

VIRTUAL CURRENCY: A NEED FOR ITS REGULATION

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Abstract

Currency is linked with the identity and sovereignty of a nation. Currency is the hallmark of a nation. Every nation has a currency which has a uniform character that it can be touched, and feel. The late 20th century witnessed an unprecedented rise in science and technology and hardly left an area of human existence untouched. It has not only entered into human existence but also the working of the state machinery. Similarly it has also impacted the country's economy. Today's country's growth and development is determined on the values and survival of its economy. The science and technology has put its imprints in the economies as well in the form of the rise of various virtual currencies. One such invention was crypto currency which has a unique existence in 2008 an entity Sathoshi Nakamoto has presented in his paper the Bitcoin. Since 2008, it has not looked back and has grown in many ways and has occupied important places irrespective of any territorial jurisdiction. Some countries have acted swiftly and have legalised it in a controlled manner while some like India banning it completely.

In India, the Reserve bank of India has banned it through a notification which subsequently was quashed by supreme court of India in “Internet and mobile association of India vs. Reserve bank of India” (2020). Finally the area is left open to determine the existence of this form of currency.

Keeping in view, the above stated backdrop of the paper is an attempt to understand the legal validity, governance issues in crypto currency. The paper will further study the rise of this form of currency from 2018-2019. The paper will evaluate the Supreme Court judgment on the issues well. At the end of paper certain suggestions will be provided.

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I. Introduction

THE CHANGE is the law of nature. Science and technology has left its imprints on all the walks of society among them one is economy. The growth of technology has not only impacted the economy but also creates its own economy which sometimes is known as "Virtual currencies". One such currency is bitcoin. Bitcoins have their origin from the paper of Satoshi Nakamoto in 2008. Since it's not seen behind and has grown in many ways and has reached its highest where it posed certain new challenges to the traditional system of legal jurisprudence pertaining to its governance and legal sanctity issues. Virtual currencies are currencies in digital form different from traditional currencies which can be touched. In the 21st century, the country's growth is determined by the growth of its economies, and all the countries believe that the pillars of their economy are strong. Strong economy and its protection is as important as the protection of territorial borders from an enemy.

India which has a unique position in global finance and is considered as one among major five economies of the world. India is planning to achieve a five trillion economy by the end of 2024-25. For the regulation of economy every country has designated a specific branch to govern its currency and in India the job is vested to the Reserve bank of India (RBI). The currency is not only a page of paper but it's a guarantee of a specific value. Currency is all over the world used by the government and is regulated by its designated authorities. While on the other hand, bitcoin is not made by government agencies but it can be made by anyone and it is made on the internet. For the first time on November 1, 2008 Satoshi Nakamoto in his paper has discussed the virtual currency or bit-coin. However the identity of Satoshi Nakamoto is yet to be confirmed since a decade has passed and there is no clear certainty whether Satoshi Nakamoto is a natural person or is it a code or group of persons. Bitcoin is a digital document which contains specific values that can be transferred in anyone's account. In India RBI does not recognise any such thing but the people have borrowed it, although the record is very low. In bitcoin transactions, the identity of the buyer and seller are confidential but their transaction is in public. Bitcoin is coded in such a way that it is extremely impossible to hack it.

The media reports¹ shows that for the first time the bitcoin was used to purchase pizza in 2010. Since then, more than a decade has passed and bitcoin has reached to its heights by getting recognition in different states and by different business entities. Currently major business entities like Dell, PayPal, and Microsoft accept transactions in bitcoins. Bitcoin is digital

