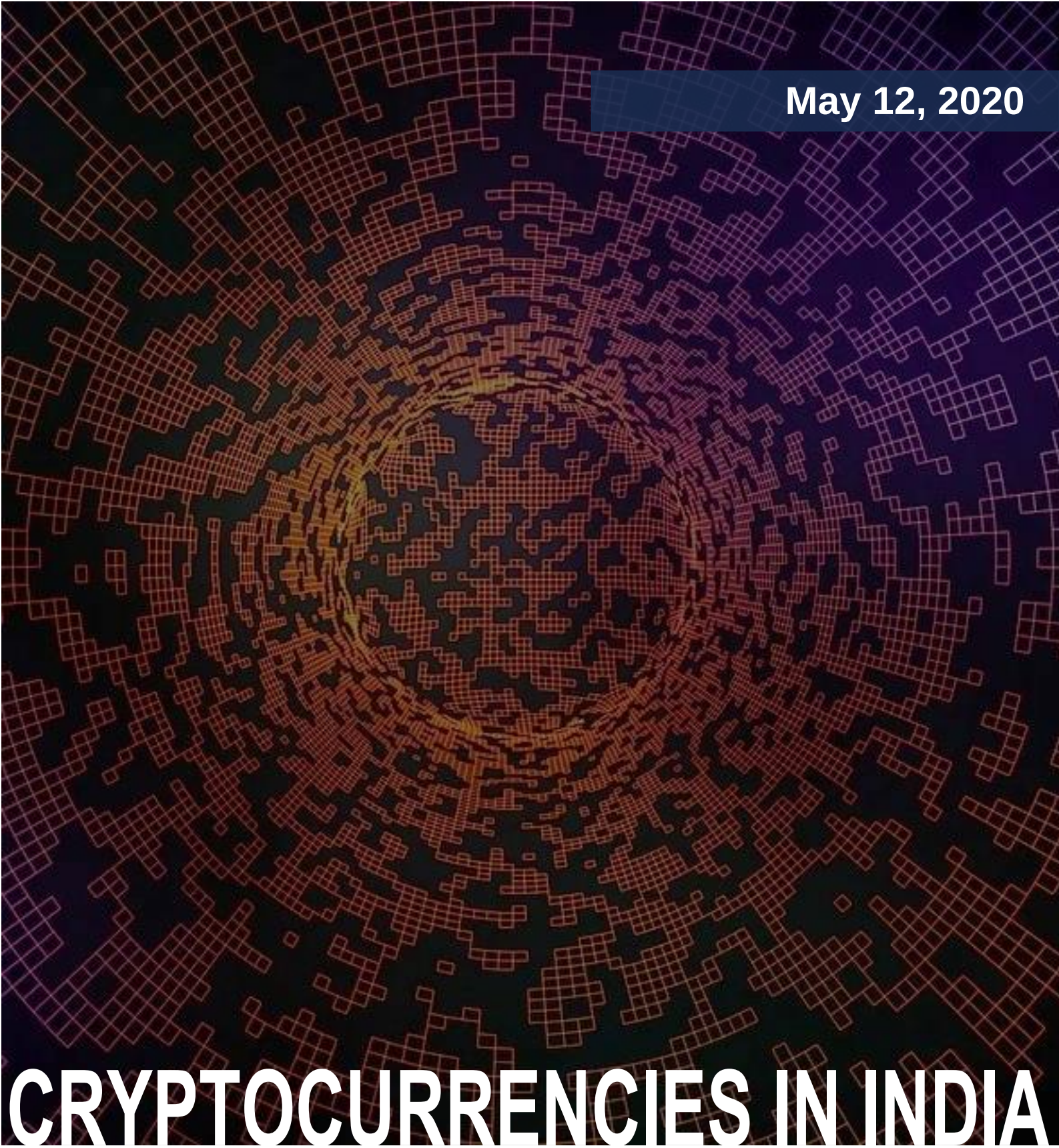

May 12, 2020

CRYPTOCURRENCIES IN INDIA

- PAST, PRESENT & FUTURE

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Cryptocurrency – Origin and Creation

The most popular cryptocurrency, bitcoin, was created in 2009 by one or more individuals under the pseudonym "Satoshi Nakamoto".[1] However, much before the creation of bitcoins, early work on cryptocurrencies can be traced back to the 1980s when a David Chaum wrote extensively on cryptography and digital cash in his papers 'security without identification'[2], 'blind signatures for untraceable payments'[3] and others. The idea was eventually executed and "DigiCash" was invented in 1994. However, ultimately, in 1998, DigiCash had to file for bankruptcy since e-commerce had not fully evolved. A few more quasi-cryptocurrencies reared their heads. Dr. Adam Black created "Hashcash" in 1997, which was akin to Digicash, but with an anti-spam mechanism where cost was levied on users for sending emails, which prevented spamming. "B-money"[4] was created in 1998 by Wei Dai, a computer scientist, to serve as a medium of exchange and a way to enforce contracts between anonymous parties. His work has been referred to by Satoshi Nakamoto in his paper on bitcoins.

Nick Szabo, a computer scientist and a lawyer came up with a theory of collectives and proposed "bit gold" in the form of a digital collectible, in 2005[5]. However, bit gold was never implemented. Based on Nick Szabo's theory of collectibles, Hal Finney invented Reusable Proof-of-Work (RPOW)[6] as a prototype for digital cash.[7] Hal Finney was also the first ever recipient of bitcoin.[8]

Creators of cryptocurrencies have been inspired by a perceived need for 'privacy', a desire to eliminate governmental intermediaries and central authorities and create a currency that is not subject to local pressures such as hyperinflation.

Activists who advocate the widespread use of strong cryptography and privacy enhancing technologies as a route to social and political change are known as cypherpunks. Cypherpunks believe that privacy cannot be expected to be granted by the government and that privacy must be defended by the people themselves with cryptography, digital signatures, electronic cash. Further, cypherpunks strongly oppose the creation of any regulation on cryptography since encryption is a private act arising out of a social contract with no national boundaries.

