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LEGAL RISKS OF CRYPTOCURRENCY IN INDIA

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Abstract

In India, the legality of cryptocurrencies has been a controversial subject with conflicting opinions and changing laws. In 2018, the Reserve Bank of India (RBI) banned cryptocurrency transactions from banks; however, the Supreme Court reversed this decision in 2020. With continuous debates concerning the possibility of outlawing private cryptocurrencies while investigating a Central Bank Digital Currency (CBDC), the regulatory landscape is still unclear in spite of this. Managing hazards including fraud, money laundering, and financial stability, as well as the requirement for consumer protection and efficient taxation, are the main obstacles. As authorities struggle to develop a framework that fosters technology advancement while protecting economic interests and investor protection, India must continue to strike a balance between innovation and regulation. This essay examines these legal nuances, their effects on the cryptocurrency sector, and possible avenues for an equitable regulatory framework in India. India's changing regulatory approach to cryptocurrencies is indicative of a larger worldwide effort to strike a balance between the hazards and rewards of digital currencies. Cryptocurrencies raise issues about market volatility, possible abuse for illegal purposes, and difficulties ensuring regulatory compliance, even while they also offer potential advantages including greater financial inclusion, quicker transactions, and technological innovation. The difficulty of developing regulations that safeguard investors without impeding innovation is shown by the Indian government's hesitancy to accept or reject cryptocurrencies in their entirety. The course that India chooses as it considers a regulatory framework might have a big impact on the country's startup scene, digital economy, and fintech industry as a whole.

Keywords - Cryptocurrency Regulation, Reserve Bank of India, Blockchain Technology, Bitcoin, Digital Currency in India, Legality, Cryptocurrency Security Risks, Transaction, Fraud, Banks, Ethereum, Services, Digital Currencies, Financial.

Introduction

The Supreme Court of India overturned the Reserve Bank of India's (RBI) 2018 banking prohibition on cryptocurrency transactions in March 2020, enabling banks to offer services to cryptocurrency exchanges. Cryptocurrencies like Bitcoin and Ethereum are not accepted as legal cash in India, as they are in the majority of other nations. Additionally, India does not have a particular licensing system for cryptocurrency businesses.

Problems and Difficulties with Cryptocurrency's Legality in India as a cutting-edge type of digital asset based on blockchain technology, cryptocurrencies—such as Bitcoin, Ethereum, and other digital currencies—have become well-known throughout the world.

Cryptocurrencies function in a decentralized fashion, employing cryptographic techniques to guarantee safe, peer-to-peer transactions, in contrast to conventional currencies issued by central banks. With advantages including efficiency, transparency, and cheap transaction costs, this breakthrough has the potential to completely change the global financial scene.

But the emergence of cryptocurrencies has also brought up serious legal and regulatory issues, especially in nations like India where the financial regulatory environment is customarily more stringent.[305]

The development of cryptocurrencies in India has been fraught with legal issues and uncertainties. Concerns over the risks of cryptocurrencies, including their high price volatility, lack of consumer protection safeguards, and its usage for illicit purposes including money laundering and financing terrorism, have been voiced by the Reserve Bank of India (RBI).

A circular published by the RBI in April 2018 forbade banks from providing services to organizations that dealt in cryptocurrencies, so forcing the fledgling sector into a gray area.

But in March 2020, the Indian Supreme Court overturned this ban, finding that the RBI's move was excessive. This gave the cryptocurrency industry new hope. The Supreme Court's decision has left the legal standing of cryptocurrencies in India unclear.

Legislation like the "Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019," which sought to outlaw private cryptocurrencies while advancing a Central Bank Digital Currency (CBDC), has been contemplated by the government. Stakeholders are in a position of uncertainty, though, as this bill has not yet been signed into law. Furthermore, the government acknowledged the existence of cryptocurrencies without offering a thorough legal framework when it included a 30% tax on revenue from cryptocurrency transactions in the Union Budget 2022. For India, the regulatory ambiguity poses a number of difficulties.

