

THE LEGAL IMPLICATIONS OF BLOCK CHAIN

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ABSTRACTS

Cryptocurrency, introduced by Satoshi Nakamoto in 2008, is a peer-to-peer digital currency system without a central authority. Since its inception, its demand has skyrocketed, with Bitcoin being the most popular form. The international position on Cryptocurrency is not homogeneous, and its legality remains a question. This paper examines the legal scenario of Cryptocurrency in India, aiming to understand its potential benefits or volatility. The Indian government has announced the "Cashless India" initiative to encourage digital payments and finance. The Supreme Court has directed the Indian government to regulate Bitcoins, but no legislation is in place yet. RBI has banned all entities from dealing with Cryptocurrency, making understanding the concept of Cryptocurrency essential for countries like India to recognize it.

Keywords: *Bank Blockchain Centralized Crowd funding Cryptography , Privacy and Security .*

Introduction

The concept of digital money was first envisioned by Nobel laureate, Milton Friedman in the late '90s who said in an interview that internet is going to reduce the role of governments and pave a way towards reliable electronic cash (1999). The cryptocurrency was then introduced by Satoshi Nakamoto (*pseudonym*) through a white paper, in which he proposed a method to stop double-spending of money by the introduction of Bitcoins. He contends that purely peer-to-peer basis electronic money would not require the element of trust on third parties and also the transaction cost would decrease. (2008, *Bitcoin: A peer to peer electronic cash system.*)

Like the U.S Dollar Bitcoins are not backed by the government. At that point of time, Bitcoins were just an electronic currency and could not be exchanged for any other currency or commodity.

Usually, transfers involving banks are subjected to strict rules whereas, CC's are being issued with no customer identification which makes it difficult to track suspicious transfers (2008, *William Hett, Digital Currencies and the Financing of Terrorism*). It was observed that Bitcoins are exciting as it shows how cheap a transaction can get (2014, *Bill Gates*). It is a cryptographic achievement and not to be duplicated in the digital world has an enormous value (2014 *Eric Schmidt, ex CEO of Google*).

In India, can CCs be regularized or is it better to stay out of it? This shall be answered in this paper by exploring the laws of the countries that has regularized it and analyze whether India has the legal infrastructure to support the same.

Position of Cryptocurrency in India

The position of Cryptocurrency in India is at a primal stage, it is neither legal nor illegal as there are no legislative documents declaring either. Recently, the Finance Minister of India, Arun Jaitley in his 2018 Union budget speech declared CC as an illegal tender, but assured that the government will explore the underlying technology of Blockchain Technology. Though this speech provides a peak into the intention of the current ruling party, it does not rule out the possibility of regularizing CC in

India like several other countries in the near future. Further, the speech does not form any legal basis on the classification of CC. Indian government is discouraged from recognizing CC because it is perceived that the only use of it is to finance terrorism and carry on illegitimate activities, which was expressed in the speech given by the Finance Minister. In the past RBI has issued notification asking the consumers not to use to CC because the government does not recognize it or provide any consumer protection in this regard.[\[1\]](#)

Lack of rules and regulations did not stop India from having CC exchanges; there were/are numerous exchanges like Zebpay, UnoCoin, and CoinSecure operating in India. On Apr 5, 2018 the RBI in order to stay out of CC business barred banks and financial institutions under it to deal in any sort of CC, RBI clarified that it shall not deal or offer services to any person or entities involving CC vide a circular. Three months time has been provided to dissolve the relationship with such entities, dealing in CC. As a result, banks under RBI which is most of the banks are not allowed to facilitate sale, purchase or even enable anyone to withdraw money or deposit money in relation to CC, which means investors won't be able to transfer money from crypto-exchange to bank or vice versa. Such a decision is estimated to affect nearly 50 lakh Indians, who have invested in CC. In a move to digitize India, this is a step backward because RBI already set up a multi-disciplinary panel to study CCs and was supposed to release a report discussing its position in the Indian economy and design a framework. Instead, RBI decides to stop involving itself in the CC market, which is a confusing move and have left many investors and businesses in the dark. The aim of RBI lies in protecting the interest of the consumers and such a sudden step to curb the use of CC served a heavy blow on CC users.[\[2\]](#)

