

Bitcoins India Report 2017

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Introduction

A bitcoin is a virtual currency first introduced in the year 2008 by an anonymous group called Satoshi Nakamoto. It's an open source peer-to-peer cryptographical system (direct connections without an intermediary) where transactions happen through a public ledger called **blockchain**, handling users' data anonymously. Eight years since its introduction, bitcoin is today the most widely used and accepted digital currency.

Other forms of crypto-currencies/virtual currencies

Bitcoins are the most sought after cryptocurrency in the market. However there are several other currencies which have gained momentum ever since the concept has been introduced.

Below are some other of cryptocurrencies that exist:

1. Ethereum – Ethereum is the second most famous name in the virtual currency market. It somewhat similar to the concept of bitcoins however it possesses some additional attributes. It is purely a blockchain based platform. What makes it special is the Ethereum Virtual Machine. The blockchain in ethereum is used not to store the data of the transaction but to make sure smooth run of a decentralized application.
2. Ripple – Ripple is more in the nature of a payment protocol created and developed by a company named Ripple, which is based on the concept of Real time Gross Settlement. It was initially released in the year 2012.
3. NEM – Similar to bitcoin, NEM is also a peer-to-peer blockchain platform launched in the year 2015. It uses the unique Proof-of-Importance algorithm , a way to validate transactions and achieve the distributed consensus.
4. Litecoin – Initially introduced in the year 2011, litecoin is mostly identical to bitcoin. What makes it stand out is the use of Segregated Witness and the Lightning Network.

Some other cryptocurrencies are bbqcoins and dogecoins which have not gained much significance due to their technical shortcomings and inability to stand out.

Blockchain technology

Most cryptocurrencies are based on blockchain technology. In simple terms, it is a system to transfer and store data or information that is generated while transacting in a cryptocurrency.

A recent Whitepaper on Blockchain^{2 **1} has broken down the concept of blockchain technology in detail.

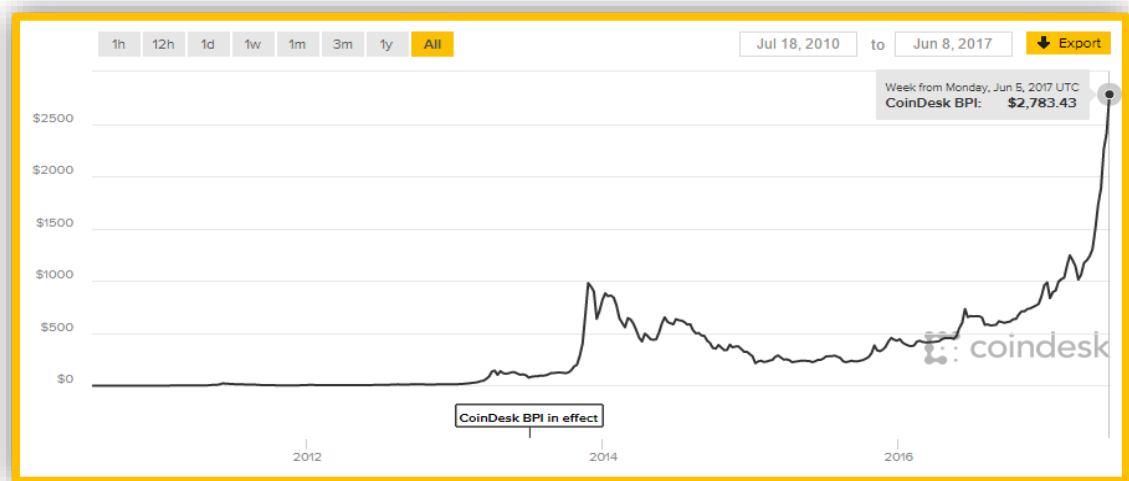
As per the paper, *“a Blockchain may be described as a tamper-evident ledger shared within a network of entities, where the ledger holds a record of transactions between the entities. To achieve tamper-evidence in the ledger, Blockchain exploits cryptographic hash functions.”*

Blockchain technology is at the heart of how cryptocurrencies work. It helps to evade any possibility of fraud and makes any kind of tampering infeasible for the users. It is a support system for the encrypted currency, whereby the transactions are recorded and stored on the ledger. So even if the users are anonymous, it still becomes difficult for anyone to possibly change the data without involving other members on the network.

Bitcoin Pricing

Since pricing in bitcoin transactions is demand based, it is exceptionally volatile. Volumes of trading happen every second. The price of a bitcoin is largely dependent on the trading i.e. demand and supply factors. More the demand, higher is the price. The prices remained under the range of US\$ 300 until late 2015. In the following year, around June 2016, in a positive hunch, the price rose to US\$ 755. After March 2017 the prices have only increased.

Chart 1.1

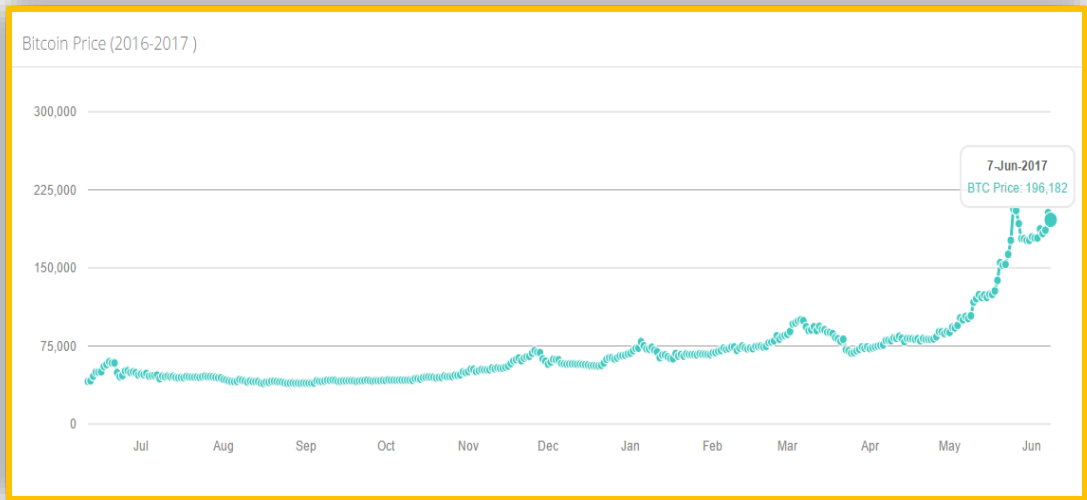


Source: <http://www.coindesk.com/price/>

**1 released on 5th January 2017 by the Institute for Development and Research in Banking Technology (an Institute established by the Reserve Bank of India),

Following similar trend, price of bitcoin in Indian crypto-market has recently gained remarkably in recent months.

