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Crypto currency - A Cauldron of Legal & Technical Challenges: An Indian Perspective

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Abstract

Crypto currency is the key action word of caution and currency in operation. Technology has enabled operations of currencies across possible by least cost with appropriate legal correctness. There are two options left to Governments of Nations: 1. Adapt to fast changing to curb Bitcoins - a symbol of challenge for the Nations and 2. Legalize crypto currencies to control their disastrous effects. The time is now to discuss the issue at the global level to address the challenge before it erupts into a volcano.

Key Words and Phrases: *Cryptocurrency, Bitcoins, legal correctness and Virtual Currency*

1.0 Introduction

The crypto currency, from using stones and beads which had a physical form, which in an "e" form does not have any physical dimensions, mankind has come a long way in devising mechanisms for bartering or conducting any sort of economic transaction. The evolution of the Banking system, both organized and unorganized, as a mechanism of recording and tracking economic transactions between entities has been one of the many milestones of the growth of economic activities. With maturity of Kingdoms and Nations, the mechanisms and responsibilities of assuring the economic value shifted from individuals to the Sovereign State through a system of legal frameworks. The concept of "legal tender", with a plethora of statutory legal frameworks ensured stability to infuse confidence in the users of these various instruments of economic value – currencies, securities, negotiable instruments, etc.

Crypto currency, which originated to circumvent the necessity of carrying cash in unsecure areas, 1has grown leaps and bounds, taking multiple forms as it evolved and matured. The innovative payment network Bitcoin, has gained popularity and grown in value from a little over a cent in 2008 to about $ 7,500 in 2017[2]. With an ever-growing demand for bitcoins, which is entirely technology driven, the accompanying pitfalls associated with it – hacking, phishing, etc. have caught up with the system and an estimated $700 million

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have been stolen in incidents officially reported since 2012[3]. With this risk of losing money looming large and no legal recourse to such a loss, and with bitcoin not considered as a legal tender in most nation's world over, this paper explores the legal options available for protecting investor's interests in India.

2.0 Bitcoins as a medium of financial transactions

The dictionary definition of bitcoin is - "a digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank"[4]. The emergence of bitcoin has challenged the monetary systems of many nations, spewing it onto the center stage of discussions of its legal status and the necessity of regulations to bring it into the legal frameworks of nations.

This network, as a parallel economy, put in place by an unknown entity, Satoshi Nakamoto in 2009 is still in its nascent stage to validate the claims put forward to support its growth. One of the major advantages as propagated by the creators – lesser cost of financial transactions as compared to transactions through other financial institutions. Like any other technology based innovative ideas, which has started its journey and stood the test of time, the costs are bound to follow the stage of adoption and acceptance. Way back in the early 90's when cable TV networks or the mobile telephony consisting of pagers and mobile phone handsets or for that matter e banking facilities which included credit cards, debit cards and internet banking, were attempting to make inroads into the society to gain acceptance, the cost of owning and utilizing these technologies was almost zero. However, once accepted by a larger section of the society, the cost of utilizing these services has slowly crept in and is here to stay.

With this context, the major factor which is challenging the sovereign states is the identity of the individual/s who are operating this parallel economy. Post the financial downturn of 2008, at which juncture the bitcoin emerged, it appeared lucrative to investors who had lost faith in the institutionalized systems as a secure means of safeguarding their wealth and ensuring its growth. However, the volatile growth of this medium casts an air of doubts on its claims of stability and growth. Starting with a value of \$ 0.30 per bitcoin in 2011[5], it rose to an all-time high of \$ 19,666 per bitcoin on 17 Dec 2017, before falling 70% to a value of \$ 5,920 on 06 Feb 2018[6]. Similarly, the e trail generated during the transactions of transferring funds from or to a secure banking system punctures the claims of secrecy of identity, thereby opening the debate on the very purpose of creating a parallel system of financial transactions and its modus operandi.

3.0 Legal status of Virtual currency (VC) owners – A Global Overview

The reaction across the globe to the genesis and subsequent growth of the Bitcoin per se as a member of the crypto currency family, has been mixed. Starting with an air of secrecy and exclusivity of membership to the club of bitcoin owners, Crypto currency as an independent platform of trading', has come a long way. However, today, it stands at a juncture where mixed and divergent signals by nations has generated an intense debate, which questions the relevance of bitcoin as a medium for conducting economic activities.