Popularity of Cryptocurrencies in India

As per Google trends in 2017, 'bitcoins' was among the most searched term on Google by Indians.[9] In the initial years after its creation, Indians were attracted to bitcoins. The popularity of bitcoins especially increased after demonetisation. In 2017, a bitcoin trade analyst, Chris Burniske, highlighted in his tweet with a chart tracking virtual currencies ("**VCs**"), that India accounted for around 10% (ten percent) of the global VC trade, i.e. 16,754.76 (sixteen thousand seven hundred

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[1] Satoshi Nakamoto, Bitcoin: A Peer-to-Peer Electronic Cash System, can be accessed at https://bitcoin.org/bitcoin.pdf.

[2] David Chaum, Security without Identification Card Computers to make Big Brother Obsolete, Communications of the ACM (October 1985), can be accessed at https://www.chaum.com/publications/Security_Wthout_Identification.html.

[3] David Chaum, Blind Signature for Untraceable Payments (1982), can be accessed at https://www.chaum.com/publications/Chaum-blind-signatures.PDF.

[4] Wei Dai, B-Money, can be accessed at http://www.weidai.com/bmoney.txt.

[5] Nick Szabo, Bit Gold (December 29, 2005), can be accessed at https://web.archive.org/web/20060329122942/http://unenumerated.blogspot.com/2005/12/bit-gold.html.

[6] Hal Finney, Reusable Proof of Work (June 16, 2006), can be accessed at https://web.archive.org/web/20060616102653/http://rpow.net/.

[7] https://nakamotoinstitute.org/finney/rpow/.

[8] https://www.alcor.org/cryonics/Cryonics2019-2.pdf.

[9] https://trends.google.com/trends/yis/2017/IN/.

fifty four point seven six) coins in trade volume.[10] However, factors such as non-availability of Indian crypto exchanges prevented further acceleration of investments in bitcoins.

The Boycott imposed by the Reserve Bank of India

Vide a circular dated April 6, 2018 ("**April 6 Circular**"), the Reserve Bank of India ("**RBI**") prohibited entities regulated by the RBI from dealing in VCs or providing services for facilitating any person or entity in dealing with or settling VCs. The April 6 Circular elaborated that such services include maintaining accounts, registering, trading, settling, clearing, giving loans against virtual tokens, accepting them as collateral, opening accounts of exchanges dealing with VCs and transfer or receipt of money in accounts relating to purchase or sale of VCs.

The April 6 Circular directed regulated entities which were already providing services that facilitated the dealing with or settling of VCs, to exit such relationship within 3 (three) months from the date of the April 6 Circular.

The April 6 Circular did not impose an outright ban on VCs or in the dealing in VCs. The April 6 Circular applied only to entities regulated by the RBI, and therefore, persons outside the RBI's sphere of influence, were entitled to deal or trade in VCs, provided they had the ability to do so without the support of entities regulated by the RBI. If any person holding VCs was desirous of selling the VCs to a buyer who was willing to pay in cash or through any other form of consideration (such as gold or any other commodity) which could be remitted to the seller other than through a banking channel, such a transaction would be legal and valid. VC exchanges started to function as escrow agents whereby, after arranging a transaction for the sale and purchase of VCs, they would hold the VCs in trust for the parties. Once the seller confirmed receipt of payment, the VCs would be released to the buyer[11].

The April 6 Circular essentially forced entities regulated by the RBI to boycott VCs.

Prior Warnings by the RBI

Much before the RBI prohibited regulated entities from dealing in VCs or providing services that facilitated the dealing with or settling of VCs, it had issued a series of warnings regarding the risks involved in dealing with VCs.

The first warning was issued by the RBI vide a press release dated December 24, 2013 ("**2013 Circular**") cautioning the users, holders and traders of VCs stating that entities providing such services have not taken any regulatory approval, registration or authorisation. Further, the RBI highlighted the following concerns:

(i) storage in a digital wallet makes VCs prone to hacking, malware, loss of passwords etc. Further VCs are not traded through a central registry and therefore, loss of a digital wallet could result in permanent loss of VCs;
(ii) lack of recourse for consumers in the events of any disputes, since VCs are traded peer to peer without involving any authorised central agency;
(iii) VCs are prone to huge volatility since they are not backed by any underlying asset;
(iv) VCs are subject to trading in various jurisdictions where the status of VCs is unclear. Therefore, they are exposed to legal and financial risk; and
(v) users of VCs may unintentionally breach anti money laundering regulations and 'combating financing of terrorism' laws due to its anonymous/ pseudonymous function.

[10] Nilanjan Chakraborty, The Bitcoins: A Scam or the Currency of the Future, International Journal of Science and Research (2018), can be accessed at https://www.ijsr.net/archive/v8i2/ART20195652.pdf.
[11] Durba Ghosh, Cryptocurrency startups pivot to P2P trading as India's Supreme Court upholds RBI's Ban, The Passage, (July 4, 2018), can be accessed at https://thepassage.cc/article/200.

Subsequently, vide a press release dated February 1, 2017, the RBI highlighted the risks stated in its earlier 2013 Circular. The RBI further clarified that it has not given licences or authorisations to any entity to deal in VCs and that the users deal in VCs at their own risk.

In a press release dated December 5, 2017, the RBI showed concern over increasing valuations of many VCs and growth in initial coin offerings.

On March 1, 2017, the Deputy Governor[12], spoke about the risks previously highlighted in the 2013 Circular. He explained that confidence in cryptocurrencies such as bitcoins is limited to the initial rounds and circles and that greater 'confidence' in any currency can come about only if it is issued by an authority. Further, the 'blockchain' technology behind bitcoins, makes the transactions 'difficult to track', which is not equivalent to 'anonymity', and therefore, blockchain can never succeed in replacing currency, by ushering in VCs.

