

CRYPTOCURRENCY TRADING SUBJECT TO ANTI-MONEY LAUNDERING LAWS

1. INTRODUCTION

- 1.1 Digital currency has recently gained immense traction in India as an alternative investment opportunity. Due to its secure nature based on blockchain technology, it not only provides anonymity to its users but also renders the transactions often immune to government intervention and scrutiny. The lack of regulation, one suspects, created an open market for unscrupulous entities to trade freely and misuse the market while staying anonymous. As a direct consequence, tracing such transactions (within and outside the country) becomes extremely difficult, which in turn exposes the cryptocurrency ecosystem to be a conduit of money laundering in India. Last year, the Directorate of Enforcement (“ED”) probed several money laundering cases against companies running cryptocurrency exchanges. As per the official press release by the Ministry of Finance (February 6, 2023)¹, ED has attached proceeds of crime worth nearly INR 936 crores (~USD 113 million) related to cryptocurrency, under the Prevention of Money Laundering Act, 2002 (“PMLA”) as on January 31, 2023.
- 1.2 In order to address growing concerns, the Ministry of Finance issued a gazette notification on March 07, 2023 (“**Notification**”)², which essentially brought the trading of cryptocurrency and other digital assets within the ambit of PMLA. With this step, the government has officially imposed domestic anti-money laundering standards on the realm of cryptocurrencies. The Notification has now ensured that all crypto businesses (including exchanges, custodians and wallet providers) are under the purview of the PMLA and afford authorities greater power to monitor encrypted transactions, including transfers outside of India. This appears to be in line with the larger policy shift focused on increasing the regulation of virtual and digital assets in India. This move is closely followed by the imposition of a 30% income tax on any income generated from trading in such assets which was introduced in April 2022³, and 1% TDS (tax deducted at source) which was mandated since July 2022.

2. WHAT DOES THE NOTIFICATION SAY?

- 2.1 The Notification included a range of transactions pertaining to virtual digital assets (“VDA”) under the ambit of the PMLA. The Notification has assigned VDA the same meaning as defined under section 2 clause (47A) of the Income Tax Act, 1961⁴ which seeks to include cryptocurrencies and non-

¹ ‘Ministry of Finance, ‘Under PMLA, Rs. 936 crore related to crypto currency is attached/seized/freed by ED as on 31.01.2023’, Press Information Bureau’, (06 February 2023), <https://www.pib.gov.in/PressReleaseDetail.aspx?PRID=1896722>.

² Ministry of Finance, Notification, The Gazette of India, (07 March 2023), <https://egazette.nic.in/WriteReadData/2023/244184.pdf>.

³ By enacting the Finance Act, 2022 on 30 March 2022.

⁴ VDA means - (a) any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the

fungible tokens (NFTs). The following nature of transactions have been brought under the ambit of the PMLA:

- a. Exchange between VDAs and fiat currencies.
- b. Exchange between one or more forms of VDAs.
- c. Transfer of VDAs.
- d. Safekeeping or administration of VDAs or instruments enabling control over VDAs.
- e. Participation in and provision of financial services related to an issuer's offer and sale of a VDA.

- 2.2 The Notification has further classified the entities dealing in the aforementioned transactions as 'reporting entity' under PMLA, adding it to the current list of reporting entities including banking companies, financial institutions, and intermediaries.

3 OVERVIEW OF THE PMLA AND POWERS OF THE DIRECTORATE OF ENFORCEMENT

The PMLA lays down the key legislative framework for the prosecution of the offence of money laundering in India. The principal authority for investigating and prosecuting such offences under the PMLA at the national level is the ED, an organization formed by the Department of Revenue, Ministry of Finance, Government of India. The ED is the primary authority responsible for prosecuting and conducting investigations into money laundering offences and has powers to initiate proceedings for the seizure and attachment of property and to prosecute under the PMLA.

Some of the key facets of the PMLA are as follows:

- a. The crime of money laundering⁵ stems from the commission of any offence mentioned in the schedule of offences specified under the PMLA which includes some of the offences under the Indian Penal Code, 1860, Information Technology Act, 2000, Customs Act, 1962, etc; and any proceeds of crime arising therefrom.
- b. For the offence of money laundering, PMLA stipulates a punishment of rigorous imprisonment between 3 to 7 years, and a fine.
- c. PMLA is a long-arm statute which confers extraterritorial jurisdiction to the authorities constituted under it.
- d. As with any other serious offence, the offence of money laundering is regarded as a continuous offence, and no specific limitation period applies to it.