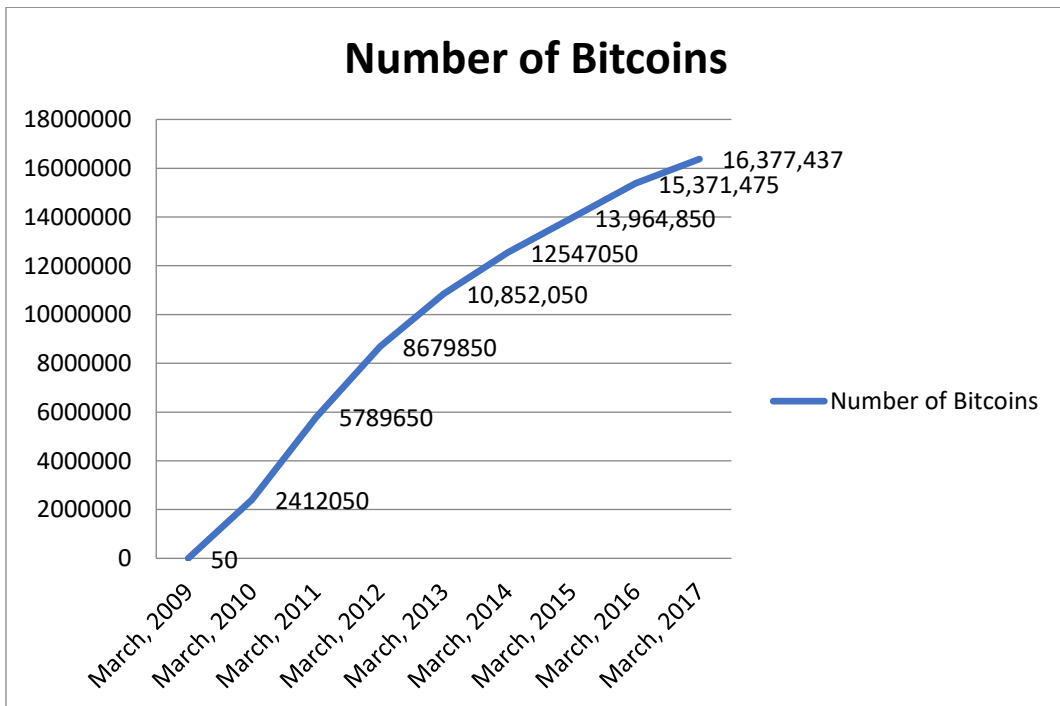
Chart 1.2



Source: <https://www.unocoin.com/charts> dated 8th June 2017

Bitcoins in Circulation

Chart 2.1



Since 2009 till March 2017, the number of bitcoins in circulation has only increased. The figure has reached to an all-time high 16,377,437 in number. (Table 2.1)

Market Capitalisation of bitcoins

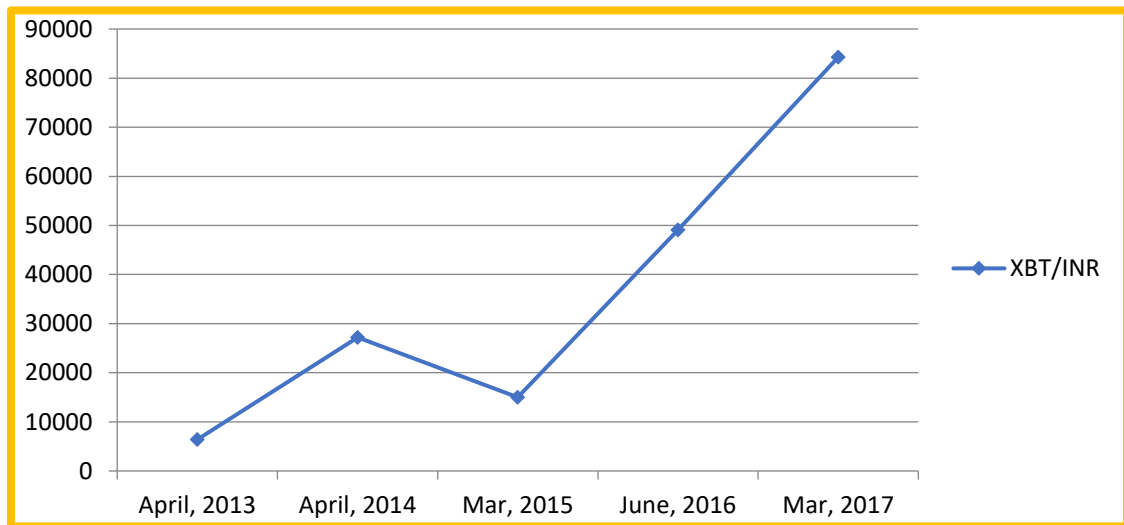
Table 2.1

Market Capitalisation	Volume (24h)	Circulating Supply	Maximum Supply
\$46,476,054,493	\$1,629,280,000	16,377,437 BTC	21,000,000 BTC
(16,377,437 BTC)	(578,813 BTC)		

Source: <https://coinmarketcap.com/currencies/bitcoin/> dated 8th June, 2017

Market capitalization of bitcoin as on 8 June 2017 has been computed to come up at US\$ 46,476,054,493, while the maximum supply in the market is limited to 21,000,000 BTC as of now.

Chart 2.2: Value of Indian Rupee per bitcoin



Bitcoin Exchanges

Typically, a bitcoin exchange is a business platform that facilitates exchange of bitcoins for another currency including a fiat currency, thereby allowing the users to trade and make profit. Bitcoin exchanges quickly spread in the market in early 2011, as more and more people started exchanging bitcoins, mostly for speculative purposes. Given the high volatility and a ready market without any regulatory intervention, people find it suitable to trade, invest and hold and make profits out of the same.

Also bitcoins are not backed by any particular asset or security, because of which its value is not driven by any factor but demand and supply in the market.