For investors, firms, and startups in the blockchain and cryptocurrency field, unclear policies breed uncertainty, which may impede innovation and push enterprises to more crypto-friendly jurisdictions. The regulatory environment is further complicated by problems like the possibility of tax evasion, cybersecurity threats, and the lack of robust anti-money laundering (AML) and Know Your Customer (KYC) standards. The topic of how to effectively regulate cryptocurrencies remains a significant and challenging one as the Indian government strikes a balance between promoting technological innovation and safeguarding its financial system.

This introduction lays the groundwork for a more thorough examination of the different technological, regulatory, and financial difficulties India has in relation to cryptocurrencies[306]. It draws attention to the necessity of a well-rounded strategy that might safeguard users and preserve financial stability while allowing India to take use of the potential advantages of digital assets and blockchain technology.

The historical background, regulatory ambiguities, and difficulties surrounding the legality of cryptocurrencies in India are described in this introduction. It lays the groundwork for additional consideration of the particular problems and potential regulatory strategies in your dissertation.[307]

1.2 India's Law Regarding Cryptocurrencies

The legal journey of cryptocurrencies in India has been complicated. The following are the main facets of cryptocurrencies' legal standing in the nation:

1.2.1 No Legal currency: Bitcoin and other cryptocurrencies are not accepted as legal currency in India. The nation's central bank, the Reserve Bank of India (RBI), has made it clear that virtual currencies are unofficial and unregulated by the government.

[305] Introduction to Legality of Cryptocurrency in India *available at:* https://sumsub.com/blog/cryptocurrency-in- india/ (Last Visited on 21-10-2024)

[306] Introduction to Legality of Cryptocurrency in India *available at:* https://sumsub.com/blog/cryptocurrency-in- india/ (Last Visited on 21-10-2024)

[307] Introduction to Legality of Cryptocurrency in India *available at:* https://sumsub.com/blog/cryptocurrency-in- india/ (Last Visited on 21-10-2024)

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1.2.2 RBI Circular of 2018: The RBI published a circular in April 2018 that forbade banks and other regulated organizations from offering services to people or companies that trade in cryptocurrencies. Because it was challenging for consumers to exchange their bitcoins for fiat money, this circular seriously disrupted the cryptocurrency ecosystem in India.

1.2.3 Supreme Court's Decision: The RBI circular was declared to be unlawful and disproportionate by the Supreme Court of India in March 2020. The bitcoin industry received relief after this historic ruling, which also cleared the path for the resumption of cryptocurrency trading and investment activity.[308]

1.2.4 Absence of Particular Regulations: Although cryptocurrencies are not prohibited in India, their use and trade are not yet governed by any particular laws or regulations. Businesses and investors involved in the bitcoin field are facing uncertainty and difficulties as a result of this legal void.

1.2.5 Proposed Cryptocurrency Regulation Bill: The Cryptocurrency and Regulation of Official Digital Currency Bill was presented by the Indian government in 2021. The measure aims to outlaw all private cryptocurrencies and offer a structure for the RBI to issue a CBDC. The bill's provisions are still being discussed and debated, though, and it has not yet been signed into law.

1.2.6 State-Level Initiatives: Telangana and Karnataka are two Indian states that have investigated the application of blockchain technology and indicated interest in deploying blockchain-based solutions across a range of industries. These efforts, however, are less concerned with the precise regulation of cryptocurrencies and more with the underlying technology.

[308] India's Law Regarding Cryptocurrency *available at:* https://www.sanctionscanner.com/blog/everything-you-should-know-about-cryptocurrency-regulations-in-india-488 (Last Visited at 22-10-2024)

1.2.7 Investor Protection Issues: The Indian government has voiced worries about the possible dangers of cryptocurrencies, including fraud, money laundering, and illegal activity. In the bitcoin ecosystem, it has underlined the necessity of consumer knowledge and investment protection.

1.2.8 Taxation and Reporting: Guidelines pertaining to the taxation of cryptocurrency transactions have been released by the Indian tax authorities. Profits from bitcoin trading are liable to income tax, and cryptocurrency holdings are regarded as assets for taxation reasons. Cryptocurrency dealers and exchanges must keep accurate transaction records and adhere to reporting requirements.[309]

1.3 ETHICAL CONCERNS ABOUT CRYPTOCURRENCIES

1.3.1 Cryptocurrency Genus: A commodity or money:

Three different purposes should be fulfilled by money:

- As a means of exchange, it need to be widely recognized.