It has to be noted that in 2017, the Supreme Court of India expressed its intention to regularize CC, which is contrary to the action of RBI. In the case of, **DwaipayanBhowmick Vs Union of India & Others**[\[3\]](#), a PIL was filed under Article 142 of the Constitution of India praying the court to issue directions clarifying the nature of CC and set up a special committee to frame appropriate regulation to deal with CC in India. The lack of any framework had rather left the market unregulated, which can harness all sorts of criminal activities. The PIL said that, regularizing the CC within the legal framework would be a game changer as it would restrict users from using it in illicit activities. CC being a global phenomenon cannot be stopped or banned because it is all on the internet; the best thing therefore is to set up a mechanism to keep a check on it. Also, it would help to boost the economy because a lot of investors and companies are looking forward to pool India's IT resources and develop a trading hub for example; BitBay a company from Poland made its entry in the Indian Market in Aug, 2017.[\[4\]](#)The SC consequently sought responses from the government but all the respondents have not filed any counter affidavit. On 2nd April, 2018 the SC ordered and granted last and final opportunity to the Respondents to file counter-affidavits within a span of 4 weeks.[\[5\]](#)Such response from the government shows its intention to classify and regularize CC or entertain public interest as such.

Recently, RBI prohibited financial institutions and banks to conduct any business or services in CC via a circular. As a result, the affected party, *Kali Digital* has approached the Delhi High Court to seek relief regarding the constitutional validity of the circular. The Court has accepted the petition and sought response from the Ministry of Finance, GST Council and RBI regarding the challenged circular. The petition states that the circular issued by the government is in violation of Fundamental Rights as guaranteed by the Indian Constitution and have contended the following;

1. Article 14, which states that, *“The state shall not deny to any person equality before the law or the equal protection of the laws within the territory of India.”*^[6]. The Cryptocurrency Company, which has been a registered company, should be protected like any other company and there should be no discrimination, it is contended that the RBI is discriminating companies dealing in CC.
2. Article 19 (1) (g), which states that, *“All citizens shall have the right to.... to practise any profession, or to carry on any occupation, trade or business”*^[7]. There is no such laws which declare the business of CC as illegal therefore, this circular is obstructing the fundamental right of citizens.

Further, they have expressed anguish over government’s failure to devise a framework on CC, which has caused uncertainty and difficulties in the Crypto business in India.

Such unwarranted move by the government is leading many Crypto companies to move outside India’s jurisdiction to conduct their business. In the following chapters I will try to examine whether the existing legal system of India can adapt Bitcoins and other CC.

Possibilities of CC classification in India

We first have to understand the structure of government in India before delving into the need of a legal framework surrounding it. India is a democracy and has a federal system of government, which gives power to both Centre and the States to legislate in accordance to the Constitution. Under A246 of the Indian Constitution, the Parliament and the State Legislatures have power to enact laws as per matters enumerated in Seventh Schedule of the Constitution. The Seventh Schedule consists of three lists; Union List (List I), State List (List II) and Concurrent List (List III). These lists specify the subjects on which the Center, State or both of them can legislate upon;

In accordance to the list, only the Union/ Central government has the power to legislate on CC because Entry 36 of List I mentions, **“Currency, coinage and legal tender; foreign exchange”** and Entry 46 of List I mentions, **“ Bills of exchange, cheques, promissory notes and other like instruments.”**^[8]It is most likely that CC shall be categorized among the above-mentioned items. It must be noted that the Constitution is the supreme law of the land and no legislation can violate its basic structure or act contrary to it. Simply put, the concept of CC should not be in conflict with the Constitution, it is interesting to observe that CC which roots itself on the concept of privacy is a recognized fundamental right in India but, necessary constraints should be provided to avoid chaos.

Therefore, regularizing CC would be fruitful to make India truly digital.

