financing of Terrorism (CFT) obligations.

As of March 2023, the regulatory framework on cryptocurrencies and crypto exchanges in India is still evolving, with no clear consensus on the legal status of cryptocurrencies. In conclusion, the regulatory framework on cryptocurrencies and crypto exchanges in India is still in flux, with various proposals and bills being debated at different levels, hence there is an urgent need to bring a law to regulate this space.

As the landscape of cryptocurrency continues to evolve with unprecedented dynamism, this research paper culminates with a series of visionary recommendations aimed at shaping a robust framework for governing cryptocurrencies and exchanges in India. The increasing prominence of digital assets necessitates the establishment of an intricate yet adaptable regulatory paradigm, stratifying cryptocurrencies for nuanced treatment while embracing innovation. In this pursuit, the implementation of licensing protocols for exchanges and wallet providers emerges as a pivotal step to ensure a secure and legitimate ecosystem. To thwart illicit activities, the stringent enforcement of anti-money laundering (AML) and know-your-customer (KYC) protocols is vital, instilling transparency and accountability. Amidst these imperatives, reinforcing consumer safeguards, fortifying market integrity against manipulation, and fortifying data privacy measures within exchanges stand as paramount features. This blueprint further accentuates the importance of cross-border transaction guidelines synchronised with international standards, transparent frameworks for cryptocurrency taxation, and incentives fostering innovation and entrepreneurship. Simultaneously, collaborative synergies between regulatory bodies, industry pioneers, and academia, along with public awareness campaigns, ought to be diligently cultivated. Lastly, a regulatory review mechanism, responsive to the relentless cadence of technological progress and sectoral trends, will engender an adaptive, secure, and forward-looking environment for cryptocurrencies and exchanges across India.