

THE ADVENT OF CRYPTOCURRENCY IN INDIA (BITCOIN)

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Abstract

Currency can be defined as tokens used as money in any country which includes metal coins, paper bank notes, cheques and also digital cash or electronic currency and many more. Digital cash or electronic currency are payment methods which are not tangible and exists only in electronic form hence the name 'electronic currency'. This digital currency can be said to have two types – (a) Virtual currency and (b) Cryptocurrency, where digital currencies are centralized while virtual currencies are unregulated and decentralised. In this article we are going to discuss about the penetration of cryptocurrency in the traditional currency system of Indian economy.

Keywords: *Bitcoin, India, Decentralized Cryptocurrency, Reserve Bank of India, Virtual Currency*

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INTRODUCTION

A crypto currency is a medium of exchange that uses cryptography to manage the creation of new units as well as secure the transactions. Bitcoin originated with the white paper that was published in 2008 under the pseudonym ‘Satoshi Nakamoto’. It was published via a mailing list for cryptography and has a similar appearance to an academic paper. The creators’ original motive behind Bitcoin was to develop a cash-like payment system that permitted electronic transactions but that also included many of the advantageous characteristics of physical cash.¹ One of the most striking features of crypto currency is that it weeds out the need for a trusted third party such as a governmental agency, bank etc. The crypto currency system collectively creates the units. The rate at which such units are created is defined beforehand and is publicly known unlike the traditional currencies where the government or the authorized banks control the supply.² At present most of the currencies in the world including reserve currencies are fiat currencies. The fiat currencies are issued by a government and if needed, the government promises to pay the holder of such currencies an equivalent amount in gold. Therefore, these currencies usually have a central regulatory body which issues them, and thus called ‘centralized’.³ Bitcoin is a virtual monetary unit and therefore has no physical representation. A Bitcoin unit is divisible and can be divided into 100 million “Satoshis,” the smallest fraction of a Bitcoin. The Bitcoin Blockchain is a data file that carries the records of all past Bitcoin transactions, including the creation of new Bitcoin units. It is often referred to as the ledger of the Bitcoin system.⁴ Bitcoin is a decentralized crypto currency, a form of payment that uses cryptography to control its creation and management, without need of any central authorities such as bank. It is open source software based online payment system introduced in 2009 by Satoshi Nakamoto. It is also known as electronic cash system based on peer-to-peer virtual data. It is world’s first decentralized currency. Each Bitcoin is subdivided down to eight decimal places, forming 100,000,000 smaller units called satoshis. Bitcoins can be transferred through a computer or smart phone without an intermediate financial institution. The processing of Bitcoin transactions is secured by servers called Bitcoin “miners”. These servers communicate over

¹ Aleksander Berentsen, Fabian Schar, *A Short Introduction To The World Of Cryptocurrency*, Available at: <https://files.stlouisfed.org/files/htdocs/publications/review/2018/01/10/a-short-introduction-to-the-world-of-cryptocurrencies.pdf>

² Akshaya Tamradaman & Sangeeta Nagpure, *Bitcoin In India*, Available at: <http://ijcsit.com/docs/Volume%208/vol8issue3/ijcsit2017080324.pdf>

³ *Ibid*

⁴ *Supra* note 1

an internet-based network and confirm transactions by adding them to a ledger which is updated and archived periodically using peer-to-peer file sharing technology, also known as the “blockchain.”⁵

COUNTRIES THAT HAVE LEGALISED BITCOINS

- Japan: In the process of legally recognizing as money.
- Australia: Proposed in budget speech 2017-18 to treat bitcoins as money.
- European Union: Convertible decentralized virtual currency.
- Canada: Digital currency/intangible.
- Indonesia: Digital currency.
- United States: “funds” under 18 U.S. Code § 1960 (virtual currency in general).
- Russia: Virtual currency (monetary surrogate).
- China: Virtual commodity.⁶

INDIAN BITCOIN REGULATIONS & ITS STATUS

Bitcoin demand is growing day by day in India. People in India now understand the power and advantages that these virtual currencies can offer. If we consider Bitcoin in India then all the rules and regulations which are presently applicable to Indian currency will become applicable to Bitcoin also. These rules and regulations for Indian currencies are controlled by RBI. As per Indian constitution, article 246 gives the list of all activities that are legislated by central and state government. Entry 36 and 46 of List I of the Seventh Schedule of the Constitution states that the Central Government is allowed to legislate in respect of currency, coinage, legal tender, foreign exchange and bills of exchange, cheques, promissory notes and other like instruments respectively. If Bitcoin falls any of these categories the central government would have exclusive power to legislate.⁷

