THE CRYPTOCURRENCY BILL, 2021:
FROM PROHIBITION TO REGULATION

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Background

- In March 2020, in a landmark decision, the Supreme Court lifted the ban on cryptocurrencies in India.
- Following the Supreme Court ruling, the Indian government brought out the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021.
- This bill is being reworked, and the reworked bill (the "**New Bill"**) is expected to recognize cryptocurrencies as an asset class ("**Crypto-assets**") regulated by the Securities Exchange Board of India ("**SEBI**").
- Crypto-assets will not be accepted as legal tender in India under the New Bill.
- Crypto-assets can be traded on existing crypto exchange platforms regulated by SEBI, but any trading violations will attract strict penalties and punishment.
- Crypto-asset holders will be prescribed a cut-off period to bring their assets under authorized crypto exchange platforms.

Advantages

- Recognizing crypto-assets under a regulatory framework will be highly beneficial for crypto-asset investors and the crypto industry in India in general.

- Unauthorized trading of private crypto-assets in India will be significantly reduced.

- Laws under the Prevention of Money Laundering Act, 2002, will be applicable to deter terror financing activities.

- Crypto-assets will aid in the implementation of the Reserve Bank of India’s proposed Central Bank Digital Currency as legal tender in India.

Drawbacks

- Crypto exchanges, cryptocurrency trading and the application of the blockchain technology will be deprived of their most essential feature that is decentralization or decentralized finance (“**DeFi**”).

- Trading of cryptocurrencies as crypto-assets will be limited to Indian exchanges.

- Cryptocurrency holders will not be allowed to maintain private crypto wallets.

- No regulatory framework for crypto or digital assets that are not mutually interchangeable like non-fungible tokens or NFTs.

Views

- An outright ban on crypto-assets would have proliferated illegal trading.
- But, recognizing crypto-assets as currency given the complexities of regulating the underlying distributed ledger technology ("**DLT**") could have weakened India's economy and financial systems.
- Hence, the middle-path proposed under the New Bill to identify and regulate crypto-assets is conducive for the time being.
- Indian investors routinely make cross-border crypto investments on foreign exchanges.
    - Changes are being proposed to Indian foreign exchange regulations to better regulate such investments.
    - Banks will have to ensure compliance with foreign exchange regulations applicable to outbound remittances.
- The Income Tax Act, 1961, should be amended to provide for taxation of income from the sale of crypto-assets as capital gains (similar to share sale transactions).

Views

- The DeFi ecosystem has been the driving force for the growth of crypto-assets; hence, centralization of a decentralized network will nip DLT in the bud.

- Authorized Indian crypto exchanges will have to develop robust customer due diligence mechanisms and governing standards for Know You Customer (KYC) to combat terror financing and money-laundering.

- Once the New Bill is approved, the Indian government and regulators will be expected to establish frameworks:

  - to regulate the practices of mining, staking, or yield farming of crypto-assets; and

  - to address the risks associated with mining, trading, or staking crypto-assets, such as impermanent loss, server risk, volatility risk, liquidation risk, etc.

Thank You

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