Under the PMLA, the ED is empowered to confiscate or attach any properties that are derived or obtained by any person as a result of criminal activities relating to the offences under the PMLA. The PMLA also provides the ED with the power of pre-trial attachment or confiscation of properties.

promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically; (b) a non-fungible token or any other token of similar nature, by whatever name called; (c) any other digital asset, as the Central Government may, by notification in the Official Gazette specify.

⁵ 'Money Laundering' under the PMLA essentially means any act where a person directly or indirectly attempts to indulge or knowingly assists in any process or activity connected to the proceeds of crime, including its concealment, possession, acquisition or use and projecting or claiming it as untainted property. 'Proceeds of crimes' under the PMLA means any property derived or obtained by any person as a result of criminal activity relating to a scheduled offence under the PMLA.

4 THE IMPLICATION OF THE NEW REGULATION

4.1 PMLA paradigm vis-à-vis reporting entity

Reporting entities must comply with the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 ("PMLA Rules"). Crypto exchanges, intermediaries and other VDA service providers are now 'reporting entities' which would necessarily mean that they must comply with rules requiring them to conduct KYC verification and follow similar reporting standards as other regulated entities.

Additionally, this would also mean that the ED will now have greater powers to search and seize while investigating any VDA service provider for potential violations under the PMLA. The consequences of violating the provisions of the PMLA could subject them to rigorous penal consequences including imprisonment of 3-7 years, in addition to the attachment of their properties.

4.2 Mandatory compliance obligations

As reporting entities, VDA-related businesses will now have to comply with certain obligations as listed in PMLA and PMLA Rules. These would broadly include:

(a) *Maintaining record of transactions*

The crypto exchanges and other VDA-related businesses must have an internal mechanism for maintaining records of all transactions including cash transactions of more than INR 10 lakhs (~USD 12,000). They must also maintain records of all series of cash transactions integrally connected to each other, which have been individually valued below INR 10 lakhs, where the monthly aggregate exceeds INR 10 lakhs, among other records. These records should be maintained for a period of 5 years and shall include details like nature, value, and date of transactions.

(b) *Reporting suspicious transactions*

The entities will be required to appoint Designated Director and Principal Officer who will be responsible for furnishing information related to suspicious transactions, along with other prescribed transactions within the prescribed time limit. The details must be furnished to the Financial Intelligence Unit-India (FIU-IND)⁶.

(c) *Performing KYC of their clients and users on the platform*

The intermediaries and exchanges dealing in VDAs in India will be required to conduct enhanced due diligence on their clients and users, as prescribed under the PMLA. It includes verification of the client's identity, steps to examine the financial position and ownership, including sources of the client's funds, nature of the relationship between the parties, and recording the reasons for conducting the transaction.

(d) *Penalty for non-compliance*

⁶ FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC), responsible for receiving, processing, analysing and disseminating information relating to suspect financial transactions. FIU-IND is further responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and financing of terrorism.

In case of non-compliance with the PMLA Rules, the newly designated reporting entities i.e., crypto exchanges and other VDA service providers can be subjected to monetary penalties which will not be less than INR 10,000 but may extend to INR 1,00,000 for each failure. The monetary penalty is in addition to any other action that may be taken under any other provisions of the PMLA⁷.

5 **INDUSLAW VIEW**

This Notification has introduced a significant amendment to the PMLA. Although its primary objective is to tighten the regulatory oversight of digital assets by mandating stricter compliance, monitoring and reporting norms, the cryptocurrency ecosystem in India, as per media reports, has nonetheless largely welcomed this move by viewing it as a precursor to legitimizing the industry. This Notification also reflects the government's intent to follow a global approach of transitioning from a light-touch approach (*i.e., from an anti-money laundering or taxing perspective*) to a more comprehensive approach. This Notification also aligns with global best practices which call for cryptocurrency exchanges to follow anti-money laundering standards in line with those followed by other regulated entities such as banks. Even as G20 President this year, India has pushed for a global consensus on arriving at a comprehensive regulation governing cryptocurrency. In the interim, this Notification is seen by many to be a prudent measure to reduce financial crimes - admittedly, India's regulatory moves in this context are being keenly followed by the global economy.

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⁷ Section 13(2) of the PMLA provides that if the Director, in the course of any inquiry, finds that a reporting entity has failed to comply with the prescribed obligations under the PMLA, then, he may- (a) issue a warning in writing; or (b) direct such reporting entity or its designated director on the Board or any of its employees, to comply with specific instructions; or (c) direct such reporting entity or its designated director on the Board or any of its employees, to send reports at such interval as may be prescribed on the measures it is taking.