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LAWS AND REGULATIONS GOVERNING COMPANIES USING CRYPTOCURRENCIES AND BLOCKCHAIN

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Abstract

Blockchain technology, which first served as the foundation for the cryptocurrency Bitcoin, has become a real game-changer. While the technology sometimes opens up new possibilities and applications, it has also attracted a good share of enthusiasts and scammers.

Various entrepreneurs and engineers are still uncertain about the true effects of blockchain technology on the country's economy as a result. They continue to be unsure about how the blockchain will affect businesses and whether or not they should make an investment in Blockchain development.

Let's talk about cryptocurrency and blockchain presuming that you're one of those entrepreneurs and want to have a good understanding of the whole situation.

Introduction

Although cryptocurrencies have been there for a while, they just recently received massive recognition and use. They now not only act as an alternative method of payment for users but also as time and money-saving solutions for many different corporate applications. Numerous other cryptocurrencies have appeared after the invention and growth of popular ones like Bitcoin, Dogecoin, and Ethereum. Traditional financial services companies like Goldman Sachs and JPMorgan have taken note of the technology and started developing their cryptocurrencies internally. Other digital companies like Facebook have also done the same.

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Although few formal regulations have been put in place, the United States largely supports the use of Bitcoin and other cryptocurrencies. The Department of Treasury, Securities and Exchange Commission (SEC), Federal Trade Commission (FTC), Internal Revenue Service (IRS), and Financial Crimes Enforcement Network (FinCEN) all have different definitions of "cryptocurrency" and opinions on how regulation ought to be carried out.

Definition of Cryptocurrency and Blockchain

Blockchain

It is a decentralized ledger known as a blockchain that keeps track of all peer-to-peer transactions. Using this technology, participants can validate transactions without a need for a centralized authority. Its uses include voting, money transfer, trade settlement, and a host of other things.

Cryptocurrency

Cryptocurrency is a combination of the terms "crypto" (data encryption) and "money". As a result, a cryptocurrency is a form of electronic cash that uses encryption to preserve transaction security. Digital money known as cryptocurrency can be used in place of cash or credit cards.

Simply explained, cryptocurrency is a type of digital or virtual currency. It can be used just like conventional currencies like pounds, dollars, yen, euros, and others. However, the cryptocurrency only exists in electronic form; there are no physical analogues in the form of notes or coins that can be taken along.

A cryptocurrency is a modern form of payment in the corporate world:

Corporates eager for decentralization

A growing number of companies all around the world are using Bitcoin and other virtual currencies for a range of investing, operational, and transactional activities. Like any frontier, there are unforeseen dangers, but there are also advantages. For enterprises to feel more at ease working with crypto assets, Mathew McDermott, global head of virtual currencies at Goldman Sachs, claims that crypto companies have had to "raise standards" and make sure that their services are of "institutional standards."

Technology-focused organizations were among the first to allocate some of their balance sheets to virtual currency. In October 2020, Square did a 50 million dollar investment in Bitcoin. Tesla listed 1.5 billion dollars in Bitcoin on its financial report in the last year. In the last quarter of 2020, Micro Strategy spent $475 million on Bitcoin.

Working with cryptocurrencies offers challenges for corporate treasurers because accounting methods were "not designed with virtual currencies in mind or assets that are not tangible in nature," according to Anthony Day, blockchain partner at IBM Global Business Services in UK and Ireland. There are significant differences between countries in the regulatory and reporting systems for multinational corporations.

According to IBM's Anthony Day, the world of cryptocurrencies and virtual assets holds great promise for transforming how businesses transfer wealth and make investments. The effectiveness and automation of programming could revolutionize international trade, complex distribution networks, and internal settlement and reconciliation.

Benefits of utilizing cryptocurrencies:

Secured transaction

People have long worked hard to make the transactions highly safe due to the frequent frauds and data manipulations. Businesses can keep transactions private and protected thanks to the private keys and improved security provided by blockchain technology. Also, once the transfer is completed, it cannot be reversed.

Protection of privacy and recognition of business

For people who use the internet, privacy has always been of the biggest importance. However, as technology has advanced, the privacy problem has decreased. When a business decides to accept cryptocurrency in the world today, it attracts the attention of customers who like to keep their identities and financial activities private. On the other hand, these companies are thought to be advancing alongside technology.

Decentralization

The laws and regulations established by the governments of many countries have prohibited the organizations for years. Without any direct governmental control, cryptographic transactions are very confidential. For owners of e-commerce businesses in some countries, the possibility of having their assets and bank accounts frozen owing to political instability is a real and present danger. This is not possible, though, because cryptocurrencies are decentralized. The money is stored in various places around the world and might be retrieved when necessary.

Inexpensive and frictionless

In general, cryptocurrencies are substantially less expensive. The security feature of cryptocurrencies eliminates away with the requirement for a third-party operator to authorize and verify transactions. The required transaction costs are thereby decreased. However, several good third-party applications can help individuals who need a little guidance or a tool to handle this issue. Even in that case, the charges are usually 1 %.