Absence of Detailed Research by the RBI before Issuing the April 6 Circular

The various warnings issued by the RBI prior to the April 6 Circular make it clear that the RBI did not view VCs in a positive light. The advantages and disadvantages of VCs were recognised by the RBI in various financial stability reports and working group reports issued by the RBI[13]. However, the RBI never published any data which conclusively demonstrated that VCs are harmful for the economy. An application under the Right to Information Act, 2005 ("**RTI Act**") was filed by Mr. Varun Sethi ("**RTI Application**") calling on the RBI to explain its actions and efforts taken to arrive at the decision stated in the April 6 Circular. In its response to the RTI Application, the RBI refrained from answering many questions that were posed in the RTI Application stating that the responses sought did not constitute 'information' as defined under section 2(f) of the RTI Act. The RBI, *inter alia*, confirmed that it had not:

(i) constituted any committee to determine the risks associated with VCs as set out in the 2013 Circular;
(ii) established a team of officers to understand the nature, working and usage of VCs; nor
(iii) communicated with central banks in other countries to understand the regulatory framework governing VCs.

Recommendations of the Inter-ministerial Committee

After the April 6 Circular, an inter-ministerial committee ("**IMC**") was constituted on November 2, 2017. On February 28, 2019, the IMC submitted a report which proposed specific actions to be taken in relation to VCs .[14] The IMC was initially of the view that VCs should not be banned as it would drive many operators underground and people would be encouraged to use VCs for illegitimate purposes. Therefore, it put forth the Crypto Token and Crypto Asset (Banning, Control and Regulation) Bill, 2018 ("**Crypto Token Regulation Bill**") to regulate cryptocurrencies.

[12] Shri R. Gandhi, Deputy Governor, *FinTechs and Virtual Currency*, FinTech Conference 2017 (March 1, 2017), can be accessed at https://www.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1036.
[13] Reserve Bank of India, Report of the Working Group on FinTech and Digital Banking (November 23, 2017), can be accessed at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/WGFR68AA1890D7334D8F8F72CC2399A27F4A.PDF.
[14] Department of Economic Affairs, Ministry of Finance, Report of the Committee to propose specific actions to be taken in relation to Virtual Currencies (February 28, 2019), can be accessed at https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf.

Crypto Token and Crypto Asset (Banning, Control and Regulation) Bill, 2018

The Crypto Token Regulation Bill proposed to: (i) prohibit persons dealing with crypto tokens from falsely posing the crypto tokens as not being securities or investment schemes or offering investment schemes due to gaps in the existing regulatory framework; and (ii) regulate VC exchanges and brokers through which sale and purchase of VCs would take place. A register of all holdings and transactions on the recognised exchanges was required to be maintained by recognised depositories.

However, as per the minutes of a meeting of the IMC held on February 22, 2018, the RBI deputy governor argued in favour of banning VCs and eventually other members of the IMC agreed. Therefore, the final report of the IMC that was submitted on February 28, 2019 recommended the imposition of a total ban on private crypto currencies through the Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 ("**BCRODC Bill**").

Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019

The BCRODC Bill provides for a blanket ban on cryptocurrencies and criminalises activities associated with cryptocurrencies in India. It also provides for the regulation of an official digital currency. The main features of the BCRODC Bill are as follows:

(a) Definition of 'cryptocurrency'**:** **'**Cryptocurrency' has been defined as any information, code, number or token which has a digital representation of value and has utility in a business activity, or acts as a store of value or a unit of account.

(b) Definition of 'mining': 'Mining' has been defined as an activity aimed at creating a cryptocurrency and/or validating a cryptocurrency transaction between a buyer and seller.

(c) Prohibited activities: Use of cryptocurrency as legal tender/currency in India is not permitted. Further, mining, buying, holding, selling, dealing in, issuance, disposal or use of cryptocurrency in the country is prohibited. The use of cryptocurrency: (i) as a medium of exchange, store of value or unit of account; (ii) as a payment system; (iii) for providing cryptocurrency related services to customers/investors such as registering, trading, selling or clearing; (iv) for trading with Indian currency or foreign currencies; (v) for issuing cryptocurrency related financial products; (vi) as a basis of credit; (vii) as a means of raising funds; and (viii) as a means for investment; is prohibited.

(d) Experimentation, research and teaching: The use of technology or processes underlying cryptocurrency for the purposes of experimentation, research or teaching is permitted, provided that no cryptocurrency can be used for making or receiving payment in such activity.

(e) Penalties and offences: Mining, holding, selling, dealing, transferring, disposing, issuing or using cryptocurrency is punishable with a fine or imprisonment for up to 10 (ten) years or both. Issuing any advertisement, soliciting, abetting or inducing participation in use of cryptocurrency is punishable with a fine or imprisonment for up to 7 (seven) years or both. Acquiring, storing or disposing of cryptocurrency with intent to use is punishable with a fine. Any subsequent conviction for any offence is punishable with a fine and imprisonment of 5 (five) to 10 (ten) years. Further, attempting to commit an offence is punishable with 50% (fifty percent) of the maximum term of imprisonment for the offence or the applicable fine, or both. Any offence punishable with fine may be compounded. Further, whilst offences related to use of cryptocurrency for issuing related financial products or for raising funds or investments are cognizable and non-bailable, other offences are non-cognizable and bailable.

(f) Maximum fine: The maximum amount of fine shall be the higher of: (i) 3 (three) times the loss or harm caused; or (ii) 3 (three) times the gain made. In the event the loss caused or the gain made cannot be reasonably determined, the maximum amount of fine that may be imposed: (i) for mining, holding, selling, dealing, transferring, disposing, issuing or using cryptocurrency shall be up to Rs. 25,00,00,000 (Rupees twenty five crore); (ii) for issuing any advertisement, soliciting, abetting or inducing participation in use of cryptocurrency shall

be up to Rs. 25,00,000 (Rupees twenty five lac); and (iii) for acquiring, storing or disposing of cryptocurrency with intent to use shall be up to Rs. 1,00,000 (Rupees one lac); (iv) for a subsequent conviction shall be up to Rs. 50,00,00,000 (Rupees fifty crore).

(g) Amendment to Prevention of Money Laundering Act, 2002 ("**PMLA**"): The PMLA is amended to include the offences prescribed by the BCRODC Bill.

(h) Digital rupee and foreign digital currency: The Central Government may, in consultation with the Central Board of the RBI, approve the 'digital rupee' i.e. a form of currency issued digitally by the RBI, to be legal tender. Further, the RBI may declare any official foreign digital currency i.e. any class, category or type of digital currency recognised as legal tender in a foreign jurisdiction, to be recognised as foreign currency in India.

