

# The Crypto Regime in India: A Confused Policy

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## Abstract

*With the advancement of financial technology, cryptocurrencies have gained much traction globally. Their largely unregulated and decentralized nature has made them controversial and a topic of hot debate in most countries. Governments and financial institutions across the globe have recognized the significance of the new asset class in the markets and have observed the upsurge in exchanges in mainstream society. Its ever-increasing popularity has pushed governments to deliberate and implement policy decisions for their regulation. Currently, there exists no uniform international law pertaining to the regulation of cryptocurrency despite its cross-border trade. While some countries have affirmed its legality, others have remained silent or have imposed a ban. India has witnessed some interesting developments in its legislative, executive and judicial domains. From the imposition of a ban on services that facilitate the trade of virtual currencies to its subsequent retraction by the judiciary, the Indian spectators are left guessing the government's next move. While a Draft Bill calling for the ban on cryptocurrency trading sits dormant in the Indian Parliament, crypto users continue to pay a hefty 30% tax on the profits from the sale or exchange of any crypto assets since its imposition in the Union Budget of 2022-2023. The legality of the cryptocurrency itself remains unsettled, and the country awaits a governmental policy decision on the same.*

**Keywords:** cryptocurrency, legality, regulation, taxation, policy decision.

## A Introduction

The digitalization of financial transactions has brought with it fundamental changes in the economy. It has revolutionized the financial system by altering the design of money itself.<sup>1</sup> The introduction of cryptocurrencies is yet another development in the field of digital markets and finance. Cryptocurrency exists as a form of digital currency that is independent of centralization by the state. Instead, they are privately issued open digital or virtual currencies (VCs) competing with central bank-issued traditional currencies.<sup>2</sup> Cryptocurrencies operate on blockchains using distributed ledger technology (DLT). Exchange transactions and

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1 A. Carstens, 'Digital Currencies and the Future of the Monetary System', Hoover Institution Policy Seminar, Bank for International Settlements, Basel (27 January 2021) 2, <https://www.bis.org/speeches/sp210127.pdf> (accessed 8 January 2023).

2 U. Asudani, 'Status of Cryptocurrency in India: A Broader Perspective' (2021) 4 IJLMH 5571.

prices are approved by crypto users online and the ledger, maintained by its users, displays a permanent record of the respective transactions.<sup>3</sup> Once the network of distributed servers or nodes affirms the validity of a particular transaction, the transaction is grouped with others in 'blocks'. These blocks contain encrypted data and are held in a 'chain', becoming part of the public database. Each of the blocks has a 'hash', which is a unique code assigned to the particular block. The blocks containing the information arrange themselves on the chain in chronological order, and the chains create a 'history of transactions which are legitimate'.<sup>4</sup>

Cryptocurrency is often lauded for being highly 'fraud proof' as it is almost impossible to tamper or break the encrypted data present in the blocks.<sup>5</sup> Stealing or redirecting cryptocurrency would require the simultaneous modification of the encrypted block on all or at least a majority of all servers in the distributed ledger system. Doing so retroactively would break the chain, exposing the illicit activity owing to the existence of its own 'unique encrypted code chained together in a sequence'.<sup>6</sup> Despite the fact that the chain is public, the encryption of each transfer of funds allows for anonymous transfers. While the wallet address can be decrypted or identified, the owners of holders of the wallets need not identify themselves to engage in transactions.

The biggest concerns related to cryptocurrencies, however, pertain to their independence from public authorities and any licensed and supervised financial institutions. Because of the very design of cryptocurrencies as peer-to-peer systems without intervention from third parties like banks, and their largely unregulated operation on the unregulated internet, the very legality of digital money has been a topic of controversy in India.

India's economy is often described as one of the fastest-growing economies of the world<sup>7</sup> and records the highest number of real-time digital payments globally.<sup>8</sup> Per CrossTower's report, India's market capitalization of the digital asset market was around US\$1.5 billion in 2013.<sup>9</sup> As of late 2021, the market capitalization stood at nearly US\$3 trillion.<sup>10</sup> The report predicts that fostering digital assets such as Bitcoin, Solana, Ether and other blockchains could contribute 'an additional \$1.1 trillion of economic growth to its GDP by 2032'.<sup>11</sup> Per the RBI Bulletin, India's digital economy is reported to be growing 2.4 times faster than the overall economic

3 Ibid., p. 5571.

4 Ibid.

5 Ibid.

6 Ibid.

7 International Monetary Fund, 'World Economic Outlook: A Rocky Recovery' (April 2023).

8 R. D'Souza & N. Ghosh, 'India's UPI Market: Projections for Growth under Various GDP Scenarios', Observer Research Foundation Occasional Paper No. 413, 3, [https://www.orfonline.org/wp-content/uploads/2023/09/ORF\\_OccasionalPaper\\_413\\_UPI-GDP.pdf](https://www.orfonline.org/wp-content/uploads/2023/09/ORF_OccasionalPaper_413_UPI-GDP.pdf) (accessed 5 October 2023).

9 CrossTower, '2022 Crypto Outlook', *CrossTower* (28 December 2021), <https://crosstower.com/wp-content/uploads/2021/12/Indias-1-Trillion-Digital-Asset-Opportunity.pdf> <https://usispf.org/wp-content/uploads/2021/12/2021-12-06-Indias-1-Trillion-Digital-Asset-Opportunity-1.pdf> (accessed 8 January 2023).

10 Ibid.

11 Ibid.

growth owing to technological adoption.<sup>12</sup> Furthermore, consulting giant Ernst & Young has predicted India's consumer digital economy to be a 'US \$800 billion market in 2030, registering a 10x growth from 2020'.<sup>13</sup> In this context, all eyes are fixed on the government's decisions with regard to digital currency regulation, particularly the unpredictable and unregulated crypto market.

This article illustrates the legal regime for cryptocurrencies in India by (see Section I) contextualizing the various developments and activities of different stakeholders that resulted in official resistance against any private dealing in VCs, (see Section II) the halt on services facilitating trade of VC and its subsequent retraction by the judiciary, and (see Section III) lastly, the current status of the cryptocurrencies and their legality.

## B Indian Context and Background

The period between 2013 and 2017 can be marked as the beginning of the 'cryptocurrency trend in India' as the country witnessed significant developments in its crypto market.<sup>14</sup> As early as 2012, India saw the launch of a large number of cryptocurrency exchanges, including cryptocurrencies such as UnoCoin, Zebpay, CoinDCX and so on.<sup>15</sup> The increase in the volume and number of exchanges caught the attention of the Reserve Bank of India (RBI), the Central Bank of India. For the first time, RBI's Financial Stability Report indicated that the regulators were 'studying the impact of online payment options and virtual currencies to determine potential risks associated with them'.<sup>16</sup> Subsequently, in December 2013, RBI issued a Press Release cautioning all stakeholders – users, traders and holders of crypto – of potential financial, operational, legal, customer protection and security-related risks ('associated risks') and reiterated that the creation, trade or usage of any VCs as a medium of payment was not authorized by any monetary authority or any central bank.<sup>17</sup>

The end of 2013 also witnessed the first-ever raid in India (second globally) of two firms dealing in Bitcoin conducted by the Enforcement Directorate. The raid

12 D. Gajbhiye et al., 'Measuring India's Digital Economy' (2022) *RBI Monthly Bulletin*, December 2022, 131, <https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/ORBIBULLETINDECEMBER2022839AD8E8AE984FA7AEE5F6EE71569DEF.PDF> (accessed 8 January 2023).