Quick Payment

There have been situations where completing an online transaction was time-consuming and incredibly complex. With its unique keys that are provided to each owner, cryptocurrency allows quick payment and very few hassles. Additionally, the payment converts the chosen currency, removing the danger of volatility.

Laws governing the use of cryptocurrencies in India

A significant obstacle to the regulation of cryptocurrencies is how difficult it is to ascertain their legal standing. Depending on how the law was interpreted and the circumstances, courts in various nations have categorized cryptocurrencies as assets, commodities, non-traditional currency, payment instruments, or money.

The Reserve Bank of India Act of 1934, the Banking Regulation Act of 1949, the Payment and Settlement Systems Act (PSSA), and the Coinage Act of 2011 do not define the terms "currency" and "money."

The Foreign Exchange Management Act provides definitions for the terms "currency," "currency notes," "Indian currency," and "foreign currency". The IMAI ruling recognized that, under the FEMA's definition of "currency," the RBI might alert users of cryptocurrencies that fall into the category of "other equivalent instruments." Since India lacks a clear set of regulations for cryptocurrencies, the following rules must be followed by organizations before they may start operating in India:

Sales regulation

The sale and exchange of cryptocurrencies are not prohibited in India, and as was already mentioned, no special legislation has been passed in India to control or forbid the trading in VCs or cryptocurrencies. However, laws that were passed in the past and cover issues like:

(i) the trading and issue of securities,

(ii) the trading of commodities,

(iii) the purchase and sale of assets to and from people residing outside India,

(iv) the acceptance of deposits by firms are triggered in some situations.

Based on whether a cryptocurrency is classified as an asset, security, commodity, store of value, etc., its nature and characteristics will decide the regulatory framework that will be applied to it.

A cryptocurrency, such as Bitcoin, is freely traded by individuals in India without the need for any kind of reporting if it is utilized as a "store of value." As part of their yearly filings, businesses with Indian corporate registries are required to disclose any interests in cryptocurrencies or venture capital (VC). Such cryptocurrencies might be viewed as either a commodity or an asset, and if bought or sold by an Indian citizen outside of India, would be subject to FEMA-notified exchange control requirements. The classification that crypto tokens may receive under current Indian law is currently unknown.

The rules governing the issuance of securities, collective investment schemes, and other similar rules and regulations may apply to entities that are incorporated in India and issue cryptocurrencies that contain rights in the ownership or assets of these entities. Similar laws would apply to corporations that issue tokens that are comparable to deposits that are accepted by the general public.

The Securities and Exchange Board of India oversees the trading of commodities and the regulation of commodity exchanges in India ("SEBI"). VCs are not now included in the definition of "commodities," although news sources suggest that this may change in the future. Crypto exchanges working in India may be impacted by this classification, which would bring them within SEBI's jurisdiction.

Another source of guidance is how India taxes the sales of cryptocurrencies in India, as well as the profits from those sales, further information on this subjectis provided in the Taxation section below.

Taxation

In India, profits and gains from the selling and trading of cryptocurrencies will be subject to taxation. Both direct income tax and indirect tax (the Goods and Services Tax, or "GST") are used by the Indian government to raise tax revenue. We'll now examine the ways that cryptocurrency can be profitable:

1. **Mining/Staking/Airdrops**: By dedicating their resources and time to a blockchain network, users can yield or earn cryptocurrency. Such users may then exchange this for payment in the form of money or other physical or intangible products.

2. **Speculative Trade**: Several people buy and collect cryptocurrencies solely intending to resell them for a profit. We'll presume that this also applies to all derivative trading.

Following are some cases in which Income Tax and GST may be applicable:

1. **Income Tax**: As of right now, cryptocurrencies are not considered to be either products or asset classes. Despite this, profits and yields from the sale of cryptocurrencies are subject to income tax in one of two ways: (a) because software is recognized as a "good" under Indian law, income derived from its sale can be classified as business income and subject to separate taxation; or (b) because the sale of any capital asset, in this case, cryptocurrencies, would trigger capital gains tax. This would be determined by examining the holding length, trading frequency, holding size, and classification in the books of accounts.
2. **GST**: In India, the sale of products is subject to GST at rates that vary depending on the type of commodities sold. If the cryptocurrency were to be considered a "good," then every transaction would be subject to GST. The

applicable GST must be charged to the buyer/service receiver, and the seller must deposit the prescribed GST with the tax authorities. The parties to the transaction also have a responsibility to apply for registration as taxable entities under the GST system.

Of course, there is also the issue of international bitcoin trades and how withholding tax and double tax avoidance agreements interact in this context. Unresolved legal issues include how to appropriately tax the sale of cryptocurrencies worldwide due to the flow of cryptocurrency tokens between wallets, exchanges, and across international boundaries.

Laws Regarding Money Transmission and Money Laundering

There are no particular rules that govern or forbid the transfer of cryptocurrency aside from the several RBI Circulars stated above. Due to the pseudonymized nature of cryptocurrency transactions, RBI sought to completely ban dealing in VCs with its Ring-Fencing Circular. After the SCI invalidated the Ring-Fencing Circular, it was replaced by the Clarificatory Circular, which permits Regulated Entities to transact in cryptocurrencies as long as it complies with the KYC, AML, and CFT regulations in place.

