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Legal Perspective on Cryptocurrency Regulation - Regulatory Framework and Challenges

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The prevalence of cryptocurrency assets is consistently growing day by day, and their existence is expected to persist for the foreseeable future. These emerging virtual assets are currently seeing fast growth and advancement. Cryptocurrencies have existed for almost ten years, but only recently have attempts to regulate them become a priority in policy discussions. Global authorities are confronted with difficult inquiries regarding crypto-assets and their regulation. With the help of this paper, we will try to understand the current position regarding the legality of Cryptocurrencies. We shall also try to address the vacuum in laws regarding cryptocurrencies in India and the future of these currencies. This paper further discusses the impact of a complete ban on cryptocurrencies and the opportunities that these currencies may provide if regulated adequately. In this paper, the approaches taken by various countries will be discussed. This paper will also discuss the challenges in formulating a regulatory framework around cryptocurrencies and suggest possible solutions to the prevalent challenges.

Keywords: *cryptocurrencies, bitcoin, crypto law, blockchain, mining.*

INTRODUCTION

Cryptocurrency is a form of digital currency that operates in a decentralized manner, using blockchain technology for security and encryption for protection. Cryptography is the process

of safeguarding data from unauthorized access by implementing encryption techniques. The majority of the assertions made by blockchain, such as anonymity and immutability, are facilitated by the use of encryption.

The origins of cryptocurrency technology may be traced back to the 1980s when the concept of a 'blinding algorithm' was first introduced. The algorithm focuses on ensuring secure and unchangeable digital transactions. It continues to be essential to contemporary digital currencies. Cryptocurrencies operate independently from government or central regulatory authorities. Cryptocurrency operates independently from the financial system, utilizing several brands or types of coins.¹ Now the question arises what is the need to regularize these currencies? As already stated, these are not controlled by any governments or any specific institution so the question arises for their authenticity and their use as well as their origin. Since the source of most of these currencies is not certain the validity of such currencies is always in question.

Presently, individuals have the option to purchase cryptocurrencies from central exchanges, brokers, or individual currency owners, as well as sell them to these entities. Exchanges or platforms provide the most convenient means to purchase or trade cryptocurrencies. After purchasing, digital currencies can be held in digital wallets. Bitcoins and other cryptocurrencies may be effortlessly transferred between digital wallets using just a smartphone. Many issues will arise rapidly with the emergence of new trends in the sphere of digital currency. The legal profession should be well equipped to anticipate and address potential challenges, while also developing the necessary skills to effectively resolve them. Prioritizing the resolution of legal matters by legislators is crucial to prevent an overwhelming influx of cryptocurrency-related cases in the judiciary.² Recently, there has been a significant surge in the value and popularity of cryptocurrencies, to the extent that it can no longer be dismissed as a temporary fad. Cryptocurrencies, which have become a digital substitute for conventional forms of payment

¹ Jaya Vaidhyanathan and Aashika Jain, 'What Is Cryptocurrency and How Does It Work?' (*Forbes Advisor*, 14 June 2023) <<https://www.forbes.com/advisor/in/investing/cryptocurrency/what-is-cryptocurrency-and-how-does-it-work>> accessed 15 April 2024

² Marco Iansiti and Karim R. Lakhani 'The Truth About Blockchain' (2017) 95(1) *Harvard Business Review* <<https://hbr.org/2017/01/the-truth-about-blockchain>> accessed 15 April 2024

such as cash or credit cards, have also given rise to differing perspectives. One perspective regards cryptocurrency as a financial tool used by fraudsters, terrorists, and criminals. This is due to their association with activities such as ransomware scams and trade on the Dark Web. However, the recent increases in the value of different cryptocurrencies have proven that they can be a profitable investment. This has had a beneficial effect on the financial situation and trading strategies of mainstream investors globally, thanks to the positive excitement surrounding the underlying blockchain technology. Reports indicate that cryptocurrencies are expected to become the predominant method of payment for products and services in the next ten years. However, this is contingent upon the level of awareness and intention among the general people to allocate funds towards cryptocurrencies.