13 EY India, 'India's Consumer Digital Economy: A US\$800b Opportunity by 2030', *EY* (4 April 2022), [https://www.ey.com/en\\_in/e-commerce/india-s-consumer-digital-economy-a-us-800b-dollar-opportunity-by-2030](https://www.ey.com/en_in/e-commerce/india-s-consumer-digital-economy-a-us-800b-dollar-opportunity-by-2030) (accessed 8 January 2023).

14 V. Shukla, M.K. Misra & A. Chaturvedi, 'Journey of Cryptocurrency in India: In View of Financial Budget 2022-2033' (2022), <https://arxiv.org/ftp/arxiv/papers/2203/2203.12606.pdf> (accessed 8 January 2023).

15 A.K. Yadav, 'Cryptocurrency in India: To Ban or Not to Ban', *The RMLNLU Law Review Blog* (2 March 2021), <https://rmlnlulawreview.com/2021/03/02/cryptocurrency-in-india-to-ban-or-not-to-ban/> (accessed 8 January 2023).

16 Reserve Bank of India, Financial Stability Report (Issue No. 7, 27 June 2013), p. 62, <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FSPI260613FL.pdf> (accessed 8 January 2023).

17 Reserve Bank of India, 'RBI Cautions Users of Virtual Currencies against Risks', *RBI Press Release, 2013-2014/1261* (24 December 2013), <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/IEPR1261VC1213.PDF> (accessed 8 January 2023).

came in light of the warning issued by RBI indicating that users of crypto risked breaking anti-money laundering and terror financing laws.<sup>18</sup> The raid came right after the first-ever raid in the world, conducted by the Federal Bureau of Investigation of the United States of America in October 2013.<sup>19</sup> RBI's warning and the subsequent raid indicated that the government did not recognize the legitimacy of VC trade and activity at this point in time.

In June 2014, the Financial Action Task Force (FATF) published a report that defined 'virtual currency' and 'cryptocurrency' in addition to highlighting the uses and risks associated with VCs.<sup>20</sup> A year later, the FATF issued a 'Guidance for a Risk Based Approach to Virtual Currencies'<sup>21</sup> that made several recommendations for the mitigation of risks associated with VCs. It identified money laundering and terrorism financing risks as potential threats and recommended that the national authorities undertake a coordinated risk assessment of VC products. In its October 2015 Report titled 'Emerging Terrorist Financing Risks',<sup>22</sup> the FATF highlighted the terrorist financing risk presented by VCs and explained how their functioning made them a viable payment option for criminal activity.

Later, in December 2015, the biannual RBI Financial Stability Report<sup>23</sup> described the issues presented by VC schemes and stated that the excessive volatility of their value, in addition to their anonymous nature, was problematic in light of global money laundering rules, rendering the lawfulness of cryptocurrencies – and 'their very existence' – questionable.<sup>24</sup> However, the report took note of the fact that the world's largest banks, in a joint effort, were setting up private blockchains and were building an industry-wide platform for standardizing the use of DLT.<sup>25</sup> Hence, it was recommended that regulators keep track of these developments. The 2016 Financial Stability Report of the RBI yet again illustrated

18 *Internet & Mobile Association of India v. Reserve Bank of India* [2020] 10 SCC 274.

19 The target, Silk Road, was founded in 2011 as a darknet or Tor network marketplace where illegal drugs and other illegal goods and services could be purchased with Bitcoin. Silk Road's founder, Ross Ulbricht, was eventually sentenced to life without parole in 2015.

20 The Financial Action Task Force (FATF) is an international cooperation of national bodies engaged in the fight against money laundering, terrorism and proliferation financing. The FATF, 'Virtual Currencies – Key Definitions and Potential AML/CFT Risks', *FATF Report* (June 2014), <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Virtual-currency-key-definitions-and-potential-aml-cft-> (accessed 8 January 2023).

21 FATF, 'Guidance for a Risk-based Approach – Virtual Currencies', *FATF Report*, (June 2015), <https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Guidance-RBA-Virtual-Currencies.pdf.coredownload.pdf> (accessed 8 January 2023). This Guidance was updated in 2019; see FATF, 'Guidance for a Risk-based Approach to Virtual Assets and Virtual Asset Service Providers', *FATF Report* (June 2019), <https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/RBA-VA-VASPs.pdf.coredownload.pdf> (accessed 8 January 2023).

22 FATF, 'Emerging Terrorist Financing Risks', *FATF Report* (October 2015), <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Emerging-Terrorist-Financing-Risks.pdf.coredownload.pdf> (accessed 8 January 2023).

23 Reserve Bank of India, *Financial Stability Report December 2015* (Issue No. 12, 23 December 2015), <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/OFSR6F7E7BC6C14F42E99568A80D9FF7BBA6.PDF> (accessed 8 January 2023).

24 *Ibid.*, p. 42.

25 *Ibid.*

the associated risks of VCs and observed how many central banks around the world had started exploring the option of creating their own digital currency.<sup>26</sup> It also should be noted that the Indian government, while remaining cautious of the risks posed by VCs, was observing the development of digital currencies and regulation attempts made by international bodies and financial institutions.

Another key event towards the end of 2016 was the announcement of demonetization of high-denomination notes to combat corruption and promote digital payments by the Central Government. The demonetization policy took the country by surprise since it invalidated around 86% of the country's paper currency in circulation.<sup>27</sup> It has been said that the 2016 demonetization policy directly and drastically increased the trade of Bitcoin and other cryptocurrency investments.<sup>28</sup> This is because people may have sought an alternate medium to hold their large cash holdings without inviting government scrutiny or tax implications. As a consequence of the spur in transactions, cryptocurrency prices (market rates) trended higher in India by 5% to 10% compared to global averages, despite strict government regulation.<sup>29</sup>

In January 2017, RBI's Institute for Development and Research in Banking Technology (IDRBT) released a whitepaper titled 'Applications of Blockchain Technology to Banking and Financial Sector in India'<sup>30</sup> which evaluated the merits and demerits of VCs. Soon thereafter, in February 2017, the RBI issued a Press Release expressing concerns regarding the use of and trade in VCs.<sup>31</sup> In April 2017, the Ministry of Finance constituted an Inter-Disciplinary Committee to observe the status of VCs, both nationally and internationally.<sup>32</sup> The Inter-Disciplinary Committee recommended the issuance of a 'very visible and clear warning' through public media announcing that the government did not consider cryptocurrencies as either coins or currencies and that they were not a legally valid medium of exchange or way to store value.<sup>33</sup> The warning was to caution the general public to stop the trade in crypto and signalled the Indian government's position against its buying, selling and exchange. Crypto owners were advised to offload them in any jurisdiction where it was not illegal to do so. All consumer protection and

26 Reserve Bank of India, *Financial Stability Report December 2016* (Issue No. 14, 29 December 2016), p. 52, [https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR\\_166BABD6ABE04B48AFB534749A1BF38882.PDF](https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR_166BABD6ABE04B48AFB534749A1BF38882.PDF) (accessed 8 January 2023).

27 G. Chodorow-Reich, G. Gopinath, P. Mishra & A. Narayanan, 'Cash and the Economy: Evidence from India's Demonetization' (2020) 135 Q J Econ 57, 58.

28 A.K. Yadav, 'Cryptocurrency in India: To Ban or not to Ban', *The RMLNLU Law Review Blog* (2 March 2021), <https://rmlnlulawreview.com/2021/03/02/cryptocurrency-in-india-to-ban-or-not-to-ban/> (accessed 8 January 2023).