The power vested in the government by the people does not rest on one body, but on three separate branches where the powers have been distributed by the Constitution namely; the Executive (which includes the Prime Minister, the President and the Council of Ministers), the Legislature (the Parliament, which is responsible for legislating laws and policies of the government) and lastly the Judiciary (adjudicating body of India, which includes the Supreme Court, High Courts and its subordinate courts). While discussing, the legality of CC in Germany and United States, we have established that all the government wings does not necessarily share a common opinion on CCs”. Similarly, in India the Executive policies are bent on restricting the use of CC whereas, the judiciary seems like having an intention to regulate it. Further, no bill has been presented in the Parliament in this regard, which excludes the legislature from the existing CC scenario.

To understand whether CC can adapt in legal ecosystem in India, I will try to answer the following questions:

1. *Can CC be considered a legal tender in India within the purview of existing laws?*

The term legal tender has not been defined in any of the existing statutes in India, what can be gathered is its characteristics, and therefore by analyzing the features of an object we can identify whether it qualifies as a legal tender or not. Legal tender is basically bank note and other equivalent instruments which is commonly used and is acceptable by the government and banks. Section 26 of RBI Act considers the money issued by RBI as legal tender.

The statutes related to this subject are RBI Act of 1934, Coinage Act of 1792 and FEMA of 1999. The definition of currency is not specified in RBI Act, but the definition of foreign currency is referred in the Act to be the same as FEMA. An inclusive definition of currency is mentioned in Section 2(m) of the FEMA which states that currency includes **“all currency notes^[9], postal notes, postal orders, money orders, cheques, drafts, travelers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank”^[10]** and currency drawn or expressed in INR is “Indian Currency” in accordance to FEMA.

The legislature has been very strict to restrict the ambit of legal tender; Section 22 of the RBI Act states that the sole right to issue bank notes belongs to the RBI. Therefore, it is difficult for CC like Bitcoins to adapt into the Indian legal system as a currency or a legal tender until and unless it is notified by the RBI. Unfortunately, RBI does not consider CC as a legal tender. As discussed above this declaration has been challenged and is pending before the honorable judiciary.

2. *What is the status of Virtual Currency in India?*

In the previous question the meaning of currency in the Indian context has been discussed, now CC is a sub-set of Virtual Currency, whose recognition in India will be dealt in this question.

“*express um facit cessare tacitum*” is a Latin maxim which means „when there is express mention of certain things, then anything not mentioned is excluded“. In the above answer it is made clear that only the RBI can issue currency. Therefore, VC which has not been notified as a legal tender in India by RBI is excluded from the purview of currency. The maxim, which I have used, has been upheld by the Supreme Court in the cases of, **Shankara Rao Badam & Ors. v. State of Mysore & Anr^[11]** and **Union of India & Anr. v. Tulsiram Patel^[12]**

Therefore, it can be concluded that CC cannot be categorized as a legal tender in India.

3. *Can Bitcoins or other CCs be treated as a commodity?*

A commodity basically means an object which has a commercial purpose, the term commodity has not been expressly defined in Indian statutes, and the closest definition of commodity can be equated with the definition of, “goods”. The definition of “goods” is mentioned in the Sale of Goods Act, 1930 which defines good as, **“every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale”^[13]**. This definition does not mention whether a good should have any physical characteristics and therefore it does not rule out the possibility of Bitcoins being classified as a good. Further, this is not an exclusive definition and can be interpreted liberally to include CC.

The Supreme Court has classified computer software as “goods” in the case of **Tata Consultancy Services Vs State of Andhra Pradesh^[14]**, although it is debatable whether CC qualifies as computer software, it still throws light on how intangible computer codes is perceived as far classification goes. SC in the above case stated that;

“computer software is intellectual property, whether it is conveyed in diskettes, floppy, magnetic tapes or CD ROMs, whether canned (Shrink-wrapped) or uncanned (customized), whether it comes as part of computer or independently, whether it is branded or unbranded, tangible or intangible; is a commodity capable of being transmitted, transferred, delivered, stored, processed, etc. and therefore as a „good“ liable To sale tax.”

