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Virtual Currency Trading: A Tumultuous Path

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ABSTRACT

The article deals with the recent decision of the Supreme Court on the removal of restrictions on virtual currencies imposed by the RBI. The article will further look at what is the international consensus on virtual currencies and the need for regulation of the same.

I. INTRODUCTION

In further of a Statement issued on April 5, 2018, the RBI issued a circular April 6, 2018 (“Circular”), restricting the dealing in Virtual Currencies (“VCs”) or providing “services for facilitating any person or entity in dealing with or settling VCs,” by RBI regulated entities. On March 4, 2020, the Supreme Court declared a judgment in the case of *Internet and Mobile Association of India v. Reserve Bank of India*,² setting aside this Circular of the RBI.

The services mentioned in the Circular and recognized by the Supreme Court include, maintaining accounts, registering, trading, settling, clearing, giving loans against virtual tokens, accepting them as collateral, opening accounts of exchanges dealing with them and transfer / receipt of money in accounts relating to purchase/ sale of VCs. It is clarified that “there is no complete ban on virtual currencies or on the use of distributed ledger technology by the regulated entities.” “The prohibition is not against trading in VCs, it is against banking companies, with respect to a class of transactions.” However, this raises speculation, as to whether the use of VCs by businesses is recognized in India and the future consequences of the same.

II. WHAT IS VC?

VC or cryptocurrency is a breed completely different from regular fiat money. It operates on block-chain technology, such that it has been issued in a limited quantity by a private entity, completely independent of a centralized government agency. Its software is designed around anonymity such that every VC transaction will be recorded by all computers engaging in VC transactions, but does not divulge substantial information about the entity engaging in

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² Writ Petition (Civil) No. 373 of 2018

the transaction. Its virtual presence and characteristics resembling money have put various authorities in a dilemma as to how it should be regulated.

In the Financial Stability Report of June 2013, the RBI, for the first time, recognized the technological risks in changing business environments. It defined VCs as a “as a type of unregulated digital money, issued and controlled by its developers and used and accepted by the members of a specific virtual community.” Thereafter in June 2014, the FATF defined cryptocurrency as “a math-based, decentralized convertible virtual currency protected by cryptography by relying on public and private keys to transfer value from one person to another and signed cryptographically each time it is transferred.”³In November 2017, the Inter-Regulatory Working Group on Fintech and Digital Banking by the RBI submitted a report which defined digital currencies as “digital representations of value, issued by private developers and denominated in their own unit of account.”

There are various definitions of VCs, which have been adopted by different governmental agencies and organizations globally; however predominantly, it has been recognized as a form of digital money/currency, carrying value and is controlled by its developers.

III. PERUSAL OF THE JUDGMENT

In the writ petition before the Supreme Court, the Petitioners represented the interests of the online and digital services industry, and included companies that run crypto assets exchange platforms, shareholders/ founders of such companies and some individual traders.

The Petitioners first argue that VCs do not qualify as money, as they do not possess the characteristics of money, and have not been considered to fall within the credit system of the country by several entities within the government. Instead they are tradable commodities/digital goods, which lie outside the scope of regulation by the RBI. The argument here is clearly two-fold, firstly that VCs cannot be considered as legal tender, and secondly the jurisdiction of the RBI is limited to money such that it cannot legislate on something which is not recognized as money.

Here, the Petitioners refer to the various statutes under which the Circular was passed. As stated in the Preamble of the RBI Act, 1934 (“RBI Act”), the Court recognizes that the RBI has the power to (i) regulate the issue of bank notes (ii) secure monetary stability in the country and (iii) operate the currency and credit system of the country to its advantage. Now Section 22(1) of the RBI Act recognizes the power of the RBI to issue bank notes, and Section 26(1) makes every bank note legal tender, guaranteed by the central government.

³ Virtual Currencies – Key Definitions and Potential AML/CFT Risks”

Therefore, the central government can declare any bank notes to cease to be legal tender, on the recommendation of the central board of directors of the RBI. This clearly indicates the power of the RBI to recognize what will and what will not be considered as legal tender in the country.

Subsequently, the Payment and Settlement Systems Act, 2007 (“PSSA”) designates the RBI to regulate and supervise payments systems in the Indian economy. Section 10(2) recognizes the jurisdiction of the RBI to issue guidelines for proper and effective management of payment systems, and Section 17 and 18 empowers RBI to issue directions to a payment system or a system participant, which, may affect the payment system, the monetary policy, the credit policy or in public interest. The Petitioners argue that VCs do not qualify as payment systems, defined under Section 2(1)(i), thus again fall outside the scope of the RBI.

Next, looking at the scope of subject matter falling in the ambit of RBI’s powers, the Banking Regulation Act, 1949 (“BRA”) also identifies certain powers of the RBI with respect to banking companies. It is claimed that the power to issue directions and the power to caution/prohibit banking companies from entering into any transaction under Section 35A (1)(a) and Section 36(1)(a) respectively, does not extend to issue of blanket directions that would deny the use of VCs for banking services.

The Court identifies that even though VCs perform the three main functions of money, it does not have the fourth characteristics as a standard of deferred payment, and thus cannot be called money. However, it clarifies that the RBI has jurisdiction even if something is not legal tender. The Court relies on the fact that “money” was first defined statutorily through an amendment to the Finance Act in 2012, which included various types of instruments, which are not legal tender.

