DOING BUSINESS OF CRYPTOCURRENCY w.r.t. INDIAN LEGAL PERSPECTIVE

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DOING BUSINESS OF CRYPTOCURRENCY

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Cryptocurrency has been called as the greatest technological breakthroughs since the Internet. However, a parallel warning from the Reserve Bank of India in April 2018 as a caution against bitcoin and other cryptocurrency, with no guidelines or order to prohibit cryptocurrency may puzzled you to ponder over –Is it legal to do business of cryptocurrency in India? In the recent judgement by the Supreme Court dated March 4th, 2020 in the matter of Internet Mobile Association of India v. Reserve Bank of India, the hon'ble Supreme Court has struck down the RBI circular dated April 6th, 2018 which barred banking and financial services from dealing in transactions involving virtual currency or cryptocurrency. And, now the cryptocurrency or virtual currencies are held valid, there may be several questions arise-how to do business of cryptocurrencies in India? There may be several questions which you may encounter w.r.t. applicable laws of India, as there are no specific guidelines issued by any Government Authority including Reserve Bank of India or Ministry of Finance.

The main stream adoption of cryptocurrency is becoming a reality despite sceptics who compare the boom to the 1636 tulip mania. The issue is not whether cryptocurrency will survive, but rather how it will evolve. The article aims to clarify certain major aspects which may be encountered for- "Doing Business of Cryptocurrency w.r.t. Indian Legal Perspective" under the evolving legal structure.

There are growing number of business and individuals using cryptocurrencies as trading platforms or exchanges and with this new growing phenomenon of cryptocurrency in India, at present, the current state of applicable laws needs to be review to provide insight as to what the proper treatment of these cryptocurrency transactions should be.

At present, there are more than 4,543 kinds of confirmed crypto currencies in the world and the market capitalization of the whole is about US$ 567 billion.

CRYPTOCURRENCY

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A medium of exchange created and stored electronically, and using encryption techniques to control the creation of monetary units and to verify the transfer of funds.

