POLICY PROPOSAL

WHITEPAPER ON FRAMEWORK TO REGULATE CRYPTO IN INDIA

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EXECUTIVE SUMMARY

The value of crypto assets worldwide crossed $2 trillion earlier this year. Bitcoin is the most widely adopted crypto asset; it is worth over $900 billion, more than any tech unicorn founded in the last decade. Global crypto adoption is accelerating with ongoing technological innovation due to corporations worldwide offering crypto assets to consumers. These crypto assets serve as digital gold or tokens powering decentralised applications and are used for transfers, remittances, trading, lending, capital raising, etc., potentially impacting industries ranging from law to logistics, media, and cybersecurity.

Like other developed countries, India has taken an initially cautious approach to crypto assets. However, many countries have now advanced to considering crypto a digital asset rather than a currency, establishing ways to regulate this new class of digital asset. With this approach, India will capitalise on the crypto industry's massive potential. It can become a home to blockchain innovations that could impact the Indian economy similar to IT services and the Internet. This will allow Indians to participate in promising new wealth creation opportunities.

The Reserve Bank of India (RBI) has reiterated several risks associated with crypto assets, including lack of backing by a tangible asset and threat of market manipulation (with consumer protection implications). India has dealt with similar novel technologies (financial and otherwise) exceptionally and established thoughtful regulations for such issues. Now it can adopt a similar approach for crypto as an example for many other regions.

IndiaTech.org has created a five-point framework to regulate the industry, mitigating these risks while fostering innovation. The five-point framework recommends regulations to **define, introduce, enable, allow, and encourage** necessary checks and balances for the optimal exploration of crypto's potential, potentially leading to enhanced adoption:

I. **Define crypto assets** and **introduce a system for registering local homegrown crypto exchanges** in India;
II. **Introduce sufficient checks and balances** through well-defined reporting mechanisms and accounting standards to counter suspicious activities;
III. **Enable taxation (direct and indirect)** to treat crypto assets similarly to other current assets, generating additional revenue for the state;
IV. **Allow innovative uses** of crypto by businesses and **create specific safeguards to protect retail investors from fraud**;
V. **Encourage self-regulation** for the industry, including a code of conduct and regulatory framework in alignment with the government's primary objective of safeguarding consumers and financial stability.

CRYPTO'S REGULATORY JOURNEY IN INDIA

Crypto has already travelled some regulatory distance in India. The RBI issued notifications and circulars in 2013, 2017, and 2018 to safeguard customers from its perception of potential threats from crypto. It was believed that crypto assets might lead to possible money laundering, fraud, and terror financing. RBI's 2018 circular led to a prohibition of the crypto industry in India and adversely impacted the homegrown crypto exchanges. Subsequently, the government of India in November 2017 constituted the Inter-Ministerial Committee that first recommended the 2018 Crypto-token Regulation Bill, though ultimately the bill made little progress, rendering the industry into a complete shut down for nearly two years until the Supreme Court's intervention.

The Supreme Court judgement in March 2020 was supportive of crypto assets and paved the way for lifting prior restrictions, citing a lack of empirical data to justify the ban. The government has also proposed the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021, intended to facilitate India's own official digital currency issued by the RBI and allowing experimentation with other crypto assets.

The Corporate Affairs Ministry also announced amendments to Schedule III of the Companies Act, which mandates companies dealing with digital currencies to disclose profit or loss incurred on crypto transactions, the number of crypto assets held, and deposits held. This amendment is a step in a positive direction in recognising cryptocurrency as an asset.

GLOBAL DISPOSITION TOWARDS CRYPTO

By regulating (and thereby offering crypto-asset legitimacy), India can benefit strategically, similar to other countries that have adopted a more progressive approach. Bitcoin is legal in the US, Japan, the UK, and most other developed countries. For instance, in 2014, the US decided Bitcoin and other crypto assets should be treated as "property", qualifying for capital gains treatment like traditional assets (i.e., stocks and bonds). There are, however, some instances where certain activities involving digital assets are treated as income and subject to taxation. US agencies collaborate with cryptocurrency exchanges such as Coinbase to enhance their law-enforcement capabilities.

Furthermore, the US government is focused on supporting innovation while regulating cryptocurrencies. Notably, the current SEC Chairman, Gary Gensler, is well-versed in cryptocurrency and taught a class on it at MIT. Switzerland has also embraced cryptocurrency. Citizens can purchase Bitcoin at hundreds of automated teller machines (ATMs) and ticket-vending machines across Switzerland.

In the interest of encouraging new ideas to thrive in such a fast-paced, nascent industry, setting up regulatory trial periods for new projects is crucial. Many countries have already set up broad "sandbox" principles that allow crypto businesses to operate without stifling overregulation.

The crypto industry is at the forefront of technological innovation. As India is home to the largest number of tech specialists, its economy stands to benefit significantly by becoming a hub of crypto innovation. Today's answer lies in creating a regulatory environment that accelerates innovation while mitigating threats posed by cryptocurrency. Given this context, **IndiaTech.org has proposed a five-point framework** to answer some of the government's most pressing concerns around cryptocurrencies.