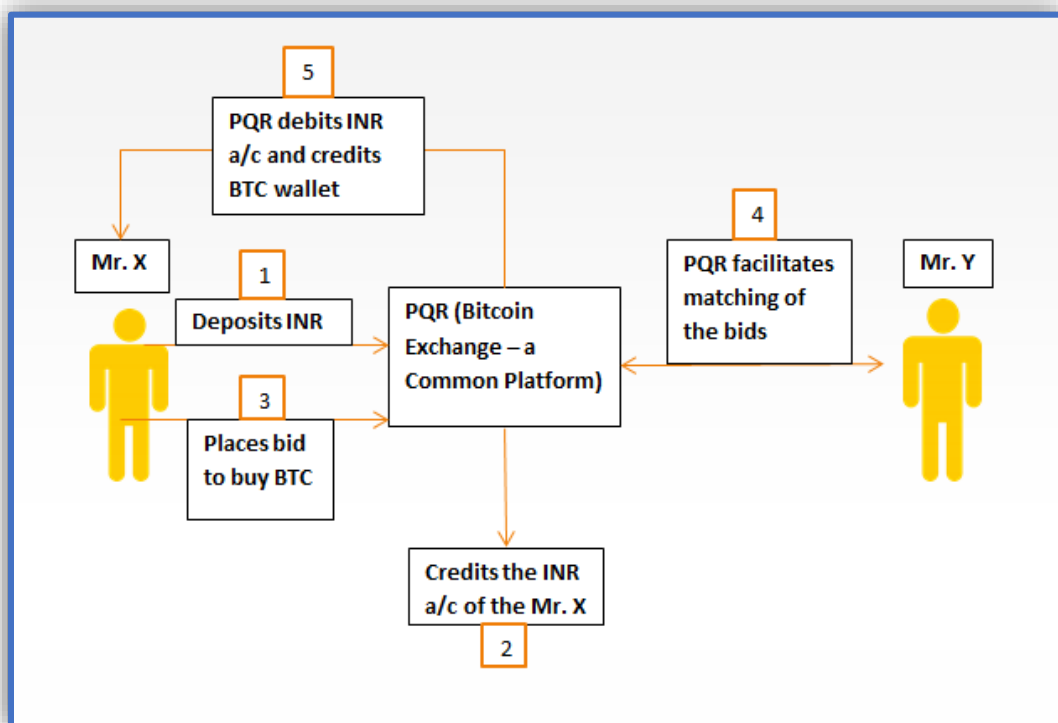
Business Model

Not much later after the inception of bitcoins, bitcoins exchanges quickly spread into the market. Since then several bitcoin exchanges in India and elsewhere have come into picture.

At a preliminary level, a bitcoin exchange is simply a common platform to the users for the purpose of buying and selling while matching mutual needs, in order to earn profits.

For instance take an idea of a stock exchange, where a person has an account and he buys stock, by paying consideration in money, from a person who wants to sell it. Stock exchanges provide a place for buyers and sellers where they can trade. On similar lines, a bitcoin exchange works by essentially providing 'service' to its users, however unlike stock trading where a broker may as well come into picture and charge commission in return for his services, in case of bitcoin exchanges, there is no third party involvement, this service is provided by the exchange itself which thereby charges commission for the trade conducted and earns revenue. A basic business model of a bitcoin exchange is reiterated in the chart below. (Chart 6.1 below)

Chart 6.1: Bitcoin Exchange trading



The model explained above is the basic model adopted by most of the exchanges operating in the market. In addition to trading services in bitcoins, these exchanges also facilitate the users to hold or own bitcoins, for which they provide the basic service of arranging a wallet which is nothing but an account.

Services provided by bitcoin exchanges in India

Amongst the plethora of services (including core and non-core services and including those driven by profit or not) provided by different exchanges in India, following are the services that are common in the market:

1. Storing bitcoin in a bitcoin wallet after deposit/receipt of the same in the wallet.
2. Exchange of bitcoin with other currency like a fiat currency.
3. A Merchant gateway service used to pay to merchants in bitcoins and acceptance by them thereon.
4. Mobile application providing ease of accessing bitcoin wallets.
5. Sending bitcoins stored in the wallet to another wallet/withdrawing.

Major exchanges operating in India

India has seen a positive growth in the cryptocurrency market vis-à-vis other countries. In line with recent growth in the global markets, bitcoin exchanges in India are very much operational and successful. Their business models range from basic trading platforms to comprehensive service providers. The type of services being offered in the current market is listed in one of the above sub-topics (supra).

Listed below are some of these exchanges that have made it big in the industry:

Table 6.1: List of major exchanges in India**

Name of the Exchange	Name of the Company promoting the platform	Brief of Company Structure	Date of Set-up of Exchange	Date of formation of Company	Website	Location(s)
Coinsecure	Secure Bitcoin Traders Pvt Ltd	company set up as a private company in India	N/a	2014	https://coinsecure.in	Delhi, India
Bitxoxo	Bitxoxo Bitcoins Online Pvt Ltd	company set up as a private company in India	N/a	2016	https://www.bitxoxo.com	Warangal, Telangana, India
Unocoin	Unocoin Technologies Pvt Ltd	company set up as a private company	2013	2015	https://www.unocoin.com	Bengaluru, Karnataka, India

		in India				
ZebPay	Zeb IT Service Pvt Ltd	Set up in India as a private company, has an associate company in Singapore called Zeb Ventures Pte Ltd.	2012	2015	https://www.zebpay.com	Ahmedabad, GJ, India
Bitcoin India	Bitcoin India Software Services Pvt Ltd	company set up as a private company in India	N/a	2014	https://bitcoin-india.org	Hyderabad, Telangana, India

*** Disclaimer: We do not guarantee the authenticity of the information contained herein, and as such this information is to be used at one's own discretion and liability.*