29 S. Moid & S. Jain, 'The Economics of Digital Currency: World of Crypto Currency' (2019) 9 *Adhyayan* 1, 4.

30 Institute for Development and Research in Banking Technology, 'Applications of Blockchain Technology to Banking and Financial Sector in India', *Whitepaper* (5 January 2017), <https://www.idrbt.ac.in/wp-content/uploads/2022/07/BCT.pdf> (accessed 8 January 2023).

31 Reserve Bank of India, 'RBI Cautions Users of Virtual Currencies', *RBI Press Release, 2016-2017/2054* (1 February 2017), <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR205413F23C955D8C45C4A1F56349D1B8C457.PDF> (accessed 8 January 2023).

32 *Internet & Mobile Association of India* (n. 19).

33 *Ibid.*

enforcement agencies were directed to take action against those who continued trading in crypto as it would be presumed that those continuing with the trade would be doing it with an ‘illegal, fraudulent or tax evading intent’.<sup>34</sup> The Report suggested that if the government was in agreement with these recommendations, the constitution of an additional committee would be recommended to suggest further actions and/or legislative changes to make crypto trade ‘expressly illegal and punishable’.<sup>35</sup> Interestingly, the Report made clear that none of its recommendations restricted the use of blockchain technology for any purpose other than for the creation of and trade in cryptocurrencies.

Later, in November 2017, the report submitted by the Inter-Regulatory Working Group on Fintech and Digital Banking, which was set up by RBI per the decision of the Financial Stability and Development Council Sub-Committee in April 2016, put forth a definition of ‘digital currencies’.<sup>36</sup> Here, the meaning of digital currencies was “digital representations of value, issued by private developers and denominated their own unit of account.”<sup>37</sup> Interestingly, two writ petitions (“2017 Writ Petitions”) were moved before the Supreme Court of India. While one sought a direction against the government declaring VCs illegal and banning all websites and applications that enable their trade,<sup>38</sup> the other sought a direction against the government regulating Bitcoin and even constituting a committee of experts to consider the ban or regulation of Bitcoin and other cryptocurrencies.<sup>39</sup> Around the same time, the government instituted a high-level Inter-Ministerial Committee (IMC) to recommend actions to be taken in relation to VCs.<sup>40</sup> In December 2017, RBI issued yet another Press Release reiterating concerns regarding VCs.<sup>41</sup> The Ministry of Finance also issued a statement by the end of December 2017 expressing the same concerns, clarifying that VCs were not considered legal tender.<sup>42</sup> The 2018 Union Budget finally made clear that the government did not consider cryptocurrencies to be legal tender and was taking

34 Ibid.

35 Ibid.

36 Reserve Bank of India, Report of the Working Group on FinTech and Digital Banking (23 November 2017), <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/WGFR68AA1890D7334D8F8F72CC2399A27F4A.PDF> (accessed 8 January 2023).

37 Ibid, p. 8.

38 *Siddharth Dalmia & Anr. v. Union of India and Ors.*, Writ Petition (Civil) No. 1071 of 2017.

39 *Dwaipayan Bhowmick v. Union of India and Ors.*, Writ Petition (Civil) No. 1076 of 2017.

40 Department of Economic Affairs, Ministry of Finance, Report of the Committee to Propose Specific Actions to Be Taken in Relation to Virtual Currencies (28 February 2019), <https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf> (accessed 8 January 2023).

41 Reserve Bank of India, ‘Reserve Bank Cautions Regarding Risk of Virtual Currencies Including Bitcoins’, *RBI Press Release, 2017-2018/1530* (5 December 2017), <https://www.rbi.org.in/commonman/Upload/English/PressRelease/PDFs/PR1530051217.pdf> (accessed 8 January 2023).

42 Ministry of Finance, ‘Government Cautions People Against Risks in Investing in Virtual “Currencies”; Says VCs Are Like Ponzi Schemes’, *Ministry of Finance Statement* (29 December 2017), <https://pib.gov.in/PressReleaseDetail.aspx?PRID=1514568> (accessed 8 January 2023).



measures to eradicate their use in financing criminal, illegal activities.<sup>43</sup> However, the Finance Minister clarified that the government would explore the use of blockchain technology to foster India's global economy.<sup>44</sup> In March 2018, the Central Board of Direct Taxes submitted a draft scheme proposing a step-by-step approach to ban cryptocurrencies.<sup>45</sup>

On the international level, before the July 2018 meeting of the G-20 Finance Ministers and Central Bank Governors, the Financial Stability Board (FSB) set out a communication indicating that, as per its initial assessment, crypto assets did not pose risks to global financial stability as their global market value was less than 1% of the global GDP even at their peak.<sup>46</sup> However, it also cautioned that this assessment could change and that cryptocurrencies could present issues with regard to consumer and investor protection, money laundering and terrorist financing.<sup>47</sup> The G-20 announcement after the meeting of its Finance Ministers and Central Bank Governors also recognized that crypto assets could potentially improve the efficiency and inclusiveness of the financial system and the economy.<sup>48</sup> However, it cautioned against threats with respect to consumer and investor protection, tax evasion, money laundering, terrorist financing and market integrity. Since crypto assets could not be classified as sovereign currencies, they could pose financial stability implications. Hence, the announcement called for the implementation of the FATF standards and encouraged the international standard-setting bodies to 'continue their monitoring of crypto-assets and their risks, according to their mandates, and assess multilateral responses as needed'.<sup>49</sup>

### **C The Halt on Services Facilitating Trade of Virtual Currencies and Its Subsequent Retraction by the Judiciary**

On 2 April 2018, RBI sent an email to the Central Government and attached a note with respect to the regulation of crypto assets.<sup>50</sup> It contained a record of the discussions of the last meeting of the Inter-Ministerial Committee on Virtual Currency and examined the merits and demerits of banning and regulating cryptocurrencies. It suggested that banning or regulation had to be done with the aid of suitable legal provisions. Immediately thereafter, on 5 April 2018, RBI issued a 'Statement on Developmental and Regulatory Policies' ('RBI Policies') requiring all RBI-regulated entities to 'not deal with or provide services to any individual or

43 A. Jaitley, Minister of Finance, 'Budget 2018-2019, Speech of Arun Jaitley Minister of Finance', 20 (1 February 2018), <https://www.indiabudget.gov.in/budget2018-2019/ub2018-19/bs/bs.pdf> (accessed 8 January 2023).

44 *Ibid.*, p. 21.

45 *Internet & Mobile Association of India* (n. 19).

46 Financial Stability Board, 'To G20 Finance Ministers and Central Bank Governors' 2 (13 March 2018), <https://www.fsb.org/wp-content/uploads/P180318.pdf> (accessed 8 January 2023).

47 *Ibid.*

48 Finance Minister and Central Bank Governors, 'G20 Communique' (19-20 March 2018), [www.g20.utoronto.ca/2018/2018-03-30-g20\\_finance\\_communique-en.pdf](http://www.g20.utoronto.ca/2018/2018-03-30-g20_finance_communique-en.pdf) (accessed 8 January 2023).