The explanation demands the property capable of being transferred, transmitted. Can Bitcoins fulfill the above? It has to be noted that, Bitcoins are stored in an electronic space called e-wallets, which is protected by a private key (*which has been discussed in Chapter 5*). This private key is used to authorize and verify transactions. Similar parallel can be drawn with any of movable objects, where the lock and key is tangible unlike e-wallet and private key. Hence, like any movable property it can be stored (in e-wallet) and transferred as per the owners wish and if CCs“ can be classified as goods, it can be taxed and monitored by the State.

4. Can CC come under the purview of, “securities”?

The term, “securities” refer to the instruments presented to investors by an investee upon investing, such instruments are the representation of the object of investment without transferring the possession of the actual object. This has been defined in Section 2(h) of SCRA, 1956 which includes:

“(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

[(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;]

[(ic) security receipt as defined in clause (zg) of Section 2 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;]

[(id) units or any other such instrument issued to the investors under any mutual fund scheme;]

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and (iii) Rights or interest in securities;

Firstly, Bitcoins or any other CC lacks the very essential feature of being described as, “security” because CCs are not backed by any underlying capital, its price depends upon demand and supply therefore, it does not qualify as “security”. Secondly, it is not issued by anyone in particular but is created by computer algorithm. It also cannot be categorized as, derivatives because it does not fulfill the primary criteria of being a security. Hence, it can be understood that CC cannot be categorized as anything except property in India.

Application of CCs“ in a Contract

If a person wants to enforce a contract using CC, will he/she be successful? There can be two case scenarios; one where Bitcoins is the consideration in the contract and second when it is the object of contract. According to the Indian Contract Act, 1872 a “contract” is a legally enforceable agreement^[15] and the necessary elements to a legally enforceable agreement include:

1. The parties should be competent to contract i.e.; should be a major, which is 18 years old.
2. There should be free consent i.e.; without any coercion, misrepresentation, undue influence, fraud and mistake.

3. There should be a lawful consideration with a lawful object, which has not been expressly declared void.[\[16\]](#)

Consideration is defined as, “When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise”[\[17\]](#)

Tax Implications of CC in India

CCs were almost overlooked by the government until the point, where the price of Bitcoins skyrocketed and generated huge profits to its owners this year. Gradually, the tax authorities started issuing notices to participants, who have gained from Bitcoin transactions. CCs“ are not recognized in India as a legal tender therefore, the only way it can be taxed is by treating it as a capital asset[\[22\]](#).

Capital Asset according to Income Tax Act, 1995 means, “**any kind of property held by an assessee, whether or not connected with his business or profession..**”[\[23\]](#)

The definition does not restrict itself to one kind of property, so it can include intangible property like Bitcoins. As long as CCs“ is used as investment instrument, the profits arising out of it can be taxed as capital gains[\[24\]](#). Further, it can be classified as long-term or short-term capital asset depending on the time the property was being held. If the property is held for more than 36 months, it is categorized as a long-term capital asset or else it is a short-term capital asset. The difference is important because the tax implication is different in each case.

Persons conducting business in CCs“ would involve frequent Bitcoin transactions, and such cannot be deemed as a capital asset but “income from business and profession.”

A miner, who uses their computer to facilitate mining of Bitcoins also get a part of the CC (as a consideration) after successful verification, this can be deemed as business income as well. But if it is considered as a capital asset, it may not have any tax implications because a miner spends no cost of acquiring the Bitcoins because it is self generated during the mining process. In the landmark case of **Commissioner of Income Tax vs. B.C. SrinivasaSetty**[\[25\]](#)it was noted that, in a case where the cost of acquisition were not ascertainable, the computation mechanism could not come into play. The same can be applied in the case of mining, where the cost of acquisition cannot be ascertained by a miner.

