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Analysing the Draft Cryptocurrency Bill of 2019

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In 2018, the Reserve Bank of India issued a public circular prohibiting regulated entities from dealing with exchanges or any other businesses dealing in 'virtual currencies. This circular, in absence of any policy decision by the government, became the only existing regulatory instrument regarding 'virtual' or Cryptocurrencies. The same was challenged by the 'Internet and Mobile Association of India' in the Supreme Court which on 4th March 2020, struck down the circular and declared the guidelines for its enforcement 'illegal'. Cryptocurrencies in India have since, remained unregulated and have seen a massive increase in popularity. Legislation to regulate private digital currencies has been in the works since the Supreme Court declared RBI's circular illegal. The government has listed the 'Cryptocurrency and Regulation of Official Digital Currency Bill, 2021', which is expected to be modeled on 'Draft Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019', for introduction into the parliament. This paper is an attempt to evaluate the framework proposed by the government to regulate Cryptocurrencies under the Draft Bill of 2019.

Keywords: *cryptocurrency, blockchain technology, digital currency.*

INTRODUCTION

Forbes defines Cryptocurrencies as "decentralised digital money based on Blockchain technology".[1] It is a type of digital asset based on an open network distributed across a large number of computers, often called 'nodes'. This network is known as a Blockchain which forms the primary technology behind any cryptocurrency. On the blockchain, transactions are recorded as 'blocks' which are linked to previous cryptocurrency transactions on a 'chain'. One of the main characteristics of Cryptocurrencies that makes them unique is that they are decentralised i.e. no single individual or entity has complete control over the functioning of the blockchain. Usually, countries base their financial models around a central bank which is the principal entity when it comes to controlling financial institutions. On the other hand, cryptocurrencies are not controlled by any such entity. All transactions on a blockchain are verified by the innumerable 'nodes' comprising a particular computer network. The process of verifying these blocks of data on a blockchain is called 'mining'. For instance, mining Bitcoin is a process that entails confirming 'blocks' so they can be added on the blockchain, and in exchange, successful 'miners' get a certain amount of Bitcoin in return for their work. Mining is a painstaking process that requires high-end and sophisticated hardware, used to solve extremely complex computational mathematical problems.

The popularity of cryptocurrency has increased dramatically over the last two years. Since the pandemic hit, the government has relaxed interest rates and increased lending to improve cash flow in the economy and hence, put more money into the pockets of Indian consumers to aid the post-pandemic recovery of the Indian economy. An enhanced buying capacity clubbed with a prolonged period of declining expenditures led Indian consumers to start exploring investment opportunities. This phenomenon can easily be verified if we look at how the stock markets (BSE and NSE) have performed in 2020 and 2021. More importantly, the major factor driving the market was the influx of new investors into the market. Individual investors rose

[1] Kate Ashford, 'What is Cryptocurrency' (*Forbes Advisor*, 2021) <https://www.forbes.com/advisor/investing/what-is-cryptocurrency/> accessed 10 December 2021

by 142 lakh in FY 2020-21.[2] Similarly, cryptocurrency markets also saw a drastic rise in customer base. With over 10.07 crore investors, India has the highest number of individuals who own cryptocurrency.[3] The United States of America stands second in that regard and has only 2.74 crore cryptocurrency owners i.e. 1/5th of India's.

Indian crypto markets have sky-rocketed in the past couple of months and investment valuations stand at a whopping $10 bn dollars in such a short span of time.[4] Cryptocurrency exchange platforms like CoinSwitchKuber and WazirX boast consumer bases of 1.1 crores and 83 lakh each. Within a year of its inception, CoinSwitchKuber entered the unicorn club with a valuation of $1.9 bn.[5] The existence of such a massive industry without any official regulatory policy is a big problem in itself. It exposes the public to a plethora of challenges. For one, there are no rules or regulations as to what is allowed and what is prohibited. The absence of this distinction becomes a great impediment for both- the people and the government, as it deprives all of the much-needed clarity in both procedural and substantive matters.

To fill the void created by the absence of any legislation, the government listed the 'Cryptocurrency and Regulation of Official Digital Currency Bill, 2021' for the Winter Session of the parliament. The words "Banning of" were dropped from the name of the bill introduced, which fuelled speculations as to whether the government had closed the book on the banning of cryptocurrencies and effectively deviated from the Draft Bill of 2019. But as per the Lok Sabha bulletin, the bill sought to "ban all private cryptocurrencies in India" while allowing "certain exceptions to promote the underlying technology and its uses".[8] After the listing of this bill, the Indian Cryptocurrency market crashed sharply which resulted in heavy losses to investors as fear took over the market and panic-selling ensued.