Volumes of Trading in Bitcoins

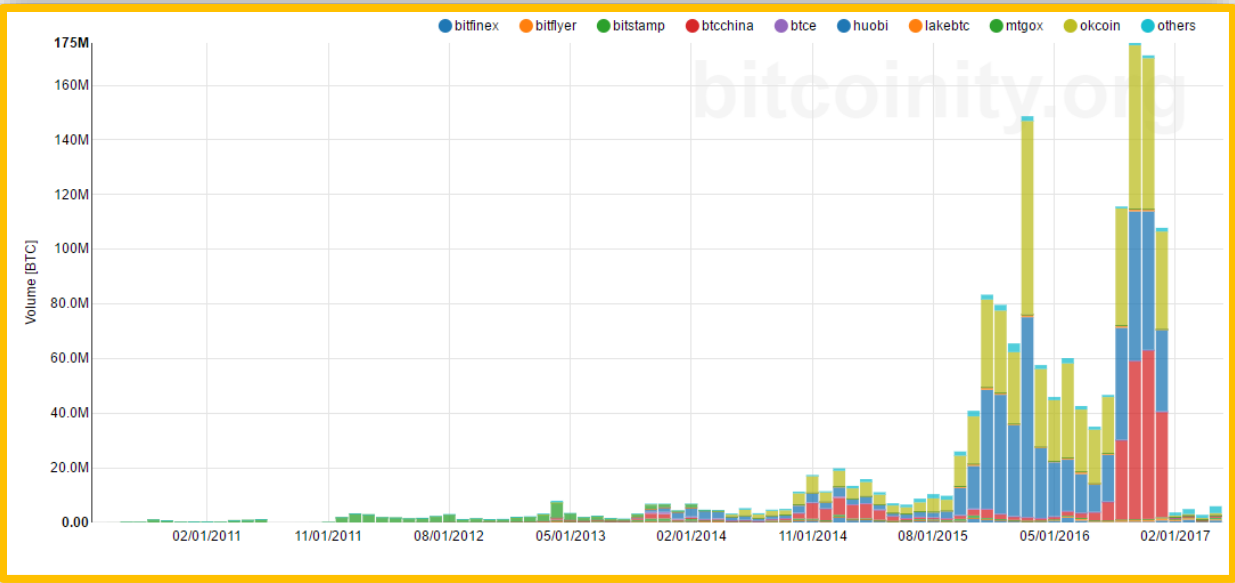
Chart 6.2: Trading Volume in LocalBitcoins in INR



Source: <https://bitcoincharts.com/charts>

LocalBitcoins is an internationally renowned bitcoin exchange, primarily used for trading purposes by users round the globe. Presented in chart 6.2 above is data showcasing volume of trading in bitcoins in Indian Rupee (INR) in the given exchange since the beginning till June 27, 2017. As on the date, the aggregate volume in trades is equivalent to almost INR 2.5 million. Evidently, high trading volumes can be ascertained in late 2015 compared to pre 2015, however the numbers reduce and then move on a normal pace while gradually increasing up to the beginning of the year 2017, where excessive trading is evident. Trading came up abnormally in the year 2017 in India and everywhere else too.

Chart 6.3: Volume of trading in exchanges outside India

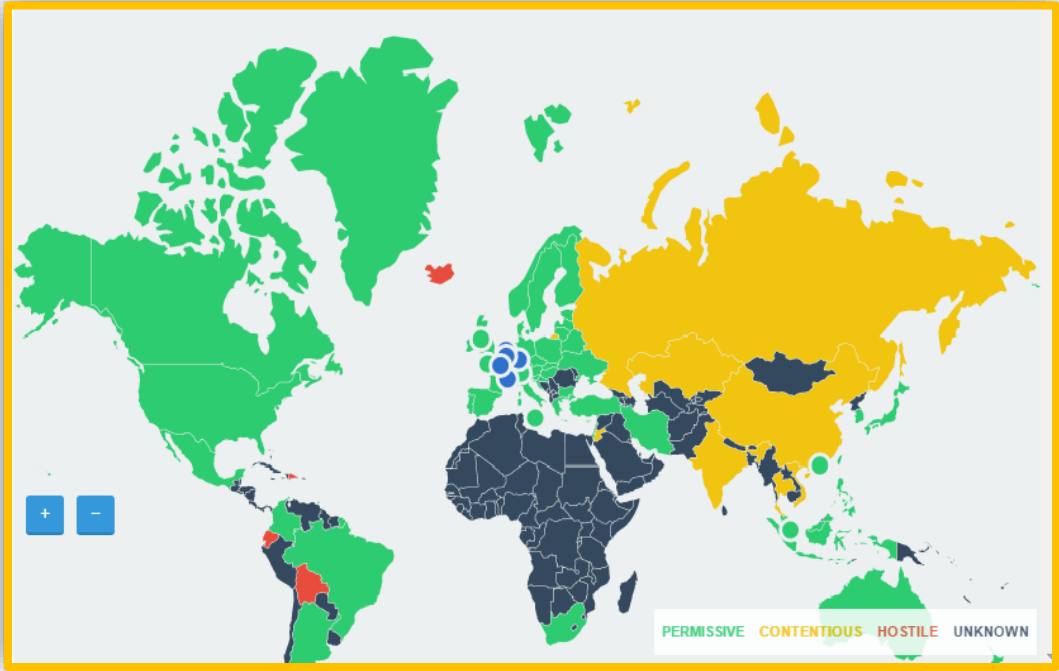


Source: <https://data.bitcoinity.org>

Data above forms part of the volume in trading over exchanges outside India since 2011 till Jan 2017. Similar to the Indian trends, it is evident from chart 6.3 above that trading volumes spiked during 2016 and 2017.

Regulatory status of bitcoins Worldwide

Picture 3.1



Source: <http://www.coindesk.com/bitcoin-legal-map/>

As evident from the Picture 3.1 above, countries shaded in light green are those that have permitted the use and trade of bitcoins explicitly while this e marked in yellow are considered as contentious markets for bitcoins. Additionally, marked in red have declared bitcoins to be treated as illegal or hostile.

Countries that have legalised bitcoins

More than half of the total number of countries in the world have taken a positive stand on dealing with bitcoins. A table below illustrates a list of some countries which have legalized bitcoins:

Country name	Legal Status	Official source
Japan	In the process of legally recognizing as money	http://www.fsa.go.jp/news/28/ginkou/20170324-1.html
Australia	Proposed in budget speech 2017-18 to treat bitcoins as money	http://www.budget.gov.au/2017-18/content/glossies/factsheets/html/FS_innovation.htm
European Union	Convertible decentralized virtual currency	http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf

Canada	Digital currency/intangible	https://www.canada.ca/en/revenue-agency/news/newsroom/fact-sheets/fact-sheets-2015/what-you-should-know-about-digital-currency.html
Indonesia	Digital currency	http://www.bi.go.id/en/ruang-media/siaran-pers/Pages/SP_160614.aspx
United States	“funds” under 18 U.S. Code § 1960 (virtual currency in general)	https://cdn.arstechnica.net/wp-content/uploads/2016/09/murgio-order.pdf
Russia	Virtual currency (monetary surrogate)	http://npaed.ru/images/downloads/translation_letter_from_the%20Federal_Tax_Service.pdf
China	Virtual commodity	http://beijing.pbc.gov.cn/beijing/132005/3230072/index.html

Legal and Taxation Issues

Regulatory Status in India

The Reserve Bank of India has neither declared bitcoins as illegal in India nor has it accepted bitcoins as a currency. The RBI has only stated the risks that are associated with virtual currencies and cautioned that people dealing in it should do so at their own risk.