49 *Ibid.*

50 *Internet & Mobile Association of India* (n. 19).

business entities dealing with or settling virtual currencies' and to terminate any pre-existing relationship that the entities may have 'with such individuals/business entities, dealing with or settling virtual currencies (VCs)'.<sup>51</sup> Consequently, on 6 April 2018, RBI released a Circular reaffirming the same.<sup>52</sup> The Circular was directed at RBI-regulated entities,<sup>53</sup> that is, all banks, financial institutions, non-banking finance companies, payment system providers and so on to stop crypto trade of any kind. It is important to note that the Circular did not impose a blanket ban on the trade of VCs but rather directed RBI-regulated entities to stop providing services that facilitated their trade. Undoubtedly, the government sought to strongly discourage the trade of VCs but fell short of imposing a blanket ban. Furthermore, it was directed only towards RBI-regulated entities (nationalized banks/scheduled commercial banks/cooperative banks/NBFCs)<sup>54</sup> from assisting crypto trade and did not directly address or mention other players such as private individuals or companies. It was also around April 2018 that the IMC instituted in November 2017 submitted an initial report along with a draft Bill titled '*Crypto Token and Cryptoasset (Banning, Control and Regulation) Bill, 2018*'. SEBI objected to this Bill claiming that the Draft Bill did not suit the regulators of cryptoassets and tokens. Further, the Annual Report Released by RBI in 2017-2018 took note of the 'serious concerns' posed by cryptocurrency on consumer and investor protection and market integrity. It also acknowledged its operational risks along with its potential threat of being used for money laundering and terrorist financing. Further, on 28 February 2019, the IMC submitted another report titled 'Report of the Committee to Propose Specific Actions to Be Taken in Relation to Virtual Currencies'.<sup>55</sup> The said Report recommended the ban of all private cryptocurrencies, except any cryptocurrency issued by the state.<sup>56</sup> It recommended a law enforcing such a ban and birthed the 'Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019' (2019 Bill).<sup>57</sup> However, the government, to date, has not enforced the 2019 Bill.

While several players had challenged the Statement and Circular through several Writ Petitions, the Supreme Court of India heard these challenges (along with the 2017 Writ Petitions) collectively in the case of *Internet and Mobile*

51 Reserve Bank of India, 'Statement on Developmental and Regulatory Policies', *RBI Statement* (5 April 2018), p. 5, <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR264270719E5CB28249D7BCE07C5B3196C904.PDF> (accessed 10 January 2023).

52 Reserve Bank of India, 'Prohibition on Dealing in Virtual Currencies (VCs)', *RBI Circular RBI/2017-18/154* (6 April 2018), <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI15465B741A10B0E45E896C62A9C83AB938F.PDF> (accessed 10 January 2023).

53 Reserve Bank of India, 'Master Direction – Know Your Customer (KYC) Direction, 2016', *RBI Master Direction RBI/DBR/2015-16/18* (25 February 2016), p. 9, <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/18MDKYCD8E68EB13629A4A82BE8E06E606C57E57.PDF> (accessed 10 January 2023).

54 *Ibid.*; Banking Regulation Act 1949, s 22.

55 Department of Economic Affairs, Ministry of Finance, Report of the Committee to Propose Specific Actions to Be Taken in Relation to Virtual Currencies (28 February 2019), <https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf> (accessed 8 January 2023).

56 *Ibid.*, p. 56.

57 *Ibid.*, p. 9.



*Association of India v. Reserve Bank of India*.<sup>58</sup> These challenges sought to remove the restriction imposed on banks and/or financial institutions from providing access to banking services to those engaged in transactions in crypto assets.<sup>59</sup> Essentially, they sought to curb the effect of RBI's Circular.<sup>60</sup> At the time the Petitioner Association filed the Writ Petition, the total number of investors in the Indian crypto market was approximately 2 million, and the average daily trade volume was at least Rs.150 crores (1.5 billion rupees or about US\$22 million).<sup>61</sup>

### *I The Petitioner's Case*

The petitioners primarily argued that RBI had no power to prohibit the activity of trading in VCs through virtual currency exchanges (VCEs) for five reasons. First, they classified VCs as tradable commodities or digital goods as opposed to legal tender, thereby falling outside the regulatory framework of the Reserve Bank of India Act, 1934 (RBI Act) or the Banking Regulation Act, 1949 (BR Act). Second, to prevent RBI from relying on the Preamble of the RBI Act that empowers RBI to operate the currency and credit system of the country to its advantage, they claimed that VCs fell outside the scope of even the credit system of the country. Third, they contended that the power to regulate the financial system and the credit system of the country was not flexible enough to cover goods that did not fall within the ambit of the financial or credit system of the country. Fourth, they challenged RBI's power to issue directions 'in the public interest' conferred to it under Section 35A(1)(a) of the BR Act as well as RBI's power under Section 36(1)(a) of the BR Act to caution or prohibit banking companies against entering into any particular transaction. Here, it was argued that the term 'public interest' appearing in the statutory prohibition should be interpreted in the context of the statute. Fifth, it was argued that VCs fell outside the scope of a 'payment system' as defined under the Payment and Settlement Systems Act, 2007 and were beyond RBI's regulatory mandate.

The petitioners also raised an alternate argument that even if the RBI had the power to regulate activities carried on by VCEs, they should be tested on certain parameters such as application of mind, malice in law or colourable exercise of power, the *M.S. Gill* reasoning,<sup>62</sup> and proportionality. They also emphasized that stakeholders such as the Department of Economic Affairs of the Government of India, the Securities and Exchange Board of India, the Central Board of Direct Taxes and so on had already recognized the beneficial aspects of cryptocurrencies. They highlighted that many countries across the globe found nothing pernicious about cryptocurrencies and the Government of India's attempt to ban crypto trade through legislation had not materialized. It was further averred that the Petitioner

58 *Internet & Mobile Association of India* (n. 19).

59 *Ibid.*

60 Reserve Bank of India, 'Prohibition on Dealing in Virtual Currencies (VCs)', *RBI Circular RBI/2017-18/154* (6 April 2018), <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI15465B741A10B0E45E896C62A9C83AB938F.PDF> (accessed 10 January 2023).

61 *Internet & Mobile Association of India* (n. 19).

62 *Mohinder Singh Gill & Anr. v. The Chief Election Commissioner, New Delhi & Ors.*, Supreme Court of India, Judgment of 2 December 1977, 1978 SCR (3) 272.

Association had taken the required precautions such as complying with Know-Your-Customer (KYC) norms, avoiding transactions in cash and permitting peer-to-peer transactions only within the country. It was also contended that RBI had not applied its mind in addressing the problem of anonymity of transactions as not all cryptocurrencies were anonymous; the ban ought to have applied only to anonymous VCs. Furthermore, they argued that it was a ‘paradox’ that the RBI accepted blockchain technology but not cryptocurrency. The Petitioners stated that since the Circular was an exercise of power by a statutory body corporate as opposed to a legislation or an exercise of executive power, the rule of judicial deference to economic policies was not available to RBI.

The Petitioners also relied on constitutional grounds to argue that a total ban imposed by way of subordinate legislation (directive from RBI) on activity that was not otherwise declared unlawful by law was violative of Article 19(1)(g) of the Indian Constitution that confers the fundamental right to ‘practise any profession, or to carry on any occupation, trade or business’.<sup>63</sup>

Other contentions were also raised. The petitioners argued that the Circular severed the ties between the Indian economy and the virtual currency market without a legislative ban, thereby encouraging black market transactions and also, that the Circular unreasonably and only targeted bidirectional flow VC schemes. Further, it was contended that VCs did not fulfill the four characteristics of ‘money’ (medium of exchange, unit of account, store of value and constituting a final discharge of debt) and, hence, RBI did not have the power to regulate them. They emphasized that ‘a decision to prohibit an article as *res extra commercium*’ must arise out of an act of the legislature or a notification released by an executive authority.<sup>64</sup> The challenged Circular was viewed as ‘manifestly arbitrary’, imposing ‘disproportionate restrictions’ and based on ‘non-reasonable classifications’. The effect of such directions was highlighted when one of the petitioner’s virtual currency exchanges (VCE) was shut down while another had become non-operational. Another VCE was also rendered non-operational along with a sum of Rs. 12 Crores frozen in its account. Only one VCE, namely Coin DCX remained operational on a peer-to-peer basis.