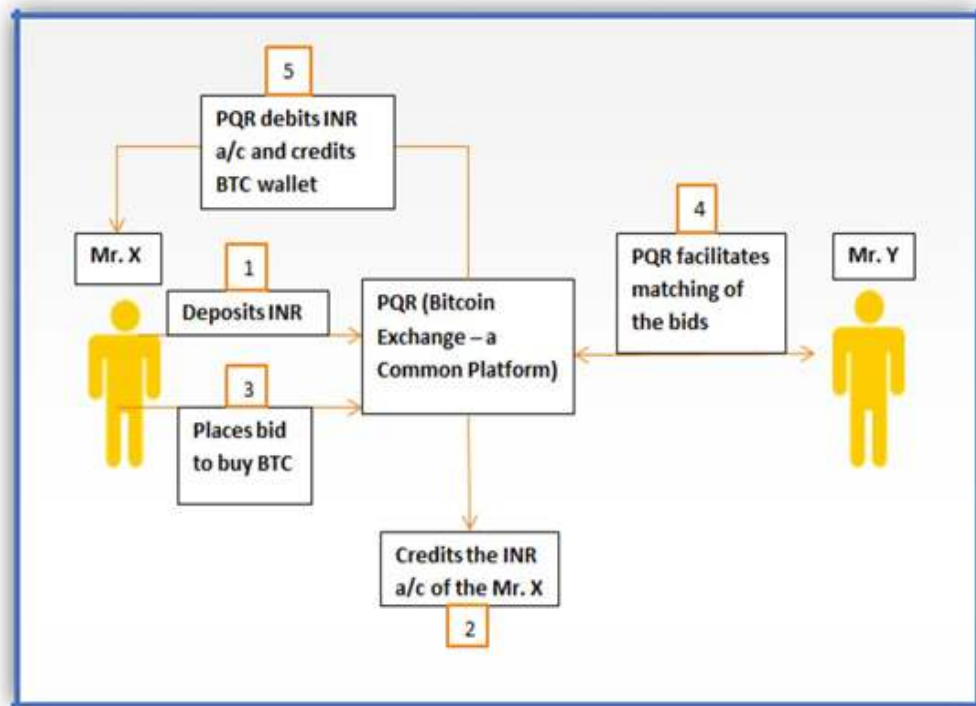
¹Available at: <https://www.youtube.com/watch?v=xVOEjtCaO2s> (last visited on Feb 27, 2020).

currency, and may be in future, it may replace the national economy but there are a number of issues involved in it. The digital world has diminished all the territorial boundaries, in the same way crypto-currency helps in removing the territorial economic border. In its process it removes the role of banks, states, and the like institution. The role of the third party in the transaction of crypto currency is axed. As bitcoin involves only the transaction between two individuals. It is actually an asset in the digital world of value, having its identity which is designed to work as a chain of exchange that uses technology which is chained rather than lying purely on authorities. Bitcoin is also called a crypto currency. crypto currency uses a system of cryptography which is an art of writing or solving codes to control the creation of coins and to verify the transactions.

In India, bitcoin has not achieved the legal recognition yet. The legal recognition of crypto-currency has yet to be decided by the RBI but the data shows that there are few individuals and companies that have already occupied the bitcoins in the digital market. The transaction rate of bitcoins in markets goes with a rapid speed. The largest bitcoin processor of world known as bit-pay has provided that the transaction rate of bitcoins in digital market has grown up to 110-120 percent during 2016² which shows that people are taking interest in it and in the near future India will not be unknown to it. Apart from crypto-currency there are other forms of digital economies which have received global attention in the recent past. Some of them are Ethereum, Ripple, NEM, Litecoin, bitcoins, dogecoins. However this paper is limited to crypto-currency. One of the essential features of crypto-currency is that it is free from infiltration which has generally originated from municipal policies of the government. Currently, in the contemporary world the major issues before the supermarkets of the world are, how to control infiltration which reduces the value of currency but the crypto-currency is free from it. The rise of bitcoins can further be understood by the fact that in the year 2015, bitcoins were the highest valued currency in the world and America witnessed an increase in bitcoin transactions.

The working of bitcoins can be further easily understood by the following diagram:

². Peter D. D'Vries, "An Analysis of Crypto currency, Bitcoin, and the Future" 1(2) *INT journal of Business Management and Commerce* 1-9 (2016).