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[2] Sakshi Bajaj, 'Retail Participation in Stock Market Rising: SBI Report' (*NDTV Profit*, 22 June 2021) <https://www.ndtv.com/business/retail-participation-in-stock-markets-rising-sbi-report-2469464> accessed 10 December 2021

[3] 'India has highest number of crypto owners in the world at 10.07 crore: report' (*Livemint*, 13 October 2021) <https://www.livemint.com/market/cryptocurrency/india-has-highest-number-of-crypto-owners-in-the-world-at-10-07-crore-report-11634110396397.html> accessed 11 December 2021

[4] Teuta Franjkovic, 'India's investment in crypto exceeds $10bn' (*Yahoo Finance*, 2 November 2021) <https://yhoo.it/31T4278> accessed 11 December 2021

[5] 'With over 10 crore users, India has highest number of Crypto owners in World: Report' (*News18*, 14 October 2021) <https://www.news18.com/news/tech/with-over-10-crore-users-india-has-highest-number-of-crypto-owners-in-world-report-4321997.html> accessed 11 December 2021

OBJECTIVES OF LEGISLATION

The primary objective of the government in formulating the bill was to establish an official cryptocurrency policy for India. No status was accorded to cryptocurrencies in India and there was no clarity as to whether it was an asset, a financial instrument, or a currency. There was also an absence of taxation policy specific to cryptocurrencies, thereby making it essential to formulate legislation for the same. The Reserve Bank of India (RBI) while pleading for a crypto-ban had previously stated that virtual currencies lacked any structured mechanism for investor grievances. RBI asserted that cryptocurrency had ineffective know-your-customer norms, made overseas transactions possible, and lacked accountability thereby putting consumers at risk.[6] On account of the aforementioned risks, the government felt the need to protect consumers and prevent offenses like money laundering and tax evasion, the risk of which increased owing to the lack of transparency in crypto transactions.

There have also been instances of large-scale frauds regarding cryptocurrencies across the world. One such scam finds mention in the report published by the Inter-Ministerial Committee on Virtual Currencies of 2019. An INR 2000 crore scam was uncovered involving GainBitcoin in India. People were promised returns on their investments in the form of Bitcoin but ultimately were paid in a different non-official virtual currency, the value of which fell rapidly causing huge losses to around 8000 people.[7] The next big concern for the government was that cryptocurrencies have no sovereign backing and are entirely private enterprises lacking any intrinsic value of their own.[8] Sovereign backing is a basic requirement for anything to qualify as 'money' as it guarantees the value of that financial instrument. After considering the risks associated with virtual currencies, the Inter-Ministerial committee suggested a blanket ban on cryptocurrencies while acknowledging the utility of the technology behind

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[6] Trisha Shreyashi & Chandan Goswami, 'Prohibition or regulation? Crypto's fate is hanging in the balance' (*Livemint*, 26 November 2021) <https://www.livemint.com/opinion/online-views/the-fate-of-cryptos-and-divergence-in-regulatory-views-11637860607641.html> accessed 12 December 2021

[7] Subhash Chandra Garg, 'Report of the Inter-Ministerial Committee on Virtual Currencies, (*PRS India,* 28 February 2019) <https://prsindia.org/files/bills_acts/bills_parliament/1970/Report%20of%20the%20Inter-Ministerial%20Committee%20on%20Virtual%20Currencies.pdf> accessed 12 December 2021

[8] Manisha Singh & Malyashree Sridharan, 'India:Note on the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021' (*Mondaq*, 01 December 2021) <https://www.mondaq.com/india/fin-tech/1136602/note-on-the-cryptocurrency-and-regulation-of-official-digital-currency-bill-2021> accessed 13 December 2021

them. They drafted the 'Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019' which paved the way for the RBI to introduce an Official Digital Currency after approval from its board.

BROAD SCOPE OF DEFINITION

The 'Draft Banning of Cryptocurrencies & Regulation of Official Digital Currency Bill' of 2019 defines Cryptocurrencies as any information, code, number, or token, generated through cryptographic means *or otherwise*, which has a digital representation of value and has utility in business activity, or acts as a store of value, or a unit of account.[9] The bill seeks to ban all things that come under the ambit of this broad definition. If the aforementioned definition is looked at theoretically, tokens like discount coupons, gift cards, and reward points also identify with the given definition. This fact clearly gives an idea as to how wide-ranging the definition actually is. Incorporating such a broad definition into a policy document leads to nothing but ambiguity. It increases the difficulty of both- the government and the bureaucracy while dealing with issues associated with the subject matter at hand. Section 25 of the Draft Bill confers upon the government, the power to exempt some activities from certain provisions of the bill, if necessary for the public interest.