Legal Status of Bitcoins

Currency?

Currency ⁴ is generally defined as tokens used as money in a country. In addition to metal coins and paper bank notes, money orders, traveler’s checks, it also includes electronic money or digital cash.

To fit in this definition, which is not exhaustive,

- Either bitcoin has to be physical and movable, and fungible. It is movable and fungible but not physical.
- Electronic money or digital cash may include bitcoin but then it needs a legal backing from an authorized entity, which is not the case in India as of now.

“Currency” includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers 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, as per Section 2(h) of Foreign Exchange Management Act, 1999⁵

- As is evident from the above definition, bitcoin doesn't fit in any of the illustrative names, however if RBI wants, it can certainly notify it to be included in the above definition.
- RBI hasn't notified bitcoin as legal tender in India and therefore it couldn't be termed as real currency for the time being.

Coins?

Provisions under law:

Coins in India are governed by the Coinage Act, 2011.

Section 2(a): "coin" means any coin which is made of **any metal** or **any other material stamped** by the Government or any other authority empowered by the Government in this behalf and **which is a legal tender** including commemorative coin and Government of India one rupee note.

Explanation.--For the removal of doubts, it is hereby clarified that a "coin" **does not include** the credit card, debit card, postal order and **e-money** issued by any bank, post office or financial institution; (b) "commemorative coin" means any coin stamped by the Government or any other authority empowered by the Government in this behalf to commemorate any specific occasion or event and expressed in Indian currency;

On study of above, bitcoin is certainly not metal or even any other material for that matter. Moreover, it's not legal tender. If it was to become e-money in the near future, still it could not be coin as per the Coinage Act, since e-money is specifically excluded from the above definition. Consequently, bitcoins cannot be considered as coins now or in the days to come.

Digital currency

- Apart from traditional currency or real currency, there's another kind called digital currency. On a broader level, it is an electronic based currency holding similar attributes of a real currency, involving prompt payment and transaction settlement.
- There are two forms of digital currency: Virtual currency and crypto currency.

Virtual currency v. Cryptocurrency

Digital currency is largely backed and regulated by the Central Bank, more like electronic money. Virtual currency, on the other hand is unregulated and decentralized. Financial Crimes Enforcement Network's ruling on 'Application of FinCen's regulations to virtual currency mining operations' clarifies that virtual

currency is a medium of exchange that operates like a currency in some environments but does not have all the attributes of a real currency. It does not hold any legal tender status anywhere⁶. Similar view was expressed in European Central Bank's publication, 'Virtual Currency Schemes'⁷.

- ❖ Bitcoins could be termed as virtual currency- they have been categorized as such by ECB⁸. They are decentralized, unregulated and have few attributes of a real currency.

Then there are crypto-currencies and non-crypto currencies. Since, bitcoin is purely based on crypto-graphical system, where you have a private and a public key, and each transaction gets recorded on the ledger, it is said to come under the definition of crypto-currency.

Decentralized currency⁹

Currency is further classified into centralized and decentralized. Those which are governed by a central repository or a designated entity for sake of trust over transactions taking place are termed as centralized currency. Bitcoin doesn't work like that. Transactions in bitcoin happen on a decentralized P2P system, where all entities operate independently, and hold the entire risk of dealing in the same.

Convertibility

In the words of Internal Revenue Service (IRS) Virtual Currency Guidance¹⁰: 'Virtual currency that has an equivalent value in real currency or which acts as a substitute for a real currency is called 'convertible' virtual currency'. European Union has categorized bitcoins as a [convertible decentralised virtual currency](#). Since it is convertible into fiat currency or legal tender of the country, it is prima facie convertible or fungible.

Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2016 enumerates the following:

"5. Manner of payment in foreign exchange :-

(1) A payment in foreign exchange by an Authorised Dealer, whether by way of remittance from India or by way of reimbursement to his branch or correspondent outside India against payment for import into India, or against any other payment, shall be as per the way prescribed thereunder segregating between few countries and others, where payment also includes in some cases, the payment made in any freely convertible currency."

To understand the word 'freely convertible currency', one shall look into the definition of 'permitted currency' in detail defined under [EXCHANGE CONTROL MANUAL- Permitted Currencies and Methods of Payment](#). Para 2.1 states that *"the expression 'permitted currency' is used in the Manual to indicate a foreign currency which is freely convertible i.e. a currency which is permitted by the rules and regulations of the country concerned to be converted into major reserve currencies like U.S. Dollar, Pound Sterling and for which a fairly active market exists for dealings against the major currencies. Accordingly, authorised dealers may maintain balances and positions in any permitted currency. Authorised dealers may also maintain positions in Euro of the European Currency Area."*

Considering above, if bitcoins are treated as a freely convertible currency only in case it is declared to be currency under any foreign legislature, the payment made will be covered under the above regulations, thereby categorizing bitcoins as foreign exchange.

If it's a virtual currency, could bitcoin be treated as property?

Bitcoin is not currency in general parlance but is treated as a virtual currency. In a notice dated March 25, 2014, the Internal Revenue Service, Washington stated that virtual currency is treated as property for U.S. federal tax purposes. To apply the same concept India, first has to be examined the definition of property. As per Section 29(c) of Benami Transactions (Prohibitions) Act, 1988¹¹, property means property of any kind, whether movable or immovable, tangible or intangible, and includes any right or interest in such property.

- ❖ This is an inclusive definition of property, where both movable and immovable properties are included. Bitcoin is movable and intangible thus it can be called a property as per this definition. However, any idea to levy tax on it as a property will require extensive reasoning and research.

The Supreme Court of India in [Vikas Sales Corporation And Anr. ... vs Commissioner Of Commercial Taxes ... on 1 May, 1996](#), discussed the expression 'property' in detail. 'Property' is said to be understood in a vast and expansive manner. To start with, one can say that property includes everything that has an extendable value. It includes the item in question and all rights and liabilities associated with it. An element which is material to the expression is 'ownership'. While the property has all interests in it, it is the ownership that lets the owner exercise such interest, where the interest extends to doing everything, an owner is capable of doing to exercise his right in the property.