Further, the RBI is also ridden with the power to frame the monetary policy framework of India. Section 45JA and Section 45L of the RBI Act give the RBI the power to regulate the financial system of the country and the credit system of the country in public interest and to its satisfaction, respectively. The Court states that this, “is a thread that connects all the provisions which confer powers upon RBI, both to determine policy and to issue directions,” clearly suggesting the wide scope of powers enjoyed by the RBI.

Therefore, the RBI has jurisdiction to deal with anything that would pose as potential risks to the monetary, credit and financial system of the country, even if it now a part of the credit and payment system. This is reflected in the case of *Keshavlal Khemchand & Sons Pvt. Ltd.*

v. *UOI*,⁴ where the court has held that VCs have a potential to affect matters the RBI regulates, and thus the RBI has the power to restrict/regulate this too. However, we must note that the power is only to regulate, and not to prohibit.

The second argument made by the Petitioner is that, if it is assumed that the RBI has the jurisdiction to address VCs, the exercise of their power is subject to certain restrictions. Therefore, while regulation of trade and business is recognized, they are subject to reasonable restrictions, and a total ban on VCs would violate Article 19(1)(g) of the Indian Constitution.

Now, while it has been repeated multiple times that there is no complete ban on VCs, but only the trading in VCs and VC exchange platforms has been restricted; the Court recognizes that “access to banking is the equivalent of the supply of oxygen in any modern economy,” thus any restriction on the same must pass the muster of reasonableness and proportionality. It must test for valid purpose to introduce such a regulation, whether this regulation is the least invasive alternative to achieve the purpose and whether it was justified.⁵ A total stoppage of business affects the right under Article 19(1)(g),⁶ and for any restriction curbing a fundamental right, the burden of proof heavily lies on the State.⁷ The Court found that there is no compelling evidence showing real harm suffered by the RBI due to VCs, nor has the RBI found anything wrong with their functioning; thus it set aside the Circular on the ground of proportionality.

The Court agrees with the Respondents that there is clear evidence of application of mind in coming to a decision due to the chronology of events from 2013 to 2018 indicating the RBI has been brooding this issue.

IV. LEGALITY OF VCS: OTHER JURISDICTIONS

There has been a lot of debate nationally and internationally addressing the issue of legality of VCs. The degree of severity of rules governing VCs/cryptocurrency varies greatly. Most prevalent are government notices warning citizens about the pitfalls of investments in cryptocurrency platforms. This stems from the fact that unlike traditional currency issues by the central bank of the country, VC is issued by a private entity and several organizations dealing with transactions in the same are not regulated.

Some other jurisdictions have expanded their regulations on VCs, by recognizing money laundering, counterterrorism, and organized crimes to include cryptocurrency markets. For

⁴ (2015) 4 SCC 770

⁵ *Modern Dental College and Research Centre v. State of Madhya Pradesh* (2016) 7 SCC 353

⁶ *Md. Yasin v. Town Area Committee* (1952) SCR 572

⁷ *Md. Faruk v. State of Madhya Pradesh & Ors.* (1969) 1 SCC 853

example, Australia, Canada, etc have enacted laws to bring crypto currency transactions and institutions that facilitate them under the ambit of money laundering and counter-terrorist financing laws. While some countries have restricted levels of investment in VCs, other countries like Pakistan, Morocco, Nepal, etc, have banned any and all activities involving VCs. Countries like China, Bangladesh, Thailand have imposed indirect restrictions by barring financial institutions within their borders from facilitating transactions involving VCs.⁸

There are some countries which lie on the other end of the spectrum, as they see a potential in the block-chain technology thus are introducing regulations to attract investment in technology companies that excel in this sector. These include Spain, Belarus, Luxemburg,⁹Countries like Venezuela are aiming to develop a crypto-currency of their own.

Barring a select few countries like Australia, Japan, Switzerland, etc, which recognize VCs as legal tender, the consensus amongst most countries around the world is to exclude VCs from the ambit of money.¹⁰ However, majority of the countries are open to recognizing cryptocurrency exchanges, as authorities have realized they cannot turn a blind eye to the rise of transactions using this medium of transfer.

V. FUTURE OF VCS IN INDIA

As identified in the judgment, a draft legislation, “Banning of Cryptocurrency and Regulation of Official Digital Currency, 2019” (“Draft Bill”) has been proposed, which not only suggests the ban on mining, trading and holding of VCs, it also imposes a severe penalty and fine for the same. However, the Draft Bill recognizes the importance of block-chain technology and allows the use of this for certain select purposes. It is important to recognize that the use of virtual currency is extremely beneficial in various types of transactions, thus regulations controlling its use would be more effective than a ban.

The judgment makes it clear that the RBI has the jurisdiction to deal with VCs, and so it will be interesting to see what kind of regulations the RBI issues regarding the same. While the great resemblance of VCs to money cannot be ignored, they maybe treated as an asset or merely a medium of exchange. Regulations should be introduced to curb the harmful uses of it, including terrorism financing, money laundering, fraud, etc.

⁸Regulation of Cryptocurrency Around the World, June 2018, The Law Library of Congress, Global Legal Research Centre

⁹*ibid*

¹⁰Cryptocurrency Regulations Around the World, Comply Advantage, <https://complyadvantage.com/blog/cryptocurrency-regulations-around-world/>