Under the Information Technology Act, 2000, “computer” means, “*any electronic magnetic, optical or other high-speed data processing device or system which performs logical, arithmetic, and memory functions by manipulations of electronic, magnetic or optical impulses, and includes all input, output, processing, storage, computer software, or communication facilities which are connected or related to the computer in a computer system or computer network*”[\[27\]](#)

Bitcoins can fall under the purview of computer because: It is a system, which fulfills the functions mentioned in the definition.

1. It is transacted via computers in a network of connected computers.

Hence, the offences related to computer, mentioned in the Act can be used to deal with CCs. The I.T Act covers the following issues:

- 1.*Hacking* – Section 43 of the IT Act states that, whoever without the consent of the computer owner; accesses his/her computer system. The term, “hacking” had been replaced by, “computer related offences” which gives a wider ambit to the meaning. This act may also include:

- Destruction, suppression and misappropriation of output from a computer process.
- Alternation of computerized data.
- Alternation or misuse of programs.[\[28\]](#)

The above mentioned Acts encompass everything from introducing a virus to the computer system to initiating a Distributed Denial of Service (DDos Attack)[\[29\]](#). Section 66 of the I.T. Act declares such act as a criminal offence. It states that whosoever with a criminal intent (dishonestly and fraudulently) commits such acts shall be punishable by imprisonment up to three years or with fine upto INR five lacs or both. “Dishonestly”[\[30\]](#)and “Fraudulently”[\[31\]](#)is to be construed from Section 24 and Section 25 of IPC.

2. *Identity Theft*– Section 66C of the IT Act makes unauthorized, fraudulent and dishonest use of digital signature a criminal offence. For example, if someone dishonestly uses my private key to access my Bitcoin e-wallet without my authorization, it would qualify as an offence under this Section. The criminal shall be penalized with imprisonment upto 3 years and a fine, which may extend up to INR One lac.[\[32\]](#)

Further, Section 66D of the Act regards Impersonation with regard to an electronic signature a criminal offence. The offender shall be imprisoned upto 3 years and a fine, which may extend upto INR One lac.[\[33\]](#)

3. *Cyber- Terrorism*– the I.T. Act states that computer-related offences with the intention to threaten the unity, integrity, security or sovereignty of India or to strike terror in the people or any section of the people. Section 66F (I) provides a punishment of imprisonment which may be extended to lifetime. Coming back to CCs, the decentralized structure and anonymity can be misused to fund terror activities, which can result in a threat to national security and economy. Supposedly, CCs are popular and highly valued in the Indian market and classified as, “securities”; in such a situation it is quite possible that a cyber-terrorist can hack into the network and disrupt the system. Such an activity might destabilize the Indian economy, defeat public order and cause serious harm to the sovereignty of India. The Financial Action Task Force, which is an inter-governmental organization to combat money laundering also states the virtual currencies like CC is a threat as it can be used to sponsor illegal activities. The technology-based on encryption makes it more difficult to track the wrong-doers. The existing legal framework is efficient enough to tackle the challenges posed by CC.

Conclusion and suggestion

Science has always helped to transform mere imaginations into reality. CC is one such example where the entire concept of money and the role of government have been challenged, this has led governments either to regulate it or ban it. In my opinion, regulating and developing mechanisms to control CC would give governments more security than by banning it completely; regulating it like Germany would generate huge revenues to the government whereas, banning CCs would not serve well in the long run because more and more countries are beginning to recognize CCs. Further, recent observations by expert suggest that Bitcoin and other Cryptocurrencies might become the biggest international currency by market capitalization.[\[1\]](#)

The existing legal environment must modify itself to integrate, recognize and regulate CCs. It might be surprising to know that companies like Microsoft are also accepting Bitcoins. People

who compared this technology to a bubble or a scam are turning out to be incorrect. In fact, in India one of the largest conglomerates, Reliance Jio is planning to launch its own CC called JioCoin, which is also reported to include smart contracts.^[2] A survey conducted by The Indian Express found that CCs worth INR 17,800 crore has been traded, which implies that the citizens are growing keen to invest in CCs though there are no legal recourse or structure protecting our citizens.^[3]

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