

## Cryptocurrency & The Challenge Of Regulatory Frameworks

written by Prashant Kataria | July 9, 2022



### Cryptocurrency Laws In India

It is inarguable that the era of information and communication technology has produced several promising potentials. The financial and commercial sectors are among those that benefit from the growing online ecosystem. The rise in internet users has inspired the creation of virtual world concepts, resulting in new commercial phenomena. As a result, new trading models, transaction systems, and currency alternatives have emerged.

Out of these, one of the most divisive fiscal mediums to emerge is cryptocurrency. Cryptocurrency refers to any non-fiat currency that can be used in a variety of financial transactions, virtual or physical.

Cryptocurrencies are intangible assets that are purportedly used in a variety of applications and networks, including peer-to-peer networks, virtual worlds, online social networks, and online games.

While India's conservative stance on cryptocurrency remains firm, some information has been clarified with the Indian Parliament's announcement of the annual fiscal budget in February 2022. The finance minister stated that the tax rate on revenue from virtual digital assets will be a flat 30%, with a 1% tax deduction at the source.

The Ministry of Corporate Affairs also amended Schedule III of the Companies Act. It specifies how businesses must prepare their balance sheets and income statements for submission to the government. It demands that Indian enterprises record the profit or loss on cryptocurrency transactions, the amount of currency on hand at the time of reporting, and any deposits or advances received from third parties for trading or investing in cryptocurrencies. The Indian government has made it clear these are not signs that crypto is legitimate, however.

As such, there are no clear regulations governing cryptocurrencies in India. For now, cryptocurrency use is not forbidden nor regulated. Individuals and businesses can own, invest in, and use cryptocurrencies as long as they follow all applicable regulations. India's stance on cryptocurrencies will become clear once the contents of the draft bill "The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021" are made public.

Before the measure becomes public, four legal and regulatory concerns exist in the current paradigm. They are as follows:

- Taxation Scenarios

- Anti-Money Laundering Objectives
  - Cross-Border Transactions
  - Securities & Exchange Board of India [“SEBI”] Regulations
- Taxation Scenarios

Until now, cryptocurrencies have not been classified as either goods or asset classes. Profits and earnings from the sale of cryptocurrencies, on the other hand, are subject to income tax because software is considered a “good” and can be taxed as such under Indian law. Similarly, the sale of any capital asset, in this case, cryptocurrency, would result in capital gains tax. This is determined by looking at the holding duration, trading frequency, holding size, and accounting treatment.

Although there is a category for residual commodities in the Tariff Schedule for Goods, there is currently no category for virtual currencies. As a result, virtual currencies may fall within the category of residuals. Goods supplied in the course or furtherance of business are taxed under the Goods & Services Tax [“GST”] system. Due to the multiplicity of virtual currencies and the unique nature of each transaction, decisions about the application of GST must be made on an individual basis. Those who sell items in the course of their business and are required to register for GST must add GST on invoices.

Furthermore, GST is levied on services offered in connection with the sale and purchase of virtual currency. When someone sells virtual currency for enjoyment without discrimination, there should be no GST consequences. The sale of previously held virtual money as an investment should not result in GST liability.

There is also the issue of international bitcoin transactions and the connection between withholding tax and double taxation treaties. Unresolved legal difficulties include how to efficiently tax the sale of cryptocurrencies globally due to the movement of cryptocurrency tokens between wallets, exchanges, and across international borders.

#### Anti-Money Laundering Objectives

Regulators frequently struggle to track virtual currency transactions due to their anonymity. Although wallet IDs are stored on the blockchain, they are impossible to correlate with specific individuals. Since regulators are unable to track the flow of money that could be used for money laundering, the concept of sending anything valuable over the internet while avoiding the conventional framework for financial surveillance is a cause of worry.

Know Your Customer [“KYC”] and Anti-Money Laundering [“AML”] regulations are currently established in several distinct legislation and RBI guidelines. These restrictions, however, do not specifically apply to businesses that use virtual currency.

#### Cross-Border Transactions

If Indian nationals send virtual money outside of India in exchange for services or goods provided by a non-resident business, the Foreign Exchange Management Regulations 2015 and the Master Directions on Export of Goods and Services are likely to apply.

These export restrictions, among other things, provide that only authorized banking channels may be utilized to receive the entire number of exports and that only an authorized bank may be used to offset import payments against export receivables. As a result, a cross-border exchange would be disallowed.

As a result, Indian nationals who carry virtual currencies across borders – without first receiving fiat cash through recognized banking channels – may be in breach of the Export Regulations.

#### SEBI Regulations

The SEBI Investment Advisers Regulation 2013 and the SEBI Portfolio Managers Regulation 2019 govern investment advisors and fund managers in India.

Despite the absence of a ban on managing and advising on crypto assets in the aforementioned regulations, SEBI has made public the list of commodities in which managers and advisers are entitled to trade. As a result, any investment counselors or fund managers providing virtual currency services in India do so in their capacity rather than as SEBI-authorized managers or advisers.

However, beginning with the current fiscal year, the Companies Act Amendment will require Indian investment advising firms and wealth management firms to disclose their holdings and ownership of cryptocurrencies and venture capital firms to the Indian government. Individual advisers and fund managers may be unaffected.

#### Looking Forward

Due to the ease of anonymity in digital wallet transactions and owing to how challenging it is to track the identity of the underlying owners, the entire endeavor of regulating crypto-related activity could be riddled with contradictions and might be at risk of being rendered pointless.

Absolute prohibitions on this technology are impracticable and may be quite easy to avoid. As with other disruptive technologies, a balanced regulatory framework is required to reduce the risks while maximizing the advantages. We sincerely hope that any future regulations or court rulings recognize this fact and continue to take a more balanced approach to it.

As the number of regulatory frameworks surrounding cryptocurrencies proliferates across jurisdictions to regulate cryptocurrency transactions and consumer behavior, some harmonization and standardization across regulatory frameworks will be required to establish cooperative legislative agencies/groups for policy enforcement and avoid the creation of safe havens, which is common in money laundering legislation schemes.

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