GLOBAL SCENARIO

Various nations globally have diverse regulations about digital currency. These are the countries at the forefront of crypto regulation:

USA: The regulatory framework for cryptocurrencies in the United States is currently ambiguous and subject to frequent changes. Various federal agencies apply varied treatment to digital resources, depending on their evaluations of the features of cryptocurrencies. Legislators may also provide input, and individual states have the authority to develop their regulations.

The Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), and the Internal Revenue Service (IRS) each possess distinct understandings of cryptocurrencies: Cryptocurrencies are securities, per the SEC. The SEC desires digital assets to be classified as securities. All offerings that qualify as investment contracts are required to be duly registered, as the agency is concerned with investor protection.³ In 2023, the SEC will move in the direction of enforcement-based regulation by filing significant lawsuits against companies such as Coinbase. The SEC approved eleven spot Bitcoin exchange-traded funds in 2024. Cryptocurrencies are commodities, per the CFTC. Cryptocurrencies, according to the CFTC, are commodities comparable to gold and energy.

³ Allie Grace Garnett, 'Cryptocurrency regulation: Rules are in development' (*Encyclopedia Britannica*, 31 July 2023) <<https://www.britannica.com/money/cryptocurrency-regulation>> accessed 15 April 2024

Commodities are defined by the agency as assets capable of providing support for futures contracts. Furthermore, it presently oversees a dynamic cryptocurrency futures market. Enforcement actions against unregistered Bitcoin futures exchanges have been initiated by the agency.⁴ Cryptocurrencies are property, per the IRS. Property is the IRS classification for digital assets. The classification of digital assets in this manner results in the potential taxation of each purchase, transfer, or exchange involving cryptocurrency, subject to capital gains tax rates. In 2014, the IRS began classifying crypto assets as property.⁵

UK: The UK exercises regulatory oversight over digital asset enterprises but typically refrains from formulating specific regulations about cryptocurrencies themselves. The Financial Conduct Authority (FCA) ensures that crypto firms adhere to optimal protocols to combat money laundering and the financing of terrorism, while the Advertising Standards Authority (ASA) seeks to govern cryptocurrency advertising. The United Kingdom classifies cryptocurrency as a capital asset for taxation purposes.⁶

Canada: Canada enforces regulations on crypto trading platforms by mandating registration with provincial agencies. Crypto investment firms are categorized as money service businesses, and cryptocurrency is subject to taxation similar to other commodities. Additionally, Canada allows cryptocurrency exchange-traded funds to function on the Toronto Stock Exchange.

Position in India: The Reserve Bank of India (RBI) has yet to recognize cryptocurrencies as legitimate currencies, and there have been no particular legislations or regulations about cryptocurrencies adopted in India thus far. As there is no precise legal definition for cryptocurrencies, they are currently governed by different norms under the relevant laws. Nevertheless, the subject of cryptocurrency taxation remains ambiguous, and the regulatory landscape surrounding cryptocurrencies is even more mysterious. The acquisition of cryptocurrencies by individuals residing in India may be considered an importation of

⁴ *Regulation of cryptocurrency around the world* (Global Legal Research Center 2018)

⁵ Thomas Kingsley, 'Who Regulates Crypto' (*American Action Forum*, 09 August 2022)

<<https://www.americanactionforum.org/insight/who-regulates-crypto/>> accessed 15 April 2024

⁶ Vladlena Benson et. al., 'Harmonising cryptocurrency regulation in Europe: opportunities for preventing illicit transactions' (2024) 57(1) *European Journal of Law and Economics* <<https://doi.org/10.1007/s10657-024-09797-w>> accessed 15 April 2024