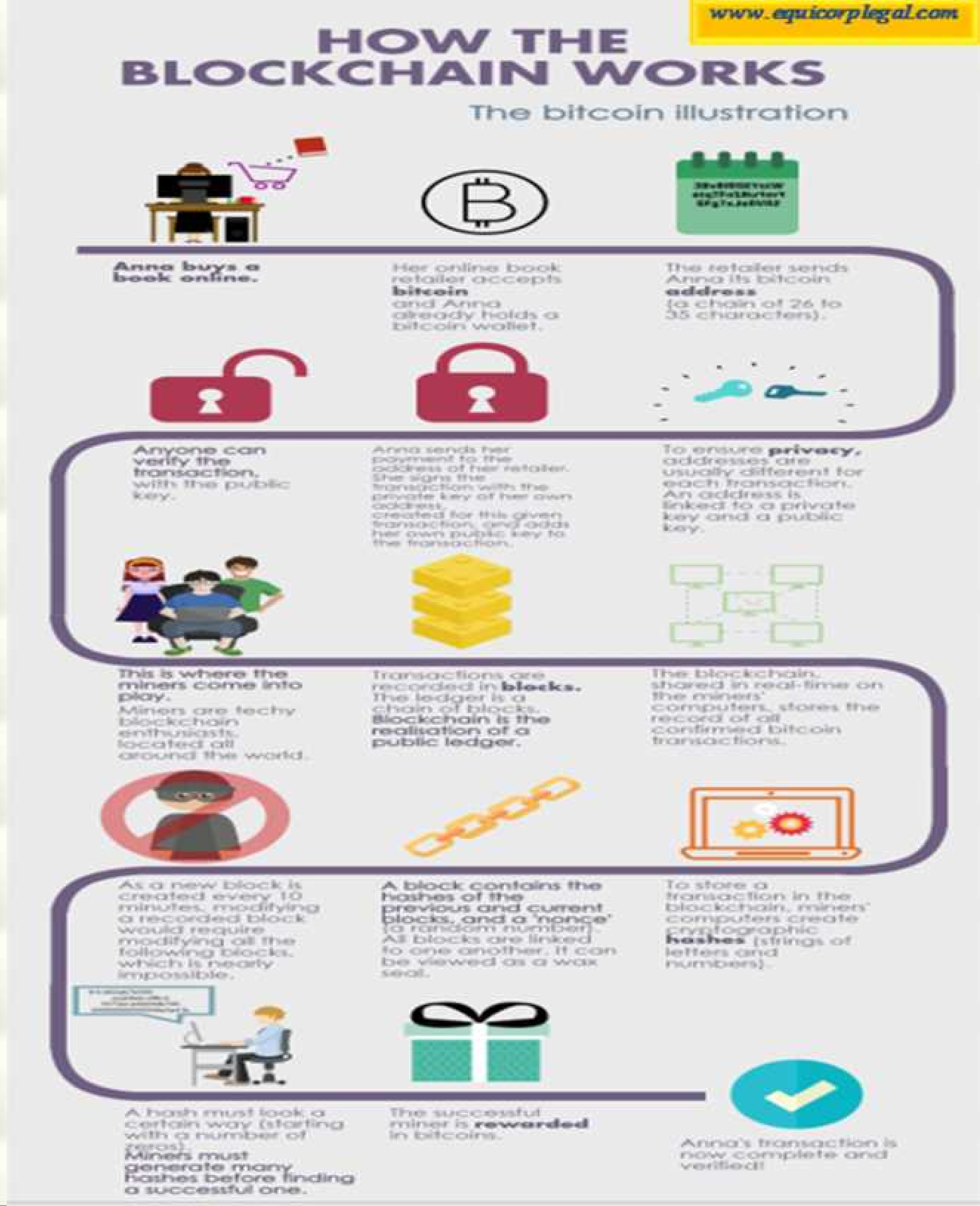
'Mining' is discovering new cryptocurrency such as Bitcoin. In reality, it's simple the verification of Bitcoin transaction. In order to make sure a Bitcoin is genuine, miners verify the transaction. There are many transactions that individuals are trying to verify and just one. These transactions are gathered into boxes with a virtual padlock on them which make up the 'blockchains'. 'Miners' run software to find the key to open that padlock. Once the computer finds it, the box pops open and the transactions are verified. Hence, it can be said that while Bitcoins are "mined" by individuals, they are issued by the software.

Cryptocurrency can be obtained mainly by the followings:

i. Mining new ones;
ii. Buying on an exchange; and
iii. Accepting them for goods and services

At present, in India real currency is being used to purchase and sell Bitcoin and other cryptocurrency at the current exchange value. Once the purchase has been made the value of the particular amount of cryptocurrency such as Bitcoin is transferred from one wallet to another. Since every wallet has its own unique 33 characters and all Bitcoin wallets are synchronized, thus a false entry by any single person being made is almost impossible. Although pseudonyms are used for trading purposes, the history of every transactions in the form of continuously updated block-chain is stored in the wallets.

Bitcoin creation and transfer are based on an open source cryptographic protocol managed in a decentralized manner, and, if harnessed properly, Bitcoin and other cryptocurrencies could deliver many benefits to the Indian economy.



Applicable Laws & Doing Business of Cryptocurrency in India

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I. *The Foreign Exchange Management Act, 1999*
II. *The Reserve Bank of India Act, 1934*
III. *The Coinage Act, 1906*
IV. *The Securities Contract Regulation Act, 1956*
V. *The Sale of Goods Act, 1930*
VI. *Indian Contract Act, 1872*
VII. *The Specific Relief Act, 1963*
VIII. *The Income Tax Act, 1961*
IX. *The Information Technology Act, 2000*
X. *The Payment and Settlement Systems Act, 2007*
XI. *The Constitution of India, 1950*

Cryptocurrency as “Legal Currency” in India

The “legal currency” are issued by government/banking authorities, whereas cryptocurrency such as Bitcoin are issued and usually controlled by its developers, and used and accepted among the members, and which relies on cryptography for its creation and management. Unlike the “Legal currency” which each country centralizes and manages and issues, the crypto currency generally indicates those (1) of which value is not guaranteed by the nation or the central bank, (2) dispersed as electronic data on the network, (3) and its management is decentralized.