## II Defence Raised

RBI responded to these arguments with the following contentions. First, they argued that VCs could not be acknowledged as currency as they did not satisfy the requisite criteria (store of value, medium of payment and unit of account). Second, they emphasized the lack of any formal or structured mechanism for handling consumer disputes regarding VCs. Third, they cautioned that VCs had the potential to be used for illegitimate activities because of their anonymous nature and their increased use could shake the monetary stability of the Indian economy. Fourth, they argued that the RBI Circular ought to be treated as legislative in character, in the domain of an economic policy, thereby warranting no intervention from the Court. They claimed that it was permissible for RBI to impose such restrictions by

63 INDIA CONST. Art. 19(1)(g).

64 *Internet & Mobile Association of India* (n. 19).

virtue of its wide powers conferred to it by the Reserve Bank of India Act, 1934, Banking Regulation Act, 1949 and the Payment and Settlement Systems Act, 2007. Fifth, it was argued that the decision did not violate any fundamental rights under Article 14 (right to equality), Article 19 (right to practice any profession, occupation or trade) and Article 21 (right to life and liberty) and that the right to conduct business on the network of entities regulated by RBI was not unfettered. Sixth, it was highlighted that the RBI's decision was a product of careful determination and application of mind; RBI argued that it had not proceeded in haste but rather with great care and caution to reach the decision 'in public interest'. They highlighted the cross-border nature of the trade in VCs in addition to the lack of accountability such that the government would not be able to control, curtail or limit the generation of VCs, thereby resulting in inevitable financial risks. They also stated that the decisions were not 'excessive, confiscatory or disproportionate' as RBI had provided three months time to the affected parties to sever their relationships with the Banks. Seventh, they contended that the KYC norms were ineffective as VCs were inherently anonymous, and the norms could not remedy the same. Since VCs could develop as parallel systems of payment presenting inevitable financial risks and the potential to impact RBI regulated payments system, RBI was empowered to enact pre-emptive measures in public interest, which included its power to prohibit. Lastly, they clarified that the decisions did not impose a complete ban on the use of DLT or VCs by the regulated entities.

### *III The Court's Analysis and Reasoning*

In its deliberation, the Court first assessed RBI's role as the central bank in the Indian economy and laid down its functions and powers conferred to it under various statutory provisions. It then undertook an inquiry into the true nature and scope of VCs. Here, the Court acknowledged the divergence of views taken on their nature and recognized the difficulty in regulation without a proper definition of VCs. It took into account the definitions put forth by international regulators (IMF, FATF etc.) and the definitions provided under different statutory and non-statutory enactments of governments across the globe. The Court observed that although VCs were not recognized as legal tender, they were 'capable of performing some or most of the functions of real currency'.<sup>65</sup> The Court then scrutinized the meaning of 'currency',<sup>66</sup> 'currency notes'<sup>67</sup> and 'Indian Currency'<sup>68</sup> under various statutes, particularly the Foreign Exchange Management Act, 1999. It also undertook an inquiry to decipher the meaning of 'money'. It studied its definition provided under Indian laws, particularly the Central Goods and Services Tax Act, 2017,<sup>69</sup> and the meaning as evolved by legal precedents. It also explored other jurisdictions to understand how foreign courts understood the word 'virtual currency'. It formed an understanding that various courts understood VCs depending on the context

65 Ibid.

66 Foreign Exchange Management Act 1999 (FEMA 1999), s 2(h).

67 FEMA 1999, s 2(i).

68 FEMA 1999, s 2(q).

69 FEMA 1999, s 2(75).

and text of the statute involved; they could be classified as property, commodity, non-traditional currency, a payment instrument, money or funds. It can be observed that despite the lengthy and comprehensive scrutiny, the Court did not define the term ‘virtual currency’.

Interestingly, the Apex Court noted that every court’s attempt to gauge the meaning of the term ‘virtual currencies’ was similar to the ‘four blind men in the Anekantavada philosophy of Jainism’ who tried to describe an elephant based on where they touched the elephant’s body and as a result, described just one physical feature of the elephant. It opined that RBI, too, was stuck in the same bind. Since RBI was the ‘sole repository of power for the management of the (Indian) currency’,<sup>70</sup> the Court held that it had the power to regulate or prohibit anything that threatened or impacted the financial system of the country regardless of whether the activity constituted a part of the credit or payment system.

The Indian courts have understood the strange dilemma presented by VCs. On the one hand, VCs seek to ‘kill the demon of a central authority’ while at the same time, ‘seek from the very same central authority, access to banking services so that the purpose of the avatar is accomplished’.<sup>71</sup> However, does the power to regulate include the power to prohibit? The Court answered in the negative as per its understanding of Section 45J A of the RBI Act and judicial precedents.<sup>72</sup> The Court went a step ahead and stated that RBI’s decision to prohibit the trade of VCs could not be categorized as a ‘total prohibition’ since it was merely directing RBI-regulated entities to stop providing banking services to those trading or facilitating the trade in VCs, thereby making it not a *per se* prohibition of trading in VCs. Furthermore, the Court acknowledged that while the directions in the Circular were restricted to RBI-regulated entities, it caused collateral damage to other establishments as well. Here, the Court opined that such persons could challenge such directions, albeit the challenge being a weak one owing to the availability of the appropriate powers. Lastly, the Petitioner’s challenge to RBI’s availability of power under Section 18 of the Payment and Settlement Systems Act, 2007, which empowers RBI to regulate payment systems in the interest of the management and operation of any payment system and in public interest, also failed. Thus, The Court concluded that RBI did, indeed, have the power to prohibit banking companies from entering into certain types of transactions.

The Court also scrutinized the mode of exercise of power and held that RBI could not be held guilty of non-application of mind as it had been closely monitoring VCs since 2013. Furthermore, the Court opined that RBI had sufficient power to issue directions to regulate its entities in the public interest and that it did not seek to achieve a different object from the one for which the power was entrusted. It followed that RBI had neither exercised its power in bad faith or had targeted certain persons so as to constitute colourable exercise of power nor was the action wrongfully and deliberately undertaken without reasonable cause so as to

70 Reserve Bank of India Act 1934, s 3.

71 *Internet & Mobile Association of India* (n. 19).