computer programs or software, as per the provisions of currency control legislation. Adhering to relevant exchange control legislation, such as the policies set forth by the Reserve Bank of India concerning the importation of services and products, is necessary for this purpose. About intangible substances produced within the boundaries of India. The Reserve Bank of India (RBI) is responsible for overseeing and controlling the management of payment systems and prepaid equipment. Prior clearance from the RBI and adherence to the applicable RBI regulations and instructions are necessary for the operation of these systems and equipment. Nevertheless, cryptocurrencies cannot be categorized as payment systems until they are acknowledged as a means of settling transactions between payers and beneficiaries and possess knowledge of the ongoing fluctuations in the value of cryptocurrencies. Still, the utilization and exchange of cryptocurrencies safeguard the confidentiality of information and sensitive personal data. Each cryptocurrency necessitates the utilization of cryptocurrencies to adhere to the necessary criteria for information security.⁷ The Indian government has lately deliberated on implementing a prohibition on privately issued cryptocurrencies through a newly proposed legislation called the Cryptocurrency and Official Digital Currency Bill Regulations, 2021 (also known as the Cryptocurrency Bill 2021). If this bill is enacted, all private cryptocurrencies, including Bitcoin, will become illegal in India. The Indian government discussed the advancement of cryptocurrencies in the proposed legislation. India would have numerous benefits if it were to develop its organized blockchain system.⁸ Transactions, for instance, exhibit enhanced security. As India has full control over its cryptocurrency, there are no additional fluctuations in its value. India implements its cryptocurrency regulations. This may encompass explicit legal prohibitions about the misuse of digital currency technologies. As cryptocurrencies are implemented using blockchain technology, their verification techniques are inherently transparent. Yet, India encounters several obstacles with cryptocurrencies, notably the task of detecting illicit transactions.

⁷ Deshant Singh Thakur et. al., 'Regulation of Cryptocurrency in India: Issues and Challenges' (2022) 6(5) Journal of Positive School Psychology <<https://journalppw.com/index.php/jpsp/article/download/9707/6356/11347>> accessed 15 April 2024

⁸ 'Everything You Should Know About Cryptocurrency Regulations In India' (*Sanction Scanner*) <<https://www.sanctionsscanner.com/blog/everything-you-should-know-about-cryptocurrency-regulations-in-india-488>> accessed 12 May 2024

CHALLENGES

The absence of explicit and exact rules regarding cryptocurrencies is frequently counterbalanced by the need to adhere to compliance obligations established through legal decisions, guidance, and explanations of current laws and regulations. Virtual asset service providers are subject to similar regulatory requirements as conventional financial services. Characterizing cryptocurrencies and determining their categorization under established legal systems presents a challenging endeavour. The decentralized nature of digital currencies poses a challenge to conventional financial terminology, necessitating adjustments to current legislation or the development of totally new frameworks. The development of regulatory clarity for cryptocurrencies has been hindered by the global nature of the sector, its technological complexity, and the wide range of application scenarios it encompasses.⁹ The crypto industry's global nature poses regulatory issues that surpass local bounds. Given the global nature of digital currencies and their operation across different countries and jurisdictions, it is essential to establish similar international regulations. This is important to prevent the exploitation of legal differences and to ensure that investor protection requirements are uniformly applied. Furthermore, national authorities may need to decide on how the underlying technology used to create crypto assets compares to other public policy goals, such as the significant energy consumption involved in 'mining' certain types of crypto assets. This is in addition to developing a framework that can oversee both actors and activities in the crypto ecosystem. Furthermore, the industry's swift advancement has posed challenges for authorities in maintaining pace. The challenges with Cryptocurrencies are primarily associated with:

Jurisdiction: Cryptocurrency transactions inherently provide privacy as a fundamental feature and benefit. However, this also presents a complex legal dilemma on issues of liability and enforcement. In the event of any issues, like as coding mistakes, data problems, or malfunctions, it can be quite challenging for the courts to determine accountability. This is because the nodes involved in a cryptocurrency transaction are decentralized and may be governed by different

⁹ Anastasia Sotiropoulou and Stéphanie Ligot, 'Legal Challenges of Cryptocurrencies: Isn't it Time to Regulate the Intermediaries?' (2019) 16(5) European Company and Financial Law Review <[10.1515/ecfr-2019-0023](https://doi.org/10.1515/ecfr-2019-0023)> , accessed 15 April 2024

and contradictory legal frameworks.¹⁰ Moreover, determining the country of residence for digital currency software is challenging because the ledger does not have a physical address. Furthermore, the global nature of the blockchain complicates the process of identifying relevant laws and choosing the appropriate jurisdiction for resolving blockchain disputes, thereby making the task of assigning culpability a challenging endeavour. The inherent transparency and international scope of crypto transactions and wallets pose a distinct challenge for central banks and governments in terms of jurisdiction and regulation.