Goods

Under Indian law, Sale of Goods Act, 1939 defines 'goods' u/s 2(7)¹². Accordingly, "Goods" means 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. To answer whether bitcoin is a good or not, first, we shall answer the following questions:

- Is it a movable property? Sale of Goods Act does not define movable property. It is however defined in the General Clauses Act, 1897¹³. As per which, movable property shall mean property of every description, except immovable property. Bitcoin is not immovable. So, yes. It may be called movable.
- Is it an actionable claim or money? No. It does not impose a claim on anybody, so it is not an actionable claim. And, precisely, since it is not legal tender, it is not money even though it represents value in money.

One important aspect for any item to be a good is that it should have an intrinsic value in itself. While bitcoins might fall under the term 'goods' as per Sale of Goods Act, 1930 but it does not seem to have any value in itself-- in other words it does not have any value or attribute which could be the reason why people would buy for its own sake. People would buy bitcoins to store value but to trade and earn profits. It is not bitcoin that has fundamental value, but the transactions in it which help earn something. Therefore, to categorise bitcoins as 'goods', will be an incorrect stance to take.

Digital Goods

Similar to digital currency, we have digital goods and virtual goods respectively. Digital goods are goods existing in electronic format. Examples could be e-books, e-newspapers, internet coupons, online traded instruments, e-tickets, downloadable software, mobile apps, etc. For bitcoin to become a digital good, it has to have the respective features. If we analyze, we find that bitcoin is being used to buy digital goods, in that way it becomes a medium of exchange to purchase digital goods rather than being a digital good itself.

Under Foreign Exchange Management Act, 1999 ('FEMA')

Given its attributes, the closest we could define bitcoin as is 'virtual currency' or more particularly 'cryptocurrency'. As far as FEMA is considered, there can be two possible scenarios:

- **When there is no regulatory framework:** Section 2(h) of the Act defines 'currency'. RBI hasn't declared bitcoins to fall under that definition. Then

there's 'foreign currency'. Section 2(m) defines, ""foreign currency" means any currency other than Indian currency". Now what is Indian currency? FEMA (Section 2(q))² also defines Indian currency. Accordingly, ""Indian currency" means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under section 28A of the Reserve Bank of India Act, 1934 (2 of 1934)^{14'}.

- **When there is a regulatory framework:** As mentioned before, the RBI can explicitly declare bitcoins to be currency; in this case it would fall under the definition of foreign currency and be dealt with accordingly.

However, the present situation is such where bitcoin doesn't fall in any of the above definitions. So, it does not cleanly fall into the category of foreign currency as per FEMA as it does not qualify to be currency as per the same Act—the RBI would have to explicitly notify it to be such in the first place.

Online transactions in bitcoin and FEMA

If one transacts into export/import transactions in bitcoin, the provisions of FEMA will get attracted. Transactions in FEMA are categorized as 'Current account transaction' and 'Capital account transaction'. First we analyze current account transactions defined under FEMA (Section 2(j)). A "current account transaction" means "*a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes,—*

- (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,*
 - (ii) payments due as interest on loans and as net income from investments,*
 - (iii) remittances for living expenses of parents, spouse and children residing abroad,*
- and*

(iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children;"

Highlighting 'a transaction other than a capital account transaction' from the above definition, capital account transaction (Section 2(e)) means "*a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6; Section 6(3) of FEMA lists out the following:*

- (a) transfer or issue of any foreign security by a person resident in India;*
- (b) transfer or issue of any security by a person resident outside India;*

(c) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
(d) any borrowing or lending in foreign exchange in whatever form or by whatever name called;
(e) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
(f) deposits between persons resident in India and persons resident outside India;
(g) export, import or holding of currency or currency notes;
(h) transfer of immovable property outside India, other than a lease exceeding five years, by a person resident in India;
(i) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
(j) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred—
(i) by a person resident in India and owed to a person resident outside India; or
(ii) by a person resident outside India.”

- Whether foreign trade in bitcoins will be treated as a current account transaction or a capital account transaction depends on assessment of whether bitcoin is a ‘good’ or an ‘asset’.
- As already discussed, we prefer not to call bitcoins a good. If it is not a good, then foreign transactions in bitcoin shall be treated as capital account transactions. Thus, such transactions are not allowed unless there is explicit nod from the RBI.

Receipts and Payments in Bitcoins:

Considering the fact that bitcoins are not legal tender in India, receipts and payments in this virtual currency in a domestic transaction as well as in imports/exports is a separate issue.

As far as receipts and payments in bitcoins are concerned, following are the possible questions that need to be answered:

- Is it possible to buy goods or services in India and make payment in bitcoins? Certain companies in India are accepting bitcoins as payment against purchase of goods or services. Even if as per the Reserve Bank of India Act, 1934 (“the Act”), payment made in legal tender is a valid discharge of an obligation or debt one has towards a payee, the Act however does not specifically exclude any other form of consideration. Meaning thereby that any form of payment

other than legal tender in India is allowed since it is not prohibited specifically, subject to the condition that there is consensus between the parties involved.

- Is it possible to export and receive payment in bitcoins? Any international transaction which involves payment or receipt shall attract the provisions of FEMA and rules made there under. If one was to export outside the Indian territory and receive payment in bitcoin, one shall first examine what bitcoins shall be treated as, for that matter. Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2016¹⁵ clearly specify the modes of payment in different cases.

Regulation 3(2) of these Regulations state the following:

*“(a) In respect of an export from India, receipt shall be made in **a currency appropriate to the place of final destination** as mentioned in the declaration form irrespective of the country of residence of the buyer.*

*“(b) **Any other mode** of receipt of export proceeds for an export from India in accordance with the **directions issued by the Reserve Bank of India** to authorized dealers from time to time.”*

Bitcoins are not legal tender in India, by virtue of which, they are not recognised as real currency. Also, RBI hasn't directed anything pertaining to receipt of bitcoins for such transactions.

Clearly, this leads one to the conclusion that anyone cannot receive bitcoins as a manner of receipt for any exports made outside India.

- Is it possible to import and remit payment in bitcoins? Regulation 6(1) states that:

*“(1) Notwithstanding anything contained in Regulation 5, a person resident in India may make payment for import of goods **in foreign exchange** through **an international card** held by him/ **in rupees** from international credit card/ debit card through the credit/ debit card servicing bank in India against the charge slip signed by the importer/ as prescribed by Reserve Bank from time to time.”*

What is “foreign exchange”? Section 2(n) of FEMA defines foreign exchange as, “foreign exchange” means foreign currency and includes,— (i) deposits, credits and balances payable in any foreign currency, (ii) drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency, (iii) drafts, travellers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency; ”

Examining the above, it's conclusive that bitcoin does not conform to the above definition and thus it is certainly not foreign exchange.