The principal laws concerning Indian currency are:

- The Constitution of India, 1950;
- The Foreign Exchange Management Act, 1999 (FEMA);

⁵ *Supra* note 2

⁶ Vallari Dubey & Team, *Bitcoins India Report*, Available at: <http://vinodkothari.com/wp-content/uploads/2017/08/Bitcoins-India-Report.pdf>

⁷ *Supra* note 2

- The Reserve Bank of India Act, 1934 (RBI Act);
- The Coinage Act, 1906 (Coinage Act);
- The Securities Contracts (Regulation) Act, 1956 (SCRA);
- The Sale of Goods Act, 1930 (Sale of Goods Act);
- The Payment and Settlement Systems Act, 2007 (Payment Act);
- Indian Contract Act, 1872 (Contract Act).

These laws will become applicable to Bitcoin if RBI wants to treat it as a currency. The Reserve Bank of India has neither declared bitcoins as illegal in India nor has it accepted bitcoins as a currency. The RBI has only stated the risks that are associated with virtual currencies and cautioned that people dealing in it should do so at their own risk.⁸ As Bitcoin is decentralized digital currency, the creation, trading or usage of Bitcoin as a medium for payment is not controlled by RBI or any other trusted authority unlike fiat currency.

CURRENCY

Currency is generally defined as tokens used as money in a country. In addition to metal coins and paper bank notes, money orders, traveller's checks, it also includes electronic money or digital cash. To fit in this definition, which is not exhaustive?

- Either bitcoin has to be physical and movable, and fungible. It is movable and fungible but not physical.
- Electronic money or digital cash may include bitcoin but then it needs a legal backing from an authorized entity, which is not the case in India as of now.⁹

“Currency” includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank, as per Section 2(h) of Foreign Exchange Management Act, 1999

- As is evident from the above definition, bitcoin doesn't fit in any of the illustrative names, however if RBI wants, it can certainly notify it to be included in the above definition.

⁸ *Supra* note 6

⁹ *Ibid*

- RBI hasn't notified bitcoin as legal tender in India and therefore it couldn't be termed as real currency for the time being.¹⁰

COINS

Coins in India are governed by the Coinage Act, 2011. *Section 2(a)*: 'coin' means any coin which is made of any metal or any other material stamped by the Government or any other authority empowered by the Government in this behalf and which is a legal tender including commemorative coin and Government of India one rupee note.¹¹

For the removal of doubts, it is hereby clarified that a 'coin' does not include the credit card, debit card, postal order and e-money issued by any bank, post office or financial institution; (b) 'commemorative coin' means any coin stamped by the Government or any other authority empowered by the Government in this behalf to commemorate any specific occasion or event and expressed in Indian currency;¹²

On study of above, bitcoin is certainly not metal or even any other material for that matter. Moreover, it's not legal tender. If it was to become e-money in the near future, still it could not be coin as per the Coinage Act, since e-money is specifically excluded from the above definition. Consequently, bitcoins cannot be considered as coins now or in the days to come.

DIGITAL CURRENCY

Digital currency is a payment method which exists only in electronic form and is not tangible. Digital currency can be transferred between entities or users with the help of technology like computers, smartphones and the internet. Although it is similar to physical currencies, digital money allows borderless transfer of ownership as well as instantaneous transactions. Digital currencies can be used to purchase goods and services but can also be restricted to certain online communities such as a gaming or social networks.¹³ There are two forms of digital currency: a) *Virtual currency* b) *Crypto currency*

VIRTUAL CURRENCY *versus* CRYPTOCURRENCY

¹⁰ *Ibid*

¹¹ *Ibid*

¹² *Ibid*

¹³ Available at: <https://www.techopedia.com/definition/6702/digital-currency>

Digital currency is largely backed and regulated by the Central Bank, more like electronic money. Virtual currency, on the other hand is unregulated and decentralized. Financial Crimes Enforcement Network's ruling on 'Application of FinCen's regulations to virtual currency mining operations' clarifies that virtual currency is a medium of exchange that operates like a currency in some environments but does not have all the attributes of a real currency. It does not hold any legal tender status anywhere. Similar view was expressed in European Central Bank's (ECB) publication, 'Virtual Currency Schemes'.¹⁴ Bitcoins could be termed as virtual currency- they have been categorized as such by ECB. They are decentralized, unregulated and have few attributes of a real currency. Then there are cryptocurrencies and non-crypto currencies. Since, bitcoin is purely based on crypto-graphical system, where you have a private and a public key, and each transaction gets recorded on the ledger, it is said to come under the definition of crypto-currency.¹⁵