(i) Power to exempt and grant immunity: The Central Government is empowered to grant immunity to a person from prosecution for any offence of such person makes a full and true disclosure in respect of the violation. Further, the Central Government is empowered to exempt activities from the list of prohibited activities if the Central Government is of the view that such exemption is necessary in public interest.

(j) Transition: Any person shall, on or after the date of commencement of the act that is brought in pursuant to the BCRODC Bill, but on or before the expiry of 90 (ninety) days from the date of commencement, make a declaration in respect of any cryptocurrency in such person's possession and shall dispose of the same within the aforesaid period.

The Supreme Court's Ruling on March 4, 2020

In the case of *Internet and Mobile Association of India* v. *Reserve Bank of India*[15] ("**IMAI Judgement**"), the Supreme Court of India struck down the April 6 Circular on grounds that the April 6 Circular was *ultra vires* the Constitution of India ("**Constitution**") since it failed to meet the test of proportionality and reasonableness while curbing a fundamental right. Though the IMAI Judgement is silent on this point, it is likely that the Supreme Court's decision has the effect of making the April 6 Circular *void ab initio,* as if it was never issued. Therefore, if the RBI had initiated any prosecution or other penal action against any entity for violation of the April 6 Circular, such prosecution or penal action shall stand vacated.

The following are the key issues deliberated by the Supreme Court in the IMAI Judgement and the grounds on which the IMAI Judgement has been pronounced:

Proportionality test under Article 19(1)(g) of the Constitution

The Supreme Court ruled that Article 19(1)(g) of the Constitution gives all Indian citizens the freedom to carry on any trade or profession and that the April 6 Circular impinges on this right since it put many citizens who dealt in VCs or offered services relating to VCs out of business. Relying on the decisions of the Supreme Court in the cases of *Md. Yasin* v. *Town Area Committee*[16] and *Bennett Coleman & Co.* v. *Union of India*[17], the Supreme Court observed that the measures taken by the State must be measured against the impact on business, in effect and substance. Further, relying on its decision in *Md. Faruk* v. *State of Madhya Pradesh*[18], the Supreme Court evaluated the April 6 Circular on the basis of: (a) its impact on the fundamental rights of the affected citizens; (b) the larger public interest sought to be achieved in light of the object; (c) the necessity for restricting the fundamental right; (d) the pernicious nature of the act prohibited which may be harmful to the public; and (e) the possibility of achieving the same with a less drastic measure.

[15] Writ Petition (Civil) No. 528 of 2018 (March 4, 2020).
[16] 6 (1952) SCR 572.
[17] (1972) 2 SCC 788.
[18] (1969) 1 SCC 853.

Applicability of Article 19(1)(g) of the Constitution to non-citizens

The RBI had contended that since Article 19(1)(g) of the Constitution applies only to Indian citizens, the Internet and Mobile Association of India ("**IMAI**") is not entitled to its benefit. The IMAI was described as a not-for-profit association of corporate entities who are in the trade.

The Supreme Court ruled that even though it is true that the rights under Article 19(1)(g) of the Constitution are available only to citizens, it would not swing the verdict in favour of the RBI since some of the petitioners were individuals (shareholders and promoters) of companies running VC exchanges, who were citizens of India. However, the Supreme Court agreed that the IMAI itself, was not entitled to the benefit of protection under Article 19(1)(g) of the Constitution.

Are cryptocurrencies 'currencies'?

The petitioners had contended that cryptocurrencies are not 'currencies' in their natural sense and that therefore the RBI cannot be said to have power over cryptocurrencies since the preamble to the Reserve Bank of India Act, 1934 ("**RBI Act**"), limits its power only to operating currencies. In order to decide if cryptocurrencies are currencies, the Supreme Court took note of the following:

- Neither the RBI Act nor the Banking Regulation Act, 1949 ("**BR Act**") nor the Payment and Settlement System Act, 2007 ("**PSS Act**") nor the Coinage Act, 2011 define the words "currency" or "money".
- The Foreign Exchange Management Act, 1999 ("**FEMA**") defines the words "currency", "currency notes", "Indian currency" and "foreign currency".
    a. "Currency" has been defined under section 2(h) of FEMA as "*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*".
    b. "Currency notes" has been defined under section 2(i) of FEMA to mean and include cash in the form of coins and bank notes.
    c. "Foreign currency" has been defined under section 2(m) of FEMA as any currency other than Indian currency.
    d. "Indian currency" has been defined under section 2(q) of FEMA as "*currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under section 28A of the Reserve Bank of India Act, 1934 (2 of 1934)*".

    The Supreme Court drew a comparison with promissory notes, bills of exchange and cheque which are also peer to peer and not exactly currency but are used to discharge debts. Further, the Supreme Court held that the RBI was never prevented from adding VCs to the "*other similar instruments*" as it appears in the definition of "currency" mentioned above.
- Section 2(b) of Prize Chits and Money Circulation Schemes (Banning) Act, 1978 defines "money" to include a cheque, postal order, demand draft, telegraphic transfer or money order.
- Clause (33) of section 65B of the Finance Act, 1994, inserted by way of Finance Act, 2012 defines "money" to mean "*legal tender, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, travellers' cheque, money order, postal or electronic remittance or any other similar instrument, but shall not include any currency that is held for its numismatic value*".
- Section 2(75) of the Central Goods and Services Act, 2017 defines 'money' as the Indian legal tender or any foreign currency, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, travellers cheque, money order, postal or electronic remittance or any other instrument recognised by the RBI, when used as a consideration to settle an obligation or exchange with Indian legal tender of another denomination but shall not include any currency that is held for its numismatic value.