Source: - Bitcoin India Report 2017 by Vallari Dubey

Circulations of bitcoin are increasing with the passage of time. Since its advent it has circulated speedily and attracts the world's attention. The statistical data, collected from 2009-2017, indicates the rapid high graph and demonstrates that the circulation of bitcoin has gained and increased so rapidly that it has crossed 16,377,437 which is higher than in any year. The following table will depict the position more clearly.

Chart

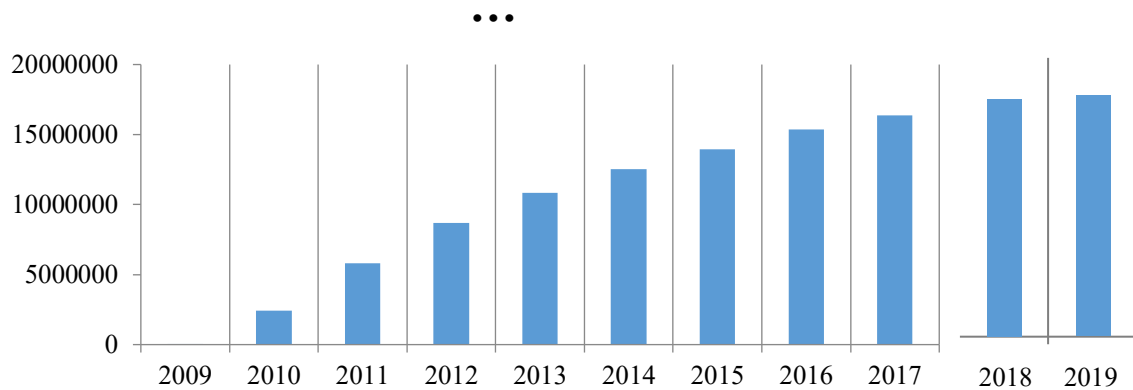


Figure: Increase in bit-coins in successive years. 2018- 17,205,000, 2019- 17,793,340

From 50 in 2009, it has reached its maximum in 2017 as 16,377,437. It further rose to 17,205,000 in 2018 and 17,793,340 in third quarter of 2019³. The above chart indicates the growth and circulation of bitcoins in the digital market. It has achieved its maximum so rapidly irrespective of territorial jurisdiction. It has achieved global attention within a short span of time.

While analyzing the rise of bitcoins from 2009 to 2019, we find that there are various reasons for it. Its use is fraud proof as all its transactions are properly stored in the public record and the identity of bitcoin users are encrypted to make sure the legitimacy of record keeping. All transactions are verified to ensure that the coins are used by its legal owner. At the same time it also protects the identity of its user and no one can hack to steal your credit card numbers and personal information. Moreover, it is very easy to use bitcoins as it is connected with the internet. All that you need is a smart device with an internet connection.

Apart from that, bitcoins are cheaper and less time consuming than many other forms of digital payments, thereby bringing home lots of profits to business organizations and individuals. They are designed to revolutionize digital trade markets by creating a free flowing trading system without fees.

³M. Szmigiera, Number of Bitcoins in circulation, *available at*:<http://www.statista.com/statistics/247280number-of-bitcoins-in-circulation/> (last visited on Feb. 24, 2020).

After 2018, most major Crypto currencies have broken their support levels. Despite that, bitcoin has held its ground. This is a positive sign as it shows that the stronger hands are not panicking.⁴

In 2019, following the US, China trade war, the prices of bitcoins were put down. Bitcoin, despite being the most widely-traded crypto currency with volumes into the billions of dollars every day, still struggles with wild price swings due to so-called market whales moving large volumes of bitcoin at above or below the current market value.⁵ Crypto currencies may revolutionize digital trade markets by creating a free flowing trading system without fees.