Financial Action Task Force (FATF) defines cryptocurrencies as math-based, decentralised convertible virtual currency that is protected by cryptography.[10] The state of New York defines virtual currency as any digital unit that is used as a medium of exchange, or a form of the digitally stored value excluding digital units that: (i) have no application outside the platform, and (ii) are part of rewards programs.[9] If we look at how cryptocurrencies are defined globally, it is evident that the Inter-Ministerial Committee departed from those standards. The definitions are given by both- the FATF and the State of New York are precise and restrictive in nature. Unlike the definition proposed by India, their scope is limited to digital currencies

[9] 'The Draft Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019' (*PRS India*) <https://prsindia.org/billtrack/prs-products/prs-legislative-brief-3300> accessed 14 December 2021

[10] 'Virtual Currencies- Key Definitions and Potential AML/CFT Risks' (*FATF Report,* 2014) <https://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf> accessed 14 December 2021

based on cryptography and digital units that can be used as a medium of exchange respectively. Precise definitions are fundamental in order to achieve procedural clarity and the Draft Bill of 2019 markedly lacks precision in its definition of virtual currencies.

ABSOLUTE BAN AND ITS IMPLICATIONS

The Draft Bill sought to prohibit mining, generation, holding, dealing in, issuing, transferring, disposing of, or any use of cryptocurrency in India. Essentially, it placed an absolute ban on cryptocurrencies. The bill was drawn up based on the suggestions rendered by the Inter-Ministerial Committee. The committee was of the opinion that cryptocurrency lacked the basic requirements to qualify as Fiat currency and hence sought a blanket ban on the same to prevent it from interfering with the prevailing financial system. A complete ban on cryptocurrency, as envisaged by the committee, can be considered too harsh a regulation. By formulating this rule, the committee moved from regulation to placing a blanket ban on all cryptocurrencies. After a thorough perusal of the committee's report, it can be stated that the committee failed to recognize the merits of cryptocurrencies and instead focussed primarily on its drawbacks.

While cryptocurrencies do have certain cons, they have many pros too. Cryptocurrencies are considered as one of the most secure digital systems as they are protected by Blockchain technology which is virtually unhackable. Blockchain systems are permissionless and the core software is open-source which means that countless people can scrutinise the network and its security.[11] Cryptocurrencies like Bitcoin and Ethereum also provide for transparency, another major concern of the government. Every transaction on these networks is published publicly, which means that there can be no manipulation of records. Virtual currencies also provide a cost-effective mode of transaction to the people by reducing the transaction fee charged to a negligible amount. As per the website of Coinbase, a cryptocurrency exchange platform, sending Bitcoin is 60x more cost-effective and 48x faster than an international wire transfer.

[11] 'What is Cryptocurrency' (*Coinbase*) <https://www.coinbase.com/learn/crypto-basics/what-is-cryptocurrency> accessed 15 December 2021

Those statistics are staggering and cryptocurrencies may very well shape the future financial and banking systems. Banning them, at such a nascent stage, is imprudent.

The committee did however recognize the potential of Distributed Ledger Technology (DLT), of which Blockchain Technology is a subset, in improving efficiency and reducing compliance costs, like in the case of KYC requirements. The committee also suggested regulators like the Reserve Bank of India, Securities, and Exchange Board of India (SEBI), etc. look into the possible uses of DLT and formulate regulations for the same. Hence, it didn't recommend a ban on the usage of Distributed Ledger Technology in India. It also made a similar exception for all technologies or processes underlying cryptocurrencies for the purpose of research, experiment, or educational instruction, provided that no transactions are done using cryptocurrencies. The same condition applies to the exemption conferred on the use and development of DLTs as well. Consequentially, another problem crops up. If transactions aren't allowed on the blockchain technology, the incentive to produce proof of work i.e. validation of transactions by the 'nodes' on a network, is effectively taken away. This essentially means that the miners who were earlier rewarded with cryptocurrency for verifying 'blocks' of data on a blockchain will no longer be awarded for their work, thereby taking away the incentive and making the blockchain insecure and more vulnerable to cyber-attacks and hacking attempts. Therefore, banning cryptocurrency will have far-reaching consequences on the development and functioning of blockchain technology. Banning cryptocurrencies will not only affect the development and usage of Blockchain technology in the country but will also render business models of all cryptocurrency exchange platforms in India, illegal.