The exchange of goods should be facilitated as much as feasible by a good medium of exchange. Therefore, the cost of currency preservation must be minimal, ensuring that the money does not deteriorate when it is transferred (paper notes, for instance, are not well qualified on this point, as their physical quality deteriorates as they are being used). products must have a high market worth relative to their volume and weight in order for the currency to be easily transported and used to pay for products wherever they are needed. only in digital form; Consequently, they are non-perishable by definition. Cryptocurrencies have a high degree of divisibility. Unlike gold and cash, there are no transportation expenses because transactions take place online. Lastly,

[309] India's Law Regarding Cryptocurrency *available at:* https://www.sanctionscanner.com/blog/everything-you-should-know-about-cryptocurrency-regulations-in-india-488

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their technological design and usage of encryption prevent them from being counterfeited.

- In order to compare the prices of goods and services over time and among merchants, it ought to be a unit of account. This implies that the standard by which prices are evaluated is money.

Cryptocurrencies are currently not suited as a unit of account because to their extremely fluctuating value.

- It ought to be a long-term, steady repository of value. Money must have the ability to be saved and used at a later time without losing value. It is crucial that the value does not change significantly in order for it to maintain its value. Due to price swings, cryptocurrencies receive a medium score on this topic. It does not truly qualify as a good store of value because of these price swings. However, because they are digital, cryptocurrencies can be preserved very well and do not expire.[310]

Therefore, regardless of its legal status, anything that can perform all three of these tasks would be considered money from an economics perspective. However, there is a structural economic issue with cryptocurrencies like Bitcoins. There can only be 21 million Bitcoins issued, and after 2140, there will be no more. The economy would experience deflation if such cryptocurrencies were to become popular and replace sovereign fiat currencies since the money supply would not rise in tandem with economic expansion.[311]

1.4 Legal Issues Surrounding Cryptocurrency

Recently, there has been a boom in public interest in cryptocurrencies like Bitcoin and Ethereum as various companies look at ways to profit from the emerging technology. Nearly every day, new applications for cryptocurrencies emerge as public interest grows. The potential legal ramifications of cryptocurrencies are growing along with their novel applications. This article examines a few typical legal concerns pertaining to cryptocurrency.

1.4.1 Juridical Problems

The fundamental tenet of the blockchain technology that powers cryptocurrencies is that it is impossible to determine the precise location of a ledger. As a result, compared to transactions on conventional platforms, blockchain transactions provide higher privacy. However, this benefit presents a difficult jurisdictional problem. First, a crypto transaction's nodes may be governed by contradictory legal frameworks because they are situated in separate jurisdictions. Second, because the ledger has no physical location, it is challenging to identify the "residence country" for bitcoin software. Third, it is quite challenging to identify applicable laws and choose the best jurisdiction for blockchain disputes due to the global character of blockchain. Due to the technology's cross-border reach, it is extremely difficult for any national regulator to enforce rules among blockchain users, transactions, or projects.

1.4.2 Fraud in Finance and Data Theft

Other urgent legal issues with cryptocurrencies include financial crime and data theft. Many users who engage in illicit activities may be persuaded to adopt cryptocurrencies for their financial transactions by the blockchain's apparent regulatory exemption and anonymity promise. A significant security vulnerability in the Ethereum blockchain was discovered by a Cornell University researcher in 2017 that made $250 million vulnerable to theft. In a similar vein, a data security breach at cryptocurrency wallet manufacturer Ledger recently exposed 1 million email addresses. The personal data of Ledger's 9,500 clients, including complete names, mailing addresses, and phone numbers, was also taken. It's unclear if current data rules can

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310 Ethical Concern About Cryptocurrency *Available at:* http://www.financialsense.com/contributors/john-butler- john-boylan/ismoney-a-store-of-value.

311 Legal Issues Surrounding Cryptocurrency *Available at:* https://freemanlaw.com/legal-issues-surrounding- cryptocurrency/ (Last Visited at 24-10-10)

handle financial crime and data theft resulting from cryptocurrency.[312]

1.4.3 Privacy Issues

Data theft in the bitcoin world is intimately linked to privacy concerns. As we've seen, ensuring user anonymity in transactions was a primary motivation behind the introduction of cryptocurrencies like Bitcoin. However, Chainalysis demonstrated that the ongoing advancements in blockchain analytical tools pose a threat to this anonymity. The blockchain analytics company asserted that the term "privacy coins" is misleading because it can track the great majority of Dash and Zcash transactions.