II. Features of bitcoins

The unprecedented growth has not only posed certain challenges but has also invited a vast debate in many circles including business and academic circles. The debate has both supporters and those who are against it. Bitcoin is subject to many features and also many limitations as well. A brief summary of its features are as below.

- i. The Bitcoin is not governed by any independent authority or any centralised authority. In this sense bitcoin enjoys autonomy in its regulation and is free from any centralised control.
- ii. The transactions of bitcoin are covered by highly technology oriented software and protects the privacy of those who are engaged in it. The identity of those who are involved in it remains unverified even between the two parties and lacks any information about those who are involved in any transaction. In this sense it not only protects the privacy of individuals but also leaves no trace marks to determine the same.
- iii. The transactions of bitcoin are mainly done in the dark web area, which is not controlled by any state or any authority.
- iv. The values of bitcoin can be subsequently transferred into the local account of national economies.
- v. The transaction record is kept in a highly sophisticated technology oriented block chain which is not easy to track or infiltrate.

⁴ Rakesh Upadhyay, Price Analysis, *available at*: <https://www.cointelegraph.com/news/price-analysis-dec-20-btc-eth-xrp-bch-ltc-eos-bnb-bsv-xtz-xlm> (last visited on Feb. 20, 2020).

⁵ Billy Bambrough, Is this the Real Reason Bitcoin suddenly Soared? *Available at*: <https://www.forbes.com/sites/billybambrough/2019/08/06/is-this-the-real-reason-bitcoin-suddenly-soared/#bb129b043804> (last visited on Mar. 22, 2020).

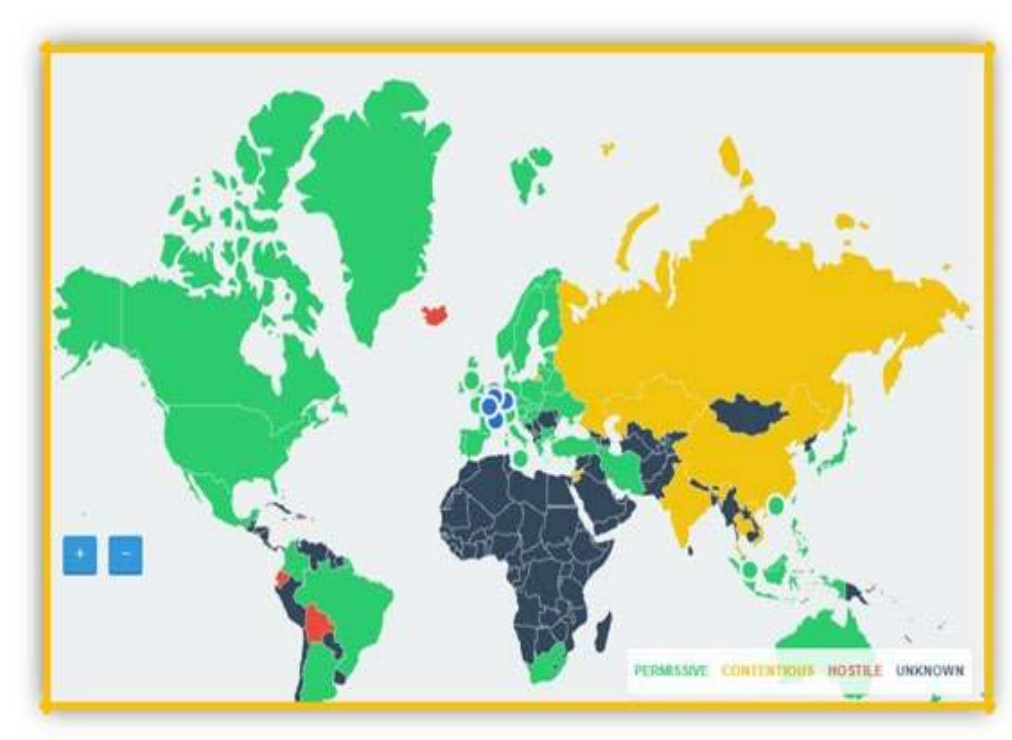
III. Drawbacks in bitcoin

As provided earlier, bitcoin is not free from any limitation. The brief summary of some major limitations are as under.