From being a silent spectator to the growth and developments related to the bitcoin version of crypto currencies to some recent reactions of sovereign bodies, the response ranges from acceptance to skepticism. While many online market place portals like Microsoft, Subway, Atlantic Virginia, Wikipedia, KFC Canada, Intuit, Expedia, eGifter and a host of other companies accept payment with bitcoins[7], it is yet to gain popularity for acceptance as a medium of payment.

Issues like terror funding and black marketing are not restricted to crypto currencies alone and hence cannot be used for advancing campaigns for banning crypto currencies, more specifically bitcoins. Similarly, some economists have postulated the possibility of another economic bubble in the making with the rapid growth of the bitcoins, which again appears to be a misplaced apprehension. Economic bubbles are created when false reporting of values related to assets are recorded within a framework of legal regulations, which when exposed leads to reduction in book values of assets in financial records. However, in case of bitcoins, since it is not reflected in the books of accounts of either individuals or institutions, the possibility of the creation of an economic bubble is not even a remote possibility. While the net value of individuals will definitely diminish, this will remain off the books and hence should not be treated as erosion of value of the legal fiscal system.

On the other hand, the response of fifteen countries/ unions to the usage of bitcoins has been mixed as researched by Andrew Nelson[8]. The position of some nations summarized below highlight the mixed reactions:

- The United States is still not clear on whether to treat crypto currencies as "currency" or "securities". Either way, the necessity of bringing in regulations has been expressed by the policy makers.
- Canada does not consider crypto currencies as "legal tender" but has been the first nation to pass national law on digital currencies, which subjects them to certain regulations.
- Japan has been more accommodative in accepting crypto currencies but is yet to formulate a national policy.
- China has banned all Initial Coin Offering (ICO) schemes apart from banning all crypto currency-based transactions. Recently, Guangzhou Development District, has also banned all promotional events related to crypto currency events.[9]
- While South Korea was considered friendly for crypto currency holders, recent rules disallow anonymous accounts from trading in crypto currencies.
- While lawmakers in Singapore state that they accept all forms of currencies including novel ways of transmitting value, recent incidents of frauds have compelled them to get serious about the crypto currency market.
- Australian lawmakers prefer to treat bitcoins as a capital gain for taxation purposes while at the same time do not consider it a financial supply for GST. But scandals have brought in a need for a balanced regulation which is anticipated to be user friendly.
- In the United Kingdom and European Union, the lawmakers have expressed the necessity of making transactions of crypto currencies transparent and exercising due diligence on customers and reporting suspicious transactions.
- Switzerland has been open to crypto currency transactions and wishes to be a 'Crypto Nation" and is working on legal standards which will maintain integrity of the financial center and be technology neutral. What it means will be known by end of 2018 when ICO working group submits its report to the Swiss Federal Council.
- Russia, like South Korea, while encouraging crypto currency transactions wishes to regulate the market to know the identity of the players and also tax crypto currency transactions.

3.1 The Indian Perspective

Considering that crypto currency is picking up as medium of transactional value accounting, India has been on the wait and watch mode as far as its stand on crypto currency. The recent statement of the Finance Minister that government **"does not consider crypto currencies as legal tender",** has sent the market into speculative mode. Compounding this speculation is the Central Board of Direct Taxes stand that earnings from bitcoins treated as income, and reported in the IT returns and is taxable.

The fine line between **not legal** and **illegal** is the escape route for the institutional stakeholders who are tasked with the responsibilities of protecting the economic and financial interests of the nation and its citizens. While a clear **illegal** verdict will empower the agencies to crackdown on the bitcoin market and ensure its total shutdown, the **not legal** opinion shifts the responsibilities of risks to the individuals who are willing to stick their neck out but also continues to keep the options open for regulating the market with legal framework even with retrospective effect later. This is probably a very mature and futuristic approach to an emerging trend, which can swing either way depending on how the other nations handle the subject. With the e trail that bitcoins transactions leave, tracking the owners and cracking down on the bitcoin market at any point of time is the easiest task for the government, the current stand appears to be on creating an environment to test how the investors react to this new medium of exchanging economic value.

