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Right Legal Issues with Cryptocurrencies & NFTS

Sahil Khan^a

^aDr. Ram Manohar Lohiya National Law University, Lucknow, India

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This article explains cryptocurrencies, NFTs, and the legal complications associated with them. Cryptocurrencies and NFTs are digital assets that work on a secure system of blockchain technology. They are secured by a decentralised chain of computer networks which makes it impossible to counterfeit them. Major development regarding cryptocurrencies has taken place in the last year with some of the prominent names of the government opposing the transactions through digital assets and asking for a blanket ban on the digital assets by reasoning that they might influence the youth negatively; so it becomes relevant to know the reason behind so much noise surrounding the digital currencies. The concepts on which cryptocurrencies and NFTs are based are explained in the article with examples. Whether digital assets are a threat to national security is also explained in the article. The article further talks about legal issues and legislation related to digital currencies in India. The article concludes by discussing the role of digital currencies in the future and how they should be dealt with.

Keywords: *blockchain technology, decentralised network, proof of work, proof of stake.*

INTRODUCTION

The market of investment has been flooded by the terms Cryptocurrencies, Non Fungible Tokens (NFTs), etc. Bitcoin was the first cryptocurrency that was founded by a group of programmers, namely Satoshi Nakamoto in the year 2009; since then the market of cryptocurrency has skyrocketed with over 18,000 cryptocurrencies introduced in the market.

Although a technologically advanced system of digital currency, the legality of cryptocurrencies has always been in question. The Sovereigns fear that if cryptocurrencies are declared legal tender, then the currency of the country will be devalued. Apart from this concern for sovereigns, the use of cryptocurrencies in the use of purchasing arms, and carrying out illegal activities has further prevented legitimising cryptocurrencies. India has not explicitly declared them illegal but the indication has always been there to declare cryptocurrencies and NFTs as illegal tenders.

CRYPTOCURRENCIES

Cryptocurrencies are essentially a decentralised network of currencies that are based on **blockchain technology**; a secure system of technology that is extremely secure and makes it impossible for anyone to forge into the record and also prevents hacking of the data. Cryptocurrency is referred to as a digital asset; that is dispensed over a large chain of computer systems. Since, the entire concept is based on a **decentralised network**; cryptocurrencies are not governed or regulated by any government authorities, which often places them in the controversial realm of being used for criminal activities.

TYPES OF CRYPTOCURRENCIES

Most of the cryptocurrencies fall under two domains or rather they work on two concepts:

Proof of Work: This concept is basically required in the mining of cryptocurrencies for the purpose of authenticating the transactions. This allows cryptocurrency transactions to happen in peer to peer manner and removes the need for a third party. The main drawback of the Proof of Work concept is that it requires massive energy in the mining of cryptocurrencies and this requirement of energy keeps on increasing as more miners join the network. This enormous amount of energy requirement makes it a non-environmental and costly mechanism. Bitcoin and Ethereum 1.0, are the cryptocurrencies that work on this concept.

Proof of Stake: Proof of Stake is a concept that is stated to be an alternative to the Proof of Work concept. Proof of Stake is a more secure system as it has structured its compensation mechanism in such a way that it is difficult to attack the network. It is a concept that allows the owners to authenticate block transactions on the basis of the number of coins a validator is

staking. Unlike proof of work; this concept does not involve the process of **mining**; as a result, it is an extremely energy efficient and environmentally friendly concept. Solana, Cardano, and Algorand are some of the most popular cryptocurrencies that work on this mechanism.

NON FUNGIBLE TOKENS (NFTS)

Non Fungible Token in its essence means something that is unique and cannot be copied. NFTs are different from cryptocurrencies in this aspect because bitcoin can be traded in exchange but NFTs cannot be dealt with in the same manner. NFTs are part of the Ethereum blockchain, Ethereum being a cryptocurrency. NFTs contain extra information and that is how an NFT is distinguished from a cryptocurrency. There's a unique and non-interchangeable unit of data stored on a digital ledger using blockchain technology to establish proof of ownership.

NFTs are digital collectable assets that hold some value just like physical forms of art. This form of art ranges from any kind of painting, photography, music, art or video, etc. Even¹ tweets and memes have been considered a form of NFT. Anything that can be stored digitally and holds some value can be made into an NFT. It is just like purchasing a form of art but rather than doing it in the traditional way, that is, in physical form; these things are purchased digitally.