HARSH PENALTIES

The bill contained a transition provision that required people to make a declaration regarding any cryptocurrencies owned by them within 90 days of the commencement of the act (if the bill had been passed) and to dispose of those assets within the 90 days itself. The offences listed under Section 8 (1) of the draft bill attract the punishment of a fine, or minimum imprisonment of 1 year which may extend to 10 yrs or both.[12] In addition, the bill also declares offences under this section as cognisable i.e. wherein a person can be arrested without a warrant, and non-bailable. These offences largely pertain to Commercial activities like issuing cryptocurrency-related financial products, using it as a means of investment, or issuing cryptocurrency to raise funds. The punishments laid down in the draft bill are severe and the same has also been stated in the Legislative brief of the bill.[9] If we compare the penalties with other economic offences, the punishment prescribed comes to be at par with the offence of possessing the proceeds of a crime involved in money laundering related to an offence under the Narcotic Drugs and Psychotropic Substances Act, 1985. The penal measures given are clearly disproportionate with the nature of offence as compared to other economic offences which hold the same punishment. Furthermore, the bill criminalizes the advertisement, promotion, inducement, or solicitation of any participation in any activity involving the use of cryptocurrencies and lays down a punishment of fine, or imprisonment which may extend to 7 years, or both.

Despite such stringent punishments, the committee was somewhat lenient in formulating penalties for non-commercial activities. Section 8 (4) provides the punishment for non-commercial use of cryptocurrencies and restricts the same to a monetary penalty.[12] Therefore, it can be stated that the committee recommended to come down heavily on any commercial activities regarding cryptocurrencies.

REGULATORY MECHANISMS ACROSS JURISDICTIONS

There exists no consensus among countries as to how cryptocurrencies are to be regulated. Policy measures range from a total ban on cryptocurrencies, like in the case of China, to let them function subject to regulation, in countries like Canada and Germany, to granting cryptocurrency a legal tender as in the case of El Salvador. This disparity is also one of the principal reasons behind most countries not having a crypto policy as there is no uniformity in policy decisions across the globe. Canada has been regarded as one of the earliest adopters of

[12] 'Draft Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019' (*PRS India*) <https://prsindia.org/files/bills_acts/bills_parliament/1970/Draft%20Banning%20of%20Cryptocurrency%20&%20Regulation%20of%20Official%20Digital%20Currency%20Bill,%202019.pdf> accessed 15 December 2021

cryptocurrencies. Cryptocurrency trading platforms are required to register themselves with provincial regulators. In taxation matters, the Canadian Revenue Authority (CRA) generally treats cryptocurrencies as 'commodities'.[13] Similarly in Japan, all cryptocurrency exchanges must register with the Financial Services Agency (FSA) and comply with Anti-Money Laundering (AML)/Combating of Financing of Terrorism (CFT) obligations. Cryptocurrencies are permitted to be used as a 'payment system' and gains from their trading are considered 'miscellaneous income' and taxed accordingly.[14]

The United States of America, like India, has no clear policy regarding cryptocurrencies. Rules and regulations differ from state to state and there exists no official policy at the federal level. The State of New York makes it mandatory for companies that hold, buy or sell cryptocurrencies to seek a licensing framework called 'BitLicense', which is issued by the Department of Financial Services.[15] The Internal Revenue Service (IRS) classifies cryptocurrency as 'property' for income tax purposes.[14] In South Korea, the Financial Supervisory Service (FSS) is responsible for the regulation of cryptocurrency exchanges in the country. These entities have to strictly adhere to AML/CFT regulations. Cryptocurrency transactions in the country avoid capital gains tax because South Korea doesn't give them the status of financial assets.[14]

In June 2021, El Salvador became the first country in the world to declare Bitcoin Legal Tender. However, it seems that a majority of the people reject the idea of using a cryptocurrency on a regular basis and have stuck with the US Dollar. Several international bodies like the World Bank, International Monetary Fund, etc have expressed their concern over the adoption of Bitcoin by El Salvador.[15] China, on the other hand, has had the harshest stance on

[13] Pranav Mukul, George Mathew and Sunny Verma, 'Explained: how are cryptocurrencies regulated in countries around the world?' (*The Indian Express*, 26 November 2021) <https://indianexpress.com/article/explained/cryptocurrency-and-regulation-of-official-digital-currency-bill-rbi-parliament-winter-session-7639969/> accessed 16 December 2021