So, while the global deliberations on what should be the status of bitcoins and its owners continues, as a common man who can own a bitcoin we need to educate ourselves on the possible scenarios as a fallout of these decisions by sovereign states. Any legislature, regulation or policy addressing bitcoin transactions will aim at transparency in dealings which apart from other aspects will include maintaining a record of the individuals who are parties to the transactions and reporting the value of all such transactions to various statutory bodies. They will also endeavor to protect the interests of all parties, maintain stability in the financial market and ensure that these coins are not used for unlawful activities. Bitcoins being universally tradeable, Indian laws and regulations will have to align to global forum policies and guidelines in addition to own regulations on various aspects.

3.2 The Legal & Technical Cauldron

The plethora of legal domains that need to be covered in legislations designed to govern crypto currencies ranges from banking laws, investment laws, foreign exchange laws, negotiable instruments, securities, etc. and many more. This paper will restrict deliberate to some legal and technical issues, specifically related to Contract Laws and IT Laws, that need to be addressed by any legislation enacted to govern the crypto currencies, and more specifically the bitcoins are discussed under two scenarios – they are declared illegal or legal.

- **Verdict "Legal"** Irrespective of whether bitcoins will be treated as negotiable instruments or securities, the robust regulations of RBI and the SEBI will address these basic requirements and has been deliberated adequately by an inter disciplinary committee appointed by the Government of India in Apr 2017 tasked to examine the existing legal framework on crypto currencies.

  When considered securities, special focus on who will be the parties to the contract needs to be addressed and defined. In the current scheme of things, where one mines their own bitcoins and the identity of the parties are kept secret, the necessity of revealing the identity of both the buyer and the seller, and yet maintain a cloud of secrecy from prying eyes needs to be clearly defined and tested.

  Similarly, when illegality either in source of funds or utilization of funds is proved, how will the equivalent of bitcoins be confiscated and who will provide the necessary codes is another issue which will need to be addressed and covered in the legal frameworks. Regulations of volatility of the value of the bitcoins also needs to be addressed.

  Last, but the most important in the Indian Context, is the legal and technical challenges of transferring the ownership of bitcoins to the legal heirs on the demise of the original owners. This is going to be a nightmare for both the legal pundits and the technical wizards and an arduous journey. On the demise of the original owner, the crypto code which becomes inaccessible permanently, cracking the code and authorizing multiple access, with the threat of hacking and phishing looming large, is not only going to be a technical challenge, but also a legal maze. Technology related legislations, specifically designed to manage one of the many such scenarios needs to be drafted and enacted.

- **Verdict "Illegal"** Once declared illegal, to initiate punitive actions against those who have invested in bitcoins concrete evidence needs to be collected. The current set of legislations need to be strengthened to ensure that the required information about investors is shared by the financial institutions with the investigating agencies. Some pointers from the Bank Secrecy Act (BSA) of the USA, which mandates that the financial agencies must collect information about their customers and share it with enforcement agencies without any specific court directions can guide us in this journey.

  Secondly, to strengthen the current drive against black money, money laundering and terror funding, legislations to mandate disclosure of source of funds by investors and details of investments by bitcoin trading platforms must be made mandatory. Provisions to deal with failure to comply must also be inbuilt into the system.

  Most importantly, the technology providers must be roped in through stringent legislations to ensure sharing of information on demand without getting in to a Facebook like situation, wherein a battle of sovereign nations with an adamant IT giant which is precipitated due to inadequate legal frameworks has kept the entire world on tenterhooks.

The issues highlighted in this paper is just the tip of the iceberg and is just an indicative list to draw the attention of the common man to the challenges that investors of bitcoins must be prepared for when they decide to invest in them. In the current situation of uncertainty all over the world, and the spate of hackings reported till date, the route of the bitcoins is speculative, risky and lucrative, which one must tread cautiously.

4.0 Conclusion

Bitcoins as a medium of financial transactions is here to stay, if not permanently at least for some time till legal frameworks decide its fate. This means policy formulation and regulations will also have to go through an overhaul either way – to rein in and arrest the growth of bitcoins as a parallel economy which can destabilize the financial market, or to create an environment that will nurture its growth as a stable medium of financial transactions. While nations have been on a "wait and watch" mode for some time, they have realized the urgency to step in and regulate this parallel economy before it derails the structured system on which the larger population of nations depend for stability. The need of the hour is that India should make its stand clear as to which side of the fence it wishes to be and not continue with its wait and watch policy until a problem, which can derail the economic stability of the nation, erupts.

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