72 *Star India Pvt. Ltd. v. Dept. of Industrial Policy and Promotion and Ors.* [2019] 2 SCC 104; *K. Ramanathan v. State of Tamil Nadu* 1985 2 SCC 116.

constitute malice in law. Thus, the action could not be deemed as a colourable exercise of power or being vitiated by malice in law. Further, the Court also rejected the *MS Gill Test*<sup>73</sup> reasoning employed by the petitioners that states that when an order is passed on a certain ground, the assessment of its validity can only be restricted to those grounds and cannot be supplemented by other grounds or reasons. Here, the Court was of the opinion that various grounds could be explored when public interest was involved and emphasized that RBI had already provided a detailed representation upon the instruction of an interim order passed during the pendency of this case. The Court also refused to assess the correctness of RBI's approach based on decisions adopted in other countries. Regardless of the fact that the petitioners had taken precautionary steps such as compliance with enhanced KYC norms, avoidance of cash transactions and confining their services to persons within India, the Court opined that they were not experts to gauge whether such safety measures were adequate to address all the concerns raised by RBI. Since RBI took the position that VCs were not banned, the question of whether RBI ought to have adopted a different approach towards different VCs was not entertained. The Court also affirmed the rationality of RBI's decision; the 'acceptance of a technological innovation' (blockchain technology) but 'rejection of a technological advancement/innovation' (virtual currencies) was declared completely rational and not paradoxical. However, the argument that RBI's decision could not be subjected to judicial deference was rejected by the Court based on its analysis of the RBI Act, 1934, and several judicial precedents.<sup>74</sup>

While the Court affirmed RBI's power to regulate and prohibit VCs, the Circular could not withstand the petitioner's attack on the basis of Article 19(1)(g). From a constitutional standpoint, any restriction on the right to trade under Article 19(1)(g) must be a reasonable restriction in terms of Article 19(6). The arguments raised were two-fold. First, it was contended that access to banking was equivalent to the supply of oxygen in the modern economy and hence, its denial to carry out a trade not prohibited by law amounted to an extremely disproportionate restriction. Second, it was contended that since the right to access to banking system was integral to carrying on any trade or profession, any legislation, subordinate or not, severely impairing such a right to carry on a trade or profession not restricted by law was violative of Article 19(1)(g).

To test the validity of a law that imposed restrictions on the right to carry out a business or a profession, the Court relied on the five-fold *Md. Faruk* parameter.<sup>75</sup> The scrutiny focused on, first, the law's "direct and immediate impact upon of the fundamental rights of the citizens affected"; second, "the larger public interest sought to be ensured in the light of the object sought to be achieved"; third, "the necessity to restrict the citizens' freedom"; fourth, "the inherent pernicious nature of the act prohibited or its capacity or tendency to be harmful to the general public"; and fifth, "the possibility of achieving the same object by imposing a less drastic

73 *Mohinder Singh Gill & Anr. v. The Chief Election Commissioner* (n. 72).

74 *Internet & Mobile Association of India* (n. 19).

75 *Md. Faruk v. State of Madhya Pradesh & Ors.* [1969] 1 SCC 853.

restraint”.<sup>76</sup> Based on these criteria, the Court made some interesting observations. The Court recognized that banking channels were indeed a lifeline of any business, profession or trade. Hence, RBI had a heavy burden to prove that larger public interest warranted the deprivation of banking facilities and severing of such a lifeline. In its analysis, the Court observed three categories of citizens that could potentially challenge the Circular under Article 19(1)(g). First were the hobbyists who buy or sell cryptocurrency by way of hobby. The second category constituted the people who were in the trade or occupation of buying and selling VCs. The third category constituted VCEs, which were online exchanges providing services such as the facility of buying and selling VCs, storing or securing them in wallets, or converting them into fiat currency or vice versa. With respect to the first category, the Court opined that Article 19(1)(g) offered no protection to hobbyists as it was restricted to occupation, trade or business. The protection offered by Article 19(1)(g) could only be extended to the second and third categories. With respect to the second category, the Court opined that the people who were in the trade or occupation of buying and selling VCs remained unaffected by the RBI Circular as it did not entirely shut down or prohibit the trade of VCs. However, the Court observed that VCEs, which fell under the third category, had suffered a ‘deadly blow’. This meant that the third category could not survive without banking channels and that they felt the devastating effects of the RBI Circular. The effect of the Circular was such that it ‘almost wiped the VC exchanges out of the industrial map of the country’ and, hence, the Court applied the test of proportionality to assess the violation of the constitutional right to trade.

To test proportionality, the Court applied a four-prong test.<sup>77</sup> The first prong assesses whether the ‘measure is designated for a proper purpose’ (a mere recital or money laundering or black money does not suffice, and alternative methods should be explored)<sup>78</sup>; the second prong assesses whether ‘the measures are rationally connected to the fulfillment of the purpose’; the third prong assesses whether there exist ‘no alternative less invasive measures’; and the fourth prong assesses whether ‘there is a proper relation between the importance of achieving the aim and the importance of limiting the right’.<sup>79</sup> Here, the Court found that RBI had not explored alternate options that were less intrusive before issuing the Circular. Three aspects were particularly important for the Court. First, RBI had not been able to find activities of VCEs to have adversely impacted the functions of RBI-regulated entities. Second, RBI consistently took the stand that it had not prohibited VCs in the country, and third, that the IMC constituted on 2 November 2017 was of the opinion that imposing a ban was an extreme measure and that the same objectives could have been achieved through regulatory measures. Initially, the Committee had recommended the Crypto-Token Regulation Bill, 2018, which reflected the acceptance of the sale and purchase of crypto assets

<sup>76</sup> *Ibid.*; *Internet & Mobile Association of India* (n. 19).

<sup>77</sup> *Modern Dental College and Research Centre v State of Madhya Pradesh* [2016] 7 SCC 353.

<sup>78</sup> *Ibid.*

<sup>79</sup> *Ibid.*



at recognized exchanges.<sup>80</sup> However, the Court took note of the 2019 Bill,<sup>81</sup> put forth by the same Committee,<sup>82</sup> that recommended a total ban on private cryptocurrency through legislative measures. In light of these circumstances, the Court noted that VCs were not banned, but the Circular had the effect of disconnecting their lifelines, that is, the interaction with the banking sector and services. This measure was taken despite the lack of finding that RBI-regulated entities did, in fact, suffer any loss or adverse effects. The lack of empirical data with regard to the degree of harm suffered<sup>83</sup> enabled the failure of the proportionality test. Hence, the Court set aside the RBI Circular on grounds of proportionality and deemed the measure to be disproportionate.

## D Current Status

Post the *Internet Mobile* case,<sup>84</sup> Nirmala Sitharaman, the Finance Minister of the Government of India, announced that a high level Inter-Ministerial Committee had been instituted to study the issues posed by cryptocurrencies and to recommend future courses of action.<sup>85</sup> The Minister of State for Finance, Anurag Thakur, announced that the Central Government was eager to introduce a bill on cryptocurrencies in the Indian Parliament.<sup>86</sup> In November 2021, the Standing Committee on Finance held a meeting along with the Blockchain and Crypto Assets Council (BACC) and concluded that imposing a ban on cryptocurrencies would be unfair but called for their regulation.<sup>87</sup> The RBI Governor, Shaktikanta Das, commented that the unregulated nature of cryptocurrencies posed a threat to the financial system and indicated RBI's interest in introducing their own digital currency. Later, in the Rajya Sabha, the Upper House of the Indian Parliament, Nirmala Sitharaman mentioned that no step towards banning cryptocurrency advertisements had been taken by the Central Government and that the Securities and Exchange Board of India (SEBI) and the RBI would take steps to spread awareness of the risks of cryptocurrencies.<sup>88</sup>

Soon thereafter, Nirmala Sitharaman's announcement in the Union Budget 2022-2023 came as a surprise to the nation.<sup>89</sup> In the Union Budget, the Government of India recommended the insertion of Section 2(47A) to the Income Tax Act of

80 *Internet & Mobile Association of India* (n. 19).

81 Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019.

82 Department of Economic Affairs, Ministry of Finance, Report of the Committee to Propose Specific Actions to Be Taken in Relation to Virtual Currencies (28 February 2019), <https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf> (accessed 8 January 2023).

83 *State of Maharashtra v Indian Hotel and Restaurants Association* [2013] 8 SCC 519.

84 *Internet & Mobile Association of India* (n. 19).