- The Sale of Goods Act, 1930 does not define "money" or "currency" but excludes money from the definition of the word "goods".
- In the case of *Dhampur Sugar Mills Limited* v. *Commissioner of Trade Tax*[19], the Supreme Court had examined whether the adjustment of price of molasses from the amount of license fee would amount to a "sale" for the purposes of the Uttar Pradesh Trade Tax Act, 1948. It was argued that an exchange or barter cannot be said to be a sale. After referring to the phrase "*cash, deferred payment or other valuable consideration*", the Supreme Court had pointed out that "money" is a legal tender, but "cash" is narrower than money. The Supreme Court opined that in contradistinction to cash, deferred payment or other valuable consideration would also come within the meaning of money, for the purpose of the Uttar Pradesh Trade Tax Act, 1948.
- The IMC has noted that a VC is a digital representation of value that can be digitally traded and that can function as a medium of exchange and/or a unit of account and/or a store of value, though it does not have the status of a legal tender.

The RBI's power to deal with, regulate or even ban cryptocurrencies

The Supreme Court reviewed various provisions of the RBI Act, BR Act and PSS Act in order to determine the powers of the RBI. The Supreme Court held that the powers given to the RBI are wide in nature. The RBI has the authority to operate the currency and credit system to its advantage and has the sole right to issue currencies. Further, the RBI has complete control over the banking companies and payment system so much so that the RBI has a say in even formulating management of banking companies. Additionally, the RBI has the power to issue directions to the payment systems if such payment systems are likely to engage in anything which may lead to a systematic risk or affect payment systems. The RBI also has the wide power to issue directions in public interest.

The Supreme Court stated that the RBI has a huge role to play in the economy of the country and is a statutory institution of high repute. The executive powers conferred upon it cannot be compared to any other institution. Therefore, it cannot be said that the RBI lacks the power to regulate or even ban cryptocurrencies.

Analysing the definition given to cryptocurrencies by various regulators, governments and judiciaries, the Supreme Court commented that most jurisdictions agree cryptocurrencies are capable of being (a) a medium of exchange; (b) a unit of account; and (c) a store of value. The argument of the petitioners that the VCs are goods or commodities and can never be regarded as real money was rejected. However, while the cryptocurrencies are capable of functioning as a currency, it has not been given a status of legal tender.

Apart from the 3 (three) functions of money mentioned above, the Supreme Court states that a fourth function has developed, being '*final discharge of debt or standard of deferred payment*'. Capitalising on this last fourth function, it was contended by the petitioners that VCs neither qualify as money in (a) legal sense, i.e. having the status of a legal tender; or (b) social sense, i.e. being widely accepted by the public. But the Supreme Court held that for the RBI to exercise its power, it does not have to have all the four functions of money. Therefore, the RBI can invoke its power even if something does not have the status of a legal tender.

The Supreme Court further held that the courts in different jurisdictions have tried to give an identity to VCs but have only ended up defining a few features. The Supreme Court stated that if intangible currency can act as a money under certain circumstances, the RBI has the power to deal with it. Therefore, the contention of the petitioner that the RBI has no jurisdiction over the activities undertaken by petitioners was rejected by the Supreme Court. Anything that poses a threat to the monetary, currency, payment, credit and financial system of the country, and anything that has

[19] (2006) 5 SCC 624.

potential to interfere with matters that the RBI has the power to restrict or regulate, can be regulated by the RBI, even if the said activity does not form part of credit system or payment system.

The Supreme Court did not comment on how it would have reacted if the RBI had imposed an outright ban on VCs and on transactions involving VCs instead of merely requiring all regulated entities to boycott VCs through the April 6 Circular. In our view, even if the RBI had imposed such an outright ban, the Supreme Court is very likely to have struck it down since such a ban would not meet the tests of reasonableness and proportionality required to curb the fundamental rights of citizens under Article 19(1)(g) of the Constitution. Further, the RBI was never in a position to demonstrate that VCs pose a threat to the monetary, currency, payment, credit and financial system of the country.

Did the RBI apply its mind while issuing the April 6 Circular?

The Supreme Court held that the RBI cannot be accused of non-application of mind since the RBI has been considering issues related to dealing in VCs since June 2013 when the financial stability report[20] was published, which led to the issuance of the 2013 Circular cautioning users of VCs. Further, the financial stability reports published in 2015[21] and 2016[22] also addressed the issues regarding volatility, money laundering, security and consumer protection issues. Before the financial stability report of 2017, a circular was again issued in February, 2017 cautioning the users. The RBI even set up the inter-regulatory working group on fintech and digital banking, the working notes of which were sent to the central government.

Was there a colourable exercise of power or malice in the RBI's actions?

It was the contention of the petitioners that the April 6 Circular is an instance of colourable exercise of power by the RBI that was tainted by malice as the April 6 Circular seeks to attain an objective different from the power that the RBI is entrusted with. Further, it was argued that "public interest" is merely a weapon for colourable exercise of power. The Supreme Court rejected these arguments and held that in order to constitute colourable exercise of power, the act must have been done in bad faith. The collateral damage done to entities that are not governed by the statutory authority while seeking to act in public interest and in the interest of depositors, banking companies or policies, cannot amount to colourable exercise of power or malic in law.

In the context of whether the April 6 Circular was colourable exercise of power by the RBI, tainted by malice:

- The Supreme Court noted that the April 6 Circular never extended to freezing any customer accounts. In fact, a period of 3 (three) months was given to banking and payment systems to stop providing services to entities dealing with or settling VCs. The Supreme Court held that the RBI had merely exercised its powers in 'public interest' to stop the gullible public from believing that VCs are legal tender.

- It was contended by the petitioners that the Enforcement Directorate, the Department of Economic Affairs, the Securities and Exchange Board of India and the Central Board of Direct Taxes did not see any threat of money laundering and have not taken extreme measures to ban VCs. However, the Supreme Court held that every institution has different functions to perform and are obligated to look at issues through a certain prism. The RBI cannot be faulted for not adopting the same approach as others.

[20] Reserve Bank of India, Financial Stability Report, Issue No. 7 (June, 2013), can be accessed at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FSPI260613FL.pdf.

[21] Reserve Bank of India, Financial Stability Report, Issue No. 12 (December, 2015), can be accessed at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR6F7E7BC6C14F42E99568A80D9FF7BBA6.PDF.