There isn't a thorough government data protection framework in the US. Rather, industry- specific privacy and data security laws and regulations—like the California Consumer Privacy Act (CCPA), the Health Insurance Portability and Accountability Act (HIPAA), and the Gramm-Leach-Bliley Act—apply. The privacy issues raised by blockchain technology are not addressed by the current privacy and data security laws and regulations in the United States. The dispersed peer-to-peer network design of blockchain technology, for instance, is generally regarded as going against the CCPA's conventional understanding of a centralized, controller-based data processing system. Put differently, the CCPA's presumption of centralized controller-based processing does not apply to cryptocurrencies since it ignores the new technology's decentralized character.[313]

1.4.4 Implication for Taxes

Cryptocurrency are property, not cash, for the purposes of US federal income tax. Because of this distinction, cryptocurrencies cannot be used as functioning currency for Internal Revenue Code purposes by US taxpayers. On their yearly tax returns, US taxpayers must, however, disclose cryptocurrency transactions in US dollars. According to this requirement, on each transaction date, US taxpayers must ascertain the fair market value of their cryptocurrencies (by translating the virtual currency into US dollars). As a result, individual taxpayers find it difficult to accurately report cryptocurrencies to the IRS as they have to keep careful track of the prices at which they were purchased and traded. Additionally, cryptocurrencies are categorized as capital assets in the US. As a result,[314] any profits made by private investors using cryptocurrencies are subject to capital gains taxes. Whether or not investors bought their bitcoin from the US or another nation, they are still subject to this duty. It is unclear, however, if US investors who bought their cryptocurrency assets on international exchanges must meet extra reporting requirements when submitting their tax returns.

1.4.5 Contractual Problem

Cryptocurrencies and blockchain technology are notable for their self-executing "smart contracts." A series of promises, typically expressed in a digital format, known as smart contracts serve as the foundation for the parties to a transaction to carry out their individual commitments. When the other party fulfil their end of the bargain, a smart contract pays them automatically. It is challenging to ascertain whether smart contracts are under the purview of conventional contract law because of their special characteristics and

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312 Fraud in Finance and Data Theft *Available at*: https://r.search.yahoo.com/_ylt=AwrKAULJDRln5QIAvIy7HAx.;_ylu=Y29sbwNzZzMEcG9zAzEEdnRpZAMEc2VjA3Ny/RV=2/RE=1730904777/RO=10/RU=https%3a%2f%2fwww.mdpi.com%2f2227-9091%2f11%2f3%2f51/RK=2/RS=llibknCiJL97BDGBiuR8FvAkpQg-

313 Privacy Issues *Available at*: https://r.search.yahoo.com/_ylt=Awrx_bFHCxlnigIAJc.7HAx.;_ylu=Y29sbwNzZzMEcG9zAzIEdnRpZAMEc2VjA3Ny/RV=2/RE=1730904136/RO=10/RU=https%3a%2f%2fwww.weforum.org%2fagenda%2f2022%2f04% 2fprivacy-concerns-loom-large-as-governments-respond-to-crypto%2f/RK=2/RS=0r5anUN49xobn7_R62uZyGCFk80- (Last Visited On: 24-10-24)

314 Implication for Taxes *Available at*: https://r.search.yahoo.com/_ylt=AwrKGG.JDBlnDgIA4Nq7HAx.;_ylu=Y29sbwNzZzMEcG9zAzIEdnRpZAMEc2VjA3Ny/RV=2/RE=1730904458/RO=10/RU=https%3a%2f%2ftaxguru.in%2fincome-tax%2ftaxation- cryptocurrency-india-rules-implications.html/RK=2/RS=SMgaKaKtQ3uihzuFskXvFGUot4Y- (Last Visited at: 24-10-24)

intrinsic complexity.[315]

1.2 CONCEPT OF CRYPTOCURRENCY IN INDIA

A digital asset built on a network dispersed among numerous computers is called a cryptocurrency. They are able to survive without being governed by governments or other central authority because of their decentralized structure.