HOW DOES NFT WORK

Initially, the Ethereum blockchain was where the NFTs were launched. The uniqueness and ownership of NFT are verifiable through a blockchain ledger. NFTs will mostly come with a license to the digital asset but it does not confer ownership of copyright. The copyright owner can reproduce work and thus the NFT owner does not gain any royalties.

In order to purchase NFTs, there are various platforms that offer this service of purchasing NFTs and in order to purchase them, a wallet specific to the platform is needed and it has to be filled with cryptocurrency. Due to the high demands of NFT, they are mostly released in the form of drops much like with events, when batches of tickets are often released at different

¹ Jui Kadam, 'Key features of an Official Digital Currency Bill, 2021' (Ipleaders , 6 March, 2022) <<https://blog.ipleaders.in/key-features-official-digital-currency-bill-2021/>> accessed 30 May 2022

times. This means a frenzied rush of eager buyers when the drop starts, so they need to be registered and have their wallets topped up and ready to spend.

LEGAL ISSUES PERTAINING TO CRYPTOCURRENCY AND NFTS

1. Lack of authority

Cryptocurrency and NFTs lack the presence of any central figure or any government authority in order to establish control over the regulation of digital currency. Because of lack of authority, it is sometimes difficult for individuals to invest or to do transactions in virtual currencies because there is no surety of their investment. There is uncertainty looming over digital currencies because there is no public authority and it functions independent of the sovereign therefore; the legality of digital currencies comes into question.

2. Tax Evasion

The taxation law of digital currency is dynamic and changes from country to country. Some countries have already imposed taxes on income generated from virtual currencies but certain countries, for example, India, have not clearly defined a taxation system. As far as India is concerned, any trading in digital currency is subject to **Foreign Exchange Management Act, 1999**.

3. Tracking of location

The traceability and tracking ability of digital currencies has always been in question, it is very difficult to determine the location and transaction address of the exchange of virtual currency. It is difficult to track them because footprints in some of these currencies are untraceable and this eventually results in tax evasion.

4. Absence of Regulation

In order to ensure the credibility of anything, there must be some laws and regulations pertaining to it but if the same is lacking then the credibility of such things comes into question. This is the case with digital currencies, the legal stand of various countries is quite dynamic; each country has its own say regarding virtual currencies but the fact is that there is

an absence of proper legislation in many countries. India is also in the same boat as we do not have well-defined legislation in place as of now.

5. No Intellectual Property Rights

Only because an NFT is developed displaying an underlying work of art, its author or owner does not hold the underlying intellectual property rights. NFT holders have to acquire a license from the owner of the art in order to reproduce the original work. So, eventually, the owner is a copyright holder who prevents change, spread, or publication of an NFT, unless the owner grants these rights to another person.

6. Data Protection Regulations

Under data protection regulations in countries like the US, users can sometimes fully delete their private information but blockchain imposes certain restrictions in doing so. It does not insist that users disclose their identities. That is why exercising their rights are almost impossible for data subjects. Non-fungible tokens that include private data might violate some of the data protection principles. So, an individual with private rights can contradict data protection guidelines and also some personal rights.²

INDIA'S STAND ON DIGITAL CURRENCY

India always has maintained a negative stance towards digital currencies, citing them to be a threat to the economic stability of the country. The Reserve Bank of India has always taken a firm stand against digital currencies; recently the deputy governor of the RBI in his speech³ has cited cryptocurrencies to be a threat to the macroeconomic and financial stability of the country. RBI circular dated way back in 2018 has explicitly stated all regulated banks to prohibit from providing any facilitating service to customers who want to deal in digital currencies and also prohibited banks to maintain accounts, registering, trading, settling,

² Ryan Haar, 'The Future of Cryptocurrency: 5 Experts' Predictions After a 'Breakthrough' 2021' (Time, 3 May, 2022) <<https://time.com/nextadvisor/investing/cryptocurrency/future-of-cryptocurrency/>> accessed 28 May 2022

³ Neil Hildreth, 'India: Cryptocurrency Bill 2021: The Road Ahead' (Mondaq, 28 December, 2021) <<https://www.mondaq.com/india/fin-tech/1145012/cryptocurrency-bill-2021-the-road-ahead#:~:text=According%20to%20the%20Lok%20Sabha,the%20Reserve%20Bank%20of%20India>> accessed 29 May 2022

clearing, and giving loans against virtual tokens. The circular was challenged in the Supreme Court and eventually, the circular was set aside by the court in May 2021 and RBI urged banks to not cite its 2018 order and not to deny banking facilities to customers who want to engage in dealing with virtual currencies. Since then a lot of meetings have taken place but there has been no major development in terms of banning cryptocurrencies, NFTs. A draft bill was supposed to be presented before the Parliament on the regulation of digital currencies in the budget session but it got postponed.