- The block chain used in the bitcoin transactions is used by many which makes it susceptible for a number of attacks. Although it's covered in a block chain, any user inside the block chain can attack any other.
- The major portion of transaction of bitcoin operates in the most vulnerable part of the internet called the Dark web, which is mainly used for criminal purposes like smuggling, illicit trafficking and many other harsh criminal activities. Working in the dark web makes it more prone to other criminals and lacks a robust mechanism for safety.
- The network has yet to develop any safe and secure network free from any cyber-attack. One of the forms of digital currency The Ethereum in 2016 2016 was subject to theft and caused a loss of 50 Million USD.
- The common people did not invest in it as the major reason behind that is the lack of having any centralised authority on its baking. As the issuance of currency is a sovereign function and is generally governed by any independent and sovereign body. However behind bitcoin there is no such authority.
- The transactions of bitcoin are covered under a digital mechanism which is not free from vulnerable attacks in the cyber world, in case of loss no compensatory mechanism is laid down.
- In India, the state lacks in encouraging transactions in bitcoin. The state neither bans it completely nor regulates it completely.

IV. Legality of virtual currency – International Perspective

As discussed earlier, the operation of virtual currencies has a base in the dark web, which is a part of the internet and knows no territorial boundary. Since the inception of bitcoin in 2008, it has reached almost all the countries and has received intention as well. Some countries around the globe have either banned it completely, or the majority regulate it in one or another way. There are countries around the world which accommodate the virtual currencies in their municipal legal system. The below-mentioned graph will make the position clearer.



Source: Bitcoins India Report 2017 By- Vallari Dubey

In the above graph, the countries in green colour depict those countries whose legal system accommodates the trade in bitcoin while the countries in red colour depicts its contrary as illegal. The countries which are in purple depicts the countries which are in the process of legalising the trade in bitcoin and the yellow countries consider it as continuous and few legal systems are closed and are unknown. The above graph is self-explanatory in nature.

The numbers of developed and developing countries are recognising or are in the process of moulding their legal system towards legalising the bitcoins. Countries like the US, China recognise it while countries like Japan are in the process of recognising it. China recognises crypto-currency as “Virtual currency” which does not have the same recognition as enjoyed by regular currency. In the same way, the US considers bitcoins as property but it has not been bestowed legal tender in any of the states the US as such. Similarly Japan, in the year 2017, recognises the crypto currency as a mode of payment. On April 1, 2017, Japan became the first country to recognise bitcoins as a legal method of payment. It gives it legal recognition and defines it as “assets”.

While in the UK, bitcoins are considered something as private currency and the transactions provided in the UK are not subject to Tax. Russia like China recognises it as “Virtual currency”

which does not carry the same status as regular coins. Australia treats Virtual Currency the same as the US. Brazil, which is an important component in Brazil, Russia, India, China and South Africa (BRICS) monitors all the activities and the transactions. The Central Bank of Brazil, like India's RBI, monitors it and is open for legal intervention. India's neighbouring countries like Bangladesh punishes it and penalises any transactions carried out under bitcoins up to 12 years of imprisonment. Australia is in the process of legalising it as highlighted by them in the 2017-18 budget speech. In Norway bitcoins are not subject to Value added Tax (VAT), the exception was announced during the 2017 budget.

In US, the Supreme Court in the case of *States vs. Faiella*⁶ The Supreme Court equates bitcoin with "money" as it can be used in exchange for money. The Supreme Court in this judgment allowed bitcoin as money.