It is hereby inferred that in exchange of any imports made by any person in India, it is manifestly impossible to remit payment in bitcoins in the ambit of law.

SEBI

Classification as 'commodity derivative'

Bitcoin is treated as 'commodity' in few foreign jurisdictions. However, to understand the intricacies revolving bitcoins as 'commodity derivative' in India, one shall have to refer [the Securities Contracts Regulation Act, 1956](#)

Section 2 clause (bc) of the Act defines the expression as:

"commodity derivative" means a contract —

- (i) for the delivery of **such goods**, as may be notified by the Central Government in the Official Gazette, and which is not a ready delivery contract; or*
- (ii) for differences, **which derives its value** from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified by the Central Government, in consultation with the Board, but does not include securities as referred to in sub-clauses (A) and (B) of clause (ac);*

To be able to be covered by the above definition, the essential element is a contract. While the definition of contract is dealt by the Indian Contract Act, 1872, either of the above two purposes is a pre-requisite for a contract to be a commodity derivative contract.

Essentially, bitcoin is not goods as already explained in the preceding sections, additionally it is also not something that has its value derived from an underlying good or something else. In fact value of bitcoins fluctuate on demand-supply phenomenon rather than anything persistent.

Conclusively, bitcoins cannot be treated as commodity; also it cannot be treated as commodity derivative. Therefore, SEBI cannot be seen as the authority overseeing bitcoin exchanges

Collective Investment Scheme ('CIS')

Collective Investment Scheme has been defined under Section 11AA (1) of [the Securities and Exchange Board of India Act, 1992](#) ('SEBI Act'). Accordingly, sub-section 2 or 2A has to be referred to, which specifies a list of conditions that have to be fulfilled in order to fall under the definition of CIS. Interestingly, Sections cited above focus on

words or expressions such as 'collective', 'pooling of interest', 'contribution'. Looking at the concept of bitcoin, it cannot be held that at any time the investor is collecting funds and then investing the money. Till date, there is no trace of any such activity in the market where a service such as pooling of funds of investors and then investing in bitcoins was done. Thus, trading in bitcoins for investment purposes has not grown enough to be regarded as CIS. If at all there is a prospective change resulting in inclusion of bitcoin trading services under the regulation of SEBI by virtue of being treated a CIS, consequential norms shall be applicable parri passu to such platform or providers of service if any.

Requirement under Section 12 of SEBI Act, 1992

Section 12 mandates obtaining registration certificate for persons specified such as brokers, sub-brokers, share transfer agents, etc. An inclusion in the provision is that of 'such other **intermediary** who may be associated with **securities market**'. The words draw one's attention to two words, namely 'intermediary' and 'securities'. To extend the above provisions to bitcoin or bitcoin exchanges, the service provider shall have to be an intermediary under SEBI and the dealing item shall be a 'security'. Since none of the criteria will be fulfilled by bitcoins, obtaining aforementioned registration cannot be extended to bitcoin exchanges.

Nodal Account Directions

RBI has issued [Directions for opening and operation of Accounts and settlement of payments for electronic payment transactions involving intermediaries](#) dated 24th November, 2009 in line with the following preamble:

"The use of Electronic/Online Payment modes for payments to merchants for goods and services like bill payments, online shopping etc. has been gaining popularity in the country. With a view to safeguard the interests of the customers and to ensure that the payments made by them using Electronic/Online Payment modes are duly accounted for by the **intermediaries** receiving such payments and remitted to the accounts of the merchants who have supplied the goods and services without undue delay, it is considered necessary to frame suitable directions for the safe and orderly conduct of these transactions. "

The directions have been issued to intermediaries as defined under the directions. *'Intermediaries' would include all entities that collect monies received from customers for payment to merchants using any electronic/online payment mode, for goods and services availed by them and subsequently facilitate the transfer of these monies to the merchants in final settlement of the obligations of the paying customers.*

Explanation: For the purpose of these directions, all intermediaries who facilitate delivery of goods/services immediately/simultaneously (e.g. Travel tickets/movie tickets etc) on the completion of payment by the customer shall not fall within the

definition of the expression “intermediaries”. These transactions which are akin to a Delivery versus Payment (DvP) arrangement will continue to be facilitated as per the contracts between the merchants and the intermediaries as hitherto and banks shall satisfy themselves that such intermediaries do not fall within the definition of the “intermediaries” when they open accounts other than internal accounts.

The Prevention of Money-laundering Act, 2002

Schedule IV of [the Prevention of Money-laundering Act, 2002](#) ('PMLA'), lists out a comprehensive text on obligations of banking companies, financial institutions and **intermediaries** which inter alia includes reporting requirements by such entities. If bitcoin exchange platforms are specifically included as intermediaries, the requirements as above shall be applicable on such platforms as well. Further, it is advised that such entities may as a self-regulatory measure adopt to fair practices ensuring that it does not get involved in illegal or illicit activities which may attract gross consequences under laws such as PMLA. A KYC policy in place is also suggested to further the adherence to best practices.

Taxation

Coming to the matter of taxation in bitcoin transaction, particularly in a case where we import bitcoin, following may apply:

- Customs Duty: As per Central Excise and Customs Act, 1944¹⁶, customs duty is levied on import of software subject to the condition that the software imported in a physical form. Therefore, software imported online is not chargeable to Customs duty. Similarly, if bitcoin is treated as software, no duty shall apply.
- VAT: VAT has now been subsumed into the Goods and Services Tax with effect from 1st July 2017. GST is discussed in later sections .

GST on bitcoins

Currency under FEMA vis-à-vis ‘money’ under GST

Currency has been defined under FEMA:

Section 2(h) “currency” includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers 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;

On perusal of the above definition, it is explicit that bitcoins does not fit in any of the mentioned types. It is in fact not been notified by the Reserve Bank as a currency. So apparently, bitcoin is not currency.

