

## From bucks to Bitcoins – Enforcement of cryptocurrency transactions

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*It was circa 1955 when a computer was used for the very first time in India and it was circa 1995 that internet services were first launched here. In 2015, one cannot imagine a life without the two. This goes to show how fast we adapt to the advancement in technology and make it a part of our daily lives. In this article, the authors seek to unfold the cryptographic world behind Bitcoins alongside the regulatory issues making the Indian Government wary of its usage in the near future. Pursuant to the warning released by the Reserve Bank of India ; are authorities in the Indian Government in denial regarding Bitcoins increasing relevance in the business world ? ❖❖EFW❖❖*

### Introduction

1. India has an internet user base of over 250 million users. Although the penetration of e-commerce is low as compared to more developed countries, one cannot deny its increasing relevance in the Indian markets. From paying our phone and electricity bills to purchasing a smart phone, it is all just a click away. The reasoning behind all this boils down to the convenience associated with online transactions. If we can purchase the same product while sitting at work, why bother going down to the shop or wait in a call centre queue? With the introduction of payment gateways, consumers are able to make easy and fast payments to purchase the products of their choice. There are third party payment facilitators such as PayPal, CC Avenue and Paytm which store credit card data and make online transactions smoother. Despite the proliferation of online payments, the idea of paying with anything other than the same currency which we use in the offline world sounds bizarre to most, but that might just be the case in the near future.

1.1 In October 2013, the world's first Bitcoins ATM opened in Vancouver, Canada, an ATM which releases Bitcoins instead of the local currency notes/coins. The Bitcoins currency system is based on an open source computer programme whose alleged originator is Satoshi Nakamoto. Simply put, Bitcoins are a virtual form of money as opposed to the physical form that we have used for centuries. The authenticity of each transaction is protected by

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a digital signature corresponding to the sending address, allowing all users to have full control over sending Bitcoins from their own Bitcoin addresses. Hence, this digital currency is also known as a cryptocurrency, since it uses cryptography to facilitate and control transactions. The Bitcoin network shares a public ledger called the block chain. Bitcoin miners engage in a set of prescribed complex mathematical calculations in order to add blocks to the block chain, which is a transactional database shared by all nodes participating in the Bitcoin system. Miners who succeed in adding a block to the block chain automatically receive a fixed number of Bitcoins as a reward for their effort.

### **The good and the bad**

2. Various channels are used by non-residents to transfer funds to India. RBI in its survey dated 13th April, 2010, noted that SWIFT (an international wire transfer system) is costlier than drafts and cheques. While the cost of sending up to \$500 from the US to India through SWIFT is less than 1-5 per cent of the funds transferred, the comparative rates for demand drafts and cheques is just 2 per cent of the remitted amount. Money transfer services like Western Union charge a higher commission, nearly 25-30 per cent more than banks. However, we must note that Bitcoin transactions are nearly instantaneous and the costs are negligible. Bitcoins are transferred from one wallet to another across the globe ; subject to confirmation in the form of block chain addition. Having said that, it is noteworthy that there is considerable fluctuation in the valuation of Bitcoins. In December 2013, the value of one Bitcoin was \$757.50, today it is valued at above just about \$200. Further, it is also important to note that crashing of the hard drive or a virus corrupting the data, Bitcoins will be lost. There are then very limited chances that the same would be recovered. One can go bankrupt within a few seconds and have absolutely no form of recovery. Absent a regulator, there is no effective framework for addressing customer complaints, resolving disputes, processing refunds, etc.

2.1 It is interesting to note that on the deep web, also known as dark web, which represents 96 per cent of the world wide web that is unseen by the average citizen and not indexed by standard search engines, Bitcoins appears to be a primary mode of payment. The US Federal Bureau of Investigation (FBI) released a report dated 22nd April, 2012 wherein the FBI has cited various illegal usages of Bitcoins. In the report, FBI has gone on to say that Bitcoins are used for various underground sites, such as Silk Road, for the sale of illegal narcotics and is thereby a safe haven for criminals to conduct all kinds of illicit activities without having to follow the traditional financial systems.

### The Indian perspective

3. India follows limited exchange control norms. The exchange control regulations in India are governed by the Foreign Exchange Management Act, 1999 ('FEMA'). The apex exchange control authority in India is the Reserve Bank of India ('RBI') which regulates the law and is responsible for all key approvals. FEMA regulates all aspects of foreign exchange and has direct implications on external trade and payments thereby dictating terms for all inflow and outflow of money to and from Indian territory. In contrast to this, United States has not had exchange controls in place for a while. Capital controls give the government authoritative, sweeping economic powers, providing for control over the currency and regulation of inflows and outflows. This is precisely where the problem lies. Bitcoins, as we now know, are anonymous and are not created or traded through any authorised dealers. Therefore, the RBI is concerned that while the current system is bank dependent and information about any remittance can be easily obtained from them, a similar advantage is not there in Bitcoins since it is a peer to peer system outside the regulated banking sector.