[22] Reserve Bank of India, Financial Stability Report, Issue No. 14 (December, 2016), can be accessed at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR_166BABD6ABE04B48AFB534749A1BF38882.PDF.

- The petitioner also contended that most countries have not imposed a ban (total or partial) on VCs, except China, Pakistan, Nepal, Bangladesh, Vietnam and UAE. However, the Supreme Court stated that the economy of India cannot be compared with that of the United States of America, United Kingdom or even Japan who have developed economies that are capable of absorbing greater shocks. The Supreme Court went on to state that in fact, the list of countries where a ban similar to the one on hand and much more has been imposed disclose a commonality with India. Almost all countries in the neighbourhood of India have adopted the same or similar approach and in essence India was ring fenced. In any event the Supreme Court stated that its decision could not be coloured by what other countries have done or not done and that comparative perspective helps only in relation to principles of judicial decision making and not for testing the validity of an action taken based on the existing statutory scheme.

Responses to Cryptocurrencies in Various Jurisdictions

Most jurisdictions have merely regulated cryptocurrencies rather than ban it, though countries like China, Pakistan, and Indonesia have banned cryptocurrencies.

United States of America

In the United States of America ("**US**"), cryptocurrencies are regulated by the federal as well as state regulators. The Commodity Futures Trading Commission ("**CFTC**") asserts that VCs fall within the definition of "commodity" as defined under US Commodity Exchange Act of 1936 ("**CEA**") under section 1(a)(9), as "*all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in*". A US federal court ruled that VCs are commodities under CEA and may be the underlying asset in a futures contract.[23]

In the case of *Securities and Exchange Commission* v. *Trendon Shavers*[24], the US Supreme Court rejected the argument that bitcoins do not qualify as money and therefore cannot be "securities". It was held that bitcoins are traded as money, but are limited to those who accept it as money. Further, it can also be exchanged for other well-established currencies. Since the Securities and Exchange Commission ("**SEC**") regulates all the coins offered to the public even as "utility" tokens, it has on multiple occasions applied the registration and fraud provisions under the Securities Act of 1933 to bitcoins and related matters.[25] However, the SEC has been reluctant to permit the listing of any financial crypto product since such products are unregulated and there are concerns of fraudulent practices in the market for such products.[26]

The US Internal Revenue System ("**IRS**") treats VCs as property for federal income tax purposes.[27] The taxable value of VCs shall be the fair market value of the VCs in US dollars as on the date of such receipt of VCs. The notice issued by the IRS contained a set of 'frequently asked questions' in which it was stated that the general tax principles that apply to property taxation shall also apply to VCs.

The Financial Crimes Enforcement Network ("**FinCEN**") requires every VC exchange service provider to register itself as "money transmitter" under the Bank Secrecy Act of 1970 and to comply

[23] CFTC v. My Big Coin Pay, No. 18-CV-10077 (D. Mass., Sept. 26, 2018); see also Houman B. Shadab, Regulating Bitcoin and Block Chain Derivatives, can be accessed at https://cftc.gov/sites/default/files/idc/groups/public/@aboutcftc/documents/file/gmac_100914_bitcoin.pdf.
[24] Case No. 4: 13-Cv-416 (August 6, 2013).
[25] SEC v. Garza, No. 3:15-CV-01760, 2015 WL 7732649.
[26] Securities and Exchange Commission, Release No. 34-80319; File No. SR-NYSEArca-2016-101 (March 28, 2017), can be accessed at https://www.sec.gov/rules/sro/nysearca/2017/34-80319.pdf.
[27] US Internal Revenue System, Notice 2014-21, can be accessed at https://www.irs.gov/pub/irs-drop/n-14-21.pdf#_blank.

with the money laundering regulations as if VCs were currencies. Individuals and miners are exempt from complying with such requirements.

In the case of *United States* v. *Murgio*[28], the southern district court of New York rejected the defence of the accused that bitcoins are classified as commodities by CFTC and property by IRS and therefore cannot be funds. The court noted that none of those classifications are based on the Crimes and Criminal Procedure, 1960 and held that it has never been suggested that VCs cannot be encompassed in the definition of "funds".

United Kingdom

In the United Kingdom ("**UK**"), there is no specific financial regulatory regime for VCs. Depending on the nature of the transaction involving each "cryptoasset", the Financial Conduct Authority ("**FCA**") decides on its regulatory perimeter. The FCA has defined "cryptoassets" as a digital representation of value or contractual rights which are powered by the likes of distributed ledger technology and are stored, transferred and traded electronically.[29] Cryptocurrencies are referred to as "exchange tokens" which are identified as a subset of cryptoassets and are a means of exchange similar to any fiat currency. However, cryptocurrencies have not been recognised as a legal tender. FCA has taken the view that cryptocurrencies are outside its regulatory perimeters[30]. However, "security token", another subset of cryptoassets, is regulated by FCA as they provide rights and obligations similar to that of specified investments under Regulated Activities Order 2001 ("**RAO**"). Further, "e-money", another subset of cryptoasset, which grants the users the right to have access to current or future goods or services, not having the function of specified investment under RAO, was stated to be governed by the Electronic Money Regulations, 2011 ("**EMR**"). It was further clarified that cryptocurrencies shall not be regulated by EMR since it does not meet the definition of "e-money" under EMR.

Therefore, an exchange which merely facilitates transaction in bitcoins, ethereum, litecoins and any other exchange tokens, is not regulated by FCA. Currently, the UK has taken the view that the total volume of transaction in VCs is too small to have a major impact on its economy. Therefore, various ways to regulate cryptoassets are still being explored.

Her Majesty's Revenue and Customs ("**HMRC**") in its policy paper[31] has provided for the tax treatment of exchange tokens in the hands of individuals. HMRC clarified that application of income tax or capital gains tax would depend on the facts of each case. Since most people hold cryptoassets for investment purposes, it will be subject to capital gains tax. However, where a person is carrying out a business in cryptoassets, such profits in exchange tokens will be subject to income tax. Further, the cryptoassets received from an employer or from mining, will be subject to income tax.