The notion of cryptocurrency revolves around a type of digital or virtual currency that uses cryptographic techniques to safeguard financial transactions outside of regular banking system. Unlike traditional currencies issued by central banks, cryptocurrencies function on decentralized networks, which are frequently built on blockchain technology – a distributed ledger that records all transactions across a network of computer.

Cryptocurrencies have the following key features:

- Decentralization
- Blockchain Technology
- Cryptography Security
- Limited Supply
- Peer-to-Peer Transaction

Decentralization: Cryptocurrencies are often not controlled by a single entity, such a government or central bank. This decentralization assures that no single entity can modify transaction records, making the system more transparent and resistant to censorship.

1.2.1 **Blockchain Technology:** The majority of cryptocurrencies rely on blockchain, which is a sort of distributed ledger that securely and transparently records transaction. Blockchain technology ensures that transaction data is immutable and can be checked by anybody on the network.

1.2.2 **Cryptography Security:** Advanced cryptography mechanisms protect transactions and limit the generation of new units. For example, public and private keys allow parties to conduct secure transactions without the need for a third-party mediator.

1.2.3 **Limited Supply:** Many cryptocurrencies, such as Bitcoin, have a capped supply, which implies that only a certain number of coins will ever be generated. Scarcity, like valuable commodities such as gold, can increase in value over time.

1.2.4 **Peer-to-Peer Transactions:** Cryptocurrencies allow users to conduct direct transaction between themselves, eliminating the need for intermediaries such as banks, The peer-to-peer nature can lower transaction costs while increasing transfer speed and efficiency.

Cryptocurrencies have gained popularity as an alternative investment and a means of conducting online transactions because to their decentralized and secure nature. But governments and financial institutions throughout the world are also keeping a close eye on them because of their volatility, regulatory ambiguity, and connection to illegal activity.[316]

Conclusion

There are many potential and difficulties associated with cryptocurrency legality in India. Legalizing cryptocurrencies raises important issues that should be carefully considered, even though it may also promote financial inclusion, economic growth, and technological innovation. To establish a secure and favorable environment for investors and consumers alike,

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315 Contractual Issue *Available at*: https://freemanlaw.com/legal-issues-surrounding-cryptocurrency/ (Last Visited at: 24-10-24)

316 Concept of Cryptocurrency *Available at*: https://r.search.yahoo.com/_ylt=AwrKGG.V4hln9QEAr4y7HAx.;_ylu=Y29sbwNzZzMEcG9zAzEEdnRpZAMEc2VjA3Nj/RV=2/RE=1730959254/RO=10/RU=https%3a%2f%2fwww.businesstoday.in%2flatest%2fcorporate%2fstory%2fcryptocurrency-in-india-what-the-govt-stand-legal-status-its-future-296570-2021-05-20%23%3a~%3atext%3dCryptocurrencies%2520are%2520not%2520illegal%2520in%2520India.%2520So%2520if%2cregulatory%2520framework%2520to%2520govern%2520cryptocurrencies%2520as%2520of%2520now./RK=2/RS=SaD3Z0IdNPhSMb9qAMeuoCOzrQk- (Last Visited at: 24-10-24)

significant concerns such as taxation complexity, regulatory ambiguity, and the possibility of financial crime must be addressed. In order to foster innovation and protect against the inherent hazards of the cryptocurrency market, a well-balanced regulatory framework is necessary. India has the opportunity to become a leader in the cryptocurrency area as the world market develops, but doing so would involve taking proactive steps to guarantee financial stability, consumer safety, and adherence to international norms.

In India, the legality of cryptocurrencies presents both noteworthy opportunities and difficulties. Legalizing cryptocurrencies might promote technical innovation, improve financial inclusion, and accelerate economic growth. However, concerns including taxes intricacies, regulatory unpredictability, and financial crime threats require careful consideration. India needs a balanced regulatory environment that encourages innovation and guarantees consumer protection in order to maximize the advantages while mitigating the risks. By taking a proactive stance, India can protect the interests of its people and the economy while establishing itself as a leader in the global bitcoin industry.