85 Shukla et al. (n. 15), p. 3.

86 *Ibid.*

87 *Ibid.*, pp. 3-4.

88 *Ibid.*, p. 4.

89 Nirmala Sitharaman, Minister of Finance, 'Budget 2022-2023, Speech of Nirmala Sitharaman Minister of Finance' 20 (1 February 2022), <https://www.indiabudget.gov.in/budget2022-23/index.php> (accessed 11 January 2023).

1961, providing a definition of ‘Virtual Digital Asset’.<sup>90</sup> The Finance Bill made clear that the transfer of any virtual currency or cryptocurrency assets would accrue a 30% tax liability on any gains.<sup>91</sup> No loss in the transaction would be permitted to be carried forward. Additionally, a tax of 1% would be levied at the source of the payments made on the transfer of digital assets.<sup>92</sup> Gifts in the form of virtual assets/cryptocurrencies (air drops) would be taxed in the hands of the receiver.<sup>93</sup> The decision to provide a specific tax regime was made owing to the exponential increase in virtual digital asset transactions.<sup>94</sup>

The peculiar aspect of this taxation regime is the fact that the government’s decision to impose such a tax does not afford legality to digital currencies. In fact, the Indian taxation regime considers ‘income earned legally as well as tainted alike’.<sup>95</sup> Thus, even if income was acquired through illegal means, illegality would have ‘no bearing on its taxability’.<sup>96</sup> Hence, merely imposing a tax on the transfer of any virtual currency or cryptocurrency does not render such transfers legal. However, at the same time, its recognition may allude to the fact that the government no longer seeks the imposition of a blanket ban. It can be observed that the tax slab is a hefty one, and the government may be seeking to deter trade owing to its unregulated nature. The Lok Sabha passed the Finance Bill of 2022 on 25 March 2022 after making some amendments. Industry data reports that the impact of the imposition of the tax has been drastic; the trade volume had decreased by nearly 70% while activity on some exchanges plunged by more than 90%.<sup>97</sup>

After the announcement of the Union Budget, the Deputy Governor of the Reserve Bank of India, Mr T. Rabi Sankar, delivered a keynote address at the Indian Banks Association, 17th Annual Banking Technology Conference and Awards.<sup>98</sup> The most interesting aspect of this address was that Mr. Sankar expressed a vehement view in favour of banning cryptocurrencies. At the onset, he emphasized that cryptos are more than technology and are an ideology in themselves that ‘embody a core tenet of anarchism, co-operation in the absence of centralised authority’.<sup>99</sup> He, thus, asserted that the very design of crypto or its products was to ‘bypass the established financial system, and on a larger scale Government itself’.<sup>100</sup>

90 Ibid.

91 Finance Bill 2022 (FB 2022), s 115BBH.

92 FB 2022, s 194S.

93 FB 2022, s 56(2)(X).

94 Nirmala Sitharaman, Minister of Finance, ‘Budget 2022-2023, Speech of Nirmala Sitharaman Minister of Finance’ (1 February 2022), p. 20, <https://www.indiabudget.gov.in/budget2022-23/index.php> (accessed 11 January 2023).

95 *CIT v. K. Thangamani* [2009] 309 ITR 015 (Mad.).

96 Ibid.

97 R.D. Desai, ‘Why Crypto’s Rough Year in India Just Got Worse’, *Forbes* (11 March 2022), <https://www.forbes.com/sites/ronakdesai/2022/05/11/why-cryptos-rough-year-in-india-just-got-worse/?sh=3b786aa36e97> (accessed 11 January 2023).

98 T.R. Sankar, ‘Cryptocurrencies – An Assessment’ (17th Annual Banking Technology Conference and Awards, Keynote Address) (14 February 2022), [https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/02SP\\_1703202220A52DAD3D0AD4EC285ADFE2340F1F931.PDF](https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/02SP_1703202220A52DAD3D0AD4EC285ADFE2340F1F931.PDF) (accessed 11 January 2023).

99 Ibid.

100 Ibid.

Thus, in his opinion, it is not 'adequate, from a regulatory point of view, to treat crypto as just another type of currency or asset or commodity but also as a potential social movement'.<sup>101</sup> The strong views expressed showcase a great level of discomfort with the inherent nature of cryptocurrencies that altogether bypasses regulatory frameworks. In fact, RBI's Financial Stability Report released on 29 December 2021 also notes the risk associated with the increased 'Anonymity-Enhanced Cryptocurrencies'.<sup>102</sup> RBI perceives anonymity as a threat because the inability to identify the source of funds jeopardizes the legitimacy of the entire system of money transmission.

In the author's view, the government remains skeptical of crypto exchanges as it views cryptocurrency trade as a threat to the stability of the economy. It can be observed that the imposition of a heavy tax on cryptocurrency trades seems to be performing a dual function. First, it acknowledges the heavy volume of crypto trade in the country and seeks to earn revenue out of the same. Second, it seeks to deter crypto trade via the imposition of a high tax slab, leading to a loss of a significant amount of money in taxes. Furthermore, it does not completely rule out the possibility of a ban. This can be evidenced by the introduction of the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 ('the 2021 Bill') in the Indian Parliament, which proposes to 'prohibit all types of cryptocurrencies in India'.<sup>103</sup> The Draft Bill calls for a complete ban on the mining, generation, holding, sale, deal, issue, transfer, use and disposal of cryptocurrency in the country.<sup>104</sup> Additionally, RBI had also instituted a Working Group on Digital Lending, including Lending through Online Platforms and Mobile Apps and submitted a report which, *inter alia*, proposed a new Act titled 'Banning of Unregulated Lending Activities Act' to curb illegal lending activities.<sup>105</sup> Keeping in mind this Report, RBI's 'Recommendations of the Working Group on Digital Lending – Implementation' also echoed the same concerns about unregulated entities engaging in digital lending and called for institutional and legislative interventions to curb the lending activity.<sup>106</sup> Should the government eventually pass such legislation, decentralized exchanges and cryptocurrencies may be severely impacted.

Despite the skepticism towards cryptocurrency, the government has committed to fostering digitalization and encouraging blockchain technology. To circumvent the lack of regulation and decentralization inherent in cryptocurrency, RBI

101 Ibid.

102 Reserve Bank of India, 'Financial Stability Report' (Issue No. 24, 29 December 2021), p. 52, [https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FSRDEC2021\\_FULLL2D99E6548CD0478CA90E717F2B85D45.PDF](https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FSRDEC2021_FULLL2D99E6548CD0478CA90E717F2B85D45.PDF) (accessed 12 January 2023).

103 Banning of Cryptocurrency & Regulation of Official Digital Currency Bill 2019 (Draft Bill 2019).

104 Draft Bill 2019, s 3(1).

105 Reserve Bank of India, 'Report of the Working Group on Digital Lending Including Lending through Online Platforms and Mobile Apps' 45-46 (18 November 2021), <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/DIGITALENDINGF6A90CA76A9B4B3E84AA0EBD24B307F1.PDF> (accessed 12 January 2023).