DECENTRALIZED CURRENCY

Currency is further classified into centralized and decentralized. Those which are governed by a central repository or a designated entity for sake of trust over transactions taking place are termed as centralized currency. Bitcoin doesn't work like that. Transactions in bitcoin happen on a decentralized P2P system, where all entities operate independently, and hold the entire risk of dealing in the same.¹⁶

FOREIGN EXCHANGE MANAGEMENT ACT, 1999 ('FEMA')

Given its attributes, the closest we could define bitcoin as is 'virtual currency' or more particularly 'crypto currency'. As far as FEMA is considered, there can be two possible scenarios:

- *When there is no regulatory framework: Section 2(h) of the Act defines 'currency'. RBI hasn't declared bitcoins to fall under that definition. Then there's 'foreign currency'. Section 2(m) defines, "foreign currency" means any currency other than Indian currency". Now what is Indian currency? FEMA (Section 2(q) also defines Indian currency. Accordingly, "Indian currency" means currency which is expressed*

¹⁴ *Supra* note 6

¹⁵ *Ibid*

¹⁶ *Ibid*

or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under *section 28A of the Reserve Bank of India Act, 1934*.

- *When there is a regulatory framework:* As mentioned before, the RBI can explicitly declare bitcoins to be currency; in this case it would fall under the definition of foreign currency and be dealt with accordingly.

However, the present situation is such where bitcoin doesn't fall in any of the above definitions. So, it does not cleanly fall into the category of foreign currency as per FEMA as it does not qualify to be currency as per the same Act the RBI would have to explicitly notify it to be such in the first place.¹⁷

SEBI

Bitcoin is treated as 'commodity' in few foreign jurisdictions. However, to understand the intricacies revolving bitcoins as 'commodity derivative' in India, one shall have to refer the *Securities Contracts Regulation Act, 1956 Section 2 clause (bc)* of the Act defines the expression as¹⁸:

'Commodity derivative' means a contract —

- for the delivery of such goods, as may be notified by the Central Government in the Official Gazette, and which is not a ready delivery contract; or*
- for differences, which derives its value from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified by the Central Government, in consultation with the Board, but does not include securities as referred to in sub-clauses (A) and (B) of clause (ac);*

To be able to be covered by the above definition, the essential element is a contract. While the definition of contract is dealt by the *Indian Contract Act, 1872*, either of the above two purposes is a pre-requisite for a contract to be a commodity derivative contract. Essentially, bitcoin is not goods as already explained in the preceding sections, additionally it is also not something that has its value derived from an underlying good or something else. In fact value of bitcoins fluctuates on demand-supply phenomenon rather than anything persistent. Conclusively, bitcoins cannot be treated as commodity; also it cannot be treated as

¹⁷ *Ibid*

¹⁸ *Ibid*

commodity derivative. Therefore, **SEBI** cannot be seen as the authority overseeing bitcoin exchanges.¹⁹

COLLECTIVE INVESTMENT SCHEME ('CIS')

Collective Investment Scheme has been defined under *Section 11AA (1)* of the *Securities and Exchange Board of India Act, 1992* ('SEBI Act'). Accordingly, *sub-section 2 or 2A* has to be referred to, which specifies a list of conditions that have to fulfill in order to fall under the definition of CIS. Interestingly, Sections cited above focus on words or expressions such as 'collective', 'pooling of interest', 'contribution'. Looking at the concept of bitcoin, it cannot be held that at any time the investor is collecting funds and then investing the money.

Till date, there is no trace of any such activity in the market where a service such as pooling of funds of investors and then investing in bitcoins was done. Thus, trading in bitcoins for investment purposes has not grown enough to be regarded as CIS. If at all there is a prospective change resulting in inclusion of bitcoin trading services under the regulation of SEBI by virtue of being treated a CIS.²⁰