“Currency” has been defined under Foreign Exchange Management Act,1999 (FEMA) to include all currency notes, postal notes, postal orders, money orders, cheques, drafts, travelers cheques, letters of credit, bills of exchange, promissory notes, credit cards or such other similar instruments as notified by Reserve Bank of India. And, as of now, there is no such declaration in respect of cryptocurrencies in general, therefore under the provisions of existing laws of India, cryptocurrencies are not legal currency in India.

Cryptocurrency as "Pre-paid Instrument" in India

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Any cryptocurrency such as Bitcoin or any other are being generated by a 'Miner' or user to himself by the use of Software. These Bitcoins issued by the software will not fall in any of the permitted categories of pre-paid instruments in India. Moreover, prepaid instruments can be issued either by- Banks, NBFC or a 'person', who are authorised and registered with Reserve bank of India.

Cryptocurrency & Know Your Customers Norms

In India, KYC norms are set by the RBI that require banks to continuously monitor their transactions, keep an up-to-date record of their identity, and take steps simply in case any of the transactions of a customer break from his or her usual pattern of behavior. The KYC requirements are also being followed by some Cryptocurrency exchanges before allowing customers to open accounts with them. It must be kept in mind that the structure of the cryptocurrency system is designed to bypass this particular measure, by ensuring that customers could not be identified by any means. Hence, one needs to have sufficient KYC norms in place as it's not as simple as in the banks or other financial institutions and leaving the Cryptocurrency exchange system vulnerable to abuse.

Foreign Direct Investment & Cryptocurrency Business in India

Whether a foreign Investor can invest in a company which provides cryptocurrency like Bitcoin related services and is foreign investment allowed in cryptocurrency trading platform & exchanges under the Foreign Direct Investment Policy?

Under the prevalent FDI policy of India, foreign investment in most sectors, other than certain restricted sectors, is permitted upto 100%. The restricted sectors include sectors such as insurance, telecom, banking, real estate, retail and defense related industries, where either no foreign investment is permitted, specific approval of one or more regulators is required or foreign investment is capped.

Companies which only provide online services may be categorized under the automatic route (since they would be providing only software platform for purchase/sale of Bitcoin or another cryptocurrency).

Taxation & Cryptocurrency Business in India

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Indirect Tax- Goods & Service Tax: Three possible scenarios:

i. *Mining of Cryptocurrency (similar to self-generated goodwill);*
ii. *Transfer of Cryptocurrency (where cryptocurrency is either a capital asset or stock-in-trade depending on the activity undertaken by the tax payer); and*
iii. *Transfer of Cryptocurrency as consideration (where cryptocurrency is either a capital asset or stock-in-trade depending on the activity undertaken by the tax payer.*

Income Tax: Under Income Tax Act, 1961, residents are subject to tax in India on their worldwide income, whereas non-residents are taxed only on income sourced in India. However, non-residents, who are resident of a country with which India signed a tax treaty, have the option of being taxed as per the tax treaty or the Income Tax Act, 1961, whichever is more beneficial.

Cryptocurrency may be considered to be capital asset or business income (where cryptocurrency is either a capital asset or stock-in-trade depending on the activity undertaken by the tax payer).

For capital assets, the income tax would be levied as capital gains tax as following:

a. *20% tax for long term capital gains tax (sale/transfer of cryptocurrency after 36 months);*
b. *30% tax for short term capital gains tax (sale/transfer of cryptocurrency within 36 months);*

For stock-in-trade, the income tax would be levied as regular income tax on the basis of income slab as prescribed by the Government of India.

Initial Coin Offerings ("ICO")

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If crypto-currencies are the future of the digital economy, then Initial Coin Offerings ("ICOs"), could be the future of fund raising.

An ICO, simply put, is a new way of crowdfunding or raising capital by startups, where the regulators around the world continue to struggle to create a framework for cryptocurrencies such as Bitcoin, Ethereum etc. The founders raise money by issuing digital tokens in exchange for crypto-currency without the transfer of any equity. Investor can use the tokens to avail the company' future services.