LEGISLATIONS AND REGULATIONS ON DIGITAL CURRENCIES

- *Regulation of Official Currency Bill, 2019*

A board set up by the legislature on virtual monetary standards had proposed restricting private virtual currencies in India. The drafted legislation restricted digital currencies by passing legislation and imposing fines for carrying out transactions in the form of digital currencies. IMC recommended banning cryptographic forms of money and termed virtual monetary standards as a criminal demonstration. The report suggested that all forms of digital currencies should be disposed of except the one established by the State.

- *Official Digital Currency Bill, 2021*

The bill seeks to overhaul the previous regulations introduced in 2019 since it did not deal with the matter comprehensively. However, ambiguity is still there because the government has equivocated the matter stating that on one hand, they are looking for a blanket ban on all digital currency, except the one introduced by the RBI; while on the other hand they have stated taxing the digital currencies as an alternative.

- *Blanket*

The cryptocurrency and regulation of the Official Digital Currency Bill, 2021 will be tabled in Parliament during the winter session which will include an exhaustive framework for the regulation of digital currencies and also for the establishment of the State's digital currency. The term banning of all 'private cryptocurrencies' has been mentioned in the draft bill which gives a very bleak outlook on the regulation of digital currencies and in case of a blanket ban, all the transactions, and dealings in private cryptocurrencies will be prohibited.

- *Taxation*

While on the one hand blanket ban seems to be a possibility the fact is that the term ‘private cryptocurrency’ is quite vague as it does not provide a clear-cut definition as to what all constitute private cryptocurrency. There is a possibility that certain currencies that are private, only those will be terminated while the rest of the digital currencies will remain functional. However, the currencies which will be functional would be taxed 30% and with 1% TDS but the clarity on the same is yet to be provided.

CONCLUSION

Looking at the involvement of people all around the globe and particularly Indians, it seems to be high time that India should regulate digital currencies rather than imposing a blanket ban. Digital currency is based on blockchain technology which seems to be the future and if India bans digital currency then it would mean taking a step back in our quest for digitising India. RBI should soften its stance against digital currencies and should not think of it as a problem in the banking system, rather it should be viewed as a technological solution to some of the banking problems.⁴ Blockchain has a huge application in trading, lending, financing, and other financial activities. Blockchain technology can stir up a revolution in the fintech area and therefore; it has the potential to improve the efficiency of financial systems in India. Cryptocurrencies and NFTs will boost the digital culture in India and will also help in the ‘**Digital India**’ mission. Electronic services, banking services, and other technology sectors will see immense growth and a period of technological revolution. The security and other issues concerning these technologies have also been comprehensively dealt with and now misusing the virtual currency has been made really difficult. So, the government should aim at regulating digital currencies rather than banning them.⁵

⁴ Ritarshi Banerjee, ‘India is demanding cryptocurrency with marketing regulations: WazirX’s Rajagopal Menon’ (Financial Express, 9 May 2022) <<https://www.financialexpress.com/digital-currency/india-is-demanding-cryptocurrency-with-marketing-regulations-wazirxs-rajagopal-menon/2502136/>> accessed 27 May 2022

⁵ Srinath Siridharan, ‘Crypto policy and India: The spectacle continues’ (Observer Research Foundation, 5 March 2022) <[https://www.orfonline.org/expert-speak/crypto-policy-and-india-the-spectacle-continues/#:~:text=Technically%2C%20there%20is%20neither%20a,that%20govern%20their%20actual%20usage](https://www.orfonline.org/expert-speak/crypto-policy-and-india-the-spectacle-continues/#:~:text=Technically%2C%20there%20is%20neither%20a,that%20govern%20their%20actual%20usage>)> accessed 28 May 2022