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Govt grappling with measures to regulate virtual currencies despite RBI ban

Questions are now being asked how exactly the government will find legal backing to tame the trade in virtual currencies

Mayank Jain September 09, 2018 Last Updated at 20:36 IST



In April, the Reserve Bank of India issued a direction to all financial institutions under its direct control to stop associating with any person or company facilitating the trade of virtual currencies in the country.

Even as banks complied with the regulator's diktat, cryptocurrency exchanges morphed into peer-to-peer platforms and sidestepped the directions. Clearly, the ban didn't prove enough. Questions are now being asked how exactly the government will find legal backing to tame the trade in virtual currencies.

The RBI took note of these developments in its recently released Annual Report. The apex banking regulator stated that the trade in virtual currencies may now move to peer-to-peer mode. This could

have implications for anti-money laundering guidelines, apart from raising several taxation related issues.

“The RBI may neither want to ban cryptocurrency altogether and nor is this within its ambit. Cryptocurrencies are recognised as assets and not currencies by the RBI itself,” said Pushan Dwivedi, associate with Ikigai Law, which is representing 11 petitioners who have approached the Supreme Court against the banking regulator’s order. The final hearing in the case is due on September 11.

Indeed, cryptocurrency exchanges like Koinex and WazirX have moved away from the banking system. The commission these exchanges and others used to charge on each trade has seen a drastic drop, but the trade hasn’t stopped.

WazirX co-founder and CEO Nishchal Shetty had told Business Standard in August that this was a legal way to trade and investors won’t be flouting any regulations by transferring money directly to their buyers/sellers and paying commissions in virtual currencies, instead of cash.

“We charge people in crypto, not Indian rupee. So we aren’t flouting any rules,” says the founder of another cryptocurrency exchange.

Even as the apex court decides on the future of cryptocurrency exchanges in India, experts are of the view that the authorities face an uphill task in regulating the trade if the transactions move away from the formal financial system. Some even claim that the RBI circular was a constitutional overreach.

“To us, the April 6 circular is overreaching and has constitutional concerns. It should be replaced by a regulation which mitigates the risks but does not ban the activity,” said a lawyer from the cryptoassets and block chain team at Nishith Desai Associates, the law firm which is representing the Internet and Mobile Association of India in the SC petition.

Moreover, there are concerns about the dichotomy in which authorities in India are seeking to look at the cryptocurrency market. While the RBI sees a systemic risk if a bubble were to develop, the income tax department sent notices to Bitcoin investors earlier this year asking them to pay taxes on their capital gains.

The treatment of virtual currencies as an asset class like gold by the I-T department seems in contradiction of the RBI’s position that privately held virtual currency carry substantial financial risks, noted Dwivedi. “Government policy approaches need to be based on evidence and synchronised. Both seem to be lacking in this case.”

So where will the legal powers come from, if the government decides to either regulate or ban virtual currency based on the Supreme Court's decision?

Lawyers from Nishith Desai Associates’ cryptocurrency and blockchain wing are of the opinion that the inter-disciplinary committee, set up under Department of Economic Affairs Secretary Subhash Garg, should come up with a “forward-looking framework” for India. They added that the RBI could also choose to regulate virtual currencies instead of banning them as in other countries such as Australia, Canada, Japan and South Korea. These countries require that banks carry out stringent KYC/AML checks with regard to crypto-asset activity.

Meanwhile, Dwivedi argues that concerns regarding violation of the Prevention of Money Laundering Act due to trade in cryptocurrency could be overstated. “It’s an open secret that gold is

used for tax evasion and money laundering. But the RBI as a regulator hasn't banned it. It actually promotes it through the formal banking channels," he added.

Lawyers from Nishith Desai Associates noted that the PMLA doesn't have any specific provision which criminalises cryptoasset trading. "The PMLA only comes into the picture when cryptocurrency has been earned using illegal means or if earnings are used in illegal activities," a lawyer added. Income tax returns could be used as useful information in the course of various types of regulatory investigations, including under the PMLA, legal experts said.

Mishi Choudhary, a lawyer practising in New York state, but involved in India's technology laws, had a rather pithy question to ask: "If you don't want to allow their trade, how can you tax them?" That more or less sums up the dilemma of officials within the government and outside it.

How cryptoexchanges work

Anyone looking to buy or sell virtual currency registers on an exchange and does KYC through Aadhaar and PAN

After opening a wallet account, a person holding currencies deposits it in an escrow account provided by the exchange

The seller finds himself a buyer online from the listings on the exchange

The buyer transfers funds directly to the seller's account and provides a receipt

As soon as the fund transfer is complete and confirmed, the escrow account releases the cryptocurrency in the buyer's account after deducting a minor commission

How others regulate virtual money

EUROPEAN UNION: Bitcoins are legal, though there's no specific legislation. Cryptocurrency exchanges are supposed to check money laundering and fraudulent activities

SOUTH AFRICA: Classifies virtual currency as an intangible asset, even as the central bank earlier said that it has 'no legal status or regulatory framework'

CANADA: Banking sector is retreating from allowing trade in cryptocurrencies, but foreign exchanges with Canadian customers can register and function as money services companies

USA: Classified as de-centralised virtual currency. Internal Revenue Service taxes it as property. Exchanges are required to register, check money laundering and provide compliance

AUSTRALIA: Treats Bitcoins as competing currency and prevents double taxation problem on people's holdings