For instance, the token offered by XYZ, Rent Coins, offers shared ownership of the fleet of cars that the startup will buy in the event of a successful ICO. Investor who buy the Rent Coins can either use the digital tokens for renting a car or receive payouts each time a car is rented out by others. The tokens can also be traded. Essentially, Rent Coin is proof of ownership of a shared asset-cars-making investors in the ICO eligible for a portion of the money the company earns by renting vehicles.

ICO is gaining much popularity as a viable means to raise capital then the regular means of raising capital, mainly due to recent jump in prices of cryptocurrencies especially bitcoin. The general query any investor come across – "is it safe?" or what are the legal points to keep in mind to secure themselves? Do India have a framework or guidelines for ICO? Is ICO an online version of IPO (Initial Public Offerings, regulated by SEBI)

In layman terms, we may say that an ICO is similar to an IPO but it differs in many ways including but not limited to offering of shares in IPO, whereas cryptocurrencies or crypto-tokens are offered at a pre-determined rate. Both are means of raising public money. Unlike the IPO of shares by company, ICOs are not formally regulated by any financial authority.

Legal & Regulatory Perspective w.r.t. Initial Coin Offerings

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3. *Classification of Crypto-currency or crypto-tokens: Digital Currency/ Security/ Payment System/ Intangible Property/ Digital Assets. This classification shall be crucial in determining the rate of taxation and require the co-ordination/liasoning with Securities Exchange Board of India (SEBI), the Reserve Bank of India (RBI) and other sectoral regulators for effective regulatory oversight.*

2. *Compliance requirements will also vary i.e. Know Your Customer norms; anti-money laundry requirements; if cryptocurrency or crypto-token as "SECURITIES", then companies will be required to comply with SEBI Listing regulations.*

1. *"Crypto-Regulations" will have to be enacted inter alia governing issuance through ICOs, transfer & management of crypto-tokens, which shall serve as the "Framework Guidelines" for intermediaries such as "crypto-exchanges" and "crypto-brokers", among others. While it will be task to regulate a "crypto-token rating agency" primarily due to overlap of jurisdiction, an effective rating agency could potentially aid a retail investor in making an informed investment decision by conducting a reliable due diligence exercise.*

Risks in Doing Business of Cryptocurrency

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Cyber Attacks & Hacking: Cryptocurrency being in digital form are stored in digital/electronic media that are called electronic wallets, which may prone to losses arising out of hacking, loss of password, compromise of access credentials, malware attack etc. Since, they are not created by or traded through any authorized central agency, the loss of the e-wallet could result in the permanent loss of the cryptocurrency held by them.

Fraud: Payments by cryptocurrency, such as Bitcoin, take place on a peer-to-peer basis without an authorized central agency which regulates such payment. As such, there is no established framework for recourse to customer problems/frauds/Ponzi schemes/ disputes/charge backs etc.

Price Fluctuation & Inflation: There is no underlying or backing of any asset for cryptocurrency. As such, their value seems to be matter of speculation. Huge volatility in the value of cryptocurrency has been noticed recently with more than 1700% in case of Bitcoin. Thus, the users are exposed to potential losses on account of such oscillation in value.

Unclear Government Policies: It is reported that cryptocurrency such as Bitcoin are being traded on exchange platforms set up in various jurisdictions whose legal status is also unclear. Hence, the traders of cryptocurrency on such platforms are exposed to legal as well as financial risks.

Crime & Vulnerability: The cryptocurrency can be used for illicit and illegal activities in several jurisdictions and absence of information of counterparties in such peer-to-peer anonymous/pseudonyms systems could subject the users to unintentional breaches of anti-money laundering and combating the financing of the terrorism laws.

TIME FOR LEGAL EXPERT?

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- ***To know further details about Doing Business of Cryptocurrency in India, ICOs, incorporation of crypto-exchange, crypto-trading platform and other legal aspects including legal structure, tax aspects and for any other query w.r.t. Cryptocurrency, please contact us at admin@equicorplegal.com / +919958709189***

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