The Singapore international commercial court in the case of *B2C2 Ltd vs. Quoine Pte Ltd*⁷ the court equates the virtual currencies as property. However the court of appeal in *Quoine Pte Ltd v. B2C2 Ltd*⁸ The court of appeal although got convinced about the equation of virtual currency as property however the court was not clear about the nature of property. The judgment is important as it remains uncontroversial about the equation of virtual currencies as property however it the issue of the nature of property remains undermined. The English court also follows almost the same reason as Singapore 's reasoning. In the English case⁹ The court equates bitcoin as property.

Libra 2020

Facebook has decided to launch its own crypto-currency in 2020, known as Libra. It will be run by Libra association, a Geneva based entity and its partners are Facebook, Visa, Uber, Vodafone and many more multinational companies. The distinct feature of Libra will be that it will be run by Libra association which will determine its value as against other bitcoins which are not regulated by anyone.

V. Regulation of Virtual currencies: Indian position

⁶ 39F.Supp.3d.544 (2014).

⁷ (2019) SGH (1)3.

⁸ (2020) 5 GCA (I)02.

⁹ *AA v. Persons unknown Re-bitcoin* (2019) EWHC 3556 (comm).

As discussed above, the virtual currencies around the globe have achieved a prominent position and attention as well. Almost all the countries around the globe deal with it some have strictly banned it while some countries consider it as property while some is currency. In India, the Reserve bank of India on its circular dated April 6, 2018 disown the virtual currencies and actually stops the banking sectors to deal with any kind of virtual currencies. The circular neither legalise it not against it. The reserve bank of India has issued certain guidelines involved with respect to risk involved in it.¹⁰ The circular was challenged by a number of associations and organisations. Finally in 2020 the circular was struck down by three judge benches on the ground of proportionality. The finance minister also denounces the use of virtual currencies like bitcoin and provides that it is not a legally tendered coin.¹¹ The author is of the view that keeping in view the global position and the strength of Indian economy and the targeted goals like as to be among the top two economies of the world, there is a dire need to regulate the virtual currencies to the effect the legal gap need to be filled after due deliberation to the effect. The definition as provided under the coinage act, 2011¹² requires the coin should be in metal and stamped by the government of India. The explanations appended with the section provides that any type of card which includes debit card, credit card, postal order, e-money order will not fall under the coin. The combined readings of the section and the explanation appended with it make it clear that the definition of coin is restricted and does not accommodate the virtual currencies. The RBI in its act under section 2(d) defines “rupee coin” as rupees which are legal tender in India under the provisions of the Indian Coinage Act. However RBI act did not provide the definition of currency but the same is provided under the Foreign Exchange Management Act, 1999¹³ which provides an inclusive definition of currency. The definition provides that the currency includes all currency notes, postal notes, money order cheques, drafts and many more. The definition grants power to the reserve bank of India to notify any currency. The power is given to the RBI to grant legal tender to any instrument. The same power was also discussed in length in the case of mobile association 2020. To grant legal recognition to that effect to the virtual currencies, or the bitcoins the RBI needs to issue a circular till the date the legislature fills the gap.

¹⁰ Reserve bank of India, “Prohibition on dealing in virtual currencies” (Vcs)-Notification Number- RBI/2017-18/154, Apr.6, 2018.

¹¹ Bitcoin ban: How Crypto currency exchanges are circumventing RBI’s circular (July.07, 2018), *available at*: <https://www.businesstoday.in/current/economy-politics/bitcoin-ban-how-cryptocurrency-exchanges-are-circumventing-rbi-circular/story/280005.html>. (Last visited on Jan. 14, 2020).

¹² The Indian Coinage Act, 2011 (Act 11 of 2011), s. 2(a).

¹³ The Foreign Exchange Management Act, 1999 (Act 14 of 1999), s. 2(h).