Decentralized and Anonymous Nature: The absence of a governing body or central authority to oversee cryptocurrency transactions makes it hard to determine who is paying and who is receiving. As a result, governments and regulatory agencies are falling behind the rapid development of new technologies, leaving financial institutions without clear rules to follow. Criminals can use crypto assets for illegal purposes like money laundering and terrorist financing, thanks to the lack of transparency and regulations. Another concern is that financial institutions have a hard time tracking where the funds are coming from and going because of the anonymity and pseudonymity of cryptocurrency transactions. Additionally, banks need to fill compliance holes with an efficient financial crime risk management strategy because crypto transactions are associated with wallet addresses instead of identities.¹¹

Control over Cryptocurrencies: The issue of extreme instability has also led to a decline in the use and acceptance of cryptocurrency, as many buyers prefer to store their investments for eventual higher selling prices instead of spending them. Cryptocurrencies have challenged governments and central banks since they may compete with fiat money; which is the government's legal tender paper currency. Cryptocurrency markets are hard to monitor because data is typically fragmented, whereas authorities are finding it difficult to keep track of all the participants who might not be obliged by regulations requiring normal transparency or reporting standards. Financial purity lies behind cryptocurrencies, especially in combating

¹⁰ Niji Oni, 'Jurisdictional Issues on Cryptocurrency Transactions' (2021) SSRN
<<https://dx.doi.org/10.2139/ssrn.3830568>> accessed 15 April 2024

¹¹ Amy Matuso, 'Crypto and digital assets: Regulatory challenges' (KPMG, 2022)
<<https://kpmg.com/us/en/articles/2022/ten-key-regulatory-challenges-2022-crypto-digital-assets.html>>
accessed 15 April 2024

financial crime. For law enforcement agencies it becomes extremely hard to deal with most crypto networks that are not open for public scrutiny.

CRYPTOCURRENCY REGULATION: THE WAY FORWARD

A regulatory body might consider endorsing or introducing a cryptocurrency capable of scaling in response to demand. Using such a cryptocurrency, the regulator could oversee the complete transaction process and effectively address concerns about price stability, security, and dependability that are prevalent among alternative cryptocurrencies. Even so, there is still plenty that the regulatory bodies need to address in this domain. It is what we believe that central banks and other regulatory bodies can exert a direct and proactive influence in regulating cryptocurrencies in two domains: The domain encompassing the implementation or endorsement of a closed-loop currency, as well as the oversight of conversion points and intermediaries. A regulatory body might consider endorsing or introducing a cryptocurrency capable of scaling in response to demand. Using such a cryptocurrency, the regulator could oversee the complete transaction process and effectively address concerns about price stability, security, and dependability that are prevalent among alternative cryptocurrencies. Third-party vendors authorized by the relevant central banks will be able to conduct verification operations under the new law, providing they meet the established standards and do not have any conflicts of interest. To safeguard innocent investors from fraudulent activities and excessive market volatility, as well as to avert major problems, guidelines are necessary¹². A vision of development and its goals should inform the establishment of robust, clear, consistent, and objective guidelines. It is important to comprehend that the cryptocurrency ecosystem relies on decentralization. The elimination of middlemen in favour of peer-to-peer and crypto-to-crypto transactions has allowed several exchanges to survive.

By the applicable state regulations, legal and governing frameworks must classify cryptocurrencies as securities or other monetary instruments and regulate their administration. As an alternative to explicit prohibition, governments ought to implement regulatory measures

¹² Brian Armstrong, 'Regulating Crypto: How we move forward as an industry from here' (*Coin Base*, 19 December 2022) <<https://www.coinbase.com/blog/regulating-crypto-how-we-move-forward-as-an-industry-from-here>> accessed 15 April 2024

on cryptocurrency transactions, such as rigorous KYC, reporting, and taxation requirements.¹³ A similar KYC system that is in place for banking involves the interlinking of the PAN and Aadhar with a mobile number and the bank account of the bearer. This system should also apply to cryptocurrency wallets. Consideration of stakeholder complaints, alternative conflict resolution, recordkeeping, audits, and independent audits may help with openness, information accessibility, and consumer protection.