It is advisable for any company, including those offering services linked to cryptocurrencies (including crypto exchanges), to comply with the stated requirements, even if the RBI's Clarificatory Circular may only extend to Regulated Entities. Compliance will give the aforementioned entities the capacity to support the investigation of enforcement agencies and release them from any direct liability. Enforcement agencies in the country have taken action against parties that engaged in cryptocurrency trading in violation of the AML legislation.

Additionally, the cryptocurrency's use case may also be a deciding factor in determining the money transmission rules that apply to it:

1. **Store of Value:** The above-mentioned RBI policies will be applied. It makes it less likely that the other cryptocurrencies will be recognized in India as a

"store of value" or as legal money given that the Indian government and RBI are seriously considering a CBDC.

2. **Utility Token:** This type of cryptocurrency enables users to acquire goods and services made available through a proprietary platform. Typically, the tokens' value is correlated with the platform's actual monetary offerings of the goods and services they represent. Depending on whether the PPI system is closed, semi-closed, or open, utility tokens may take on the role of prepaid payment instruments (PPIs), in which case the relevant sections of the Payment and Settlement Systems Act, 2007, as well as RBI Circulars on PPIs, may also start to apply.

3. **Commodity or Security Token:** If cryptocurrency is regarded as a commodity, then SEBI's standards for KYC, AML, and CFT will come into play. Presently, cryptocurrencies in any form or manner are not among the commodities which can be traded under SEBI's supervision. The sector has, however, made a strong effort since it believes SEBI is the best organization to oversee cryptocurrency regulation in India. The Proposed Bill might also take this viewpoint into account.

Testing and Promotion

The Enabling Framework for Regulatory Sandbox (the "Framework") was released by the RBI on August 13th, 2019, to encourage the adoption and use of new technologies in the Indian fin-tech space. The Framework expressly excludes "Cryptocurrency/Crypto asset services, Initial Coin Offerings, Trading/investing/settling in crypto assets, etc." from the regulatory sandbox, but currently includes "Applications under blockchain technologies" in the suggestive list of innovative technologies which may be tested upon.

To "foster innovation in technological matters relating to trying out new products, business models, processes, services, etc. in the live environment of a regulatory sandbox in the securities markets," SEBI issued a notification on April 17, 2020, under the SEBI (Regulatory Sandbox) Regulations, 2020 providing relaxation on the enforcement of other regulations. A regulatory sandbox was developed in August 2020 by India's Insurance Regulatory and Development Authority "to create a safe and congenial environment to experiment with novel techniques (including Fin-Tech solutions)" in the insurance industry. Unlike the RBI Framework, neither of these sandboxes explicitly includes or excludes blockchain, venture capital, or digital assets. Each application submitted to the relevant sandbox is examined on an individual basis by the appropriate regulatory agency.

Nonetheless, to keep up with domestic and international advancements in the field, it might be essential to specially provide a regulatory sandbox for virtual currencies once the eagerly awaited Proposed Bill is introduced, put into effect, and the government bodies in charge of regulating cryptocurrencies are identified.

Ownership and licensing requirements

The SEBI (Portfolio Managers) Regulation, 2019 and the SEBI (Investment Advisers) Regulation, 2013 control the operations of investment advisors and fund managers in India.

The list of things that managers and consultants can deal in has been made public by SEBI and does not contain cryptocurrencies/VCs, even though there is no clear prohibition in the abovementioned legislation on managing and consulting about crypto assets. As a result, any investment advisers or fund managers offering services in India linked to cryptocurrencies or venture capital are doing so in their capacities rather than as managers or advisers authorized by SEBI.

The CA Amendment, however, will require investment advising firms and wealth management firms in India to reveal their holdings and ownership of cryptocurrencies and venture capital firms to the Indian government starting with the current fiscal year. Fund managers and individual advisers might not be covered by this.

Declarations and Restrictions at Border

The nation's financial system is regulated by the RBI. Under FEMA, it occasionally issues exchange and capital control regulations, more specifically:

1. The Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000, which govern the purchase and selling of assets located outside of India
2. The Foreign Exchange Management (Export of Goods and Services) Regulations, 2015, address India's exports of goods (which includes software) in place of foreign exchange.

The relevant legislation may be triggered if cryptocurrencies are classified by Indian law either as a capital asset or a product. To comply with reporting requirements, KYC, and other AML standards, each cross-border cryptocurrency transaction would have to be processed through authorized dealer banks.

Conclusion

Cryptocurrency's future is still in a very precarious state. Critics only see risk, whilst fans only see the limitless potential. Authorities must establish proper regulatory frameworks that support the adoption of cryptocurrencies and the expansion of crypto-based trade, as also protocols to maintain the integrity, security, and stability of the financial system.

A detailed understanding of the blockchain technology that drives cryptocurrencies and has the potential to revolutionize the world's financial system is essential for prudent regulation. Cross-jurisdictional cooperation and industry-government collaboration are necessary for a realistic global regulatory framework for cryptocurrencies.

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