INDIATECH.ORG PROPOSES THE FOLLOWING FIVE-POINT RECOMMENDATIONS

I. DEFINITION AND INDIAN OWNERSHIP REQUIREMENTS:

a. **Definition:** Define cryptocurrencies as digital assets, *not* currencies, and grant them recognition as digital assets (similar to gold, stocks, or marketable securities). Several countries (including the US and Australia) have taken a similar approach.

b. **Indian ownership requirements:** Introduce a system of registering Indian crypto exchanges and grant them recognition by establishing checks and balances. Initially, India may seek to allow only Indian founders to operate such businesses. By doing so, India will save billions of dollars of revenues that may be payable to foreign exchanges. We recommend minimum ownership of 26% by Indian founders/entities in crypto exchanges, similar to the practice followed in the banking sector in India (FDI capped at 74%).

II. COMPLIANCE, VERIFICATION, AND REPORTING:

a. **Customer verification:** Verify all crypto holders through a KYC (know your customer) process administered by crypto exchanges. Build a mechanism to report all trades for taxation. India may refer to the upcoming Financial Action Task Force (FATF) guidance to implement necessary safeguards.

b. **Accounting standard:** Notify Indian accounting standards through accounting bodies like the Chartered Accountants/Cost Accountants to adjust their treatment of crypto assets.
c. **Classification of cryptocurrencies:** Classify crypto assets as "current assets" on corporate balance sheets, similar to stocks or marketable securities, but not as cash or currencies. If India considers crypto a currency, it can levy neither income tax nor GST.
d. **Suspicious Transaction Reporting (STR) mechanism:** The government should notify the authority/unit in government and manner/format of reporting wherein crypto exchanges can report suspicious activities/transactions.
e. **Traceability:** Recognise only those crypto assets that give access to forensic analysis and can be subjected to defined lawful enforcement. Specific privacy-focused crypto assets can be prohibited. For example, certain crypto assets such as Bitcoin are completely traceable due to their open-ledger blockchain system.
f. **Anti-money-laundering:** Bring crypto assets within the purview of established money-laundering regulations.

III. **TAXATION, DISCLOSURE, AND IMPORT:**

Extend financial assistance via tax credits and other incentives to crypto startups to foster rapid growth and drive innovation.

a. **Direct Taxation:** Establish a provision in the direct tax laws to render recognition and treatment under the head of "Income Profit and Gains from Business and Profession" or "Income from Capital Gains," depending on the holder's kind of business and the timeline of ownership.
b. **GST:** Treat crypto assets like stock and subject trading to GST. This GST should be levied on the brokerage or exchange fees (as in stock markets), not on the transaction value. The potential GST collections from this could range from 200cr to 600cr in the next 12 months.
c. **Disclosure:** Additionally, for individuals holding crypto assets at the end of a financial year, introduce disclosure requirements similar to those presented by the Ministry of Corporate Affairs for companies holding crypto assets. Individuals should be required to disclose crypto assets on their income tax returns. Also, some individuals/organisations may generate crypto assets through mining, which should be treated as self-generated assets with a separate computation for the cost of acquisition.
d. **Import of Crypto:** Apply appropriate FEMA regulations and assign HS codes to treat crypto assets purchased from persons outside of India.

IV. TREATMENT- PAYMENTS & NEW TOKEN ISSUES:

a. **Payments:** For individuals or businesses, trades in goods or services against any crypto assets should not be considered cash transactions but rather as "barters." This might be irrelevant due to the high cost of transferring crypto in the current form. It can be optional, but companies should be allowed to build their infrastructure using crypto to make current payment systems more efficient. Alternatively, India may initially consider prohibiting crypto as a payment instrument, solely allowing holding and trading.
b. **New Token Issues:** Tokens are digitally native instruments and can be classified as securities, commodities, or neither, depending on their use case. Since a regulatory framework for tokens does not exist, exchanges must ensure due diligence on tokens and projects around (a) the robustness of the underlying blockchain code, (b) the entrepreneurs backing the project, (c) circulating supply, liquidity, and "tokenomics," and (d) use cases. Countries such as the US apply the Howey Test to determine if tokens are securities. Therefore, it is crucial to understand the underlying

characteristics to determine if a digital token is a type of defined financial instrument under Indian law. Exchanges should apply existing Indian law where applicable. The industry needs a specific framework that can protect retail investors from the risks associated with tokens.

V. **SELF-REGULATION:**
Self-regulation, essentially defining a code of conduct, has proven successful for emerging sectors in the past. The Government of India should recommend principle-based self-regulatory guidelines for the industry to follow until it introduces further regulation. A government-recognised body should implement this self-regulatory model and ensure accountability and transparency.

Crypto has a bright future in India. It is at a unique stage to attract FDI, generate employment, and foster innovation, which enhances India's strategic importance within the global landscape. While there are associated risks (as with any financial asset), the government can address these threats with policies that do not stifle but support the promise of these emerging technologies. IndiaTech.org offers to collaborate on behalf of the industry and work with the government, regulators, and think tanks (such as NITI Aayog) to create a conducive policy environment and support the process of defining a self-regulatory framework for the industry.

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About IndiaTech.org

IndiaTech.Org (TSIA) is an industry association representing India's technology start-ups, unicorns, and investors, with an objective of building India as the world's largest and most successful internet commerce ecosystem. The association serves as a collaborative platform for Indian internet start-ups, unicorns and their investors to support positive business, conducive policy and regulations.

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