[14] Timothy Smith, 'Cryptocurrency Regulations Around the World' (*Investopedia*, 21 September 2021) <https://www.investopedia.com/cryptocurrency-regulations-around-the-world-5202122> accessed 16 December 2021

[15] Jocelyn Fernandes, 'Cryptocurrency Regulation: Here's what countries around the world have done' (*Moneycontrol*, 25 November 2021) <https://www.moneycontrol.com/news/business/cryptocurrency/cryptocurrency-regulation-heres-what-countries-around-the-world-have-done-7760921.html> accessed 16 December 2021

cryptocurrencies. The People's Bank of China (PBOC) bans cryptocurrency exchanges from operating in the country. In a major clampdown, China placed an absolute ban on Bitcoin Mining in May 2021. The country is developing Digital Yuan, a centrally regulated official digital currency.[14] It can be observed that most countries have liberal policies regarding cryptocurrencies. A majority of these states use national regulatory bodies or licensing frameworks to keep a check on cryptocurrency exchanges and transactions. It is imperative that India also chooses the path of regulation instead of imposing an outright ban on virtual currencies.

CRITICAL APPRAISAL

As stated before, imposing a blanket ban, as given under the Draft Bill of 2019, is premature and imprudent. Furthermore, it is contended by experts that no country can absolutely ban cryptocurrencies because cryptocurrencies are nothing but computer codes, therefore banning them becomes incredibly difficult. The government can create barriers for entry into the virtual currency market by banning exchanges and criminalizing holding and selling crypto but this only prevents mainstream users from using cryptocurrencies. People who are actually involved in illegal activities like tax evasion or money laundering will find alternate means to do so and will eventually turn to black-market trading of cryptocurrencies.[16] Despite the regulatory crackdown in China, many traders continue participating in cryptocurrency transactions by using VPNs or illicit addresses.[7] If a regime as strict as the one China has, is unable to enforce a ban on cryptocurrencies then the task should be considered near impossible for India, which lacks the infrastructure to enforce such a ban.

The nature of the government's clampdown on cryptocurrency is disproportionate to the potential risks posed by it. There is no denying the fact that cryptocurrencies can be misused and that some of the concerns expressed by the Inter-Ministerial Committee are valid but those concerns do not justify the radical suggestions and recommendations made by the committee. There is no precedent that can justify a policy that imposes a complete ban on

[16] BI India Bureau, 'Here is why a ban on cryptocurrencies may not be even possible' (*Business Insider India*, 19 May 2021) <https://www.businessinsider.in/cryptocurrency/news/here-is-why-a-ban-on-cryptocurrencies-may-not-be-even-possible/articleshow/82741310.cms> accessed 16 December 2021

cryptocurrencies, rather employing the said policy leads to more problems as has been explained earlier. If such a policy is imposed, it would effectively deprive the Indian citizens of a technology that could very well be a norm in the future. The best way for the government to formulate a policy is to work alongside industry experts and cryptocurrency trading platforms. These platforms can come under the purview of industry regulators like RBI or SEBI which can ensure compliance by operators to AML/CFT obligations and other concerned regulations. The cryptocurrency ecosystem that existed in 2019, when the Draft Bill was drawn up, is very different from the one that prevails today. Consumer bases of crypto exchange platforms have increased at an unprecedented rate and so has the amount invested by Indians. It has become a full-fledged service industry with multiple trading platforms. Therefore, the number of stakeholders has also risen. There is no question about the fact that a regulatory policy for cryptocurrencies is necessary, however, the policy framed should be in consonance with the current scenario. Legislation can only be successful if the people framing it understand the problems it stands to solve in a comprehensive manner. Therefore, keeping in mind how widespread the use and possession of cryptocurrency is, a ban should definitely be ruled out.

There is hope that the government will re-evaluate its stance regarding cryptocurrencies because the 'Cryptocurrency and Regulation of Official Digital Currency Bill, 2021' has been pushed back and its introduction into the parliament has been deferred. The bill was on the agenda for the Winter Session but the matter was not brought up by the government during the session. At the end of the day, cryptocurrency is a technology very much in development. Changes are frequent and can be extensive and thus framing a policy to deal with such a dynamic technology becomes difficult. It remains to be seen whether the Indian Government will adopt a liberal approach towards cryptocurrencies or will it retain its stance of prohibition as provided under the 'Draft Banning of Cryptocurrency and Regulation of Official Digital Currency Bill' of 2019.