#### *RBI v. Bitcoins ?*

4. The RBI on 24th December, 2013, released a Press Release warning users, holders and traders of virtual currencies specifically pointing out Bitcoins. Although the RBI ended the Press Release by stating that "...it is presently examining the issues associated with the usage, holding and trading of [virtual currencies] under the extant legal and regulatory framework of the country..." it is reported that a crackdown followed on Bitcoin exchanges post the Press Release. From where we stand today, the only scope for Bitcoins to be legalised and regulated in India is if the RBI notifies it as a currency. Section 2(h) of FEMA gives the RBI, power to notify Bitcoins as a currency. However, one may question RBI's intention of releasing such a Press Release wherein the Central Bank is neither accepting the use of Bitcoins as currency nor is it completely restricting the use of the crypto currency. Sure, it can be argued that RBI is only trying to duly play its role in the public interest, but in turn is it not discouraging what many might perceive as a breakthrough in computer sciences. Having said that, recently, the RBI Governor did talk about the crypto currency in a somewhat positive manner by stating that :

"I have no doubt that down the line, we will be moving towards primarily a cashless society and we'll have some kind of currencies like this (such as Bitcoins) which will be at work<sup>1</sup>."

1. As Reported by Coin Desk : <http://www.coindesk.com/indias-central-bank-one-day-use-digital-currency-chief-says/>

### The future of Bitcoins in e-commerce

5. As discussed above, Bitcoins are yet to be classified as 'currency'. Till date, neither the RBI nor the Central Government (whether under Securities Contract Regulation Act, 1956 or otherwise) has taken steps to regularise Bitcoins as legal tender or securities. Therefore, the question as of today is ; what would be the treatment of Bitcoins under Indian law? Bitcoins are lines of code which systematically transfer Bitcoin currency from one account to another. The Indian Copyright Act, 1957 defines the term "computer programme" as "a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result". On the basis of this definition, one could say that Bitcoins would fall under the definition of the term "computer programme". The General Clauses Act, 1897, further, defines the term "movable property" as property of every description, except immovable property. Immovable property has been defined to include land, benefits arising out of land or things attached to the earth or permanently fastened to anything attached to the earth. Thus, a "computer programme" would not fall under the definition of "immovable property" but would instead be considered as "movable property". Additionally, the Forward Contracts (Regulation) Act, 1952 goes on to define 'goods' to mean "every kind of movable property other than actionable claims, money and securities". Hence, Bitcoins would also fulfill this condition and could be defined as goods under the Indian laws.

6. Owing to the above, Bitcoins would probably be treated as goods. However, since the Sale of Goods Act, 1930 ('SOGA') requires payment of money as consideration, any transaction whereby payment is made in Bitcoins would come within the category of a barter transaction. For example, if Amazon starts accepting payment in Bitcoin then the transaction of paying for a phone through Bitcoin would in fact be a barter transaction and would not be governed by SOGA either. That being said, such a transaction would only be enforceable under the Indian Contract Act, 1872 if it encompasses lawful consideration and is not against public policy. It is important to note here that a consumer transacting with Bitcoins can seek relief under the Consumer Protection Act, 1985, thereby bringing in the jurisdiction of the consumer courts. However, barter transactions would have no implication as to the implied warranties that a buyer would generally receive under the SOGA. Purchasing a product on Amazon through Bitcoins could make the online retailer and the user contractually liable. If Amazon fails to deliver the product or if the user fails to pay the amount in Bitcoins, they could be liable for contractual default in the eyes of law. Similarly, transactions involving Bitcoins can also be brought within the ambit of the Income-tax Act, 1961 if individuals earning Bitcoins convert their earnings into rupees and then

pay income-tax on the same. There is need for clarity of tax treatment of Bitcoins as a transferor or seller of Bitcoins may or may not be liable to pay capital gains tax in India. One may note that recently, the United States Internal Revenue Service has recognised Bitcoins as property for the purposes of capital gains tax<sup>2</sup>.

### Conclusion

7. Bitcoins can currently be classified only as movable property and more specifically as computer software, but such a position has not been tested in any court of law and the twin risks of enforcement of barter contracts coupled with the RBI crackdown on virtual currencies loom large. It is worth noting that unlike other digital currencies such as e-gold, liberty reserve, etc., Bitcoin is a peer to peer network based currency which does not have one centralised agency or institution regulating the entire system and, therefore, it is argued that if the agencies want to regulate or shut it down they will not physically be able to do so as there is no nodal institution that the authorities can go after. Although, Bitcoins have not yet been widely accepted in India, *highkart.com* is the first Indian website to accept payments exclusively in Bitcoins. An online portal, *Buysellbitco.in*, was set up to facilitate the purchase and sale of Bitcoins but it was shut down after a raid by the Enforcement Directorate found that it had violated foreign exchange laws<sup>3</sup>. In an era of increasing e-commerce, the use of digital currencies is inevitable. More than a year on after the RBI Press Release, it is time that the authorities decide on the treatment of Bitcoins much in the same way as jurisdictions across the world are doing, otherwise cryptocurrency will remain a near mythical creature in India.

2. As reported by NASDAQ : <http://www.nasdaq.com/article/3-reasons-the-irs-bitcoin-ruling-is-good-for-bitcoin-cm339333>

3. As reported by Coin Desk : <http://www.coindesk.com/indian-authorities-swoop-buysellbitco/>