Excessive regulation presents an additional obstacle, which has the potential to impede innovation in the crypto assets business. Overregulation can hinder the expansion of this rapidly growing industry. The substantial increase in the worth of assets, such as Bitcoin, has made fundraising opportunities more accessible to newcomers. This emphasizes the necessity for intentionally designed regulatory measures that allow financially constrained small enterprises to obtain money from a wide variety of investors. India needs to stop relying on outdated payment methods and start making waves in the next IT revolution.¹⁴ Blocking such money won't solve the problem entirely because it will discourage new business owners. The implementation of appropriate regulation of specific KYC criteria is crucial. That is all that is required to attempt to push for appropriate regulation. From information technology engineers to marketers, it will generate fresh employment possibilities at all facets of the economy while slowing the rate of unemployment and, in the long run, helping to lift people out of poverty. Blockchain technology is another important new development that regulators should keep a close eye on. Cryptocurrencies are based on blockchain technology, which is fundamentally changing many parts of the banking and finance industries. Blockchain is an open system that makes sure that protected ledger information can be copied safely. Companies all over the world are already using distributed ledgers to make public tasks easier, like the health sector and keeping track of identities.

¹³ Eddie Ponce, 'What does KYC mean for Crypto?' (*Mitek*, 21 June 2022)

<<https://www.miteksystems.com/blog/what-does-kyc-mean-for-crypto>> accessed 16 April 2024

¹⁴ Ahmad Chokor and Élise Alfieri, 'Long and short-term impacts of regulation in the cryptocurrency market' (2021) 81 *Quarterly Review of Economics and Finance* <<https://doi.org/10.1016/j.qref.2021.05.005>> accessed 16 April 2024

CONCLUSION

Stopping cryptocurrency would be akin to prohibiting the Internet. In the same way that the Internet revolutionized how individuals conduct routine tasks, cryptocurrencies, and blockchain platforms will exert a similarly profound influence. While still undergoing development, they have already implemented more affordable and practical methods for conducting financial transactions. It is imminent that the international community adopts this technology and endeavours to surmount its limitations. The temporary prohibition had an impact on both investors and legitimate enterprises. This technique hindered the investors from amassing a substantial amount of economic benefit. Rather than relegating cryptocurrencies to the periphery of financial systems, governments, banks, and other regulatory bodies must take the initiative to integrate them. One potential strategy to address the jurisdictional challenges posed by the borderless nature of cryptocurrency transactions is to implement regulations at the exchange points, where such transactions occur in exchange for tangible products or services or cash. Before this can occur, a thorough comprehension of cryptocurrencies and a willingness to confront associated issues must exist. Cryptocurrency is rapidly gaining popularity in the realm of emerging technologies. The increasing significance of this lies in its ability to address the forthcoming era of the digital revolution. Despite the various risks associated with this digital money, millions of dollars have been invested in it because of its constant transparency, traceability, low transaction cost, zero handling fees, and potential for profits.

The complexity and multifaceted nature of the regulatory challenges within the cryptocurrency industry are not hidden. Equivalently as essential as mitigating the risks connected to digital assets is the development of regulations that foster innovation.¹⁵ Multiple nations have implemented distinct regulatory strategies regarding cryptocurrencies. In recent years, the United States has tended to adopt a more stringent approach, whereas Hong Kong and Singapore have opted for more amicable methods to entice innovators. A certain degree of trial and error is inevitable due to the nascent stage of the market and, in particular, the regulations that govern it. As time passes, the most effective regulatory strategies ought to become

¹⁵ Ruholamin Haqshan, 'Crypto Regulation Challenges: Balancing Innovation and Investor Protection' (*Techopedia*, 6 July 2023) <<https://www.techopedia.com/crypto-regulation-challenges>> accessed 16 April 2024

apparent. In the future, regulators around the globe must establish a unified strategy that strikes a balance between investor protection and innovation. They can establish a secure and dependable environment that fosters the crypto industry's sustainable expansion.