106 Reserve Bank of India, 'Recommendations of the Working Group on Digital Lending – Implementation' (10 August 2022), <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR689DL837E5F012B244F6DA1467A8DEB10F7AC.PDF> (accessed 12 January 2023).

announced the launch of India's first retail digital Rupee (e₹-R) pilot on 1 December 2022.<sup>107</sup> The Digital Rupee or e-Rupee is RBI's official form of currency and is known as Central Bank Digital Currency (CBDC). As per RBI's concept note,<sup>108</sup> CBDCs can be classified into two broad categories. The first is general purpose or retail (CBDC-R), while the second is wholesale (CBDC-W). While Wholesale CBDC is limited only to select financial institutions, Retail CBDC is potentially available for use by the private sector, nonfinancial consumers and businesses.<sup>109</sup> Furthermore, CBDCs can be either 'account-based' or 'token-based'. A token-based CBDC is a 'bearer instrument' like cash. Whoever holds the token at a time is presumed to be its owner, while an account-based system requires the maintenance of records containing all transactions and balances of all holders along with the indication of ownership of the monetary balances.<sup>110</sup> Here, an intermediary such as a bank verifies the identity of the account holder while the person receiving a token verifies their ownership in a token-based CBDC. Per RBI, 'a token-based CBDC is viewed as a preferred mode for CBDC-R as it would be closer to physical cash, while an account-based CBDC may be considered for CBDC-W.'<sup>111</sup> As per RBI's Press Release, the e₹-R would be 'in [the] form of a digital token that represents legal tender' and would be distributed through intermediaries, that is, banks.<sup>112</sup> The e₹-R can be accessed via a digital wallet offered by the banks and can be stored on mobile phones. Person-to-Person (P2P) transactions as well as Person-to-Merchant (P2M) transactions are covered. Based on the robustness and learning from this pilot, RBI intends to test the e₹-R token and architecture in future pilots.<sup>113</sup>

On 29 March 2022, SEBI also issued 'Operational Guidelines for "Security and Covenant Monitoring" Using Distributed Ledger Technology (DLT)' that envisaged the maintenance of statutory information by creating a DLT platform.<sup>114</sup> Thereafter, on 28 April 2022, the Indian Computer Emergency Response Team (CERT-In), which operates under the Ministry of Electronics and Information Technology, issued directions to strengthen cyber security in India, address virtual digital assets and mandate the reporting of attacks relating to blockchain, virtual assets,

107 Ministry of Finance, 'Central Bank Digital Currency (CBDC) Pilot Launched by RBI in Retail Segment Has Components Based on Blockchain Technology' (12 December 2022), <https://pib.gov.in/PressReleaseSelfFramePage.aspx?PRID=1882883> (accessed 4 January 2023).

108 Government of India, Reserve Bank of India, FinTech Department, 'Concept Note on Central Bank Digital Currency' (October 2022), <https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/CONCEPTNOTEACB531172E0B4DFC9A6E506C2C24FFB6.PDF> (accessed 14 January 2023).

109 Ibid.

110 Ibid.

111 Ibid.

112 Reserve Bank of India, 'Operationalisation of Central Bank Digital Currency– Retail (e₹-R) Pilot', *RBI Press Release, 2022-2023/1275* (29 November 2022), <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR12755768C88D86624673A14B2C7F5CF68908.PDF> (accessed 14 January 2023).

113 Ibid.

114 Securities and Exchange Board of India, 'Operational Guidelines for "Security and Covenant Monitoring" Using Distributed Ledger Technology (DLT)' (29 March 2022), [https://www.sebi.gov.in/legal/circulars/mar-2022/operational-guidelines-for-security-and-covenant-monitoring-using-distributed-ledger-technology-dlt\\_57331.html](https://www.sebi.gov.in/legal/circulars/mar-2022/operational-guidelines-for-security-and-covenant-monitoring-using-distributed-ledger-technology-dlt_57331.html) (accessed 4 January 2023).

virtual asset exchanges and so on.<sup>115</sup> It also mandated the maintenance of all information as part of the KYC procedures and financial transactions from all virtual asset exchange providers, virtual asset service providers and custodian wallet providers for a period of five years.<sup>116</sup>

Interestingly, cryptocurrency and virtual digital assets were not mentioned in the Union Budget of 2023 presented on 1 February 2023. The silence on the regulation and taxation of crypto may be on account of the release of the Economic Survey of 2023,<sup>117</sup> which was released just a day before the presentation of the Union Budget. The Economic Survey put forth a cross-country analysis and highlighted the necessity of a common approach for the regulation of the crypto ecosystem.<sup>118</sup> The survey emphasized the volatile nature of the crypto asset market by noting the difference in its total valuation, which dropped from US\$3 trillion in November 2021 to less than US\$1 trillion in January 2023.<sup>119</sup>

## E Conclusion

So far, the measures taken by the Government of India allude to the fact that it is discouraging crypto transactions in the country. The Prime Minister, during the Summit for Democracy in December 2021, emphasized the need for global consensus with respect to the regulation of emerging technologies like social media and cryptocurrencies such that they are used to empower democracies instead of undermining them.<sup>120</sup> On the one hand, the nation's commitment towards the development of blockchain technology is apparent and evidenced through the updated version of the 'National Strategy on Blockchain' ('Strategy').<sup>121</sup> The Strategy aims to develop 'blockchain as a service' and integrate blockchain technology at infrastructure layers.<sup>122</sup> On the other hand, while crypto traders may hope that the government finds appropriate regulatory measures addressing and tackling the threats posed by VCEs, it seems unlikely that the Central Government may provide clarity in the near future. Nirmala Sitharaman, while speaking at

115 Ministry of Electronics and Information Technology (MeitY), Indian Computer Emergency Response Team (CERT-In), 'Directions under Sub-section (6) of Section 70B of the Information Technology Act, 2000 Relating to Information Security Practices, Procedure, Prevention, Response and Reporting of Cyber Incidents for Safe & Trusted Internet' (28 April 2022), [https://www.cert-in.org.in/PDF/CERT-In\\_Directions\\_70B\\_28.04.2022.pdf](https://www.cert-in.org.in/PDF/CERT-In_Directions_70B_28.04.2022.pdf) (accessed 4 January 2023).

116 Ibid.

117 Ministry of Finance, 'Economic Survey 2022-2023' (31 January 2023), pp. 102-105, <https://www.indiabudget.gov.in/economicsurvey/doc/eschapter/echap04.pdf> (accessed 4 December 2022).

118 Ibid.

119 Ibid., p. 103.

120 Ministry of External Affairs, 'National Statement by Prime Minister Narendra Modi at the Summit for Democracy' (10 December 2021), <https://www.mea.gov.in/Speeches-Statements.htm?dtl/34637/National+Statement+by+Prime+Minister+Narendra+Modi+at+the+Summit+for+Democracy> (accessed 4 December 2022).

121 Ministry of Electronics & Information Technology (MeitY), 'National Strategy on Blockchain' (December 2021), [https://www.meity.gov.in/writereaddata/files/National\\_BCT\\_Strategy.pdf](https://www.meity.gov.in/writereaddata/files/National_BCT_Strategy.pdf) (accessed 4 December 2022).

122 Ibid.

Stanford University, clearly stated that the government's approach towards crypto 'cannot be rushed'.<sup>123</sup> While the nation awaits the government's decision on virtual digital asset/crypto regulation, it remains that the government is proactively passing regulations and laws to encourage digital-first businesses in India. This can be evidenced through its Draft National Data Framework Policy, Draft National Cyber Security Strategy, and the passing of the 2023 Digital Personal Data Protection Act. The author remains hopeful that the implementation of such policies and regulations shall foster and develop India's digital ecosystem.

123 R.D. Desai, 'Why Crypto's Rough Year in India Just Got Worse', *Forbes* (11 March 2022), <https://www.forbes.com/sites/ronakdesai/2022/05/11/why-cryptos-rough-year-in-india-just-got-worse/?sh=3b786aa36e97> (accessed 11 January 2023).