INDIAN COMPANIES USING BITCOIN

November 8, 2016, the Reserve Bank of India (RBI) removed 500 and 1000 Rupee notes from circulation, stripping the nation of 86% of its currency. India aimed to quell its shadow economy and to defeat its never-ending illicit activities. At the same time, this economic crisis indirectly taught its 1.3 billion people that cash was unreliable - one day there, the next day gone - and there was a nationwide frenzy with the stock market falling by 7 per cent, cash shortages and several deaths from people queuing to exchange their worthless money. A significant disruption to the economy occurred with more of India's largely younger population turning to Bitcoin. At the time, a large number of industries were already using Bitcoin and shortly, thereafter, the number of investor grew to the point where mid-2017, 2,500 Indians invested in Bitcoin daily, according to The Economic Times. The digital coin attracted people in India, since it offered a safer system for their money, a haven from inflation, refuge from government regulation and interference, and a system that avoids

¹⁹ *Ibid*

²⁰ *Ibid*

political and economic turmoil.²¹

India is now the 6th largest economy in the world with its GDP of \$2.6 trillion, displacing France, according to the database of the International Monetary Fund's World Economic Outlook (WEO) for April 2018. A 2016 study by PricewaterhouseCoopers found that 233 million people in India, or 40% of its population, still have no bank account. To put this in perspective, 65 million people live in Britain. This means that there are 3.5 times more unbanked people in India than people who live in the U.K. The fact that so many Indians are unbanked is because you need a form of identification and a fixed address, among other information, which for many homeless Indians is impossible. These individuals, then, rely on cash which hinders their spending abilities. Along comes Bitcoin which allows you to make deals all over the world quickly, cheaply and securely - without needing a bank account. No wonder, then, that to date more than 600,000 Indians use Bitcoin, according to several bitcoin outlets. In 2015, more than 500 merchants in India and five of India's largest companies, including Dell, accepted the crypto currency as payment, according to GBminers co-founder Amit Bhardwaj. The number grows by day. True, that Bitcoin is far from popular, and most Indians prefer fiat money, but a recent Forbes article reports Bitcoin's craze is catching on and that, to date, there are more than 600,000 users in the country. Although India's RBI has long warned crypto currency users and traders of its perils, Indian Prime Minister, Narendra Modi, indirectly promoted Bitcoin, on July, 2, 2015, with his ambitious Digital India Plans included digitizing government data, improving India's digital infrastructure, and optimizing its online connectivity. Then, the government formed an inter-disciplinary committee to examine the framework on virtual currencies and set up a forum MyGov for public opinion on virtual currencies.²²

FUTURE OF BITCOIN IN INDIA

Observers predict that India's government will regulate Bitcoin in stages. India's Bitcoin industry welcomes these changes knowing that government acceptance will give the crypto currency the backing it needs. In fact, India's Bitcoin industry has long tried to popularize Bitcoin with strategies that include conducting security checks, requesting identification from users, such as government-verified address documents, Permanent Account Numbers (PAN)

²¹ *The Future of Cryptocurrency In India*, Available at: <https://www.compareremit.com/money-transfer-guide/the-future-of-cryptocurrencies-in-india/>

²² *Ibid*

or Aadhaar IDs, and sometimes even checking bank details. Private Bitcoin companies have also launched an association, called the Digital Assets and Blockchain Foundation of India, to educate lay people on Bitcoin benefits and usage. Government intervention credits their efforts.²³

RISKS ASSOCIATED WITH BITCOINS

- RBI through its press release dated 24th December, 2013 has warned the public about the negative attributes of bitcoins and its usage. It specifically pointed out, that since they are stored digitally, they are exposed to risks such as hacking, attacks, compromises etc.
- Bitcoins are not backed and/or regulated by a centralized agency till date, making them less reliable.
- There is no forum, where a user can possibly reach out for any help or grievance, as a result of which Indian consumers are being exposed to transactional and informative risks.
- Another issue pertains to awareness. Lot of consumers has little or no information regarding risks associated with bitcoins lending them into unwanted trouble under regulations such as anti-money laundering.
- One of the very important attributes of bitcoins is its volatility. Steep changes every second are expected, making investors prone to zero-worth risks.
- Several incidences have occurred stating that bitcoins have been used for illicit and illegal activities around the globe. Reportedly, a recent ransom ware attack called WannaCry spread on a large scale basis; the hackers had demanded payment in respect to ransom money in bitcoins. The incidence among others has raised questions on the viability of the crypto currency. Bitcoins have also been used in Ponzi schemes, resulting in huge loss of money for several investors.²⁴

CONCLUSION

The Bitcoin creators' intention was to develop a decentralized cash-like electronic payment system. It has already gained wide acceptance around the world- hence banning them would not be an option in India. Instead, this industry would need to be regulated. The sooner this is done, the better.

²³ *Ibid*

²⁴ *Supra* note 6