On lines similar to the definition above, lawmakers have framed the definition of 'money' under GST which is same as the one under Section 65B (33) of Schedule V of the Finance Act, 1994 pertaining to Service Tax. Section 2(75) of CGST Act defines: "money" means the Indian legal tender or any foreign currency, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller cheque, money order, postal or electronic remittance or **any other instrument recognised by the Reserve Bank of India when used as a consideration** to settle an obligation or exchange with Indian legal tender ... of another denomination **but shall not include any currency that is held for its numismatic value**;

Money

'Money', as defined, has been kept out of the purview of GST.

Goods

'Goods' has been defined under GST. Section 2(52) "goods" means every kind of movable property **other than money and securities** but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;

Bitcoin doesn't have any intrinsic value in itself; hence it would be technically incorrect to refer it as goods.

Where bitcoin is not being used as anything except as a 'means of payment', it needs to come under the arena of currency. Otherwise, GST implications with respect to supply of goods/services will arise.

Until specifically declared by RBI, bitcoin shall not be 'money'. Several countries have declared bitcoin as 'money' thereby making it exempt from GST. For example, a European Court of Justice Ruling has exempted bitcoin from VAT. Australian Federal Government has also proposed to exempt bitcoins from tax in its budget 2017.

Computer Programme

The system on which bitcoin works, is nothing but software, a set of codes which may be considered a 'computer programme'. Indian Copyright Act, 1957 defines the word 'computer programme':

Section 2(ffc): "computer programme" means 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. Under GST, if classified as software/computer programme a rate of 18% shall apply.

Section 2(24) of the Income Tax Act, 1961 defines 'income'. Accordingly tax is applicable subject to the basic exemption limit on any profit made on dealing with bitcoins.

On sale of bitcoins and any resultant profit is subject to capital gains tax under as applicable as per the Income Tax Act, 1961.

In Tata Consultancy Services v. State of Andhra Pradesh (Order dated 5th November, 2004), the Court held that a software whether customized or non-customised will be goods if it satisfies a set of three attributes, namely:

1. Utility;
2. Capable of being bought and sold;
3. Capable of being transmitted, transferred, delivered, stored and possessed

Goods might be tangible or intangible. Bitcoin does satisfy the above last two points, however, it doesn't seem to have the same utility as of other goods. There is no absolute usefulness that might be associated with bitcoin. A bitcoin is definitely bought and sold for purposes such as investment or trading; however, these facts do not necessarily make an item 'goods'. Since bitcoin has utility which is specific to itself and not general, and further to add, having no intrinsic value, it cannot be termed as 'goods'.

Foreign Ruling ON Bitcoins

The GST implications of transactions involving bitcoin - GSTR 2014/3 – A Goods and Services Tax Ruling, Australian Taxation Office, Australian Government¹⁹, (original ruling dated 17th December, 2014)

The Ruling summarises following significant points with respect to application of GST on bitcoins and related implications:

1. The ruling as specified has considered the classification of bitcoin as 'money' or a 'financial supply' under the GST Act.
2. As pointed out, there must be a '**supply for consideration**' for there to be a taxable supply.
3. **A transfer of bitcoin from one entity to another is a 'supply' for GST purposes.** The exclusion from the definition of supply for supplies of money does not apply to bitcoin because **bitcoin is not 'money' for the purposes of the GST Act.**
4. The **supply of bitcoin is not a 'financial supply'**. Further, it is not an input taxed supply.
5. **A supply of bitcoin is a taxable supply** and the supply of bitcoin is not GST-free (for example, a supply to a non-resident for use outside of Australia).
6. **A supply of bitcoin in exchange** for goods or services will be **treated as a barter** transaction.

7. **Bitcoin is not goods** and cannot be the subject of a taxable importation. However, an offshore supply of bitcoin can be a taxable supply under the ‘reverse charge’ rules.

The above ruling significantly points out that bitcoin is neither money nor its supply a financial supply; moreover, it is also not goods. Interestingly, Australian Government has proposed to exempt bitcoins from tax.

Status of bitcoins under Indirect Taxation in different jurisdictions

Country/Region	Status
Singapore	Profit on trading in bitcoins in ordinary course is taxable ²⁰
Australia	Propose to exempt bitcoins from taxation by treating it as money
European Union	Any exchange of bitcoins for another currency does not attract VAT or GST, as the case may be
USA	Treated as property as per Internal Revenue Service, USA ²¹
Norway	As proposed in 2017, no VAT shall be levied on trading in bitcoins ²²
Japan	In 2017, officially recognised bitcoins as a means of payment
Germany	Declared as private money; income received in bitcoins from sales shall be taxed
Sweden	Sweden Tax Agency ruled stating that trading in bitcoins is exempt from VAT

Prospective Regulations that may be applicable²³

Given, its modality and attributes, following is a non-exhaustive list of regulations which could be applicable on bitcoin:

- ❖ The Foreign Exchange Management Act, 1999
- ❖ The Reserve Bank of India Act, 1934
- ❖ The Coinage Act, 1906
- ❖ The Securities Contracts (Regulation) Act, 1956

- ❖ The Sale of Goods Act, 1930
- ❖ The Payment and Settlement Systems Act, 2007
- ❖ The Indian Contract Act, 1872

Risks associated with bitcoins

- RBI through its press release dated 24th December, 2013²⁴ has warned the public about the negative attributes of bitcoins and its usage. It specifically pointed out, that since they are stored digitally, they are exposed to risks such as hacking, attacks, compromises etc.
- Bitcoins are not backed and/or regulated by a centralized agency till date, making them less reliable.
- There is no forum, where a user can possibly reach out for any help or grievance, as a result of which Indian consumers are being exposed to transactional and informative risks.
- Another issue pertains to awareness. Lot of consumers has little or no information regarding risks associated with bitcoins lending them into unwanted trouble under regulations such as anti-money laundering.
- One of the very important attributes of bitcoins is its volatility. Steep changes every second are expected, making investors prone to zero-worth risks.
- Several incidences have occurred stating that bitcoins have been used for illicit and illegal activities around the globe. Reportedly, a recent ransomware attack called WannaCry spread on a large scale basis; the hackers had demanded payment in respect to ransom money in bitcoins. The incidence among others has raised questions on the viability of the cryptocurrency. Bitcoins have also been used in Ponzi schemes, resulting in huge loss of money for several investors.

Conclusion

The silence of the RBI on the regulatory status of bitcoins may prove to be damaging. An industry has grown around bitcoins in India- traders, exchanges and merchants who accept payments in bitcoins. Bitcoins have already gained wide acceptance around the world- hence banning them would not be an option in India. Instead, this industry would need to be regulated. The sooner this is done, the better.

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