Recently, the high court in UK, in the matter of *AA* v. *Persons Unknown*[32], has held bitcoin to be a property and has therefore held that bitcoin is subject to propriety injunction. It ruled that generally, property can either be "things in possession" or "things in action". However, a property can also be a novel thing other than things in action or possession. Therefore, crypto assets, being intangible assets, were held to be a property and a property injunction was granted. This ruling is a relief to many people seeking a remedy for misappropriation of cryptoassets. However, the UK treats each transaction differently and does not believe in a single classification since VCs can be held for various purposes or acquired through various different ways.

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[28] No. 15-CR-769 (AJN), 2016 WL 5107128

[29] Financial Conduct Authority, Guidance on Cryptoassets, Consultation Paper, CP 19/3, (January 2019), can be accessed at https://www.fca.org.uk/publication/consultation/cp19-03.pdf.

[30] *Ibid.*

[31] HM Revenue and Customs, Cryptoassets: tax for individuals, policy paper (December 20, 2019), can be accessed at https://www.gov.uk/government/publications/tax-on-cryptoassets/cryptoassets-for-individuals.

[32] [2019] EWHC 3556 (Comm).

China

Since December 3, 2013, all financial institutions in China have been prohibited from providing any services to VC platforms. Subsequently on September 4, 2017, an announcement on preventing token issuance and financial risk[33] was jointly issued by the People's Bank of China ("**PBC**"), the Central Internet Information Office, the Ministry of Industry and Information Technology, the Industrial and Commercial Administration, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission. The joint statement provided as follows:

(i) VCs such as bitcoins or ethereum shall not be circulated in the market as currency, as they are not issued by the monetary authority and therefore are prone to many illegal activities;

(ii) any token issuance or a related financing activity was stopped from the date of the announcement and any organisation which had issued such tokens had to liquidate such tokens and reasonably protect the rights and interests of investors;

(iii) exchange platforms providing intermediary services in cryptocurrencies were prohibited from providing such services and accordingly their websites and mobile applications were to be removed and business licenses were revoked; and

(iv) financial institutions and non-banks payment institutions were prohibited from providing any product or services involving VCs.

While on one hand the PBC has shown reluctance to allow privately issued cryptoassets in the economy, on the other hand, China is releasing its own sovereign digital currency which is currently in the testing stage and will be issued by the PBC. Such VCs shall have the same status as a Chinese yuan.

Russia

Russia allows VCs to be traded for other goods or services. These transactions involve the use of VCs as a mode of payment. The Russian Civil Code was amended to introduce the concepts of "digital money" and "digital rights" which may assist in protecting the rights of the owners of cryptocurrencies although there is no law that directly governs cryptocurrencies in Russia.[34]

A draft law on digital financial assets was issued by the Ministry of Finances in Russia on January 20, 2018 ("**Russian Draft Law**"). The Russian Draft Law has been controversial and is still pending in the State Duma, the Russian parliament. The regulatory object of the Russian Draft Law was the creation, issuance, storage and circulation of "digital financial assets", as well as the exercise of rights and performance of obligations under smart contracts. Further, digital financial assets ("**DFA**") are defined as property in electronic form, created using cryptographic means and are not recognised as legal tender. Cryptocurrency is a type of DFA that is created and accounted for in the distributed registry of digital transactions. DFA could be used for exchanging with other DFA, conversion into rubles or foreign currency, or other property only through operators of exchanges. Initially, the Russian Draft Law defined 'mining' as an activity aimed at the creation of cryptocurrency with the purpose of receiving compensation in the form of cryptocurrency. Mining was treated as an entrepreneurial activity subject to taxation if the miner exceeds the energy consumption limits established by the government for 3 (three) months in a row.[35] The rationale

[33] People's Bank of China, Announcement of the People's Bank of China, Central Internet Information Office, Ministry of Industry and Information Technology, Industrial and Commercial Administration, China Banking Regulatory Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission on Preventing Token Issuance and Financing Risks (September 4, 2017), can be accessed at PBC http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3374222/index.html.

[34] Vasilisa Strizh, Dmitry Dmitriev and Anastasia Kiseleva, Blockchain and Cryptocurrency Regulation 2020| Russia, can be accessed at https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/russia.

[35]The Law Library of Congress, Global Legal Research Directorate, Regulation of Cryptocurrency Around the World (June 2018), can be accessed at https://www.loc.gov/law/help/cryptocurrency/cryptocurrency-world-survey.pdf.

behind such a measure was that there are many commercial enterprises which are involved in large scale mining, for the purpose of creating cryptocurrency and taxation will be incident on such enterprises at the time of creation of the cryptocurrency.

The Russian central bank opposes the legalisation of cryptocurrency and expects the Russian Draft Law to ban the issuance and circulation of cryptocurrencies.[36] The State Duma, where the Russian Draft Law is still pending, has advocated some crypto initiatives. According to reports, the amended Russian Draft Law shall prohibit the use of cryptocurrency as a mode of payment. Further, it has also been reported that the Russian Draft Law will regulate the issuance and circulation of DFAs but shall not include regulations in respect of cryptocurrency mining.

Australia

Cryptocurrencies and cryptocurrency exchanges are legal in Australia. In 2017, the Australian government whilst declaring cryptocurrencies as legal, specifically stated that bitcoin (and cryptocurrencies that have similar characteristics) should be treated as "property", and be subject to capital gains tax.

In December 2014, the Australian Securities and Investments Commission ("**ASIC**") had made a submission to the Senate (during the course of an inquiry into digital currency), suggesting that digital currencies do not fit within the legal definitions of a "financial product" under the Australian Securities and Investments Commission Act, 2001 ("**ASIC Act**") or the Corporations Act, 2001 ("**Corporations Act**").

However, due to the increase in initial coin offerings ("**ICOs**") and the several purposes for which tokens (or coins) are used, ASIC has, since, updated the information fact sheet INFO 225. As per INFO 225, though pure digital currencies like bitcoin still do not fall within the scope of the term "financial products", crypto assets and ICOs would fall within the scope of the term based on the characteristics of crypto assets and ICOs.