From the above stated definition it's clear that it did not include the virtual currencies as a coin or a note so, in order to include virtual currency as a legal tender, the amendment to that effect needs to be done. The legal gap has to be filled with the relevant laws. The Law Commission of India under the chairmanship of justice B S Chauhan in its 276th report on 2018 "Legal Framework: Gambling and Sports Betting Including in Cricket In India". Provides that crypto currency is like an online mode of transaction however the report lacks in having an in-depth analysis of the same.

VI . Inter-ministerial group report 2019

The inter-ministerial group was constituted by the government of India in 2017 to look into legality of crypto currency and suggest necessary reforms as well. The high level committee was headed by Chandra Garg (IAS officer) who serves as finance secretary government of India. The committee recommends complete ban on private crypto currency citing various risks involved in it. The Group also drafted a law and suggested a bill titled as "Banning of crypto currency and Regulation of official Digital currency Bill, 2019". The main features of the bill are as under: _

- The bill mandates fine, jail up to 10 years.
- Repeat offences punishable with imprisonment up to five years, extending to 10 years with fine.
- Fine imposed could be three times the loss or harm caused by the offender.
- Fine could also be three times again made by the offender or up to Rs 25 crores.
- The committee also recommended a crackdown on crypto currency but suggested the introduction of an official digital currency (ODC) which can be given status of currency by RBI.

Observation of the Group: The group has issued several concerns and has made certain observations as well. Some among them are as under.

- i. The group has issued a concern over crypto currency issued abroad.
- ii. The group has issued concerns about the reports that a growing number of people are investing in crypto currency.
- iii. Crypto currency is entirely created by private entities which are not known.
- iv. Private crypto currency lacks all attributes of having a currency.

- v. It has no fixed nominal value.

VII . Regulations of bitcoins in India - much needed and role of RBI

As mentioned earlier, bitcoin has affected Indian markets, and Indian investors & business tycoons are also interested in it. The importance of Indian economy has achieved global attention as India is the third largest economy in the world and is likely to be second within a few years. India is providing one of the largest markets in the world and is a prime member of G8 nations and other international platforms. Keeping the global activities and regulations in mind India must move forward and make suitable amendments in its Municipal legal system so as to accommodate the global challenges like crypto-currency. Bitcoins have gained acceptance in larger parts of the world and major economies of the world like the US and China have also recognised it. Bitcoins are now deliberated in India as well. However, the bitcoins need to be regulated in order to prevent the fraud.

The concept of welfare state provides that the state should regulate those conducts of society which provides the potential threat for society. As mentioned earlier, the crypto currency is prone to fraud and threat; the state should regulate it so that its citizens may not suffer any harm. In regulating it the role of RBI is of vital importance because it has been entrusted with the task of regulating the currency network in India.

VIII. Virtual currencies regulation - A need in India

The author of the paper suggests that the bitcoin or the virtual currencies instead of banning it completely should be regulated by the state. The argument is supported by the following reasons.

- After the Supreme Court judgment in the case of Internet and Mobile Association of India vs. *Reserve Bank of India* (Judgment delivered on March 4, 2020) which struck down the RBI circular has widened the legislative gap which needs to be filled.
- It's better to regulate it then completely closing the doors of its working. That will not couple up with judicial scrutiny and likely will be struck down on the ground of extreme step or rule of proportionately.

- The regulation will raise the income of the state in the form of tax, transaction costs which will ultimately help the state in generating more funds for people's welfare.
- Instead of giving it the status of currency the state can control it as the "commodity" as done in the United States.
- The state should regulate it as it would invite the people to invest in the same and work on confidence building measures among the people.
- India is currently one of the major economies of the world and is planning to land on a five trillion economy planet within the next four to five years. It will be important to regulate the virtual economies for that goal as well.
- Internationally India is a major part of G8 and G20 organisations where the majority of the countries regulate this form of currency in one form or another similarly India should take a lead in the direction.
- The intervention of the state in regulating the virtual currencies will erase the self-regulating principles which will ensure people's investment in the same.
- The regulation of the state will protect their citizens from any frauds as virtual currencies know no physical borders which opens its scope for the vulnerable.

IX. *Internet and Mobile association v. Reserve Bank of India*- Analysis of Supreme court Judgement

Judgment is important in many aspects. The 180 pages judgment delivered by three judge bench was hearing the case. The judgment was delivered against the RBI circular released on April 5 and subsequently April 6, 2018 which prohibits dealing with the virtual currencies. Several bodies challenge the circulars on various grounds. The circular was statutory in nature as it was passed in exercise of powers to RBI given under various statutes like the Reserve bank of India Act, 1934 Banking and Regulation Act 1949, payment settlement act 2007 and other relevant statutes. The court dwells upon positions around various jurisdictions across the globe. The court has analysed various statutes and observed that neither Reserve Bank Of India act 1934, nor Banking Regulation Act of 1949, nor payment of settlement act 2007 and coinage act 2011 define the term or word currency, currency notes Indian currency and foreign currency. The court also took note of various committees constituted for the purpose of virtual currencies like as the inter-ministerial committee which recommended a specific legislation on the point namely "Crypto-token Regulation bill 2018" which suggests that banning completely virtual currencies will not serve a purpose and will be an extreme step but the state should

regulate it. However the new bill was presented in 2019 which recommended the total ban on all forms of private crypto currency.

The Supreme Court concluded that the virtual currencies are not banned in India but the RBI circular issued on April 6, 2018 restricted them from banking sector which is the life blood for any business community. Finally after the hearings the concluded that the circular issued on April 6 fails the test of proportionality and infringes article 19(1) (g)¹⁴ of the Constitution. The Supreme Court sets aside the circular on the ground of proportionality as court term the circular as an extreme step. The court also directs the RBI to release the funds in the accounts frozen after the notification.

After the judgment, the legislature should come forward and enact a piece of legislation which should govern the virtual currencies in India. The legislative gap needs to be filled. It's better to govern the virtual currencies rather than self-governing or banning it completely.

X. Conclusion and Suggestion

From the above discussion, it can be concluded that bitcoin has posed a unique question to our traditional method of transaction in the economical world. The crypto currency has achieved a global status irrespective of territorial jurisdiction although its legitimacy is at the infancy stage. Keeping in view the G8 Nations and BRICS nations including India should regulate it in order to avoid any fateful event. In Asia, India should take a lead so that the other countries follow suit. Although India is one of the largest economies in the world, it is not free from hunger, poverty, illiteracy, small nutrition and many more. Global hunger index, released in 2017, puts India in 100th rank out of 119 nations. If a state regulates the crypto currency, the state can earn tax which ultimately increases the budget and the same money can be used for the welfare of people and eradication of these evils.

The regulation of virtual currencies will also provide a strong support for “digital India mission”, one of the dream projects of the government which ultimately will invite and secure the individual property in safe and secure transactions. The regulation will be a basis for the regulatory mechanism for the same.

¹⁴Freedom of trade, business and commerce.

Bitcoin is a popular crypto-currency in the world. However, its instant complete and blanket ban will hurt the customers, cooling off period should be given. Recent study conducted shows that bitcoins are used for tax evasion and at this juncture it is expected to touch five trillion economies within the next few years and cannot afford to allow a parallel economy. It is in interest of India that the bitcoins instead of banning it should be regulated.

As discussed and highlighted above, certain jurisdictions consider virtual currencies as property while as some as economy. However keeping in view, the Indian position India has to take a stand about it instead of completely banning it. The RBI in India has to evolve many options available including issuing its own virtual currencies which should be highly sophisticated keeping in view the security concern.

It's pertinent to note here that the United Nations should take a lead and should come up with a model law for the states and should initiate the dialogue process with all the major economies of the world. After an extensive dialogue process a united nation model law on virtual currency should be brought so that the states should mould their domestic law in the same way as Virtual currency knows no physical border.