Further, as per INFO 225, where a crypto-asset is a financial product (whether it is an interest in a managed investment scheme, security, derivative or non cash payment facility), any platform that enables consumers to buy (or be issued) or sell these crypto-assets may involve the operation of a financial market. To operate in Australia, the platform operator will need to hold an Australian market licence, unless covered by an exemption. There are currently no licensed or exempt platform operators in Australia that enable consumers to buy (or be issued) or sell crypto-assets that are financial products. Platform operators must not allow financial products to be traded on their platform without having the appropriate licence as this may amount to a significant breach of the law.[37]

In 2018, the Australian Transaction Reports and Analysis Centre ("**AUSTRAC**") announced the implementation of more robust cryptocurrency exchange regulations that, *inter alia*, require exchanges operating in Australia to register with AUSTRAC, identify and verify users, maintain records, and comply with reporting obligations. On April 3, 2018, AUSTRAC commenced regulation of digital currency exchanges ("**DCEs**") under new anti- money laundering and counter-terrorism financing laws in Australia made through amendments to the Anti-Money Laundering and Counter Terrorism Financing Act 2006. The laws apply to anyone that provides a registrable DCE service, which covers services that involve exchange of fiat currencies and cryptocurrencies. In order to be covered, the services should be provided in the course of carrying on a digital currency exchange business. Cryptocurrency, or "digital currency", is defined as a "*digital representation of value that functions as a medium of exchange, a store of economic value, or a unit of account*"

[36] Helen Partz, Russia Postpones Its Crypto Law Again, Now Blaming Coronavirus (March 31, 2020), can be accessed at https://cointelegraph.com/news/russia-postpones-its-crypto-law-again-now-blaming-coronavirus.
[37] Australian Securities and Investments Commission, Information Sheet 225 (INFO 225), Initial coin offerings and crypto assets (Updated in May 2019), can be accessed at https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/.

and is also stated to be publicly available, interchangeable with money, able to be used for consideration and not government-issued.[38]

Japan

Japan has one of the biggest crypto asset markets in the world. Half the transactions in cryptocurrencies worldwide are carried out in Japan. In September 2017, Japan approved transactions by its exchanges in cryptocurrencies.[39]

The Payment Services Act, 2009 ("**PSA**") and the Financial Instruments and Exchange Act ("**FIEA**") govern the regulatory framework for cryptocurrency in Japan.

Article 2(5) of the PSA defines the term **"**virtual currency" as used in the PSA to mean any of the following:

"(i) property value which is recorded on an electronic device or any other object by electronic means,) which can be used in relation to unspecified persons for the purpose of paying consideration, or for the purchase or leasing of goods or the receipt of provision of services and can also be purchased from and sold to unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system; and

(ii) property value which can be mutually exchanged with what is set forth in the preceding item with unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system."[40]

Japanese currency, foreign currencies and currency- denominated assets are therefore excluded from the definition of **"**virtual currency" under the PSA. Further, the type of VC described in article 2(5)(i) of the PSA are permitted as a payment method in Japan.

In March 2019, the Financial Services Agency of Japan ("**FSA**") proposed amendments to the PSA and the FIEA to strengthen protections for investors in crypto assets, which came into effect from May 1, 2020 ("**Japan Crypto Amendment**"). The Japan Crypto Amendment used the term "crypto assets" in place of "virtual currency" and added "crypto assets" to the term "financial instruments" for the purposes of defining the underlying assets of derivative transactions that are subject to derivative regulations under the FIEA. Therefore, the same regulations applicable to other derivative transactions under the FIEA, such as prohibition of unsolicited solicitations and the loss cut regulations, are applicable to crypto asset derivative transactions as well.[41]

Crystal Gazing – What does the Future Hold for Cryptocurrencies in India?

The Indian government needs to choose between regulation of cryptocurrencies, as is being done in countries such as Japan, South Korea, Russia, Australia etc. and an outright ban on cryptocurrencies, as has been implemented in China, Pakistan, and Indonesia. In case of the latter,

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[38]Shaun Whittaker, Sylvia Ng and Hana Lee, New AML/CTF Regulations for Cryptocurrency exchanges, (April 23, 2018), can be accessed at https://www.pwc.com.au/legal/assets/legaltalk/new-amlctf-regulations-cryptocurrency-exchanges-23apr18.pdf; Part 1, Section 5, Anti-Money Laundering and Counter-Terrorism Financing Act 2006, can be accessed at https://www.legislation.gov.au/Details/C2019C00011.

[39] *Internet and Mobile Association of India* v. *Reserve Bank of India*, Writ Petition (Civil) No.528 of 2018.

[40]Article 2(5), The Payment Services Act, 2009, can be accessed at http://www.japaneselawtranslation.go.jp/law/detail/?id=3078&vm=02&re=02.

[41]Makoto Hibi and Hienori Shibata, Bill to Revise Regulations on Virtual Currencies (Crypto-Assets) and ICOs in Japan, (April 2019), can be accessed at *https://www.pwc.com/jp/en/legal/news/assets/legal-20190425-en.pdf.*

it will have to demonstrate using research and data that such a ban is required and justified, failing which, the ban is likely to be overturned by the Supreme Court.

So far, no country in the world has demonstrated through data or research that cryptocurrencies have harmed or are likely to harm the economy on a large scale. However, it is clear that cryptocurrencies have the potential to be used to launder dirty money or fund criminal or terrorist activities. Therefore, in our view, it is likely that India will promulgate a law on VCs which will not impose an outright ban on cryptocurrencies. VCs could be treated as a commodity. VCs which permit the holder to remain anonymous shall likely be banned. Further, it will probably be mandatory for VC exchanges to be registered with SEBI. Operators of such exchanges and any person who issues VCs would possibly have to maintain a record of all issuances and transfers so that at any given point in time, the Indian government is aware of the legal and beneficial owners of all VCs that are in circulation in India.

Cryptocurrencies were invented to, *inter alia*, offer anonymity to its holders and bypass any central authority. If the approach followed by the Indian government is in line with the predictions made above, it is very likely that there shall be no stampede to invest in VCs. However, a steady market in VCs for those who merely wish to have a different type of investment in their investment portfolio, is likely to be in play.

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